**OIL AND GAS DOCKET NO. 02-0278952**

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

**EXCEPTIONS OF INTERVENORS PIONEER NATURAL RESOURCES USA, INC., DEVON ENERGY PRODUCTION COMPANY, L.P., LAREDO PETROLEUM, INC. AND BP AMERICA PRODUCTION COMPANY**

**TO THE HONORABLE RAILROAD COMMISSION OF TEXAS:**

**COME NOW, Intervenors Pioneer Natural Resources USA, Inc., Devon Energy Production Company, L.P., Laredo Petroleum, Inc. and BP America Production Company** (collectively, "Intervenors") and submit these Exceptions, and in support thereof would respectfully show the Commission as follows:

## I. SUMMARY

Whether the leases upon which EOG Resources, Inc. ("EOG") proposes to drill its well authorize or prohibit drilling in the manner proposed by EOG requires interpretation of the title granted to EOG in its leases. The Leases unambiguously authorize the well proposed by EOG. Further, the Railroad Commission of Texas has no jurisdiction to rule otherwise. Title disputes such as the Klotzmans' claims must be decided by the Courts. Therefore, the Klotzmans' complaint must, as a matter of law, be dismissed.

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## II.
## INTRODUCTION

The Proposal for Decision in this case is based on three fundamental errors. First, the Proposal purports to decide title, which is the responsibility of the courts and outside the Commission's jurisdiction. Second, the Proposal interprets the parties' rights and obligations under the oil and gas leases at issue in this hearing, and does so in a way that is contrary to the provisions of those leases and contrary to Texas oil and gas law (here, too, the Proposal would impermissibly invade the province of the courts). Third, the Proposal stakes its finding concerning the title EOG holds (which it finds lacking) on the proposition that creating a drilling unit to satisfy spacing rules is the "very definition of pooling."[1] This is incorrect and is contrary to well-established Texas law. As discussed in detail in these exceptions, it is undisputed that EOG holds valid oil and gas leases and thus a fee simple determinable interest property right in the mineral estate into which it proposes to drill. The Klotzman Leases do not restrict the drilling of the proposed well; they expressly grant EOG the right to drill the well. This recommendation, which is legally incorrect and improper, would have far-reaching negative impacts on the ability to drill horizontal wells in Texas and would result in enormous physical and economic waste. The Commission should not adopt the Proposal, but should overrule the Proposal and issue the permit for the Klotzman Lease (Allocation) Well No. 1H.

## III.
## BACKGROUND

This hearing was called because of a complaint filed by two royalty interest owners protesting the drilling permit application submitted by their lessee, EOG Resources, Inc. ("EOG"), relating to a horizontal Eagleville (Eagle Ford-2) Field well (the "Klotzman Well") in

[1] Proposal at Finding of Fact 13.

Dewitt County. EOG, the lessee under two adjoining leases—the 516.569-acre Georgia DuBose to Glassell Lease and the 304.97-acre Georgia DuBose to Pierce Lease (hereinafter the "Leases")[2]—applied to drill a horizontal well that begins on the 304.97 acre Lease and ends on the 516.569 acre Lease with production to be derived from both Leases. EOG applied to permit the Well as an allocation well, one of three methods used to obtain a drilling permit for a well like the Klotzman Well.[3]

The property rights granted to EOG under the Leases convey a fee simple determinable interest in the mineral estate—rights long recognized under Texas law as authorizing, among other things, the holder to drill into and to produce from that mineral estate.[4] Technological advances in the industry have led to a place where such drilling can be conducted in a number of new and exciting ways, the most recent being horizontal shale drilling. It is now possible to drill into a mineral estate in a number of different ways, from above (in a vertical well), from the side (in a deviated or horizontal well), or even from below, but irrespective of the method employed, the required property rights remain the same.[5] In the specific setting involved here, Texas law has established the legal effect of a horizontal well that traverses multiple leases: "[e]ach tract traversed by the horizontal wellbore is a drillsite tract, and each production point on the wellbore is a drillsite."[6] Intervenors' Exhibit B hereto presents a visual depiction of this principle; the red

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[2] EOG Exhs. 9, 10.

[3] Drilling permits for horizontal wells that traverse multiple leases have historically been granted under one of three recognized procedures: (i) as an allocation well (where the applicant holds title to the tracts to be traversed), (ii) as a pooled (unit) well (where the applicant has the right—and desires—to pool acreage from the tracts to be traversed) and (iii) as a production sharing agreement well (where the applicant seeks and obtains requisite approvals from parties with an interest in the well in the form of a production sharing agreement). The fact that these three recognized methods exist reflects that a one-size-fits-all process has historically proved inadequate in handling horizontal well permits. Different circumstances require application of different processes.

[4] The full panoply of such rights is much broader, as discussed below, than as summarized here.

[5] Intervenors' Exhibit A attached hereto is an idealized depiction of some of the various ways in which a leasehold owner is legally entitled to drill into the mineral estates depicted.

[6] *Browning Oil Co., Inc. v. Luecke,* 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet denied).

reflects the configuration of an example well as actually drilled, the blue represents the proper legal characterization of the well. Under Texas law, it is as though three wells were drilled with each of leases A, B and C constituting a drillsite tract and the producing points in the wellbore underlying each individual lease constituting a drillsite as to that lease.

Once the Klotzman Well is drilled and placed in production, EOG will be responsible—under the terms of the Leases and applicable law—to allocate to the royalty owners their respective shares of production that can be attributed to their particular tract(s) with reasonable probability. But that process is not implicated at the well permitting phase; it is a matter governed by the parties' contractual undertakings as those undertakings have been interpreted and applied in the courts.

It is, of course, necessary at this pre-drill phase for EOG to obtain a drilling permit in order to remove the regulatory bar to drilling. To achieve that, EOG is required to demonstrate that it has a good faith claim of ownership in the property. That it has done; indeed, no one seriously disputes that EOG in fact holds title to the property into which it proposes to drill.

The objecting royalty interest owners, Katherine Larson Reilly and Melanie McCollum Klotzman (hereinafter "Klotzman"), are lessors under both Leases. They oppose the permit application in an effort to bar the drilling of the Well under the Leases.[7] Klotzman argued in this hearing that an oil and gas lease does not provide the lessor the right to drill a horizontal well from one lease to another and does not allow allocation of the proceeds of production to the royalty owners without either pooling the leases or obtaining a production sharing agreement from at least 65% of the royalty interest owners. Neither of these contentions is correct as a

[7] The record suggests that the Klotzmans do not oppose drilling altogether; rather they would like drilling to occur under new leases providing the lessor with more favorable terms, such as a higher royalty, depth severances, reduced marketing deductions, and a drilling commitment. Tr. 45–46, 110–12, 122–25.

matter of Texas law, but the more critical point is that assessing whether they are correct, or incorrect, is a question for the courts, a question that is beyond the province of this Commission.

## IV.
## EXCEPTIONS

### A. Intervenors Except to the Proposal for Decision Because It Recommends That the Commission Exceed its Jurisdiction by Deciding Title

Intervenors except to proposed Finding of Fact 15 stating that EOG does not have real property and contractual rights to drill and produce the applied-for well and the legal right to develop and produce the minerals. Intervenors except to proposed Conclusion of Law 5 that EOG does not have a good faith claim to title. Both of these findings are in error and exceed the Commission's jurisdiction by ignoring EOG's good faith claim to title to drill the Klotzman Well.

#### 1. The Commission's Analysis of Ownership Is Limited to Whether the Applicant Has a Good Faith Claim to Title

The relationship between lessors and lessees under an oil and gas lease is a private contractual relationship. The duties in that relationship are properly the province of the courts, not the Commission. The function of the Railroad Commission in permitting wells "is to administer the conservation laws," rather than to "adjudicate questions of title or rights of possession," which is the province of courts. *Magnolia Petroleum Co. v. Railroad Comm'n,* 170 S.W.2d 189, 191 (Tex. 1943). Thus, in *Magnolia*, the Court points out that the Railroad Commission's drilling permit does not grant title, and that the permit merely removes the regulatory bar to drilling. *Id.* The court explains that someone challenging the permittee's title must go to the courts for a determination of the title dispute and seek an injunction, if appropriate. *Id.* Finally, the Court makes clear that the Commission cannot deny a permit for lack of title/right of possession if "the applicant makes a reasonably satisfactory showing of a good faith claim of ownership in the

property." *Id.* The recommendation in the Proposal would exceed the Commission's jurisdiction by ignoring the good faith claim to title of an oil and gas lessee to drill wells on lands validly leased and by going on to attempt to decide the title issues based on new and unprecedented theories that are contrary to existing Texas law.

### 2. The Language of EOG's Oil and Gas Leases Gives EOG the Right To Drill a Horizontal Well Across Those Leases; Pooling Is Not Implicated

The Proposal erroneously confuses (1) the issue whether EOG has adequate title to drill the Klotzman Well with (2) the issue whether EOG's leases give EOG pooling authority. Thus, in proposed Finding of Fact 15, the Proposal states that EOG lacks a good faith claim to title because EOG's leases do not authorize pooling.[8] But an absence of pooling power does not divest EOG of title to the minerals under EOG's leases.

As the Supreme Court recognized nearly 80 years ago, "the ordinary oil lease operates to invest the lessee with a determinable fee in oil and gas in place." *Sheffield v. Hogg*, 124 Tex. 290 (Tex. 1934). That fee simple determinable provides the owner of the mineral estate with "'stick[s]' in the bundle of five real property rights" that include "the right to develop" the minerals. *Lesley v. Veterans Land Bd. of State*, 352 S.W.3d 479, 480–81 (Tex. 2011); *Altman v. Blake*, 712 S.W.2d 117, 118 (Tex. 1986); *Luckel v. White*, 819 S.W.2d 459, 464 (Tex. 1991). Indeed, the right to develop the minerals in place is the key right granted to the lessee under a standard mineral lease. Thus, when a mineral lease is executed, the lessee obtains "the right to develop" the mineral estate, while the lessor retains "all rights that are bargained for in connection with the lease, which usually include the payment of royalties, delay rentals, and bonuses." *Concord Oil Co. v. Pennzoil Exploration & Prod. Co.*, 966 S.W.2d 451, 460 (Tex.

[8] As discussed below, this finding is, in turn, based on a second erroneous finding in the Proposal, namely that creating a drilling unit to satisfy spacing requirements is the equivalent of "pooling."

1998) (plurality op.); *Altman*, 712 S.W.2d at 118. The right to develop the mineral estate—a right possessed by EOG here—carries with it "the right to drill, explore, and produce from the land." *BP Am. Prod. Co. v. Marshall*, 342 S.W.3d 59, 70 (Tex. 2011). EOG's leases specifically grant, lease, and let unto the lessee:

> the land covered hereby for the purposes and with the exclusive right of exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals (whether or not similar to those mentioned), together with the right to make surveys on said land, lay pipe lines, establish and utilize facilities for surface or subsurface disposal of salt water, construct roads and bridges, dig canals, build tanks, power stations, telephone lines, employee houses and other structures on said land, 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 hereto.

Intervenors' Exhibit C (granting language in 304.97-acre DuBose to Pierce lease); EOG Exhibits 9 and 10.

Neither Texas law nor the language of EOG's leases prevents EOG from developing the mineral estate through the use of horizontal drilling technology. A lessee's right to drill a horizontal well traversing leases in which it holds title—but without possessing valid pooling power—was confirmed by the Austin Court of Appeals in *Browning Oil Co v. Luecke,* 38 S.W.3d 625 (Tex. App.—Austin 2000, pet denied). *Browning* demonstrates that drilling a horizontal well across multiple adjoining leases is the legal equivalent of drilling a separate well on each one of those adjoining leases. Thus, in *Browning*, the court held that having horizontal wells cross the various leases is legally equivalent to having "multiple drillsites on multiple tracts." *Browning*, 385 S.W.3d at 646. In oil and gas law, a drillsite is the location where a well penetrates the mineral estate; a drillsite tract is a tract on which the well is physically located on

the surface. The court found that each of the tracts traversed by the horizontal drainhole was properly characterized as a drillsite tract. *Id.*[9]

Although the operator in *Browning* attempted to drill the two wells in reliance on pooling authority in its leases, the court determined that no pooling had occurred because the operator did not comply with the pooling provisions. As a result, the operator in *Browning* in fact drilled wells across lease lines without valid pooling authority. But the Austin Court of Appeals in *Browning* held that the drilling (and production) of the horizontal wells was within the right of the lessees' under the leases. Like EOG here, and other applicants for allocation well permits, the operator in *Browning* held a valid oil and gas lease on the tracts traversed by the horizontal wells. Therefore, the *Browning* court held that the horizontal wells were properly drilled within the operator's authority under the leases.

The court in *Browning* also addressed the question of how an operator should allocate the proceeds from production where a horizontal well traverses multiple leases that have not been pooled. Although this allocation question is not implicated by an application for a permit to drill, it is instructive to note that existing jurisprudential rules establish how this is to be done. The royalty interest owner plaintiffs in *Browning* argued that because the leases were not validly pooled, they were entitled to royalties on the total production from each well, not just the portion attributable to their leases. Pooling affects how the operator/lessee must allocate production because pooling involves a cross-conveyance of property interests in the pooled tracts. Pooling provisions typically dictate that production will be allocated based upon the amount of surface acreage that each of the participating leases contributes to the pooled unit.[10] Where leases are

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[9] As noted above, Intervenors' Exhibit B visually depicts this principle.

[10] A pool "can have no effect other than to constitute all the lessors of land in the unitized block as joint owners, or joint tenants, of all royalties reserved in each of the several leases in such block, *the ownership being in the*

not pooled, no cross-conveyance is involved, and production is allocated in the manner described in the *Browning* decision: the royalty due is based on the share of production attributable to each royalty owner's lease with reasonable probability. *Id.* In the *Browning* court's words:

> We decline to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells and would discourage the use of this promising technology. The better remedy is to allow the offended lessors to recover royalties as specified in the lease, compelling a determination of what production can be attributed to their tracts, with reasonable probability.

38 S.W.3d at 647.

The *Browning* decision was discussed in detail in a legal opinion by Professor Ernest E. Smith of the University of Texas Law School, the leading treatise writer on Texas oil and gas law. In a letter provided to assist the examiner in the 2009 hearing in Oil and Gas Docket No. 06-0262000 addressing field rules for the Carthage (Haynesville) Field (the "Haynesville Hearing"), Professor Smith provided an opinion addressing an operator's authority, under an oil and gas lease, to drill a horizontal well across lease lines. Professor Smith's opinion analyzes the range of an operator's contractual authority (1) to drill horizontal wells across multiple leases and/or units and (2) to allocate production to the impacted leases based on the percentage of production that is reasonably allocable to each lease. Professor Smith's analysis confirms that a horizontal well may be drilled across lease and unit lines under the authority of the existing leases. (Haynesville Hearing, Devon Ex. 34 at 2–5 [hereinafter "Smith Op."]).[11]

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*proportion which the acreage each lease contract bears to the total.*" *Veal v. Thomason*, 159 S.W.2d 472, 476 (Tex. 1942) (emphasis added). "Pooling is, in effect, a cross-conveyance of interests in land by agreement among the participating parties, each of whom obtains an undivided joint ownership in the royalty earned from the land in the 'block' created by the agreement." *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 52 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.); Ernest E. Smith, *Gas Marketing by Co-Owners*, 39 BAYLOR L. REV. 365, 408 (1987) ("By authorizing pooling, each lessor has authorized his lessee to convey a part of the royalty interest to the lessor of every other tract within the pooled area.").

[11] A copy of the Smith Opinion is included with this filing as Intervenors' Exhibit D.

Professor Smith points out that "exceptionally strong support for the proposed horizontal well is provided by the repeated emphasis by Texas courts on the policies of avoiding rulings that would hamper or discourage the use of new technology." Smith Op. at 6. Professor Smith discusses the Texas Supreme Court decision in *Coastal Oil & Gas Corp. v. Garza Energy Trust,* 268 S.W.3d 1, 13 (Tex. 2008), noting the court's emphasis on "the policy of facilitating production by new technologies and of not hindering their use through actions in trespass."

Professor Smith also addresses the alternative approach of obtaining a production sharing agreement in order to drill wells across lease and unit lines. He notes that such agreements are desirable in avoiding disputes over the allocation of royalties, but that the absence of a production sharing agreement does not preclude the right to drill, concluding that "uncertainty over how production should be allocated does not override a lessee's right to drill." Smith Op. at 7–8.[12] Professor Smith concludes that "[t]he failure of the parties to reach any agreement on ownership, much less how royalty is to be divided once production is obtained, does not override the lessee's right to drill." Smith Op. at 8.

In attempting to minimize the importance of Professor Smith's opinion, the Proposal states that Professor Smith limits his opinion to the circumstance in which an operator does have the authority to pool. That is incorrect; Professor Smith actually (1) sets out his assumption that "the leases pooled grant a fee simple determinable to the lessee/operator with the right to pool

[12] As further support for his opinion that an operator can drill across lease lines without pooling and without a production sharing agreement, Professor Smith notes that a lessee can unquestionably drill in a situation where there are multiple claimants or disputed undivided shares. *Id.* at 8. Similarly, a situation requiring allocation of proceeds exists within one of the two leases crossed by the Klotzman Well, and Klotzman does not dispute that EOG can drill across those tracts. One of the leases crossed by the Klotzman Well is the Reilly Lease, which is the site of an existing horizontal well. Proceeds from the Reilly 1H, a lease well, will be allocated among three tracts within the Reilly Lease because the lessors made conveyances of interests within the lease after they granted the lease in 1959. (Tr., 10, 50-52, 62-64) Thus, even though the Reilly Well No. 1H is located entirely on a single lease, the production proceeds from the Reilly 1H must be allocated among the differing royalty interests owned in separate tracts created by conveyances made after leasing. Klotzman does not dispute EOG's right to drill the Reilly 1H Well.

but not necessarily the right to amend the resulting pooled units" and (2) notes that the pooling authority in the leases under consideration is irrelevant to the ability to drill across lease and unit lines because the pooling authority has been used to create smaller units. *Id.* at 1, 9. He states that in the situation he is asked to address, Devon has no more right to form a new pooled unit that includes all three existing units but exceeds the 640 (or 704) acre limit imposed by the leases than the defendant in *Browning* had to form a unit in violation of the anti-dilution clause in its leases. *Id.* at 9. Professor Smith's opinion is based on the understanding that there is no authority to re-form those units to create larger pooled units for the horizontal well. The fact that an operator has authority in a lease to form a 320-acre pooled unit is irrelevant to the question whether the operator has authority to drill a well across multiple leases of 640 acres. Thus, the attempt in the Proposal to distinguish the facts considered by Professor Smith from the EOG facts is without merit.

There is no dispute that EOG is the lessee of the two leases to be traversed by the Klotzman Well. Neither lease prohibits the drilling of horizontal wells, and neither lease prohibits the drilling of horizontal wells across the boundary of the lease. The fact that EOG lacks pooling authority does not diminish EOG's right to develop, by exploration and drilling, the mineral estates conveyed to EOG under EOG's leases. Thus, the absence of pooling power does not undermine EOG's right to drill the Klotzman Well, or to drill any number of other wells.

### B. The Proposal for Decision Is Based on the Further Erroneous Premise That EOG's Designation of a Drilling Unit To Comply with Spacing Requirements Was the Equivalent of "Pooling"

The Proposal, and the resulting recommendation to deny the EOG permit application, is also flawed in that it confuses what pooling is under Texas law and what the creation of a drilling

unit is under Texas law. These are two markedly distinct things. Intervenors except to proposed Finding of Fact 12, which states that combining a 40-acre tract from one Klotzman Lease with a 40-acre tract from the other Klotzman Lease "would be pooling the tracts." Intervenors also except to proposed Finding of Fact 13, which states that EOG's attempt to combine a 40-acre tract from one lease with another 40-acre tract from another lease is "the very definition of pooling." In addition, Intervenors except to proposed Finding of Fact 14c, which states that the Commission lacks authority to grant an application for an allocation well that combines acreage from separate leases if those leases "do not provide for pooling authority."

The *Browning* Court also faced this question, and rejected the idea that the creation of a drilling unit and issuance of a drilling permit (or creation of a proration unit) amounts to pooling:

> Although pooled units are often formed to satisfy spacing requirements, the grant of a permit to drill a well does not result in the valid pooling of the separately owned interests within the drilling unit. Similarly the designation of a proration unit does not have the effect of creating a pooled unit. The Railroad Commission has no authority to determine property rights. *See Jones v. Killingsworth,* 403 S.W.2d 325, 328 (Tex. 1965); 2 Smith and Weaver, *supra* 10.1.

38 S.W.3d 634. On this point, the Proposal is just wrong on Texas law.[13]

The Proposal mistakes the characteristics and impacts of pooling. Pooling allows operations on a single well on a single lease to preserve other leases that are pooled with the lease that is the drillsite tract. It allows small tracts that could otherwise not justify a well to share in production from a well on another tract. While pooling continues to have a role to play

[13] The Proposal relies on *Jones v. Killingsworth,* 403 S.W.2d 325, 328 (Tex. 1965), for the proposition that "orders of the Railroad Commission cannot compel pooling agreements that the parties themselves do not agree upon." Proposal at 21. Indeed, this is Intervenors' point: an operator-created or Commission-sanctioned drilling unit does not and cannot constitute pooling. The Proposal also quotes Smith and Weaver's treatise, *Texas Law of Oil and Gas,* for the proposition that "[p]ooling occurs when tracts from two or more leases are combined for the purpose of drilling a single well." Proposal at 20–21 (quoting 1 SMITH & WEAVER, TEXAS LAW OF OIL AND GAS, §4.8 (Matthew Bender & Company, 2012)). But this does not support the Proposal's reading of Texas law either. The Smith & Waver treatise is in accord with *Jones,* and the Proposal omits the very next sentence in Smith and Weaver's treatise, which sets forth a second key characteristic of pooling: "[t]he principal effect of pooling on the oil and gas lease is that production and operations anywhere on the pooled unit are treated as if they have taken place on each tract within the unit." 1 SMITH & WEAVER, TEXAS LAW OF OIL AND GAS, §4.8. *Browning* expressly rejected the notion that in the context of a horizontal well production or operations on one drillsite tract (at one drillsite) constitutes production or operations on other drillsite tracts (or other drillsites) traversed by the well.

for horizontal wells, it is less important for drilling horizontal wells than for drilling vertical wells because horizontal wells can be physically drilled across multiple tracts.

While pooling only allows royalty interest owners to share the proceeds of production based on acreage contributed to the pooled unit, allocation wells enable royalty interest owners to be paid royalty based on their share of the production from the well, their share based on that portion of the well that is physically located under the lands they leased. Allocation wells also allow operators to more efficiently locate horizontal wellbores than when tied to the particular acreage in a lease or pooled unit, thus preventing waste and protecting the correlative rights of all owners. As described in the Haynesville Hearing and as explained by Professor Smith, in many instances pooled units have been formed that are too small or that are shaped in such a way as to inhibit the drilling of horizontal wells, and the pooling clause does not allow the formation of other larger pooled units.

## C. The Proposal Would Erroneously Deny a Permit to a Well That Is in Compliance With Railroad Commission Rules

### 1. Existing Railroad Commission Statewide Rules, which Govern the Permitting of Wells, Authorize Issuance of a Permit for an Allocation Well

Intervenors except to proposed Finding of Fact 10, which states that "There is no Texas statute, Commission Statewide Rule or Commission Final Order authorizing the permitting of 'allocation' wells." EOG's application is in compliance with Railroad Commission Statewide Rules, which govern the permitting of wells. Rule 5—entitled Application to Drill, Deepen, Reenter, or Plug Back—addresses permitting of all oil and gas wells in Texas and provides that an application for a permit to drill, deepen, plug back, or reenter any oil well, gas well, or geothermal resource well shall be made under the provisions of Statewide Rules 37, 38, 39, and 40. 16 Tex. Admin. Code § 3.5. EOG has filed the required paperwork under these rules. It has

complied with Rule 37 by requesting an exception and filing the appropriate waiver. It has complied with Rule 38 by assigning the required acreage to the well. The well is in compliance with Rule 39 as the proration unit will be contiguous. EOG has properly stated in its W-1 package that it will make appropriate acreage assignments for proration purposes to assure compliance with Rule 40. Klotzman in this hearing challenged EOG's compliance with Rule 40, based on an argument that EOG was required to file a Form P-12. This argument is without merit because the Form P-12 applies to pooled units, and EOG has not formed a pooled unit. 16 Tex. Admin. Code § 3.40. Instead, EOG properly filed a PSA-12, the form utilized by the Commission to designate acreage assignment for production sharing agreement wells and allocation wells.

Klotzman also argued in this proceeding that production from the Klotzman Well would violate the commingling restrictions of Rule 26. This argument is incorrect because Rule 26 regulates surface commingling, and surface commingling will not occur in the Klotzman Well. The Commission's Rule 10 restricts downhole commingling, but only when multiple Commission fields are commingled—a situation that obviously does not apply here.[14]

Intervenors except to proposed Finding of Fact 10a, which states that there is no Commission form on which to apply for allocation well permits. This finding is incorrect because the Commission's Form W-1 applies to all drilling permit applications. The Commission has adapted its drilling permit application forms over time to require specific information concerning horizontal wells, production sharing agreement wells, and allocation

[14] There is good reason that Rules 10 and 26 are specific to the commingling of fields and to surface commingling, respectively, and that reason is allowables. Commission-issued allowables are specific to wells and to fields. Thus, if production from wells or fields is to be commingled, the Commission needs to regulate that commingling to assure compliance with its allowable system. An allocation well, on the other hand, is treated as a single well for regulatory purposes and is assigned only one allowable. Thus, no rule exception is required to properly regulate the well's allowable.

wells. Drilling permit applications are now filed online. The online drilling permit application requires the operator to indicate (1) whether a well is to be drilled as a horizontal well, and, if so, (2) the type of horizontal well (PSA, Allocation, or Stacked Lateral). *See* Intervenors' Exhibit E attached hereto.[15] In conjunction with production sharing agreement and allocation wells, the Commission requires operators to include in the "Remarks" box on the W-1 a statement that the lessor holds the leasehold on all tracts traversed by the well.[16] Every detail of paperwork filings cannot be addressed in a formal rule, so the Commission offers seminars, manuals, and online information to educate the industry concerning proper filing procedures. In the Commission's drilling permits seminars, the Commission staff provides detailed information to assist operations in using Form W-1 to apply for an Allocation well drilling permit. Intervenors' Exhibit F.[17]

Intervenors except to proposed Finding of Fact 10b, which states that (1) all applications for allocation wells have been filed on Form PSA-12, and (2) the PSA-12 is intended for production sharing agreement wells. The PSA-12 was first adopted effective on September 12, 2011, which was after Mr. Lineberry's April, 2010 letter authorizing the permitting of the first allocation well, the Taylor-Abney-Obanion (Allocation) Well. 36 Tex. Reg. 5835. Operators initially provided an attachment entitled "Production Sharing Description" to show the leases and/or units traversed by the well.[18] More recently the Commission staff has instructed operators to utilize the Form PSA-12 for uniformity. Intervenors' Exhibit H. Thus, the proposed Finding

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[15] Intervenors request that the Commission take official notice of Intervenors' Exhibits E, F, and H through K, which are official Commission records. Intervenors submit that there is good cause for taking official notice after the hearing because the parties could not have reasonably anticipated the need to file Commission records to address statements in the Proposal that are not consistent with Commission practice with respect to allocation well drilling permit applications.

[16] In addition, the Commission requires acreage assignment information to assure the Commission that the operator has sufficient density under Rule 38 and that there will be no double assignment of acreage in violation of Rule 40. This backup information is consistent with 5(a), which provides that "[a]n application must be accompanied by any relevant information, form, or certification required by the Railroad Commission or a Commission representative necessary to determine compliance with this rule and state law." 16 Tex. Admin. Code § 3.5.

[17] *See* in particular pages 1, 2, 3, 8, 10, 14, and 17.

[18] Intervenors' Exhibit G, which is page 4 of Exhibit 35 in the Haynesville Hearing.

is inaccurate in stating that all applications for allocation wells have been filed on the PSA-12. It is not clear what the source is of proposed Finding of Fact 10b's statement that the PSA-12 is "intended" for production sharing agreement wells, but the Commission staff has clearly directed otherwise based on instructions to operators to use that form.

To the extent that the Proposal suggests that if there is no form for something, it cannot exist, it puts form over substance and bureaucracy over policy. The same is true in the discussion of the absence of a particular rule for allocation wells. An allocation well is a kind of horizontal well. The name is a convenient way to indicate that the well starts on one lease or pooled unit and ends on another.

The Commission can take official notice that the first horizontal well permit issued by the Railroad Commission was Permit No. 323272 issued to Amoco Production Company for the Joseph R. Skrivanek, Jr. No. 2 Well in Burleson County on November 24, 1986. Between that date, and the effective date of Statewide Rule 86 on June 1, 1990, the Commission records show that 541 horizontal wellbores were permitted. The Commission may take official notice of these records, attached as Exhibit I, and the Commission is respectfully requested to do so.

Under the reasoning of the Proposal, the Commission could not have issued those 541 horizontal well permits, because there wasn't a rule that addressed horizontal wellbores. In addition, the Form W-1H for horizontal wellbores was not promulgated by the Commission until April 12, 2004. (29 Texas Register 3612, 3615, April 9, 2004)(adopting new Form W-1H). The Commission may take official notice of its own records, which the Commission is respectfully requested to do, that there were 10,434 drilling permits issued for horizontal wellbores between the first horizontal well permit was issued in 1986 until the adoption of the Form W-1H, which contained information specific to horizontal wellbores. Intervenors' Exhibit J. Under the

reasoning of the Proposal, the Commission could not have issued these permits, because there was no form specific to horizontal wells.

The Commission delayed the adoption of formal rules for horizontal wellbores until some four years after they were initially permitted by the Commission. This allowed the Commission some time to work out the scope of the regulatory system and to give some definition to its parameters. Meanwhile, wells could be properly permitted under the existing Statewide Rules addressing well permitting.

### 2. Issuance of a Permit for an Allocation Well is Consistent with Accepted Commission Practice and Procedure

Intervenors except to proposed Finding of Fact 9, which states that EOG's application does not fall within the minimal good faith standard. Established Commission practice and procedure demonstrates that EOG has a good faith claim to title to drill the Klotzman Well.

As noted above, discussion before the Commission of the permitting of allocation wells arose in conjunction with the Haynesville Hearing. In that hearing, Devon presented evidence to show that many of its units formed for drilling vertical wells in the area were oddly shaped and thus not suitable for the drilling of horizontal wells of the length and orientation necessary to develop the Carthage (Haynesville) Field. (Haynesville Hearing, I Tr. 51-53).[19] Devon showed that it would be necessary to drill horizontal wells across lease and unit lines in order to efficiently develop the field, recover the hydrocarbons, and prevent waste. Devon requested that the Commission adopt an allocation rule in the field rules for the Carthage (Haynesville) Field. The Commission declined to adopt this field rule concluding that the Commission did not have

[19] The examiners in Oil and Gas Docket No. 02-0278952 have taken official notice of Docket No. 06-0262000, including the proposal for decision in that docket and the file in that docket. Tr. 13. Citations in these Exceptions to the file in Docket No. 06-0262000 will be labeled "Haynesville Hearing." Transcript and exhibit citations without such designation are to the record in Oil and Gas Docket No. 02-0278952.

the authority to extend or modify leases or to determine the ownership of oil and gas or how the proceeds from the sale of oil or gas should be apportioned. While Devon certainly concurs that the Commission does not have authority to extend or modify leases or to allocate the proceeds of production, Devon respectfully disagreed that its proposed allocation rule asked the Commission to do any of these things.

Devon (1) appealed the Commission's decision in Oil and Gas Docket No. 06-0262000 and (2) filed a well permit application for an allocation well, the Taylor-Abney-Obanion Allocation Well. Devon clearly disclosed in its permit application that the wellbore would cross pooled unit lines. On April 21, 2010, the Commission's Director of the Hearing Section, Mr. Colin Lineberry, notified Devon that based on the representation that it holds the leases on each of the tracts crossed and that there are no unleased interests within 330 feet of any point on the wellbore, the Commission would process the permit application "with the notation that the applicant has made a sufficient showing of a good faith claim to the right to produce the minerals under the proposed unit such that the good faith claim issue does not bar issuance of a permit." (Exhibit B attached to EOG Exhibit 3).

When the Commission issued the April 21, 2010 letter from Colin Lineberry indicating that the Commission would grant the permit for the Taylor-Abney-Obanion well, thus recognizing the Commission's responsibility to issue such permits, Devon filed a notice of nonsuit withdrawing the appeal. EOG Exhibit 13 shows that, as of the hearing, more than 70 allocation well drilling permit applications have been filed. The Commission issues permits for these wells in accordance with its Statewide Rules.

Commission staff has previously concluded in Mr. Lineberry's April 21, 2010 letter that by virtue of its oil and gas leases Devon held a good faith claim to title to drill across multiple

pooled units without pooling and without a production sharing agreement. That determination of good faith claim to title was based on a Form W-1 filing similar to that of EOG and was specifically based on (1) the representation by applicant that it held leases covering 100% of each tract traversed by the wellbore and (2) the absence of unleased interests within 330' of any point on the wellbore. Based on those facts, Mr. Lineberry concluded that "it appears that applicant has met the minimal good faith claim standard necessary for issuance of a permit." (Exhibit B to EOG Exhibit 3).

The proposed Finding of Fact 9—stating that EOG's application "does not fall within the minimal good faith standard of the Lineberry letter" because EOG's leases "do not contain pooling authority for oil"—is based on an erroneous presumption that Devon was able to demonstrate a good faith claim to title only because Devon (unlike EOG here) was proposing to drill a horizontal well across three validly pooled units. But Devon did not represent to the Commission that (1) Devon had formed a pooled unit for the horizontal well,[20] or that (2) Devon had authority to do so. Devon was proposing to drill across pooled unit lines and, thus, to drill across un-pooled tracts—just as EOG is proposing to drill across un-pooled lease lines here. Both Devon's and EOG's right to drill is based on the authority in their leases rather than reliance on a pooling clause. The fact that Devon had pooling authority to form the three pooled units that the well would cross was irrelevant to the determination that Devon had a good faith claim to title to drill the well. Thus, in all relevant aspects, the EOG application is identical to the situation addressed in the Lineberry letter.

[20] The Form W-1 for the Taylor-Abney-Obanion Well indicates the tract is not a pooled unit. See Box 23, Form W-1, in Intervenors' Exhibit K, which is a copy of the Commission file for the Taylor-Abney-Obanion Well.

## D. The Recommendation in the Proposal for Decision Would Have Tremendous Negative Statewide Impact

The Proposal is not limited in any way to this particular well permit application and, as written, would have tremendous statewide impact on operators' ability to permit and drill horizontal wells. Notice of this application was provided only to EOG and Klotzman and was not provided to the many operators statewide who would be impacted if this Proposal were adopted. As shown in EOG Exhibit 14, allocation wells to date have been permitted by 17 operators in multiple areas throughout the State. The record also shows that denial of allocation well permits would have significant harmful effects in causing waste and denying the mineral owners and lessees their rights to produce the minerals under their lands. Because the application was not noticed as a statewide matter, there was no notice and opportunity to present evidence of the statewide impact. EOG showed that for the particular tracts under consideration in this hearing, the denial of permits for allocation wells would result in substantial waste in the form of loss of treatable lateral length and of hydrocarbon recovery. On these two leases alone, an additional 48,883 feet less of treatable horizontal lateral can be completed by drilling allocation wells across lease lines rather than by drilling single-lease wells. (Tr. 84) This additional lateral length is the equivalent of 10 to 11 additional horizontal laterals. (Tr. 85) And the testimony indicates that the greater the treatable lateral, the greater the ultimate recovery. (Tr. 83) Thus, on these two leases alone, EOG's petroleum engineer testified that allocation wells would produce over five million more barrels of oil more than if horizontal wells were restricted to a single lease.

If the Commission is not inclined to reverse the recommendation in the Proposal on the current record, then Intervenors submit that the record must be reopened and expanded to address the statewide impact of this decision. Further, if the Commission were to ignore the

applicable law and Statewide Rules and issue a precedential decision changing the existing practice and requirements for permitting of allocation wells affecting all of Texas, notice should be given to all affected operators in the State, so that all affected operators will have an opportunity to address this issue of statewide impact, and the Commission must consider whether such changes should proceed as a formal rulemaking proceeding. Section 2001.003 of the Administrative Procedure Act defines a rule as a state agency statement of general applicability that:

(i) implements, interprets, or prescribes law or policy; or

(ii) describes the procedure or practice requirements of a state agency.

The recommendation in this Proposal for Decision, if adopted, would implement a policy of denying permits to wells that are legally entitled thereto, and that were previously eligible for a permit, and would establish a new policy, procedure, or practice for this agency.

## V.
## CONCLUSION

The issue in this hearing is set forth in Mr. Lineberry's October 5, 2012 letter: whether, on the specific facts of this case, EOG has a sufficient good faith claim to authorize issuance of an Railroad Commission drilling permit for the proposed allocation well. Mr. Lineberry states: "This is the first case of which I am aware in which a mineral owner has asserted prior to the permitting of a well that the specific terms of the leases bar an operator from having even a good faith claim to a right to drill a horizontal well across lease lines." The Klotzmans have put on no evidence in this hearing to show that EOG lacks a good faith claim. The Klotzman complaint should be dismissed because Klotzman is asking the Commission not only to make a title determination, which is outside the Commission's authority, but also to change the estate that Klotzman granted to EOG in a manner that is contrary to long-established Texas oil and gas law.

This Proposal recommends denial of a drilling permit application based solely on a novel and erroneous interpretation of title and the provisions of the leases at issue. For all of the reasons stated herein, Intervenors except to the proposed Conclusion of Law 6, stating that EOG's application should be dismissed. The Commission should not adopt the Proposal, but should overrule the Proposal and issue the permit for the Klotzman Lease (Allocation) Well No. 1H.

**Respectfully submitted,**

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## CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of July, 2013, a true and correct copy of the foregoing Exceptions was provided to the following parties of record e-mail and/or by depositing same in the United States Mail, first class postage prepaid, to the addresses listed below:

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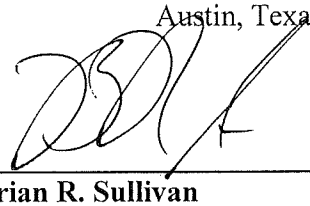

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