BEFORE THE RAILROAD COMMISSION OF TEXAS

PETITION TO INITIATE RULEMAKING PROCEEDINGS TO AMEND STATEWIDE RULE 40 TO REGULATE THE DRILLING OF HORIZONTAL WELLS THAT CROSS LEASE OR UNIT BOUNDARIES

SUBMITTED BY
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JENNINGS MINERAL COMPANY, SUSAN P. & THOMAS V. ARMIN,
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The Texas Land and Mineral Owners Association and the other above listed parties (hereinafter collectively "Petitioners") hereby petition the Railroad Commission of Texas, pursuant to Texas Government Code § 2001.021 and 16 Texas Administrative Code §1.21, to initiate rulemaking proceedings to adopt the attached Amendment to Statewide Rule 40, 16 Texas Admin. Code §3.40 (hereinafter "the Proposed Amendment").

The Proposed Amendment establishes uniform procedures for the filing and processing of a drilling permit for a horizontal well when the lateral for the proposed well will cross a line or lines dividing separate leases or pooled units.

Pursuant to the Proposed Amendment, an operator may obtain a permit to drill a horizontal well that will cross lines dividing separate leases or pooled units only if the operator has solicited and obtained agreement by at least 65% of the interest holders for each affected lease or pooled unit to participate in a Production Sharing Agreement covering production from the proposed well and governing the allocation of production to the respective interest holders.

Why Rulemaking is Necessary

Adoption of the Proposed Amendment is necessary because current Commission practices lack uniformity and have resulted in gradual erosion of the rights of Texas mineral owners to protect themselves from unauthorized pooling and production by operators.

In a proceeding in 2008, the Commissioners endorsed 65% as the minimum mineral owner participation for approval of a permit to drill a horizontal well that crosses lease or unit boundaries. However, since then, some operators have been successful in acquiring drilling permits for horizontal wells that cross lease lines without representing that the operator has the right to pool the tracts or that the operator has obtained the agreement of a single mineral owner

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to a production sharing agreement. It is unclear how this practice evolved, especially in light of a decision by the Commission in 2009 in Oil & Gas Docket No. 06-026200, that soundly rejected the practice.

Initiation of rulemaking proceeding is appropriate because rulemaking proceedings conducted pursuant to the Texas Administrative Procedures Act provide a forum for the participation of all affected parties, unlike the proceedings that have shaped the Commission's practice to date. For several years, various operators have been attempting to establish a precedent for drilling of "allocation wells" without obtaining agreement from mineral and royalty owners. They have pursued their objective in the context of field rule hearings, permit applications and other Commission proceedings that do not provide notice to mineral owners. For the Commission to address an issue with such a significant impact on mineral owners in forums that do not allow for effective mineral owner participation is improper.

The Texas Supreme Court has held consistently that "a presumption favors adopting rules of general applicability through the formal rulemaking procedures" set forth in the Texas Administrative Procedure Act. *Rodriguez v. Service Lloyds Insurance Company*, 997 S.W.2d 248, 255 (Tex. 1999). "Under these procedures the agency must provide notice, publication, and invite public comment, among other things. In this way, the APA assures that the public and affected persons are heard on matters that affect them and receive notice of new rules. Indeed, the Legislature delegates formal rulemaking power to an agency in the expectation that an agency will ordinarily adopt rules of general application through that power." *Id. (citations omitted).*

Adoption of the Proposed Amendment is also necessary to provide a clear and unambiguous prohibition of the practice of issuing drilling permits to operators to complete horizontal wells across lease lines despite the lack of any contractual authorization from affected mineral owners. Some operators are using such permits to achieve forced pooling of mineral interests when the mineral owners have granted no authority to pool their interests, in clear contravention of Texas law.

"A lessee's authority to pool is derived solely from the terms of the lease; a lessee has no power to pool absent express authority." *Browning Oil Co., Inc v. Luecke*, 38 S.W.3d 625, 634 (Tex. App. – Austin, 2000, pet. denied). "... the acts of the Railroad Commission cannot be said to operate effectively to extend the restrictive terms of a lease. The orders of the Railroad Commission cannot compel pooling agreements that the parties themselves do not agree upon." *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1966).

Lastly, adoption of the Proposed Amendment is necessary to prevent operators from circumventing the prohibition against forced pooling by simply calling their actions something else. As the Examiner noted in Docket No. 06-0262000, "Although Devon may argue that it is not pooling portions of existing units, this is, in fact, what it is doing. . . . 'Pooling occurs when tracts from two or more leases are combined for the purpose of drilling a single well.' 1 Smith & Weaver, Texas Law of Oil & Gas, §4.8. That is precisely what Devon proposes – combining multiple tracts for purposes of drilling a horizontal well." PFD, p. 12.

Statutory Authority for Adoption of the Amendment

The Commission has the authority to adopt the Proposed Amendment pursuant to Texas Natural Resources Code §§ 81.051 and 81.052.

Conclusion

Since at least 1943, it has been clear that the Railroad Commission does not issue a drilling permit to an operator who cannot in good faith claim the right to drill the well. *Magnolia Petroleum Co. v. Railroad Commission*, 170 S.W.2d 189, 191 (Tex. 1943). By the same principle, the Commission should not issue a drilling permit for a well that requires the combining of separate leases or units when the operator cannot represent in good faith that he has obtained the right from the mineral owners to combine the tracts for such purpose.

For these reasons, the above Petitioners respectfully request that the Commission initiate rulemaking proceedings to adopt the attached Proposed Amendment to Statewide Rule 40.

If the Commission elects to grant this Petition and initiate rulemaking proceedings, Petitioners also request, pursuant to Texas Government Code § 2001.029, that the Commission call a public hearing to hear testimony regarding the Proposed Amendment.

Respectfully submitted,

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By: 
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TEXAS ADMINISTRATIVE CODE
TITLE 16 ECONOMIC REGULATION
PART 1 RAILROAD COMMISSION OF TEXAS
CHAPTER 3 OIL AND GAS DIVISION
RULE §3.40 Assignment of Acreage to Pooled Development and Proration Units

(a) – (d) *(No change.)*

(e) The Commission may issue a permit for a horizontal drainhole well that crosses a dividing line between two or more leases or pooled units (a "PSA Well"), subject to the following requirements:

(1) The lease name as designated on Commission records must end with the notation "(PSA)." In addition, the applicant must state in the remarks section of Form W-1 that the application involves a Production Sharing Agreement ("PSA").

(2) The operator must file the following supporting documentation with the application:

(A) a signed statement that the applicant has all necessary property and contractual rights to drill and operate a well at the proposed location, including, if applicable, the right to use the applied-for off-lease surface location and/or to penetrate the target field off-lease, and that the applicant has the legal right to develop and produce the minerals under all acreage assigned to the well;

(B) a signed statement specifying the percent of ownership of "affected parties" in the PSA Well for working and royalty interest owners within each lease or pooled unit on which the PSA Well is located who have agreed to a method of allocating production from the PSA Well among the leases or units crossed by the Well. No permit will be issued for a PSA Well if participation for either working or royalty interest owners who are affected parties is less than 65% for any lease or pooled unit on which the PSA Well is located. If the productive interval of the wellbore crosses an existing pooled unit that unitizes the depths from which the proposed PSA Well will produce, all interest owners in the unit are considered "affected parties"; if the productive interval crosses an existing lease not included in a pooled unit as to the depths from which the proposed PSA well will produce, all interest owners in any tract within the lease on which any part of the proposed wellbore will be located are considered "affected parties;"

(C) a signed statement that the operator made a good faith effort to determine and locate all current "affected parties" and extended to each of them an offer to participate in the PSA;

(D) the Sharing Agreement Form PSA-12 detailing the amount of acreage to be assigned from each lease and/or pooled unit contributing to the PSA;

(E) a plat indicating acreage being assigned from each participating lease/unit wellbore path, penetration point, terminus, and the proposed perforations and any other points at which the wellbore will be open within the designated interval of the permitted field. The plat also must indicate the distance from the applied-for well to each other well that is completed in the same field and located on a lease/unit affected by the PSA Well;

(F) a PSA code sheet; and

(G) in the remarks section of Form W-1, a notation to identify the well as a PSA Well and a statement indicating the total number of existing and applied-for wells in the applied-for field on the lease/units affected by the PSA.

(f) Production of hydrocarbons from a PSA well will be treated for purposes of Rule 26 as production from a single lease. Production from a PSA well must be separately measured and may not be comingled with production from another lease, unit or PSA well prior to measurement.

(g) The provisions of this rule relating to the drilling and production of PSA wells shall have no affect on the rights of mineral owners who do not sign a Production Sharing Agreement.