CAUSE NO. D-1-GN-18-001111

MONROE PROPERTIES, INC., SRO LAND & MINERALS, L.P. AND THE LEE M. STRATTON LIVING TRUST, MARY ELIZABETH STRATTON, TRUSTEE, Plaintiffs,	§	IN THE DISTRICT COURT OF
vs.	§	TRAVIS COUNTY, TEXAS
RAILROAD COMMISSION OF TEXAS, Defendant.	§	53RD TH JUDICIAL DISTRICT

PLAINTIFFS' ORIGINAL PETITION FOR JUDICIAL REVIEW

Plaintiffs Monroe Properties, Inc., SRO Land & Minerals, L.P., And The Lee M. Stratton Living Trust, Mary Elizabeth Stratton, Trustee (collectively, "Plaintiffs" or "SRO"), file this Original Petition for Judicial Review and would respectfully show as follows:

DISCOVERY CONTROL PLAN

1. Discovery in this matter is intended to be conducted under Level 3 of TEX. R. CIV. P. 190.

NATURE OF THE CASE

2. This is an appeal from a decision of the Railroad Commission of Texas ("RRC") in RRC Docket No. 08-0305330 in which Plaintiffs, who are mineral owners, filed a complaint protesting the issuance of a drilling permit to Devon Energy Production Co., L.P., ("Devon") for a well on Plaintiffs' property. Devon filed a motion to dismiss the complaint and a prehearing conference was heard by a Commission Administrative Law

Judge, in which the parties presented evidence and argument. Plaintiffs argued *inter alia* that Devon had no contractual right to drill the proposed well, that the well would violate established case law requiring express lease authority to drill such a well and would also violate existing Commission rules. Plaintiffs further alleged that no Commission rule recognized the validity of the type of well Devon proposed to drill. Devon's motion to dismiss relied *inter alia* on Commission practice of approving permits to drill wells like the one Devon planned to drill on the property covered by Plaintiffs' oil and gas lease ("Lease") and the Commission's ruling in an earlier docket.

3. On or about December 18, 2017, the Commission issued an Order of Dismissal that granted Devon's motion. A copy of that Order is attached as Exhibit A.

PARTIES

4. Plaintiffs are Monroe Properties, Inc., SRO Land & Minerals, L.P., And The Lee M. Stratton Living Trust, Mary Elizabeth Stratton, Trustee.

5. Defendant Railroad Commission of Texas ("the Commission") is the state agency authorized by TEX. NAT. RES. CODE. § 85.051 to regulate the drilling and production of oil and gas in the State of Texas. The Commission may be served with citation and process by serving the Commission Secretary Kathryn ("Kathy") A. Way at the Commission's offices at 12th floor, 1701 N. Congress Avenue, Austin, Texas, 78701.

6. Devon Energy Production Company, LP, was a party to the agency proceeding below and, pursuant to TEX. GOV'T CODE ANN. § 2001.176, must be served with a copy of this Petition. Devon may be served by serving its attorney for the proceeding below,

Brian Sullivan, at the offices of McElroy, Sullivan & Miller, at 1201 Spyglass Drive, Suite 200, Austin, Texas 78746.

JURISDICTION AND VENUE

7. This Court has jurisdiction over Plaintiffs' claims pursuant to TEX. NAT. RES. CODE ANN. § 85.241; TEX. GOV'T CODE ANN. § 2001.171 (Vernon 2008), TEX. GOV'T CODE ANN. §§ 24.007-.008, 24.011 (Vernon 2004).

8. Venue is mandatory in Travis County, Texas pursuant to TEX. GOV'T CODE ANN. § 2001.176(b)(1) and Texas Natural Resources Code § 85.241.

BACKGROUND

9. The Railroad Commission regulates drilling for oil and gas in Texas through "Statewide Rules" promulgated by the Commission pursuant to the rulemaking provisions of the Administrative Procedure Act ("APA"). Because the appropriate spacing and density (among other characteristics) of wells can vary depending on specific reservoir conditions, the Commission also promulgates "field rules" that apply only to wells completed in specific reservoirs. The specific field rules applicable to the subject well are not at issue here but certain Statewide Rules are.

10. When operators are developing a field with horizontal drilling, it is sometimes optimal to drill a horizontal well that will cross "lease lines" – the lines that divide tracts subject to separate leasing agreements. A well that crosses lease lines raises legal issues that are both contractual and regulatory. Prior to 2010, most operators addressed the contractual issues by pooling the tracts traversed by the horizontal well. In instances where one or more of the subject leases did not contractually allow for pooling, the

operators went to the mineral owners and negotiated new lease terms to provide for pooling. This solution also addressed the regulatory issues, because the Commission's rules recognized and allowed for drilling on and production from leases that had been pooled.

11. A few operators, rather than pooling the subject tracts, resorted to a different device, which has come to be known as a "Production Sharing Agreement." Prior to drilling the well, the operator enters into an agreement with the mineral owners in the tracts that will be traversed by the well. The agreement authorizes the well and establishes how production from the well will be allocated to the separate tracts for purposes of paying royalties. The Commission has never promulgated a textual rule authorizing "Production Sharing Agreement" wells, but it has promulgated forms specific to Production Sharing Agreement wells and has established an unwritten policy that an operator must have 65% of the mineral ownership for the affected tracts sign a Production Sharing Agreement before a permit to drill the well will be issued.

12. The concept of an "allocation well" was developed by operators who lacked the contractual authority to pool the tracts that would be traversed by a horizontal well and either failed to get agreement from 65% of the mineral ownership, or never tried. Starting in 2010, the operators' representatives persuaded Commission staff to begin issuing drilling permits to operators who had neither the contractual right to pool the subject tracts nor a Production Sharing Agreement with the mineral owners. This significant change in Commission procedures was made without resort to APA-prescribed rulemaking procedures, without hearings and without notice to the persons

most directly affected – Texas mineral owners. The permits issued were called "allocation well" permits. In conjunction with the practice of issuing "allocation well" permits, the Commission includes the following statement in every such permit issued:

> Commission Staff expresses no opinion as to whether a 100% ownership interest in each of the leases alone or in combination with a "production sharing agreement" confers the right to drill across lease/unit lines or whether a pooling agreement is also required. However, until that issue is directly addressed and ruled upon by a Texas court of competent jurisdiction it appears that a 100% interest in each of the leases and a production sharing agreement constitute a sufficient colorable claim to the right to drill a horizontal well as proposed to authorize the removal of the regulatory bar and the issuance of a drilling permit by the Commission, assuming the proposed well is in compliance with all other relevant Commission requirements. Issuance of the permit is not an endorsement or approval of the applicant's stated method of allocating production proceeds among component leases or units. All production must be reported to the Commission as production from the lease or pooled unit on which the wellhead is located and reported production volume must be determined by actual measurement of hydrocarbon volumes prior to leaving that tract and may not be based on allocation or estimation. Payment of royalties is a contractual matter between the lessor and lessee. Interpreting the leases and determining whether the proposed proceeds allocation comports with the relevant leases is not a matter within Commission jurisdiction but a matter for the parties to the lease and, if necessary, a Texas court of competent jurisdiction. The foregoing statements are not, and should not be construed as, a final opinion or decision of the Railroad Commission.

13. Plaintiffs are the owners of a mineral interest in a tract across which Devon proposes to drill a horizontal well named the NI Helped (Alloc) well ("Well"). Plaintiffs own a 1/2 mineral interest in a tract of 153.34 acres subject to an oil and gas lease from Cynthia L. Monroe, et al. to Gulf Oil Corporation dated January 4, 1967 ("Lease"). Plaintiffs are successors-in-interest to the lessors of said Lease. Devon is the successor-

in-interest to the original lessee. The tract is included in the pooled unit depicted as "Monroe Unit No. 1" on the well location plat filed by Devon with its permit application.

14. On or about June 5, 2017, Devon filed its drilling permit application for the Well. On or about July 6, 2017, Plaintiffs filed a Complaint protesting issuance of the requested permit. On or about August 17, 2017, Devon amended its application. The changes made in the amendment did not cure the problems addressed in the original complaint. On or about August 23, 2017, Plaintiffs filed an Amended Complaint protesting the amended request.

15. According to its amended drilling permit application, Devon proposes to drill the Well horizontally so that the Well will produce both from Plaintiffs' tract and two adjacent tracts, without forming a pooled unit encompassing the tracts from which the Well would produce and without obtaining a Production Sharing Agreement from Plaintiffs. Devon labeled the well an "allocation well" in its application for drilling permit.

16. Plaintiffs contend that, under the terms of their Lease, Devon lacks the authority to conduct operations dedicated to the production of minerals from unpooled adjacent acreage. Plaintiffs further contend that Devon has not obtained any other agreement with them that could authorize Devon to drill the proposed Well.

17. The proposed Well would cross three tracts. The tract in which the Plaintiffs have an interest is included in the Monroe Unit No. 1, formed in 1968 and encompassing 663.97 acres. The middle tract to be crossed by the proposed well is included in a different pooled unit, the Burkholder Unit No. A-1, formed in 1970, encompassing 640

acres. Plaintiffs own mineral interests in tracts within the Burkholder Unit No. A-1, located in Sections 54 and 55, Block 33, H&TC RR Co. Survey, and Section 31-1/2, Scrap File 7666, J.S. Ross Original Grantee. None of those tracts in the Burkholder Unit No. A-1 in which Plaintiffs have mineral interests, however, are to be crossed by the proposed Well. The third tract crossed by the proposed well is a lease tract not included in any pooled unit.

18. As Devon's amended application sets out, Devon believes the proposed Well could be completed as either an oil well or a gas well. According to Devon, how production from the Well would be allocated would depend on whether it is classified as an oil well or a gas well, since the two pooled units crossed by the proposed Well only pool production from wells classified as gas wells. Devon's amended application proposes that, if the Well is completed as an oil well, production would be allocated among the three tracts crossed by the wellbore based on the percentage of the perforated lateral on each tract. But if the Well is a gas well within the unitized depths, that portion of the production allocated to the Monroe Unit tract would be allocated among all royalty owners in the Monroe Unit, and that portion of the production allocated to the Burkholder Unit No. A-1 would be allocated amongst all royalty owners in the Burkholder Unit No. A-1. Therefore, Devon's proposed method for allocation of production is vastly different depending on the well classification.

19. The Lease requires the lessee to pay royalties on 3/16 of the "oil produced and saved from the leased premises," and on 3/16 of the gas sold or used from the leased premises. The Lease lists 5 tracts and specifies that each tract is a separate and distinct

lease and is for all purposes to be treated as a separate lease. The Lease does not authorize pooling of the Lease tract with any non-contiguous tract or with any other property for production from an oil well, absent a separate agreement from the Lessors. The Lease does allow pooling for production from a gas well, but only under very limited circumstances and subject to conditions that were specifically negotiated for the Lease. Devon has not obtained permission or agreement from Plaintiffs either to drill the proposed Well on a pooled unit or to implement Devon's proposed methods of allocation of production from the Well by way of a Production Sharing Agreement.

20. No provision of the Lease allows payment of royalties based on an estimated volume of oil or gas produced from the leased premises and other lands, nor does the Lease allow the commingling of oil and gas produced from the leased premises with oil and gas produced from other leases or lands.

21. No Texas case has ever construed an oil and gas lease to permit the lessee to pay royalties on an estimated share of commingled production. The only method authorized by the Lease for commingling production from multiple tracts is by forming pooled units. Therefore, Devon does not meet the Commission's standard for a "colorable claim to the right to drill" the proposed Well.

22. Lessees in Texas have no power to pool without the lessor's express authorization. *See Southeastern Pipeline Company, Inc. v. Tichacek*, 997 S.W.2d 166 (Tex. 1999). If the right to pool is not expressly granted to the lessee, it is a right retained by the mineral owner. *See Jones v. Killingsworth*, 403 S.W.2d 325 (Tex. 1966). Devon's request for a permit here is an improper attempt to circumvent these lease limitations. "[T]he 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." *Killingsworth*, 408 S.W.2d at 328.

23. In *Browning Oil Company, Inc. v. Luecke,* 38 S.W.3d 625 (Tex. App.--Austin 2000, writ denied), the court held that an operator's completion of a horizontal well across lease lines violated the terms of the leases. If the drilling of a well will violate the terms of an operator's lease, the operator obviously cannot in good faith claim a right to drill the well.

24. No Commission rule authorizes the granting of a drilling permit for a horizontal well that will cross lease or unit lines, in the absence of pooling authority or the agreement of mineral owners. In addition, the requested permit violates the Commission's Statewide Rule 40, found at 16 Tex. Admin. Code § 3.40. That rule provides that an operator may combine acreage from two or more tracts to create a drilling unit only "in accordance with appropriate contractual authority." Devon does not have the "appropriate contractual authority" to combine the tracts at issue here.

25. The requested permit also violates Commission Statewide Rule 26, found at 16 Tex. Admin. Code § 3.26, because Devon's proposed completion would render it impossible to measure all hydrocarbon production before it leaves the lease from which it is produced. Rule 26 requires all "oil and other liquid hydrocarbons" to be measured "before the same leaves the lease from which they are produced." 16 Tex. Admin. Code § 3.26(a)(2). Production from the Monroe Unit tract will leave that tract without being

measured. The exceptions contained in Rule 26 that allow for commingling do not apply to Devon's requested permit. Plaintiffs are entitled to the protections afforded by Rule 26.

26. The Commission has both the authority and the duty to examine and evaluate contract rights in the performance of its regulatory duties. *See Magnolia Petroleum Co. v. Railroad Commission*, 170 S.W.2d 189, 191 (Tex. 1943). The mere fact that a party asserts a property or contractual right to drill a well is not sufficient grounds for the Commission to issue the requested permit. Per *Magnolia*, the Commission has the power and the duty to examine Devon's claim for reasonableness. *See also Cheesman v. Amerada Petroleum Corporation*, 227 S.W.2d 829 (Tex. Civ. App. – Austin 1950, no writ) (holding Commission can and should consider legal authority of operator to pool when deciding whether to grant a permit).

27. In spite of this controlling law, Devon filed a motion to dismiss Plaintiffs' complaint without a hearing, arguing that the Commission had previously decided the issues raised by Plaintiffs in its 2013 Final Order In Docket No. 02-0278952 (*Klotzman*). In *Klotzman* the Commission had held that EOG Resources, Inc. had a sufficient good faith claim to drill a proposed allocation well. Devon also argued that Commission forms allow Devon to obtain the permit. The landowners in *Klotzman* appealed the Commission's ruling, but the matter was settled before any decision on the appeal.

28. On or about November 9, 2017, after notice, a Commission Administrative Law Judge conducted a prehearing conference that included consideration of Devon's motion to dismiss, with evidence presented by both sides.

29. On or about December 18, 2017, the Commission issued an Order of Dismissal, attached hereto as Exhibit A, that granted Devon's motion.

30. On or about January 9, 2018, Plaintiffs timely filed a Motion for Rehearing to the Order of Dismissal. A copy of the motion is attached as Exhibit B.

31. On or about February 13, 2018, the Commission issued an Order Denying Plaintiffs' Motion for Rehearing. A copy of that order is attached as Exhibit C.

32. The Commission's Order must be reversed because of multiple errors of statutory law, arbitrary and capricious action, and lack of substantial evidence, each causing substantial prejudice to Plaintiffs. The specific arguments are those set out in Plaintiffs' Motion for Rehearing.

CAUSE OF ACTION: Petition for Judicial Review of Agency Action

33. Paragraphs 2 through 32 are incorporated herein by reference.

34. Texas Government Code § 2001.174 provides that a reviewing court shall reverse or remand a case for further proceedings if substantial rights of the appealing parties have been prejudiced because the administrative findings, inferences, conclusions, or decisions are (A) in violation of constitutional or statutory provision; (B) in excess of the agency's statutory authority; (C) made through unlawful procedure; (D) affected by other error of law; (E) not reasonably supported by substantial evidence considering the reliable and probative evidence in the record as a whole; or (F) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

3. The errors of the Commission are set out in Plaintiffs' motion for rehearing, which is incorporated into this petition by reference as if fully set out herein. The errors are summarized below:

35a. The Commission acted unlawfully by issuing a permit in violation of its own rules.

35b. The Commission's Order is arbitrary and capricious because it is inconsistent with the Commission's order in Oil and Gas Docket No. 06-026200 and the Commission has failed to explain its departure from the precedent set in that order.

35c. The Commission erred in finding that *Klotzman* precludes consideration of Plaintiffs' complaint because the facts here are different from those in *Klotzman.*

35d. The Commission erred in finding that it lacks jurisdiction to review Devon's authority under the SRO leases. On the contrary, established Texas case law requires the Commission to review the SRO leases.

35e. The Commission erred in finding that *Browning Oil Co. v. Luecke,* 38 S.W.3d 625, 632, 641-42 (Tex. App.--Austin 2000, pet. denied) does not control so as to preclude Devon from having a good faith claim to drill the well.

35f. The Commission erred in determining that neither pooling authority nor a production sharing agreement is required to establish a good faith claim to drill an allocation well and that Devon has a good faith claim; and

35g. The Commission erred in concluding that the complaint is moot because of *Klotzman.*

PRAYER

WHEREFORE, PREMISES CONSIDERED, Plaintiffs request that:

(a) Defendant Railroad Commission of Texas be cited to appear and answer herein;

(b) the Court reverse the Order, hold that Plaintiffs are entitled to a contested case hearing on their complaint, and remand this case to the Commission for further proceedings in accordance with the Court's order;

(c) the Court grant Plaintiffs such other and further relief, at law or in equity, to which they may show themselves justly entitled.

Respectfully submitted,

John B. McFarland
State Bar No. 13598500
jmcfarland@gdhm.com
Mary A. Keeney
State Bar No. 11170300
mkeeney@gdhm.com
Natasha M. Martin
State Bar No. 24083255
nmartin@gdhm.com
GRAVES, DOUGHERTY, HEARON & MOODY,
A Professional Corporation
401 Congress Avenue, Suite 2200
Austin, Texas 78701-3619
Tel: (512) 480-5682
Fax: (512) 480-5882

By: Mary A. Keeney
Mary A. Keeney

ATTORNEYS FOR PLAINTIFFS

RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

OIL & GAS DOCKET NO. 08-0305330

COMPLAINT OF MONROE PROPERTIES, INC., ET AL. THAT DEVON ENERGY PRODUCTION CO, L.P. DOES NOT HAVE A GOOD FAITH CLAIM TO OPERATE THE N I HELPED 120 (ALLOC) LEASE, WELL NO. 6H, PHANTOM (WOLFCAMP) FIELD, WARD COUNTY, TEXAS

ORDER OF DISMISSAL

The Railroad Commission of Texas ("Commission") finds that after notice, a prehearing conference was heard by a Commission Administrative Law Judge on November 9, 2017, to consider a motion to dismiss filed by respondent Devon Energy Production Co, L.P. ("Devon"). Complainants—Monroe Properties, Inc., SRO Land & Minerals, L.P. and the Lee M. Stratton Living Trust, Mary Elizabeth Stratton, Trustee ("Complainants")—and Devon appeared, and presented evidence and argument. After considering the evidence and argument of the parties, the Commission finds the motion to dismiss should be granted and adopts the following findings of fact and conclusions of law.

Findings of Facts

1. On March 7, 2017, Devon filed an application for a permit to drill the N I Helped 120 (Alloc) Lease, Well No. 6H (the "Well"), in Ward County, Texas. The Well is a horizontal well that would cross multiple tracts. Devon does not intend to form a pooled unit that encompasses all tracts crossed by the Well.

2. The proposed Well is an allocation well, which is commonly known as a horizontal well that is drilled across multiple leases and/or pooled units without pooling of all leases traversed by the well.

3. On March 10, 2017, Complainants protested Devon's permit application for the Well, claiming Devon does not have a good faith claim to drill the well. The basis for Complainants' assertion is that in order for Devon to have authority to drill an allocation well, either the applicable contractual lease relied on by Devon must contain pooling authority or Devon must have a production sharing agreement. Complainants assert because Devon has neither, it does not have a good faith claim to drill the Well as the proposed allocation well.

4. On September 24, 2013, the Commission entered a final order in Oil and Gas Docket No. 02-0278952 ("the Klotzman case") concluding that an operator with an oil and gas lease had a sufficient good faith claim to drill an allocation well. (Devon

EXHIBIT
A

Exhibit 17). The Commission rejected the argument that an applicant must show it has pooling authority or a production sharing agreement to establish it has a good faith claim to drill an allocation well.

5. On March 14, 2017, Lorenzo Garza, Manager, Drilling Permits, sent an email to Complainants regarding Complainants' protest of the Well permit application, stating: "The Commission has previously ruled on the matter of Allocation Wells in Oil and Gas Docket 02-0278952. As the circumstances appear similar to that case I will not hold up the permitting of this well. As you stated, Devon has the mineral interests in the tract under lease. They have met the minimum threshold in the issuance of a drilling permit." Mr. Garza notified Complainants that they could file a complaint with the Hearings Division if they wished to pursue the protest.

6. On June 14m 2017, Complainants filed this complaint challenging Devon's good faith claim to drill and operate the Well, resulting in this case before the Hearings Division.

7. A drilling permit was issued to Devon for the Well on September 13, 2017.

8. There is no dispute in this proceeding that Complainants are successor lessors/royalty interest owners under leases that are the subject of the complaint in this case.

9. There is no dispute in this proceeding that Devon is the lessee and operator for the oil and gas Commission designated leases that are the subject of the complaint in this case.

10. There is no dispute in this proceeding that Devon holds leases on the tracts crossed by the Well.

11. There is no dispute in this proceeding that certain leases crossed by the Well have been pooled for gas only pursuant to the applicable oil and gas leases, because the leases limit pooling to gas. There is no dispute in this proceeding about the validity of these pooled units.

12. Since the decision in the Klotzman case, the Commission has permitted a significant number of allocation wells.

    a. The Proposal for Decision in the Klotzman case states that the evidence in that hearing indicated there were fewer than 100 allocation wells permitted as of the December 3, 2012 hearing in that case.

    b. Excluding amended permits, as of November 9, 2017, the Commission had issued permits to 3,324 wells classified as allocation wells.

13. It has been Commission practice to allow the drilling of allocation wells.

a. Page two of the Commission's Form P-16 specifically applies to Allocation Wells.

   i. Section V of the Form P-16 is entitled "LISTING OF ALL TRACTS CONTRIBUTING ACREAGE TO AN RRC DESIGNATED DRILLSITE DEVELOPMENTAL UNIT THAT IS NOT A SINGLE LEASE, POOLED UNIT, OR GROUP OF TRACTS UNITIZED BY CONTRACT FOR PURPOSES OF SECONDARY RECOVERY."

   ii. Section V of the Form P-16 requires operators of Allocation Wells to list each lease or pooled unit the Allocation Well will traverse to show acreage assignment for each such lease or pooled unit crossed by the well.

   iii. Section VI of the Form P-16 is entitled "LISTING OF ALL WELLS IN THE APPLIED FOR FIELD ON THE SAME ACREAGE AS THE LEASE OR POOLED UNIT DESIGNATED FOR THE TRACTS LISTED IN SECTION V BY FILER."

b. The Commission's Form W-1, Application for Permit to Drill, Recomplete or Reenter, specifically addresses Allocation Wells as a type of horizontal well eligible for a drilling permit. Item No. 9 on the Form W-1 asks the operator to specify whether the horizontal well completion type is Allocation, PSA, or Stacked Lateral.

c. The Commission's drilling permit seminars and online publications instruct operators how to file drilling permit applications and completion filings for Allocation Wells that cross multiple pooled units, like the N I Helped Well.

   i. Railroad Commission of Texas publication "PSA Wells, Allocation Wells and Stacked Laterals" specifically instructs operators how to file allocation well permits that cross multiple pooled units.

   ii. Railroad Commission of Texas publication "PSA Wells, Allocation Wells, Stacked Laterals and Use of Form P-16 Data Sheet, August 2017" specifically instructs operators how to file Allocation Well permits that cross multiple pooled units.

d. The Commission issues electronic notices to the public that address Allocation Wells and other types of horizontal wells.

   i. The day prior to the hearing on the motion to dismiss in this docket, the Commission issued emails to the public advising of enhancements to its electronic completions screen to indicate when a horizontal well is an allocation well, which the email indicated will provide oil and gas operators

with information necessary to file a well completion more quickly and accurately.

ii. The day of the hearing on the motion to dismiss in this docket, the Commission issued emails to the public to advise that the file format for the online completions data subscription will be modified to include values for wells that are both Stacked Laterals and Allocation Wells.

14. In the Klotzman case, the Commission has previously decided that it does not require proof of pooling authority for an applicant to show a good faith claim necessary to obtain a permit for an allocation well. There has been no change in the law since the decision in the Klotzman case. This issue has been previously decided by the Commission. To relitigate this issue would be an unnecessary duplication of proceedings.

15. While the Complainants may have a bona fide lease dispute with Devon, the determination of whether there has been a breach and the appropriate remedy is outside the jurisdiction of the Commission.

16. Complainants' reliance on *Browning Oil Co. v. Luecke*, 38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied) ("Browning case") is misplaced.

a. The Browning case was decided prior to the Klotzman case and considered in the Klotzman case.

b. The Browning case does not establish that pooling authority is required for authority to drill an allocation well. For example, Ernest Smith, Professor of Law at the University of Texas School of Law and co-author of the *Texas Law of Oil & Gas* treatise, has written an article on the issue and concludes that pooling authority is not required to drill an allocation well. Ernest E. Smith, *Applying Familiar Concepts to New Technology: Under the Traditional Oil and gas Lease, A Lessee Does Not Need Pooling Authority to Drill a Horizontal Well that Crosses Lease Lines,* TEX. J. OF OIL, GAS, AND ENERGY LAW Vol. 12:1 (2017). Regarding the Browning case, he states:

> *Browning* does not hold that, where a lease is silent on pooling, a lessee is required to obtain pooling authority before the lessee can drill a horizontal well that crosses lease lines. And the result that Browning dictates—i.e. that each lessor whose tract is traversed by the horizontal well should be paid the royalties due under his or her lease—is exactly the result that should obtain for the horizontal allocation well. *Id.* at 10.

17. Neither pooling authority nor a production sharing agreement is required to establish a good faith claim for a permit to drill an allocation well.

18. Consistent with the Commission's order in the Klotzman case, Devon has a good faith claim to drill and operate the Well as an allocation well.

Conclusions of Law

1. Devon's motion to dismiss should be granted as unnecessary duplication of proceedings and moot because the Commission has previously decided that pooling authority is not required to show a good faith claim for a permit to drill an allocation well. *See* 16 TEX. ADMIN. CODE § 1.107(2) and (4).

2. Devon's motion to dismiss should be granted because the complaint amounts to a lease dispute, which is outside the jurisdiction of the Commission. *See* 16 TEX. ADMIN. CODE § 1.107(5).

Ordering Provisions

Devon's motion to dismiss is **GRANTED**. Complainants' complaint is **DISMISSED**. Consequently, the above captioned and docketed case in the Hearings Division is **DISMISSED**.

It is further **ORDERED** by the Commission that this order shall not be final and effective until 25 days after the order is signed, unless the time for filing a motion for rehearing has been extended under TEX. GOV'T CODE § 2001.142, by agreement under TEX. GOV'T CODE § 2001.147, or by written Commission order issued pursuant to TEX. GOV'T CODE § 2001.146(e). If a timely motion for rehearing is filed by any party at interest, this order shall not become final and effective until such motion is overruled, or if such motion is granted, this order shall be subject to further action by the Commission. Pursuant to TEX. GOV'T CODE § 2001.146(e), the time allotted for Commission action on a motion for rehearing in this case prior to its being overruled by operation of law is hereby extended until 90 days from the date the parties are notified of this order in accordance with TEX. GOV'T CODE § 2001.144.

Done this 18th day of December 2017.

Randall Collins, Director
Hearings Division

BEFORE THE

RAILROAD COMMISSION OF TEXAS

OIL & GAS DOCKET NO. 08-0305330
APPLICATION OF DEVON ENERGY PRODUCTION CO., L.P.
TO DRILL, RECOMPLETE OR RE-ENTER
NI HELPED 120 (ALLOC) WELL, WELL NO. 6H,
PHANTOM (WOLFCAMP) FIELD
WARD COUNTY, TEXAS

FILED WITH THE HEARINGS DIVISION
OFFICE OF DOCKET SERVICES

MOTION FOR REHEARING OF MONROE PROPERTIES, INC., SRO LAND & MINERALS, L.P., AND THE LEE M. STRATTON LIVING TRUST, MARY ELIZABETH STRATTON, TRUSTEE

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BEFORE THE

RAILROAD COMMISSION OF TEXAS

OIL & GAS DOCKET NO. 08-0305330
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MOTION FOR REHEARING OF MONROE PROPERTIES, INC., SRO LAND & MINERALS, L.P., AND THE LEE M. STRATTON LIVING TRUST, MARY ELIZABETH STRATTON, TRUSTEE

Monroe Properties, Inc., SRO Land & Minerals, L.P., and the Lee M Stratton Living Trust, Mary Elizabeth Stratton, Trustee (collectively, "SRO" or "Complainants") file this timely Motion for Rehearing for the Commission to reconsider the December 18, 2017 Order of Dismissal (the "Order") issued in this matter. In support of this motion, SRO respectfully shows as follows:

INTRODUCTION

Complainants file this motion for rehearing challenging the Commission's findings and conclusions in the Order. The errors identified by the Complainants are summarized as follows:

1. The Commission erred in relying on "Commission practice", and not properly adopted rules, to support its position on allocation wells;
2. The Commission's decision to allow Devon to drill the well violates Commission Rules 26 and 40;

3. The Commission's Order is inconsistent with its order in Oil and Gas Docket No. 06-026200 and its failure to follow that precedent or explain its departure from it is arbitrary and capricious;
4. The Commission erred in finding that litigating this case would be an "unnecessary duplication of proceedings" because the facts here are different from those in *Klotzman*, and neither *Klotzman* nor any other Commission proceeding nor any Commission Rule provides a basis for dismissal of SRO's Complaint;
5. The Commission erred in finding that the Commission lacks jurisdiction to review Devon's authority under the SRO leases;
6. The Commission erred in finding that *Browning Oil Co. v. Luecke,* 38 S.W.3d 625, 632, 641-42 (Tex. App.--Austin 2000, pet. denied) does not control so as to preclude Devon from having a good faith claim to drill the well;
7. The Commission erred in determining that neither pooling authority nor a production sharing agreement is required to establish a good faith claim to drill an allocation well and that Devon has a good faith claim; and
8. The Commission erred in concluding that the complaint is moot because of *Klotzman.*

Based on the errors identified, and the supporting arguments that follow, Complainants respectfully request that the Commission grant this motion for rehearing and reverse its Order.

ARGUMENT

I. The Commission erred in relying on "Commission practice", and not properly adopted rulemaking, to support its position on allocation wells. (Response to FOF 13).

The Commission cannot rely on forms, seminars, online publications, and emails on allocation wells as Commission rules that allow allocation wells. In an attempt to justify its practice of allowing allocation wells, the Commission in FOF 13, provides a laundry list of

forms, seminars, online publications, and emails related to allocation wells. None of these is a rule. The Commission fails to cite any rules authorizing allocation wells because there are none. The Commission is subject to the rulemaking requirements under the Administrative Procedure Act ("APA"). Those procedures require notice, opportunity for comment, a public hearing, and a reasoned justification for the rule. *See* Tex. Gov't Code § 2001.021 - .037. None of these forms, seminars, online publications, and emails identified by the Commission was adopted pursuant to the APA. None of the documents gives the Commission authority to allow the drilling of allocation wells.

II. The Commission's decision to allow Devon to drill the well violates Commission Rules 26 and 40.

A foundation principle of Commission rules is that an operator must measure and report its production. That requirement is essential to the Commission's responsibility to regulate production to prevent waste and protect correlative rights. Mineral owners also rely on the Commission's measurement requirements to assure that their operators properly measure and account for production from their properties.

The measurement requirement is set forth in Rule 26. Rule 26 requires all "oil and other liquid hydrocarbons" to be measured "before the same leaves the lease from which they are produced." 16 Tex. Admin. Code ("TAC") § 3.26(a)(2). Rule 26 provides for exceptions when the two tracts "have identical working interest and royalty interest ownership in identical percentages" or when no protest to the proposed commingling is received after 21 days' notice to all working and royalty interest owners and other specified conditions are met. 16 TAC §3.26(b)(1)(C). Neither of those exceptions applies here.

Rule 40 is the companion to Rule 26. It addresses production from multiple tracts by a single well. Rule 40 provides that an operator seeking to combine acreage from separate leases or units to create a drilling unit or proration unit must file a "certified plat delineating the pooled

unit and a Certificate of Pooling Authority, Form P-12." 16 TAC § 3.40(a). The P-12 is required to be filed "with the drilling permit application when two or more tracts are joined to form a pooled unit for Commission purposes to obtain a drilling permit." 16 TAC § 3.40(a)(4)(A). On the form, the operator is directed to "separately list each tract committed to the pooled unit by authority granted to the operator." 16 TAC § 3.40(a)(2)(A). The rule also contains other provisions intended to protect the interests of mineral owners "for which pooling authority does not exist." 16 TAC §3.40(b)&(c). In effect, a properly formed pooled unit becomes a single tract or "lease" for Commission purposes, allowing the operator to ignore interior lease lines and report production under Rule 26 as production from a single "lease."

Production from an allocation well violates Rules 26 and 40 because production from an allocation well comes from two or more separate leases that are not combined by pooling. Rule 26 requires all "oil and other liquid hydrocarbons" to be measured "before the same leaves the lease from which they are produced." 16 TAC §3.26(a)(2). In an allocation well, production from multiple leases is commingled in the wellbore so that it is impossible to determine how much production comes from each separate lease. Operators have no authority under any Commission rule to commingle production in an allocation well.

In this respect, the requirements of an oil and gas lease and the requirements of Commission rules coincide. The lease requires royalties to be paid on production from the leased premises (or pooled unit). Calculation of the royalties requires accurate measurement. Rules 26 and 40 assure that accurate measurement takes place. Commission rules thereby protect the correlative rights of mineral owners.

Historically and by its current rules, in order to combine tracts for purposes of obtaining a drilling permit an applicant must certify that it has authority to combine the tracts included in its

permit. Devon's permit does not do so and the Commission's approval of its permit violates the Commission's precedent and existing rules 26 and 40.

III. The Commission's Order is inconsistent with its order in Oil and Gas Docket No. 06-026200, and its failure to follow that precedent or explain its departure from it is arbitrary and capricious.

In Oil and Gas Docket No. 06-0262000, the Commission rejected Devon's request that the Commission adopt an "allocation rule" that would "allow drilling horizontal wells across unit and/or lease boundaries without the agreement of any royalty or working interest owners." Proposal for Decision in Docket No. 06-0262000, Finding of Fact (FF) 14. The Examiners concluded in that proceeding that the Commission had no authority to adopt such an allocation rule and that such a rule "is not necessary to prevent waste and could harm correlative rights." *Id.*, Conclusion of Law (CL) 8. The Commission adopted FF 14 and CL 8 and related findings and conclusions with respect to the allocation well issue. Final Order at 1, Paragraph 2. The Commission's decision in this case conflicts with its decision in Docket 06-0262000, and the Commission has provided no basis for failing to follow that precedent. Ignoring this prior decision is arbitrary and capricious.

IV. The Commission erred in finding that litigating this case would be an "unnecessary duplication of proceedings" because the facts here are different from those in *Klotzman*, and neither *Klotzman* nor any other Commission proceeding nor any Commission Rule provides a basis for dismissal of SRO's Complaint. (Response to FOF 14 and COL 1).

Litigating this proceeding would not result in unnecessary duplication. The Commission finds that *Klotzman* has settled the issues raised here. It has not. *Klotzman* involved different facts and the Commission's findings and conclusions in *Klotzman* were narrowly limited to the facts and the parties in that case. In *Klotzman*, the proposed well crossed a lease line between two leases. Here, the proposed Well crosses two existing pooled units. This distinction is key because Devon's proposed Well would produce oil and gas from tracts subject to the terms of the

pooled units. Once again, Devon's proposed method of allocation has no support in any reported case.

V. The Commission erred in finding that the Commission lacks jurisdiction to review Devon's authority under the SRO leases. (Response to FOF 15 and COL 2).

This proceeding is not a breach-of-lease dispute. Devon has wrongly claimed that SRO's complaint is about royalty payments under the SRO leases. SRO is not asking the Commission to determine what royalties Devon must pay under the leases or to resolve any other payment disputes. The complaint here is that the pooling provisions in the leases do not allow Devon to drill the allocation well it is proposing to drill. The issue is not one of title, but one of the contractual authority granted to Devon in its leases.

The Commission's finding that review of Devon's contractual authority under the leases is beyond its jurisdiction is incorrect. Review of the authority provided to the operator by lease is well within the Commission jurisdiction. The Commission's existing rule, Statewide Rule 40 requires that an operator like Devon, seeking to combine acreage from separate tracts to form a drilling unit, must include with the drilling permit application a Form P-12 on which the operator swears to the "contractual authority" to pool the subject acreage. The Commission is obligated to review any challenge by a lessor of a lease on which Devon relies for its contractual authority and determine if Devon has the requisite contractual authority. For example, the courts have ruled that the Commission can and should consider the legal authority of the operator to pool when deciding whether to grant a drilling permit. *Cheesman v. Amerada Petroleum Corporation*, 227 S.W.2d 829 (Tex. Civ. App. – Austin 1950, no writ). The Commission has jurisdiction over this complaint.

VI. The Commission erred in finding that *Browning Oil Co. v. Luecke,* 38 S.W.3d 625, 632, 641-42 (Tex. App.--Austin 2000, pet. denied) does not control so as to preclude Devon from having a good faith claim to drill the well.

Browning Oil Co. v. Luecke, 38 S.W.3d 625, 632, 641-42 (Tex. App.--Austin 2000, pet. denied) is closely on point to the issues presented in this proceeding. In *Browning*, a case involving a horizontal well, a mineral owner brought suit against an operator who had drilled a horizontal well across multiple properties. As Devon itself admitted at the hearing on its motion to dismiss, *Browning* involved an allocation well. *See* 11/09/17 Transcript at 139:5-6 ("This is in fact the first allocation well ... ."). The Court held that the lessee/operator was in breach of the lease because the horizontal well did not comply with the pooling provisions in the lease. *Id.* at 642. Devon, like Browning, failed to obtain the lease authority, or property right, required in *Browning* and therefore cannot show that it has a sufficient "good faith" claim to drill its proposed allocation well.

The findings in the Order on *Browning* are incorrect. This misunderstanding of binding precedent led the Commission to improperly declare that Devon has a good faith claim to drill the allocation well. A brief explanation of the Commission's misapplication of *Browning* follows in the Response to FOFs 17 and 18 below.

VII. The Commission erred in determining that neither pooling authority nor a production sharing agreement is required to establish a good faith claim to drill an allocation well and that Devon has a good faith claim. (Response to FOFs 17 and 18).

Based on *Browning*, pooling or other explicit contractual authority in a lease is required to drill the well Devon seeks to drill here. The Commission ignores this binding law and attempts to give rights to Devon that it does not have by declaring that Devon has a good faith claim of authority to drill the allocation well.

The Commission has failed to follow state law by declaring that Devon has a good faith claim to drill the proposed allocation well. The Commission also fails to follow *Magnolia*

Petroleum Co. v. Railroad Commission, 170 S.W.2d 189 (Tex. 1943). In *Magnolia*, a suit to invalidate two oil well permits issued by the Commission, the Court declared "the Railroad Commission should not do the useless thing of granting a permit to one who does not claim the property in good faith. The Commission should deny the permit if it does not reasonably appear to it that the applicant has a good faith claim in the property." *Id.* at 191. Here, the Commission should either cancel Devon's permit for failure to demonstrate a good faith claim or allow the parties to have meaningful discovery and a hearing to present relevant facts for the Commission's consideration of Devon's good faith claim.

VIII. The Commission erred in concluding that the complaint is moot because of *Klotzman*. (Response to COL 1).

For the reasons previously stated here, SRO's complaint is not moot. The Commission concludes that the complaint is moot because *Klotzman* precludes giving SRO a hearing on its complaint. As discussed in the Response to FOF 13 earlier, *Klotzman* is a narrow ruling based on different facts. The *Klotzman* Final Order in no way suggests the decision extends beyond the *Klotzman* case itself to address pooled units like those present here.

CONCLUSION AND PRAYER

For the reasons stated SRO respectfully requests that the Commission grant this motion for rehearing, and reverse its Order. SRO seeks such other and further relief to which it may be entitled.

Respectfully submitted,

John B. McFarland
State Bar No. 13598500
jmcfarland@gdhm.com
Mary A. Keeney
State Bar No. 11170300
mkeeney@gdhm.com
Natasha M. Martin
State Bar No. 24083255
nmartin@gdhm.com

GRAVES, DOUGHERTY, HEARON & MOODY,
A Professional Corporation
401 Congress Avenue, Suite 2200
Austin, Texas 78701-3619
Tel: (512) 480-5682
Fax: (512) 480-5882

By: Mary A. Keeney
Mary A. Keeney

CERTIFICATE OF SERVICE

I certify that on January 9, 2018, a copy of the foregoing was served either by email or by hand delivery to the interested persons or entities listed below.

DEVON:
Brian R. Sullivan
bsullivan@msmtx.com
Sandra Buch
sbuch@msmtx.com
McElroy, Sullivan, Miller, Weber & Olmstead, LLP
1201 Spyglass Drive, Suite 200
Austin, TX 78746
Attorneys for Devon Energy Production Co., LP

EOG:
Doug Dashiell
ddashiell@scottdoug.com
303 Colorado St., Suite 2400
Austin, Texas 78701
Attorneys EOG Resources, Inc.

RRC:
Mr. Lorenzo Garza
Railroad Commission of Texas,
District Office 08 - Midland
Manager, Drilling Permit Unit
P.O. Drawer 12967
E-mail: lorenzo.garza@rrc.state.tx.us

Mary A. Keeney
Mary A. Keeney

RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

OIL & GAS DOCKET NO. 08-0305330

COMPLAINT OF MONROE PROPERTIES, INC., ET AL. THAT DEVON ENERGY PRODUCTION CO, L.P. DOES NOT HAVE A GOOD FAITH CLAIM TO OPERATE THE N I HELPED 120 (ALLOC) LEASE, WELL NO. 6H, PHANTOM (WOLFCAMP) FIELD, WARD COUNTY, TEXAS

Order Denying Motion for Rehearing

The Commission has considered the merits of the motion for rehearing filed by Monroe Properties, Inc., SRO Land & Minerals, L.P. and the Lee M. Stratton Living Trust, Mary Elizabeth Stratton, Trustee. The motion is **DENIED**.

Signed this 13th day of February 2018.

RAILROAD COMMISSION OF TEXAS

Christi Craddick
CHAIRMAN CHRISTI CRADDICK

COMMISSIONER RYAN SITTON

COMMISSIONER WAYNE CHRISTIAN

ATTEST:

Kathy Way
SECRETARY

EXHIBIT
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