

**HOLLIDAY ENERGY LAW GROUP**

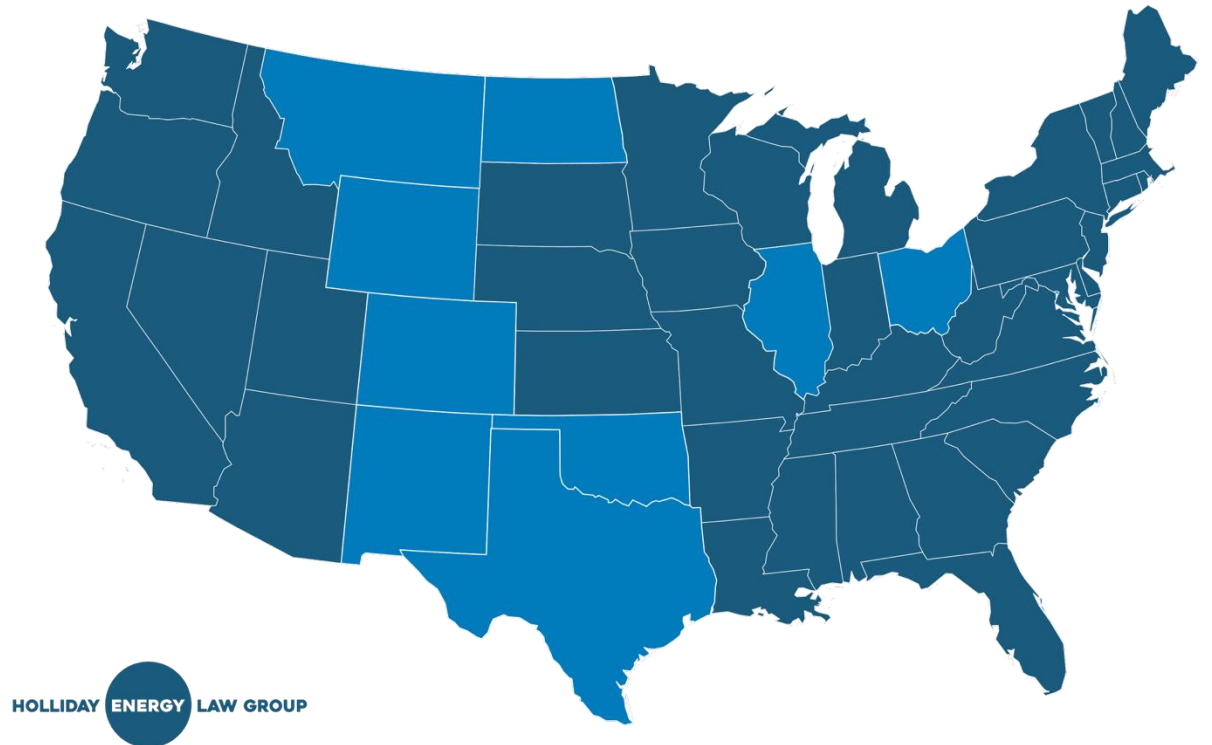
# **Just Across the Fence: NM & TX Regulatory Approaches to Multi-Tract Horizontals**

**Houston Association of Professional Landmen  
2026 Technical Seminar**

**Benjamin Holliday**

# HOLLIDAY ENERGY LAW GROUP

Holliday Energy Law Group, PC is a San Antonio-based energy law firm focused on providing operational/regulatory advising to oil and gas operators active across the continental United States. We represent clients throughout all stages of their drilling programs, from acquisition through divestiture, in Texas, New Mexico, Oklahoma, Colorado, North Dakota, Wyoming, Montana, Ohio, Pennsylvania, and Illinois.



The background features a complex, abstract pattern of glowing blue lines that flow and swirl across the frame, creating a sense of dynamic energy. Small, bright blue particles are scattered throughout, adding to the futuristic and high-tech aesthetic. The overall color palette is a range of blues, from deep navy to bright cyan.

# OVERVIEW

ENERGY IS THE CENTER OF EVERYTHING WE DO

# How Far We've Come Pooling: Black Gnat, Johnson County TX

TOPOGRAPHIC LAND SURVEYORS OF TEXAS  
*Surveying and Mapping for the Energy Industry*  
 5029 E. HWY 377 • CLEVELAND, TEXAS 75044  
 TELEPHONE: (817) 810-2872 • FAX: (817) 328-5181

JOHNSON County, Texas  
 Description 3299' FUEL & 3524' FUEL  
 T. ROBERT SURVEY, A-716

NEAR THE INTERSECTION OF FM 917 AND FM 2331

J. F. SALAS A-780  
 T. ROBERT A-716  
 E. HENDRICKS A-108  
 A. PUTNEY A-277

WELL LOCATION  
 TYPING LOCATION  
 SURFACE LOCATION  
 FORMATION POINT

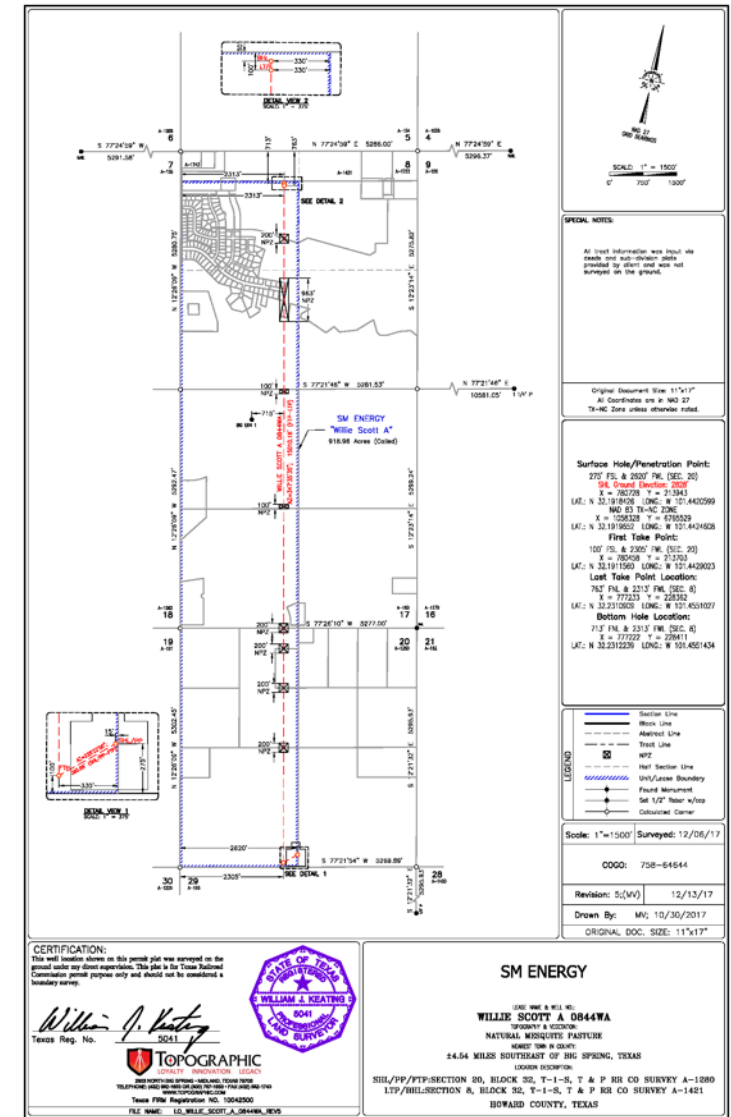
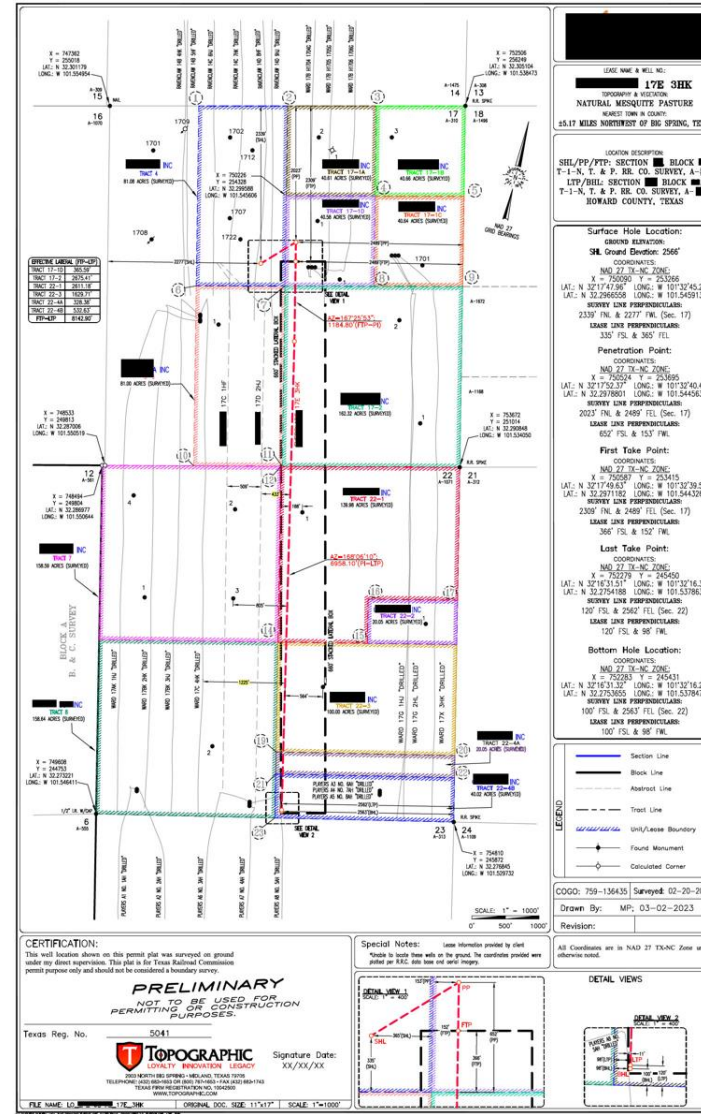
LEASING INFORMATION PROVIDED BY ARRINGTON OIL & GAS  
 Date Staked MAY 08, 2007

Operator DAVID H. ARRINGTON OIL & GAS  
 Lease Name & Well No. BLACK GNAT #1H  
 Ground Elev. 751' Total Acreage 56.34  
 Good Drill Site? YES Stakes Set 4.0 MILES SOUTHWEST OF LILLIAN, TX  
 Topography & Vegetation WOODED PASTURE  
 Best Accessibility to Location FROM CR. 604 TO A POINT ±2500 FEET NORTHWEST OF LOCATION  
 Distance & Direction FROM THE INTERSECTION OF FM 2331 & FM 917, GO SOUTHWEST ON FM 917  
 4.0 MILES, THENCE SOUTHEAST ON CR. 604 ±0.8 MILES TO A POINT ±2500 FEET NORTHWEST OF LOCATION

CERTIFICATION  
 I, Michael Blake Brown, a Registered Professional Land Surveyor, and an authorized agent of Topographic Land Surveyors, do hereby certify that the above described well location was surveyed and staked on the ground as shown herein.

Invoice # 123743 M.W.L. Texas Reg. No. 5857

# Allocation Wells: Permian Basin



# Multi-Tract Wells: Technology Created a Dilemma for Operators

- Technology is ahead of the law
  - Lateral length capability has outpaced structure of pooling agreements
- Operators have a financial incentive/requirement to maximize production/profit
- New Mexico and Texas share a common reservoir (Delaware Basin) and solved the problem in different ways (same same but different)
- New Mexico = Structured, well-defined method (Comp.Pool)
- Texas = Organic, no statutes or case law (Allocation Wells)

The background is a vibrant blue with a complex, wavy pattern of lines and particles, creating a sense of motion and energy. The lines are dense and curved, resembling a topographical map or a field of energy. Small white dots are scattered throughout, adding to the dynamic feel.

# NEW MEXICO

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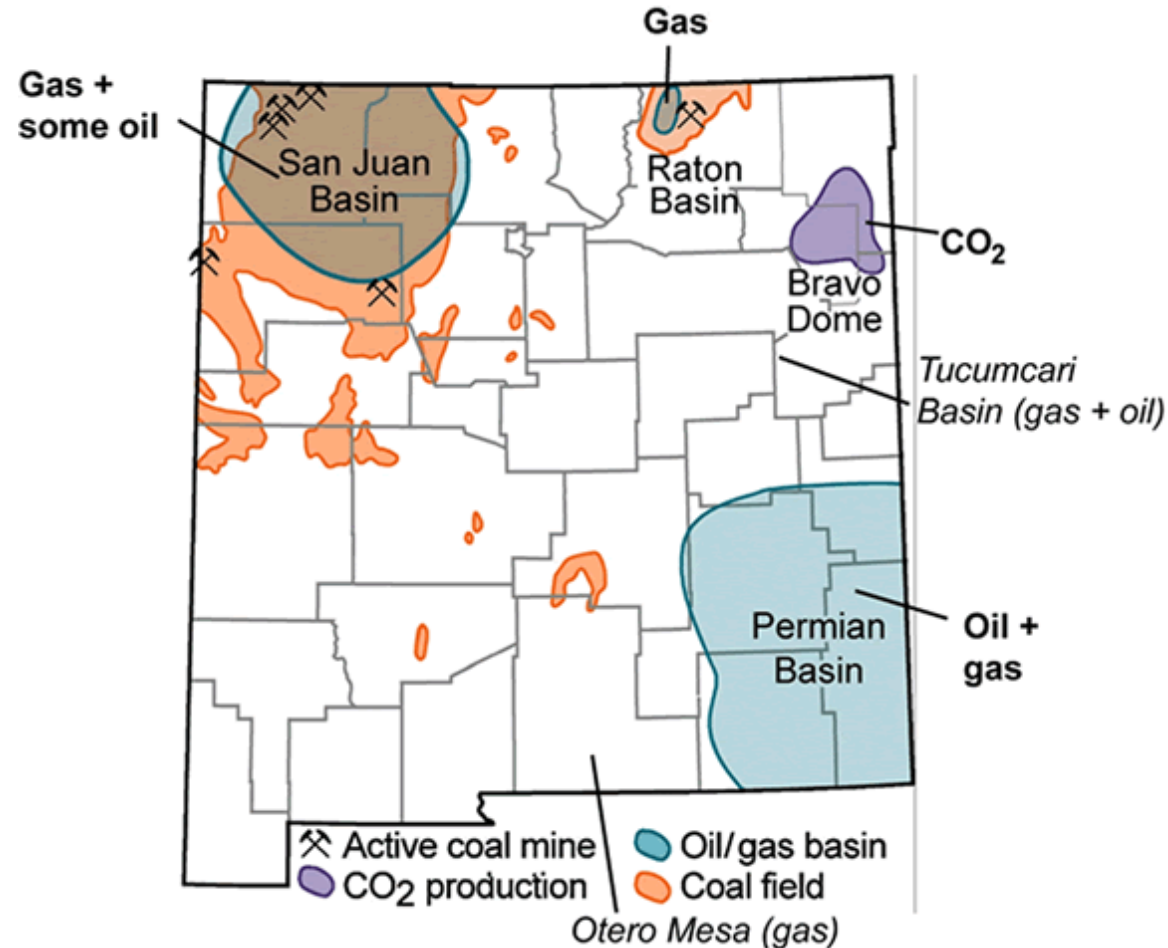
# New Mexico OVERVIEW

- Long history of oil & gas production
- Oil & gas law is well-developed
- From a legal standpoint, more statute-driven (like Oklahoma) than case law driven (like Texas)
- Federal & State Governments are major players
  - Large Mineral Owners
  - Significant oversight and regulatory involvement
- Great production results

# New Mexico OVERVIEW

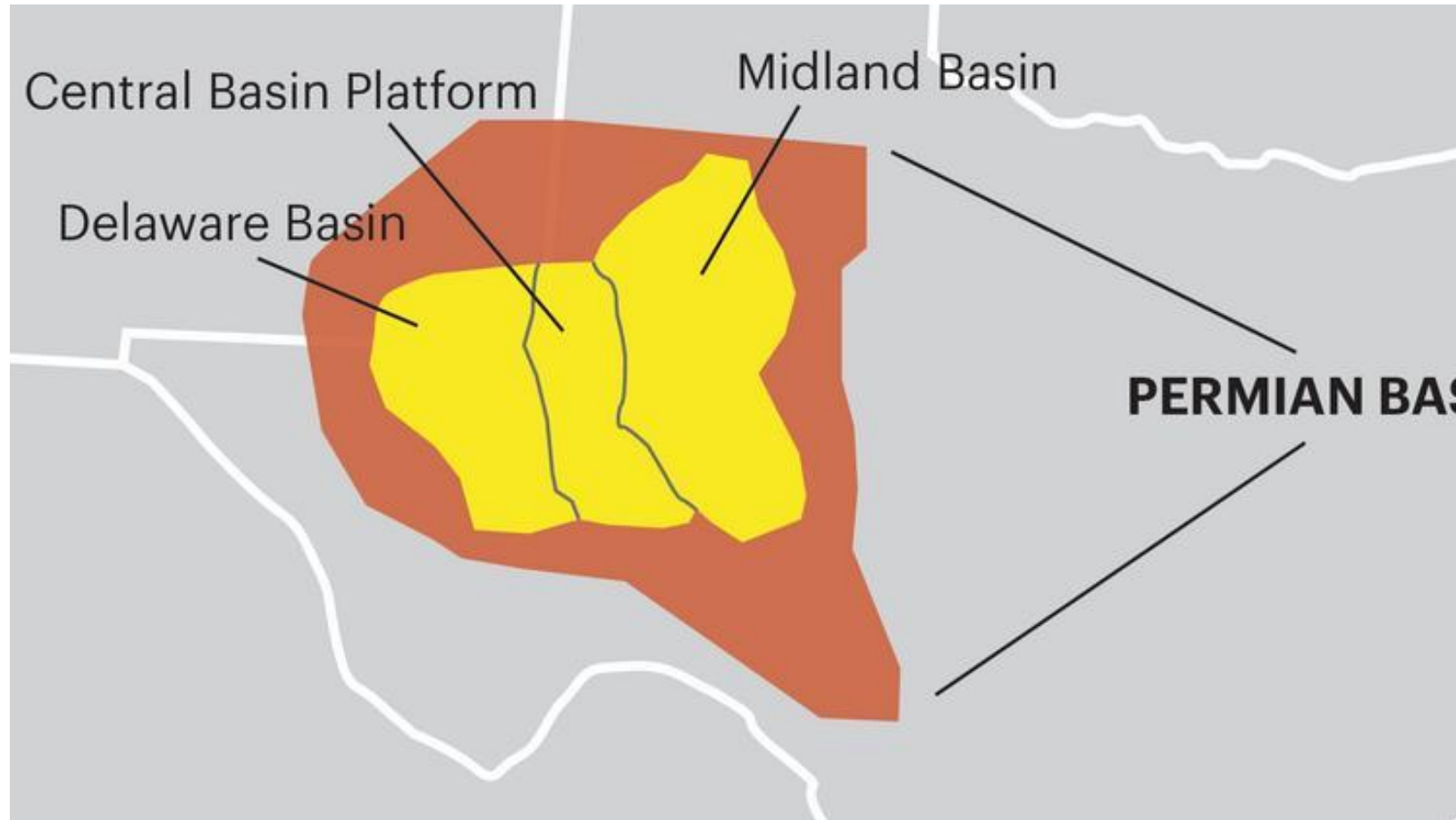
- Oil & Gas Revenue is **CRITICAL** to State Budget
- **>35%** of New Mexico Annual State Budget comes **from oil and gas industry** *(data from NMOGA)*
  - **\$13,000,000,000.00 State and Local Revenue** in 2024 (Billion with a B)
  - **Total Education Funding 2024 = \$2,300,000,000.00 (\$2.3B)**
    - ~30% of New Mexico school funding
    - ~\$80,000.00/teacher and \$6,278.00/student

# New Mexico Overview of Producing Areas



# New Mexico

## Delaware Basin is Main Area of Activity



The background features a complex, abstract pattern of blue and white. It consists of numerous thin, curved lines that create a sense of depth and movement, resembling a topographical map or a digital data visualization. Small white dots are scattered throughout the blue areas, giving it a particle-like or starry appearance. The overall color palette is dominated by various shades of blue, from deep navy to bright cyan.

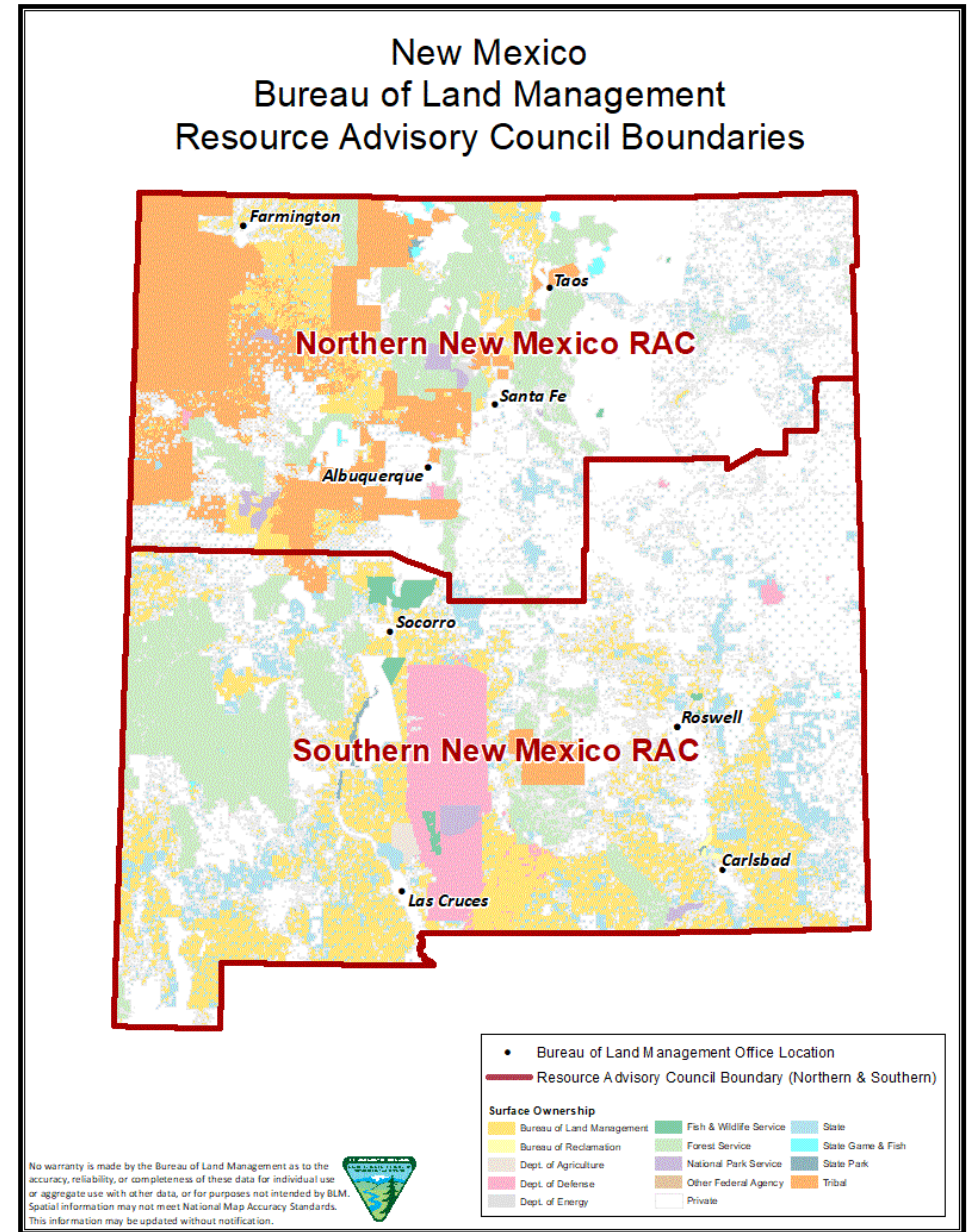
# NEW MEXICO Who Are We Dealing With?

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# New Mexico

## Surface and Mineral Ownership

- United States
  - Federal Government is most consequential mineral owner in New Mexico
  - Bureau of Land Management
- State of New Mexico
  - State Land Office
  - Oil, Gas, and Minerals Division
- Private fee owners



The background features a complex, abstract pattern of blue and white. It consists of numerous thin, curved lines that create a sense of depth and movement, resembling a topographical map or a digital data visualization. Small white dots are scattered throughout the blue field, adding to the intricate texture. The overall color palette is a range of blues, from deep navy to bright cyan.

# **NEW MEXICO REGULATORY LANDSCAPE**

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# New Mexico Regulatory Bodies

- **New Mexico Oil Conservation Division**
  - Primary regulator of oil and gas development in New Mexico
  - Gathers production data
  - Permits new wells
  - Enforcement of oil and gas laws and administrative rules
  - Administers oil and gas portions of Water Quality Act
  - Regulates development and production of geothermal resources



# New Mexico Compulsory Pooling

- **Virtually all HZ wells in New Mexico are drilled subject to a Compulsory Pooling Order** (every HZ well must be in a standard/non-standard HSU)
- Why Do We Need CP?
  1. Unleased mineral owner refuses to join in drilling operations
  2. 2+ Working Interest owners cannot agree on development plan



# Multi-Tract HZs in New Mexico: How Compulsory Pooling Works

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# New Mexico Compulsory Pooling – Can We Pool It?

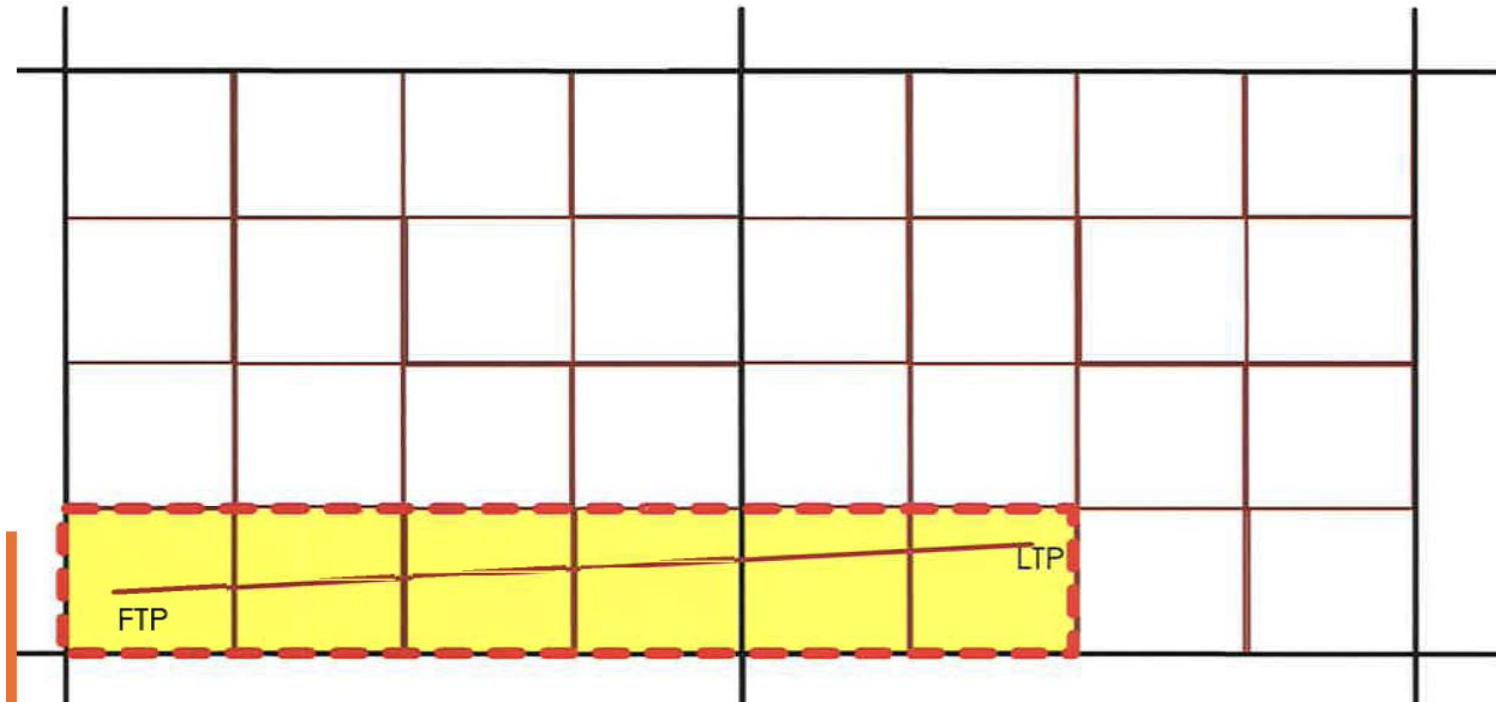
- Essential Elements of Compulsory Pooling
  1. 2+ separately owned tracts and/or 2+ undivided interests in oil and gas minerals in same tract
  2. Within a single spacing/proration unit
  3. Where owners have not voluntarily pooled (voluntary pooling is allowed) despite efforts
    1. i.e. you have to make a legitimate attempt to voluntarily pool
  4. An owner of the right to drill either has drilled or proposes to drill a well on the unit to a common source of supply (i.e. to a specific formation)

Upon proper application, the OCD – to prevent waste and protect correlative rights – **shall** pool all/any parts of the lands or interests in the spacing unit

# New Mexico Compulsory Pooling – How Does It Work?

- 2018 Established new HZ Rules for HSUs – Horizontal Spacing Unit
  - The spacing unit dedicated to a HZ well
- Unit Size is based on **Building Block** system (default Statewide Rules, may be pre-empted by applicable pool rules)
  - Oil = 40 acres (quarter-quarter section) / Gas = 160 acres (quarter section)
- Earn acreage through drilling/producing
  - Ex: Oil Well. Each quarter-quarter section penetrated by HZ well's completed interval is earned
  - May include adjoining tracts if productive lateral is within 330' (**proximity tracts**)
- Must be substantially Square or Rectangular (or must permit as non-standard)

# New Mexico Compulsory Pooling Standard HSU



- Target oil pool is under statewide rules
- Tract size = 40 acres
- Completed interval penetrates six 40-acre tracts
- Standard HSU = 240 acres

Source: From 2018 AAPL New Mexico Land Institute presentation, “HZ Development in New Mexico” by Beth Ryan, et al.

# New Mexico Compulsory Pooling **Proximity** **Tracts**

- **Proximity Tract** = Adjoining tract w/in 330' of the lateral
- Operator may include 'proximity tracts' to increase the size of the unit
  - Otherwise, well w/in 330' would be an unorthodox location and require OCD Hearing
  - Terminology:
    - Orthodox Well: HZ that complies with relevant spacing and density requirements
    - Unorthodox Well: HZ that does not comply with statewide spacing and density; requires notice and hearing at OCD

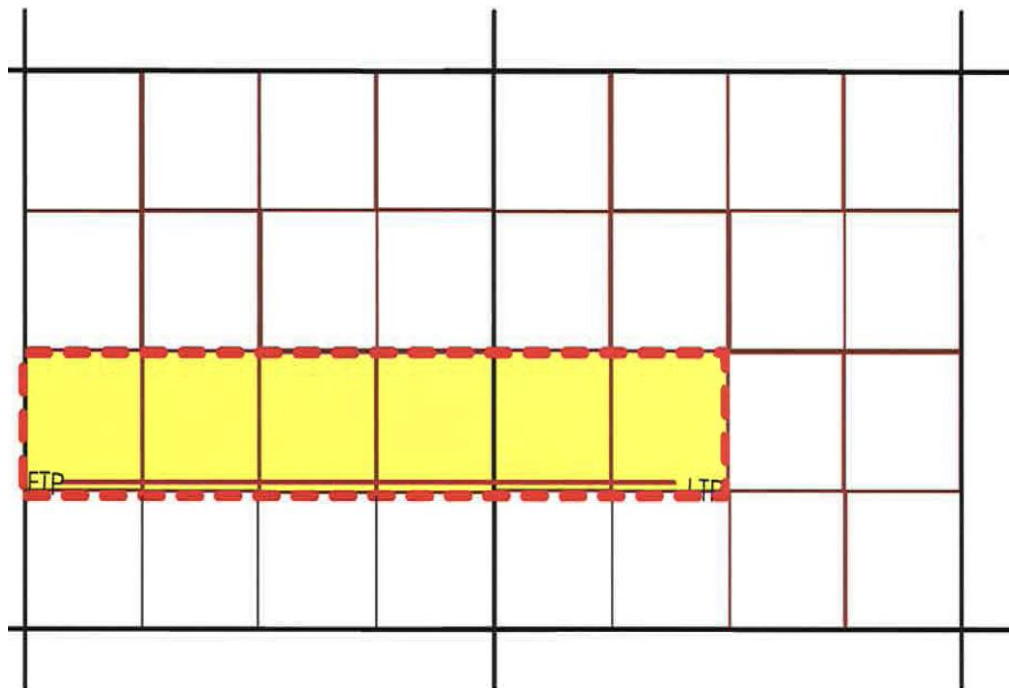
# New Mexico Compulsory Pooling **Proximity** **Tracts**

- Initial Well – *aka Defining Well* - placement is a strategic decision
  - **Defining Well:** The permitted HZ used to create the HSU
  - Placing Defining Well within 330' of adjoining tracts (i.e. building blocks) will allow operator to expand the size of HSU

# New Mexico Compulsory Pooling Proximity Tracts

## Standard Spacing Unit Example

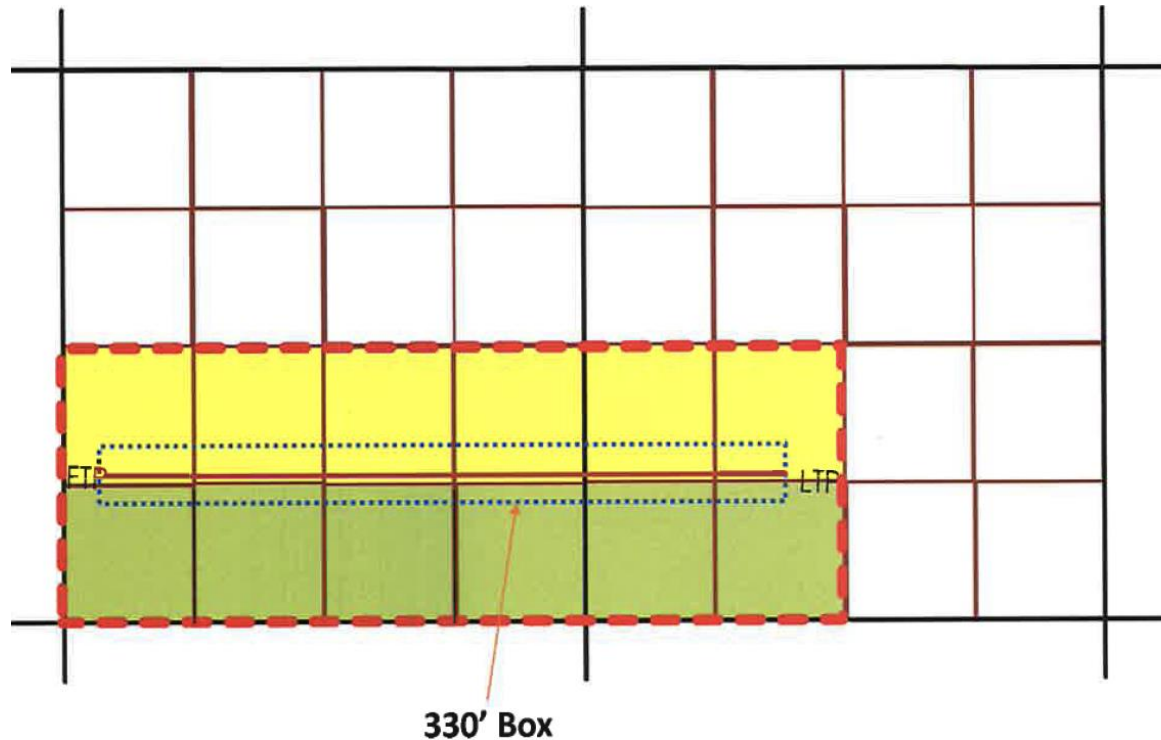
 Outline of HSU       Penetrated Tracts



- Target oil pool is under statewide rules
- Tract size = 40 acres
- Completed interval penetrates six 40-acre tracts, 75' from the offsetting tracts
- Since completed interval is located at an unorthodox location, notice, opportunity for protest and NMOCD approval is required
- Standard HSU = 480 acres

Credit: 2018 AAPL New Mexico Presentation, "HZ Development in New Mexico" by Beth Ryan, et al.

# New Mexico Compulsory Pooling Proximity Tracts



- Target oil pool is under statewide rules
- Tract size = 40 acres
- Completed interval penetrates six 40-acre tracts, 75' from the offsetting tracts
- An additional six 40-acre tracts are within 330' of the completed interval ("proximity" tracts)
- Operator elects to include proximity tracts
- Standard HSU = 480 acres

Source: From 2018 AAPL New Mexico Land Institute presentation, "HZ Development in New Mexico" by Beth Ryan, et al.

# New Mexico Compulsory Pooling Standard v. Non-Standard Spacing Unit

- Standard Spacing Unit is an HSU in the shape of a square or rectangle that is dedicated to a single well
  - Unit size (acreage) determined by how many building blocks (quarter-quarter sections) are penetrated by producing lateral
- Non-Standard Spacing Unit: Operator may desire to...
  - permit a non-rectangular unit, or
  - (more commonly) establish one HSU encompassing multiple laterals
    - Ex: 1,280 acre HSU that encompasses 2 entire sections
      - 4 laterals used to justify acreage allocation
      - 1 HSU instead of 4

# New Mexico Compulsory Pooling Standard v. Non-Standard Spacing Unit

- Ex: 1,280 acre HSU that encompasses 2 entire sections
- 4 laterals used to justify acreage allocation
- 1 HSU instead of 4 adjacent HSUs
- Why?
  - More efficient from a filing perspective
  - 1 Tank Battery and Central Gathering Facility v. 4 separate

MUST IDENTIFY NON-STANDARD SPACING UNIT IN THE APPLICATION

NMOCD MUST SPECIFICALLY APPROVE THE CREATION OF NON-STND HSU

# New Mexico Compulsory Pooling

## Non-Standard HSU

### Non-Standard Spacing Unit Example



Outline of HSU



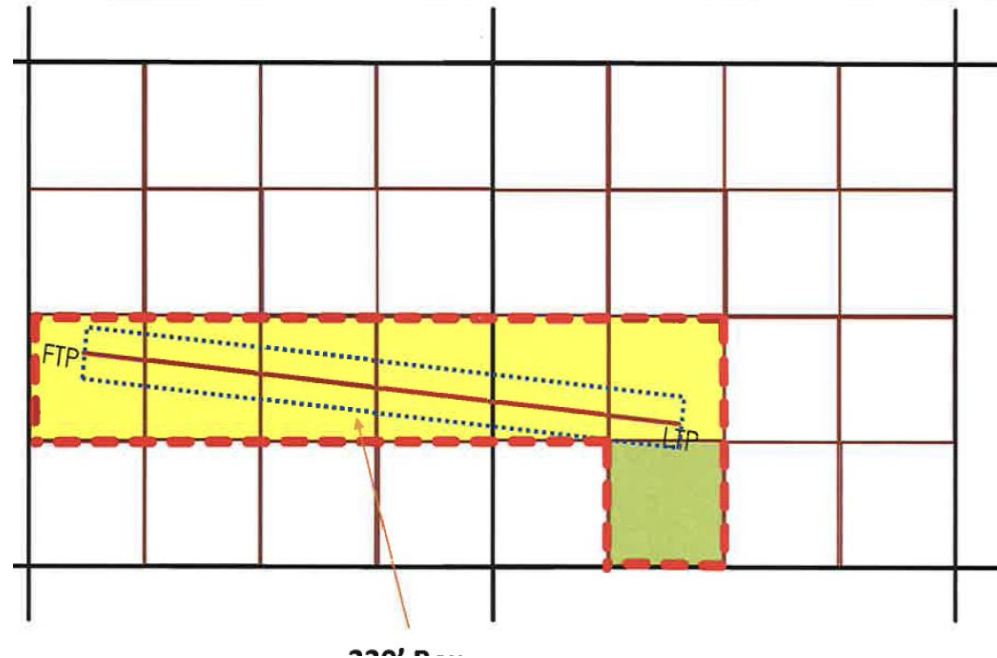
Penetrated Tracts



Proximity Tracts

Operator may wish to form HSU that is not substantially in form of rectangle.

- Requires Notice & Hearing at OCD
- Otherwise, process is same



- Target oil pool is under statewide rules
- Tract size = 40 acres
- Completed interval penetrates six 40-acre tracts
- An additional 40-acre tract is within 330' of the completed interval
- Since the perimeter of the area that includes all of the tracts that the proposed horizontal oil well penetrates defines a rectangle, then additional tracts cannot be brought in that would result in a non-rectangular horizontal spacing unit.
- Non-Standard HSU = 320 acres

Credit: 2018 AAPL New Mexico Presentation, "HZ Development in New Mexico" by Beth Ryan, et al.

# New Mexico Compulsory Pooling Spacing & Lease Line Setbacks

## 1. Oil Well

- 330' from Lease Boundary
- 100' from first/last take point

## 2. Gas Well

- 660' from Lease Boundary
- 330' from first/last take point



# Multi-Tract HZs in New Mexico: The Compulsory Pooling Hearing

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# New Mexico Compulsory Pooling – What’s Our Timeline?

<b>Date</b>	<b>Deadline/Action</b>
<b>30+ Days Prior to Hearing</b>	Application Must Be Filed at OCD
<b>20+ Days Prior to Hearing</b>	Certified Mailing Notice Deadline to All Parties to Be Pooled (WI, Unleased Minerals, ORRI)
<b>10+ Days Prior to Hearing</b>	Notice by Publication
<b>8+ Days Prior to Hearing</b>	Deadline for Intervention with Ability to Introduce Evidence at Hearing
<b>7+ Days Prior to Hearing</b>	Pre-Hearing Statement Filing
<b>7+ Days Prior to Hearing</b>	Hearing Exhibits Filing

# New Mexico Compulsory Pooling - Getting On the Docket

## When will my case be heard?

**NMOCD Dockets**: Generally 2nd and 4th Thursday of Each Month  
(but it changes)

1<sup>st</sup> Docket: New Applications and Hearings by Affidavit

2<sup>nd</sup> Docket: Status Conferences ONLY

**Contested Hearings**: Dates set up on availability of Division and agreement of parties. Generally, 2 days set aside for hearing.

- Going forward - Likely 2<sup>nd</sup> and 4<sup>th</sup> Tuesday of each month

# New Mexico Compulsory Pooling – The Hearing

- Must have testimony from
  - Landman
  - Geologist
  - Might want Engineer (generally only when contested)
- **Goal:** Demonstrate to Division that pooling the interests will prevent waste and lead to conservation of resources
- If no party contests, then hearing is conducted “**By Affidavit**”
  - ~90%+ are by affidavit
  - Parties pre-file testimony and exhibits
  - OCD reviews and if no problems, then case is “taken under advisement” and an order typically issued in 60 days

# New Mexico Compulsory Pooling – The Hearing

- If a party contests, then ultimately contested hearing will be scheduled and conducted at OCD hearing room in Santa Fe
  - Parties pre-file testimony and exhibits like in uncontested
  - Each party puts on testimony and evidence supporting their case
  - Administrative law proceeding; rules of evidence are a guide but not strictly enforced like in District Court
    - Goal is for Examiner to obtain all accurate and relevant information
- Typically, two days
- Written closing arguments submitted ~30 days
- Orders can take several months

# New Mexico Compulsory Pooling – The Order

- After hearing, OCD enters an order pooling all interests within the HSU on terms that:
  - Are fair and reasonable,
  - Afford each owner the opportunity to recover/receive just/fair share w/out unnecessary expense
- 200% Non-Consent Risk Penalty is common
- Unleased mineral owner gets 7/8 WI and 1/8 Royalty

# New Mexico Compulsory Pooling

- Pooling Federal or State Leases
  1. Must obtain a Communitization Agreement
  2. BLM (for Federal) or State Land Commissioner (for State of New Mexico) must approve any Communitization Agreement

The background is a dynamic, abstract composition of various shades of blue. It features intricate, wavy patterns that resemble topographical contour lines or perhaps the ripples on water. Interspersed throughout these patterns are numerous small, bright blue particles or specks, some of which appear to be in motion, creating a sense of depth and energy. The overall effect is one of a complex, interconnected system.

**TEXAS**

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# Texas

## Regulatory Oversight:

- Railroad Commission of Texas
  - Regulates oil and gas production
- Texas Commission on Environmental Quality
  - Regulates air emissions and water pollution



Texas  
Commission  
on  
Environmental  
Quality

# Why Is It Called “Railroad Commission?”

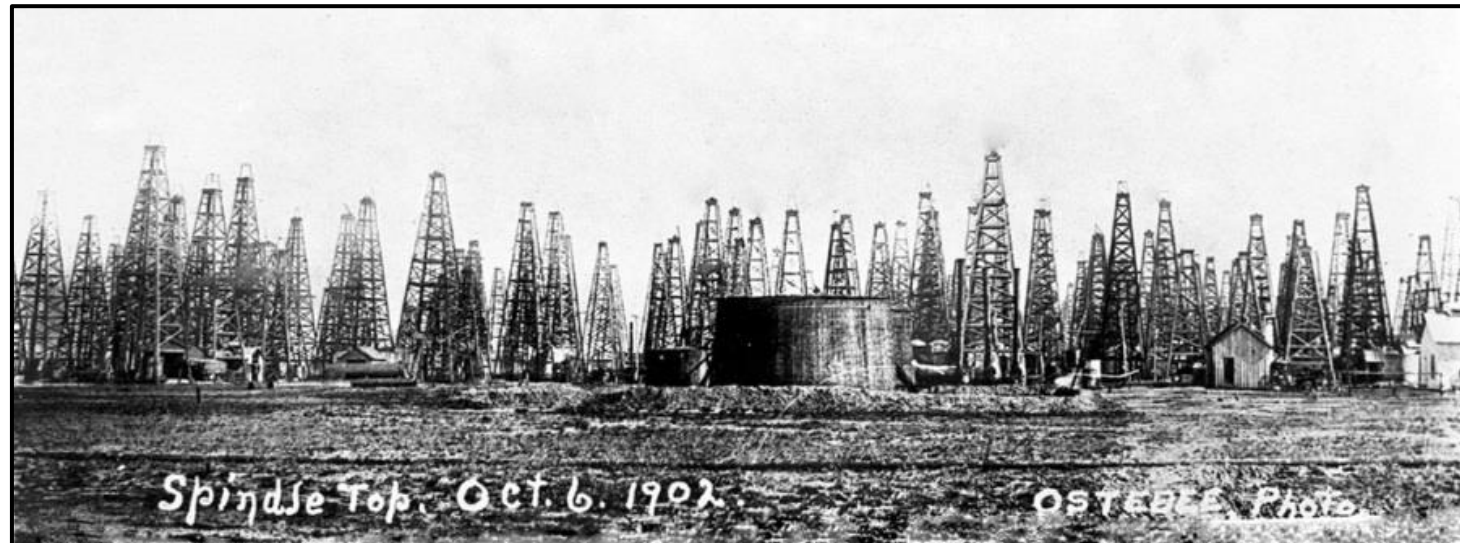
- **RRC Established 1891 to regulate rail industry**
  - Reaction to Texas agrarian populism of late 1800s
  - Political movement hostile to growth of Eastern US trusts and monopolies
- **March 29, 1899 – Texas’ First Regulation of Flaring**
  - Legislature declares that any gas well is to be shut-in within ten days after its completion until such time as the gas produced therefrom is to be used for light, fuel or power purposes.

# Why Is It Called “Railroad Commission?”

- **February 20, 1917 – RRC begins oversight of oil and gas**
  - Legislature declares pipelines to be common carriers and gives Railroad Commission jurisdiction over same.
  - This is the first act to designate the Railroad Commission as the agency to administer the conservation laws relating to oil and gas.
- **March 31, 1919 – Commission formally charged with regulatory oversight of oil and gas**
  - Legislature enacts a statute requiring the conservation of oil and gas, forbidding waste, and giving the Railroad Commission jurisdiction.

# TEXAS REGULATORY OVERSIGHT: HISTORY

- East Texas Field is discovered
- Wells are cheap and easy, government oversight is resisted
- Legal challenges prevented Commission's ability to meaningfully prorate production
- Reservoir Damage
- Safety Issues



# TEXAS REGULATORY OVERSIGHT: THE RAILROAD COMMISSION

- Through the Texas Natural Resources Code, the Texas Legislature has delegated its regulatory authority over oil and gas production to the Railroad Commission of Texas (“RRC”).
- The RRC’s stated regulatory objectives are to **prevent waste** and **protect correlative rights**. **PURPOSE IS TO ENFORCE CONSERVATION LAWS.**
  - Correlative = Naturally or reciprocally related; *synonym = reciprocal*
  - **Correlative Rights** = Legal doctrine limiting the rights/use of landowners to their reasonable share of a common good (e.g. groundwater, oil); aka right to a fair share of a common good

# TEXAS REGULATORY OVERSIGHT: THE RAILROAD COMMISSION

- Establishes Temporary and Permanent Rules
  - Can be Statewide or Field specific
- Most common HZ spacing requirements
  - 330' from lease line
  - 100' from first/last take point
- 2 options if want to drill & produce closer to another tract:
  1. Seek permission from offset owner, or
  2. Obtain an Exception from Commission after notice and opportunity for hearing

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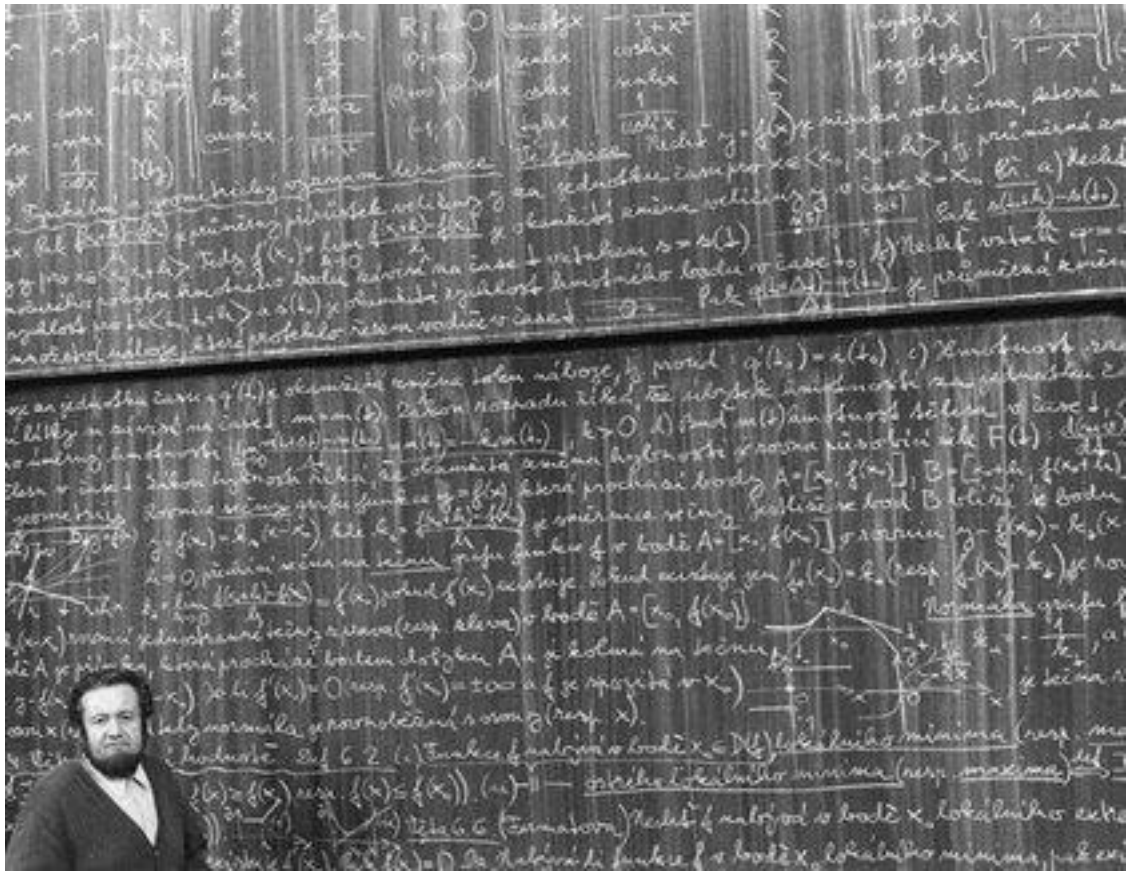
# Multi-Tract HZs in Texas

## Part 1:

# Voluntary Pooling

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# Voluntary Pooling: Texas v. New Mexico



# Voluntary Pooling: The Basics

- State's Regulatory Role (minimal)
- Units formed by operator(s)
  - Limited by lease terms (depth & acreage size)
- Operator permits wells and pooled unit with Texas Railroad Commission (RRC)
  - W1 – Application for Drill Permit
  - P12 – Certificate of Pooling Authority

# Voluntary Pooling: The Basics

- **Pooling** = Combining multiple distinct tracts covered by separate oil and gas leases together into a single “pooled unit”
  - Entire ‘unit’ treated as a single tract
  - Unitization DOES NOT EQUAL Pooled Unit
    - Pooled Unit = Contractual agreement to develop as a single tract
    - Unitization = Secondary Recovery
  - **Production Anywhere = Production Everywhere**
    - Production anywhere within the pooled unit is treated as production from all pooled tracts
    - Production anywhere on pooled unit is sufficient to HBP all pooled tracts/leases

# Voluntary Pooling: Allocating Production Amongst Pooled Tracts

- All production from the unit is allocated amongst the tracts upon a **mutually agreed basis** (as set forth in lease)
- **Most common** basis for allocating production in a pooled unit = **Surface Acreage Basis**
- Tract Surface Acreage / Unit Surface Acreage = Percentage of Production Allocated to Tract (aka Tract Participation Factor)
  - Typical DOI Formula = [(Mineral Interest x Lease Royalty) x TPF]

# Voluntary Pooling: Lessor MUST Authorize

- Lease MUST authorize pooling
  - Or separate pooling authority must be obtained

**Lessee has no power to pool absent authority in a lease.**  
*Browning v. Luecke*, 38 S.W.3d 625 (Tex.App. – Austin, 2000,  
pet. denied)

# Voluntary Pooling: Pooling = Cross-Conveyance of Interests

- In TX, Pooling = Cross Conveyance of Interests
  - *Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968)
  - Pooling is considered a cross-conveyance amongst the various pooled mineral interest owners
  - Mineral owners convey to each other as much interest as necessary so that they each own their respective undivided share of the entire pool
  - This is the reason for requiring pooling ratification from non-executive mineral interest and NPRI owners
    - Executive cannot 'convey' another's royalty interest into pool via pooling absent express authority
    - **MUST HAVE CONSENT TO DILUTE:** Diluting the royalty interest of non-execs/NPRI owners requires consent

# Voluntary Pooling: Methods of Pooling

1. **Pooling Clause** in Lease
2. **Pooling Agreement**
3. **Community Lease** = Combining 2+ separately owned tracts in a single lease pools the tracts
  - **NPRI/Non-Exec ISSUE**: Combining 2+ tracts together in a single lease, where 1+ have separate royalty ownership, constitutes an implied offer by the executive(s) to pool the royalty interest
    - NPRI owner can reject pooling and insist on full undiluted share of production
      - To NPRI owner's advantage if NPRI is a drillsite tract
    - NPRI owner can consent to pooling via ratification (exec consent not required)
      - To NPRI owner's advantage if NPRI is not a drillsite tract, or if there is more production from other tracts within the lease
    - NPRI owner can take a 'wait and see' approach

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# Mineral Interest Pooling Act “MIPA”

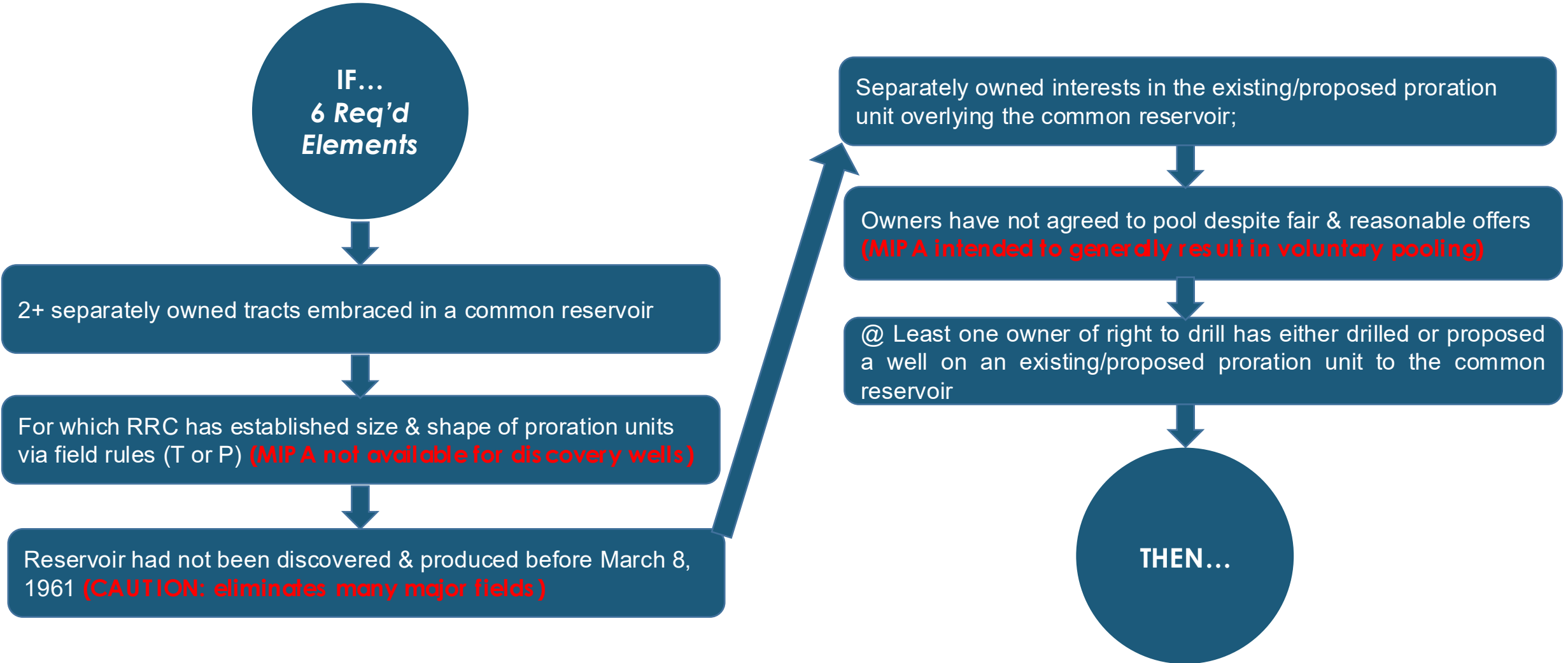
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# Texas Natural Resources Code Section 102 - Mineral Interest Pooling Act

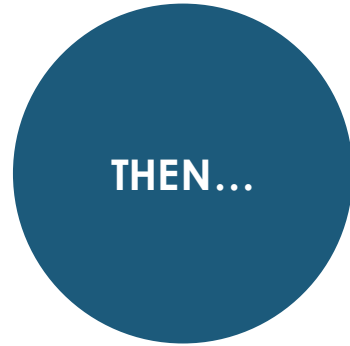
- Texas' Compulsory or Forced Pooling Statute
- More accurate is "Forced Voluntary Pooling Act"
  - Parties must demonstrate that they have exhausted efforts to negotiate pooling
  - Efforts generally result in voluntary pooling

**REMEMBER: VOLUNTARY POOLING  
OUTCOME IS THE ULTIMATE GOAL**

# MIP A Overview



# MIP A Overview



THEN...

Upon application of proper party (one of the Three Amigos)

For the proper purpose(s) (*avoid drilling unnecessary wells, protect correlative rights, prevent waste*)

Commission SHALL establish a unit and pool all interests in the unit within an area containing the approximate acreage of a proration unit

Maximum MIPA Unit Size

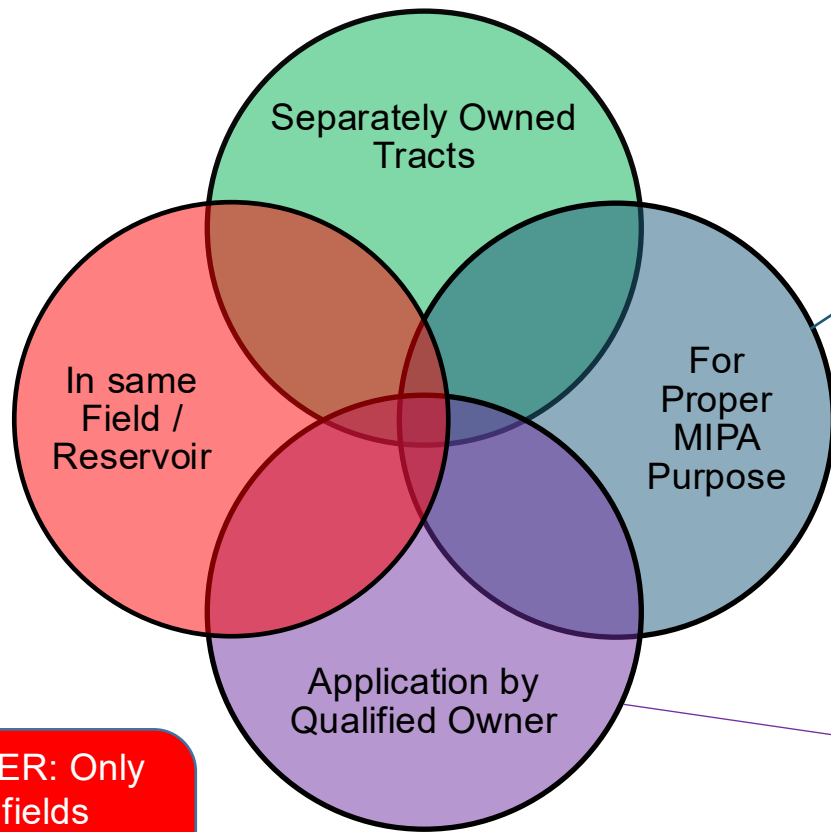
Gas = 704 ac  
640ac + 10%

Oil = 176 ac  
160ac + 10%

Pooling Order SHALL be on F&R terms and afford each owner opportunity to receive fair share

Order shall designate the operator and well location

# As a result of MIPA, RRC now has authority to compel pooling in cases of....



Must be 1 of the 3

Protect Correlative Rights

Prevent Drilling of Unnecessary Wells

Prevent Waste

Must be pursued by...

Owner of any interest in oil or gas in an existing proration unit

Owner of any working interest

Any owner of an unleased tract other than royalty owner

REMEMBER: Only applies to fields discovered & produced after March 8, 1961

REMEMBER: RRC cannot pool on its own motion

# PSA & Allocation Wells - Overview

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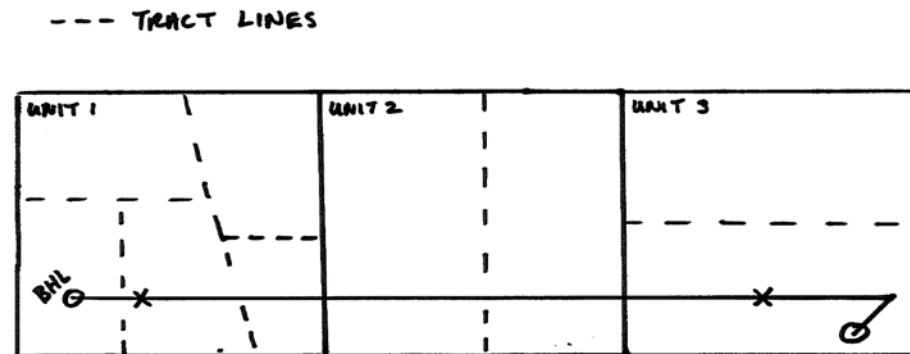
# REMEMBER....

- **PSA Well** = Interest owners **agree** how production from a multi-tract HZ well will be shared
  - Regardless of where take-points are
  - Super-pooling
- **Allocation Well** = HZ well that traverses the boundary of 2+ leases that have not been pooled AND where there is **no agreement** among the royalty owners as to how production will be shared

# PSA and Allocation Wells

## A Brief History – Pre-Klotzman

- 2009 – Devon applies for a permit for what seems to be the **first allocation well** – it will cross 3 pooled units without a production sharing agreement



- DEVON HAS UNITS 1, 2, 3 100% LEASED
- LACKS POOLING AUTHORITY TO COMBINE INTO 1 UNIT
- WANTS TO DRILL 1 WELL & ALLOCATE PRODUCTION AMONGST VARIOUS TRACTS

# PSA and Allocation Wells

## A Brief History – Pre-Klotzman

- The RRC hesitates to approve at first, but in 2010 RRC Staff issues letter notifying operator that it will issue an “allocation well” permit
  - *“It appears that a 100 percent interest in each of the leases is 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 requirements.”*
- RRC begins approving allocation well permits without addressing legality
- *NOTE: RRC has no jurisdiction to determine title or contractual rights*

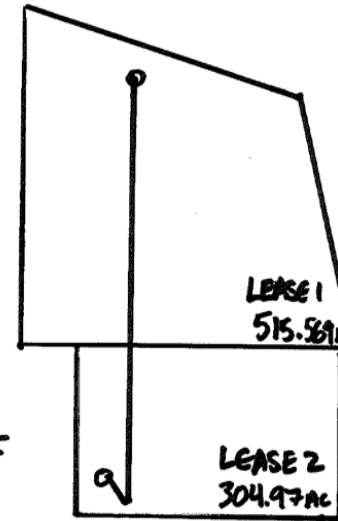
# PSA and Allocation Wells

## A Brief History - Klotzman

- 2012 Klotzman Case
- First Contested Application for Allocation Well

\* COMPLETELY FICTIONAL ILLUSTRATIVE DEPICTION

- NORMALLY SWR 37 REQ'S 330' LEASE LINE OFFSETS
- EDG POSITION IS THAT B/C OPERATOR ON EITHER LEASE, CAN GRANT SELF WAIVER



EDG HAS BOTH TRACTS 100% LEASED, BUT CANNOT POOL B/C LACK GRANT POOLING AUTHORITY THAT LARGE

- EDG CLAIMS NO POOLING, BUT RATHER RIGHT TO OPERATE ON BOTH LEASES → B/C ALLOCATING PRODUCTION, NO POOLING

# PSA and Allocation Wells

## A Brief History - Klotzman

- Initial Hearing - RRC Hearing Examiners (ALJ) side with the Klotzmans
- PFD (Proposal for Decision)
  - RRC **should not issue** the allocation well permit
  - Basis that **EOG lacks a good faith claim** to the right to drill its proposed allocation well
  - Why? **No right to pool.**
  - Strongly worded.

# PSA and Allocation Wells

## A Brief History - Klotzman

- The Commissioners reverse the Examiners' decision
- The Final Order was brief and adopted the following substitute finding of fact:
  - EOG is the operator of and owns 100% of the working interest rights to the Eagleville (Eagleford – 2) Field under the 515.569-acre Lease and the 304.97-acre Lease and there are no unleased interests within 330 feet of any point on the proposed wellbore.

# PSA and Allocation Wells

## A Brief History - Klotzman

- The following substitute conclusions of law were also adopted:
  - EOG Resources has a *sufficient good faith claim to drill* its proposed Klotzman (Allocation) Well No. 1H on an 80-acre drilling unit...
  - A Statewide **Rule 37** leaseline spacing **exception** for the well **may be granted administratively** pursuant to 16 Tex. Admin. Code Section 3.37(h)(2)(B) **as EOG Resources, Inc. is its own offset.**
- i.e. EOG had a sufficient good faith claim to drill the well because an exception to the spacing rules could be administratively granted where EOG owned all of the working interest in the affected leases
- Klotzmans appeal the Commission's Final Order to district court, but the parties reach a settlement and appeal is withdrawn

The background features a complex, abstract pattern of blue and white lines that resemble ripples on water or a topographic map. The lines are dense and swirling, creating a sense of depth and movement. Small white dots are scattered throughout the blue areas, giving the impression of a starry sky or a digital data field. The overall color palette is dominated by various shades of blue, from deep navy to bright cyan.

# RRC Role in PSA & Allocation Wells

ENERGY IS THE CENTER OF EVERYTHING WE DO

# Texas Railroad Commission

## What Does Commission NOT Do?

- **No jurisdiction over:**
  - PRIVATE causes of action
  - Title Disputes
  - Contract Disputes (i.e. lease interpretation)
  - Torts



# Texas Railroad Commission

## What Does Commission Do?

- TX Nat.Res.Code 81.051(a): Legislature grants Commission jurisdiction over:
  1. Common Carrier Pipelines
  2. Oil & Gas Wells
  3. Persons Owning/Operating Natural Gas Wells
  4. Persons Owning/Engaged in Drilling/Operating Oil & Gas Wells
- TX Nat.Res.Code 85.201: Commission MAY make/enforce rules & orders to **conserve** oil and gas and **prevent waste**



# Texas Railroad Commission

## What Does Commission Do?

### 1. Prevent Waste

- Focus on conserving natural resources in public interest
- MAXIMIZING THE AVAILABLE PIE (making pie bigger)
- Power to prevent waste is very broad
  - Primarily focused on preventing physical waste
  - Economic waste is a tougher case

### 2. Protect Correlative Rights

- Regulating private property rights of people who own an interest in a common source of supply
- DISTRIBUTING THE PIE THAT IS AVAILABLE (divvying up the pie)
- Ex: Prorationing

# Texas Railroad Commission

## *What Does Commission Do Regarding PSA and Allocation Wells?*

1. **Broadly**: Determines whether there is a regulatory reason to bar (i.e prevent) the requested action
2. **Specifically**: Is there a regulatory reason to deny the Permit to Drill a multi-tract non-pooled well?
  1. RRC grants or denies drilling permit
3. **Basis**: Does the applicant show a reasonably satisfactory **Good Faith Claim to the Right to Drill and Operate the Well?**

# RRC/Magnolia v. Opiela

## Good Faith Claim to Operate

- **TX Supreme Court**: To be entitled to a permit, Operator is required to make a reasonably satisfactory showing of good faith claim to operate the well in question. *Magnolia Petroleum Co. v. Railroad Comm'n*, 170 S.W.2d 189, 191 (Tex. 1943).
  - **Good Faith Claim** (16 Tx. Admin. Code 3.15(a)(5) & SWR 15)
    1. Factually supported claim
    2. Based on a recognized legal theory to
    3. A continuing possessory right in a mineral estate  
E.g. OGL or Fee Mineral Deed (for self-development)
  - Good Faith Claim is not defeated or obviated by a good faith dispute to that claim
    - Not basis to deny drilling permit if another party ALSO has a good faith claim

# RRC: PSA and Allocation Wells

## Granting the Permit: RRC Form P-16

- **P-16 = Certificate of Pooling Authority**
- Distinction in permit application for allocation and PSA well:
  - Allocation Well: only tracts actually traversed by the well will contribute acreage.
  - PSA Wells: tracts not traversed by the well can contribute acreage.
- Form P-16 is now mandatory for horizontal wells and vertical wells in UFT fields
- For each horizontal well drilled across multiple tracts without pooling, the Form P-16 discloses how acreage crossed by the well has been assigned.
- Updated P-16 in 2022 - <https://www.rrc.texas.gov/announcements/063022-rrc-adopts-revisions-to-form-p-16-acreage-designation/>

The background is a vibrant blue with a complex, wavy pattern of lines that resemble ripples or a topographical map. Small, bright blue particles are scattered throughout, giving it a dynamic, almost digital feel. The overall effect is one of energy and movement.

# Production Sharing Agreements

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# Production Sharing Agreements

- What is a PSA?
  - Interest Owners in various tracts agree how production from a multi-tract well will be shared irrespective of where the take-points are.
  - Agreement between owners of different tracts/leases allocating production
  - May include other covenants regarding drilling and production
  - Often includes relevant definitions
- When are PSAs used?
  - Horizontal well lengths that exceed available pooling authority
    - Laterals drilled with certain orientation
  - Existing pooled units/unpooled interests not configured properly
  - Lease/Unit-line wells

# Production Sharing Agreements

- Single Well PSA
  - Between all owners of all tracts
  - Allocation usually based on footage (*We know what well will look like*)
- Designated Area PSA
  - Large area comprised of multiple pooled/unpooled tracts
  - Often incorporates traditional surface acreage allocation
- Sharing Well PSA
  - No specific acreage; open ended. (*We don't know what well(s) will look like*)
  - Sharing Well if the productive drainhole crosses separate tracts
  - Usually an amendment to existing OGL
  - Expands Lessee's pooling authority
    - Flexibility in locating future wells (most desirable PSA for Lessee)

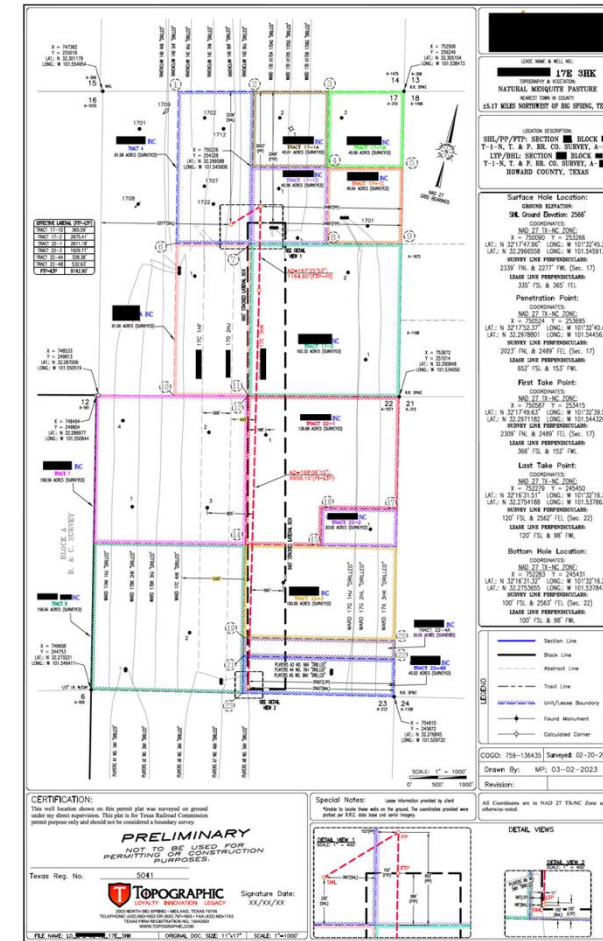
The background is a vibrant blue with a complex, wavy pattern of lines that resemble water ripples or energy waves. Small, bright blue particles are scattered throughout the scene, adding a sense of motion and depth. The overall aesthetic is futuristic and dynamic.

# Allocation Wells

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# Allocation Wells Overview

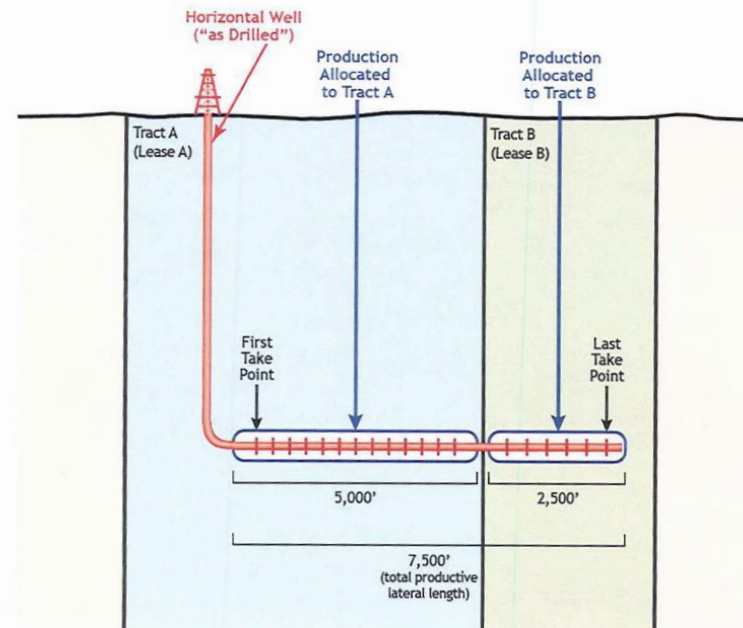
- **A well drilled:**
  1. without pooling authority
  2. across separate tracts/leases
  3. where there is no agreement amongst royalty owners as to how production will be shared
- Absent agreement, production is allocated to the tract where minerals are captured by the wellbore
  - Determined with “reasonable certainty” Browning v. Luecke
- Common Scenarios
  - Operator owns 100% leasehold interest; or
  - Notice of Rule 37 exceptions issued
  - Operator has <65% of ownership under PSAs



# Allocation Wells

## How to Allocate Production

### Picture of Hypothetical Example



#### Assumptions for example:

- Total productive lateral length = 7,500 feet
- Productive lateral length below Tract A = 5,000 feet
- Productive lateral length below Tract B = 2,500 feet
- Royalty owner Y holds a 1/8 (12.5%) interest in Tract A
- Well produces 1,000 units in month Z

#### Calculation formula (month Z):

- For royalty interest owner Y, (Tract A productive lateral length ÷ total productive lateral length) x production
- Thus,  $12.5\% \times (5,000 \div 7,500) \times 1,000 = 83.33$

1

# Allocation Wells

## How to Allocate Production

- Two Main Methods (Must be reasonable allocation)
  1. **Portion of Productive Lateral (most common)**
    1. Ratio of (1) productive length of well within a tract to (2) the entire productive length of well (from first take point to last take point)
    2. Variation on this is to measure from penetration point to terminus of well, but this doesn't seem as reasonable
    3. One consideration: exclude length of NPZ or portion of well deemed non-productive by operator
  2. **Take Point Ratio**
    1. Ratio of (1) number of take points within a tract to (2) total number of take points within well from first take point to last take point



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# PSA Wells & *Opiela* Case

ENERGY IS THE CENTER OF EVERYTHING WE DO

# RRC/Magnolia v. Opiela

## Main Takeaways

- **OPINION WAS VACATED; ONLY USED FOR GUIDANCE**
- Fight was over whether Commission should have granted drilling permit
- Court skirted whether 65% Threshold for PSA Wells is a proper rule
- **HELD: HZ Drilling Pursuant to PSA Well DOES NOT Equal Pooling**
- 65% Consent to PSA interpreted narrowly
  - Consents to pool were not sufficient
  - Must obtain actual Production Sharing Agreements

# RRC/Magnolia v. Opiela

## Basic Facts

- Opiela's own ~25% minerals under Tract A subject to 1955 Lease
- **Opiela lease prohibits pooling “in any manner whatsoever”**
- Enervest obtains Allocation Well permit for a HZ Well to traverse Tract A and other tracts.
- Opiela's protest on basis that Enervest had no right to pool.
- Enervest takes position that allocation well is not pooling. Drills the well. Sells to Magnolia.

# RRC/Magnolia v. Opiela

## Basic Facts

- Magnolia obtains Amended Permit for well to be PSA Well.
- Opiela amends complaint asserting “No Good Faith Claim to Operate” PSA Well b/c the Opiela Lease does not allow pooling. Seeking to revoke permit.
- RRC Proposal For Decision: Magnolia has reasonably satisfactory good faith claim to operate well.
  - Shown “**written agreements**” with >65% of Royalty & WI Owners
  - Permit Revocation denied.
- Opiela’s sue in district court

# RRC/Magnolia v. Opiela Oversight for PSA Wells

- No TX legislation regulating PSA or Allocation Wells (incl. permits)
- RRC has not adopted Administrative Code rules specific to PSAs
  - RRC has both rulemaking and adjudicatory powers to regulate OG
  - May use 'informed discretion' in deciding which method to use
- **65% Consent Threshold (Informal Guidance)**
  - 2008 Hearing – 2 of 3 RRC Commissioners approve PSA permit
  - RRC Staff instructed that permit applications for PSA Wells should be approved when:
    1. Usual criteria is met for drilling permit
    2. 65% of royalty and working interest owners have signed a Production Sharing Agreement

# RRC/Magnolia v. Opiela

## ISSUE #1: Does Asserting Right to Drill Under PSA Infringe on Lease's Anti-Pooling Language

- **NO**
- TX Statutes do not expressly require pooling to drill a HZ well that crosses property lines
- PSA is contractual agreement on how to allocate production
  - In absence of pooling authority, must determine with reasonable probability how production should be allocated. PSA does this.

# RRC/Magnolia v. Opiela

## ISSUE #1: Does Asserting Right to Drill Under PSA Infringe on Lease's Anti-Pooling Language

- **HOLDING: Production via PSA Well is NOT POOLING**
  - Remember
    - **Pooling** means production anywhere is proportionately attributed to each tract based on the leases
    - **PSA** means production is attributed according to an agreement other than lease
    - **Allocation** means production is attributed only to the tract where it occurred, despite the fact that there is production from multiple tracts simultaneously
- Commission is responsible for determining whether there is a regulatory reason to deny the permit
  - Good faith claim is what is important to deciding whether permit can be granted
  - *Klotzman*: Where operator has right to drill on both leases and there is no regulatory bar (e.g. spacing), there is sufficient good faith claim to drill

# RRC/Magnolia v. Opiela

## ISSUE #1: Does Asserting Right to Drill Under PSA Infringe on Lease's Anti-Pooling Language

- Commission precedent (*Klotzman*) is that OGL's lack of pooling authority is irrelevant to whether permit should be granted
  - Commission is only looking at whether operator has a good faith claim to drill/operate
- Good faith claim DOES NOT mean that you are in compliance with the lease or rights at common law
  - It just means you have a sufficiently good claim to the right to drill such that there is not a regulatory reason to stop you
- May be many good civil reasons why you shouldn't drill the well
  - That's outside the Commission's jurisdiction
  - That's a fight for another venue (District Court)

# RRC/Magnolia v. Opiela

## ISSUE #2: Whether Magnolia Made Reasonably Satisfactory Showing of Good Faith Claim to Drill/Operate

- RRC = Yes
- 3rd Court = No
- Opiela Argument: RRC did not follow Texas Administrative Procedures Act for making rules re: PSA wells
- Whether Magnolia made requisite showing of good faith claim to operate hinges on whether 65% threshold is a properly adopted rule.
  - i.e. is 65% Threshold a Properly Adopted Rule?
  - IF NO (if rule itself is invalid), then Order is invalid based on error of law
  - IF YES (if rule is valid), then appellate court concludes that order was not supported by substantial evidence

# RRC/Magnolia v. Opiela

## ISSUE #2: Whether Magnolia Made Reasonably Satisfactory Showing of Good Faith Claim to Drill/Operate

- Assuming the 65% Threshold is Valid (court punts)....
- **HOLDING: No substantial evidence supporting that 65% threshold was met in this case.**
  - **Substantial evidence does not support finding that 65% of interest owners “signed the Production Sharing Agreement.”**
- 2008 Guidance required 65% of royalty and working interest owners to sign “Production Sharing Agreement”
  - Did not define the term
  - Did not say that other documents could be determined the equivalent of PSA for purposes of the 65% threshold
  - Did not say whether multiple PSAs could be signed

# RRC/Magnolia v. Opiela

## ISSUE #2: Whether Magnolia Made Reasonably Satisfactory Showing of Good Faith Claim to Drill/Operate

- Here, 65% (65.625%) threshold based on:
  - PSAs = 15.625%
  - Ratifications = 0.563%
  - Consents to Pool = 49.437%
- Consent to Pool is not a valid substitute for Production Sharing Agreement
  - Exception: If Pooling Consent and PSA call for same production sharing formula across unpooled tracts
  - **WHY? PSA Well IS NOT Pooling**
    - Pooled Unit and PSA Well 1) Divide Production Differently, and 2) Invoke Different Property Rights
- **HOLDING: Even if 65% Threshold is Proper, Magnolia did not meet because no substantial evidence that 65% signed PSA**

# RRC/Magnolia v. Opiela

## ISSUE #3: Whether Commission had authority to adjudicate rights under the OGLs

- **NO**
- Commission has no power to determine property rights based on a lease or other title documents
  - Venue to discuss what's in the lease is in District Court
- PLUS: HZ well under PSA is not pooling
  - No harm in Commission failing to look at anti-pooling language because this is a PSA well and not pooling
  - Anti-Pooling Clause wasn't implicated

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# SUMMARY

ENERGY IS THE CENTER OF EVERYTHING WE DO

# Multi-Tract Wells: Technology Created a Dilemma for Operators

- Technology is ahead of the law
  - Lateral length capability has outpaced structure of pooling agreements
- Operators have a financial incentive/requirement to maximize production/profit – the wells are going to get drilled, only question is how
- New Mexico and Texas share a common reservoir (Delaware Basin) and solved the problem in different ways (same same but different)
- New Mexico = Structured, thoughtful approach b/w gov and industry
- Texas = Organic industry solution

# QUESTIONS?

[ben@theenergylawgroup.com](mailto:ben@theenergylawgroup.com)

Reach out on LinkedIn - <https://www.linkedin.com/in/benjamin-holliday/>

