

# Production Sharing Agreements and Allocation Wells Update



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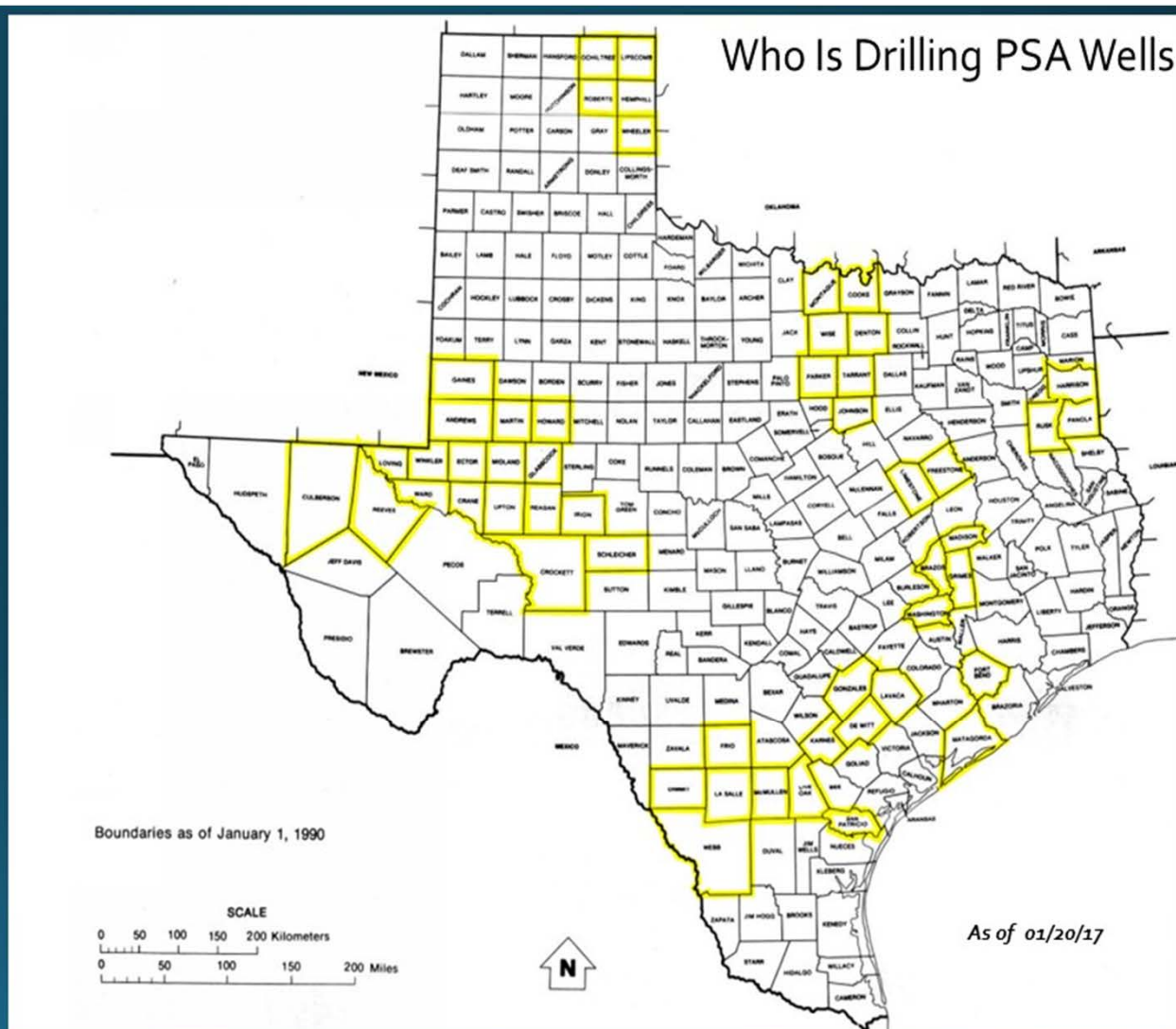
**March 23, 2017 Texas A&M Energy Law  
Symposium**



# Who is Drilling PSA Wells?

(Thanks to Brian Sullivan of McElroy, Sullivan, Miller, Weber & Olmstead, L.L.P.)

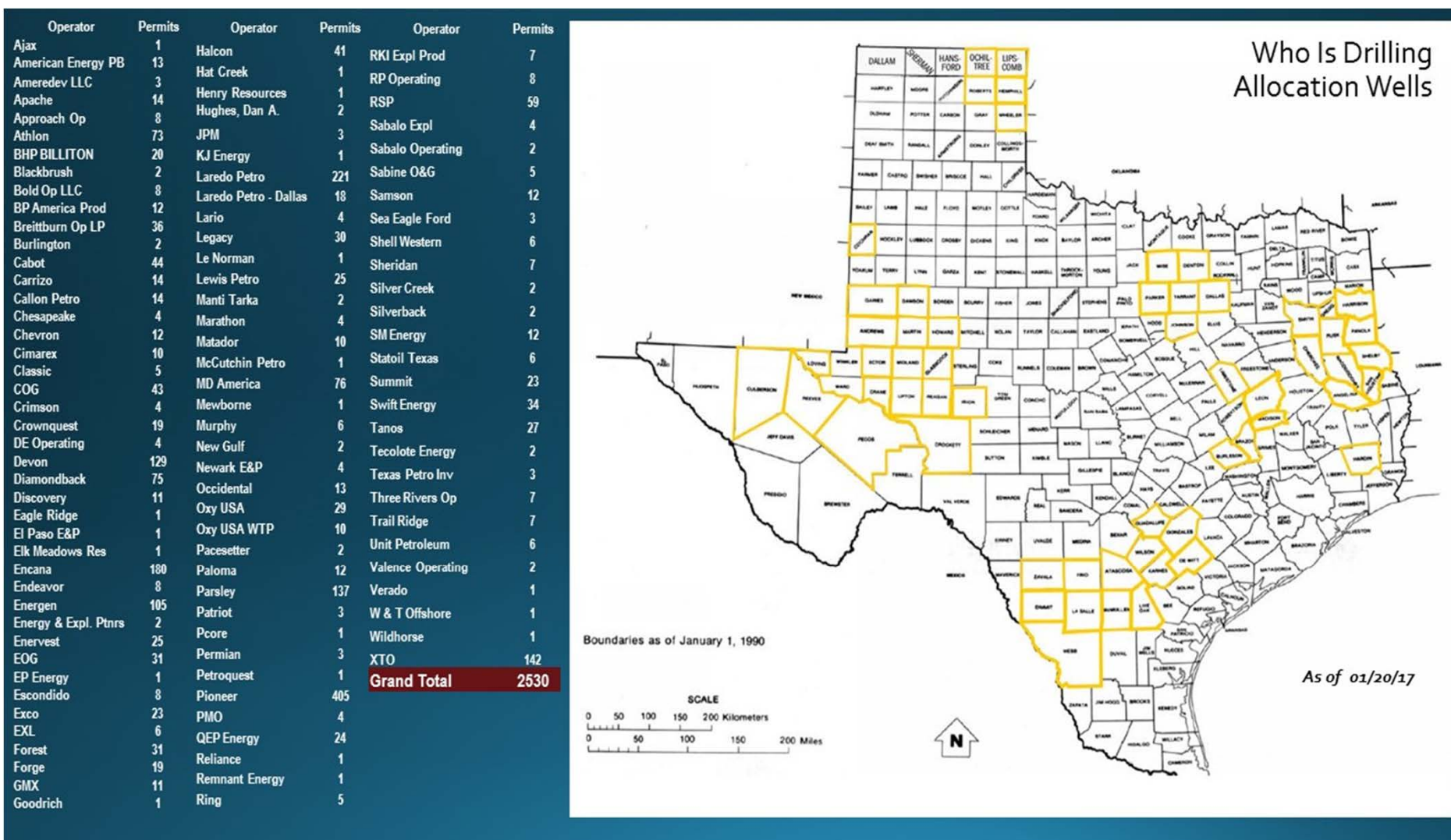
Operator	Permits	Operator	Permits
Anadarko	59	Lario Oil & Gas	3
Apache	19	Le Norman	1
BHP	31	Linn	4
Bold Op	10	Marathon Oil	11
BP America Prod	7	Matador Production	5
Burlington	11	MDC Texas Energy	1
Callon	28	Memorial Prod Op	54
Chesapeake	58	Mewbourne	1
Chevron USA	61	Murphy	9
Cimarex	8	Navidad	1
Cinnabar	2	Newfield	3
Classic	6	NFR	4
CML	1	Oxy USA	47
COG	4	Parsley Energy	29
Devon	630	Patriot	10
Diamondback	4	Penn Virginia	6
Discovery	4	Pioneer	31
El Paso E&P	1	QEP	1
Elk Meadows	3	Quicksilver	2
Encana	2	Resolute	19
Energen	99	RKI	6
Energvest	53	Sabalo Expl	1
EOG	30	Sabine O&G	11
Escondido	1	Samson	4
Fidelity	2	Silverback	2
Foreland Op	2	SM Energy	86
Forest	2	Statoil	25
Goodrich	2	Talisman	5
Hat Creek	1	Texakoma	1
High Sky Prtns	10	Texas American Res	4
Highmount Expl	2	Titan	1
Hunt Oil	49	Unit Petro	6
Jilpetco	1	Vantage	96
Laredo Petro	5	WBH	19
		XTO	8
		<b>Grand Total</b>	<b>1725</b>





# Who is Drilling Allocation Wells?

(Thanks to Brian Sullivan of McElroy, Sullivan, Miller, Weber & Olmstead, L.L.P.)





No reported case law in Texas federal or state courts discussing PSA or allocation wells

- A few cases on “production sharing agreements” with foreign governments (concessions), but those N/A

No Texas statute or regulation addressing either but RRC guidance provides instructions on how to obtain drilling permits for both:

- <http://www.rrc.state.tx.us/search-result?q=production+sharing+agreement>
- PSA authority statement (K right to drill & produce all tracts; if >65% WI and MIO signed, permit as PSA well); Acreage Allocation (plat, PSA-12 Code Sheet, P-16 data sheet)

# Klotzman RRC Final Order



## RAILROAD COMMISSION OF TEXAS HEARINGS DIVISION

OIL AND GAS DOCKET  
NO. 02-0278952

APPLICATION OF EOG RESOURCES,  
INC. FOR ITS KLOTZMAN  
LEASE(ALLOCATION) WELL NO. 1H,  
(STATUS NO. 744730), EAGLEVILLE  
(EAGLEFORD-2) FIELD, DEWITT  
COUNTY, AS AN ALLOCATION WELL  
DRILLED ON ACREAGE ASSIGNED  
FROM TWO LEASES.

### FINAL ORDER

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The Commission hereby adopts the following Substitute Finding of Fact:

#### Substitute Finding of Fact:

4. EOG is the operator of and owns 100% of the working interest rights to the Eagleville (Eagleford-2) Field under the Georgia Dubose-Glassell 516.569-acre Lease and the Georgia Dubose-Pierce 304.97-acre Lease and there are no unleased interests within 330 feet of any point on the proposed wellbore.

The Commission hereby adopts the following Substitute Conclusions of Law:

#### Substitute Conclusions of Law:

3. EOG Resources, Inc. has a sufficient good faith claim to drill its proposed Klotzman (Allocation) Well No. 1H on an 80-acre drilling unit composed of 40 acres from the Georgia Dubose-Glassell 516.569-acre lease and 40 acres from the Georgia Dubose-Pierce 304.97-acre lease.

# Klotzman RRC Final Order



Oil & Gas Docket No. 02-0278952  
Final Order

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4. A Statewide Rule 37 lease line spacing exception for the well may be granted administratively pursuant to 16 Tex. Admin. Code §3.37(h)(2)(B) as EOG Resources, Inc. is its own offset.

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Done this 24th day of September, 2013.

RAILROAD COMMISSION OF TEXAS

  
CHAIRMAN BARRY T. SMITHERMAN

  
COMMISSIONER DAVID PORTER

  
COMMISSIONER CHRISTI CRADDICK

ATTEST:

  
SECRETARY





# Rule 37 Self-Waiver

## Texas Administrative Code

<u>TITLE 16</u>	ECONOMIC REGULATION
<u>PART 1</u>	RAILROAD COMMISSION OF TEXAS
<u>CHAPTER 3</u>	OIL AND GAS DIVISION
RULE §3.37	Statewide Spacing Rule

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(h) Exceptions to Rule 37.

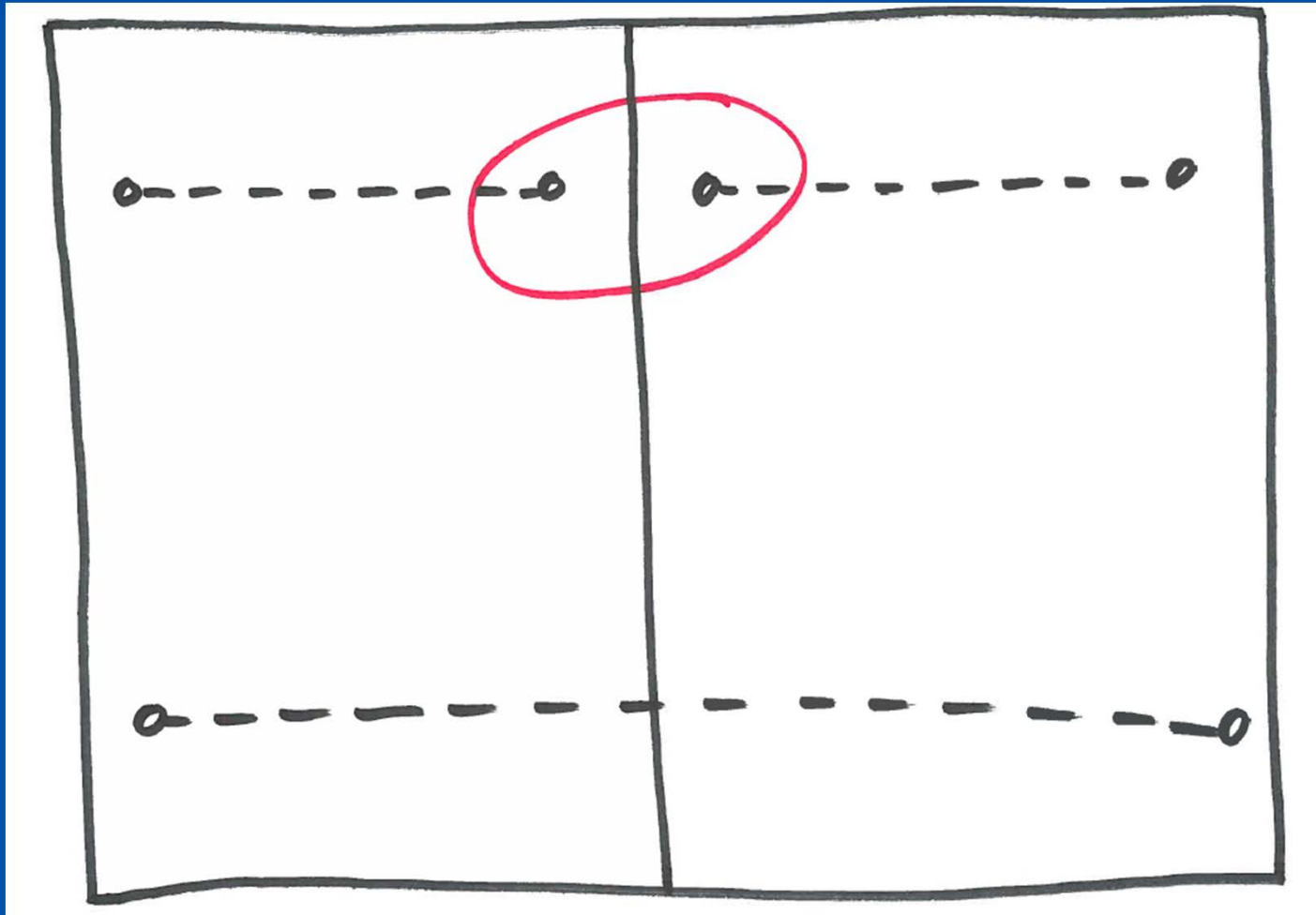
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(2) The director of the Oil and Gas Division or a delegate of the director may issue an exception permit for drilling, deepening, or additional completion, recompletion, or reentry in an existing well bore if:

(A) a notice of at least 10 days has been given, and no protest has been made to the application; or

(B) written waivers of objection are received from all persons to whom notice would be given pursuant to subsection (a)(2) of this section.

# Klotzman – Commissioner Porter's Drawing







## Analogous Case Law

- *Cockrell v. Texas Gulf Sulphur Co.*, 299 S.W.2d 672, 675 (Tex. 1956) – greatest possible estate granted rule – allows lessee to drill anywhere on lease, including border to border, unless expressly prohibited by the lease
- *Humble v. West*, 508 S.W.2d 812, 818-9 (Tex. 1974) – burden of proof is on commingler of native and injected (stored) gas into partially-depleted reservoir to prove each party's share with "reasonable certainty" by expert testimony, and the act of commingling did not obligate the commingler to pay royalties on all gas under confusion of goods theory absent such evidence
- *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App. – Austin 2000, pet. denied) – each party in a HZ well entitled to its share of production attributed to each individual tract with "reasonable probability" and not 8/8ths undiluted royalty
- *Springer Ranch v Jones*, 421 S.W.3d 273, 285-6 (Tex. App. – San Antonio 2013, no writ) – expert's opinion that production from multiple tracts allocated on basis of HZ well's distance between first and last take points within the correlative interval reasonable (see 16 Tex. Admin. Code §3.86 for definitions)
- *Magnolia Petroleum Co. v. Railroad Comm'n of Texas*, 170 S.W.2d 189 (Tex. 1943) – "reasonably satisfactory showing of good-faith claim of ownership in the property" (lease) is what is required to obtain drilling permit (followed in *Klotzman /EOG* case by RRC for allocation well permit; COL# 3 in 9/24/13 Final Order)



## Analogous Texas Statutes and Regulations

- Tex. Nat. Res. Code §85.046(c): RRC may permit wellbore commingling from different reservoirs, and surface commingling of oil and gas from two or more tracts of land, if RRC finds commingling prevents waste, promotes conservation or protects correlative rights. Amount of production attributable to each tract shall be determined in a manner consistent with this title.
- 16 Tex. Admin. Code §3.10 (wellbore commingling of production from different strata) and surface commingling under §3.26 (oil) and §3.27 (gas) allowed to prevent waste, promote conservation or protect correlative rights where method of allocating production shown to “accurately attribute to each interest its fair share of aggregated production”
- 16 Tex. Admin. Code §3.86 defines, in a HZ well:
  - Correlative interval – depth interval designated by field rules or new field designation
  - Take point – any point in HZ well where oil or gas can be produced from CI
  - First take point – take point in HZ well nearest to point where well penetrates top of CI
  - Last take point – take point in HZ well nearest terminus (end of well)
  - Nonperforation zone (NPZ) – portion of HZ well designated as containing no take points



## One of the Highest Legal Authorities

- Ernest E. Smith's 3/11/2015 letter to Rep. Thomas Craddick:  
Under SWR Rules 10 (commingling within a wellbore between different strata), 26 (surface commingling of oil) and 27 (surface commingling of gas), as authorized by Tex. Nat. Res. Code §85.046(c), the RRC has been measuring and allocating production "for decades" and that practice is "substantially similar" to allocating production between tracts in a HZ allocation well
- Ernest E. Smith's 3/31/2015 letter to Rep. Thomas Craddick and Senator Troy Fraser:  
"H.B. No. 1552 (the proposed allocation well bill in Texas' last legislative session) does not create or cause pooling, forced or otherwise."  
"In *Browning*, a horizontal well was drilled across multiple adjoining leases, but the *Browning* court held that such a horizontal well is legally equivalent to drilling a separate well on each of the adjoining leases."



## A Couple of Other State's Approaches to Allocation Wells

- Pennsylvania S.B. 259 (2013); now at 58 P.S. §34.1 (2016):

“Where an operator has the right to develop multiple contiguous leases separately, the operator may develop those leases jointly by horizontal drilling unless expressly prohibited by a lease. In determining the royalty where multiple contiguous leases are developed, in the absence of an agreement by all affected royalty owners, the production shall be allocated to each lease in such proportion as the operator reasonably determines to be attributable to each lease.”
- Oklahoma S.B. 78 (2011); now at 52 Okl. St. §87.8 (2015):

The OCC “is authorized to allow multiunit horizontal wells in order to prevent waste and protect correlative rights of the owners of oil and gas rights ... and shall further require the allocation of the commingled production and proceeds from the completion interval of a multiunit horizontal well, with any allocation to be in a manner that will prevent waste and protect the correlative rights of the owners of the oil and gas rights in each of the affected units which the well actually penetrates within the completion interval.”



## Hierarchy of Drilling Across Tract Lines in Texas

- Pooling – been around for a hundred years and usually done on surface acreage basis; certainty of legal rights under many court opinions – least uncertainty of legal risk, but subject to bad faith pooling claims
- PSA wells – while no case law, parties have to the right to contract, and contracts entered into at arms-length and free of fraud in the inducement are enforced by the courts – still low uncertainty of legal risk
- Allocation wells – no guiding case, statutory or regulatory law on point; only RRC practice, *Klotzman* RRC case, and hundreds and hundreds of allocation wells being drilled statewide
  - Promotes conservation by precluding drilling separate wells (economic waste)
  - Prevents waste of HCN's – loss of reserves in “dead zone” between tracts
  - Is the implied covenant to manage and administer the lease implicated? See Smith and Weaver, Texas Law of Oil & Gas at §5.4[A] discussing duty to seek administrative action such as well spacing exceptions
  - Of the three, most uncertainty of legal risk due to no law on point in Texas



## H.B. 1552/S.B. 919 (Texas 84<sup>th</sup> Leg. Session 2015)

Sought to amend Tex. Nat. Res. Code §85.046 by adding new subsection (d)

Unless expressly prohibited by a lease, deed, or other contract, an operator or lessee with the right to drill an oil or gas well on or produce or develop oil or gas from each tract independently may, under a permit issued by the commission, drill, operate, and produce oil or gas from an oil or gas well that traverses multiple tracts in order to prevent waste, promote conservation, or protect correlative rights. If there is not an agreement with one or more of the affected owners of royalty or mineral interests in the tracts traversed by the well regarding the manner in which production from the well shall be allocated among the tracts, the operator or lessee shall allocate to each tract its share of the aggregated production from the well as determined by the operator or lessee with reasonable probability. The operator or lessee must send written notice of its method of production allocation among the tracts, and the resulting allocation factor for each of the tracts, to each affected royalty or mineral interest owner at the owner's last known address.

## H.B. 1552/S.B. 919 (84<sup>th</sup> Tex. Leg. 2015)



- The Bill died in committee after the Texas General Land Office and The University of Texas Lands issued a negative fiscal impact note of \$490 million on 4/6/2015
- Industry and trade associations have been working with GLO and UL on acceptable revisions to the bill, and appear to have reached consensus on an acceptable bill
- Stay tuned for possible new allocation well bill in 2017



## In the Meantime ...

- Pool or drill PSA wells after obtaining PSA's – what method should be used to determine allocation of production among the tracts/units?
  - First to last take point in correlative interval (*Springer Ranch*)
  - Same, but less any portion of the HZ well deemed by the RRC to be a no-perf zone (NPZ) and/or deemed non-productive in the sole good faith opinion of the operator
  - Surface acreage approach (660' rectangle around wellbore in producing field interval) for lease line or unit line wells
- Many operators drilling AW's with no push-back whatsoever, but many MIO's amending their lease forms to preclude allocation wells
- Allocation wells are a valuable tool to develop oil & gas reserves to the benefit of all affected parties