

Oil & Gas Law

Class 5:

**RoC: Regulatory Responses (2 of 4) –
The “Small Tract” Problem and
Pooling**

Admin: Cancelled Class(es)

■ Syllabus shifts 1 day

- Tonight: CL 5
- Week of Feb. 4 → CL 6 (2/4) and CL 7 (2/6)
- CL 8 / Quiz: TU 2/11
- CL 9: TH 2/13 and so on ...

■ Make-up class is possible

- Law School has advised us that Friday, April 11 will be the make-up day for classes cancelled Jan. 28
- Keep that day in reserve ... we may use it IF I think I'm going to have to cancel another class (or if I've already done so)
- If not, we won't need to have a make-up

“Too few lawyers for many energy deals”

- Headline - last Sunday's HC Bus. Section ...
 - “The oil and gas boom in Texas has provided a seismic jolt for the law firms that represent energy companies.”
 - "It is a very good time to be an energy lawyer in Texas right now..."
 - "There's a significant need for new pipelines, new drilling wells, new processing plants ... There's also a lot of private equity money out there that needs to be put to work."
- <http://www.houstonchronicle.com/business/article/Too-few-lawyers-for-many-energy-deals-5173602.php?t=fb82f87b51>

Rule 37(g) Exceptions – History

- Spacing and Density Rules (Rules 37 and 38)
- Purposes (Rule 37(d))
 - Prevent waste
 - Protect Corr. Rts – prevent confiscation of land
- Gulf Land v. Atl. Ref. (1939 – p. 701 FN 65): Ct. equates “confiscation” w/ landowner not having a fair chance to recover O&G under his/her land
 - ... became “each tract of land, no matter how small, is, as a matter of right, entitled to a well”

Rule 37(g) Exceptions – History (cont'd.)

- **BUT ...** if “each tract of land, no matter how small, is entitled to a well”, spacing rules become meaningless
 - Landowner keeps subdividing land to get more wells
- **BUT ...** if Rule 37 strictly enforced (no post-1919 subdivision entitled to exception), then small landowners who received their land pre-O&G would be unable to drill → too harsh
- Friction between small landowners’ right to drill and spacing rule’s goal of protecting against waste

Rule 37(g) Exceptions – History (cont'd.)

- So ... compromise
 - “Suspicious subdivisions” made to get more wells would be denied;
 - Otherwise, exception granted
- Courts stepped in to interpret (g)(1)
 - Those decisions cut-&-pasted into Rule 37(g)
 - Became sub-sections (g)(2) – (6)

TX Voluntary Subdivision Rule – Text

■ Rule 37(g). Subdivision of property.

- (1) In applying Rule 37 (Statewide Spacing Rule) of statewide application and in applying every special rule with relation to spacing in every field in this state, no subdivision of property made subsequent to the adoption of the original spacing rule will be considered in determining whether or not any property is being confiscated within the terms of such spacing rule, and no subdivision of property will be regarded in applying such spacing rule or in determining the matter of confiscation if such subdivision took place subsequent to the promulgation and adoption of the original spacing rule.
- (2) Any subdivision of property creating a tract of such size and shape that it is necessary to obtain an exception to the spacing rule before a well can be drilled thereon is **a voluntary subdivision and not entitled to a permit** to prevent confiscation of property **if** it were either:
 - (A) **segregated** from a larger tract **in contemplation of oil, gas,** or geothermal resource **development**; or
 - (B) segregated by **fee title conveyance** from a larger tract **after** the spacing rule became effective and **the voluntary subdivision rule attached**.
- (3) The date of attachment of the voluntary subdivision rule is **the date of discovery of oil, gas,** or geothermal resource production in a certain **continuous reservoir, regardless of the subsequent lateral extensions of such reservoir**, provided that such rule does not attach in the case of a segregation of a small tract by fee title conveyance which is not located in an oil, gas, or geothermal resource field having a discovery date prior to the date of such segregation.

TX Voluntary Subdivision Rule – Text

- (4) The date of attachment of the voluntary subdivision rule for multiple reservoir fields located in the same structural feature and separated vertically but not laterally (i.e., the multiple reservoirs overlap geographically at least in part), shall be the same date as that assigned to the earliest discovery well for such multiple reservoir structure.
- (5) If a newly discovered reservoir is located outside the then productive limits of any previously discovered reservoirs and is classified by the commission as a newly discovered field, then the date of discovery of such newly found reservoir remains the date of attachment for the voluntary subdivision rule, even though subsequent development may result in the extension of such newly discovered reservoir until it overlies or underlies older reservoirs with prior discovery dates.
- (6) The date of attachment of the voluntary subdivision rule for a reservoir that has been developed through expansion of separately recognized fields into a recognized single reservoir and is merged by commission order is the earliest discovery date of production from such merged reservoir, and that date will be used subsequent to the date of merger of the fields into a single field.
- (7) The date of attachment of the voluntary subdivision rule for a reservoir under any special circumstance which the commission deems sufficient to provide for an exception may be established other than as prescribed in this section, so that innocent parties may have their rights protected.

Vol. Subd. Rule – Summary (in Eng.)

- **Sec. (2A) – O&G leases (& other dev. transfer docs):**
always triggers V.S. Rule – entered into “in contemplation of” O&G development
 - (even in “[wildcat well](#)” area – [p. 4 FN3](#))
- **Sec. (2B) – Transfer by “fee title conveyance” (e.g., deeds, wills, etc.):** refer to sub-Sec. (3)–(6) to see if VS Rule “attached”
 - (3) Date of discovery in reservoir, even for laterals – BUT if transfer pre-dates subsequent ext., rule doesn’t attach
 - (4/5) Multiple reservoirs separated vertically – each res. gets its own date (Benz-Stoddard pp. 701-702); and new reservoir keeps its own discovery date, even if later dev. extends it above / below other reservoirs
 - (6) Several fields merge into 1 reservoir – earliest date
- **Sec. (7) – “Innocent Parties’ Rights” catch-all**

Voluntary Subdivision Rule Problems



Voluntary Subdivision Rule Prob. – 1

■ Assume a 40-acre / well limit:

- ❑ 1. The nearest production to a parcel of land is 25 miles away. A farmer, Thompson, owns 50 acres (in what is “wildcat territory”), and leases the north 10 acres to Green Oil Co. for oil & gas development. Is the lessee entitled to an exception?
- ❑ 2. The nearest production to a parcel of land is 25 miles away. A farmer , Thompson, owns 50 acres in wildcat territory and deeds the north 10 acres to Jones, another farmer. Subsequently, Jones leases the 10 acres to Brownman E&P Co. Can B E&P Co. receive an exception?

Voluntary Subdivision Rule Prob. – 2

- 3. At a time when there's no drilling or development of O&G in the vicinity, the owner of an 80-acre farm conveys a ½-acre lot to Jones. Several years later, oil is discovered in the vicinity, and Jones seeks a Rule 37 exception to prevent confiscation. Will he get it? Would it make any difference whether there was a well on an adjacent tract that was draining Jones' tract?
- 4. A new discovery well is completed 3 miles outside of town. Stevens, who owns a large tract of land on the edge of town, sells the tract, except a small corner lot where he plans to build a Sonic. Additional drilling reveals that the new reservoir extends beneath the town. Stevens concludes that an oil well would be more profitable than a Sonic. Should the RRC grant his application for a Rule 37 permit?

Voluntary Subdivision Rule Prob. – 3

- 5. Dad owns 40-ac. tract in wildcat territory. In 1980, he leases to CQ Oil Co.; in 1982, he deeds half to Son, other half to Daughter; in 1984, O&G are discovered in the area. Is CQ Oil Co. entitled to 1 permit, or 2 permits?

Pooling



Pooling - Intro

- Pooling: Definition: p. 696
- WHY DO WE NEED POOLING?
- Allows owner(s) of small tract(s) to drill on their property
 - P. 702 – Next-to-last ¶
- 4 options
 - Century doctrine (pp. 702-703) → rarely invoked
 - Equitable pooling (pp. 697-698) → MS only
 - Voluntary pooling
 - Compulsory (a/k/a forced) pooling

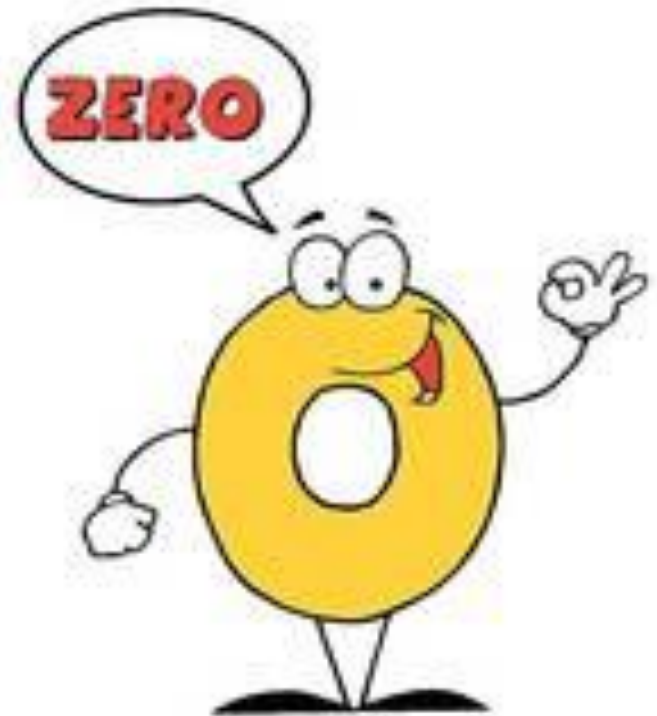
Ryan Consolidated Petro. Corp.

(Supp. Case – also p. 698 FN 59; p. 703)

- 4 lots (total 0.4 acres) leased by 2 parties (Pickens / Coffield – Lots 10 & 11; Ryan – Lots 12 & 13)
 - Each party applies for Rule 37 exception; when its appl. is denied, Ryan wants to participate in Pickens' well
- *Why can't Ryan & Pickens each drill a well?*
- *How does the RRC decide which applicant should get the drilling permit?*
 - p. 9 “race to the RRC” – State's interest in developing NOW
 - p. 6: “RoC is still in force...” in TX
- pp. 5-6: Ct. specifically rejects equitable pooling
- *What did Ryan end up getting in this case?*

Ryan Consolidated

- No well ...
- No production ...
- No satisfaction!!!
 - (w/ apologies to ...
 - ... the Rolling Stones)



Well Allowables (pp. 704-707)

- 3rd exception to Spacing and Density Rules
 - 1st two were waste and anti-confiscation
- Concept: other than Vol. Subd. Rule, landowner has the right to drill 1+ wells, and to operate the well(s) at an allowed rate that yields a reasonable profit
 - if you're not going to restrict distance between wells, you can limit how much each well can produce
 - thus giving each well a more equal / more balanced (i.e., more of a “fair share”) access to the common reservoir
 - not just the O&G under your land, but also a share of what's flowing
- **BUT HOW DO YOU CALCULATE EACH WELL'S ALLOWABLE?**

Halbouty (Supp. Case)

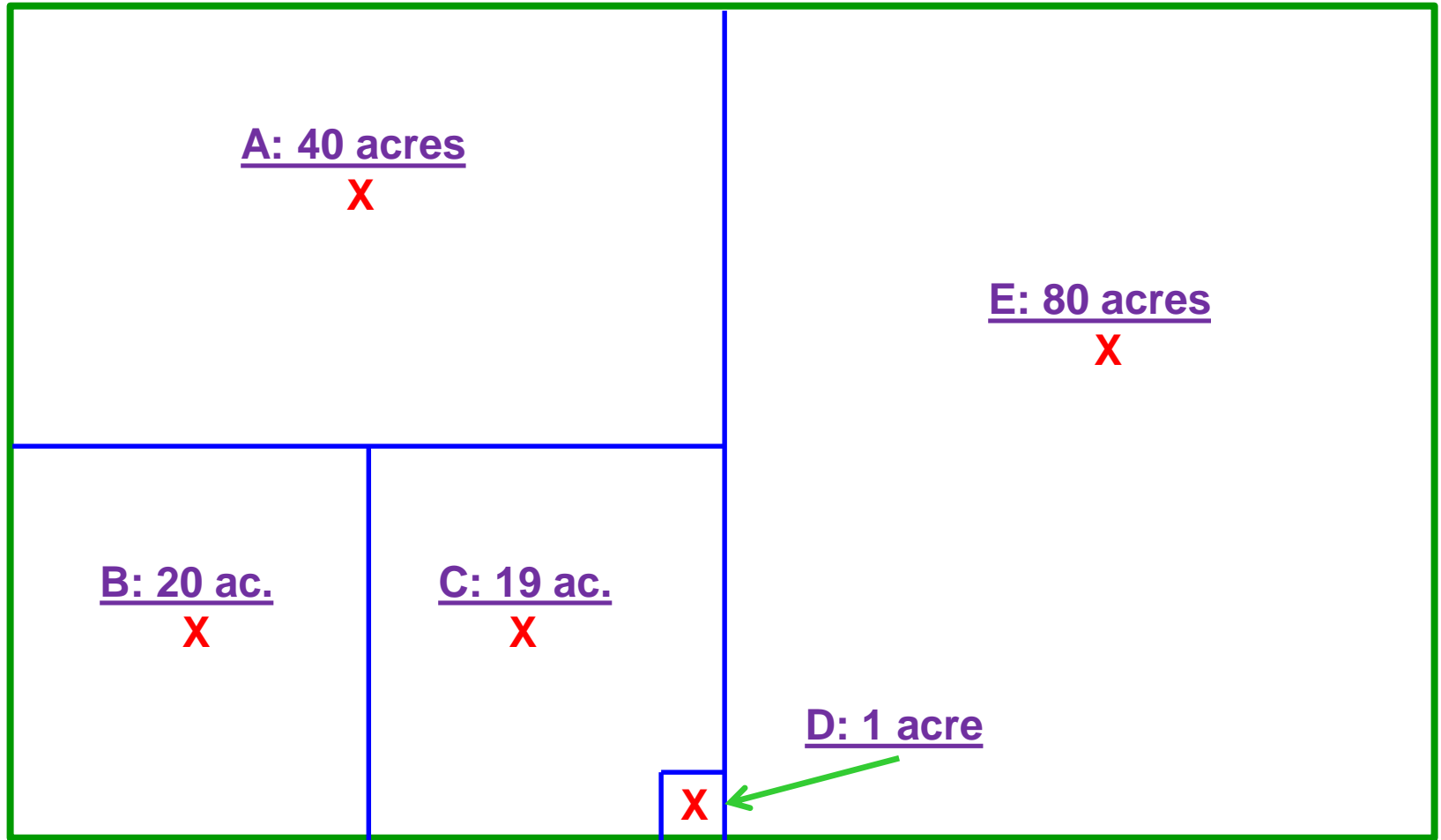
- **Hawkins Field (p. 704): attempting to balance between owners of large tracts of land and small landowners**
 - 50% per well + 50% per acre



Halbouty

- **Claimant's Claims?**
- Under the 1/3 – 2/3 formula, parties still don't get to produce their "fair share" of O&G (pp. 5)
 - ❑ Gross income for 1-ac tract: \$407k (1/3-2/3) vs. \$51k (acreage)
 - ❑ t/f, 1/3-2/3 gives small tract owner too much \$
 - ❑ **So claimants must own what kind of tracts?**
- Allocation formula [33% per well + 67% per acre] is not supported by the substantial evidence ... t/f it's arbitrary and confiscatory (p. 5)
- RRC Order overturned (next-to-last paragraph in majority decision – p. 12): the formula ordered by the RRC is invalid b/c it
 - ❑ (1) doesn't give all the owners the opportunity to produce their "fair share of the minerals", and
 - ❑ (2) "it is not reasonably supported by substantial evidence."
- Shift from "reasonable profit" / "living allowable" (p. 704) to "protect Correlative Rights"

P. 706 ¶ 1: Example - Situation



P. 706 ¶ 1: Example - Comparison

- 160-ac.
field
allowable =
1,600 bbl.
- =====
- **Compare**
- “acreage
only”
allocation
- 50-50
allocation
- 1/3 wells,
2/3 acreage
allocation
- “wells only”
allocation

		ACREAGE <u>ONLY</u>	<u>BLENDED</u> (50-50)	<u>BLENDED</u> (1/3-2/3)	WELLS <u>ONLY</u>
A 80/160		800	560	640	320
B 40/160		400	360	373.33	320
C 20/160		200	260	240	320
D 19/160		190	255	233.33	320
E 1/160		10	165	113.33	320

P. 706 ¶ 1: Example - Calculations

160 acres, producing 1,600 bbl./d from 5 wells

Per well: 320 bbl./d [each owner gets this]

Per acre: 10 bbl./d [each owner gets this, multiplied
by the number of acres they have]

=====

ASSUME we're looking at Owner A, owner of 80 ac.

If “blended” on a 1/3 – 2/3 basis (i.e., 1/3 per well +
2/3 per acre), the calculation is as follows

$$320 \quad \times 1/3 = 106.67$$

$$800 \quad \times 2/3 = \underline{533.33}$$

$$640.00$$

Forced Pooling in TX

- Only producing state to oppose forced pooling → based on RoC
- Legislature viewed forced pooling as a “socialistic intrusion upon free enterprise”
 - THAT’S WHY the RRC came up with the allowables approach
 - Favored small-tract mineral owners
 - Discouraged voluntary pooling

Forced Pooling in TX: Carson

- Voluntary pooling agreement offered to 97 owners in a field
 - Carson the only owner who didn't ratify
 - BTA seeks forced pooling under the MIPA
- **What's the issue?**
- MIPA: before RRC can order pooling, the pooling applicant must make an offer that is "fair and reasonable"
- Here, not fair and reasonable
 - Take-it-or-leave-it at time when Carson's rts. were known

Forced Pooling in OK: Anderson

- 80-acre spacing unit made up of 2 40-acre tracts
 - Anderson is the only owner who refuses to participate
 - He ends up getting a bonus and a cost-bearing royalty, in return for assigning his interest in the well
 - Constitutional challenge: fails
 - OCC order upheld as being supported by substantial evidence
 - Good discussion about (1) the policy behind, and the need for, conservation laws; and (2) the need for energy
 - OK approach: pay reasonable value and owner gets pooled
-

Next Classes

- **TU 2/4: Class 6 – Unitization**
 - Ch. 4 Sec. B 6
 - pp. 746 – 758; and 783 – 796
- **TH 2/6: Class 7 – Other Regulatory Responses**
 - Ch. 4 Sec. B 1 and B 3
 - pp. 631 – 647; and 674 – 685