REVISITING THE EFFECT OF GOVERNMENTAL AUTHORITY ON RETAINED ACREAGE PROVISIONS

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"OMG, no, please no."

"Are you kidding me?"

"Come on. You've got to be joking."

For the sake of client confidentiality, I will not ascribe names to the above quotes. However, I assure you that they were indeed uttered, usually in conjunction with a few expletives, and they were uttered primarily in response to ongoing discussions about continuous development and retained acreage provisions[1] that incorporate provisions of the "governmental authority having jurisdiction", i.e. the Texas Railroad Commission (the "Commission" or the "RRC").

The frustration, perhaps, comes from a lack of certainty in understanding what the provision means for land personnel involved in day to day operations. It has been my experience that oil and gas operators need certainty – they need certainty to schedule drilling programs, certainty to comply with continuous drilling obligations, and certainty for a host of other reasons in an often uncertain industry. So, if oil and gas operators need certainty, why do they incorporate the rules and regulations of a governmental authority that has the authority to, and often does, change the field rules? Why tie the retained acreage to what may potentially be a moving target?

The thought process behind a retained acreage provision is simple enough. Lessors do not want one well holding hundreds of acres without additional impetus for development. If the Lessee does not develop the entirety of the acreage by the end of the primary term, or continuous development term, as the case may be, retained acreage provisions typically require the release of the excess acreage where the lessee retains a predetermined amount of acreage around each well. But the devil is always in the details. With retained acreage provisions, there does not appear to be a "one size fits all" form and each different form of retained acreage provision "must be construed on its own, under governing principles of contract interpretation."[2] Lessors and lessees negotiate back and forth on what is enough acreage, but not too much.

Often that middle ground may be the regulatory authority that has set certain benchmarks for the prevention of waste and protection of correlative rights. To address this issue, I wrote an article a few years back styled, *Drafting the Retained Acreage Clause: The Effect of Governmental Authority on Retained Acreage* to provide a nuts and bolts approach to some basic Commission background and to identify some potential landmines in retained acreage provisions. The primary theme of that article was that a practitioner needed to beware of attempts to pull in Commission rules and regulations without fully understanding the theory and application underpinning those rules. It was a cautionary note about some potential RRC rules and regulations that may prove to be operator landmines.

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[1] Williams & Meyers, MANUAL OF OIL AND GAS TERMS, 1066 (Stephen Ford et al., eds., 8th vol., 1992) (a retained acreage clause is a "lease clause authorizing the lessee to retain acreage around a producing well or acreage in a producing unit in the event of forfeiture of a lease").

[2] Endeavor Energy Resources, L.P. and Endeavor Petroleum, L.L.C. v. Discovery Operating, Inc. and Patriot Royalty and Land, L.L.C, No. 15-0155, slip op., at 12 (Tex. Apr. 13, 2018).

Since then, the landscape has changed. The industry has seen a resurgence in the Permian and, at least in my experience, the lease forms in West Texas are much more apt to incorporate the provisions of governmental authority into the retained acreage provisions than many other areas of Texas. Perhaps not coincidentally, we have seen some of these landmines explode and additional case law evolve, primarily with *ConocoPhillips Company v. Vaquillas Unproven Minerals*[3], *Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.*[4], and *XOG Operating, LLC v. Chesapeake Exploration L.P.*[5]

The purpose of this paper is to revisit some of the nuts and bolts of Commission rules and regulations and to examine same in light of the above cases, as well as to offer some additional thoughts in light of allocation wells and other issues. As such, this article will attempt to: (i) provide general background on the Commission's rules and regulations; (ii) identify some common problems in drafting retained acreage provisions; and, (iii) examine the effect of recent case law on future drafting.

I. BACKGROUND OF COMMISSION RULES AND REGULATIONS.

For those unfamiliar with the RRC, some of the rules and regulations may seem somewhat Byzantine. However, the Commission has a very detailed, thorough approach to regulating oil and gas in the State of Texas, and uses its rules and regulations to promote the orderly production of oil and gas, to prevent waste of the State's natural resources, and to protect the correlative rights of its citizens.[6] An understanding of the Commission's rules and regulations is a necessary component when reviewing any retained acreage clause that is tied to governmental authority.

1. *Field Rules.*

For any practitioner drafting a retained acreage provision, it is recommended that, first and foremost, you review the field rules for the area that is intended to be developed. Yes, the goal of the retained acreage provision is to be applicable to all fields that may be developed under the respective lease. As a practical matter, though, you need to understand the lay of the land and how the Commission is handling that particular field (at least at the time of drafting your provision).

The purpose of field rules is to use well spacing and density provisions to promote the regular development of oil and gas in such a way that the wells are not clustered together and damaging to the reservoir.[7] The actual orders for the respective fields are available from the Commission. An example of field rules is reflected in the attached Exhibit "A" for the Final Order Amending the Field Rules for the Phantom (Wolfcamp) Field.

While each field has its specific lease line and density provisions, lease line spacing is generally handled by the RRC under 16 T.A.C. §3.37 ("Statewide Rule 37") and density is generally handled under 16 T.A.C. §3.38 ("Statewide Rule 38"). Statewide Rule 37 provides for the minimum distance that a well may be located with respect to lease lines, property lines, or subdivision lines ("lease line spacing"), as well as the minimum distance that a well can be located with respect to another well completed in the same reservoir on the same lease ("between well spacing"). Statewide Rule 38 provides for density provisions that establish the number of

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[3] ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd., No. 04-15-00066-CV, 2015 WL 4638272, at *1 (Tex. App.—San Antonio Aug. 5, 2015, pet. granted, judgm't vacated w.r.m.) (mem. op.).

[4] Endeavor Energy Resources, L.P. and Endeavor Petroleum, L.L.C. v. Discovery Operating, Inc. and Patriot Royalty and Land, L.L.C, No. 15-0155, slip op. (Tex. Apr. 13, 2018).

[5] XOG Operating, LLC and Geronimo Holding Corporation v. Chesapeake Exploration Limited Partnership and Chesapeake Exploration, LLC, No. 15-0935, slip op. (Tex. Apr. 13, 2018).

[6] Texas Oil and Gas, Discussions of Law, Practice and Procedure, Railroad Commission of Texas, at Page 1.

[7] Texas Oil and Gas, Discussions of Law, Practice and Procedure, Railroad Commission of Texas, at Page 4.

acres that are required for each well in a given reservoir.

A field, or common source of supply as determined by pressure communication, is regulated by the RRC under one of three different rule systems: (A) Statewide Rules; (B) County Regular Rules, and (C) Special Field Rules.

A. Statewide Rules.

The Court in *ConocoPhillips Co. v. Ramirez* noted that to regulate oil and gas production, the "Railroad Commission of Texas has adopted general rules applicable throughout the State… [but] because these general rules cannot adequately address the widely varying conditions found in the thousands of oil and gas reservoirs in Texas, the Commission may issue orders with detailed regulations for a specific field…"[8] The "general rules applicable throughout the State" to which the court refers are known as Statewide Rules. The RRC defines Statewide Field Rules as being 467 feet lease line spacing and 1,200 feet between well spacing. Under Statewide Rules of "467/1200" and the density provisions of Statewide Rule 38, the Railroad Commission requires 40 acres for each well from a single property in a particular field.[9] One should be aware that under Statewide Rules, density for a gas well is only 40 acres. This issue proved problematic in *ConocoPhillips Company v. Vaquillas Unproven Minerals* as discussed further below.

B. District/County Regular Rules.

Under District Spacing (which are more commonly referred to as County Regular Rules), special spacing is applicable only in Railroad Commission Districts 7B and 9, and McCulloch County, which is located in District 7C. Specifically, the following counties are affected:

> Archer (09), Baylor (09), Brown (7B), Callahan (7B), Clay (09), Coleman (7B), Comanche (7B), Coryell (7B), Denton (09), Eastland (7B), Erath (7B), Grayson (09), Hardeman (09), Haskell (7B), Hood (7B), Jack (09), Jones (7B), Knox (09), Lampasas (7B), McCulloch (7C), Nolan (7B), Palo Pinto (7B), Parker (7B), San Saba (7B), Shackelford (7B), Somervell (7B), Stephens (7B), Stonewall (7B), Taylor (7B), Throckmorton (7B), and Wichita (09).

District Spacing is only applicable in situations where your completions are 5,000 feet or less. If your completions are deeper than 5,000 feet, then Statewide Rules become applicable. District Spacing is often overlooked in drafting retained acreage clauses, but doing so may be a problem in that the acreage requirements differ based upon depth. Indeed, if you are unaware of the spacing rules in these counties at depths less than 5,000 feet, you may find that tying the retained acreage to the RRC's acreage requirements would give you only two acres for a well drilled between zero and 2,000 feet subsurface, only ten acres for a well drilled between 2,000 and 3,000 feet subsurface, and twenty acres for a well drilled between 3,000 and 5,000 feet subsurface. In other words, if you tie your retained acreage to governmental acreage requirements, a practitioner needs to know where the proposed wells will be located and the respective depths in which they are expected to be completed.

C. Special Field Rules.

The final form of Field Rule is the Special Field Rule. Basically, under Special Field Rules, an operator may request different spacing and density requirements due to geologic variations in the field itself. To obtain Special Field Rules, the party requesting it must file an application that shows the basis for such a request and which identifies the correlative interval via well logs on file with the Railroad Commission. Special Field Rules

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[8] ConocoPhillips Co. v. Ramirez, 2006 Tex. App. LEXIS 5710, at *4 (Tex. App. – San Antonio 2006).
[9] 16 Texas Administrative Code ("T.A.C.") §3.38(b)(2)(A).

often allow an operator to create larger pooled units or retained acreage areas if the corresponding lease provision incorporates "governmental authority". They are also helpful in mitigating a lessor's claims for "failure to develop" and in increasing (or decreasing, as the case may be) your allowables. See Exhibit "A" for an example of Special Field Rules applicable to the Phantom (Wolfcamp) Field.

2. *Proration vs. Density.*

As noted above, density provisions establish the number of acres that are required for each well in a given reservoir for drilling units, and are "intended to establish the acreage that wells in the specific field can drain effectively."[10] Except as may obtained via an exception, the Commission mandates that "[n]o well shall be drilled on substandard acreage…"[11] Further, Statewide Rule 38 stipulates that the "standard drilling unit for all oil, gas, and geothermal resource fields wherein only spacing rules, either special, country regular, or statewide, are applicable is hereby prescribed to be the following":

Figure: 16 TAC §3.38(b)(2)(A)

Spacing Rule	Acreage Requirement
(1) 150 - 300	2
(2) 200 - 400	4
(3) 330 - 660	10
(4) 330 - 933	20
(5) 467 - 933	20
(6) 467 - 1200	40
(7) 660 - 1320	40

So, again, if you are operating under Statewide Rules of 467/1200, you would have a standard drilling unit of only 40 acres.

However, the concept of "density" needs to be viewed in relation to its cousin, "proration". While density applies to the acreage necessary to drill a particular well, a "proration unit" refers to the acreage that is "assigned to a well for the purpose of assigning allowables and allocating allowable production to the well."[12] Phrased another way, density is what you need to drill the well, whereas proration is how much from that well that you are able to produce, i.e. the allowable.[13]

"Allowables" result from an allocation formula employed by the RRC to prevent waste and protect correlative rights by "fairly distributing the available market for production from the reservoir."[14] Acreage that is assigned to a well for allowable purposes cannot be assigned to any other well, regardless if such wells are to

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[10] Texas Oil and Gas, Discussions of Law, Practice and Procedure, Railroad Commission of Texas, at Page 4.
[11] 16 T.A.C. §3.38(b)(1).
[12] 16 T.A.C. §3.38(a)(3).
[13] In many fields in the State of Texas the allocation formula has been indefinitely suspended and the Commission has classified them as Absolute Open Flow, or AOF. The RRC has administratively suspended the allocation formulae for many fields because "each operator from that field has a market, for 100% of the deliverability… for its respective wells". The Commission may reinstate such allowables "…at the request of an operator from a field with a suspended allocation formula or at any time the commission deems reinstatement necessary to protect correlative rights or prevent waste." 16 T.A.C. §3.31(j)(3)(B). A practitioner is advised to consult the applicable field rules and the RRC to confirm whether a field is indeed "AOF".
[14] Texas Oil and Gas, Discussions of Law, Practice and Procedure, Railroad Commission of Texas, at Page 7.

be completed in the same reservoir. In other words, there cannot be double assignment of acreage for allowable purposes.[15]

The Commission has a wide degree of latitude in determining the formula and may base it on productive acreage, initial potential, net-acre feet, deliverability, pressure, or some varying combination thereof. Productive acreage is, therefore, not the only basis for determining an allowable,[16] and as such, the RRC may determine an allowable based upon non-acreage terms. A potential landmine to consider is a situation where a retained acreage clause is tied to governmental authority, but your allocation formula does not even use acreage as part of the calculation.

Consider that the field rules attached as Exhibit "A" hereto have classified gas as associated-prorated, whereby the Commission employs a formula based upon 5% allocation among all individual proratable wells producing in the field and 95% allocation among the individual wells in the proportion that the *deliverability* of that well bears to all pro-ratable wells producing from the field. This aspect of the rule is derived primarily from deliverability. However, the same field rules provide that the maximum daily oil allowable is determined by multiplying the number of acres in the proration unit by 13.0 barrels per acre, i.e. this aspect of the rule is derived from an acreage component.

A. Tolerance Acreage.

The Commission defines tolerance acreage as being "[a]creage within a lease, pooled unit, or unitized tract that may be assigned to a well for proration purposes pursuant to special field rules in addition to the amount established for a prescribed or optional proration unit."[17] As noted by the Commission, tolerance acreage provisions were designed for field rules to incorporate "scrap acreage".[18] However, please note that the Commission distinguishes "tolerance acreage" from "surplus acreage", insofar as "tolerance acreage is defined in context with proration regulation, while surplus acreage is defined by this rule only in context with well density regulation."[19] Again, there is a distinction between density and proration.

Choosing your words carefully matters when your retained acreage provision allows you to hold a proration unit tied to the maximum allowable. This issue was a particular factor in *Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.* as discussed below. Remembering that the first step is to consult the field rules, consider that, hypothetically, if you had a well drilled in the Phantom (Wolfcamp), the Special Field Rules allow tolerance acreage of ten percent for a gas proration unit, such that you could have a proration unit of 352 acres (i.e. 320 acres plus 32 acres).[20] However, the Special Field Rules allow no such additional tolerance acreage for oil wells and instead limit the proration unit to 320 acres.[21] What if you have a well with a Gas to Oil Ratio such that the well could be reclassified from a gas well to an oil well? See the discussion on GOR and how it may affect retained acreage further below.

B. Statewide Rule 86.

One should note that many of the Commission's rules and regulations have evolved over the years. While certainly not new, horizontal completions are increasingly the new normal, and the Commission adapted existing rules by supplementing with 16 T.A.C. §3.86 ("Statewide Rule 86"), Horizontal Drainhole Wells.

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[15] 16 T.A.C. §3.40. See also, 16 T.A.C. §3.49.
[16] 16 T.A.C. §3.31(j).
[17] 16 T.A.C. §3.38(a)(6).
[18] Texas Oil and Gas, Discussions of Law, Practice and Procedure, Railroad Commission of Texas, at Page 6.
[19] 16 T.A.C. §3.38(a)(5).
[20] See Rule 3(a) in the attached Exhibit "A". As an additional note, consider that the Special Field Rules also allow for "Maximum Proration Unit Size" in the field rules.
[21] See Rule 3(b) in the attached Exhibit "A".

Statewide Rule 86 holds that for both proration units and drilling units, an operator is entitled to assign additional acreage "to each horizontal drainhole well for the purpose of allocating allowable oil or gas production up to the amount specified by applicable rules for a proration unit for a vertical well plus the additional acreage assignment as provided in this paragraph."[22]

Phrased another way, a proper use of Statewide Rule 86 provides additional acreage that you could retain, provided that your retained acreage provision is properly drafted. Attached hereto is the amount of acreage that you are allowed to assign under Statewide Rule 86:

Figure: 16 TAC §3.86(d)(1)

Additional Acreage Assignment

For Fields with a Density Rule of 40 Acres or Less

Horizontal Drainhole Displacement, ft	Additional Acreage Allowed, acres
100 to 585	20
586 to 1,170	40
1,171 to 1,755	60
1,756 to 2,340	80
2,341 to 2,925	100
2,926 to 3,510	120
etc. - 585 ft increments	etc. - 20 acre increments

Additional Acreage Assignment

For Fields with a Density Rule Greater Than 40 Acres

Horizontal Drainhole Displacement, ft	Additional Acreage Allowed, acres
150 to 827	40
828 to 1,654	80
1,655 to 2,481	120
2,482 to 3,308	160
3,309 to 4,135	200
4,136 to 4,962	240
etc. - 827 ft increments	etc. - 40 acre increments

Something to consider, however, is that the proration and drilling units must "consist of continuous and contiguous acreage and proration units shall consist of acreage that can be reasonably considered to be productive of oil or gas." Further, it holds that the maximum daily allowable assigned to a horizontal well

[22] 16 T.A.C. §3.86.

must comply with the above-referenced table, unless Special Field Rules specify something different.[23] Again, knowledge of your respective field rule is a critical component in determining the "maximum allowable".

3. *Choosing Your Words Carefully.*

There is a saying that words are free, but how you use them may cost you. As discussed further below, some words which may appear to have a basic meaning take on greater consequence when you incorporate RRC background. One basic word which should be straightforward is "unit", but please consider that "unit" may have multiple meanings in the regulatory context. For instance:

A. A "drilling unit" is "the acreage assigned to a well for drilling purposes" and is the acreage submitted with the Form W-1 drilling permit to show that you have sufficient acreage for density requirements.[24] It is a regulatory term of art with limited purposes and it is not even required for permits on vertical wells anymore.[25]

B. A "proration unit" is "the acreage assigned to a well for the purpose of assigning allowables and allocating allowable production to the well."[26] The actual configuration of a proration unit depends on situations where, as discussed above, acreage is used as part of the allowable calculation. Not all allowables use acreage as a factor.

C. A "voluntary pooled unit" or "pooled unit" is "the acreage formed by joining separately owned tracts, usually to constitute a drilling or proration unit".[27] This is the Unit Declaration filed in the official public records of the county where the land is located. A Voluntary Pooled Unit filed at the courthouse as a Unit Declaration is not the same thing as the pooled unit filed at the Railroad Commission on the appropriate Form P-12.

D. A "forced pooled" unit is the joining of separately owned tracts under Chapter 102 of the Texas Natural Resources Code, or the Mineral Interest Pooling Act ("MIPA").[28]

E. A "production unit" is a defined term seen in certain lease forms, whereby practitioners distinguish the area from voluntary pooled units and prorations units.

In addition to properly defining your underlying "unit", please consider the size of the unit reflected at the Railroad Commission versus the size of the pooled unit filed in the official public records. The units filed at both the Railroad Commission and in the official public records do not *have* to cover the exact same acreage, but it is advisable to make sure that they do. Technically, one could have a pooled unit declaration covering particular lands filed at the RRC on its Form P-12, but have a different unit declaration filed in the official public records that has more than the lands reflected on the Form P-12. The Commission's rules do not specifically mandate that the units be identical, but requires that an operator have at least a "good faith claim to the right to produce the minerals in the tracts that will be penetrated by the well bore."[29]

II. COMMON PROBLEMS ENCOUNTERED WITH RETAINED ACREAGE CLAUSES TIED TO GOVERNMENTAL AUTHORITY

[23] 16. T.A.C. §3.86(d).
[24] 16 T.A.C. §3.38.
[25] 16 T.A.C. §3.5(h).
[26] 16 T.A.C. §3.38.
[27] Ernest E. Smith & Jacqueline Lange Weaver, Texas Law of Oil and Gas, §10.1(B).
[28] TEX. NAT. RES. CODE ANN. §§102.001-102.112.
[29] Quoting correspondence from Colin Lineberry, former Director of the Hearings Section, Railroad Commission of Texas, to author.

1. *Prescribed vs. Permitted.*

Many of the pre-printed lease forms contain clauses that tie retained acreage or pooled units to "governmental authority". In drafting a retained acreage clause you should be cautious of language that ties your retained acreage or pooled units[30] to language such as "prescribed or permitted by governmental authority" but go on to limit the acreage to that which is "prescribed". In drafting your retained acreage language, be aware of what these terms mean. Our earlier discussion of field rules and background information is meant to tie into how these clauses may affect an operator, as illustrated by the following example:

> West Texas Newco is a new player in the Permian and has acquired its first lease for the Phantom (Wolfcamp) Field in Reeves, County, Texas. Miraculously, its lease covers 100% of a 640-acre tract, and its goal is to drill a horizontal oil well with a horizontal displacement of 6,800 feet.

The subject lease, however, includes the following language:

> …provided, however, that should governmental authority having jurisdiction **prescribe or permit** the creation of units larger than those specified, units thereafter may conform substantially in size with those **prescribed** by governmental regulations…. (emphasis added)

The Phantom (Wolfcamp) Field allows standard drilling and proration units of 320 acres under the Special Field Rules, plus optional units of 40 acres. However, the Commission rule for Horizontal Wellbores, 16 T.A.C. §3.86 ("Statewide Rule 86"), also allows horizontal wells to take advantage of additional acreage based upon the horizontal displacement of the well. As reflected in the chart for Statewide Rule 86, with a 6,800-foot horizontal wellbore displacement, the operator would normally be allowed an additional 320 acres, resulting in a total retained acreage of 640 acres.

In our example, however, West Texas Newco is limited to retainer of 320 acres instead of 640 acres because its retained acreage clause asserts that the unit must conform to the unit "*prescribed*" by governmental regulations. In *Jones v. Killingsworth*, 403 S.W.2d 325, 326-327 (Tex. 1966), the court encountered a clause such as the one referenced above and limited the retained acreage to the lower of the "prescribed" or "permitted" acreage. In other words, if Commission rules such as Statewide Rule 86 grant additional acreage based on the length of the horizontal drainhole (i.e. additional acreage is "permitted"), but the minimum acreage "prescribed" by the RRC is the basic drilling and proration unit outlined in the field rules, such language would prevent your retainer of the additional 320 acres obtained pursuant to Statewide Rule 86.

Additionally, remembering to consult your field rules, consider that certain field rules actually use the word "prescribed" in identifying the proration unit. See the discussion in *XOG v. Chesapeake Exploration* below for field rules that use the term "prescribed" for allocating allowable gas production.

2. *"Maximum Allowable".*

As discussed above, allowables are an integral tool in the Commission's ability to prevent waste and

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[30] Please note that many of the governmental authority cases, such as *Jones v. Killingsworth*, review the language in terms of pooling authority. While this paper is necessarily focused on retained acreage provisions, you are advised to ensure that your retained acreage provisions are consistent with your pooling provisions. Phrased another way, you are advised to make sure that your retained acreage provisions always allow you to retain the entirety of any acreage included within a pooled unit. For further reading, please see H. Philip "Flip" Whitworth & D. Davin McGinnis, *Square Pegs, Round Holes: The Application and Evolution of Traditional Legal and Regulatory Concepts for Horizontal Wells*, 7 TEX. J. OIL GAS & ENERGY L 177, 209 (2012).

provide for the orderly production of oil and gas, and you will continue to find pre-printed lease forms that allow for larger units when it is necessary for obtaining the "maximum allowable". Generally speaking, including in your retained acreage clause language permitting enlargement of the retained acreage in order to obtain the maximum allowable is a good thing. However, as referenced above, it may be a problem if your allocation formula does not use acreage as a determining basis.

Again, it is critical that you are familiar with the specifics of your respective field rules and understand how they interact with your retained acreage clause. By way of example, a client had a well with lease line spacing of 467/1200. Their retained acreage provision was as follows:

> If larger units than any of those allowed under the terms of this Lease are required under any governmental rule or order in order to **obtain the maximum allowable** from any well to be drilled, such units may be established or enlarged to conform to the size **permitted under such governmental rule**…. (emphasis added)

The land department knew what field they had completed the well in, but no one actually looked up the specific field rule order. Many in the land department saw "467/1200" and just automatically defaulted to thinking that the field was governed under Statewide Rules. As such, they had assumed that the acreage they could retain was the standard drilling and proration unit plus the additional acreage under Statewide Rule 86 for its lateral.

A quick review of the field revealed that the rules were actually Special Field Rules rather than Statewide Rules. The Special Field Rules had a separate formula, based on acreage, that allowed for approximately *three times* what they had assumed they could retain under Statewide Rules plus Statewide Rule 86. In not fully analyzing the Special Field Rules, the client almost missed the biggest issue of all – the allocation formula allowed the retention of more acreage.

But the above should be taken with a caveat – a party should not just assume that more acreage equals more allowable. While it could be true that more acreage equals more allowable, an operator should be careful in determining whether the acreage permitted under "maximum allowable" is indeed necessary to achieve its top allowable rates. By way of example, assume that you have an oil well in the Phantom Wolfcamp that produces 500 barrels of oil per day. If the field rules allow for a maximum daily allowable for oil by multiplying the number of acres in its proration unit by 13.0 barrels per acre, then 13.0 barrels times 320 acres in a standard proration unit equals 4160 barrels per day! If an operator attempts to hold more acreage than 320 under the guise of achieving a maximum allowable, it may open itself up to claims that it did not act in a good faith basis in retaining such acreage. This issue was brought to attention in *Endeavor v. Discovery* as discussed further below.

3. *Change in GOR.*

As referenced above, a potential landmine to be wary of is changes in the production characteristics of an existing well and how such a change affects the acreage you are allowed to retain. The RRC defines what is an "oil well" and what is a "gas well" by the Gas to Oil Ratio, or the "GOR". Specifically, the GOR is defined as the ratio of "2,000 cubic feet of gas per barrel of oil produced".[31] If your well, originally classified as a gas well, ends up producing less than 2000 cubic feet of gas per barrel of oil produced, then the Commission may change its classification to an oil well, and vice-versa. This may be especially important in your drafting if the client company wishes to drill or recomplete another well on its retained acreage.

[31] 16 T.A.C. §3.49.

Practically all of the time, your retained acreage will differ upon whether it pertains to a gas well or an oil well. For example, if your field rules call for 160 acres for gas and 40 acres for oil, and your previously classified gas well passes under the GOR threshold and produces more oil, then the well will be reclassified as an oil well. Under many leases, the retained acreage would be reduced to the acreage allowed for oil under the field rules, i.e. 40 acres. The reverse may be that you have an oil well and 40 acres, but the gas ratio goes up in your production and it is then classified by the RRC as a gas well. Unless your lease allows you to revise retained acreage upwards (which most do not), then in the second scenario you could not produce that well because you do not have enough acreage, i.e., you have 40 acres but need 160 acres to produce the full allowable. This is an untenable situation.

The court in *Hunt Oil Company v. H.E. Dishman* addressed a situation such as this where a gas well experienced a change in the GOR. The court opined that, without adherence to the rework provisions of the lease, the change in GOR triggered the dissolution of the gas unit, and the parties were entitled to retain only the 40 acres allocated to an oil well. Thus, changing classification from a gas well to an oil well resulted in lost acreage. Specifically, the court held that the:

> …agreement made *no express provision controlling a well that would change from oil to gas or from gas to oil production*. In this situation we think the problem should be considered as though two different locations were producing - one as a gas well of 320 acres and the other an oil well of 40 acres. If the gas well in this example should cease production and no effort was made to renew its life, the 320 acres would revert to the lessor. Likewise, if such an oil well ceased production and no effort was made to renew it, the 40 acres would likewise revert. That the wells occupied the same location should not require a different solution under the facts before us…. Consequently, we hold that after the end of gas production in Dishman-Lucas No. 4 and failure to attempt reworking operations looking to further gas production, Hunt lost its determinable fee in the 320 mineral acres, except the 40-acre area for the well as an oil well…. Hunt argues that if a well originally holding 320 acres may later be cut to 40 acres under the settlement agreement, then a well holding 40 acres should likewise upon later production of gas, cover 320 acres. *We are not persuaded by this argument*.[32]

4. *Plats and the Statute of Frauds.*

An additional issue to consider is the filing of a plat with your respective proration unit and how that translates with respect to the Statute of Frauds. For instance, consider the following retained acreage provision:

> Upon expiration of the primary term or cessation of continuous drilling operations, whichever is later, this Lease shall terminate as to all the lands and depths then covered thereby save and except those lands and depths ***located within a governmental proration unit assigned*** to a well producing oil or gas in paying quantities, with each such governmental proration unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for obtaining the maximum producing allowable for the particular well… (emphasis added)

Under this provision, you would be required to show what acreage the operator has assigned to a particular proration unit. At the Commission, this is normally accomplished via the filing of a plat with the RRC. However, it should be noted that there are certain field rules which do not require the filing of a plat at

[32] Hunt Oil Company v. H.E. Dishman, 352 S.W.2d 760, 764 (Tex.App.-Beaumont 1961).

the RRC. Further, filings at the RRC are not the same as filing a plat of record in the official public records of the county in which the land is located.[33]

> By way of example, the Phantom (Wolfcamp) asserts that:
>
> the determination of acreage credit in this field, operators shall file for each oil or gas well in this field a Form P-15 Statement of Productivity of Acreage Assigned to Proration Units. On that form or an attachment thereto, the operator shall list the number of acres that are being assigned to each well on the lease or unit for proration purposes. For oil or gas wells, operators shall be required to file, along with the Form P-15, a plat of the lease, unit or property; ***provided that such plat shall not be required to show individual proration units***. (emphasis added).

So, the operator is not required to show the individual proration units in this field. But that does not mean that it is not a good idea to do so anyway. Regarding the regulatory structure, even if the field rules do not require a plat, an operator typically has the option to file one.

Additionally, the release of acreage is a transfer of real property and is therefore subject to the Statute of Frauds, which is codified in §26.01 of the Texas Business & Commerce Code. Texas case law suggests that, in addition to being in writing and signed by the bound person, a document transferring real property must furnish within itself, or by reference to some other existing data, the particular land to be identified with reasonable certainty.[34] As the Court in in *U.S. Enterprises, Inc. v. Dauley* noted, descriptions without boundary lines, beginning points, or other means by which the acreage can be located have often been held to be insufficient under the Statute of Frauds.[35] Smaller maps may be deficient in terms of legal description because they often fail to adequately describe the surveys in which the properties are located. In situations where the boundaries do not coincide with survey lines or follow established tract boundaries, it is unlikely that the map would provide a sufficient legal description which may be "…identified with reasonable certainty."[36]

Accordingly, it is recommended that a plat be prepared with enough specificity that a person could identify the retained tract with reasonable certainty, and that you file a copy of same in *both* the official public records of the county in the which the land is located and with the RRC.

5. *Allocation Wells.*

The issue of production sharing agreements wells and allocation wells (collectively referred to herein as "Allocation Wells"[37]) could be a distinct paper by itself. Without commenting one way or the other on whether Allocation Wells are proper, it should be noted that they continue to be attacked.[38] Further, the RRC's language on Allocation Well permits does not exactly provide a warm and fuzzy feeling that Allocation Wells are on solid ground:

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[33] See, Tex. Property Code, §13.001. A conveyance of real property or an interest in real property or a mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed for record as required by law. Also, see Tex. Property Code §13.002. An instrument that is properly recorded in the proper county is… notice to all persons of the existence of the instrument…

[34] U.S. Enterprises, Inc. v. Dauley, 535 S.W. 2d 623, 627 (Tex. 1976).

[35] *Id.*, at 628.

[36] See, Terry Cross, *The Ties that Bind: Preemptive Rights and Restraints on Alienation that Commonly Burden Oil and Gas Properties,* 5 Tex. Wesleyan L. Rev. 193, 218 (1999).

[37] Please note that there are different meanings for a "Production Sharing Agreement Well" and an "Allocation Well", as those terms are used at the Commission, and that the collective use of "Allocation Well" here is for convenience only.

[38] See, https://www.oilandgaslawyerblog.com/2018/03/challenge-devon-allocation-well.html and reference therein to Plaintiff's Original Petition for Judicial Review in Cause No. D-1-GN-18-001111, styled, Monroe Properties , Inc., SRO Land & Minerals, L.P., and the Lee M . Stratton Living Trust, Mary Elizabeth Stratton, Trustee v. Railroad Commission of Texas, 53rd Judicial District, Travis County, Texas.

> 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 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. (emphasis added)

Allocation Wells have been drilled in the State of Texas for several years now, and operators are increasingly relying upon them for efficient development of minerals. In situations where an underlying lease does not address Allocation Wells, it is recommended that clients obtain production sharing agreements, whereby the affected parties agree to the allocation of production as set forth therein and amend the terms of their leases insofar as is necessary to allow the drilling and production of Allocation Wells. However, as operators continue to move forward and continue to be lured by the sirens' song of Allocation Wells, some operators have noted that obtaining production sharing agreements can be both difficult and time consuming. Some operators are avoiding the production allocation agreements altogether by obtaining new oil and gas leases that proactively incorporate Allocation Well language.

The concepts in an oil and gas lease are like parts of a clock, whereby all the moving parts must work in unison. With leases that incorporate Allocation Well concepts, the practitioner drafting said lease needs to confirm that retained acreage concepts have also been incorporated. Consider the following provision:

> Sharing Well. In the event a Sharing Well is drilled the following provisions shall apply: "Sharing Well" means any horizontal well open for production on the Leased Premises or lands pooled therewith and also located on lands adjacent to the Leased Premises or lands pooled therewith. "Allocation Tract" means the Leased Premises, the lands pooled with the Leased Premises, if any, and the lands on which any portion of the Sharing Well is also located. Production from a Sharing Well shall be allocated to each Allocation Tract proportionately, allocating to each such tract its proportionate share of the Sharing Well as depicted on the final "as drilled" plat. Each Allocation Tract's pro rata share shall be calculated by a fraction, the numerator of which is each Allocation Tract's share of said "as drilled" wellbore, and the denominator of which is the "as drilled" horizontal wellbore open for production on the "as drilled" plat of the Sharing Well. Royalties payable to each Allocation Tract shall be paid in accordance with the terms of this Lease, the pooling agreement if the Lease is pooled, and the terms applicable to production from other Allocation Tracts. Operations with respect to, or production from, any Sharing Well shall be deemed actual operations on, or a production from, the Leased Premises for all purposes except for the calculation and payment of royalties.
>
> Lessee shall designate the acreage surrounding each well to be retained under this provision (herein, a "Production Unit") by filing a written instrument, with plat, of each Production Unit in the official public records of the county in which the Leased Premises are located on before sixty (60) days from the expiration of the primary term or the cessation of the continuous

> drilling program, whichever occurs later. The Production Unit so designated shall include all lands included within a governmental proration unit assigned to a Sharing Well producing oil or gas in paying quantities, with each such Production Unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas for obtaining the maximum producing allowable for the particular Sharing Well….

Please note that the above provision is not the entirety of the retained acreage provision, but is an example of a provision that relates to Allocation Wells. A practitioner is advised to ensure that a provision such as the above, if used, be consistent with and incorporate retained acreage provisions elsewhere in the respective lease for retained leasehold acreage and/or pooled units to ensure that the drafter accounts for each scenario (e.g. retained lease tract, retained pooled unit, and/or retained "Production Unit").

III. RECENT CASES.

The above sections were intended to provide general background on the Commission's rules and regulations and to identify some landmines commonly seen in tying retained acreage provisions to governmental authority. More recently, however, there has been additional case law which suggests that some of the landmines affecting retained acreage provisions may have detonated.

1. *ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd.*

The case of *ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd.* ("Vaquillas") is illustrative of how critical it is to understand the interplay between the Commission's rules and regulations and the retained acreage provision. In this case, ConocoPhillips thought it had developed its two leases in a manner sufficient to hold all of the combined 33,362.79 acres covered by the leases. However, the interpretation of a retained acreage clause in relation to the Commission's rules resulted in ConocoPhillips being required to release 15,351 acres out of that acreage. The case was subsequently settled, and the holding was vacated; however, the cautionary nature of the tale is very much worth examining.

In this case, ConocoPhillips believed it was allowed to retain 640 acres per well. However, the retained acreage provision in both leases had the following language:

> …Lessee covenants and agrees to execute and deliver to Lessor a written release of any and all portions of this lease which have not been drilled to a density of at ***least 40 acres for each producing oil well and 640 acres for each producing or shut-in gas well,*** except that ***in case any rule adopted*** by the Railroad Commission of Texas or other regulating authority for any field on this lease provides for a spacing or proration establishing different units of acreage per well, then ***such established different units shall be held*** under this lease by such production, in lieu of the 40 and 640-acre units above mentioned…[39] (emphasis added).

The field rules (which are not identified in the Memorandum Opinion) purportedly adopt lease line spacing of 467/1200, but do not adopt a specific density provision. The court looked to Statewide Rule 38 and the table of density (as noted in the chart above) and found that the standard drilling unit for a gas field had a density of forty (40) acres per well for both oil and gas wells. The court went on to state that "[b]ecause this standard acreage is 'different' from the initial acreage set forth in the retained acreage clause, the standard acreage controls the number of acres ConocoPhillips was entitled to retain under the leases."[40] Ergo, ConocoPhillips was only entitled to retain 40 acres around each well, and was required to release the

[39] ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd., No. 04-15-00066-CV, 2015 WL 4638272, at *1 (Tex. App.—San Antonio Aug. 5, 2015, pet. granted, judgm't vacated w.r.m.) (mem. op.).
[40] *Id.*, at *6.

remainder.

ConocoPhillips had several arguments in its defense. It proposed that Statewide Rule 38 established a minimum number of acres to drill a well, not a maximum. It also argued that if the court gave effect to the minimum acreage required under Statewide Rule 38, then the use of 640 acres for a gas well in the retained acreage provision would never apply. It also argued that the provision conflicted with the pooling provision.

While the court disposed of each of the above arguments, it would appear, in general, that the court went back to the basic proposition that the parties were free to contract amongst themselves. It held that:

> [a]lthough ConocoPhillips may not have "fully anticipated the consequences" of tying the retained acreage clause to a field rule that provided for spacing that established different units of acreage per well**, this court is not allowed to rewrite the parties' lease**. See *Am. Mfrs. Mut. Ins. Co. v. Schaefer*, 124 S.W.3d 154, 162 (Tex. 2003); see also Scott C. Petry, Drafting the Retained Acreage Clause: The Effect of Governmental Authority on Retained Acreage, State Bar of Tex. Prof. Dev. Program, 27TH ANNUAL ADVANCED OIL, GAS AND ENERGY RESOURCES LAW COURSE 3 (2009) (noting when a lease ties the retained acreage clause to governmental authority, the parties may not "fully anticipate the consequences of doing so").(emphasis added)[41]

Finally, the court asserted that "[t]he only dispute relates to the number of acres ConocoPhillips is entitled to retain."[42]

A. But when is a field rule not "any rule adopted"? Statewide vs. Special Field Rules.

Lord Byron is purported to have once said "a drop of ink may make a million think." In drafting a retained acreage provision, a practitioner should exercise greater caution with the use of the word "adopted" insofar as it applies to the RRC's rules and regulations. As referenced above, one of the arguments put forth by ConocoPhillips was that if the court gave effect to the minimum acreage required under Statewide Rule 38, then the use of 640 acres for a gas well in the retained acreage provision could never be put into effect. The court's response, and citation to the case of *ConocoPhillips Co. v. Ramirez* ("Ramirez"), made an interesting distinction.

First, the court in *Vaquillas* asserted that the exception being discussed was only applicable if a field rule was "adopted". The court noted that if a rule was not "adopted" then the general applicability of 40 acres for oil and 640 acres for producing or shut-in gas would have remained in effect. Per Black's Law Dictionary, the term "adopted" means "to accept, appropriate, choose, or select"; however, the Court in *ConocoPhillips Co. v. Vaquillas Unproven Minerals, Ltd.* took a more limited view. Citing the *Ramirez* case in a footnote, it asserted that "[f]ield rules are distinct from statewide rules, and only a specially adopted field rule, as opposed to statewide rules, triggers the exception in the retained acreage clause".[43] Thus, the court made a distinction between Statewide and Special Field Rules on the basis of the word "adopted".

In *Ramirez,* the court was faced with a similar fact scenario as in *Vaquillas*, but reached a different result. In that case, the court examined the following provision:

At the end of five years after the expiration of the primary term hereof, Lessee covenants and

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[41] *Id.*, at *7.
[42] *Id.*, at *9.
[43] *Id.*, at *5, n.1. (citing ConocoPhillips Co. v. Ramirez, No. 04-05- 00488-CV, 2006 WL 1748584, at *2 (Tex. App.—San Antonio June 28, 2006, no pet.)).

> agrees to execute and deliver to Lessor a written release of any and all portions of this lease which have not been drilled to a density of at least ***forty (40) acres for each producing oil well*** and ***three hundred and twenty (320) acres for each producing or shut-in gas well from depths above 5,000 feet from the surface of the ground and 640 acres for each producing or shut-in gas well from depths below 5,000*** feet from the surface of the ground ***except that in case any rule adopted*** by the Railroad Commission of Texas or other regulating authority for any field on this lease provides for a spacing or proration establishing different units of acreage per well, ***then such established different units shall be held under this lease*** by such production, in lieu of the units above mentioned . . . .[44]

As you can see, the language in *Vaquillas* was similar to the language in *Ramirez*. However, in *Ramirez*, the court distinguished between Statewide Rules versus Special Field Rules via focus on the word "adopted". While acknowledging that "the Railroad Commission of Texas has adopted general rules applicable throughout the State…" citing therein *R.R. Comm'n of Tex. v. WBD Oil & Gas Co.*, 104 S.W.3d 69, 70, 46 Tex. Sup. Ct. J. 442 (Tex. 2003), the court went on to assert that the Statewide Rules are "promulgated in accordance with the rulemaking provisions of the Texas Administrative Procedure Act" whereas "field rules, on the other hand, apply to a specific field and a specific group of operators and must therefore be adopted under the adjudication provisions of the TAPA."[45] The court went on to assert that "[t]hese differences make clear that a statewide rule is not a field rule…[and] because statewide Rule 37(b) and Former Rule 38(b)(1) were not 'adopted' 'for' the field …. they are not field rules and therefore do not trigger the 'except' clause…."

The moral of both *Vaquillas* and *Ramirez* is that every word, including "adopted", has meaning. Accordingly, in drafting your retained acreage provision, say what you mean and mean what you say. Also, if it is your goal to incorporate Statewide Field Rules, it needs to be explicitly set forth.

2. *Endeavor Energy Resources LP v. Discovery Operating*.

The Texas Supreme Court issued *Endeavor Energy Resources LP v. Discovery Operating* on April 13, 2018, and brought to bear additional clarification on the interplay of Commission rules with retained acreage provisions. In that case, Endeavor Energy Resources, L.P. and Endeavor Petroleum, L.L.C. (collectively, "Endeavor") had leases with the following retained acreage provision:

> ...the lease shall automatically terminate as to all lands and depths covered herein, ***save and except*** those lands and depths located within a ***governmental proration unit assigned to a well*** producing oil or gas in paying quantities and the depths down to and including one hundred feet (100') below the deepest productive perforation(s), with each such governmental proration unit to contain the number of acres required to comply with the applicable rules and regulations of the Railroad Commission of Texas ***for obtaining the maximum producing allowable*** for the particular well.[46]

Remember the recommendation is to always consult the field rules in question. The field at issue was the Spraberry Trend, and per the field rules then in effect, the standard drilling and proration units were established at eighty (80) acres. However, as the Court noted, the field rules were amended in 2008, and granted operators the election to assign "a tolerance of not more than EIGHTY (80) acres of additional unassigned lease acreage to a well on an EIGHTY (80) acre unit and shall in such event receive allowable credit

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[44] ConocoPhillips Co. v. Ramirez, 2006 Tex. App. LEXIS 5710, at *2 (Tex. App. – San Antonio 2006).
[45] *Id.*, at *5.
[46] Endeavor Energy Resources, L.P. and Endeavor Petroleum, L.L.C. v. Discovery Operating, Inc. and Patriot Royalty and Land, L.L.C, No. 15-0155, slip op., at 16 (Tex. Apr. 13, 2018).

for not more than ONE HUNDRED SIXTY (160) acres."[47] Accordingly, the standard density was 80 acres, but the Special Field Rules *allowed tolerance of an additional 80 acres in order to achieve the maximum allowable*.

Notwithstanding the above, Endeavor drilled four wells, and assigned proration units of 81.21 acres each at the RRC for two of the wells, and 81 acres each for the two remaining wells, even though they were authorized to assign proration units of up to 160 acres for each. Thereafter, the primary terms of Endeavor's leases expired. Patriot Royalty and Land, LLC ("Patriot") reviewed the Endeavor leases in conjunction with the proration unit plats filed at the RRC, concluded that the leases terminated insofar as to the lands outside of the prorations units, and leased same under new leases from the mineral owners. Patriot then assigned the new leases to Discovery Operating, Inc. ("Discovery"), which proceeded to drill an additional four wells under the new leases.[48]

Endeavor subsequently came around and asserted that the governmental proration units allowed 160 acres for each of its previous four (4) wells, and that Discovery's leases were therefore invalid. Asserting that it had mistakenly failed to assign 160 acres to each well, Endeavor then attempted to file new plats with the Commission that reflected 160 acres for each well. Discovery filed a trespass to try title suit, and the trial court ruled in Discovery's favor, which was affirmed by the appeals court.

The Texas Supreme Court provides guidance on contract construction as well as various aspects of the oil and gas lease and interplay with the Commission's rules and regulations, but focuses on two primary aspects of the retained acreage provision: (1) the language regarding the "proration unit assigned to a well" and (2) "the maximum allowable".

A. Proration Unit Assigned to a Well.

In this case, Endeavor made the argument that the retained acreage provision was ambiguous because it did not assert whether it was Endeavor that assigned acreage to the proration unit or it was actually the Commission that assigned the acreage to the proration unit. The Court declined to adopt the "Commission assigns" position for several reasons. First, it noted that for there to be an ambiguity, both parties interpretations must be reasonable.[49] In this situation, the Court found that there was no ambiguity "because the only reasonable construction of that reference is to the operator's assignment of a proration unit through its filing of a proration plat with the Commission".[50] The Court points to the language of the field rules which clearly state that operators are to file certified plats which provide the necessary components for determining acreage credit. Finally, the Court notes that numerous amici, including the Railroad Commission itself, all assert and agree that the operator, rather than the Commission, assign the relevant lands to proration units.[51]

A second argument of Endeavor was that the leases should not be read to make leasehold interests dependent upon regulatory filings because, in essence, the Commission cannot adjudicate property rights. The Court dismisses this argument and notes that the parties are free to contract amongst themselves. Specifically, it noted that

> …the parties are free to agree that the operator's leasehold interest will survive and continue only to the extent of that assignment. **That is exactly what the parties did here.** The retained-

[47] *Id.*, at 15, (citing Tex. R.R. Comm'n, *Final Order Amending Field Rule Nos. 2 and 3 in the Spraberry (Trend Area) Field Various Counties, Texas*, Oil and Gas Docket No. 08-0259977 (Dec. 16, 2008)).
[48] *Id.*, at 5.
[49] *Id.*, at 18.
[50] *Id.*, at 19.
[51] *Id.*, at 21.

> acreage clauses that govern Endeavor's rights following the expiration of the leases' primary terms unambiguously provides that those rights extend only to a proration unit "assigned to" a well, and within this regulatory context that can only refer to the operator's assignment. The operator's assignment affects the operator's leasehold interest because Endeavor's contractual agreement, made within the context of the Commission's applicable rules, requires that result.[52] (emphasis added)

B. Obtaining the Maximum Allowable.

As noted earlier in this article, one should be cautious of assuming that more acreage equals more allowable. However, Endeavor's second argument was exactly that. The Court noted that "Endeavor argues that the leases' references to 'maximum producing allowable' means that each proration unit automatically consists of the greatest amount of acreage the Commission's rules permit an operator to assign, because that amount will result in the 'maximum producing allowable.'"[53] The Court disagreed.

The Court focused on what Endeavor actually assigned to the proration unit and ruled that if Endeavor's "regulatory filings included an amount sufficient to obtain the maximum producing allowable, then that amount—however small it might be—would be excepted from termination under the retained-acreage clauses." Per the Special Field Rules in question, the maximum daily allowable for an 80-acre proration unit was 515 barrels per day. It was undisputed that "Endeavor's wells could not achieve the maximum producing allowable for that amount of acreage" under the field rules, and that the Commission's hearing examiner asserted that "the 81.0 acre allowables will allow the wells to produce an amount of oil far in excess of the amount of oil the wells are currently capable of producing."[54] As such, Endeavor had already assigned the acreage necessary for it to achieve a full allowable for its wells.

While the Court focused on what was *actually* assigned by Endeavor, it also struck a note of caution worth repeating here:

> To retain 160 acres per well, Endeavor needed to actually assign 160 acres to each well. Rule 3 provides that Endeavor could have attempted to assign to each of its existing proration units an additional 80 acres of "tolerance acreage." Although such an assignment would hypothetically raise each well's maximum producing allowable, when productive acreage is a component of the maximum producing allowable—as it is here—the ***operator must "verify… that additional acreage is actually necessary or required to achieve the maximum allowable***." Philip C. Mani, Interpreting and Drafting Retained Acreage Provisions—Partial Termination of Leasehold Rights, STATE BAR OF TEX. OIL, GAS, & MINERAL TITLE EXAMINATION COURSE, at 6 (2015). Indeed, if a well "is draining a certain amount of acreage, but the operator intends to claim more than that amount, the operator may open itself up to claims that it is not acting in good faith in purporting to retain a substantially greater amount of acreage." Id.; see also Petry at 4 ("If the technical evidence clearly show that the well is draining eighty (80) acres, but the client operator is claiming three hundred twenty (320) acres under the maximum allowable, that client may open itself up to claims that it did not act in good faith in retaining the full 320 acres."). Of course, this question is not directly before us, as Endeavor did not assign any tolerance acreage to its proration units….(emphasis added)[55]

Given the above-referenced statement, one should be cautious in asserting "more acreage equals more

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[52] *Id.*, at 21.
[53] *Id.*, at 22.
[54] *Id.*, at 24.
[55] *Id.*, at 25.

allowable" if the additional acreage is not necessary to produce the full allowable.

3. *XOG v. Chesapeake Exploration*.

The Texas Supreme Court also issued *XOG v. Chesapeake Exploration* on April 13, 2018, and examined similar issues, but with some noticeable differences in the language used. In this case, XOG Operating, LLC and Geronimo Holding Corporation (collectively, "XOG") entered into a term assignment with Chesapeake Exploration Limited Partnership and Chesapeake Exploration, LLC (collectively, "Chesapeake") which had the following retained acreage provision:

> **save and except that portion** of [the leased acreage] **included within the proration** or pooled **unit of each well** drilled under this Assignment and producing or capable of producing oil and/or gas in paying quantities. **The term "proration unit"** as used herein, **shall mean the area within the surface boundaries of the proration unit then** established or **prescribed by field rules** or special order of the appropriate regulatory authority for the reservoir in which each well is completed**. In the absence of such field rules** or special order, **each proration unit shall be deemed to be 320 acres** of land in the form of a square as near as practicable surrounding…a well completed as a gas well producing or capable of production in paying quantities….[56] (emphasis added)

Chesapeake drilled six wells and filed Form P-15's (Statement of Productivity of Acreage Assigned to Proration Units) for the wells that were less than what was allowed for under the retained acreage provision. XOG asserted that the Form P-15's and the acreage designated on said Form P-15's were what controlled the acreage held under the retained acreage clause. Chesapeake disagreed and asserted that the acreage to be retained for each well was the acreage "prescribed by field rules".[57]

Again, please remember the recommendation to always consult the field rules in question. The field at issue in this case for five of six wells was the Alliston Britt Field, and the field rules assert that:

> **The acreage assigned to the individual gas well for the purpose of allocating allowable gas production thereto shall be known as the prescribed proration unit.** No proration unit shall consist of more than three hundred twenty (320) acres except as hereinafter provided; . . . provided that tolerance acreage of ten (10) percent shall be allowed for each unit so that an amount not to exceed a maximum of three hundred fifty-two (352) acres may be assigned. **For allowable assignment purposes, the prescribed proration unit shall be a three hundred twenty (320) acre unit**, and each unit containing less than three hundred twenty (320) acres shall be a fractional proration unit.[58]

Noting that the *Endeavor* case set forth the principles the Court used in its analysis, the Court asserted that retained acreage "…provisions are contractual and vary widely because parties are free to contract in any way they choose not prohibited by law".[59] "Simply put, the retained acreage provision in XOG had different language than in Endeavor, and use of the word "prescribed" had meaning. As the Court noted,

> …the field rules in Endeavor referred to assignments by operators "claim[ing]" acreage. The

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[56] XOG Operating, LLC and Geronimo Holding Corporation v. Chesapeake Exploration Limited Partnership and Chesapeake Exploration, LLC, No. 15-0935, slip op., at 3 (Tex. Apr. 13, 2018).
[57] *Id.*, at 5.
[58] *Id.*, at 4.
[59] *Id.*, at 6, (citing Endeavor Energy Resources, L.P. and Endeavor Petroleum, L.L.C. v. Discovery Operating, Inc. and Patriot Royalty and Land, L.L.C, No. 15-0155, slip op. (Tex. Apr. 13, 2018), at *7).

> field rules in this case also refer to "assigned" acreage, but unlike the field rules in Endeavor, they also "prescribe" proration units. The two are not mutually exclusive. More than 50 years ago, in *Jones v. Killingsworth*, we explained that the Railroad Commission may "prescribe" the size of a proration unit while at the same time permitting operators to designate other sizes. That is exactly what the Commission has done in the Allison-Britt Field rules. They prescribe 320 acres but permit slightly larger and fractional units. In Endeavor, neither the retained-acreage provision nor the field rules refer to a "prescribed" proration unit.[60]

XOG makes a further argument that the size of the proration units in the field rules was designed for allowables, not for determining retained acreage. As in Endeavor, the Court dismisses this argument and notes that the parties are free to contract amongst themselves. The Court goes on to state that "…unquestionably, parties can contract as they will within the law, and when it comes to retained-acreage provisions, they do exactly that. The parties and amici curiae in both cases acknowledge that differences abound. This case and Endeavor apply the same principles and ascribe the words the parties chose their plain meaning. That is not confusing."[61]

IV. CONCLUSION.

This article was intended to give you a brief overview and update regarding retained acreage clauses that tie themselves to the rules of the "governmental authority having jurisdiction". Recent case law suggests that the courts will give effect to retained acreage provisions as written and will not engage in revisions outside the four corners. As such, practitioners are advised to to know the regulatory structure and to proactively incorporate the terms.

[60] *Id.*, at 8 (citing Jones v. Killingsworth, 403 SW 2d 325, 328 (Tex. 1965)).
[61] *Id.*, at 9.

EXHIBIT "A"

Amended Field Rules
Phantom (Wolfcamp) Field
Culberson, Loving, Reeves, Ward and Winkler Counties, Texas

RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

OIL AND GAS DOCKET NO. 08-0290788

IN THE PHANTOM (WOLFCAMP) FIELD, CULBERSON, LOVING, REEVES, WARD AND WINKLER COUNTIES, TEXAS

FINAL ORDER
AMENDING THE FIELD RULES FOR THE PHANTOM (WOLFCAMP) FIELD CULBERSON, LOVING, REEVES, WARD AND WINKLER COUNTIES, TEXAS

The Commission finds that after statutory notice in the above-numbered docket heard on September 10, 2014, and May 14, 2015, the presiding examiners have made and filed a report and recommendation containing findings of fact and conclusions of law, for which service was not required; that the proposed application is in compliance with all statutory requirements; and that this proceeding was duly submitted to the Railroad Commission of Texas at conference held in its offices in Austin, Texas.

The Commission, after review and due consideration of the examiners' report and recommendation, the findings of fact and conclusions of law contained therein, hereby adopts as its own the findings of fact and conclusions of law contained therein, and incorporates said findings of fact and conclusions of law as if fully set out and separately stated herein.

Therefore, it is **ORDERED** by the Railroad Commission of Texas that the field rules for the Phantom (Wolfcamp) Field, Culberson, Loving, Reeves, Ward and Winkler Counties, Texas, as set out in Oil & Gas Final Order 08-0277363, are hereby amended and set out in their entirety as follows:

RULE 1: The entire correlative interval from 9,515 feet to 12,447 feet as shown on the log of the Petrohawk Operating Company - Oxy Fee "24" Lease, Well No. 1 (API No. 42-389-32637), Section 24, Block C18, PSL Survey, A-2150, Reeves County, Texas, shall be designated as a single reservoir for proration purposes and be designated as the Phantom (Wolfcamp) Field.

RULE 2: No well for oil or gas shall hereafter be drilled nearer than THREE HUNDRED AND THIRTY (330) feet to any property line, lease line, or subdivision line. There is no minimum between well spacing requirement. The aforementioned distances in the above rule are minimum distances to allow an operator flexibility in locating a well; and the above spacing rule and the other rules to follow are for the purpose of permitting only one well to each drilling and proration unit. Provided however, that the Commission will grant exceptions to permit drilling within shorter distances and drilling more wells than herein prescribed, whenever the Commission shall have determined that such exceptions are necessary either to prevent waste or to prevent the confiscation of property. When exception to these rules is desired, application therefor shall be filed and will be acted upon in accordance with the

provisions of Commission Statewide Rules 37 and 38, which applicable provisions of said rules are incorporated herein by reference.

In applying this rule, the general order of the Commission with relation to the subdivision of property shall be observed.

Provided, however, that for purposes of spacing for horizontal wells, the following shall apply:

a. A take point in a horizontal drainhole well is any point along a horizontal drainhole where oil and/or gas can be produced into the wellbore from the reservoir/field interval. The first take point may be at a different location than the penetration point and the last take point may be at a location different than the terminus point.

b. No horizontal drainhole well for oil or gas shall hereafter be drilled such that the first and last take points are nearer than TWO HUNDRED (200) feet to any property line, lease line or subdivision line.

c. For each horizontal drainhole well, the perpendicular distance from any take point on such horizontal drainhole between the first take point and the last take point to any point on any property line, lease line, or subdivision line shall be a minimum of THREE HUNDRED AND THIRTY (330) feet.

For the purpose of assigning additional acreage to a horizontal well pursuant to the table listed in this Order, the distance from the first take point to the last take point in the horizontal drainhole shall be used in such determination, in lieu of the distance from penetration point to terminus.

In addition to the penetration point and the terminus of the wellbore required to be identified on the drilling permit application (Form W-1H) and plat, the first and last take points must also be identified on the drilling permit application (remarks section) and plat. Operators shall file an as-drilled plat showing the path, penetration point, terminus and the first and last take points of all drainholes in horizontal wells, regardless of allocation formula.

If the applicant has represented in the drilling application that there will be one or more no perf zones or ""NPZ"s"" (portions of the wellbore within the field interval without take points), then the as-drilled plat filed after completion of the well shall be certified by a person with knowledge of the facts pertinent to the application that the plat is accurately drawn to scale and correctly reflects all pertinent and required data. In addition to the standard required data, the certified plat shall include the as-drilled track of the wellbore, the location of each take point on the wellbore, the boundaries of any wholly or partially unleased tracts within a Rule 37 distance of the wellbore, and notations of the shortest distance from each wholly or partially unleased tract within a Rule 37 distance of the wellbore to the nearest take point on the wellbore.

A properly permitted horizontal drainhole will be considered to be in compliance with the spacing rules set forth herein if the as-drilled location falls within a rectangle established as follows:

a. Two sides of the rectangle are parallel to the permitted drainhole and 50 feet on either side of the drainhole;

b. The other two sides of the rectangle are perpendicular to the sides described in (a) above, with one of those sides passing through the first take point and the other side passing through the last take point.

Any point of a horizontal drainhole outside of the described rectangle must conform to the permitted distance of the property line, lease line or subdivision line measured perpendicular from the wellbore.

For any well permitted in this field, the penetration point need not be located on the same lease, pooled unit or unitized tract on which the well is permitted and may be located on an Offsite Tract. When the penetration point is located on such Offsite Tract, the applicant for such a drilling permit must give 21 days notice by certified mail, return receipt requested to the mineral owners of the Offsite Tract. For the purposes of this rule, the mineral owners of the Offsite Tract are (1) the designated operator; (2) all lessees of record for the Offsite Tract where there is no designated operator; and (3) all owners of unleased mineral interests where there is no designated operator or lessee. In providing such notice, applicant must provide the mineral owners of the Offsite Tract with a plat clearly depicting the projected path of the entire wellbore. In the event the applicant is unable, after due diligence, to locate the whereabouts of any person to whom notice is required by this rule, the applicant must publish notice of this application pursuant to the Commission's Rules of Practice and Procedure. If any mineral owner of the Offsite Tract objects to the location of the penetration point, the applicant may request a hearing to demonstrate the necessity of the location of the penetration point of the well to prevent waste or to protect correlative rights. Notice of Offsite Tract penetration is not required if (a) written waivers of objection are received from all mineral owners of the Offsite Tract; or, (b) the applicant is the only mineral owner of the Offsite Tract. To mitigate the potential for well collisions, applicant shall promptly provide copies of any directional surveys to the parties entitled to notice under this section, upon request.

RULE 3a: The acreage assigned to the individual gas well shall be known as a proration unit. The standard drilling and proration units are established hereby to be THREE HUNDRED TWENTY (320) acres. No proration unit shall consist of more than THREE HUNDRED TWENTY (320) acres; provided that, tolerance acreage of ten (10) percent shall be allowed for each standard proration unit so that an amount not to exceed a maximum of THREE HUNDRED FIFTY TWO (352) acres may be assigned. Each proration unit containing less than THREE HUNDRED TWENTY (320) acres shall be a fractional proration unit. All proration units shall consist of continuous and contiguous acreage which can reasonably be considered to be productive of gas. No double assignment of acreage will be accepted.

RULE 3b: The acreage assigned to the individual oil well for the purpose of allocating allowable oil production thereto shall be known as a proration unit. The standard drilling and proration units are established hereby to be THREE HUNDRED TWENTY (320) acres. No proration unit shall consist of more than THREE HUNDRED TWENTY (320) acres except as hereinafter provided. All proration units shall consist of continuous and contiguous acreage which can reasonably be considered to be productive of oil. No double assignment of acreage will be accepted.

If after the drilling of the last well on any lease and the assignment of acreage to each well thereon in accordance with the regulations of the Commission there remains an additional unassigned acreage of less than THREE HUNDRED TWENTY (320) acres, then and in such event the remaining unassigned acreage up to and including a total of FORTY (40) acres may be assigned as tolerance acreage to the last well drilled on such lease or may be distributed among any group of wells located thereon, so long as the proration units resulting from the inclusion of such additional acreage meet the limitations prescribed by the Commission.
The acreage assignable to the individual horizontal oil or gas well shall be determined by the following table:

Horizontal Drainhole Length, feet	**Maximum Proration Unit Size, acres**
0' - 1,500'	320
1,501' - 3,000'	480
3,001' - 4,500'	640
> 4,500'	704

An operator, at his option, shall be permitted to form optional drilling and fractional proration units of FORTY (40) acres, with a proportional acreage allowable credit for a well on fractional proration units.

For the determination of acreage credit in this field, operators shall file for each oil or gas well in this field a Form P-15 Statement of Productivity of Acreage Assigned to Proration Units. On that form or an attachment thereto, the operator shall list the number of acres that are being assigned to each well on the lease or unit for proration purposes. For oil or gas wells, operators shall be required to file, along with the Form P-15, a plat of the lease, unit or property; provided that such plat shall not be required to show individual proration units. There is no maximum diagonal limitation in this field.

RULE 4a: The gas field shall be classified as associated-prorated. The daily allowable production of gas from individual wells completed in the subject field shall be determined by allocating the allowable production, after deductions have been made for wells which are incapable of producing their gas allowables, among the individual wells in the following manner:

FIVE percent (5%) of the field's total allowable shall be allocated equally among all the individual proratable wells producing from the field.

NINETY FIVE percent (95%) of the total field allowable shall be allocated among the individual wells in the proportion that the deliverability of such well, as evidenced by the most recent G-10 test filed with the Railroad Commission bears to the summation of the deliverability of all proratable wells producing from this field.

RULE 4b: The maximum daily oil allowable for each well in the subject field shall be determined by multiplying the number of acres in its proration unit by 13.0 barrels per acre.

RULE 5: A flowing oil well will be granted administratively, without necessity of filing fees unless the Commission requires filing fees in the future for Statewide Rule 13(b)(5)(a) exceptions, a six month exception to Statewide Rule 13(b)(5)(a) regarding the requirement of having to be produced through tubing. A revised completion report will be filed once the oil well has been equipped with the required tubing string to reflect the actual completion configuration. This exception would be applicable for new drills, reworks, recompletions or for new fracture stimulation treatments for any flowing oil well in the field. For good cause shown, an operator may obtain administratively, without necessity of filing fees unless the Commission requires filing fees in the future for Statewide Rule 13(b)(5)(a) exceptions, an extension for an additional three months. If the request for an extension of time is denied, the operator may request a hearing.

RULE 6: An oil well will be granted administratively, without necessity of filing fees unless the Commission requires filing fees in the future for Statewide Rule 51(a) exceptions, a six month exception to the provisions of Statewide Rule 51(a) regarding the 10 day rule for filing the potential test after testing of the well. This will allow for the backdating of allowables on the oil wells without requiring a waiver to be secured from all field operators. This rule will grant the Commission the authority to issue an allowable back to the initial completion date for all oil wells in the field to prevent unnecessary shut-ins to alleviate potential overproduction issues related to the completion paperwork filings and producing the oil wells without tubing. If an extension of time is granted under Rule 5, the exception to Statewide Rule 51(a) under this rule is automatically extended for the additional time.

The exceptions to Statewide Rule 13(b)(5)(a) and 51(a) provided for in the rules adopted in this final order shall be applicable to all wells in the field, regardless of when completion forms are filed and including wells for which completion forms were filed prior to the entry of this order.

RULE 7: For oil and gas wells, Stacked Lateral Wells within the correlative interval for the field that are drilled from different wellbores may be considered a single well for regulatory purposes, as provided below:

1. A horizontal drainhole well qualifies as a Stacked Lateral Well under the following conditions:

a) There are two or more horizontal drainhole wells on the same lease or pooled unit within the correlative interval for the field;

b) Horizontal drainholes are drilled from different surface locations;

c) Each point of a Stacked Lateral Well's horizontal drainhole shall be no more than 300 feet in a horizontal direction from any point along any other horizontal drainhole of that same Stacked Lateral Well. This distance is measured perpendicular to the orientation of the horizontal drainhole and can be illustrated by the projection of each horizontal drainhole in the Stacked Lateral Well into a common horizontal plane as seen on a location plat. Where one drainhole of a Stacked Lateral is longer than that of another drainhole of the Stacked Lateral, the 300 feet maximum shall be measured between the longer lateral and a projection of the shorter lateral along the same path as the existing lateral; and

d) There shall be no maximum or minimum distance limitations between horizontal drainholes of a Stacked Lateral Well in a vertical direction.

2. A Stacked Lateral Well, including all surface locations and horizontal drainholes comprising such Stacked Lateral Well, shall be considered as a single well for density and allowable purposes.

a) All points between the first Take Point and the Last Take Point on all drainholes of a Stacked Lateral Well, including all Take Points on any horizontal drainhole that is longer than the Record Well, must fall within a box with a surface area equal to the number of acres to be assigned to the Stacked Lateral Well for allowable purposes. Two sides of the box will be formed by the two horizontal laterals that are the farthest apart in a horizontal direction, which shall be no greater than the 300 foot requirement in Item 1 above.

b) For the purpose of assigning additional acreage to the Stacked Lateral Well pursuant to the table in Rule 3 above, the horizontal drainhole displacement shall be calculated based on the distance from the first take point to the last take point in the horizontal drainhole for the Record Well, regardless of the horizontal drainhole displacement of other horizontal drainholes of the Stacked Lateral Well.

3. Each surface location of a Stacked Lateral Well must be permitted separately and assigned an API number. In permitting a Stacked Lateral Well, the operator shall identify each surface location of such well with the designation "SL" in the well's lease name and also describe the well as a Stacked Lateral Well in the "Remarks" of the Form W-1 drilling permit application. The operator shall also identify on the plat any other existing, or applied for, horizontal drainholes comprising the Stacked Lateral Well being permitted.

4. To be a regular location, each horizontal drainhole of a Stacked Lateral Well must comply with (i) the field's minimum spacing distance as to any lease, pooled unit or property line, and (ii) the field's minimum between well spacing distance as to any different well, including all horizontal drainholes of any other Stacked Lateral Well, on the same lease or pooled unit in the field. Operators may seek exceptions to Rules 37 and 38 for Stacked Lateral Wells in accordance with the Commission's rules, or any applicable rule for this field.

5. Operators shall file separate completion forms for each surface location of the Stacked Lateral Well. Operators shall also file a certified as-drilled location plat for each surface location of a Stacked Lateral Well showing each horizontal drainhole from that surface location, confirming the well's qualification as a Stacked Lateral Well and showing the maximum distances in a horizontal direction between each horizontal drainhole of the Stacked Lateral Well.

6. In addition to the completion forms for each surface location of a Stacked Lateral Well, the operator must file a separate Form G-1 or Form W-2 for record purposes only for the Commission's Proration Department to build a fictitious "Record Well" for the Stacked Lateral Well. This Record Well will be identified with the words "SL Record" included in the lease name. This Record Well will be assigned an API number and Gas Well ID or Oil lease number and listed on the proration schedule with an allowable if applicable.

7. In addition to the Record Well, each surface location of a Stacked Lateral Well will be listed on the proration schedule, but no allowable shall be assigned for an individual surface location. Each surface location of a Stacked Lateral Well shall be required to have a separate G-10 or W-10 test and the sum of all horizontal drainhole test rates shall be reported as the test rate for the Record Well.

8. Operators shall report all production from horizontal drainholes included as a Stacked Lateral Well on Form PR to the Record Well. Production reported for a Record Well is the total production from the horizontal drainholes comprising the Stacked Lateral Well. Operators shall measure the production from each surface location of a Stacked Lateral Well. Operators may measure full well stream with the measurement adjusted for the allocation of condensate based on the gas to liquid ratio established by the most recent G-10 well test rate for that surface location. The gas and condensate production will be identified by individual API number and recorded and reported on the "Supplementary Attachment to Form PR".

9. If the field's 100% AOF status should be removed, the Commission's Proration Department shall assign a single gas allowable to each Record Well classified as a gas well. The Commission' s Proration Department shall also assign a single oil allowable to each Record Well classified as an oil well. The assigned allowable may be produced from any one or all of the horizontal drainholes comprising the Stacked Lateral Well.

10. Operators shall file an individual Form W-3A Notice of Intention to Plug and Abandon and Form W-3 Well Plugging Report for each horizontal drainhole comprising the Stacked Lateral Well as required by Commission rules.

11. An operator may not file Form P-4 to transfer an individual surface location of a Stacked Lateral Well to another operator. P-4's filed to change the operator will only be accepted for the Record Well if accompanied by a separate P-4 for each surface location of the Stacked Lateral Well.

It is further **ORDERED** that the allocation formula in the Phantom (Wolfcamp) Field will remain suspended. The allocation formula may be reinstated administratively, in accordance with the Commission's rules, if the market demand for gas in the Phantom (Wolfcamp) Field drops below 100% of deliverability.

Done this 14th day of July, 2015.

RAILROAD COMMISSION OF TEXAS

(Order approved and signatures affixed by Hearings Divisions' Unprotested Master Order dated July 14, 2015)