

Allocation Wells, Unauthorized Pooling, and the Lessor's Remedies

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I. INTRODUCTION

Horizontal drilling coupled with multi-stage hydraulic fracturing has revolutionized the oil and gas industry.¹ The result of these transformative techniques is that Texas has experienced a boom in crude oil production that ten years ago seemed unimaginable.²

The development of the property rights of the mineral estate, including the formative period where pooling authority was developed, occurred in

¹For the week ending on December 31, 2004, less than 15% of the wells being drilled at that time in the United States were oil wells, and only 10% of those wells were horizontal wells. Thus, United States onshore activity largely centered on natural gas, and at that time horizontal drilling represented a minor drilling technique. In only a decade, the energy industry has been radically transformed by oil development in unconventional shale formations. For the week ending on December 26, 2014, approximately 82% of the wells being drilled in the United States were oil wells, and more than 73% of those wells were horizontal wells. For the rig count information cited above, see *North America Rotary Rig Count*, BAKER HUGHES, <http://phx.corporate-ir.net/phoenix.zhtml?c=79687&p=irol-reports> (last visited Feb. 23, 2016) (follow “North America Rotary Rig Count (Jan. 2000–Current)” link; then follow the “U.S. Oil & Gas Split” tab at the bottom of the page; then scroll to the appropriate timespan). Texas has led the nation in this transformation towards oil shale development activities and horizontal drilling. As of December 26, 2014, 91% of the wells being drilled in Texas were oil wells, and 73% of the wells being drilled were horizontal wells. For the data to support this assertion, see *id.* (follow “North America Rotary Rig Count Pivot Table (Feb. 2011–Current); then scroll to the far left of the document; then select “Texas” from the “State/Province” dropdown menu; then scroll to the appropriate timespan); see also *id.* (follow “North America Rotary Rig Count Pivot Table (Feb. 2011–Current); then follow the “Master Data” tab at the bottom of the page; then click the arrow next to the “State/Province” tab at the top of the page; then click “sort A to Z”; then scroll to the appropriate timespan for Texas). Horizontal drilling in shale oil formations has revolutionized the oil and gas industry and has become the new paradigm against which existing Texas oil and gas common law principles must be measured. For an overview of horizontal drilling and hydraulic fracturing process, see Monika Ehrman, *The Next Great Compromise: A Comprehensive Response to Opposition Against Shale Gas Development Using Hydraulic Fracturing in the United States*, 46 TEX. TECH L. REV. 423, 428–34 (2014).

²For a detailed analysis of the economic impact of the Eagle Ford shale production, see THOMAS TUNSTALL ET AL., CENTER FOR COMMUNITY AND BUSINESS RESEARCH, THE UNIVERSITY OF TEXAS AT SAN ANTONIO, ECONOMIC IMPACT OF THE EAGLE FORD SHALE 10 (2013), <http://library.stmarytx.edu/acadlib/edocs/aacog%20eagle%20ford.pdf>.

the context of vertical wells.³ Historically, Rule 11 provided that all wells must be drilled as nearly vertical as possible. Thus, oil and gas leases executed prior to 1990 contemplated vertical wells. Moreover, under the Rule of Capture,⁴ the lessee of a legally-spaced well is not liable to adjacent landowners for drainage of the adjacent tract as long as the lessee's legal production is done in a non-negligent manner.⁵

In contrast to that historic, vertical-well paradigm, today's horizontal wells are radically different, and thus, challenge the efficacy of common law conventions developed in the vertical well context.⁶ Today's horizontal wells are now being drilled in unconventional shale formations⁷ with a

³ See Jordan K. Mullins, *Production Allocation Issues: Non-Participating Royalty Interest Owners in Vertically and Horizontally Pooled Units*, 40TH ANNUAL ERNEST E. SMITH OIL, GAS & MIN. L. INST. 6 (2014).

⁴ See *Barnard v. Monongahela Nat. Gas Co.*, 65 A. 801, 802 (Pa. 1907).

⁵ In *Elliff v. Texon Drilling Co.*, 201 S.W.2d 558, 562 (Tex. 1948), the Court made clear that nonliability for drainage did not extend to negligent development. On remand, the negligent lessee was liable to the adjacent landowner for any damage caused to the adjacent tracts due to negligent production. See *Texon Drilling Co. v. Elliff*, 216 S.W.2d 824, 826 (Tex. Civ. App.—San Antonio 1948, writ ref'd n.r.e.). The holding in *Elliff* is consistent with a line of Texas cases that holds that a lawful practice that was unreasonable under the circumstances exposes the operator to liability to adjacent landowners who have suffered damage; the protection of the Rule of Capture would not apply in this instance as the rule of capture is a nonliability rule that only protects an operator with respect to reasonable production from a lawful well. See *Comanche Duke Oil. Co. v. Tex. Pac. Coal & Oil Co.*, 298 S.W. 554, 560–61 (Tex. Comm'n App. 1927) (excessive amounts of nitroglycerin caused damage to adjacent landowners); *Roskey v. Gulf Oil Corp.*, 387 S.W.2d 915, 919 (Tex. Civ. App.—Houston [14th Dist.] 1965, writ ref'd n.r.e.); *Humble Oil & Ref. Co. v. Grucholski*, 376 S.W.2d 950, 952 (Tex. Civ. App.—Waco 1964, writ ref'd n.r.e.); *Sinclair Oil & Gas Co. v. Gordon*, 319 S.W.2d 170, 172 (Tex. Civ. App.—Austin 1958, no writ); *Klostermann v. Hous. Geophysical Co.*, 315 S.W.2d 664, 667 (Tex. Civ. App.—San Antonio 1958, writ ref'd).

⁶ A growing chorus of scholars and practitioners state historic oil and gas principles are strained when applied to a variety of scenarios posed in the horizontal drilling context. See, e.g., Benjamin Holliday, *New Oil and Old Laws: Problems in Allocation of Production to Owners of Non-Participating Royalty Interests in the Era of Horizontal Drilling*, 44 ST. MARY'S L.J. 771, 773 (2013) (“This evolution in the techniques operators use to drill for oil and gas is occurring at speeds that are, at times, beyond our legal framework’s ability to keep up.”); H. Philip 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, 213 (2012) (“The continued expansion of horizontal drilling will undoubtedly present new land and legal challenges for the oil and gas industry, its regulators, and the interest owners it affects to resolve.”).

⁷ For an overview of the geological differences between shale formations and conventional formations, see GROUNDWATER PROT. COUNCIL & ALL CONSULTING, MODERN SHALE GAS DEV. IN THE U. S.: A PRIMER 15 (2009), <http://www.eogresources.com/responsibility/doeModern>

horizontal drainhole extending more than a mile away from the drill site.⁸ These horizontal wells often have multi-stage completions that allow operators to obtain production from multiple tracts traversed by the horizontal wellbore. From a single surface location, a horizontal well can be fractured in more than twenty-five stages and require the use of up to six million gallons of water per horizontal well.⁹ Multiple horizontal wells can be drilled from a single location and possess multiple horizontal lateral legs drilled in stacked fashion¹⁰ or running in multiple different directions from the same surface well site.¹¹ These realities create radically different fact patterns in comparison to those presented with a traditional vertical well where production occurs only from production points located directly underneath the drill site.

To their great credit, Texas courts have been willing to hit the reset button when the logic of earlier case law was shown to be ill-conceived.¹²

ShaleGasDevelopment.pdf.

⁸See NATIONAL ENERGY TECH. LABORATORY, STRATEGIC CTR. FOR NATURAL GAS & OIL, MODERN SHALE GAS DEV. IN THE U. S.: AN UPDATE 47 (2013), <https://www.netl.doe.gov/File%20Library/Research/Oil-Gas/shale-gas-primer-update-2013.pdf>; see also Larry Chorn, Neil Stegent & Jeffrey Yarus, *Optimizing Lateral Lengths in Horizontal Wells for a Heterogeneous Shale*, SOC'Y OF PETROLEUM ENG'RS No. 167692 6 (2014), http://www.baroidip.com/premium/tech_papers/source_files/consulting/SPE_167692.pdf (stating that laterals of 6,500 feet optimize cost/benefits of the well and that "laterals + 5,000 ft. range are very common in most North American shale developments).

⁹NATIONAL ENERGY TECH LABORATORY, *supra* note 8, at 49–50.

¹⁰To accommodate production in different zones, the Railroad Commission rules treat a well that has stacked laterals as a single well for well spacing and well density purposes. See 16 TEX. ADMIN. CODE § 3.86(e)(2) (2014) (Tex. R.R. Comm'n, Inclination and Directional Surveys Required).

¹¹See Whitworth & McGinnis, *supra* note 6, 196–200; Bruce M. Kramer, *Pooling for Horizontal Wells: Can They Teach an Old Dog New Tricks?*, 55 ROCKY MTN. MIN. L. INST. § 8.02, at 8–8 (2009).

¹²The Texas Supreme Court jettisoned the "living allowable" after many years of sanctioning the over-allocation of production to small tract owners. See R.R. Comm'n of Tex. v. Aluminum Co. of Am., 380 S.W.2d 599, 602 (Tex. 1964) (noting that the Normanna decision is only to be applied prospectively to fields discovered after the date of that decision (*i.e.*, Mar. 8, 1961)); Atl. Ref. Co. v. R.R. Comm'n of Tex., 346 S.W.2d 801, 811 (Tex. 1961) (the so-called Normanna decision). The Texas Supreme Court announced its surface destruction test, and then within thirteen years replaced the surface destruction test with the ordinary and natural meaning test. Compare Reed v. Wylie, 597 S.W.2d 743, 747 (Tex. 1980) (refining the surface destruction test), and Acker v. Guinn, 464 S.W.2d 348, 352 (Tex. 1971) (articulating the surface destruction test), with Moser v. U.S. Steel Corp., 676 S.W.2d 99, 103 (Tex. 1984) (stating that the ordinary and

Consistent with this history, in recent years, Texas courts have demonstrated that they are receptive to arguments that longstanding oil and gas principles, developed in the vertical well context, may sometimes need to be reformulated in order to achieve appropriate outcomes in the hydraulic fracturing and horizontal well context. In this regard, in *Coastal Oil & Gas Corp. v. Garza Energy Trust*, the Texas Supreme Court refused to apply longstanding principles of trespass to an operator who hydraulically fractured a legally spaced well and caused the hydraulically induced fractures and frack fluids to cross lease lines.¹³ In language that shows a staunch effort to promote the efficient development of the state's finite natural resources, the Texas Supreme Court refused to apply traditional notions of trespass to hydraulic fracturing in part because "common law liability for a long-used practice essential to an industry is ill-advised and should not be extended absent a compelling need"¹⁴ In addition, in *Browning Oil Co. v. Luecke*,¹⁵ the Austin appellate court refused to apply the longstanding nonapportionment rule¹⁶ and the Rule of Capture¹⁷ (with

natural meaning test, not the surface destruction test, would apply to deeds executed prospectively (after June 8, 1983)). The Texas Supreme Court walked back an ill-conceived ruling that a mineral estate conveyance by deed did not convey an interest in a pre-existing oil and gas lease unless the deed explicitly so stated. *Compare* *Caruthers v. Leonard*, 254 S.W. 779, 782–83 (Tex. Comm'n App. 1923, judgment adopted), *with* *Harris v. Currie*, 176 S.W.2d 302, 305–06 (Tex. 1943) (reversing the holding of *Caruthers v. Leonard*). Initially, the Texas Supreme Court viewed the executive right as a "power of appointment," but later reversed itself and held that the executive right was an interest in land that would be conveyed with all of the other appurtenances of the mineral estate, except where explicitly withheld. *Compare* *Pan Am. Petroleum Corp. v. Cain*, 355 S.W.2d 506, 510–11 (Tex. 1962), *with* *Day & Co. v. Texland Petroleum, Inc.*, 786 S.W.2d 667, 669–70 (Tex. 1990). And, although it may be premature to proclaim its full demise, the Texas Supreme Court has refused to apply the ephemeral two-grant theory for deed construction in recent cases. *Compare* *Hoffman v. Magnolia Petroleum Co.*, 273 S.W. 828, 831 (Tex. Comm'n App. 1925, holding approved) (explicitly setting forth the two-grant theory), *with* *Concord Oil Co. v. Pennzoil Expl. & Prod. Co.*, 966 S.W.2d 451, 459 (Tex. 1998) (applying a four-corners approach to deed construction in lieu of applying the two grant theory). For a discussion of the two-grant theory, *see* Ernest E. Smith, *The "Subject To" Clause*, 30 ROCKY MTN. MIN. L. INST. §§ 15–1, 15.02[1] (1984). *See generally* Laura H. Burney, *The Regrettable Rebirth of the Two-Grant Doctrine in Texas Deed Construction*, 34 S. TEX. L. REV. 73 (1993).

¹³ 268 S.W.3d 1, 12–13 (Tex. 2008).

¹⁴ *Id.* at 16.

¹⁵ 38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied).

¹⁶ *See* *Japhet v. McRae*, 276 S.W. 669, 670 (Tex. Comm'n App. 1925, judgment adopted).

¹⁷ *See* *Barnard v. Monongahela Nat. Gas Co.*, 65 A. 801, 802 (Pa. 1907).

its existing exceptions)¹⁸ in a case where a horizontal well had not been validly pooled, yet produced from multiple tracts.¹⁹ The reason for not applying such principles was directly stated as follows:

[W]e recognize the immense benefits that have accompanied the advent of horizontal drilling, including the reduction of waste and the more efficient recovery of hydrocarbons We decline to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells and would discourage the use of this promising technology.²⁰

These remarkable decisions signal a willingness on the part of the Texas courts to rework longstanding oil and gas common law to ensure that justice and sound public policy outcomes are promoted in the horizontal drilling and hydraulic fracturing context.²¹

But, the question that practitioners are now grappling with is the legal consequences that arise when a lessee (who lacks pooling authority) drills a horizontal well that traverses multiple tracts.²² As will be extensively discussed in Section II.A, the typical oil and gas lease defines pooling as the combining of multiple tracts of land for purposes of creating a single drilling unit. However, this straightforward definition for pooling (which is based upon a plain meaning construction of the typical oil and gas lease and its pooling clause) was developed in the vertical well context, and so the question many have posed is whether the plain meaning of the typical lease should be set aside in the horizontal drilling context or does the literal

¹⁸For a discussion of the Rule of Capture and its limits, see ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 1.1 (2nd ed. 2014).

¹⁹For a similar case, see *Springer Ranch, Ltd. v. Jones*, 421 S.W.3d 273, 284 (Tex. App.—San Antonio 2013, no pet.) (construing a contractual provision that requires royalties to be paid on wells on said tract to require the royalty to be allocated among the productive portions of the tracts traversed by the horizontally drilled well).

²⁰See *Browning Oil Co.*, 38 S.W.3d at 647.

²¹For another example of where a further reformulation of the Texas common law is needed due to the transformational nature of horizontal drilling, see generally Bret Wells, *The Dominant Mineral Estate in the Horizontal Well Context: Time to Extend Moser Horizontally*, 53 HOUS. L. REV. 193 (2015).

²²See Michael E. McElroy, *Production Allocation: Looking for a Basis for Discrimination*, 38 OIL, GAS & ENERGY RES. L. SEC. REP. 47, 57 (2014) (recognizing that significant disagreement exists among lawyers on these issues and advocates for a position contrary to that of the author of this Article).

construction of the typical oil and gas lease provide appropriate outcomes in the horizontal well context? The stakes are high, as a majority of the wells drilled in Texas are horizontal wells,²³ and so a correct understanding of the law that applies to horizontal drilling is fundamental. To ensure that the correlative rights of all affected parties are protected and at the same time to ensure the efficient production of the state's finite natural resources, this Article argues that a lessee who (without pooling authority) drills a horizontal well that traverses multiple tracts has exceeded its authority under the existing common law and has engaged in unauthorized pooling by the drilling of such a well. As set forth in Section II.B, the lessor's remedies against the lessee for this unauthorized multi-tract development include the following: (1) a right to seek a judicial determination to invalidate the well permit, (2) a right to bring a slander of title cause of action against the lessee to obtain compensation for the fair market value royalty and such other leasehold benefits as the lessor would have received if the lessee had fairly compensated the lessor for her pooling consent, (3) a right to seek injunctive relief to have the illegally drilled well plugged, and (4) an action for punitive damages in fact patterns where the lessee's actions were motivated by a willful disregard of the lessor's retained pooling authority.

However, notwithstanding that the lessor's remedies set forth above serve to protect the private property rights of all affected parties, the Texas legislature should amend the Mineral Interest Pooling Act (MIPA) in two ways as set forth in this Article in order to ensure the reasonable development of the state's finite natural resources in the horizontal well context. First, MIPA should be amended to make clear that MIPA allows for the forced pooling of acreage for horizontal wells that comply with Rule 86 (as modified by the applicable field rules), even when the proposed unit size exceeds the maximum acreage amounts currently set forth in MIPA.²⁴ In this regard, the acreage limits set forth in MIPA § 102.011 (160 acres for oil wells and 640 acres for gas wells plus a 10 percent tolerance) were established before the advent of modern horizontal drilling practices.²⁵ The Texas legislature should remove MIPA's maximum acreage restrictions for horizontal wells, so lessees may more broadly utilize MIPA in the horizontal well context. Secondly, MIPA § 102.011, which limits the

²³ See BAKER HUGHES, *supra* note 1 (approximately 85% of all wells now being drilled are horizontal wells).

²⁴ TEX. NAT. RES. CODE ANN. § 102.011 (West 2011 & Supp. 2015) (“[W]hich unit shall in no event exceed 160 acres for an oil well or 640 acres for a gas well plus 10 percent tolerance.”).

²⁵ *Id.*

authority of the Railroad Commission to force pool productive acreage into a unit that is no larger than the size of units in that field, should not restrict the Railroad Commission's ability to utilize MIPA whenever the acreage assigned to a horizontal well in a particular field is in accordance with statewide Rule 86 (which assigns additional acreage based on the length of the horizontal drainhole) as modified by the applicable field rules. However, although these reforms within MIPA would promote the state's goal of efficiently developing its finite natural resources, the obligation to make a fair and reasonable offer for the landowner's pooling consent before seeking forced pooling under MIPA should not be changed, as the fair offer prerequisite protects the correlative rights of all affected parties.

In order to properly frame the discussion of the relevant legal analysis, this Article posits the following hypothetical fact pattern:

Allocation Well Hypothetical: A lessee desires to drill a horizontal well in the Eagle Ford shale. As indicated in the below diagram, three separate tracts are posited: Tract A, Tract B, and Tract C. The surface location for the well is on Tract A. Tract A has the penetration point²⁶ into the correlative interval²⁷ and has three take-points.²⁸ The lateral then extends onto Tract B, and Tract B has five take-points. Finally, the horizontal drainhole extends to Tract C, and Tract C has seven take-points, along with the terminus²⁹ of

²⁶ 16 TEX. ADMIN. CODE § 3.86(a)(5) (2014) (Tex. R.R. Comm'n., Horizontal Drainhole Wells) (defining the penetration point as the point where the drainhole penetrates the top of the correlative interval).

²⁷ *Id.* § 3.86(a)(1) (defining the correlative interval as, "The depth interval designated by the field rules, by new field designation, or, where a correlative interval has not been designated by the commission, by other evidence submitted by the operator showing the producing interval for the field in which the horizontal drainhole is completed.").

²⁸ By field rules, the RRC has defined take-points to refer to where the casing has been perforated, thus exposing the wellbore to the formation so that trapped oil and gas is able to migrate from the formation into the wellbore. *See* Whitworth & McGinnis, *supra* note 6, at 192–96. If the horizontal drainhole were drilled and left uncased, then all points along the uncased wellbore would be open to the formation and thus every point after the "penetration point" would be a take-point. However, for most horizontal wells drilled in shale formations, the horizontal drainhole will be cased in order to preserve its structural integrity and then will be perforated every few hundred feet along the horizontal drainhole.

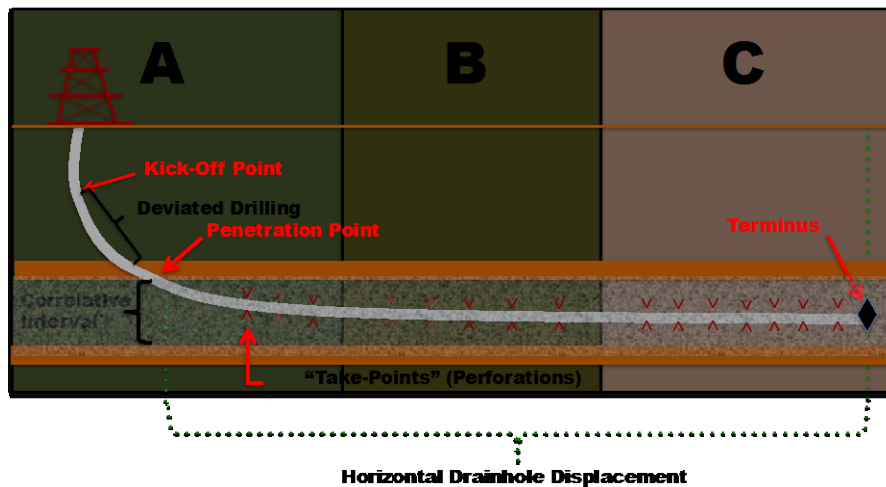
²⁹ 16 TEX. ADMIN. CODE § 3.86(a)(6) (Tex. R.R. Comm'n., Horizontal Drainhole Wells) (defining the terminus as the farthest point required to be surveyed along the horizontal drainhole from the penetration point and within the correlative interval).

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ALLOCATION WELLS

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the horizontal well.³⁰ Based upon information obtained by the lessee during the evaluation, drilling, and completion of its horizontal well, a reasonable argument exists that Tract B is the more productive tract with the consequence that an allocation of production among the tracts based solely on lateral length, surface acreage, or the number of take-points potentially under-allocates the oil and gas production to the Tract B mineral estate.

Allocation Well Hypothetical

For purposes of this **Allocation Well Hypothetical**, this Article assumes that the mineral interest owners in Tract A, B, and C executed separate oil and gas leases with the same lessee many years ago, and those leases are being held in the secondary term by production from marginal wells producing from conventional formations underlying these tracts. Thus, a single lessee has the sole working interest on each tract in the **Allocation Well Hypothetical Diagram**.

The lessors are entitled to receive a standard 1/8th royalty under these old leases. But importantly, none of the leases authorize the lessee to pool

³⁰In actual operation, a horizontal well may traverse more tracts, including unleased tracts, and may possess many more separate perforation zones. In addition, multiple additional horizontal wells could be drilled from the same surface site and could extend in different directions. However, even though this **Allocation Well Hypothetical** is simplified, it is sufficiently detailed to frame the pooling issues addressed in this Article.

the tracts into a unit of sufficient size to drill the horizontal well depicted in the above diagram. The lessee approaches the lessors of Tract A, B, and C to request the authority to pool portions of each of the three tracts depicted above, but the lessors condition their approval on the lessee's agreement to pay a 1/6th royalty for any production derived from the proposed horizontal well. It is assumed that the market royalty rate for new leases in the Eagle Ford shale is at least a 1/6th royalty. In addition, the lessors condition their consent on the lessee providing detailed information about the allocable amount of production derived from each tract, and the lessors also condition their consent upon their right to audit and inspect the lessee's books and records with respect to the proposed horizontal well. The lessee has read commentators who assert the following: "Operationally, the option of drilling an allocation well would liberate lessees faced with restrictive pooling provisions or no pooling authority at all."³¹

The lessee, therefore, files an application for a drilling permit with the Railroad Commission based upon the lessee's claim that it is the sole working interest owner of each of the tracts in the **Allocation Well Hypothetical** and designates the proposed horizontal well as an allocation well. Even though the lessee has no pooling authority under any of the leases in Tract A, B, or C, the Railroad Commission issues a drilling permit to the lessee, and the lessee drills the horizontal well depicted in the above diagram. What remedies, if any, are available to the lessors in this **Allocation Well Hypothetical**?

³¹ Clifton A. Squibb, *The Age of Allocation: The End of Pooling As We Know It?*, 45 TEX. TECH L. REV. 929, 957 (2013). Another notable practitioner has stated as follows:

The typical oil and gas lease contains no prohibition against horizontal drilling. An oil and gas lease grants to the lessee the right to drill the well up and down or sideways . . . Under Texas law, a conveyance of an estate in land, such as an oil and gas lease, is interpreted to convey the greatest estate to the grantee, which is consistent with the language contained in the grant.

If the lessor seeks to prohibit horizontal drilling, he must do so in the oil and gas lease. See McElroy, *supra* note 22, at 57.

II. ASSERTION OF POOLING AUTHORITY OCCURS AT THE MOMENT
THE LESSEE ASSERTS AND/OR OBTAINS A MULTI-TRACT DRILLING
PERMIT FOR AN ALLOCATION WELL

A. *Multi-Tract Development Without Pooling Authority is an
Unauthorized and Illegal Act.*

The typical lease form provides that a lessee can produce from “said land” [the land described in the lease] and must pay royalty for production from “said land.”³² Alternatively, a typical lease form provides that the lessee has authority to pool the “said land” in whole or in part with other lands and, when this is done, can then pay royalty based upon the allocation specified in the pooling clause of the lease.³³ However, the typical lease does not provide a third alternative, namely that the lessee can combine “said land” with other land for the purpose of obtaining a drilling permit, commingle production from said land with other lands that have not been

³² See Am. Ass’n of Prof’l Landmen, Form 675 Oil and Gas Lease, <http://www.landman.org/docs/forms/texa675.pdf?sfvrsn=0> (“The royalties to be paid by Lessee are as follows: On oil, one-eighth of that produced and saved from said land . . .”).

³³ See *id.* Form 675 states as follows:

For the purpose of computing the royalties to which owners of royalties and payments out of production and each of them shall be entitled upon production of oil and gas, or either of them **from the pooled unit**, there shall be allocated to the land covered by this Lease and included in said unit a pro rata portion of the oil and gas, or either of them, produced **from the pooled unit** after deducting that used for operations on the pooled unit. Such allocation shall be on an acreage basis, that is to say, there shall be allocated to the acreage covered by this Lease and included in the pooled unit that pro rata portion of the oil and gas, or either of them, produced from the pooled unit which the number of surface acres covered by this Lease and included in the pooled unit bears to the total number of surface acres included in the pooled unit. Royalties hereunder shall be computed on the portion of such production, whether it be oil or gas or either of them, so allocated to the land covered by this Lease and included in the unit just as though such production were from such land. The production from an oil well will be considered as production from the Lease or oil pooled unit from which it is producing and not as production from a gas pooled unit; and production from a gas well will be considered as production from the Lease or gas pooled unit from which it is producing and not from the oil pooled unit.

Id. (emphasis added).

pooled, and then allocate royalty between the various landowners based on some allocation methodology determined by the lessee.

Texas courts have consistently held that the interpretation of an oil and gas lease is a matter of contract interpretation.³⁴ As such, leases should be interpreted so as to effectuate the intent of the parties, not to make the contractual terms more equitable.³⁵ In addition, Texas law has long held that where an oil and gas lease is capable of multiple interpretations, the lease should be construed against the lessee because it is presumed the lessee wrote the lease.³⁶ The lease is the instrument that conveys to the lessee a fee-simple determinable estate,³⁷ and so the basis for the lessee's development rights derives solely from the terms of the lease. Thus, simply as a matter of contractual interpretation, the lessee must ground its authority

³⁴In *Danciger Oil & Ref. Co. of Tex. v. Powell*, the Texas Supreme Court articulated its analysis of how to interpret a lease in terms of implied covenants with the following statement:

An implied covenant must rest entirely on the presumed intention of the parties as gathered from the terms as actually expressed in the written instrument itself, and it must appear that it was so clearly within the contemplation of the parties that they deemed it unnecessary to express it, and therefore omitted to do so, or it must appear that it is necessary to infer such a covenant in order to effectuate the full purpose of the contract as a whole as gathered from the written instrument. It is not enough to say that an implied covenant is necessary in order to make the contract fair, or that without such a covenant it would be improvident or unwise, or that the contract would operate unjustly.

154 S.W.2d 632, 635 (Tex. 1941). For further judicial support for the notion that the lease terms should be construed to effectuate the intent of the parties in a variety of contexts other than in terms of implied covenants, see *Tittizer v. Union Gas Corp.*, 171 S.W.3d 857, 860 (Tex. 2005); *Fox v. Thoreson*, 398 S.W.2d 88, 92 (Tex. 1966); *McMahon v. Christmann*, 303 S.W.2d 341, 344 (Tex. 1957); *Superior Oil Co. v. Dabney*, 211 S.W.2d 563, 565 (Tex. 1948); *Mayfield v. Benavides*, 693 S.W.2d 500, 504 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.); *Shown v. Getty Oil Co.*, 645 S.W.2d 555, 559 (Tex. App.—San Antonio 1982, writ ref'd). For an analysis of the various canons of lease interpretation, see Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 TEX. TECH L. REV. 1, 65–66 (1993).

³⁵See, e.g., *Gulf Prod. Co. v. Kishi*, 103 S.W.2d 965, 970 (Tex. 1937) (refusing to imply an obligation to develop the leasehold estate when the lease contained an explicit provision that set forth the parties' development intent).

³⁶See *Champlin Petroleum Co. v. Ingram*, 560 F.2d 994, 998 (10th Cir. 1977) (applying Texas law to hold that mineral leases be construed in lessor's favor when there are two or more reasonable constructions); *Zeppa v. Hous. Oil Co. of Tex.*, 113 S.W.2d 612, 615 (Tex. Civ. App.—Texarkana 1938, writ ref'd).

³⁷*In re Devon Energy Prod. Co.*, 321 S.W.3d 778, 783 (Tex. App.—Tyler 2010, no pet.).

for its actions within the property rights granted under the lease. If the lessee had wanted to have the ability to combine tracts on an unpooled basis and to allocate production outside of the pooling clause of the lease, then the lease could have provided another paragraph that authorized the lessee to unilaterally enter into production sharing agreements, but the typical oil and gas lease does not contain such an authorization. Accordingly, if one construes the lease in terms of what the lease actually provides for, the typical lease does not provide the lessee with authority to develop the mineral estate except with respect to a well situated on “said land” or with a well that involves a combination of tracts that have been pooled in the manner set forth in the pooling clause of a lease.

Because the typical oil and gas lease does not provide authority to develop the mineral estate outside of these two explicitly provided for scenarios, the lessee who drills the well in the **Allocation Well Hypothetical** is in the position of asserting the existence of an inherent development right to enter into the equivalent of a production sharing agreement without the benefits of a lease clause that authorizes that unilateral action.³⁸ If the lessee had wanted an authority to engage in multi-tract development (a development right typically set forth in a pooling clause or in a separately negotiated production sharing agreement), then the lease could have provided the lessee with such authority, but when the lease is silent about multi-tract development authority then a reasonable lease interpretation is that the lessee did not bargain for such authority. If one construes the actual provisions of the lease with the understanding that the lease should be construed against the lessee, the above analysis leads one inexorably to conclude that the lessee does not have authority to drill a multi-tract well except where specifically authorized by the pooling clause of the lease.

This particular lease interpretation is made all the more reasonable when one considers the existing regulatory prohibitions that likely existed at the time that this lease was executed as this regulatory framework provides further context for determining the likely intent of the parties. In this regard, Rule 26 (for oil) and Rule 27 (for gas) requires operators to separately measure production from a particular tract before it leaves that tract and is

³⁸For a review of the evolution of the use of production sharing agreements, *see* Amoco Prod. Co. v. Alexander, 622 S.W.2d 563, 568 (Tex. 1981).

commingled with production from other tracts.³⁹ This prohibition on inter-tract commingling can be excused only if there is identical royalty and working interest owners among each of the tracts or if all royalty owners do not object.⁴⁰ Said differently, the existing Railroad Commission rules prohibit commingling and thus express the view that the lessee has no inherent authority to commingle goods under the typical oil and gas lease except where the royalty owners explicitly consent to such treatment, and so the Railroad Commission affords royalty owners with the right to protest commingling of production even if their land has been leased to an operator. This regulatory paradigm lends further credence to the point of view that the parties, at the time their lease was entered into, would have believed that the lessee does not have the inherent authority to commingle production from “said land” with production legally allocable to other lands except where the royalty owners have given their explicit consent. A horizontal well that traverses multiple tracts produces commingled production, and this reality was the subject of considerable attention at the only contested hearing involving a drilling permit for an allocation well.⁴¹ But, whether or not the Railroad Commission could or should change its rules to explicitly authorize downhole commingling,⁴² the fact remains that from a lease interpretation perspective that the broadly worded regulatory prohibition against commingling production from “said land” with production allocated to other lands espoused in Rule 26 and Rule 27 buttresses the position that the parties likely understood that a lessee does not inherently have the authority to commingle production from “said land” with production from other lands absent an expressed grant of such

³⁹ See 16 TEX. ADMIN. CODE § 3.26(a) (2014) (Tex. R.R. Comm’n, Separating Devices, Tanks, and Surface Comingling of Oil); 16 TEX. ADMIN. CODE § 3.27(a) (Tex. R.R. Comm’n, Gas To Be Measured and Surface Comingling of Gas).

⁴⁰ See 16 TEX. ADMIN. CODE § 3.26(b)(1)(C) (Tex. R.R. Comm’n, Separating Devices, Tanks, and Surface Comingling of Oil).

⁴¹ See *infra* notes 138 and 142.

⁴² Some have argued that downhole commingling should not be within the intended scope of Rule 26 or Rule 27. See Squibb, *supra* note 31, at 947–56; see also EOG Resources Inc.’s Reply Closing Statement at 5–6, Tex. R.R. Comm’n, *Application of EOG Resources, Inc., Klotzman Lease (Allocation) Well No. 1H, Eagleville (Eagle Ford -2) Field, Dewitt County, Texas*, Docket No. 02-0278952 (Jan 11, 2013) [hereinafter EOG Resources Reply Closing], <http://www.oilandgaslawyerblog.com/files/2015/02/EOG-Reply-Closing-Statement.pdf>. For a thorough review of the cases and early development of commingling, see generally Terry E. Hogwood, *Horizontal Wells and Commingling*, 39TH ANNUAL ERNEST E. SMITH OIL, GAS & MIN. L. INST. (2013).

authority from the royalty owner. In fact, it is this belief that the lessee does not have inherent authority to drill a well on behalf of a multi-tract unit that explains why leases actually set forth pooling clauses when the parties want to provide lessees with authority to develop on a multi-tract basis. Thus, when one considers the regulatory framework, the most reasonable interpretation of the typical oil and gas lease is that the lessee has not been granted the inherent authority to drill a multi-tract well except as authorized by the pooling clause of the lease or upon the separate consent of the lessor obtained through a production sharing agreement or otherwise.

The above analysis is further confirmed if one considers the literal language of the typical pooling clause and the common law that has developed with respect to these pooling clauses. To begin our consideration of pooling clauses, one must begin with the historic regulatory requirements for obtaining a well permit. In this regard, a lessee who desires to drill a well in Texas must obtain a drilling permit from the Railroad Commission.⁴³ To obtain such a permit, a lessee's application for a drilling permit must comply with the well spacing and well density rules contained in Rule 37 and Rule 38.⁴⁴ When a lessee could not comply with these well density and well spacing requirements and therefore could not obtain a Rule 37 spacing exception, pooling two or more tracts into a multi-tract unit became an effective means to obtain a drilling permit.⁴⁵ Furthermore, even when a drilling permit could be obtained for a single tract, pooling separate tracts may still be desirable from an operational perspective because pooling acreage into a multi-tract unit can ameliorate harmful overdrilling that prematurely depletes reservoir pressure.⁴⁶ Consequently, in order to

⁴³ 16 TEX. ADMIN. CODE § 3.5 (Tex. R.R. Comm'n, Application To Drill, Deepen, Reenter, or Plug Back).

⁴⁴ The nuances of the statewide well density and well spacing rules of Rule 37 and Rule 38 are adequately discussed elsewhere. See SMITH & WEAVER, *supra* note 18, §§ 9.3–.6.

⁴⁵ See Ralph B. Shank, *Some Legal Problems Presented by the Pooling Provisions of the Modern Oil and Gas Leases*, 23 TEX. L. REV. 150, 163 (1945). (“The magnitude and complexity of the problems that arise in nowise condemn pooling itself. As pointed out in the beginning, scientifically it is sound . . . Courts have pointed out the benefits that flow to both the lessor and the lessee, as well as society in general. The pooling clause in the modern oil and gas lease is an effort on the part of the industry to realize these benefits.”).

⁴⁶ See 4 EUGENE KUNTZ, A TREATISE ON THE LAW OF OIL AND GAS § 48.3(a)(1) (1990). This proposition has been long accepted. See, e.g., Shank, *supra* note 45, at 150; see also A. W. Walker, Jr., *Developments in the Law of Oil and Gas in Texas During the War Years—A Resume*, 25 TEX. L. REV. 1, 12 (1946) (“This trend [of leases with pooling clauses] is attributable to the

comply with regulatory restrictions and to promote sound conservation, leases typically contain pooling clauses that would provide the following authority to the lessee:

Lessee, at its option, is hereby given the right and power to pool or combine the acreage covered by this lease, or any portion thereof as to oil and gas, or either of them, with other land, lease or leases in the immediate vicinity thereof to the extent, hereinafter stipulated, when in Lessee's judgment it is necessary or advisable to do so in order properly to develop and operate said leased premises in compliance with the spacing rules of the Railroad Commission of Texas, or other lawful authority, or when to do so would, in the judgment of Lessee, promote the conservation of oil and gas from said premises.⁴⁷

The purpose of the above typical pooling language is clear: this provision provides an explicit grant of authority to the lessee to join land from two or more leases into a single unit of sufficient size to warrant a drilling permit.⁴⁸ Pooling clauses, in preference to community leases, became the preferred voluntary means for combining tracts to obtain a

desire to promote the more scientific and efficient development of the reservoir, to eliminate the drilling of unnecessary wells . . .").

⁴⁷This first sentence of a typical pooling clause appears in numerous Texas cases. *See, e.g.*, *Jones v. Killingsworth*, 403 S.W.2d 325, 326–27 (Tex. 1965); *Kinnear v. Scurlock Oil Co.*, 334 S.W.2d 521, 524 (Tex. Civ. App.—Beaumont 1960, writ ref'd n.r.e.).

⁴⁸SMITH & WEAVER, *supra* note 18, § 4.5(D) (“[The pooling clause] allows the lessee to join land from two or more leases into a single drilling unit of sufficient size to warrant a drilling permit.”); KUNTZ, *supra* note 46, § 48.3(a)(1) (“It is frequently feasible or even essential that the lessee combine the land covered by an oil and gas lease with other land in order to develop the underlying oil and gas. Such situation can arise because of a peculiar geological formation or because of governmental regulations that prorate production, control the density of drilling, or regulate the utilization of scarce equipment The provisions of the oil and gas lease that are commonly referred to as the pooling clause vary considerably in detail from lease to lease, but there is considerable uniformity with respect to their broad purpose and effect. They are designed to permit the lessee, by unilateral action, to modify the respective rights of the lessor and lessee under the lease by authorizing the lessee to combine all or possibly a part of the leased premises with other land for purposes of operations under the lease and, with rare exception, for purposes of sharing production from the unit so formed.”); JACQUELINE LANG WEAVER, *UNITIZATION OF OIL AND GAS FIELDS IN TEXAS: A STUDY OF LEGISLATIVE, ADMINISTRATIVE, AND JUDICIAL POLICIES* 7 (1986) (“*Pooling* is the process of combining small tracts into an area of . . . a well permit under the field’s applicable spacing rule.”) (emphasis in original).

drilling permit since at least the mid-1930s.⁴⁹ This is the core purpose for a pooling clause. Without the need to promote sound conservation or to satisfy governmental well spacing and well density restrictions as a precondition for obtaining a drilling permit, the pooling clause would never have been invented. But, once such a clause is put into effect, a variety of other attendant consequences could be addressed in other portions of a typical pooling clause.⁵⁰

Consistent with this historic purpose and in recognition for why pooling clauses were invented, commentators early-on articulated the definition of pooling as the combining of tracts to form a drill site in a well spacing pattern,⁵¹ and this accepted definition has been carried forward in the leading treatises.⁵² Courts have repeatedly used this definition, stating that “pooling means the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules”⁵³ But, horizontal wells physically traverse multiple tracts, and so the question that arises is whether this definition of pooling, which was constructed in the vertical-well context, should be applied without change to the horizontal well context.

The only Texas case to address whether a horizontal well that traverses multiple tracts represents pooling is *Browning Oil Co. v. Luecke*, and in that case, the Austin court of appeals in the following language repeated without change the same historic definition of pooling and applied that definition to the horizontal well context:

⁴⁹ See Paul H. Long, *The Pooling Clause in an Oil and Gas Lease*, 11 OKLA. L. REV. 1, 4 (1958).

⁵⁰ The other portions of a typical pooling provision, including the allocation of royalties, the impact of production anywhere in the pooled unit to extend the term of leases for all tracts contained in the pooled unit, the amount of acreage that can be combined into a single unit, and the addition of various Pugh clauses are not relevant to the fundamental issue of addressing the basic authority to pool that is dealt with in this first sentence of a typical pooling clause. The issues addressed by these other attendant consequences are adequately addressed elsewhere and are beyond the scope of what is needed for addressing the legal issues framed by this Article. See 1 BRUCE M. KRAMER & PATRICK H. MARTIN, *THE LAW OF POOLING AND UNITIZATION* §§ 8.1, 8.3 (3rd ed. 2015).

⁵¹ See A. Allen King, *Pooling and Unitization of Oil and Gas Leases*, 46 MICH. L. REV. 311, 313 (1948); Leslie Moses, *Some Legal and Economic Aspects of Unit Operations of Oil Fields*, 21 TEX. L. REV. 748, 753 (1943).

⁵² See SMITH & WEAVER, *supra* note 18, § 4.5(D).

⁵³ *Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342, 347 (Tex. App.—Amarillo 1995, writ denied).

Often, if a tract is of insufficient size to satisfy the state's spacing or density requirements, lessees will "pool" acreage from different leased tracts. Pooling allows a lessee to join land from two or more leases into a single unit.⁵⁴

It is important to note that the court in *Browning Oil Co. v. Luecke* did not refer to a horizontal well in that case as an "allocation well" even though (1) the horizontal well traversed multiple tracts and (2) the lessee was the working interest owner in each tract traversed by the horizontal well. Rather, the Austin court of appeals repeated the age-old definition of pooling and analyzed the horizontal well in that case in terms of pooling authority and found that the lessee's actions violated the retained pooling authority of the lessor.⁵⁵

A commentator has argued that pooling requires more than combining tracts to obtain a drilling permit with the following assertion:

[T]his simple definition of pooling [that pooling occurs when multiple tracts are combined to obtain a drilling permit] ignores important and, perhaps, essential features of pooling. Specifically, pooling (1) provides a basis on which production from a pooled unit is allocated and (2) assures that operations within the unit will constructively serve as operations on each pooled tract so that a pooled lease may be perpetuated.⁵⁶

However, this argument was explicitly rejected in *Browning Oil Co. v. Luecke*.⁵⁷ The court framed essentially the same argument as made by the commentator in the following manner: "Finally, Lessees argue that the pooling provisions are intended as a means of allocating royalties and not as a limitation on drilling. Therefore, Lessees contend they had the authority to drill any size [horizontal] well they deemed feasible."⁵⁸ Thus, the operator in *Browning Oil Co. v. Luecke* argued before the court that its authority to drill the well was not limited to the pooling provisions of the lease since the particular well was a horizontal well (not a vertical well) and the operator

⁵⁴ *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied).

⁵⁵ *Id.* at 634, 650.

⁵⁶ See Squibb, *supra* note 31, at 943.

⁵⁷ *Browning Oil Co.*, 38 S.W.3d at 643 ("[W]e hold that Lessees failed to comply with the pooling provisions . . .").

⁵⁸ *Id.* at 642.

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possessed a working interest in each tract.⁵⁹ The court in *Browning Oil Co. v. Luecke* recognized that each location along the horizontal well represented a separate drill site tract for purposes of the Railroad Commission rules,⁶⁰ and the court recognized that the operator had the authority to drill a vertical well on each of the tracts that were traversed.⁶¹ Thus, the facts in *Browning Oil Co. v. Luecke* posit an allocation well scenario that is similar to the **Allocation Well Hypothetical** (except for one important omitted fact that will be important for the later discussion in Section II.B.2 below).⁶² Yet, the court in *Browning Oil Co. v. Luecke* found that the lessee's attempt to drill a horizontal well that traversed multiple tracts represented an assertion of pooling authority, stating as follows:

In contravention of this intent, Lessees drilled [horizontal] wells they knew would not fit within the eighty acre spacing requirement and exceeded the authority granted in the pooling provisions. **We hold that the trial court did not err in ruling that Lessees failed to comply with the pooling provisions in the leases.**⁶³

Another leading practitioner has argued that the direct holding of *Browning Oil Co. v. Luecke* is very narrow—significantly narrower than the above language would suggest. In the view of this leading practitioner, *Browning Oil Co. v. Luecke* can be limited to the following holding:

The actual holding [of *Browning Oil Co. v. Luecke*] was much more narrow. The issue in *Browning* was whether or not the pooled units that the lessee had attempted to form complied with the pooling clause in the leases. The court found that they did not and, therefore, the lessee had breached the pooling clause The court in *Browning* was not presented with the question, and therefore did not hold, that the mere drilling of the well across lease lines violated the lease terms. It did hold that the lessee's attempt

⁵⁹ *Id.*

⁶⁰ *Id.* at 634.

⁶¹ *Id.* at 638.

⁶² See *supra* Part I. The **Allocation Well Hypothetical** set forth in this Article posits that the current market royalty rate for new leases is higher than the historic rate set forth in the lease. This additional fact was not an issue before the court in *Browning Oil Co. v. Luecke*.

⁶³ *Browning Oil Co.*, 38 S.W.3d at 642 (emphasis added).

to pool in violation of the lease pooling clause violated the pooling clause.⁶⁴

However, the above narrow construction of the court's holding in *Browning Oil Co. v. Luecke* is problematic on several levels. First, this reading of *Browning Oil Co. v. Luecke* ignores the case law that defines pooling as involving the combination of multiple tracts to obtain a drilling permit, which again is exactly the definition of pooling that the court in *Browning Oil Co. v. Luecke* articulated as applicable to the horizontal well context. Furthermore, to make it crystal clear that the court believed that the pooling clause was breached due to the drilling of the well without pooling authority and not simply because the lessee made an incorrect designation of the unit as a pooled unit (i.e., the "narrow holding" proffered by this leading practitioner), the court went on to state as follows:

If these Lessees determined that drilling a horizontal well on an eighty acre unit was economically impractical, they could have attempted to expand their pooling authority. They could have sought field-wide regulatory action and attempted to convince the Railroad Commission that providing an optional eighty acre spacing requirement for horizontal wells is imprudent. Failing that, they could have exercised the option of not drilling a well on the Lueckes' tracts. What they could not do was pool the Lueckes' interests beyond the authority expressed in the leases.⁶⁵

The Austin appellate court cited several law review articles that indicated that pooling authority is needed to combine separate tracts into a single multi-tract unit for a horizontal well.⁶⁶ The above reasoning makes it apparent that the court was not creating a new type of well (such as an "allocation well"). Instead, the legally relevant fact identified by the court as controlling the outcome of that case was the operator's act of drilling a multi-tract well, and it was this unauthorized act of drilling a multi-tract well that created the breach of the pooling clause, as the above extended excerpt from the court's opinion in *Browning Oil Co. v. Luecke* makes plain.⁶⁷ Thus, the effort to create a "narrow holding" for *Browning Oil Co.*

⁶⁴ See EOG Resources Reply Closing, *supra* note 42, at 7–8.

⁶⁵ *Browning Oil Co.*, 38 S.W.3d at 641–42 (citations omitted).

⁶⁶ See *id.* at 642.

⁶⁷ See *id.* at 641–42.

v. Luecke creates the need for one to ignore the actual legal reasoning used by the court to reach its holding. Said differently, the court in *Browning Oil Co. v. Luecke* framed its legal analysis for its decision in terms of accepting that a multi-tract horizontal well by definition implicated the pooling clause of the lease and that the act of drilling such a multi-tract well represented a breach of the pooling provisions of the lease when that pooling provision does not authorize the combining of tracts in acreage amounts assigned to the horizontal well.

In response to the argument that horizontal wells are “just different” and should not be analyzed within the pooling authority framework, the court in *Browning Oil Co. v. Luecke* “note[d] the physical characteristics that distinguish horizontal wells from vertical wells”⁶⁸ and recognized that the Railroad Commission rules treated each portion of the horizontal well as a separate drillsite tract, but even after recognizing these important distinctions between vertical wells and horizontal wells the court then said that “[n]othing in the pooling provisions limits their applicability to vertical wells.”⁶⁹ It is true that *Browning Oil Co. v. Luecke* provided an important “reformulation” of the common law as to the manner of allocating royalties between tracts traversed by a horizontal well,⁷⁰ but that aspect of the court’s decision should not draw attention away from the court’s equally important reasoning in *Browning Oil Co. v. Luecke* that the lessee’s effort to drill a horizontal well in the **Allocation Well Hypothetical** represents an unauthorized assertion of pooling authority. The combining of multiple tracts in order to obtain a drilling permit is the affirmative assertion of pooling authority, and that long-standing common law definition was applied without change in *Browning Oil Co. v. Luecke* in the course of that court’s decision.

Thus, although the issue of an “allocation well” was not a contested issue in that case, the fair reading of the Austin appellate court’s reasoning leads one to conclude that the court took great effort to continue to utilize the historic vertical well definition of pooling in its resolution of the dispute over a horizontal well that traversed multiple tracts. If the court had wanted to say that an operator who has the working interest for all tracts of a multi-tract unit can drill a horizontal well with or without pooling authority (as

⁶⁸ *Id.* at 632.

⁶⁹ *Id.* at 640.

⁷⁰ See sources cited *supra* notes 12–16 and accompanying text, wherein the court in *Browning Oil Co. v. Luecke* refused to apply the longstanding Rule of Capture and nonapportionment rule to a horizontal well that produced from multiple tracts and was not validly pooled.

the court was explicitly urged to do by *Browning Oil Co.*),⁷¹ the court could have said so, but it did not. The court did not provide any language for a lessee's effort to develop on a multi-tract basis as anything other than an effort to pool, and the issue in that case was whether the lessee had authority to pool the tracts that were traversed by the horizontal well.⁷² When a lessee contemplates drilling a horizontal well that traverses multiple tracts and the lessee does not have pooling authority, the Austin appellate court stated that the lessee has two options: not drill the well or seek proper pooling authority.⁷³ These were the two bookends for the field of inquiry framed by the Austin appellate court in its decision. It is within this "pooling framework" that the court then found that the lessee did neither of these two options.⁷⁴ And, having failed to do either, the Austin appellate court in *Browning Oil Co. v. Luecke* found that the lessee breached the pooling clause of the lease.⁷⁵ Thus, efforts to formulate a "narrow holding" for *Browning Oil Co. v. Luecke* can only be done if one were to believe that the court, in the course of its opinion, simply made several fundamental lapses in its reasoning. A noted scholar has attempted to make the case for the acceptability of allocation wells under existing law in certain highly stipulated facts, but importantly, that noted scholar was careful to stipulate that his views of when allocation wells are permissible was limited to situations where the lessee already possessed the requisite pooling authority to drill a multi-tract horizontal well.⁷⁶

⁷¹ See *Browning Oil Co.*, 38 S.W.3d at 642.

⁷² *Id.* at 640.

⁷³ See *id.* at 642.

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ In a widely discussed opinion letter written by Professor Ernest Smith, Professor Smith advised on certain stipulated facts that a lessee was authorized under existing law to drill a multi-tract horizontal well. See Letter from Professor Ernest E. Smith to Bryan Sullivan, McElroy, Sullivan, & Miller LLP (July 22, 2009) (on file with the Baylor Law Review). However, a careful review of that opinion letter is not inconsistent with the thesis of this Article, as the following analysis of that opinion letter by the staff of the Texas Railroad Commission makes plain:

EOG and Devon rely heavily on a July 23, 2009 opinion letter written by Professor Ernest Smith. In the letter, Professor Smith never asserts that an operator, with no authority to pool, has the right to drill a horizontal well that will cross lease lines. In fact, Professor Smith limits his opinion to the circumstances in which an operator does have the authority to pool.

Professor Smith begins his letter by stating he has been asked to make certain assumptions, which include the following: "... please assume that the units in question

Because pooling authority serves to promote the development goals of the state and serves to protect the interest of all parties, courts have stated that this authority to pool separate tracts into a single drilling unit should be liberally construed as a matter of public policy.⁷⁷ However, even though courts liberally construe pooling clauses, the common law is clear that the absence of an expressed grant of pooling authority to the lessee means that the lessee simply does not have the authority to create such a unit.⁷⁸ Moreover, even when a lessee has the authority to pool multiple tracts, the lessee's pooling authority does not impact the rights of the nonparticipating royalty interest owner whose consent to pooling must be separately obtained.⁷⁹ Finally, even when the lessee has authority to pool acreage, the exercise of that pooling authority must be done in good faith.⁸⁰ For this

are validly formed and pool gas rights to all depths from 'grass roots to the center of the earth' . . . further assume the (i) the leases pooled grant a fee simple determinable to the lessee/operator with the right to pool . . ." Professor Smith never states that the use of horizontal technology should be viewed as giving an operator the right to override the mineral owner's reservation of pooling authority.

At the close of his letter, Professor Smith states again that his opinions rely on the existence of the operator's pooling authority. "This conclusion has assumed a traditional pooling clause that has not been amended or modified in any way."

Professor Smith acknowledges that the court in *Luecke* rejected the argument that the availability of horizontal drilling technology and the "prudent operator rule" excused the operator's compliance with the "express pooling limitations" in the lease. The *Luecke* court held that the drilling of the subject well violated the lease and Professor Smith acknowledged that fact.

See Tex. R.R. Comm'n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagle Ford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 16, Docket No. 02-0278952 (June 25, 2013) (proposal for decision) (citations omitted), <http://www.rrc.state.tx.us/media/11191/02-278952-mfe-pfd.pdf>.

⁷⁷*Mengden v. Peninsula Prod. Co.*, 544 S.W.2d 643, 647 (Tex. 1976) ("[I]n the absence of clear language to the contrary, pooling clauses should not be construed in a narrow or limited sense . . .") (quoting *Texaco, Inc. v. Letterman*, 343 S.W.2d 726, 732 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.); *Elliott v. Davis*, 553 S.W.2d 223, 226 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.).

⁷⁸*Knight v. Chi. Corp.*, 188 S.W.2d 564, 566 (Tex. 1945); *Edwin M. Jones Oil Co. v. Pend Oreille Oil & Gas Co.*, 794 S.W.2d 442, 447 (Tex. App.—Corpus Christi 1990, writ denied).

⁷⁹*Brown v. Smith*, 174 S.W.2d 43, 46 (Tex. 1943).

⁸⁰*Circle Dot Ranch, Inc. v. Sidwell Oil & Gas, Inc.*, 891 S.W.2d 342, 345, 349 (Tex. App.—Amarillo 1995, writ denied) (determining there is fact issue of whether pooling done after drilling a well represented bad faith pooling); *Elliott*, 553 S.W.2d at 227 (holding that pooling undrilled

purpose, good faith means that the effort to combine acreage must take into account the interest of both the lessee and the lessor.⁸¹

In *Jones v. Killingsworth*,⁸² the relevant pooling clause contained the exact same first sentence as set forth above but then contained the following additional sentence:

Units pooled for oil hereunder shall not substantially exceed 40 acres each in area, and units pooled for gas hereunder shall not substantially exceed in area 640 acres each plus a tolerance of 10% thereof, provided that should governmental authority having jurisdiction prescribe or permit the creation of units larger than those specified, units thereafter created may conform substantially in size with those prescribed by governmental regulations.⁸³

The lessee attempted to pool the lessor's tract (the Jones tract) into a 170.86 acre unit.⁸⁴ The court found that the Railroad Commission only prescribed a minimum unit size of 80 acres but permitted a larger unit size.⁸⁵ Based upon these facts, the court held that the lessee did not have authority to pool a tract larger than 80 acres under the above pooling clause because, although the Railroad Commission rules permitted a larger unit, it only prescribed a unit size of 80 acres.⁸⁶ Subsequent cases repeatedly endorsed the principles established in *Jones v. Killingsworth* that the lessee's efforts to combine tracts into a single unit is ineffective vis-à-vis the lessor when the lessee does not have the authority to pool multiple tracts.⁸⁷ This point bears repeating: Texas does not recognize "implied"

tracts shortly before end of primary term is evidence of bad faith pooling); *Amoco Prod. Co. v. Underwood*, 558 S.W.2d 509, 512–13 (Tex. Civ. App.—Eastland 1977, writ ref'd n.r.e.) (holding that bad faith pooling existed when lands were pooled into a gerrymandered unit that was designed to hold the maximum acreage under lease without regard to geological considerations).

⁸¹ See *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 568 (Tex. 1981).

⁸² 403 S.W.2d 325 (Tex. 1965).

⁸³ *Id.* at 327.

⁸⁴ *Id.* at 327.

⁸⁵ *Id.* at 328.

⁸⁶ *Id.*

⁸⁷ The Austin Court of Appeals stated as follows:

Before drilling the horizontal wells, Lessees were required to procure a drilling permit, delineating the size of the drilling units. According to the leases, if Lessees drilled on the Lueckes' land and pooled it, they were to utilize the lesser spacing requirement to

pooling authority; rather, a lessee has no authority to pool separate tracts into a single drilling unit except in the manner set forth in the pooling clause of the lease.⁸⁸

Thus, the existing common law, admittedly originally developed in the vertical well context, is clear on two points. First, the absence of an explicit grant of pooling authority means that the lessee does not have the authority to combine multiple tracts into a single drilling unit.⁸⁹ And second, the act of combining separate tracts into a multi-tract unit for the purpose of obtaining a drilling permit is by definition “pooling” under the historic definition of that term, and this historic definition of pooling was repeated without change by the Austin appellate court in *Browning Oil Co. v. Luecke* for its handling of a lessee who drilled a horizontal well that traversed multiple tracts without the requisite pooling authority.⁹⁰ A lessee who finds itself in the posture of wanting to drill a multi-tract horizontal well but does not have pooling authority for such a well, in the words of the court in *Browning Oil Co. v. Luecke*, either can decide to not drill the multi-tract horizontal well or alternatively can seek to obtain pooling consent. There is no case law support for a third avenue of not receiving pooling authority and yet drilling a multi-tract well. Whether the Texas Supreme Court should “reformulate” the existing common law and create new principles for the horizontal well context is a separate policy question that will be addressed below in Section II.B.5, but what is important to note at this

reduce the need to pool non-Luecke land. The parties were aware that a drilling unit could exceed eighty acres, and they executed a lease that restricted the size of the units. To allow Lessees to drill any size well and then attempt to comply with the leases *after* the well has been drilled would defeat the intention of the parties to limit pooled units to the smallest unit allowed by the rules. In contravention of this intent, Lessees drilled wells they knew would not fit within the eighty acre spacing requirement and exceeded the authority granted in the pooling provisions. We hold that the trial court did not err in ruling that Lessees failed to comply with the pooling provisions in the leases.

Browning Oil Co. v. Luecke, 38 S.W.3d 625, 642 (Tex. App.—Austin 2000, pet. denied) (citations omitted); *see also* *Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999) (“A lessee has no power to pool without the lessor’s express authorization, which is usually contained in the lease’s pooling clause.”) (citing *Jones*, 403 S.W.2d at 327); *Pampell Interests, Inc. v. Wolle*, 797 S.W.2d 392, 394 (Tex. App.—Austin 1990, no writ) (“[P]arties to an oil and gas lease must strictly comply with its terms . . . [The] parties to the Pampell lease were required to strictly comply with its pooling provisions. Pampell did not.”).

⁸⁸ *See Se. Pipe Line Co.*, 997 S.W.2d at 170.

⁸⁹ *See Browning Oil Co.*, 38 S.W.3d at 634.

⁹⁰ *Id.* at 641.

juncture is that the existing common law has defined pooling authority, and this clearly understood pooling definition has been applied without change to the horizontal well context by the Austin court of appeals in *Browning Oil Co. v. Luecke*.⁹¹

B. The Lessor's Remedies for Unauthorized Multi-Tract Development

1. The Lessor's Right to Petition a Court to Set Aside the Drilling Permit

Texas case law has long held that a lessee must have a good faith claim of right to drill the well in order for the lessee to validly obtain a drilling permit.⁹² The Texas Supreme Court set forth this principle in its opinion in *Magnolia Petroleum Co. v. Railroad Commission* wherein the court stated the following:

Of course, the Railroad Commission should not do the useless thing of granting a permit to one who does not claim the property in good faith. The Commission should deny the permit if it does not reasonably appear to it that the applicant has a good-faith claim in the property.⁹³

Thus, the Railroad Commission should not issue a drilling permit to a lessee unless the lessee has the requisite authority to drill the well, and if a drilling permit is issued to an applicant who does not have the requisite authority then the drilling permit can be set aside by a court if the applicant's title claims are found to be invalid.⁹⁴ Thus, the logical first issue

⁹¹It is important to note that while *Browning Oil Co. v. Luecke* stated that the effort to drill a horizontal well that traverses multiple tracts represents an assertion of pooling, it did provide a standard for allocating to the various tracts that is different from the vertical well authorities. *See supra* text accompanying notes 12–16. However, the alteration of those other common law principles has nothing to do with the question of whether pooling authority exists, and as to that latter question, the court refused to hold that a lessee who owns the working interest of multiple tracts does not have authority to drill a well that traverses those tracts absent pooling authority.

⁹²In *Magnolia Petroleum Co. v. R.R. Comm'n*, the Texas Supreme Court held that the Railroad Commission should determine whether the applicant has a good faith claim of title. *See* 170 S.W.2d 189, 191 (Tex. 1943); *see also* Trapp v. Shell Oil Co., 198 S.W.2d 424, 437–38 (Tex. 1946); Humble Oil & Ref. Co. v. Carr, 243 S.W.2d 709, 714 (Tex. Civ. App.—Austin 1951, writ ref'd n.r.e.).

⁹³170 S.W.2d at 191.

⁹⁴*See* Humble Oil & Ref. Co. v. MacDonald, 279 S.W.2d 914, 916 (Tex. Civ. App.—Austin 1955, writ ref'd n.r.e) (stating that a permit issued to an operator who knows that the operator does

to address is the validity of a permit issued for a multi-tract horizontal well where the applicant has no authority to pool or combine the tracts into a single drilling unit.

When the lessee files an application for a drilling permit, the lessee is required to designate the acreage assigned to the well on Form W-1.⁹⁵ Furthermore, as part of that drilling permit application process, Rule 5(h) indicates that the lessee must attach a plat that includes, among other things, all tracts that are part of the drilling unit, the surface location of the drill site, the distance from that location to the nearest lease line, and the nearest existing well.⁹⁶ Rule 86 amends these rules with respect to horizontal wells. In particular, Rule 86(f)(2)(A)(i) requires that the plat show the lease, pooled unit, or unitized tract and show the acreage assigned to the drilling unit for the proposed well and acreage assigned to the drilling unit.⁹⁷ Rule 86(f)(2)(A)(ii) through (vi) requires, among other things, that the lessee specify the surface location, penetration points, and terminus locations of all drainholes on the plat and also depict the distance from the horizontal well to the nearest lease line or other pooled unit and the distance to the next closest well's penetration point, drainholes, and terminus.⁹⁸ Furthermore, when a horizontal well traverses multiple tracts, that well must be assigned acreage in accordance with Rule 40.⁹⁹ Rule 40 requires that each separate tract must be identified, and Rule 40 requires the lessee to assert that it has authority to combine these tracts into a pooled unit.¹⁰⁰ In applying for a permit for a multi-tract drilling unit, operators historically

not have authority to drill the well is invalid as a matter of law); *Cheesman v. Amerada Petroleum Corp.*, 227 S.W.2d 829, 832 (Tex. Civ. App.—Austin 1950, no writ) (finding that it is incumbent on the Railroad Commission to require the applicant for a permit to make a satisfactory showing of a good faith legal basis for a permit, including examining whether the applicant has a good faith basis to assert pooling authority).

⁹⁵For a copy of the form and its instructions, *see* Tex. R.R. Comm'n, Form W-1 Application for Permit to Drill, Recomplete or Re-enter, <http://www.rrc.state.tx.us/media/2951/finalw-1-92104.pdf>; Tex. R.R. Comm'n, Form W-1 Instructions, <http://www.rrc.state.tx.us/media/2594/finalw-1inst92104.pdf>.

⁹⁶*See* 16 TEX. ADMIN. CODE. § 3.5(h) (2014) (Tex. R.R. Comm'n, Enhanced Oil Recovery Projects—Approval and Certification for Tax Incentive).

⁹⁷*Id.* § 3.86(f)(2)(A)(i) (Tex. R.R. Comm'n, Horizontal Drainhole Wells).

⁹⁸*Id.* § 3.86(f)(2)(A)(ii)–(vi).

⁹⁹*Id.* § 3.86(d)(2) (2014).

¹⁰⁰*Id.* § 3.40(a)(2)(A) (Tex. R.R. Comm'n, Assignment of Acreage to Pooled Development and Proration Units). The Railroad Commission, in recognition of this requirement, modified its drilling permit application to remove this assertion.

were required to attach to Form W-1 an accompanying Form P-12. Form P-12 is specifically referenced and authorized by Rule 40.¹⁰¹ Form P-12 requires the applicant to set forth all of the tracts that the applicant wants to combine into a single drilling unit and requires the applicant to swear under penalties of perjury that the applicant has authority to pool the multiple tracts that are being combined into the drilling unit.¹⁰²

Once the lessee has received a permit to drill on the multi-tract unit, the issuance of that drilling permit impacts the ability for anyone else to drill other wells as those other wells must then comply with the state well density and well spacing requirements of Rule 37, Rule 38, and Rule 86. Rule 40 also states that the assigned acreage cannot be used for other wells.¹⁰³ Thus, the approval to drill the horizontal well in the **Allocation Well Hypothetical** and the subsequent drilling of that horizontal well effectively prevents the assigned acreage in that multi-tract unit from being used for another drilling plan and potentially restricts the location of other wells that may be drilled in the future.

In 2011, the Railroad Commission formally adopted rules to provide permits for so-called PSA wells to operators authorized to drill multi-tract horizontal wells under the authority of production sharing agreements.¹⁰⁴ Although the Railroad Commission protocol for granting permits to operators with authority under production sharing agreements has evolved over time, in order to demonstrate the applicant's good faith claim of right for obtaining the permit, the Railroad Commission's current guidelines for issuing a PSA well permit requires the applicant to represent that it has authority to drill such a well by reason of a production sharing agreement

¹⁰¹ *Id.* § 3.40(a)(1).

¹⁰² Form P-12 requires the foregoing statement:

I declare under penalties prescribed pursuant to the Sec. 91.143, Texas Natural Resources Code, that I am authorized to make the foregoing statements and that the information provided by me or under my direction on this Certificate of Pooling Authority is true, correct, and complete to the best of my knowledge.

For a copy of Form P-12 and its instructions, see Tex.R.R. Comm'n, Form P-12 Certificate of Pooling Authority, <http://www.rrc.state.tx.us/media/2737/p-12p.pdf>.

¹⁰³ See 16 TEX. ADMIN. CODE § 3.40(d) (Tex. R.R. Comm'n, Assignment of Acreage to Pooled Development and Proration Units).

¹⁰⁴ See 36 TEX. REG. 3569 (2011), *adopted* 36 TEX. REG. 5837 (2011) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.80).

that has been ratified by at least sixty-five percent of the royalty interest owners of each traversed tract.¹⁰⁵

Notwithstanding the above protocol for PSA wells, starting in 2010, the Railroad Commission's legal staff confirmed that it also would issue permits for wells that the Railroad Commission designates as "allocation wells."¹⁰⁶ An allocation well is a term of art developed by the Railroad Commission to refer to a horizontal well that traverses more than one tract and where less than sixty-five percent of the royalty interest owners have approved the drilling plan (thus failing the Railroad Commission's guidelines for issuing a PSA well permit).¹⁰⁷ Instead of conditioning the grant of a permit for an allocation well upon an affirmative representation by the applicant that it has pooling authority or has otherwise obtained the consent from its lessors to drill the multi-tract horizontal well, the Railroad Commission only requires the applicant to represent that it has the entire working interest for the traversed tracts without any further representation by the applicant that it has pooling authority or has obtained the consent of royalty owners for a multi-tract well.¹⁰⁸ The first so-called allocation well permit was issued in 2010 to Devon even though Devon had not received

¹⁰⁵In 2011, the Railroad Commission formally adopted rules for PSA wells and authorized operators to file for such permits by filing Form PSA-12. *See id.* However, as stated in the text, to obtain a PSA well permit under the current rules, the operator must represent that at least sixty-five percent of the working interest owners and sixty-five percent of the royalty interest owners in each of the drillsite tracts have agreed to the PSA. *See Whitworth & McGinnis, supra* note 6, at 192–96, 212 (stating the above proposition and indicating that these permitting standards are available upon request from the Railroad Commission). The adoption of these rules in 2011 merely formalized the administrative policy that had evolved up until that date. The approval of PSA wells where less than 100 percent of the royalty interest owners had given their consent was an administrative practice that started in 2008. *See* Closing Statement of EOG Resources Inc. at 2, Tex. R.R. Comm'n, *Application of EOG Resources, Inc., Klotzman Lease (Allocation) Well No. 1H, Eagleville (Eagle Ford -2) Field, Dewitt County, Texas*, Docket No. 02-0278952 (Jan 4, 2013), <http://www.oilandgaslawyerblog.com/files/2015/02/EOG-Closing-Statement.pdf> (asserting that the administrative practice began in 2008 for authorizing the issuance of permits for production sharing agreements with sixty-five percent of the royalty interest owners and sixty-five percent of the working interest owners). Commentators have noted that the administrative practice of issuing well permits for PSA wells where all of the mineral interest owners had consented started in 1998 with vertical wells and in 2008 for horizontal wells. *See* Robert D. Jowers & Mickey R. Olmstead, *Drafting Production Sharing Agreement*, 39TH ANNUAL ERNEST E. SMITH OIL, GAS & MIN. L. INST. 4 (2013).

¹⁰⁶*Whitworth & McGinnis, supra* note 6, at 213.

¹⁰⁷*See id.* at 212–13.

¹⁰⁸*See id.*

consent from sixty-five percent of the royalty interest owners and did not have pooling authority.¹⁰⁹ The Railroad Commission has continued to issue allocation well permits to other operators.¹¹⁰ In 2012,¹¹¹ the Railroad Commission was urged to adopt formal guidelines for its evolving allocation well permitting practice so as to require operators to comply with the guidelines established for PSA well permits,¹¹² but the Railroad Commission declined to open a formal rulemaking proceeding at that

¹⁰⁹ See Letter from Colin K. Lineberry, Director, Hearings Section, Office of Gen. Counsel, Tex. R.R. Comm'n, to Brian Sullivan, McElroy, Sullivan & Miller, LLP (Apr. 21, 2010) (on file with the Tex. R.R. Comm'n), <http://www.rrc.state.tx.us/media/11198/02-278952-mfe-pfd-attachments.pdf> (“[B]ased on information submitted and particularly the representation by applicant that it holds leases covering 100% of each tract traversed by the wellbore and that there are no unleased interests within 330 feet of any point on the wellbore, it appears that applicant has met the minimal good faith claim standard necessary for issuance of a permit. The Commission expresses no opinion as to whether the leases alone confer the right to drill across lease lines as contended by applicant or whether a pooling agreement or production sharing agreement is also required.”). After issuance of this letter, the Railroad Commission issued a permit to Devon for a well that was designated as an allocation well. Tex. R.R. Comm'n, *Application of Devon Energy Prod. Co. for Well No. 1H, Taylor-Abney-Obanion (Allocation) Unit, Carthage, (Haynesville Shale) Field, Harrison County*, Docket No. 0265591 (Apr. 27, 2010) [hereinafter *Devon Application*]. The legal basis for issuing allocation well permits was later questioned in a subsequent letter. See Letter from Colin K. Lineberry, Director, Hearings Div., Office of Gen. Counsel, Tex. R.R. Comm'n, to Spencer S. Klotzman, Klotzman Law Firm, PLLC & Doug J. Dashiell, Scott, Douglass & McConnico, L.L.P. (Oct. 5, 2012) (on file with the Tex. R.R. Comm'n) (“EOG is correct in asserting that the Commission staff has previously accepted as sufficient proof of a good faith claim to drill a horizontal well across two or more leases operators' uncontested assertions that their leases alone give them the right to drill, even without an allegation that the leases have been pooled. EOG is also correct in noting that the Commission staff indicated that it was expressing no opinion as to whether leases alone confer the right to drill across lease lines. This is the first case of which I am aware in which a mineral owner has asserted, prior to the permitting of the well, that the specific terms of its leases bar an operator from having even a good faith claim to the right to drill a horizontal well across lease lines. In my view, the complainants' assertions cast sufficient doubt on the applicant's assertion of a good faith claim to preclude the administrative approval of the requested permit at this juncture.”). For the subsequent procedural history of the EOG/Klotzman controversy, see *infra* note 134 and accompanying text.

¹¹⁰ Whitworth & McGinnis, *supra* note 6, at 213.

¹¹¹ See Petition by Tex. Land & Mineral Owners Ass'n, et al. to Initiate Rulemaking Proceedings to Amend Statewide Rule 40 to Regulate the Drilling of Horizontal Wells That Cross Lease or Unit Boundaries (Nov. 30, 2012), <http://www.tlma.org/news%20files/Allocation%20Well%20Rulemaking%20Petition%20As%20Filed.pdf>.

¹¹² For requirements to obtain a drilling permit for a PSA well, see *Amoco Prod. Co. v. Alexander*, 622 S.W.2d 563, 568 (Tex. 1981).

time¹¹³ and has not adopted any formal rules with respect to its permitting of allocation wells as of the time of the writing of this Article.

On November 12, 2013, as a change to prior administrative practice, the commissioners proposed in an open meeting to change the administrative practice of the Railroad Commission with respect to amendments to forms, applications, and filing requirements with respect to oil and gas activities.¹¹⁴ In this regard, in cases it deemed appropriate, the commissioners announced that the Railroad Commission prospectively may make amendments to its existing forms, applications, and filing requirements without opening a formal rulemaking proceeding.¹¹⁵ At an open hearing held on June 17, 2014, the commissioners unanimously agreed to adopt this more liberal procedure.¹¹⁶ One of the very first actions taken by the Railroad Commission under this new procedure was to adopt a new Form P-16 to be used for its evolving allocation well permitting process.¹¹⁷ Interestingly, the Railroad Commission identifies Rule 40 as the authorizing rule that

¹¹³The commissioners approved the staff's recommendation to not open a rulemaking to amend Rule 40. See Tex. R.R. Comm'n, Formal Comm'n Actions, Hearings Div., *Petition for Rulemaking to Amend 16 TEX. ADMIN. CODE § 3.40 (Assignment of Acreage to Pooled Development and Proration Units) pursuant to TEX. GOV. CODE § 2001.021, O&G Docket No. 20-0280116* 33 (Jan. 29, 2013) <http://www.rrc.state.tx.us/media/8735/012913.pdf>.

¹¹⁴See Memorandum from the Office of Gen. Counsel, Tex. R.R. Comm'n to the Chairman of the Tex. R.R. Comm'n (Mar. 18, 2014) (on file with the Tex. R.R. Comm'n), <http://www.rrc.state.tx.us/media/9481/prop-amend-3-80-remove-table-of-forms-march2014-sig.pdf>. This proposed amendment to Rule § 3.80 was codified in 2014. See 16 TEX. ADMIN. CODE § 3.80 (2014) (Tex. R.R. Comm'n, Commission Oil and Gas Forms, Applications, and Filing Requirements).

¹¹⁵Memorandum from the Office of Gen. Counsel, *supra* note 114, at 1.

¹¹⁶See Tex. R.R. Comm'n, Formal Comm'n Actions, Hearings Div., *Amendment of 16 TEX. ADMIN. CODE § 3.80, relating to Commission Oil and Gas Forms, Applications, and Filing Requirements, O&G Docket No. 20-0287605* 32 (June 17, 2014), http://www.rrc.state.tx.us/media/21678/6-17-14_minutespdf.pdf. These adopted amendments to Rule § 3.80 were published in the Texas Register the following month. See 39 Tex. Reg. 2661 (Apr. 11, 2014), *adopted* 39 Tex. Reg. 5148 (July 4, 2014) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.80).

¹¹⁷See Tex. R.R. Comm'n, Form P-16 Acreage Designation, <http://www.rrc.state.tx.us/media/30771/form-p-16-10-9-15.pdf>; Tex. R.R. Comm'n, Form P-16 Acreage Designation Attachment Page 1A, <http://www.rrc.state.tx.us/media/30769/p-16-attach-1a-10-15.pdf>; Tex. R.R. Comm'n, Form P-16 Acreage Designation Attachment Page 2A, <http://www.rrc.state.tx.us/media/30768/p-16-attach-2a-10-15.pdf>. To review the rule cited by the Railroad Commission as authorizing Form P-16, see Tex. R.R. Comm'n, Form P-16 Data Sheet Instructions, <http://www.rrc.state.tx.us/media/23515/p-16-instructions-9-9-14-final.pdf>.

supports their creation of new Form P-16.¹¹⁸ Rule 40 explicitly addresses “assignment of acreage to pooled development,” stating in relevant part that “[a]n operator may pool acreage, in accordance with appropriate contractual authority and applicable field rules, for the purpose of creating a drilling unit”¹¹⁹ To reinforce the point that Rule 40 can be invoked only when multiple tracts are validly pooled into a single drilling unit, Rule 40(a)(2)(A) requires the applicant to separately indicate the basis for its authority for including each tract included in the pooled unit.¹²⁰

However, even though Rule 40 only envisions the assignment of acreage to pooled units by operators with pooling authority, new Form P-16 does not require the applicant to provide any proof that it has pooling authority as the older Form P-12 had required.¹²¹ Thus, even though new Form P-16 purports to be authorized by existing Rule 40, the reality is that the new Form P-16 fails to elicit the information that Rule 40 specifies as necessary for the issuance of a permit under Rule 40 as the new Form P-16 nowhere requires any proof of pooling authority on the part of the applicant. The Railroad Commission has not attempted to explain how its new Form P-16 can at the same time (1) omit any required representation on the part of the applicant that it has pooling authority and yet (2) rely on existing Rule 40 as the basis for creating a new form that does not elicit the information that the enabling Rule 40 requires (namely a showing of pooling authority). Thus, without having engaged in any formal rulemaking proceeding to amend Rule 40, the Railroad Commission created a new form to allow applicants to file for a multi-tract drilling permit under the auspices of Rule 40 even though this new Form P-16 does not attempt to satisfy the substantive requirements contained in Rule 40. As a result, since the creation of new Form P-16, operators now have a new means to lodge an application for a multi-tract drilling permit by filing Form W-1, can avoid filing old Form P-12 that explicitly requires the applicant to affirmatively assert pooling authority as required by Rule 40, and instead can attach the new Form P-16 in its stead. This revised application protocol allows operators to request authority to combine multiple tracts into a single drilling unit under the auspices of Rule 40 without ever providing evidence that the applicant has the requisite pooling authority mandated by Rule 40.

¹¹⁸ See Tex. R.R. Comm’n, Form P-16 Data Sheet Instructions, *supra* note 117.

¹¹⁹ 16 TEX. ADMIN. CODE § 3.40(a) (2015) (Tex. R.R. Comm’n, Assignment of Acreage to Pooled Development and Proration Units).

¹²⁰ *Id.*

¹²¹ See *Brown v. Smith*, 174 S.W.2d 43, 46 (Tex. 1943).

The evolving allocation well permitting process of the Railroad Commission has created significant controversy among the industry. In this regard, in a widely followed “test case” allocation well proceeding, EOG Resources, Inc. filed an application for a drilling permit for a horizontal well on an approximately eighty-acre unit.¹²² The eighty-acre unit was comprised of two tracts.¹²³ EOG held a working interest in both tracts.¹²⁴ However, the lessors for the tracts had not given EOG pooling authority, and the lessors on one of the tracts (hereafter referred to simply as the Klotzmans) protested EOG’s application for a drilling permit.¹²⁵ The Klotzmans argued that the issuance of a drilling permit for a so-called allocation well was unsupported by existing oil and gas case law, and the Klotzmans argued that the Railroad Commission did not have the right to issue a drilling permit for a multi-tract unit when the lessee did not possess pooling authority and had failed to comply with the forced pooling requirements set forth in MIPA.¹²⁶ In its proposal for decision, the Railroad Commission examiners agreed with the Klotzmans, finding that EOG did not have a good faith claim to support the grant of a drilling permit because EOG did not have pooling authority or satisfying the requirements for forced pooling under MIPA.¹²⁷ However, when the case was heard by the commissioners, the commissioners declined to follow the examiner’s proposal for decision and awarded EOG a drilling permit for its so-called allocation well.¹²⁸ The commissioners stated that a drilling permit was appropriate because EOG effectively owned the entire working interest for

¹²² See Letter from Colin K. Lineberry, Director, Hearings Section, Office of Gen. Counsel, Tex. R.R. Comm’n, to Brian Sullivan, McElroy, Sullivan & Miller, LLP, (April 21, 2010) (on file with the Tex. R.R. Comm’n), <http://www.rrc.state.tx.us/media/11198/02-278952-mfe-pfd-attachments.pdf>.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ Tex. R.R. Comm’n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagle Ford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 3–4, Docket No. 02-0278952 (June 25, 2013) (proposal for decision), <http://www.rrc.state.tx.us/media/11191/02-278952-mfe-pfd.pdf>.

¹²⁶ *Id.* at 3, 20–21.

¹²⁷ *Id.* at 20–22.

¹²⁸ Tex. R.R. Comm’n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagle Ford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 2, Docket No. 02-0278952 (Sept. 24, 2013) (final order), <http://www.rrc.state.tx.us/media/11182/02-278952-mfe-order.pdf>.

the two tracts and there was no unleased interest within the minimum required spacing and density rules that applied to the proposed wellbore.¹²⁹

The Klotzmans filed suit in district court to contest EOG's drilling permit, but the case was settled prior to trial.¹³⁰ However, because the Railroad Commission continues to issue drilling permits for so-called allocation wells to operators who possess the entire working interest for each tract without mandating that the operator demonstrate that it has pooling authority or that it has complied with the forced pooling provisions of MIPA, the issuance of a drilling permit for these so-called allocation wells is likely to be the subject of future litigation.¹³¹ In that future litigation, the controlling legal principle will be that a drilling permit is invalid if the lessee does not have a good faith claim for their asserted right to drill the well.¹³² In the Klotzman controversy, EOG admitted that it had not received any expressed pooling authority under its leases and that it did not comply with the forced pooling provisions of MIPA, so there was no dispute in that contested proceeding that EOG did not have any colorable claim of pooling authority.¹³³

In this fact pattern, when such a case does proceed to trial, a court should rule in favor of the party in the posture of the Klotzmans and should set aside the drilling permit issued to the operator if the operator does not have pooling authority nor complied with the forced pooling provisions of MIPA.¹³⁴ For the reasons set forth in Section II.A, an operator's action of drilling a horizontal well that traverses multiple tracts represents an unauthorized act that is unsupported by existing case law.

¹²⁹ *Id.*

¹³⁰ *Reily v. R.R. Comm'n of Tex.*, No. D-1-GN-13-004306 (98th Dist. Ct., Travis Cty., Tex. Dec. 23, 2013).

¹³¹ See SMITH & WEAVER, *supra* note 18, § 9.9[B][f] (predicting that "[t]he legality of the commission's authorization of drilling permits for allocation wells has not yet been the subject of judicial review . . ."). In fact, at least one case is currently docketed. See *Casey v. MD Am. Energy, LLC*, No. 15-13995-278-10 (278th Dist. Ct., Madison Cty., Tex. June 16, 2015).

¹³² See *Magnolia Petroleum Co. v. R.R. Comm'n*, 170 S.W.2d 189, 191 (Tex. 1943).

¹³³ See EOG Resources Application, *supra* note 125, at 20–21.

¹³⁴ The further arguments for asserting that the drilling permit should have been set aside is beyond the scope of this Article and is adequately set forth in the Klotzman filings with the Railroad Commission. See, e.g., Motion for Rehearing of Katharine Larson Reilly & Melanie McCollum Klotzman at 1–2, *Tex. R.R. Comm'n, Application of EOG Resources, Inc., Klotzman Lease (Allocation), Well No. 1H, Eagleville (Eagle Ford-2) Field, Dewitt County, Texas*, Docket No. 02-0278952 (Oct. 14, 2013), <http://www.oilandgaslawyerblog.com/files/2015/02/02-0278952-Klotzman-Motion-for-Rehearing.pdf>.

However, even though this analysis has relevance for future parties in the posture of the EOG/Klotzman controversy, this analysis may apply to a small subset of royalty interest owners as few lessors are likely to have an opportunity to intervene prior to the drilling of the well. This is because the working interest owner is not required under existing Railroad Commission rules to provide notice to their lessors of their application for a multi-tract drilling permit.¹³⁵ So, many lessors may find out about an allocation well permitting proceeding only after-the-fact. Consequently, because a lessee may obtain a drilling permit even though it has no pooling authority and then can proceed to drill a multi-tract horizontal well without the lessor ever receiving any notice that her pooling rights are being impacted, the first notification to the lessor may be the lessor's receipt of a division order with respect to the already producing horizontal well. Thus, the more important legal question, at least in actual practice, is likely to be what remedies are available to the lessor in the reasonably foreseeable scenario where the lessee (without pooling authority) drills a multi-tract horizontal well and the lessor had no actual notice of this action until after the well commences production. It is to this question that the remainder of this Section II.B now turns.

2. The Lessor's Right to Obtain Damages for the Lost Leasehold Benefits That Would Have Been Bargained For

For the reasons set forth in Section II.A, a lessee does not have authority to drill a multi-tract well unless that lessee has been granted pooling authority for each of the traversed tracts.¹³⁶ In this posture, if the lessee proceeds to drill the horizontal well depicted in the **Allocation Well Hypothetical** without first obtaining the lessor's pooling consent, then the lessee's combining of tracts into one drilling unit constitutes a slander of the lessor's retained pooling authority.¹³⁷

¹³⁵ See 16 TEX. ADMIN. CODE § 3.37(h)(2)(B) (2014) (Tex. R.R. Comm'n, Statewide Spacing Rule).

¹³⁶ See *supra* Section II.A.

¹³⁷ For a discussion of the elements necessary to plead a slander of title claim, see SMITH & WEAVER, *supra* note 18, § 7.1. Based on the definition of a slander of title claim in the restatement, a lessee "who publishes a false statement harmful to the interests of another is subject to liability for pecuniary loss resulting to the other if . . ." the lessee recognizes that the public assertion of the lessee's right to drill a multi-tract well "harm[s] . . . interests of the other . . ." and the lessee "knows that the statement is false or acts in reckless disregard of its truth or falsity." RESTATEMENT (SECOND) OF TORTS § 623A (AM. LAW INST. 1977).

Consequently, regardless of the appropriateness of the Railroad Commission's act of issuing drilling permits for wells that have no legal status in Texas law, the case law is clear that "[t]he orders of the Railroad Commission cannot compel pooling agreements that the parties themselves do not agree upon."¹³⁸ Thus, even though the Railroad Commission may issue a permit for a multi-tract unit (which is quintessentially the definition of pooling as discussed in Section II.A, *supra*), that government approval cannot authorize pooling. Furthermore, any party damaged by the lessee's activities, even if sanctioned by the Railroad Commission, is entitled to bring a private cause of action.¹³⁹ Thus, even if the lessee proceeds to drill a well under the color of regulatory approval, the Railroad Commission's permitting process does not foreclose the rights of private parties to seek redress against operators who commit a tort in contravention of the private property rights of the true owner.¹⁴⁰ A recent Texas case has reiterated the principle that "a permit is not a get out of tort free card."¹⁴¹ Thus, even though the operator may receive a permit to drill a so-called allocation well, Texas case law is clear that this regulatory approval does not shield the operator from private causes of action based on the obligations (expressed or implied) that the operator owes to its lessor.¹⁴²

One common counter-argument made in support of the allocation well permitting process is that the filing of a drilling permit application for an allocation well, if it did constitute an unauthorized assertion of pooling

¹³⁸ *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965).

¹³⁹ TEX. NAT. RES. CODE ANN. § 85.321 (West 2011); *see also* SMITH & WEAVER, *supra* note 18, § 8.3[F][1].

¹⁴⁰ *See* *Gregg v. Delhi-Taylor Oil Corp.*, 344 S.W.2d 411, 417–19 (Tex. 1961); *Phillips Petroleum Co. v. Am. Trading & Prod. Corp.*, 361 S.W.2d 942, 944–46 (Tex. Civ. App.—El Paso 1962, writ ref'd n.r.e.).

¹⁴¹ *See* *FPL Farming Ltd. v. Envtl. Processing Sys.*, 351 S.W.3d 306, 311 (Tex. 2011).

¹⁴² *See* *R.R. Comm'n of Tex. v. Manziel*, 361 S.W.2d 560, 565, 574 (Tex. 1962) (holding open the possibility for private causes of action against the lessee who engages in actions approved by the Railroad Commission). Private disputes involving causes of action that cannot be resolved by the Railroad Commission are inherently judicial in nature and, therefore, represent an exception to the doctrine of primary jurisdiction. *See* *Gregg*, 344 S.W.2d at 415. The courts have held that actions in trespass, negligence, negligence per se, nuisance, negligent and intentional infliction of emotional distress, and strict liability are all judicial questions that are not within the authority of the Railroad Commission to resolve or determine. *See In re Apache Corp.*, 61 S.W.3d 432, 436 (Tex. App.—Amarillo 2001, no pet.). In *Foree v. Crown Cent. Petroleum Corp.*, the Texas Supreme Court left unresolved whether the Railroad Commission's incidental findings are entitled to deference in subsequent private litigation of a judicial claim. 431 S.W.2d 312, 316 (Tex. 1968).

authority, would be ineffective and thus would constitute a legal nullity since the lessee has no pooling authority.¹⁴³ This line of reasoning is correct in its assertion that the attempt to pool when a lessee has no pooling authority is ineffective under Texas law,¹⁴⁴ but this conclusion fails to address the corollary and obvious necessary secondary issue of whether the act of developing the mineral estate on a multi-tract basis without pooling authority represents a slander of the pooling authority (i.e., the retained private property right) of the lessor.¹⁴⁵ A leading treatise posits that “[o]ftentimes, lessors will insist on striking the pooling clause, which forces the lessee to seek the lessor’s separate consent to a pooling or to seek compulsory pooling.”¹⁴⁶ The lessee’s assertion of authority to drill an allocation well for the combined tracts of Tract A, Tract B, and Tract C contravenes the pooling authority retained by the lessor and destroys the

¹⁴³ See Squibb, *supra* note 31, at 947 (“The drilling of an allocation well across lease lines certainly involves the combination of a series of contiguous tracts along and surrounding the horizontal path of the well. But in contrast to a typical pooling, an allocation well is not accompanied by a cross-conveyance of interests or any contractual agreement among the parties by which production is allocated.”); McElroy, *supra* note 22, at 59 (stating in response to assertion that drilling across multiple tracts is forced pooling, the commentator says, “This is an incorrect statement of the law. In order to form a pooled unit, the lessee must comply with the pooling authority granted in the lease.”). The purported attempt to combine acreage into a single unit is not effective absent an expressed grant of pooling authority, but the effort to assert a right that one does not possess represents slander of title, an issue unaddressed by either commentator.

¹⁴⁴ See Squibb, *supra* note 31, at 942; see also sources cited *supra* notes 65–69. The court in *Browning Oil Co. v. Luecke*, stated as follows:

Although pooled units are often formed to satisfy spacing requirements, the grant of a permit to drill a well does not result in the valid pooling of the separately owned interests within the drilling unit. Similarly, the designation of a proration unit does not have the effect of creating a pooled unit. The Railroad Commission has no authority to determine property rights.

38 S.W.3d 625, 634 n.7 (Tex. App.—Austin 2000, pet. denied) (citing *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965); *SMITH & WEAVER*, *supra* note 18, § 10.1).

¹⁴⁵ The publication of a claim of right to drill a multi-tract well is inherently an assertion of pooling authority as pooling is the combining of multiple tracts into a single drilling unit. See sources cited *supra* Section II.A and accompanying text. The court in *Browning Oil Co. v. Luecke* applied this exact same definition of pooling (the combining of multiple tracts to create a drilling unit) and found the lessee’s unit well represented “unauthorized pooling.” See 38 S.W.3d at 634, 642.

¹⁴⁶ See KUNTZ, *supra* note 46, § 48.3[a][1].

economic value of the lessor's retained private property interest (her pooling authority) without compensation.¹⁴⁷

In Texas, the elements for a slander of title action are identified as the following: (1) the uttering and publishing of disparaging words; (2) falsity; (3) malice; (4) special damages; (5) possession of an estate or interest in the property disparaged; and (6) the loss of a specific sale.¹⁴⁸ As to the first two elements, publication of a falsity can either be written or oral in nature,¹⁴⁹ and so the filing of sworn statements by the lessee with a government agency (namely, the Railroad Commission) where the lessee asserts an authority to obtain a drilling permit for a multi-tract unit represents the wrongful publication of authority¹⁵⁰ that is false if in fact the lessee has not been granted pooling authority. This wrongful assertion of a development right that is not supported by the lease slanders the property rights of the true owner (namely the lessor).

As to malice, the definition of this term has different meanings depending upon whether the claimant desires to obtain actual damages or punitive damages. If the lessor seeks only actual damages, then legal malice means simply that the lessee's "act or refusal was deliberate conduct without reasonable cause."¹⁵¹ In other words, the lessor must show that the lessee's asserted authority was not made in "good faith" in order for legal malice to exist.¹⁵²

A lessee may attempt to argue that it must be acting in good faith because the Railroad Commission implicitly must believe that the lessee had a good faith claim as a condition precedent to the agency's issuance of

¹⁴⁷The Texas Supreme Court has recognized that the wrongful assertion of a property right that one does not possess can give rise to a cause of action for slander of title. *Ellis v. Waldrop*, 656 S.W.2d 902, 905 (Tex. 1983) ("[A] cause of action to recover damages for the failure to release a purported, though not actual, property interest is a cause of action for slander of title."); *see also* *A. H. Belo Corp. v. Sanders*, 632 S.W.2d 145, 146 (Tex. 1982); *Reaugh v. McCollum Expl. Co.*, 163 S.W.2d 620, 622 (Tex. 1942); *Shell Oil Co. v. Howth*, 159 S.W.2d 483, 490 (Tex. 1942).

¹⁴⁸*Williams v. Jennings*, 755 S.W.2d 874, 879 (Tex. App.—Houston [14th Dist.] 1988, writ denied).

¹⁴⁹*Walley v. Hunt*, 54 So. 2d 393, 396 (Miss. 1951).

¹⁵⁰*See* sources cited *supra* Section II.A and accompanying text.

¹⁵¹*Kidd v. Hoggett*, 331 S.W.2d 515, 518 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.).

¹⁵²*See* *Duncan Land & Expl., Inc. v. Littlepage*, 984 S.W.2d 318, 332 (Tex. Civ. App.—Fort Worth 1998, pet. denied).

a drilling permit.¹⁵³ However, due to the circumstances surrounding the issuance of allocation well permits, a court should hold that the Railroad Commission's issuance of a drilling permit has no relevance for purposes of analyzing the slander of title cause of action between private parties. In this regard, the typical allocation well permit contains an unusual disclaimer from the Railroad Commission staff that limits the scope of their regulatory inspection, and this disclaimer clearly disavows any determination of the merits of the lessee's private property rights or whether pooling authority exists or if pooling authority was needed as a precondition for the issuance of the permit.¹⁵⁴

Given the disavowal of responsibility for determining the legitimacy of the applicant's legal rights and the explicit statement in the permit issued by the Railroad Commission that the Railroad Commission leaves for a court of competent jurisdiction to determine those rights and disclaims any consideration of those claims, it is difficult to believe that an operator who

¹⁵³ See *Magnolia Petroleum Co. v. R.R. Comm'n*, 170 S.W.2d 189, 191 (Tex. 1943).

¹⁵⁴ The typical order that grants a permit for an allocation well contains the following disclaimer in its permit:

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

See, e.g., *Tex. R.R. Comm'n*, Form W-1 Application for Permit to Drill, Recomplete, or Re-Enter, MD America Energy, LLC for Henderson (Allocation), Well No. 1H, Madison, County, Oil & Gas Docket No. 0291157.

receives a drilling permit with such a disclaimer can claim that the Railroad Commission's authorization has any relevance with respect to the substantive merits of the legal claims between private parties. Thus, a court should be able to reach the merits of the slander of title claim in a de novo review. Given the lack of any case law authority to support the notion that the lessee has the right to drill a multi-tract well where no pooling authority has been granted, sufficient facts exist in the **Allocation Well Hypothetical** for a jury to reasonably conclude that the operator acted with legal malice in disregard of the lessor's retained pooling authority.¹⁵⁵

As to the element of the loss of a specific sale, Texas law follows the minority rule of permitting the landowner to waive their right to damages in a claim for trespass and instead sue in assumpsit for the reasonable value of the asserted right that should have instead been contractually bargained for.¹⁵⁶ Thus, if the other elements of a trespass are available, then the injured party for the trespass¹⁵⁷ may forego having their damages measured by the actual loss sustained and instead have their damages based upon the implied contract rights that were misappropriated by the other party.¹⁵⁸

The ability to combine assumpsit remedies within other tort theories arises as the natural consequence of the fact that Texas does not follow rigid

¹⁵⁵ See *Williams v. Jennings*, 755 S.W.2d 874, 882–83 (Tex. App.—Houston [14th Dist.] 1988, writ denied) (“In the present case, appellants had constructive notice through their agents that the reformed deed created an ambiguity and passed no title. Furthermore, when agent Frierson called Charles Brightwell about leasing the mineral rights, Brightwell alerted him to the possibility that the Brightwells no longer owned any rights. There was then sufficient time between that call and the taking of the lease for appellant company to do a thorough check of the deed records and to contact the parties to clarify their intent. That this procedure was not followed was unreasonable under the circumstances. The evidence is both legally and factually sufficient to support a finding of deliberate conduct without reasonable cause . . .”). In like manner, the failure to knowingly proceed to drill an allocation well without providing notice or clarifying the operator's pooling rights creates a fact question for a jury to determine the reasonableness of the operator's actions.

¹⁵⁶ See *Phillips Petroleum Co. v. Cowden*, 241 F.2d 586, 592 (5th Cir. 1957); *Gulf, Colo. & Santa Fe Ry. Co. v. Dunman*, 19 S.W. 1073, 1074 (Tex. 1892); *Estes v. Browning*, 11 Tex. 237, 246 (1853); *Harrell v. F. H. Vahlsing, Inc.*, 248 S.W.2d 762, 772–73 (Tex. Civ. App.—San Antonio 1952, writ ref'd n.r.e.).

¹⁵⁷ For a case involving trespass, see, e.g., *Phillips Petroleum Co.*, 241 F.2d at 592.

¹⁵⁸ For an analysis of the historic development of the law involving claims in assumpsit, see generally J. B. Ames, *The History of Assumpsit*, 2 HARV. L. REV. 1 (1888); James Oldham, *Reinterpretations of 18th-Century English Contract Theory: The View from Lord Mansfield's Trial Notes*, 76 GEO. L.J. 1949 (1988).

forms of action for pleading tort claims.¹⁵⁹ Thus, in the oil and gas context, the Texas Supreme Court has allowed a slander of title cause of action to be styled as an action in trespass¹⁶⁰ with the consequence that landowners are able to bring claims akin to an assumpsit proceeding, thus allowing the lessor to obtain the speculative leasehold benefits that would have been received if the lessee had adequately compensated the lessor for its retained property right even when no specific sale was lost. In *Humble Oil & Refining Co. v. Kishi*, a lessee (Humble Oil) asserted that it had the executive right with respect to Kishi, but this assertion was legally incorrect.¹⁶¹ However, Humble Oil's wrongful assertion clouded Kishi's retained executive right. Humble Oil then drilled a dry hole, so this action made it impossible from a practical perspective for Kishi to bargain for fair compensation for his retained executive right from other potential lessees or from Humble Oil.¹⁶² The court held that Humble Oil's wrongful assertion of authority on behalf of Kishi constituted a trespass of Kishi's retained executive right, and the remedy was that Kishi was held to be entitled to the leasehold benefits that Kishi would have received if Kishi had been paid for the property right that Humble Oil contravened.¹⁶³

¹⁵⁹ See, e.g., *Phillips Petroleum Co.*, 241 F.2d at 592.

¹⁶⁰ For a case that appears to be based on a slander of title type cause of action that the Court styled as a trespass, see *Humble Oil & Ref. Co. v. Kishi*, 276 S.W. 190, 190–91 (Tex. Comm'n. App. 1925, judgment adopted), *judgment set aside on reh'g*, 291 S.W. 538 (Tex. Comm'n. App. 1927, holding approved). A leading treatise has rightly viewed *Humble Oil & Refining Co. v. Kishi* as involving a slander of title claim where loss of a specific economic sale was not required to be shown. See SMITH & WEAVER, *supra* note 18, § 7.2 (“On its facts *Kishi* presents serious analytical problems. Slander of title seems a more appropriate theory than trespass, for Humble had an apparent right to be on the land Although it is doubtful that *Kishi* should have been decided under a trespass theory, the opinion's conclusion as to the measure of recovery against a trespasser who engages in unsuccessful drilling operations seems sound. Holding such a trespasser liable for the decrease in value of the mineral estate is consistent with the measure of damages applied in cases involving other types of trespass to land. Moreover, the plaintiff in a trespass action does not have to show loss of a specific sale as a result of the defendant's action, as would be required for recovery in a slander-of-title action.” (footnote omitted)).

¹⁶¹ 276 S.W. at 191.

¹⁶² *Id.* at 190–91.

¹⁶³ See *id.* at 191. The court was ambiguous on what it considered in determining leasehold benefits, but scholars early-on recognized that these leasehold benefits should include lost bonus and potentially lost royalty. See A. W. Walker, Jr., *Fee Simple Ownership of Oil and Gas in Texas*, 6 TEX. L. REV. 125, 137–38 (1928). The holding in *Humble Oil & Refining Co. v. Kishi* was clarified by the Texas Supreme Court in *Byrom v. Pendley*, 717 S.W.2d 602, 605 (Tex. 1986) (“[A] lessee of mineral interests who enters the land after termination of the lease and termination

The holding in *Humble Oil & Refining Co. v. Kishi* is directly relevant to the allocation well issue. The lessee in the **Allocation Well Hypothetical** asserts the right to drill a multi-tract well in contravention of the lessor's retained pooling authority. The lessee's assertion of the executive right to drill a multi-tract drilling well represents a denial of the lessor's pooling authority and permanently clouds that authority once the Railroad Commission has acted upon this wrongful assertion. Based on *Humble Oil & Refining Co. v. Kishi*, once the lessee conducts drilling operations on a multi-tract unit (the essence of pooling) without the requisite pooling authority, the lessee's actions represent an irreversible slander of the retained pooling authority of the lessor with the consequence that the lessor has the right to sue in assumpsit in order to receive just compensation for the leasehold benefits that would have been available to the lessor had the lessor been able to bargain for fair compensation for her pooling consent.¹⁶⁴ In 1986, the Texas Supreme Court had an opportunity to walk back its decision in *Humble Oil & Refining Co. v. Kishi*, but the court instead chose to re-explain and reaffirm its support for the holding in *Humble Oil & Refining Co. v. Kishi*, reiterating that a wrongful assertion of an executive right by the lessee against the retained executive rights of its own lessor represents an actionable trespass that affords the lessor with the right to assert damage claims that are akin to an action based in assumpsit in order to receive the market value for the leasehold benefits that were wrongfully asserted by the lessee.¹⁶⁵

Finally, as to the measure of actual damages, the Texas Supreme Court provided guidance for valuing the lessor's pooling authority in *Carson v. Railroad Commission of Texas*.¹⁶⁶ In that case, BTA (the lessee) attempted to force pool Carson's royalty interest into an existing tract where a producing well was already located at a time when BTA's offer would have reduced Carson's interest in the already producing well.¹⁶⁷ In response to the offer made by BTA, Carson suggested that BTA compensate him for reducing his interest in the already existing producing well by increasing Carson's right to a share of a 1/6th royalty interest to reflect prevailing

of the right to enter is liable to his nonconsenting lessor for injury resulting from such unlawful entry.").

¹⁶⁴ See *supra* Section II.B.1.

¹⁶⁵ See *Byrom*, 717 S.W.2d at 605.

¹⁶⁶ 669 S.W.2d 315, 317–18 (Tex. 1984).

¹⁶⁷ *Id.* at 316.

royalty rates in recently signed leases¹⁶⁸ (which the court understood was a 1/6th rate).¹⁶⁹ But, BTA refused, stating that it did not feel obligated to raise Carson's royalty rate above the 1/8th royalty rate specified in the lease.¹⁷⁰ Although the court stated that it would "not attempt to define a fair and reasonable offer, or to determine the various elements thereof," the court did cite approvingly an article by a noted scholar on MIPA that stated that MIPA requires as a condition precedent that a bona fide attempt be made to reach a voluntary agreement and that BTA's unwillingness to compensate Carson at market royalty rates caused BTA's actions to fail to represent a "fair and reasonable offer."¹⁷¹ Thus, applying this analogous holding in *Carson v. Railroad Commission of Texas* to the fact pattern set forth for the **Allocation Well Hypothetical**, a jury should have sufficient grounds to conclude that the lessor's lost lease benefit includes the difference between the 1/8th royalty contained in the existing lease and the right to have bargained for a 1/6th royalty that represents the current market value of royalty rates in modern leases.¹⁷²

Browning Oil Co. v. Luecke is not inconsistent with the above synthesis of the law. After holding that Browning Oil's drilling of a horizontal well for a multi-tract unit violated the pooling provisions of the lease, the Austin appellate court then fashioned a remedy that was based on the facts set forth in the record of that case.¹⁷³ There is no indication that the royalty rate provided to the Lueckes in their existing lease was below market, and so it is not surprising that the court did not find that the Lueckes should have received a higher rate of royalty. Instead, the Lueckes argued for double royalty, which the court believed was punitive and represented an unjust outcome.¹⁷⁴

Thus, the **Allocation Well Hypothetical** contains an additional legally relevant fact that was not present in *Browning Oil Co. v. Luecke*, namely

¹⁶⁸ *Id.* at 316, 318.

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 318.

¹⁷¹ *Id.*; see also Ernest E. Smith, *The Texas Compulsory Pooling Act*, 44 TEX. L. REV. 387, 388–91 (1966).

¹⁷² See SMITH & WEAVER, *supra* note 18, § 7.1[F] ("Usually, damages [for slander of title] will simply be the amount of lost bonus. However, if a market value can be established for the lost royalty, this amount should be awarded as well." (footnote omitted)).

¹⁷³ See *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 642–47 (Tex. App.—Austin 2000, pet. denied).

¹⁷⁴ *Id.* at 644–45.

that the market royalty rate for new leases is now a 1/6th royalty rate whereas the old leases in the **Allocation Well Hypothetical** only provided for a 1/8th royalty rate. This additional fact causes the **Allocation Well Hypothetical** set forth in this Article to fit within the precedent provided by *Humble Oil & Refining Co. v. Kishi*, namely that the lessor in the **Allocation Well Hypothetical** should be entitled to the speculative leasehold benefits that would have been received had the lessor been able to bargain for fair consideration for granting her pooling consent.

As a separate but related area of concern, it is important to recognize that the right to receive transparent information about production and production costs¹⁷⁵ has long been recognized as an area of concern for lessors that requires special drafting considerations.¹⁷⁶ The Railroad Commission has issued specific rules dealing with commingling of production that a multi-tract horizontal well simply cannot comply with.¹⁷⁷ The risks and consequences of this commingling was the subject of

¹⁷⁵This point was poignantly brought home in *Chesapeake Exploration, L.L.C. v. Hyder* where the lessor asserted that the lessee (Chesapeake) changed the way it calculated the lessors' (the Hyders') royalty at least four times with no notice as to the those changes or as to the actual methodology. Brief for Respondent at 5, *Chesapeake Exploration, L.L.C. v. Hyder*, 427 S.W.3d 472 (Tex. App.—San Antonio 2014, pet. filed) (No. 04-12-00769-CV). Without a right to demand an audit of the lessee's business records, it would be very difficult if not impossible for the lessor to protect her interest. Moreover, even if a lessor were successful in negotiating contractual rights to demand an audit of the lessee's business records, lessees must be diligent to do so or risk forfeiture of their valid claims.

¹⁷⁶Professor Lowe has stated as follows:

The common law recognizes the right of the landowner to an accounting of production and some states have statutes requiring the operator or companies purchasing the oil or gas to make available the information necessary for the landowner to evaluate the adequacy of the royalties received. The procedures for enforcing either the common law or a statutory right, however, are likely to be more cumbersome than those for enforcing a lease clause and additionally a benefit is realized by putting the operator on notice during the lease negotiation that accurate accounting information will be required by the landowner. Therefore, a clause in the lease permitting the landowner and his agents reasonable access to the books and records of the operator is recommended.

See John S. Lowe, *Representing the Landowner in Oil and Gas Leasing Transactions*, 31 OKLA. L. REV. 257, 272 (1978) (footnotes omitted).

¹⁷⁷These rules that safeguard against commingling of production from separate wells have been exhaustively discussed by the parties in the EOG/Klotzman controversy and by others and are beyond the scope of this Article. For a discussion of those issues, compare Squibb, *supra* note 31, at 947–55, with SMITH & WEAVER, *supra* note 18, § 9.9[B][2][f].

considerable concern to the Klotzmans in their protest¹⁷⁸ and has been cataloged in a leading treatise.¹⁷⁹ By withholding pooling authority, the lessor preserved the opportunity to negotiate for transparent information about the particular well that produces commingled production for a multi-tract unit. By asserting an authority to drill an allocation well that Texas common law has not recognized, the lessee has denied the lessor the opportunity to bargain for reasonable leasehold protections (including audit and inspection rights) that a knowledgeable lessor would have contractually bargained for.¹⁸⁰ Furthermore, under the facts set forth in the **Allocation Well Hypothetical** posited in this Article, the lessors of Tract B have reasonable grounds to believe that Tract B should be afforded a higher allocation of production than would be allocated if the allocation methodology were based solely on the number of take-points, lateral length underneath Tract B, or based upon surface acreage. In the situation where the lessor has been denied the ability to bargain for audit and inspection rights and the facts indicate that Tract B arguably is entitled to a larger percentage of the production than what would otherwise be allocated to Tract B under the lessee's methodology, the Tract B lessor should be able to contest the lessee's allocation methodology and should be able to obtain the audit and inspection rights that would have been bargained for had the lessee not tortiously interfered with the lessor's pooling authority.¹⁸¹

Actions based upon slander of title must be filed within two years of the occurrence of the slander.¹⁸² If the lessee's wrongful assertion of pooling

¹⁷⁸ See Tex. R.R. Comm'n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagle Ford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 13–17, Docket No. 02-0278952 (June 25, 2013) (final order granting application) (setting forth the Klotzman's concerns regarding commingling).

¹⁷⁹ See SMITH & WEAVER, *supra* note 18, § 9.9[B][2][f].

¹⁸⁰ For an example of audit and inspection protections that are utilized by knowledgeable lessors, see 4–6 HOWARD R. WILLIAMS & CHARLES J. MEYERS, *OIL & GAS LAW* § 671 (1959).

¹⁸¹ For a thorough discussion of the issue of which party bears the burden of proof in a contest between the commingler and the lessor, see Hogwood, *supra* note 42, at 4–15 (setting forth the development of the confusion of goods doctrine); H. Martin Gibson, *Modifying Oil & Gas Documents for Horizontal Drilling*, 19 TEX. WESLEYAN. L. REV. 77, 94–97 (2012) (recognizing that the law is unsettled whether the confusion of goods doctrine applies to downhole commingling created by multi-tract horizontal drilling); Whitworth & McGinnis, *supra* note 6, at 204–05 (arguing against application of the confusion of goods doctrine to allocation issues created by horizontal wells).

¹⁸² TEX. CIV. PRAC. & REM. CODE ANN. § 16.003 (West 2014).

authority remains uncontested for ten years, then the lessee will be able to claim title through adverse possession of the pooling authority that has been slandered.¹⁸³

3. The Lessor's Right to Injunctive Relief

If the well in the **Allocation Well Hypothetical** were drilled and it were determined that the lessee did not have authority to drill that well for the reasons set forth in Section II.A, *supra*, then Texas law provides that all of the well's production would be considered unlawful.¹⁸⁴ This is true even in the situation where an operator receives a permit from the Railroad Commission and a court only later determines that the permit is invalid.¹⁸⁵ Once a court determines that the well permit is invalid, the Railroad Commission rules specify that the well is not entitled to produce and should be plugged.¹⁸⁶ Thus, a further remedy available to the lessor beyond the revocation of the drilling permit discussed in Section II.B.1, *supra*, would be for the lessor to seek injunctive relief to have the so-called allocation well plugged.

Notwithstanding the above black letter law, if a court provided injunctive relief to require the well to be plugged, one would expect that the parties would privately negotiate a mutually acceptable settlement as it would be in their mutual interest to arrive at an agreement that would support a valid permit for the horizontal well depicted in the **Allocation Well Hypothetical**.¹⁸⁷ Furthermore, once a lessee obtains the pooling consent of the lessor under such a settlement, one would expect that the Railroad Commission, based on these new facts, would allow the well to be

¹⁸³ See *id.* § 16.026(a); BP Am. Prod. Co. v. Marshall, 342 S.W.3d 59, 69–70 (Tex. 2011).

¹⁸⁴ See TEX. NAT. RES. CODE ANN. §§ 115.001(10), .003(a), .031–.034 (West 2011); see also Am. Trading & Prod. Corp. v. Phillips Petroleum Co., 449 S.W.2d 794, 801 (Tex. Civ. App.—El Paso 1969, writ ref'd n.r.e.) (determining that the operator has no right to the production from an illegally drilled well (meaning a well with an invalid permit) or its proceeds).

¹⁸⁵ See Brown v. Humble Oil & Ref. Co., 83 S.W.2d 935, 945 (Tex. 1935).

¹⁸⁶ 16 TEX. ADMIN. CODE § 3.37(e) (2015) (Tex. R.R. Comm'n., Statewide Spacing Rule).

¹⁸⁷ Other scholars have set forth a more detailed analysis of the game theory aspects of extremely harsh regulatory prescriptions (a.k.a. the regulatory “nuke”) and its likely impact on private parties and are generally consistent with the views of the author in this context. See Zachary Bray, *The Hidden Rise of ‘Efficient’ (De)Listing*, 73 MD. L. REV. 389, 450–53 (2014); see generally Brigham Daniels, *When Agencies Go Nuclear: A Game Theoretical Approach to the Biggest Sticks in an Agency's Arsenal*, 80 GEO. WASH. L. REV. 442 (2012).

re-permitted and to start producing.¹⁸⁸ Thus, even in the situation where a good well were required to be plugged, the likely result would be only a temporary stoppage of production as the parties would have the economic incentive to reach a consensual arrangement that affords fair compensation to the lessor for her private property rights either through voluntary pooling or through the forced pooling provisions of MIPA.

4. The Lessor's Right to Punitive Damages in Certain Fact Patterns

In Section II.B.2, this Article sets forth the basis for the lessor to claim actual damages based on a slander of title claim where legal malice is proved.¹⁸⁹ If, however, the lessor could prove as part of her slander of title claim that her lessee acted with actual malice in willful disregard of her retained pooling authority, then the lessor would be entitled to seek punitive damages against her lessee. In order to pursue a slander of title claim based on actual malice, the lessor must prove that the lessee acted with "ill will, bad or evil motive, or such gross indifference to or reckless disregard of the rights of [the lessor] as will amount to a wilful [sic] or wanton act."¹⁹⁰ The fact that the lessee relied on the advice of an attorney does not protect the lessee from being found to have acted with malice towards the property rights of another.¹⁹¹ Given the analysis in Section II.A that the combination of multiple tracts in order to create a single drilling unit requires pooling authority, a jury should be able to reasonably conclude that the lessee's act of drilling the horizontal well in the **Allocation Well Hypothetical** constitutes actual malice where the facts also demonstrate that the lessee

¹⁸⁸Harrington v. R.R. Comm'n of Tex., 375 S.W.2d 892, 898 (Tex. 1964) (holding that refusal to re-permit well after it had been re-drilled to prevent well from excessively deviating from the vertical was punitive when the well, as re-drilled, now complied with permitting guidelines of Rule 37); R.R. Comm'n v. Magnolia Petroleum Co., 125 S.W.2d 398, 402 (Tex. Civ. App.—Austin 1939, writ ref'd) (requiring Greer to seek re-permitting for well drilled at wrong location before being able to keep production from said well).

¹⁸⁹See *supra* Section II.B.2.

¹⁹⁰See Kidd v. Hoggett, 331 S.W.2d 515, 518 (Tex. Civ. App.—San Antonio 1959, writ ref'd n.r.e.).

¹⁹¹Murren v. Foster, 674 S.W.2d 406, 412 (Tex. App.—Amarillo 1984, no writ) (remanding case for a jury to determine whether wrongful assertion of title had any good faith basis); *but see* Humble Oil & Ref. Co. v. Luckel, 171 S.W.2d 902, 906 (Tex. Civ. App.—Galveston 1943, writ ref'd w.o.m.) ("[A] claim of title does not constitute malice where such claim is made under color of title upon the advice of attorneys . . .").

asserted its unauthorized action in an effort to willfully circumvent the lessor's pooling authority as a means to avoid paying higher royalties.¹⁹²

5. Public Policy Goals of the State of Texas are Promoted by the Availability of the Above Lessor Remedies

The preceding Section II.B.1 through Section II.B.4 has set forth the remedies that are available to the lessor under the existing common law against its lessee who (without pooling authority) has attempted to drill a multi-tract horizontal well without seeking the lessor's consent. The remedies include setting aside the illegal permit, seeking the leasehold benefits that would have been received by the lessor had the lessee adequately compensated the lessor for her pooling consent, providing injunctive relief to plug the illegally drilled well until such time as the lessor's consent is obtained, and punitive damages when the lessee's failure to seek the lessor's pooling consent was motivated by a willful and intentional effort to destroy the economic value of the lessor's retained property rights. Seen in combination, these remedies serve to ensure that the lessor's private property rights are protected.

However, does the existing common law reach an appropriate outcome from a public policy perspective? This line of inquiry is important because, as previously stated, the courts (including the court in *Browning Oil Co. v. Luecke*) have signaled a willingness to reformulate existing common law principles in order to promote the efficient development of the state's finite natural resources in the horizontal well context. One commentator has forcefully argued in favor of reformulating the common law that has developed for pooling as follows:

Recognition of allocation wells as an appropriate means of drilling horizontal wells would have far-reaching consequences for the pooling landscape in Texas. Rather than being handicapped by the absence of pooling authority or shackled to restrictive pooling provisions, operators would be free to drill horizontally across lease lines.¹⁹³

¹⁹² See *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443, 462, 468–69 (1993) (upholding a jury's award of \$19,000 of actual damages and \$10 million of punitive damages for a slander of title action because the defendant engaged in a malicious scheme to reduce royalties paid to the plaintiff).

¹⁹³ See Squibb, *supra* note 31, at 931.

The response to this assertion is two-fold. First, the common law remedies set forth in this Article only seek to provide the lessor with leasehold benefits at currently prevailing market rates, or, in the alternative, put the parties on a pathway to bargain for market outcomes that are consistent with those existing private property rights, or seek to punish lessees who willfully disregard the rights of others when the facts justify a punitive damage award. Accordingly, these results are not excessive. Said differently, the outcome under the existing common law does not shackle the lessee's efforts to engage in horizontal drilling. Preservation of the lessor's private property claims allows the lessor to receive fair compensation for her property rights and seeks to put the parties in the economic condition that is consistent with their existing private property rights.

Horizontal drilling has created a boom in crude oil production. If the lessor were savvy enough (or fortuitous enough) to have retained a property right that would allow the lessor to receive market-based compensation for authorizing the drilling of this horizontal well, then the law should afford outcomes that provide an appropriate market-based sharing of the benefits that have been afforded by horizontal drilling because this outcome allows the lessor to receive the same consideration that other similarly situated lessors receive when they bargain for relinquishing their retained mineral rights under current leases. Putting the lessee in the position of having to compensate the lessor in the same manner as similarly situated lessors preserves market outcomes and does not inhibit the legitimate production of the state's finite natural resources as the lessor is only receiving the royalties that other similarly situated royalty owners receive under new leases.¹⁹⁴ Thus, the outcomes set forth in this Article allow the state's finite natural resources to be efficiently and effectively produced while at the same time ensure that the lessor receives just compensation in exchange for her valuable property right.

C. The Texas Legislature Should Amend the Mineral Interest Pooling Act so That Appropriate Outcomes are Achieved in the Horizontal Well Context.

As a second response to the above assertion, this commentator makes a good point to the extent this comment is directed toward the restrictions that

¹⁹⁴For sworn testimony before the House Energy Resources Committee that supports this assertion, see *infra* notes 215–219.

prevent MIPA from potentially applying in all of the horizontal well contexts where it would be efficacious for it to apply. MIPA does serve to provide a pathway for the efficient development of the state's finite natural resources,¹⁹⁵ so instances where MIPA is inapplicable can represent areas for needed reform.

However, before focusing on where MIPA needs to be modified to better promote horizontal drilling in this state, the reader should understand that EOG was not hamstrung in any way from using MIPA in the Klotzman controversy set forth in Section II.B.1, *supra*, so it would be wrong to use that controversy as a basis to exaggerate the MIPA deficiencies that currently exist.¹⁹⁶ The fact that EOG did not choose to proceed under MIPA may well be because EOG did not want to pay the Klotzmans the market rate of royalty that would be required as a condition precedent before MIPA could be availed of.¹⁹⁷ If in fact this inference is the correct inference to take from the EOG/Klotzman controversy, then another policy objection can be lodged against the allocation well practices of the Railroad Commission, namely that this allocation well permitting process attempts to achieve forced pooling outcomes without satisfying the statutory prerequisites that the legislature put in place as a condition precedent to

¹⁹⁵For a key decision that allowed forced pooling of tracts before a horizontal well was drilled, *see* Tex. R.R. Comm'n, *Application of Finley Resources, Inc. for the Formation of a Unit Pursuant to the Mineral Interest Pooling Act for the Proposed East Side Unit, Newark, East (Barnett Shale) Field, Tarrant County* at 13, Docket No. 09-0252373 (May 14, 2007) (final order granting application), <http://www.rrc.state.tx.us/media/9959/finleysignedfinalorder.pdf>. For a discussion of the significance of this order, *see* Ronnie Blackwell, *Forced Pooling Within the Barnett Shale: How Should the Texas Mineral Interest Pooling Act Apply to Units with Horizontal Wells?*, 17 TEX. WESLEYAN L. REV. 1, 10–11 (2010); John Hicks, *Pooling and Unitization Methods Across Shale Basins (Or Lack Thereof): Texas (Eagle Ford and Barnett)*, 60 ROCKY MTN. MIN. L. FOUND. § V(G)(2) (2014).

¹⁹⁶*See* SMITH & WEAVER, *supra* note 18, §§ 8.3[B][3][b], [F][1] (inferring that MIPA would have been available to EOG had it chosen to utilize its provisions); *see also* Protestant's Response to Closing Statements, Tex. R.R. Comm'n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagle Ford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 15–17, Docket No. 09-0252373 (Jan.11, 2013) (stating that the only thing preventing EOG from receiving pooling consent was an unwillingness on their part to agree to market-based lease terms in exchange for that consent).

¹⁹⁷*See* TEX. NAT. RES. CODE ANN. § 102.013 (West 2011); *Carson v. R.R. Comm'n of Tex.*, 669 S.W.2d 315, 316, 318 (Tex. 1984).

forced pooling.¹⁹⁸ Seen in this light, the **Allocation Well Hypothetical** seeks to subvert the public policy goals that motivated the Texas legislature when it mandated that a property owner must receive a fair and reasonable offer for voluntary pooling before her retained property right can be forced pooled. Through its permitting of so-called allocation wells, the Railroad Commission in effect has forced pooled the lessor's interest in a proceeding where the lessor has not received a fair and reasonable offer. This objection is important to bear in mind because criticism of MIPA should not cause one to simply conclude that lessees are shackled in some fashion. The real point to be drawn from the EOG/Klotzman controversy is that EOG simply did not want to pay fair compensation to their lessors for their pooling consent.

Nevertheless, even though deficiencies in MIPA's scope should not be overstated, it is appropriate to ensure that MIPA is broadly applicable in the horizontal well context so that lessors cannot unreasonably withhold their pooling consent and thus frustrate the efficient development of the state's finite natural resources. Thus, areas of deficiency that exist within MIPA should be corrected, and there are at least two areas where incremental reforms should be made. First, as has been pointed out by a thoughtful article by a leading practitioner, MIPA does not allow the Railroad Commission to create a unit in excess of the standard proration unit in the field, and under current Railroad Commission policy, this restriction appears to be creating unnecessary complexity with horizontal wells that can be drilled at varying lateral lengths.¹⁹⁹ According to this practitioner, the Railroad Commission should have authority to force pool acreage under MIPA any time that the proposed proration unit is established either under statewide Rule 86 or under the applicable field rules.²⁰⁰ This proposal is a reasonable proposal and should be endorsed as it would allow MIPA to be applicable for wells that are drilled in compliance with existing spacing and well density rules. Second, MIPA contains an absolute prohibition on its applicability to force pool tracts above a maximum acreage amount.²⁰¹ In this regard, MIPA § 102.011 provides that the unit created through MIPA by a Railroad Commission order "shall in no event exceed 160 acres for an

¹⁹⁸ For an analysis of the public policy goals for requiring a fair and reasonable offer as a condition precedent to being able to utilize the forced pooling provisions of MIPA, *see* Smith, *supra* note 171, at 388–94.

¹⁹⁹ *See* Blackwell, *supra* note 195, at 21.

²⁰⁰ *Id.* at 23.

²⁰¹ *See* Tex. NAT. RES. CODE ANN. § 102.011.

oil well or 640 acres for a gas well plus 10 percent tolerance.”²⁰² A leading treatise has pointed out the following:

These acreage limits often render MIPA useless to operators or royalty interest owners in fields where horizontal well drilling is the best technology for development. Under Statewide Rule 86 and special field rules adopted for horizontal wells, oil proration units are often substantially larger than 160 acres and gas prorationing units are significantly larger than 640 acres.²⁰³

This artificial acreage restriction contained in MIPA was put into place before the advent of the previously unforeseen horizontal drilling practices of today and should now be removed for horizontal wells.

The reforms and adaptations of compulsory pooling statutes in other states demonstrate that it is time for Texas to also reform MIPA in order to ensure that the state’s public policy objectives are achieved in the horizontal well context. For example, in 2011, the Oklahoma legislature enacted the Shale Reservoir Development Act²⁰⁴ to empower the Oklahoma Corporation Commission to force pool acreage²⁰⁵ of up to 2,560 acres (four sections) for horizontal wells drilled in shale formations when in the Commission’s determination this large unit size promotes the greater ultimate recovery of oil and gas, prevents waste, and protects the correlative rights of the owners.²⁰⁶ In recognition of this same need but utilizing a different solution, Ohio’s regulatory agency has issued unitization orders as a means to force pool acreage of a sufficient size to allow horizontal wells to be drilled with sufficient length to be profitable.²⁰⁷ Finally, under the North Dakota compulsory pooling statute, the North Dakota Industrial Commission has authority to force pool without an artificial acreage

²⁰² *Id.*

²⁰³ See SMITH & WEAVER, *supra* note 18, § 12.3[A][7].

²⁰⁴ 2011 Okla. Sess. Law Serv. ch. 54 (West).

²⁰⁵ See OKLA. STAT. ANN. tit. 52, § 87.1(a)–(e) (West 2011). The information necessary to make an application for compulsory pooling is set forth in OKLA. ADMIN. CODE § 165:5-7-6 (2015).

²⁰⁶ See OKLA. STAT. ANN. tit. 52, § 87.9(c).

²⁰⁷ See OHIO DEP’T OF NAT. RES., Order No. 2013-06, ORDER FOR UNIT OPERATIONS OF THE UTICA/POINT PLEASANT FORMATIONS FOR THE COLESCOTT SOUTH UNIT, CARROLL COUNTY, OHIO (2013) (unitizing 549 acres using the unitization statute set forth in OHIO REV. CODE ANN. § 1509.28 (2015)).

restriction,²⁰⁸ and the North Dakota Industrial Commission has regularly exercised its authority to approve pooling of 1,280 acre spacing units, 2,560 acre spacing units, and 5,100 acre spacing units for horizontal wells.²⁰⁹ Thus, whether by legislative amendment, by the creative use of already existing unitization statutes, or through the expansive use of inherent regulatory authority, other states and their regulatory agencies are working to ensure that the scope of their forced pooling statutes are broad enough to apply to today's horizontal wells. Amending MIPA to remove artificial acreage restrictions for horizontal wells would ensure that the lessor does not unreasonably withhold her pooling consent.

However, in lieu of improving MIPA's applicability to the horizontal well context, competing policy prescriptions are being offered that provide for an unbalanced outcome that fails to respect the private property rights of the lessor. In this regard, it is important to note that Oklahoma,²¹⁰ Pennsylvania,²¹¹ and Louisiana²¹² have all recently enacted legislation that expands the operator's authority to drill a multi-tract horizontal well regardless of whether the operator has pooling authority as long as the operator has the working interest for each of the traversed tracts.

In the 84th legislative session, the Texas legislature considered similar legislation that would have statutorily imbued lessees (who possess the working interest for each tract) with the added statutory authority to drill allocation wells whether or not those lessees have pooling authority for the

²⁰⁸ See 2014-7 N.D. Cent. Code Adv. Legis. Serv. 528-30 (LexisNexis).

²⁰⁹ N.D. INDUS. COMM'N, Order No. 14496, ORDER TO CONSIDER THE ESTABLISHMENT OF 2560-ACRE DRILLING OR SPACING UNITS IN THE BAKKEN POOL FOR FUTURE HORIZONTAL WELLS (2010) (establishing criteria for determining whether a 2,560 acre spacing unit is appropriate for proposed horizontal wells); N.D. INDUS. COMM'N, Order No. 14497, ORDER TO CONSIDER THE ESTABLISHMENT OF STANDUP AND/OR LAYDOWN 1280-ACRE DRILLING OR SPACING UNITS IN THE BAKKEN POOL FOR HORIZONTAL WELLS (2010) (approving creation of 1,280 acre multi-tract unit for horizontal drilling); N.D. INDUS. COMM'N, Order No. 24702, ORDER TO CONSIDER THE APPLICATION OF CONTINENTAL RESOURCES, INC. FOR AN ORDER EXTENDING THE FIELD BOUNDARIES AND AMENDING THE FIELD RULES FOR THE STONEVIEW, NORTH TIOPA, LINDAHL, AND/OR BATTLEVIEW-BAKKEN POOLS (2014) (establishing a 5,120 acre multi-tract spacing unit for horizontal drilling and also establishing another 2,560 acre spacing unit for a different horizontal well); N.D. INDUS. COMM'N, Order No. 25175, ORDER TO CONSIDER THE APPLICATION OF CONTINENTAL RESOURCES, INC. FOR AN ORDER EXTENDING THE FIELD RULES FOR THE DOLLAR JOE-BAKKEN POOL (2015) (establishing several 1,280 acre spacing units, establishing a 2,560 acre spacing unit, and another spacing unit of 5,120 acres).

²¹⁰ OKLA. STAT. ANN. tit. 52, § 87.8 (West 2011).

²¹¹ 58 PA. STAT. AND CONS. STAT. ANN. § 34.1 (West 2015).

²¹² LA. STAT. ANN. §§ 30:9(B), :9.2 (2015).

multi-tract unit.²¹³ The Energy Resources Committee of the House of Representatives requested that the Railroad Commission, the General Land Office, and the University of Texas estimate the financial impact to the state of Texas if this legislation were enacted. In a fiscal note provided to the Energy Resources Committee of the House of Representatives, the University of Texas estimated that the proposed legislation would cause the Permanent University Fund to experience a reduction in revenues of \$390 million per year, and the General Land Office estimated that the proposed legislation would reduce revenues to the Permanent School Fund by \$100 million per year.²¹⁴ In a hearing held on April 6, 2015, before the Energy Resources Committee, representatives of the General Land Office and the University of Texas indicated that their estimates of H.B. 1552's revenue loss was based upon the expectation that operators, once unilaterally empowered by statute to combine multi-tract units without the need to obtain pooling consent, then would be empowered and emboldened to circumvent private negotiations as a matter of course with a consequence that the state would lose its ability to negotiate for current market-based royalties and for retained acreage clauses with respect to their leased lands.²¹⁵

The conclusions drawn by these state agencies that there would be a substantial revenue loss to landowners is a logical inference for the agencies to have drawn from this proposed legislation as the legislation, if enacted, would remove any incentive for operators to engage in meaningful private negotiations after the operators have been statutorily authorized to combine

²¹³ In the 84th legislative session, the Texas legislature considered legislation that would expressly provide legal authority to the lessee to drill an allocation well. *See* Tex. H.B. 1552, 84th Leg., R.S. (2015), <http://www.capitol.state.tx.us/BillLookup/Text.aspx?LegSess=84R&Bill=HB1552>; *see also* Tex. S.B. 919, 84th Leg., R.S. (2015), <http://www.capitol.state.tx.us/BillLookup/Text.aspx?LegSess=84R&Bill=SB919>.

²¹⁴ *See* Fiscal Note, Tex. H.B. 1552, 84th Leg., R.S. (2015), ftp://ftp.legis.state.tx.us/bills/84R/fiscalnotes/html/house_bills/HB01500_HB01599/HB01552I.htm.

²¹⁵ *See* Hearing on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 3:33:00 to 3:44:00 (Apr. 6, 2015) (statement of Mark Houser, University of Texas) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>); Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res. 84th Leg., R.S., 3:44:00 to 3:52:00 (Apr. 6, 2015) (statement of Richard Brantley, University of Texas) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>); Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 4:01:00 to 4:13:00 (Apr. 6, 2015) (statement of Mark Havens, Texas General Land Office) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>).

multiple tracts without first having paid for this valuable pooling authority.²¹⁶ What is more, if the royalty interest owner of state-owned lands can be expected to experience a substantial revenue loss from this proposed legislation, it is certainly reasonable to believe that private landowners, who often have less legal representation than these large state agencies, also could face significant losses as a result of this proposed legislation.²¹⁷

In addition to highlighting the profound revenue loss that would be experienced by landowners if this legislation were enacted, testimony at the April 6th hearing also undercut the policy rationale for such legislation. In this regard, the Texas General Land Office and the University of Texas indicated that the status quo, where operators must seek the consent of royalty interest owners and mineral interest owners before drilling multi-tract horizontal wells, does not negatively impact the ultimate development of the state's finite natural resources as private negotiations achieve acceptable outcomes in substantially all situations.²¹⁸ Other testimony at the hearing indicated that only one percent of all horizontal wells are drilled as

²¹⁶This point was forcefully argued in testimony by personnel from the Texas General Land Office and the University of Texas. *See* Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 3:33:00 to 3:44:00 (Apr. 6, 2015) (statement of Mark Houser, University of Texas) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>); Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 3:44:00 to 3:52:00 (Apr. 6, 2015) (statement of Richard Brantley, University of Texas) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>); Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 4:01:00 to 4:13:00 (Apr. 6, 2015) (statement of Mark Havens, Texas General Land Office) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>).

²¹⁷*See* Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 1:46:00 to 2:13:00 (Apr. 6, 2015) (statement of John McFarland, representing Texas Land and Mineral Association) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>) (stating that the legislature should not impose a lease interpretation on the private parties and the bill would state that lessees have authority to drill a well which is a contested issue of existing leases).

²¹⁸*See* Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 3:33:00 to 3:44:00 (Apr. 6, 2015) (statement of Mark Houser, University of Texas) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>) (stating that ninety-nine percent of all pooling requests get approved); Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 4:01:00 to 4:13:00 (Apr. 6, 2015) (statement of Mark Havens, Texas General Land Office) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>) (stating that the parties typically come to amicable agreements because all parties want to develop the mineral estate).

allocation wells,²¹⁹ thus further undercutting the urgency for legislation that would dramatically alter the fundamental private property rights of the various mineral interest owners through legislative fiat.

To its great credit, the Texas legislature did not enact this ill-conceived and one-sided legislation. In the next legislative session, instead of creating new private property rights in the hands of operators who did not pay for that private property right and instead of destroying the economic value of the retained private property rights of landowners by legislative fiat, the Texas legislature instead should direct their legislative focus towards reforming MIPA in the manner set forth in this Article. The forced pooling provisions in MIPA provide an appropriate balancing of interests that is not represented in H.B. 1552. The existing MIPA framework ensures that the correlative rights of all affected parties are protected while at the same time sets forth a framework that promotes the efficient development of the state's finite natural resources. If the Texas legislature wants to promote the efficient development of the state's finite natural resources while at the same time protecting correlative rights, it should resist the suggestion made by operators to legislatively transfer private property rights between members of its citizenry without adequate compensation and should instead expand the potential applicability of MIPA in the horizontal well context. Horizontal drilling does require a fundamental re-examination of existing principles, but the existing MIPA framework provides the means to provide a balanced outcome that simultaneously promotes efficient horizontal development of the state's finite natural resources while at the same time protects the private property rights of all affected parties. Accordingly, further legislative reform should be directed towards expanding the scope and applicability of MIPA, not towards creating a substitute statutory regime that effectively supplants (in the horizontal well context) the already existing MIPA framework.

²¹⁹See Hearings on Tex. H.B. 1552 Before the House Comm. on Energy Res., 84th Leg., R.S. 1:46:00 to 2:13:00 (April 6, 2015) (statement of John McFarland, representing Texas Land and Mineral Association) (recording available from <http://www.house.state.tx.us/video-audio/committee-broadcasts/>) (stating that less than 539 allocation well permits since 2010 compared to more than 47,000 horizontal wells; some of these wells don't get drilled and some become PSA wells. So, allocation wells account for only one percent of the horizontal wells that are being drilled. "This is not Armageddon for the industry" and "does not substantially impair the industry").

III. CONCLUSION

Voluntary pooling has long been used as the appropriate means to obtain a drilling permit for a multi-tract unit. The Texas legislature provided a means to force pool with the enactment of MIPA, but this legislation was careful to ensure that forced pooling under MIPA was available only after a fair and reasonable offer was made for voluntary pooling, thus ensuring that the affected party had an opportunity to be fairly compensated for the forced disgorgement of her retained property rights. Thus, forced pooling is statutorily authorized only after the affected party has rejected a fair and reasonable offer for voluntary pooling. As a result, MIPA is careful to not create an unjust outcome to the party whose interest is being forced pooled. Seen in this light, MIPA strikes an appropriate balance that promotes the efficient development of the state's finite natural resources while protecting the private property rights of parties who are forced into a compulsory pooling arrangement. Where further reforms are needed to ensure that MIPA works appropriately for horizontal wells as set forth in Section II.C of this Article, those reforms should be made within the framework set forth in MIPA.

Undeniably, horizontal wells are essential for the efficient development of the state's finite natural resources. Horizontal drilling coupled with hydraulic fracturing has opened unforeseen opportunities for oil and gas development, and so the common law needs to support and promote these essential technologies. However, in the context of the **Allocation Well Hypothetical**, the existing common law framework for combining multiple tracts into a single drilling unit (i.e., pooling) works well and thus should not be fundamentally up-ended. Where incremental modifications or tweaks to MIPA are needed as recognized in Section II.C above, incremental reforms should be made within the context of amendments to the existing MIPA framework and should not be used as a pretext for a wholesale rejection of that entire statutory MIPA regime. Giving legal status to allocation wells is akin to throwing out (in the horizontal well context) the pooling framework that the legislature and the courts have established without any compelling policy reason to do so.

The Railroad Commission's allocation well permitting process creates potentially unjust outcomes as this permitting process awards a drilling permit for a multi-tract unit before the lessor has paid for the right to combine the tracts into a multi-tract unit. Seen in this light, allocation wells present a fundamental question: will the need for horizontal wells be used as a pretext to deny the legitimate sharing of the boom in oil production

between the lessor and lessee? The public policy goal of ensuring the efficient development of the state's finite natural resources should not be used as a stalking horse to promote outcomes like the one posited in the **Allocation Well Hypothetical**. If the marketplace were not supplanted, the lessor would be able to bargain for fair compensation for her retained pooling authority. The lessor could not bargain for more than fair compensation or else she will be subjected to forced pooling under MIPA—particularly after the MIPA reforms endorsed by this Article are put into place. Thus, the existing framework (both voluntary pooling and the forced pooling mechanism set forth in MIPA), in combination, provide a framework that ensures the efficient development of the state's finite natural resources while at the same time protects the correlative rights of all affected parties.

Because the Railroad Commission's allocation well permitting process ignores the prescribed means under Texas law for combining multiple tracts into a single drilling unit (i.e., for pooling), the legality of allocation wells is likely to be addressed in future litigation. When confronted with the **Allocation Well Hypothetical**, the courts should see these cases for what they are: unauthorized pooling that has slandered the lessor's retained pooling authority. Once seen in that light, courts can quickly dispense of these cases in a manner that protects the correlative rights of all affected parties. Once lessees recognize that courts will treat the drilling of an allocation well as a slander of the pooling authority of the lessor, lessees will be encouraged by this common law outcome to provide fair and reasonable offers to their lessors in order to obtain their pooling consent either voluntarily or as the essential condition precedent for availing itself of MIPA. The promotion of business practices that respect the private property rights of all affected parties is exactly the result Texas law should encourage.