RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

Oil and Gas Docket No. 01-0302640	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 11, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302641	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 11, WELL NO. 2H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302642	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 13, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302643	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 13, WELL NO. 2H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302644	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 26, WELL NO. 2H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302646	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 28, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302647	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 28, WELL NO. 2H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS

Oil and Gas Docket No. 01-0302648	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE NAYLOR JONES UNIT 31, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302649	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE BLOCK A UNIT, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302650	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE BLOCK A UNIT, WELL NO. 2H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302651	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE FOWLERTON UNIT B, WELL NO. 1H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302652	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THE RVER LOWE RANCH WELL NO. 11H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302653	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THERIVER LOWE RANCH WELL NO. 14H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302654	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THERIVER LOWE RANCH WELL NO. 15H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302655	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR THERIVER LOWE RANCH WELL NO. 16H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS
Oil and Gas Docket No. 01-0302656	§	THE APPLICATION OF AMMONITE OIL & GAS CORP PURSUANTTO THE MINERAL INTEREST POOLING ACT FOR THE STATE LEASE M-117248 FOR RIVER LOWE RANCH, WELL NO. 17H, EAGLEVILLE (EAGLE FORD-1) FIELD, MCMULLEN COUNTY, TEXAS

APPEARANCES

For Applicant Ammonite Oil and Gas Corporation:
Rob Hargrove, Attorney at Law
William Osborn, President, Ammonite Oil and Gas Corporation

For Respondent, EOG Operating, Inc.
Doug Dashiell, Attorney at Law
Tim Smith, Petroleum Engineer

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

Date Applications Filed:	November 29, 2016
Date of Notice of Hearing:	December 19, 2016
Date of Hearing:	January 25, 2017
Record Closed:	March 24, 2017
Proposal for Decision Issued:	September 1, 2017
Heard by:	Marshall Enquist, Legal Examiner Karl Caldwell, Technical Examiner
Author:	Clayton J. Hoover, Administrative Law Judge

STATEMENT OF THE CASE

Ammonite Oil and Gas Corporation ("Ammonite") has filed these 16 applications under the Texas Mineral Interest Pooling Act ("MIPA"), Chapter 102 of the Texas Natural Resources Code. These dockets were consolidated for the purpose of a joint hearing record.[1] By its applications, Ammonite is requesting that the Commission enter orders creating sixteen (16) force-pooled units in McMullen County to include sixteen (16) EOG wells and surrounding leasehold with contiguous Ammonite leases on portions of the riverbed of the Frio River owned by the State of Texas, as shown on Appendix "A".

Ammonite has a statutory burden to demonstrate that: (1.) Ammonite has an ownership interest in the proposed tracts to be pooled into the EOG tracts, as required pursuant to MIPA §102.012; (2.) Ammonite has made a reasonable offer to voluntarily pool the tracts; (3.) Ammonite provided proof that forced pooling of the riverbed acreage is necessary to avoid the drilling of unnecessary wells, to protect correlative rights, or to prevent waste; and (4.) the EOG wells and the subject Frio River riverbed acreage "embrace a common reservoir."

EOG contends Ammonite failed to meet statutory requirements (2.), (3.) and (4.).

[1] See Notice of Hearing and Joint Record, December 19, 2016

One of the Units exceeds the maximum size for oil units prescribed by MIPA. The Administrative Law Judge and Technical Examiner recommend **approval** of the remaining fifteen (15) proposed MIPA Units.

APPLICABLE LAW

MIPA:

Texas does not have a compulsory pooling statute as do the majority of oil and gas producing states. Rather, it has what has been characterized as a compulsory voluntary pooling statute, known as the Mineral Interest Pooling Act ("MIPA"). MIPA was originally designed to apply when necessary to prevent minerals underlying small, irregularly shaped tracts from being wasted, produced by offset wells or produced by unnecessary wells. Although it was originally passed to address the difficulty in economically developing small, irregularly shaped tracts under spacing and density requirements, it has taken on a new importance in light of the difficulty in economically developing small, irregularly shaped tracts in unconventional oil and gas plays.

FAILURE TO NEGOTIATE:

MIPA is designed to encourage voluntary pooled units by making resort to MIPA an undesirable option. Those owners not in favor of a MIPA unit are still expected to negotiate in good faith; they cannot refuse to make a counteroffer without having such refusal being part of the record and running the risk of not prevailing. As summarized by Smith & Weaver:

> "In all of the cases involving fair and reasonable offers, the party perceived by the court as refusing to negotiate lost the case."[2]

This is consistent with legislative intent and public policy.

STATE OF TEXAS MINERALS:

State of Texas minerals are specifically addressed in the statute. MIPA gives the Commissioner of the General Land Office ("GLO") broad power and flexibility to determine when MIPA units are necessary to protect State of Texas minerals and the Permanent School Fund. Hence, when State of Texas minerals will be stranded without a MIPA unit, consideration must be given to this original legislative intent and any GLO authorization of a MIPA application. The fact that waste or drainage of State of Texas minerals is not in the public interest must be a basic foundation of analysis and statutory interpretation in each such case.

A narrow interpretation of MIPA, which denies a reasonably conceived MIPA unit proposed by the GLO or its lessee, should be a last resort. It should be done only when

[2] Smith and Weaver, Texas Law of Oil and Gas, Vol. 3, Chapter 12, §12.3(B) at page 12-37 (LexisNexis Matthew Bender 2015).

it is absolutely clear the MIPA requirements have not been met and when there exist other options for development and production of State of Texas minerals.

MIPA REQUIREMENTS:

Subject to limitations found elsewhere in the act, **Section 102.011 of MIPA** provides:

> "[w]hen two or more separately owned tracts of land are embraced in a common reservoir of oil or gas for which the Commission has established the size and shape of proration units, whether by temporary or permanent field rules, and where there are separately owned interests in oil and gas within an existing or proposed proration unit in the common reservoir and the owners have not agreed to pool their interests, and where at least one of the owners of the right to drill has drilled or has proposed to drill a well on the existing or proposed proration unit to the common reservoir, the Commission, on the application of an owner specified in Section 102.012 of [the MIPA] and for the purpose of avoiding the drilling of unnecessary wells, protecting correlative rights, or preventing waste, shall establish a unit and pool all of the interests in the unit within an area containing the approximate acreage of the proration unit, which unit shall in no event exceed 160 acres for an oil well or 640 acres for a gas well plus 10 percent tolerance."

MUSCLE IN PROVISION:

Regarding small tracts being pooled into larger tracts which may be in excess of standard proration units, the Muscle-In provision, **Section 102.014**, states:

> "(a) The Commission shall not require the owner of a mineral interest, the productive acreage of which is equal to or in excess of the standard proration unit for the reservoir, to pool his interest with others unless requested by the holder of an adjoining mineral interest, the productive acreage of which is smaller than such pattern, who has not been provided a reasonable opportunity to pool voluntarily.
>
> "(b) If the conditions specified in Subsection (a) of this section exist, the Commission shall pool the smaller tract with adjacent acreage on a fair and reasonable basis and may authorize a larger allowable for the unit if it exceeds the size of the standard proration unit for the reservoir."

There are conflicting views on the interpretation of this provision where field rules have prescribed or allowed proration units in excess of 176 acres for oil and 704 acres for gas. The oft-argued interpretation that these statutory maximums cannot be exceeded under any circumstances makes subsection (b) totally meaningless and would therefore contradict well established canons of construction. Section 102.014 seems to contemplate MIPA units in excess of 176 acres for oil and 704 acres for gas. However, the Commission has denied MIPA applications for exceeding these acreage limits.

DISCUSSION OF THE EVIDENCE

Ammonite's Applications and Proposed Units

All sixteen (16) of the proposed MIPA units (shown in Appendix "A") in these dockets are in the Eagleville (Eagle Ford - 1) Field, McMullen County.

The proposed MIPA Unit for the EOG Naylor Jones Unit 11, Well No. 1H well contains 60.3 total acres comprised of 60.1 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 11, Well No. 2H well contains 60.3 total acres comprised of 60.1 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 13, Well No. 1H well contains 55.5 total acres comprised of 55.3 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 13, Well No. 2H well contains 55.5 total acres comprised of 55.3 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 26, Well No. 2H well contains 550.02 total acres comprised of 546.85 acres of EOG acreage and 3.17 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 28, Well No. 1H well contains 46.61 total acres comprised of 46.40 acres of EOG acreage and .21 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 28, Well No. 2H well contains 46.40 total acres comprised of 46.19 acres of EOG acreage and .21 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Naylor Jones Unit 31, Well No. 1H well contains 98.64 total acres comprised of 98.31 acres of EOG acreage and .33 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Block A Unit, Well No. 1H well contains 61.6 total acres comprised of 61.4 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Block A Unit, Well No. 2H well contains 61.6 total

acres comprised of 61.4 acres of EOG acreage and .2 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG Fowlerton Unit B, Well No. 1H well contains 63.35 total acres comprised of 63.02 acres of EOG acreage and .33 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG River Lowe Ranch, Well No. 11H well contains 42.21 total acres comprised of 42 acres of EOG acreage and .21 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG River Lowe Ranch, Well No. 14H well contains 42.21 total acres comprised of 42 acres of EOG acreage and .21 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG River Lowe Ranch, Well No. 15H well contains 42.21 total acres comprised of 42 acres of EOG acreage and .21 acres of the Frio River as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG River Lowe Ranch, Well No. 16H well contains 64.575 total acres comprised of 64.3 acres of EOG acreage and .275 acres of the Frio as outlined on the plat included in the written offer to voluntarily pool.

The proposed MIPA Unit for the EOG River Lowe Ranch, Well No. 17H well contains 64.575 total acres comprised of 64.3 acres of EOG acreage and .275 acres of the Frio as outlined on the plat included in the written offer to voluntarily pool.

Field Discovery Date, State of Texas Ownership and Common Reservoir

The MIPA does not apply in fields discovered and produced before March 8, 1961, and it does not apply to land in which the State of Texas has an interest unless the State has given consent.[3] These exceptions do not apply in this case—the proposed MIPA units lie within the productive limits of the Eagleville (Eagle Ford - 1) Field, which was established and had field rules established in 2010,[4] and while leases covering State-owned minerals exist within the proposed MIPA units, the General Land Office consented to the applications. [5] Because all of the proposed MIPA units are located in,and all existing EOG wells are completed in, the Eagleville (Eagle Ford - 1) Field, Ammonite contends that they are in a common reservoir for purposes of forming the sixteen (16) units in accordance with the language of the MIPA. [6]

[3] MIPA §§ 102.003, 102.004.

[4] App. Exs. 49-50

[5] Applicant's Ex. 51

[6] MIPA §§ 102.011

The Voluntary Pooling Offers

On various dates in 2015, Ammonite sent voluntary pooling offers to counsel for EOG.[7] Ammonite offered EOG the formation of sixteen (16) specifically described units, subject to a mutually acceptable Joint Operating Agreement with EOG as Operator and a ten percent (10%) risk penalty.[8] Ammonite asserts that the terms included in its voluntary offers were fair and reasonable because they contained terms approved by the Commission in other MIPA cases in resource plays.[9] EOG never responded to these offers with any counteroffer.[10]

Need for MIPA Wells

Ammonite contends that, absent approval of the proposed MIPA units, the reserves underlying the Frio River will not be recovered and will therefore be wasted.[11] Mr. Osborn testified that MIPA approval was necessary to prevent reserves underlying the riverbed from being stranded and wasted, while also giving all unit owners a reasonable opportunity to recover their fair share of the oil and gas underlying the proposed units.[12]

Charge for Risk

Ammonite's applications requested that the Commission's MIPA pooling orders for these dockets include a 10% charge for risk attached to the working-interest component, as authorized under Section 102.052 of MIPA.[13] Its contention is that a 10% charge for risk is reasonable in an unconventional resource play such as the Eagleville (Eagle Ford - 1) Field, that such a 10% charge for risk has been approved by the Commission in similar resource-play situations, but that an increase in the risk penalty could be considered fair and reasonable and would not be adverse.[14]

EOG's Contentions and Evidence

EOG contends that there must be a showing of drainage as proof of a common reservoir, as proof that the voluntary pooling offers were fair and reasonable and as a prerequisite for forced pooling to protect correlative rights. Such contentions are based on several Proposals for Decision in prior cases where protection of correlative rights was the sole

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[7] Applicant's Exs. 37 to 43

[8] *Id.*

[9] Tr. Pg. 47, lns. 19-22.

[10] Tr. Pg 97, ln 15

[11] Tr pg 86, lns 8-17

[12] Tr., pg. 102, lns. 7 - 10.

[13] Applicant's Exs. 2A, 2H, 2I, and 2J.

[14] Tr., pg. 97, lns. 4-18.

basis for MIPA pooling.[15] EOG also contends that limited permeability and the use of unconventional drilling and completion techniques on wells in the Eagle Ford Shale trend results in a substantial portion of such wells not reaching payout or being commercially successful and that, based on such analysis, a 100% risk penalty is more appropriate.[16]

Well Spacing in the Eagle Ford, Drainage and Common Reservoir Requirement

EOG presented testimony and documentary evidence from Tim Smith, a petroleum engineer, on its contentions. Mr. Smith testified and presented exhibits to show that the Eagle Ford Shale is a resource play, that the reservoir rock has extremely limited permeability and that the current stimulated reservoir volumes and drainage areas of the sixteen (16) wells do not include any of the Frio Riverbed tracts owned by Ammonite.[17] Stimulated reservoir volume may only extend 150 feet or less from a horizontal wellbore completed in the Eagle Ford Shale in this area.[18] He also testified (1) that, while there is currently no drainage of the Frio Riverbed tracts at issue from the five existing EOG wells as they are currently drilled and completed, the Eagle Ford Shale is a continuous hydrocarbon system and (2) that the Eagle Ford Shale within the Eagleville (Eagle Ford - 1) Field is a "continuous hydrocarbon system"[19].

Substantial Risk of Individual Wells Not Being a Commercial Success

Mr. Smith presented exhibits to show that the Eagle Ford Shale, while extensive, is a very heterogenous reservoir and that development of the Eagle Ford Shale in this area may be commercially successful overall even though a substantial portion of such wells may not reach payout or achieve a commercial return on capital expenditures.[20] Based on this evidence, Mr. Smith expressed his opinion that a reasonable risk penalty would be 100%.[21]

Taking in Violation of Constitutional Due Process

EOG also contends that formation of these MIPA units would constitute a taking of property without due process of law, violating the United States and Texas Constitutions.

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[15] Tr., pg. 136, ln.1-Pg. 137, ln 11; Protestant's Exs. 2, 3 and 4

[16] Protestant's Ex. 23, Tr. Pg. 261, lns 19-22

[17] Tr., pg. 278 lns 12 to 24; Protestant's Exs. 16

[18] Tr., pg. 177, lns 16-23

[19] Tr., pg. 199, lns 5, 25

[20] Protestant's Ex. 7, 11, 13 and 14

[21] Protestant's Ex. 23, Tr. Pg. 261, lns 19-22

ADMINISTRATIVE LAW JUDGE OPINION

The Railroad Commission is a creature of the Legislature and has no inherent authority.[22] Like other state administrative agencies, the Commission has only those powers that the Legislature expressly confers upon it and any implied powers that are necessary to carry out the express responsibilities given to it by the Legislature.[23] It is not enough that the power claimed by the Commission be reasonably useful to the Commission in discharging its duties; the power must be either expressly conferred or necessarily implied by statute. The agency may not exercise what is effectively a new power, or a power contradictory to the statute, on the theory that such a power is expedient for administrative purposes.[24]

The Commission, therefore, does not have unlimited authority to compel or deny the pooling of mineral interests whenever it is presented with a compulsory pooling application that in some sense may be deemed conceptually sound. Compulsory pooling may be ordered only as expressly authorized by the MIPA, which is a limited compulsory pooling statute unique to Texas.[25] Outlining a general theme in interpretation of the MIPA, Smith & Weaver state:

> "Its legislative history has played a key role in the Texas Supreme Court's subsequent interpretation of the act. The courts have consistently construed MIPA as limited in function to protecting small-tract lessees rather than as a broad act designed to protect correlative rights generally..." [26]

The Administrative Law Judge and Technical Examiner are of the opinion that the Ammonite applications should be granted as to fifteen (15) of the proposed units because (1) Ammonite's leases are in a common reservoir with the EOG wells, (2) Ammonite's offers to voluntarily pool were fair and reasonable, and (3) compulsory pooling is necessary to prevent waste. Ammonite met its burden in demonstrating the statutory requirements.

Authority to Apply for and Approve MIPA

As required by MIPA § 102.003, the Field in this case was discovered after March 8, 1961. Testimony and exhibits show that the Eagleville (Eagle Ford - 1) Field was established in 2010. [27] Ammonite proved that the proposed MIPA units fall within such field and that

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[22] Public Util. Comm'n v. GTE-SW Corp., 901 S.W.2d 401, 407 (Tex. 1995)

[23] Public Util. Comm'n v. City Pub. Serv. Bd., 53 S.W.3d 310, 316 (Tex. 2001)

[24] Gage, 582 S.W.2d at 413.

[25] Smith and Weaver, Texas Law of Oil and Gas, Vol. 3, Chapter 12, §12.1(B) at page 12-4 (LexisNexis Matthew Bender 2015).

[26] Smith and Weaver, Texas Law of Oil and Gas, Vol. 3, Chapter 12, §12.1(B) at page 12-5 (LexisNexis Matthew Bender 2015).

[27] App. Exs. 49-50

such field constitutes a common reservoir, per MIPA § 102.011. This fact was corroborated by Protestant's expert witness, Tim Smith, who testified repeatedly that the Eagle Ford Shale in the area is a "continuous hydrocarbon system."[28]

Ammonite has adequately demonstrated that it has authority to apply for pooling pursuant to MIPA § 102.012. While Ammonite does not own an interest in the Frio River riverbed tracts, Ammonite leased such tracts from the State of Texas, such leases confer authority upon Ammonite to bring the applications and the General Land Office consented to such applications.[29]

The proposed MIPA Unit for the EOG Naylor Jones Unit 26, Well No. 2H well contains 550.02 total acres comprised of 546.85 acres of EOG acreage and 3.17 acres of the Frio River. However, MIPA prescribes a maximum size of units for oil to be 176 acres; hence, the application as to this unit must be denied and will not be included in the remainder of the discussion contained herein as to the remaining fifteen (15) proposed units.

Fair and Reasonable Offer

The Administrative Law Judge and Technical Examiner conclude that Ammonite's offers to voluntary pool were fair and reasonable as to all of the remaining fifteen (15) proposed MIPA Units.

Section 102.013 of the MIPA requires that the applicant for forced pooling "set forth in detail the nature of voluntary pooling offers made to the owners of the other interests in the proposed unit." This section also provides that the Commission shall dismiss the application if it finds that a fair and reasonable offer to pool voluntarily has not been made by the applicant. The Commission does not have jurisdiction under the MIPA unless a fair and reasonable offer to pool voluntarily has been made.[30] The MIPA has thus been characterized by scholars as a "compulsory voluntary pooling act," because a force pooling order will not issue unless the applicant has made a strong effort to secure pooling voluntarily and has been rebuffed.[31] A fair and reasonable offer to pool voluntarily is one which takes into consideration those relevant facts, existing at the time of the offer, which would be considered important by a reasonable person in entering into a voluntary agreement concerning oil and gas properties.[32] While it is true that authority exists for the position that whether an offer to pool voluntarily is "fair and reasonable" is to be judged from the standpoint of the party being forced to pool,[33] the facts of each MIPA application

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[28] Tr., pg. 199, lns 5, 25

[29] Applicant's Ex. 51

[30] *Carson v. Railroad Com'n of Texas*, 669 S.W.2d 315, 316 (Tex. 1984).

[31] *See* Smith and Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3(B-1) at pg. 12-24.1 (LexisNexis Matthew Bender 2015).

[32] *Carson v. Railroad Com'n of Texas, supra* at page 318.

[33] *Windsor Gas Corp. v. Railroad Com'n of Tex.*, 529 S.W.2d 834, 837 (Tex.Civ.App.-Austin 1975, writ dism'd as moot); *Pend Orielle Oil & Gas Co., Inc. v. Railroad Com'n of Texas*, 788 S.W.2d 878 (Tex.App.-Austin 1990, *writ granted*), *affirmed in part, reversed in part on other grounds* 817 S.W.2d 36 (Tex. 1991).

will determine whether an offer was fair and reasonable to all parties.[34] Here, Ammonite made an initial voluntary offer to pool these separate proposed MIPA units as described in these dockets and the record. EOG refused to respond to Ammonite's offers with counteroffers. As in the *Mulvey* MIPA case, the fact that the party into which pooling is sought did not respond to the initial voluntary pooling offer supports granting the MIPA.

In *Mulvey*[35], the Examiner stated that it was significant that the party to be pooled into (i.e., Bay Rock Operating Co.), made no counteroffer to Mulvey and made no attempt to negotiate or respond to Mulvey's offer in any manner. This determination is in line with the Texas Supreme Court's holding in *Carson*:

> "It is well recognized that the intent of the MIPA is to encourage negotiation and voluntary pooling. In *American Operating Co v Railroad Commission*,[36] the court stated, 'The fact that the MIPA was enacted to encourage voluntary pooling would seem to contemplate a process of negotiations among the parties. . . Although the MIPA does not require that a counter offer be made in response to a voluntary pooling offer, it is a factor which we consider in making a determination as to whether such an offer is a fair and reasonable. . ."[37]

When judged from the standpoint of the parties being forced to pool, Ammonite's voluntary pooling offers to EOG were fair and reasonable. These voluntary offers presented by Ammonite did not substantially dilute EOG's share of the production from the common reservoir. Here, Ammonite's proportionate share of the pooled interest would be relatively small: less than 1% of the MIPA units in all of the fifteen (15) units. [38] These Ammonite voluntary offers, including, and in light of, the proposed risk penalty (which could have been negotiated had EOG responded) and common reservoir issues discussed below, were fair and reasonable under the circumstances and were the exact type of offers contemplated in the creation of the MIPA.[39]

Charge for Risk

Section 102.052 of the MIPA states the Commission shall make "provision in the pooling order for reimbursement ... of all actual and reasonable drilling, completion, and operating costs plus a charge for risk not to exceed 100 percent of the drilling and completion costs."[40] The clear implication from the MIPA is that imposition of a "risk penalty" is to

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[34] *See* Oil & Gas Docket 2-97041; *Application of Michael R. Mulvey pursuant to the Mineral Interest Pooling Act to Pool into the Pecos Development Corporation's Block 71 Unit, Well No. 2, Clayton (Wilcox 7360) Field, Live Oak County, Texas.* (Final Order issued April 6, 1992).

[35] *Id*

[36] 744 S.W.2d 149, 154 (Tex. App.–Houston [14th Dist.] 1987), *writ denied.*

[37] *See also Carson*, 669 S.W.2d at 318 (discussing that failure to negotiate by offeror contributed to holding that the offer was not fair and reasonable), *and Windsor*, 529 S.W.2d at 834 (holding that "take it all" or "leave it all" offer was not fair and reasonable).

[38] Applicant's Exs. 37 to 43

[39] *See Carson*, at 317.

[40] Tex. Nat. Res. Code 102.052 (emphasis added).

assure that the economic risk assumed in the drilling and completing of a well is reasonably shared by the operator and the working interest owners.

The Commission has previously recognized the "standard for assessing a fair and reasonable risk penalty is the actual chance of a successful completion at the time the well [is] drilled."[41] Further, the Commission has also recognized that in the absence of evidence of risk, and where most wells drilled in the field appear to be commercially producible, the Commission has concluded that a nominal risk penalty (e.g. 10%) is appropriate.[42]

While many wells in the Eagleville (Eagle Ford - 1) Field do not payout or achieve commercial success, virtually all of them become commercially producible and recover a substantial portion of the capital expenditures. There is almost no possibility of a dry hole, which greatly reduces one of the main risks the MIPA penalty is designed to address. In addition, it should be noted that if a MIPA applicant such as Ammonite is pooled with a well that does not reach payout, that applicant will not be allocated any production, thereby sharing the misery and mitigating to some extent the need for a risk penalty.

In its voluntary pooling offers presented to EOG, Ammonite proposed a charge for risk of 10%, which would be taken out of its share of production from and after the effective date of the pooled unit or payout of the existing well, whichever is later. Such a penalty is supported by precedent and the fact that EOG failed to respond to these offers in any way.

In order to balance this conflicting evidence and the other factors, it is recommended that a 50% charge for risk based on the facts of this case, is fair and reasonable as is required by § 102.017 of the MIPA.

Common Reservoir

The Eagle Ford Shale is a resource play being developed with unconventional drilling and completion techniques. Although heterogenous with localized sweet spots, it is a continuous hydrocarbon system, as Tim Smith repeatedly points out. All proposed MIPA units in these dockets are within the correlative interval and the geographic parameters of the Eagleville (Eagle Ford - 1) Field. Within the Eagleville (Eagle Ford - 1) Field, the Eagle Ford Shale is a "continuous hydrocarbon system" [43] and is therefore a "common reservoir" for purposes of MIPA.

Protestant's reliance on the PFD's from prior cases before the Railroad Commission is unpersuasive since those cases relied on existing drainage as the predominant factor in establishing a common reservoir and on protecting correlative rights as the sole basis for

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[41] Oil & Gas Dockets 3-77,090 & 3-79,517, the *Applications of General Production Corp. Et. Al., Giddings (Austin Chalk, Gas) Field, Lee County, Texas*, at page 6 (Final Order signed April 9, 1984.)

[42] Oil & Gas Docket 6-75,587, *Application of Panola Producing Company, Carthage (Cotton Valley) Filed, Panola County, Texas* (Final Order signed September 7, 1982).

[43] Tr., pg. 199, lns 5, 25

MIPA pooling therein. Waste was definitely not an issue. Drainage can be relevant, but it is not mentioned in the MIPA and is not an essential element of a successful application if all the other requirements are met. The PFD's cite Smith & Weaver for the proposition that a showing of drainage is necessary for MIPA pooling. [44] Smith & Weaver cites the case of *Railroad Commission v. Broussard, 755 S.W.2d 951, (Tex. App.-Austin 1988, writ denied)*, and states, "It is unfair to let an applicant share in production from a well that does not drain any oil or gas from the applicant's tract." [45] EOG also cites this case for the same proposition in its Closing Argument. While this statement may reflect an accurate conclusion in the context of the facts in *Broussard*, it is important to note that it was made in connection with the reasonableness of an offer to pool in a conventional reservoir. Such case did not involve waste and did not involve a resource play like the Eagle Ford Shale, a continuous hydrocarbon system with permeability and drainage areas so low that many wells cannot even drain their proration unit. The case is easily distinguishable on that basis. While the existence of drainage may be some evidence of a common reservoir and of a fair and reasonable offer, especially in a conventional reservoir context, there is ample evidence in the record to show that the absence of drainage should not be one-dimensional litmus test for the success of a MIPA pooling application in the Eagle Ford Shale trend or the Eagleville (Eagle Ford - 1) Field.

Compulsory Pooling Required

Ammonite demonstrated that the proposed MIPA units will prevent waste of the State's mineral reserves. Testimony demonstrated that Ammonite is unable to drill a well on the meandering Frio River riverbed acreage. Therefore, it is not possible for the State's Frio River riverbed oil and gas reserves to be produced without pooling.[46] Under the MIPA, the Commission may order compulsory pooling only if it is necessary to protect correlative rights or prevent waste. Here, by denying the proposed MIPA units, the State of Texas's General Land Office and the Permanent School Fund would be denied the reasonable opportunity to recover their fair share of the oil and gas in the shared common reservoir and would additionally thereby cause waste by stranding the Eagle Ford Shale reserves underlying the Frio River riverbed tracts.

Due to the location and the meandering configuration of the riverbed tracts, there is no feasible way for the mineral reserves in the Eagleville (Eagle Ford - 1) Field underlying these State of Texas tracts to be developed and recovered without pooling.[47] Because of limited permeability, this is also true of the currently undrained acreage within EOG's existing leases and units. The testimony and Exhibits presented by Tim Smith demonstrate that none of the EOG wells are likely to drain all of the acreage included within their respective leases, the existing proration units or the proposed MIPA units. It is clear from his testimony that future drilling, workovers, completions or stimulation operations will ultimately be required to recover reserves from EOG's undrained acreage included in the existing proration units and the proposed MIPA units. Compulsory pooling

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[44] Smith & Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3[A][6] at pg. 12-18-12-39
[45] Smith & Weaver, *Texas Law of Oil and Gas*, Vol. 3, Chapter 12, §12.3[B] at pg. 12-30
[46] Tr. Pg. 112, lns 8-19
[47] *Id.*

as proposed by Ammonite, enabling such current or future wells to produce from such undrained acreage, both on EOG's acreage and the Frio Riverbed tracts, is the only way to prevent waste and to permit all owners to have their fair share of hydrocarbons produced from the common reservoir in this case. EOG, as operator of the proposed MIPA units, will then be able to formulate and execute an appropriate plan to reasonably develop all acreage in each of the units.

Finally, EOG's contention that formation of the requested MIPA units constitutes a taking ignores the fact that valuable riverbed mineral acreage is being contributed to each unit for production and development, past, present and future, and that the benefits thereof will be allocated on an acreage basis, a well-established and fair method of doing so. Hence, formation of the MIPA units involves the exchange of valuable consideration in the same way parties do when dealing at arms-length. There is certainly quid pro quo.

The proposed MIPA Unit for the EOG Naylor Jones Unit 26, Well No. 2H well contains 550.02 total acres comprised of 546.85 acres of EOG acreage and 3.17 acres of the Frio River. However, MIPA prescribes a maximum size of units for oil to be 176 acres; hence, the application as to this unit must be denied.

The Administrative Law Judge and Technical Examiner believe that as to the remaining fifteen (15) proposed MIPA units, (1) the separately owned tracts fall within a common reservoir, (2) Ammonite's voluntary pooling offers were fair and reasonable and (3) pooling under MIPA is necessary to prevent waste and to protect correlative rights.

Therefore, based on the record in this case, adoption of the following Findings of Fact and Conclusions of Law is recommended:

FINDINGS OF FACT

1. Notice of the hearing was provided by mail to all interested parties at mailing addresses provided by the applicant at least 30 days prior to the hearing.

2. In addition, notice was published in the *The Progress* December 21 and 28, 2016, as well as January 4 and 11, 2017.[48]

3. At various times in 2015, Ammonite sent voluntary pooling offers to EOG for each of the sixteen (16) proposed MIPA units in these dockets.

4. The basic terms outlined in the voluntary pooling offer made by Ammonite have been found to be fair and reasonable in other cases. Ammonite has stated that the risk penalty may be adjusted without be considered adverse.

5. The tracts within each proposed MIPA unit are within a common reservoir. They are embraced within a continuous hydrocarbon system and are all within the

[48] Applicant's Ex. 46.

Eagleville (Eagle Ford - 1) Field, for which the Commission has established the size and shape of proration units.

6. The Eagleville (Eagle Ford - 1) Field and its field rules were established in 2010, providing for 330' lease-line spacing with no between-well spacing requirement. Standard drilling/proration unit for the Field is 80 acres with optional 40-acres.[49] As set out above, in Docket No. 01-0302644, Ammonite proposed a unit of 550.02 acres comprised of 546.85 acres of EOG acreage and 3.17 acres of the Frio River, for which the Commission lacks authority to issue a compulsory pooling order because Ammonite's proposed unit size exceeds the limits authorized by Texas Natural Resources Code 102.011 and cannot be reformed.

7. Formation of the proposed MIPA units is the only option for accessing and producing reserves under the riverbed tracts and the contiguous undrained acreage within the existing leases and units so as to prevent waste.[50]

8. Without compulsory pooling, Ammonite will not be able to drill any wells, Ammonite and its lessees will not have a reasonable opportunity to recover their fair share of hydrocarbons from the reservoir and the underlying hydrocarbons will be left unrecovered.

CONCLUSIONS OF LAW

1. Pursuant to Texas Natural Resources Code § 102.016, notice of the hearing was given to all interested parties by mailing the notices to their last known addresses at least 30 days before the hearing and, in the case of parties whose whereabouts were unknown, by publication of notice for 4 consecutive weeks in a newspaper of general circulation in the county where the proposed unit is located at least 30 days before the hearing.

2. The proposed MIPA Unit for the EOG Naylor Jones Unit 26, Well No. 2H well contains 550.02 total acres comprised of 546.85 acres of EOG acreage and 3.17 acres of the Frio River. However, MIPA prescribes a maximum size of units for oil to be 176 acres; hence, the application as to this unit must be denied

3. As to as to the remaining fifteen (15) proposed MIPA Units, the Commission has jurisdiction over the parties and the subject matter and has authority to issue a compulsory pooling order pursuant to Texas Natural Resources Code § 102.011.

4. Ammonite made fair and reasonable offers to pool voluntarily to EOG, as required by Texas Natural Resources Code § 102.013, as to the remaining fifteen (15) proposed MIPA Units. A risk penalty of 50% can be used without being considered adverse by Ammonite. The fifteen (15) proposed MIPA unit are within a common reservoir because they are all within the Eagleville (Eagle Ford - 1) Field and are

[49] Applicant's Exs. 34 ,35, 36, 37, 38, 39 and 40.

[50] Tr., pg. 102, lns. 7 - 10.

all within a continuous hydrocarbon system, which is being developed as an unconventional resource play.

5. As to the fifteen (15) proposed MIPA Units, the terms and conditions of the Commission's Final Order in this proceeding are fair and reasonable, will afford the owner of each tract or interest in each respective unit the opportunity to produce or receive a fair share of, and will prevent waste of, produced hydrocarbons.

RECOMMENDATION

It is recommended that the Application for the proposed MIPA Unit for the EOG Naylor Jones Unit 26, Well No. 2H (Docket No. 01-0302644) be **denied**.

It is further recommended that Ammonite's applications be **approved** as to the remaining fifteen (15) proposed MIPA Units, subject to conditions, as set forth in the attached Final Orders.

Respectfully Submitted,

Clayton J. Hoover
Administrative Law Judge

Karl Caldwell
Technical Examiner