

CHRISTI CRADDICK, *CHAIRMAN*
RYAN SITTON, *COMMISSIONER*
WAYNE CHRISTIAN, *COMMISSIONER*



RANDALL D. COLLINS, *DIRECTOR*

RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL & GAS DOCKET NO. 08-0305785

COMPLAINT OF LANEXCO, INC. REGARDING SBJ ENERGY PARTNERS, L.L.C. (OPERATOR NO. 749824), THE STATE OF TEXAS LEASE, WELL NO. 1001HZ, AND THE UNIVERSITY LANDS LEASE, WELL NO. 1201, SHAFTER LAKE (YATES) FIELD, ANDREWS COUNTY, TEXAS

PROPOSAL FOR DECISION

HEARD BY: Jennifer Cook – Administrative Law Judge
Peggy Laird, P.G. – Technical Examiner

PROCEDURAL HISTORY:

Hearing Date: December 4, 2017
Post-hearing Briefing Deadline
and Close of Record: January 31, 2018
Proposal for Decision Issued: April 17, 2018

APPEARANCES:

For Complainant Lanexco, Inc. -
Ms. Cathy Cone

For Respondent SBJ Energy Partners, L.L.C. -
Mr. Glenn E. Johnson
Kelly Hart & Hallman LLP

Table of Contents

I.	Statement of the Case.....	3
II.	Jurisdiction and Notice	3
III.	Applicable Legal Authority	4
IV.	Discussion of Evidence	4
V.	Examiners' Analysis	6
VI.	Recommendation, Proposed Findings of Fact and Proposed Conclusions of Law.....	7

I. Statement of the Case

Lanexco, Inc. (“Complainant” or “Lanexco”), filed a complaint (“Complaint”) claiming that SBJ Energy Partners, L.L.C. (“Respondent” or “SBJ”) does not have a good faith claim to operate the State of Texas Lease, Well No. 1001HZ and the University Lands Lease, Well No. 1201 (“1001HZ Well” and “1201 Well,” and collectively referred to as “Wells”). Complainant requests that the 1201 Well be ordered plugged and that Respondent’s permit application for the 1001HZ Well be denied.

Complainant asserts Respondent does not have a good faith claim to operate the Wells. Respondent filed a permit application for the 1001HZ Well, but no permit has been issued and the well has not been drilled. Respondent does have a permit for the 1201 Well, and that well has been drilled.

Complainant has a contractual lease covering the Wells and executed a farmout agreement with Respondent including acreage covering the Wells. Complainant asserts the farmout agreement provides that Respondent’s obtaining any acreage was conditioned upon and was to occur after Respondent paid \$100,000 to Complainant. Complainant claims the \$100,000 was never paid so the acreage was never earned or assigned to Respondent. Therefore, Complainant argues, Respondent does not have a good faith claim to operate the Wells.

Respondent acknowledges that \$100,000 was not paid. Respondent asserts the dispute with Complainant is a contract or title dispute, the determination of which is outside the jurisdiction of the Commission. Respondent maintains it has a farmout agreement with Complainant, giving it the right to operate the Wells, and Complainant’s dispute as to the amount of monies owed under the farmout agreement does not defeat Respondent’s good faith claim.

The Administrative Law Judge and Technical Examiner (collectively “Examiners”) respectfully submit this Proposal for Decision (“PFD”) and recommend the Railroad Commission (“Commission” or “RRC”) dismiss the complaint as to the 1001HZ Well, find SBJ demonstrated a good faith claim to operate the 1201 Well and deny Complainant’s request that the 1201 Well be plugged.

II. Jurisdiction and Notice¹

Sections 81.051 and 81.052 of the Texas Natural Resources Code provide the Commission with jurisdiction over all persons owning or engaged in drilling or operating oil or gas wells in Texas and the authority to adopt all necessary rules for governing and regulating persons and their operations under the jurisdiction of the Commission.

On September 1, 2017, the Hearings Division of the Commission sent a Notice of Hearing (“Notice”) via first-class mail to Complainant and Respondent setting a hearing

¹ The hearing transcript in this case is referred to as “Tr. at [pages].” Complainant’s exhibits are referred to as “Complainant Ex. [exhibit nos.].” Respondent’s exhibits are referred to as “Respondent Ex. [exhibit nos.].”

date of October 4, 2017.² The Notice contains (1) a statement of the time, place, and nature of the hearing; (2) a statement of the legal authority and jurisdiction under which the hearing is to be held; (3) a reference to the particular sections of the statutes and rules involved; and (4) a short and plain statement of the matters asserted.³ In a letter dated October 26, 2017, the hearing was rescheduled to December 4, 2017, due to an unexpected closure of the Commission's Austin office. The hearing was held on December 4, 2017. Consequently, all parties received more than 10 days' notice. Complainant and Respondent appeared at the hearing.

III. Applicable Legal Authority

Complainant alleges the current operator, SBJ, does not have a good faith claim to operate the Wells as that term is defined. A "good faith claim" is defined in the Texas Natural Resources Code and in Commission rule as:

A factually supported claim based on a recognized legal theory to a continuing possessory right in the mineral estate, such as evidence of a currently valid oil and gas lease or a recorded deed conveying a fee interest in the mineral estate.⁴

IV. Discussion of Evidence

Complainant asserts Respondent does not have a good faith claim to operate the Wells; the permit application for the 1001HZ Well should be denied and the 1201 Well should be ordered plugged.⁵

Respondent claims it has a farmout agreement covering the acreage where the Wells are located and this agreement gives it a possessory right in the mineral estate.⁶ There is a farmout agreement dated December 20, 2016 ("Farmout Agreement"), between Complainant and Respondent, in which Complainant gives Respondent the right to drill wells and capture the hydrocarbons under the acreage where the Wells are located.⁷

Complainant does not dispute that the Farmout Agreement covers the Wells. Complainant asserts that Respondent's obtaining any acreage pursuant to the Farmout Agreement was conditioned upon and was to occur after Respondent paid \$100,000 to Complainant. Complainant claims the \$100,000 was never paid so the acreage was never earned or assigned to Respondent. Therefore, Complainant argues, Respondent does not have a good faith claim to operate the wells.⁸

² See Notice of Hearing issued September 1, 2017.

³ See TEX. GOV'T CODE §§ 2001.051, .052; 16 TEX. ADMIN. CODE §§ 1.42, 1.45.

⁴ TEX. NAT. RES. CODE § 89.002(11); 16 TEX. ADMIN. CODE § 3.15(a)(5).

⁵ Tr. at 11-13, 25-76, 172.

⁶ See, e.g., Complainant Ex. 7; Tr. at 14, 77-163.

⁷ Complainant Ex. 2.

⁸ Complainant Ex. 8-9; Tr. at 11-13, 25-76.

Complainant relies on the following provision in the Farmout Agreement (“Paragraph 2”):

On or before May 31, 2017, SBJ shall pay a location fee of \$100,000 for the right to drill as many wells upon the Acreage Block as SBJ in its sole opinion deems necessary to fully capture and develop the Yates Sand located associated with the Acreage Block (minimum of 4 wells, maximum of 16 wells). Said payment shall be proportionally reduced as to Lanexco’s total number of acres controlled within the 160-acre block divided by 160 acres.⁹

The Farmout Agreement contains thirteen paragraphs discussing the terms of the agreement. For example, the agreement requires SBJ “to commence operations for the drilling of the initial well” by May 31, 2017, which is the same date the payment in Paragraph 2 is due.¹⁰

Complainant also relies on a letter dated May 26, 2017 from the CEO and Managing Partner of SBJ to Lanexco regarding the assignment. It states, among other things, “Upon the payment of \$100,000 Lanexco agrees to assign SBJ the acreage earned pursuant to the December 20, 2016 Farmout Agreement letter.” Complainant refused to sign an assignment of the acreage at issue because Respondent did not pay the full amount of \$100,000.¹¹ To date, Complainant has not assigned the acreage at issue to SBJ.

Pursuant to the Farmout Agreement, Respondent obtained a permit for and drilled the 1201 Well.¹² Pursuant to the Farmout Agreement, Complainant and Respondent signed a Commission Form P-4 *Certificate of Compliance and Transportation Authority* to change the Commission operator of record for the 1201 Well from Complainant to Respondent.¹³ Pursuant to the Farmout Agreement, Respondent has operated and produced hydrocarbons from the 1201 Well.¹⁴

Pursuant to the Farmout Agreement, Respondent applied for a permit for the 1001HZ Well. Because Respondent did not submit required information to the Commission when applying for a permit for the 1001HZ Well, Commission staff dismissed the application.¹⁵

Respondent acknowledges that it has paid an amount less than \$100,000 to Complainant. Respondent asserts that the dispute with Complainant is a contract or title dispute, the determination of which is outside the jurisdiction of the Commission. Respondent disputes the amount owed. Respondent asserts it has a farmout agreement with Complainant giving it the right to operate the Wells and Complainant’s dispute as to

⁹ Complainant Ex. 2, ¶ 2.

¹⁰ Complainant Ex. 2, ¶ 6.

¹¹ Complainant Ex. 3-4, 8-9.

¹² Respondent Ex. 2-4.

¹³ Respondent Ex. 1.

¹⁴ Respondent Ex. 4-6.

¹⁵ Respondent Ex. 7.

the amount of monies owed under the farmout agreement does not defeat Respondent's good faith claim.

Respondent has an active Commission Form P-5 *Organization Report* with a \$50,000 cash deposit as its financial assurance on file with the Commission.¹⁶

V. Examiners' Analysis

The Examiners recommend Complainant's requested relief be denied and the Commission find Respondent provided sufficient evidence of a good faith claim to operate the Wells.

Complainant alleges Respondent does not have a good faith claim to operate the Wells. A good faith claim is defined in Commission rule as:

A factually supported claim based on a recognized legal theory to a continuing possessory right in the mineral estate, such as evidence of a currently valid oil and gas lease or a recorded deed conveying a fee interest in the mineral estate.¹⁷

The origin of the "good-faith claim" requirement comes from the Texas Supreme Court in *Magnolia Petroleum Co. v. Railroad Commission*.¹⁸ In discussing the Commission's authority to grant a drilling permit, the Court stated, "The function of the Railroad Commission in this connection is to administer the conservation laws. When it grants a permit to drill a well it does not undertake to adjudicate questions of title or rights of possession. These questions must be settled in the courts."¹⁹ The Court concluded, "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."²⁰ A showing of a good faith claim does not require an applicant to prove title or a right of possession. It is sufficient for an applicant to make "a reasonably satisfactory showing of a good faith claim," and another's good faith dispute of title or possessory interest will not alone defeat an applicant.²¹

Regarding the 1001HZ Well, the issues in this case are moot because a permit was never granted and the permit application has been dismissed.

Regarding the 1201 Well, the Examiners find there is sufficient evidence that SBJ has a good faith claim. The Farmout Agreement is an agreement between Complainant and Respondent, the purpose of which is to allow Respondent to drill and capture hydrocarbons under the acreage where the 1201 Well is located. Complainant claims the

¹⁶ Respondent Ex. 3.

¹⁷ 16 TEX. ADMIN. CODE § 3.15(a)(5).

¹⁸ *Id.*; see *Magnolia Petroleum Co. v. R.R. Commission of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943); see also *Trapp v. Shell Oil Co.*, 198 S.W.2d 424, 437-38 (Tex. 1946); *Rosenthal v. R.R. Comm'n of Tex.*, 2009 WL 2567941, *3 (Tex. App.—Austin 2009, pet. denied); *Pan Am. Petroleum Corp. v. R.R. Comm'n of Tex.*, 318 S.W.2d 17 (Tex. Civ. App.—Austin 1958, no writ).

¹⁹ *Magnolia Petroleum Co. v. R.R. Comm'n of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943).

²⁰ *Id.* at 191 (emphasis added).

²¹ *Id.*

failure to pay a \$100,000 fee results in no transference of acreage. All parties agree \$100,000 was not paid. Respondent claims even if monies are owed, the matter is a contract dispute. While the Farmout Agreement does contain language regarding a \$100,000 location fee, it is susceptible to other possible interpretations other than the interpretation relied on by Complainant. Even if monies are owed, it is not clear that would deprive Respondent of the right to operate on the acreage at issue.

There is sufficient evidence that Respondent has a good faith claim. For these reasons, the Examiners recommend the Commission deny the relief requested in the Complaint.

VI. Recommendation, Proposed Findings of Fact and Proposed Conclusions of Law

Based on the record in this case and evidence presented, the Examiners recommend the Commission deny the relief requested in the Complaint because Complainant did not provide sufficient evidence that SBJ does not have a good faith claim to operate the Wells and there was evidence that SBJ does have a good faith claim. The Examiners recommend the Commission adopt the following findings of fact and conclusions of law.

Findings of Fact

1. Lanexco, Inc. (“Complainant” or “Lanexco”), filed a complaint (“Complaint”) claiming that SBJ Energy Partners, L.L.C. (“Respondent” or “SBJ”) does not have a good faith claim to operate the State of Texas Lease, Well No. 1001HZ and the University Lands Lease, Well No. 1201 (“1001HZ Well” and “1201 Well,” and collectively referred to as “Wells”). Complainant requests that the 1201 Well be ordered plugged and that Respondent’s permit application for the 1001HZ Well be denied.
2. On September 1, 2017, the Hearings Division of the Commission sent a Notice of Hearing (“Notice”) via first-class mail to Complainant and Respondent setting a hearing date of October 4, 2017.²² The Notice contains (1) a statement of the time, place, and nature of the hearing; (2) a statement of the legal authority and jurisdiction under which the hearing is to be held; (3) a reference to the particular sections of the statutes and rules involved; and (4) a short and plain statement of the matters asserted.²³ In a letter dated October 26, 2017, the hearing was rescheduled to December 4, 2017, due to an unexpected closure of the Commission’s Austin office. The hearing was held on December 4, 2017. Consequently, all parties received more than 10 days’ notice. Complainant and Respondent appeared at the hearing.

²² See Notice of Hearing issued September 1, 2017.

²³ See TEX. GOV’T CODE §§ 2001.051, 052; 16 TEX. ADMIN. CODE §§ 1.45, 1.48.

3. Respondent has an active Commission Form P-5 *Organization Report* with a \$50,000 cash deposit as its financial assurance on file with the Commission.
4. Respondent claims it has a farmout agreement covering the acreage where the Wells are located, and this agreement gives it a possessory right in the mineral estate.
5. There is a farmout agreement dated December 20, 2016 (“Farmout Agreement”), between Complainant and Respondent, in which Complainant gives Respondent the right to drill wells and capture the hydrocarbons under the acreage where the Wells are located.
6. Complainant does not dispute that the Farmout agreement covers the Wells.
7. Pursuant to the Farmout Agreement, Respondent obtained a permit for and drilled the 1201 Well.
8. Pursuant to the Farmout Agreement, Complainant and Respondent signed a Commission Form P-4 *Certificate of Compliance and Transportation Authority* to change the Commission operator of record for the 1201 Well from Complainant to Respondent.
9. Pursuant to the Farmout Agreement, Respondent has operated and produced hydrocarbons from the 1201 Well.
10. Pursuant to the Farmout Agreement, Respondent applied for a permit for the 1001HZ Well.
11. Because Respondent did not submit required information to the Commission when applying for a permit for the 1001HZ Well, Commission staff dismissed the application.
12. Complainant asserts that in the Farmout Agreement, the right to drill and operate is conditioned upon Respondent paying \$100,000 to Complainant
13. Respondent asserts the issue of whether monies are owed under the Farmout Agreement is a lease dispute and does not defeat Respondent’s good faith claim.
14. While the Complainant may have a bona fide lease dispute with Respondent, the determination of whether there has been a breach and the appropriate remedy is outside the jurisdiction of the Commission.
15. While the Complainant may have a bona fide lease dispute with Respondent, it does not defeat Respondent’s good faith claim.

16. Respondent has demonstrated a good faith claim to a continuing right to operate the Wells.

Conclusions of Law

1. Proper notice of hearing was timely issued to appropriate persons entitled to notice. See, e.g., TEX. GOV'T CODE §§ 2001.051, .052; 16 TEX. ADMIN. CODE §§ 1.42, 1.45.
2. The Commission has jurisdiction in this case. See, e.g., TEX. NAT. RES. CODE § 81.051.
3. At the hearing in this matter, SBJ provided a reasonably satisfactory showing of a good faith claim to continue operating the 1201 Well.
4. Complainant's good faith dispute with Respondent does not defeat Respondent's reasonably satisfactory showing of a good faith claim.
5. Because the permit application for the 1001HZ Well was not granted and was dismissed by Commission staff, the issues in the Complaint as to that well are moot and obsolete.
6. The allegations in Complaint as to the 1001HZ Well should be dismissed. See 16 TEX. ADMIN. CODE § 1.107(4)

Recommendations

The Examiners recommend the Commission enter an order dismissing the complaint as to the 1001HZ Well, finding SBJ demonstrated a good faith claim to operate the 1201 Well and denying Complainant's request that the 1201 Well be plugged.

Respectfully,



Jennifer Cook
Administrative Law Judge



Peggy Laird, P.G.
Technical Examiner