RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

EXAMINERS' REPORT AND RECOMMENDATION

OIL & GAS DOCKET NO. 08-0316595

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE REBEL 145 UNIT, WELL NO. H145WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

OIL & GAS DOCKET NO. 08-0316598

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE REBEL 140 UNIT, WELL NO. H140WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

OIL & GAS DOCKET NO. 08-0316603

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE CHARGER 150 UNIT, WELL NO. H150WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

OIL & GAS DOCKET NO. 08-0316606

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE REBEL 150 UNIT, WELL NO. H150WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

OIL & GAS DOCKET NO. 08-0316612

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE CHARGER 145 UNIT, WELL NO. H145WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

OIL & GAS DOCKET NO. 08-0316655

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE CHARGER 140 UNIT, WELL NO. H140WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS

HEARD BY: Jennifer Cook, Administrative Law Judge
Petar Buva, Technical Examiner

PROCEDURAL HISTORY:

Application Filed -	November 27 and 30, 2018
Notice of Hearing -	December 14, 2018
Hearing Date -	January 16, 2019
Transcript Received and Record Closed -	February 6, 2019
Conference -	March 26, 2019

APPEARANCES:
For Applicant Permian Deep Rock Oil Company, LLC -
Mark Hanna and Michael Bernstein, *Scott Douglass & McConnico*
Wayne Bailey, Vice President of Land, Permian Deep Rock Oil Company, LLC
Rick Johnston, Principal at Johnston & Cloud, Consulting Petroleum Engineer

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I. Statement of the Case

Six docketed cases are presented together in this Examiners' Report and Recommendation ("Report") because they have common facts, parties and legal issues.

Permian Deep Rock Oil Company, LLC ("Applicant" or "Permian") filed six applications ("Applications") under the Mineral Interest Pooling Act ("MIPA").[1] These Applications were assigned separate docket numbers, but heard simultaneously. The Applications ask the Railroad Commission of Texas ("Commission") to create six force-pooled units covering approximately 100 acres each within the city limits and urban core of the City of Midland, Texas. These units, named after local high schools' mascots, are proposed as the Rebel 140 Unit (approximately 100.32 acres), the Rebel 145 Unit (approximately 100.33 acres), the Rebel 150 Unit (approximately 100.34 acres), the Charger 140 Unit (approximately 99.57 acres), the Charger 145 Unit (approximately 99.03 acres), and the Charger 150 Unit (approximately 98.96 acres). Applicant was successful in leasing at least 80% of the net acres within each of the proposed MIPA units. If the Applications are approved, Permian intends to drill and complete the MIPA wells as horizontal oil wells in the Spraberry (Trend Area) Field in Midland County, Texas.

The Applications are unprotested. Applicant asserts forced pooling is necessary to prevent waste and protect correlative rights given the complexity of the urban location. The Administrative Law Judge and Technical Examiner ("Examiners") respectfully submit this Report and recommend that the Commission grant the Applications.

II. Jurisdiction and Notice[2]

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. The MIPA grants the Commission authority to pool mineral interests into a unit under certain conditions.[3]

On December 14, 2018, the Hearings Division of the Commission sent a Joint Notice of Hearing on the Applications via first-class mail to all interested parties setting a hearing date of January 16, 2019.[4] Applicant published the Notice of Hearing four (4) times in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County, on December 14, 2018, December 21, 2018, December 28, 2018, and January 4, 2019.[5] The notice contained (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

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[1] Tex. Nat. Res. Code §§ 102.001-102.112.
[2] The hearing transcript in this case is referred to as "Tr. Vol. [number] at [page(s)]." Applicant's exhibits are referred to as "Applicant Ex. [exhibit no.]." Staff's exhibits are referred to as "Staff Ex. [exhibit no.]."
[3] *See* Tex. Nat. Res. Code § 102.011.
[4] Tr. 22:12 – 23:3; Applicant's Ex. 3.
[5] Tr. 23:9 – 24:3; Applicant's Ex. 4.

involved; and (4) a short and plain statement of the matters asserted.[6] The hearing was held on January 16, 2019, as noticed. Consequently, all parties received more than 30 days' notice.[7] Applicant appeared at the hearing on January 16, 2019, and presented evidence and argument. No one appeared in protest.

III. Applicable Legal Authority

At issue in these cases is whether Applicant can create pooled units consisting of both leased and force-pooled unleased mineral interests into units under the MIPA. Pertinent sections of the MIPA at issue in this case are as follows:

> Sec. 102.003 APPLICATIONS TO CERTAIN RESERVOIRS. The provisions of this chapter do not apply to any reservoir discovered and produced before March 8, 1961.
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> Sec. 102.011. AUTHORITY OF COMMISSION. When 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 this code 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.
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> Sec. 102.012. OWNERS AUTHORIZED TO APPLY FOR POOLING. The following interested owners may apply to the commission for the pooling of mineral interests:
>
> (1) the owner of any interest in oil and gas in an existing proration unit or with respect to a proposed unit;
> (2) the owner of any working interest; or
> (3) any owner of an unleased tract other than a royalty owner.
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> Sec. 102.013. REQUIRED VOLUNTARY POOLING OFFER.
> (a) The applicant shall set forth in detail the nature of voluntary pooling offers made to the owners of the other interests in the proposed unit.

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[6] *See* Tex. Gov. Code §§ 2001.051, 2001.052; 16 Tex. Admin. Code §§ 1.41, 1.42, 1.45.
[7] Tex. Nat. Res. Code § 102.016.

(b) 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.
(c) An offer by an owner of a royalty or any other interest in oil or gas within an existing proration unit to share on the same yardstick basis as the other owners within the existing proration unit are then sharing shall be considered a fair and reasonable offer.[8]

According to the MIPA, for an applicant to prevail, the following must be established:

1. There are two or more separately owned tracts of land;
2. They are embraced in a common reservoir of oil or gas;
3. The commission has established the size and shape of proration units for the reservoir;
4. There are separately owned interests in oil and gas within an existing or proposed proration unit in the common reservoir;
5. The reservoir was not discovered and produced before March 8, 1961;
6. The owners have not agreed to pool their interests;
7. 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;
8. An application for the Commission to pool has been made by one of the following:
   (1) the owner of any interest in oil and gas in an existing proration unit or with respect to a proposed unit;
   (2) the owner of any working interest; or
   (3) any owner of an unleased tract other than a royalty owner;
9. Applicant made a fair and reasonable offer to pool voluntarily; and
10. A pooled unit will avoid the drilling of unnecessary wells, protect correlative rights, or prevent waste.

If these criteria are met, the Commission must establish a unit and pool all of the interests in the unit within an area containing the approximate acreage of the proration unit.

IV. Discussion of Evidence

A. Background and Summary of the Evidence

Applicant seeks approval for six pooled units, all within the city limits of Midland, Texas, and all covering the Spraberry (Trend Area) Field. According to Applicant, the urban and residential core of the City has yet to be developed, mostly due to the complexity of the necessary leasing program within this urban area.

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[8] Tex. Nat. Res. Code §§ 102.003, 102.011, 102.012, 102.013.

Applicant's first witness was Wayne Bailey. He is Permian's Vice President of Land and Legal.[9] He testified as both a fact witness and as an expert in petroleum land management.[10] Mr. Bailey explained that the proposed MIPA units are part of Permian's larger plan to develop tracts within the City of Midland (the "Midland Project"). According to Mr. Bailey's testimony, Permian has been working for the past five years to obtain leases to support the Midland Project.[11] Mr. Bailey stated that there are thousands of tracts within the area of Permian's Midland Project, and Permian has expended a significant amount of time, energy, and resources in attempting to lease all of these tracts.[12] Mr. Bailey explained that Permian's efforts include engaging five different land services companies, making in-person visits to prospective lessors' houses, sending over 16,200 letters, making over 20,000 phone calls, and utilizing 33 title attorneys.[13]

According to Mr. Bailey's testimony Permian has leased between 82% and 99.5% of the net acres in each of the proposed MIPA units.[14] But Mr. Bailey testified the unleased tracts within the proposed MIPA units have thus far precluded Permian from carrying out their development plans.[15]

Applicant's second witness was Rick Johnston. He testified as an expert petroleum engineer. As discussed more fully below, Mr. Johnston explained how the MIPA applies here despite the Spraberry (Trend Area) Field's 1952 discovery date. Mr. Johnston also testified as to the need for MIPA wells and the appropriate charge for risk.

B. Evidence Regarding MIPA Requirements

1. Application to Certain Reservoirs

The MIPA does "not apply to any reservoir discovered and produced before March 8, 1961."[16] Applicant seeks to pool all reservoirs in the Spraberry (Trend Area) Field falling within the area of the proposed MIPA units.[17] Permian offered argument and evidence that no reservoir within the proposed MIPA units was discovered and produced before March 8, 1961.

Permian argued, based on Texas Supreme Court precedent, that the term "reservoir" is distinct from the term "field," and that a reservoir is a common pool or accumulation of hydrocarbons that is not in natural communication with another pool or accumulation.[18] Mr. Johnston, an expert petroleum engineer, testified that the area of the proposed MIPA units is not in natural communication with any reservoir that was

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[9] Tr. at 16:9 – 16:13.
[10] Tr. at 18:7 – 18:9.
[11] Tr. at 24:9 – 24:14.
[12] Tr. at 24:11 – 28:8.
[13] Tr. at 25:24 – 28:8; Applicant's Ex. 7.
[14] Applicant's Ex.'s 2A-2F.
[15] Tr. at 32:10 – 32:14.
[16] Tex. Nat. Res. Code § 102.003.
[17] Applicant's Ex.'s 2A-2F.
[18] Tr. at 46:11 – 47:6, 54:8 – 55: 11. *See Railroad Com'n of Texas v. Graford Oil Corp.*, 557 S.W.2d 946, 950 (Tex. 1977); *Gage v. Railroad Com'n of Texas*, 582 S.W.2d 410, 414 (Tex. 1979).

discovered and produced before March 8, 1961.[19]

Mr. Johnston testified that there was no well within 2.5 miles of the proposed MIPA units that produced from any reservoir proposed to be pooled prior to March 8, 1961.[20] Mr. Johnston explained that 2.5 miles is the standard that the Commission uses to determine whether or not an operator is entitled to a new field discovery.[21] In support of that conclusion, Permian offered into evidence Railroad Commission Form P-7, the *New Field Designation And/Or Discovery Allowable Application*.[22] Form P-7 states that an operator obtains a new field designation by "proving that a new completion is in a reservoir separated both vertically and horizontally from all other reservoirs."[23] The Form's instructions require an applicant to identify all wells within a 2.5 mile radius with producing intervals that penetrate to the same general depth as an Applicant's proposed discovery wells.[24] Mr. Johnston testified that based on the Form P-7 instructions and his general experience, if the nearest production from the same stratigraphic interval is more than 2.5 miles away, an operator is entitled to a new field as a separate reservoir.[25]

Mr. Johnston did identify two wells which were located just outside of 2.5 miles from the proposed MIPA units that produced from the Upper Spraberry Sand and Lower Spraberry Sand prior to March 8, 1961.[26] But those wells produced from separate and distinct reservoirs from the reservoirs targeted by the proposed MIPA units because the intervals in which those wells were completed would not have been in natural communication with the proposed MIPA unit area.[27] Mr. Johnston also testified it was his expert opinion that if an operator had sought a new field discovery for the proposed MIPA unit area (after the above-described wells had produced) in March of 1961, the Commission would have granted the application because the two wells are more than 2.5 miles away and are separate reservoirs.[28]

2. The Voluntary Pooling Offer

Between December 3 and December 22, 2018, Permian sent a voluntary pooling offer to all locatable mineral owners of unleased tracts within the boundaries of the proposed MIPA Units.[29] Permian offered these unleased mineral owners three options for inclusion of their interests in the proposed MIPA Units: a lease option, a working-interest participation option, and a farm-out option.[30]

The lease option included a 25% royalty, a bonus of $10,000 per net mineral acre,

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[19] Tr. at 47:16 – 56:19.
[20] Tr. at 47:16 – 49:22.
[21] Tr. at 48:10 – 48:19.
[22] Applicant's Ex. 23.
[23] *Id.*
[24] *Id.*
[25] Tr. at 53:13 – 54:7.
[26] Tr. at 50:6 – 56:6.
[27] *Id.*
[28] Tr. at 53:18 – 54:7.
[29] Tr. at 32:15 – 34:14; Applicant's Ex.'s 18A.1 – 18F.62.
[30] Applicant's Ex.'s 18A.1 – 18F.62.

and a primary term of 3 years.[31] The oil, gas and mineral lease attached to the offer letter provided that Permian was authorized to pool the tract owner's mineral interest into a pooled unit.[32]

The participation option provided each unleased owner an opportunity to participate as a working interest owner in the proposed MIPA units.[33] By electing this option, the owner would be responsible for a proportionate share of the costs of drilling and completing the well or wells in the unit and would share proportionately in the production from the well. Each offer letter had as an attachment an estimated cost of drilling and completing the proposed MIPA unit well and a calculation of each respective owner's estimated proportionate cost of the proposed well. This option stated that if the owner failed to fully pay his or her proportionate share of costs to Permian within 15 days prior to commencement of actual drilling operations, then the owner would be subject to the non-consent penalties set forth in the standard Joint Operating Agreement ("JOA") Permian proposed. Permian represented to each owner that the proposed JOA would not contain any of the following: (1) a preferential right of the operator to purchase mineral interests in the unit; (2) a call on or option to purchase production from the unit; (3) operating charges that may include any part of district or central office expenses other than reasonable overhead charges; or (4) a prohibition against non-operators questioning the operation of the unit.[34]

The farm-out option proposed to each unleased owner that he or she convey to Permian an 80% net revenue interest attributable to his or her mineral interest and retain an overriding royalty interest equal to 20%, proportionately reduced to the extent that each owner's mineral interest bears to all of the mineral interests in the unit, until payout of all well costs (to drill, test, fracture stimulate, complete, equip, and connect the well for production).[35] At payout, the electing owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

Mr. Bailey, an expert in petroleum land management, testified that the terms included in Permian's voluntary offer were fair and reasonable, including an explanation of how the terms of the lease offer compared favorably to terms generally accepted in the area.[36] For example, Mr. Bailey testified that the $10,000 per net mineral acre bonus included in Permian's lease offer was roughly twice the amount of bonus Permian paid to mineral owners who had voluntarily leased with Permian for the Midland Project.[37]

3. Need for MIPA Wells

Permian offered into evidence a model to predict recovery from horizontal wells completed in the Spraberry (Trend Area) Field—all with varying drainhole lengths.[38]

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[31] *Id.*
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] Tr. at 38:2 – 40:15.
[37] *Id.*
[38] Applicant's Ex.'s 25-27.

Permian also presented a map showing Spraberry (Trend Area) wells within a 5-mile radius of the proposed MIPA units.[39] Permian also offered a cross-section over that area showing the various formations within the field.[40] From the study of the cross-section, Permian concluded that the Spraberry (Trend Area) Field is present throughout the proposed MIPA units and is expected to be productive over the entirety of that area.[41]

For every well within the 5-mile radius study area with sufficient data (135 wells), Permian plotted the estimated drainhole length of the well versus the well's estimated ultimate oil recovery ("EUR").[42] Permian then calculated the estimated ultimate recoveries ("EURs") by decline curve analysis.[43] Using the EUR as the y-coordinate and the estimated drainhole length as the x-coordinate, Permian created a scatter plot of the data points.[44] A least-squares regression of the plotted data points resulted in a line through the points with a positive slope of 0.0386 and an R-squared coefficient of 0.2508.[45] The inference of this resulting equation is that an average well within the 5-mile radius will recover 39 barrels of oil for each incremental foot of drainhole length.[46]

Permian's plats showed that, in spite of the percentage of acreage under lease, there was no path for the planned wellbores that would not encounter some unleased, unpooled interest.[47] Permian contends that, absent MIPA approval of the proposed wells, the underlying reserves could not be recovered and would therefore be wasted.[48] Based on (1) the completable drainhole length lost for each proposed well if MIPA is not approved and (2) a recovery factor of 39 barrels of oil for each incremental foot of drainhole length, Permian estimates that a total of 2,167,347 barrels of oil will be wasted if the Applications are not approved (without including wasted reserves from future wells).[49] Permian also testified that MIPA approval was necessary to protect correlative rights by giving Permian and its lessors a reasonable opportunity to recover their fair share of the oil and gas underlying the proposed MIPA units.[50]

C. Charge for Risk

Permian's Applications requested that the Commission's MIPA pooling order include a 100% charge for risk attached to the working-interest component, as authorized under Section 102.052 of MIPA.[51] In addition, the Notice of Hearing for the MIPA Applications gave notice that Permian was seeking a 100% charge for risk.[52] No party appeared to protest the 100% charge for risk, or any other aspect of the Applications.

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[39] Applicant's Ex. 22
[40] Applicant's Ex. 24.
[41] *See* Tr. at 59; Applicant's Ex. 24.
[42] Tr. at 60:9 – 63:19; Applicant's Ex.'s 25-27
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] Applicant's Ex.'s 28-33.
[48] Tr. at 66:16 – 70:12.
[49] Applicant's Ex. 34; Tr. 68:17 – 70:13.
[50] *Id.*
[51] Applicant's Ex.'s 2A – 2F.
[52] Applicant's Ex. 3.

Permian demonstrated that private joint operating agreements in the area of the proposed MIPA units typically provide for non-consent penalties of at least 200%.[53] To further support the proposed 100% charge for risk, Permian offered testimony relating to the Society of Petroleum Evaluation Engineers' ("SPEE") *Thirty-Fourth Annual Survey of Parameters Used in Property Evaluations*—a study conducted of reservoir reserves for purposes of determining fair market value of oil and gas assets or "risking" the reserves.[54] Mr. Johnston, an expert petroleum engineer and member of SPEE, opined that the reserves in the area of the proposed MIPA Units is most similar to the "proved undeveloped" reserve category identified on the "Unconventional Reserve Adjustment Factors" table.[55] Mr. Johnston opined that the study fully supports the requested charge for risk.[56]

Permian asserts that there exists significant risk that a well completed in the area of the proposed MIPA units will be uneconomic, meaning that the well will not recover the cost of drilling and completing the well.[57] Using an average cost of drilling and completing equal to roughly $11,500,000 and operating expenses of $3,500 per month, an oil price of $50 per barrel, a net revenue interest of 75%, and production taxes of 4.6%, Mr. Johnston concluded that the break-even recovery point (where the average well's cost would be recouped) was approximately 326,150 barrels of oil.[58] Of the 135 wells within the 5-mile study area, about 71 had estimated ultimate recoveries below a payout amount necessary for a well to be considered economic.[59] Moreover, the scatter plot of the estimated ultimate recovery of wells within the 5-mile study area shows significant variability in individual well performance.[60]

D. The Applications are Unprotested

No one has protested the Applications or the proposed charge for risk.[61]

V. Examiners' Analysis

The Examiners recommend the Commission grant the Applications and allow a 100% charge for risk. The Examiners recommend the Commission find that Applicant has met the requirements in the MIPA for forced pooling, including the following:

1. There are two or more separately owned tracts of land;
2. They are embraced in a common reservoir of oil or gas;
3. The commission has established the size and shape of proration units for the reservoir;

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[53] Tr. at 41:15 – 42:20.
[54] Tr. at 71:21 – 74:24; Applicant's Ex. 36.
[55] *Id.*
[56] *Id.*
[57] Tr. at 70:15 – 71:20; Applicant's Ex. 35.
[58] *Id.*
[59] *Id.*
[60] Applicant's Ex. 27.
[61] Tr. at 10:6 – 11:18

4. There are separately owned interests in oil and gas within an existing or proposed proration unit in the common reservoir;
5. The owners have not agreed to pool their interests;
6. 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;
7. An application for the Commission to pool has been made by one of the following:
   (1) the owner of any interest in oil and gas in an existing proration unit or with respect to a proposed unit;
   (2) the owner of any working interest; or
   (3) any owner of an unleased tract other than a royalty owner.
8. The applicant made a fair and reasonable offer to pool voluntarily; and
9. A pooled unit will avoid the drilling of unnecessary wells, protect correlative rights or prevent waste.

A. Applicant meets the general criteria for pooling set out in the MIPA

The MIPA requires there be two or more separately owned tracts of land embraced in a common reservoir of oil or gas for which the commission has established the size and shape of proration units for the reservoir. Applicant provided evidence of multiple different interest owners of tracts of land to be drilled in the Spraberry (Trend Area) Field. The Commission has established the proration units for the field.

The MIPA requires that 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. In this case, Applicant has the right to drill and proposes to drill one well per each of the six units in the Spraberry (Trend Area) Field.

The MIPA requires that the owners have not agreed to pool their interests. While Applicant has made offers to pool, it has not been able to secure 100% agreement to pool.

The MIPA requires that an application for the Commission to pool has been made by one of the following:

(1) the owner of any interest in oil and gas in an existing proration unit or with respect to a proposed unit;
(2) the owner of any working interest; or
(3) any owner of an unleased tract other than a royalty owner.

Applicant is an owner of mineral interests in each of the proposed MIPA units.

The proposed units do not contain land owned by the State of Texas nor to land in which the State of Texas has an interest directly or indirectly.

B. The reservoir at issue meets the requirement of MIPA that it was not discovered and produced before March 8, 1961

The MIPA provides "[t]he provisions of this chapter do not apply to any reservoir discovered and produced before March 8, 1961."[62] The MIPA does not define the term "reservoir." Applicant points to the Supreme Court of Texas' definition through its decisions interpreting the word "reservoir" in the context of statutes governing the Texas Railroad Commission. Applicant maintains that first in 1977 and then again in 1979, the Supreme Court tied the meaning of "reservoir" to the concept of natural communication.[63] Applicant provided quotations from the two cases to support its claim. In *Graford*, the Court states:

> [s]ince we hold that a common reservoir consists of a common pool or a common accumulation of hydrocarbons, separate and distinct pools of oil or gas, which are not connected, and which do not communicate with one another, do not constitute a 'common reservoir.' Each separate pool or accumulation is, under the statute, a separate reservoir, even though several different reservoirs may underlie a single gas-producing area and an entire gas-producing area may often be loosely referred to as a 'field.'[64]

In *Gage*, the Court states:

> in Graford, we held that separate reservoirs could not be transformed into one common reservoir as defined by statute through artificial means. Rather, the statute is drawn in terms of [n]atural communication between producing sands or zones.[65]

Applicant asserts that these cases show that the concept of natural communication is key.

Applicant also points to the Final Order Amending the Field Rules for the Spraberry (Trend Area) Field to show that the field is made up of multiple reservoirs when it states "[t]his [field] is intended to include all reservoirs between the top of the Clearfork and the top of the Strawn formations."[66] And a recent MIPA Proposal for Decision acknowledged the presence of multiple reservoirs within the Spraberry (Trend Area) Field: "[s]ince 1952, when the Spraberry (Trend Area) Field ("Field") was first created, numerous reservoirs have been consolidated into the Field. As such, the Field contains a range of discovery

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[62] Tex. Nat. Res. Code §102.003.

[63] *Railroad Com'n of Texas v. Graford Oil Corp.*, 557 S.W.2d 946 (Tex. 1977); *Gage v. Railroad Com'n of Texas*, 582 S.W.2d 410 (Tex. 1979).

[64] *Graford*, 557 S.W.2d at 950.

[65] *Gage*, 582 S.W.2d at 414. The Commission was later given the authority to prorate production from commingled zones as if they were a common reservoir by the "Commingling Statutes." *See* Tex. Nat. Res. Code §§ 85.046, 85.053, 85.055, 86.012, 86.081; *see also Railroad Com'n of Texas v. Pend Oreille Oil & Gas Co., Inc.*, 817 S.W.2d 36 (Tex. 1991) (discussing the Commingling Statutes and concluding the Commission has authority to force pool separate deposits of gas in man-made communication through a common wellbore).

[66] Applicant's Ex. 21 at 1.

dates for the various consolidated reservoirs within."[67] That Application, which sought the force-pooling of units within the Spraberry (Trend Area), was approved by the Commission on October 30, 2018.[68]

Applicant provided evidence that in March 8, 1961, no discovered reservoir was in natural communication with the area at issue in these Applications. In this case, Permian has established, through the expert testimony and evidence, that the area of the proposed MIPA units is not in natural communication with any reservoir that was discovered and produced before March 8, 1961. The Examiners recommend the Commission find that the MIPA applies to these Applications.

C. Applicant meets the requirement of making a fair and reasonable offer to pool voluntarily

For the Commission to force pool under the MIPA, the applicant must make a "fair and reasonable offer to pool voluntarily."[69] 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.[70] 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.[71]

Here, Applicant made an offer to unleased mineral owners that included three options to voluntarily pool their interests: a lease option, a working-interest option, and a farm-out option. The Examiners believe that Applicant's voluntary pooling offers were fair and reasonable. Applicant's offers followed the framework—providing a lease, participation, and farm-out option—that the Commission has determined to be fair and reasonable in recently approved MIPA applications.[72]

D. The proposed units are necessary to protect correlative rights and prevent waste

MIPA provides for forced pooling to avoid the drilling of unnecessary wells, protect correlative rights or prevent waste.[73] Applicant provided expert testimony from a

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[67] Proposal for Decision for Oil & Gas Docket Nos. 08-0309997, et al., the Applications of Sinclair Oil & Gas Company and Four Sevens Operating Company Pursuant to the Mineral Interest Pooling Act (Final Order signed October 30, 2018).
[68] Final Order for Oil & Gas Docket Nos. 08-0309997, et al.
[69] Tex. Nat. Res. Code §102.013.
[70] *Carson v. Railroad Com'n of Texas*, 669 S.W.2d 315, 316 (Tex. 1984).
[71] *Id.*
[72] *See e.g.* Final Order for Oil & Gas Docket Nos. 08-0309997, et al.; Proposal for Decision for Oil & Gas Docket Nos. 08-0304690, et al., the Applications of Colgate Operating, LLC Pursuant to the Mineral Interest Pooling Act (Final Order signed August 1, 2017).
[73] Tex. Nat. Res. Code § 102.011.

petroleum engineer regarding how pooling will prevent waste and protect correlative rights. For the reasons discussed below, the Examiners recommend the Commission find Applicant has proven compulsory pooling is necessary to prevent waste and protect correlative rights.

1. There is sufficient evidence forced pooling will prevent waste

The term "waste" generally means the ultimate loss of oil.[74] Prevention of waste occurs if hydrocarbons are produced that otherwise would be lost.[75] Applicant provided evidence that the requested pooling will prevent waste.

Applicant's proposed MIPA units are made up of numerous small tracts within an urban environment. Applicant has leased or obtained mineral rights to at least 80% of the acreage within each proposed MIPA unit.[76] The unleased tracts are sprinkled within each proposed MIPA unit, making it impossible to drill horizontal wells without causing trespass. Due to the locations of the unleased tracts within the proposed MIPA units, the proposed wells cannot be drilled to their full lengths without compulsory pooling. Applicant cannot drill the proposed wells as planned unless compulsory pooling is ordered because of the impracticality of drilling around the unleased tracts. Therefore, in the absence of compulsory pooling, the mineral interest owners within these proposed MIPA units would not be afforded a reasonable opportunity to recover their fair share of hydrocarbons, and Spraberry (Trend Area) Field resources beneath the City of Midland would forever be stranded.

2. There is sufficient evidence forced pooling will protect correlative rights

Every owner or lessee of land is entitled to a fair chance to recover the oil and gas in or under her land, or their equivalents in kind.[77] As the Texas Supreme Court stated in *Eliff v. Texon Drilling Co.*:

> In our state the landowner is regarded as having absolute title in severalty to the oil and gas in place beneath his land. The only qualification of that rule of ownership is that it must be considered in connection with the law of capture and is subject to police regulations. The oil and gas beneath the soil are considered a part of the realty.[78]

Generally, protection of this right in relation to other mineral interest owners with interest in a common reservoir is protection of an owner's correlative rights. As the Texas Supreme Court further stated:

> Thus it is seen that, notwithstanding the fact that oil and gas beneath the surface are subject both to capture and administrative regulation, the fundamental rule of absolute ownership of the minerals in place is not

[74] *See e.g.*, Tex. Nat. Res. Code § 85.046; *Gulf Land Co. v. Atl. Ref. Co.*, 131 S.W.2d 73, 80 (Tex. 1939).
[75] *See id.*
[76] Tr. at 19:19 – 19:25.
[77] *Gulf Land*, 131 S.W.2d at 80.
[78] *Eliff v. Texon Drilling Co.*, 210 S.W.2d 558, 561 (Tex. 1948) (internal citations omitted).

> affected in our state. In recognition of such ownership, our courts, in decisions involving well-spacing regulations of our Railroad Commission, have frequently announced the sound view that each landowner should be afforded the opportunity to produce his fair share of the recoverable oil and gas beneath his land, which is but another way of recognizing the existence of correlative rights between the various landowners over a common reservoir of oil or gas…This reasonable opportunity to produce his fair share of the oil and gas is the landowner's common law right under our theory of absolute ownership of the minerals in place[79]

Compulsory pooling as proposed by Applicant, wherein the proposed horizontal wells will extend the length of the units, protects correlative rights because all tract owners, whether leased or unleased, will have their fair share of hydrocarbons produced. Furthermore, the wells and units proposed by Applicant would allow the Commission to fashion an order in compliance with Section 102.017 of the MIPA, which requires that a MIPA order be made on terms that are fair and reasonable and will afford the owner of each tract in the unit the opportunity to produce and receive their fair share.

E. The Examiners recommend a 100% charge for risk

Section 102.052(a) of the MIPA provides that, "[a]s to an owner who elects not to pay his proportionate share of the drilling and completion costs in advance, the commission shall make provision in the pooling order for reimbursement solely out of production, to the parties advancing the costs, 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."

Applicant's unprotested applications requested a 100% charge for risk be applied to the working interest portion of an owner who elects not to pay his proportionate share of the drilling and completion costs in advance. The evidence supports a 100% charge for risk. No one protested the proposed 100% charge. Additionally, a 100% charge for risk is consistent with recently approved MIPA Applications.[80]

For these reasons, the Examiners recommend that the Commission grant the Applications with a 100% charge allowed for risk.

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

Based on the record in this case, the Examiners recommend the Commission grant the Applications and adopt the following findings of fact and conclusions of law.

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[79] *Id.* at 562; *see also Coastal Oil & Gas Corp. v. Garza Energy Tr.*, 268 S.W.3d 1, 15 (Tex. 2008).

[80] *See e.g.* Final Order for Oil & Gas Docket Nos. 08-0309997, et al.; Proposal for Decision for Oil & Gas Docket Nos. 08-0304690, et al., the Applications of Colgate Operating, LLC Pursuant to the Mineral Interest Pooling Act (Final Order signed August 1, 2017).

Findings of Fact

1. Permian Deep Rock Oil Company, LLC ("Applicant" or "Permian") filed six applications ("Applications") under the Mineral Interest Pooling Act ("MIPA"). These Applications were assigned separate docket numbers, but heard simultaneously. The Applications ask the Railroad Commission of Texas ("Commission") to create six force-pooled units covering approximately 100 acres each within the city limits and urban core of the City of Midland, Texas. These units, named after local high schools' mascots, are proposed as follows:

    a. The Rebel 140 Unit (approximately 100.32 acres),
    b. The Rebel 145 Unit (approximately 100.33 acres),
    c. The Rebel 150 Unit (approximately 100.34 acres),
    d. The Charger 140 Unit (approximately 99.57 acres),
    e. The Charger 145 Unit (approximately 99.03 acres) and
    f. The Charger 150 Unit (approximately 98.96 acres).

    Applicant has leased at least 80% of the net acres within each of the proposed MIPA units. If the Applications were approved, Permian intends to drill and complete the MIPA wells as horizontal oil wells in the Spraberry (Trend Area) Field in Midland County, Texas.

2. On December 14, 2018, the Hearings Division of the Commission sent a Joint Notice of Hearing on the Applications via first-class mail to all interested parties, setting a hearing date of January 16, 2019. Applicant published the Notice of Hearing four (4) times in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County, on December 14, 2018, December 21, 2018, December 28, 2018, and January 4, 2019. The notice contained (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. The hearing was held on January 16, 2019, as noticed. Consequently, all parties received more than 30 days' notice.

3. Notice of the hearing was published in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County, on December 14, 2018, December 21, 2018, December 28, 2018, and January 4, 2019.

4. The hearing was held on January 16, 2019, as noticed.

5. Permian appeared at the hearing and presented evidence and argument.

6. No one appeared at the hearing in opposition to Permian's applications.

7. For the proposed MIPA units, there are two or more separately owned tracts of land embraces within a common reservoir of oil or gas.

8. The tracts within the proposed MIPA units include all of the reservoirs which have been consolidated into the Spraberry (Trend Area) Field. The Commission has established the size and shape of proration units for these reservoirs within the Spraberry (Trend Area) Field. The Spraberry (Trend Area) Field is present and reasonably productive in the area covering all the proposed MIPA units.

9. The Commission has established the size and shape of proration units, whether by temporary or permanent field rules for the Spraberry (Trend Area) Field.

10. The proposed units reasonably appear to lie within the productive limits of the reservoir.

11. Between December 3 and December 22, 2018, Permian sent detailed voluntary pooling offers to all mineral owners of unleased tracts within the boundaries of the proposed MIPA units. The unleased mineral owners were offered three options for inclusion of their interests in the proposed units: a lease option, a working-interest participation options, and a farm-out option.

    a. The lease option included a 25% royalty, a bonus of $10,000 per net mineral acre, and a primary term of 3 years. The oil, gas and mineral lease attached to the offer letter provided that Permian was authorized to pool the tract owners' mineral interest into a pooled unit.

    b. The participation option provided each unleased owner an opportunity to participate as a working interest owner in the respective proposed MIPA units. By electing this option, the owner would be responsible for a proportionate share of the costs of drilling and completing the well or wells in the unit and would share proportionately in the production from the well. Each offer letter had as an attachment an estimated cost of drilling and completing the proposed MIPA unit well as well as a calculation of each respective owner's estimated proportionate cost of the proposed well. This option stated that if the owner failed to fully pay his or her proportionate share of costs to Permian within 15 days prior to commencement of actual drilling operations, then the owner would be subject to the non-consent penalties set forth in the standard Joint Operating Agreement ("JOA") Permian proposed. Permian represented to each owner that the proposed JOA would not contain any of the following: (1) a preferential right of the operator to purchase mineral interests in the unit; (2) a call on or option to purchase production from the unit; (3) operating charges that may include any part of district or central office expenses other than reasonable overhead charges; or (4) a prohibition against non-operators questioning the operation of the unit.

    c. The farm-out option proposed to each unleased owner that he or she convey to Permian an 80% net revenue interest attributable to his or her

mineral interest and retain an overriding royalty interest equal to 20%, proportionately reduced to the extent that each owner's mineral interest bears to all of the mineral interests in the unit, until payout of all well costs (to drill, test, fracture stimulate, complete, equip, and connect the well for production). At payout, the electing owner would have the option to convert the retained override to a 25% working interest, proportionately reduced.

d. Permian provided the essential terms of the participation option and the farm-out option in its offer letter. Permian did not enclose copies of its participation agreement or farm-out agreement, but instead offered to provide a copy of its participation agreement to any mineral owner who was interested in one or both of those options.

12. Applicant's pooling agreement and offer to pool does not containing any of the following provisions:

a. Preferential right of the operator to purchase mineral interests in the unit;

b. A call on or option to purchase production from the unit;

c. Operating charges that include any part of district or central office expense other than reasonable overhead charges; or

d. A prohibition against nonoperators questioning the operation of the unit.

13. Not all owners agreed to pool their interests.

14. Applicant's voluntary pooling offer was fair and reasonable.

15. Applicant has the right to drill and has proposed to drill on the proposed MIPA units.

16. Applicant is the owner of an interest in oil and gas in the proposed MIPA units.

17. The reservoirs within the proposed MIPA units were not discovered and produced prior to March 8, 1961.

18. Permian presented an expert technical study showing that an average well within a 5-mile radius of the proposed MIPA units will recover 39 barrels of oil for each incremental foot of drainhole length.

19. Permian cannot economically or feasibly drill the proposed wells or other future wells on the proposed MIPA units unless compulsory pooling is ordered as requested. The proposed wells and other future wells cannot be drilled to their full planned length without traversing one or more unleased tracts.

20. There are no regular locations within the proposed MIPA units where a feasible horizontal well could drain the proposed MIPA units.

21. Compulsory pooling within the proposed MIPA units as requested by Permian will allow the mineral interest owners to recover their fair share of the recoverable hydrocarbons under their tracts and prevent significant waste. Without compulsory pooling, Permian will not be able to drill the proposed wells or future wells, Permian 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.

22. The proposed units do not contain land owned by the State of Texas nor land in which the State of Texas has an interest directly or indirectly.

23. Permian presented evidence supporting a charge for risk of 100 percent of the drilling and completion costs of the proposed wells and any future wells by showing the significant risks of drilling these long horizontal wells to the target reservoirs.

24. Establishment of the proposed MIPA units will prevent waste and protect correlative rights.

25. Permian agreed on the record or in writing that pursuant to the provisions of Texas Government Code § 2001.144(a)(4)(A), this Final Order shall be final and effective on the date a Master Order relating to this Final Order is signed.

Conclusions of Law

1. Notice was provided to all parties entitled to notice. *See* Tex. Nat. Res. Code § 102.016.

2. The Commission has jurisdiction in this case. *See* Tex. Nat. Res. Code § 102.011.

3. Permian made a fair and reasonable offer to pool voluntarily to the mineral owners of the unleased tracts within each of the proposed MIPA units, as required by Texas Natural Resources Code § 102.013.

4. Compulsory pooling of the owners of the unleased tracts within each of the proposed proration units as owners of a 25% royalty and 75% working interest, proportionately reduced, with these owners' share of expenses, subject to a charge for risk of 100%, payable only from the owners' working-interest component, and subject to a no-surface-use restriction, is fair and reasonable within the meaning of Texas Natural Resources Code § 102.017.

5. Compulsory pooling of the mineral interests in all tracts within the boundaries of the proposed MIPA units will serve the purpose of preventing waste and protecting correlative rights.

6. The terms and conditions of the Commission's Final Orders in these proceedings are fair and reasonable and will afford the owner of each tract or interest in each respective unit the opportunity to produce or receive his or her fair share of the hydrocarbons in question.

7. Pursuant to § 2001.144(a)(4)(A) of the Texas Government Code and the agreement of Permian, this Final Order can be final and effective when a Master Order relating to this Final Order is signed.

Recommendation

The Examiners recommend that Permian's Applications be approved.

Respectfully,

Jennifer Cook
Administrative Law Judge

Petar Buva
Technical Examiner