RAILROAD COMMISSION OF TEXAS
HEARINGS DIVISION

EXAMINERS' REPORT AND RECOMMENDATION

OIL & GAS DOCKET NO. OG-20-00002685

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE CHAPARRAL LEASE, WELL NO. 110UH, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002658

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 130WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002659

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 125WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002660

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 120WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002661

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 110UH, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002662

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 115WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002663

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 140UH, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002664

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 135WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002665

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 145WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002666

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 160WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002667

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 150WB, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

OIL & GAS DOCKET NO. OG-20-00002668

APPLICATION OF PERMIAN DEEP ROCK OIL COMPANY, LLC (655805) PURSUANT TO THE MINERAL INTEREST POOLING ACT FOR THE KNIGHT LEASE, WELL NO. 155WA, SPRABERRY (TREND AREA) FIELD, MIDLAND COUNTY, TEXAS; DISTRICT 08

HEARD BY: Jennifer Cook, Administrative Law Judge
Austin Gaskamp, P.E., Technical Examiner

PROCEDURAL HISTORY:

Application Filed -	February 10, 2020
Notice of Hearing -	March 18, 2020
Hearing Date -	April 24, 2020
Transcript Received -	April 28, 2020

APPEARANCES:

For Applicant Permian Deep Rock Oil Company, LLC -
Mark Hanna and Ross Sutherland, *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

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

Permian Deep Rock Oil Company, LLC ("Applicant" or "Permian") filed twelve applications ("Applications") under the Mineral Interest Pooling Act ("MIPA").[1] These Applications were assigned separate docket numbers, but heard simultaneously. In the Applications, Applicant asks the Railroad Commission of Texas ("Commission") to create twelve force-pooled units covering differing sizes, from approximately 99 - 162 acres each, within the city limits and urban core of the City of Midland, Texas. These units, named after local college and high school mascots, are proposed as the Chaparral 110 Unit (approximately 156.84 acres), the Knight 110 Unit (approximately 161.74 acres), the Knight 115 Unit (approximately 99.31 acres), the Knight 120 Unit (approximately 101.63 acres), the Knight 125 Unit (approximately 119.69 acres), the Knight 130 Unit (approximately 100.6 acres), the Knight 135 Unit (approximately 100.2 acres), the Knight 140 Unit (approximately 100.22 acres), the Knight 145 Unit (approximately 100.02 acres), the Knight 150 Unit (approximately 100.23 acres), the Knight 155 Unit (approximately 100.18 acres), and the Knight 160 Unit (approximately 143.39 acres). The 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 March 18, 2020, the Hearings Division of the Commission sent a Notice of Hearing on the Applications via first-class mail to all interested parties, setting a hearing date of April 24, 2020.[4] The Applicant published the Notice of Hearing four (4) times in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County,

[1] Tex. Nat. Res. Code §§ 102.001-102.112.
[2] The hearing transcript in this case is referred to as "Tr. at [page(s)]." Applicant's exhibits are referred to as "Applicant Ex. [exhibit no(s).]."
[3] *See* Tex. Nat. Res. Code § 102.011.
[4] Applicant's Ex. 3A, 3B.

on March 23, 2020, April 3, 2020, April 10, 2020, and April 17, 2020.[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 involved; and (4) a short and plain statement of the matters asserted.[6] The hearing was held on April 24, 2020. Originally, the hearing was to be held live at the Railroad Commission of Texas, but in light of the Amended COVID-19 Emergency Response Order issued by the Hearings Division on March 23, 2020, the hearing was held virtually via Zoom on April 24, 2020.[7] Consequently, all parties received more than 30 days' notice.[8] Applicant appeared virtually at the hearing on April 24, 2020, 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.
>
> 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:

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[5] Applicant's Ex. 4.
[6] *See* Tex. Gov. Code §§ 2001.051, 2001.052; 16 Tex. Admin. Code §§ 1.41, 1.42, 1.45.
[7] Amended COVID-19 Emergency Response Order (Mar. 23, 2020).
[8] Tex. Nat. Res. Code § 102.016.

(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.

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.
(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.[9]

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.

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

IV. Discussion of Evidence

A. Background and Summary of the Evidence

Applicant seeks approval for 12 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 and produced, mostly due to the complexity of the necessary leasing program within this urban area.

Applicant's first witness was Wayne Bailey. He is Permian's Vice President of Land and Legal.[10] He testified as both a fact witness and as an expert in petroleum land management.[11] Permian has been working for the past six years to obtain leases in the Chaparral and Knight units.[12] It has obtained thousands of leases within the two units and expended a significant amount of time, energy, and resources in attempting to lease all of these tracts.[13] Permian's efforts include engaging 87 landmen in the Chaparral and Knight units, five different land services companies, making in-person visits to prospective lessors' houses, sending 11,800 letters, making 19,500 phone calls, making numerous attempts to locate mineral owners in person, and utilizing 14 title attorneys.[14] These efforts cost Permian over $30 million, and this number is independent of any cost of the actual leases.[15]

According to Mr. Bailey's testimony, Permian has leased between 84% and 98% of the net acres in each of the proposed MIPA units.[16] But Mr. Bailey testified the unleased tracts within the proposed MIPA units have thus far precluded Permian from carrying out their development plans.[17]

Applicant's second witness was Rick Johnston. He testified as an expert petroleum engineer. Mr. Johnston testified as to the application of the MIPA to certain reservoirs, 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."[18] Applicant seeks to pool all reservoirs in the Spraberry (Trend Area) Field falling within the area of the proposed MIPA units.[19] Permian offered argument and evidence that no reservoir within the proposed MIPA units was discovered and produced before March 8, 1961.

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[10] Tr. at 16:15 – 16:17.
[11] Tr. at 17:22 – 17:25.
[12] Tr. at 40:21 – 40:23.
[13] Tr. at 36:23 – 37:8.
[14] Tr. at 37:12 – 28:8; Applicant's Ex. 6.
[15] Tr. at 39:25 – 40:7.
[16] Applicant's Ex. 6.
[17] Tr. at 47:17 – 48:3.
[18] Tex. Nat. Res. Code § 102.003.
[19] Applicant's Ex.'s 2A-2F.

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 discovered and produced before March 8, 1961.[20] He further 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.[21] 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.[22] In support of that conclusion, Permian offered into evidence Railroad Commission Form P-7, the *New Field Designation and/or Discovery Allowable Application*.[23] 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."[24] 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.[25] 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.[26]

Mr. Johnston identified one well, the Tillman No. 1, located just inside a 2.5-mile radius from the proposed MIPA units that produced from the Lower Spraberry Sand prior to March 8, 1961.[27] But Mr. Johnston explained that the Tillman No. 1 produced from a separate and distinct reservoir from the reservoirs targeted by the proposed MIPA units because the interval in which that well was completed would not have been in natural communication with the proposed MIPA unit area.[28] Mr. Johnston concluded that the proposed MIPA unit area and interval therefore does not include any reservoir that was discovered and produced prior to March 8, 1961.

2. The Voluntary Pooling Offer

Permian sent over 700 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, and a primary term of 3 years.[31] The oil, gas and mineral lease attached to the offer letter

[20] Tr. at 87:10 – 87:22.
[21] *Id.*
[22] Tr. at 80:8 – 81:19.
[23] Applicant's Ex. 17.
[24] *Id.*
[25] *Id.*
[26] Tr. at 80:8 – 81:19.
[27] *Id.*
[28] Tr. at 87:10 – 87:18.
[29] Tr. at 50:13 – 50:22; Applicant's Ex.'s 12A – 12L.
[30] Applicant's Ex.'s 12A – 12L.
[31] Applicant's Ex.'s 12A – 12L.

provided that Permian was authorized to pool the tract owners' 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.[34] 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.[35]

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).[36] 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.[37] For example, Mr. Bailey testified that the $10,000 per net mineral acre bonus included in Permian's lease offer was greater than the average amount of bonus Permian paid to mineral owners who had voluntarily leased with Permian prior to the voluntary pooling offer. Mr. Bailey also explained that the terms of the voluntary pooling offer were substantially the same as those offered in the previous MIPA applications filed by Permian for units just to the south and approved by the Commission.[38]

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[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] Tr. at 65:20 – 65:23.
[38] Tr. at 52:21 – 54:24.

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.[39] Permian further offered a cross-section over that area showing the various formations within the field.[40] Permian also presented a map showing Spraberry (Trend Area) wells within a 5-mile radius of the proposed MIPA units.[41] From the study of the wells within a 5-mile radius, Permian concluded that the proposed Knight and Chaparral units are expected to be productive over the entirety of that area.[42]

For every well within the 5-mile radius study area with sufficient data (194 wells), Permian plotted the estimated drainhole length of the well versus the well's estimated ultimate oil recovery ("EUR").[43] Permian then calculated the estimated ultimate recoveries ("EURs") by decline curve analysis.[44] 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.[45] A least-squares regression of the plotted data points resulted in a line through the points with a positive slope of 0.0424.[46] The inference of this resulting equation is that an average well will recover 42.4 barrels of oil for each incremental foot of drainhole length.[47]

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.[48] Permian contends that, absent MIPA approval of the proposed wells, the underlying reserves could not be recovered and would therefore be wasted.[49] Based on (1) the completable drainhole length lost for each proposed well if MIPA is not approved and (2) a recovery factor of 42.3 barrels of oil for each incremental foot of drainhole length, Permian estimates that a total of 4,265,058 barrels of oil will be wasted if the Applications are not approved (without including wasted reserves from future wells).[50] 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.[51]

C. Charge for Risk

The Applications requested that the Commission's MIPA pooling order include a 100% charge for risk attached to the working-interest component, as authorized under

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[39] Applicant's Ex.'s 20 - 21.
[40] Applicant's Ex. 18.
[41] Applicant's Ex. 16.
[42] Tr. at 77:24 – 78:6; Applicant's Ex. 16.
[43] Tr. at 90:11 – 91:22; Applicant's Ex. 22.
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] Applicant's Ex.'s 23A – 24.
[49] Tr. at 97:2 – 97:12.
[50] Applicant's Ex. 24; Tr. at 95:24 – 96:20.
[51] Tr. at 97:13 – 97:20.

Section 102.052 of MIPA.[52] In addition, the Notice of Hearing and the newspaper publication for the MIPA Applications gave notice that Permian was seeking a 100% charge for risk.[53] No party appeared to protest the 100% charge for risk, or any other aspect of the Applications.

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%.[54] To further support the proposed 100% charge for risk, Permian offered testimony relating to the Society of Petroleum Evaluation Engineers' ("SPEE") *Thirty-Sixth 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.[55] Mr. Johnston, an expert petroleum engineer and member of SPEE, stated that the reserves in the area of the proposed MIPA units are most similar to the "proved undeveloped" reserve category identified on the "Unconventional Reserve Adjustment Factors" table.[56] Mr. Johnston noted that the study fully supports the requested charge for risk.[57]

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.[58] Using an average cost of drilling and completing equal to roughly $14,000,000 and operating expenses of $3,500 per month, an oil price of $45 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 440,034 barrels of oil.[59] Of the 194 wells within the 5-mile study area and an oil price of $45 per barrel, about 146 have estimated ultimate recoveries below a payout amount necessary for a well to be considered economic.[60] At an oil price of $50 per barrel, the wells with an estimated ultimate recovery below a payout to be considered economic moves lower to 126 wells.[61] Moreover, the scatter plot of the estimated ultimate recovery of wells within the 5-mile study area shows significant variability in individual well performance.[62]

D. The Applications are Unprotested

No protestant appeared at the hearing.[63] Although protests were filed in connection with some of the Applications, each protest was withdrawn prior to the hearing.

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[52] Applicant's Ex.'s 2A, 2B.
[53] Applicant's Ex.'s 3A – 4.
[54] Tr. at 61:21 – 61:23.
[55] Applicant's Ex. 26.
[56] Tr. at 102:15 – 104:11; Applicant's Ex. 26.
[57] *Id.*
[58] Tr. at 117:4 – 118:9; Applicant's Ex. 26.
[59] Tr. at 115:5 – 116:8; Applicant's Ex. 25.
[60] Applicant's Ex. 25.
[61] *Id.*
[62] Applicant's Ex. 22.
[63] Tr. at 128:17 – 129:6.

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;
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:
    a. the owner of any interest in oil and gas in an existing proration unit or with respect to a proposed unit;
    b. the owner of any working interest; or
    c. 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.

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 twelve 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.[64]

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.[65]

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."[66] In this case, Permian has established, through 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.[67] The Examiners recommend the Commission find that the MIPA applies to the 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."[68] Section 102.013 of the MIPA requires that the applicant for forced pooling "set forth in detail the nature of the 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.[69] 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.[70]

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

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[64] Tr. at 16:13 – 16:23.
[65] Tr. at 42:21 – 42:23.
[66] Tex. Nat. Res. Code § 102.003.
[67] Tr. at 87:10 – 87:18; Applicant's Ex.'s 17 – 19.
[68] Tex. Nat. Res. Code § 102.013.
[69] *Carson v. Railroad Com'n of Texas*, 669 S.W.2d 315, 316 (Tex. 1984).
[70] *Id.*

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.[71]

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.[72] Applicant provided expert testimony from a 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.[73] Prevention of waste occurs if hydrocarbons are produced that otherwise would be lost.[74] 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.[75] 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.[76] 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

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[71] *See e.g.* Final Order for Oil & Gas Docket Nos. 09-0322222, 09-0322237, and 09-0322238 (signed Feb. 11, 2020); Final Order for Oil & Gas Docket Nos. 08-0316595 et al. (signed Mar. 26, 2019); Final Order for Oil & Gas Docket Nos. 08-030997, 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 Aug. 1, 2017).
[72] Tex. Nat. Res. Code § 102.011.
[73] *See e.g.*, Tex. Nat. Res. Code § 85.046; *Gulf Land Co. v. Atl. Ref. Co.*, 131 S.W.2d 73, 80 (Tex. 1939).
[74] *See id.*
[75] Tr. at 19:19 – 19:25.
[76] *Gulf Land*, 131 S.W.2d at 80.

> 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.[77]

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 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[78]

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

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[77] *Eliff v. Texon Drilling Co.*, 210 S.W.2d 558, 561 (Tex. 1948) (internal citations omitted).
[78] *Id.* at 562; *see Coastal Oil & Gas Corp. v. Garza Energy Tr.*, 268 S.W.3d 1, 15 (Tex. 2008).

for risk. No one protested the proposed 100% charge. Additionally, a 100% charge for risk is consistent with recently approved MIPA Applications.[79]

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.

Findings of Fact

1. Permian Deep Rock Oil Company, LLC ("Applicant" or "Permian") filed twelve 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 school and college mascots, are proposed as follows:

    a. The Chaparral 110 Unit (approximately 156.84 acres),
    b. The Knight 110 Unit (approximately 161.74 acres),
    c. The Knight 115 Unit (approximately 99.31 acres),
    d. The Knight 120 Unit (approximately 101.63 acres),
    e. The Knight 125 Unit (approximately 119.69 acres),
    f. The Knight 130 Unit (approximately 100.6 acres),
    g. The Knight 135 Unit (approximately 100.2 acres),
    h. The Knight 140 Unit (approximately 100.22 acres),
    i. The Knight 145 Unit (approximately 100.02 acres),
    j. The Knight 150 Unit (approximately 100.23 acres),
    k. The Knight 155 Unit (approximately 100.18 acres), and
    l. The Knight 160 Unit (approximately 143.39 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 March 18, 2020, 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 April 24, 2020. Applicant published the Notice of Hearing four (4)

[79] *See e.g.* Final Order for Oil & Gas Docket Nos. 09-0322222, 09-0322237, and 09-0322238 (signed Feb. 11, 2020); Final Order for Oil & Gas Docket Nos. 08-0316595 et al. (signed Mar. 26, 2019); Final Order for Oil & Gas Docket Nos. 08-030997, 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 Aug. 1, 2017).

times in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County, on March 23, 2020, April 3, 2020, April 10, 2020, and April 17, 2020. 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 April 24, 2020, as noticed. Consequently, all parties received more than 30 days' notice. Applicant appeared at the hearing on January 16, 2019, and presented evidence and argument.

3. Notice of the hearing was published in the *Midland Reporter-Telegram*, a newspaper of general circulation in Midland County, on March 23, 2020, April 3, 2020, April 10, 2020, and April 17, 2020.

4. The hearing was held on April 24, 2020, 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 embraced 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. Permian sent over 700 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 contain 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 42 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 Texas Government Code 2001.144(a)(4)(A), the Final Order in this case shall be final and effective on the date a Master Order relating to the Final Order in this case 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 this proceeding 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, the Final Order in this case can be final and effective when a Master Order relating to the Final Order in this case is signed.

Recommendation

The Examiners recommend that Permian's Applications be approved.

Respectfully,

DocuSigned by:
Jennifer Cook
C5ED86E8FF3C443...
Jennifer Cook
Administrative Law Judge

DocuSigned by:
Austin Gaskamp
A58638711FA24A5...
Austin Gaskamp, P.E.
Technical Examiner