# RAILROAD COMMISSION OF TEXAS

## OFFICE OF GENERAL COUNSEL

**OIL & GAS DOCKET NO. 03-0262001**

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**APPLICATION OF GEORGE L. MCLEOD, INC., PURSUANT TO THE MINERAL INTEREST POOLING ACT TO CREATE A POOLED UNIT FOR THE MILAGRO EXPLORATION, L.L.C. H. C. COCKBURN YEGUA LEASE, WELL NO. 1, MAGNET WITHERS (MARTINEZ SAND) FIELD, WHARTON COUNTY, TEXAS**

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**OIL & GAS DOCKET NO. 03-0262003**

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**APPLICATION OF GEORGE L. MCLEOD, INC., FOR STANDING, AND IF STANDING IS APPROVED, TO CONSIDER ADOPTION OF FIELD RULES FOR THE MAGNET WITHERS (MARTINEZ SAND) FIELD, WHARTON COUNTY, TEXAS**

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**PROPOSAL FOR DECISION**

**APPEARANCES:**

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| **FOR APPLICANT:** | **APPLICANT:** |
| Lloyd Muennink<br>Michael McLeod<br>Paul Britt | George L. McLeod, Inc. |
| **FOR PROTESTANTS:** | **PROTESTANTS:** |
| H. Philip Whitworth<br>John Camp | Milagro Exploration, L.L.C. |
| Tim George | Exxon Mobil Corporation |
| **FOR OBSERVER:** | **OBSERVER:** |
| Larry Borella | Texas General Land Office |

## PROCEDURAL HISTORY

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| **DATE APPLICATIONS FILED:** | May 28 and June 5, 2009 |
| **DATE OF NOTICES OF HEARING:** | June 15, 2009 |
| **DATE OF PRE-HEARING CONFERENCE:** | August 17, 2009 |
| **HEARD BY:** | James M. Doherty, Hearings Examiner<br>Richard Atkins, Technical Examiner |
| **DATE RECORD CLOSED:** | November 2, 2009 |
| **DATE PFD CIRCULATED:** | November 12, 2009 |

## STATEMENT OF THE CASE

This proceeding involves the application of George L. McLeod, Inc. ("McLeod") pursuant to the Mineral Interest Pooling Act to force pool productive acreage in the Magnet Withers (Martinez Sand) Field from McLeod's 246.24 acre Cockburn Lease with productive acreage from Milagro Exploration, L.L.C.'s ("Milagro") 2510.41 acre H. C. Cockburn Yegua Lease for the Milagro H. C. Cockburn Yegua Lease, Well No. 1, Magnet Withers (Martinez Sand) Field, Wharton County, Texas. In a related application, McLeod proposes that the Commission establish field rules for the Magnet Withers (Martinez Sand) Field. The applications are opposed by Milagro and Exxon Mobil Corporation.

A hearing on the merits of the applications originally was scheduled for July 24, 2009, but a continuance to August 17, 2009, was granted at the request of Milagro. On July 23, 2009, Milagro filed a motion to dismiss the applications, contending that the Milagro acreage sought to be force pooled voluntarily had been pooled into a 441.1 acre unit that included a 13.8 acre riverbed tract owned by the State of Texas. In this motion, Milagro contended that §102.004 of the MIPA provides that the MIPA does not apply to land owned by the State or land in which the State has a direct or indirect interest, absent the approval or consent of the board or agency having jurisdiction of such land. The filing of this motion resulted in an examiner's letter ruling converting the August 17, 2009, hearing to a pre-hearing conference. The pre-hearing conference was held on August 17, 2009, and McLeod, Milagro, and Exxon Mobil Corporation made appearances. The Texas General Land Office also appeared as an observer.

After consideration of the evidence and arguments presented at the pre-hearing conference and the pleadings filed by the parties, the legal examiner issued a letter ruling on September 2, 2009, stating that the examiner had concluded that McLeod was seeking a Commission order force pooling land in which the State of Texas has an ownership interest or land in which the State of Texas has an interest directly or indirectly, and the MIPA does not apply to this land unless the approval or consent of the Commissioner of the General Land Office for the proposed compulsory pooling is first obtained. This letter ruling abated the proceedings in both of the subject dockets for 60 days to provide McLeod with an opportunity to obtain the required approval or consent, and stated that if evidence of such approval or consent was not provided to the examiner on or before November 2,

2009, the examiner would prepare a proposal for decision recommending that the applications be dismissed. McLeod has not filed evidence that the approval or consent of the School Land Board or Commissioner of the Texas General Land Office has been obtained.[1]

## BACKGROUND AND DISCUSSION

The McLeod MIPA application originally requested that the Commission force pool 28.7 productive acres from McLeod's Cockburn Lease with 97.3 productive acres from Milagro's H. C. Cockburn Yegua Lease into a 126 acre unit for the Milagro H. C. Cockburn Yegua Lease, Well No. 1, Magnet Withers (Martinez Sand) Field, Wharton County, Texas. After the pre-hearing conference, McLeod amended the MIPA application to propose that 61.4 productive acres from McLeod's Cockburn Lease be force pooled with 233.4 productive acres from Milagro's H. C. Cockburn Yegua Lease.

In the related field rules docket, McLeod originally proposed that the Commission adopt field rules for the Magnet Withers (Martinez Sand) Field providing for 467'/1,200' well spacing, 120 acre proration units, allocation based on surface productive acres, and a maximum diagonal of 4,000'. After the pre-hearing conference, McLeod amended its field rules application to propose that the Commission adopt field rules providing for 467'/1,200' well spacing, 300 acre proration units, allocation based on surface productive acres, and a maximum diagonal of 8,300'. The examiners have officially noticed that McLeod is not an operator in the Magnet Withers (Martinez Sand) Field.

On July 23, 2009, Milagro filed a motion to dismiss the McLeod applications. In this motion, Milagro asserted that the Milagro acreage sought to be force pooled had been voluntarily pooled into a 441.1 acre pooled unit containing a 13.8 acre riverbed tract owned by the State of Texas. This, according to Milagro, gave the State an interest in the lands proposed to be force pooled by the McLeod MIPA application. In its motion, Milagro relied upon §102.004 of the MIPA which provides that the MIPA does not apply to "land owned by the State of Texas nor to land in which the State of Texas has an interest directly or indirectly" unless the approval or consent of any board or agency having jurisdiction is first obtained.

Attached to Milagro's motion to dismiss was a copy of a pooling agreement entered into and effective July 1, 2009, between the Commissioner of the General Land Office of the State of Texas and Milagro purporting to form the 441.1 acre State of Texas/Milagro Exploration, LLC Cockburn State Yegua Unit in Wharton County, consisting of 427.3 acres from Milagro's H. C. Cockburn Yegua Lease and 13.8 acres in an adjacent riverbed tract owned by the State. A copy of this pooling agreement is attached to this proposal for decision as Appendix 1. At the pre-hearing conference, McLeod stated that it did not dispute that this pooling agreement had been entered into by the State and Milagro. Paragraph 3 of the pooling agreement provides that "the State shall receive its share

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[1] McLeod conceded at the pre-hearing conference that such approval or consent had not been obtained prior to the pre-hearing conference.

of unit production in the form of a royalty as provided in Exhibit "1" and allocated to the State as provided in Exhibit "2" with no obligation to the State for operating costs of any kind, including but not limited to exploring, drilling, equipping, completion, treating, transporting, marketing, plugging, abandonment or restoration." Exhibit "1" to the pooling agreement provides for 25% royalty to the State. As to allocation of production, Exhibit "2" to the pooling agreement provides that there shall be allocated to each tract in the unit that pro rata portion of production which the number of surface acres covered by each such tract bears to the total number of surface acres included in the unit.

At the pre-hearing conference, McLeod presented evidence to show that Milagro's oil and gas lease covering the H. C. Cockburn Yegua Lease limits the size of pooled unit that may be formed to 320 acres plus 10% tolerance. Counsel for Milagro conceded this point and represented that for this reason, only Milagro's leasehold interest in the H. C. Cockburn Yegua Lease acreage is pooled with the State riverbed tract into the 441.1 acre State of Texas/Milagro Exploration, LLC Cockburn State Yegua Unit pursuant to the pooling agreement. The royalty interest in the H. C. Cockburn Yegua Lease is not pooled, and the royalty owners in this lease will continue to be paid royalties as if no pooling had occurred.

The pooling agreement between the State and Milagro contains Paragraph 2 that provides that nothing in the agreement shall be construed as granting a leasehold interest to Milagro in the State's riverbed tract. At the pre-hearing conference, counsel for Milagro explained that this provision was included in the agreement because under §52.076(a)(4) of the Texas Natural Resources Code, the School Land Board may pool unleased riverbeds without advertising for bids as would have been necessary if the State had leased the riverbed tract to Milagro.

The Milagro acreage with which McLeod seeks to force pool is some of the acreage included in the 441.1 acre State of Texas/Milagro Exploration, LLC Cockburn State Yegua Unit, but does not include the 13.8 acre State riverbed tract. At the pre-hearing conference, McLeod presented a geologist/geophysicist who gave his interpretation of seismic covering the area of the Magnet Withers (Martinez Sand) Field. This witness could not say whether the State riverbed tract is productive in the Martinez Sand, but had the opinion that if it is productive, it is a productive area separated from the area of the field beneath portions of the McLeod and Milagro acreage.

Milagro contends that effective with pooling of Milagro's leasehold interest with the State's unleased interest in the riverbed tract, the State acquired an ownership interest, or at least a direct or indirect interest, in all of the Milagro acreage in the 441.1 acre Cockburn State Yegua Unit, including the Milagro acreage which is the subject of McLeod's MIPA application. Milagro believes that execution of the pooling agreement resulted in a cross-conveyance of all interests in the Cockburn State Yegua Unit. See *Veal v. Thompson*, 159 S.W.2d 472, 476 (Tex. 1962). If this be true, each owner owns an undivided interest in the entire unitized acreage in the proportion that such owner's tract bears to the total acreage in the unit. Alternatively, Milagro argues that even if there be no cross-conveyancing of interests, the Milagro/State of Texas pooling agreement, which provides the State of Texas with a royalty interest on production of minerals from a well wherever drilled on

the pooled unit, creates a direct, or at least an indirect, interest in all the lands within the 441.1 acre Cockburn State Yegua Unit, because a royalty interest is an interest in land. Milagro also stresses that force pooling as proposed by McLeod would diminish royalty amounts paid to the State, which Milagro asserts is the very result sought to be avoided by §102.004 of the MIPA.

On the other hand, McLeod questions whether a pooled unit such as the Cockburn State Yegua Unit can exist without at least two leases to pool. In any event, even if a pooled unit was created by the pooling agreement, McLeod says that there can be no cross-conveyancing of interests by contract. McLeod also contends that the interest acquired by the State pursuant to the pooling agreement is nothing more than a contractual interest in production, akin to a production payment, and is not an interest in land of the type to which §102.004 of the MIPA applies. McLeod believes that pooling of the State's riverbed tract by Milagro was purely a defensive maneuver to thwart McLeod's application under the MIPA.

Exxon Mobil Corporation is aligned with Milagro for the purposes of this case. According to counsel for Exxon Mobil, the Magnet Withers (Martinez Sand) Field area was formerly owned by Exxon or Exxon Mobil. The terms of sale of this interest allowed Exxon Mobil to come into the working interest in any particular well drilled in the area, and Exxon Mobil has made an election to participate in the working interest as to the H. C. Cockburn Yegua Lease, Well No. 1.

A letter dated August 4, 2009, filed by the General Counsel for the Texas General Land Office ("GLO") stated that: (1) the GLO owns a mineral interest in the H. C. Cockburn Yegua Lease, Well No. 1; (2) GLO understands that the proposed force pooling would dilute the State's interest in the H. C. Cockburn Yegua Lease, Well No. 1; (3) Section 102.004 of the MIPA clearly and unambiguously exempts, absent consent from the GLO, state-owned land from being force pooled under the provisions of the MIPA: and (4) GLO believes its consent is a jurisdictional prerequisite to any order purporting to pool any land into an existing well or unit in which the State owns an interest. At the pre-hearing conference, counsel for GLO stated his opinion that: (1) the statute is unambiguous; (2) the State owns a mineral interest that is pooled into the Cockburn State Yegua Unit; and (3) whether the State's interest was created by contract or cross-conveyance is irrelevant.

## EXAMINERS' OPINION

Because the 13.8 acres in the State's riverbed tract are not sought to be force pooled by McLeod, the determination of whether the MIPA applies to McLeod's application depends on whether, by virtue of the July 1, 2009, pooling agreement, the State acquired an ownership interest, or other direct or indirect interest, in the Cockburn State Yegua Unit acreage which McLeod *does* seek to force pool. The examiners conclude that the State did acquire such an interest, and the MIPA

does not apply to McLeod's MIPA application absent the approval or consent of GLO or other board or agency having jurisdiction.[2]

The relevant provisions of Section 102.004 of the MIPA are plainly and expansively worded:

> **"§ 102.004. Application to Public Land**
>
> (a) The provisions of this chapter do not apply to land owned by the State of Texas nor to land in which the State of Texas has an interest directly or indirectly.
>
> . . .
>
> (d) With the approval or consent first obtained, or at the instance of the Commissioner of the General Land Office, or any board or agency having jurisdiction, the land in which the State of Texas has an interest as described in this chapter may be pooled under the provisions of this chapter."

Texas courts have embraced the theory that pooling of separate leases effects a cross-conveyance of interests in all tracts in the unit, so that each owner owns an undivided interest in the entire unitized acreage in the proportion that such owner's tract bears to the total acreage in the unit. If Milagro is correct that the pooling agreement between the State and Milagro resulted in such a cross-conveyance of interests, then the State plainly has an ownership interest in the acreage in the Cockburn State Yegua Unit sought to be force pooled by McLeod. But whether such a cross-conveyance resulted from the pooling agreement is not an issue that need be decided.

It appears clear to the examiners that by virtue of the pooling agreement, the State acquired *some* kind of "interest" in the lands in the Cockburn State Yegua Unit that McLeod seeks to force pool. The pooling agreement calls the State's interest a royalty interest, and it appears to have all the characteristics of such an interest, that is a non-possessory and non-cost bearing interest in all unit reserves produced from wells on the pooled unit wherever they may be located. The State's royalty is carved-out of Milagro's working interest, in the same way overriding royalty interests are created. Although McLeod prefers to refer the State's interest as a "production payment," this interest does not have one of the important characteristics of a production payment, that is, a specified upper limit on the amount of the payment. See Smith & Weaver, *Texas Law of Oil & Gas*, Vol. 1, Chap. 2, §2.4(D) at page 2-67 ["A 'production payment' is a right to a specified fraction of production *until a specified sum has been received.*" (Emphasis added)].

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[2] The examiners disagree with McLeod's contention that Milagro could not form a lawful pooled unit without leasing the State's mineral interest in the 13.8 acre riverbed tract. Section 52.076(a)(4) of the Texas Natural Resources Code specifically authorizes the School Land Board to pool or bring an action to force pool unleased riverbed tracts.

The State's royalty interest is in all of the lands covered by the Cockburn State Yegua Unit, including the lands sought to be force pooled by McLeod. A royalty interest is an interest in real property. See Smith & Weaver, *Texas Law of Oil & Gas*, Vol. 1, Chap. 2, §2.4[B] at page 2-62 ["A royalty is usually categorized in accordance with the transaction in which it was created. These are principally the execution of an oil and gas lease, the transfer of an interest in land by deed, and the assignment of all or part of a lessee's working interest. *Regardless of how created, all such royalties are interests in real property and are governed by the doctrines applicable to real property.*" (Emphasis added)] While the examiners do not believe that the State's interest is in the nature of a production payment, even a production payment is an interest in land. See Smith & Weaver, *Texas Law of Oil & Gas*, Vol. 1, Chap. 2, §2.4(E) at page 2-69 ["All varieties of royalties, overriding royalties, and production payments are nonpossessory interests in land, whether payable in money or payable in kind." (Footnotes omitted)].

Section 102.004 of the MIPA provides that absent the approval or consent of any board or agency having jurisdiction, the MIPA does not apply to land in which the State has an interest directly or indirectly. The Railroad Commission does not have jurisdiction to order compulsory pooling except as authorized by the MIPA. Accordingly, because the State has an ownership or other direct or indirect interest in land sought to be force pooled by McLeod, and the approval or consent of the Commissioner of the General Land Office or the School Land Board has not been obtained, the examiners believe that the McLeod MIPA application must be dismissed.

The McLeod field rules application in Oil & Gas Docket No. 03-0262003, is directly related to the McLeod MIPA application. Only operators in the field have automatic standing to prosecute applications to establish field rules. McLeod is not an operator in the Magnet Withers (Martinez Sand) Field. McLeod's field rules application was docketed and set for hearing only because it is directly related to McLeod's MIPA application. Where an applicant seeks to invoke the MIPA as to a reservoir for which the Commission has not previously established the size and shape of proration units, whether by temporary or permanent field rules, the Commission traditionally has permitted the filing and prosecution of a companion field rules application by the MIPA applicant. Except as related to its application under the MIPA which the examiners recommend be dismissed, McLeod has not established its standing to propose field rules for the Magnet Withers (Martinez Sand) Field. Accordingly, the McLeod field rules application in Oil & Gas Docket No. 03-0262003 should also be dismissed.

Based on the record made at the pre-hearing conference, the examiners recommend adoption of the Following Findings of Fact and Conclusions of Law.

## FINDINGS OF FACT

1. Notice of the pre-hearing conference in these dockets was provided to George L. McLeod, Inc. ("McLeod"), and Milagro Exploration, L.L.C. ("Milagro"). Appearances at the pre-hearing conference were made by McLeod, Milagro, Exxon Mobil Corporation, and the Texas General Land Office.

2. In Oil & Gas Docket No. 03-0262001, by application filed on May 28, 2009, pursuant to the Mineral Interest Pooling Act ("MIPA"), McLeod requested that the Commission force pool 28.7 productive acres from McLeod's Cockburn Lease with 97.3 productive acres from Milagro's H. C. Cockburn Yegua Lease into a 126 acre unit for the Milagro H. C. Cockburn Yegua Lease, Well No. 1, Magnet Withers (Martinez Sand) Field, Wharton County, Texas. Subsequently, McLeod amended this application to propose that 61.4 productive acres from McLeod's Cockburn Lease be force pooled with 233.4 productive acres from Milagro's H. C. Cockburn Yegua Lease.

3. In Oil & Gas Docket No. 03-0262003, by application filed on June 5, 2009, McLeod proposed that the Commission adopt field rules for the Magnet Withers (Martinez Sand) Field providing for 467'/1,200' well spacing, 120 acre proration units, allocation based on surface productive acres, and a maximum diagonal of 4,000'. Subsequently, McLeod amended this application to propose field rules providing for 467'/1,200' well spacing, 300 acre proration units, allocation based on surface productive acres, and a maximum diagonal of 8,300'.

4. The McLeod application in Oil & Gas Docket No. 03-0262003 is directly related to the McLeod application in Oil & Gas Docket No. 03-0262001. McLeod is not an operator in the Magnet Withers (Martinez Sand) Field.

5. On July 23, 2009, Milagro filed a motion to dismiss the McLeod applications, asserting that the Milagro acreage sought to be force pooled had been pooled voluntarily into a 441.1 acre pooled unit containing a 13.8 acre riverbed tract owned by the State of Texas. In the motion, Milagro contended that this pooling gives the State an interest in the lands proposed to be force pooled by the McLeod MIPA application, and §102.004 of the MIPA provides that the MIPA does not apply to land owned by the State of Texas nor to land in which the State has an interest directly or indirectly, unless the approval or consent of any board or agency having jurisdiction of the State land is first obtained.

6. On August 17, 2009, a pre-hearing conference on the McLeod applications was held, and all parties were provided an opportunity to provide evidence and submit argument concerning the subject matter of Milagro's motion to dismiss.

7. On July 1, 2009, the Commissioner of the General Land Office of the State of Texas and Milagro entered into a pooling agreement ("the pooling agreement") forming the 441.1 acre State of Texas/Milagro Exploration, LLC Cockburn State Yegua Unit in Wharton County, consisting of 427.3 acres from Milagro's H. C. Cockburn Yegua Lease and 13.8 acres in an adjacent riverbed tract owned by the State.

8. McLeod's MIPA application does not seek to force pool the State's 13.8 acre riverbed tract, but does seek to force pool acreage in the State of Texas/Milagro Exploration, LLC Cockburn State Yegua Unit.

9. The July 1, 2009, pooling agreement provides the State of Texas with a 25% royalty on production anywhere on the Cockburn State Yegua Unit, with no obligation to the State for operating costs of any kind, including but not limited to exploring, drilling, equipping, completion, treating, transporting, marketing, plugging, abandonment, or restoration. The pooling agreement provides that for the purpose of computing the share of production to which each interest owner shall be entitled from the pooled unit, there shall be allocated to each tract committed to the unit that pro rata portion of the pooled mineral produced from the pooled unit which the number of surface acres covered by each such tract and included in the unit bears to the total number of surface acres included in said unit.

10. The State's interest in the 13.8 acre riverbed tract is pooled into the Cockburn State Yegua Unit as an unleased interest pooled pursuant to §52.076(a)(4) of the Texas Natural Resources Code. Milagro's lease covering its 427.3 acres in the Cockburn State Yegua Unit does not permit pooling into units of more than 320 acres plus 10% tolerance, and so only Milagro's leasehold interest in the 427.3 acres is pooled with the State's unleased interest.

11. Under the terms of the pooling agreement, the Cockburn State Yegua Unit is to be operated as an entirety for the exploration, development, and production of the pooled mineral, rather than as separate tracts, all drilling operation, reworking or other operations on land within the unit is to be considered as though the same were on each separate tract in the unit, regardless of the actual location of the well or wells thereon, and production from the unit allocated to each separate tract is to be deemed to have been produced from each such separate tract in the unit, regardless of the actual location of the well or wells thereon.

12. Force pooling as proposed by McLeod would diminish royalties payable to the State of Texas on production from the Cockburn State Yegua Unit.

13. The State of Texas has an ownership or other direct or indirect interest in land proposed to be force pooled by McLeod.

14. Neither the School Land Board nor the Commissioner of the Texas General Land Office has approved or consented to the force pooling proposed by McLeod.

## CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued by the Railroad Commission to appropriate persons legally entitled to notice.

2. Pursuant to §52.076(a)(4) of the Texas Natural Resources Code, the School Land Board may pool unleased river bed tracts by pooling agreement.

3. Pursuant to §102.004 of the Mineral Interest Pooling Act, Chapter 102, Texas Natural Resources Code, the Mineral Interest Pooling Act does not apply to land owned by the State of Texas nor to land in which the State of Texas has an interest directly or indirectly, unless the approval or consent of any board or agency having jurisdiction over the land is first obtained.

4. The State of Texas has an ownership interest or other direct or indirect interest in the land from the Cockburn State Yegua Unit sought to be force pooled by George L. McLeod, Inc., within the meaning of §102.004 of the Mineral Interest Pooling Act, Chapter 102, Texas Natural Resources Code.

5. The Mineral Interest Pooling Act, Chapter 102, Texas Natural Resources Code, does not apply to the land from the Cockburn State Yegua Unit sought to be force pooled by George L. McLeod, Inc.

6.. The Railroad Commission has no jurisdiction to order compulsory pooling except as authorized by the Mineral Interest Pooling Act, Chapter 102, Texas Natural Resources Code.

7. The Railroad Commission has no jurisdiction to grant the relief sought by George L. McLoed, Inc., in Oil & Gas Docket No. 03-0262001, and the application in this docket should be dismissed.

8. The application in Oil & Gas Docket No. 03-0262003 is directly related to the application in Oil & Gas Docket No. 03-0262001.

9. George L. McLeod, Inc., which is not an operator in the Magnet Withers (Martinez Sand) Field, has not established its standing to propose field rules for the Magnet Withers (Martinez Sand) Field as a matter unrelated to a Mineral Interest Pooling Act application over which the Commission has jurisdiction.

## RECOMMENDATION

The examiners recommend that the McLeod MIPA application in Oil & Gas Docket No. 03-0262001 be dismissed for want of jurisdiction. The examiners recommend that the McLeod field rules application in Oil & Gas Docket No. 03-0262003 be dismissed by reason of McLeod's failure to establish standing to prosecute the application.

Respectfully submitted,

James M. Doherty
Hearings Examiner

Richard Atkins
Technical Examiner