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**FUN NEW WAYS FOR DENSITY AND
PRORATION RULES TO BUST YOUR LEASE:
RETAINED ACREAGE CLAUSES AND
“GOVERNMENTAL AUTHORITY” LANGUAGE IN
THE WAKE OF THREE RECENT TEXAS CASES**

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For decades, drafters of Texas oil and gas leases have commonly referenced density and proration rules adopted by the Railroad Commission of Texas (the “Commission”) to define certain aspects of their leases. Such references are often called “governmental authority” clauses because they define the quantum of lease acreage a lessee may pool or retain by incorporating by reference into the text of the lease the applicable density and proration rules for its wells. Such clauses can lead to a variety of interpretive questions, but one of the more common is, “How much acreage?”

*Jones v. Killingsworth*¹ is the seminal Texas case addressing this question. *Jones* was decided by the Supreme Court of Texas in 1965 and now forms the basis for the “permitted vs. prescribed” drafting paradigm that is commonplace in governmental authority clauses today. At its core, *Jones* addressed the question of how the Commission’s density and proration rules can interact with a governmental authority clause to determine the maximum acreage an oil and gas lessee may pool into a unit.

Until recently, all reported Texas cases directly addressing the “how much?” question

¹ 403 S.W.2d 325 (Tex. 1965). See Doug J. Dashiell, *Pooling Update*, STATE BAR OF TEXAS 25TH ANN. OIL, GAS & MIN. L. INST. (Mar. 26, 1999); see Mark W. Hanna, *Drafting Tips in the Modern Oil & Gas World*, STATE BAR OF TEXAS 32ND ANN. OIL, GAS & MIN. L. INST. (October 2-3, 2014).

have involved pooling authority clauses with lease language substantially similar to that in *Jones*, with likewise similar holdings. Texas has now seen three unique cases in as many years that involve the same fundamental question, but as it applies to retained acreage clauses with novel governmental authority language. This paper aims to analyze and compare the holdings in *Endeavor Energy Resources, L.P. v. Discovery Operating, Inc.*,² *XOG Operating, LLC v. Chesapeake Exploration L.P.*,³ and *ConocoPhillips Company v. Vaquillas Unproven Minerals*,⁴ and comment on the status of Texas law in their wake.

DENSITY AND PRORATION RULES

In 1953, the Railroad Commission of Texas first adopted what would become Statewide Rule 38 for the regulation of the minimum acreage required to drill an oil or gas well.⁵ Although the text and mechanics of Rule 38 have changed significantly since then, the core concept remains the same: an

² 448 S.W.3d 169, 2014 Tex. App. LEXIS 11664 (Tex. App.—Eastland 2014, pet. filed).

³ 480 S.W.3d 22, 2015 Tex. App. LEXIS 9411 (Tex. App.—Amarillo 2015, pet. filed).

⁴ 2015 Tex. App. LEXIS 8194, 2015 WL 4638272 (Tex. App.—San Antonio Aug. 5, 2015, pet. abated).

⁵ Adopted under Special Order Nos. 20-27,088 and 20-31,866. See Andrew M. Taylor, *Overview of Railroad Commission’s Regulatory Role and the Mechanics of Presenting a Case*, STATE BAR OF TEXAS 16TH ANN. OIL, GAS & MIN. L. INST. (Mar. 30, 1990).

applicant for a drilling permit must have a minimum number of undrilled acres to dedicate to the drilling of his oil or gas well. This concept is known as “well density” and the acreage dedicated to a well for issuance of a drilling permit is known as a “drilling unit.”⁶

The density rule for a particular well depends on several increasingly complex factors. Most wells drilled in Texas are subject to special field rules for density, which preempt Statewide Rule 38 and establish a standard unit size for assignment of acreage to a well.⁷ Upon completion of a well, field rules typically require the operator to designate the well’s productive acreage, known as a “proration unit,”⁸ in order to receive a production allowable to produce the well.⁹

⁶ See 16 TEX. ADMIN. CODE §3.38(a)(2).

⁷ See *id.* at §3.38(b)(2)(A).

⁸ See *id.* at §3.38(a)(3). From Rule 3 of the current Eagleville (Eagle Ford-2) field rules: “The acreage assigned to the individual oil well for the purpose of allocating allowable oil production thereto shall be known as a proration unit. The standard drilling and proration units are established hereby to be EIGHTY (80) acres. No proration unit shall consist of more than EIGHTY (80) acres except as hereinafter provided.” Final Order Amending Field Rules for the Eagleville (Eagle Ford-2) Field, DeWitt, Karnes, Lavaca, and Live Oak Counties, Texas (March 8, 2016) (Railroad Commission Oil & Gas Docket No. 02-0297221).

⁹ An “allowable” is loosely defined as the volume of oil or gas that may be produced from a completed well, as regulated by the Commission. See 16 TEX. ADMIN. CODE §§3.31, 3.45, & 3.52. The maximum and actual daily production allowable for a well is typically found under Rule 4 of the field rules for the applicable field. The actual allowable for a well determined by formula that may involve proration unit size, well deliverability, and other factors, and is published in monthly proration schedules. The top allowable for a field is governed by a “yardstick” formula under Statewide Rule 45, which is then allocated among the wells in that field. Allowables may be further limited by market demand for the sake of price stability; however, the Commission has not done this since 1973. Ernest E. Smith & Jacqueline Lang Weaver, TEXAS LAW OF OIL & GAS §10.1(B) (2d ed. 2000). The top allowable for a field may be increased by proving at hearing that the maximum efficiency rate or “MER” for the field is

Special density and proration rules usually allow the operator to designate proration units larger or smaller than the standard size, often in exchange for a proportionate increase or decrease, respectively, in the maximum production allowable for that well.¹⁰ An upward departure from the standard is known as adding “tolerance acreage”¹¹ and a downward departure is known as forming an “optional” drilling unit and/or a “fractional” proration unit.¹² For field rules in which the

higher than the yardstick, meaning it can be produced at a higher rate without causing waste. *Id.* at §10.3(C). Proration for gas wells is more complex than for oil due in part to the challenges of transportation and marketing, but generally follows the same principles. *Id.* at §10.4(A). Allowables for horizontal wells are controlled by formula under Statewide Rule 86, unless preempted by special field rules. 16 TEX. ADMIN. CODE §3.86(d)(5).

¹⁰ From Rule 3 of the current Spraberry (Trend Area) field rules: “Notwithstanding the above, operators may elect to assign a tolerance of not more than EIGHTY (80) acres of additional unassigned lease acreage to a well on an EIGHTY (80) acre unit and shall in such event receive allowable credit for not more than ONE HUNDRED SIXTY (160) acres.” Final Order Amending Field Rules for the Spraberry (Trend Area) Field, Various Counties, Texas (June 12, 2012) (Railroad Commission Oil & Gas Docket No. 7C-0297471).

¹¹ See 16 TEX. ADMIN. CODE §3.38(a)(6).

¹² For example, Rule 3 of the current Spraberry (Trend Area) field rules allows addition of tolerance acreage, but does not allow for administrative formation of fractional proration units. *Supra* note 10 regarding Rule 3 of Spraberry (Trend Area) field rules. Conversely, Rule 3 of the current Garden City, S. (Wolfcamp) field rules allows for administrative formation of fractional proration units, but does not allow addition of tolerance acreage: “For oil and gas wells, an operator shall be permitted to form optional drilling and fractional proration units of EIGHTY (80) acres, with a proportional acreage allowable credit for a well on fractional proration units.” Order Nunc Pro Tunc Amending Field Rules for the Garden City, S. (Wolfcamp) Field, Glasscock County, Texas (July 8, 2014) (Railroad Commission Oil & Gas Docket No. 08-0287087). Note that “optional” is typically used to describe a substandard drilling unit and “fractional” is typically used to describe a substandard proration unit, though the terms are often used interchangeably. See 16 TEX. ADMIN. CODE §3.38(a)(4-6).

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