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WELLBORE TRANSACTIONS UPDATE - CONVEYANCES, RESERVATIONS AND RELATED LEASE SEVERANCE ISSUES

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I. INTRODUCTION:

This article focuses on the state of Texas law regarding wellbore rights and various related issues raised by transactions involving such rights (and other similar lease severance issues) and provides some practical tips to help avoid potential pitfalls.

II. WELLBORE INTERESTS GENERALLY

At its core, a wellbore interest is simply a fractionalized carveout from a larger real property estate. To the point, the conveyance of such an interest has been called the "narrowest form of an oil and gas assignment."[1] Despite its "narrow" characteristics, it is fundamentally no different than any other conveyance that transfers less than the entire interest owned by a particular grantor/assignor. However, due to the heightened requirement for greater specificity when describing a wellbore interest, there are a host of issues that should be considered and addressed. The first step is to review the relevant case law on this subject and to determine how best to draft the applicable conveyancing (or reservation) language to account for these decisions.

a) *Petro Pro, Ltd. v. Upland Res., Inc.*[2]

The *Petro Pro* case examines the specific granting clause used to convey a wellbore interest and what additional rights were granted thereby. In that case, the parties presented three competing interpretations for the following conveyance clause which was included in two separate assignments:

> All of Seller's right, title and interest in and to the oil and gas leases described in Exhibit "A" attached hereto and made a part hereof ("Subject Leases") insofar and only insofar as said leases cover rights in the wellbore of the King "F" No. 2 Well.[3]

At the time of the conveyances, the King "F" No. 2 Well was the only well producing on the leased premises and was also included in a 704-acre unit.

The first competing interpretation was put forth by Petro Pro, Ltd. ("***Petro***"). Petro was the successor in interest to the assignee of the foregoing assignments and it argued that the conveyance language conveyed all of the assignor's right, title and interest in and to the entire 704-acre unit, including the right to "extend one or more horizontal drainholes from the King "F" No. 2 wellbore into other productive areas of the lease." [4]

The second competing interpretation was put forth by Upland Resource, Inc. ("***Upland***"). Upland was the successor in interest to the assignor of the foregoing assignments and it argued

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[1] *Petro Pro, Ltd. v. Upland Res., Inc.*, 279 S.W.3d 743, 752 (Tex. App.—Amarillo 2007).

[2] *Id.*

[3] *Id* at 746.

[4] *Id* at 749.

that the conveyance language conveyed to the assignee only rights in the wellbore of the King "F" No. 2 Well limited to the then producing formation in such well (being the Cleveland formation).[5]

The third competing interpretation was put forth by a group of intervenors who owned royalty interests in the 704-acre unit. The intervenors argued that the conveyance language conveyed to the assignee rights only in the wellbore of the King "F" No. 2 Well (similar to Upland's argument) but that these rights were further limited to an undetermined 40 acres surrounding the well in accordance with the applicable density rules of the Railroad Commission.[6] At the time of this case, many operators in the area (including Upland and Petro) were completing wells in the Brown Dolomite formation.

Taking these three interpretations into consideration, the court first determined the effect of using the phrase "insofar and only insofar" in the conveyance clause. Likening this to the phrase "subject to", the court held that the "insofar" language constituted a limitation on the overall grant.[7]

Having established that the phrase created a limit on the overall grant, the court then applied the limitation to the vertical and horizontal rights that were conveyed under the assignments.[8] Determining the vertical rights first, the court held that the conveyance language granted rights in the entire depth of the existing wellbore (not just as to the Cleveland formation as argued by Upland).[9] The court further held that to accept the vertical limitation as argued by Upland would require the court to read additional limiting language into the assignments "that does not exist."[10]

Second, the court applied the limitation to the horizontal rights granted under the assignments. Rejecting both Petro's and the intervenors' interpretations, the court held that the assignments were limited only to the horizontal area covered by the actual hole of the King "F" No. 2 wellbore.[11] Specifically, the court discussed intervenors' argument that Petro's rights extended to the "minimum amount of surface acreage needed to obtain a plug back permit for recompletion in the Brown Dolomite formation."[12] Intervenors based this argument on the fact that the assignments were expressly made "subject to . . . government regulations."[13] However, the court rejected this argument and held that the foregoing language was not sufficient to limit the overall grant as provided in the conveyance clause.[14]

Lastly, having established both the vertical and horizontal limits of the assignments, the court held that Petro was granted the right to develop and/or rework the "King "F" No. 2 well so

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[5] *Id*.

[6] *Id.*

[7] *Id* at 750 ("[insofar and only insofar] neither conveys an interest to the assignee, nor does it reserve or retain an interest in favor of the assignor. It merely limits the extent of the interest granted").

[8] *Id.*

[9] *Id* at 751.

[10] *Id* at 750.

[11] *Id* at 751.

[12] *Id.*

[13] *Id.*

[14] *Id.*

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