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The Legal Landscape for Allocation Wells and Associated Legal Issues

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THE LEGAL LANDSCAPE FOR ALLOCATION WELLS AND ASSOCIATED LEGAL ISSUES

I. INTRODUCTION

An allocation well is a horizontal well that traverses the boundary between two or more leases that have not been pooled and for which no agreement exists among the royalty owners as to how production will be shared.[1] A production sharing agreement (PSA) well, on the other hand, is a horizontal well drilled pursuant to a written agreement between lessors and working interest owners holding interests in the tracts that will be traversed by the horizontal well through which they agree upon a formula to allocate production.[2] The legality of such wells and the RRC's related permitting practices have been the subject of controversy and debate for over a decade, the latest example of which is the ongoing *Opiela v. Railroad Commission of Texas* case—a dispute currently pending in the petition-for-review stage at the Supreme Court of Texas. The goal of this article is to provide operators with insights into the recurring questions and legal issues associated with drilling allocation and PSA wells in Texas, particularly against the backdrop of the *Opiela* dispute.

This article begins with a discussion of the nature of horizontal wells in Part II and the methods operators have utilized to drill horizontal wells across multiple tracts in Part III. Part IV discusses recurring issues and questions in the allocation/PSA well debate. Part V discusses prominent pre-*Opiela* disputes that played out before the RRC at the administrative stage. Part VI traces the history of the *Opiela* dispute from the RRC to the district court to the Third Court of Appeals. Finally, Part VII, in addition to addressing various questions posed by *Opiela* and its potential effect on the future of allocation and PSA wells in Texas, examines practical considerations for operators who have drilled, or who intend to drill in the future, allocation or PSA wells.

II. HORIZONTAL WELLS GENERALLY

Horizontal drilling has transformed the oil and gas industry and brought about an unprecedented boom in oil and gas production.[3] It has enabled operators to increase the exposure of the producing portion of the wellbore by thousands of feet over a traditional vertical well, resulting in far greater oil and gas drainage over a given field, while also enabling operators to limit the impact to the surface by reducing the amount of surface locations and equipment necessary to produce the oil and/or gas beneath particular acreage.[4] Though vertical wells are still the most common method used to produce oil and gas in Texas, over 40% of all wells permitted in Texas since 2011 were for horizontal completions.[5]

The RRC defines a horizontal well as "any well that is developed with one or more drainholes having a horizontal drainhole displacement of at least 100 feet."[6] Takepoints through which

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[1] Clifton A. Squibb, *The Age of Allocation: The End of Pooling As We Know It?*, 45 TEX. TECH L. REV. 929, 930 (2013).
[2] *Id.*
[3] *See* Michael E. McElroy, *Production Allocation: Looking for a Basis for Discrimination*, 38 OIL, GAS & ENERGY RESOURCES L. SEC. REP. 47, 47, 56 (2014).
[4] Jessica Crawford & Travis L. Crawford, *Allocation Wells: Another Take [Point]*, 2021 TXCLE OIL AND GAS DISPUTES COURSE 10.3 (2021).
[5] Benjamin Holliday, *New Oil and Old Laws: Problems in Allocation of Production to Owners of Non-Participating Royalty Interests in the Era of Horizontal Drilling*, 44 St. Mary's L.J. 771, 776 (2013).
[6] 16 TEX. ADMIN. CODE § 3.86(a)(5).

production flows into the well are located along the well's horizontal displacement.[7] As horizontal drilling became more common, the RRC implemented Statewide Rule 86, which applies to all horizontal wells or drainholes filed in Texas except those horizontal wells in the fields that have special horizontal rules currently in effect. The RRC's regulatory approach under Statewide Rule 86 is to allow more acreage to be assigned to a horizontal well than a vertical well, resulting in a greater allowable for the horizontal well.[8] The rule achieves this goal by providing that the maximum allowable for the horizontal drainhole is to be calculated by multiplying the applicable allowable for a vertical well in a field by a given fraction, the numerator of which is the acreage assigned to the well for proration purposes, and "the denominator of which is the maximum acreage authorized by the applicable field rules . . . exclusive of tolerance acreage."[9]

III. METHODS BY WHICH HORIZONTAL WELLS ARE DRILLED ACROSS MULTIPLE TRACTS

Because horizontal wells must often be drilled across multiple tracts for the well to be economically viable, combining multiple tracts into a single production unit large enough to accommodate these wells has become a vital component of oil and gas development in Texas. Under the RRC's current rules and policies, operators can generally obtain a permit to drill a multi-lease horizontal well as either a pooled unit well, a PSA well, or an allocation well.

A. Pooled Unit Wells

Voluntary pooling is the traditional method of combining two or more oil and gas leases or mineral tracts to form a unit of sufficient size to receive a drilling permit from the RRC.[10] Statewide Rule 40 provides that an operator may pool acreage in accordance with appropriate contractual authority for the purpose of creating a drilling unit or a proration unit and sets out requirements to do so.[11] Some Texas cases stand for the proposition that the operator's exercise of the pooling power effects a cross-conveyance among the mineral interest owners so that they all own undivided interests under the pooled unit in the proportion their acreage contribution bears to the unit.[12] The legal effect of the cross-conveyance theory is that, once pooled, the mineral owners cease to own the full undivided interest underneath their respective tracts for the duration of the pooling.[13] Rather, they own undivided interests in the production from the entire pooled unit.[14] Moreover, when tracts are pooled, operations anywhere within the unit are treated as if they occurred on all the land within the unit, and production from a well on the pooled unit is treated as occurring on all the tracts in the pooled unit.[15] Most pooling clauses contain a provision reiterating that all production from the pooled unit shall be allocated to all lands included within the unit.[16] With rare exception, the provision for

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[7] *Id.* at (a)(11).
[8] H. Philip Whitworth & D. Davin McGinnis, *Square Pegs, Round Holes: The Application and Evolution of Traditional Legal and Regulatory Concepts for Horizontal Wells*, 7 TEX. J. OIL GAS & ENERGY L. 177, 184 (2012).
[9] 16 TEX. ADMIN. CODE § 3.86(d)(5); Whitworth & McGinnis, *supra* note 8, at 184.
[10] *See* Ernest E. Smith & Jacqueline Lang Weaver, TEXAS LAW OF OIL AND GAS, § 4.5[D] (2d ed. 2010) [hereinafter *SMITH & WEAVER*].
[11] 16 TEX. ADMIN. CODE § 3.40.
[12] *See, e.g.*, Montgomery v. Rittersbacher, 424 S.W.2d 210, 213 (Tex. 1968).
[13] Browning Oil Co. v. Luecke, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied).
[14] *See id.*
[15] *See, e.g.*, Se. Pipe Line Co. v. Tichacek, 997 S.W.2d 166, 170 (Tex. 1999).
[16] *See* Bruce M. Kramer & Patrick H. Martin, WILLIAMS & MEYERS, OIL AND GAS LAW § 669.13 (LexisNexis Matthew Bender 2020) [hereinafter *KRAMER & MARTIN, OIL & GAS LAW*].

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