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## Applying Familiar Concepts to New Technology: Under the Traditional Oil and Gas Lease, a Lessee Does Not Need Pooling Authority to Drill a Horizontal Well That Crosses Lease Lines [reprint, first published 2017]

Ernest E. Smith

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# ONE J

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APPLYING FAMILIAR CONCEPTS TO NEW  
TECHNOLOGY: UNDER THE TRADITIONAL OIL  
AND GAS LEASE, A LESSEE DOES NOT NEED  
POOLING AUTHORITY TO DRILL A HORIZONTAL  
WELL THAT CROSSES LEASE LINES\*

[reprint, first published 2017]

ERNEST E. SMITH\*\*

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\*\* Ernest Smith is a Professor of Law and the Rex G. Baker Centennial Chair in Natural Resources Law at The University of Texas School of Law; he is also the co-author of the *Texas Law of Oil & Gas* treatise. Professor Smith is also a faculty advisor to the TEXAS JOURNAL OF OIL, GAS, AND ENERGY LAW.

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*I. The Proliferation of Horizontal Wells in the Shale Has Raised the Question Whether a Lessee Without Pooling Authority Is Authorized to Drill an “Allocation Well”*

Oil and gas development in Texas has witnessed a proliferation of horizontal wells that often must cross lease lines to be economical.<sup>1</sup> By drilling such horizontal wells that cross lease lines, lessees have unlocked vast mineral resources for production.<sup>2</sup> The technology that enables the drilling of horizontal wells has rapidly matured, but the legal system has not

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1. See Michael E. McElroy, *Production Allocation: Looking for a Basis for Discrimination*, 38 OIL, GAS & ENERGY RESOURCES L. SEC. REP. 47, 47 (2014).

2. See *id.* at 56.

been as swift in providing mineral lessees with guidance as to how traditional oil and gas law principles apply when a mineral lessee sets out to drill a horizontal well that crosses lease lines. In this respect, one question has repeatedly emerged: where a lessee has a right to drill and produce from two adjacent tracts, does the lessee need pooling authority (or some other express consent from his lessors) to drill a horizontal well that crosses the boundary of those two adjacent leases?

The Texas Railroad Commission (the Railroad Commission or the Commission) has given significant attention to the question whether pooling authority is required before a lessee can drill a horizontal well that crosses lease lines, where that lessee holds leases on all tracts crossed by the horizontal well.<sup>3</sup> The Commission has determined that a lessee is not required to demonstrate any pooling authority in order for the Commission to issue a permit to drill a horizontal well that crosses lease lines, where all the leases involved are held by the lessee.<sup>4</sup> The Commission will issue a permit to drill a horizontal allocation well where the applicant shows a good-faith claim of a right to drill, which is satisfied with leasehold or mineral rights.<sup>5</sup> In the Railroad Commission, such a well—i.e., a horizontal well, drilled without pooling authority, that crosses lease lines, where all the leases involved are held by the lessee—is known as an “allocation well.”<sup>6</sup> For an allocation well, production from the perforations along the wellbore is allocated to each tract to recognize the production contribution from each tract.<sup>7</sup> By contrast, when tracts are pooled, production from any tract in the

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3. When this article refers to a lessee that holds leases on all tracts traversed by a horizontal well, the author intends to include any situation where the one drilling the horizontal well, regardless of whether he is the lessee, holds the right to drill, whether under the lease, by operating agreement, or otherwise.

4. Tex. R.R. Comm'n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation) Well No. 1H, (Status No. 744730), Eagleville (Eagleford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases* at 1, Docket No. 02-0278952 (Sept. 24, 2013) (final order).

5. *See id.*

6. Clifton A. Squibb, *The Age of Allocation: The End of Pooling As We Know It?*, 45 TEX. TECH L. REV. 929, 930 (2013) (“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.”).

7. *See generally* Springer Ranch, Ltd. v. Jones, 421 S.W.3d 273, 285 (Tex. App.—San Antonio 2013, no pet.) (“Production from a well, whether horizontal or vertical, is not obtained from the entire length of the well, but from the part of the well that pierces and drains the reservoir in which the hydrocarbons reside.”) (citing 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS § 8.2[A]-[C], 8-16.8-8-22) (2d. ed., 2013); Browning Oil Co v. Luecke, 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet.

pool is treated as production from every tract in the pool and is, therefore, allocated to every tract in the pool.<sup>8</sup> For example, if a producing 40-acre tract is pooled into a 160-acre unit, only a quarter of the production from the well on the 40-acre tract is allocable to that 40-acre tract. But if the well on the 40-acre tract is an allocation well, then the entire production attributable to the portion of the well that is on the 40-acre tract is allocated to the 40-acre tract. Allocation wells have become prevalent in Texas: as of May 2016, the Railroad Commission had issued permits to drill over 1,700 allocation wells.<sup>9</sup>

Commentators have also addressed the question whether a lessee without pooling authority is authorized to drill a horizontal well that crosses lease lines, where that lessee holds leases on all tracts crossed by the horizontal well. In a recent *Baylor Law Review* article, Professor Bret Wells argues that the act of drilling a horizontal well that crosses lease lines is, by definition, an act of pooling, such that pooling authority is required for a lessee to be authorized to drill a horizontal allocation well that crosses lease lines—even if the lessee holds leases on all the tracts that are crossed by the horizontal well.<sup>10</sup> Professor Wells contends that, if a lessee who lacks pooling authority drills a horizontal allocation well that crosses lease lines, then the lessee could be sued in tort—even if the lessee holds leases on all the tracts that are crossed by the horizontal well.<sup>11</sup> Herein, I shall refer to Professor Wells’s article as the “Wells Article.”

I disagree with the conclusions reached in the Wells Article because such a horizontal well, drilled across lease lines where the lessee holds leases on all tracts crossed by the horizontal well, is no different from vertical wells on each tract. And, even without pooling authority, such vertical wells would be clearly authorized by each lease. Below, I explain why pooling authority is *not* required for a lessee to drill a horizontal allocation well that crosses lease lines, so long as the lessee holds leases on each tract crossed by the horizontal well.

As set out in Part II below, the typical oil and gas lease conveys to the lessee a fee simple determinable estate in 100% of the minerals on the land.

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denied) (“Each tract traversed by the horizontal well is a drillsite tract, and each production point on the wellbore is a drillsite.”).

8. *Hooks v. Samson Lone Star, Ltd. P’ship*, 457 S.W.3d 52, 62 (Tex. 2015).

9. Greg Mathews, *Production Sharing Agreements and Allocation Wells Update 3* (Apr. 5, 2016) (on file with author).

10. Bret Wells, *Allocation Wells, Unauthorized Pooling, and the Lessor’s Remedies*, 68 *BAYLOR L. REV.* 1, 7 (2016).

11. *Id.* at 26–48.

And the typical oil and gas lease expressly permits the lessee to drill into the minerals and to produce the minerals. Thus, the typical oil and gas lease gives the lessee all of the authority required to produce minerals from a lease by drilling a well that horizontally traverses that lease, from one side of the lease to the other side. From the perspective of an individual lessor, that is how the horizontal well should be conceived: as a well that originates at one boundary of the lessor's tract and terminates at a boundary on the other side of that lessor's tract. The question whether the lessee may further extend the wellbore into the next adjacent mineral estate is a matter between the lessee and the lessor of that next adjacent mineral estate. Thus, assuming that the lessee holds typical oil and gas leases covering all of the tracts that will be traversed by a horizontal wellbore, those leases give the lessee all of the authority needed to drill a horizontal well that traverses, from one boundary to the next, each of the tracts covered by those leases.

The Wells Article reaches the opposite conclusion by wrongly contending that pooling authority is required for a lessee to drill a horizontal well that crosses lease lines.<sup>12</sup> As explained in Part III below, when a lessee pools, the lessee cross-conveys royalty interests. Pooling enables the lessee to allocate production among pooled tracts according to the standard pooling formula: in a pool, each tract is allocated a fraction of production that is equal to (1) the surface acreage of that tract, as compared with (2) the total surface acreage of the pooled tracts. Because pooling involves conveying a portion of the lessor's royalty interest to third parties, and because pooling changes how the lessee allocates production to the lessor's tract, a lessee cannot pool leases absent the consent of the lessors.

But the act of drilling a horizontal well does not, in and of itself, result in a cross-conveyance of royalty interests or change how production is allocated to each tract that is traversed by the wellbore. As long as the lessee is not purporting to convey a portion of the lessor's royalty interest to someone else, and as long as the lessee continues to pay royalties to each lessor based on the production allocable to that lessor's tract, the typical mineral lease gives the lessee all of the authority needed to produce from a lease by drilling a horizontal well that travels from one boundary of that lease to the other boundary of that same lease.

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12. *See id.* at 7 (“[T]his Article argues that a lessee who (without pooling authority) drills a horizontal well that traverses multiple tracts has exceeded its authority under the existing common law and has engaged in unauthorized pooling by the drilling of such a well.”); *see also id.* at 13 (“[T]he lessee does not have authority to drill a multi-tract well except where specifically authorized by the pooling clause of the lease.”).

Part IV of this article is devoted to addressing the lessor's potential remedies against a lessee who, without pooling authority, drills a horizontal well that crosses lease lines. Because, even absent pooling authority, the standard oil and gas lease gives the lessee the right to exploit the minerals through a horizontal allocation well, it follows that, where a lessee drills such a well, the lessor should not have any claim against the lessee to revoke the lessee's drilling permit or to enjoin the lessee from operating the horizontal well. Nor should any tort claim lie against the lessee for drilling such an allocation well. The suggestion in the Wells Article that such a lessee should be liable for tort damages, and even exemplary damages, is, in my view, completely incorrect.

## *II. The Standard Oil and Gas Lease Grants to the Lessee Authority to Drill a Horizontal Well That Crosses Lease Lines*

In the typical oil and gas lease, the lessee is given ownership of the lessor's interest in the minerals in place and is given the right to drill and produce those minerals. As the Texas Supreme Court has written, "[i]n a typical oil or gas lease, the lessor . . . grants a fee simple determinable interest to the lessee."<sup>13</sup> That fee simple determinable interest in the minerals "carries with it the right to enter [the land] and extract [the minerals], and all other such incidents thereto as are necessary to be used for getting and enjoying them."<sup>14</sup>

The typical oil and gas lease imposes virtually no restrictions on where, within the leased tract, the lessee is allowed to drill, or what technologies the lessee may use to drill. Thus, for example, the Texas Supreme Court held in *Merriman v. XTO Energy, Inc.* that "[i]f the mineral owner or lessee has only one method for developing and producing the minerals, that method may be used regardless of whether it precludes or substantially impairs an existing use of the servient surface estate."<sup>15</sup> In other words, under the typical oil and gas lease, the lessee is entitled to use whatever technologies are available. And the lessee is entitled to drill anywhere in the leased tract, whether vertically or horizontally.<sup>16</sup>

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13. *Nat. Gas Pipeline Co. of Am. v. Pool*, 124 S.W.3d 188, 192 (Tex. 2003).

14. *Tarrant Cty. Water Control & Imp. Dist. No. One v. Haupt, Inc.*, 854 S.W.2d 909, 911 (Tex. 1993).

15. 407 S.W.3d 244, 249 (Tex. 2013).

16. *See* McElroy, *supra* note 1, at 57 ("The typical oil and gas lease contains no prohibition against horizontal drilling. An oil and gas lease grants to the lessee the right to drill the well up and down or sideways.").

The mineral lessee's ownership of, and right to produce, the minerals is grounded in the language found in the typical oil and gas lease. The typical lease recognizes that the lessee has the right to "drill[]" into, and "produc[e]" minerals from, the "land" subject to the lease.<sup>17</sup> The Wells Article refers to American Association of Professional Landmen Form 675—a lease form stating that the lessor "does hereby *grant, lease and let unto Lessee for the purpose of exploring, prospecting, drilling and mining for and producing oil and gas and all other hydrocarbons . . . the following described land . . .*"<sup>18</sup> Thus, the typical lease plainly and unambiguously authorizes the lessee to drill wells to produce minerals from the lands subject to the mineral lease—without limiting whether the lessee may drill vertically or horizontally on the leased tract.

Although mineral lessees have customarily produced minerals by drilling vertical wells that originate on the surface estate and penetrate downward into the mineral estate, nothing in mineral law, and nothing in the typical oil and gas lease, mandates that the lessee must produce the minerals through this customary practice of drilling vertical wells.<sup>19</sup>

Nothing in mineral law or the typical mineral lease prohibits the lessee from instead drilling a horizontal well that passes through the mineral estate from one side to the other. The fact that the same horizontal well may also pass, border-to-border, through a neighboring tract does not prevent the lessee from fully developing a particular tract by drilling horizontally through that tract.

The Wells Article suggests that a horizontal well traversing multiple tracts is prohibited because the Railroad Commission regulates commingling of production from multiple tracts.<sup>20</sup> But the fact that the Railroad Commission regulates commingling has no bearing on contractual rights, and could equally suggest that the typical oil and gas lease would not prohibit such commingling.

And, if drilling a horizontal well is reasonably necessary for the lessee to produce minerals from "Tract #1," then a wellsite on "Tract #1" should not be an excessive use of the surface of "Tract #1," even if the wellsite on "Tract #1" is used to produce from a horizontal well that also traverses "Tract #2." The lessee under a mineral lease has an implied easement to use

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17. ERNEST E. SMITH & JACQUELINE LANG WEAVER, 1 TEXAS LAW OF OIL & GAS § 4.2[B][1], 4-16-4-17 (2d ed. 2015).

18. Form 675 Oil and Gas Lease, AM. ASS'N OF PROF'L LANDMEN, <http://landman.org/docs/forms/texa675.pdf> (emphases added).

19. McElroy, *supra* note 1, at 57.

20. Wells, *supra* note 10, at 14.

the surface as is reasonably necessary for production of the minerals.<sup>21</sup> So long as the surface acreage used is no more than would be used for a horizontal well drilled completely on that tract, no excessive use claim should lie.<sup>22</sup> Neither a claim for damages nor injunctive relief should lie in that circumstance. A different situation was presented in *Robinson v. Robbins Petroleum Corp.*, where the Texas Supreme Court found excessive use of an eighty-acre surface tract when a lessee removed sufficient salt water from that eighty-acre surface tract in order to produce oil from thousands of acres.<sup>23</sup> *Robinson* did not involve a normal use of the surface estate, such as placing a wellsite on the surface for the horizontal well.

### *III. A Lessee Does Not Need Pooling Authority to Drill a Horizontal Well That Crosses Lease Lines*

*A. Drilling a horizontal well that crosses lease lines is not pooling because the horizontal well does not result in a cross-conveyance of royalty interests or change the allocation of production*

The Wells Article conflates drilling a horizontal well with pooling by conceptualizing a horizontal well as a single well that passes through multiple tracts of land and crosses lease lines as it moves from tract to tract.<sup>24</sup> But in evaluating a lessor's claim that an oil and gas lease prohibits the lessee's activity on the leased tract, the focus should be on whether the lessee's activity on that particular tract is authorized by the lease. Thus, the inquiry whether the lessee is violating the lease should begin and end with recognizing that the lease authorizes the lessee to drill a horizontal well that begins at one side of the lessor's tract and ends on the other side of that tract.<sup>25</sup> The fact that the horizontal well may also extend into an adjacent tract is irrelevant under the traditional oil and gas lease that does not specify whether the lessee may drill vertically or horizontally. As the court noted in *Browning Oil Co. v. Luecke*: "Each tract traversed by the horizontal well is

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21. *Sun Oil Co. v. Whitaker*, 483 S.W.2d 808, 811 (Tex. 1972); *Humble Oil & Refining Co. v. Williams*, 420 S.W.2d 133, 134 (Tex. 1967).

22. *See Cole v. Anadarko Petroleum Corp.*, 331 S.W.3d 30, 38 (Tex. App.—Eastland 2010, pet. denied) (noting that the surface owner suffers no damage where the lessee's incidental use of surface to support production from other tracts does not increase surface acreage used by the lessee).

23. 501 S.W.2d 865, 867 (Tex. 1973).

24. *See Wells*, *supra* note 10, at 8–9.

25. *See supra* Parts I–II (discussing the lessee's right to drill a horizontal well that begins on one border of a tract and ends on the opposite border).

a drillsite tract, and each production point on the wellbore is a drillsite.”<sup>26</sup> Thus, taking the position, as the Wells Article does, that a horizontal well traversing multiple tracts is improper absent pooling would be akin to saying that producing from vertical wells on adjoining tracts is improper absent pooling. And, of course, the latter would be nonsense.

Contrary to the position taken in the Wells Article, pooling does not result from the mere fact that a wellbore crosses lease lines. When a lessee pools, the lessee engages in a cross-conveyance of property: the lessee conveys—to each of the tracts in the pool—a portion of the royalty interest from each of the *other* tracts in the pool.<sup>27</sup> The lessors under each of the leases in the pool become “joint owners, or joint tenants, of all royalties reserved in each of the several leases in such block,” and each lessor’s percentage ownership interest is equal to the proportion of (1) the surface acreage that the lessor contributes to the pool, as compared with (2) the total surface acreage of the pool.<sup>28</sup>

When production is obtained from pooled tracts, production from any tract in the pool is treated as production from every tract in the pool.<sup>29</sup> That production is then apportioned to each of the tracts in the pool based on the acreage that the tract contributed to the pool.<sup>30</sup> Royalties are calculated based on the amount of production allocated to a particular tract and the royalty obligations stated in the lease covering that tract.<sup>31</sup> Pooling requires lessor consent because pooling results in a cross-conveyance of royalty interests and affects the royalties that the lessor receives under its lease.<sup>32</sup>

Unlike pooling, the act of drilling a horizontal well that crosses lease lines does not have the consequence of cross-conveying royalty interests.<sup>33</sup> As noted above, in such a situation, (1) the portion of the horizontal well that is located on each tract is a drillsite with production points

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26. 38 S.W.3d 625, 634 (Tex. App.—Austin 2000, pet. denied).

27. Ernest E. Smith, *Gas Marketing by Co-Owners*, 39 BAYLOR L. REV. 365, 408 (1987) (“By authorizing pooling, each lessor has authorized his lessee to convey a part of the royalty interest to the lessor of every other tract within the pooled area.”).

28. *Hooks v. Samson Lone Star, Ltd. P’ship*, 457 S.W.3d 52, 62 (Tex. 2015); *Veal v. Thomason*, 159 S.W.2d 472, 476 (Tex. 1942).

29. *Hooks*, 457 S.W.3d at 62; *Key Operating & Equip., Inc. v. Hegar*, 435 S.W.3d 794, 798 (Tex. 2014).

30. *Hooks*, 457 S.W.3d at 62.

31. *Id.*

32. *See Montgomery v. Rittersbacher*, 424 S.W.2d 210, 213 (Tex. 1968).

33. *Squibb*, *supra* note 6, at 947 (“[I]n contrast to a typical pooling, an allocation well is not accompanied by a cross-conveyance of interests or any contractual agreement among the parties by which production is allocated.”).

(perforations) for that tract, and (2) when a wellbore merely crosses lease lines, each affected lessor remains entitled to royalty based on the production obtained from his or her individual tract and the provisions of his or her individual lease. The act of drilling a horizontal well that crosses lease lines does not change the lessee's royalty obligations under the leases covering the affected tracts. As shown below, this is precisely the holding of the Texas Court of Appeals in *Browning Oil Co. v. Luecke*.<sup>34</sup>

*B. The Browning decision illustrates the difference between pooling and drilling a horizontal well that crosses lease lines*

The difference between pooling and drilling a horizontal well that crosses lease lines is apparent from the Texas Court of Appeals' decision in *Browning Oil Co. v. Luecke*.<sup>35</sup> In *Browning*, the lessee drilled a horizontal well that crossed lease lines.<sup>36</sup> Purporting to pool the affected tracts, the lessee (1) filed with the Railroad Commission a Certificate of Pooling Authority and (2) paid royalties as if the lessee had validly cross-conveyed the lessors' royalty interests.<sup>37</sup> However, the court held that the lessee's purported pool was invalid because it failed to comply with the pooling provisions in the leases.<sup>38</sup> As a result, the court concluded that there had been no "valid pooling."<sup>39</sup> The court held that, where the lessee drills a horizontal well that crosses lease lines but does not pool the affected tracts, each lessor is entitled to be paid "royalties as specified in the lease," i.e., royalties on the "production [that] can be attributed to [the lessor's] tract[] with reasonable probability."<sup>40</sup>

The Wells Article suggests that *Browning* held that the lessee's horizontal well breached the pooling provisions in the lease.<sup>41</sup> But *Browning* does not hold that the lessee breached those pooling provisions merely by drilling a horizontal well that crosses lease lines. Instead, as noted above, *Browning* holds that the lessee breached the pooling provisions in the leases, not because the lessee drilled a horizontal well across lease lines, but rather because the lessee purported to create a pool that did not comply with the pooling provisions in the leases—and thus

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34. 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied).

35. *See id.*

36. *Id.* at 638.

37. *Id.*

38. *Id.* at 643.

39. *Id.*

40. *Id.* at 647.

41. Wells, *supra* note 10, at 19.

never established a pool. Because no pool had been created, the court of appeals held that each lessor was entitled to be paid royalties on the production obtained from that lessor's tract. As the court noted: "The Lueckes were entitled to royalties on the oil and gas produced from their land, but were not entitled to royalties on production that was recovered from lands they did not own."<sup>42</sup> *Browning* does not hold that, where a lease is silent on pooling, a lessee is required to obtain pooling authority before the lessee can drill a horizontal well that crosses lease lines. And the result that *Browning* dictates—i.e., that each lessor whose tract is traversed by the horizontal well should be paid the royalties due under his or her lease—is exactly the result that should obtain for the horizontal allocation well.

*C. The Browning decision indicates why a lessee may prefer to exercise pooling authority when drilling a horizontal well that crosses lease lines*

As noted above, in *Browning*, the lessee attempted to pool the tracts that would be traversed by the horizontal well, but the lessee's attempt at pooling failed. There are good reasons why a lessee, like the lessee in *Browning*, might wish to exercise pooling authority when drilling a horizontal well that crosses lease lines—including the fact that pooling carries with it a defined method to calculate what royalties are due to each lease that is pooled. Where a horizontal well crosses lease lines, the lessee, in calculating royalties owed to royalty owners, faces the challenging question of how to allocate production among the tracts traversed by the horizontal well. The oil and gas industry has developed three answers to that allocation question.

First, if the lessor has given the lessee authority to pool the lessor's tract with other tracts, then the lessee can resolve the allocation problem by combining the tracts traversed by a horizontal well into a pool. As explained above, the act of pooling involves a cross-conveyance of royalty interests, such that all of the lessors contributing acreage to the pool become joint owners of all royalties reserved in each of the leases in the pool.<sup>43</sup> The lessee then pays royalties to each lessor based on the fraction of (1) the surface acreage that the lessor contributes to the pool, as compared with (2) the total surface acreage of the pool.<sup>44</sup> Because this formula is used to pay royalties based on production from a pool, when a lessee desires to

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42. *Browning*, 38 S.W.3d at 650.

43. *See supra* Part III.A.

44. *Veal v. Thomason*, 159 S.W.2d 472, 476 (Tex. 1942); *accord* *MCZ, Inc. v. Triolo*, 708 S.W.2d 49, 52–53 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

drill a horizontal well, the lessee can avoid the challenging question of production allocation by combining tracts into a pool.

Second, the lessee can address the question of production allocation by reaching agreements with affected royalty owners as to how production will be allocated among the various tracts. Such agreements—whereby royalty owners agree to an allocation of production—are commonly referred to as Production Sharing Agreements (or “PSAs”).<sup>45</sup> When a lessee drills a horizontal well pursuant to a PSA, the PSA is normally executed before the lessee drills the horizontal well. Thus, by the time the lessee obtains production from the horizontal well, the lessee already knows how that production will be allocated. The Railroad Commission will grant a permit to drill a horizontal well based on a PSA as long as 65% of affected royalty and working-interest owners consent to the PSA.<sup>46</sup> In other words, the lessee can rely on a PSA as a basis for obtaining a permit to drill a horizontal well even if (1) the lessee has not created a pool and (2) up to 35% of affected royalty and working-interest owners do not consent to the PSA.<sup>47</sup>

Third, if the lessee lacks pooling authority and cannot obtain the requisite level of consent to a Production Sharing Agreement, then the lessee can address the production allocation question by drilling an allocation well. When a lessee drills an allocation well, the lessee allocates production to the various tracts traversed by the horizontal wellbore by determining, to a reasonable probability, the amount of production that came from each such tract.<sup>48</sup>

Of these three options for allocating production from a horizontal well that traverses lease lines, lessees might normally prefer to allocate production by creating a pooled unit or obtaining a Production Sharing Agreement. When the lessee pools tracts, the law provides a clear formula for allocating production among royalty owners, so royalty owners are unlikely to challenge the lessee’s allocation of production to that particular lessor’s tract. Thus, where a lessee has authority to create a pooled unit of the requisite size, it will generally make sense for the lessee to exercise that pooling authority for the purpose of creating a pooled unit covering the lands across which it intends to drill a horizontal well. Similarly, if a lessee can obtain a Production Sharing Agreement, then most or all of the affected royalty owners will have consented to the lessee’s production allocation

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45. See generally Squibb, *supra* note 6, at 940–41.

46. *Id.*

47. *Id.*

48. See *supra* Part III.A.–B.

formula before the horizontal well is drilled. A Production Sharing Agreement will generally limit the lessee's exposure to claims by unsigned royalty owners, making it more likely that any challenges can be efficiently resolved.

By contrast, when a lessee drills an allocation well, the lessee must allocate production based on the facts and circumstances surrounding the horizontal well. This fact-driven production allocation is more likely to be challenged by a royalty owner who believes that the lessee is allocating an inadequate volume of production to his tract. But the lessee's likely preference for resolving allocation issues by pooling or agreement does not detract from the lessee's authority, even without pooling, to drill a horizontal allocation well that crosses lease lines. Thus, two separate and independent legal questions are presented: (1) does the lessee, without pooling authority, have authority under the leases to drill a horizontal well across lease lines; and (2) how does the lessee allocate the production from the horizontal well? The answer to the first question is "yes" regardless of the difficulties inherent in answering the second question.

*D. In the Klotzman case, the Railroad Commission concluded that, even though the lessee lacked pooling authority, the lessee had a good faith claim to title to obtain a permit for drilling a horizontal well across lease lines*

The *Browning* analysis may have influenced the Railroad Commission in *Klotzman v. EOG Resources, Inc.*, the only contested case in which a landowner has contended that the Commission should deny an operator's application for a permit to drill an allocation well across lease lines because the operator lacked pooling authority.<sup>49</sup> In *Klotzman*, the hearings examiner issued a proposal for decision in favor of the landowner.<sup>50</sup> That proposal for decision contained findings of fact and conclusions of law stating that "combining a 40-acre tract . . . with [another] 40-acre tract . . . to form an 80-acre drilling unit for the purpose of drilling a [horizontal] well would be pooling the tracts," and concluding that, because the lessee did not have pooling authority, the lessee lacked "a good faith claim to drill its proposed [horizontal well]."<sup>51</sup> However, the Railroad Commission did *not* adopt

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49. Tex. R.R. Comm'n, *Application of EOG Resources, Inc. for its Klotzman Lease (Allocation), Well No. 1H (Status No. 744730), Eagleville (Eagleford-2) Field, Dewitt County, as an Allocation Well Drilled on Acreage Assigned from Two Leases at 2-3*, Docket No. 02-0278952 (June 25, 2013) (proposal for decision).

50. *Id.* at 26.

51. *Id.* at 24-26.

those findings and conclusions.<sup>52</sup> Instead, the Railroad Commission concluded that the operator's leases—which did not give the operator pooling authority—nevertheless gave the operator “a sufficient good faith claim to drill its proposed [allocation well].”<sup>53</sup> In other words, the Railroad Commission agreed with this author's conclusion that pooling authority is not required before a lessee can drill a horizontal well that crosses lease lines, where that lessee holds leases on all tracts crossed by the horizontal well.

In support of its conclusion that a lessee engages in pooling by drilling a horizontal well that crosses lease lines, the Wells Article refers to certain findings of fact and conclusions of law contained in the hearings examiner's proposal for decision in the *Klotzman* case.<sup>54</sup> But those findings of fact and conclusions of law were not adopted by the Railroad Commission in *Klotzman*.<sup>55</sup> And, perhaps more importantly, the hearings examiner's findings and conclusions contravened Texas oil and gas law because, even absent pooling authority, the lessee is authorized to drill a horizontal well that crosses lease lines, so long as the lessee holds leases on all tracts traversed by the horizontal well.<sup>56</sup>

The Wells Article quotes language from the *Klotzman* hearings examiner's proposal for decision dealing with this author's letter before the Commission in relation to a well permit application filed by Devon Energy.<sup>57</sup> However, the Wells Article misconstrues this author's letter. While that letter contains an assumption that the lessee had valid pooling authority, that assumption was made because the horizontal well traversed multiple units, such that the author was assuming that each unit had been validly pooled. That letter in no way suggests that pooling authority is required for a horizontal well that traverses multiple tracts, so long as the lessee holds leases on each tract.

*E. The common usage of Production Sharing Agreements suggests that pooling authority is not required for a lessee to drill a horizontal well that crosses lease lines*

The proliferation of Production Sharing Agreements indicates that a lessee can drill a horizontal well that crosses lease lines absent pooling

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52. See Tex. R.R. Comm'n, *supra* note 4, at 2.

53. *Id.* at 1.

54. Wells, *supra* note 10, at 22–23 n.76.

55. See Tex. R.R. Comm'n, *supra* note 4, at 1.

56. See *supra* Part II.

57. Wells, *supra* note 10, at 22–23 n.76.

authority and absent the lessor's express consent for the lessee to drill a horizontal well. The Wells Article does not challenge the Railroad Commission's practice of granting permits to drill horizontal wells based on a PSA that has been ratified by only 65% of royalty and working-interest owners of the affected tracts.<sup>58</sup> Thus, the Wells Article does not challenge the Railroad Commission's practice of granting a permit to drill a horizontal well based on a PSA where up to 35% of the affected royalty and working-interest owners have not consented. But such permits are perfectly appropriate because the lessee, so long as he has leases on all the tracts traversed by the horizontal well, could drill the horizontal well without the PSA.<sup>59</sup> The PSA has the salutary effect of moving the lessee forward on the second question of how production from the horizontal well will be allocated among the tracts.

*F. The public policy of Texas supports interpreting the typical oil and gas lease to allow a lessee to drill a horizontal well that crosses lease lines, even where the lessee lacks pooling authority*

The Texas legislature has adopted a public policy favoring recovery of minerals in Texas.<sup>60</sup> The Texas Supreme Court has focused on crafting legal rules that encourage full exploitation of the state's mineral resources through use of innovative technology.<sup>61</sup> Because economics would preclude production of much of the state's minerals absent the drilling of a horizontal well that crosses lease lines, requiring pooling authority before a lessee could drill such a well would hinder mineral production in Texas. The state's public policy does not support erecting obstacles to mineral production, especially production by one who owns the right to drill a well to produce those minerals.

*IV. Because a Lessee Does Not Engage in Pooling by Drilling a Horizontal Well That Crosses Lease Lines, a Lessee Does Not Engage in Any Wrongful Conduct by Drilling Such a Well Absent Pooling Authority*

The Wells Article contends that where a lessee, absent pooling authority, drills a horizontal well that crosses lease lines, the lessee can be subjected

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58. *Id.* at 28–29, 29 n.105.

59. *See supra* Part II.

60. *Coastal Oil & Gas Corp. v. Garza Energy Trust*, 268 S.W.3d 1, 46 (Tex. 2008) (Johnson, J., concurring in part and dissenting in part).

61. *Id.* at 34 (Willett, J., concurring).

to all manner of legal liability.<sup>62</sup> According to the Wells Article, the lessor can have the lessee's drilling permit revoked, can sue the lessee in tort, and can even obtain exemplary damages against the lessee in certain situations.<sup>63</sup> The analysis in the Wells Article is based on the assumption that the typical oil and gas lease does not permit the lessee, absent pooling authority, to drill a horizontal well that crosses lease lines.<sup>64</sup> But as demonstrated above, the typical oil and gas lease, absent pooling authority, does authorize the lessee to drill a horizontal well that crosses lease lines, so long as the lessee holds leases on all the tracts traversed by the horizontal well.<sup>65</sup> In that situation, the lessee that drills the horizontal well should not be subject to any of the remedies outlined in the Wells Article.

*A. A drilling permit should not be set aside, and production should not be enjoined, if, absent pooling authority, the lessee seeks a permit for or drills a horizontal well that crosses lease lines*

The Wells Article contends that a lessor can seek to have a drilling permit revoked if a lessee, absent pooling authority, obtains a permit to drill a horizontal well that crosses lease lines, where the lessee holds leases on all tracts traversed by the horizontal well.<sup>66</sup> And the Wells Article also concludes that the lessor can obtain an injunction against the operation of such a horizontal well that crosses lease lines if that well was not drilled pursuant to pooling authority.<sup>67</sup> But both of those conclusions are based on the erroneous premise that pooling authority would be required for the lessee to drill a horizontal well that crosses lease lines. As explained above, pooling authority is not necessary for a lessee to drill a horizontal well that crosses lease lines, where the lessee holds leases on all tracts traversed by the horizontal well. Therefore, there is no basis for revoking the lessee's permit authorizing such a well in that situation. This was essentially the holding of the Railroad Commission in the *Klotzman* case, where the Commission concluded that, although the lessee did not have pooling authority, the leases nevertheless gave the lessee "a sufficient good faith claim to drill its proposed [allocation well]."<sup>68</sup>

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62. Wells, *supra* note 10, at 26–48.

63. *Id.*

64. *Id.* at 7, 13.

65. See discussion *supra* Part II.

66. Wells, *supra* note 10, at 26.

67. *Id.* at 46.

68. See Tex. R.R. Comm'n, *supra* note 4, at 1.

*B. The lessee does not engage in tortious conduct if, absent pooling authority, the lessee drills a horizontal well that crosses lease lines*

The Wells Article is based on a faulty premise because Professor Wells assumes that a lessee needs pooling authority to drill a horizontal well that crosses lease lines—even where the lessee holds leases on all tracts traversed by the horizontal well. Based on that faulty premise, the Wells Article contends that a lessee that drills such a horizontal well without pooling authority commits a tort. Thus, the Wells Article contends that the lessee slanders the lessor's title because the lessee implicitly conveys that it possesses pooling authority when, in fact, such pooling authority has been retained by the lessor.<sup>69</sup> But the premise of the Wells Article is flawed because nothing in the typical mineral lease precludes the lessee from drilling a well horizontally from one border of the lessor's tract to the other border of the lessor's tract.<sup>70</sup> Thus, the lessee who drills such a horizontal well is not purporting to exercise pooling authority and is not slandering the "title" that is the lessor's right to authorize a cross-conveyance of its royalty interest by pooling.

*C. The lessee is not exposed to exemplary damages if, absent pooling authority, the lessee drills a horizontal well that crosses lease lines*

Finally, the Wells Article contends that a lessor may have a claim for exemplary damages against a lessee who, without pooling authority, drills a horizontal well that crosses lease lines—even if the lessee holds a lease on all of the tracts traversed by the horizontal well.<sup>71</sup> The Wells Article contends that exemplary damages may be available against such a lessee because, as explained above, the Wells Article assumes that a lessee commits a tort (slander of title) when the lessee, without pooling authority, drills a horizontal well that crosses lease lines.<sup>72</sup> Here again, I disagree with the conclusion reached in the Wells Article because I disagree with the basic premise on which the Wells Article is based. The Wells Article assumes that the typical oil and gas lease does not authorize such a horizontal well across lease lines, but, as explained above, the Wells Article is incorrect.<sup>73</sup> The typical mineral lease authorizes the lessee—even without pooling authority—to drill a horizontal well that crosses lease lines, so long

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69. Wells, *supra* note 10, at 35.

70. See discussion *supra* Part II.

71. Wells, *supra* note 10, at 47.

72. *Id.*

73. See discussion *supra* Part II.

as the lessee holds leases on all tracts traversed by the horizontal well.<sup>74</sup> A lessee that drills such a horizontal well does not slander the lessor's title.<sup>75</sup> And the lessee having committed no tort, exemplary damages should not be available. And the lessee could not be guilty of the malice or gross negligence necessary for exemplary damages given the analysis herein of the lessee's right to drill such a horizontal well across lease lines, where the lessee holds leases on all the tracts traversed by the horizontal well.

#### *V. Conclusion*

The standard oil and gas lease gives the lessee all of the authority needed to drill a horizontal well that crosses lease lines. Although a lessee may find it beneficial to exercise pooling authority in conjunction with the drilling of such a well, the act of drilling such a horizontal well does not in itself result in pooling. The lessee does not need pooling authority to drill a horizontal well that crosses leases lines because the typical oil and gas lease authorizes such a horizontal well, so long as the lessee holds leases on all tracts traversed by the horizontal well and allocates, to each tract traversed by the horizontal well, only such production as can be attributed to that tract with reasonable probability. Because the traditional oil and gas lease authorizes the lessee, even absent pooling authority, to drill a horizontal well that crosses lease lines, the drilling of such a well, by such a lessee, is not wrongful and should not expose the lessee to liability. Nor should the lessor be entitled to an injunction precluding the drilling of such horizontal wells.

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74. *Id.*

75. *See* discussion *supra* Part IV.B.