

RUNNING OFF THE TRACKS: THE TEXAS RAILROAD COMMISSION'S ALLOCATION AND PSA PERMITTING AUTHORITY

Cooper Bradbury*

I. INTRODUCTION

The boom isn't over, not yet at least. But *Railroad Commission of Texas & Magnolia Oil & Gas Operating, LLC v. Opiela* could be the Armageddon the Texas oil and gas industry wants to avoid.¹ In Karnes County, Texas, southeast of San Antonio and home to under 15,000 residents,² sits Audioslave Well No. 102H (Audioslave well).³ The Audioslave well is the flashpoint of the *Opiela* action, but the heart of the matter is broader and more impactful. The primary dispute revolves around one issue: whether the Texas Railroad Commission, the regulatory agency responsible for overseeing the oil and gas industry,⁴ has the authority to issue allocation and production sharing agreement (PSA) permits for oil and gas wells.⁵ This Comment will provide a summary of the Railroad Commission's practices for issuing

*J.D. Candidate, 2024, Baylor University School of Law; B.S., Texas Christian University, 2020. There are several people I must thank for helping me develop this article: Professor Jessica Asbridge for serving as my faculty advisor and providing critical feedback; Jacob Davidson and William Farrar for proposing the topic as an area needing scholarship; Professor Craig Bennett for his expertise in Texas administrative law; Jeff Rees for providing valuable insight into the operator's perspective; and the *Baylor Law Review* staff. Thank you to my friends and family for your patience in listening to me discuss the joyous complexities of Texas oil and gas and administrative law. *Pro Ecclesia, Pro Texana!*

¹During the initial drafting of this comment, the Third Court of Appeals had yet to rule. Prior to publication, however, the appellate court announced its opinion. *R.R. Comm'n of Tex. v. Opiela*, 681 S.W.3d 397 (Tex. App.—Austin 2023, pet. filed). This comment has been revised to account for the Court's opinion.

²U.S. CENSUS BUREAU, *Total Population in Karnes County, Texas* (2020), <https://data.census.gov/all?q=karnes+county> (last visited Dec. 12, 2023).

³There is a common practice in Texas oil fields to name wells after rock bands. The Audioslave name is a tribute to the early-2000's rock band Audioslave. For more information on the Audioslave band, see *Audioslave*, WIKIPEDIA, <https://en.wikipedia.org/wiki/Audioslave> (last visited Feb. 6, 2024).

⁴TEX. NAT. RES. CODE ANN. § 85.201; *Texaco, Inc. v. R.R. Comm'n*, 583 S.W.2d 307, 310 (Tex. 1979).

⁵See *Opiela*, 681 S.W.3d at 400.

allocation and PSA permits for horizontal drilling across unpooled tracts. It will briefly explain the history of Texas oil and gas production with respect to allocation and PSA wells, the Railroad Commission's rule-making authority under the Texas Administrative Procedure Act, and ultimately argue for the preservation and continuance of allocation and PSA permits under the current regulatory regime.

A. Texas Oil and Gas History and the Move to Horizontal Wells

Horizontal wells are an incredible technology in the oil and gas industry. They allow producers to tap into formations once considered depleted for the continued production of oil and gas.⁶ Unsurprisingly, Texas, as a leading energy producer, was one of the first states to take significant advantage of this new technology.⁷ Beginning in the mid-2000s, operators initially used horizontal wells primarily to produce natural gas.⁸ The benefits of such wells were obvious,⁹ and horizontal wells quickly took the industry by storm. Today, thousands of horizontal wells across the state of Texas are producing massive quantities of oil and gas.¹⁰

Operators begin drilling horizontal wells in the vertical orientation, much like a traditional well.¹¹ However, horizontal wells depart from the vertical to a horizontal trajectory at a “kickoff” point.¹² From the kickoff point, the wellbore travels horizontally until it reaches the productive pay zone or target horizon.¹³ In this orientation, the wellbore can travel thousands of feet

⁶Univ. of Calgary, *Horizontal Well*, ENERGY EDUC., https://energyeducation.ca/encyclopedia/Horizontal_well (last visited Dec. 20, 2023).

⁷Gary S. Swindell, *TECHNOLOGY U.S. Horizontal Wells Show Varied Production Performance*, OIL & GAS J. (March 25, 1996), <https://www.ogj.com/home/article/17235228/technology-us-horizontal-wells-show-varied-production-performance>.

⁸See Jack Perrin, *Horizontally Drilled Wells Dominate U.S. Tight Formation Production*, TODAY IN ENERGY (June 6, 2019), <https://www.eia.gov/todayinenergy/detail.php?id=39752>.

⁹See *infra* Part VI. Briefly, some of the benefits include the more efficient capture of hydrocarbons and less waste.

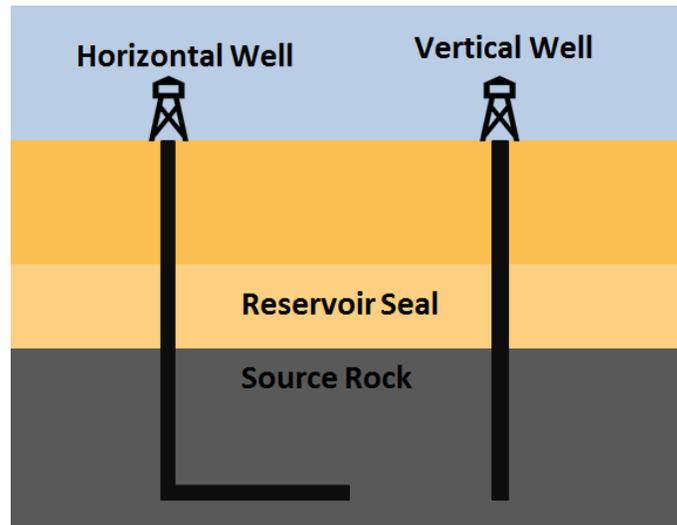
¹⁰See Perrin, *supra* note 8.

¹¹Lynn Helms, *Horizontal Drilling*, 35 DEP'T OF MIN. RES. NEWSL. (N.D. Dep't of Min. Res., Bismarck, N.D.), Jun. 2008, No. 1, at 1.

¹²See 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, 179 (2012).

¹³*Id.*

underground, crossing both lease and property lines.¹⁴ A simple diagram may provide a better visualization of the difference between horizontal and vertical wells.¹⁵



Under the umbrella of horizontal wells there are two primary subtypes for drilling on what is known as “unpooled acreage”: (1) allocation wells and (2) Production Sharing Agreement (PSA) wells.¹⁶ “Pooling” is an industry term that refers to combining multiple tracts of land from several leases for the purpose of drilling a single well where production from the single well is constructive production from every tract, and production is allocated to every tract within the pooled unit.¹⁷ Unpooled acreage, therefore, is not subject to pooling.

Allocation wells are horizontal wells that cross multiple unpooled leases when no agreement exists between royalty owners regarding production sharing.¹⁸ The Railroad Commission calls the tracts the horizontal traverses

¹⁴ *Id.*

¹⁵ Univ. of Calgary, *supra* note 6.

¹⁶ See Whitworth & McGinnis, *supra* note 122, at 210, 212–13.

¹⁷ *Hooks v. Samson Lone Star, Ltd. P’ship*, 457 S.W.3d 52, 62 (Tex. 2015); see also 1 ERNEST E. SMITH ET AL., TEXAS LAW OF OIL & GAS § 4.8 (2d ed. LexisNexis 2019) (defining pooling).

¹⁸ Clifton A. Squibb, *The Age of Allocation: The End of Pooling as We Know It?*, 45 TEX. TECH. L. REV. 929, 930 (2013).

a “developmental unit.”¹⁹ These developmental units can only include tracts where the wellbore is perforated²⁰ or from which the well is producing.²¹ Production revenues from allocation wells are allocated to each individual tract (hence the name “allocation wells”), typically in proportion to the amount of perforated lateral pipe that traverses each tract.²² PSA wells, on the other hand, are horizontal wells crossing multiple unpooled leases where at least 65% percent of the mineral and working interest owners within the developmental unit have signed an agreement as to how production revenues will be shared.²³ Because of the agreement between the mineral and working interest owners regarding the production proceeds, a PSA well does not need to be perforated on every tract of land within the developmental unit.²⁴

While the oil and gas industry adapts quickly to technological advancements, the law, on the other hand, does not. Most of the law surrounding oil and gas is designed for vertical wells, not horizontal wells.²⁵ Historically, Texas oil and gas wells were exclusively vertical wells,²⁶ largely due to the inability of 19th and 20th century technology to accommodate unconventional production.²⁷ But not all reservoirs within the state can be

¹⁹ See Tex. R.R. Comm’n, Oil & Gas Docket No. 02-0315435, Proposal for Decision, *Complaint of Elsie Opiela and Adrian Opiela regarding Magnolia Oil & Gas Operating LLC’s (521544) Audioslave A Lease, Well No. 102H, Permit No. 839487, Sugarkane (Austin Chalk) Field, Karnes County, Texas* at Findings of Fact No. 12 [hereinafter *Proposal for Decision, Audioslave A Lease*].

²⁰ A perforation is a small hole in the casing of well. These holes connect the oil reservoir to the wellbore and allow the oil to flow into the wellbore and be brought to the surface. See Melvin Devadass, *Increasing Oil Well Production by Maximizing Under-balance during Perforation*, 3M MALAYSIA (Nov. 2007), <https://multimedia.3m.com/mws/media/486234O/technical-article-increasing-oil-well-production.pdf>.

²¹ See *Proposal for Decision, Audioslave A Lease*, *supra* note 19, at Findings of Fact No. 12; see also Ernest E. Smith, *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*, 12 TEX. J. OIL GAS & ENERGY L. 1, 3 (2017).

²² Smith, *supra* note 21, at 3. As a general principle in Texas oil and gas law (and absent an agreement to the contrary, like pooling), a mineral owner is only entitled to the production coming from his or her land. Perforations allow oil and gas to flow from the reservoir into the wellbore and to the surface. If there are no perforations in the lateral drainpipe across a lessor’s tract, then the lessor’s tract is not producing oil or gas.

²³ See *Proposal for Decision, Audioslave A Lease*, *supra* note 19, at Findings of Fact No. 12.

²⁴ *Id.*

²⁵ See Whitworth & McGinnis, *supra* note 12, at 182.

²⁶ See *id.* at 179.

²⁷ See Helms, *supra* note 11, at 2.

accessed and made profitable using a vertical drilling orientation.²⁸ Today's technological advancements in downhole drilling motors, downhole telemetry equipment, and hydraulic fracturing make horizontal wells commercially feasible, thereby unlocked reservoirs across the state and making them profitable.²⁹ Horizontal wells offer amazing benefits to the oil and gas industry, lessors/landowners, and the state.³⁰

Due to their inherent differences, courts have struggled at times to apply existing law to horizontal wells. Texas courts have gone as far to say that they “decline to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells and would discourage use of this promising technology.”³¹ Some of the issues that highlight the legal difficulties posed by applying vertical-well-oriented law to horizontal wells include spacing requirements, off-lease penetration points, “stacked” lateral wells, underground trespass, and unpooled or unleased interests in the path of the wellbore.³² Many of these issues either do not exist with the exclusive use of vertical wells or the concepts and applications change drastically when applied to horizontal wells.³³

Texas landowners recently challenged the Railroad Commission, the regulatory agency charged with overseeing the Texas oil and gas industry, in relation to the Commission's current practices for approving horizontal wells. Specifically, the landowners attack the Commission's authority to issue permits for allocation and PSA wells (two similar types of horizontal wells for unpooled acreage).³⁴ The case initially began as a complaint to challenge the permitting of the Audioslave Well as an allocation well and then a PSA well, and the Travis County District Court sided with the plaintiffs, holding

²⁸ *Id.* at 180.

²⁹ See SMITH ET AL., *supra* note 17, at 1.

³⁰ See Whitworth & McGinnis, *supra* note 12, at 180.

³¹ *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied).

³² See H. Philip Whitworth, The Ctr. for Am. & Int'l L. Inst. for Energy L., Presentation for the Tex. Min. Title Course: Land and Regulatory Issues Related to Horizontal Wells (May 2–3, 2013) (available at <https://www.cailaw.org/media/files/IEL/ConferenceMaterial/2013/TexasMineralTitle/PWhitworth-ppt.pdf>).

³³ See Whitworth & McGinnis, *supra* note 12, at 182.

³⁴ See generally Brief of Appellees Elsie Opiela and Adrian Opiela, Jr., R.R. Comm'n of Tex. v. Opiela, 681 S.W.3d 397 (Tex. App.—Austin 2023, pet. filed), No. 03-21-00258-CV, 2022 WL 265589.

that the Commission did not have the authority to issue permits for allocation and PSA wells.³⁵

The Third Court of Appeals in Austin, Texas, recently announced its *Opiela* opinion. While Magnolia may have lost the battle with respect to the Audioslave Well, it seems to have largely won the war—for now. This case will almost certainly make its way to the Texas Supreme Court, and the industry is anticipating the Supreme Court’s ultimate ruling. The goal of this Comment is to lay a legal and academic framework for upholding allocation and PSA permits as a valid application of the RRC’s permitting authority.³⁶ Further, this Comment will discuss some of the policy arguments for maintaining the current permitting regime. Allocation and PSA wells are vitally important to maintaining Texas oil production as well as American energy independence. Accordingly, this Comment hopes to steer the law towards affirming and continuing these wells.³⁷

B. Obtaining a Permit to Drill Horizontal Wells

To carry out its legislative charge in regulating the oil and gas industry, the Railroad Commission requires operators to submit drilling permit applications and obtain drilling permits prior to drilling.³⁸ The Commission has established rules to guide operators in applying for the proper permits and forms to be submitted during the application process.³⁹ Depending on the type of well, attachments and other forms may be necessary.

The Commission will only deny a permit “if it does not reasonably appear to [the Commission] that the applicant has a good-faith claim in the property.”⁴⁰ Statewide Rule 15 defines the “good faith” standard for

³⁵ See *Proposal for Decision, Audioslave A Lease*, *supra* note 19; Final Judgment, *Opiela v. R.R. Comm’n of Tex.*, No. D-1-GN-20-000099 (250th Dist. Ct., Travis County, Tex. May 12, 2021), *aff’d in part rev’d in part*, 681 S.W.3d 387 (Tex. App.—Austin 2023, pet. filed).

³⁶ See *infra* Part 0I.

³⁷ If the *Opielas*’ challenge is successful, the Railroad Commission will likely need to create a new rule using the Texas APA procedures discussed below. This may force the Commission to temporarily halt the permitting of allocation and PSA wells, slowing oil and gas exploration and production across the state.

³⁸ TEX. NAT. RES. CODE ANN. §§ 81.051, 85.201, 85.202.

³⁹ E.g., Tex. R.R. Comm’n, *Oil and Gas Division Form P-16 Instructions and Guidelines for Drilling Permit Application (Form W-1)*, (June 2022), <https://www.rrc.texas.gov/media/euhpdv3v/p-16-instructions-drilling-permits.pdf> [hereinafter *Form P-16 Instructions*].

⁴⁰ *Magnolia Petroleum Co. v. R.R. Comm’n*, 170 S.W.2d 189, 191 (Tex. 1943).

evaluating and approving drilling permits.⁴¹ The definition provides that a good faith claim is “[a] factually supported claim based on a recognized legal theory to a continuing possessory right in a mineral estate, such as evidence of a currently valid oil and gas lease or a recorded deed conveying a fee interest in the mineral estate.”⁴² Notably, when evaluating drilling permits, the Commission does not evaluate an operator’s legal authority to drill or status as a true titleholder to the mineral estate.⁴³

An operator seeking to drill a well will first need to complete the online Form W-1 application.⁴⁴ If seeking to drill a horizontal well, the operator will need to designate the horizontal well as either an allocation or PSA well.⁴⁵ Upon making the required designation, the operator will then need to complete a Form P-16.⁴⁶ The progression to Form P-16 is an important part of the Railroad Commission’s argument in support of its continued ability to issue allocation and PSA well permits.

Adopted in 2011, the Commission formalized and published Form PSA-12, instructing operators to use this form when applying for allocation and PSA drilling permits.⁴⁷ Notably, Form PSA-12 underwent the notice-and-commenting rulemaking procedure pursuant to the Texas Administrative Procedure Act. In 2014, Form PSA-12 was updated to be what is now Form P-16. Within Form P-16, the Commission defines an allocation well as:

[A] horizontal wellbore crossing two or more tracts/leases and for which the operator allocates production among the tracts/leases crossed. The operator has made a good faith claim that it holds leases covering each tract included in the development[al] unit. For an allocation well to be

⁴¹ 16 TEX. ADMIN. CODE ANN. § 3.15(5) (Tex. R.R. Comm’n, Surface Equip. Removal and Inactive Wells).

⁴² *Id.*

⁴³ The Railroad Commission is not an adjudicator of legal rights.

⁴⁴ Tex. R.R. Comm’n, *Application for Permit to Drill, Recomplete or Re-Enter* (2020), <https://www.rrc.texas.gov/media/ip0mwjw0/form-w-1-instructions.pdf>.

⁴⁵ Operators seemingly tend to prefer PSA wells. However, if an operator cannot get 65% of the mineral and working interest owners to sign the production sharing agreement, then the operator will resort to the allocation well. This decision is driven by how and to whom production proceeds will be paid.

⁴⁶ *Form P-16 Instructions*, *supra* note 39, at 3.

⁴⁷ 36 Tex. Reg. 5835–36 (2011) (to be codified at 16 TEX. ADMIN. CODE § 3.80) (proposed Jun. 10, 2011) (Tex. R.R. Comm’n, Comm’n Oil and Gas Forms, Applications, and Filing Requirements).

2024]

TEXAS RRC PERMITTING AUTHORITY

163

administratively approved, the developmental unit can only include tracts where the wellbore is perforated/from which it is producing.⁴⁸

Form P-16 defines a PSA well as:

[A] horizontal wellbore crossing two or more tracts/leases and for which the operator certifies that at least 65% of the mineral and working interest owners from each tract within the developmental unit have signed an agreement as to how proceeds will be divided. The wellbore need not be perforated within each tract of the developmental unit.⁴⁹

The PSA wells have a noticeable numerical threshold requirement that must be met.⁵⁰ An operator must demonstrate that 65% of the mineral and working interest owners have signed a production sharing agreement.⁵¹ This requirement stems from a 2008 Commission instruction that having 65% of mineral and working interest owners sign a production sharing agreement constitutes a “good faith claim” to drill a PSA well.⁵²

Once the Form W-1 and Form P-16 are submitted (as well as any additional attachments), the Commission reviews the application.⁵³ Through this process, the Commission has approved and continues to approve of thousands of allocation and PSA wells.⁵⁴

C. R.R. Comm’n of Tex. & Magnolia Oil & Gas Operating, LLC v. Opiela

The Opiela action began as a challenge to Magnolia Oil & Gas Operating, LLC’s (“Magnolia”) PSA permit.⁵⁵ The Commission initially permitted the Audioslave well as an allocation well with EnerVest Operating, LLC as the

⁴⁸ *Form P-16 Instructions*, *supra* note 39, at 8.

⁴⁹ *Id.*

⁵⁰ *See id.*

⁵¹ *Id.*

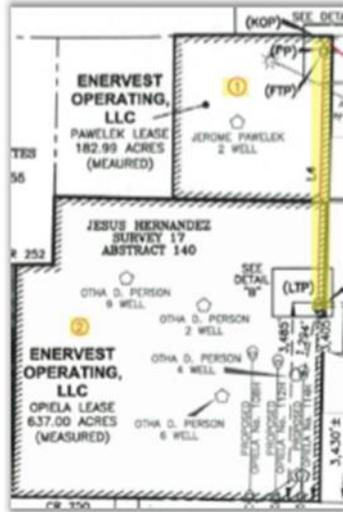
⁵² Tex. R.R. Comm’n, Formal Comm’n Actions, Hearings Div., Status #665639 (Sept. 9, 2008); *infra* note 103; *see* ERNEST E. SMITH ET AL., TEX. LAW OF OIL & GAS, § 4.5(D) (2d ed. LexisNexis 2010).

⁵³ Tex. R.R. Comm’n, *Drilling Permits (W-1): Online Filing User Guide*, at 73, (June 2022), <https://www.rrc.texas.gov/media/qgmhxxex/dpmanual.pdf>.

⁵⁴ *Proposal for Decision, Audioslave A Lease*, *supra* note 19, at 11.

⁵⁵ R.R. Comm’n of Tex. v. Opiela, 681 S.W.3d 397, 403 (Tex. App.—Austin 2023, pet. filed).

operator.⁵⁶ EnerVest submitted a plat (shown below)⁵⁷ with its permit application, and the plat showed the wellbore crossing three adjacent tracts—the Pawelek tract, a highway tract, and the Opiela tract (called the “Person tract” in the Commission hearing).⁵⁸ The well sits on the surface of the Pawelek tract, runs across the highway tract, and is bottomed on the Opiela



tract.⁵⁹ Elsie Opiela and Adrian Opiela, Jr. own mineral interests in the Opiela tract, and their interests are subject to an oil and gas lease of which they are the lessors and (at the time) EnerVest was the lessee.⁶⁰

After drilling operations began, EnerVest transferred its interest to Magnolia Oil & Gas Operating, LLC.⁶¹ The Audioslave well met the criteria necessary to be permitted for either an allocation or PSA well, and, in 2018, Magnolia amended the permit to a PSA well upon obtaining signatures of over 65% of the royalty owners for various forms of production agreements.⁶²

⁵⁶ Appellant’s Brief of Magnolia Oil & Gas Operating LLC at 16, R.R. Comm’n of Tex. v. Opiela, 681 S.W.3d 397 (Tex. App.—Austin 2023, pet. filed) (No. 03-21-00258-CV), 2021 WL 4150835.

⁵⁷ *Proposal for Decision, Audioslave A Lease*, supra note 19, at 6.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ Tex. R.R. Comm’n, Oil & Gas Docket No. 02-0315435, *Prehearing Conf. Tr.*, 24:16–25, Dec. 10, 2018.

⁶¹ *Id.*

⁶² *Proposal for Decision, Audioslave A Lease*, supra note 19, at 3–5.

2024]

TEXAS RRC PERMITTING AUTHORITY

165

The Commission granted Magnolia's amended permit, making the Audioslave well a PSA well.⁶³

The Opielas own 25% of the royalty from all oil and gas produced from their tract of land.⁶⁴ They filed a complaint with the Railroad Commission seeking to divest Magnolia of the amended PSA permit for the Audioslave well, arguing that Magnolia did not have a good faith claim to operate the well.⁶⁵ The Commission, through the Texas administrative contested case procedure, heard the case, and an Administrative Law Judge found that Magnolia had a good faith claim to operate the well, ultimately recommending the denial of the Opielas' complaint in a Proposal for Decision (PFD).⁶⁶ The Commission then issued a Final Order that adopted the PFD.⁶⁷

The Opielas then appealed the Final Order to the Travis County District Court.⁶⁸ Rather than solely attacking the Audioslave well or the Audioslave's PSA permit, the Opielas took an entirely different approach. The Opielas argued that the Railroad Commission wholly lacked the authority to issue allocation and PSA permits at all.⁶⁹ The district court agreed with the Opielas, rendered a judgment that reversed the Commission's Final Order, and determined that the Commission did not have the authority to issue allocation and PSA permits in the first place.⁷⁰

Magnolia and the Railroad Commission appealed.⁷¹ On appeal, the Third Court of Appeals affirmed in part, reversed in part, and remanded the case to the Commission for further proceedings.⁷² While the appellate court determined that Magnolia had not satisfied its good faith requirement to drill

⁶³ *Id.* at 5.

⁶⁴ *Id.* at 7.

⁶⁵ *Id.* at 3.

⁶⁶ *Id.* at 14.

⁶⁷ See Tex. R.R. Comm'n, Oil & Gas Docket No. 02-0315435, Final Order, *Complaint of Elsie Opiela and Adrian Opiela Regarding Magnolia Oil & Gas Operating LLC's (521544) Audioslave A Lease, Well No. 102H, Permit No. 839487, Sugarkane (Austin Chalk) Field, Karnes County, Texas*, (Oct. 1, 2019).

⁶⁸ See Final Judgment, *Opiela v. R.R. Comm'n of Tex.*, No. D-1-GN-20-000099 (250th Dist. Ct., Travis Cnty., Tex. May 12, 2021), *aff'd in part rev'd in part*, 681 S.W.3d 397 (Tex. App.—Austin 2023, pet. filed).

⁶⁹ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 18.

⁷⁰ Final Judgment, *supra* note 68, at 2.

⁷¹ *Opiela*, 681 S.W.3d at 397.

⁷² *Id.* at 401.

the Audioslave well,⁷³ the Court held that production under a PSA is not the same as pooling.⁷⁴ Further, the Court reaffirmed existing Texas law, making clear that the Commission is not an arbiter of rights under a lease.⁷⁵ Most importantly to the Opielas, the Court passed on the issue of compliance with the APA.⁷⁶

The Opielas have recently appealed their case to the Supreme Court of Texas.⁷⁷ While the Supreme Court has yet to rule on the Opielas' Petition for Review, industry players are expecting this case to ultimately be decided by the Texas Supreme Court. Due to the far-reaching implications of the case, the industry, its allies, and its opponents will all be watching this case closely.

II. IS THE UPDATE TO FORM P-16 A NEW RULE?

The Railroad Commission has exercised jurisdiction and its authority to permit unpooled horizontal wells for over a decade.⁷⁸ However, the Travis County district court found that, “[t]he Commission erred in adopting rules for allocation and Production Sharing Agreement (“PSA”) well permits without complying with the requirements of the Administrative Procedure Act, Tex. Gov’t Code § 2001.001 et seq., and further erred in applying those rules by issuing well permits for the Audioslave A 102H Well (the “Audioslave Well”).”⁷⁹ This decision requires the assumption that the Commission issued new rules for allocation and PSA well permits.⁸⁰ However, as Magnolia and others argued, the Commission was authorized to grant allocation and PSA permits under the existing statutory framework.⁸¹ This section will describe the arguments made by the parties in favor of the Commission’s authority to permit allocation and PSA wells.

⁷³ *Id.* at 408, 414.

⁷⁴ *Id.* at 409.

⁷⁵ *Id.* at 409–10.

⁷⁶ *Id.* at 410–11.

⁷⁷ The Opielas filed their Petition for Review on November 22, 2023. Pet. for Review of Elise Opiela and Adrian Opiela, Jr., *Opiela v. R.R. Comm’n of Tex.*, No. 23-0772 (Tex. 2023).

⁷⁸ See Squibb, *supra* note 18, at 940.

⁷⁹ Final Judgment, *supra* note 68, at 2.

⁸⁰ *Opiela*, 681 S.W.3d at 400–01.

⁸¹ *Id.*

A. Rulemaking Under the Texas Administrative Procedure Act

The Texas Legislature has granted the Railroad Commission broad authority over all of the oil and gas wells in Texas,⁸² including the authority to issue drilling permits.⁸³ The Commission also has the implied authority to create policy and offer guidance to the oil and gas community.⁸⁴ As Magnolia noted in its Brief to the Third Court of Appeals, the Commission's broad authority is not limited to any particular type of well.⁸⁵ Rather, the Commission's oversight applies to the entire industry and the "ever-changing drilling landscape."⁸⁶ Texas courts have repeatedly recognized the discretion provided to agencies such as the Commission in carrying out their regulatory functions.⁸⁷ In accordance with this authority, the Commission has promulgated a variety of rules, procedures, and forms necessary to guide the oil and gas permitting process.⁸⁸ To aid in the debate as to whether Form P-16 constitutes a "rule," it is important to understand Form P-16's development and statutory undergirding.⁸⁹

To adopt a rule, the Texas Administrative Procedure Act imposes several requirements on state agencies. First, the agency must give notice of a proposed rule, and this notice must be filed with the Secretary of State and published in the *Texas Register*.⁹⁰ Upon publication, state agencies must give the public the opportunity to comment orally or in writing, and the state agencies are required to consider such comments.⁹¹ The agencies are then required to adopt the proposed rule using an order and then file the adopted

⁸²TEX. NAT. RES. CODE ANN. § 81.05.

⁸³*Id.* §§ 85.201, 85.202(a)(3).

⁸⁴See *Seagull Energy, E&P, Inc. v. R.R. Comm'n of Tex.*, 99 S.W.3d 232, 237 (Tex. App.—Austin 2003, pet. granted), *aff'd*, *Seagull Energy E&P, Inc. v. R.R. Comm'n of Tex.*, 226 S.W.3d 383 (Tex. 2007).

⁸⁵Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 22.

⁸⁶*Id.*

⁸⁷See *Reliant Energy, Inc. v. Pub. Util. Comm'n*, 153 S.W.3d 174, 189 (Tex. App.—Austin 2004, pet. denied) (quoting *City of Corpus Christi v. Pub. Util. Comm'n*, 572 S.W.2d 290, 297 (Tex. 1978)) ("An administrative agency is created to centralize expertise in a certain regulatory area and, thus, is to be given a large degree of latitude by the courts in the methods by which it accomplishes its regulatory function.").

⁸⁸See *About Us*, R.R. COMM'N OF TEX., <https://www.rrc.texas.gov/about-us/> (last visited Dec. 19, 2023); 16 TEX. ADMIN. CODE § 1.201.

⁸⁹Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 3.

⁹⁰TEX. GOV'T CODE ANN. § 2001.023.

⁹¹*Id.* § 2001.029.

rule with the Secretary of State to have it take effect.⁹² This process is generally referred to as “notice-and-comment” rulemaking. Agency rules that fail to comply with these requirements are voidable.⁹³

Created in 1976, Statewide Rule 5 is the Commission’s principle permitting rule for all applicants who want to drill, deepen, re-enter, or plug wells.⁹⁴ Generally speaking, Rule 5 establishes the procedure and standard for obtaining drilling permits. When an operator wants to apply for a permit to drill a well under Rule 5, the operator must first submit a Form W-1.⁹⁵ If the operator is applying for an allocation or PSA well, such a designation must be indicated on the Form W-1. Rule 5 also grants the Commission the requisite authority to issue “forms” to assist operators in obtaining drilling permits, noting that applicants are required to provide “any relevant information, form or certification required by the Railroad Commission.”⁹⁶ The adoption of Rule 5 complied with the Texas APA’s notice-and-comment procedure.⁹⁷ Since its adoption, Rule 5 has been the primary Rule under which Texas operators have applied for and received drilling permits for oil and gas wells.⁹⁸

Statewide Rule 86 applies specifically to “Horizontal Drainhole Wells.”⁹⁹ Similar to Rule 5, the Commission implemented Rule 86 through the Texas APA’s notice-and-comment procedure.¹⁰⁰ Substantively, Rule 86 sets the basic parameters an operator must abide by when drilling a horizontal well. Together, Rule 5 and Rule 86 work in tandem to allow the Commission to issue drilling permits for horizontal wells and mandate that operators submit Commission-created forms when applying for drilling permits. For years, the

⁹² *Id.* §§ 2001.033, 2001.036.

⁹³ *Id.* § 2001.035(a).

⁹⁴ 16 TEX. ADMIN. CODE ANN. § 3.5 (Tex. R.R. Comm’n, Application To Drill, Deepen, Reenter, or Plug Back).

⁹⁵ Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 11.

⁹⁶ 16 TEX. ADMIN. CODE § 3.5(a) (Tex. R.R. Comm’n, Application To Drill, Deepen, Reenter, or Plug Back).

⁹⁷ 8 Tex. Reg. 3184, 3184 (1983) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.5) (Tex. R.R. Comm’n, Application To Drill, Deepen, Reenter, or Plug Back).

⁹⁸ Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 23.

⁹⁹ 16 TEX. ADMIN. CODE § 3.86 (Tex. R.R. Comm’n, Horizontal Drainhole Wells).

¹⁰⁰ 15 Tex. Reg. 2635, 2635 (1990) (to be codified at 16 TEX. ADMIN. CODE § 3.11) (R.R. Comm’n of Tex., Inclination and Directional Surveys Required).

Railroad Commission has issued permits for allocation and PSA wells pursuant to Rules 5 and 86.¹⁰¹

An operator wanting to drill a horizontal well was originally required to submit a Form PSA-12 as an attachment.¹⁰² Form PSA-12 is the predecessor to Form P-16 that Magnolia used to amend the Audioslave's permit.¹⁰³ The original Form PSA-12 was adopted through the Texas APA's notice-and-comment process.¹⁰⁴ The Commission adopted Form PSA-12 in September 2011 so that an operator could submit data to support an application for a well on a tract covered by a production sharing agreement.¹⁰⁵ Accordingly, there has been an APA-compliant procedure in place for permitting allocation and PSA wells for over a decade.¹⁰⁶

Having created this regulatory procedure, the Commission integrated these forms with the "rules and orders . . . for the drilling of wells."¹⁰⁷ Combined with the common-law-like precedential value of *Klotzman*, where the Commission upheld its ability to permit allocation wells upon an operator's good faith showing, allocation and PSA wells have been entrenched within the "rules and order . . . for the drilling of [horizontal] wells" for twelve years.¹⁰⁸ Following its common-law-style precedent that stems from the agency's adjudicatory function, the Commission has repeatedly applied *Klotzman* to subsequent allocation permit challenges.¹⁰⁹

Notably, however, the landscape over which the Railroad Commission amends its forms changed drastically with the adoption of Statewide Rule 80. Rule 80, like the Rules mentioned above, was adopted through the Texas

¹⁰¹ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 24.

¹⁰² *Id.* at 12, 24.

¹⁰³ *Id.* at 24.

¹⁰⁴ 36 Tex. Reg. 5835, 5835–36 (2011) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.80) (R.R. Comm'n of Tex., Comm'n Oil and Gas Forms, Applications, and Filing Requirements).

¹⁰⁵ *Id.* at 5837.

¹⁰⁶ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 24.

¹⁰⁷ TEX. NAT. RES. CODE ANN. § 85.202(a)(3).

¹⁰⁸ See R.R. Comm'n of Tex. v. Lone Star Gas Co., 844 S.W.2d 679, 688 (Tex. 1992) ("[T]he legislature created a 'dual' system of oil and natural gas regulation in which the [Railroad] Commission possesses both rulemaking and adjudicatory powers."); see 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*, Docket No. 02-0278952 (Oil & Gas Div. Sept. 24, 2013) (final order) [hereinafter "*Klotzman*"].

¹⁰⁹ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 25 n.17.

APA notice-and-comment process.¹¹⁰ However, Rule 80(a) modified the requirements for amending drilling permit application forms.¹¹¹ Rather than going through the formal notice-and-comment process for each form amendment, Rule 80(a) provided an avenue through which that the Commission may amend forms (and only forms) through posting the proposed revisions on the Commission's website, a mandatory public review and comment period, and publication upon an affirmative vote at an open Commission meeting.¹¹²

Using this modified and streamlined procedure, the Commission replaced Form PSA-12 with Form P-16 in 2014.¹¹³ Both PSA-12 and P-16 required an applicant to provide the information necessary to determine the appropriateness of allocation and PSA wells. However, P-16 was an optional attachment used to designate acreage until a 2016 amendment to Rule 40 (governing horizontal wells) made P-16 mandatory.¹¹⁴ This amendment was largely due to the expansion of unconventional fracture fields¹¹⁵ and the Commission's need to adjust the requirements for drilling horizontal wells.

When Rule 40 was amended to require P-16, Form P-16 was concurrently amended to be more fulsome in accordance with Rule 80's streamlined notice-and-comment process.¹¹⁶ Again, in 2019, the Commission amended P-16 to provide more guidance on allocation and PSA wells.¹¹⁷ Today, the 2019 version of P-16 is used by the Commission. In order to receive the requisite permit to drill an allocation or PSA well, today's operator must submit both the Form P-16 and the basic Form W-1.¹¹⁸

¹¹⁰39 Tex. Reg. 5148, 5184 (2014) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.80) (R.R. Comm'n of Tex., Comm'n Oil and Gas Forms, Applications, and Filing Requirements).

¹¹¹*Id.*

¹¹²*Id.*

¹¹³*Id.*

¹¹⁴16 TEX. ADMIN. CODE § 3.40(i) (R.R. Comm'n of Tex., Assignment of Acreage to Pooled Dev. and Proration Units).

¹¹⁵An unconventional fracture field is a field where horizontal drilling and hydraulic fracturing must be used to recover oil, gas, and other minerals from all or part of the field. 16 TEX. ADMIN. CODE § 3.86(a)(13) (R.R. Comm'n of Tex., Horizontal Drainhole Wells).

¹¹⁶Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 27.

¹¹⁷*Id.* at 28.

¹¹⁸*Id.* at 13.

B. The Railroad Commission's Position

The Railroad Commission, Magnolia, and their supporters argue that the updates to Form P-16 are not a rule subject to the Texas APA.¹¹⁹ They argue further that if the additions to Form P-16 constitute a rule, then the additions are a valid rule through either substantial compliance with the APA or ad hoc rulemaking.¹²⁰ At its core, Form P-16 is nothing more than the mere progression of the Railroad Commission's pre-existing authority to issue drilling permits under Texas law.¹²¹ Combining its "rule and order" authority¹²² and precedential value of prior contested case decisions, nothing about P-16 suggests that revising and requiring the form constitutes a violation of the Texas APA.

First, Rule 80, which describes the process used to modify P-16, was adopted through the APA's formal rulemaking requirements (i.e., notice-and-comment).¹²³ Further, even if the amendments to P-16 *look* like a rule, the Texas APA merely requires substantial compliance with the formal rulemaking procedures.¹²⁴ The substantial compliance standard requires simple compliance with the "essential" requirements of the APA.¹²⁵ Pulling from Baylor Law School Professor Emeritus Ron Beal,¹²⁶ the Third Court

¹¹⁹ See Brief for Commission at 42, R.R. Comm'n v. Opiela, No. 03-21-00258-CV (Tex. App.—Austin 2022); Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 3; Brief for Pioneer at 14, R.R. Comm'n v. Opiela, No. 03-21-00258-CV (Tex. App.—Austin 2022).

¹²⁰ See Brief for Commission, *supra* note 119, at 55; Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 38; Brief for Pioneer, *supra* note 119, at 14; Brief for Permian Basin Petroleum Association at 18, R.R. Comm'n v. Opiela, No. 03-21-00258-CV (Tex. App.—Austin 2022).

¹²¹ TEX. NAT. RES. CODE ANN. § 81.051.

¹²² This refers specifically to the Commission's authority to make rules and issue orders. See, e.g., 16 TEX. ADMIN. CODE §§ 3.5, 3.40, 3.86.

¹²³ 26 Tex. Reg. 4088, 4089 (2001) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.80) (R.R. Comm'n of Tex., Comm'n Oil and Gas Forms, Applications, and Filing Requirements).

¹²⁴ TEX. GOV'T CODE ANN. § 2001.035(a).

¹²⁵ *Methodist Hosps. of Dallas v. Tex. Indus. Acc. Bd.*, 798 S.W.2d 651, 654 (Tex. App.—Austin 1990, writ dismissed d.w.o.j.), *superseded by statute*, TEX. GOV'T CODE ANN. § 2001.039, *as recognized in Patient Advocates of Tex. v. Tex. Workers Comp. Comm'n*, 80 S.W.3d 66 (Tex. App.—Austin, 2002), *aff'd in part rev'd in part*, 136 S.W.3d 643 (Tex. 2004).

¹²⁶ Professor Beal is a long-time professor of Texas Administrative Law and an expert in the field. He filed several briefs in *Opiela* as amicus curie on behalf of the Opielas. However, Professor Craig Bennett, also a Texas Administrative Law professor at Baylor Law School and subject-matter expert, authored an opposing amicus brief on behalf of the Permian Basin Petroleum Association.

created a two-pronged test for substantial compliance: the agency action that attempts to comply with the Texas APA must “(1) secure the legislative objectives that underlie the [statutory] requirement and (2) come fairly within the character and scope of each action or thing explicitly required by the statute in terms that are concise, specific, and unambiguous.”¹²⁷

Here, the Commission published the proposed change to P-16 on its website, held a public review and comment period, and published P-16 upon the affirmative vote of the Commission at an open meeting.¹²⁸ This process tracks directly with the formal rulemaking process, albeit more streamlined (rather than being published in the *Texas Register*, the proposal was placed on the Commission’s website). The procedure followed by the Commission effectively ensured that the public and affected parties had the opportunity to voice critiques of P-16’s updates.¹²⁹ The Commission then responded to the comments in an open meeting, much like it would have done if attempting to promulgate a formal rule.¹³⁰ Therefore, the Commission secured the legislative objectives behind the Texas APA’s formal rulemaking requirements and acted within the scope of the statutory requirements. Accordingly, the Commission complied with the “essential” requirements of the Texas APA, satisfying the substantial compliance test.¹³¹

Further, the Texas legislature has expressly stated that “mere technical defects that [do] not . . . prejudice a person’s rights or privileges [are] not grounds for invalidation of a rule.”¹³² But again, the current version of P-16

Professor Bennett’s brief conceded that P-16 and the 65% requirement are rules but argued that they are still *valid* rules through ad hoc rulemaking.

¹²⁷*Methodist Hosps.*, 798 S.W.2d at 654 (citing Ron Beal, *The Scope of Judicial Review of Agency Rulemaking: The Interrelationship of Legislating and Rulemaking in Texas*, 39 BAYLOR L. REV. 597, 646–47 (1987)).

¹²⁸41 Tex. Reg. 785, 787 (2016) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.40) (R.R. Comm’n of Tex., Assignment of Acreage to Pooled Dev. and Proration Units).

¹²⁹*Id.*; Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 566, at 27.

¹³⁰*See* 41 Tex. Reg. 785, 787 (2016) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.40) (R.R. Comm’n of Tex.); Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 566, at 27.

¹³¹*See Methodist Hosps.*, 798 S.W.2d at 654 (citing *Santos v. Guerra*, 570 S.W.2d 437, 440 (Tex. App.—San Antonio, 1978, writ ref’d n.r.e.); *Wentworth v. Medellin*, 529 S.W.2d 125, 128 (Tex. App.—San Antonio, 1975, no writ); *Fitzgibbons v. Galveston Electric Co.*, 136 S.W. 1186, 1187 (Tex. App. 1911, no writ); *Nat’l Ass’n of Indep. Insurers v. Texas Dep’t of Ins.*, 888 S.W.2d 198, 210 (Tex. App.—Austin 1994), *rev’d on other grounds*, 925 S.W.2d 667 (Tex. 1996).

¹³²TEX. GOV’T CODE ANN. § 2001.035(d).

2024]

TEXAS RRC PERMITTING AUTHORITY

173

is not a new rule.¹³³ The Commission had no need to create a new rule in order to issue allocation and PSA wells as it already had the authority to do so.¹³⁴ Accordingly, there was no need to follow the APA's formal rulemaking procedure to update the form. As Magnolia pointed out in its Brief, PSA-12 was originally adopted through formal rulemaking, the form amendment process (Rule 80) was adopted through formal rulemaking, and making P-16 mandatory (Rule 40) was adopted through formal rulemaking.¹³⁵ Only the amendments to the current form were not subject to the formal rulemaking process.¹³⁶ But these amendments were still subject to Rule 80's publication, comment, and public vote requirements. Accordingly, even if the updates to P-16 constitute a new rule, the Commission's actions did not prejudice the rights or privileges of the regulated community. Therefore, the updates to P-16, if a rule at all, would be a valid rule.¹³⁷

In both their brief to the Third Court of Appeals and Petition for Review to the Supreme Court, the Opielas' contentions zeroed-in on the definitions of "allocation" and "PSA wells" provided by Form P-16.¹³⁸ The Opielas contend that the requirements for obtaining either an allocation or PSA well permit constitutes a rule that is not exempt from the notice-and-comment requirements of the Texas APA and is therefore invalidly adopted.¹³⁹ Specifically, they challenge the 65% threshold requirement for PSA wells and the good faith standard's lack of pooling authority consideration for allocation wells.¹⁴⁰

The Opielas point to the Texas APA's definition of "rule" and assert that the Commission's utilization of allocation and PSA wells constitute an agency rule. The Texas APA expressly defines what a "rule" is in Texas Government Code § 2001.003(6):

(A) a state agency statement of general applicability that

¹³³ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 30.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *See id.*

¹³⁷ *See* Off. of Pub. Util. Couns. v. P.U.C. of Tex., 104 S.W.3d 225, 235 (Tex. App.—Austin 2003, no pet.).

¹³⁸ *See* Brief for Opielas at 25–32, R.R. Comm'n v. Opiela, No. 03-21-00258-CV (Tex. App.—Austin 2022); Pet. for Review at 19–27, Opiela v. R.R. Comm'n, No. 23-0772 (Tex. 2023).

¹³⁹ *See* Brief for Opielas, *supra* note 138, at 25–42; Pet. for Review, *supra* note 1388, at 19–28.

¹⁴⁰ *See* Brief for Opielas, *supra* note 1388, at 27–28; Pet. for Review, *supra* note 1388, at 19–31.

- i. implements, interprets, or prescribes law or policy; or
- ii. describes the procedure or practice requirements of a state agency;

(B) includes the amendment or repeal of a prior rule; and

(C) does not include a statement regarding only the internal management or organization of a state agency and not affecting private rights or procedures.¹⁴¹

For allocation and PSA wells, the Opielas argue, “[t]he Commission’s policies . . . meet this broad definition [because] [t]he policies are of ‘general applicability . . .’”¹⁴² Certainly, the Commission considers drilling permit applications daily and imposes these requirements of all applicants, making the requirements generally applicable.¹⁴³ But Texas courts have repeatedly held that not all agency actions or statements are rules.¹⁴⁴ In *Teladoc, Inc. v. Texas Medical Board*, the Third Court of Appeals held that the Texas Legislature intentionally defined “rule” narrowly, such that it “exclude[s] . . . unofficial, individually directed, tentative, or other non-proscriptive agency or staff issuances concerning law or policy.”¹⁴⁵ Observing the policy implications of a rule to the contrary, the appellate court stated that, “[A]gencies would be reduced to impotence . . . if bound to express their views as to ‘law,’ ‘policy,’ and procedural ‘requirements’ through contested-case hearings or formal rules exclusively; and they could not under such a theory exercise powers explicitly delegated to them by the [L]egislature.”¹⁴⁶

To accompany the idea that not every statement by an agency constitutes a rule, or, more precisely, a *new* rule, the Third Court of Appeals has also held that the mere restatement of a pre-existing rule is not in and of itself a new rule under the APA.¹⁴⁷ To be eligible for a drilling permit, an operator

¹⁴¹TEX. GOV’T CODE ANN. § 2001.003(6).

¹⁴²Brief for Opielas, *supra* note 138, at 27; *see also* Pet. for Review, *supra* note 138, at 19 (calling the threshold requirement “the 65% Rule”).

¹⁴³*Id.*; Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 56, at 15.

¹⁴⁴*See* *Tex. Educ. Agency v. Leeper*, 893 S.W.2d 432, 443 (Tex. 1994); *Tex. Dep’t of Pub. Safety v. Salazar*, 304 S.W.3d 896, 904 (Tex. App.—Austin 2009, no pet.); *Brinkley v. Tex. Lottery Comm’n*, 986 S.W.2d 764, 769 (Tex. App.—Austin 1999, no pet.).

¹⁴⁵453 S.W.3d 606, 621–22 (Tex. App.—Austin 2014, pet. denied).

¹⁴⁶*Id.* at 621 (citing *Brinkley*, 986 S.W.2d at 769).

¹⁴⁷*Tex. Dep’t of Transp. v. Sunset Transp., Inc.*, 357 S.W.3d 691, 704 (Tex. App.—Austin 2011, no pet.).

must have a good faith claim to drill the well.¹⁴⁸ This requirement was expressly established in the 1934 landmark case of *Magnolia Petroleum*, and the Texas Supreme Court determined that the Commission does not need to adjudicate the actual legal rights of an operator to drill a well when determining whether a good faith claim exists.¹⁴⁹ Contrary to the Opielas' claim, the Commission's decision to forego determining an operator's legal pooling rights for the application of an allocation well is thus not a new rule subject to the notice-and-comment requirements.

Being that the Commission does not assess an operator's legal claims regarding title, the Commission determines the non-title criteria necessary to reach the good faith standard.¹⁵⁰ Relating to PSA wells, the Commission set the threshold at 65% of the mineral and working interest owners.¹⁵¹ This serves two primary purposes. First, it guarantees that a majority of the mineral and working interest owners agree to the terms of the production sharing agreement.¹⁵² Second, it prevents a minority interest holder from hindering the development of profitable reservoirs and from thwarting the rights of the majority.¹⁵³

The 65% threshold has become the standard for establishing a good faith claim to drill a PSA well.¹⁵⁴ Establishing the criteria necessary to demonstrate a good faith claim is left solely to the discretion and expertise of the Railroad Commission. The Commission argues that there is no formal rulemaking required for establishing these criteria.¹⁵⁵ As *Magnolia* noted, "[t]o require the agency charged with applying a good faith standard to conduct notice-and-comment rulemaking each and every time it exercises its discretion in

¹⁴⁸TEX. NAT. RES. CODE ANN. § 89.002(11); 16 TEX. ADMIN. CODE § 3.15(1)(5); *see Magnolia Petroleum Co. v. R.R. Comm'n of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943).

¹⁴⁹*Magnolia Petroleum Co.*, 170 S.W.2d at 191.

¹⁵⁰*Id.*

¹⁵¹In 2008, Devon Energy applied for a PSA well permit. Having production sharing agreements from less than 90% of the mineral and working interest owners, the Commissioners voted in an open meeting to approve the permit (indicating that Devon had satisfied the good faith requirement). The Commissioners directed staff to approve applications for PSA well permits when the traditional criteria are satisfied and the operator certifies that at least 65% of the mineral and working interest owners in each component tract have signed the agreement. *Tex. R.R., Comm'n, supra* note 52, at 3.

¹⁵²*See* Brief of Appellant R.R. Comm'n of Tex., *supra* note 119, at 33–34.

¹⁵³Appellant's Brief of *Magnolia Oil & Gas Operating LLC, supra* note 56, at 35.

¹⁵⁴*Id.* at 14–15.

¹⁵⁵*Id.* at 35.

furtherance of its statutory mandate would paralyze the regulatory process.”¹⁵⁶

When considering the substantive makeup of Form P-16, the Opielas’ contentions that the contents of Form P-16 constitute a rule seems to miss the forest for the trees. The instructions accompanying Form P-16 include definitions for different types of wells and information for obtaining permits (a screenshot of the relevant part of the P-16 instructions can be seen below).¹⁵⁷ The definitions and information provided within the Form are merely designed to help operators in the permitting process.¹⁵⁸ The actual information is not a rule. To the contrary, the information provided simply helps the public comply with the Commission’s already-adopted rules for obtaining drilling permits.

**FORM P-16 INSTRUCTIONS
FOR DRILLING PERMIT APPLICATION**

**REFERENCE: STATEWIDE RULES 38, 40 & 86
REV 06/2022**

ALLOC. (ALLOCATION WELLBORE): For purposes of this document, a horizontal wellbore crossing two or more tracts/leases and for which the operator allocates production among the tracts/leases crossed. The operator has made a good faith claim that it holds leases covering each tract included in the developmental unit. For an allocation well to be administratively approved, the developmental unit can only include tracts where the wellbore is perforated/from which it is producing.

PSA (PRODUCTION SHARING AGREEMENT WELLBORE): For purposes of this document, a horizontal wellbore crossing two or more tracts/leases and for which the operator certifies that at least 65% of the MINERAL and WORKING interest owners from each tract within the developmental unit have signed an agreement as to how proceeds will be divided. The wellbore need not be perforated within each tract of the developmental unit.

The allocation and PSA permitting regime merely restates decades-old law. The components of Form P-16 have all been approved through the APA’s notice-and-comment requirements.¹⁵⁹ The definition of a PSA well, including the 65% threshold, does not negate the Commission’s authority to grant PSA and allocation well permits.¹⁶⁰ Accordingly, the Commission and Magnolia both argue that the current version of Form P-16 is not a rule under the Texas APA.¹⁶¹

¹⁵⁶ *Id.*

¹⁵⁷ R.R. COMM’N OF TEX., FORM P-16 INSTRUCTIONS & GUIDELINES 8 (2022).

¹⁵⁸ *Id.* at 2.

¹⁵⁹ 1 Tex. Reg. 785, 787 (2016) (to be codified as an amendment to 16 TEX. ADMIN. CODE § 3.40) (R.R. Comm’n of Tex.).

¹⁶⁰ See 2 ERNEST E. SMITH & JACQUELINE LANG WEAVER, TEXAS LAW OF OIL AND GAS, § 11.4(b) (2d Ed. LexisNexis 2020) (detailing the “informal” 65% threshold for PSA developmental unitization as “not a statutory requirement for Commission approval”).

¹⁶¹ Appellant’s Brief of Magnolia Oil & Gas Operating LLC, *supra* note 19, at 35; Brief of Appellant R.R. Comm’n of Tex., *supra* note 119, at 42.

C. The 65% Threshold's Likely Categorization

To their credit, the Opielas are likely correct that the Commission's development of the 65% threshold for PSA wells constitutes a rule under the Texas APA.¹⁶² After the 2008 Devon Energy PSA permit application,¹⁶³ all operators are subject to the 65% threshold.¹⁶⁴ The generally applicable 65% threshold interprets law and implements the policy of the state,¹⁶⁵ fitting squarely within the definition of a rule under Texas Government Code § 2001.003.¹⁶⁶ Accordingly, the 65% threshold, absent a very limited exception,¹⁶⁷ is subject to the APA's notice-and-comment process.

Further, the strict threshold and its rigid application is not a mere restatement of prior Commission rules. To be a restatement of an existing rule such that a new statement need not go through the APA notice-and-comment process, a new statement must track the language of the pre-existing rule.¹⁶⁸ Rules 5 and 86, discussed above and on which the Commission relies, fail to mention a numeric threshold of consenting mineral and working owners for permitting a PSA well.¹⁶⁹ Therefore, the Supreme Court will likely rule that the 65% threshold is a rule.

Though the parties "extensively argued" this issue, the Third Court of Appeals did not expressly opine as to whether the 65% threshold constituted a rule.¹⁷⁰ Finding that the issues of whether the threshold constitutes a rule and, if so, whether it is a valid rule were not necessary to the final disposition of the case, the Court of Appeals declined to resolve such questions.¹⁷¹ Because the Opielas' Petition for Review narrowed the points on appeal to

¹⁶² See TEX. GOV'T CODE ANN. § 2001.003(6)(a).

¹⁶³ See Tex. R.R. Comm'n, *supra* note 52.

¹⁶⁴ Appellant's Brief of Magnolia Oil & Gas Operating LLC, *supra* note 566, at 14.

¹⁶⁵ Namely, 65% consent by mineral and working interest owners is needed (in addition to the other criteria) to establish a good faith claim to drill a PSA well.

¹⁶⁶ TEX. GOV'T CODE ANN. § 2001.003(6)(a).

¹⁶⁷ The limited exception is the ad hoc rulemaking exception. See *infra* Part III(A)(3).

¹⁶⁸ See Tex. Dep't of Transp. v. Sunset Transp., Inc., 357 S.W.3d 691, 704 (Tex. App.—Austin 2011, no pet.).

¹⁶⁹ See 16 TEX. ADMIN. CODE §§ 3.5, 3.86 (Tex. R.R. Comm'n, Application To Drill, Deepen, Reenter, or Plug Back & Horizontal Drainhole Wells).

¹⁷⁰ R.R. Comm'n v. Opiela, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726, at *26 (Tex. App.—Austin June 30, 2023, pet. filed).

¹⁷¹ *Id.*; TEX. R. APP. P. 47.1.

pooling and rulemaking, the Supreme Court will likely have to address whether the 65% requirement constitutes a rule.¹⁷²

D. Utilizing the Ad Hoc Rulemaking Exception

The ad hoc rulemaking exception allows an agency to use its adjudicatory function to issue common-law style precedents as valid rules rather than follow the formal rulemaking procedures of the Texas APA.¹⁷³ Because of the Commission's ability to hear contested cases concerning horizontal wells and the increased technological progression of horizontal wells that are incompatible with vertical well regulations, the Commission is able to take advantage of the ad hoc rulemaking exception and apply it to horizontal well permitting.

Ad hoc rulemaking is quite simple. In the context of contested case proceedings, agencies may formulate and enforce a general requirement through a decision in a particular case and then, using principles of stare decisis, apply the ruling to all other cases going forward.¹⁷⁴ As Professor Beal wrote, ad hoc rulemaking allows an "agency . . . [to] wholly forego substantially complying with the notice and comment procedure set forth in the APA and exclusively utilize the mandated contested case procedures."¹⁷⁵

The United States Supreme Court recognized the legitimacy of ad hoc rulemaking in *SEC v. Chenery Corp.*¹⁷⁶ The Court stated that "[n]ot every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule"¹⁷⁷ and that "an administrative agency must be equipped to act either by general rule or by individual order."¹⁷⁸ In doing so, the Supreme Court upheld the Securities and Exchange Commission's determination that an amendment to a public utility's reorganization plan violated the Public Utility Holding Company Act of 1935.¹⁷⁹ The SEC interpreted statutory law and applied its interpretation against a corporation in the context of a contested case hearing.¹⁸⁰ This is

¹⁷² See Pet. for Review of Elsie Opiela and Adrian Opiela, Jr., *supra* note 77, at 10.

¹⁷³ 1 RONALD BEAL, TEXAS ADMINISTRATIVE PRACTICE AND PROCEDURE § 2.4 (2021).

¹⁷⁴ *Rodriguez v. Serv. Lloyds Ins. Co.*, 997 S.W.2d 248, 255 (Tex. 1999).

¹⁷⁵ BEAL, *supra* note 1733.

¹⁷⁶ 332 U.S. 194, 202 (1947).

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 199–200.

¹⁸⁰ *Id.* at 200.

rulemaking (interpreting law) and enforcement (applying law) absent formal compliance with the (federal) APA.¹⁸¹ Thus, the Supreme Court allowed the agency to combine its rulemaking and adjudicatory powers to create new rules.¹⁸²

The Texas Supreme Court, following the *Chenery* holding, also allows agencies with both rulemaking and adjudicatory powers to exercise these powers simultaneously.¹⁸³ Further, the Third Court of Appeals has recognized the validity of ad hoc rulemaking.¹⁸⁴ In doing so, Professor Beal noted that “all decisions have held that the agency has a choice of setting forth its rule by notice and comment rule making proceedings *or through ad hoc adjudication.*”¹⁸⁵ Accordingly, the Railroad Commission can utilize ad hoc rulemaking. Here, even if the 65% threshold is a rule subject to the APA’s notice-and-comment requirement, the application of the ad hoc rulemaking exception in a contested case effectively permits the Commission to establish the threshold requirement without APA rulemaking. To exercise the ad hoc rulemaking requirement, however, there must be a contested case.¹⁸⁶

¹⁸¹ *Id.* at 201.

¹⁸² *See id.* at 201–03. It is worth noting that rules are generally applicable and apply to the entire regulated community. Contested case decisions only apply to the party before the agency. Due to the need for consistency and predictability within the regulated field, agencies can prospectively apply contested case decisions to the entire regulated community. This form of rulemaking relies heavily on the principles of stare decisis to create a new rule.

¹⁸³ *See* R.R. Comm’n of Tex. v. Lone Star Gas Co., 844 S.W.2d 679, 688 (Tex. 1992); BEAL, *supra* note 1733.

¹⁸⁴ *See, e.g.,* CenterPoint Energy Entex v. R.R. Comm’n of Tex., 213 S.W.3d 364, 369 (Tex. App.—Austin 2006, no pet.); Entergy Gulf States v. P.U.C. of Tex., 173 S.W.3d 199, 212 (Tex. App.—Austin 2005, pet. denied).

¹⁸⁵ BEAL, *supra* note 1733 (emphasis added) (citing *City of El Paso v. Pub. Util. Comm’n*, 883 S.W.2d 179, 189, n.21 (Tex. 1994); *Lone Star Gas Co.*, 844 S.W.2d at 689; *Sw. Bell Tel. Co. v. Combs*, 270 S.W.3d 249, 261 (Tex. App.—Amarillo 2008, pet. denied); *Tex. Workers’ Comp. Comm’n v. E. Side Surgical Ctr.*, 142 S.W.3d 541, 547–49 (Tex. App.—Austin 2004, no pet.); *Amarillo I.S.D. v. Meno*, 854 S.W.2d 950, 958 (Tex. App.—Austin 1993, writ denied); *Tex. Bd. of Pharmacy v. Seely*, 764 S.W.2d 806, 814 (Tex. App.—Austin 1988, writ denied); *R.R. Comm’n of Tex. v. Concerned Citizens*, 741 S.W.2d 602, 604 (Tex. App.—Austin 1987, writ dismissed w.o.j.); *Madden v. Tex. Bd. of Chiropractic Exam’rs*, 663 S.W.2d 622, 626 (Tex. App.—Austin 1983, writ refused n.r.e.); *Bd. of Ins. v. Deffebach*, 631 S.W.2d 794, 799 (Tex. App.—Austin 1982, writ refused n.r.e.); *First Fed. Sav. & Loan v. Vandygriff*, 639 S.W.2d 492 (Tex. App.—Austin 1982, writ dismissed w.o.j.); *see also* *R.R. Comm’n of Tex. v. WBD Oil & Gas Co.*, 104 S.W.3d 69, 74 (Tex. 2003).

¹⁸⁶ BEAL, *supra* note 1733.

Prior to the *Opielas*' contested case, the Commission faced similar contested cases in *Klotzman* and *Monroe*. In *Klotzman*, mineral owners directly challenged the Commission's issuance of an allocation well permit for acreage in unpooled units.¹⁸⁷ The Commission ultimately affirmed its process for granting allocation wells, determining that an operator has a good faith claim when it owns leases on all of the tracts through which the horizontal well will traverse.¹⁸⁸ In *Monroe*, mineral owners sought to have a horizontal well permit revoked, arguing that the Commission did not have the ability to approve permits for allocation wells given the evidence provided to the Commission.¹⁸⁹ Again, the Commission reaffirmed its process for granting allocation and PSA well permits.¹⁹⁰

Opiela is now the third case to address this issue, and the Commission affirmed its process for granting such permits once again.¹⁹¹ With such consistency across decisions and the continued need for consistency within the industry and the regulated community, the Commission has decided to enforce its general requirements through its decision in *Klotzman* and apply the ruling and requirements prospectively.¹⁹² *Stare decisis* controls—a good faith claim to drill a PSA well can be established by demonstrating that 65% of the mineral owners have consented to an allocation method.¹⁹³ This action by the Commission falls within the scope of ad hoc rulemaking and is a valid exercise of the Commission's authority as both rulemaker and adjudicator.

The landscape of the oil and gas industry, especially relating to horizontal wells and hydraulic fracturing, is rapidly evolving. The Commission must keep up with such speedy growth, progress, and technological advancement. Ad hoc rulemaking allows the Commission to quickly adapt to the changing

¹⁸⁷Klotzman, *supra* note 1088, at 1 (EOG Resources, Inc.'s Exceptions to the Proposal for Decision).

¹⁸⁸Klotzman, *supra* note 1088; *see* Smith, *supra* note 211, at 13.

¹⁸⁹Tex. R.R. Comm'n, *Complaint of Monroe Properties, Inc., et al. that Devon Energy Production CO. L.P. Does Not Have a Good Faith Claim to Operate the N I Helped 120 (Alloc) Lease, Well No. 6H, Phantom (Wolfcamp) Field, Ward County, Texas*, Docket No.08-0305330 (Oil & Gas Div., Dec. 18, 2017) (Order of Dismissal); Tex. R.R. Comm'n, *Complaint of Monroe Properties, Inc., et al. that Devon Energy Production CO. L.P. Does Not Have a Good Faith Claim to Operate the N I Helped 120 (Alloc) Lease, Well No. 6H, Phantom (Wolfcamp) Field, Ward County, Texas*, Docket No.08-0305330 (Oil & Gas Div., Feb. 13, 2018) (Order Denying Motion for Rehearing) [collectively hereinafter *Monroe*].

¹⁹⁰*Id.*

¹⁹¹*See generally* Proposal for Decision, *Audioslave A Lease*, *supra* note 355.

¹⁹²*Id.*

¹⁹³*Id.*

oilfields in a manner that promotes efficiency, sustainability, and predictability. Therefore, ad hoc rulemaking is an incredibly useful tool through which the Commission can implement policy and apply that policy throughout the state. Using the ad hoc rulemaking exception, the Railroad Commission's creation of the 65% threshold requirement is a valid rule.

III. THE COMMISSION'S AUTHORITY TO GRANT THE PERMIT FOR THE AUDIOSLAVE WELL UNDER EXISTING COMMISSION PROCEDURES

The Travis County district court rejected the Railroad Commission's determination that Magnolia made the requisite showings to obtain a drilling permit.¹⁹⁴ Though the trial court's final judgment was an incredibly short order, much of the court's reasoning subverted common and well-established principles of Texas oil and gas law.

A. *Good Faith Requirement*

Texas law requires only that an operator make a good faith showing of a claim to drill an oil and gas well.¹⁹⁵ The Commission determined that Magnolia made such a showing, and an adjudication of Magnolia's pooling rights were not necessary to entitle Magnolia to the permit.¹⁹⁶ The Texas Natural Resources Code and Commission Rule 15 define a "good faith claim" to drill as:

A factually supported claim based on a recognized legal theory to a continuing possessory right in a mineral estate, such as evidence of a currently valid oil and gas lease or a recorded deed conveying a fee interest in the mineral estate.¹⁹⁷

At the conclusion of the contested case hearing, the Administrative Law Judge and Technical Examiner (Examiners, collectively) determined that

¹⁹⁴ See *Opiela v. R.R. Comm'n of Tex.*, No. D-1-GN-20-000099 (53rd Dist. Ct., Travis County, Tex. May 12, 2021).

¹⁹⁵ *Magnolia Petroleum Co. v. R.R. Comm'n of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943).

¹⁹⁶ See, e.g., *Trapp v. Shell Oil Co.*, 198 S.W.2d 424, 437–38 (Tex. 1946); *Rosenthal v. R.R. Comm'n of Tex.*, No. 03-09-00015-CV, 2009 WL 2567941, at *3 (Tex. App.—Austin Aug. 20, 2009, pet. denied) (mem. op.).

¹⁹⁷ TEX. NAT. RES. CODE ANN. § 89.002(11); 16 TEX. ADMIN. CODE § 3.15(a)(5) (Tex. R.R. Comm'n, Surface Equipment Removal Requirements and Inactive Wells).

Magnolia had established its good faith claim to drill.¹⁹⁸ The Commission had previously determined in *Monroe* and *Klotzman* that oil and gas leases covering the traversed tracts were sufficient to establish a good faith claim to drill an allocation well.¹⁹⁹ For the Audioslave well, Magnolia has valid leases on all three tracts the well traverses: the Pawelek tract, the highway tract, and the Opiela tract.²⁰⁰ Accordingly, Magnolia has a sufficient good faith claim to drill the allocation well, regardless of any pooling dispute. And the Commission agreed.²⁰¹

As for the good faith claim relating to the PSA, the Examiners found that 65.625% of the mineral and working interest owners on the Opiela tract had signed either a production sharing agreement, consent to pool, or unit ratification.²⁰² Although interest owners may have signed different documents, the Commission Examiners determined that all signed documents established the method for dividing production proceeds.²⁰³ For the Pawelek tract, the Examiners noted that 68.993% of mineral owners were either lessors or had ratified the lease, and the lease itself provided a means of dividing proceeds.²⁰⁴ Lastly, the General Land Office had signed a pooling agreement detailing the means of dividing proceeds for the highway tract (the General Land Office is the sole mineral owner of the highway tract).²⁰⁵ Since Magnolia had purportedly met its 65% threshold, Magnolia established a good faith claim to drill a PSA well.²⁰⁶ Again, the Commission agreed.²⁰⁷

In its fourth point of decision, the Travis County district court ruled that, “[t]he Commission erred in finding that Magnolia showed a good faith claim

¹⁹⁸ See *Proposal for Decision, Audioslave A Lease*, *supra* note 355.

¹⁹⁹ See *Monroe*, *supra* note 18989; *Klotzman*, *supra* note 1088.

²⁰⁰ *Proposal for Decision, Audioslave A Lease*, *supra* note 355, at Findings of Fact No. 4.

²⁰¹ See Tex. R.R. Comm’n, Oil & Gas, *Complaint of Elsie Opiela and Adrian Opiela Regarding Magnolia Oil & Gas Operating LLC’s (521544) Audioslave A Lease, Well No. 102H, Permit No. 839487, Sugarkane (Austin Chalk) Field, Karnes County, Texas*, Docket No. 02-0315435, at 1 (Oil & Gas Div. Oct. 1, 2019) (final order).

²⁰² *Proposal for Decision, Audioslave A Lease*, *supra* note 355, Finding of Fact No. 8.

²⁰³ *Id.*

²⁰⁴ *Id.* at Finding of Fact No. 9.

²⁰⁵ *Id.* at Finding of Fact No. 10.

²⁰⁶ *Id.* at Finding of Fact No. 16.

²⁰⁷ See Tex. R.R. Comm’n, Oil & Gas, *Complaint of Elsie Opiela and Adrian Opiela Regarding Magnolia Oil & Gas Operating LLC’s (521544) Audioslave A Lease, Well No. 102H, Permit No. 839487, Sugarkane (Austin Chalk) Field, Karnes County, Texas*, Docket No. 02-0315435, at 1 (Oil & Gas Div. Oct. 1, 2019) (final order).

of right to drill the Audioslave Well.²⁰⁸ This point is mistaken and seems to rest on the proposition that the Commission should have considered the legal rights of the parties relating to the mineral leases and pooling agreements.²⁰⁹ A good faith claim to drill a well does not rest on whether the operator has pooling authority or the legal right to take any number of actions under the lease.²¹⁰ The Commission is not an adjudicator of legal rights, and disputes concerning legal rights, including pooling authority, are not sufficient grounds for denying Magnolia a permit.²¹¹ Magnolia demonstrated that it had procured the necessary leases and agreements.²¹² This was all that was needed to establish a good faith claim to drill the Audioslave well. Accordingly, the district court misapplied existing Texas law by ruling that the Commission's determination was erroneous.

B. Magnolia's Lacking Good Faith Claim

While the Court of Appeals observed that Magnolia had a good faith claim to drill on any one of the subject leases, the Court of Appeals held that Magnolia did not have a good faith claim to drill a PSA well because only 15.625% of the interest owners had signed a production sharing agreement.²¹³ Whereas the Commission and the Examiners did not distinguish between the different agreements relating to the allocation of production signed by the interest owners (production sharing agreement, consent to pool, ratification of designated unit), the Court of Appeals did.²¹⁴

The Commission found that over 65% of the interest owners had signed some type of written agreements relating to production allocation.²¹⁵ Magnolia received production sharing agreements from 15.625% of the interest owners, ratifications of designation of unit from 0.563% of interest owners, and consents to pool from 49.437% of the interest owners.²¹⁶ The

²⁰⁸*Opiela v. R.R. Comm'n of Tex.*, No. D-1-GN-20-000099 (53rd Dist. Ct., Travis County, Tex. May 12, 2021).

²⁰⁹*See id.*

²¹⁰*R.R. Comm'n of Tex. v. Opiela*, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726, at *14–15 (Tex. App.—Austin June 30, 2023, pet. filed).

²¹¹*See Magnolia Petroleum Co. v. R.R. Comm'n of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943).

²¹²*Id.* at 190.

²¹³*Opiela*, 2023 Tex. App. LEXIS 4726, at *31–32.

²¹⁴*Id.* at *32; *Proposal for Decision, Audioslave A Lease*, *supra* note 355, at Finding of Fact Nos. 7, 15.

²¹⁵*Proposal for Decision, Audioslave A Lease*, *supra* note 355, at Finding of Fact Nos. 7, 15.

²¹⁶*Opiela*, 2023 Tex. App. LEXIS 4726, at *31.

majority of the Court of Appeals, noting that pooling is not required for a PSA well,²¹⁷ refused to allow Magnolia to satisfy the 65% requirement with other agreements that were not production sharing agreements.²¹⁸ Since pooling authority is not required for a PSA well, the Court rejected Magnolia's attempt to meet its threshold via consents to pool.²¹⁹ Magnolia's inability to acquire consent from 65% of the interest owners under a production sharing agreement precluded it from establishing a good faith claim to drill the Audioslave well.²²⁰

The Court's holding is also based on the timing of the Audioslave well's permit application. Form P-16's definition of a PSA well allows for 65% of interest owners to sign "an agreement as to how proceeds will be divided."²²¹ The Commission added this language to Form P-16 in 2019, but the Audioslave well's permit applications were filed in May and August 2018.²²² Because the permit applications and subsequent grants for the Audioslave well predated Form P-16's PSA definition, the Court of Appeals refused to apply this "expanded"²²³ definition.²²⁴ Justice Kelly, the lone dissenter, stated that she would conclude that Magnolia's unchallenged representation that over 65% of the interest owners had signed some sort of agreement as to how proceeds were to be shared constituted sufficient evidence to support Magnolia's good faith claim to drill the Audioslave well, whether that be through production sharing agreements or otherwise.²²⁵ While the Court found no good faith claim to drill the Audioslave well amongst the existing agreements, the discussion concerning the timing of the Form P-16 PSA definition seems to leave open the question as to whether consents to pool or

²¹⁷The Court noted both that the Commission does not require pooling to permit a PSA well and that PSA wells are not the same as pooling. The differences between pooling and PSA/allocation are discussed *infra* Part IV(B).

²¹⁸*Opiela*, 2023 Tex. App. LEXIS 4726, at *32.

²¹⁹*Id.*

²²⁰*Id.*

²²¹*Id.* at *33.

²²²*Id.*; see also R.R. COMM'N OF TEX., FORM P-16 INSTRUCTIONS & GUIDELINES, at 8 (2022).

²²³The Court of Appeals described Form P-16's current definition of a PSA well as an "expanded" definition because it now includes *any* type of agreement that establishes how proceeds will be divided.

²²⁴*Opiela*, 2023 Tex. App. LEXIS 4726, at *33–34.

²²⁵*Id.* at *35–38 (Kelly, J., dissenting) (disputing that Magnolia made a satisfactory good faith showing). Justice Kelly also noted that, in addition to deciding that Magnolia did in fact show a good faith claim to drill the Audioslave well, she would address whether the Commission complied with the APA. *Id.* at *38.

ratifications of designation of unit can serve as the basis of a good faith claim to drill a PSA well on applications after the 2019 definition.²²⁶ Accordingly, this question may need to be answered by the Supreme Court on review.

C. The RRC's Adjudication of Pooling Authority

For horizontal allocation and PSA wells, the Commission has repeatedly determined that it is not required to adjudicate the pooling rights of an operator when deciding whether to issue a permit.²²⁷ Such a requirement has no basis in either statute or case law. To the contrary, the Commission has refused to expand its power and make such a determination when considering permit applications.

The final judgment issued by the district court, however, seems to imply that the Commission must consider an operator's pooling authority prior to permitting an allocation or PSA well. From a purely regulatory perspective, however, adjudicating the operator's pooling authority is not necessary for permitting these types of horizontal wells. Decisions that impact or determine individual pooling rights are outside the jurisdiction of the Commission.²²⁸ As stated by the court in *Magnolia Petroleum Co. v. R.R. Comm'n*, "[t]he function of the Railroad Commission . . . is to administer the conservation laws. When [the Commission] grants a permit to drill a well [the Commission] does not undertake to adjudicate questions of title or rights of possession."²²⁹

Courts, not the Commission, are the proper place for determining questions of pooling authority. The Commission does not have the requisite

²²⁶ *See id.* at *37 (Kelly, J., dissenting) ("I would conclude that an operator's certification that at least 65% of the mineral and working interest owners from each tract have agreed as to how production will be shared from a horizontal well, when supported by signed agreements in the record, is sufficient to show a good-faith claim to operate the proposed well. Because royalty calculations are specific to each lease and subject to negotiation, the exact shares or method for dividing proceeds from production (such as by surface acreage or in proportion to the length of the well that traverses the land) under any particular agreement is immaterial. Agreeing to share production differently with some interest owners simply means the operator may end up paying a larger royalty share than if the agreements had been uniform. In addition, this approach—considering only whether an agreement to share production exists, without regard to its specific terms—is consistent with Texas Supreme Court directive that the Commission should not be in the business of interpreting lease rights.").

²²⁷ *Id.* at *21–22.

²²⁸ *See Magnolia Petroleum Co. v. R.R. Comm'n of Tex.*, 170 S.W.2d 189, 191 (Tex. 1943).

²²⁹ *Id.*

authority to decide title disputes and determine property rights.²³⁰ Accordingly, the standard for receiving an allocation or PSA well permit is not whether the operator has pooling authority. Instead, the operator must simply have a good faith claim to drill the well. The *Magnolia* Court proceeded to say:

“If the applicant makes a reasonably satisfactory showing of a good faith claim of ownership in the property, the mere fact that another in good faith disputes his title is not alone sufficient to defeat his right to the permit; neither is it ground for suspending the permit . . .”²³¹

Repeatedly, Texas courts have affirmed the Commission’s standard for receiving a permit—that the operator has a good faith claim to drill the well.²³² The Commission determined that EnerVest, and subsequently *Magnolia*, had a good faith claim to drill the Audioslave well.²³³ The district court, therefore, cannot step in and invalidate the Audioslave’s PSA permit on the grounds that EnerVest/*Magnolia* lacked pooling authority.

Following *Magnolia*, the Commission limits its consideration of pooling authority and other legal rights under the lease when determining whether an operator has a good faith claim to drill.²³⁴ In *Klotzman*, EOG Resources, Inc., as the operator, applied for an allocation well permit on an 80-acre developmental unit made up of two 40-acre tracts on separate leases.²³⁵ Neither lease granted EOG pooling authority.²³⁶ Royalty owners for some of the affected acreage challenged the permit application, and the Hearing Examiner recommended that the Commission deny the permit due to the lack of pooling authority.²³⁷ The Commission, however, rejected the recommendation and approved EOG’s allocation permit because EOG had

²³⁰ *Amarillo Oil Co. v. Energy-Agri Prods., Inc.*, 794 S.W.2d 20, 26 (Tex. 1990); *Trapp v. Shell Oil Co.*, 198 S.W.2d 424, 437 (Tex. 1946).

²³¹ *Magnolia Petroleum*, 170 S.W.2d at 191.

²³² *See, e.g.*, *R.R. Comm’n of Tex. v. Austin*, 524 S.W.2d 262, 268 (Tex. 1975); *Jones v. Killingsworth*, 403 S.W.2d 325, 328 (Tex. 1965); *Superior Oil Co. v. R.R. Comm’n of Tex.*, 571 S.W.2d 51, 55–56 (Tex. App.—Austin 1978, writ red’d n.r.e.).

²³³ *R.R. Comm’n of Tex. v. Opiela*, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726, at *5–6 (Tex. App.—Austin June 30, 2023, pet. filed).

²³⁴ *Id.* at *15–16.

²³⁵ *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*, Docket No. 02-0278952, at 2–3 (Oil & Gas Div. June 25, 2013) (proposal for decision).

²³⁶ *Id.* at 3.

²³⁷ *Id.*

established a good faith claim to drill the well by having leases on the tracts through which the wellbore traversed.²³⁸ The Commission stated that it is not the one to adjudicate the pooling authority of an operator.²³⁹

In 2017, the Commission faced a similar challenge in *Monroe*. In *Monroe*, royalty owners challenged Devon Energy Production Co.’s application for an allocation well permit, arguing that Devon did not have a good faith claim to drill the well because the leases lacked pooling authority.²⁴⁰ The Director of the Commission’s Hearing Division noted that “the Commission has previously decided [in *Klotzman*] that it does not require proof of pooling authority for an applicant to show a good faith claim necessary to obtain a permit for an allocation well.”²⁴¹ Relying on the precedential value of prior decisions within the contested case context, the Director ultimately dismissed the *Monroe* complaint entirely.²⁴²

At trial, the Opielas relied heavily on *Browning Oil Co. v. Luecke* to argue that an operator needs pooling authority prior to drilling an allocation or PSA well.²⁴³ But *Browning* does not announce such a rule. As Professor Ernest E. Smith²⁴⁴ stated, “*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.”²⁴⁵ Rather, the *Browning* Court held that Browning Oil Company had breached the pooling provisions within its oil and gas leases by failing to uphold certain anti-dilution covenants (namely, that any pooled units must include 60% of the acreage from the tract on which the well sits).²⁴⁶ The *Browning* decision did not turn on whether Browning Oil Co. had the necessary pooling authority prior to applying to

²³⁸Klotzman, *supra* note 1088, at 1.

²³⁹*See id.*; *see also* Rosenthal v. R.R. Comm’n of Tex., No. 03-09-00015-CV, 2009 Tex. App. LEXIS 6522, at *17 (Tex. App.—Austin Aug. 20, 2009, pet. denied); Pan Am. Prod. Co. v. Hollandsworth, 294 S.W.2d 205, 211–12 (Tex. App.—Austin 1956, no writ).

²⁴⁰*Monroe*, *supra* note 189.

²⁴¹*Id.*

²⁴²*Id.*

²⁴³38 S.W.3d 625 (Tex. App.—Austin 2000, pet. denied); *see, e.g.*, R.R. Comm’n of Tex. v. Opiela, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726, at *80 (Tex. App.—Austin June 30, 2023, pet. filed).

²⁴⁴Professor Smith is the Rex G. Baker Centennial Chair Emeritus in Natural Resources Law at the University of Texas School of Law. He is widely regarded as the leading academic expert in oil and gas law. He has authored the leading casebook in Oil & Gas Law, the primary treatise on Texas Oil & Gas Law, and has been instrumental in shaping Texas oil and gas jurisprudence.

²⁴⁵Smith, *supra* note 211, at 10.

²⁴⁶*Browning Oil Co.*, 38 S.W.3d at 632.

the Railroad Commission for a drilling permit. Such a determination is not within the Railroad Commission's wheelhouse.

Interestingly, it appears as though the Opielas know that Travis County district court cannot invalidate the Audioslave's permit due to the lack of pooling authority. Concurrent with this litigation in the Third Court of Appeals, the Opielas filed suit against Magnolia in Karnes County, where both the mineral interest and Audioslave well are located.²⁴⁷ This is the appropriate forum to adjudicate the oil and gas lease, pooling clause, and the corresponding property rights.²⁴⁸ Requiring the Railroad Commission to consider and adjudicate pooling rights for PSA and allocation permits runs contrary to existing Texas oil and gas law.²⁴⁹ Accordingly, the Third Court of Appeals was correct to reverse the ruling of the district court.²⁵⁰

IV. PSA AND ALLOCATION WELL PERMITS AND TEXAS POLICY

In addition to the strong legal support for the Railroad Commission's continued practice of permitting allocation and PSA wells, there are also strong policy reasons to support the continuation of drilling these wells. Among these reasons are Texas's strong policy of discouraging waste and promoting the efficient recovery of hydrocarbons, the compatibility of allocation and PSA wells with existing pooling law, the contribution of horizontal wells to increased Texas oil production, and the interests of operators across the state who utilize allocation and PSA wells.

A. *The Texas Constitution*

The Texas Constitution states, "The conservation and development of all of the natural resources of this State . . . and the preservation and conservation of all such natural resources of the State are each and all hereby declared public rights and duties."²⁵¹ The frequent utilization of allocation

²⁴⁷Opiela v. EnerVest Operating, LLC, No. 18-06-00153-CVK (81st Dist. Ct., Karnes County, Tex. filed June 14, 2018).

²⁴⁸See Cheesman v. Amerada Petroleum Corp., 227 S.W.2d 829, 832 (Tex. App.—Austin 1950, no writ) (per curiam).

²⁴⁹Further, many commentaries argue persuasively that the utilization of allocation and PSA wells do not constitute pooling. See *infra* Part V(B). If allocation and PSA wells do not result in a type of pooling, then the pooling authority under a lease is wholly irrelevant.

²⁵⁰R.R. Comm'n of Tex. v. Opiela, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726, at *23–25 (Tex. App.—Austin June 30, 2023, pet. filed).

²⁵¹TEX. CONST. ART. XVI, § 59.

and PSA wells operate to prevent waste, conserve natural resources, and advance the efficient production of oil and gas.

Texas courts have candidly promoted advancements in the oil and gas industry that increase production while decreasing waste. In *Lightning Oil Co. v. Anadarko E&P Onshore, Inc.*, the Texas Supreme Court stated that “[it] has always viewed waste-reducing innovations favorably” and “[it] is the longstanding policy of this state to encourage maximum recovery of minerals and to minimize waste.”²⁵² The Court has repeatedly crafted rules that encourage and advance exploration and recovery of natural resources using new and innovative technology.²⁵³

Allocation and PSA wells are absolutely necessary technologies that work to reduce waste through horizontal drilling. The Texas Oil and Gas Association (TXOGA) provided a real example faced by operators across the state:

Under Statewide Rule 37, an operator cannot drill a well (including horizontal wells) “nearer than 467 feet to any property line, lease line, or subdivision line” without an exception from the RRC. 16 Tex. Admin. Code § 3.37(a)(1). Thus, an operator holding a lease on two adjacent tracts that cannot be pooled may be forced to drill two different wells and to leave oil and gas in the ground simply because it is too close to a lease line.²⁵⁴

Absent allocation and PSA wells, the operator would then be forced to expend tremendous amounts of capital and resources to drill two adjacent wells. Allocation or PSA wells can wholly eliminate this issue and greatly reduce waste. Instead of drilling multiple wells, expending large amounts of capital and vital resources, an operator can simply drill one horizontal well that traverses both tracts. Drilling one horizontal well across the two tracts reduces the cost of extracting the hydrocarbons, increases oil and gas production, reduces waste, and eliminates unnecessary expenses.

²⁵²520 S.W.3d 39, 51 (Tex. 2017).

²⁵³*Coastal Oil & Gas Corp. v. Garza Energy Tr.*, 268 S.W.3d 1, 34 (Tex. 2008) (Willett, J., concurring).

²⁵⁴Brief of Amicus Curiae Texas Oil & Gas Ass’n at 6–8, *R.R. Comm’n of Tex. v. Opiela*, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726 (Tex. App.—Austin June 30, 2023, pet. filed).

Waste in the context of oil and gas production is illegal under Texas Natural Resource Code § 85.045.²⁵⁵ If Texas wholly removes allocation and PSA wells as viable drilling options, operators will necessarily be forced to commit various types of waste.

B. Allocation Wells, PSA Wells, and Pooling

The initial challenge to the Audioslave well's permit focused on Magnolia's lack of pooling authority under the Opielas' lease.²⁵⁶ Counsel for the Opielas went even further to argue that "[t]here is no functional distinction between [allocation, PSA, and pooled unit] wells" and that "[allocation, PSA, and pooled unit wells] are all ways to pool multiple tracts."²⁵⁷ This is not true, however, and the Third Court of Appeals acknowledged that the differences between allocation wells, PSA wells, and wells within a pooled unit are not merely semantical.²⁵⁸ Because of these differences and distinctions, allocation and PSA wells do not violate no-pooling provisions in leases nor does the utilization of these wells constitute unlawful pooling.

The Law of Pooling and Unitization, the primary treatise on pooling, calls allocation and PSA wells "Innovative Alternatives to Pooling."²⁵⁹ Professor Ernest E. Smith explained the difference between allocation/PSA wells and pooling in his article *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*.²⁶⁰ Highlighting some of these key differences and their legal implications, it

²⁵⁵TEX. NAT. RES. CODE ANN. § 85.045 ("The production, storage, or transportation of oil or gas in a manner, in an amount, or under conditions that constitute waste is unlawful and is prohibited."); *see also* Key Operating & Equip., Inc. v. Hegar, 435 S.W.3d 794, 798 (Tex. 2014).

²⁵⁶Brief of Appellees Elsie Opiela and Adrian Opiela, Jr. at 54–55, R.R. Comm'n of Tex. v. Opiela, No. 03-21-00258-CV, 2023 Tex. App. LEXIS 4726 (Tex. App.—Austin June 30, 2023, pet. filed); *see Opiela*, 2023 Tex. App. LEXIS 4726, at *18 (The Opielas' anti-pooling provision stated: "Nothing contained herein shall authorize Lessee in any manner whatever to pool said land or any part of the same for oil, and for the production of oil from said land under this lease, and in the event oil is discovered on and under said land Lessor shall receive as his royalty the full one-eighth of all the oil produced and saved from said entire tract of land leased hereunder, as herein in Paragraph 3 provided.").

²⁵⁷Brief of Appellees Elsie Opiela and Adrian Opiela, Jr., *supra* note 2566, at 21.

²⁵⁸*Opiela*, 2023 Tex. App. LEXIS 4726, at *19–23.

²⁵⁹1 BRUCE M. KRAMER & PATRICK H. MARTIN, *THE LAW OF POOLING AND UNITIZATION* § 7.05(6) (3d ed. 2012) (emphasis added).

²⁶⁰*See generally* Smith, *supra* note 211.

becomes clear that allocation and PSA wells are compatible with current pooling law and that no pooling authority is needed to drill allocation and PSA wells.

Unlike pooling, allocation and PSA wells do not change the way production is allocated and how royalties are paid.²⁶¹ So long as the lessor is receiving his rightful portion of the royalty from production on his tract, “the typical mineral lease gives the lessee all of the authority needed” to drill horizontal wells that cross lease lines.²⁶² Typical oil and gas leases do not prevent the operator from utilizing horizontal wells to obtain production from the land.²⁶³ Pooling is not the inherent result of a wellbore crossing lease lines.²⁶⁴ Rather, pooling is a sort of cross-conveyance in which the lessee conveys a portion of the royalty interest to all of the tracts within the pooled unit.²⁶⁵ Within the pooled unit, production from one tract is constructive production from all tracts.²⁶⁶

Allocation and PSA wells, on the other hand, do not result in a cross-conveyance when the wellbore crosses lease lines.²⁶⁷ And, when production is achieved, the lessor is only entitled to royalty on the production of his individual tract.²⁶⁸ Further, production from PSA and allocation wells, when crossing lease lines, do not constitute constructive production for all tracts.²⁶⁹ Therefore, to maintain a lease on a tract through which an allocation or PSA well is drilled, the operator must achieve production on each individual tract. Because the constructive production is not applicable to allocation and PSA wells, drilling such wells cannot be said to be a form of pooling.²⁷⁰ As long as the operator has the authority to drill on each tract through which the wellbore travels, the horizontal well is a legal and valid exercise of the operator’s ability to drill without the need for pooling authority.

Understanding these principles, the Third Court of Appeals concluded that production from a PSA well is *not* the same as pooling under Texas

²⁶¹ *Id.* at 564–65.

²⁶² *Id.* at 557.

²⁶³ *Id.*

²⁶⁴ *Id.* at 561.

²⁶⁵ *Id.*

²⁶⁶ *Hooks v. Samson Lone Star, Ltd. P’ship*, 457 S.W.3d 52, 62 (Tex. 2015); *Key Operating & Equip., Inc. v. Hegar*, 435 S.W.3d 794, 798 (Tex. 2014).

²⁶⁷ *See Squibb*, *supra* note 188, at 947.

²⁶⁸ *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied).

²⁶⁹ *Smith*, *supra* note 211, at 562.

²⁷⁰ *See Se. Pipe Line Co. v. Tichacek*, 997 S.W.2d 166, 170 (Tex. 1999).

law.²⁷¹ Though not discussed, the same analysis and rationale leads to the conclusion that allocation wells are similarly not a form of pooling. Because PSA wells, and likely allocation wells, are not pooled, the Court of Appeals found that no pooling authority is needed to drill a PSA well.²⁷² The Texas Supreme Court should adopt this approach and affirmatively establish PSA and allocation wells as a non-pooling form of oil and gas production.

C. A Resurgence in Texas Oil Production

Texas has seen a resurgence in oil and gas production since allocation and PSA wells were introduced.²⁷³ According to the TXOGA amicus brief, Texas oil production in 2011, when the Commission first adopted Form PSA-12, was roughly 1,452,000 barrels of crude oil per day.²⁷⁴ Eight years later, horizontal wells had Texas operators producing over 5,101,000 barrels of crude oil per day, an increase of more than 300%.²⁷⁵ Similarly, natural gas production increased from roughly 6,632,000 million cubic feet (“MCF”) to over 8,170,000 MCF during the same time period.²⁷⁶ While this increased production cannot be solely attributed to the utilization of allocation and PSA wells specifically, such wells allow operators to more flexibly use horizontal drilling and fracking technology. Horizontal wells have unlocked producing formations across the state, boosting hydrocarbon production and bringing billions of dollars into Texas.²⁷⁷

D. Industry-wide Reliance Interests

The district court ruling, though targeted only at the Audioslave well, is incredibly broad, so much so that it may invalidate thousands of wells throughout the state of Texas and disrupt the Commission’s permitting process.²⁷⁸ The Commission’s Drilling Permit Query system indicates that

²⁷¹R.R. Comm’n of Tex. v. Opiela, No. 03-21-00258-CV, 2023 LEXIS 4726, at *21 (Tex. App.—Austin June 30, 2023, pet. filed) (“We conclude that production through a PSA well is not the same as pooling under Texas law.”).

²⁷²*Id.* at *23.

²⁷³Brief of Amicus Curiae Texas Oil & Gas Ass’n, *supra* note 2544, at 5.

²⁷⁴*Id.*

²⁷⁵*Id.*

²⁷⁶*Id.*

²⁷⁷See Michael E. McElroy, *Production Allocation: Looking for a Basis for Discrimination*, 38 OIL, GAS & ENERGY RESOURCES L. SEC. REP. 47, 47, 56 (2014).

²⁷⁸Brief of Amicus Curiae Texas Oil & Gas Ass’n, *supra* note 2544, at 5.

the Commission has approved over 20,000 allocation well permits and over 3,600 PSA well permits.²⁷⁹ Since the start of 2022, the Commission has granted over 4,849 allocation well permits²⁸⁰ and 591 PSA well permits.²⁸¹ In the aggregate, allocation and PSA wells constitute more than half of all horizontal well permits issued by the Railroad Commission since 2020.²⁸² This trend has since continued due to the capital benefits provided by allocation and PSA wells.²⁸³ Declaring now that such permitting is impermissible, the Texas courts will effectively be undercutting and diminishing promising developments in the oil and gas industry, a position the courts have previously refused to take.²⁸⁴ The Third Court of Appeals declined to invalidate allocation and PSA permitting,²⁸⁵ and the Supreme Court should continue to do the same.

V. CONCLUSION

Texas oil and gas producers must be able to continue using allocation and PSA wells. Horizontal drilling has brought about technological advancements that have reshaped the drilling landscape. Producing more oil and gas from fewer wells, traversing thousands of feet underground, and minimizing the costs and resources associated with drill wells, horizontal wells have firmly rooted themselves in the Texas oil and gas industry. Adapting to the changing industry, the Railroad Commission has stayed within its lawful authority to permit allocation and PSA wells. Doing away with allocation and PSA wells, even for a short time, would slow the advancement of the Texas oil and gas industry during a time in which American energy independence is more vital than ever before. Accordingly, it is up to the Texas courts to preserve and promote the industry's progress and uphold the utilization of the allocation and PSA wells. Otherwise, the prosperous future of lessees, lessors, and the state may run right off the tracks.

²⁷⁹ See Drilling Permit (W-1) Query, <https://webapps2.rrc.texas.gov/EWA/drillingPermitsQueryAction.do> (retrieved on Apr. 7, 2023).

²⁸⁰ See *id.*

²⁸¹ See *id.*

²⁸² See *id.*

²⁸³ See discussion *supra* Part IV(A).

²⁸⁴ *Browning Oil Co. v. Luecke*, 38 S.W.3d 625, 647 (Tex. App.—Austin 2000, pet. denied) (“We decline to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells *and would discourage the use of this promising technology.*”) (emphasis added).

²⁸⁵ *Id.*