

What Every Landman Should Know About the Railroad Commission of Texas

by Jack M. Wilhelm

The Railroad Commission of Texas¹ was created in 1891 under a constitutional and legislative mandate to prevent discrimination in railroad charges and to establish reasonable tariffs. It is the oldest regulatory agency in the state and one of the oldest of its kind in the nation. A pioneer in rail regulation, the Railroad Commission has four regulatory divisions that oversee the following:

- Texas oil and gas industry;
- gas utilities, pipeline and rail safety;
- safety in the liquefied petroleum gas industry; and
- the surface mining of coal and uranium.²

There are two other agencies in Texas with which Texas oil and gas landmen have regular dealings: the Texas General Land Office and the Texas Comptroller. The Texas General Land Office administers the leasing of state-owned lands for oil and gas exploration. The Texas Comptroller is the state's treasurer, administering and collecting severance taxes³ and sales and use taxes, among other things.

This article focuses on the Oil & Gas Division, the division that oversees the Texas oil and gas industry.

Ten Things the Railroad Commission Does that You Need to Know

Drilling and Production

1. Spacing and density of drilling are regulated, including horizontal drainholes, affecting the placement and number of wells on a tract.

2. Production is regulated to prevent waste, protect correlative rights, and must be lawful to gain the protection of non-liability for capture.
3. Waterflooding and waterflood units may be approved, insulating the operator from liability for trespass and confiscation.
4. Location exceptions may be given for oil and gas wells (referred to as Rule 37 Applications).

Gathering and Pipelines

5. The commission regulates of intrastate crude oil and gas pipelines as common carriers and common purchasers.
6. Classification of a pipeline as a utility or common carrier vests it, among other things, with the power of eminent domain.

Environmental and Safety Regulation

7. The commission regulates the environmental and safety aspects of oil and gas production, including well plugging. The RRC regulations are broad and flexible.
8. Regulation of the disposal of oil-field waste, including the permitting of commercial landfarm operations and disposal wells is administered.
9. The commission regulates the injection of carbon dioxide into producing reservoirs.

About the Author



Jack Wilhelm is a solo practitioner in Austin, Texas, who focuses his practice on oil and gas law, including oil and gas title examination, oil and gas commercial transactions and litigation and state

administrative representation. In addition, Wilhelm represents taxpayers before the Texas Comptroller of Public Accounts. Wilhelm has a JD from the University of Arkansas and an LLM in energy and environmental law from Tulane University. He is licensed to practice in the states of Texas, Louisiana, Arkansas and Illinois, as well numerous federal courts, including the U.S. Supreme Court. Before entering into private practice, he served as in-house counsel for Amoco Corp. (now BP America) and Mobil

Oil Corp. (now ExxonMobil Corp.), as well as associate general counsel of United Gas Pipeline Co. (a major interstate gas pipeline company). He has also served the current Strayhorn administration as a Texas State Tax Judge for the Texas Comptroller of Public Accounts, the agency responsible, among other things, for the collection of oil and gas severance taxes and motor fuels taxes. Wilhelm is the immediate past chair of the Austin Bar Association Section on Oil, Gas and Mineral Law and is a frequent speaker on oil and gas law issues.

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Information

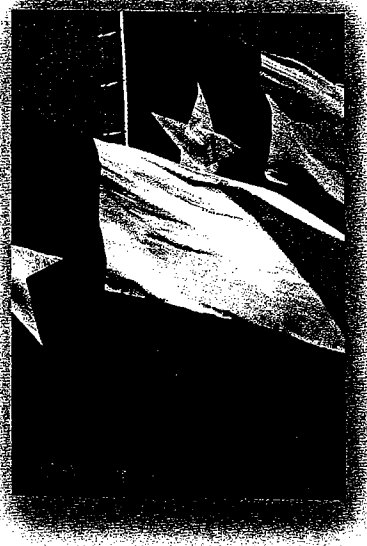
10. The commission maintains some important information, such as well logs, field and pipeline maps, and production reporting numbers.

Statutory Authority

The legislature has delegated the following authority to the Railroad Commission:

§ 81.051. JURISDICTION OF COMMISSION. (a) The commission has jurisdiction over all:

- (1) common carrier pipelines defined in Section 111.002 of this code in Texas;
- (2) oil and gas wells in Texas;
- (3) persons owning or operating pipelines in Texas; and
- (4) persons owning or engaged in drilling or operating oil or gas wells in Texas. Persons listed



in Subsection (a) of this section and their pipelines and oil and gas wells are subject to the jurisdiction conferred by law on the commission.⁴

2. No well may be drilled closer than 1,200 feet to the nearest well on the same tract which is completed in or drilling to the same reservoir.

Rule 38⁶ establishes the minimum number of acres that must be assigned to each well in order to obtain a drilling permit for fields without special field rules. Again many, if not most, fields have their own special field rules, so always check for those specific field rules.

Absent special field rules, the statewide density rule says the minimum requirement is 40 acres per well.

Tolerance Acreage

Rule 38(c) allows the drilling of an additional well if the remaining (tolerance) acreage is greater than or equal to half the standard proration unit size.

An exception to Rule 37 exists if the applicant will suffer a net uncompensated drainage from his tract. However, it is easy to run afoul of The Voluntary Subdivision Rule, which provides that a voluntary subdivision made after the attachment of Rule 37 will not be considered for purposes of determining whether an application to drill must be granted in order to prevent confiscation.

Rule 11⁷ requires that "all wells shall be drilled as nearly as vertical as possible by normal, prudent, practical drilling operations." The Rule specifically addresses two classes of wells: (1) wells that are intentionally deviated and (2) wells that are not intentionally deviated but where the cumulative displacement is such that the well bore could have crossed the lease or property line.

An open issue is the commission's interest in regulating a well drilled from a Rule 37 legal surface location but that is bottom-holed nearer than the otherwise allowable legal location (e.g., deviation, intentional or not).

Production Rates

It is well established that the Railroad Commission, like its counterparts in

Presentation focuses on Spacing/Density, Production Rates, Field Designations, Units and Spacing/Density Exceptions

Spacing and Density Regulation – Rules 37, 38 and 11

Rule 37 was first adopted in 1919,⁵ establishing minimum well spacing requirements for fields without special field rules. Many, if not most, fields have their own special field rules, so always be sure to check for those specific, special field rules.

Absent special field rules, the statewide spacing rules are as follows:

1. No well may be drilled closer than 467 feet to the nearest property, lease or subdivision line.


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other states, has the constitutional authority to regulate the production of oil and natural gas. That authority was restated by the U.S. Supreme Court as recently as 1989. *Northwest Cent. Pipeline v. Kan. Corp. Comm'n*, 489 U.S. 493 (1989). The Commission's rules concerning proration and allowables are set forth in Rules 31, 42 and 45.

Because overall Texas production rates no longer have a direct impact on the worldwide price of oil, production rates are not as controversial as in the distant past. Most disputes center on correlative production rights of competing operators within a field.

Fields and Field Rules

Field rules establish the parameters for the development and operation of a field. These rules typically cover the following:

- well spacing;
- well density;
- production allowable allocation formula for the field; and
- surface casing requirements.

Since field rules are on a reservoir basis, and multiple reservoirs may be covered by a given lease, careful analysis should be given to the interaction between field rules and a lease.

Field is synonymous with "common reservoir." "A common reservoir consists of a common accumulation of hydrocarbons ..." *Railroad Commission v. Graford Oil Corp.*, 557 S.W.2d 946 (Tex. 1977).⁸

Pooling and Unitization

Unlike Louisiana, most units are voluntary pooled units, which will be discussed in greater detail later in the article.

In Texas, there are five types of units:

1. **Drilling Unit** — The acreage area shown on the Form W-1 application for the permit to drill. It is the area shown to establish that the applicant has sufficient unassigned acreage to satisfy the density requirement. The designation of a drilling unit has no title significance.

1.00000000



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2. **Proration Unit** — This is the acreage designated on a Form P-15 and the attached plat to show the acreage assigned to the well for proration purposes where field rules provide for the setting of allowables on an acreage basis, in whole or in part. The proration unit is designated after the well is drilled and completed, and only productive acreage can be assigned to a proration unit. The designation of a proration unit can be changed at any time. A proration unit has no title significance.

3. **Voluntary Pooled Unit** — The most common unit in Texas is a unit formed by the voluntary joinder of separate ownership interests. A voluntary pooled unit is created by one of three mechanisms:

- the community lease;
- pooling under a lease pooling clause;
- pooling by agreement of the interest owners in the proper-

ty to be pooled. Any amount of acreage can be pooled by such agreement.

4. **Pooling and Cooperative Agreements** — These are commission approved units necessary to effect secondary recovery operations for oil or gas including recycling, repressuring, water flooding and gas repressurizing. These pooled units do not bind a landowner, royalty owner, lessor, lessee, overriding royalty owner or any other person who does not execute the cooperative agreement. The purpose of these units is largely to protect the operator from claims for violating correlative rights and antitrust claims (most often called a fieldwide unit). Normally the RRC requires that at least 65 percent of the royalty interest and 85 percent of the working interest commit to the

unit agreement before a hearing on approval will be granted.

Importantly, subsurface movement of hydrocarbons and water pursuant to a commission approved secondary recovery operation does not result in a trespass. Thus, commission approval is an important protection for the operator from lawsuits by arguably adversely affected nearby landowners. *Railroad Commission v. Manziel*, 361 S.W.2d 560 (Tex. 1962).

5. **Forced Pooling under the Mineral Interest Pooling Act (MIPA)** — The Railroad Commission may force pool certain tracts under limited circumstances, such as:

- The field must have been discovered after March 8, 1961.
- No wildcats.
- There must be special field rules.
- There must be two or more separately owned tracts. It cannot be

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used merely to pool separate interests in the same tract.

- One of the interest owners with the right to drill must have drilled or proposed to drill a well on the existing or proposed proration unit.
- Units are limited to 160 acres for oil; 640 acres for gas, plus a 10 percent tolerance.
- Cannot force pool state-owned lands.
- The pooling must result in the avoidance of the drilling of unnecessary wells, the protection of correlative rights or the prevention of waste.
- As a prerequisite, there must have been a fair and reasonable offer to pool. The commission determines whether the offer was fair and reasonable. *Railroad Commission v. Pend Oreille Oil & Gas Co., Inc.*, 817 S.W.2d 36 (Tex. 1991).

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Well Bonding (Plugging or Performance Bonds)

Plugging bonds are relatively new to Texas. The state now requires bonds in the following amounts:

- for 10 or fewer wells, \$25,000;
- for 11 to 100 wells, \$50,000; and
- for over 100, \$100,000.¹⁰

Not surprisingly, there are additional bonding requirements pertaining to offshore wells. Furthermore, operators can elect to post letters of credit of cash deposits in lieu of performance bonds.¹¹

Horizontal Drainholes

This technology has presented challenges to the Railroad Commission in administering spacing rules and the assignment of allowables. That said, the commission has had guidelines for

horizontal drilling since 1987.

Statewide Rule 86 (16 TAC § 3.86) governs the drilling of horizontal drainhole wells. Rule 86 requires the following:

- All portions of the horizontal drainhole must comply with the applicable lease-line and between well spacing requirements for the field. Otherwise, a Rule 37 exception application is required.
- Operators may obtain an acreage bonus (and usually an allowable bonus) roughly keyed to the length of the horizontal drainhole.¹²
- The operator must conduct a directional survey on every horizontal drainhole well.
- Optional special field rules for horizontal drilling in individual fields is required.

And yes, the surface location of the horizontal drainhole may be outside the geographic boundaries of the unit.



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Authority of a City to Assess Pipeline Fees and Recover Damages

For a number of years, some cities on the Gulf Coast have imposed and attempted to impose fees on pipelines that traverse public roads. Fearing this authority would be abused if left unregulated, the legislature imposed some limitations in the last session.¹³

Now, by statute, a municipality may impose the following charges (but no more):

- Assess a reasonable annual charge, not to exceed the city's cost for administering, supervising, inspecting and otherwise regulating the location of the pipeline facility, including maintaining records and maps of the location of the pipeline facility.
- Recover the reasonable cost of repairing damage to a public road that is caused by the placement, construction, maintenance, repair, replacement, operation or use of a pipeline.

Increased Regulation of Natural Gas Gathering Systems¹⁴

At least one industry trade association¹⁵ has expressed a concern that gas gathering systems are taking advantage of natural gas producers. The Texas Alliance argues that pipelines that have a monopoly have taken advantage of their overwhelming market power and forced producers to accept contracts that are undesirable. Producers are told to "take it, or leave it" and shut in their wells.

In response, legislation was introduced in the last legislative session that would have required a gas utility (e.g., gas pipeline or gathering system) to transport gas for fair and reasonable fees.¹⁶ The gas utility would have been required to post a tariff that is available for public inspection¹⁷ and that includes geographical identity of receipt and delivery points, the identity of the shipper and the nature of type of service. If the gas utility elected not to post a tariff, the pipeline would have to transport gas at the lowest rate charged by the utility to any person. If the pro-

ducer disagreed with the tariff, he could file a complaint with the RRC, which would then establish a just and reasonable rate.

There were a series of compromise legislative proposals and, ultimately, nothing passed. However, you can expect this issue — the severity of regulation of gas gathers and transporters — to be before the public and our industry for several years to come. ~~DE~~

End Notes

¹ Railroad Commission Homepage, www.rrc.state.tx.us.

² The Railroad Commission's mission statement is as follows: We serve Texas by:

- Our stewardship of natural resources and the environment
- Our concern for personal and community safety
- Our support of enhanced development and economic vitality for the benefit of Texans

³ 7.5 percent on gas; 4.6 percent on oil.

⁴ The statutes governing the Railroad Commission can be found beginning at Title 3 of the Texas Natural Resources Code, Section 81.001 et seq. The Commission's Oil and Gas Division rules and regulations appear at Title 16 Texas Administrative Code, Part 1, Chapter 3, Section 3.1 et seq. Additionally, these rules can be found at www.rrc.state.tx.us.

⁵ 16 Tex. Admin. Code § 3.37. See Appendix D for a complete copy of Rule 37.

⁶ 16 Tex. Admin. Code § 3.38. See Appendix D for a complete copy of Rule 38.

⁷ 16 Tex. Admin. Code § 3.11. See Appendix D for a complete copy of Rule 11.

⁸ For purposes of the common purchaser laws, a field may be defined as a geographic area.

⁹ Tex. Nat. Res. Code §101.001 et seq.

¹⁰ 16 Tex. Admin. Code § 3.78.

¹¹ HB 380 by West (79th Leg. Sess., 2005) authorizes the Railroad Commission to also accept a prepaid well-specific plugging insurance policy (in lieu of bond, letter of credit or cash deposit).

¹² For fields with a density requirement of 40 acres or less, the operator may assign an additional 20 acres to the proration unit; for fields with a density requirement greater than 40 acres, the general rule is that for every 827 feet of horizontal drainhole, the operator may assign an additional 40 acres to the proration unit.

¹³ HB 951 by West (79th Leg. Sess., 2005).

¹⁴ This is not a new issue. See for instance, Jack M. Wilhelm, *States Considering the Regulation of Natural Gas Gathering Systems*, Nat. Gas Mag. (Apr. 1996).

¹⁵ The Texas Alliance.

¹⁶ HB 821 by Keffer (79th Leg. Sess., 2005).

¹⁷ Currently, tariffs are not available for public inspection.

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Texas Railroad Commissioners

Texas Railroad Commissioners are elected to six-year terms with one commissioner seeking election every two years. When a commissioner is appointed by the governor to fill an unexpired term, the appointee serves until the next General Election at which time the appointee may run for the remainder of the unexpired term.

Chairman Victor Carrillo joined the Texas Railroad Commission in February 2003 when Governor Rick Perry appointed him to fill the unexpired term of Tony Garza who became U.S. Ambassador to Mexico. He is also chairman of the newly created Texas Energy Planning Council whose mission is to create a comprehensive energy plan for the state of Texas.

A native Texan, *Commissioner Elizabeth Ames Jones* is the newest member of the commission, having been appointed earlier this year upon the resignation of

Commissioner Charles Matthews. Prior to her appointment, Commissioner Jones served as a state representative out of the San Antonio area. Her family has been in the oil and gas business for several generations. She is a graduate of the University of Texas.

Michael L. Williams was initially appointed to the Texas Railroad Commission by former Governor George W. Bush in December 1998 to serve the unexpired term of Carole Keeton Rylander. Williams was elected by his fellow commissioners in September 1999 to chair the commission. In November 2000, the people of Texas elected him to complete the term expiring in the year 2002, and in November 2002, they reaffirmed their support by electing him to a term expiring in 2008. He is the first African American in Texas history to hold a statewide executive post and is the highest ranking African American in Texas state government.



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