

The Texas Third Court of Appeals Weighs in on Production Sharing Agreement Wells

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On the Friday before the Fourth of July holiday, the oil and gas industry got a long-awaited answer from Texas' Third Court of Appeals in the case of [*Railroad Commission of Texas, et al. v. Opiela*](#). No. 03-21-00258-CV, 2023 WL 4284984, at *1 (Tex. App.—Austin June 30, 2023, no pet. h.).

The case addresses production sharing agreement (PSA) wells and offers a glimpse into how that court views allocation wells. Since the explosion of horizontal drilling in Texas in the mid-2000s, the Railroad Commission of Texas (RRC) has issued thousands of permits to oil and gas operators for both PSA wells and allocation wells. Both of these types of wells cross lease lines without pooling.

Beginning in 2013, landowners objected at the RRC to the legality of allocation- and PSA-well permits, as well as the RRC's authority to grant them. The RRC rejected these challenges, finding that it indeed has authority to grant allocation- and PSA-well permits. Since then, landowners' challenges have expanded to include suits against operators who intend to drill new wells under allocation- or PSA-well permits. However, none of these challenges have reached a decision in a Texas appellate court until now. Landowners' main arguments have been that allocation- and PSA-well permits amount to involuntary pooling, which they argue Texas law does not permit. The RRC and the oil and gas industry retorted that allocation- and PSA-wells differ from pooling in key ways, such as the absence of cross-conveyances and the separateness of production from different tracts.

In May 2021, a Travis County District Court granted judgment in a landowner's favor (the Opielas), finding the RRC lacked authority to grant the challenged PSA-well permit and that the RRC erred finding that the operator (Magnolia) showed a good-faith claim of right to drill the PSA well. The RRC and Magnolia appealed. The Third Court of Appeals, based in Austin, issued a decision in the appeal on June 30, 2023.

Most importantly, the Third Court of Appeals held that aggregating tracts to drill PSA wells is not the same as pooling, and therefore pooling prohibitions in underlying leases are not relevant to RRC's review of PSA well permits. (The logic used by the court should apply equally to allocation wells, but no allocation-well issue was before the court.) The appellate court further held that the operator had not shown that it was entitled to a PSA-well permit under the RRC's rules requiring written consent by at least 65% of the affected interest owners. In addition to the 15% of the interest owners who signed a PSA, the operator also relied, in part, on approximately 50% of interest owners that consented to pooling. Based on the court's reasoning that PSA's are not the same as pooling, the operator could not rely on a consent to pool to show good faith support for the PSA. This limited ruling does not address the validity of PSA wells or allocation wells as a concept.

While the court did not explicitly hold that PSA wells or allocation wells are valid under Texas law per se, its reasoning provides persuasive evidence supporting such well permits. The industry will no doubt keep watch as the parties have an opportunity to seek review by the Supreme Court of Texas in the coming months. While the Supreme Court of Texas has discretionary review, the court

will often accept cases that present unresolved issues important to industries, like those presented by the *Opiela* case.