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INSIGHTS

Offsite Drilling: Lightning Oil v. Anadarko and Its Potential Impact on Offsite Surface Use in Horizontal Drilling

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As the global commodity price rout continues, operators have become hypersensitive to increasing efficiencies in order to lower break-even prices. Following a recovery in early 2016, oil prices have remained somewhat range-bound between roughly $45 and $55 per barrel for the past twelve months.***[1]*** A corresponding decrease in service prices has offered some relief, but this alone has proven unsustainable for many producers to continue their current drilling plans. While the geological attributes of formations found in the Permian Basin offer unique opportunities to attain break-even prices in the $30s and $40s, those operating elsewhere continue to search for other efficiencies that allow them to compete (or merely survive) until prices recover.***[2]*** The decision handed down last month by the Texas Supreme Court in *Lightning Oil Company v. Anadarko E&P Onshore, LLC*, may present such an opportunity.***[3]*** While the full opinion can be found ***here***, a brief statement of the facts are as follows:

Anadarko entered into an oil and gas lease with the State of Texas that restricted its use of the surface and required Anadarko to drill the leased premises from offsite locations "when prudent and feasible."***[4]*** To allow for that development, Anadarko entered into an agreement with the surface owner of the adjacent tract, the Briscoe Ranch, to allow it drill on the Briscoe Ranch surface to access the minerals it had leased from the State. Lightning had leased the minerals under the Briscoe Ranch, and the plan Anadarko laid out resulted in at least one drilling site on the surface of the lands covered by Lightning's lease. Wellbores would start vertically and then "kick-off" horizontally passing through portions of the mineral-bearing formations under Lightning's leased premises. Lightning objected to this and sued Anadarko for trespass and tortious interference, seeking to enjoin Anadarko from drilling from the Briscoe Ranch surface. Shortly thereafter, Anadarko and the surface owner entered into a Surface Use and Subsurface Easement Agreement that specifically authorized Anadarko to carry out its development plan. Therefore, in addition to injunctive relief, Lightning sought the court's review of whether or not the owners of the Briscoe Ranch could authorize Anadarko's subsurface activities absent Lightning's consent.***[5]***

In denying Lightning's trespass claim, the court reiterated that "the surface owner owns all non-mineral molecules, i.e., the mass that undergirds the surface estate" and that mineral lease does not usually convey the right to possess the specific place or space where the minerals are located.***[6]*** With respect to the actual minerals covered by Lightning's lease that Anadarko's wellbores would invariably come into contact with between the kickoff point and the bottom hole point of Anadarko's wells, the court concluded, "that the loss of minerals Lightning will

suffer by a well being drilled through its mineral estate is not a sufficient injury to support a claim for trespass."[7] In reaching this conclusion, the court balanced the small loss of minerals suffered by Lightning against the State's longstanding policy to encourage maximum recovery of minerals and minimize waste.[8]

Although Anadarko's situation here is distinguishable from many situations in that their lease with the State effectively prohibited them from accessing the minerals under the leased premises from the surface of the leased premises, it has become more and more common to see operators being required (or preferring to) drill their leases from off-site locations. This is especially true in urban areas and on big ranches where existing or desired surfaces uses are legally protected (whether contractually or through the accommodation doctrine[9]). Additionally, the use of off-site drilling locations can allow an operator to maximize the portion of productive wellbore underlying its leasehold interest by positioning the well such that the horizontal portion begins right as it crosses into the leasehold boundary. In any event, operators seeking to access to the surface overlying a neighboring lessee's leasehold estate should welcome this decision. As the court itself recognized,

"[O]ff-lease drilling arrangements often provide the most efficient means of fully exploiting the minerals through horizontal drilling. It can take several thousand feet to kick-out and transition the roughly 90 degrees from vertical to horizontal. Thus, many times when an operator drills a horizontal well from the surface under the which its minerals lie, blind spots occur beneath these transition intervals that may never be fully produced unless another well is drilled to reach them. By drilling from adjacent surface locations, this effect is minimized and it is less likely that additional wells will be required because the wellbore is nearly or completely horizontal when it enters the productive lease formation. Such drilling activities allow for recovering the most minerals while drilling the fewest wells."[10]

It is worth noting that the efficiencies gained by drilling offsite will necessarily be constrained by an operators ability to align their interest with the interest of adjacent mineral and surface owners. This can be accomplished through carefully negotiated surface use agreements that grant surface owners a specified override or one-time cash payment in exchange for the operator's access to an adjacent tract. The key focus for the operator is, of course, to ensure that the efficiencies gained by offsite drilling locations outweigh the consideration paid to the adjacent surface owner for such right.

While the *Lightning* case somewhat clears the air in establishing that the surface estate encompasses sufficient rights to the subsurface to allow the holder of that right to penetrate the subsurface of the tract in question for purposes other than developing the mineral estate under such tract, it may still be prudent for operators who are able to secure those rights to involve the mineral lessee of the tract they are planning to penetrate. For example, in *Lightning*, the court noted that while Anadarko could drill through Lightning's mineral estate as planned, its rights were not any greater than those of Briscoe as surface owner.[11] Lightning's mineral estate remained the dominant estate, and thus would receive the benefit of the implied right of use of as much of the surface – and subsurface – as is reasonably necessary to recover its minerals.[12] While the accommodation doctrine would appear to still apply between a mineral lessee and a surface lessee in the same tract who both intend to drill through and reach the respective mineral interests they have leases on, the court's ruling does remove the trespass claim obstacle claimed by Lightning and could encourage a race to drill from coveted surface locations on the tract shared by the surface and mineral lessee. As such, there may be

an increase in the need for operators in those situations seeking a solution by working together to coordinate development from that tract and entering into contractual arrangements where they agree to either divvy out surface locations or even swap drilling locations above each other's mineral leasehold interests to allow both mineral lessees to drill longer laterals. Given the prolonged low price environment and the need to maximize efficiencies from longer laterals, parties are likely to at least give stronger consideration to new cooperative arrangements such as this. In addition, the court's decision in *Lightning* could prompt surface owners (hoping to secure additional income) to solicit adjacent mineral lessees with attractive surface lease terms. Whether or not the economics work out will remain to be proven.

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[1] David Becker, *Crude Oil Price Analysis for June 2, 2017*, FX Empire (June 2, 2017) ***http://www.nasdaq.com/markets/crude-oil.aspx?timeframe=1y***.

[2] Clifford Krauss, *Land Rush in Permian Basin, Where Oil is Stacked Like a Layer Cake*, The New York Times (Jan. 17, 2017) ***https://www.nytimes.com/2017/01/17/business/energy-environment/exxon-mobil-permian-basin-oil.html?_r=0***.

[3] *See Generally Lightning Oil Company v. Anadarko E&P Onshore, LLC*, No. 15-0910 (Tex. May 19, 2017), available at ***http://docs.texasappellate.com/scotx/op/15-0910/2017-05-19.johnson.pdf***.

[4] *Lightning Oil Company v. Anadarko E&P Onshore, LLC*, No. 15-0910, slip op. at 1 - 6 (Tex. May 19, 2017), available at ***http://docs.texasappellate.com/scotx/op/15-0910/2017-05-19.johnson.pdf***.

[5] *Id.*

[6] *Id* at 9.

[7] *Id* at 17-18.

[8] It is noteworthy that this is the same reasoning used in support of another recent horizontal drilling topic—allocation wells. In *Browning Oil Co. v. Luecke*, the lessee had a producing horizontal well that was drilled across several un-pooled tracts, and the court required the lessee to pay the lessors' royalties based upon "a determination of what production can be attributed to their tracts with reasonable probability." *Browning Oil Co. v. Luecke*, 38 S.W.3d 625 (Tex. App.--Austin 2000, pet. denied). The court stated it chose this course after "declin[ing] to apply legal principles appropriate to vertical wells that are so blatantly inappropriate to horizontal wells and would discourage the use this promising technology." *Id*. More recently, EOG made this same argument in successfully persuading the Texas Railroad Commission to allow a permit for an allocation well in the EOG v. Klotzman matter.

[9] *See Merriman v. XTO Energy, Inc.*, 407 S.W.3d 244, 249 (Tex. 2013) (The accommodation doctrine holds that the owner of the mineral estate must reasonably accommodate the surface owner's existing uses.)

[10] *Id* at 16 (internal citations omitted).

[11] *Id* at 15.

[12] *See* Coyote Lake Ranch, LLC v. City of Lubbock, 498 S.W.3d 53, 63 (Tex. 2016).