

 CAPITAL

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Wellbore Assignments - Some Guidance At Last

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The practice of making "wellbore assignments" to consummate the sale of existing oil and gas production has become commonplace, but the legal interpretation of a wellbore assignment is problematic under the Texas theory of oil and gas ownership in place, whereby the mineral owner is considered as owning the oil and gas molecules located under specifically described lands in place.

In a wellbore assignment, the assignee's interest is limited to rights "in the wellbore" of a specifically defined well or wells.

The Amarillo Court of Civil Appeals was required to construe the legal effect of a wellbore assignment in the case of *Petro Pro, Ltd. v. Upland Resources, Inc.*, 279 S.W.3rd 743. There, Petro Pro was the successor to an assignee of a wellbore assignment in the King "F" No. 2 well, which was completed as a gas well in the Cleveland formation at the time of the wellbore assignment in 1998. Subsequently, Upland, as the owner of all leasehold rights in the 500 acre lease on which the King "F" No. 2 well was drilled, as well as in an adjoining 204 acre tract which was unitized with the 500 acre lease to form a 704 acre unit, drilled three Brown Dolomite wells (up hole from the Cleveland formation) in close proximity to the King "F" No. 2 well. Petro Pro claimed that its wellbore assignment gave it the right both to plug back to produce in the Brown Dolomite formation and to horizontally extend the wellbore to produce all oil and gas located anywhere within the 704 acre pooled unit, and claimed that the three Brown Dolomite wells drilled by Upland constituted a trespass and conversion of gas reserves it was entitled to produce under the wellbore assignment.

The Court of Appeals interpreted the wellbore assignment consistently with the ownership in place theory to mean that the only oil and gas Petro Pro owned in place was that located within the wellbore of the King "F" No. 2 well, defined as the "orifice in the ground made by drilling." The court rejected Upland's argument that Petro Pro had no right to plug its well back to produce in the Brown Dolomite formation because the assignment did not specifically limit wellbore operations to a specific depth or formation. Therefore, the court held that the vertical limit of the wellbore assignment was defined by the depth of the wellbore at the time of the assignment.

In addition to these rather limited rights of ownership of gas in place, the court also found that the wellbore assignee was conveyed all rights appurtenant to the assigned wellbore under the underlying oil and gas leases. One of these appurtenant rights was defined as the right to use surface area adjacent to the wellbore as reasonably necessary to operate the well. Another ancillary right was described as including the right to rework the well so as to produce from any formation that might possibly be reached from the existing wellbore, but the court resisted Petro Pro's urging to extend this right to the right to deepen or extend laterally the existing wellbore. Finally, an appurtenant right assigned was the right to produce gas not owned in place from the assigned wellbore. Consistent with the Texas "rule of capture," the right to produce from the wellbore includes the right not only to produce the minerals owned in place within the confines of the wellbore, but also the right to produce minerals migrating from adjacent property. Therefore, Petro Pro was allowed to produce minerals outside the confines of the wellbore which it did not own as gas in place.

Although this opinion provides more guidance to drafters of wellbore assignments than previously available, wellbore assignments continue to be problematic in resolving operational issues between the owners of various interests. In the instant case, the court rejected arguments of the royalty owner intervenors to interpret the wellbore assignment as creating exclusive rights in a 40 acre spacing unit around the assigned wellbore. If the royalty owners' argument had been accepted, there would have been greater clarity in defining the rights and obligations of the parties.

As it is, since Railroad Commission spacing rules are determined on a field specific basis, the priority of the competing theoretical rights of Petro Pro to recomplete its well to produce in the Brown Dolomite formation and the rights of Upland to drill Brown Dolomite wells depends on the ability of each party to obtain drilling permits under the Railroad Commission spacing rules, which require legally mandated setback distances from prior producing wells in the same field. This creates the anomaly that a "permit race" between Petro Pro and Upland would determine whether Upland receives a Brown Dolomite drilling permit close enough to the King "F" No. 2 Cleveland formation wellbore to block Petro Pro's subsequent permit application to recomplete in the Brown Dolomite formation or conversely, whether Petro Pro's recompletion permit application is granted first, restricting Upland's future locations for Brown Dolomite wells to the legally prescribed distance from that wellbore.

This is undoubtedly a result intended by neither party to the conveyance, so despite the helpful clarification provided by this opinion, wellbore assignments should continue to be used with extreme caution. ■