



RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

OIL & GAS DOCKET NO. 06-0267386

APPLICATION OF OPTIMAL UTILITIES, INC. PURSUANT TO STATEWIDE RULE 38(d)(3) TO DISSOLVE THE TOPAZ WATERFLOOD UNIT, TOPAZ (CLARKSVILLE) FIELD, RED RIVER COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT:

Mike McElroy
Robert Long

APPLICANT:

Optimal Utilities, Inc.

FOR PROTESTANTS:

Eric C. Camp

T. Lynn Warthan, M.D.

PROTESTANTS:

Dr. Lynn Warthan
Gary Warthan
Jonell Donahue

The Warthan Family

FOR INTERVENORS:

Ron Cooper
Mary Ruth Duncan

INTERVENORS:

Self
Self

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE APPLICATION FILED:
DATE OF NOTICE OF HEARING:
DATE OF HEARING:
HEARD BY:

August 31, 2010
September 15, 2010
October 20, 2010
James M. Doherty, Hearings Examiner
Richard Atkins, Technical Examiner

DATE TRANSCRIPT RECEIVED:
DATE PFD CIRCULATED:

November 2, 2010
November 22, 2010



STATEMENT OF THE CASE

This is the application of Optimal Utilities, Inc. ("Optimal") pursuant to Statewide Rule 38(d)(3) for Commission approval of the dissolution of the Topaz Waterflood Unit, Topaz (Clarksville) Field, Red River County, Texas. The application is protested by Dr. Lynn Warthan, Gary Warthan, and Jonell Donahue ("Warthan family"). Ron Cooper and Mary Ruth Duncan are intervenors in the case aligned with Optimal.

Notice of the application was mailed to affected mineral interest owners and also published once per week for four consecutive weeks in The Clarksville Times, a newspaper of general circulation in Red River County. A hearing was held on October 20, 2010. Optimal, the Warthan family, Ron Cooper and Mary Ruth Duncan appeared at the hearing and presented evidence.

APPLICABLE LAW

Pursuant to Statewide Rule 38(d)(3), if two or more separate tracts are joined to form a unit for oil or gas development, the unit is accepted by the Commission, and the unit has produced hydrocarbons in the preceding twenty (20) years, the unit may not thereafter be dissolved into the separate tracts with the rules of the Commission applicable to each separate tract if the dissolution results in any tract composed of substandard acreage for the field from which the unit produced, unless the Commission approves such dissolution.

The Commission may approve unit dissolution only after application, notice, and an opportunity for hearing. The applicant must provide a list of the names and addresses of all current lessees and unleased mineral interest owners of each tract within the joined or unitized tract at the time the application is filed. The Commission must give notice of the application to all such persons. Additionally, if one or more wells on the unitized tract has produced from the field within the 12-month period prior to the application, the applicant must include on the list all affected persons described in Rule 38(h)(1)(A), and the Commission must also give notice to these affected persons.

If no protest to the application is filed or if written waivers are filed by all affected persons, a Commission designee may grant administrative approval of the application if it is determined that the granting of the application will not result in the circumvention of the density restrictions of Rule 38 or other Commission rules.

BACKGROUND

On March 23, 1999, in Oil & Gas Docket No. 06-0221090, the Commission issued a Final Order granting Sonat Exploration Company authority for unitization and secondary recovery for the 1,558-acre Topaz Field Unit, Topaz (Clarksville) Field, Red River County, Texas. On or about January 21, 2000, a subsequent operator, Classic Oil & Gas, Inc. filed a Form P-6 to subdivide 37

acres out of the Unit, thereby creating the 1,529.96 acre Topaz Waterflood Unit.

On September 25, 2007, Optimal filed a Form P-6 to subdivide the Topaz Waterflood Unit and Forms P-4 to create from the Unit new regulatory oil leases with wells: the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; and the Cooper "D" (14823) Lease, Well No. 6. Commission staff advised Optimal that the Unit could not be taken apart and certain of its constituent tracts recognized as lease tracts for regulatory purposes without an order of approval from the Commission. Staff also advised Optimal that if any resulting tract was substandard under the applicable 40 acre density rule, a request for hearing pursuant to Rule 38(d)(3) would be necessary.

On or about May 8, 2008, Optimal provided the Commission with a list of the names and addresses of affected mineral owners in the Topaz Waterflood Unit, and a copy of an affidavit of the last operator of the Unit, Topaz Mineral Operations, LLC, acknowledging that the Unit had terminated. Optimal also represented that it had effective mineral leases covering the properties for the new lease tracts that the Commission had been requested to recognize by Optimal's Form P-6 and Form P-4 filings. Optimal further represented that dissolution of the Unit would not result in any separate tract that was substandard under the density rule for the Topaz (Clarksville) Field.

Because Rule 38(d)(3) requires notice and hearing regarding a proposed dissolution of unit only if the dissolution results in one or more substandard tracts under the applicable density rule, Commission staff determined, based on Optimal's representations, that notice and hearing were not required. Optimal's unit dissolution request was placed on the uncontested master order agenda, and on July 29, 2008, a Final Order was signed in Oil & Gas Docket No. 06-0257756 which approved Optimal's application to dissolve the Topaz Waterflood Unit and recognized Optimal as the operator of the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; and the Cooper "D" (14823) Lease, Well No. 6.

In April 2009, the Warthan family filed a complaint that they had not received notice of Optimal's application to dissolve the Topaz Waterflood Unit or notice of any proposal of the Commission to recognize Optimal as the operator of the 41 acre Duncan (14819) Lease. The Warthan family alleged that 20.5 acres included in the 41 acre Duncan tract included in the Unit were owned by the Warthans and the oil and gas lease covering the Warthan acreage had terminated.

The Warthan complaint led to a hearing in Oil & Gas Docket No. 06-0261927, *Commission Called Hearing to Provide Optimal Utilities, Inc. An Opportunity to Show Cause Why the Final Order in Oil & Gas Docket No. 06-0257756 Should Not Be Vacated and the Duncan (14819) Lease, Well No. 1, Topaz (Clarksville) Field, Red River County, Texas Be Ordered Shut In*. On September 22, 2010, the Commission entered a Final Order in Oil & Gas Docket No. 06-0261927 ordering that the Final Order in Oil & Gas Docket No. 06.0257756, signed on July 29, 2008, was void *ab initio*.

The Final Order in Oil & Gas Docket No. 06-0261927 also ordered that the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; and the Cooper "D" (14823) Lease, Well No. 6 be shut in. In this Final Order, the Commission adopted findings that Optimal's proposed dissolution of the Topaz Waterflood Unit would result in separate tracts that were substandard under the applicable density rule, and the prior dissolution order in Oil & Gas Docket No. 06-0257756 had been entered without the notice and opportunity for hearing required by Rule 38(d)(3). At the time of the hearing in the present docket, the proceeding in Oil & Gas Docket No. 06-0261927 was still pending on Optimal's motion for rehearing.

Optimal filed the application for unit dissolution in the present docket following the issuance of the Commission's Final Order in Oil & Gas Docket No. 06-0261927 which found the prior dissolution order void.

DISCUSSION OF THE EVIDENCE

Optimal Utilities, inc.

The Topaz (Clarksville) Field is in Red River County, near Avery, Texas. The field was discovered in April 1995. According to Optimal, at the time of this discovery, the nearest Clarksville field was 16 miles away and the nearest Smackover field was about six miles away.

The Topaz Waterflood Unit was originally formed by Sonat Exploration Company-Tyler. Subsequent operators of the Unit were Classic Oil and Gas, Inc., 3 Tec Energy Corporation, Cordell Energy Corporation, Brooks Pumping Services, and Topaz Mineral Operations, LLC. The last reported production for the Unit was in February 2006. According to a May 1, 2008, affidavit of Topaz Mineral Operations LLC, the last operator of the Unit, the Unit Agreement provided that the term of the Agreement, unless sooner terminated, was for and during the time that unitized substances were produced in paying quantities and as long thereafter as drilling or reworking operations were conducted in good faith in accordance with the leases covering the Unit area, but, in any event, the Agreement would expire with respect to the leases covering the Unit area at the end of one year after final cessation of production in paying quantities from the Unit area. The affidavit stated that Topaz Mineral Operations, LLC ceased profitable production in November 2005, and ceased total production in February 2006. According to the affidavit, the Unit terminated at the latest on November 1, 2006.

Optimal presented Exhibit No. 9 which is a map showing the boundaries of mineral tracts all or portions of which were included in the Topaz Waterflood Unit. Only portions of some of these mineral tracts were included in the Unit because under §101.013 of the Texas Natural Resources Code, the area covered by the unit agreement may contain only that part of the field that has reasonably been defined by development. According to Optimal, the mineral tracts, all or portions of which were included in the Unit, all contained more than 40 acres, except for four tracts in the

northeastern part of the Unit that had been pooled together for the drilling of the Barrow No. 1 dry hole. Two of these four tracts contained 12.48 acres each and the other two tracts contained 15 acres each. Optimal does not have these four tracts under lease.

The Duncan tract, 20.5 acres of which were included in the Topaz Waterflood Unit, contains a total of 245 acres according to Optimal Exhibit No. 9. At the time the Unit was formed, the 20.5 acres from the Duncan tract were pooled with 20.5 acres from the Warthan tract, and the 41 acre pooled unit was included as a constituent tract of the Unit. The Duncan No. 1 well was originally permitted in July 1996 by Sonat Exploration Company-Tyler at a regular location on the 41 acre pooled unit. Optimal makes no claim that the 20.5 acres from the Warthan tract is any longer under lease to Optimal. The Duncan No. 1 well is drilled on the Duncan tract and is located 137 feet from the Warthan lease line.

The Duncan No. 1 well is drilled at the peak of the Clarksville structure on the Duncan tract. According to Optimal, this is a water drive reservoir, and the Warthan tract is structurally higher than is the Duncan tract. Optimal believes that oil that can be produced by the Duncan No. 1 well cannot be recovered by any other well on the Duncan tract and no other well at a regular location could recover this oil. According to Optimal, unless the Duncan No. 1 is allowed to produce, anywhere from 18,000 BO to 30,000 BO will be wasted.

Intervenors

Ron Cooper and Mary Ruth Duncan are mineral owners under tracts all or portions of which were previously in the Topaz Waterflood Unit and which are now proposed to be operated by Optimal as lease tracts. Mr. Cooper testified that the subject field has been in a state of disarray and infrastructure is in poor condition. Optimal has started to clean up Mr. Cooper's property. Both Mr. Cooper and Ms. Duncan believe that Optimal has been forthright in dealings with the mineral owners, and both support Commission dissolution of the Topaz Waterflood Unit.

The Warthan Family

Counsel for the Warthan family stated that the Warthans do not object to dissolution of the Topaz Waterflood Unit. The Warthans do object to Optimal being permitted to produce the Duncan No. 1 because in their opinion, the well is in violation of Statewide Rule 37 being closer to their lease line than allowed by the 467 foot lease line spacing rule applicable in the field. Dr. Warthan testified that he believes the Duncan No. 1 will drain oil from the Warthan tract, and Optimal should not be allowed to produce the well without obtaining a Rule 37 exception permit.

EXAMINERS' OPINION

No one disputes the fact that the Topaz Waterflood Unit has terminated due to a cessation of production on the Unit. The last reported production for the Unit was in February 2006, and the

last Unit operator, Topaz Mineral Operations, LLC, has affirmed by affidavit that based on a cessation of production in paying quantities, the Unit terminated under the Unit Agreement no later than November 1, 2006. No regulatory purpose is being served by continued Commission recognition of the Unit.

Optimal has obtained currently effective oil and gas leases on tracts that were formerly in the Unit and wishes to produce these tracts as lease tracts. The wells on these lease tracts are already in Optimal's name on the Oil Proration Schedule. In the opinion of the examiners, the Commission should approve the dissolution of the Topaz Waterflood Unit. There is no evidence that dissolution will enable Optimal to circumvent the density provisions of Statewide Rule 38. The lease tracts proposed to be operated by Optimal have sufficient acreage to assign to the wells proposed to be produced by Optimal to meet the 40 acre density rule for the Topaz (Clarksville) Field.

The evidence does not establish that dissolution will result in the circumvention of any other Commission rule. The Warthans have raised an issue of whether Optimal may commence to produce the Duncan No. 1 well without obtaining a Rule 37 exception because the well is only about 137 feet from the Warthan lease line. Optimal takes the position that the well does not need a Rule 37 exception because the well was at a regular location on a 41 acre pooled unit at the time the well was permitted, and Optimal believes that a well that is once regular is always regular. Counsel for both parties have agreed, however, that the Rule 37 issue is not within the call of this hearing. The examiners have officially noticed that a complaint proceeding has been opened in Oil & Gas Docket No. 06-0267941 to consider the Rule 37 issue for the Duncan No. 1 well. The examiners thus believe that it would be inappropriate to decide this issue here. While the parties disagree about whether a Rule 37 exception is needed for the Duncan No. 1 well, there is no basis for concluding that Unit dissolution will enable Optimal to circumvent Rule 37.

Based on the record in this case, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. At least ten (10) days notice of this hearing was mailed to all affected mineral owners. Notice was also published once per week for four consecutive weeks in The Clarksville Times, a newspaper of general circulation in Red River County, Texas.
2. In Oil & Gas Docket No. 06-0221090, the Commission issued a Final Order on March 3, 1999, granting Sonat Exploration Company authority for unitization and secondary recovery for the 1,558-acre Topaz Field Unit, Topaz (Clarksville) Field, Red River County, Texas. On or about January 21, 2000, a subsequent operator, Classic Oil & Gas, Inc., filed a Form P-6 to subdivide 37 acres out of the Unit, thereby creating the 1,529.96 acre Topaz Waterflood Unit.

Proposal for Decision

3. Optimal Utilities, Inc. ("Optimal") seeks the Commission's approval of its application to dissolve the Topaz Waterflood Unit pursuant to the provisions of Statewide Rule 38(d)(3).
4. The Commission previously has recognized and accepted the Topaz Waterflood Unit, the Unit produced hydrocarbons from the Topaz (Clarksville) Field in the twenty (20) years preceding the filing of the Optimal application to dissolve the Unit, and dissolution of the Unit will result in separate tracts that are substandard under the density rule applicable to the Topaz (Clarksville) Field.
 - a. Because under §101.013 of the Texas Natural Resources Code, a unit agreement may cover only that area of the field that has reasonably been defined by development, only portions of certain mineral tracts were included in the Topaz Waterflood Unit.
 - b. The mineral tracts, all or portions of which were included in the Topaz Waterflood Unit, all exceeded 40 acres, with the exception of four tracts in the northeastern part of the Unit that had been pooled together for the drilling of the Barrow No. 1 dry hole.
 - c. The four substandard tracts that would result from dissolution of the Topaz Waterflood Unit include two tracts of 12.48 acres each and two tracts of 15 acres each.
5. If the Commission approves dissolution of the Topaz Waterflood Unit, Optimal will operate certain mineral tracts, all or portions of which were included in the Unit, as separate lease tracts, more specifically, the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; the Cooper "D" (14823) Lease, Well No. 6, and the Blankenship Heirs (14824) Lease, Well No. 1, all in the Topaz (Clarksville) Field, Red River County, Texas. Optimal has been recognized as the operator of these resulting regulatory lease tracts on the Commission's Oil Proration Schedule.
6. Optimal has effective oil and gas leases covering the mineral tracts where the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; the Cooper "D" (14823) Lease, Well No. 6, and the Blankenship Heirs (14824) Lease, Well No. 1 are located.
7. There is sufficient acreage in the mineral tracts under lease to Optimal to assign to the Duncan (14819) Lease, Well No. 1; the Cooper "A" (14820) Lease, Well No. 1; the Cooper "B" (14821) Lease, Well No. 9; the Cooper "C" (14822) Lease, Well No. 3; the Cooper "D" (14823) Lease, Well No. 6, and the Blankenship Heirs (14824) Lease, Well No. 1 to conform to the density rule applicable in the Topaz (Clarksville) Field.

8. None of the substandard tracts that will result from dissolution of the Topaz Waterflood Unit are under lease to Optimal.
9. The Topaz Waterflood Unit has terminated.
 - a. Production was last reported to the Commission for this Unit in February 2006.
 - b. The unit agreement for the Unit provided that the term of the agreement was for so long as there was production of unitized substances in paying quantities.
 - c. The last Unit operator has confirmed by affidavit that the last production in paying quantities from the Unit was in November 2005, there was a total cessation of production from the Unit in February 2006, and the Unit terminated at the latest on November 1, 2006.
10. The Duncan (14819) Lease, Well No. 1 was permitted by Sonat Exploration Company-Tyler at a regular location on a 41 acre pooled unit in July 1996. The pooled unit on which the well was permitted included 20.5 acres from the Warthan tract. The Warthan tract is now unleased, and the Duncan No. 1 well is 137 feet from the Warthan lease line.
11. The field rules applicable to the Topaz (Clarksville) Field provide for 467 foot lease line spacing. The issue of whether Optimal is allowed to produce the Duncan No. 1 well without a Rule 37 exception is pending before the Commission in Oil & Gas Docket No. 06-0267941.
12. There is no evidence that dissolution of the Topaz Waterflood Unit will result in circumvention of the density provisions of Statewide Rule 38 or any other Commission rule.

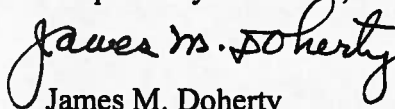
CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued to appropriate persons entitled to notice.
2. All things necessary to the Commission attaining jurisdiction have occurred.
3. The application of Optimal Utilities, Inc. meets the requirements of Statewide Rule 38(d)(3) [16 TEX. ADMIN. CODE §3.38(d)(3)] for dissolution of the Topaz Waterflood Unit.
4. Approval of the dissolution of the Topaz Waterflood Unit with the rules of the Commission applicable to each separate tract will not circumvent the density restrictions of Statewide Rule 38 [16 TEX. ADMIN. CODE §3.38] or any other Commission rule.

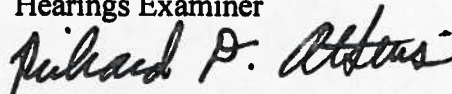
RECOMMENDATION

The examiners recommend approval of the application of Optimal Utilities, Inc. and recommend the issuance of the attached final order dissolving the Topaz Waterflood Unit, with the rules of the Commission applicable to each separate tract.

Respectfully submitted,



James M. Doherty
Hearings Examiner



Richard Atkins
Technical Examiner