OIL & GAS DOCKET NO. 06-0235018 **AMENDED PROPOSAL FOR DECISION**

THE APPLICATION OF STONEWALL PRODUCTION COMPANY PURSUANT TO STATEWIDE RULE 38(D)(3) FOR THE DISSOLUTION OF THE BARBEE PALUXY UNIT IN THE CHAPEL HILL FIELD, SMITH COUNTY, TEXAS

APPEARANCES

APPLICANT:	**REPRESENTING:**
Robert Ellis	Stonewall Production Co., Inc.
Steve Pinkston	Stonewall Production Co., Inc.
John L. Jones, Landman	Stonewall Production Co., Inc.
Katie Howard, Attorney	Stonewall Production Co., Inc.

PROTESTANT:

Mildred McNair	Self
Ruby Hicks	F.G. Gipson
Donald Hicks	F.G. Gipson
Lillie Pinke	F.G. Gipson
Larry Gipson	F.G. Gipson
Wanda Gibson	F.G. Gipson
Glenda A. Sturges	F.G. Gipson

PROCEDURAL HISTORY

Application to subdivide unit:	April 10, 2003
Application for Rule 38(d)(3) Exception:	May 19, 2003
Hearing Held:	August 22, 2003
Reopened Hearing Held:	April 8, 2004
Record Closed:	April 8, 2004
Transcript Received:	April 21, 2004
PFD Circulated:	December 23, 2003

Amended PFD Circulated: July 14, 2004

Heard by: Scott Petry, Hearings Examiner
Margaret Allen, Technical Examiner

STATEMENT OF THE CASE

The applicant, Stonewall Production Company, Inc. ("Stonewall"), requests that the Commission approve the dissolution of the Barbee Paluxy Unit, Chapel Hill Field, in Smith County, Texas, pursuant to Statewide Rule 38(d)(3). The Barbee Paluxy Unit was formed for secondary recovery and was approved by the Railroad Commission on May 8, 1967, under Oil & Gas Docket No. 6-57,266. Stonewall wishes to dissolve the unit and produce the Barbee Paluxy Unit Well No. 402 ("Well No. 402" or "subject well") on a lease basis, to be identified in the future as the James Warren Well No. 2.

The application is protested by Mildred McNair, Ruby Hicks, Donald Hicks, Lillie Pinke, Larry Gipson, Wanda Gibson, and Glenda A. Sturges ("protestants"). The protestants are mineral interest owners in tracts that are part of the Barbee Paluxy Unit. The protestants believe the unitization should be preserved and that Stonewall's application should be denied.

The protestants appeared at the hearing to contest this matter on August 22, 2003. The applicant's case in chief failed to sufficiently indicate that a contractual termination of the underlying unit agreement had been effected prior to the hearing or to show that correlative rights would be protected, and, on December 23, 2003, a proposal for decision was issued recommending denial of the applicant's request. Subsequent to the issuance of the proposal for decision, but before being posted for public conference, the applicant retained counsel and requested that the hearing be reopened to provide additional evidence pertaining to the contractual dissolution of the unit agreement and the waste of hydrocarbons underlying the unit tracts. The motion to reopen was granted and the hearing was reopened on April 8, 2004. The protestants also appeared at the reopened hearing and cross-examined the applicant's witnesses.

BACKGROUND

Statewide Rule 38(d)(3) provides that, if: (1) two or more separate tracts are joined to form a unit for oil or gas development, (2) the unit is accepted by the Commission, and (3) the unit has

produced hydrocarbons in the preceding twenty 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 rule further provides that the Commission shall grant approval of such dissolution only after proper application, notice, and an opportunity for hearing has been provided. The rule states that 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 unitized tract and that the Commission shall give notice of this application to the current lessees and unleased mineral interest owners of each tract within the joined or unitized tract. The rule also explicitly states that a Commission designee may grant administrative approval only if the Commission designee determines that granting the application will not result in the circumvention of the density restrictions set by the Commission.

Secondary recovery and cooperative agreements are governed by Texas Natural Resources Code, §101 et seq. Specifically, § 101.011 states that,

> Subject to the approval of the commission, as provided in this chapter, persons owning or controlling production, leases, royalties, or other interests in separate property in the same oil field, gas field, or oil and gas field may voluntarily enter into and perform agreements for the following purpose:
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> > (1) to establish pooled units, necessary to effect secondary recovery operations for oil or gas, including those known as cycling, recycling, repressuring, water flooding, and pressure maintenance and to establish and operate cooperative facilities necessary for the secondary recovery operations....

Further, Texas Natural Resources Code, §101.013 states that:

> Agreements for pooled units and cooperative facilities are not legal or effective until the commission finds, after application, notice, and hearing:
>
> > (1) that the agreement is necessary to accomplish the purposes specified in Section 101.011 of this code;

(2) that it is in the interest of the public welfare as being reasonably necessary to prevent waste and to promote the conservation of oil or gas or both;

(3) that the rights of the owners of all the interests in the field, whether signers of the unit agreement or not, would be protected under its operation;

(4) that the estimated additional cost, if any, of conducting the operation will not exceed the value of additional oil and gas so recovered, by or on behalf of the several persons affected, including royalty owners, owners of overriding royalties, oil and gas payments, carried interests, lien claimants, and others as well as the lessees;

(5) that other available or existing methods or facilities for secondary recovery operations or for the conservation and utilization of gas in the particular area or field concerned or for both are inadequate for the purposes; and

(6) that the area covered by the unit agreement contains only that part of the field that has reasonably been defined by development, and that the owners of interests in the oil and gas under each tract of land in the area reasonably defined by development are given an opportunity to enter into the unit on the same yardstick basis as the owners of interests in the oil and gas under the other tracts in the unit.

DISCUSSION OF THE EVIDENCE

This docket involves the Chapel Hill Field, which was discovered in 1940 and which produces from several different reservoirs. Field rules for the Chapel Hill Field specify 40-acre density and well spacing of at least 467' from lease lines and at least 933' between wells. Well No. 402, completed in 1952, was the first well to produce from the Barbee sand of the Paluxy Formation in the Chapel Hill Field. According to the applicant, Well No. 402 is the only well on the "former" Barbee Paluxy Unit still capable of oil production.

I. Applicant's Position and Evidence

Stonewall asserts that it initially took over the subject wells from a prior operator for salvage

value, but later learned that Well No. 402 was still capable of producing oil. According to the applicant, the leases and agreements necessary for the unitization have lapsed, and it is necessary to dissolve the unit so that it may produce the tract on which it has a lease. Otherwise, the applicant argues that the hydrocarbons surrounding its subject well will be wasted.

In support of its initial application, Stonewall presented evidence regarding the unit's past production and geology, its current role and participation in the unit, and its attempts to provide adequate notice to the numerous parties involved in the former unit. In the reopened hearing, Stonewall further maintained: 1) that the unit agreement has terminated according to its own terms, 2) that a legal dissolution of the unit has been effected, and 3) that the production from Well No. 402 will not harm correlative rights because the well will produce oil that was originally in place before secondary recovery efforts were commenced.

History and Geology of the Unit

The Barbee Paluxy Unit ("subject unit") was formed on May 25, 1966, by Cities Service Oil Company. The unit agreement was signed by the twelve working interest owners and by numerous royalty interest owners. The subject unit, which originally had 14 tracts but was amended to include only 13 tracts on May 17, 1967, contains 375 acres. Well No. 402 was on the 85-acre Tract 4.

The subject unit contains all 239 net productive acres that were mapped in this limited reservoir. Total reservoir production at the time the unit was approved was 616,000 barrels of oil, which the original operator estimated to be 95% of the recoverable primary reserves. The amount of incremental secondary recovery was estimated to be 722,000 barrels of oil. The oil in the Barbee sandstone has low gravity (20° API) and contains hydrogen sulfide. The primary drive mechanisms for the Barbee Paluxy reservoir were thought to be fluid expansion and solution gas. Cumulative secondary production since 1967 has been approximately 550,000 barrels of oil.

While the initial response to the waterflood operations proved positive, later operations showed lower production. Records indicate that production fell and leveled out at approximately 85 barrels of oil per day in 1972. Oil production declined at about 10% per year until 1997, when the decline rate steepened to 35%. R.A. Miller Energy Inc. acquired the unit from Moon Operating in August 1998, and the production became more erratic. The unit was shut-in between February and

June 1999. In February 2000, the unit was sold to Southwest Operating Inc. According to Stonewall, the production began to improve again but remained erratic due to high water cuts and deteriorating surface facilities. Monthly oil production for the period from July, 1999, through August, 2001, ranged from zero to approximately 700 barrels.

Starting in September 2001, the wells on the subject unit were shut-in for approximately thirteen months. Stonewall testified that it acquired the wells in May, 2002, and brought Well No. 402 back on production in October 2002. Stonewall testified that it has produced 4,041 barrels of oil from Well No. 402 through December, 2003. All revenue from this oil is being held in escrow by the purchaser, Plains Marketing LP, until ownership is decided.

Stonewall's Participation

Stonewall maintains that it had to repair the equipment on the unit before any of the wells could be tested for remaining production. It asserted that extensive repairs were necessary due to the heavy gravity of the oil produced. The oil separating equipment and disposal facilities were in disrepair, and the flowlines were plugged with heavy oil. Stonewall claims that the other wells on the unit produce only water.

Average daily production from Well No. 402 since October 2002 has been 10 barrels of oil at 75% water cut. The proration schedule shows that this well has a potential of 10 barrels of oil per day pumping, with a gas/oil ratio of 5400 cubic feet per barrel. Stonewall argues that Well No. 402 is capable of recovering another 11,000 barrels of oil, that it has the rights to produce the James Warren Lease where Well No. 402 is located, and that it wants to produce the remaining oil from this well on an individual lease basis. As there is no longer any injection and Stonewall has effected a contractual dissolution of the subject unit, the applicant believes that the unit formed for secondary recovery should be dissolved for Commission purposes and that the well name should be changed to the James Warren No. 2.

The applicant argues that the economics of Well No. 402 unit are marginal because the water cut has increased to 75% or more and the low gravity of the sour crude reduces the oil's market value. Stonewall testified that the current pumping operation in Well No. 402 is essentially a skimming procedure whereby the pump lifts minor amounts of oil with ever increasing volumes of

water.[1]

Notice

Stonewall maintains that it attempted to notify the nearly 500 persons from the May, 2001, division order of the prior operator, and that it updated these addresses whenever possible. The Commission issued a notice of hearing on this application to all known lessees and unleased mineral interest owners in the Barbee Paluxy Unit on July 21, 2003.[2] The applicant published its notice of application under Statewide Rule 38(d)(3) in the Tri-County Leader, a weekly newspaper published in Whitehouse, Smith County, on June 12, 2003, June 19, 2003, June 26, 2003, and July 3, 2003. Stonewall also published the notice of hearing in the Tri-County Leader on July 24, 2003, July 31, 2003, August 7, 2003, and August 14, 2003.

Stonewall admits that it does not have a complete, updated address list, but points out that most of the wells are over 50 years old. The applicant contends that there are over 500 royalty owners in the various base tracts of the unit, and that many of these interests have no documentation regarding heirship and/or have moved without leaving forwarding addresses. Stonewall claims it made diligent efforts to correct the addresses of the interest owners that were on the May, 2001, division order of the prior operator, but that it is the responsibility of a royalty owner to notify an operator of an address change. At the time of the hearing(s), Stonewall asserted that it did not have leases on ten of the thirteen base tracts that were combined in the unit, and that it would be a huge burden to locate all the property owners where it has no leases.

Unit Termination

In both the initial hearing and the reopened hearing, Stonewall argued that the subject unit

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[1] The applicant maintains that it is economically feasible to produce this high water-cut well because it has a legal right to use the only remaining injection well for disposal purposes. Stonewall stated that it purchased the property where the injection well is located, and is operating this well for disposal purposes only, not for waterflooding.

[2] Notice to the interests offsetting the unit, however, was not required because the Commission had previously determined that these offset interests were "unaffected" pursuant to the requirements of Statewide Rule 38.

was no longer operational by its own terms and that it should be dissolved at the Commission. In support of its argument, the applicant points to Article 15 of the unit agreement, which states:

> The terms of this agreement shall be for the time that unitized substances are produced in paying quantities and as long thereafter as operations for the production of same are conducted without a cessation of more than ninety(90) consecutive days.

Stonewall asserts that the nonproduction between September 2001 and October 2002, when coupled with the aforementioned clause, caused the unit agreement to lapse and cease to be in effect.

According to Stonewall, ten of the leases assigned to the unit lapsed when the unit agreement ceased to be in effect due to the cessation of production. The three remaining leases remained in effect because they were held by deeper production. The applicant also submitted a "Release of Oil, Gas and Mineral Leases", which it contends was done at the request of mineral interest owners involved in the ten lapsed leases, to "...release, relinquish and surrender unto the current mineral owners" all of Stonewall's interests in the oil, gas and mineral leases covering the above referenced ten leases. Stonewall's release is dated and notarized June 30, 2003.

Contractual Dissolution of the Unit

The applicant also provided an operator's certificate of unit termination for the Barbee Paluxy Unit. Stonewall asserts that the purpose of filing this certificate was to provide a contractual dissolution of the unit and to give the public notice that the unit had indeed terminated. The effective date for the certificate of unit termination was September 1, 2002, which the applicant acknowledges is approximately 120 days after Stonewall acquired the property. Steve Pinkston, on behalf of Stonewall, testified that the chosen date was one "...that we were very comfortable with that was more than 90 days after cessation of production or operations." The applicant maintains that it was the designated operator of the unit and that, pursuant to the unit agreement's terms, it had the authority to "...file in the courthouse a certificate of unit termination on behalf of itself and the other working interest owners."

Well No. 402: Original Oil in Place

Stonewall asserts that the oil underlying Well No. 402 consists of primary reserves which

were missed by the waterflood in the field. Specifically, the applicant believes that Well No. 402 has had limited communication with the reservoir that was waterflooded by the injection wells. In support of this theory, Stonewall presented several lines of evidence.

First, Stonewall points out that the subject well, Well No. 402, has a different, current bottomhole pressure from the other wells in the unit. The subject well has a depleted bottomhole pressure of 255 psia. The other wells on the unit have current bottomhole pressures ranging anywhere from 933 psia to 2480 psia, which show bottomhole pressure supported by water injection.

Second, the applicant states that water cuts show that Well No. 402 is in a separate reservoir compartment. Stonewall presented evidence which shows that the water cut from the subject well is distinct from the water cut seen in the other unit wells. When first completed, the subject well had an initial water cut of approximately 20%, whereas the other wells had water cuts ranging anywhere from 2% to 8% at the time of their initial completions. The monthly production reports through 1988[3] show that Well No. 402's cumulative water cut was approximately 25%, whereas the other wells had cumulative water cuts of 70% to 90%. In the most recent production reports available, the other unit wells produced 94% to 100% water, whereas Well No. 402 produced only 73% water.

Third, the cumulative production of the various wells indicates that the "compartment" surrounding Well No. 402 was not influenced by the waterflood. The applicant presented evidence which shows that Well No. 402's cumulative recovery through November 1988 was 126,643 barrels of oil, or 3,958 barrels of oil per foot of pay. In contrast, the cumulative recovery for Well No. 403, which is the unit well closest to the subject well, for the same time period, was 186,801 barrels of oil, or 11,675 barrels of oil per foot of pay. The applicant states that the subject well did not benefit from the injected water and further asserts that the oil surrounding Well No. 402 was not pushed there from other tracts on the unit.

Based on decline curve analysis, Stonewall maintains that Well No. 402 has remaining recoverable reserves of about 11,000 barrels of oil. Its volumetric calculations indicate that this is the amount of recoverable reserves from underneath four acres if one assumes a 10% recovery and that this remaining oil will be recovered due only to the original depletion drive, not the injected water.

[3] Detailed records of production by well were maintained only through November, 1988, when Cities Service/Oxy USA ceased to operate the unit.

The applicant argues that the remaining reserves were originally present under the James Warren Tract, that this oil did not originate on other tracts within the unit, and that it will take approximately four years to recover the remaining 11,000 barrels of oil.

Finally, Stonewall asserted that there are six wells currently on the proration schedule for the Barbee Paluxy Unit, including the disposal well and the original water supply well. Stonewall maintains that the proposed dissolution of the subject unit is not an attempt to circumvent Commission rules and that the unit dissolution complies with Rule 38(d)(3)[4]. Specifically, the applicant notes that its primary goal is to produce Well No. 402, which is at a regular location on Stonewall's 85-acre James Warren Lease, and that it is not an attempt to exceed Commission restrictions on density. Stonewall further noted that the other producing well on its 85-acre Warren lease, Well No. 403, is at a regular location with regard to lease lines and between well spacing.

II. Protestants' Position and Evidence

The protestants argue that the unit agreement is still in effect. While the protestants did not put on any direct evidence concerning the application of Statewide Rule 38(d)(3), they did cross-examine the applicant's witnesses. One of the protestants' primary objections was that the notice should have been printed in the local Tyler paper rather than in the Tri-County Leader. The protestants allege that this was done to avoid giving notice to the parties that needed it.

Mildred McNair appeared at the hearing as a representative of the Moseley family, which owns interests in several of the base tracts. Ms. McNair believes that there is no reason to dissolve the unit. She testified that Stonewall's survey was not properly done and that the company cannot verify the acreage involved. She asserts that Stonewall's information is incorrect in general, and that its list of royalty owners is also incomplete. She stated that the applicant's petition does not address each well and is vague in scope. In Ms. McNair's opinion, the application is a scam to get around Commission rules.

Ms. McNair also argued that Stonewall did not prove ownership and did not submit copies

[4] Stonewall's Exhibit 6 shows that each of the 13 base tracts in the unit took its size and shape prior to discovery of the Chapel Hill Field, but that 12 of the 13 tracts are substandard (less than 40 acres).

of its leases. She questioned the reasons that all the wells apart from Well No. 402 were shut-in. She is concerned that Well No. 402 will drain oil from other tracts where her family has mineral interests. She pointed out that the disposal well that Stonewall is using is on Mosely land. Ms. McNair stated that Stonewall has not shown waste with regard to the Barbee Paluxy Unit. In her opinion, the Barbee Paluxy Unit is still intact and the period of non-production "does not qualify a unit to be dissolved."

Ruby Hicks also represented the protestants. Ms. Hicks agreed that the royalty owner list is not up-to-date and complained that she did not know many people who were listed on the prior operator's division order. She stated that her family specifically did not sign a lease with Stonewall and questioned the validity of the leases underlying the subject unit. She questioned why Stonewall would assert that it did not have the leases when she had recently received a letter from Stonewall's landman requesting new leases and stating that two more wells were planned. In cross examination, Stonewall asserted that it had approached Ms. Hicks about leasing another prospect in another formation that was separate from the Barbee Paluxy Unit, but Ms. Hicks disputes this and states that the applicant was trying to get a lease in the Paluxy Field. She also feels that Stonewall failed to show that the unit has been dissolved.

Donald Hicks does not like the proposed change in the name of the wells as this unit involves his great-grandfather's land. He wants to be treated fairly and does not believe that Stonewall's proposal will do so. He also complained of receiving a royalty check for only 26 cents. At the reopened hearing, Mr. Hicks questioned Stonewall's need to present 23 additional exhibits and questioned one of its witness' credentials.

Glenda Sturges stated that her main purpose for appearing at the hearing was to prevent any changes to the unit. Ms. Sturges also cross-examined Stonewall's witnesses with regards to the technical meaning of a waterflood. Wanda Gibson questioned Stonewall as to who actually performed the reservoir analysis and to the time that it took to prepare the analysis.

Lillie Pinke wanted to know why Stonewall's landman is still interested if, as Stonewall testified, this field is almost depleted. She questioned Stonewall's definition of "salvage", pointing out that salvage means different things to different people, and that the operator may wish to bring the "capped" wells back on production.

EXAMINERS' OPINION

If a tract in a unit is a legal subdivision at the time the unit is formed, does not come under common ownership and control with other tracts in the unit, and there are no subdivisions of the tract after the formation of the unit, the tract reverts to its legal subdivision status upon dissolution of the unit and Railroad Commission approval pursuant to Statewide Rule 38(d)(3). Dissolution of a unit pursuant to Statewide Rule 38(d)(3) may be granted if the dissolution will not result in the circumvention of the density restrictions of Rule 38 or other Commission rules, and if written waivers are filed by all affected persons or no protest is filed.[5] The language regarding "...density restrictions...or other Commission rules," however, indicates that circumvention of Commission rules pertains not just to the rules affecting density, but to *all* Commission rules, including those regarding secondary recovery units and Texas Natural Resources Code §101 et seq.

Statewide Rule 38(d)(3) references a "unit" dissolution, and past Commission dockets indicate that it is applicable to both pooled units and secondary recovery units. While both are termed "units", however, they are significantly different in nature. Assuming that the operator of a pooled unit meets the requirements of Statewide Rule 38(d)(3), that operator may dissolve a pooled unit into its constituent tracts, which then revert to their legal subdivision tract. Accordingly, a mineral interest owner or lessee, assuming that no wells are currently drilled on that tract, may, if practical, have the redress of drilling its own well to achieve its fair share of hydrocarbons. A mineral interest owner or lessee in a secondary recovery unit, however, does not typically have this redress because it is contemplated that its fair share, depending on location, will intentionally be moved off lease to the highest structural point in the unit.

The applicant in this docket has the burden of showing that the requested dissolution of the secondary recovery unit comports with the prerequisites of Statewide Rule 38, and that, as is implicit

[5] The protestants in this docket argued that the applicant attempted to avoid giving notice by publishing in the Tri-County Leader rather than in the Tyler paper. In cases of notice by publication, however, Commission procedure states that notice shall be printed in a newspaper of general circulation in the county where the land or facility is located, and it is undisputed that the Tri-County Leader is located in Smith County, which is the situs of this secondary recovery unit. While publication in the Tyler newspaper may have had the potential to reach a greater number of people, the examiners find that the notice provisions have been properly met by publication in the Tri-County Leader.

in any Statewide Rule 37 or 38 case, waste will be prevented and/or correlative rights will be protected. Additionally, the use of Statewide Rule 38(d)(3) as a tool to dismember a secondary recovery unit requires that the underlying unit agreement be contractually terminated *before* the case is heard by the Commission. Evidence of this contractual dissolution may include, but is not limited to, an operator's certificate of unit termination filed in the appropriate county court. For the reasons enumerated below, the examiners conclude that Stonewell has met these requirements and that the requested dissolution should be granted.

I. Correlative Rights & Prevention of Waste

Given the special nature of secondary recovery units and attending correlative rights issues, special safeguards were enacted by the Texas Legislature in Texas Natural Resources Code, §101 et seq. Specifically, §§101.011 and 101.013 indicate that agreements for units and cooperative facilities are not legal or effective until the Commission finds, after hearing, that it is necessary to effect secondary recovery operations for oil or gas. These sections further enumerate safeguards that must be met by the parties to ensure that the operations are in the public welfare, that they are necessary to prevent waste and to promote the conservation of oil or gas, and that the rights of the owners of all the interests in the field, whether signers of the unit agreement or not, are protected under the agreement.

These safeguards are meant to acknowledge and protect correlative rights, and past Commission decisions have indicated reticence to dissolve a secondary recovery unit unless the conservation of oil and gas necessitates it. In one such decision regarding the dissolution of a secondary recovery unit, the examiners noted that:

> ...Commission approval of unit agreements is an extremely important legal prerequisite to the institution of secondary recovery projects requiring unitization, in the interests of conservation. To subject unitization agreements to possible revocation of Commission approval, absent a showing of waste or violation of statutes, rules or orders, could negatively impact the viability of projects which are needed for conservation of oil and

gas.[6]

Stonewall, however, argues that the facts of this docket necessitate dissolution of the unit in furtherance of the conservation of oil and gas. Indeed, the applicant has made a sufficient showing to indicate that correlative rights would be protected should the unit dissolution be granted because the oil underlying the subject well was not pushed there as a result of the waterflood. The applicant has shown that differing bottomhole pressures, waters cuts, and cumulative production between the subject well and other wells in the unit point to Well No. 402 being in a separate reservoir compartment. Further, Stonewall has shown that this separate compartment has remaining recoverable reserves of about 11,000 barrels of oil. The applicant has shown that it does not have the legal authority to produce the Barbee Paluxy Unit under the terms of the lapsed unit agreement and that, absent the dissolution of the unit, the remaining reserves will go unrecovered.

II. Contractual Dissolution of the Unit Agreement

A unit agreement for secondary recovery operations is born when the parties sign a private, contractual agreement. This agreement, however, may only go into effect after the Commission has determined that it comports with Texas Natural Resources Code, §§101.011 and 101.013. Once the Commission has determined that it complies with the statutes, the new agreement is approved by a final order signed by the Railroad Commissioners and the secondary recovery efforts are commenced. After the secondary recovery efforts have lived out their days, the reverse of this process also holds true and a final order signed by Commissioners is necessary. One should never hold a funeral until *after* the doctor has declared the patient dead, and so it is with secondary recovery units. Evidence of the contractual termination of the unit agreement is necessary before the Commission can properly dissolve a secondary recovery unit, and past Commission dockets reinforce this maxim.

[6] Oil & Gas Docket No. 3-92,476, *A Commission Called Hearing on the Complaint of Kenneth T. Ward, on Behalf of Numerous Royalty Owners, to Consider Canceling, Revoking or Otherwise Terminating Commission Approval of the West Hastings Unit, Hastings, West Field, Brazoria and Galveston Counties, Texas* (Order signed April 3, 1989), at Page 9.

In Docket No. 9-97,554,[7] Mitchell Energy wished to dissolve its secondary unit because the unit had watered out and there was only one remaining well capable of production. While this case was unprotested, the documents in the record indicate that Mitchell first obtained a signed, notarized Operator's Certificate of Unit Termination, which was filed before the application to dissolve the unit was made. This unit agreement termination was not protested or questioned, as Mitchell Energy was the owner of all of the working interests and leases involved in the subject agreement. The application to dissolve the secondary recovery unit was approved by the Commission in a final order dated August 3, 1992.

In Docket No. 3-92,476,[8] which was protested, various working interest owners in the West Hastings Unit requested that the Commission dissolve the unit on the basis that it was no longer economically feasible to produce. Unlike the above referenced Mitchell docket, however, the parties had not provided evidence of a contractual termination of the unit agreement. The Commission adopted an order denying the application on the basis that contractual disputes are not within the jurisdiction of the Commission. In the proposal for decision that accompanied this order, the examiners recommended that,

> ...this complaint be dismissed, and that the parties be directed to proceed with their contract negotiations...to resolve their contractual dispute regarding the continuance or dissolution of the WHU Unit Agreement. If an agreement is reached...or if a court order is entered revoking or otherwise terminating the Unit Agreement, the parties should present this evidence to the Railroad Commission for future action.[9]

As the examiners put it, the hearing was not called to determine whether the contract had been, or should be, rescinded or revoked, "...nor does the Railroad Commission have the jurisdiction

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[7]Oil & Gas Docket No. 9-97,554, *Application of Mitchell Energy Corporation pursuant to Statewide Rule 38(d)(3) for Dissolution of the Speer-Deaver (Atoka) Unit in the Alvord (Atoka Conglomerate) Field in Wise County, Texas* (Order signed August 3, 1992).

[8]Oil & Gas Docket No. 3-92,476, *A Commission Called Hearing on the Complaint of Kenneth T. Ward, on Behalf of Numerous Royalty Owners, to Consider Canceling, Revoking or Otherwise Terminating Commission Approval of the West Hastings Unit, Hastings, West Field, Brazoria and Galveston Counties, Texas* (Order signed April 3, 1989).

[9]*Id.* at Page 2.

to take such action."[10] Rather, the examiners indicated that the proper way to handle the unit dissolution was for the contractual issues to be handled in a court of competent jurisdiction, and then to bring the action back to the Commission at a future date.[11]

Even though the outcomes of the two above-referenced cases are divergent, they both hold the same legal premise - that the proper, contractual dissolution of the underlying unit agreement must always precede the Commission's dissolution of a unit. To hold otherwise would be for the Commission to make a determination as to the proper interpretation of a contract. In Stonewall's initial hearing, it argued that the unit agreement had terminated according to its own terms, despite the fact that the protestants were arguing that the agreement was still in full force and effect. Stonewall's testimony, by itself, would have required the Commission to reach a legal conclusion that the contract had terminated and would have required the Commission to exceed its jurisdictional authority.

At the re-opened hearing, however, Stonewall supplied additional evidence to indicate that the unit had been contractually terminated. It provided an operator's certificate of unit termination for the Barbee Paluxy Unit, which it asserts provided a contractual dissolution of the unit and gave the public notice that the unit had indeed been terminated. The applicant maintained that it was the designated operator of the unit and that, pursuant to the unit agreement's terms, it had the authority to "...file in the courthouse a certificate of unit termination on behalf of itself and the other working interest owners." This certificate of unit termination was filed by the applicant in Smith County, Texas on February 3, 2004. Finally, both the protestants and the applicant acknowledged that "...any dispute between the unit participants ... would be a contractual dispute between the former unit operator and those people in a civil court of law."

The totality of the evidence in this docket indicates that Stonewall has contractually terminated the unit, that there is a significant amount of hydrocarbons underlying Well No. 402, and that these hydrocarbons will be wasted absent a dissolution of the secondary recovery unit pursuant

[10] *Id.* at Page 8.

[11] *Id.* at Page 9.

to Statewide Rule 38(d)(3). Accordingly, the examiners recommend that Stonewall's application to dissolve the subject unit be *granted*. Based on the record in this docket, the examiners further recommend adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Notice of the hearing on the application under Statewide Rule 38(d)(3) for the dissolution of the Barbee Paluxy Unit by Stonewall Production Company ("Stonewall" or "applicant") was issued to known lessees and unleased mineral interest owners in the Barbee Paluxy Unit ("subject unit") on July 21, 2003. Notice of the hearing was also published in the Tri-County Leader, a weekly newspaper published in Whitehouse, Smith County, on July 24, 2003, July 31, 2003, August 7, 2003, and August 14, 2003.

2. Notice to offset interests was not required as they were deemed unaffected by the Railroad Commission on May 12, 2003.

3. Mildred McNair, Ruby Hicks, Donald Hicks, Lillie Pinke, Larry Gipson, and Glenda A. Sturges (collectively referred to as "protestants") appeared in protest of the application.

4. Stonewall applied to the Commission for an order to dissolve the 375 acre Barbee Paluxy Unit into its separate constituent tracts. Applicant proposes to dissolve the unit and then produce the Barbee Paluxy Unit Well No. 402 on an individual lease basis, to be identified in the future as the James Warren Well No. 2.

5. The subject unit was formed for secondary recovery of oil from the Barbee Paluxy sand in the Chapel Hill Field and was approved by the Railroad Commission on May 8, 1967, under Oil & Gas Docket No. 6-57,266.

6. Applicant maintains the 85 acre James Warren Lease. Well No. 402 is located 467' from the nearest line of the James Warren Lease and 933' from the inactive Well No. 403, also located on the James Warren Lease.

7. Field rules for the multi-formation Chapel Hill Field, which was discovered in 1940, require

wells to be 467 feet from lease lines and 933 feet apart, with 40-acre proration units.

8. Well No. 402, drilled in 1952, was the first well to produce from the Barbee sand of the Paluxy Formation in the Chapel Hill Field.

9. The oil in the Barbee Paluxy reservoir is a heavy (20 degree API gravity), sour crude.

10. Well No. 402 is in a separate reservoir compartment from the other Barbee Paluxy wells and has not been influenced by the waterflood.

11. Well No. 402 will recover an additional 11,000 barrels of oil over the next four years. This oil was originally present on the James Warren Lease and has not migrated to the lease from other tracts in the unit.

12. Stonewall filed an operator's certificate of unit termination for the Barbee Paluxy Unit in Smith County, Texas on February 3, 2004.

13. Stonewall took over the subject wells from a prior operator for salvage value in May 2002.

14. The subject unit did not produce from September, 2001 through September, 2002. The unit agreement holds that the agreement will remain in effect "...for the time that unitized substances are produced in paying quantities and as long thereafter as operations for the production of same are conducted without a cessation of more than ninety(90) consecutive days."

15. Well No. 402 produced at least 4,041 barrels of oil from October 2002 to December 2003. Stonewall's purchaser, Plains Marketing LP, has placed revenue from this oil in an escrow account until proper ownership has been decided.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued by the Railroad Commission to appropriate

persons legally entitled to notice.

2. All things necessary to the Commission attaining jurisdiction over the subject matter and the parties in this hearing have been performed.

3. The Railroad Commission has the authority to dissolve the subject unit pursuant to Statewide Rule 38 [16 TEXAS ADMIN. CODE §3.38].

4. The Commission has the authority pursuant to Texas Natural Resources Code §§85.049 and 85.051 to determine if any rule or order should be adopted or any other action taken to correct, prevent, or lessen the waste of oil or gas.

5. Stonewall's application is not an attempt to circumvent Commission rules.

6. Dissolution of the Barbee Paluxy Unit pursuant to Statewide Rule 38(d)(3) will prevent the waste of a substantial amount of hydrocarbons and will protect correlative rights.

RECOMMENDATION

The examiners recommend that the application of Stonewall Production to dissolve the Barbee Paluxy Unit pursuant to Statewide Rule 38 be ***granted***.

Respectfully submitted,

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Scott Petry	Margaret Allen
Hearings Examiner	Technical Examiner