
* KEY ISSUES: ECONOMIC WASTE *
* Equidistant offset rule *
* Substantial compliance *
*
* FINAL ORDER: R37 EXCEPTION DENIED *

Rule 37 Case No. 0204252

**APPLICATION OF JONES ENERGY, LTD. FOR AN EXCEPTION TO STATEWIDE
RULE 37 TO COMPLETE ITS NO. 3 WELL, PHELPS "40" LEASE, IN THE WARREN
(WOLFCAMP) FIELD, HANSFORD COUNTY, TEXAS**

APPEARANCES:

REPRESENTING:

APPLICANT

William Osborn

Jones Energy, Ltd.

Dave Johns

"

PROTESTANT

David Gross

Texaco E&P, Inc.

Timothy S. Dwyer

"

William S. Lyons

"

William V. Jones, Jr.

"

Sandra Bolz Buch

Questa Energy Corp.

Keith B. Masters

"

Carroll Martin

ER Operating

Dean D. Hunt

North Central Oil Corp.

INTERESTED PERSONS

George C. Neale

Royalty Interest Owners

PROCEDURAL HISTORY

Application Filed:	January 10, 1994
Notice of Hearing:	January 13, 1994
Hearing Held:	February 9, 1994
PFD Circulated	April 5, 1994
Heard by:	Larry Borella, Hearings Examiner Margaret Allen, Technical Examiner

STATEMENT OF THE CASE

Jones Energy, Ltd. ("Jones" or "applicant") produces the Phelps 40-3 Well from the Collard (Fort Riley) Field. Eleven hundred feet to the southwest is the Jones Phelps 40-1 Well which is completed in the shallower Warren (Wolfcamp) Field. Jones believes that the recently drilled 40-3 Well has encountered commercial quantities of gas in the Warren (Wolfcamp) Field. Because the between-well spacing for these fields is 1200 feet, Jones is prohibited from producing the wells concurrently from the same field. Consequently, Jones has requested an exception to the between-well spacing so that both wells can be produced from the Warren (Wolfcamp). Texaco E&P, Inc. ("Texaco") and Questa Energy Corp. ("Questa") who offset Jones to the north and northeast respectively, entered evidence in protest of the application. North Central Oil Corp. and ER Operating appeared in protest but offered no evidence.

APPLICANT'S EVIDENCE AND POSITION

In July 1991 Jones completed its Phelps 40-1 Well in the Hunter (White Dolomite). In June 1992 Jones completed its Collard 1-41 Well (approximately 1700 feet east of the 40-1 Phelps) in the same field. Jones subsequently (October 1993) perforated a shallower zone in the 1-41 Well. Later, pursuant to a Commission order, the deeper zone became the Collard (Fort Riley) Field and the zone identified in the Phelps 40-1 Well as the Hunter (White Dolomite) was assigned to the Warren (Wolfcamp) Field. Jones' lessors on the Phelps tract demanded protection from drainage in the Collard (Fort Riley) Field. Mechanical considerations made it impossible to produce the existing Phelps 40-1 Well from the Collard (Fort Riley). As a consequence of the demand letter, Jones drilled the Phelps 40-3 Well and completed it in the Collard (Fort Riley) Field. This information, plus the fact that the Phelps 40-1 Well was Jones' second-choice location (Jones original choice was

a rule 37 exception location which was withdrawn as a result of a Texaco protest) proves that neither of these wells was drilled as a subterfuge to bolster an economic waste case.

Jones concludes that it is entitled to the applied-for exception under one or more of the following theories:

- (1). Substantial compliance - the applied-for exception well is 1107 feet from the other well on the lease. The required distance is 1200 feet. The Commission considers a margin of 10% or less to be substantial compliance.
- (2). The equidistant offset rule - Jones is entitled to an equidistant offset to the Texaco Blakemore to set up a no-flow boundary to prevent confiscation.
- (3). Economic waste - neither well on the subject tract was drilled as a subterfuge to bolster a rule 37 exception, therefore Jones is entitled to the exception to avoid the economic waste associated with drilling another well.

PROTESTANTS' EVIDENCE

Texaco E & P, Inc.

Texaco's technical evidence is summarized as follows: The Jones Phelps 40-3 Well occupies the highest point on the field's anticlinal closure. The Warren (Wolfcamp) pay is sealed by a tight section of the Winfield Dolomite and underlain by a southwestward dipping gas-water contact. The reservoir comprises 6,182 acre-feet and originally contained estimated recoverable reserves of .98 BCFG, .45 BCF of this recoverable gas is attributable to the section on which the applied-for exception well is located. The Jones Phelps 40-1 Well has, as of December 1993, produced .55 BCF. Depending on its as yet undefined decline rate, the 40-1 Well can be expected to ultimately recover a minimum .69 BCF (assuming a 90% decline rate). Because Jones will recover more than its fair share from the existing well, the applied-for exception is not warranted.

Questa

Questa presented data generally in agreement with that of Texaco and draws the same conclusion. Questa calculated between 2.6 BCFG and 3.6 BCFG originally in place, with recoverable reserves of 1.9 BCFG to 2.7 BCFG. The recoverable reserves originally under section 40 was between .674 BCFG and .786 BCFG. Questa anticipates that the Jones Phelps 40-1 Well will ultimately recover between .860 BCFG and 1.25 BCFG thereby giving Jones more than its fair share from the tract.

EXAMINERS' ANALYSIS

Exceptions to rule 37 are granted to prevent waste or confiscation. To receive an exception to prevent waste, the applicant must show that, absent an exception, a substantial amount of hydrocarbons will forever remain unrecovered. No such showing was made in this case. Jones asserts that it is entitled to an exception to prevent economic waste. The examiners disagree. The genesis of the economic waste theory was the Exxon case in which the court found that economic circumstances could qualify as an unusual condition. Exxon Corp. v. Railroad Commission, 571 S.W.2d 497 (Tex. 1978). The exception in Exxon was granted to prevent waste of oil, not "waste" of the applicant's financial resources. Furthermore, the Austin Court of Appeals made it clear in Schlachter v. Railroad Commission that economic considerations would not support granting an exception based on waste unless "(1) the existing well bore will recover oil reserves that cannot be produced by any other existing well; and (2) it is not economically feasible to drill at a regular location." Schlachter v. Railroad Commission 825 S.W.2d 737 (Tex.App.-Austin 1992). The applicant met neither of these requirements.

Jones also relies on a pre-Schlachter Commission order (Rule 37 Case No. 108,188) granting a rule 37 exception to Union Pacific Resources Company ("UPRC") for a horizontal wellbore. The exception was granted so that UPRC could avoid the 30 degree deviation in the wellbore otherwise necessary to make the well regular. Schlachter notwithstanding, Jones' reliance on this case is misplaced because UPRC's exception was found to cause no greater harm to the offsetting protestant than a regular location. There is no evidence to support such a conclusion in this case. The applicant is not entitled to an exception to prevent waste.

Regarding confiscation, the Supreme Court in Gulf Land Co. v. Atlantic Refining Co stated "[T]he term confiscation evidently has reference to depriving the owner or lessee of a fair chance to recover the oil or gas in or under his land, or their equivalents in kind". Gulf Land Co. v. Atlantic Refining Co., 131 S.W.2d 73 (Tex. 1939). If the exception is sought for second or additional wells on the tract, the applicant must show some circumstance that prohibits his obtaining his fair share from a regular or less irregular location. [see Magnolia Petroleum Co. v. Railroad Commission, 96 S.W.2d 273 (Tex. 1936), adopting lower court ruling reported at 90 S.W.2d 659, 662. and Railroad Commission v. Gulf Producing Co., 132 S.W.2d 254 (Tex. 1939)]. The only evidence presented concerning fair share recovery shows that Jones will recover at least its fair share from the existing well in the Warren (Wolfcamp) Field.

The equidistant offset rule on which Jones relies is a method of evaluating the reasonableness of an irregular location in the absence of quantitative reserve data if an irregular location is warranted. No irregular location is warranted in this case because Jones has a reasonable opportunity to recover the tract's reserves without an exception to rule 37.

Jones' reliance on the substantial compliance is similarly flawed and, like its equidistance offset assertion, amounts to a collateral attack on the field rules. Substantial compliance is a doctrine that arose from the recognition that absolute precision of bottom-hole location is neither required nor

possible. It is applicable when an operator has, in good faith attempted, but failed, to place a well at the permitted location. Jones made no attempt to separate its wells in the Warren (Wolfcamp) Field by the specified 1200' distance.

FINDINGS OF FACT

1. Notice of hearing was given on January 13, 1994, to all designated operators, lessees of record for tracts that have no designated operator, and owners of record of unleased mineral interests for each adjacent tract and each tract nearer to the well than the prescribed minimum lease-line spacing distance.
2. Jones Energy Corporation ("applicant") has applied on Form W-1 for an amended permit to complete Well No. 3 on the Phelps "40" Lease. The existing No. 3 wellbore is located 1107 feet from applicant's No. 1 Well completed in the Warren (Wolfcamp) Field which is under statewide rules requiring 1200' between-well spacing.
3. Applicant's Phelps "40" Lease is a tract of regular size and shape, containing 640 acres.
4. The applicant will recover its fair share of recoverable Warren (Wolfcamp) Field reserves under the Phelps "40" Lease from the Jones Energy Corporation Phelps 40-1 Well.
5. Reserves anticipated to be recovered from the applied-for completion in the Warren (Wolfcamp) Field can be recovered by existing wells in the field.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred and have been done to give the Commission jurisdiction to decide this matter.
3. An exception to the between-well spacing requirements is not necessary to prevent waste or confiscation.

EXAMINERS' RECOMMENDATION

Because Jones failed to meet its burden of proof that an exception to rule 37 is necessary to prevent waste or confiscation, the examiners recommend that the applied-for exception be denied.

Respectfully submitted,

Larry Borella,
Hearings Examiner

Margaret Allen,
Technical Examiner