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* KEY ISSUES: CONFISCATION & WASTE *
*           Unit w/margin interests *
*           First well              *
*           Existing wellbore-plugback *
*           No regular location available *
*                                     *
* FINAL ORDER: R37 GRANTED          *
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PROPOSAL FOR DECISION
RULE 37 CASE NO. 0207615
DISTRICT 2

APPLICATION OF BAY ROCK OPERATING COMPANY FOR AN EXCEPTION TO STATEWIDE RULE 37 TO PLUG BACK WELL NO. 2, BLOCK 71 UNIT, CLAYTON (SLICK 6450), CLAYTON (LULING) AND WILDCAT FIELDS, LIVE OAK COUNTY, TEXAS.

APPEARANCES:

REPRESENTING:

APPLICANT -

Calhoun Bobbitt, Attorney
John P. MacDiarmid

Bay Rock Operating Company

PROTESTANT -

Thomas J. Fisher, Attorney
Michael Mulvey

Michael Mulvey

PROCEDURAL HISTORY

Amended Application Filed:	November 16, 1995
Notice of Hearing:	December 21, 1995
Hearing Opened:	January 18, 1996
Ruling on Notice:	May 17, 1996
Amended Notice of Application:	August 19, 1996
Storm Assoc. Protest Filed:	September 3, 1996
Amended Notice of Hearing Issued:	October 2, 1996
Mulvey Complaint Withdrawn:	October 28, 1996
Storm Assoc. Protest Withdrawn:	October 28, 1996
Hearing Closed:	October 30, 1996
PFD Circulated	March 25, 1997

Heard by:

Colin K. Lineberry,
Hearings Examiner
Thomas H. Richter, P.E.,
Technical Examiner

STATEMENT OF THE CASE

Bay Rock Operating Company ("Bay Rock" or "applicant") seeks an exception to Statewide Rule 37 to plug back its Well No. 2 on the Block 71 Unit to the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields. The application is protested by Michael Mulvey ("Mulvey" or "protestant"), who owns fractional interests in the mineral estate of tracts offsetting the drillsite tract, both within and outside the Block 71 Unit. The Clayton (Slick 6450), Clayton (Luling) and Wildcat field rules mandate spacing of 467 feet from lease lines and 1200 feet between wells. The Block 71 Unit contains sufficient acreage to comply with applicable density requirements.

Well No. 2, the existing well bore that applicant proposes to plug back, will be the only well on the 160-acre Block 71 Unit in the subject fields. Although Well No. 2 is more than 467 feet from the boundary lines of the unit, Bay Rock does not have the right to operate all of the mineral interests in the four leases that comprise the unit and, as a result, Well No. 2 is only 330 feet from the nearest property or lease line within the unit. Accordingly, exceptions pursuant to Statewide Rule 37 to the applicable spacing rules for the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields are necessary.

PROCEDURAL HISTORY

The hearing in this docket was called on January 16, 1996 to consider the application of Bay Rock for an exception to Statewide Rule 37 for Well No. 2 on its Block 71 Unit and to consider the complaint of Mulvey that Bay Rock had violated § 91.143 of the Texas Natural Resources Code and Statewide Rule 5 in its operation of the same well. The applicant presented one witness in support of its case. Protestant Mulvey cross-examined applicant's witness and presented its own exhibits. The protestant did not present any direct testimony.

At the hearing, the protestant argued that notice of the hearing was defective in that the applicant had only given notice to the interest holders of adjacent tracts within the unit (Tract 3366 to the north and Tract 3364 to the south), and not to all tracts adjacent to the drillsite tract. (See attached plat). The parties filed briefs on the notice issue after the hearing recessed. After reviewing the filings of the parties and applicable law, the examiners issued a ruling requiring that notice be given to the mineral interest holders of all tracts adjacent to the drillsite tract. After the applicant provided the names and addresses of the persons holding mineral interests in the adjacent tracts, an amended notice of application was served on all persons entitled to notice. In addition to Mulvey, offset interest holders Storm Associates and Stallion Oil Company filed notices of intent to protest the application. As a result, a notice of re-opened hearing was issued and the hearing was scheduled to reconvene to take additional evidence from the new protestants on October 30, 1996.

Prior to the re-convened hearing, on October 28, 1996, Storm Associates withdrew its protest to the application. On the same day, Mulvey filed a letter indicating that he wished to withdraw his complaint regarding the subject well. As scheduled, the hearing was reconvened on October 30, 1996. The applicant appeared at the scheduled re-opening and urged that its applied-for exception be granted. No one appeared in protest to the application at the re-opened hearing. Accordingly, the hearing was closed and this proposal for decision prepared based on the evidence submitted by the applicant and by protestant Mulvey during the first day of the hearing.

APPLICANT'S EVIDENCE

Applicant's Block 71 Unit was formed by pooling four narrow tracts designated as Tract 3364, 3365, 3366, and 3370 (See attached plat). The drillsite tract of the Block 71 Unit, Tract 3365, took its present size and shape prior to 1907. The existing Well No. 2 on the Block 71 Unit (the "subject well") was originally drilled in 1989. The subject well is a regular distance (more than 467 feet) from the external unit lines of the Block 71 Unit. Applicant does not, however, have leases on all of the mineral interests in any of the four tracts that comprise the Block 71 Unit. As a result, there are internal property lines between the drillsite tract and the adjoining tracts in the unit. The subject well is only 330 feet from property lines between the drillsite tract and the adjacent tracts to the north and south. Because of its long and narrow shape, there is not a location on the drillsite tract that complies with the 467' minimum lease-line distance requirements for the applied-for fields. The subject well is regular as to adjoining tracts to the east and west but only 330 feet from the tracts to the north and south (both of which are included in the designation of the Block 71 Unit).

Bay Rock, the P-4 operator of the subject well, seeks a permit to plug back and produce the well from the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields. The well was originally drilled and completed in the Clayton (Wilcox 7720) Field. Subsequently, the well was plugged back to the Clayton (Wilcox 7360) Field. In June of 1994, Bay Rock requested permission to plug back the subject well and test the Clayton (Slick 6450) Field pursuant to Statewide Rule 5. Based on conversations with the San Antonio District Office and the Rule 37 Department of the Commission, Bay Rock believed that it could produce the well without obtaining an exception to Rule 37 and it began doing so. In January of 1995, Bay Rock was informed by the Commission that a Rule 37 exception was required to produce the well. In April of 1995, the subject well was shut-in by the Commission. The well remains shut-in.

MacDiarmid of Bay Rock estimated the recoverable Clayton (Slick 6450) reserves under the Block 71 Unit to be 190 mmcf of gas. These reserves are worth approximately \$145,000. MacDiarmid further testified that a substantial portion of the reserves will be drained by offsetting wells if Bay Rock is not granted the requested Rule 37 exception. The cost of drilling, completing and equipping a new well in the Clayton (Slick 6450) Field was estimated as \$175,000. MacDiarmid also testified that it would not be economically feasible to drill a new well to test the Clayton (Luling) Field.

PROTESTANT MULVEY'S EVIDENCE & POSITION

Protestant Mulvey cross-examined Mr. MacDiarmid of Bay Rock and offered some cross-examination exhibits but did not present any direct testimony. Mulvey pointed out that Bay Rock had acknowledged in responses to Requests for Admissions that it was notified by the Commission in August and October of 1994 that it needed to obtain a Rule 37 exception to produce the subject well from the Clayton (Slick 6450) Field. Mulvey also cross-examined MacDiarmid extensively concerning the nature, extent and continued validity of Bay Rock's leasehold interest in the tracts that make up the subject unit and Bay Rock's right to operate the subject unit. Mulvey established that there is a pending district court action regarding these issues. Mulvey did not present any geological or engineering evidence and did not cross-examine the applicant concerning his testimony in those areas.

EXAMINERS' OPINION

Exceptions to Statewide Rule 37 may be granted to prevent waste or to protect correlative rights/prevent confiscation. Applicant claimed entitlement to a well based on both waste and confiscation. An applicant seeking an exception to Rule 37 based on waste must establish three elements: 1) that unusual conditions, different from conditions in adjacent parts of the field, exist under the tract for which the exception is sought; 2) that, as a result of these conditions, hydrocarbons will be recovered by the well for which a permit is sought that would not be recovered by any existing well or by additional wells drilled at regular locations; and, 3) that the volume of otherwise unrecoverable hydrocarbons is substantial. Applicant's own testimony established that other wells in the applied-for field would drain the Block 71 Unit. Further, applicant failed to establish that the volume, if any, of otherwise unrecoverable hydrocarbons is substantial. Accordingly, applicant is not entitled to an exception based on waste

To obtain an exception to Statewide Rule 37 to prevent confiscation, the applicant must show that: 1) It is not possible for the applicant to recover its fair share of minerals under its tract from regular locations; and, 2) that the proposed irregular location is reasonable. The subject unit contains sufficient acreage and the subject well is more than the prescribed minimum distance from unit lines. As a result of the "internal lease lines", however, there is no regular location on the drillsite tract within the Block 71 Unit. The drillsite tract is not a voluntary subdivision and is entitled to protection against confiscation since it took its size and shape in 1907, prior to the discovery of the applied-for fields. Because the Block 71 Unit contains the required amount of acreage and the proposed well location is more than the required minimum distance from lease lines, but there is not a regular location available, the first requirement for an exception has been met - applicant cannot recover its fair share from a regular location. The remaining issue is whether the proposed location is reasonable.

The applicable spacing rules for all of the applied-for fields prescribe a minimum lease line distance of 467 feet. The proposed location (the location of the existing well bore) is centered 990 feet between the north and south lines of the Block 71 Unit and 330 feet from the north and south "internal lease lines" between the drillsite tract and adjacent pooled tracts. The location is 940 feet from the east lines of the drillsite tract and unit and approximately 1600 feet from the west line of the drillsite tract and unit. Thus, the location is roughly centered on the unit and far exceeds the

minimum spacing requirements as to all tracts offsetting the unit. See attached plat.

There are no existing wells on the Block 71 Unit permitted for any of the applied-for fields. The applicant presented unrefuted evidence that there are 190 mmcf in remaining recoverable Clayton (Slick 6450) reserves under the Block 71 Unit. The applicant also presented unrefuted evidence that it would receive \$145,000 from the sale of these reserves and that the cost of drilling and completing a new well to recover the reserves would be about \$175,000. Accordingly, it would not be economically feasible to drill a new well to recover the reserves.

It is undisputed that the existing wellbore that applicant proposes to produce in the Clayton (Slick 6450) Field was drilled in good faith in 1989 and completed as a commercial producer in a different formation. The examiners do not believe that the applicant's allegedly improper production for several months after it properly plugged back under the provisions of Statewide Rule 5 is relevant to the issue of whether an exception to protect correlative rights should be granted now. The subject well has been shut-in for nearly two years.

As to the secondary targets, the Clayton (Luling) and Wildcat Fields, the applicant presented unrefuted testimony that due to the marginal chances of finding significant reserves, no prudent operator would drill a well exclusively for those reserves. The applied-for location is roughly centered on the unit and more than double the minimum spacing distance from all unit lines and is presumptively reasonable as to the secondary target fields. The protestant did not present any evidence refuting the reasonableness of the applied-for location.

Protestant Mulvey's arguments and cross-examination centered on the validity of various leases and on whether Bay Rock has the right to operate all of the tracts in the Block 71 Unit. Evidence introduced at the hearing indicated that most, if not all, of these issues are being litigated in district court in Live Oak County (Cause No. 7178-C; Michael R. Mulvey v. Pecos Development Corporation, et al., 343rd District Court, Live Oak County, Texas). The district court is the proper forum for ultimate determination of these issues. For purposes of this proceeding, applicant Bay Rock is only required to demonstrate that it has a good faith claim to the right to operate the subject well and each of the tracts included in the Block 71 Unit. Bay Rock is the Commission designated P-4 operator of the subject well and unit and adequately demonstrated that it has a good faith claim to a right to operate at least a portion of the mineral estate in each of the tracts that comprise the Block 71 Unit.

Based on the unrefuted evidence concerning applicant's fair share, the central location of the wellbore, and the fact that there is no less irregular location available, the examiners believe that the applied-for location and use of the existing wellbore, which was drilled in good faith, is reasonable and that applicant should be granted the applied-for permit to prevent confiscation. Protestant Mulvey has requested that his complaint concerning production of the subject well without first obtaining an exception to Statewide Rule 37 be withdrawn. Because applicant only requested that his complaint be withdrawn after he had presented all of his evidence, we recommend that the complaint be dismissed with prejudice.

The examiners recommend adoption of the following proposed findings of fact and

conclusions of law:

FINDINGS OF FACT

1. Notice of the hearing was given at least 10 days prior to the hearing 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. Bay Rock Operating Company ("applicant") has applied on Form W-1 for a permit to plug back and produce Well No. 2 on the Block 71 Unit. Well No. 2 is located 330 feet from the north line of the drillsite tract and 940 feet from the east line of the drillsite tract. The well is located 940 feet from the east line of the unit and 990 feet from the north line of the unit and 1850 feet from the north-east line of the B.S. & F. Survey, Abstract A-129 and 1500 feet from the north-west line of the R.W. Fant Survey, Abstract A-620., Live Oak County, Texas.
3. Applicant has applied to plug back Well No. 2 to the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields. The application is protested by Michael Mulvey ("protestant").
4. The rules applicable to the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields all require spacing of 467 feet from lease lines and 1200 feet between wells.
5. Applicant's Block 71 Unit contains 160 acres and there are not any other wells on the lease permitted for or drilled to the applied-for fields.
6. Applicant is the entity designated to the Commission as the operator of the Block 71 Unit. Applicant has leases or assignments of leases covering some or all of the mineral interests in each of the tracts that comprise the Block 71 Unit.
7. Due to internal property lines, there is not a location on the Block 71 Unit that complies with the spacing requirements of the applicable field rules.
8. Well No. 2 on the rectangular drillsite tract within the Block 71 Unit is centered between the north and south boundary lines of the tract and more than double the minimum prescribed distance from the east and west boundary lines.
9. The drillsite tract within the Block 71 Unit took its present size and shape in 1907.
10. The Clayton (Slick 6450) Field was discovered in 1965. The Clayton (Luling) Field was discovered in 1949.
11. There are approximately 190 mmcf of remaining recoverable gas in the Clayton (Slick 6450) Field under the applicant's Block 71 Unit.

12. The existing Well No. 2 on the Block 71 Unit was drilled in 1989, completed, and produced from the Clayton (Wilcox 7720) Field.
13. Because of the narrow, rectangular shape of the drillsite tract, the proposed location (i.e. existing Well No. 2), which is centered between the north and south lease lines of the drillsite tract, could not be less harmful to offset interest owners that are closer than the minimum lease line distance.
14. Because the location is centered on the tract and no less irregular location that would be less harmful to offsets exists, the location is reasonable.
15. The applicant would not drill a new well to attempt to recover the reserves in the Clayton (Luling) or Wildcat Fields that may be under its Block 71 Unit.
16. After the close of its case, the protestant requested that its complaint, concerning alleged violations of Statewide Rule 5 and § 91.143 of the Texas Natural Resources Code by the applicant, be withdrawn.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred or have been done that are necessary to give the Commission jurisdiction to decide this matter.
3. Applicant Bay Rock has a good faith claim to a right to operate all or a portion of the mineral interests in each of the tracts that comprise the Block 71 Unit.
4. The mineral interest owners of the Block 71 Unit are entitled to a reasonable opportunity to recover their fair share of hydrocarbons in the applied-for fields underlying the Block 71 Unit.
5. An exception pursuant to Statewide Rule 37 to the Clayton (Slick 6450), Clayton (Luling) and Wildcat Field rules regarding well spacing is necessary to permit the plug back, completion, and production of Well No. 2 on the Block 71 Unit in the applied-for fields.
6. There is not a potential well location on the Block 71 Unit that complies with the spacing requirements of the applied-for fields.
7. The proposed drillsite tract within the Block 71 Unit is not a voluntary subdivision.
8. The applied-for location is reasonable.
9. Approval of the requested permit to drill a well at the proposed location is necessary to

prevent confiscation of gas from the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields currently in place under the Block 71 Unit.

10. There is no pending complaint regarding alleged violations of Rule 5 and § 91.143 of the Texas Natural Resources Code by the applicant concerning Well No. 2 on the Block 71 Unit.

RECOMMENDATION

The examiners recommend that the subject application be approved in accordance with the attached final order.

Respectfully submitted,

Colin K. Lineberry
Hearings Examiner

Thomas H. Richter, P.E.
Technical Examiner