

Key Issues:

R37 Granted/Denied

RULE 37 CASE NO. 0207615

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

APPEARANCES:

FOR APPLICANT:

Gene Day, Consultant
John McDiarmid, President

APPLICANT:

Bay Rock Operating Company
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FOR PROTESTANTS:

Thomas John Fisher, Attorney
Michael Mulvey

PROTESTANTS:

Michael Mulvey
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PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATION FILED:	March 15, 1999
NOTICE OF HEARING:	May 26, 1999
DATE CASE HEARD:	June 15, 1999
HEARD BY:	Marshall Enquist, Hearings Examiner Donna Chandler, Technical Examiner
TRANSCRIPT RECEIVED DATE:	August 13, 1999
PFD CIRCULATION DATE:	November 17, 1999

STATEMENT OF THE CASE

Bay Rock Operating Company (“Bay Rock” or “applicant”) seeks an exception to Statewide Rule 37 to plug back its existing Well No. 2 on the 160 acre Block 71 Unit in the Clayton (Luling)

Field. The application is protested by Michael Mulvey (“Mulvey” or “protestant”), a mineral interest owner in tracts offsetting the drillsite tract, both within and outside the Block 71 Unit. The Clayton (Luling) Field requires spacing of 467 feet from leaselines and 1200 feet between wells on 40 acre units.

In a previous application, heard as a contested case on January 18, 1996, Bay Rock received a permit to plug back Well No. 2 on the Block 71 Unit to the Clayton (Slick 6450), Clayton (Luling) and Wildcat Fields. Bay Rock received its permit, good for two years, on April 22, 1997. During the period the permit was valid, Bay Rock plugged back to the Clayton (Slick 6450) but not the Clayton (Luling). The completion in the Clayton (Slick 6450) Field is currently producing approximately 120 MCF/day, but production is declining. Because Bay Rock’s 1997 permit has now expired, it is re-applying to plug back to the Clayton (Luling) Field.

The applied-for well has a surface location 940 feet from the east line and 990 feet from the north line of the subject unit (see Attachment I). However, the four 40 acre tracts composing the unit each have different mineral interest owners, and not all of the interests are operated by Bay Rock. The well is centered on the drillsite tract, 330 feet from an internal leaseline to the north and 330 feet from an internal leaseline to the south.

DISCUSSION OF THE EVIDENCE

APPLICANT'S EVIDENCE

Bay Rock Operating Company presented one witness and five exhibits at the hearing. Bay Rock based its case on both waste and confiscation.

There are 143 MMCF of recoverable reserves available in the Clayton (Luling) Field beneath the Block 71 Unit. At today’s prices, the net value of those reserves to the working interest is \$214,000. Because it would cost \$288,000 to drill and complete a new well, Bay Rock believes those reserves are only recoverable by a plugback of the existing wellbore.

According to Bay Rock, the reserves beneath the Block 71 Unit cannot be recovered by any other well on or off the unit. A log cross-section indicates the reservoir is productive beneath the Bay Rock unit, but that the sand is not productive in two adjacent wells, the Block 70 Unit No. 3 which is 2,250 feet to the southwest of the applied-for location and the Dorothy Nicholson No 1 which is 2,000 feet southeast of the applied-for location. Bay Rock believes that the nearest production in any correlative interval is over a mile away.

The Block 71 Unit is made up of four identical rectangular tracts of 40 acres each. Each tract is 2,600 feet long from east to west and 660 feet wide from north to south (see Attachment I). A well centered on any of the four tracts would necessarily be within 330 feet of a leaseline. Due to the internal leaselines, no regular location is available anywhere on the unit. However, Well No. 2 is

regular to all external leaselines. Because no less irregular location can be found on the unit, Bay Rock believes the location of the well is reasonable.

PROTESTANT'S EVIDENCE

Michael Mulvey presented one witness and three exhibits at the hearing. Mulvey attacked Bay Rock's waste case by pointing out that Bay Rock did not provide a structure map of the reservoir and failed to show that a well drilled at a regular location off-lease could not drain the reserves under the Block 71 Unit.

Mulvey also contends that Bay Rock cannot show that it has a good faith claim to operate the Block 71 Unit. According to Mulvey, Bay Rock's good faith claim to title rests on farm-out agreements from Mobil and Arco. Mulvey contends that title in the farm-outs has reverted to Mobil and Arco due to reversionary provisions in each farm-out agreement.

EXAMINERS' OPINION

Exceptions to Statewide Rule 37 may be granted to prevent waste or to protect correlative rights/prevent confiscation.

An applicant seeking an exception based on waste must establish three elements: 1) unusual conditions, different from conditions in adjacent parts of the field, exist under the tract for which the exception is sought; 2) as a result of the unusual conditions, hydrocarbons will be recovered by the well for which the permit is sought that would not have been recovered by any existing well or by additional wells drilled at regular locations; and 3) that the volume of otherwise unrecoverable reserves is substantial.

Bay Rock did not demonstrate the presence of any unusual condition beneath the Block 71 Unit that would prevent the recovery of hydrocarbons by any well other than the plugback of Well No. 2. Some evidence was offered indicating that the reservoir does not extend to wells approximately 2,000 feet southwest and southeast of the applied-for location, but this demonstrates nothing as to the limits of the reservoir to the east or west and all points north. Bay Rock did not show that the reserves could not be recovered by any other well off the unit and is not entitled to a Rule 37 exception based on waste.

To obtain an exception to Statewide Rule 37 to protect correlative rights, the applicant must show: 1) that it is not possible for the applicant to recover its fair share by placing the well at any regular location; and 2) that the proposed irregular location is reasonable.

The Block 71 Unit contains 160 acres, far more than the 40 acres required for a well in the applied-for field. The subject well is more than 467 feet from all external leaselines. However, each of the four 40 acre tracts composing the unit is only 660 feet wide. A well located in the center of

any of the tracts would be only 330 feet from a lease line, internal or external, and so could not be regular. Bay Rock presented unrefuted evidence that its fair share of recoverable reserves in the Clayton (Luling) Field is 143 MMCF. Well No. 2 is over twice the lease line spacing distance from the north, south and east unit lines. The well is over three and one half times the lease line spacing distance from the west unit line. There are no regular locations on the drillsite tract and the well is as far from internal property lines as it could possibly be located. Bay Rock has shown that it cannot recover its fair share by placing the well at any regular location and has shown that the irregular location is reasonable.

Bay Rock established its good faith claim to operate the Block 71 Unit in several ways. On November 7, 1990, Pecos Development Corporation executed the unit designation for the Block 71 Unit. The president of Pecos Development was Kip Gilliland, who was also president of Espero Energy. Gilliland took some of the leases for the unit in the name of Pecos Development and some in the name of Espero Energy. On January 4, 1991, Pecos Development resigned as operator of the unit and nominated Bay Rock as its successor operator, having already transferred the Form P-4 operatorship effective January 1, 1991. Bay Rock has been the designated operator of the unit since that time.

As part of its showing of a good faith claim in the present hearing, Bay Rock provided four lease ratifications that it obtained in 1995. These ratifications were of leases originally held by Pecos Development and Espero Energy in tracts 3364, 3366 and 3370.

On voir dire, protestant elicited testimony from Bay Rock that, as completed in the Clayton (6450) Field, Bay Rock had a 0.01515953 interest in the Block 71 Unit Well No. 2 and later acquired an additional 0.20904247 interest in the well from Pecos Development (see Transcript p. 45, lines 7-14 and p. 47, lines 16-21).

Further, protestant Mulvey himself, testifying as an expert title examiner, acknowledged that Bay Rock had obtained an interest in the subject unit by assignment from Pecos Development.

- Q. (Attorney Fisher) Did that assignment - - then did Pecos then assign some interest that it received under that assignment from Mobil, did it assign anything to Bay Rock?
- A. (Mulvey) Yes, it did.
- Q. Did that assignment cover the Clayton (Luling) Field which is the subject of this proceeding?
- A. Yes, it did.

(Transcript, p. 97, lines 4-11)

Mulvey argued that any good faith claim to title under the Mobil farm-out was extinguished by a reversion of title to Mobil (and Arco) due to a period of non-production of approximately two years. However, this period of non-production resulted from a complaint that Mulvey made to the Commission that caused the subject well to be sealed pending the outcome of a hearing. Accordingly, the lapse in production may be excused by the force majeure clause of the lease. It is

not necessary or appropriate for the Commission to attempt to resolve this issue in this hearing. Whether or not the farm-out agreements are terminated due to the effect of reversionary clauses is a matter of contract interpretation and title determination that only a district court can finally decide. In fact, the title dispute is in District Court (Cause No. 7178-C; Michael R. Mulvey vs. Pecos Development Corporation, et al., 343rd District Court, Live Oak County, Texas) and has been at least since the time of the previous hearing in 1996. An applicant for a permit is only required to show that it has a good faith claim to a right to operate the lease for which it seeks a permit. "When an applicant for a permit makes a reasonably satisfactory showing of a good faith claim of ownership in property, the fact that another disputes his title is not alone sufficient to defeat his right to a permit." Magnolia Petroleum Co. v. Railroad Commission, 170 S.W.2d 189, 191 (Tex. 1943). In this case, Bay Rock's status as designated operator, the lease ratifications provided by Bay Rock, and the evidence concerning working interest ownership establish that Bay Rock has at least a good faith claim to operate the Block 71 Unit.

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

FINDINGS OF FACT

1. Notice of hearing was given on May 26, 1999 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. All things necessary to the Commission attaining jurisdiction over the subject matter and the parties in this hearing have been performed or have occurred.
3. The applicant, Bay Rock Operating Company, seeks an exception to Statewide Rule 37 to plugback Well No. 2 ("subject well") on the Block 71 Unit in Live Oak County. Applicant proposes to plugback its well at a location 990 feet FNL and 940 feet FEL of the unit, and 1850 feet FNEL of A-129 and 1500 feet FNWL of A-620 of the survey. The location is only 330 feet from an internal lease line separating non-identical mineral ownership interests within the unit. Applicant has applied for completion of its proposed well in the Clayton (Luling) Field, having spacing rules of 467 feet from lease lines, and 1200 feet between wells, on 40 acre units.
4. Applicant's Block 71 Unit is a tract of regular size and shape, containing 160 acres.
5. Applicant's primary objective is the Clayton (Luling) field.
6. Applicant is recognized by the Commission as the P-4 operator of the subject well and unit and has been the designated operator since 1991.

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7. The mineral interest owners of the Block 71 Unit cannot recover their fair share of hydrocarbons in the subject fields underlying the unit from a regular location.
 - a. Due to internal leaselines, there is no location on the Block 71 Unit that complies with the spacing requirements of the applicable field rules.
 - b. No other well on the unit is permitted for the applied-for field.
 - c. There is approximately 143 MMCF of recoverable gas in the Clayton (Luling) Field in place beneath the Block 71 Unit.
 8. The location of the well is reasonable.
 - a. The subject well is located in the center of the drillsite tract, as far from internal property lines as possible because of the narrowness of the tract.
 - b. Well No. 2 is over twice the leaseline spacing distance from the north, south and east lines of the unit, and three and one half times the leaseline spacing distance from the west line of the unit.
 9. In 1995, Bay Rock obtained ratifications of leases on tracts in the Block 71 Unit originally obtained by Pecos Development Corporation and Espero Energy.

CONCLUSIONS OF LAW

1. Proper notice was timely given to all parties legally entitled to notice.
2. The Commission has jurisdiction to decide this matter.
3. The mineral interest owners of the Block 71 Unit in Live Oak County are entitled to protection from confiscation.
4. An exception to the lease-line spacing requirements is necessary to permit the plug back of the applied-for well.
5. Approval of a permit to plug back a well at the proposed location is necessary to give owners of the subject tract a reasonable opportunity to recover their fair share of hydrocarbons in the applied-for fields underlying the tract or the equivalent in kind.
6. Bay Rock has a good faith claim to operate the Block 71 Unit and the subject well.

RECOMMENDATION

The examiners recommend that Applicant's request for an exception to Statewide Rule 37 for its Block 71 Unit, Well No. 2, in the Clayton (Luling) Field, Live Oak County, Texas, be granted.

Respectfully submitted,

Marshall F. Enquist
Hearings Examiner

Donna Chandler
Technical Examiner

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