
* KEY ISSUES: Confiscation *
* Legal Subdivision *
* Date of Attachment of Vol. Sub. Rule *
* *
* FINAL ORDER: R37 GRANTED/Allo. Form. DENIED *

RULE 37 CASE NO. 0212263

APPLICATION OF UPLAND RESOURCES, INC., FOR AN EXCEPTION TO STATEWIDE RULE 37 TO DRILL WELL NO. 1, JENNY LOU LEASE, FELDMAN (TONKAWA), HUMPHREYS (MORROW, UPPER), HUMPHREYS NW (MORROW, UPPER) AND WILDCAT FIELDS, HEMPHILL COUNTY, TEXAS.

OIL AND GAS DOCKET NO. 10-0212653

ALLOCATION FORMULA BASED ON PRODUCTIVE ACREAGE HUMPHREYS, NW (MORROW, UPPER) FIELD, HEMPHILL COUNTY, TEXAS.

APPEARANCES:

FOR APPLICANT:

William Osborn (Attorney)
Keith Selinger (Petroleum Engineer)
Steve Zemkoski (Geologist)
Bailey Peyton (President, Upland)

APPLICANT:

Upland Resources, Inc.
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FOR PROTESTANTS:

George C. Neale (Attorney)
Jim Dunford (Petroleum Landman)
Chuck Peterson (Petroleum Engineer)
W.M. McKinney (Petroleum Geologist)

PROTESTANTS:

Sonat Exploration Company
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Michael McElroy (Attorney)

MW Petroleum Corporation

PROPOSAL FOR DECISION**PROCEDURAL HISTORY**

DATE OF REQUEST FOR ACTION: April 24, 1996
DATE CASE HEARD: August 1, 1996
HEARD BY: Marshall Enquist,
Hearings Examiner
Colin Lineberry,
Hearings Examiner
Donna Chandler, P.E.
Technical Examiner

TRANSCRIPT DATE: August 5, 1996
PFD CIRCULATION DATE: October 11, 1996

STATEMENT OF THE CASE

This is the application of Upland Resources, Inc. for an exception to Statewide Rule 37 to drill Well No. 1 on the Jenny Lou Lease ("subject tract") in the Feldman (Tonkawa), Humphreys (Morrow, Upper), Humphreys NW (Morrow, Upper) and Wildcat Fields. This hearing is consolidated with a productive acreage hearing on the Humphreys NW (Morrow, Upper) Field. MW Petroleum Corporation had originally requested a hearing to determine the productive acreage of the Humphreys NW (Morrow, Upper) Field. MW withdrew this request but Sonat Exploration Company sought such determination and assumed the burden of proof on this issue. The subject lease of the Rule 37 application is a narrow, rectangular tract about three miles long from west to east and about 500 feet wide. It is a pooled unit composed of two tracts; the Thomas Howard Lockhart, Sr. Lease (Section 1) consisting of 66.55 acres and the Doris Kenyon Martin Lease (Section 2) consisting of 115 acres. The pooled unit amounts to 181.55 acres, which is in excess of the 160 acre drilling unit required by the field rules for the Feldman (Tonkawa) and the Humphreys NW (Morrow, Upper) fields. The proposed location for the Jenny Lou No. 1 Well is 1045 feet from the west line and 234 feet from the north and south lines. The proposed location is 907 feet from the Apache/MW 3-37 well to the north. There is no regular location on the lease. (See Appendix I.) Field rules for the Feldman (Tonkawa) Field are 660/1320/160 (660 feet to leaseline, 1320 feet between-well spacing, and 160 acre drilling tract). Field rules for the Humphreys (Morrow, Upper) Field are 467/1200/40. Field rules for the Humphreys NW (Morrow, Upper) Field are 660/1320/160. Upland seeks the exception to prevent confiscation.

The Rule 37 application is protested by Sonat Exploration Company and MW Petroleum Corporation. Sonat operates adjacent tracts to the south of Upland Resources' subject tract. MW operates an adjacent tract to the north of Upland Resources' subject tract.

DISCUSSION OF THE EVIDENCE

APPLICANT'S EVIDENCE

Upland Resources, Inc., ("Upland") asserts that the target reservoir is an E-W trending channel-fill sand separated into non-communicating reservoirs by N-S trending faults. Upland contends that the portion of the reservoir underlying their tract is being drained by the Apache/MW 3-37 Well to the north.

Upland presented evidence to show that the proposed Jenny Lou No. 1 and the Apache/MW 3-37 are fault separated from the two Sonat wells (27-2 and 19-A) to the south-east. This evidence indicates that the Morrow and Tonkawa reservoirs under the subject tract are the same reservoirs that the Apache/MW 3-37 to the north is in and that the subject tract is being drained by that well. Upland's primary target is the Morrow; the Tonkawa is a secondary target. Upland believes there are 727 MMCF of currently recoverable reserves beneath the pooled unit in the primary target reservoir (Morrow), down from original recoverable reserves of 1138 MMCF due to drainage by the Apache/MW 3-37.

Upland presented an isopach map of the Morrow reservoir in which it believes the subject well will be productive. The productive acreage depicted by Upland includes approximately 514 acres and includes the MW No. 3-37 well, for which MW has requested a new field designation. Upland's map indicates that the reservoir is bounded by faults to the east and west and by sand pinch-outs to the north and south. Based on this map, the Jenny Lou tract has 27 productive acres in the Morrow.

PROTESTANT'S EVIDENCE - SONAT

It is Sonat Exploration Company's ("Sonat") position that Section 1 (the 66.55 acre portion) of the subject tract is a voluntary subdivision and that it is not entitled to a well in order to prevent confiscation. Sonat argues that the subject tract, even though standard in size, is substandard in shape and thus is a voluntary subdivision according to recent Commission interpretation of Statewide Rule 37. Sonat also disputes the contention that the proposed well and the Apache/MW 3-37 are in the same reservoir, contending instead that the proposed drilling location will bottom in the same reservoir as the Sonat/Woods 27-2.

Sonat's evidence established the dates of discovery of the subject fields, the dates the various tracts were leased for oil and gas development, and the dates the tracts were held under common ownership. According to Sonat, the subject reservoir is a NW-SE trending point bar deposit (not a channel fill) with a general NW-SE trend, divided by a WNW-ESE trending fault through the Lockhart 1-A Well (a dry hole), placing the proposed Upland well in the same reservoir as the Sonat/Woods 27-2. Sonat contends that Section 1 of the subject tract can recover its fair share of hydrocarbons through the Sonat/Woods 27-2 to the south-east. Under Sonat's analysis, the Morrow

reservoir in which the subject well will be completed contains approximately 222 acres.

Sonat presented evidence to show that the productive acreage on the subject tract amounts to approximately 27 acres (Upland agrees that there are 27 productive acres under their tract). Sonat also expressed concerns as to the amount of drift possible when drilling for a target at 11,000 feet as well as concerns over fracture stimulation that might go beyond the lease lines.

PROTESTANT'S EVIDENCE - MW

MW Petroleum Corporation (MW), like Sonat, argues that Section 1 of the subject tract is a voluntary subdivision and became so in January of 1978. It is MW's position that Section 1 of the subject tract was under common ownership and control with Sections 19 and 27 from 1916 until 1983, and, therefore, the separate tracts merged into one tract. MW argues that because there was oil and gas activity in the area in the 1950s, field rules attached at that time so that the subsequent lease of the subject tract after the time of attachment was a voluntary subdivision. MW agrees with Sonat that the voluntary subdivision rule must apply to tracts with sufficient acreage to meet the requirements of Statewide Rule 38, but which are so configured as to have no regular location. MW did not present a direct case. Counsel for MW participated in the hearing by cross-examining the witnesses and making a closing argument.

EXAMINERS' OPINION

"It is the law that every owner or lessee of land is entitled to a fair chance to recover the oil and gas in or under his land, or their equivalents in kind. Any denial of such fair chance would be 'confiscation' within the meaning of Rule 37 and the Rule of May 29th." Gulf Land Co. v. Atlantic Refining Co., 131 S.W.2d 73, 80 (Tex. 1939). This right is not absolute, but is subject to the application of the Voluntary Subdivision Rule (the Rule of May 29th), which states:

(2) Any subdivision of property creating a tract of such size and shape that it is necessary to obtain an exception to the spacing rule before a well can be drilled thereon is a voluntary subdivision and not entitled to a permit to prevent confiscation of property if it were either:

(A) segregated from a larger tract in contemplation of oil, gas, or geothermal resource development; or

(B) segregated by fee title conveyance from a larger tract after the spacing rule became effective and the voluntary subdivision rule attached.

16 Texas Administrative Code §3.37(g).

The subject tract is a pooled unit composed of two small tracts; Section 1 of 66.55 acres and

Section 2 of 115 acres. Both were created by deed on November 26, 1904. The chain of title up to 1916 is not clear, but the parties agree that between 1916 and 1983 the mineral interest of the drillsite tract (Section 1) and of Sections 19 (689.5 acres) and 27 (684.8 acres) to the south was under the common ownership and control of the Lockhart family. "If an applicant has common ownership and control of other tracts from which he receives a fair share of the oil underlying the land upon which he seeks another well, the well permit will be denied." Ernest E. Smith and Jacqueline Lang Weaver, Texas Law of Oil and Gas, vol. 2, p. 194 (1996). For Statewide Rule 37 and 38 purposes, the internal boundaries of adjacent tracts under common ownership and control disappear and the tracts merge into one large tract. For all other purposes, the interior lines remain intact. In this case, the Commission would have viewed the Lockhart holdings, until 1983, as one large tract consisting of 1,440.85 acres, entitled to a total of nine wells in a reservoir on 160 acre density rules.

"If there is no common ownership and control, the well permit will be granted upon proof of confiscation." (Emphasis added). Ernest E. Smith and Jacqueline Lang Weaver, Texas Law of Oil and Gas, vol. 2, p. 194 (1996). This situation was created on January 14, 1983, when Thomas Howard Lockhart, Sr. deeded all of his mineral interest (an undivided 3/32nds interest) in sections 19 and 27 to his two sons, but retained his mineral interest in Section 1, the 66.55 acre portion of the subject tract. This conveyance destroyed the common ownership and control that had existed between the tracts from 1916 until 1983. Subsequent to the conveyance, it was no longer possible for Mr. Lockhart to receive his fair share of the hydrocarbons underlying Section 1 through the Sonat/Woods 27-2 or 19-A, or any other well drilled on sections 19 and 27.

The purpose of the Voluntary Subdivision Rule is to prevent the creation of separate tracts that could be used to circumvent the spacing rules. "...if the purpose of the subdivision be in fact to circumvent the spacing rule, the voluntary segregation rule would no doubt be applied regardless of the situation otherwise." Nash v. Shell Petroleum Corp., 120 S.W.2d 522, 524 (Tex. Civ. App. -- Austin 1938, writ dism'd). "Small tracts of land created by collusive title actions or consent judgments entered into by parties with the purpose of circumventing Rule 37 will not be granted exception wells." Ernest E. Smith and Jacqueline Lang Weaver, Texas Law of Oil and Gas, vol. 2, p. 165-1 (1996). In the present case, the 1983 transfer of mineral interest by deed took place three years prior to discovery of the primary target field and thirteen years prior to pooling and application for a drilling permit. There is no evidence indicating that the conveyance of the mineral interest was a collusive title action, nor is there any evidence indicating the transfer was a subterfuge designed to avoid application of the voluntary subdivision rule.

The controlling issue in this case is a simple one. If there are two or more reservoirs under a tract, is the date of attachment of the voluntary subdivision rule always the date of discovery of the oldest reservoir? The answer, clearly, is "no". The Commission explicitly recognizes two exceptions. Under Statewide Rule 37(g)(4), the date of attachment in a multiple reservoir field in which the reservoirs are separated vertically is the date of discovery of the oldest reservoir if they are in "the same structural feature." Presumably, if vertically separated reservoirs are not in the same structural feature, and have different dates of discovery, their respective dates of attachment would be different. In a different context, this line of reasoning finds support in Statewide Rule 37 (g)(5)

which states:

If a newly discovered reservoir is located outside the then productive limits of any previously discovered reservoirs and is classified by the commission as a newly discovered field, then the date of discovery of such newly found reservoir remains the date of attachment for the voluntary subdivision rule, even though subsequent development may result in the extension of such newly discovered reservoir until it overlies or underlies older reservoirs with prior discovery dates.

Statewide Rule 37 also allows the Commission to exercise discretion in determining the circumstances under which the date of attachment is established:

The date of attachment of the voluntary subdivision rule for a reservoir under any special circumstance which the commission deems sufficient to provide for an exception may be established other than as prescribed in this section, so that innocent parties may have their rights protected.

16 Texas Administrative Code § 3.37(g)(7). In the present case, the applied-for reservoirs are not located in the same structural feature. The two reservoirs are separated vertically by 3,325 feet. The Morrow, at approximately 10,950' below surface, is a faulted formation containing discrete stratigraphic traps which may consist of channel fills or point bar deposits. The Tonkawa, at approximately 7,625' below surface, is a blanket sand.

The discovery date of the Feldman (Tonkawa) Field was April 27, 1957. As a result, the January, 1983 subdivision of Section 1 from Sections 19 and 27 occurred after the date of attachment for the Feldman (Tonkawa) and is a voluntary subdivision as to that field. As such, Section 1 is not entitled to protection against confiscation in that field. Because the applicant presented a case based on confiscation, and not on waste, the application should be denied as to the Feldman (Tonkawa) Field.

The discovery date for the Humphreys (Morrow, Upper) Field is February 1, 1986. The discovery date for the Humphreys, NW (Morrow, Upper) Field is August 1, 1986. The January, 1983 subdivision occurred prior to the date of attachment for the Humphreys (Morrow, Upper) Field and the Humphreys, NW (Morrow, Upper) Field and thus Section 1 is a legal subdivision as to those fields. Because the applicant proved that an exception is necessary to prevent confiscation, the permit should be granted as to the Humphreys (Morrow, Upper), the Humphreys NW (Morrow, Upper), and the Wildcat fields (by definition, a "wildcat field" cannot have a date of discovery and therefore can't have a date of attachment).

The examiners do not believe that determination of productive acreage is appropriate at this time. Neither Upland's nor Sonat's maps have sufficient control to determine field limits of the Morrow reservoir in which the proposed well is to be completed. There is, however, no dispute between the parties that the Jenny Lou tract has only 27 productive acres in the Morrow.

FINDINGS OF FACT

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 or have occurred.
3. The applicant, Upland Resources, Inc., seeks an exception to Statewide Rule 37 to drill the Jenny Lou No. 1 on a 181.55 acre pooled unit consisting of Section 1 (66.55 acres) and Section 2 (115 acres) in Hemphill county. Applicant proposes to drill its well at a location 1045 feet FWL and 234 feet FNL of the unit.
4. Applicant has applied for completion of its proposed well in the Feldman (Tonkawa) Field with a spacing rule of 660/1320/160, the Humphreys (Morrow, Upper) Field with a spacing rule of 467/1200/40, the Humphreys NW (Morrow, Upper) Field with a spacing rule of 660/1320/160, and the Wildcat Field.
5. The discovery date (date of attachment) of the applied-for fields is:

Feldman (Tonkawa) -- April 27, 1957.
Humphreys (Morrow, Upper) -- February 1, 1986.
Humphreys NW (Morrow, Upper) -- August 1, 1986.
6. The two tracts comprising the pooled unit of 181.55 acres took their present size and shape in 1904.
7. Sections 19 and 27 were segregated by mineral deed from the main Lockhart tract of 1,440.85 acres on January 14, 1983, leaving the remainder tract, Section 1, consisting of 66.55 acres.
8. Section 1 of the pooled unit was segregated from the main Lockhart tract after the discovery date (date of attachment) for the Feldman (Tonkawa) Field.
9. Section 1 of the pooled unit was segregated from the main Lockhart tract before the discovery date (date of attachment) for the Humphreys (Morrow, Upper) and the Humphreys NW (Morrow, Upper).
10. Due to the shape of the pooled unit, a narrow rectangle, no regular location is possible.
11. There are no wells on the unit producing from the applied-for fields.

12. The pooled unit of 181.55 acres contains 727 MMCF of currently recoverable reserves that cannot be recovered without an exception.
13. An offset well, the Apache/MW 3-37, located 907 feet to the north, is draining the applicant's lease. The Apache/MW 3-37 is in the same reservoir as applicant's proposed well.
14. The ownership of the mineral estate of Section 1 of the pooled unit is not the same as any adjoining tract.
15. The proposed well is equidistant (234 feet) from the N and S lines of the lease.
16. The proposed well location is 1045 feet from the west line of the lease and 928 feet from the Apache/MW 3-37 to the north.

CONCLUSIONS OF LAW

1. Proper notice was timely given to all parties legally entitled to notice.
2. The application on Form W-1 was properly filed.
3. The Commission has jurisdiction to decide this matter.
4. Section 1 of the 181.55 acre pooled unit is a voluntary subdivision as to the Feldman (Tonkawa) Field and is not entitled to protection against confiscation.
5. Section 1 of the 181.55 acre pooled unit is a legal subdivision as to the Humphreys (Morrow, Upper), the Humphreys NW (Morrow, Upper) and the Wildcat fields and is entitled to protection against confiscation.
6. The mineral owners of the subject tract are entitled to a reasonable opportunity to recover the hydrocarbons in the Humphreys (Morrow, Upper) Field and the Humphreys NW (Morrow, Upper) Field under the 181.55 acre pooled unit, or their equivalents in kind. Denial of this application would deny the mineral owners the right to recover the hydrocarbons under this tract in the subject fields and would constitute confiscation.
7. The proposed location is reasonable and necessary to prevent confiscation.
8. Sonat did not meet its burden of proof in defining the limits of the Morrow reservoir which was the subject of this hearing.

RECOMMENDATION

The examiners recommend that Applicant's request for an exception to Statewide Rule 37 for its Jenny Lou Lease, Well No. 1, as to the Feldman (Tonkawa) Field be denied and as to the Humphreys (Morrow, Upper), Humphreys NW (Morrow, Upper), and the Wildcat fields, Hemphill County, Texas, be granted.

Respectfully submitted,

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Hearings Examiner

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MFE