
* **KEY ISSUES: WASTE** *

* Notice *

Good faith claim to title *

Leaseline spacing *

* *

* **FINAL ORDER: DENIED** *

RULE 37 CASE NO. 0215934

**APPLICATION OF SHANGHAI CORPORATION FOR AN EXCEPTION TO
STATEWIDE RULE 37 TO DRILL WELL NO. 1, HARBERT POHL UNIT, LITTLE
ROK (FRIO), LITTLE ROK (MIOCENE), AND WILDCAT FIELDS, LAVACA
COUNTY, TEXAS.**

APPEARANCES:

FOR APPLICANT:

R. Steven Hicks
David R. Torok
Maynard N. Little

APPLICANT:

Shanghai Energy Corporation
"
"

FOR PROTESTANTS:

Mary Ann Krenek
Doug Krenek
Bennie Marek
Ted Marek

PROTESTANTS:

Mary Ann Krenek
Doug Krenek
Bennie Marek
Ted Marek

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATION FILED:	April 23, 1997
NOTICE OF HEARING:	June 5, 1997
DATE CASE HEARD:	July 7, 1997
DATE CASE RE-OPENED:	April 2, 1998
HEARD BY:	Marshall Enquist, Hearings Examiner Donna Chandler, Technical Examiner
TRANSCRIPT RECEIVED DATE:	June 29, 1998
PFD CIRCULATION DATE:	July 29, 1998

STATEMENT OF THE CASE

Shanghai Energy Corporation ("Shanghai" or "applicant") seeks an exception to Statewide Rule 37 to drill its proposed Well No. 1 on the 276-acre Harbert Pohl Unit in the Little Rok (Frio), Little Rok (Miocene) and Wildcat Fields. The primary target is the Wildcat Field. The application is protested by several unleased mineral interest owners ("protestants") within Tract No. 6 (Klimitchek Tract) of the Harbert Pohl Unit. The three subject fields all require spacing of 467 feet from lease lines and 1200 feet between wells, with 40-acre units.

The examiners issued a PFD in this case on October 8, 1997. In response to exceptions, an amended PFD was issued December 12, 1997. The examiners recommended denial because Shanghai did not present any case for a Rule 37 exception for two of the fields, the Little Rok (Frio) and the Little Rok (Miocene). As to the Wildcat Field, Shanghai failed to show that a substantial quantity of hydrocarbons would be lost if a well was drilled at an available regular location as opposed to the applied-for location. At conference on February 24, 1998, the Commission directed that this case be re-opened. The case was re-heard on April 2, 1998.

As originally assembled, the Harbert Pohl Unit consisted of four tracts: a.) the Paul Petroskey tract of 48.278 acres, b.) the James M. Barron Estate tract of 38.65 acres, c.) the Klimitchek tract of 59.43 acres and d.) the Harbert A Pohl tract of 129.887 acres (see Attachment I). The applied-for location is 1,742 feet from the west line and 574 feet from the south line of the original unit. At the time of the first hearing, applicant had leased all but approximately 25% of the mineral interest in the Klimitchek tract. About 1/3 of that unleased interest, for a total of 8% of the tract's mineral interest, is represented by the protestants. The Klimitchek tract has an eastern lease line only 33 feet west of applicant's proposed location, which necessitates a SWR 37 exception.

DISCUSSION OF THE EVIDENCE

APPLICANT'S EVIDENCE

At the re-opened hearing, Shanghai presented seven new exhibits and the testimony of three witnesses. Shanghai argues that the target Wildcat Field is analogous to other water-drive fields such as the Little Rok Field, the Speaks Field and the Phillips-Mead Field, which are, respectively, 1 mile, 4 miles and 8 miles away.

Shanghai offered seismic evidence that a Wildcat Field exists beneath the Harbert Pohl Unit and that the proposed well location is at the highest structural point in that reservoir. Applicant argues that moving the well location to any other point would result in waste: moving the well north along the seismic line would mean running out of pay sand, and moving to any other location would cause loss of structural advantage. Shanghai estimates the recoverable reserves for this field to be

somewhere between one quarter BCF and one BCF. Based on its assumption that the high point of the structure is at the applied-for location, and that a move to a regular location would be a move down-structure, Shanghai stated "In the minimum case we predict 67,824 MCF of gas will be wasted. Most of this gas lies under our own leases." (Shanghai Exhibit No. 12)

PROTESTANTS' EVIDENCE

The protestants presented four exhibits and the testimony of two witnesses. Protestants raise the point that Shanghai has failed to maintain leases on three of the four tracts comprising the Harbert Pohl Unit. Protestants argue that this changes the nature of the case from an internal lease line spacing problem to an external lease line spacing problem, thus requiring notice to the mineral interest owners of the three lapsed tracts.

The protestants assert that Shanghai is trying to drill as close as possible to their lease line in order to drain their land without incurring the obligation to compensate them for their hydrocarbons. The protestants argue that granting the applied-for Rule 37 exception permit to Shanghai would violate the correlative rights of the unleased mineral interest owners of the Klimitchek Tract, as well as those of the unleased mineral interest owners of the Petroskey and Barron Tracts.

Protestants also presented evidence that other fields in Lavaca County have a pressure-depletion drive, citing the Smith Well No. 1, Teltschick Well No. 3-F and Clark, S.A. Well No. 1-A, all approximately 4 miles from Shanghai's applied-for location. Protestants argued that there are water-drive reservoirs, pressure-depletion reservoirs and some pressure depletion reservoirs with very weak water-drives in the area, and, therefore, the assertion that Shanghai's targeted Wildcat Field must have a water-drive is simply conjecture.

EXAMINERS' OPINION

I. NOTICE

The applicant's pooled unit originally consisted of four tracts; the Petroskey Tract, the Barron Tract, the Klimitchek Tract and the Pohl Tract (see Attachment I). Evidence presented at the April 2, 1998 re-hearing indicates that Shanghai no longer has leases on three (Petroskey, Barron and Klimitchek) of the four tracts comprising its pooled unit. When asked by the examiner if current leases existed and if they could be provided as late-filed exhibits, Shanghai admitted that the leases do not exist and cannot be provided. The leases for the Petroskey Tract, the Barron Tract and the Klimitchek Tract expired on January 15, 1998, January 15, 1998 and November 12, 1997, respectively.¹ At the time of the April 2, 1998 re-hearing, Shanghai had a property interest only in the Pohl Tract (see Attachment II).

¹ The Petroskey, Barron and Klimitchek leases had all expired prior to the February 24, 1998 conference at which the Commission directed that this case be re-opened.

Because Shanghai no longer has a property interest in three of the tracts, the applied-for well location is no longer irregular as to internal leaselines, but is now irregular as to external leaselines. Notice of the re-opened hearing was sent only to the parties that appeared in the original hearing. In that hearing, Shanghai, as lessee, was presumed to represent the leased mineral interest owners of all four tracts. Shanghai's failure to maintain its leases means that it no longer represents the mineral interest owners of the Petroskey, Barron and Klmitchek Tracts. The unleased mineral interest owners of the Petroskey, Barron and Klmitchek tracts, as offsets within a Rule 37 leaseline spacing distance, were entitled to notice of the re-opened hearing. However, those unleased mineral interest owners did not receive notice of this hearing. The Commission has no jurisdiction in this case.

Because necessary parties were not noticed of the hearing and the Commission's jurisdiction did not attach, the examiners recommend that this application be dismissed.

II. GOOD FAITH CLAIM TO OPERATE

The applicant is seeking a drilling permit for a pooled unit in which it has lost its property interest as to three out of four tracts (compare Attachment I and Attachment II). Shanghai's Form W-1 Drilling Application and attached plat are no longer accurate. Because the 40-acre proration unit that Shanghai seeks for its applied-for well is composed of portions of the four originally leased tracts, and three of those tracts are no longer held by Shanghai, Shanghai does not have either a pooled unit or a 40-acre proration unit, at least not as described in its original drilling application and plat. Upon notice that the hearing was being re-opened, Shanghai could have filed a new Form W-1 Drilling Application and a new plat reflecting its actual property interest (with a differently configured 40-acre proration unit) but did not do so.

The established rule guiding the Railroad Commission was stated in 1943, by the Supreme Court in this language: "...the Railroad Commission should not do the useless thing of granting a permit to one who does not claim the property in good faith. The Commission should deny the permit if it does not reasonably appear that the applicant has a good-faith claim in the property." Magnolia Petroleum Co. v. Railroad Commission, 141 Tex. 96, 170 S.W.2d 189, 191 (1943). The rule was reaffirmed by the Supreme Court in Trapp v. Shell Oil Co., 145 Tex. 323, 198 S.W.2d 424, 437 (1946).

Superior Oil Co. v. Railroad Com'n, 571 S.W.2d 51 (Civ. App. -- Austin, 1978). Because Shanghai does not have a good faith claim to a property interest in three of the four tracts comprising its pooled unit, nor in the greater part of the applied-for 40-acre proration unit, the Commission should not "do the useless thing" of issuing a drilling permit.

III. THE CASE ON ITS MERITS

The notice defect and Shanghai's lack of a good faith claim to operate are sufficient cause to

dismiss this case. However, even if these defects were cured, the examiners believe the exhibits and testimony in the re-opened hearing demonstrate that Shanghai is not entitled to its requested exception.

Shanghai based its case for a Rule 37 exception on waste. 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 the otherwise unrecoverable reserves is substantial.

A. Little Rok (Frio) and Little Rok (Miocene) Fields

As in the prior hearing, Shanghai has not provided any evidence addressing the three elements required for a Rule 37 exception based on waste in the Little Rok (Frio) and Little Rok (Miocene) Fields. Accordingly, the examiners recommend that the requested Rule 37 exceptions in those fields be denied.

B. Wildcat Field

Shanghai's waste argument is founded on the proposition that its Seismic Line 1 (see Attachment III) directly overlies the high point of the structure of the Wildcat Field. A targeted structural high combined with a water-drive would meet the first element (unusual conditions) of a waste case. However, when asked if the actual structural high of the target reservoir might be either east or west of Seismic Line 1, Shanghai's expert, David Torok, testified that, due to the underlying paleo-structure, the high would not likely be east of Seismic Line 1 but very well could be west of the line, possibly as much as 500 to 800 feet (Tr., pp. 65-67). In addition, Mr. Torok revealed that Shanghai originally staked the well location west of the present applied-for location. Shanghai's other expert witness, Maynard Little, expanded on this by stating that the well was originally staked 200 feet due west of the applied-for location "...within the right angle turn of the road. That would have been on the protestant's minerals" (Tr., p. 67). Despite Shanghai's assertion that any well location other than the applied-for location on its Seismic Line 1 would cause waste, it is obvious that Shanghai would not have originally staked a well location on the Klimitchek Tract (200 feet west of the present applied-for location) if it truly believed that only a location on the seismic line was at the structural high.

A well drilled on the Klimitchek tract, with its outstanding 25% unleased interest, would have obligated Shanghai to pay out 25% of the production from the well to the unleased owners, in addition to the 1/8 royalty to the leased mineral interest owners of the remaining 75% interest. However, a well drilled on the adjoining Harbert Pohl tract a mere 33 feet off the lease line would effectively drain the Klimitchek Tract without incurring any obligation to pay the unleased mineral interest owners of the Klimitchek tract. This suggests that Shanghai's request for the applied-for SWR 37 exception location may be motivated by economic factors, rather than structural position.

If the target reservoir has a pressure-depletion drive, the applied-for location will drain the entire reservoir, including the hydrocarbons under the unleased Petroskey, Barron and Klimitchek Tracts. If the reservoir has a water-drive, as Shanghai insists, the applied-for well location, which is very likely down-structure of the true high, will not prevent waste but will cause waste if it is granted. In either case, the correlative rights of the offset unleased mineral interest owners would be harmed.

IV. SUMMARY

Shanghai has allowed three of its four leases comprising the Harbert Pohl Unit to lapse. Because the mineral interest owners of those tracts did not receive notice of this hearing, the Commission has no jurisdiction to decide this case. Shanghai must either re-lease the four tracts and re-apply, or amend its W-1 application to reflect its current interest in only one tract and provide a list of all offset operators and unleased mineral interest owners. However, the examiners believe that the testimony and exhibits from the first hearing and the re-opened hearing demonstrate that Shanghai is not entitled to a Rule 37 exception at the applied-for location in either circumstance. Therefore, rather than suggest that this application be re-heard a third time, the examiners recommend that the application be dismissed.

FINDINGS OF FACT

1. Notice of hearing was not given on March 9, 1998 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 not been performed and have not occurred.
3. The applicant, Shanghai Energy Corporation, seeks an exception to Statewide Rule 37 to drill Well No. 1 on the Harbert Pohl Unit. Applicant proposes to drill its well at a location 1,742 feet FWL and 574 feet FSL of the unit, and 3,170 feet FEL of the A-417 Survey and 4,570 feet FNL of the A-278 Survey. Applicant proposes to drill its well at a location 33 feet FEL of the Klimitchek Tract. This location is 21 feet FSL of the Petroskey Tract and approximately 30 feet FSL of the Barron Tract. Applicant has applied for completion of its proposed well in the Little Rok (Frio), Little Rok (Miocene) and Wildcat Fields, having spacing rules of 467 feet from leaselines, 1200 feet between wells, and requiring 40 acre units.
4. As originally constituted, applicant's Harbert Pohl Unit was of regular size and shape, containing 276.245 acres, consisting of the following four tracts:

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|----|---------------------|---------------|
| a. | Petroskey Tract | 48.278 acres |
| b. | Barron Estate Tract | 38.65 acres |
| c. | Klimitchek Tract | 59.43 acres |
| d. | Harbert Pohl Tract | 129.887 acres |
5. The applicant's leases for the following tracts expired on the following dates:
- | | |
|------------------|-------------------|
| Petroskey Tract | January 15, 1998 |
| Barron Tract | January 15, 1998 |
| Klimitchek Tract | November 12, 1997 |
6. At the time of the re-opened hearing, April 2, 1998, Shanghai had one remaining lease: the 129.887 acre Harbert Pohl Tract.
7. Applicant's primary objective is the Wildcat field.
8. Applicant has no interest in tracts offsetting the Harbert Pohl Tract.
9. The mineral interest owners of the unleased Petroskey, Barron and Klimitchek Tracts are offsets of the Harbert Pohl Tract and were entitled to notice of the April 2, 1997 hearing in this docket, but did not receive notice.

CONCLUSIONS OF LAW

1. Proper notice was not timely given to all parties legally entitled to notice.
2. Shanghai's application on Form W-1 does not correctly reflect Shanghai's property interest in the applied-for unit.
3. The Commission does not have jurisdiction to decide this matter.

RECOMMENDATION

The examiners recommend that Applicant's request for an exception to Statewide Rule 37 for the Harbert Pohl Unit, Well No. 1, for the Little Rok (Frio), Little Rok (Miocene) and Wildcat Fields be **dismissed**.

Respectfully submitted,

Marshall F. Enquist
Hearings Examiner

Donna Chandler
Technical Examiner

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