

**KEY ISSUES: Confiscation
Failure to Negate Regular Location**

R37 DENIED

September 19, 2000

**Rule 37 Case Nos. 0224945 and 0224946
District 7C**

**APPLICATIONS OF EL PASO SYSTEMS FOR EXCEPTIONS TO STATEWIDE RULE 37
TO DRILL ITS NO. 2 AND NO. 3 WELLS, TROGLIN RANCH LEASE, DARE I (HOPE),
FIELD, CONCHO COUNTY, TEXAS**

APPEARANCES:

FOR APPLICANT:

Jim Levy, Vice President

APPLICANT:

El Paso Systems

FOR PROTESTANT:

Caroll Martin, Attorney
Paul Bowman, Petroleum Geologist
Marion Olive, Petroleum Engineer

PROTESTANT:

Ultra Oil & Gas, Inc.
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PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATIONS FILED:

May 7, 2000

NOTICES OF HEARING:

June 19, 2000

HEARD BY:

Mark Helmueller - Hearings Examiner
Donna Chandler - Technical Examiner

HEARING DATE :

July 27, 2000

TRANSCRIPT RECEIVED:

September 14, 2000

PFD CIRCULATION DATE:

September 19, 2000

STATEMENT OF THE CASE

El Paso Systems (“El Paso” or “Applicant”), seeks exceptions to Statewide Rule 37 to drill its No.2 and No. 3 wells, Troglin Ranch Lease, in the Dare I (Hope) Field, Concho County, Texas. The Dare I (Hope) Field is subject to spacing requirements of 330 feet minimum spacing to the nearest lease line and 660 feet minimum spacing between wells. The subject lease is rectangular and locations regular to lease-lines are available. The proposed locations are both only 142 feet east of the western lease line and comply with the between well spacing requirements.

The Troglin Ranch Lease (the “Troglin Lease” or “subject lease”) is depicted in both applications as 80 acres as outlined on the plat attached to the Form W-1s (Application for Permit to Drill, Deepen, Plug Back, or Re-Enter) submitted by El Paso on May 7, 2000. No other wells have been completed into the applied-for fields on the subject lease.

El Paso’s applications are protested by Ultra Oil & Gas, Inc. (“Ultra” or “Protestant”). Ultra is the operator on the offset tract located to the west of the subject lease.

APPLICANT’S POSITION AND EVIDENCE

El Paso’s applications seek Rule 37 exceptions to prevent confiscation in the Dare I (Hope) Field. El Paso estimated that approximately 10 productive acres in the Dare I (Hope) Field underlie the subject lease. Four wells drilled by Ultra on the Troglin Lease at regular locations were not productive in the Dare I (Hope) Field. El Paso claims that in the mud log for one of these wells, the Troglin Ranch No. 4, a gas show indicates a close proximity to the sand pinch out line, which is the reservoir limit for the Dare I (Hope) Field. El Paso claimed that the gas show was misinterpreted as coal gas.

Relying on its interpretation of the mud log for the Troglin Ranch No. 4 Well, a structure map of the Dare I (Hope) Field submitted in the Field Rules hearing before the Commission, and additional well logs for producing and nonproducing wells in the vicinity of the western border of its lease, El Paso sketched the eastern reservoir limit for the Dare I (Hope) Field. El Paso’s sketch depicts approximately 10 productive acres extending onto the Troglin Lease. El Paso estimated that between 5000 and 10,000 barrels of oil in place would be present for each productive acre. Accordingly, El Paso estimated that between 50,000 and 100,000 barrels of oil are in place. El Paso did not provide a recovery factor for the oil in place and therefore presented no estimate of the recoverable reserves in the Dare I (Hope) Field beneath the Troglin Lease. El Paso also did not account for the impact of Ultra’s production in determining its fair share of the current recoverable reserves.

When presented with evidence that El Paso’s own depiction of the Dare I (Hope) Field included a regular location which would encounter the field, El Paso responded that the field could “feather out” at that location. El Paso believes that there would be an increased risk that drilling at a regular location would lead to a non productive well.

El Paso also claimed that the exceptions were necessary to prevent waste. El Paso believes that the Dare I (Hope) Field has a water drive mechanism. El Paso further noted that its proposed wells would be updip of Ultra’s current producing wells on the offset lease. El Paso argued that, because its

wells would be structurally higher in a water drive reservoir, an exception is required to prevent waste.

PROTESTANT'S POSITION AND EVIDENCE

Ultra is the operator of the offset tract to the west of the subject lease. Ultra is currently producing from 17 wells in the Dare I (Hope) Field. Ultra contends that the field's production history indicates that it is a solution gas drive as opposed to a water drive reservoir. Ultra's exploration manager testified that the field experienced an early significant pressure decline. Ultra is currently injecting water to maintain reservoir pressure and has applied to the Commission to increase the scope of its waterflood program.

Ultra previously held the Troglin Lease. Ultra attempted to determine the eastern boundary of the Dare I (Hope) Field, by drilling four wells at regular locations on the Troglin Lease. All four wells were unsuccessful. Based primarily on data obtained through its extensive drilling program, Ultra concluded that the productive limits of the Dare I (Hope) Field do not extend onto the Troglin Lease. Ultra submitted a structure map depicting the sand pinch out running roughly parallel to the eastern lease line of its Pfluger lease with no extension of the reservoir onto the Troglin Lease.

Ultra also reviewed the sketch produced by El Paso depicting the Dare I (Hope) Field extending onto the Troglin Lease. While Ultra disputes this depiction, it also pointed out that applicant's own representation shows that regular locations are available on the Troglin Lease that potentially could encounter the Dare I (Hope) Field. Ultra contended that until El Paso negated this regular location that it would not be entitled to any exception to the lease line spacing requirements.

EXAMINERS' OPINION

A. Confiscation

To establish entitlement to an exception to Rule 37 to prevent confiscation, an applicant must show that, absent the applied-for well, it will be denied a reasonable opportunity to recover its fair share of hydrocarbons currently in place under the lease, or its equivalent in kind. The applicant must satisfy a two pronged test: 1) the applicant must show that it will not be afforded a reasonable opportunity to recover its fair share of hydrocarbons currently in place by drilling a well at a regular location; and 2) the applicant must show that the proposed irregular location is reasonable.

Failure to Negate a Regular Location

It is the basic right of every landowner or lessee to a fair and reasonable chance to recover the oil and gas under his property as recognized by the Texas Supreme Court in *Gulf Land Co. v. Atlantic Refining Co.*, 131 S.W.2d 73, 80 (Tex. 1939). Denial of that fair chance is confiscation within the meaning of Rule 37. *Id.* Because an application cannot seek redress for past drainage, an applicant must

provide evidence that it will not be afforded an opportunity to recover the reserves **currently** in place under its lease - this is its “fair share”.

El Paso’ own evidence illustrated that viable regular locations exist on the Troglin Lease. Though a regular location exists on the subject lease, El Paso claimed that it would not be comfortable drilling at a regular location because the Dare I (Hope) Field could “feather out” at the regular location.

Exceptions to Rule 37 are not granted to eliminate all risk for an operator, but to provide a reasonable opportunity to recover the oil and gas on an operator’s lease. El Paso’s own map of the Dare I (Hope) Field depicts regular locations within the confines of the reservoir. El Paso was required to produce evidence to rule out any regular locations in order to justify its application for a Rule 37 exception. El Paso failed to produce such evidence and therefore failed to establish that an exception was necessary to afford it a reasonable opportunity to recover the reserves on its Troglin Lease.

Finally, El Paso provided no estimate of the current recoverable reserves underlying its lease. This evidence is a required element of establishing entitlement to an exception to prevent confiscation. Without an accurate estimate of current recoverable reserves, there is no “benchmark” to measure against to determine whether a regular location will provide a reasonable opportunity to recover an applicant’s fair share. Accordingly, El Paso has failed to establish that it is entitled to exceptions to prevent confiscation.

B. Waste

El Paso also argued that Rule 37 exceptions are necessary to prevent the waste of hydrocarbons. 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.

El Paso’s waste case rests on the faulty assumption that the Dare I (Hope) Field is a water drive reservoir and that its proposed wells would be structurally higher than Ultra’s. This presumably would allow El Paso’s proposed wells to continue to produce as the lower wells watered out.

The examiners have concluded from the evidence presented that the Dare I (Hope) Field is in fact a solution gas drive reservoir. This negates the underlying premise of El Paso’s waste argument. No further analysis is necessary to conclude that El Paso is not entitled to exceptions based on waste.

CONCLUSION

The evidence and legal authority presented establish that El Paso is not entitled to a Rule 37 exception in order to prevent confiscation or waste. The examiners therefore recommend that the subject application be denied.

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. At least 10 days notice of this hearing was given to the designated operator, all lessees of record for tracts that have no designated operator, and all owners of record of unleased mineral interests for each affected adjacent tract.
2. Applications for two exceptions to Statewide Rule 37 were originally filed with the Commission by El Paso Systems. ("El Paso") on Form W-1 (Application to Drill, Deepen, Plug Back or Re-Enter) on May 7, 2000.
3. El Paso seeks exceptions to Statewide Rule 37 to drill Well #2 and Well #3 on the Troglin Ranch Lease ("subject lease") to the Dare I (Hope) Field. The Dare I (Hope) Field is subject to spacing requirements of 330' minimum spacing to the nearest lease line and 660' minimum spacing between wells. The subject lease is rectangular. Locations regular to lease-lines are available. The proposed wells would both be located 142' east of the western lease line.
4. El Paso's applications are protested by Ultra Oil & Gas, Inc. ("Ultra"). Ultra is the operator of the offset tract located to the west of the subject lease.
5. There are regular locations on the subject lease that would encounter the Dare I (Hope) Field as depicted on El Paso's map of the eastern reservoir limit.
6. El Paso did not provide any estimate of the current recoverable reserves underlying the subject lease in the Dare I (Hope) Field.
7. Regular locations exist on the subject lease which would give El Paso a reasonable opportunity to recover the reserves currently underlying the subject lease in the Dare I (Hope) Field.
8. The Dare I (Hope) Field is a solution gas drive reservoir.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred to give the Commission jurisdiction to decide this matter.
3. El Paso failed to prove that a well at a location regular to lease lines will not provide it with a reasonable opportunity to recover the reserves currently in place under the subject lease.
4. Exceptions to Statewide Rule 37 for the two wells at the applied-for location are not necessary to prevent confiscation or waste .

RECOMMENDATION

The examiners recommend that the subject applications be denied in their entirety in accordance with the attached final order.

Respectfully submitted,

Mark J. Helmueller
Hearings Examiner

Donna Chandler
Technical Examiner