

November 30, 2006

OIL & GAS DOCKET NO. 7B-0247430

COMMISSION CALLED HEARING ON THE COMPLAINT OF JUD AND JOANNIE EDWARDS THAT PROPER NOTICE WAS NOT GIVEN REGARDING THE EXCEPTION TO STATEWIDE RULE 37 PERMIT GRANTED TO CHOLLA PETROLEUM, INC., STATE RODEO LEASE, WELL NO. 1, VARIOUS FIELDS, PALO PINTO COUNTY, TEXAS.

RULE 37 CASE NO. 0244734

APPLICATION OF CHOLLA PETROLEUM, INC. FOR AN EXCEPTION TO STATEWIDE RULE 37 FOR ITS STATE RODEO LEASE, WELL NO. 1, VARIOUS FIELDS, PALO PINTO COUNTY, TEXAS.

FOR WILLINGHAM RANCH:

Jud Edwards
Joannie Edwards

FOR CHOLLA PETROLEUM, INC.:

Jamie Nielson, Attorney
Lloyd Powell, President
Mike Paulson, Geologist
Greg Cloud, Petroleum Engineer

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF ORIGINAL RULE 37 HEARING:	December 9, 2005
DATE OF COMPLAINT:	January 17, 2006
DATE OF NOTICE OF HEARING:	May 9, 2006
DATE OF HEARING:	June 22, 2006
DATE HEARING CLOSED:	July 21, 2006
HEARD BY:	Marshall Enquist, Hearings Examiner Donna Chandler, Technical Examiner
DATE PFD CIRCULATED:	November 30, 2006

STATEMENT OF THE CASE

On December 9, 2005, Cholla Petroleum, Inc. ("Cholla") was granted a Rule 37 exception (Permit No. 607917) pursuant to Statewide Rule 37(h)(2)(A) for its State Rodeo Lease, Well No. 1, Various Fields, Palo Pinto County, Texas. By letter dated January 17, 2006, Jud and Joannie Edwards ("the Edwards") of Willingham Ranch complained that they had been entitled, as unleased adjacent mineral owners, to notice of the Cholla Rule 37 application, but did not receive such notice. This proceeding was called in response to their complaint.

By letter dated April 18, 2006, Cholla stated that it would not contest the Edwards' complaint, but would instead present its case for an exception to Statewide Rule 37 for the disputed well. At hearing on June 22, 2006, Cholla again indicated it would not contest the Edwards' complaint and would go forward with proving its Rule 37 exception case. For all practical purposes, Cholla's stance conceded that the Edwards' notice complaint has merit and that Cholla is presently obligated to prove its need for a Statewide Rule 37 exception location on the State Rodeo Lease. The Edwards indicated they opposed the grant of the requested Cholla Rule 37 exception and participated as protestants in the case.

SUMMARY OF CHOLLA'S RULE 37 POSITION AND EVIDENCE

Cholla is the lessee of several State riverbed tracts, which are part of the submerged Brazos River under Possum Kingdom Lake. The tract at issue has been named the Rodeo Lease by Cholla, and is a long narrow tract of 235 acres with no regular locations. No wells exist on the tract and Cholla contends the requested location is reasonable, in that it is located nearly in the center of the underwater banks of the tract. Without this well, Cholla and the State of Texas will be unable to recover the minerals in place beneath the river tract, resulting in waste and confiscation.

Cholla initially applied for its exception location in a large number of fields¹ due to the nature of fields in the area. Fields and reservoirs come and go erratically in the area and it is difficult to predict which field may be found in a well. Drainage areas are also difficult to predict and are sometimes very limited in size.

At hearing, Cholla amended its application and reduced the number of fields it requested for its exception location (see table below). Aside from the Pickwick (Marble Falls), which is a limestone formation, the fields listed below are some of the numerous fields known collectively in the area as the Big Saline Conglomerates, found at a depth between 3600' and 4200'. Cholla now requests an exception permit in the following fields:

FIELD NO.:	FIELD:	SPACING:	DENSITY:
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¹ Palo Pinto Co. Regular ; Palo Pinto Co. Reg. (Gas) Field; Whittenberg (Strawn Lower); Lucky lane (Marble Falls Lime); Strong, SW (Congl. D); Strong, SW (Congl. "A"); Strong, SW (Duffer); Strong (Congl.); W.A. Gragg (Atoka Congl.); W.A. Gragg, S. (Atoka Congl.); PK Bass Hollow (Atoka Congl.); Borock (Miss); Possum Kingdom, West (Congl.); Possum Kingdom (Congl.); Jill (Congl. N); Pickwick (Marble Falls)(oil); B.R.A. (Congl.)(oil); Weldon (Conglomerate); Belding (Bend Congl.)(oil); P.K. Lake (Congl.)(oil); Rickels (Conglomerate); Pickwick (Marble Falls); Pickwick (Conglomerate); B.R.A. (Congl.); Kimberlin Ranch (Congl. 3620); P.K. Dam (Congl. 3820); and Belding (Bend Congl.).

04809500	B.R.A. (Congl.)(oil)	County Regular	County Regular ²
04809500	B.R.A. (Congl.)(gas)	467'-1200'	160
49295200	Kimberlin Ranch (Congl. 3620)(oil)	467'-1200'	80/40
49295200	Kimberlin Ranch (Congl. 3620)(gas)	467'-1200'	80/40
68136500	P.K. Dam (Congl. 3820)(oil)	467'-1200'	40
68136500	P.K. Dam (Congl. 3820)(gas)	467'-1200'	40
68140300	P.K. Lake (Congl.)(oil)	County Regular	County Regular
68140300	P.K. Lake (Congl.)(gas)	County Regular	County Regular
68707333	Palo Pinto Co. Reg. (Gas)	County Regular	County Regular
68707001	Palo Pinto County Regular(oil)	County Regular	County Regular
68707001	Palo Pinto County Regular(gas)	County Regular	County Regular
71370400	Pickwick (Marble Falls)(oil)	County Regular	County Regular
71370400	Pickwick (Marble Falls)(gas)	467'-1320'	160

Cholla emphasizes the erratic nature of the conglomerate fields, noting that wells drilled exactly between two good producers can easily be dry holes. Cholla also notes that the profusion of conglomerate fields has allowed producers in the area to be creative in assigning fields to their wells, demonstrated by well logs showing completions in adjacent wells assigned to the same field, though the productive zones may be vertically separated by hundreds of feet. Conversely, two wells with identical logs may be reported as completed in separate fields (as shown by pressure differentials) at the same depth, again taking advantage of the opportunity for creative field assignment.

At the exception location, the river tract is only 433' wide. Cholla has placed its bottomhole location 269' from the north line and 164' from the south line of the river tract. The protestant's property line is on the north side of the river 269' from the well location.

Wells in the Big Saline Conglomerates tend to drain relatively small areas, so each successful well, on average, will recover reserves that cannot be recovered by any other well. Due to the small aerial extent of many of the conglomerate fields, it is Cholla's opinion that all the gas under this portion of Palo Pinto County will not be recovered until the area is drilled on 20 or 40 acre spacing. In this area, a conglomerate well yielding 1 BCF EUR is considered an excellent well, 0.5 BCF EUR is a good well and 0.25 BCF EUR is a mediocre well. The Kadane Oil Company Tennyson Well No. 2, as completed in the B.R.A. (Congl.) Field, has an EUR of 0.19 BCF, and a calculated drainage area of 43 acres with a drainage radius of 772 feet. It is 800 feet from the State Rodeo Lease and will not drain the Rodeo lease. The same well is also completed in the Palo Pinto County Regular Gas Field, with an EUR of 0.77 BCF and a calculated drainage area of 118 acres with a drainage radius of 1,279 feet. Its drainage area encroaches on the State Rodeo Lease by 479 feet, which exceeds the width of the Rodeo Lease, resulting in some drainage of the Willingham Ranch minerals. Thus, depending on the permeability and porosity of the field completed in, a well adjacent to the Rodeo Lease may not drain it in one field (causing waste, absent a permitted well on the Rodeo Lease), but may drain it in a different field (causing confiscation).

² County Regular spacing for the depths involved for these fields, 3,001 - 5,000 feet, is 330' leaseline spacing and 933' between well spacing on 20 acres.

The calculated recovery for a well in the Big Saline Conglomerate oil fields, using 21 nearby wells completed in the conglomerate fields, indicates an average recovery of 12,327 BO EUR (Cholla Ex. # 48). On this basis, Cholla calculates the current recoverable reserves under the Rodeo Lease to be 180,950 Stock Tank Barrels (Cholla Ex. # 49). Cholla would require 15 wells to drain the Rodeo Lease.

The calculated recovery for a well in then Big Saline Conglomerate gas fields, using 109 nearby wells completed in the conglomerate fields, indicates an average recovery of 380,581 MCF EUR (Cholla Ex. # 50). On this basis, Cholla calculates the current recoverable gas in place under its tract to be 1,320,700 MCF (Cholla Ex. # 52). Cholla would require 4 wells to drain the Rodeo Lease.

The calculated recovery for a well in the Pickwick (Marble Falls)(oil) Field, using seven nearby wells completed in the same zone, indicates an average recovery of 6,465 BO EUR (Cholla Ex. #46). Cholla calculates the current recoverable oil under the Rodeo Lease to be 124,550 Stock Tank Barrels (Cholla Ex. #47). Cholla would require 20 wells to drain the Rodeo Lease.

The calculated recovery for a well in the Pickwick (Marble Falls)(gas) Field, using seven nearby wells completed in the same zone, indicates an average recovery of 657,714 MCF EUR (Cholla Ex. #44). Cholla calculates the current recoverable gas in place under its tract to be 961,150 BCF (Cholla Ex.# 45). Cholla would require 2 wells to drain the Rodeo Lease.

Although Cholla is only asking for one exception location for a well in this application, it reserves the right to come before the Commission at a later date and request additional exception locations. The evidence demonstrates that a single well will not recover all the currently recoverable reserves in place in all fields beneath the State Rodeo Lease, so additional wells will eventually be necessary.

Cholla notes this narrow riverbed tract has never been drilled. Without an exception location, the riverbed tract will never be drilled and the State of Texas will never receive any royalty on the hydrocarbons beneath the tract. The tract took its size and shape at the turn of the century, before any of the applied-for fields were discovered. The record in this case is not clear whether the Rodeo Lease was divided from a larger riverbed tract at the time it was leased from the Texas General Land Office, or if the tract was already in its present configuration. However, the tract contains 235 acres, which is in excess of the proration units called for in the field rules of any of the applied-for fields. Thus, even if the Rodeo Lease is divided from a larger tract, the division is not an illegal voluntary subdivision designed to circumvent the spacing rules of the Commission. Cholla contends the tract is entitled to a first well as a matter of law. There are no lease line regular locations on the tract. Further, no single well will recover all the reserves in place under the tract. The well will prevent waste and confiscation and the proposed location is reasonable. A location in the center of any narrow tract without regular locations is presumptively considered reasonable. In this case, the off-center location 269 feet from the protestant and 164 feet from the opposite bank actually favors the protestant. Cholla could move the requested exception location to the center of

the river tract, but a move to an exactly central location would cause more drainage of the protestant's tract.

Cholla asks that the Commission approve the application. Cholla requests that the deadline for expiration of its Rule 37 drilling permit be extended from the normal two years to four years to allow it to complete in and drain the applied-for fields. Cholla, quoting Statewide Rule 37(k), also requests that the Order in this case make it clear that a completion in one field does not invalidate the permit as to all other applied-for fields.

SUMMARY OF THE EDWARDS' POSITION AND EVIDENCE

The Edwards represent Willingham Ranch, which has retained the mineral interest under a significant portion of Possum Kingdom Lake. At the site of the Rodeo Lease, the old Brazos riverbed is not in the center of the lake but is closer to the south shore. The Willingham interests offset the Rodeo Lease to the north and west, with a considerable amount of acreage under the lake that is not currently accessible by drilling. The Willingham Ranch is concerned with preventing drainage of their minerals by wells drilled on the State Rodeo lease. Whereas Cholla will be able to condemn surface locations near the submerged Brazos tract and access the minerals through directional drilling, the technology does not yet exist to allow the Willingham Ranch to access its minerals adjacent to the State riverbed tract through directional drilling. The distance is simply too great to effectively directionally drill targets located near the Brazos River tract.

Many of the fields that Cholla proposes to drill have 330 foot leaseline spacing. The Edwards, on behalf of the Willingham Ranch interests, request that the bottomhole location for the Cholla well be moved to 330 feet from their leaseline, rather than the proposed 269 feet.

EXAMINERS' OPINION

To obtain an exception to Statewide Rule 37 to protect correlative rights and prevent confiscation, the applicant must show: (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.

Cholla's drillsite tract, the Rodeo Lease, is a long narrow strip of State-owned riverbed. The riverbed is so narrow that there are no regular locations available anywhere along its length from which Cholla can recover its fair share of the calculated quantity of minerals in place beneath its lease.

On a long, narrow lease with no regular locations, a well placed in the center of the lease is presumptively considered reasonable. In this case, the well is placed off-center, but in such a way that it favors the only protestant in the case. A bottomhole exactly centered in the Brazos riverbed would be 216 feet from the opposite leaselines. The location proposed by Cholla is 269 feet from the protestant's leaseline, which operates to the benefit of the protestant in that it reduces the

potential drainage of protestant's minerals. Under the facts of this case, the proposed irregular location is reasonable.

The examiners conclude that Cholla has shown that it is entitled to a Rule 37 exception based on prevention of confiscation.

Drilling permits are issued for a period of two years. In this case, the number of fields requested in the present hearing are substantially reduced from the number of fields applied-for in the prior walk-through of the permit. The amended permit, if issued, will be valid for a period of two years starting from the new date of issuance. The grant of a permit period greater than two years would create an administrative tracking problem at the Commission and would set a precedent resulting in a probable flood of applications requesting permit validation periods of various lengths. At present, Commission Statewide Rule 5(g) plainly states "(g) Expiration. Any permit to drill, deepen, plug back, or reenter granted by the Commission expires no later than two years after the date of original approval." Absent an amendment to Statewide Rule 5(g) through rulemaking, the examiners believe Cholla's request for a four year permit period must be denied.

Applicant also requests that the permit contain language to the effect that completion in one of the permitted fields will not invalidate the permit as to all of the permitted fields. Applicant cites Statewide Rule 37(k) which states:

Exceptions to Statewide Rule 37 apply to the total depth for which the permit is granted or if special field rules are applicable, an exception to the spacing rule shall be granted only for the reservoir or reservoirs or applicable depth to which the well is projected. Subsequent recompletion of the well to reservoirs other than that covered by the permit would be granted only after the filing and processing of a new application.

However, Rule 37 exception permits clearly state: "Completion of the well in a field authorized by this permit voids the permit for all other fields included in the permit unless the operator indicates on the initial completion report that the well is to be a dual or multiple completion and promptly submits an application for multiple completion (emphasis added)." As suggested by the underlined portion of the statement, the operator's defense to the voiding of the non-completed fields is to file a Commission Form W-4 Application for Multiple Completion (see Statewide Rule 6). An operator may seek additional relief by filing for a commingling permit under Statewide Rule 10, or even applying for a field consolidation hearing. In this particular case, applicant has already presented evidence of the erratic nature of the numerous individually named conglomerate fields within the interval generally known as the Big Saline Conglomerate. Consolidating the applied-for conglomerate fields, and others, into a single field would effectively solve the problem applicant seeks to avoid. The examiners recommend that the extraordinary relief sought by applicant be denied.

FINDINGS OF FACT

1. At least ten (10) days notice of the hearing in this consolidated docket was sent to all parties

entitled to notice.

2. Notice of hearing was given on May 9, 2006 to all designated operators, lessees of record for tracts that have no designated operator, and owners of record of unleased mineral interest for each adjacent tract and each tract owner nearer to the well than the prescribed minimum leaseline spacing distance (check current standard).
3. Cholla Petroleum, Inc. does not contest the complaint of Jud and Joannie Edwards in Oil & Gas Docket No. 7B-0247430 that proper notice was not given to them in the application of Cholla Petroleum, Inc. for its Rule 37 exception permit (#607917) for its State Rodeo Lease, Well No. 1, Palo Pinto County, granted on December 9, 2005.
4. The applicant in the Rule 37 Case No. 0244734, Cholla Petroleum, Inc., seeks an exception to Statewide Rule 37 to drill Well No. 1 on the State Rodeo Lease, Palo Pinto County, Texas in the following fields:

FIELD NO.:	FIELD:	SPACING:	DENSITY:
04809500	B.R.A. (Congl.)(oil)	County Regular	County Regular
04809500	B.R.A. (Congl.)(gas)	467'-1200'	160
49295200	Kimberlin Ranch (Congl. 3620)(oil)	467'-1200'	80/40
49295200	Kimberlin Ranch (Congl. 3620)(gas)	467'-1200'	80/40
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71370400	Pickwick (Marble Falls)(oil)	County Regular	County Regular
71370400	Pickwick (Marble Falls)(gas)	467'-1320'	160

5. The State Rodeo Lease is a long, narrow tract of 235 acres comprised of the submerged bed of the Brazos River beneath Possum Kingdom Lake. The proposed well will be the first well drilled on the tract.
6. The State Rodeo Lease is narrow, with no regular locations available anywhere along its length.
7. The bottomhole location of the proposed well is 269 feet from the north line and 164 feet from the south line of the submerged banks of the Brazos River.
8. A well at the center of the Rodeo lease would be 216 feet from the north and south leaselines, and such location would ordinarily be deemed reasonable for an exception based on prevention of confiscation.

9. The bottomhole location of the proposed well is 269 feet from protestant's tract and favors protestant's tract by reducing the possible drainage of its minerals. The proposed location is reasonable.

CONCLUSIONS OF LAW

1. Proper notice of this hearing was timely given to all persons legally entitled to notice.
2. All things necessary to the Commission attaining jurisdiction over the subject matter of the consolidated dockets, the subject matter and the parties in this hearing have been performed or have occurred.
3. The Rule 37 exception permit (#607917) granted to Cholla Petroleum Inc. for its State Rodeo Lease, Well No. 1, Palo Pinto County, on December 9, 2005 is void for lack of proper notice to affected parties Jud and Joannie Edwards.
4. Cholla Petroleum Inc. is entitled to an exception to Statewide Rule 37 on its State Rodeo Lease, Various Fields, Palo Pinto County, Texas based on prevention of confiscation, and should be granted as amended by limitation to the applied-for fields:

FIELD NO.:	FIELD:
04809500	B.R.A. (Congl.)(oil)
04809500	B.R.A. (Congl.)(gas)
49295200	Kimberlin Ranch (Congl. 3620)(oil)
49295200	Kimberlin Ranch (Congl. 3620)(gas)
68136500	P.K. Dam (Congl. 3820)(oil)
68136500	P.K. Dam (Congl. 3820)(gas)
68140300	P.K. Lake (Congl.)(oil)
68140300	P.K. Lake (Congl.)(gas)
68707333	Palo Pinto Co. Reg. (Gas)
68707001	Palo Pinto County Regular(oil)
68707001	Palo Pinto County Regular(gas)
71370400	Pickwick (Marble Falls)(oil)
71370400	Pickwick (Marble Falls)(gas)

RECOMMENDATION

The examiners recommend that the Statewide Rule 37 application of Cholla Petroleum Inc. for its State Rodeo Lease, Well No. 1, Various Fields, Palo Pinto County, as amended in this hearing, be granted. The examiners also recommend that the previously granted Permit # 607917 be voided.

Respectfully submitted,

Marshall Enquist
Hearings Examiner

Donna Chandler
Technical Examiner