



RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

August 12, 2010

RULE 37 CASE No. 0264854
DISTRICT 3

**APPLICATION OF CYPRESS E & P CORPORATION FOR AN EXCEPTION TO STATEWIDE RULE 37 TO
DRILL WELL No. 1 ON ITS IRON HORSE LEASE, WILDCAT FIELD, WHARTON COUNTY, TEXAS.**

APPEARANCES:

FOR APPLICANT Cypress E & P Corporation:

George Neale
Rick Johnston
David Cape
Ryan Cochran

FOR PROTESTANT J. Michael Hershey:

James Bostic

FOR PROTESTANT Olive Hershey Spitzmiller:

Olive Hershey Spitzmiller

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATION FILED:	February 26, 2010
NOTICE OF HEARING:	April 19, 2010
HEARING DATE:	May 19, 2010
HEARD BY:	Mark Helmueller - Hearings Examiner Andres Trevino - Technical Examiner
TRANSCRIPT RECEIVED:	May 29, 2010
PFD CIRCULATION DATE:	July 30, 2010

STATEMENT OF THE CASE

Cypress E & P Corporation (“Applicant” or “Cypress”) seeks an exception to Statewide Rule 37 to directionally drill Well No. 1 on its Iron Horse Lease, Wildcat Field, Wharton County, Texas. The Iron Horse Lease is a 3.55 acre 100 foot wide strip in the J. C. Clark Survey, in Wharton County.

The Wildcat Field is subject to spacing requirements of 467 feet minimum distance to the nearest lease line and 1200 feet minimum distance between wells. There are no regular locations on the tract. The bottomhole location of the proposed well is to be directionally drilled to the center of the strip, 50 feet from the northern and southern lease lines. A copy of the plat filed with Applicant’s W-1 (Application for Permit to Drill, Deepen, Plug Back or Re-Enter) is attached.

The application is protested by J. Michael Hershey and Olive Hershey Spitzmiller (“Protestants”), the owners of unleased mineral interests offsetting the proposed well on both sides of the strip. Protestants own an undivided 24% of the mineral interests. Cypress has leased 76% of the mineral interests north of the tract, and 67% of the mineral interests south of the tract. Cypress has tendered offers to all of the owners of undivided mineral interests offsetting the proposed well.

APPLICANT’S POSITION AND EVIDENCE

Cypress claims that the Iron Horse No. 1 is necessary to prevent confiscation on the 3.55 acre right-of-way strip. Cypress argues: 1) the strip of land is a legal subdivision; 2) the proposed location of the well is in the geometric center of the legal subdivision tract, which by definition constitutes a reasonable location; 3) a substantial volume of reserves underlie the target interval; and, 4) the mineral owners are entitled to recover their fair share of minerals which underlie their property as a matter of right.

Cypress contends that the 3.55 acre strip of minerals identified as the Iron Horse Lease took its original size and shape in 1899 through a conveyance of the 100 foot wide strip to the Cane Belt Railroad Company.¹ The 1899 conveyance did not reserve the mineral rights, which therefore passed to the railroad. The railroad did not acquire the mineral interests to the northwest of the 3.55 acre strip. To the southeast, the railroad acquired by separate conveyances the mineral interests in the contiguous 9.92 acre tract adjoining the 3.55 acre strip and a 12.69 acre strip tract which adjoins the 9.92 acre tract to the southeast. With respect to contiguous mineral interests, the railroad ultimately acquired a total 26.16 contiguous acres in a 100 foot by 2 ½ mile strip: the 3.55 acre Iron Horse tract,

¹The northern boundary of the 3.55 acre strip is State Highway 102. The highway strip is divided in two portions. The original 60 foot right-of-way for the highway was obtained by prescriptive easement. Because this property was obtained by a prescriptive easement, the mineral interests remained in the original property owner. The rights are now jointly owned by Duncan Minerals and protestants. Cypress has obtained a lease from Duncan Minerals for their interests.

In 1931, the state widened Highway 102. The additional 40 foot strip for the right-of-way was acquired from the Duncan Family in fee by the State of Texas. Accordingly, the General Land Office manages the ownership of the mineral estate in the 40 foot strip. Cypress has obtained a lease from the General Land Office for this strip.

the adjoining 9.92 acre tract, and the 12.69 acre tract.

Prize leased all of the BNSF Railway Company's mineral interests, an estimated 789 acres, underlying the railroad right of way in Wharton County in July 2009. Prize's 789 acre mineral lease included the 3.55 acre Iron Horse tract. In August 2009, Cypress obtained its rights to the 3.55 acre Iron Horse Lease through a mineral sublease from Prize Energy Resources.

Cypress contends the Iron Horse tract, has never lost its status as a legal subdivision. Cypress does not believe the railroad's common ownership of 22.61 contiguous acres extinguished the right to drill a well on the individual Iron Horse tract. Additionally, Cypress argues that neither the Iron Horse tract nor any portion of the contiguous tracts have ever been pooled with any other property for the purpose of developing the mineral estate.

The proposed well target is the Wilcox formation. There is existing Wilcox production in the Dynamic (Wilcox 12,500) Field, in the Duncan No. 3 Well drilled by Cypress to the south of the proposed well. Production in the Duncan No. 3 Well is between 12,556 and 12,811 feet. A log section for the Duncan No. 3 Well depicts the G Sand in the Wilcox. Log interpretation estimates 107 feet of good porosity development in this sand in the Duncan No. 3 Well. Cypress' seismic analysis and mapping depict the proposed Iron Horse No.1 Well in the same fault block as the Duncan No. 3 Well. Cypress maps also show the Iron Horse tract is separated from the adjacent 100 foot wide railway strips located to the southeast by a 1,500 foot sealing fault.

Cypress believes it will encounter a similar amount of pay in the proposed well as it found in the Duncan No. 3 well. Based on additional data obtained from the Duncan No. 3 well, Cypress' volumetric calculations estimate that the recoverable gas under the 3.55 acre Iron Horse Lease is approximately .21 Bcf. Cypress notes that this is a conservative estimate based on higher than normal estimated abandonment pressures and water saturation percentages used in the volumetric analysis.

PROTESTANT'S POSITION AND EVIDENCE

Protestants contend that the Iron Horse tract is a voluntary subdivision because it was merged with two contiguous tracts, and then was split off after oil and gas was discovered in the area. Protestants do not contend that the lease between BNSF and Prize merges all 789 acres identified in the July 2009 lease, as they acknowledge that the merger doctrine only applies to contiguous acreage. However, protestants urge the merger doctrine is applicable to the 22.61 contiguous strip. Protestants contend that *Sohio Petroleum Co. v. Schumacher*, 460 S.W.2d 445 (Tex. Civ. App. - Austin 1970), supports their position as the court in that case found a 2.66 acre highway tract was a voluntary subdivision from a 17.8 acre highway tract. Protestants therefore urge that the 3.55 acre Iron Horse Lease is also a voluntary subdivision from the 22.61 contiguous strip that was created through the sublease Cypress obtained from Prize.

EXAMINERS' OPINION

The only significant contested issue in this case is whether the 3.55 acre Iron Horse Lease is entitled to a well to provide the mineral interest owner with an opportunity to develop the mineral estate. Cypress stipulated that the only basis for an exception for the well at the proposed location was to prevent confiscation. Accordingly, there is no need to discuss whether the proposed well is necessary to prevent waste.

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. 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". Additionally, an applicant must establish if a tract is of a size and shape that it is necessary to obtain an exception to the spacing provision, it must have taken that shape prior to the attachment of Statewide Rule 37. *Gulf Land* at p. 81

Cypress is seeking the first well on the 3.55 acre Iron Horse Lease arguing that the tract is a legal subdivision which was created in 1899 before the development of oil and gas in the area. Generally, a first well on a legal subdivision is necessary to prevent confiscation. *Benz-Stoddard v. Aluminum Company of America*, 368 S.W.2d 94 (Tex. 1963).

It is uncontested that the Iron Horse Lease 3.55 acre strip of minerals took its original size and shape in 1899 through a conveyance of the 100 foot wide strip to the Cane Belt Railroad Company. The 1899 conveyance did not reserve the mineral rights, which therefore passed to the railroad. There has not been any challenge that Cypress has obtained the legal right to develop the minerals under this tract.

However, the Iron Horse Lease is not entitled to a well because it is a voluntary subdivision. Any right to develop the minerals separately on the 3.55 acre strip disappeared when the adjacent tracts came under common ownership by the railroad, thereby creating a 2 ½ mile 26.16 acre contiguous 100 foot wide strip for Rule 37 purposes. See *Stanolind Oil & Gas Co. v. Railroad Commission of Texas*, 92 S.W.2d 1057, 1059-1060 (Tex Civ. App. Austin -- 1936). Further, there is no question that the July 2009 BNSF-Prize lease merges all of the contiguous acreage identified in that lease agreement for the purpose of mineral development under *Stanolind*. Accordingly, any analysis regarding whether a legal subdivision exists must begin with the contiguous 26.16 acre strip, not the 3.55 acre Iron Horse tract.

The Handbook of Texas Online indicates that oil and gas production began in Wharton County in 1925. The Commission proration schedule reflects that the Dynamic (Wilcox 12,500) Field, from which the applicant's Duncan No. 3 produces, was discovered in 2001. Oil and gas production clearly existed in Wharton County long prior to the 2009 mineral sub-lease that segregated the subject tract from the larger Prize lease.

Under Railroad Commission Statewide Rule 37(g)(2), a sub-standard tract is a voluntary subdivision and not entitled to a well to prevent confiscation if, inter alia, it was “segregated from a larger tract in contemplation of oil, gas or geothermal resource development ...” The 3.55 acre tract at issue was carved out of a larger mineral lease by a mineral sublease in August, 2009. The sublease was for the purpose of oil and gas development and clearly therefore, in the words of the rule, in contemplation of oil and gas development.

Because the sub-standard, 3.55 acre Iron Horse Lease identified in this docket, is a voluntary subdivision created in contemplation of oil and gas development long after the discovery of oil and gas in the area, Cypress cannot be granted a permit in order to prevent confiscation. Further, Cypress has stipulated that it is not entitled to a permit to prevent waste. Accordingly, the application for an exception to Rule 37 to permit the proposed well on the 3.55 acre Iron Horse Lease should 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. Cypress E & P Corporation (“Applicant” or “Cypress”) seeks an exception to Statewide Rule 37 to directionally drill Well No. 1 on its Iron Horse Lease, Wildcat Field, Wharton County, Texas. Cypress appeared at the hearing and presented evidence in support of its application.
2. The application is protested by J. Michael Hershey and Olive Hershey Spitzmiller (“Protestants”), the owners of unleased mineral interests offsetting the proposed well on both sides of the strip. Protestants own an undivided 24% of the mineral interests.
3. The Wildcat Field is subject to spacing requirements of 467 feet minimum distance to the nearest lease line and 1200 feet minimum distance between wells.
4. The Iron Horse Lease is a 3.55 acre 100 foot wide strip in the J. C. Clark Survey, in Wharton County.
5. Cypress stipulated that the only basis for a Rule 37 exception for the well at the proposed location was to prevent confiscation.
6. The Iron Horse 3.55 acre strip of minerals is part of contiguous 22.61 acre, 100 foot wide strip of minerals which includes the contiguous 9.92 acre and 12.69 acre tracts located to the southeast that came under common ownership by the BNSF Railway Company.
7. The 3.55 acre Iron Horse Lease is a voluntary subdivision from the larger contiguous strip of mineral interests leased by Prize from the BNSF Railway Company.

- a. Prize Energy Resources leased all of the BNSF Railway Company's mineral interests on the railroad right of way which includes the Iron Horse Lease in July 2009.
- b. Cypress obtained its rights to the 3.55 acre Iron Horse Lease through a mineral sublease from Prize Energy Resources in August 2009.

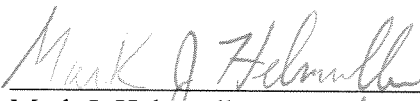
CONCLUSIONS OF LAW

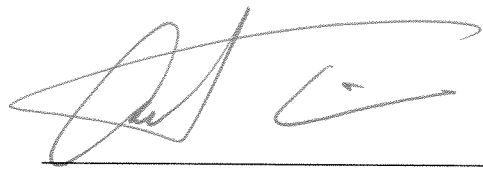
1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred to give the Commission jurisdiction to decide this matter.
3. The 3.55 acre Iron Horse Lease is a voluntary subdivision segregated from a larger tract in contemplation of oil and gas development.
4. The 3.55 acre Iron Horse Lease is not entitled to a drilling permit to prevent confiscation.
5. The proposed well on the 3.55 acre Iron Horse Lease is not necessary to prevent confiscation or waste.

RECOMMENDATION

The examiners recommend that Cypress's application be denied in accordance with the attached final order.

Respectfully submitted,


Mark J. Helmueller
Hearings Examiner


Andy Treviño
Technical Examiner