

OFFICE OF

RAILROAD COMMISSION
OF TEXAS



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LEGAL DIVISION

67th ST. CONGRESS

CAPITOL STATION - P. O. BOX 4014

AUSTIN, TEXAS 78766

OIL & GAS DOCKET No. 0201687
PROPOSAL FOR DECISION

AN APPLICATION BY KAISER-FRANCIS OIL COMPANY FOR AN EXCEPTION TO STATEWIDE RULES 37 AND 38 FOR ITS LOHBERGER/MEADOWS No. 1013 WELL, BUFFALO WALLOW (A CHERT ZONE) AND WILDCAT FIELDS, WHEELER COUNTY, TEXAS

APPLICANT: Kaiser-Francis Oil Company
FOR APPLICANT: Brian Sullivan, Tom Weber, Michael D. Flaherty, Alan Benson

PROTESTANTS: Marsh Operating Company, Philcon Development Company
FOR PROTESTANT MARSH: John Soule
FOR PROTESTANT PHILCON: Rex H. White, Jr., Gary Bagwell, Danny Conklin

HEARINGS EXAMINER: Dwight Martin
TECHNICAL EXAMINER: Margaret Allen

PROCEDURAL HISTORY

APPLICATION FILED: 4-21-93
HEARING NOTICE DATE: 4-23-93
HEARING DATE: 6-17-93

TRANSCRIPT DATE: 7-8-93
PFD CIRCULATION DATE: 11-22-93
CURRENT STATUS: Protested

STATEMENT OF THE CASE

The Lohberger/Meadows Unit ("the unit") is a 640 unitized tract in Wheeler County. Applicant Kaiser-Francis is a 10.60 per cent working interest owner in the unit and assignee of the lease for at least one of the unitized tracts. Protestant Philcon is the operator of the unit and of the acreage to the immediate west and the immediate south of the unit. Protestant Marsh operates the acreage touching the unit's southwest corner. Applicant seeks an exception to Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§ 2.37 and

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3.38 (Statewide Rules 37 and 38) to prevent confiscation, and proposes to drill a well to the Buffalo Wallow (A Chert Zone) Field and to the Wildcat Field, at a location 467 feet from the west line and 1,867 feet from the south line of both the unit and Section 13, Block R&E, Roberts & Eddleman Survey, Abstract No. A-498. Proposed total depth is 14,900 feet. Field rules require a 1,867 foot lease-line spacing and a 3,735 foot between-well spacing for the Buffalo Wallow (A Chert Zone) Field; the Wildcat is under the statewide spacing rules, and neither a spacing nor a density exception is required. The proposed well would be the second well on the unit in the Buffalo Wallow (A Chert Zone) Field. Owing to the large between-well spacing component of the field rules, there are no regular locations on the unit.

Protestant Philcon filed a motion to dismiss, complaining that the Applicant does not have a good-faith claim of title sufficient to support the permit application. The principal theme of Protestants' complaint is that under the joint operating agreement (JOA), the proposed well cannot be drilled without the consent of each party to the agreement. At the hearing, Philcon assumed the posture of non-consent, and asks that the Commission not do the "useless thing" of granting a permit for a well that will not be drilled. Philcon does not explain why such an argument would not defeat an operator's application for an exception location on a tract governed by the same JOA provisions, if protested by a non-operating working interest owner who likewise assumed the posture of non-consent.

Referring to a statement in the "Remarks" section of the Form W-1 filed by Applicant that it is authorized to drill under the JOA without the consent of the operator, Philcon, Protestants also assert that Applicant is basing its right to obtain a permit on provisions of the JOA rather than on a claim of title. At the hearing, Applicant's witness testified unambiguously on cross-examination by counsel for one of the Protestants that Applicant has been assigned the leasehold interest to at least one of the unit's tracts, and has acquired a corresponding percentage of the unit's working interest. This is good faith title; it is not qualitatively different from Protestant Philcon's title. While Philcon has been made operator by, or under, the JOA, this status is not determinative of Philcon's title. Indeed, the JOA allows for election of an operator; if, hypothetically, Philcon were voted out as operator and replaced by the Applicant, it could not be argued that this change of status had somehow impaired Philcon's title; neither can it be argued that Applicant's status as nonoperator undercuts its good-faith claim of title.

Since any impediment to drilling arises from the provisions of the JOA and not from Applicant's lack of a good faith claim of title, the motion was denied. Protestant Philcon retains its rights, and its remedies against the Applicant, under the law of contract; the granting of a permit merely removes the regulatory bar to drilling.

DISCUSSION OF THE EVIDENCE

The subject field is one of several Upper Morrow sands producing in the area from

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a depth of about 14,000 feet; in the A Chert zone, only distributary channel facies are productive of gas. These facies are characterized by pronounced variability of pay thickness, north-south elongation in the direction of flow, and relatively high permeability. Each well in the field is in pressure communication with every other well in the field. Each tract in the area, including the unit, is a 640 acre section; of the eight offsetting tracts, seven have Buffalo Wallow (A Chert Zone) producers, five of which are within a Rule 37 distance of the unit. None of the offsetting tracts have more than one well in the field.

At the hearing, evidence was offered on the question, whether or not certain interest owners in the unit *other than the Applicant* were receiving their fair share of the gas from the existing well. Since a lessee of a tract, unitized or otherwise, has the right to a fair-share opportunity, and since the evidence shows that the Applicant as lessee was not receiving its fair share of the gas underlying the unit, no consideration is given in this document to whether these working interest owners are receiving their fair share.

Rule 38

Applicant prepared net pay maps by log analysis supplemented with volumetric calculations, from which were derived figures for the original and remaining recoverable gas in place under the unit. Philcon performed a study of the area in which somewhat different results were obtained, but both the methodology and execution of the study were called into substantial question on cross-examination, and the examiners accepted Applicant's figures. The data in these maps and the associated pressure data suggest that the recoverable gas remaining in place under the unit is 8.4 Bcf. The unit's existing well will recover 3.1 Bcf, none of which will be drained from surrounding tracts. Therefore, without consideration of the performance of nearby wells in which the Applicant has an interest, the existing well on the unit will fail to recover 5.3 Bcf of gas; it is not giving Applicant its fair-share recovery.

Protestants concede this point, but introduced exhibits purporting to show that the Applicant will eventually receive a higher percentage of the field's gas than its percentage of ownership interest in the field as a whole. The exhibits, based on Applicant's figures, showed that two offsetting wells, the Philcon/E.T. Smith E. Treadwell No. 1, and the Philcon/E.T. Smith Lohberger No. 3, are producing more than their respective sections' share of the field's gas. As a consequence of this "overproduction," Applicant will eventually receive a greater percentage of the field's gas than its percentage-based expectation. Therefore, Philcon argues, Applicant will enjoy its fair-share opportunity.

Fair-share analysis is based on an applicant's interest in the tract on which a well is sought, not its interest in other tracts or in the field as a whole. Statewide Rule 38 permits may be denied on a showing that an applicant will recover its fair share of gas *under its tract*, through any or all of: (1) production by the existing well of gas *under the tract*; (2) production by the existing well *on the tract* of gas via drainage from offsetting tracts (the so-called "equivalent in kind"); or (3) recovery of gas *underlying the tract* via its

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interest in nearby wells capable of draining *the tract*. Philcon's theory of fair share is wrong generally because it factors into the fair-share analysis any "overproduction" enjoyed by applicant in other wells in the field, without establishing that the "overproduction" is a result of drainage in the first place, or, if it is, then without establishing which tracts are being drained. In this case, a substantial portion of the "overproduction" by the Treadwell No. 1 and the Lohberger No. 3 consists of drainage not from the unit, but from other tracts (26 and 34). Applicant's interest in these tracts is irrelevant to the fair-share analysis.

Applicant has a 10.60 per cent working interest ownership in the Philcon/E.T. Smith E. Treadwell No. 1, located within a Rule 37 distance 467 feet west of the unit line, identical to its 10.60 per cent ownership of the unit; this well produced, as of March 31, 1993, at a rate of 5,779 Mcf per day; it is draining the unit, and this drainage is one reason why the existing well on the unit will not recover the Applicant's fair share of the unit gas. However, no matter how much unit gas is drained by the Philcon/E.T. Smith E. Treadwell No. 1, Applicant benefits just as if it had been produced through the unit well. All that can be said of the E. Treadwell No. 1's production is that Applicant's claim of drainage of its tract must be reduced by whatever amount of the drainage is attributable to the E. Treadwell No. 1, because that amount does not represent a loss to Applicant. The E. Treadwell No. 1 is also draining Section 34, immediately northwest of the unit.

Applicant also has a 14.50 per cent working interest in the Philcon/E.T. Smith Lohberger No. 3 Well, which produced as of March 31, 1993 at the rate of 2600 Mcf per day and which is regularly located in the center of Section 25, 2,640 feet to the north of the unit. This well is draining the unit and Section 26, its northern neighbor. The existing unit well, located 2,100 feet from the northern unit boundary, produced as of March 31, 1993, at the rate of 1,128 Mcf per day. This production is limiting drainage of the northern portion of the unit by the Lohberger No. 3 Well.

There are four other producers within a Rule 37 distance of the unit; Applicant has no interest in any of them. Two are poor producers, and two are good wells undoubtedly causing substantial drainage of the unit. The combined production of the two good wells, as of March 31, 1993, was 6,063 Mcf per day; the average distance of these wells from the unit boundary is 800 feet. Under any reasonable reservoir hypothesis, such as that presented by the Applicant, the drainage of the unit attributable to these two wells is vastly greater than any drainage attributable to the Philcon/E.T. Smith Lohberger No. 3, producing at less than half the rate and located more than three times as far from the unit boundary.

Finally, the existing well is not draining any adjoining tracts.

Therefore, while Applicant does have an interest in two of the six wells draining its unit, and while its interest in one of them is greater than its interest in the unit well, Applicant is entitled to a second well on the unit because the Applicant is suffering net uncompensated drainage to its interest in the unit. Philcon's field-wide fair-share theory

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is contrary to established law, impractical to apply, and should not be adopted.

Rule 37

Once the entitlement to a second well has been established on a tract with no remaining regular location, Applicant must establish that its proposed location is reasonable. The proposed location is regular to the south unit line, but is only 467 feet from the west unit line. Not counting the Philcon/E.T. Smith E. Treadwell No. 1, of whose drainage Applicant cannot complain, there is a well within a Rule 37 distance (950 feet) of the unit's southwest corner, the Seagull Midcon/Amarillo Brown, et al. No. 106. This well is about 2800 feet south-southwest of the proposed location, and produced as of March 31, 1993 at a rate of 4040 Mcf per day. There is also a well within a Rule 37 distance (467 feet) of the western one-third of the unit's southern boundary, the Philcon/Amarillo Evans No. 2-7. This well is about 2500 feet to the south-southeast of the proposed location, and produced as of March 31, 1993 at a rate of 2023 Mcf per day. Each of these wells is substantially draining the unit, and the Applicant has no interest in them. The proposed location will allow Applicant to protect its fair-share opportunity by countering the drainage in the southwestern portion of the unit; it is reasonable.

The Texaco Case

Protestant Philcon's theory of fair-share also is in potential conflict with the holding of *Texaco, Inc. v. Railroad Commission*, 716 S.W.2d 138 (Tex. App.—Austin, 1986, writ ref'd n.r.e.). That case holds squarely that the rule announced in *Railroad Commission v. Williams*, 356 S.W.2d 131 (Tex. 1961) limiting the rights of a grantee to those of its grantor has no application to standard-sized tracts such as the Lohberger/Meadows Unit. Putting aside the dispute over title, Applicant rightly argues (citing *Texaco*) that if it assigned its rights to a newcomer without any other interest in the field, the assignee would be entitled to a well as a matter of law to remedy the net uncompensated drainage of the unit conceded to exist by Philcon. Philcon's fair-share theory, if adopted, could unnecessarily fragment ownership of a field with assignments of interest made purely to gain entitlement to a permit; it should be rejected.

EXAMINERS' OPINION

The examiners recommend granting the application to prevent confiscation. Applicant's evidence shows that the existing well cannot recover an estimated 5.3 Bcf of gas remaining under Applicant's tract, and that unless Applicant is granted the proposed exception, the gas will remain in place or be drained by any of several wells located on the periphery of the unit.

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Findings of Fact

1. Notice of hearing was sent on April 23, 1993, to all designated operators, lessees of record for tracts having no designated operator, and owners of record of unleased mineral interests, for each adjacent tract and each tract nearer than 1,867 feet to Applicant's proposed well.
2. Applicant has applied on Form W-1 to drill well No. 1013 on the Lohberger Meadows unit at a location 467 feet from west line and 1,867 feet from the south line of both the unit and Section 13, Block R&E, Roberts & Eddleman Survey, Abstract No. A-489. Proposed completion is in the Buffalo Wallow (A Chert Zone) Field and in the Wildcat Field. Applicant proposes a total depth of 14,800 feet. Field rules require a 1,867 foot lease-line spacing and a 3,735 foot between-well spacing for the Buffalo Wallow (A Chert Zone) Field, with 640 acres per well density; the Wildcat is under the statewide spacing and density rules, and no exception is required.
3. The existing well was drilled at a regular location on the lease; there are no more regular locations left on the lease for the Buffalo Wallow (A Chert Zone) Field.
4. The existing well cannot recover Applicant's fair share of the gas in place underlying the unit.
5. Of eight offsetting tracts, one has no Buffalo Wallow (A Chert Zone) producer and seven have one; of these seven, five are at a Rule 37 distance from the unit.
6. Of the five wells located within a Rule 37 distance of the unit, three are substantially draining the unit. Applicant has an interest in one of them, the Philcon/E.T. Smith E. Treadwell No. 1 Well, equal to its interest in the unit. The drainage of the unit caused by this well, located in Section 35 within a Rule 37 distance of the unit's western boundary, is substantial but does not harm Applicant, who owns the same percentage interest in that well that it owns in the unit. The E. Treadwell No. 1 Well is also draining Section 34, to the immediate northwest of the unit.
7. The Philcon E.T. Smith Lohberger No. 3, regularly located in the center of Section 25 to the north of the unit, produced as of March 31, 1993 at a rate of 2601 Mcf per day. Applicant owns a slightly greater working interest percentage in the Lohberger No. 3 (14.50 per cent) than its percentage in the unit (10.60 per cent). This well is draining the unit and possibly Section 26 as well, but the southward drainage is limited by the existing unit well. The drainage suffered by the unit from this well is much less than the combined drainage of the unit by the Seagull/Midcon Amarillo Brown et al. No. 1-6 Well, located 1,000 feet from the southwest corner of the unit, which produced at a rate of 4040 Mcf per day on March, 1993, and the Philcon/Amarillo Evans No. 2-7 Well, located 600 feet

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south of the western portion of the unit, whose March 31, 1993 production was 2023 Mcf per day.

8. The Seagull/Midcon Amarillo Brown et al. No. 1-6 Well, located 1,000 from the unit's southwest corner, and the Philcon/Amarillo Evans No. 2-7 Well, located 600 feet south of the western portion of the unit, are substantially draining the unit; Applicant owns no interest in them.

9. The existing unit well is not draining any off-unit gas.

10. If Applicant is denied a permit to drill the proposed well, about 5.3 Bcf of recoverable gas underlying its tract will be drained by offsetting wells or left in place under the unit. While not all the 5.3 Bcf of gas will be lost to Applicant's interest, the loss to the Applicant will be substantial.

11. The proposed location, roughly equidistant from three offsetting Rule 37 locations, is reasonable because it will allow the Applicant to recover substantial reserves of gas underlying the unit that would otherwise be drained by the offsetting wells or left in place under the unit.

Conclusions of Law

1. Timely and legally sufficient notice was given to all persons legally entitled thereto.
2. Applicant properly filed Railroad Commission Form W-1.
3. The Railroad Commission has jurisdiction over the Applicant, the Protestants, and the subject matter of the application.
4. Applicant is entitled to an exception to Statewide Rules 37 and 38 to prevent confiscation of its interest in the Lohberger/Meadows Unit.
5. The proposed location is reasonable; approval of a permit to drill at the proposed location is necessary to give Applicant a reasonable opportunity to recover its fair share of the hydrocarbons underlying the unit and to avoid confiscation.
6. The amount of gas not originally underlying the unit produced by off-unit wells is not relevant to the fair-share analysis in this case, whether or not the Applicant has an interest them.
7. Applicant's leasehold interest in one or more unitized tracts is a claim of title sufficient to support an application for a drilling permit.

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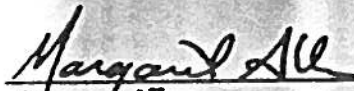
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8. Provisions of the Joint Operating Agreement for the Lohberger/Meadows Unit allow and regulate the proposal of wells by nonoperators, and require the consent of all the parties to the Operating Agreement to drill a well requiring an exception Commission spacing rules. Interpretation of these provisions is not necessary to decide whether the Applicant has asserted a good-faith claim of title.

RECOMMENDATION

The examiners recommend approval of the application as set forth in the attached Final Order.

Respectfully submitted,


Margaret Allen
Technical Examiner


Dwight Martin
Hearings Examiner

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RAILROAD COMMISSION OF TEXAS
OIL AND GAS DIVISION

DOCKET No. 0201687
DISTRICT 6

ORDER ON MOTION FOR REHEARING

Motions for Rehearing in the captioned case were timely filed by the Protestants Philcon Development Company and Marsh Operating Company. After consideration of the motions and the reply filed by Applicant Kaiser-Francis Oil Company, IT IS ORDERED that the Motions for Rehearing be, and hereby are, GRANTED for the limited purpose of taking official notice of the Form W-1 (Application to Drill, Deepen, Plug Back or Re-enter) filed by Applicant Kaiser-Francis on May 19, 1994, for a location 1,267 feet from the west line and 467 feet from the south line of both the Lohberger/Meadows Lease and Section 13, Elock R&E, Roberts & Eddleman Survey, Abstract No. A-498.

Done this 13th day of June, 1994.

RAILROAD COMMISSION OF TEXAS

CHAIRMAN

Mary Scott Rabus
COMMISSIONER

Benny H. Williams
COMMISSIONER



ATTEST

Rum Williams
SECRETARY