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RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL & GAS DOCKET NO. 08-0309365

THE COMPLAINT OF BHP BILLITON PETROLEUM (TXLA OPERATING) COMPANY REGARDING RIO OIL AND GAS (PERMIAN) II, LLC'S DRILLING PERMIT FOR THE BROWN STATE 44-2 LEASE, WELL NO. 1H, FORD, WEST (WOLFCAMP) FIELD, REEVES COUNTY, TEXAS

PROPOSAL FOR DECISION

HEARD BY: Jennifer Cook – Administrative Law Judge
Paul Dubois – Technical Examiner

PROCEDURAL HISTORY:

Complaint Filed -	January 24, 2018
Hearings Division Letter Issued -	February 16, 2018
Notice of Hearing -	March 16, 2018
Hearing -	March 28, 2018
Proposal for Decision Issued -	April 5, 2018

APPEARANCES:

FOR COMPLAINANT -

Rob Hargrove, Attorney
Osborn, Marsland & Hargrove

COMPLAINANT -

BHP Billiton Petroleum (TXLA Operating) Company

FOR RESPONDENT -

Brian R. Sullivan, P.E., Attorney
McElroy, Sullivan, Miller & Weber, L.L.P.

RESPONDENT -

Rio Oil and Gas (Permian) II, LLC

OBSERVERS -

Robert Hatter, Daryl Morgan and Dan Gutierrez
General Land Office

CASE SUMMARY

The parties to this case are in agreement regarding the disposition of the matters at issue. Their agreement is presented in the format of a Proposal for Decision due to the novelty of the issues presented.

BHP Billiton Petroleum (TXLA Operating) Company ("BHP") filed a complaint against Rio Oil and Gas (Permian) II, LLC ("Rio") regarding Rio's BROWN STATE 44-2 1H (the "Rio Well"). BHP alleges that the Rio Well, permitted in both Section 44, Block 56-T2 and Section 2, Block 56-T3 (the "Subject Sections") should not have been issued a regular permit in the Ford, West (Wolfcamp) Field, but instead, that the Rio Well should have been permitted in the Phantom (Wolfcamp) Field where the Rio Well would be required to obtain an exception to Statewide Rule 40, 16 TEX. ADMIN. CODE § 3.40. Prior to this hearing, Rio and BHP reached a settlement of their dispute. BHP agreed to withdraw its protest if Rio would (1) re-permit the Rio Well in the Phantom (Wolfcamp) Field, (2) obtain a Rule 40 exception to produce the Rio Well in the Phantom (Wolfcamp) Field and (3) land and complete the horizontal lateral of the Rio Well in Rio's "B1" target bench of the Wolfcamp formation (described more completely below). Rio agreed to these terms and proceeded at the hearing to present evidence in support of items (1) and (2). As to Item (3), the Rio Well is currently drilling and it is not anticipated that the Rio Well will be landed in Rio's "B1" target bench until the first week in April 2018. Rio will supply BHP information to confirm where the Rio Well was landed and completed.

In addition, the Texas General Land Office made an appearance in support of Rio's application to obtain an exception to Statewide Rule 40 and the settlement between BHP and Rio. Proceeds from the minerals to be produced by Rio's well are a part of the Permanent School Fund.

The Examiners recommend the Commission issue an order consistent with the parties' agreement. The Examiners recommend that the Commission grant an exception to Rule 40 for the Rio Well and transfer the Rio Well to the Phantom (Wolfcamp) Field. The Examiners further recommend the Commission dismiss the complaint without prejudice until Rio confirms the Rio Well has been landed in its B1 target bench, at which time the dismissal would become with prejudice.

APPLICABLE LAW

Any person drilling a well to produce oil and/or gas in Texas is required to obtain a permit from the Texas Railroad Commission. See 16 TEX. ADMIN. CODE § 3.5. In addition, the Commission rules do not permit the "double assignment" of acreage to two different wells in the same Railroad Commission designated field. 16 TEX. ADMIN. CODE § 3.40. Because the Commission-approved correlative intervals of several fields in Reeves County, Texas overlap, there can be issues as to the proper placement of wells in fields. This issue is further complicated when horizontal severances occur within the correlative interval for a given field. The question of how to permit and where to permit can become complicated.

DISCUSSION OF THE EVIDENCE

Because this matter settled prior to hearing, only Rio presented sworn testimony and evidence.

Respondent's Evidence – Rio Oil and Gas (Permian) II, LLC

Rio sponsored Exhibits A-G and 1-24, all of which were admitted into the record. Rio sponsored three witnesses, all of whom qualified as experts.

Rio's first witness was Mr. Jon Baker, Senior Vice President for Geosciences and Evaluations. Mr. Baker sponsored Rio Exhibits 1-16. Mr. Baker testified that Rio holds leases on numerous tracts of land in Reeves County, Texas. (Exhibit 2) These leases are generally depth-severed minerals in the Wolfcamp formation. (Exhibits 2, 3, 15, 16) For geologic identification and development purposes, Rio divides the Wolfcamp formation into "benches" that are likely targets for horizontal drilling and production. From the top of the Wolfcamp down, these benches are identified by Rio as the WCXY, WCA1, WCA2, WCA4, WCB1, WCB2, WCB3 and WCC. (Exhibit 4) Relevant to this case, BHP drilled two wells in the shallowest portions of the Wolfcamp formation (the "BHP Wells"). (Exhibit 16) The BHP Brown State 56-T2-44-1H well is located in what Rio describes as the WCA4 bench, and the horizontal lateral of BHP's BROWN STATE 56-T3-2 1H well is located in what Rio describes as the WCA1 bench. (Exhibit 16) At the location of the leasehold at issue in this case, Rio essentially owns all Wolfcamp benches below what Rio calls the "WCA4" bench. (Exhibit 16) The Rio Well is targeted for the WCB1 bench within the lease rights of Rio. (Exhibit 16)

For purposes of this case, Rio's B1 bench is described as the correlative depth below 11,000' in the Anadarko Petroleum, Wahoo 56-3-3 Well No. 1 (API No. 42-389-32436).

Prior to permitting the Rio Well, Rio was aware that the BHP Wells were producing from the Phantom (Wolfcamp) Field. (Exhibit F) Based on Rio's experience in the Midland Basin, it looked for another correlative field to place its well in. Mr. Baker compared the Texas Railroad Commission's designated correlative intervals for three fields to see if Rio's target bench fit within those designated intervals. Rio's WCB1 bench is within the correlative interval of the Ford, West (Wolfcamp), Wolfbone (Trend Area) and Phantom (Wolfcamp) Fields. (Exhibits 4, 8, 9, 10, 13, 14, 15) From a geologic perspective, the Rio Well could appropriately be placed in any of those three fields.

Mr. Baker last undertook to study the relationship between the Delaware sub-basin and the Midland sub-basin. Mr. Baker prepared cross-sections to demonstrate that the Wolfcamp formation is the same in the Midland sub-basin as in the Delaware sub-basin. (Exhibit 12, 13, 14, 15) The point of these exhibits is to demonstrate that in the Spraberry (Trend Area) Field (which includes the Wolfcamp formation) in the Midland sub-basin there is a blanket Rule 40 exception where severed mineral estates exist. There is no

geologic difference between the Wolfcamp in the Delaware sub-basin and in the Midland sub-basin, and thus a Rule 40 exception is geologically appropriate in this case.

Mr. Dalton Smith, Senior VP for Business Development and Land was Rio's second witness. Essentially, Mr. Smith testified to the land issues. Mr. Smith sponsored exhibits 17-22 and referenced exhibits F and G. Mr. Smith testified as to how Rio came into possession of the severed minerals below the BHP Wells. He demonstrated the exact depths of the mineral severances in Sections 2 and 44 that were used in Mr. Baker's exhibits. Importantly, Mr. Smith testified that he and Rio relied on past Commission practice when it permitted its well in the Ford, West (Wolfcamp) Field. Exhibit 22 shows where, in 2013, in a severed leasehold ownership situation identical to this situation; permits for earlier shallow Wolfcamp wells were granted in one field and Rio was granted a permit in a second field for its deeper Wolfcamp wells. Each of the fields used, the Spraberry (Trend Area) Field and the Garden City, S. (Wolfcamp) Field, have overlapping correlative intervals in the Wolfcamp formation. This is exactly the situation here. Mr. Smith further testified that in reliance on this past Commission well permitting and completion practice, Rio spent approximately \$105,000,000 to purchase severed leasehold rights from the State of Texas. He further testified that placing Rio's well in the Ford, West (Wolfcamp) Field was consistent with how Rio had permitted and produced wells in the Midland sub-basin.

Mr. Stacey Cude, PE, President and CEO of Rio, was Rio's third witness. Mr. Cude presented petroleum engineering testimony and sponsored Exhibits 23 and 24. Exhibit 24 shows the wells that Mr. Cude analyzed to create a type curve of WCB1 production. (Exhibit 24) According to his analysis, the expected production from the Rio Well is 2.642 million barrels of oil equivalent. This results in severance and ad valorem tax of more than \$6,000,000 and approximately \$10,000,000 in royalty to the State of Texas. Further, Mr. Cude testified that no existing well is capable of draining the reserves that will be produced by Rio's well. Thus, unless this well is allowed to produce, substantial quantities of oil and gas will be wasted.

FINDINGS OF FACTS

1. On June 29, 2010, the predecessor in interest to BHP Billiton Petroleum (TXLA Operating) Company ("BHP") entered into an *Oil and Gas Lease* with the State of Texas, acting by and through its agent, The George R. Brown Partnership, L.P. (the "BHP Lease") covering all depths of the following lands situated in Reeves County, Texas:
 - All of Section 2, Block 56, Township 3, T&P Ry. Co. Survey; and
 - All of Section 44, Block 56, Township 2, T&P Ry. Co. Survey (collectively the "Subject Sections")
2. The Wolfcamp formation contains a series of stacked "benches" that are the targets of horizontal drilling and production. Rio labels these benches from shallowest to deepest as the WCXY, WCA1, WCA2, WCA4, WCB1, WCB2, WCB3

- and WCC benches. BHP uses a completely different method for defining its targets.
3. Pursuant to the BHP Lease, BHP Billiton Petroleum (TXLA) Operating Company, an affiliate of BHP, drilled, completed and continues to produce oil and gas from the Wolfcamp formation under the Subject Sections from the following described horizontal wells (the "BHP Wells"): the BROWN STATE 56-T2-44 1H and the BROWN STATE 56-T3-2 1H.
 4. The BHP Wells were drilled, completed and continue to produce oil and gas from two benches in the Wolfcamp formation, in benches Rio labels the Wolfcamp A4 and Wolfcamp A1, respectively.
 5. At a certain date, the Horizontal Pugh Clause in the BHP Lease became operational.
 6. Effective March 6, 2017, BHP released all depths below 10,547 feet in Section 2, Block 56, Township 3, and all depths below 10,847 feet in Section 44, Block 56, Township 2.
 7. On March 13, 2017, Rio's predecessor in interest entered into an *Oil and Gas Lease* with the State of Texas acting by and through its agent, The George R. Brown Partnership, L.P. (the "Rio Lease") covering the depths released by BHP under the Subject Sections.
 8. On January 19, 2018, Rio filed an application for a permit to drill the BROWN STATE 44-2 1H in the Ford, West (Wolfcamp) Field in Reeves County, Texas. The well is a horizontal well and is targeted for what Rio labels the "B1" target bench ("B1 Bench") of the Wolfcamp formation.
 9. Rio's B1 Bench of the Wolfcamp formation is defined by Rio, and herein shall mean: the correlative depth below 11,000' in the Anadarko Petroleum, Wahoo 56-3-3 Well No. 1(API No. 42-389-32436).
 10. On January 24, 2018, the Railroad Commission of Texas issued Rio a regular drilling permit for the BROWN STATE 44-2 1H with Permit Number 835369 and an API No. 42-389-36756.
 11. On January 24, 2018, BHP filed a complaint with the Railroad Commission of Texas against the permit issued to Rio, claiming it was permitted in an incorrect Commission-designated field.
 12. The BHP complaint alleges that Rio's BROWN STATE 44-2 1H well should properly be placed in the Phantom (Wolfcamp) Field, and that, in order to drill and produce its well, Rio needs to obtain an exception to Statewide Rule 40.
 13. BHP's complaint was assigned Oil and Gas Docket No. 08-0309365, the hearing was set for March 28, 2018 and the Notice of Hearing was sent to all parties on March 16, 2018.

14. At the call of the hearing on March 28, 2018, BHP and Rio announced that the matter had settled. The terms of the settlement are that BHP agrees to withdraw its complaint if:
 - a. Rio agrees to re-permit its well in the Phantom (Wolfcamp) Field,
 - b. Rio agrees to obtain a Rule 40 exception for the BROWN STATE 44-2 1H well, and
 - c. Rio agrees to land and complete the BROWN STATE 44-2 1H well at or below Rio's WCB1 or Rio's B1 Bench.
15. In support of the re-permitting of the BROWN STATE 44-2 1H well into the Phantom (Wolfcamp) Field, and in support of the Rule 40 exception request, Rio submitted witnesses and testimony.
16. The target zone for Rio's BROWN STATE 44-2 1H well, the Rio's B1 Bench, is contained within the correlative interval designated by the Railroad Commission of Texas in at least the Phantom (Wolfcamp), Ford, West (Wolfcamp) and Wolfbone (Trend Area) Fields.
17. Rio's B1 Bench in the Wolfcamp formation is not developed under the Subject Sections.
18. Rio's BROWN STATE 44-2 1H well is anticipated to produce 2.642 million barrels of oil equivalent.
19. No other well drilled by BHP or Rio will produce the oil and gas that will be produced by the Rio Well.
20. If the Rio Well is not permitted and allowed to be produced, substantial waste will occur.
21. If the Rio Well is not permitted and allowed to be produced, Rio will be denied its correlative right to produce the hydrocarbons it owns.
22. Permitting Rio's BROWN STATE 44-2 1H well in the Phantom (Wolfcamp) Field will recover hydrocarbons that would not otherwise be recovered.
23. Permitting Rio's BROWN STATE 44-2 1H well in the Phantom (Wolfcamp) Field allow Rio and the State of Texas to recover their fair share of the hydrocarbons.
24. Granting Rio a Rule 40 exception for the Rio Well in the Phantom (Wolfcamp) Field is necessary to prevent waste, protect correlative rights and promote the orderly development of production.
25. Given the agreements above, BHP agrees to withdraw its complaint, and it should be dismissed without prejudice.
26. As of the date of hearing, Rio was still drilling its BROWN STATE 44-2 1H well. Rio has agreed that it will later provide confirmation to BHP that the BROWN

STATE 44-2 1H well was landed and completed within Rio's B1 Bench of the Wolfcamp formation. BHP agrees that, once this confirmation is provided, the dismissal of its complaint should be considered to be with prejudice.

27. In the past, the Commission has granted exceptions to Statewide Rule 40 to prevent waste and promote orderly development of production via horizontal wells. See Tex. R.R. Comm'n, *Application of Pioneer Natural Resources USA, Inc. to Amend Field Rules for the Sprayberry (Trend Area) Field in Various Counties, Texas*, Oil and Gas Docket Nos. 7C-0291169 and 7C-0291171 (Order issued December 2, 2014 adopting findings and conclusions in the *Examiner's Report and Recommendation*).
28. Both Rio and BHP agreed on the record that the Final Order in this case is to be final and effective when the Final Order is signed.

CONCLUSIONS OF LAW

1. Rio's application to re-permit its BROWN STATE 44-2 1H well into the Phantom (Wolfcamp) Field is necessary to prevent waste, protect correlative rights and to allow for the orderly development of the Wolfcamp formation under Sections 2 and 44.
2. Rio's application for an exception to Statewide Rule 40 for the Rio Well is necessary to prevent waste, protect correlative rights and to allow for the orderly development of the Wolfcamp formation under Sections 2 and 44.
3. Pursuant to § 2001.144(a)(4)(A), of the Texas Government Code, and by agreement of the parties on the record, **the parties have waived the right to file a motion for rehearing and the Final Order in this case can be final and effective on the date the Final Order is signed.**

EXAMINERS' RECOMMENDATION

The Examiners recommend the Commission issue an order consistent with the parties' agreement. The Examiners recommend that the Commission grant an exception to Statewide Rule 40 for the Rio Well and transfer the Rio Well to the Phantom (Wolfcamp) Field. The Examiners further recommend the Commission dismiss the complaint without prejudice until Rio confirms the Rio Well has been landed in its B1 target bench, at which time the dismissal becomes with prejudice.

Respectfully,



Jennifer Cook
Administrative Law Judge



Paul Dubois, P.E.
Technical Examiner