

OFFICE OF GENERAL COUNSEL

February 8, 2012

OIL & GAS DOCKET NO. 06-0267941

COMMISSION CALLED HEARING ON THE COMPLAINT OF T. LYNN WARTHAN AGAINST OPTIMAL UTILITIES THAT THE DUNCAN (14819) LEASE, WELL NO. 1, TOPAZ (CLARKSVILLE) FIELD, RED RIVER COUNTY, TEXAS IS IN VIOLATION OF STATEWIDE RULE 37.

APPEARANCES:

FOR COMPLAINANT T. LYNN WARTHAN:

Eric Camp, Attorney
T. Lynn Warthan, M.D.

FOR RESPONDENT OPTIMAL UTILITIES, INC.:

Mike McElroy, Attorney
George C. Neale, Attorney

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR HEARING:	October 22, 2010
DATE OF NOTICE OF HEARING:	October 28, 2010
DATE OF HEARING:	March 29, 2011
HEARD BY:	Marshall Enquist, Hearings Examiner
DATE PFD CIRCULATED:	February 8, 2012

STATEMENT OF THE CASE

This hearing was called as a result of the complaint of Dr. T. Lynn Warthan (hereinafter "Complainant" or "Warthan") that Optimal Utilities, Inc. (hereinafter "Optimal") has failed to obtain an exception to Statewide Rule 37 for its Duncan Lease, Well No. 1. It is Warthan's contention that the well, which is only 137 feet from the Warthan lease line in a field which requires 467 foot spacing, must have a Statewide Rule 37 exception.

Dr. T.Lynn Warthan appeared at the hearing, represented by Eric Camp, attorney. Optimal appeared, represented by Mike McElroy, attorney.

APPLICABLE LAW

Statewide Rule 38(d)(3) governs unit dissolution and states:

- (A) If two or more separate tracts are joined to form a unit for oil or gas development, the unit is accepted by the Commission, and the unit has produced hydrocarbons in the preceding twenty (20) years, the unit may not thereafter be dissolved into the separate tracts with the rules of the commission applicable to each separate tract if the dissolution results in any tract composed of substandard acreage for the field from which the unit produced, unless the Commission approves such dissolution.
- (B) The Commission shall grant approval only after application, notice, and an opportunity for hearing. The applicant seeking the unit dissolution shall provide a list of the names and addresses of all current lessees and unleased mineral interest owners of each tract within the joined or unitized tract at the time the application is filed. The Commission shall give notice of the application to all current lessees and unleased mineral interest owners of each tract within the joined or unitized tract. Additionally, if one or more wells on the unitized tract has produced from the field within the 12-month period prior to the application, the applicant shall include on the list all affected persons described in subsection (h)(1)(A) of this section, and the Commission shall give notice of the application to these affected persons.

BACKGROUND

The well at issue in this case, Well No. 1 on the Duncan Lease, was drilled on a pooled unit to the Topaz (Clarksville) Field and completed on August 4, 1996. The pooled unit, created by Sonat Exploration Company, consisted of 41 acres, with 20.5 acres taken from the Duncan Tract to the south and 20.5 acres taken from the Warthan Tract to the north.

On March 23, 1999, the Commission issued a Final Order granting Sonat Exploration Company authority for unitization and secondary recovery for its 1,558-acre Topaz Field Unit, which included the Duncan Lease and Warthan Lease within its boundaries. On January 21, 2000, a successor operator, Classic Oil & Gas, Inc., filed a Form P-6 to subdivide 37 acres out of the unit, creating the 1,521-acre Topaz Waterflood Unit (RRC Lease ID# 13412). The Duncan Lease and Warthan Lease remained within the Topaz Waterflood Unit.

The last reported production from the Topaz Waterflood Unit was 68 BO in February 2006. Approximately one and a half years after that, by letter dated September 25, 2007, Optimal filed a Form P-6 to subdivide the Topaz Waterflood Unit and also filed Forms P-4 to create five new lease

tracts. One of those leases was for the Duncan Lease, Well No. 1 (RRC Lease ID# 14819, API# 387-30468), still represented as a 41-acre tract, with 20.5 acres of Duncan land and 20.5 acres of Warthan land.

In response to Optimal's dissolution request, the Commission's Office of General Counsel advised Optimal, by letter dated October 8, 2007, that "Because this unit was formed for regulatory purposes by the Commission, the unit cannot be taken apart and certain of its constituent tracts recognized as lease tracts for regulatory purposes without an order of approval signed by the Railroad Commissioners." Optimal was further advised that "If any tract resulting from dissolution of the unit will be substandard under the 40-acre density rule applicable to the Topaz (Clarksville) Field, the request for hearing should be made pursuant to Rule 38(d)(3)...".

Optimal replied to the Commission by letter dated May 8, 2008, in which it provided the Commission with the name and address of the prior operator and the names and addresses of affected mineral interest owners in the Topaz Waterflood Unit. Optimal also represented that unit dissolution would not result in the formation of any tracts substandard (less than 40 acres) for the Topaz (Clarksville) Field. Additionally, Optimal represented that all tracts it desired to become the P-4 operator of were under lease.

Relying on the information provided by Optimal, the examiner in that docket approved the new leases administratively, without hearing. By Final Order in Docket No. 06-0257756¹, signed July 29, 2008 as part of a Master Order, the Commission approved the dissolution of the Topaz Waterflood Unit and recognized Optimal as operator of five new leases. One of those leases was the Duncan Lease (RRC Lease ID# 14819), represented as consisting of 41 acres.

However, approximately nine months after dissolution of the Topaz Waterflood Unit and recognition of five leases in Optimal's name, the Commission received a complaint letter from Dr. T. Lynn Warthan asserting that (1) as affected parties, Warthan family members had not received notice of the application to dissolve the Topaz Waterflood Unit, and that, (2) 20.5 acres included within the Duncan (14819) Lease designated by Optimal consisted of Warthan land and minerals that were not under lease to Optimal.

The Warthan Complaint (Complaint No. 2009-050) led to a hearing in Oil & Gas Docket No. 06-0261927². In this hearing, Optimal's Exhibit 3 was a letter from Topaz Mineral Operations, Inc. dated May 8, 2008 stating that the Topaz Waterflood Unit had terminated at the latest on November

¹ *Docket No. 06-0257756: The Application of Optimal Utilities, Inc. To Dissolve the Topaz Waterflood Unit, Topaz (Clarksville) Field, Red River County, Texas.*

² *Oil & Gas Docket No. 06-0261927: Commission Called Hearing to Provide Optimal Utilities, Inc. an Opportunity to Show Cause Why the Final Order in O&G Docket No. 06-0257756 Should Not be Vacated and the Duncan (14819) Lease, Well No. 1, Topaz (Clarksville) Field, Red River County, Texas, Be Ordered Shut-In.*

1, 2006. Optimal Exhibit 4 was a Disclaimer of Oil, Gas, and Mineral Lease made in favor of the Warthan Family, formally acknowledging that the Warthan Lease that Optimal had previously claimed 20.5 acres under, for inclusion in the 41-acre Commission-approved Duncan Lease, had terminated. It was also determined that (1) the Warthans were affected parties who did not receive notice of the dissolution application, and (2) dissolution of the Topaz Waterflood Unit would result in some tracts being substandard (less than 40 acres) in the Topaz (Clarksville) Field, requiring dissolution pursuant to statewide Rule 38(d)(3). Due to the notice issue, the Commission issued a Final Order on November 30, 2010, finding that the dissolution of the Topaz Waterflood Unit was void *ab initio* due to lack of notice to affected parties and that the five leases created by Optimal for its operations should be shut-in.

Following this Order, Optimal applied to the Commission for dissolution of the Topaz Waterflood Unit pursuant to Statewide Rule 38(d)(3). This was heard as Oil & Gas Docket No. 06-0267386³. The examiners found that “There is no evidence that dissolution will enable Optimal to circumvent the density provisions of Statewide Rule 38.” The examiners also found that “The evidence does not establish that dissolution would result in the circumvention of any other Commission rule.” In that docket, the examiners recognized one of the parties’ fundamental disagreements, that being Optimal’s contention that it did not need a Statewide Rule 37 exception for the Duncan Lease, Well No. 1, as opposed to Warthan’s contention that the well was only 137 feet (rather than 467 feet) from the Warthan leaseline and did need a Statewide Rule 37 exception. The examiners noted that, despite their disagreement, both parties agreed that the Statewide Rule 37 question was not within the call of the hearing. The examiners further noted that the Statewide Rule 37 issue was set for hearing in the present docket. On these facts, the examiners approved the dissolution of the Topaz Waterflood Unit without further inquiry into the Statewide Rule 37 issue as it related to the Duncan Lease, Well No. 1. A Final Order approving dissolution of the Topaz Waterflood Unit was signed by the Commissioners on January 13, 2011.

DISCUSSION OF THE EVIDENCE

Dr. T. Lynn Warthan

Warthan states that most of the facts of this case are not in dispute. The Duncan Lease, Well No. 1, was permitted by Sonat Exploration Company on 41 pooled acres composed of 20.5 acres taken from a larger Duncan lease and 20.5 acres taken from a larger Warthan lease. As permitted on the original 41-acre tract, the well was at a regular location.

In the years prior to this complaint, Optimal acquired the Duncan Well No. 1, and dissolved the Topaz Waterflood Unit in 2008. The dissolution was subsequently voided, but then Optimal successfully dissolved the unit pursuant to Commission Statewide Rule 38(d)(3) in 2011.

³ *Oil & Gas Docket No. 06-0267386: Application of Optimal Utilities, Inc. Pursuant to Statewide Rule 38(d)(3) to Dissolve the Topaz Waterflood Unit, Topaz (Clarksville) Field, Red River County, Texas.*

Currently, Optimal seeks to permit the well with acreage taken solely from the Duncan lease tract. The Duncan Lease, Well No. 1 is 137 feet south of the common line between the Warthan and Duncan tracts. At that location, if Optimal is allowed to produce the well, it will drain the unleased Warthan tract. The field rules for the Topaz (Clarksville) Field are 467 foot leaseline spacing and 1200 foot between-well spacing on 40 acres; therefore, Warthan believes the Duncan Well No. 1, at 137 feet from his leaseline, requires a Statewide Rule 37 exception.

Warthan has heard Optimal's "Once legal, always legal" defense, but believes it does not make sense. That argument, in Warthan's view, constitutes an end run around Statewide Rule 37. A well might be drilled perfectly legally and equitably in a pooled unit, just inches from an interior leaseline. Then, upon dissolution of the unit, an operator allowed to use the "Once legal, always legal" theory could produce the well and drain the neighboring tract with impunity.

Warthan is aware that Optimal places great reliance on Oil & Gas Docket No. 3-94,663⁴, but believes that case is not relevant here. In that case, T Bar Energy sought to dissolve the 80-acre Telg Unit into its constituent tracts, being the 61.956-acre Telg Tract and the 18.044 Bailey Tract. The Telg Unit Well No. 1 was located 456.76 feet south of the Bailey Tract leaseline. T Bar G had originally applied for both a Statewide Rule 37 exception and a Statewide Rule 38(d)(3) exception, but was noticed by the Commission prior to the hearing that a Statewide Rule 37 exception was not necessary. Warthan believes a Statewide Rule 37 exception was not required because the well was 456 feet from the leaseline and fell within the 10% rule of thumb employed by the Commission regarding substantial compliance with spacing distances pursuant to Statewide Rule 11.

Optimal Utilities, Inc.

Optimal also entered into evidence the T Bar Energy case, but additionally included a letter to the parties in that case from Legal Examiner Ronald C. Schultz, Jr. in which Examiner Schultz informed the parties to the T Bar Energy case that the Statewide Rule 37 exception requested was not necessary.

"The examiners have reviewed T Bar G's application which indicates that the subject well was originally drilled at a regular location. Commission practice and rules dictate that a Rule 37 exception is not required where the loss of previously pooled acreage makes the well location irregular provided that the well will continue to produce from the same field."

Pre-hearing letter to the parties in Oil & Gas Docket No. 3-94,663 from Ronald C. Schultz, Legal Examiner, February 16, 1990. Optimal also presented the testimony of George Neale, a practitioner before the Commission, who stated that in his experience, a well such as the one at issue on this

⁴ Oil & Gas Docket No. 3-94,663: Application of T Bar Energy, Inc. for an Exception to Statewide Rule 38(d)(3) for the Telg Unit, Giddings (Austin Chalk-3) Field, Burleson County, Texas.

hearing fell under the theory summed up as “Once legal, always legal”. As stated by Mr. Neale, “... an applicant has a right to rely on the permit approved as long as applicant did not misstate the facts at the time the application was approved.” Mr. Neale also stated that this doctrine might not apply “...when it is shown that the operator took affirmative action to release acres or otherwise get a competitive advantage.”

Optimal notes that the subject well was drilled at a regular location originally, and was a legal well. Optimal also notes that the rules for the Topaz (Clarksville) Field are still the Statewide Rules of 467 lease line spacing, 1200 foot between-well spacing and 40 acre density. Optimal believes that the Warthans have other options available to them. They could (1) use the MIPA to force pool their way into the Duncan Lease, Well No. 1, (2) drill their own well, or (3) lease their acreage to Optimal.

Optimal cites two cases, Potter v. Sun Oil Co., 189 S.W.2d 482 (1945) and Magnolia Petroleum Co. v. New Process Production Co., 104 S.W. 2d 1106 (1937) for the proposition that “...when one of these cases reaches the court it must be tried on conditions that existed at the time the commission acted.” Magnolia at 1111. Optimal asserts that this is the genesis of the “Once legal, always legal” theory.

MATTERS OFFICIALLY NOTICED

The examiner has taken Official Notice of the “P-4 Inquiry” mainframe screen to determine the operator of the Duncan Lease, Well No. 1 and the “Master Inquiry” mainframe screen to determine the status of Technology & Engr. Careers Inc. The Duncan (14819) Lease, Well No. 1, has undergone a P-4 transfer from Optimal Utilities, Inc. (Operator No. 625177), whose President is Anthony Peter Lewis, to Technology & Engr. Careers Inc. (Operator No. 840918), whose President is Anthony P. Lewis. The P-4 transfer was effective October 6, 2011.

In addition, the examiner has taken Official Notice of the files in Oil & Gas Docket No. 06-0257756: *The Application of Optimal Utilities, Inc. To Dissolve the Topaz Waterflood Unit, Topaz (Clarksville) Field, Red River County, Texas*; Oil & Gas Docket No. 06-0261927: *Commission-Called hearing to provide Optimal Utilities, Inc. An Opportunity to Show Cause why the Final Order in O&G Docket No. 06-0257756 Should Not be Vacated and the Duncan (14819) Lease, Well No. 1, Be Ordered Shut-in, Topaz (Clarksville) Field, Red River County, Texas*; and Oil & Gas Docket No. 06-0267386: *Application of Optimal Utilities, Inc. Pursuant to Statewide Rule 38(d)(3) to Dissolve the Topaz Waterflood Unit, Topaz (Clarksville) Field, Red River County, Texas*.

The examiner has taken Official Notice of the Commission’s “Permitting and Production Services Filing Procedures Manual” (hereinafter “Filing Procedures Manual” or “Manual”), in particular Section B. The examiner has also taken Official Notice of the history of the Duncan Lease, Well No. 1, on the Commission’s NEUBUS system and the production history of the well.

EXAMINER'S OPINION

Optimal's case is based on the theory that once a well has been permitted at a legal location, the well remains legal thereafter regardless of changes in acreage, operatorship or other underlying facts. The Warthan Family replies that allowing the subject well to be produced, only 137 feet from their lease line, will result in drainage of their property and damage to their correlative rights. Under the facts of the present case, the examiner is not persuaded that the "Once legal, always legal" theory is applicable. Accordingly, the examiner finds that the location of the Duncan Lease, Well No. 1, only 137 feet from the unleased Warthan Tract and significantly less than the 467 feet required under field rules, requires a Statewide Rule 37 exception.

The "Once Legal, Always Legal" Theory

The examiner finds no authority in statute or Commission Statewide Rule that supports the theory of "Once legal, always legal". Likewise, there is no authority to be found in the February 16, 1990 examiner's letter in Railroad Commission Docket No. 3-94,663 cited by Optimal which opines, in an unsupported conclusory statement, that a Statewide Rule 37 exception was not required in that particular case. The letter states that examiner's opinion and is not a Commission order. There is no evidence the examiner's statement was ever adopted by the Commission.

Optimal stated that its cited caselaw was the genesis of the "Once legal, always legal" theory. It is not. The cited caselaw stands for the proposition that a District Court, or higher court, when considering the Commission's actions regarding its interpretation of its spacing rule, must consider the case based on the conditions that existed at the time the Commission made its decision. "The district court has the authority to hear proper evidence bearing on the issues involved, but 'the judicial inquiry must be confined to conditions as they existed at the time the commission acted.'" Potter v. Sun Oil Co., 189 S.W.2d 482 (1945), quoting Magnolia Petroleum Co. v. New Process Production Co., 129 Tex. 617, 104 S.W.2d 1106, 1111 (1937). These cases do not outline any theory that a well, once drilled, is forever a legal well. Instead, the cases primarily define the limitations on the powers of District Courts and higher courts to review Commission decisions. However, these limitations are not ascribed to the Commission.

This is not a situation in which an operator formed a pooled unit, drilled a well, and then, through no fault of its own, lost some acreage and had to amend its well permit to reflect a reconfigured unit. The examiner expresses no opinion as to the proper outcome of that situation. In this case, the unit on which the well was originally drilled terminated and the Commission designated unit was formally dissolved by Commission order pursuant to Statewide Rule 38(d)(3). The original operator and original unit are no longer involved. In this case, optimal has selectively chosen which acreage from the old unit to lease and which wells to operate.

The Duncan Lease, Well No. 1, was originally drilled by Sonat Exploration Company as a pooled unit composed of two 20.5-acre tracts, with the W-1 filed in 1996 and the well drilled in

1997. This 41-acre unit was later made part of the 1558-acre Topaz Field Unit by Sonat in 1999, which in turn was subdivided into the slightly smaller 1520.96-acre Topaz Waterflood Unit by Classic Oil & Gas, Inc. in 2000. Production subsequently ceased and the unit terminated no later than November 1, 2006.

Whether a well is drilled on a small 41-acre pooled unit or a larger 1558-acre or 1520.96-acre secondary recovery unit, the standard model regarding leaseline spacing is the same. Leaseline spacing distances under the applicable field rule are still observed as to the external boundaries of the unit, but leaseline spacing distances to internal boundaries of 100% leased tracts are disregarded in the placement of wells. This is not problematic because all parties to the pooled unit or secondary recovery unit participate on a pro rata basis in the proceeds from the unit.

Once the unit is dissolved, however, well locations that happen to have been drilled nearer internal leaselines than required under the field rules do become problematic. A well drilled closer than a Rule 37 leaseline spacing exception distance to an internal leaseline in a pooled unit or secondary recovery unit which is 100% leased that was previously unobjectionable because all parties to the unit shared in the production from the well, may become objectionable after the previous internal leaselines are re-established as external leaselines. After re-establishment of original leaselines, a mineral owner previously entitled to a share of production from a well very near his leaseline would be excluded from a share of the production. In that instance, the new operator who has designated new external boundaries for the regulatory unit containing the well must obtain a Rule 37 exception permit if it desires to produce the irregularly located well.

The evidence in the record⁵ indicates the Topaz Waterflood Unit terminated at the latest on November 1, 2006. Apparently unwilling to reconstruct the entire 1520.96-acre Topaz Waterflood Unit and take over all the old wells, Optimal acquired selected acreage that included five wells from the terminated unit, each assigned 40 or more acres as necessary under the field rules, for a total of 209 acres assigned to the wells. In order to accomplish this, it was first necessary for Optimal to dissolve the Topaz Waterflood Unit pursuant to Statewide Rule 38(d)(3).

The effect of a successful application pursuant to Statewide Rule 38(d)(3) is that the unit is "...dissolved into the separate tracts with the rules of the commission applicable to each separate tract...". The result, in this case, is that the Warthan Tract and the Duncan Tract, after entry of the Commission's Final Order on January 13, 2011, became separate tracts with the rules of the Commission applicable to each. Optimal's affirmative act terminated the Topaz Waterflood Unit, and with it, any right to consider the Duncan Lease, Well No. 1 as entitled to consideration as a unit well that had inadvertently lost acreage through no fault or intent of the operator.

⁵ Oil and Gas Docket No. 06-0261927.

Correlative Rights

The Warthan Family fears that if Optimal is allowed to operate the subject well, the well will drain the Warthan property in the Topaz (Clarksville) Field. Essentially, the Warthan family is asking the Commission for due process protection of its correlative rights.

The Correlative Rights Doctrine is “... a recognition that owners of interests in a common source of supply stand in a special relationship with each other in that any production by one owner will necessarily affect all of the others. Thus each operator has an obligation to the other owners not to produce in such a way as to injure the common source of supply or to interfere unduly with the interests of other owners.” Smith & Weaver, Texas Law of Oil and Gas, Chapter 1(1.1)(B)(2), Matthew Bender & Company, June 2011, referencing Elliff v. Texon Drilling Co., 210 S.W.2d 558, (Tex. 1948). Correlative rights are specifically recognized in Chapter 86 of the Texas Natural Resources Code as a basis for Commission adjustment of gas allowables to prevent overproduction and prevent waste. Chapter 85 of the Texas Natural Resources Code does not specifically mention correlative rights, but the Texas Supreme Court, in Railroad Commission v. Sample, 405 S.W.2d 338 (Tex. 1966), recognized the Commission had broad statutory authority to adjust oil well allowables to protect correlative rights (see Smith & Weaver, at Chapter 8(8.3)(C)(2)(a)).

After the January 13, 2011 dissolution of the Topaz Waterflood Unit, all rules of the Commission applied to the Duncan Lease as an individual lease and the Warthan tract as an individual tract. One of those rules is Statewide Rule 37, which requires that “No well for oil, gas or geothermal resources shall hereafter be drilled nearer than 1,200 feet to any well completed in or drilling to the same horizon on the same tract or far, and no well shall be drilled nearer than 467 feet to any property line, lease line, or subdivision line; provided the Commission, in order to prevent waste or to prevent confiscation of property, may grant exceptions...” Commission Statewide Rule 37(a)(1), amended effective September 1, 2004, 29 TexReg 8271. The Topaz (Clarksville) Field is on Statewide Rules.

The correlative rights of the Warthan Family were not threatened when their lands were included in a pooled unit, or when their lands were later included in a secondary recovery unit. However, after dissolution of the secondary recovery unit, the correlative rights of the Warthan family in the Topaz (Clarksville) Field were at risk. Well No. 1 on the Duncan Lease, being only 137 feet from the Warthan lease line and not 467 feet, requires a Statewide Rule 37 exception.

Recommendation

The examiner recommends that the Commission enter a Final Order that Well No. 1 on the Duncan (14819) Lease remain shut-in, pending successful application for an exception to Statewide Rule 37.

FINDINGS OF FACT

1. At least ten (10) days notice of the hearing in this docket was sent to all parties entitled to notice. Dr. T. Lynn Warthan (“Warthan” or “Complainant”) and Optimal Utilities (“Optimal”) appeared at the hearing and presented evidence and testimony.
2. The Warthan Family complains that the Duncan (14819) Lease, Well No. 1, completed in the Topaz (Clarksville) Field, is located only 137 feet from the boundary of the Warthan Tract and that the well should be required to obtain a Statewide Rule 37 exception permit.
3. The Topaz (Clarksville) Field is on Statewide rules, which require 467 foot leaseline spacing, 1200 foot between-well spacing, and 40 acre units.
4. Well No. 1 on the Duncan Lease (“subject well”) was originally completed on August 4, 1996, on a 41-acre pooled unit, composed of 20.5 acres from the Duncan Lease and 20.5 acres from the Warthan Lease.
 - a. The subject well was regular to external unit lines, but only 137 feet from the common line between the Duncan and Warthan leases.
 - b. Both the Duncan and Warthan leases were 100% leased to the operator of the subject well.
 - c. As lessor royalty owners, the Duncans and the Warthans shared, on a pro rata basis, in the production of the subject well.
5. The subject well was later pooled into the 1,558-acre Topaz Field Unit.
 - a. The 1,558-acre Topaz Field Unit was a secondary recovery unit organized by Sonat Exploration Company.
 - b. The 1,558-acre Topaz Field Unit received approval by Commission Order on March 23, 1999.
6. The 1,558-acre Topaz Field Unit was subdivided by Classic Oil & Gas, Inc. into the 1,521-acre Topaz Waterflood (13412) Unit on January 21, 2000.
7. The subject well, formerly in a pooled unit and later in a secondary recovery unit, was drilled without regard to the common leaseline, which at the time was an internal leaseline, between the Duncan and Warthan Tracts, both of which were 100% leased.
 - a. Wells in a pooled unit or a secondary recovery unit must respect the leaseline spacing

distance to the external boundaries of the unit.

- b. Wells drilled within a Rule 37 leaseline spacing distance of an internal leaseline in a pooled unit or secondary recovery unit are not objectionable when the adjoining tracts are 100% leased, because all the leased mineral owners in the unit share in the production of any well on the unit on a pro rata basis.
8. The last reported production on the Topaz Waterflood Unit was 68 BO in February, 2006. The record evidence indicates the Topaz Waterflood Unit terminated at the latest on November 1, 2006.
9. After determining the Topaz Waterflood Unit had terminated, Optimal acquired leases that included the surface locations of five wells from the defunct unit, and assigned 40 or more acres to each well, resulting in a total of 209 acres assigned to the five wells.
10. In order to create new regulatory leases for the five wells that Optimal planned to operate, it was first necessary to formally dissolve the former 1,521-acre Topaz Waterflood (13412) Unit pursuant to Statewide Rule 38(d)(3).
 - a. In Oil & Gas Docket No. 06-0261927, Optimal presented its case for dissolution of the Topaz Waterflood Unit, an affirmative act which resulted in unit dissolution by Commission Final Order on January 13, 2011.
 - b. The effect of the Commission Final Order on January 13, 2011 was to dissolve the Topaz Waterflood Unit into its separate tracts with the rules of the Commission applicable to each separate tract.
 - c. The Commission Final Order on January 13, 2011 dissolving the Topaz Waterflood Unit resulted in changed conditions on the Duncan Tract and the Warthan Tract.
11. After dissolution of the Topaz Waterflood Unit, the rules of the Commission applied to the Warthan Tract as a separate tract entitled to protection against the drainage of its minerals and protection of its correlative rights in the Topaz (Clarksville) Field and to the Duncan Lease as a separate tract.
 - a. The Duncan (14819) Lease, Well No. 1, is 137 feet from the common boundary line between the Duncan Lease and the unleased Warthan Tract.
 - b. The field rules for the Topaz (Clarksville) Field require 467 foot leaseline spacing.
 - c. The Duncan (14819) Lease, Well No. 1, if allowed to produce, will drain the

Warthan Tract and adversely affect the correlative rights of the owners of the Warthan tract.

12. The Form P-4 responsibility for the Duncan (14819) Lease, Well No. 1 was transferred from Optimal Utilities, Inc. (Operator No. 625177), whose President is Anthony Peter Lewis, to Technology & Engr. Careers Inc. (Operator No. 840918), whose President is Anthony P. Lewis, effective October 6, 2011.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred and been accomplished to give the Commission jurisdiction to decide this matter.
3. Dissolution of the Topaz Waterflood Unit by Commission Final order on January 13, 2011 returned the constituent tracts of the unit to their former status as separate tracts with the rules of the Commission applicable to each separate tract.
 - a. The Duncan and Warthan Tracts were returned to their status as separate tracts.
 - b. Dissolution of the Topaz Waterflood Unit by Commission Final Order on January 13, 2011 resulted in changed conditions as to the constituent tracts of the unit.
 - c. The Commission may consider changed conditions when determining the Statewide Rule 37 status of a well.
4. The Duncan (14819) Lease, Well No. 1, at a distance of 137 feet from the Warthan Tract, is within a Statewide Rule 37 leaseline spacing distance of the Warthan Tract
5. The Duncan (14819) Lease, Well No. 1, requires a Statewide Rule 37 exception in order to produce from the Topaz (Clarksville) Field.

RECOMMENDATION

The examiner recommends that the Duncan (14819) Lease, Well No. 1, remain shut-in until its operator successfully applies for a Statewide Rule 37 exception.

Respectfully submitted,

Marshall Enquist
Hearings Examiner