

**KEY ISSUES: Confiscation
Producing Field w/o Permit
Rules 10 & 37 Violations**

FINAL ORDER: R37 Dismissed With Prejudice

**RULE 37 CASE NO. 0221255
OIL AND GAS DOCKET NO. 10-0221408**

APPLICATION OF DEEP REEF INDUSTRIES FOR A STATEWIDE RULE 37 EXCEPTION FOR THE HODGES LEASE, WELL NO. 1-39, HODGES (MORROW, UPPER) FIELD, AND THE COMPLAINT OF J. M. HUBER CORPORATION AGAINST DEEP REEF REGARDING THE ALLEGED VIOLATION OF STATEWIDE RULES 10 AND 37 ON THE HODGES LEASE, HODGES (MORROW, MIDDLE) AND HODGES (MORROW, UPPER) FIELDS, ROBERTS COUNTY, TEXAS

APPEARANCES:

REPRESENTING:

FOR APPLICANT/RESPONDENT:

APPLICANT/RESPONDENT:

Pat Sasser, President and Sole Owner
M. S. McKaye

Deep Reef Industries

FOR PROTESTANT/COMPLAINANT:

PROTESTANT/COMPLAINANT:

Jeri Wechsler, Attorney
Joel Christal

J. M. Huber Corporation

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF HEARING:

May 14, 1999

DATE OF REOPENED HEARING:

August 23, 1999

TRANSCRIPT RECEIVED:

October 11, 1999

HEARD BY:

Meredith Kawaguchi, Legal Examiner
Thomas Richter, Technical Examiner

PFD CIRCULATION DATE:

November 3, 1999

CURRENT STATUS:

Protested

STATEMENT OF THE CASE

These dockets involve two fields: the Hodges (Morrow, Upper) Field and the Hodges (Morrow, Middle) Field.

In 1978 Deep Reef Industries ("Deep Reef") drilled its Hodges Well No. 1-39 to the Hodges (Morrow, Upper) Field, perforating the well at a depth of 9,458-66 feet. Deep Reef obtained a regular permit for the well and was in compliance with the spacing rules, placing the well 467' from the nearest lease line.

On December 22, 1998, J. M. Huber Corporation ("J. M. Huber") filed a complaint regarding Deep Reef's Well No. 1-39, alleging that the well was producing currently from a different field than that for which Deep Reef received a regular permit in 1978. According to J. M. Huber, whose tract directly offsets Well No. 1-39, the well was producing from the Hodges (Morrow, Middle) Field in violation of Statewide Rule 37. Deep Reef has no permit to produce from the Hodges (Morrow, Middle) Field, and field rules for this zone require wells to be placed 933 feet from the nearest lease line. J. M. Huber also alleged that Deep Reef had been commingling production from the Morrow, Upper and Morrow, Middle Fields. J. M. Huber has withdrawn this allegation.

The Commission extended to Deep Reef an opportunity to respond to J. M. Huber's allegations in writing. Deep Reef's only response was to apply for a Rule 37 exception for its Hodges Well No. 1-39 in the Hodges (Morrow, Middle) Field. Deep Reef continued to produce from the Morrow, Middle Field until the well was shut-in on June 17, 1999, pursuant to an Interim Order entered by the Commission on May 25, 1999.

A hearing on the merits of J. M. Huber's complaint and Deep Reef's Rule 37 application was convened on May 14, 1999. Two days prior, Deep Reef requested a postponement of the hearing "as we are researching pressures of offsetting wells." No other excuse or justification was given. The examiners denied the request for postponement of the hearing. Deep Reef did not appear on May 14, 1999. J. M. Huber appeared and gave evidence in support of its complaint. Based on this evidence, the Commission entered its Interim Order of May 25, 1999.

On August 23, 1999, the hearing was reopened to take evidence and argument concerning whether Deep Reef had complied with the Commission's Interim Order by timely shutting in the subject well, whether Deep Reef should be referred to the Attorney General under TEX. NAT. RES. CODE ANN. §§86.222 and 86.223, and why the Rule 37 application should not be dismissed.

DISCUSSION OF THE EVIDENCE

J. M. Huber's evidence shows, and Deep Reef conceded at the reopened hearing, that it had been producing the Hodges Well No. 1-39 from the Hodges (Morrow, Middle) Field since 1982. Deep Reef presented a Form G-1 for the No. 1-39 dated January 1, 1982. In the "remarks" section of the Form G-1, Deep Reef states: "Squeeze old perfs. 9458-66 w/150 sx. to shut off wtr. File to

reflect new perfs in same producing zone." The new perfs referred to are 10,130-10,137 feet. Although not convinced that this evidence proves no commingling of zones occurred, J. M. Huber withdrew its commingling charge. Deep Reef relies on this Form G-1 to prove that it did not attempt to conceal the zone it perforated and in good faith believed that although it deepened No. 1-39, it remained in the Morrow, Upper Field.

In response to Deep Reef's claim of ignorance regarding the field it had penetrated, J. M. Huber asked the examiners to officially notice the following:

1. Field Rules applicable to Hodges Field, (Morrow Middle), Roberts County, Texas previously tendered into evidence by J. M. Huber Corporation at the May 14, 1999 hearing of this matter as Exhibit 4 ("Field Rules") are presently in force and applicable;
2. The copy of the Field Rules tendered as Exhibit 4 is a true and correct copy of the original, applicable Field Rules.
3. The introductory statement in the Field Rules that statutory notice was given and hearing held on September 24, 1980 is true and correct;
4. As an offsetting operator, Deep Reef would have received notice of the September 24, 1980 hearing, sent to the address provided on Deep Reef's P-5 pursuant to Railroad Commission Rules of Practice and Procedure;
5. Temporary Field Rules adopted following the September 24, 1980 hearing pursuant to Order No. 10-75,802 were effective and binding on operators on November 10, 1980;
6. Operators, including Deep Reef, who had notice of the September 24, 1980 hearing, and had the opportunity to appear were charged with knowledge of the temporary field rules applicable to the Middle Morrow Field made effective November 10, 1980;
7. All wells drilled into or producing from the Middle Morrow Field subsequent to November 10, 1980 were governed by the temporary field rules;
8. Temporary Field Rules, effective as of November 10, 1980 were unchanged and made permanent by Order effective June 7, 1982;
9. Offsetting Operators, including Deep Reef, would have received notice of and were charged with knowledge of the Temporary Field Rules and the Permanent Field Rules;
10. Deep Reef's Hodges 1-39 well has been subject to the Field Rules since November 10, 1980.

Deep Reef did not object to the Motion for Official Notice and it was granted by the examiners.

The examiners also officially notice that Deep Reef's Hodges Lease offsets the discovery tract, the Hodges "G" Lease, in the Hodges (Morrow, Middle) Field.

At the reopened hearing, J. M. Huber established through cross-examination of Mr. Sasser, sole owner of Deep Reef, that he did receive a copy of the Commission's Interim Order of May 25, 1999. The Interim Order required that the No. 1-39 well be shut-in within 15 days of the May 24th order, the fifteenth day being June 9, 1999. J. M. Huber presented an inspection report from the Pampa District Office dated June 9th. District inspectors on that date physically inspected the well and found the well to still be producing. On June 11, 1999, a District inspector noted that the well was producing approximately 100 MCF per day. J. M. Huber presented a document from the Railroad Commission to GPM Gas Corporation ("GPM"), the gatherer of the gas from Deep Reef's Hodges Lease, notifying GPM of the Interim Order and requesting GPM to shut-in the well.

Deep Reef admitted at the reopened hearing that the well was shut-in by GPM on June 17, 1999. When asked why Deep Reef had not shut-in the well as ordered by the Commission, Mr. Sasser answered, "I think I was still...at that time I was considering an offer that J. M. Huber had made us." (Transcript at 16). Mr. Sasser could not remember the date of the alleged discussions with J. M. Huber after issuance of the Interim Order.

When Deep Reef was asked to address the issue of whether its Rule 37 application should be dismissed, Deep Reef responded by withdrawing its Rule 37 application. J. M. Huber objected to the withdrawal, fearing that if the application is not denied, or dismissed with prejudice, Deep Reef will renew its application at the earliest opportunity, which would require J. M. Huber's further response, preparation, and attendance at hearings.

EXAMINERS' OPINION

Deep Reef has the right to withdraw its Rule 37 application, despite J. M. Huber's objection. Therefore, the Commission may dismiss the application pursuant to 16 T.A.C. §1.126(3).

In regard to J. M. Huber's complaint, the examiners believe that the complainant met its burden to prove that Deep Reef produced the Hodges 1-39 well for 17 years without any permit, and that Deep Reef knowingly did so. Statewide Rule 43, 16 T.A.C. §3.43, requires an applicant for temporary field rules to provide the Commission with a list of names of all operators holding leases on land touching the tract on which the discovery well is located. Deep Reef, in 1980 when temporary field rules were adopted, was such an operator. Its Hodges Lease directly offsets the Hodges "G" Lease where the discovery well for the Morrow, Middle Field was located. In 1980, J. M. Huber operated the discovery well, the Hodges "G" Well no. 1-193 and was the applicant for the temporary field rules.

Additionally, the well log for the Hodges No. 1-39 shows a substantial shale break between

the Morrow, Upper Field and Morrow, Middle Field, sufficient to alert anyone that the two zones are entirely separate. It is unknown how Deep Reef accounted for the significant separation between fields when it claimed on Form G-1 that its new perforations were in the same producing zone as the Morrow, Upper. The examiners note that Deep Reef made this claim more than one year after Deep Reef received notice of the temporary field rule hearing.

Despite two opportunities, the May 14th and the August 23rd hearings, Deep Reef presented no evidence and made no claim that failure to produce its Well No. 1-39 at its existing irregular location would cause waste or confiscation. The evidence indicates that neither will be caused if the well is plugged in the Morrow, Middle Field. Well logs of Deep Reef's Well No. 1-39 and the offsetting J. M. Huber Well No. 1-40 (at a regular distance 933 feet from Deep Reef's lease line) demonstrate the strong geologic correlation of the Morrow, Middle Field from well to well. There appears to be no impediment to drainage; in fact, J. M. Huber is convinced that its offsetting leases have been drained considerably by the Deep Reef well. From 1982 to the end of 1998, Deep Reef produced nearly 1 BCF of gas from the Hodges (Morrow, Middle) Field without a permit. At the time of hearing the well was producing approximately 100 to 150 MCF per day.

EXAMINERS' RECOMMENDATION

The examiners recommend that the Commission dismiss Deep Reef's Rule 37 application due to its withdrawal of the application. It is further recommended that the Commission order Deep Reef to plug-back the subject well or otherwise permanently close the Hodges (Morrow, Middle) Field perforations in the subject wellbore within 45 days of the date of entry of the final order. The well should remain shut-in until it is plugged. Finally, the examiners recommend that Deep Reef be assessed an administrative penalty of \$10,000 for violation of Statewide Rule 37 and the Commission's Interim Order of May 25, 1999.

FINDINGS OF FACT

1. J. M. Huber filed its complaint against Deep Reef on December 22, 1998 regarding the Hodges Well No. 1-39. On or about February 11, 1999, Deep Reef filed its application for a Rule 37 exception for the subject well. These dockets were combined and notice of hearing was issued on March 22, 1999, to all affected persons pursuant to Rule 37(a)(2)(A), including the complainant and respondent.
2. J. M. Huber appeared at the May 14, 1999 hearing and presented its complaint case. Deep Reef did not appear. The hearing was reopened on August 23, 1999. Both J. M. Huber and Deep Reef appeared at the reopened hearing.
3. Deep Reef has been the operator of the Hodges Well No. 1-39 since 1978.
4. From 1982 until June 17, 1999, Deep Reef produced the Hodges Well No. 1-39 in the Hodges (Morrow, Middle) Field 467 feet from J. M. Huber's lease line without a permit.

Field rules for the Hodges (Morrow, Middle) Field require a distance of 933 feet to the nearest lease line.

5. Temporary field rules for the Hodges (Morrow, Middle) Field were adopted on November 10, 1980, after statutory notice was given and a hearing held on September 24, 1980.
6. As an operator of a tract offsetting the discovery tract, Deep Reef received notice of the September 24, 1980 field rule hearing.
7. Temporary field rules, effective as of November 10, 1980, were unchanged and made permanent by Commission Order effective June 7, 1982.
8. Offsetting operators, including Deep Reef, received notice of, and were charged with knowledge of, the temporary and permanent field rules for the Hodges (Morrow, Middle) Field.
9. On May 25, 1999, the Commission entered an Interim Order requiring Deep Reef to cease producing its Well No. 1-39, Hodges Lease, from the Hodges (Morrow, Middle) Field, within fifteen days of the date of entry of the Interim Order. The interim order was served on Deep Reef at its P-5 address by first class mail and was not returned to the Commission.
10. Deep Reef failed to comply with the Interim Order. Ultimately, Well No. 1-39 was shut in by the gatherer GPM Gas Corporation on June 17, 1999, eight days after the June 9th deadline for shutting in the well.
11. On August 23, 1999, at the reopened hearing, J. M. Huber withdrew its complaint concerning its allegation that Deep Reef produced Well No. 1-39 in violation of Rule 10.
12. On August 23, 1999, at the reopened hearing, Deep Reef withdrew its Rule 37 application to produce Well No. 1-39 from the Hodges (Morrow, Middle) Field. At the hearing, Deep Reef acknowledged that it had received the Interim Order and was aware of the requirement that the subject well be shut in by June 9 but that it failed to comply with the order.
13. Although two hearings have been convened, one to consider the merits of its application and the other to consider, among other things, why the Rule 37 application should not be dismissed, Deep Reef has presented no evidence to support its Rule 37 application.
14. Deep Reef did not allege, nor is there any evidence to show, that absent a Rule 37 exception for Deep Reef's Hodges Well No. 1-39, waste will occur.

CONCLUSIONS OF LAW

1. Proper notice has been given to all persons legally entitled to notice.

2. Deep Reef produced its Well No. 1-39, Hodges Lease, Hodges (Morrow, Middle) Field in violation of Statewide Rule 37, 16 T.A.C. §3.37, for seventeen years.
3. Deep Reef's application currently pending as Rule 37 Case No. 0221255 should be dismissed pursuant to 16 T.A.C. §1.126(3).
4. Pursuant to Statewide Rule 37(e), 16 T.A.C. §3.37(e) and TEX. NAT. RES. CODE ANN. §86.041, Deep Reef should be ordered to plug Well No. 1-39 on the Hodges Lease in the Hodges (Morrow, Middle) Field.
5. Pursuant to TEX. NAT. RES. CODE ANN. §§86.222 and 86.223, Deep Reef should be ordered to pay an administrative penalty for violation of the Commission's Interim Order of May 14, 1999 and Statewide Rule 37, 16 T.A.C. §3.37 and collection of that penalty should be referred to the Attorney General.

Respectfully submitted,

Meredith Kawaguchi
Legal Examiner

Thomas H. Richter, P.E.
Technical Examiner

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