



RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL AND GAS DOCKET NO. 08-0282700

APPLICATION OF PECOS OPERATING COMPANY, L.L.C.,
TO TRANSFER WELLS FROM THE
MARTIN (CONSOLIDATED) FIELD TO THE FUHRMAN-MASCHO FIELD
ANDREWS COUNTY, TEXAS

HEARD BY: Paul Dubois - Technical Examiner
Marshall Enquist - Legal Examiner

DATE OF HEARING: August 1, 2013

APPEARANCES:

Flip Whitworth
Steve Gray

REPRESENTING:

Pecos Operating Company, L.L.C.

EXAMINERS' REPORT AND RECOMMENDATION

STATEMENT OF THE CASE

This is the application of Pecos Operating Company, L.L.C. (Pecos) to transfer wells from the Martin (Consolidated) Field to the Fuhrman-Mascho Field in Andrews County, Texas. Pecos is requesting that all 26 of the drilled and permitted wells in its Goldsmith North, San Andres Consolidated Unit (GNSAU) be transferred to the Fuhrman-Mascho Field.

In 2010 the Martin (Consolidated) Field was expanded by the consolidation of several additional fields in the area (Docket No. 08-0265191). This action also transferred all wells of the GNSAU from the Goldsmith, N. (San Andres, Cons.) Field into the Martin (Consolidated) Field. Unrecognized at the time, this transfer directly resulted in the over-assignment of acreage in the Martin (Consolidated) Field within the geographic footprint of the GNSAU. Thus full development of shallow mineral rights (such as Pecos' situation in the San Andres Formation) was prohibited because of acreage held by operators with deeper rights in the same Martin (Consolidated) field, and vice versa.

The application was not protested. The examiners recommend approval of the field transfer as requested by Pecos.

APPLICABLE LAW

Commission Statewide Rule 40(d) [TEX. ADMIN. CODE §3.40(d)] states "Acreage assigned to a well for drilling and development, or for allocation of allowable, shall not be assigned to any other well or wells projected to or completed in the same reservoir; such duplicate assignment of acreage is not acceptable, provided, however, that this limitation shall not prevent the reformation of development or proration units so long as no duplicate assignment of acreage occurs, and further, that such reformation does not violate other conservation regulations."

MATTERS OFFICIALLY NOTICED

The examiners have taken Official Notice of Oil & Gas Docket No. 08-0225627: Combining the Martin (Clear Fork), Martin (Clear Fork, Lo), Martin (Wichita) and Block 11 (Wichita, Lo) Fields, Adopting a Designation of Martin (Consolidated) Field for the Field Formed by Such Combination of Fields and Adopting Rulse and Regulations for the Martin (Consolidated) Field, Andrews and Ector Counties, Texas.

The examiners have take Official Notice of Oil & Gas Docket No. 08-0252161: The Application of Energen Resources Corporation to Consolidate the Martin (Wolfcamp) Field into the Martin (Consolidated) Field and Amend the Field Rules For the Martin (Consolidated) Field, Andrews County, Texas.

The examiners have taken Official Notice of Oil & Gas Docket No. 08-0265191: The Application of Sandridge Expl. and Prod., LLC to Consolidate Various Martin Fields and Transferring Wells into the Martin (Consolidated) Field and to Amend the Field Rules for the Martin (Consolidated) Field, Andrews and Ector Counties, Texas.

The examiners have taken Official Notice of Oil & Gas Docket No. 08-0266448: The Application of Sandridge Expl. and Prod., LLC to Consolidate the Block 11 (Fusselman) and Martin, West (Fusselman) Fields into the Martin (Consolidated) Field and to Amend the Field Rules for the Martin (Consolidated) Field, Andrews, Howard and Ector Counties, Texas.

The examiners requested that the Manager of Drilling Permits provide a summary of assigned acreage of leases that share the same geographic footprint as the 1,424 acre GNSAU. Pecos' GNSAU (Lease no. 08-40071) has an assigned acreage of 549.10 acres. Five other non-Pecos leases account for an assigned 1,314 acres. These five leases predate the Pecos GNSAU lease in the Martin (Consolidated) Field. The total assigned acreage in Martin (Consolidated) Field within the 1,424 acre GNSAU geographic area is 1,863 acres.

DISCUSSION OF THE EVIDENCE

The subject wells of the GNSAU were completed in the San Andres Formation and were assigned to what came to be known in 1964 as the Goldsmith, N. (San Andres, Cons.) Field, Andrews County, Texas. The earliest wells in the field date to at least 1948. The GNSAU was created by a Unit Agreement filed on December 29, 1972, and is approximately 1,424 acres (two and one quarter sections). The Unit Agreement defines the 'Unitized Formation' as "that subsurface portion of the unit area commonly known as the San Andres formation which is the same zone as the top and bottom of which were encountered at logged depths of 4123' and 5270' in the Atlantic Richfield-Phillips University 11 Sec. 1A Well No. 4 as shown on the Lane-Wells Radioactivity log of said well...." At the time of unitization there were 32 wells in the unit, for a density of 1 well per 44.5 acres. Over the years the number of wells has varied, as new production and injection wells were drilled, wells were converted to injection, and wells were plugged. Currently there are 23 producing wells (one well per 62 acres), four injection wells, and 24 plugged and abandoned wells.

Field Consolidation History

The history of the field assignment and subsequent field consolidation is complex but directly relevant to Pecos' current situation and application for field transfer; Pecos became operator of the GNSAU coincident with – but without knowledge of – the unit's wells being transferred into the Martin (Consolidated) Field; the prior owner/operator of the GNSAU, Merit Energy Company (Merit), was properly noticed and did not protest. This history is summarized below.

1. Goldsmith, N. (San Andres, Cons.) Field, Special Order No. 8-53,296, Issued June 1, 1964

The Goldsmith, N. (San Andres, Cons.) Field was established on June 1, 1964, (Special Order No. 8-53,296, as amended) by the consolidation of the Andecter (Non-Associated Gas), North Goldsmith, North Goldsmith (Associated Gas), Martin (San Andres) and Martin (San Andres)(Associated Gas) Fields. At the time of unitization in 1972, all of the GNSAU wells were assigned to the Goldsmith, N. (Sand Andres, Cons.) Field. The Special Order consolidating the fields did not specify a correlative interval, but it did indicate that the new field was the product of consolidating several San Andres Formation fields. The GNSAU-defined correlative interval for the San Andres Formation was 4,123 feet to 5,270 feet in the Atlantic Richfield-Phillips University 11 Sec. 1A Well No. 4.

2. Martin (Consolidated) Field, Docket No. 08-0225627, Issued December 1, 2000

The Martin (Consolidated) Field was established on December 1, 2000, (Docket No. 08-0225627) by the consolidation of the Martin (Clearfork), Martin (Wichita), Martin (Clear Fork, Lo.) and Block 11 (Wichita Lo) Fields. The correlative interval of 5,640 to 7,960 feet

was established for the field, which corresponds to the Clear Fork and Wichita formations (below the San Andres).

Additional fields were added to the Martin (Consolidated) Field by three subsequent Commission Final Orders (Dockets 08-0252161, 08-0265191 and 08-0266448).

3. Martin (Consolidated) Field, Docket No. 08-0252161, Issued July 17, 2007

Docket 08-0252161 was the application of Energen Resources Corporation to consolidate the Martin (Wolfcamp) into the Martin (Consolidated). In a Final Order issued on July 17, 2007, a new correlative interval and type log was established for the field: The entire combined correlative interval from 5,640' to 7,960' as shown on the Platform Express Litho-Density Compensated Neutron log of the Energen Resources, University "14-A" Well No. 2, Section 14 Block 11, University Land Survey, Andrews County, Texas, shall be designated as a single reservoir for proration purposes and be designated as the Martin (Consolidated) Field.

4. Martin (Consolidated) Field, Docket No. 08-0265191, Issued June 22, 2010

The Final Order for Docket 08-0265191 approved the application of Sandridge Expl. And Prod., LLC (Sandridge) to consolidate several fields into the Martin (Consolidated) Field and to amend field rules to allow for 10 acre optional proration units. This action included the addition of the GNSAU wells, which were at the time owned by Merit Energy Company. However, the Goldsmith, N. (San Andres, Cons.) Field was not a part of initial notice for field consolidation.

The April 5, 2010, notice for the hearing to be held on April 28, 2010, proposed the following fields to be consolidated into the Martin (Consolidated) Field:

- Martin (Clear Fork)
- Martin (Clear Fork, Lo)
- Martin (Clear Fork, South)
- Martin (Ellenburger)
- Martin (Fusselman)
- Martin (Glorieta)
- Martin (McKee)
- Martin (Montoya)
- Martin (San Andres)
- Martin (Second Simpson Sd.)
- Martin (Tubb)
- Martin (Wichita)
- Martin (Wolfcamp)
- Martin (5700)
- Martin (7200)

With regard to the proposed field list, note that the Martin (Clear Fork), (Clear Fork,

Lo) and (Wichita) were among the fields originally incorporated into the Martin (Consolidated) in 2000, and the Martin (Wolfcamp) was consolidated in 2007. Also, Merit Energy Company, operator of the GNSAU wells, was not noticed on this matter as the proposal at this time did not include the Goldsmith, N. (San Andres, Cons.) Field. The April 5, 2010, notice also requested a revised correlative interval of 4,199 to 8,827 feet as shown on the log of the Phillips Petroleum Company University ATP #5 (API 003-37265).

To resolve a potential protest from Whiting Oil & Gas Corporation, Sandridge agreed to remove the fields representing the Fusselman through Ellenburger formations, which were the deepest formations included in the proposed consolidation. Thus Sandridge removed the following fields from the proposal:

- Martin (Ellenburger)
- Martin (Fusselman)
- Martin (McKee)
- Martin (Montoya)
- Martin (Second Simpson Sd.)

Following the hearing on April 28, 2010, Sandridge identified wells in the Goldsmith, N. (San Andres, Cons.) Field that were within the Martin (Consolidated) Field area and were contained within the proposed correlative interval. These Goldsmith wells included the GNSAU wells, at the time operated by Merit. On May 13, 2010, a notice was issued for a re-convened hearing on Docket 08-0265191 to be held on May 28, 2010. The notice presented a revised field list for consolidation as follows:

- Martin (Clear Fork, South)
- Martin (Glorieta)
- Martin (San Andres)
- Martin (Tubb)
- Martin (5700)
- Martin (7200)
- Block 11 (Fusselman)

In addition, the notice proposed to transfer 69 wells from the Goldsmith, N. (San Andres, Cons.) Field into the Martin (Consolidated) Field as these wells were within the Martin (Consolidated) Field area and were contained within the proposed correlative interval. Included in this group of 69 wells were the 20 GNSAU wells operated by Merit Energy Company; Merit was served notice on the matter and did not protest. The May 1, 2010, proration schedule listed 192 active wells for the Goldsmith, N. (San Andres, Cons.) Field, but only 69 of these were identified for transfer based on their geographic location. Of the 69 transferred wells, only two were operated by Sandridge.

The hearing was re-convened on May 28, 2010. By letter dated June 4, 2010, Sandridge's representative requested the Commission remove the Block 11 (Fusselman) Field from the proposed consolidation. The field consolidation was approved by Commission Final Order (Docket 08-0265191, dated June 22, 2010, and effective June 1,

2010) and included the six Martin fields above and the transfer of 69 wells from the Goldsmith, N. (San Andres, Cons.) Field. The correlative interval was revised to 4,199 to 7,923 feet as shown on the log of the Phillips Petroleum Company University ATP #5 (API 003-37265).

5. Martin (Consolidated) Field, Docket No. 08-0266448, Effective August 24, 2010

By Final Order (Docket 08-0266448) dated August 24, 2010, the Commission approved Sandridge's unopposed application to add two fields to the Martin (Consolidated) Field:

- Block 11 (Fusselman)
- Martin, West (Fusselman)

The correlative interval was amended from 4,202 feet to 8,444 feet as shown on the log of the Philips University No. 1 (API 003-04649). Notice for this hearing was dated July 6, 2010. Merit was included on the service list; Pecos was not noticed. As the ownership transfer of the GNSAU occurred on June 4, 2010, and the Final Order transferring the wells was signed on June 22, 2010, it is possible and reasonable that the Form(s) P-4 transferring the unit was not yet filed, processed or recorded in Commission records at the time the service list was created on July 6, 2010. Regardless, by this time the GNSAU was already transferred by Commission Final Order into the Martin (Consolidated) Field.

Pecos' Ownership of GNSAU Wells

Testimony provided by Pecos indicated that in April and May of 2010 it was engaged in negotiations with Merit to acquire the GNSAU. The legal transfer of the GNSAU and wells occurred on June 4, 2010, which was after the May 28, 2010, hearing but before the Final Order was issued on June 22, 2010.

Applicant's Exhibit No. 6 was a copy of the April 5, 2010, hearing notice. This notice was not served to Merit because the matter at the time did not include the Goldsmith, N. (San Andres, Cons.) Field or the GNSAU. Pecos did not receive notice, either, as it was not an operator in one of the subject fields and thus not entitled to notice.

In testimony, Pecos indicated that Merit had received notice, but this is not substantiated by the exhibit. Instead, it is likely that Pecos was referring to the May 13, 2010, re-notice that did include Merit on the service list. During the hearing Pecos did not indicate whether or not Merit was obligated to notify Pecos of the matter for which it (Merit) received notice; this would be a matter between Pecos and Merit, not the Commission.

On July 9, 2010, Pecos received from Merit a notice from the Commission in response to the Final Order for Docket 08-0265191, effective June 1, 2010, transferring the GNSAU wells from the Goldsmith, N. (San Andres, Cons.) Field to the Martin (Consolidated) Field. The notice was dated "June 2010" and was not uniquely addressed to Merit, but was likely sent to all affected operators. The notice required operators of the

affected wells to file Commission Form P-4, 'Producer's Transportation Authority and Certificate of Compliance', for all affected leases. Pecos testified that receipt of this letter, forwarded to it from Merit, was its first notice that the GNSAU and wells were transferred into the Martin (Consolidated) Field. Pecos further testified that the significance and impact of this action on its operations was not immediately apparent. Only after Commission staff notified Pecos that several drilling permit applications could not be approved because the requested acreage was already assigned to deeper wells in the consolidated field, did Pecos begin to understand how the transfer would affect its ability to develop the resources it owned.

GNSAU Area Development

Within the horizontal area defined by the 1,424 acre GNSAU boundaries there are currently 94 wells (Pecos has 26 producing, injecting or permitted wells; ConocoPhillips has eight wells, and OXY USA has 60 wells). All of these wells are assigned to the Martin (Consolidated) Field. Only Pecos' wells are completed in the San Andres Formation, as it holds the rights to the base of the San Andres in this area. ConocoPhillips and OXY USA hold rights to the deeper formations. For all 94 wells, the average density is 15.14 acres per well; in the San Andres interval alone, the 26 Pecos wells have an average density of 54.76 acres per well (or, about 62 acres per producing well). The Martin (Consolidated) Field currently provides for 40 acre standard and 10 acre optional units.

Pecos testified that there are 20 locations on 20 acre spacing that have never been drilled in the GNSAU. However, acreage for all of these wells has already been allocated to wells producing from the deeper reservoirs, below the San Andres but within the Martin (Consolidated) Field. Pecos has provided reservoir production data and volumetric calculations that estimate a well on 20-acre spacing will produce 40,000 BO from the San Andres Formation. According to Pecos, other operators in the area are successfully producing from 10 acre spacing in the San Andres. In the GNSAU, 10 acre spacing would yield an additional 70 drillable locations. Pecos estimates that 10-acre wells would yield 37,500 to 48,200 BO per well.

The additional wells cannot currently be developed because acreage in the field is not available for San Andres wells; Pecos is not able to develop its San Andres resource rights. Pecos also believes that the acreage it is currently holding via its producing wells is also limiting the deeper mineral owners from fully developing their resources as well.

Requested Relief

Pecos proposes to transfer its GNSAU wells out of the Martin (Consolidated) Field and into the Fuhrman-Mascho Field. The Fuhrman-Mascho Field is immediately east of and adjacent to the GNSAU. Pecos provided a stratigraphic log section indicating the correlative intervals for both the Fuhrman-Mascho and the GNSAU represent identical geological formations. This transfer will resolve the over-assignment conflicts with deeper mineral rights owners, and allow Pecos to fully develop its acreage in the GNSAU.

The GNSAU wells were originally a part of the Goldsmith, North (San Andres, Cons) Field. The Goldsmith field is a large field; there are still many wells active in this field from four to 15 miles south of the GNSAU area. Transferring the GNSAU wells back to this field would also resolve the conflict with deeper mineral rights owners. Pecos evaluated whether to transfer the wells back to the Goldsmith, N. (San Andres, Cons.) Field, but determined it was more appropriate to transfer them instead to the Fuhrman-Mascho Field as it is immediately adjacent to the GNSAU.

EXAMINERS' OPINION

The GNSAU wells should not have been transferred into the Martin (Consolidated) Field in June of 2010. The consolidation hearing records from the spring and summer of 2010 suggest some chaos and confusion in the effort by Sandridge to expand the Martin (Consolidated) Field: The list of proposed fields changed several times, fields were removed to resolve a protest, and the first matter (Docket 08-0265191) was noticed and heard twice. The second application (Docket 08-0266448) was filed nine days after the Final Order for the first matter was approved by the Commission.

The GNSAU wells (and other wells in the Goldsmith, N. [San Andres, Cons.] Field) appear to have been transferred into the Martin (Consolidated) Field because they were located within the area of interest for the field consolidation being considered by Sandridge in Docket 08-0265191; because the wells were within the correlative interval and the geographic location of interest, they were included. There is no evidence indicating any party knew that double assignment of acreage would result from the transfer. Field consolidation, in this case, was undertaken for the express purposes of reducing waste and protecting correlative rights. Specifically, Sandridge sought to increase the correlative interval for the Martin (Consolidated) Field to bring more potentially (and marginally) productive intervals into economically viable production.

During this time, Pecos was in negotiations with Merit to acquire the GNSAU, and did acquire the unit before the Commission issued the Final Order transferring the wells into the Martin (Consolidated) Field. The effective date of the Final Order, however, was June 1, 2010, three days before the actual transaction. The prior owner of the wells, Merit, was appropriately not noticed for the first hearing for Docket 08-0265191, and was appropriately noticed for the second hearing.

That Pecos should have known through more effective due diligence, or that Merit might have had an obligation but failed to notify Pecos about the pending Sandridge application, is secondary to the fact that, regardless, once approved by the Commission, the transfer of the wells resulted in a duplicate assignment of acreage in violation of Statewide Rules 38 and 40, and should not have happened. Perhaps this is a check that applicants would be prudent to make – or should be asked to make – prior to or as a part of a request for field consolidation or transfer.

The examiners believe that the appropriate remedy for this situation is to transfer the GNSAU wells to the Fuhrman-Mascho Field, as requested by Pecos.

FINDINGS OF FACT

1. Notice of this hearing was sent to all operators in the subject field at least ten (10) days prior to the hearing.
2. The hearing was not protested.
3. Pecos acquired the GNSAU with the knowledge and understanding that it had exclusive rights to the San Andres Formation within the boundaries 1,424 acre unit.
4. No party other than Pecos holds rights to minerals in the San Andres Formation in the GNSAU area.
5. Merit, the prior owner of the wells, was not notified and not entitled to notice of the April 28, 2010 hearing for Docket 08-0265191 because the GNSAU wells were at that time not being considered for transfer into the Martin (Consolidated) Field
6. Merit was noticed for the May 28, 2010, hearing for Docket 08-0265191 and did not protest.
7. Pecos was not noticed and not entitled to notice for the May 28, 2010, hearing for Docket 08-0265191.
8. No violations of service and notice requirements were identified.
9. Pecos was not notified by Merit about the field consolidation and transfer application by Sandridge.
10. The question of acreage assignment status did not come up in the hearing for consolidation on May 28, 2010.
11. On June 22, 2010, the Commission acted to transfer the wells from the Goldsmith, N. (San Andres, Cons.) Field to the Martin (Consolidated) Field. The Final Order indicated an effective date of June 1, 2010, which was three days prior to Pecos' acquisition of the wells. Per TEX. ADMIN. CODE §1.149(a) the decision was made effective on or about July 15, 2013.
12. The over-assignment of acreage occurred as a result of transferring the GNSAU wells into the Martin (Consolidated) Field (Docket 08-0265191).
13. Martin (Consolidated) Field development is limited for all member intervals within the geographical area of the GNSAU unit
14. The Fuhrman-Mascho field is geologically correlative with the GNSAU and immediately adjacent and to the east of the GNSAU.

15. The nearest Goldsmith, N. (San Andres, Cons.) wells are several miles south of the GNSAU.
16. Transfer of the GNSAU wells to the Fuhrman-Mascho Field is a resolution that protects the correlative rights of Pecos and the deep rights owners and corrects an incidental and unintended consequence of field consolidation and transfer.

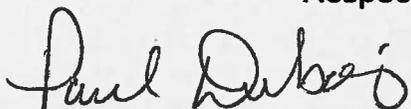
CONCLUSIONS OF LAW

1. Proper notice of this hearing was given to all persons legally entitled to notice.
2. All things have occurred or been accomplished to give the Railroad Commission jurisdiction in this matter.
3. The transfer of GNSAU wells from the Goldsmith, N. (San Andres, Cons.) Field to the Martin (Consolidated) Field by Final Order (Docket No. 08-0265171) resulted in violations of Statewide Rules 38 and 40.
4. The proposed transfer of GNSAU wells from the Martin (Consolidated) Field to the Fuhrman-Mascho Field will remedy this violation of Statewide Rules 38 and 40 and protect correlative rights.

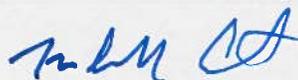
EXAMINERS' RECOMMENDATION

Based on the above findings and conclusions of law, the examiners recommend approval of the proposed transfer of Pecos Operating Company, L.L.C. Goldsmith North San Andres Consolidated Unit wells from the Martin (Consolidated) Field to the Fuhrman-Mascho Field, and that any such fees associated with such transfer, including drilling permit fees, be waived.

Respectfully submitted,



Paul Dubois
Technical Hearings Examiner



Marshall Enquist
Legal Hearings Examiner