

October 8, 2007

OIL AND GAS DOCKET NO. 09-0249222

COMMISSION CALLED HEARING ON THE COMPLAINT OF WOOLSEY WELL SERVICE, L.P. AND J & C OPERATING CO. REGARDING THE VALIDITY OF THE PERMITS ISSUED FOR RSK-STAR LEASE, WELL NOS. 5 AND 6, NEWARK, E. (BARNETT SHALE) FIELD, WISE COUNTY, TEXAS .

APPEARANCES:

For Complainant Woolsey Well Service, L.P. and J & C Operating Co.

Dick Marshall
Rick Woolsey

For Respondent Star of Texas Energy Services, Inc.

David Gross
Ray Ledesma
Carey P. Holtzendorf

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

COMPLAINT REFERRED FOR HEARING:	September 1, 2006
NOTICE OF HEARING:	October 6, 2006
HEARING DATE:	October 31, 2006
RECORD CLOSED:	December 29, 2006
HEARD BY:	Mark Helmueller - Hearings Examiner Donna Chandler - Technical Examiner
PROPOSAL FOR DECISION ISSUED:	October 8, 2007

STATEMENT OF THE CASE

Woolsey Well Service, L.P. and J & C Operating Co. ("Woolsey") contend the drilling permits issued to Star of Texas Energy Services, Inc., ("Star") for the RSK-Star Lease, Well Nos. 5 and 6, Newark, E. (Barnett Shale) Field, Wise County, Texas, are invalid for failure to provide proper notice as required under Statewide Rule 37. Woolsey purchased 4 vertical wells from Star and received assignments of Star's working interests for the wells. Woolsey asserts the assignment agreement subdivided the base lease, thereby establishing boundary lines which trigger the notice requirements under Statewide Rule 37 for wells drilled within the minimum prescribed lease line spacing requirement for the field. Star urges that no boundary lines were created by the assignments.

FACTUAL SUMMARY

The RSK-Star Lease is an irregular shaped 264.91 acre unit in Wise County created by a farmout agreement of a 585.1 acre base lease. In July 2002, Star entered into an Exploration Agreement to drill wells to the Barnett Shale formation on the 264.91 acre unit. Under the terms of the Exploration Agreement, Star would earn 80 acres for each successful well.

Star drilled and completed 4 vertical wells in the Barnett Shale on the RSK-Star Lease, Well Nos. 1, 2, 3, & 4, thereby earning all of the acreage in the RSK-Star Lease identified in the Exploration Agreement. Each well was permitted on the 264.91 acre unit. Well No. 1 and Well No. 2 were permitted simultaneously on August 27, 2002. Well No. 3 was permitted on February 18, 2003. Well No. 4 was permitted on August 13, 2003. A copy of the plat submitted with the drilling permit application for Well No. 4 which depicts the four vertical wells drilled by Star and the acreage assigned to each well is attached for reference purposes as Attachment A to this proposal for decision.

On July 11, 2005, the Commission approved several changes to the field rules for the Newark, East (Barnett Shale) Field. Minimum lease line spacing requirements were retained at 330 feet, but the between well spacing requirement for wells on the same lease was eliminated. Optional 20 acre drilling units were allowed. Additionally, the requirement that operators file a plat depicting the acreage assigned to each proration unit on multiple well units was eliminated as long as the allocation formula for the field is suspended.

In September 2005, Star and Woolsey negotiated a sale of Star's working interests in 37 vertical wells completed in the Barnett Shale formation.¹ Included in this sale were the four vertical wells on the RSK-Star Lease. The four wells on the RSK-Star Lease were sold to Woolsey pursuant to individual assignment agreements. Each assignment agreement identifies the forty acres assigned to the well by reference to a metes and bounds description. The described acreage in each assignment is identical to the boundary identified for each forty acre proration unit shown on the plat submitted with the drilling permit application for Well No. 4.

Both parties agree that the sale of Star's working interest in Well Nos. 1, 2, 3, & 4 did not include all of Star's interests in the 264.91 acre RSK-Star Lease, as Star still owned an interest in 104.91 acres, because only 160 acres were assigned to four vertical wells. The parties acknowledge that they discussed the sale of the unassigned 104.91 acres on the unit, but that the sale did not include Star's interest in the unassigned acreage. The sale agreement is silent with respect to future development of the unassigned acreage.

¹ The parties agree that the sale was only for Star's working interest in the wells. Several working interest owners opted not to sell their interests to Woolsey.

On October 5, 2005, Woolsey filed Commission Form P-4s (Producer's Transportation Authority and Certificate of Compliance) to be recognized as the operator of Well Nos. 1, 2, 3, and 4, effective September 30, 2005. The Commission approved the P-4s on October 31, 2005.

Star filed an application for a permit to drill Well No. 5 as a vertical well on October 7, 2005 on the 264.91 acre RSK-Star Lease. The permit application and plat noted the nearest lease line was 350 feet to the north of the proposed well. The nearest well to Well No. 5 was identified as Well No. 1, at a distance of 1280 feet. The application also included a Form P-15 (Statement of Productivity of Acreage Assigned to Proration Units) identifying that each of the five wells were assigned 40 acres on the 264.91 acre unit. Consistent with the amended field rules, the plat only depicted the acreage assigned to Well No. 5, and did not depict the assignment of acreage to all five wells on the RSK-Star Lease. The drilling permit was granted administratively on October 7, 2005. A copy of the plat submitted with the permit application for Well No. 5 is included for reference purposes as Attachment B to this proposal for decision.

Well No. 5 was spudded on October 18, 2005. Surface casing was set October 19, 2005. Drilling operations were completed on November 11th, and the well was completed on December 5, 2005. The well first reported production in December 2005 and produced 251,983 MMCF through January 2007.

Star filed a drilling permit application for Well No. 6 on March 7, 2006 on the 264.91 acre RSK-Star Lease. A 20 acre drilling unit was identified on the plat submitted with the permit application. The permit application and plat noted the nearest lease line was 650 feet to the northeast from the proposed well location. Well No. 4 was identified as the nearest well on the lease, at a distance of 1150 feet. No other units were depicted on the plat. The permit application and plat did not identify the distance from the proposed well to the acres assigned to the nearest well operated by Woolsey on the unit. The application also includes a Form P-15 identifying the number of acres assigned to the six wells, but, again consistent with the field rules, the plat only identifies the acreage assigned Well No. 6. The drilling permit was granted administratively on March 8, 2006. Well No. 6 has been completed, but has remained shut-in. A copy of the plat submitted with the permit application for Well No. 6 is included for reference purposes as Attachment C to this proposal for decision.

WOOLSEY'S POSITION AND EVIDENCE

Woolsey argues Star's permits for both Well No. 5 and Well No. 6 were obtained without providing the required notice under Statewide Rule 37. Woolsey asserts both wells are too close to the boundary lines for the units it purchased from Star. Woolsey claims Well No. 5 and Well No. 6 are both approximately 50 feet from the boundary line created by the assignments based on GPS surveys. Woolsey further contends the accumulated displacement for both wells triggers the directional survey requirements under Statewide Rule 11.

Woolsey claims Star subdivided the 264.91 acre RSK-Star Lease and created property lines as defined by Statewide Rule 37 when Star conveyed the 4 wells and the associated acreage as part of the sales agreement. Woolsey argues the metes and bounds description in each assignment show that Star conveyed a property interest in the underlying lease.

Assuming that the assignment is a conveyance of each 40 acre tract, Woolsey then argues that this conveyance is similar to the property line recognized by the Commission for the purpose of Rule 37 notice when a tract in a pooled unit is only partially leased because the mineral interest is owned by several individuals. Woolsey urges that these “interior lease line” cases are no different than the subdivision created by Star’s assignment to Woolsey and should be treated in the same way for notice purposes under Rule 37.

Woolsey further argues that the notice requirement will not impose any additional burden on the Commission as the Commission relies on the operator to identify the parties entitled to notice. Additionally, Woolsey contends the requirement is equitable as the operators are only being asked to recognize the property lines they create.

Finally, Woolsey asserts that both Well No. 5 and Well No. 6 should be required to have directional surveys performed under Statewide Rule 11. The need to run a directional survey is contingent on the Commission’s recognition of the boundaries Woolsey claims were created by Star’s assignments.

STAR’S POSITION AND EVIDENCE

Star asserts the assignment agreements do not establish boundary lines for the purpose of Rule 37. Star claims it prepares a written assignment with a metes and bounds description to identify the acreage assigned to a well for all working interest owners. Star urges that this is not a subdivision of the mineral interests, but is merely a convenience for its investors to prevent any misunderstanding regarding each owner’s investment in a particular well and the percentage of ownership. Star contends that an assignment merely recognizes the existing proration unit and is not a conveyance which subdivides the underlying mineral interest. Star cites the following language in each assignment agreement to support this position:

Assignor’s right, title and interest in and to the oil, gas and mineral leases described in Exhibit “A”, together with all of ASSIGNOR’s property and rights incident thereto, but expressly subject **to the proration unit created by Assignor as more fully described in Exhibit “A”** (herein called the “Subject Leases”) (emphasis added)

Star further argues that Woolsey's understanding of the intent of the assignments has changed to conform with his complaint. Star believes Woolsey does not understand the distinction between a proration unit used to assign acreage to a well for the purpose of assigning an allowable, and the subdivision of a lease which creates a property line.

Star contends Commission policy allows an operator flexibility in establishing the acreage assigned to a well for drilling and production purposes, i.e., the "regulatory lease". The regulatory lease may adopt the same boundaries as the ground lease but it is not required to specify the same acreage or boundaries. The Commission does not review the ground lease to establish that it has the same boundary lines as the regulatory lease.

Finally, Star contends the proposed "Woolsey Rule" would recognize a new class of "affected persons" for the purposes of notice under Statewide Rule 37. Star argues that the Commission does not evaluate differences in working interest ownership when considering a drilling permit application if there is no subdivision in ownership of the underlying mineral estate. Star notes the Commission routinely grants drilling permits to more than one operator on a regulatory lease, a common result of a farmout agreement. Star believes additional burdens would be placed on operators permitting wells to ensure that proper notice was provided to a substantially larger list of affected parties. Star also believes there would be additional burdens imposed on Commission staff to review the list of working interest and leasehold interest owners provided by the operator to ensure the Commission issues proper notice of application. Finally, Star claims the new rule would bring into question the validity of permits for existing wells.

EXAMINERS' OPINION

Statewide Rule 37(a)(1) provides, in pertinent part:

[N]o well shall be drilled nearer than 467 feet to any **property line, lease line or subdivision line**; (emphasis added)

The central dispute in this case is whether the purchase and sale agreement of the four wells created property lines for the purpose of notice under Statewide Rule 37. Unfortunately, the agreement of the parties has no provision regarding Star and Woolsey's respective responsibilities and duties regarding further development of the 264.91 acre RSK-Star Unit including: re-entry into existing wells: the drilling of additional wells: and, the applicability of Statewide Rule 37 spacing requirements.²

² It is the examiners' opinion that the silence of the sales agreement with respect to further development was a significant oversight in light of the field rules in effect at the time the agreement was consummated. A total of 13 wells can be drilled on the acreage under twenty acre drilling units. Woolsey could drill an additional four wells on the acreage assigned to the four wells it bought from Star. Star could drill an additional five wells on the acreage that was not assigned to a well. Additionally, both operators could choose to re-enter the existing wells to drill new laterals.

The Subdivision Issue Requires Determination of a Disputed Contractual Provision.

The parties take conflicting positions on whether the sale subdivided the 264.91 acre RSK-Star unit for the purpose of Statewide Rule 37 lease line spacing requirements. Woolsey claims that the metes and bounds description of the acreage assigned to each of the wells is evidence that the assignment subdivided the unit. Woolsey relies on the language in the assignments which states that it received all of “Assignor’s right, title and interest in and to the oil, gas and mineral leases ... together with all of ASSIGNOR’s property and rights incident thereto.” Woolsey argues that a fixed property line was created by each assignment. Star therefore subdivided the property, triggering the notice requirements of Rule 37 for any wells drilled within the minimum prescribed lease line spacing of the new property lines.

Star looks at the same language and claims that the language making the assignment “expressly subject to the proration unit created by Assignor” supports its interpretation that the metes and bounds description is only meant to identify the acreage assigned to each well for proration purposes. Star argues that proration unit lines are not fixed lines for the purpose of notice requirements under Statewide Rule 37 and can be changed by the operator. Star therefore urges that the unit remains a 264.91 acre property and claims it was within its rights under the agreement to identify a 264.91 acre unit when permitting Well Nos. 5 and 6.

This dispute is further complicated by the changes in the field rules for the Newark, East (Barnett Shale) Field. The rules approved by the Commission eliminate the requirement for the designation of acreage on a plat filed with a Commission Form P-15. In other words, operators are no longer required to identify proration unit boundaries on multiple well leases.³ Star’s permit applications for Well No. 5 and Well No. 6 recognize this change, as neither permit contains a plat for the purpose of identifying the acreage assigned to each proration unit.

The question of whether the sale subdivided the unit or simply identified the acreage currently assigned to each of the wells for proration purposes requires resolution of a disputed issue in the sales agreement and assignments. The Commission cannot resolve such contractual disputes, especially where the agreement is silent on the critical issue of future development of the 264.91 acre RSK-Star Unit. The Commission does not have jurisdiction over contractual claims and cannot make an order determining property rights and contractual obligations between parties. See *Amarillo Oil Co. v. Energy-Agri Products, Inc.*, 794 S.W.2d 20, 26, (Tex. 1990). Where the parties disagree over the intent and impact of their agreement, the appropriate avenue to resolve the disagreement is in the appropriate District Court. Accordingly, no action should be taken with respect to the existing permits for Well Nos. 5 and 6. Additionally, no further wells should be

³The amended field rules for the Newark, East (Barnett Shale) Field recognize that as new wells are drilled, proration lines are constantly shifting, making the lines difficult to define on multiple well units. Accordingly, consistent with the request of the operators in the Newark, East (Barnett Shale) Field, the field rules eliminate the requirement to identify the boundary of any proration unit in multiple well units.

permitted on the RSK-Star Lease until the parties resolve their dispute over the interpretation of their agreement.

The Disputed Boundary Issue Is Not Analogous to An Internal Lease Line

The examiners note that the facts in this case are distinguished from the internal lease line spacing cases cited by Woolsey. The courts have historically recognized that Statewide Rule 37 protects adjacent landowners from drainage due to a well drilled in close proximity to the property line by requiring the operator seeking the permit to provide notice to the adjacent landowners:

The commission itself in Rule 37, except in prescribed emergencies or in case of waiver, has obviously construed the interested parties to include adjacent owners, by requiring that they be given notice where exceptions to the rule are applied for. Under the uncontroverted facts of this case, if the well on the 1½ acres involved be permitted to operate in such close proximity to appellant's lands, injury to those lands will directly result, drainage occur, and waste result. Thus the property rights of the adjacent landowner are immediately and directly affected. *Humble Oil & Refining Co. v. Railroad Commission*, 68 S.W.2d 622, 624-625 (Tex. Civ. App. - Austin 1934, *aff'd*, 83 S.W.2d 935 (Texas 1935).

Consistent with these decisions, the Commission requires notice of application for an exception to Statewide Rule 37 be provided to the lessee where all of the mineral interests are covered by leases. The Commission requires notice of an exception application be provided to unleased undivided mineral interest owners of tracts included in a pooled unit if the well is within the minimum lease line spacing distance to the tract with the unleased interest. This is commonly referred to as an "internal or interior lease line" spacing exception. In such cases, while there may be a lease covering the tract included in the pooled unit, the lease does not cover all of the mineral interest owners. For the leased portion, the operator has the responsibility of protecting the mineral interest owners under the duties expressly and impliedly defined by the contractual agreement.

An operator who includes a tract in a pooled unit with unleased, undivided mineral interests, is not charged with a contractual duty to protect the owners of the unleased undivided interests. Because no duty is created by a contract, the unleased mineral interest owner becomes the *only* affected person who can protect their property rights. Under such circumstances, consistent with the due process rights of the unleased mineral interest owner, the Commission requires the applicant to provide notice of an exception application if the well will be located within the minimum lease line spacing requirements from the unleased interests.

However, in this case, there are no unleased mineral interests which require due process protection through the Rule 37 notice provisions. Both Star and Woolsey's interests in the minerals in the RSK-Star Unit are derived from the same 585.1 acre base lease, regardless of how subsequent farmouts and development contracts later divvied up the mineral rights based on depth or earned acreage. This distinguishes the instant case from the Commission practice of requiring notice for

internal lease lines for unleased mineral interests.

CONCLUSION

The RSK-Star Lease Well Nos. 1, 2, 3, and 4 were permitted on a 264.91 acre unit as identified and recognized by the Commission. The parties do not agree that the unit was subdivided by the purchase and sale agreement. Because the interpretation of the agreement must be resolved in the District Court, the current 264.91 acre unit remains in force and effect for the existing wells, including Well Nos. 5 and 6. However, because the current Newark, East (Barnett Shale) Field rules would allow an additional 8 wells to be drilled on the RSK-Star Lease without obtaining a density exception, and there is no between well spacing requirement, the examiners do not believe any additional wells should be permitted on the RSK-Star Unit until either: 1) the parties arrive at an agreement concerning their respective rights and obligations for future development; or, 2) a final determination is made in the courts as to whether the agreement subdividing the unit, thereby establishing a property line for the purpose of Statewide Rule 37.

Based on the record in this Docket, the examiners recommend adoption of the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. Notice of Hearing was provided to the parties through their attorneys of record who attended the proceedings and presented evidence.
2. The RSK-Star Lease is an irregular shaped 264.91 acre unit in Wise County created by a farmout agreement of a 585.1 acre base lease.
3. In July 2002, Star of Texas Energy Services, Inc., (“Star”) entered into an Exploration Agreement to drill wells to the Barnett Shale formation on a 264.91 acre unit.
 - A. Under the terms of the Exploration Agreement, Star earned 80 acres for each successful well.
 - B. Star completed 4 vertical wells to the Barnett Shale on the RSK-Star Lease, Well Nos. 1, 2, 3, & 4, thereby earning all of the acreage in the RSK-Star Lease identified in the Exploration Agreement.
 - C. Each well was permitted on the 264.91 acre unit.
4. In September 2005, Star and Woolsey Well Service, L.P. and J & C Operating Co. (“Woolsey”) negotiated a sale of Star’s working interests in 37 vertical wells completed in the Barnett Shale formation. Included in this sale were the 4 vertical wells on the RSK-Star Lease.

5. Each well on the RSK-Star Lease sold to Woolsey was subject to its own assignment agreement.
6. Woolsey was recognized as the operator of the four RSK-Star Lease wells upon the Commission's approval of Commission Form P-4s (Producer's Transportation Authority and Certificate of Compliance) on October 31, 2005.
7. On July 11, 2005, the Commission approved amended field rules for the Newark, East (Barnett Shale) Field.
 - A. Minimum lease line spacing requirements were retained at 330 feet, but the between well spacing requirement for wells on the same lease was eliminated.
 - B. 320 acre units with optional 20 acre drilling units were allowed.
 - C. The requirement that operators file a plat depicting the acreage assigned for proration units on multiple well units was eliminated when the allocation formula for the field is suspended.
8. Star filed a Commission Form W-1 (Application for Permit to Drill, Recomplete or Re-Enter) to drill Well No. 5 as a vertical well on October 7, 2005.
 - A. Star identified the unit as containing 264.91 acres.
 - B. A forty acre drilling unit was identified on the plat submitted with the permit application.
 - C. The permit application and plat noted the nearest lease line was 350 feet to the north of the proposed well.
 - D. No notice of application was issued and the drilling permit was granted administratively on October 7, 2005.
9. Well No. 5 was spudded on October 18, 2005. Surface casing was set October 19, 2005. Drilling operations were completed on November 11th, and the well was completed on December 5, 2005. The well first reported production in December 2005 and produced 251,983 MMCF through January 2007.
10. Star filed a drilling permit application to drill Well No. 6 as a vertical well on March 7, 2006.

- A. Star identified the unit as containing 264.91 acres.
- B. A twenty acre drilling unit was identified on the plat submitted with the permit application.
- C. The permit application and plat noted the nearest lease line was 650 feet to the northeast of the proposed well.
- D. No notice of application was issued and the drilling permit was granted administratively on March 8, 2006.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred to give the Commission jurisdiction to decide this matter.
3. The Commission does not have jurisdiction over contractual claims and cannot make an order determining property rights and contractual obligations between parties. See *Amarillo Oil Co. v. Energy-Agri Products, Inc.*, 794 S.W.2d 20, 26, (Tex. 1990).
4. The Commission recognized the boundary of the 264.91 acre RSK-Star Lease identified by Star when it approved Star's drilling permit applications for Well Nos. 1, 2, 3, & 4.
5. The Commission is unable to ascertain whether the parties intended to establish property lines for the purpose of Statewide Rule 37 for further development on the 264.91 acre RSK-Star Lease as a result of their purchase and sale agreement.
6. Because the Commission is unable to determine whether the parties to the assignment agreements intended to subdivide the 264.91 RSK-Star Lease, the Commission cannot find that Star failed to provide notice to Woolsey as required by Statewide Rule 37 when it filed an application for a permit to drill Well No. 5.
7. Because the Commission is unable to determine whether the parties to the assignment agreements intended to subdivide the 264.91 RSK-Star Lease, the Commission cannot find that Star failed to provide notice to Woolsey as required by Statewide Rule 37 when it filed an application for a permit to drill Well No. 6.
8. Because the Commission is unable to determine whether the parties to the assignment agreements intended to subdivide the 264.91 acre RSK-Star Lease, no further drilling permits should be granted on the 264.91 acre RSK-Star Lease until the parties agree to a resolution of the dispute, or a court enters a final order adjudicating the issue.

9. No action should be taken with respect to the complaint filed in this matter.

RECOMMENDATION

The examiners recommend that no further drilling permits should be granted on the 264.91 acre RSK-Star Lease until the parties agree to a resolution of the dispute, or a court enters a final order adjudicating the issue. The examiners further recommend the Commission take no action with respect to the complaint filed in this matter.

Respectfully submitted,

Donna K. Chandler
Technical Examiner

Mark J. Helmueller
Hearings Examiner