

DAVIS OIL CO.

IBLA 80-847

Decided March 2, 1981

Appeal from the decision of the Geological Survey refusing to rescind the second revision of the Shannon "B" Sandstone Formation Participating Area within the Indian Creek II Unit.

Affirmed.

1. Geological Survey -- Oil and Gas Leases: Unit and Cooperative Agreements

A determination by the Geological Survey to include certain land within the participating area of a producing oil or gas well established pursuant to an approved unit agreement will not be set aside where it is not arbitrary or capricious and is supported by competent evidence, and the appellant has not demonstrated by a clear and definite showing that the determination was in error.

2. Oil and Gas Leases: Unit and Cooperative Agreements

When the Geological Survey determines that certain lands have been reasonably proven to be productive in paying quantities and approves a revision to a participating area to include those lands, later exclusion of the lands must be based on a finding that the lands did not contain unitized substances in paying quantities. Mechanical failure of a well on those lands and resulting failure to produce does not support exclusion.

APPEARANCES: Richard H. Bate, Esq., Schultz & Bate, Denver, Colorado, for appellant; G. E. Taylor, Esq., San Francisco, California, for Sohio Petroleum Co.; and William R. Murray, Jr., Esq., Office of the Solicitor, Department of the Interior, for the Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Davis Oil Company (Davis) has appealed the June 26, 1980, decision of the Acting Chief, Conservation Division, Geological Survey (Survey), affirming a decision of the Area Oil and Gas Supervisor for Casper, Wyoming, denying its application to rescind approval of the second revision of the Shannon "B" Sandstone Formation Participating Area. 1/

The second revision, approved on November 4, 1975, effective July 1, 1975, added the NW 1/4 sec. 32, T. 48 N., R. 78 W., sixth principal meridian, to the participating area. The lands were determined to be productive of unitized substances in paying quantities based on information on the operations of unit well No. 4. Unit well No. 4 was drilled by Webb Resources, Inc., 2/ and completed on July 3, 1975. It flowed at an initial daily rate of 337 barrels of oil, 113 Mcf of gas, and 0.7 barrels of water. In addition, Davis, the operator, had reported initially that:

The #4 unit well is predicted to ultimately recover 80,000 barrels of oil * * *. The current oil price is \$12.73 per barrel of oil and there is not sufficient gas production to merit a pipeline. The well will yield \$855,000 revenue to the working interest owners after royalty and severance taxes. Operating expenses and production taxes will total \$129,000. Net income to the working interest partners will be \$726,000. The investment of \$337,000 to drill and complete the well will pay out in 9 months and result in \$389,000 profit.

By January 1976, average production from the well had declined to 133 barrels of oil per day and the gas to oil ratio had declined to 121 SCF/bbl. Production continued declining to a low of 25 barrels of oil per day in October 1976 when production ceased because of damage to the well. Cumulative oil recovery totaled 48,419 barrels of oil.

In support of its application to rescind approval of the second revision Davis alleged that unit well No. 4 was not a paying well; that the addition of lands to the participating area was based on data obtained from the well; that the lands are not being drained by any other well; and that there are insufficient remaining recoverable oil reserves beneath the lands to warrant drilling a new well. In response to the Area Oil and Gas Supervisor's denial, Davis argued that when a determination is made that a well is a paying well prior to payout, and an expansion of a participating area is predicated on that

1/ The Shannon "B" Sandstone Formation Participating Area in the Indian Creek II Unit Area, Johnson County, Wyoming. Davis Oil Company is the unit operator.

2/ Sohio Petroleum Company is successor-in-interest to Webb Resources, Inc., as a result of a merger.

determination, then if the well does not pay out for any reason, the participating area must be revised to exclude the lands previously added on the basis of that well's expected production.

The Survey decision appealed herein concluded:

The issue at bar is whether the decision denying an application to rescind approval of the Second Revision * * * was correct. In 1975, the lands added by the Second Revision were determined to have been reasonably proven to be productive of unitized substances in paying quantities. Appellant has not shown that the 1975 determination was erroneous in any respect. While it appears that Unit Well No. 4 may not have paid out, the appellant has not demonstrated that this alleged failure occurred because the well ceased to have the capability to produce unitized substances in paying quantities through exhaustion of the resources. In fact, the record indicates that the most probable cause of the cessation of production was downhole mechanical problems. ^{1/} Accordingly, under the unit agreement, the lands must continue to be regarded as having been properly determined as reasonably proved to be productive of unitized substances in paying quantities.

The unit agreement expressly provides that "[N]o land shall be excluded from a participating area on account of depletion of the unitized substances * * *. It follows that, under the unit agreement, the partial depletion of lands such as that involved here does not afford a basis for the exclusion of such lands from the participating area.

Moreover, under the unit agreement, "[A] separate participating area shall be established for each separate pool or deposit of unitized substances or for any group thereof which is produced as a single pool or zone * * *. Unit agreement, page 9. (Emphasis added). At the time the Second Revised Participating Area was established, the lands included were being produced as a "single pool or zone," i.e., the same Shannon Formation Reservoir as the wells (Nos. 1 and 9) which contributed the information on which the Initial and First Revision of the Shannon "B" Sandstone Formation Participating Area were based. For this reason the Second Revised Participating Area was properly established once it was determined that the lands

^{1/} In this connection appellant alleges:

In the case of Well No. 4, it is not certain that the original determination that the well was paying was erroneous. There is a possibility that Well No. 4 did not pay out because it was damaged by repair work.

added had been reasonably proved to be productive of unitized substances in paying quantities from the same common source within the Shannon Formation. At this time, it is irrelevant that allegedly the lands added by such Revision are not being drained by any wells within the revised participating area, as under the unit agreement, such an absence of drainage is not a basis for the exclusion of lands from a duly constituted participating area.

Accordingly the Acting Chief, Conservation Division, determined that the record did not afford a ground for recession of the Second Revision of the participating area.

In its statement of reasons, Davis reiterates its argument made to the Acting Chief, Conservation Division, Survey. In support, Davis cites a portion of paragraph II of the Unit Agreement:

The participating area or areas so established shall be revised from time to time, subject to like approval, to include additional land then regarded as reasonably proved to be productive in paying quantities, or necessary for unit operations, or to exclude land then regarded as reasonably proved not to be productive in paying quantities and the schedule of allocation percentages shall be revised accordingly.

On the basis of this provision appellant asserts that the Unit Agreement

contemplates the continual re-assessment of the propriety of participation or non-participation of unit lands. The relevant decision is not the veracity of past determinations to include or not to include unit lands * * * but rather to evaluate the propriety of participation in light of new information, which "from time to time" may become available, a new determination as to the status of unit lands is to be made at that time, as the words "then regarded" indicate. It is only through this process of continual re-evaluation of the Participating Area that the equitable distribution of costs and benefits that is the heart of the success of unit plans of operation may be maintained.

Davis contends that the status of well No. 4 is important to the reassessment in this case because of the definition of paying quantities found in paragraph 9 of the unit agreement. 3/

3/ Paragraph 9 of the unit agreement defines paying quantities as "quantities sufficient to repay the costs of drilling, completing and producing operations, with a reasonable profit."

Davis further argues that the essential premise for establishing a participating area within a unit is that it will include only lands regarded as reasonably proven to be productive of unitized substances in paying quantities. Appellant adds that the determination of the appropriate boundaries of a participating area underlies fair and equitable treatment of the interest owners of the lands. Thus, appellant concludes that if the lands associated with well No. 4 are not excluded the interest owners of those lands will share in unit production without contributing to it. In summary, appellant contends that Survey's initial decision that lands are capable of production in paying quantities is not irreversible but rather must be viewed as subject to revision as actual operation of the well on the lands is evaluated.

Davis adds that if the Board agrees that the lands subject to the Second Revision should be excluded, then July 1, 1975, should be the effective date of the exclusion because well No. 4 did not produce sufficient oil to pay the costs of developing the well and therefore never contributed to net unit production.

Appellant has also asked to be allowed to present oral argument to support its appeal.

Both Survey and Sohio Petroleum Company (Sohio) have replied to appellant's statement of reasons. Survey argues that revision of a participating area is based on the condition of the lands involved not on the status of a well on the lands, and therefore the decision that the lands involved herein had been "reasonably proved productive in paying quantities" was not changed by the fact that well No. 4 did not pay out. Survey notes that paragraph II of the unit agreement also prohibits revision of a participating area based on "depletion of the unitized substances" except when all wells in the formation are abandoned. This provision "is designed to insure proper royalty allocation among all lands reasonably proved productive regardless of the development sequence." Survey contends that appellant's argument that the failure of the well to pay out and the fact that only limited quantities of unitized substance remain should result in exclusion of the lands is a depletion argument.

Survey also suggests that the real dispute over cost and benefit sharing is governed by the unit agreement, a contract solely between the interested parties. Survey concludes that Davis has made no clear showing of error in its approval of the second revision and therefore the Board should affirm the Acting Chief's decision.

In its response Sohio also points out the distinction between the decision that its lands had reasonably proved to be productive in paying quantities and the fact that well No. 4 did not pay out. Sohio argues that Davis' interpretation of the unit agreement, i.e., that the determination whether lands are reasonably proved to be productive in paying quantities is solely a function of whether the well has paid out, would have a chaotic effect on unitization and the benefits of unitization.

Sohio urges that the mechanical failure suffered by its well is distinctly different from a finding of a lack of producible commercial reserves in the area drained by the well.

In response to these replies appellant contends that the area/well distinction ignores the definition of "paying quantities" contained in the unit agreement; that its argument is not based on depletion but rather unanticipated cost increases; and that all royalty owners, overriding royalty owners and production payment owners, not just the private parties, have an economic stake in the allocation of the production from the unit.

[1] A determination by Survey to include certain land within the participating area of a producing oil and gas well, established pursuant to an approved unit agreement, will not be set aside where it is not arbitrary or capricious and is supported by competent evidence, and the appellant has not demonstrated by a clear and definite showing that the determination was in error. Margaret D. Okie, 43 IBLA 326 (1979).

We agree with Davis that the determination of the boundaries of a participating area is the key to the fair treatment of the interest owners but disagree with the basis they would use to determine those boundaries. As argued by Survey and Sohio, the relevant question in setting the boundaries of a participating area within a given unit is whether the lands are productive in paying quantities, not whether a certain well is producing.

A portion of the Acting Chief's decision bears repeating:

At the time the Second Revised Participating Area was established, the lands included were being produced as a "single pool or zone," i.e., the same Shannon Formation Reservoir as the wells (Nos. 1 and 9) which contributed the information on which the Initial and First Revision of the Shannon "B" Sandstone Formation Participating Area were based. For this reason the Second Revised Participating Area was properly established once it was determined that the lands added had been reasonably proved to be productive of unitized substances in paying quantities from the same common source within the Shannon Formation. [Emphasis added.]

The purposes for establishing a participating area within a unit are to insure that each interest owner of lands covering a single producible pool will receive the benefits of its fair share of production from the pool and to promote the efficient production of unitized substances. The issue of how much of the unitized substances is produced by any one well in the participating area is not the key to determining the boundaries of a participating area. Rather, the key is whether it has been reasonably proven that lands included in a participating area contain unitized substances sufficient such that the lands would be productive

in paying quantities if a well were drilled and placed in operation on that land. While information from the drilling and producing operations of a well by definition are used to gauge whether unitized substances exist in paying quantities so as to support inclusion of lands in a participating area, once the determination is made that those quantities do exist, if the same well never produced, that fact would not be grounds for later exclusion of the lands. Exclusion can only be based on a finding that the lands did not contain sufficient unitized substances as originally determined. Davis has not provided such a showing of error in the original revision herein.

Whether well No. 4 itself would pay out was a risk assumed when the decision to drill was made. Once the decision was made to include the NW 1/4 sec. 32, T. 48 N., R. 78 W., sixth principal meridian, in the Shannon "B" Formation Participating Area, the allocation of the costs and benefits of operations within the area were governed by the unit agreement. The mechanical failure of well No. 4 did not change the allocated interests in production from the area.

It is the Board's opinion that the extensive statement of reasons for appeal submitted by Davis has adequately presented its arguments and that holding oral argument would serve no useful purpose. Davis' request for oral argument is denied.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Douglas E. Henriques
Administrative Judge

We concur:

Bernard V. Parrette
Chief Administrative Judge

Anne Poindexter Lewis
Administrative Judge

