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S. H. Bennion v. Gulf Oil Corporation, A Pennsylvania Corporation and the Utah State Board of Oil, Gas And Mining, An Agency of the State of Utah : Brief of Appellant

IN THE SUPREME COURT

OF THE STATE OF UTAH

S. H. BENNION, Plaintiff and Appellant, v. GULF OIL CORPORATION, a Pennsylvania corporation and the UTAH STATE BOARD OF OIL, GAS AND MINING, an Agency of the State of Utah, Defendants and Respondents.	: : : : : : : : :	Case No. 19144

BRIEF OF APPELLANT

Appeal From a Judgment of the Third Judicial

District Court in and for Salt Lake County

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BRIEF OF APPELLANT

STATEMENT OF THE NATURE OF THE CASE

The action is an appeal by plaintiff, S. H. Bennion (hereinafter "Bennion") from an Order of the Utah State Board of Oil, Gas and Mining (hereinafter "Board") which, despite an existing production well, redesignated a test well drilled by defendant Gulf Oil Corporation (hereinafter "Gulf") as the production well for the same production unit and again assessed the costs of the second well to the unit's interest owners.

DISPOSITION BELOW

The Court below denied Bennion's Motion for Summary Judgment and granted Gulf's Motion for Summary Judgment finding that the Board had proceeded and acted within its authority.

RELIEF SOUGHT ON APPEAL

Bennion seeks to have the lower Court's Summary Judgment in favor of Gulf reversed and that Summary Judgment be granted in favor of Bennion on the grounds that the lower Court erred as a matter of law in affirming the Board's decision.

STATEMENT OF FACTS

Section 40-6-6(a), (b) and (c) of the Utah Oil and Gas Conservation Act, Utah Code Ann. (1953) § 40-6-1, et seq., provide that the Board "(a) . . . shall have the power to establish drilling units covering any pool. . ., (b) . . . the acreage and shape of which . . . shall not be smaller nor greater than the maximum area that can be efficiently and economically drained by one well, [and] (c) . . . no more than one well shall be drilled for production from the common source of supply or any unit. . . ." (Emphasis added)

Pursuant to this Section the Board in September, 1972, by Order in Cause No. 139-8 (R. pp. 149-153) established numerous oil and gas drilling units, one of which corresponds to Section 8 of Township 3 South, Range 5, West, Uintah Special Meridian, Duchesne County, Utah, the particular drilling unit concerned in this case.

The Order in accordance with the Act, further provided:

> "that no more than one well shall be drilled on any such unit for the production of oil, gas, and associated hydrocarbons from the common source of supply . . ." (R. p. 152)

Gulf subsequently drilled the Albert Smith 1-8C5 well which was designated the production well for the Section 8 drilling unit.

The Section 8 drilling unit covers an area in which there are several owners, one of which is Bennion. These owners are statutorily entitled to their "correlative rights" or a share in the underground reservoir of oil and gas. (Utah Code Ann. § 40-6-4(e)(g) and (j)). The Conservation Act provides that the owners' share of the advanced costs of drilling and producing the unit well may be recouped from the interest owners' shares of production. Once the costs are recouped the well is termed "paid out." As one of the owners, Bennion's share of the production of the well was retained by Gulf until such time that the costs of drilling, completing and equipping the well had been recouped by Gulf. The well has been paid out for several years.

On or about August 25, 1980, Gulf received from a petroleum engineer of the Division of Oil, Gas and Mining (to be distinguished from the Board), without notice and hearing, approval to drill a second well, the Albert Smith 2-8C5 well, in the same drilling unit. The well was to be drilled as a test well. (R. pp. 180, 195.)

Learning of the drilling of the second well in the unit, Bennion petitioned the Board to enjoin further drilling of the second well and for a determination that he not be obligated to pay the costs of the second well. The petition was based on the legal propriety of the drilling of the second well in the same unit. (R. p. 155.)

Pursuant to the petition, the Board determined that the drilling of the second well as a test well was authorized and that, as a test well, Bennion was not required to pay the costs of the well. However, the Board added that should the well someday be designated the unit production well Bennion would be liable for his share of the costs of the second well. (See Order in Cause No. 139-20, R. pp. 159-161.)

Gulf expended approximately $1,470,000.00 to drill and complete the second "test" well. (R. pp. 139-142.) Gulf subsequently, without notice and hearing or order allowing, "shut in" the first well, i.e., stopped operation and production, and applied to have the second well designated the unit production well. (R. pp. 180-181.)

A hearing was held by the Board on April 30, 1981 concerning Gulf's application. (Transcript R. pp. 184-237.) At the hearing the only relevant evidence introduced in regards to Section 8 and the wells therein was that (1) the second well was drilled as a test well (R. p. 195), (2) the first commercial perforation in the second well occurred on January 26, 1981, on

which day the well produced 833 barrels of oil and zero water (R. p. 236), (3) the test well produced 512 barrels of oil, zero barrels of water, and 656 mcf of gas in a 24-hour test on February 5, 1981 (R. p. 196), and (4) the first well was shut-in on March 10, 1981 and was producing at that time 18-20 barrels of oil and 280 barrels of water per day (R. pp. 196-197). All other evidence concerned other issues and wells. There was no evidence of the size of the reservoir, foreseeable length of production, productive trend of the second well, or any other factor regarding the recovery of oil from Section 8 or the consequential economic impact on all the interest owners in the unit.

After the April 30th hearing the production of the second well steadily decreased until the well was producing no more and usually considerably less than the production from the first well when shut-in. (Compare 1980 and 1981 annual reports of the first well (R. pp. 167, 168) with the second well's 1981 annual report (R. p. 169) and the 1982 monthly reports (R. pp. 170-178). This fact was evident before the Board ruled.

Despite a decrease in production of the test well, the Board by Amended Order in Cause No. 139-20(B), dated the 22nd day of October, 1981, found that Gulf had shut-in the first well, designated the second well as the unit production well and required Bennion to pay Gulf his share of the costs of drilling the second well and the costs of producing the second well during

the testing period, which costs could be recouped from Bennion's share of production and account. (R. pp. 162-165.)

Bennion appealed the Board's Order to the Third Judicial District Court. Despite the fact that the second well's production had quickly dropped to less than the production from the first well at the time it was shut-in, the District Court by cursory Memorandum Opinion (R. p. 143-145) and Summary Judgment (R. p. 238-239) found the Board to have acted within its authority. From that Judgment and Opinion, Bennion now appeals maintaining that the trial court erred as a matter of law and prior order in finding that the Board had lawfully designated the second well for production and assessing the costs of the second well to interest owners.

ARGUMENT

POINT I

THE ORDER OF THE BOARD VIOLATES THE MANDATE OF THE OIL AND GAS CONSERVATION ACT AND PRIOR ORDER.

The establishment of drilling units as provided in § 40-6-6 of the Conservation Act is "(a) [t]o prevent waste of oil or gas, to avoid the drilling of unnecessary wells, or to protect correlative rights, . . ."

The mandate of subpart (b) is that after notice and hearing for the purpose of establishing a drilling unit, the size and shape of the unit shall not be "smaller nor greater than the maximum area that can be efficiently and economically drained by

one well." (Emphasis added.) That determination is to be made from the evidence presented at hearing.

The mandate of the Act to the Board is to determine what size of unit can bear and justify the costs of drilling one well. Obviously though one well might not drain completely the reservoir below the unit, the order establishing the drilling unit is to avoid the drilling of a second well which in view of its cost is not economical nor efficient even though it might allow some speculative additional recovery of oil or gas.

Pursuant to this statutory mandate the Board, after notice and hearing on September 20, 1972, entered an Order in Cause No. 139-8 (R. pp. 149-253) which established Section 8 as a drilling unit. After having taken evidence and "after further drilling and development operations and the information and data obtained therefrom, both within and beyond the presently defined boundaries" (R. p. 150), the Board determined that:

> One well on a governmental section consisting of 640 acres, more or less, will efficiently and economically drain the recoverable oil, gas and associated hydrocarbons from the foresaid common source of supply underlying the lands described in paragraph 4(b) above, and that a governmental section drilling unit is not larger than the maximum area that can be efficiently and economically drained by one well. (R. p. 152.)

Pursuant to that finding the Board ordered:

> That no more than one well shall be drilled on any such unit for the production of oil, gas and associated hydrocarbons from the common source of supply . . . . (R. p. 152.)

There has been no contrary finding by the Board in regards to Section 8. The Board at the hearing on April 30, 1981 and the Order in Case No. 139-20(B) does not consider any economic or efficiency factors to allow shut-in of the first well and production of the second well. The only finding by the Board is that the first well was at the point of marginal recovery which means that within a few months of the April hearing and at the time the Order was entered, the second well was at a point of less than marginal recovery. The Board has utterly failed to give reason or to consider factors as to why the finding in Order No. 139-8 that one well would efficiently and economically drain the 640 acres should be now disregarded to allow production by a second well at the further expense of owners.

Subsection (d) of § 40-6-6 addresses the circumstances in which the drilling of a second well for production in the same drilling unit might be justified. The subsection states:

> (d) An order establishing drilling units for a pool shall cover all lands determined by the board to be underlaid by such pool, and may be modified by the board from time to time to include additional areas determined to be underlaid by such pool. When found necessary for the prevention of waste, or to avoid the drilling of unnecessary wells, or to protect correlative rights, an order establishing drilling units in a pool may be modified by the board to increase the size of drilling units in the pool or any zone thereof, to decrease the size of drilling units or to permit the drilling of additional wells on a reasonably uniform plan in the pool, or any zone thereof.

The Board's implied justification of designating the second well for production is a supposed mandate to maximize recovery of oil and gas (R. p. 163), apparently at any cost. In such a case, as noted in the above cited subsection, the proper procedure would be to modify the unit drilling order to decrease the size of drilling units where it is shown that a second well will more economically and efficiently drain the field. (See § 40-6-6(b)).

In this case there has been no attempt to show that the Unit Drilling Order should be modified. Instead the Board has allowed Gulf to proceed by a backdoor to allow the production of the second well and assess its costs without going through the protective measures of modifying the Unit Drilling Order. This backdoor approach, in contrast to what would be necessary to modify the Unit Drilling Order, does not require the consideration of the owner's economic concerns, and does not require the amount of extensive evidence, data and information that was initially invested in and would be necessary to modify the original Unit Drilling Order.

Interestingly, the procedural propriety of modification of the Unit Drilling Order was recognized in the Board's Order No. 139-20 (R. pp. 154-161) which justified the drilling of the second well as a test well. At page 4 of Order No. 139-20 (R. p. 157), the Board refers to previous approval of test wells. Shell Oil had been permitted to drill two test wells in the drilling

unit "on the basis of experimental 320 acre spacing." After testing over a period of time, it was determined that the area was being drained by the original wells and that further wells were not economical. Thus the original 640 acre unit was found proper for the particular area. Thus, the test wells were drilled in order to provide evidence for modifying the Unit Drilling Order. This same justification was used by the Board in this case to allow the drilling of the second well as a test well. If in fact there is sufficient evidence from the test that a second well will economically and efficiently drain the field, then the Unit Drilling Order should be modified, not the Unit Drilling Order violated.

The defendants should not now be allowed to simply shut-in the first well and designate the second well for production. This procedure would bypass the protective procedures and economic and efficiency factors required by the Act. The bottom line is that regardless whether the second well produces for the moment more oil than the production well, it has not been determined whether it is productive enough to economically justify imposing an additional 1.4 million dollars of cost upon the backs of the interest owners in the unit.[1] If it is, then the Unit

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[1]Gulf, of course, after investing 1.4 million dollars in the well, has a profound interest in establishing it as the production well, regardless of how long or in what amount it can produce, in order that it recoup as much of its costs as it can. It is for this reason that the Board must take substantial evidence before it changes the original Unit Order, and must protect the interests of the other unit owners

Drilling Order should be modified, after substantial geologic evidence has been presented, so that correlative rights are protected. These issues have simply not been addressed by the Board as is evident in Order No. 139-20(B).

In this case two wells have now been drilled for production in violation of § 40-6-6 and Order in Cause No. 139-8. Until proper procedures for modification of the drilling unit are followed and protection of interests allowed, the second well should be found to be producing in violation of Utah law and prior Board Order.

POINT II

THE PURPOSE AND INTENT OF THE OIL AND GAS CONSERVATION ACT AND PRIOR ORDER OF THE BOARD IS THAT THE OWNERS SHOULD BE LIABLE FOR ONLY ONE SET OF COSTS.

As noted, drilling units are established on the criteria of what amount of area can most economically and efficiently be drained by one well. A reading of Order No. 139-8 reveals that much evidence, data and information was considered in the resulting 640 acre spacing.

Subparts (f) and (g) of § 40-6-6 consider in detail the liability and sharing of costs of a well by the owners. The consideration of costs of drilling and completing a well are always mentioned in reference to "a" or "the" well in the singular. That single well would, of course, be the one unit well drilled for production.

Subpart (d) of § 40-6-6 allows the modification of drilling units so that spacing might be increased or decreased in

size when necessary to prevent waste, avoid the drilling of unnecessary wells and protect correlative rights.

This method of modifying units protects the owners who must eventually shoulder the costs of producing wells. The procedure of modification requires evaluation of all aspects, both regarding the recovery of oil and the economics of the recovery. By properly finding justification for unit modification the Board essentially approves the drilling of another well in the previously larger unit, but has also found that the foreseeable production will justify the costs of the drilling and completing of the second well. In this manner the owners are protected from the financial burden of drilling unnecessary, uneconomical or speculative wells.

It would obviously not be economical to drill a well, the cost of which will not be recovered from production. This economic burden is doubled when a paid-out producing well, which provides a certain, even though small, return to owners, is shut-in as in the case at hand. The cost of drilling and completing the second well would need be again recovered and such possibility of recovery is unaddressed by the Board and completely speculative. The required procedure of modification of a Unit Drilling Order would prevent this inequitable result.

Pursuant to Order in Cause No. 139-20(B) Bennion and others have been required to bear the risks of Gulf's drilling of the second well and have lost the assured return from the now

shut-in first production well. The owners are now liable for two sets of costs, one set for each well, even though the intent and purpose of the Act and prior order is that owners should be liable for only one set of costs for one well per unit. That limitation of liability is the very purpose of establishing a drilling unit. §§ 40-6-4(i) and 40-6-6(a), (b) and (c).

Gulf's drilling of the second well as a test well did not provide sufficient evidence or justification for modification of the Unit Drilling Order. Just as the Shell Oil wells, as mentioned in the Board's Order in Cause No. 139-20, the well should be shut in. Gulf should not now after having voluntarily run the risk be allowed to have the well designated the unit production well so as to regain the burdensome costs of its venture at the expense of owners.

The burden that the Boards' Order places on the owners demonstrates the need and very purposes of the establishment of drilling units. In the case of modification of the unit the owner is not subject to duplicative cost since all the costs of each one well on each unit has been justified. In this case if modification of the unit had been sought and approved, the owners would still be receiving their return on the paid out first well and there would have been a finding that the Drilling Unit Order should be modified so as to allow the second well to be a producing well for another smaller unit. In that case the owners' rights would be protected. In this case they are not.

POINT III

THE ORDER OF THE BOARD ALLOWING COMPLETE RECOUPMENT OF COSTS OF DRILLING AND COMPLETING THE 2-8C5 WELL IS IN VIOLATION OF THE POLICY OF THE CONSERVATION ACT AND INEQUITABLE.

The declaration of public interest of which the Conservation Act seeks to protect, § 40-6-1, states that one purpose of the Act is "to authorize and to provide for the operations and development of oil and gas properties in such manner . . . that the correlative rights of all owners be fully protected."

The Conservation Act permits the Board to issue a pooling order which shall make provision for the drilling and operation of a well and for the payment of the costs of the same, including a reasonable charge for supervision and storage facilities. § 40-6-6(f). The owner's share of cost, as previously noted, may be recouped from the owner's share of production. These amounts on the first well have already been recouped and the well is "paid out." Gulf now seeks to drill a second well, designate it the production well, and reassess the costs of drilling and equipment to the owners. Allowing such assessment does not allow "adjustment among the owners of the unit area of their respective investment in wells [equipment] and other things and services of value attributable to the unit operations" as would be required of the division in providing for the unit operation of a pool, § 40-6-17(d). The assessment of Order in Cause No. 139-20(B) does not even credit the owner with the value of salvageable equipment

from the first well. The Order therefore does not protect the correlative rights of owners but instead allows Gulf to drill at the expense of owners.

Furthermore, the drilling and equipping of the test well was not attributable to a well drilled for production under the findings of the Board and assertions of Gulf. The costs are those of a test well. In such a case then the owners should not be required to pay for the drilling and equipping of two wells but only for the drilling of a well drilled for production and the operation of a production well. If Gulf desires and gets approval to drill another well and then later designates it for production, Gulf should carry the burden of the costs of its secondary drilling. Only the costs of operation after designation should be born by the owners who have already born the burden of bringing a producing well to a paid-out status. Section 40-6-6(g) allows recoupment of drilling costs "if not already drilled, ..."

In this case Gulf and the Board construe the second well to have been drilled as a "test" well, not as a producing well. Then upon request of designation, Gulf seeks to construe the well to be a production well of which the costs of drilling and equipping are allocable to owners. If the well is in fact not to be considered a well drilled for production and therefore not drilled in violation of the Act and Unit Drilling Order, then the well should be considered already "drilled" and equipped under §

40-6-6(g) for which Gulf cannot obtain recoupment of costs. In this case Gulf seeks to have the drilling labelled "not for production" in order that its drilling not be in violation of the Unit Drilling Order, and yet retroactively considered drilled "for production" in order to recoup the costs of drilling and equipment. To allow both is incongruous and does not protect the rights of the owners. If complete recoupment is permitted, Gulf has the best of both worlds at the expense of owners. With the simple approval of a petroleum engineer, Gulf can repeatedly drill "test" wells and, if they happen to spurt momentarily more oil than the original production well, Gulf can, without any approval, shut in the first well, designate the second for production, and assess the costs to owners.

In all fairness, the owners should need only pay once for the drilling, completion and equipping of a single unit production well and then bear the burden of continued operation, even though the operator may wish to designate other wells as the producing wells.

If Gulf is to be allowed to recoup the costs of drilling and equipping twice, then the second well should be considered to have been drilled for production and obviously in violation of the Unit Drilling Order and § 40-6-6.

CONCLUSION

The designation of the test well for production very simply means there have been two wells drilled for production in

the Section 8 Drilling Unit. And even if, as will be contended, only one has been producing at the same time, there have been two wells drilled and two sets of costs assessed to owners. The Board's Order allowing such redesignation and assessment of costs and the lower court's determination that the Board was so authorized to act are wrong as a matter of law for the reasons that:

(1) The procedures and result violate the specific mandates of the Oil and Gas Conservation Act which requires notice and hearing regarding modification of a drilling unit and permit only one well to be drilled for production per drilling unit,

(2) The result imposes the unlawful economic burden on owners of being deprived of the income, however small, from the paid-out production well and duplicative assessment of costs of drilling and equipping a second well for production, and

(3) The result violates the intent, policy and equity embodied in the Act which seeks to protect the rights of all interested parties and limit exposure to the economic burdens in the speculative business of oil and gas drilling.

DATED this 27th day June, 1983.

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