RAILROAD COMMISSION OF TEXAS

OFFICE OF GENERAL COUNSEL

September 25, 2007

OIL AND GAS DOCKET NO. 05-0251069

APPLICATION OF WORTHAM OIL & GAS TO SUPERCEDE THE PROVISIONS OF THE FINAL ORDER IN OIL & GAS DOCKET NO. 05-0211978 ISSUED APRIL 14, 1998 REQUIRING THE PLUGGING OF THE GARDNER LEASE, WELL NO. 1, RED OAK, SOUTH (SUBCLARKSVILLE) FIELD, LEON COUNTY, TEXAS.

APPEARANCES:

FOR APPLICANT:	**APPLICANT:**
Paul Burns, President	Wortham Oil & gas
Sharon Feess, Vice-President, Treasurer	"

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR ACTION:	March 20, 2007
NOTICE OF HEARING:	March 23, 2007
DATE CASE HEARD:	April 20, 2007
HEARING RE-OPENED:	July 31, 2007
DATE HEARING CLOSED:	August 7, 2007
HEARD BY:	Marshall Enquist, Hearings Examiner
PFD CIRCULATION DATE:	September 25, 2007

STATEMENT OF THE CASE

This Hearing was set to consider the request of Wortham Oil & Gas (hereinafter "Wortham") to supercede the Final Order signed April 14, 1998 and issued April 15, 1998 in Docket No. 05-0211978 requiring plugging of Well No. 1 on the Gardner (03207) Lease, Red Oak (SubClarksville 6060) Field (hereinafter "subject well"), and to recognize Wortham as the operator of record. Wortham asserts that it can restore the well to production and therefore the well should not be plugged.

SUMMARY OF EVIDENCE

The examiner took official notice of the Final Order in Oil & Gas Docket No. 05-0211978, Commission records related to Wortham's most recent Commission Form P-5 (Organization Report)

filing on December 6, 2006, and Commission records identifying the wells for which Wortham is currently recognized as the operator.

The current Commission recognized operator of the subject lease, Texas Southern Resources, Inc. (hereinafter "TSR"), submitted a Commission Form P-4 (Producer's Transportation Authority and Certificate of Compliance), for the subject lease effective December 31, 1993. In Oil & Gas Docket No. 05-0211978, by Final Order issued April 15, 1998, TSR was ordered to plug numerous wells on numerous leases, including Well No. 1 on the Gardner (03207) Lease, and pay a combined administrative penalty of $23,200.00. TSR has not complied with the terms of the Final Order.

The applicant in this case made an earlier attempt to take over the subject lease by single signature P-4 transfer received by the Commission on September 15, 2006. All requisites for a single-signature transfer were met and by December 13, 2006, this examiner approved the P-4 transfer. At this point, the plug hold on the well was found to be due to the pre-existing plug-only order, meaning that a superceding order was necessary. On March 20, 2007, applicant requested a hearing to supercede the order in Docket No. 05-0211978.

Wortham has submitted a single-signature Form P-4 to designate itself as the operator of the subject lease and has stated that it has no officers in common with TSR or any connection to TSR. TSR received notice of this hearing at its P-5 Organization Report address, but did not appear in protest. The superceding order sought by Wortham would be effective only as to transferring the ownership of the subject well and removing the plug-only requirement. The Final Order in Oil & Gas Docket No. 05-0211978 would remain in effect as to the assessment of administrative penalties and as to the order to plug wells not at issue in this docket.

Wortham has posted financial assurance with the Commission in the form of a $25,000 Letter of Credit and currently operates 7 wells. Paul Burns, President of Wortham, appeared at the hearing and presented evidence in support of the application. Wortham bases its good faith claim to operate the Gardner Lease on the assignment to it of a 75% net revenue interest in three leases taken by N. Michael Hornsby. Wortham was allowed to late-file documents further supporting its good faith claim to operate the Gardner Lease. Those documents were received July 23, 2007 and the hearing was re-opened July 31, 2007 for admission of the late-filed exhibits. Most prominent among the late-filed exhibits is an affidavit filed by Paul Burns indicating Wortham's continued reliance on the force majeure clauses of its assigned leases to keep them in effect.

As evidence that waste would be prevented by allowing Wortham to produce the applied-for well, Wortham notes that the well casing has 1,000 pounds of pressure on it and that on cracking the valve, the well unloaded high-gravity oil or condensate. Based on the amount of production from wells it operates nearby, Wortham believes the subject well may be able to produce between twelve to twenty barrels of oil a day.

AUTHORITY

Texas Natural Resources Code §85.049(a) provides:

> On a verified complaint of any person interested in the subject matter that waste of oil or gas is taking place in this state or is reasonably imminent, or on its own initiative, the commission after proper notice, may hold a hearing to determine whether or not waste is taking place or is reasonably imminent and if any rule or order should be adopted or if any other action should be taken to correct, prevent or lessen the waste.

Texas Natural Resources Code §89.041 establishes the affirmative statutory responsibility of the Commission concerning abandoned wells:

> If it comes to the attention of the commission that a well has been abandoned or is not being operated is causing or is likely to cause pollution of fresh water above or below the ground or if gas or oil is escaping from the well, the commission may determine at a hearing, after due notice, whether or not the well was properly plugged as provided in Section 89.011 or Section 89.012 of this code.

Texas Natural Resources Code §89.042(a) provides:

> If the commission finds that the well was not properly plugged, it shall order the operator to plug the well according to the rules of the commission in effect at the time the order is issued.

Texas Natural Resources Code §91.107 requires that an operator have, on file with the Commission, financial assurance in the form of a bond, letter of credit or cash deposit in the amount necessary for both existing wells operated and any wells being transferred, prior to Commission approval of the transfer.

Under Statewide Rule 14, the Commission may require a person seeking to be recognized as the operator of a well to provide evidence of a good faith claim of a continuing right to operate.

Final Orders in Commission Enforcement Proceedings generally require an operator to plug a well for a violation of Statewide Rule 14(b)(2) if there is no reported production from the well (or injection for injection and disposal wells) in the past 48 months. These "plug-only" orders reflect the Commission policy, that in cases where a well is in violation of Commission rules and has not reported any production or injection activity for a lengthy period of time, that the Commission will require that the well be plugged.

To support these "plug-only" orders, a Finding of Fact identifies when the well or lease last

reported any production or injection activity. An additional finding of fact addresses the statutory requirement in Texas Natural Resources Code §89.041, by finding that the unplugged well is causing or is likely to cause pollution of fresh water above or below the ground.

A "plug-only" order falls under the Commission's authority in Texas Natural Resources Code §89.042. Further, the courts recognize that a Commission order to plug a well "is entitled to the same weight and finality as an order granting or refusing a permit to drill a well." *Wrather Petroleum Corporation v. Railroad Commission*, 230 S.W.2d 388, 390 (Tex.App. - Austin 1950, *reh'g denied*) citing *Railroad Commission of Texas v. Gulf Production Co.*, 132 S.W.2d 254, 256, (Tex. 1939). Finally, the findings of fact are not "technical prerequisites" but satisfy a "substantial statutory purpose." *Morgan Drive Away, Inc. v. Railroad Commission*, 498 S.W.2d 147, 150 (Tex.1973); *Railroad Commission of Texas v. R. J. Palmer*, 586 S.W.2d 934 (Tex.App. - Austin1979, *no writ*).

EXAMINER'S OPINION

Wortham asserts that it can meet the requirements to be recognized as the operator of the subject lease and restore the well to active production. However, this claim is complicated by the Final Order requiring that TSR plug the well. An order superceding a Commission Final Order may be warranted if the operator shows: 1) that it has a good faith claim of a continuing right to operate the well or lease; 2) that it has met the financial assurance requirements of Texas Natural Resources Code §91.107; and 3) that a superceding order is necessary to prevent waste. Additionally, the prospective operator is asked the basis of the belief that the well is capable of production, and whether or not the prospective operator has officers in common with the prior operator or any other connection with the prior operator.

The first two factors apply to all transfers of inactive wells, not just cases where a well is ordered to be plugged. Any operator seeking to acquire an existing well which has been inactive for more than 12 months must show that it has a good faith claim of a continuing right to operate the well upon demand by the Commission. This requirement is found in Statewide Rule 14(b)(2). Additionally, the operator must show that it has met the requirements of Texas Natural Resources Code §91.107 which preclude the Commission from approving the requested transfer of an existing well to a new operator unless the new operator has filed financial assurance with the Commission in the form of a bond, letter of credit or cash deposit.

In this case, the good faith claim of a right to operate the subject lease and well is not based on the entire assignment of a lease, but an assignment of 75% of the net revenue interest in three leases. The lease dates are, respectively, December 26, 2005 (A.M. Easterling and wife Peggy); January 30, 2006 (Freddie S. Gardner French) and January 28, 2006 (James Porter Gardner and wife Mary). Each lease is for a primary term of one (1) year. The assignment of interest took place on October 26, 2006. Absent an event maintaining the validity of the leases, they each expired in one year, in this case no later than January 30, 2007. Thus, it is possible that the leases expired prior to the hearing, held April 20, 2007 and even prior to the request for a hearing, made March 20, 2007.

At hearing, applicant was informed by the examiner that the leases appeared to have expired. Wortham stated that it believed the leases were still valid. In an affidavit filed with the Commission on July 23, 2007, Paul Burns, President of Wortham, stated his belief that the three leases were still in force and effect due to Paragraph 11 of each lease, which states:

> 11. If, while this lease is in force, at, or after the expiration of the primary term hereof, it is not being continued in force by reason of the shut-in well provisions of Paragraph 3 hereof, and Lessee is not conducting operations on said land by reason of (1) any law, order, rule or regulation (whether or not subsequently determined to be invalid) or (2) any other cause, whether similar or dissimilar (except financial) beyond the reasonable control of the lessee, the primary term hereof shall be extended until the first anniversary date hereof occurring ninety (90) or more days following the removal of such delaying cause, and this lease may be extended thereafter by operations as if such delay had not occurred.

This is a typical *force majeure* clause, commonly found in oil and gas leases. Wortham relies on Paragraph 11(1) for the argument that an order of the Commission has prevented Wortham from complying with the provisions of its leases.

The quoted paragraph is in each of the three leases and each lease was taken by N. Michael Hornsby, former President of TSR, the company ordered to plug the subject well. The assignment of the three leases from Hornsby to Wortham purports to convey "all assignor's right, title and interest in and to those certain oil, gas and mineral leases as described...", but actually retains a substantial interest to Hornsby under the guise of an overriding royalty.

> "Save and except from the above, assignor reserves unto themselves, their heirs, successors and assigns an overriding royalty equal to the difference between existing lease burdens and twenty-five percent (25.00%) of all oil, gas, casing head gas, and other hydrocarbons produced, saved, and sold from the lands covered by said leases, free of all costs to assignor, except applicable taxes. It is the intent of the assignor to deliver to assignee a seventy-five percent (75.00%) net revenue lease."

Assignment and Bill of Sale, Hornsby to Wortham Realty, Co., October 26, 2006. Because the existing burden on each lease is three-sixteenths, Hornsby has effectively retained a one-sixteenth interest in the leased property to himself, though it is now characterized as an "overriding royalty interest". Wortham thus became the effective "lessee".

Texas law is clear that a lessee may not claim a lease is extended under a force majeure provision if it was within the power of that lessee to prevent the occurrence making a lease extension necessary. "The purpose of a *force majeure* clause is to excuse the lessee from non-performance of lease obligations when the non-performance is caused by circumstances beyond the control of the lessee, Hemingway, §7.11, at 387, or when non-performance is caused by an event which is unforeseeable at the time the parties entered the contract." *Hydrocarbon Management, Inc. v. Tracker*, 861 S.W.2d 427, at 435-436, (Tex.App.-Amarillo, 1993, rehearing overruled) citing *Valero Transmission v. Mitchell Energy*, 743 S.W.2d 658, at 663 (Tex. App.-Houston [1st Dist.] 1987, no writ). In this case, the leases grant broad authority to the lessee for the exclusive right of "exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals....".

The Commission's order to plug the applied-for well pertained only to that well and did not prevent other operations on the lease. It was within Wortham's power, under the lease terms, to drill and otherwise conduct operations on the leased land which would have kept the leases in effect. Further, the order was in existence at the time the leases were granted as to Hornsby and at the time of the subsequent assignments from Hornsby to Wortham. The plug order was not, in any sense, "unforeseeable" at the time the leases were granted or at the time Wortham took the assignment.

An additional problem is the fact that N. Michael Hornsby, President of TSR at the time of the Final Order in Oil & Gas Docket No. 05-0211978, retains an interest in the three leases. Hornsby's retention of a 6.25% overriding royalty in the leases and transfer of 75% of the net revenue interest to Wortham places Wortham in privity with Hornsby. In essence, Wortham is the proxy of Hornsby. Hornsby, and those in privity with him, are barred by the doctrine of Collateral Estoppel from seeking to supercede the prior Final Order. Collateral Estoppel "..or as it is sometimes phrased, estoppel by judgment, bars relitigation in a subsequent action upon a different cause of action issues actually litigated and essential to a prior judgment." See *Benson v. Wanda Pet Co.*, 468 S.W.2d 361, 362 (Tex. 1971). "The rule is generally stated as binding a party and those in privity with him." *Id.*, at 363, citing *Kirby Lumber Corp. v. Southern Lumber Co.*, 145 Tex. 151. "Privity connotes those who are in law so connected with a party to a judgment as to have such an identity of interest that the party to the judgment represented the same legal right." *Id.* at 363. A "privy" is "In connection with the doctrine of res judicata, one who, after the commencement of the action, has acquired an interest in the subject matter affected by the judgment through or under one of the parties, as by inheritance, succession, purchase or assignment." Black's Law Dictionary, Sixth Edition, 1990. (Emphasis added.)

If Wortham's application for a Superceding Order is approved, TSR (Hornsby) will have shifted its longstanding liability (9 years) for plugging the well to Wortham and gained one-sixteenth of the production, if any, from the well. Because Wortham does not have a good faith claim to operate the subject well due to the expiration of the leases and because Wortham is in a close contractual relationship (privity) with the former operator of the well, it is unnecessary to inquire into the reliability of Wortham's claim that a grant of its application will prevent waste. The examiner recommends that the application of Wortham Oil & Gas for a Superceding Order to enable it to operate Well No. 1 on the Gardner Lease, Red Oak, South (Subclarksville) Field, Leon County, be denied.

Based on the record in this docket, the examiner recommends adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Wortham Oil & Gas (hereinafter "Wortham") and Texas Southern Resources (hereinafter "TSR") were given at least 10 days notice of this proceeding. Wortham appeared at the scheduled time and place for the hearing through its President Paul Burns and presented evidence. TSR did not appear.

2. Wortham filed its first Commission Form P-5 (Organization Report) with the Commission on December 20, 2004. Wortham has posted financial assurance with the Commission in the form of a $25,000 letter of credit.

3. Texas Southern Resources, ("TSR"), was recognized as the operator of the Gardner (03207) Lease, Well No. 1 (hereinafter "subject lease" and "subject well") after filing Commission Form P-4s (Producer's Transportation Authority and Certificate of Compliance), effective December 31, 1993.

4. In Oil & Gas Docket No. 05-0211978, TSR, whose President was N. Michael Hornsby, was ordered to plug numerous wells on numerous leases, including Well No. 1 on the Gardner (03207) Lease and pay an administrative penalty of $23,200.00 pursuant to a Final Order issued on April 15, 1998.

5. TSR has not plugged any of the wells or paid the administrative penalty under the terms of the Final Order in Oil & Gas Docket No. 05-0211978.

6. By assignment from N. Michael Hornsby, Wortham is the owner of a 75% net revenue interest in three leases covering the subject lease. The three leases (hereinafter, "the three leases") were taken, respectively, on December 26, 2005 (A.M. Easterling and wife Peggy); January 30, 2006 (Freddie S. Gardner French) and January 28, 2006 (James Porter Gardner and wife Mary). Each lease carried a primary term of one year.

7. The three leases, presented by Wortham as evidence of its good faith claim to operate, grant broad authority to the lessee for the exclusive right of "exploring, drilling, mining and operating for, producing and owning oil, gas, sulphur and all other minerals....". All three leases were executed long after the Gardner No 1 became subject to the plug only order in Oil & Gas Docket No. 05-0211978.

8. The plug-only order issued by the Commission in Docket No. 05-0211978 on April 15, 1998 applied only to Well No. 1 on the Gardner Lease and did not preclude Wortham from otherwise exercising its rights to conduct operations on the Gardner Lease.

9. Under the three leases and the assignment from Hornsby to Wortham, Wortham and N. Michael Hornsby remain in a contractual relationship under the terms of which Hornsby retains a 6.25% interest in the production of the well.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued to the appropriate persons entitled to notice.

2. All things necessary to the Commission attaining jurisdiction have occurred.

3. The pre-existing order in Oil & Gas Docket No. 05-0211978 was not a *force majeure* condition under the terms of the three leases.

4. Wortham does not have a good faith claim of a right to operate the subject lease.

5. Wortham and TSR, in the person of N. Michael Hornsby, are in privity.

6. In the present circumstances, Wortham, as a privy of TSR and N. Michael Hornsby, is collaterally estopped from obtaining a Superceding Order and the right to operate Well No. 1 on the Gardner (03207) Lease.

RECOMMENDATION

The examiner recommends that the Commission deny Wortham's request to supercede the provisions in the Final Order entered in Oil & Gas Docket No. 05-0211978 requiring plugging of Well No. 1 on the Gardner (03207) Lease.

Respectfully submitted,

Marshall Enquist
Hearings Examiner