

OIL & GAS DOCKET NO. 03-0234892

ENFORCEMENT ACTION AGAINST IPACT (OPERATOR NO. 425810) FOR VIOLATIONS OF STATEWIDE RULES ON THE BISSONET (02351) LEASE, WELL NOS. 3, 6, 7, 8, 9, AND 10, HUMBLE FIELD, HARRIS COUNTY, TEXAS

APPEARANCES:

FOR MOVANT:

Lowell E. Williams
Staff Attorney

MOVANT:

Enforcement Section
Railroad Commission of Texas

FOR RESPONDENT:

Maurice T. Larrea
President

RESPONDENT:

IPACT

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE COMPLAINT FILED:	January 28, 2004
DATE OF NOTICE OF HEARING:	February 13, 2004
DATE OF HEARING:	March 18, 2004
HEARD BY:	Scott Petry, Hearings Examiner
DATE RECORD CLOSED:	July 14, 2004
PFD PREPARED BY:	James M. Doherty, Hearings Examiner
PFD CIRCULATION DATE:	January 20, 2005

STATEMENT OF THE CASE

This proceeding was called by the Commission on the recommendation of the District Office to determine the following:

1. Whether the respondent IPACT¹ should be required to plug or otherwise place in compliance with Statewide Rule 14(b)(2) [Tex. R. R. Comm'n, 16 TEX. ADMIN. CODE §3.14(b)(2)] the Bissonet (02351) Lease, Well Nos. 3, 6, 7, 8, 9, and 10, Humble Field, Harris County, Texas;
2. Whether IPACT has violated provisions of Title 3, Oil and Gas, Subtitles A, B, and C, Texas Natural Resources Code, Chapter 27 of the Texas Water Code, and Commission rules and laws pertaining to safety or prevention or control of pollution by failing to plug the subject wells or otherwise place the subject wells in compliance with Statewide Rule 14(b)(2);
3. Whether IPACT should be assessed administrative penalties of not more than \$10,000.00 per day for each offense committed regarding the subject wells; and
4. Whether any violations of Statewide Rule 14(b)(2) by IPACT should be referred to the Office of the Attorney General for further civil action pursuant to TEX. NAT. RES. CODE ANN. §81.0534.

A hearing was held on March 18, 2004.² Lowell E. Williams, Staff Attorney, appeared representing the Enforcement Section of the Office of General Counsel (“Enforcement”). Maurice T. Larrea, President, appeared to represent IPACT and presented evidence. Enforcement’s certified hearing file was admitted into evidence. After the hearing, the record was first held open until April 20, 2004, and subsequently, pursuant to agreement of the parties, until June 30, 2004, to allow IPACT a further opportunity to submit evidence of its good faith claim of right to operate the subject lease and to achieve compliance and settlement. On July 14, 2004, IPACT filed documentation relating to the good faith claim issue, in the form of a “Deed Under Execution,” which, without objection from Enforcement, has been considered a part of the record.³ On January 5, 2005, Enforcement advised the Hearings Section of the Office of General Counsel that resolution of this docket had not been achieved by settlement. The record closed on January 18, 2005.

Enforcement recommends that a penalty be assessed against IPACT in the amount of \$12,000.00. The examiner recommends a penalty of \$9,000.00.

APPLICABLE LAW

¹ IPACT is the acronym for Independent Producers Alliance Corporation of Texas.

² The hearing was before Hearings Examiner Scott Petry. Before a proposal for decision was prepared, Examiner Petry left the employment of the Commission. Pursuant to §1.121(c) of the General Rules of Practice and Procedure, the case was reassigned to Hearings Examiner James M. Doherty.

³ Enforcement no longer contests that IPACT has now presented evidence of its good faith claim of right to operate the subject lease.

The operator of a well must properly plug the well when required and in accordance with the Commission's rules. *See* TEX. NAT. RES. CODE ANN. §89.011(a). The Commission's Statewide Rule 14(b)(2) provides that plugging operations on each dry or inactive well shall be commenced within a period of one year after drilling or operations cease and shall proceed with due diligence until completed.

Rule 14(c)(1) provides that the entity designated as the operator of a well specifically identified on the most recent Commission-approved operator designation form filed on or after September 1, 1997, is responsible for properly plugging the well in accordance with Rule 14 and all other applicable Commission rules and regulations concerning plugging of wells.

If a person violates provisions of Title 3 of the Texas Natural Resources Code or a Commission rule pertaining to safety or the prevention or control of pollution, the person may be assessed a civil penalty by the Commission not to exceed \$10,000.00 a day for each violation. In determining the amount of the penalty, the Commission must consider the respondent's history of previous violations, the seriousness of the violation, any hazard to the health or safety of the public, and the demonstrated good faith of the respondent. *See* TEX. NAT. RES. CODE ANN. §81.0531.

DISCUSSION OF THE EVIDENCE

Enforcement's Evidence

At the time of the hearing, IPACT's most recent Form P-5 Organization Report had been approved on March 28, 2003. This Form P-5 reported that IPACT was a corporation and listed its officers as Maurice T. Larrea, President, and David Allen Cothran, Secretary-Treasurer. The examiner has officially noticed Commission Form P-5 records showing that IPACT's latest Form P-5 was filed on May 27, 2004, and IPACT filed financial security in the form of a letter of credit in the amount of \$250,000.

The examiner has also officially noticed Commission records showing that as of the date the record closed, IPACT was the operator of 732 wellbores and 744 wells having total depth of 1,911,524 feet. Of the 744 wells operated by IPACT, 400 were subject to Statewide Rule 14(b)(2). IPACT had applied for Rule 14(b)(2) plugging extensions for 400 wells, 314 of which had been approved and 86 of which had been denied. IPACT was the operator of 214 wells that had been shut-in for 36 months or more.

IPACT designated itself operator of the Bissonet (02351) Lease, Well Nos. 3, 6, 7, 8, 9, and 10, by filing a Form P-4 (Producer's Transportation Authority and Certificate of Compliance) which was approved August 9, 2002, and effective August 1, 2002. The previous operator was APT Energy Co.

Inspections of the subject lease by the District Office on September 15, October 20,

December 9, and December 29, 2003, disclosed that the subject wells were inactive. No production has been reported for the subject lease since November 2001. A certification of the Commission's Secretary dated March 16, 2004, stated that no Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) had been filed or approved, and no Commission Form W-1X (Application for Future Re-entry of Inactive Well Bore and 14(b)(2) Extension Permit) was in effect for any of the subject wells.⁴ The estimated cost to the State to plug the subject wells is \$32,041.00.

An affidavit of Keith Barton, P.E., Field Operations, stated that: (1) Any wellbore, cased or otherwise, is a potential conduit for flow from oil or saltwater zones to zones of usable quality water or to the surface; (2) Holes or leaks may develop in cased wells, allowing oil or saltwater to communicate with usable quality zones or to flow to the surface; and (3) Uncased wells allow direct communication between zones and provide unimpeded access to the surface.

Respondent's Evidence

IPACT stated that it was a "contract operator" of the subject lease for Loch Energy, Inc. ("Loch"). IPACT explained that it is a bonded operator and charges a fee to its "clients" for bringing the clients' wells under its financial security. Under this arrangement, IPACT makes the client responsible for "maintaining the leases," and IPACT does "reporting."

On April 22, 2002, IPACT and Loch entered into an "IPACT Contract Operating Agreement" with respect to five leases, not including the subject lease. On July 9, 2002, Loch sent IPACT a letter requesting that the subject lease be added to the IPACT Contract Operating Agreement. IPACT stated that the contract with Loch was typical of the contracts that IPACT makes with its clients.

The IPACT contract with Loch provided that Loch was the owner of the subject lease and engaged IPACT to act as operator subject to the terms of the contract. For a monthly fee of \$2,260.00, IPACT agreed to prepare and file with the Commission monthly production reports. The contract provided that this was the only function that IPACT would perform, and provided specifically that IPACT would have no obligation with respect to "title matters, drilling, reworking, production, accounting or tax matters." Loch indemnified IPACT and held it harmless from any and all claims, actions, demands, liabilities, damages, causes, litigation, administrative proceedings and the like arising from any actions taken or not taken in regard to the properties covered by the contract other than reporting of production. Loch acknowledged that it would be responsible for the physical operation of the leases covered by the contract.

IPACT stated that when it received correspondence from the Commission relating to the alleged Rule 14(b)(2) violations on the subject lease, it sent copies to Loch, but Loch did nothing

⁴ The examiner has officially noticed Commission records showing that currently, Well Nos. 3, 7, and 9 have Rule 14(b)(2) plugging extensions that are effective until April 2005. Plugging extensions for Well Nos. 6, 8, and 10 were denied because H-10 tests were either failed or are delinquent.

in response. IPACT stated also that Loch did not pay IPACT sums due under the contract, and, as a result, IPACT filed a lawsuit against Loch and obtained a summary judgment. A copy of the summary judgment signed December 22, 2003, indicates that IPACT recovered the sum of \$99,323.16, plus attorney's fees, and obtained foreclosure of a Mineral Contractor's Lien filed by IPACT on the leases, including the subject lease, that were the subject of the IPACT contract with Loch.

Following the hearing, on July 14, 2004, IPACT filed a copy of a "Deed of Execution" signed on July 7, 2004, by the Constable of Harris County Precinct 4. This deed recited that by virtue of writ of execution issued on February 16, 2004, the leases upon which foreclosure had been had, including the subject lease, were sold and conveyed to IPACT.

IPACT presented a copy of the Oil, Gas and Mineral Lease which IPACT represented had been held by Loch and which IPACT acquired by virtue of the "Deed of Execution." This is an April 12, 1995, Oil, Gas and Mineral Lease from Joseph V. Maxwell to Continental Consultants, Inc., which has a primary term of ten (10) years. How Loch succeeded to the interest in this lease is not disclosed in the evidence.⁵

IPACT stated that top leases had been taken on the subject property by Daystar Oil & Gas Corp. Daystar apparently is an IPACT affiliate that physically operates, or will operate, some leases of which IPACT is the "contract operator." The top leases are dated March 16, 2004, have a primary term of ninety (90) days, and include a provision that the effective date of the top leases is the date of termination of the April 12, 1995, Oil, Gas and Mineral Lease from Joseph V. Maxwell.

Because IPACT was a bonded operator, the subject wells could have received Rule 14(b)(2) plugging extensions during the relevant period, except for the fact that H-15 tests were delinquent.

IPACT stated that it did not timely perform the H-15 tests because of the pendency of the lawsuit against Loch.⁶

⁵ The file in this docket indicates that at an earlier date, IPACT filed a Form P-4 to transfer the subject lease to Loch. Because this docket was pending, Loch was required to establish a good faith claim of right to operate the lease before Enforcement would remove its "hold" on transfer of the lease. Loch submitted a copy of a June 30, 2003, letter from Wayne Haskins, APT Energy Co., authorizing Loch to serve as operator of the subject lease "until terms are agreed and finalized on the referenced lease sale." Loch was requested to file additional good faith claim documentation, including an explanation as to how Haskins/APT had acquired the right to authorize Loch to operate the lease. When Loch failed to do so, Enforcement was advised that the Hearings Section was unable to make a determination that Loch had a good faith claim of right to operate the lease.

⁶ Exactly how the pendency of the lawsuit had an effect on IPACT's duty or ability to perform the H-15 tests was not explained.

IPACT stated that it intends to put the subject wells back into production and does not want to plug them. It also stated that it intended to perform the required H-15 tests.

EXAMINER'S OPINION

It is perfectly apparent that the practical effect of IPACT's contract with Loch was to rent out to Loch the benefit of IPACT's financial security for a monthly fee of \$2,260.00.⁷ IPACT committed to do nothing more than prepare and file production reports. Loch agreed to do everything else with regard to operation of the wells covered by the contract. This became a bad deal for IPACT when Loch did not pay and failed to achieve compliance on the subject lease.

Legally, by signing and filing the Form P-4 designating itself as the operator of the subject lease, IPACT assumed the responsibility for regulatory compliance, including the duty to perform required H-15 tests and plug wells as required by the Commission's rules.⁸

The evidence shows that production from the subject lease was last reported in November 2001. Wells on the subject lease became subject to Statewide Rule 14(b)(2), requiring that plugging operations on each inactive well be commenced within a period of one year after drilling or operations cease, on December 1, 2002. IPACT became the record operator of the subject lease, and the party responsible for plugging the subject wells, on August 1, 2002. Plugging extensions could not be granted for the subject wells after July 7, 2003, because H-15 tests were delinquent.

On November 6, 2003, December 17, 2003, and January 12, 2004, the District Office sent IPACT correspondence, notices, or copies of memoranda to Field Operations in Austin, advising that

the subject wells were in violation of Statewide Rule 14(b)(2). IPACT's response was to send

⁷ While this type of arrangement may benefit IPACT and its "clients," it appears to be counterproductive from the perspective of the Oil Field Clean Up Fund. The IPACT/Loch contract, for example, covered a total of 59 wells. Effective September 1, 2004, all operators must file a bond, letter of credit, or cash deposit as financial security. The blanket bond financial security requirement for an operator of 59 wells is \$50,000, or \$847.46 per well. IPACT now operates 732 wellbores, and its financial security requirement is \$250,000, or \$341.53 per well. When IPACT incrementally adds wells as a result of new contracts with "clients," its per well financial security diminishes.

⁸ IPACT could not avoid this regulatory responsibility by private contract, but did the next best thing from its perspective by requiring Loch to indemnify and hold IPACT harmless from any liability for penalties assessed on account of violations of the Commission's rules.

copies to Loch.⁹

There is no adequate explanation as to why IPACT did not perform timely H-15 tests on the subject wells in order to qualify them for plugging extensions. IPACT's assertion that it did not do the H-15 tests because of pendency of its lawsuit against Loch, and that IPACT preferred to wait until Daystar obtained the March 16, 2004, top leases, is not persuasive. The lawsuit against Loch had no effect on IPACT's duty to perform the tests, and how timely performance of the tests would have impacted the lawsuit is not explained or apparent. Obtaining by Daystar of the top leases likewise would appear to be irrelevant to performance of the tests, because: (1) the duty of IPACT to perform the tests was unaffected by the issue of whether IPACT had an effective mineral lease; and (2) the top leases do not even become effective until April 2005 when the primary term of the April 12, 1995, lease from Joseph V. Maxwell expires.

The examiner has officially noticed Commission H-15 records showing that IPACT tested the subject wells, except for Well No. 10, on April 14, 2004. Form H-15 filings by IPACT were approved for Well Nos. 3, 7, and 9, and it appears that these three wells were granted Rule 14(b)(2) plugging extensions on April 20, 2004, that are effective until April 2005. Form H-15 filings by IPACT for Well Nos. 6 and 8 were not approved because the Forms H-15 showed that the fluid level in the wells was at the surface, and the base of the deepest usable quality water was at 1,500 feet. Well Nos. 6 and 8 do not currently have plugging extensions. The H-15 test for Well No. 10 is still delinquent, and this well does not currently have a plugging extension.

Well Nos. 3, 7, and 9 on the subject lease appear to have been out of compliance with Statewide Rule 14(b)(2) from July 7, 2003, until April 20, 2004. Well Nos. 6 and 8 appear to have become noncompliant with Statewide Rule 14(b)(2) on July 7, 2003, and are still noncompliant. Well No. 10 was noncompliant with Statewide Rule 14(b)(2) from July 7, 2003, to April 19, 2004, and from July 21, 2004, to the current date. The subject lease was severed on September 19, 2003, due to discrepancies in production reporting, on December 1, 2003, due to delinquency in production reporting, on January 12, 2004, for violations of Statewide Rule 14(b)(2), and on July 21, 2004, for failed H-15 testing. These severances have not been resolved, and the certificate of compliance for the subject lease remains canceled.

From the date of the first correspondence to IPACT from the District Office regarding the Statewide Rule 14(b)(2) violations to the date of the hearing in this docket, IPACT had more than five months to correct the violations. Since the date of the hearing, more than nine additional months have passed, and still there is no total compliance, even though the record was held open on the premise that compliance and a settlement with Enforcement could be achieved.

Because IPACT was able to achieve compliance with respect to Well Nos. 3, 7, and 9 on the

⁹ IPACT's typical contract with its "clients" may actually serve as a disincentive to IPACT to achieve compliance with Commission rules, because IPACT takes the position that the "clients" have a contractual duty to IPACT to maintain the leases in compliance.

subject lease by obtaining plugging extensions for these wells after approved H-15 tests were performed, the examiner recommends that, as to these wells, IPACT be assessed a penalty of \$1,000.00 per well for time out of compliance with Statewide Rule 14(b)(2) between July 17, 2003, and April 14, 2004. With respect to Well Nos. 6, 8, and 10 on the subject lease, the examiner recommends that IPACT be assessed a penalty of \$2,000.00 per well for violations of Statewide Rule 14(b)(2) commencing July 17, 2003, and which are continuing. The examiner also recommends that IPACT be ordered to plug Well Nos. 6, 8, and 10, or otherwise place these wells into compliance with Commission rules.

The total penalty recommended is \$9,000.00. The recommendation for a penalty of \$2,000.00 per well for those wells which are still noncompliant is consistent with the standard penalty for violations of Statewide Rule 14(b)(2) in the recommended standard penalty schedule for enforcement cases. The recommended total penalty is appropriate because the violations are serious and pose a hazard to the health and safety of the public. IPACT has no history of previous Commission orders entered against it for violations of Commission rules, but it cannot be said to have acted in good faith, because it failed to achieve compliance after being given ample notice and opportunity to do so.

Based on the record in this docket, the examiner recommends that the following Findings of Fact and Conclusions of Law be adopted.

FINDINGS OF FACT

1. IPACT was given at least ten (10) days notice of this proceeding by certified mail, addressed to IPACT's most recent Form P-5 Organization Report address. Maurice T. Larrea, President, appeared at the hearing to represent IPACT and presented evidence.
2. IPACT is a corporation. It last filed an approved Form P-5 on May 27, 2004, and filed financial security in the form of a letter of credit in the amount of \$250,000.
3. IPACT has no history of prior Commission orders entered against it for violations of Commission rules.
4. The officers of IPACT, as listed on Forms P-5 effective at the time of the hearing, were Maurice T. Larrea, President, and David Allen Cothran, Secretary-Treasurer. Maurice T. Larrea and David Allen Cothran were persons in a position of ownership or control of IPACT at the time the violations involved in this docket occurred.
5. The violations committed by IPACT are violations of a Commission rule related to safety and the prevention or control of pollution.
6. As of January 18, 2005, the date the record closed, IPACT was the operator of 732 wellbores and 744 wells having total depth of 1,911,524 feet. Of the 744 wells operated by IPACT,

- 400 were subject to Statewide Rule 14(b)(2). IPACT had applied for Rule 14(b)(2) plugging extensions for 400 wells, 314 of which had been approved and 86 of which had been denied. IPACT was the operator of 214 wells that had been shut-in for 36 months or more.
7. IPACT designated itself to the Commission as the operator of the Bissonet (02351) Lease, Well Nos. 3, 6, 7, 8, 9, and 10, by filing a Form P-4 (Producer's Transportation Authority and Certificate of Compliance) which was approved August 9, 2002, and effective August 1, 2002.
 8. The subject wells have been inactive for more than one year.
 - (a) The wells were inactive as of September 15, October 20, December 9, and December 29, 2003, when the District Office inspected the subject lease.
 - (b) No production has been reported to the Commission for the subject lease since November 2001.
 9. The subject wells have not been plugged. No Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) has been filed or approved.
 10. No Statewide Rule 14(b)(2) plugging extension has been in effect for Well Nos. 6 and 8 on the subject lease since July 7, 2003. Plugging extensions cannot be approved for these wells because of failure of IPACT to perform approved H-15 tests.
 11. No Statewide Rule 14(b)(2) plugging extension was in effect for Well No. 10 on the subject lease from July 7, 2003, to April 19, 2004, and no plugging extension has been in effect for this well since July 21, 2004. Well No. 10 cannot be granted a plugging extension because a H-15 test for the well is delinquent.
 12. Well Nos. 3, 7, and 9 on the subject lease had no Statewide Rule 14(b)(2) plugging extension during the period July 7, 2003, to April 20, 2004. Plugging extensions could not be granted for these wells during this period because of the failure of IPACT to perform required H-15 tests.
 13. IPACT performed H-15 tests on the subject wells, except Well No. 10, on April 14, 2004. Forms H-15 were approved for Well Nos. 3, 7, and 9. Forms H-15 for Well Nos. 6 and 8 were not approved because the Forms H-15 showed that the fluid level in these wells was at the surface, and the base of the deepest usable quality water was at 1,500 feet. An H-15 test for Well No. 10 is still delinquent.
 14. Well Nos. 3, 7, and 9 on the subject lease were granted Statewide Rule 14(b)(2) plugging extensions on April 20, 2004, which are effective until April 2005.

15. On November 6, 2003, December 17, 2003, and January 12, 2004, the District Office sent IPACT correspondence, notices, or copies of memoranda advising that the subject wells were in violation of Statewide Rule 14(b)(2).
16. The estimated cost to plug the subject wells is \$32,041.00.
17. Usable quality groundwater in the area was likely to be contaminated by migrations or discharges of saltwater and other oil and gas wastes from the subject wells during the period of their noncompliance with Statewide Rule 14(b)(2). Unplugged wellbores constitute a cognizable threat to the public health and safety because of the risk of pollution.
18. IPACT has not demonstrated good faith in that it failed timely to place the subject wells into compliance with Commission rules after being notified of the Rule 14(b)(2) violations by the District Office.

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. IPACT is the operator of the Bissonet (02351) Lease, Well Nos. 3, 6, 7, 8, 9, and 10, Humble Field, Harris County, Texas, as defined by Commission Statewide Rules 14, 58, and 79 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§3.14, 3.58, and 3.79] and Chapters 85 and 89 of the Texas Natural Resources Code.
4. As operator, IPACT has the primary responsibility for complying with Statewide Rule 14 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.14], Chapters 89 and 91 of the Texas Natural Resources Code, and other applicable statutes and Commission rules respecting the subject wells.
5. Well Nos. 3, 7, and 9 on the subject lease were not plugged or otherwise in compliance with Statewide Rule 14 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.14], or Chapters 85, 89 and 91 of the Texas Natural Resources Code, during the period from July 7, 2003, to April 20, 2004.
6. Well Nos. 6, 8, and 10 on the subject lease are not properly plugged or otherwise in compliance with Statewide Rule 14 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.14], or Chapters 85, 89, and 91 of the Texas Natural Resources Code. Well Nos 6 and 8 have been out of compliance since July 7, 2003. Well No. 10 was out of compliance from July 7, 2003, to April 19, 2004, and has been out of compliance from July 21, 2004, to the current date.
7. The documented violations committed by IPACT constitute acts deemed serious and a

hazard to the public health, and demonstrate a lack of good faith as provided by TEX. NAT. RES. CODE ANN. §81.0531(c).

8. As officers in a position of ownership or control of IPACT at the time IPACT violated a Commission rule related to safety and the prevention or control of pollution, Maurice T. Larrea and David Allen Cothran, and any organization in which they may hold a position of ownership or control, are subject to the restrictions of TEX. NAT. RES. CODE ANN. §91.114(a)(2).

RECOMMENDATION

The examiner recommends that the Commission adopt the attached final order requiring that IPACT:

1. Plug, or otherwise place into compliance with Commission rules, the Bissonet (02351) Lease, Well Nos. 6, 8, and 10, Humble Field, Harris County, Texas; and
2. Pay an administrative penalty in the amount of NINE THOUSAND DOLLARS (\$9,000.00).

Respectfully submitted,

James M. Doherty
Hearings Examiner