

May 11, 2006

OIL & GAS DOCKET NO. 01-0244749

APPLICATION OF DONOCO OIL COMPANY CONTESTING PROPOSED CANCELLATION OF THE P-4 CERTIFICATE OF COMPLIANCE FOR THE LENZ, LOUIS II (00840) LEASE, GUADALUPE COUNTY, TEXAS.

APPEARANCES:

FOR RAILROAD COMMISSION OF TEXAS:

David Cooney
Tim Poe
Keith Barton

FOR OPERATOR DONALD DOEGE:

Donald Doege

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

NOTICE OF HEARING:	March 11, 2005
DATE CASE HEARD:	March 28, 2005
HEARING REOPENED:	April 28, 2005
REOPENED HEARING HELD:	May 16, 2005
RECORD CLOSED:	May 31, 2005
HEARD BY:	Mark Helmueller, Hearings Examiner Margaret Allen, Technical Examiner
PFD CIRCULATION DATE:	May 11, 2006
CURRENT STATUS:	Protested

STATEMENT OF THE CASE

This was a Commission-called hearing on the request of Donoco Oil Company, to determine the following:

1. Whether the certificate of compliance for the Lenz, Louis, II (00840) Lease should be canceled; and
2. The amount of any reconnect fees that should be required to be paid related to any cancellations of the certificate of compliance.

PROCEDURAL HISTORY

On February 9, 2005, Donoco Oil Company (hereinafter "Donoco") was issued computer generated correspondence from the Commission advising that the certificate of compliance for the Lenz, Louis, II (00840) Lease ("subject lease") would be canceled for the failure to file approved Commission Form H-15 (Test on an Inactive Well More than 25 Years Old) test for Well No. 1. The February 9, 2005 letter provided that Donoco could request a hearing to contest the cancellation.

Donoco timely requested a hearing on March 2, 2005. At the original hearing on March 28, 2005, Donoco appeared and presented evidence. No appearance was made by Commission Staff. The Commission's computer mainframe indicated that despite the timely request for hearing, the certificate of compliance had been canceled on March 11, 2005 and a reconnect fee assessed. The examiners requested that staff provide further information to address why the certificate of compliance had been administratively canceled when there was a pending request for hearing. The examiner then requested staff rescind the cancellation and assessment of reconnect fees pending the outcome of this hearing. The cancellation was rescinded as requested. Staff was also advised of the process that would be required to enter an appearance and reopen the hearing.

Staff's request to appear and reopen the hearing was granted on April 28, 2005. David Cooney, Staff Attorney, appeared at the reopened hearing representing the Commission and presented witnesses and documentary evidence. Donoco also appeared at the reopened hearing.

MATTERS OFFICIALLY NOTICED

Current Organization Records

Commission records show that the most recent approved Commission Form P-5 (Organization Report) for Donoco was filed on December 1, 2005. Donoco is currently identified as the operator of 80 wells, with a total depth of 65,125 feet. Donoco operates 21 leases including the Lenz, Louis, II (00840) Lease. Donoco has on file a blanket letter of credit as financial security in the amount of \$50,000.00.

Lease Records

The examiners have officially noticed Commission Form P-4 records which establish Donoco was recognized as the operator of the 4 wells on the subject lease when the Commission Form P-4 (Certificate of Compliance and Transportation Authority) submitted for the subject lease was approved by the Commission on July 2, 2003. The examiners have also officially noticed P-4 Certificate of Compliance Certified Letter/Cancellation/Reissue Inquiry computer records that show the subject lease had its certificate of compliance canceled on January 18, 2002 for a violation of Statewide Rule 14. Commission records indicate the violation was resolved by the issuance of a new certificate of compliance to Donoco. A reconnect fee of \$100 was assessed. This fee is listed as not paid on Commission mainframe computer records, however, the same records show an amount paid of \$100.

P-4 Certificate of Compliance Certified Letter/Cancellation/Reissue Inquiry computer records that show that the Lenz, Louis, II (00840) Lease had its certificate of compliance canceled on November 8, 2004 because the H-15 test for Well No. 1 was not approved as the reported fluid level was higher than the deepest usable quality water present in the area. The violation is listed as resolved on November 9, 2004. A reconnect fee of \$300 was assessed but has not been paid.

Donoco submitted a retest of the fluid level for Well No. 1 on January 30, 2005. The retest was rejected because of the prior test showing that the reported fluid level was higher than the deepest usable quality water present in the area. Correspondence noting the intent to cancel the certificate of compliance for the rejected retest was sent on February 9, 2005.

H-15 Testing Guidelines

The examiners have also officially noticed two memoranda concerning staff review and processing of H-15 tests. The first memoranda is noted as effective April 2004. With respect to the evaluation of fluid level tests, the guideline advises, "If a well fails a fluid level test, then a MIT must be performed." With respect to testing requirements for Mechanical Integrity Tests, the guideline notes one special consideration, "In lieu of a traditional MIT, operators may request approval to perform an ADA Pressure Test."

The second memoranda lists an effective date of February 2005. The February 2005 guideline retains the same requirement for wells that fail fluid level tests. However, an additional special consideration is included as follows: "Where the testing requirements in SWR 14(b)(3) for mechanical integrity cannot be met, alternatives will be considered on a case-by-case basis." No discussion on the factors or considerations is provided in the guideline.

DONOCO'S POSITION

Donoco admits that the certificate of compliance was canceled for the subject lease. Mr. Doege claims that he was diagnosed with leukemia in 2003 and let all of his regulatory obligations lapse while he dealt with his health issues. He is in remission after treatment, and is trying "to do the right thing" with respect to his responsibility for these wells. In 2004, he renewed Donoco's organization report, posted financial security in the amount of \$50,000 and conducted fluid level tests for the wells.

Donoco advises that the 4 wells on the subject lease are all shallow 2 7/8" slim hole completions that are produced on pump through 1" tubing. He believes that all of the wells on the lease are capable of production at marginal levels. When he tested the fluid levels in the wells, the observed level in Well No. 1 was higher than the base of usable quality water in the area. Because he sought to restore the well back to production, he pumped off the fluid and ran a new fluid level test. He was advised that the retest was not acceptable, and that he would be required to perform a pressure test on each well to confirm the mechanical integrity of the 2 7/8" casing.

Donoco claims the cost of conducting a pressure test on a slim hole well exceeds the average cost of plugging the well and makes it uneconomic to restore the well to production. He asserts that it is difficult if not impossible to conduct a pressure test on a slim hole well due to the limited diameter of the casing. He argues that where there is evidence that the well can be restored to production he should be allowed to submit the retest to meet the well test requirements. He also claims that there is no continued violation of the H-15 testing requirements as the well now meets the required standard.

STAFF POSITION

Staff asserts that the only issue before the examiners in this hearing is whether the lease was in compliance with Commission rules at the time the notice of intent to cancel was sent. Staff asserts that if it is determined that the lease is not in compliance, then cancellation of the certificate of compliance is appropriate and the operator should be responsible for reconnect fees.

Staff contends that Donoco is responsible for paying the reconnect fee for the cancellation of the certificate of compliance on January 18, 2002 before it was designated as the operator. Staff further contends that Donoco is responsible for the cancellation on November 8, 2004, for the failure to submit an approved H-15 test for Well No. 1. Finally, Staff asserts that cancellation of the certificate of compliance pursuant to the February 2, 2005 notice of intent to cancel is appropriate based on the rejected retest of the fluid level for Well No. 1.

Staff asserts that Donoco should be required to either perform a pressure test to ensure the mechanical integrity of the casing on Well No. 1 or plug the well. Staff further asserts that Donoco should be required to pay \$900 in reconnect fees for a total of 3 cancellations of the certificate of compliance, including cancellation pursuant to the February 9, 2005 notice of intent to cancel, less \$100 in credit for prior payments, regardless of when the cancellations occurred.

AUTHORITY

Texas Natural Resources Code §85.164 provides:

The commission may cancel any certificate of compliance issued under the provisions of this subchapter if it appears that the owner or operator of a well covered by the provisions of the certificate, in the operation of the well or the production of oil or gas from the well, has violated or is violating the oil and gas conservation laws of this state or rules or orders of the commission adopted under those laws. Before canceling a certificate of compliance, the commission shall give notice to the owner or operator by personal service or by registered or certified mail of the facts or conduct alleged to warrant the cancellation and shall give the owner or operator an opportunity to show compliance with all requirements of law for retention of the certificate as required by Section 2001.054, Government Code.

Texas Natural Resources Code §85.167(a) currently provides:

If a certificate of compliance for an oil lease or gas well has been canceled for violations of one or more commission rules, the commission may not issue a new certificate of compliance until the owner or operator submits to the commission a nonrefundable fee of \$300 for each severance or seal order issued for the lease or well.

EXAMINERS' OPINION

Three determinations must be made with respect to this matter. First, should Donoco be allowed to satisfy the requirements of Statewide Rule 14(b)(3) through the submission of fluid level retests where the claimed alternative is to plug the well? Second, can the certificate of compliance for the Lenz, Louis II (00840) Lease be canceled twice for the same failure to file acceptable fluid level tests for Well No. 1 in 2004? Third, can Donoco be held responsible for the payment of reconnect fees resulting from the cancellation of the certificate of compliance before it was recognized as the operator by the Commission?

Fluid Level Retests

The primary issue presented in this case is whether the fluid level retest submitted in January 2005 is an acceptable alternative to a pressure test on the casing. In essence, Donoco claims that the retest performed after pumping off fluid on Well No. 1 should be accepted because it intends to restore the well to production. Donoco claims that this is the only option to plugging the well, because the slim hole casing makes it both difficult and costly to perform a pressure test to confirm the mechanical integrity of the casing. Donoco asserts that the costs of performing a pressure test would exceed the cost of plugging the well.

With respect to the need to perform a pressure test on the casing before the well can be restored to production, there is a dispute between staff and Donoco as to whether a pressure test can be performed. The examiners believe that the testimony of the staff engineer setting forth the manner in which such a test could be performed is sufficient to show that such tests are possible for slim hole casing wells. The examiners therefore recommend that the pressure test for Well No. 1 be required before Donoco is allowed to restore the well to production.

Multiple Cancellations of the Certificate of Compliance for the Same Violation

The examiners need not consider whether the cancellation of the certificate of compliance for November 8, 2004 was proper, as it is uncontested that proper notice was issued to Donoco, and Donoco did not request a hearing. Accordingly, the cancellation at issue is the proposed cancellation raised by the February 9, 2005 correspondence.

The significant issue presented by multiple cancellations is not the actual cancellation itself, but the required reconnect fee as the authority to produce and transport production is terminated by the original cancellation. Donoco attempted to resolve the violation that led to the November 2004 cancellation by submitting a fluid level retest in January 2005 when the first test was rejected. The original test was properly rejected because it did not meet the required standard. The retest was also properly rejected by Commission staff due to the prior failed test. However, the submission of a retest to address the prior cancellation is not a separate violation which would justify an additional cancellation of the certificate of compliance.

Because the rejected test was a direct attempt by Donoco to respond to the November 2004 cancellation, it is the examiners' determination that cancellation of the certificate is not proper for the rejected retest in January 2005 as it would cancel the certificate of compliance a second time for the same violation. The examiners therefore recommend that no further cancellation of the certificate of compliance be issued.

Reconnect Fees for Past Violations

The remaining issue to be determined in this matter is whether Donoco is required to pay a reconnect fee related to the cancellation of the certificate of compliance on January 18, 2002 when the well was operated by a different entity. Staff asserts that a \$300 reconnect fee for the cancellation is appropriate, regardless of when the cancellation occurred and who was responsible for the cancellation. The examiners disagree. The January 18, 2002 cancellation occurred when a different entity was the recognized operator of the well. Further, the mainframe records indicate that the Commission acknowledged the prior violation when it issued the certificate of compliance to Donoco on April 25, 2003.

When the Commission issues a new certificate of compliance, the provisions of Texas Natural Resources Code §85.161 mandate a finding of "compliance with the oil or gas conservation laws of the state and conservation rules and orders." The issuance of a new certificate of compliance to Donoco in April 2003 under circumstances reflecting specific awareness of the old violation at

the time the new certificate was issued absolves Donoco of any responsibility to remedy the prior violation or to pay any reconnect fee for the cancellation that resulted from the violation.

Amount of Reconnect Fees

The remaining issue to be determined in this matter is the reconnect fee to be paid by Donoco. Because the certificate of compliance should not be cancelled a second time due to the attempt to resolve the initial cancellation by submitting a retest, and the preexisting violation was resolved by issuance of the certificate to Donoco, there is only one cancellation and only one \$300 reconnect fee required in this matter. Because Commission records reflect a credit of \$100 in prior payments of reconnect fees, the total reconnect fee required from Donoco prior to the reissuance of the certificate of compliance for the Lenz, Louis II (00840) Lease would be \$200.

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. On February 9, 2005, Donoco Oil Company (hereinafter “Donoco”) was issued computer generated correspondence from the Commission advising that the certificate of compliance for the Lenz, Louis II (00840) Lease (“subject lease”) would be canceled for the failure to file approved a Commission Form H-15 (Test on an Inactive Well More Than 25 Years Old) for Well No. 1.
2. Donoco timely requested a hearing on March 2, 2005.
3. At the original hearing on March 28, 2005, Donoco appeared and presented evidence. No appearance was made by Commission Staff.
4. The Commission’s computer mainframe records for the subject lease indicated that despite the timely request for hearing, the certificate of compliance had been canceled on March 11, 2005 and a reconnect fee assessed.
5. The cancellation of the certificate of compliance and assessment of reconnect fees were rescinded pending the outcome of this hearing.
6. Staff’s request to appear and reopen the hearing was granted on April 28, 2005. David Cooney, Staff Attorney, appeared at the reopened hearing representing the Commission. Donoco also appeared at the reopened hearing.
7. Commission records show that the most recent approved Commission Form P-5 (Organization Report) for Donoco was filed on December 1, 2005. Donoco is currently identified as the operator of 80 wells, with a total depth of 65,125 feet. Donoco operates 22 leases including the subject lease. Donoco has on file a blanket letter of credit as financial security in the amount of \$50,000.00.

8. Donoco was recognized as the operator of the 4 wells on the subject lease when the Commission Form P-4 (Certificate of Compliance and Transportation Authority) submitted for the subject lease was approved by the Commission on July 2, 2003.
9. P-4 Certificate of Compliance Certified Letter/Cancellation/Reissue Inquiry computer records that show that the subject lease had its certificate of compliance canceled on January 18, 2002 for a violation of Statewide Rule 14 by the prior operator. Commission records indicate the violation was resolved by the issuance of a new certificate of compliance to Donoco. A reconnect fee of \$100 was assessed. This fee is listed as not paid on Commission mainframe computer records, however, the same records show an amount paid of \$100.
10. P-4 Certificate of Compliance Certified Letter/Cancellation/Reissue Inquiry computer records that show that the Lenz, Louis, II (00840) Lease had its certificate of compliance canceled on November 8, 2004 because the H-15 test for Well No. 1 was not approved as the reported fluid level was higher than the deepest usable quality water present in the area. The violation is listed as resolved on November 9, 2004. A reconnect fee of \$300 was assessed but has not been paid.
11. Donoco submitted a retest of the fluid level for Well No. 1 on January 30, 2005. The retest was rejected because of the prior test showing that the reported fluid level was higher than the deepest usable quality water present in the area.
12. Under Statewide Rule 14(b)(3), Well No. 1 on the subject lease was required to successfully pass a fluid level test as a condition of continued deferral of the plugging requirement.
 - A. Well No. 1 was drilled more than 25 years prior to the date that an H-15 test was due.
 - B. Well No. 1 had been inactive for more than 12 months prior to the date that an H-15 test was due.
13. Well No. 1 on the subject lease failed a fluid level test submitted by Donoco on August 3, 2004 because the reported top of fluid was above the lowest reported depth of usable quality water in the vicinity of the well. After the failed test, Donoco pumped off fluid from the well prior to retesting.
14. A retest of the fluid level for Well No. 1 on the subject lease submitted by Donoco on January 30, 2005 does not satisfy the requirements of Statewide Rule 14(b)(3) in this instance.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued by the Railroad Commission to appropriate persons legally entitled to notice.
2. All things necessary to the Commission attaining jurisdiction over the subject matter and the parties to this hearing have been performed or have occurred.
3. Donoco is the operator of the 4 wells on the Lenz, Louis II (00840) Lease as defined by Statewide Rule 14 and §89.002 of the Texas Natural Resources Code.
4. Donoco is responsible for maintaining the 4 wells on the Lenz, Louis II (00840) Lease in compliance with all applicable statutes and Commission rules, including Statewide Rule 14(b)(3).
5. The Commission's cancellation of the certificate of compliance in November 2004 was proper.
 - A. Proper notice of the intent to cancel the certificate of compliance was issued to Donoco.
 - B. Donoco did not request a hearing with respect to the cancellation.
6. Rejection of a retest submitted by an operator to correct a violation that resulted in a cancellation of the certificate of compliance is not a separate violation which justifies an additional cancellation of the certificate of compliance.
7. Texas Natural Resources Code §85.161 mandates a finding of compliance with the oil or gas conservation laws of the state and conservation rules and orders prior to the issuance of a certificate of compliance.
8. The issuance of a new certificate of compliance to Donoco in July 2003 under circumstances reflecting specific awareness of the old violation at the time the new certificate was issued absolves Donoco of any responsibility to remedy the prior violation or to pay any reconnect fee for the cancellation that resulted from the violation.
9. Effective September 1, 2003, Texas Natural Resources Code §85.157 provided for a reconnect fee of \$300 for each severance or seal order issued by the Commission for a lease or well.

RECOMMENDATION

The examiners recommend that the attached Final Order be entered requiring:

- 1) a pressure test be performed on Well No. 1 on the Lenz, Louis II (00840) Lease or the well be properly plugged prior to reissuance of the Certificate of Compliance;
- 2) the certificate of compliance for the Lenz, Louis II (00840) Lease not be canceled based on the submission of the retest in January 2005, and no reconnect fee imposed with respect to the submission of the retest; and,
- 3) Donoco pay total reconnect fees of \$300, less \$100 previously paid, prior to reissuance of the Certificate of Compliance for the Lenz, Louis II (00840) Lease.

Respectfully submitted,

Mark J. Helmueller
Hearings Examiner

Margaret Allen
Technical Examiner