

June 28, 2005

OIL AND GAS DOCKET NOS. 01-0235191 & 01-0235192

APPLICATIONS OF TEJONES OPERATING CORP., TO CONSIDER EXCEPTIONS TO STATEWIDE RULE 21 TO ALLOW PRODUCTION BY SWABBING, BAILING, OR JETTING OF 19 WELLS: WELL NOS. 16, 17, AND 18 ON THE LEY (11932) LEASE; AND WELL NOS. 1-13 AND 15-18 ON THE POOLE (11686) LEASE, SOMERSET FIELD, BEXAR COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT TEJONES OPERATING CORP.:

Tom Gouger

FOR PROTESTANT MINERAL INTEREST OWNERS:

John Ley
June Ramirez
James Merrell

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR ACTION:	May 14, 2003
NOTICE OF HEARING:	March 23, 2005
DATE CASE HEARD:	May 2, 2005
RECORD CLOSED:	June 17, 2005
HEARD BY:	Mark Helmueller, Hearings Examiner Donna Chandler, Technical Examiner
PFD CIRCULATION DATE:	June 28, 2005

STATEMENT OF THE CASE

Tejones Operating Corp. (hereinafter “Tejones”) has applied for exceptions to Statewide Rule 21 to allow it to temporarily produce by regularly swabbing 19 wells in the Somerset Field in Bexar County: Well Nos. 16, 17, and 18 on the Ley (11932) Lease; and Well Nos. 1-13 and 15-18 on the Poole (11686) Lease (hereinafter “Ley Lease,” “Poole Lease,” and/or “subject wells”).

Tejones appeared at the hearing and presented evidence in support of its applications. Mineral interest owner June Ramirez appeared at the hearing to protest the application to produce the wells on the Poole Lease by swabbing contending that Tejones possesses no legal right to produce the minerals. Mineral interest owner John Ley appeared at the hearing to protest the application to produce the wells on the Ley Lease by swabbing contending that Tejones possesses no legal right to produce the minerals. The record was left open until June 17, 2005 to allow the parties to submit additional evidence on the issue of Tejones’ continuing right to operate the subject wells.

The examiners recommend that the applications be denied because Tejones was unable to establish a current good faith claim of a continuing right to operate any of the subject wells.

MATTERS OFFICIALLY NOTICED

Official Notice was taken of the following printouts of reports from the Commission’s mainframe database: 1) Tejones’ initial and most recent Commission Form P-5 (Organization Report) filings; 2) Commission Form P-4 (Producer’s Transportation Authority and Certificate of Compliance) filings for the Ley and Poole Leases; and 3) On-Schedule Leases, Wells, Wellbores By Operator Records for Tejones as of May 30, 2005 that identify the leases and wells for which Tejones is currently recognized as the operator. Official Notice was also taken of printouts from the Commission’s Production Data Query database from January 1993 through February 2005 regarding reported production and dispositions from the Ley and Poole Leases.

SUMMARY OF EVIDENCE

Tejones first filed an Organization Report with the Commission in 1995, and filed its most recent Organization Report in December 2004. Tejones is currently listed as the operator of 99 wells with a total depth of 254,387 feet. Tejones submitted a \$50,000 letter of credit as its financial assurance at the time of its most recent Organization Report. Tejones was recognized as the operator of the 19 wells on the Ley and Poole Leases when the Commission approved Form P-4s on April 28, 2003.

Good Faith Claim of Right to Operate

Tejones claims its right to produce the subject wells derives from assignments it obtained from the prior operator, Austin Energy Operations, Inc. (“Austin Energy”). Each assignment submitted is based on an Oil, Gas and Mineral Lease between the mineral interest owner and A&H Resources in 1986. The primary term of each lease has expired. Each lease also contains language providing that the lease shall remain in force and effect after the expiration of the primary term “as long thereafter as oil, gas or other mineral is produced from said land hereunder.”

Additional relevant lease conditions include a provision that deems the lease to be terminated within 30 days of the cessation of production after the expiration of the primary term unless the lessee engages in additional drilling or reworking operations. Each of the leases also contains identical force majeure provisions which provide in pertinent part:

“If any operation permitted or required hereunder, or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations or requirements of the Government of the United States or of any state or other governmental body, or any agency, officer, representative or authority of any of them, or because of delay or inability to get materials, labor, equipment or supplies, on or on account of any other similar or dissimilar cause beyond the control of Lessee, the period of such delay or interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above, so long as the cause or causes for such delays or interruptions continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof.”

Tejones admits that it has not produced any of the wells since they were acquired, but asserts that assignments it obtained through quit claims for each of the leases remain valid because the Commission’s enactment of Rule 21 prevented Tejones from producing the wells, thereby triggering “force majeure” provisions in each original lease. Tejones notes that it filed applications for swabbing authority within 30 days after it was recognized by the Commission as the operator of the leases.

Mineral interest owner June Ramirez contests Tejones’ claim that it has a right to operate the Poole Lease. Ramirez contends that the original lease lapsed for non-production. Mineral interest owner John Ley also contests Tejones’ claim that it has a right to operate the Ley Lease. Ley claims that the original lease is invalid because the original lessee defaulted on the provisions of the lease.

Proposed Operations and Other Requirements

Tejones advises that the wells were swabbed by the prior operator, Austin Energy. None of the wells are currently equipped to produce by pumping. The wells were drilled in the 1980's and range in depth from 1400-1500 feet. The wells are cemented from the total depth to the surface. Correspondence from the Texas Commission on Environmental Quality notes that fresh water in the area is required to be protected to a depth of 600 feet below the surface. Testimony and Commission inspections show that each well is equipped with a cap with a 1" valve. The inspections also indicate that a tank battery is present on each lease.

Tejones has swabbed wells to initiate production, but has not used swabbing as a production method. It proposes the following step-by-step process to swab the subject wells. Upon arriving at each well, the swabber will first remove the cap on the wellhead. A boom on the swabbing unit will be lowered over the well and then hooked up to the wellbore. Swabbing cups will be lowered by a retractable cable until they reach the top of the fluid level in the well. The swabber will then lower the cups to the uppermost perforations in the wellbore. The cable will then be retracted. As the cable is retracted, the swabbing cups will form a seal against the casing, thereby forcing any fluid to the surface. Any fluid raised by this process will be carried into a tank on the back of the swabbing truck by a tank hose. When swabbing is completed, the unit will be disconnected and the cap reinstalled. After all the wells on a lease are swabbed, the swabber will proceed to the tank battery to pump the fluids into a storage tank and record the increased fluid level.

The most recent production information for the subject wells is found in Commission reports filed by Austin Energy from January 2001 through April 2003. During that time period, Commission records indicate that the total reported production from swabbing the 19 wells was 470 barrels, an average of 0.88 barrels of oil per well per month¹.

Tejones has limited its request to swab the wells to only the next twelve months. Tejones acquired the wells to determine whether some of them could be restored to pumping production. The equipment necessary to conduct swabbing operations was included in its purchase of these properties. It intends to swab the wells to make enough production so that it will not realize a loss when it plugs any well that is not a candidate for pumping production.

Tejones advises that it has no internal account set up to cover plugging costs for the subject wells, but contends that such an account is not necessary as its principals are affiliated with Pegasus Cementers, Inc., ("Pegasus"), a Commission approved plugger that has plugged wells under Commission awarded contracts. Commission records show that Pegasus has been awarded contracts to plug 131 wells in District 1 in an amount totaling \$184,712.00.

¹Reported production from the 16 wells on the Poole Lease totaled 415 barrels, an average of .92 barrels per well per month. Reported production from the 3 wells on the Ley Lease totaled 55 barrels, an average of .65 barrels per well per month.

EXAMINERS' OPINION

Statewide Rule 21(k)(1)(B)(vi) requires an operator seeking to produce a well by swabbing, bailing or jetting to present evidence establishing that it possesses a continuing good faith claim to the right to operate the well. Because Tejones is unable to show that it has a legal right to operate the wells, the examiners recommend that the applications be denied.

Tejones admits that it has not produced any of the wells on the Ley and Poole Leases. It claims its right to produce the 19 wells derives from assignments it obtained from Austin Energy. Each assignment is based on an Oil, Gas and Mineral Lease signed in 1986. The primary term of each lease has expired. Each lease also contains language providing that the lease shall remain in force and effect after the expiration of the primary term "as long thereafter as oil, gas or other mineral is produced from said land hereunder."

Additional relevant lease conditions include a provision that deems the lease to be terminated from lack of production after the expiration of the primary term unless the lessee engages in additional drilling or reworking operations within 30 days of the cessation of production. A force majeure clause provides that if performance of any lease provision is delayed or interrupted directly or indirectly by government action, that such delay or interruption shall not be counted against lessee and the primary term will be automatically extended during the time period of any delay.

Tejones admits that the primary term has expired and that there has been no production or payment of delay rentals after the cessation of production. Tejones' claim of a continuing right to operate hangs on the governmental action condition in the leases' force majeure clauses. Tejones claims that the Commission rule requiring a permit to produce the wells by swabbing rig was governmental action beyond its reasonable control and that the leases remain valid.

Tejones' argument is not supported by the language of the force majeure provision. The operative clauses provide that a force majeure event may extend the **primary** term of the leases. There is no language which extends the leases after the primary term has expired. Absent specific language in the force majeure provisions stating that a force majeure event will keep the lease operative after the expiration of the primary term, there is no contractual basis for Tejones' claim that the force majeure provision is applicable.

In addition to the evidentiary discrepancy between Tejones' argument and the actual language of the force majeure provision in each contract, it is important to observe that the Texas Courts have rejected arguments that an oil, gas and mineral lease is extended by a force majeure provision where Commission rules impose requirements to operate a well. These arguments have traditionally focused on the fact that compliance with regulatory requirements is within the reasonable control of the operator.

The recognized purpose of the force majeure provision is to excuse non-performance of lease obligations only when caused by circumstances beyond the reasonable control of the lessee. See *Hydrocarbon Management, Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 435-36 (Tex.App.-- Amarillo 1993, no writ). The parties to an oil and gas lease are presumed to have contracted with knowledge of the law and regulations of the Texas Railroad Commission concerning the production of oil and gas. *Id.* at 436; *Hughes v. Cantwell*, 540 S.W.2d 742, 745 (Tex.Civ.App.-- El Paso 1976, writ ref'd n.r.e.). Thus, the force majeure provision of an oil and gas lease is not triggered when the Commission orders a well shut-in due to the lessee's failure to comply with its regulations, at least when compliance with the regulation is within the reasonable control of the lessee. See also *Atkinson Gas Co. v. Albrecht*, 878 S.W.2d 236, 241 (Tex.App.-- Corpus Christi 1994, writ denied).

The changes to Statewide Rule 21 that required operators to file for an exception permit to produce a well by swabbing, bailing or jetting, were adopted by the Commission on September 12, 2002 and made effective by operation of law on October 2, 2002, over 6 months prior to Tejones' acquisition of the leases and filings of P-4s to be recognized as the operator.² Under both the *Hydrocarbon Management, Inc.* and *Hughes* cases, Tejones is presumed to have had knowledge of the applicable law and Commission regulations at the time it contracted to purchase any rights in the subject wells. It cannot claim ignorance of the applicable rules to support its legal argument.

Additionally, the claim that non-performance of the lease obligations was beyond Tejones' reasonable control must also be rejected. Tejones asserts that it was prohibited from operating the subject wells by the Commission's requirement that an operator obtain a permit to produce any well by swabbing under Statewide Rule 21. However, the requirement that an operator obtain a permit for swabbing did not prohibit Tejones from producing the subject wells by conventional means.

The facts in this case are analogous to the facts in *Atkinson* and *Hydrocarbon Management*. In those cases the Commission canceled an operator's certificate of compliance for the failure to file proper production reports. The wells were then shut-in. Each operator claimed that the Commission's action was a force majeure event which extended the oil, gas, and mineral lease.

Both the *Atkinson* and *Hydrocarbon Management* courts rejected this argument, holding that an operator's compliance with Commission regulatory requirements is within the operator's reasonable control. Any Commission action resulting from the failure of the operator to meet its regulatory duties therefore is not a force majeure event under an oil, gas and mineral lease. Similarly, the Commission requirement that an operator obtain authority to use swabbing as a production method is not a force majeure event because it does not impact an operator's ability to produce the wells by other means. It is undisputed that it was within Tejones' control to produce any of the wells by conventional methods at any time after it was recognized as the operator.

² Notably, prior to the Commission's adoption of the amendments Statewide Rule 21 in October 2002, the rule prohibited swabbing, bailing and jetting as production methods.

Tejones itself asserted that its intent was to restore as many of the subject wells to pumping production as it could. However, there is no evidence that Tejones took any action to test or restore pumping production for any of the subject wells during the two years after it was recognized as the operator. Because Tejones possessed reasonable control over its ability to comply with the Commission's requirements, there is no legal basis for asserting that Commission regulatory requirements concerning swabbing as a production method are a force majeure event.

CONCLUSION

In sum, there is no recognized legal authority to support Tejones' claim that Commission requirements under Statewide Rule 21 are force majeure events that perpetuate the five leases which Tejones acquired by assignment. Accordingly, the examiners therefore recommend that Tejones' applications be denied based on its failure to establish a good faith claim of a continuing right to operate the 19 wells on the Ley and Poole Leases.

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. Tejones Operating Corp. (hereinafter "Tejones") has applied for exceptions to Statewide Rule 21 to allow it to temporarily produce by regularly swabbing 19 wells in the Somerset Field in Bexar County: Well Nos. 16, 17, and 18 on the Ley (11932) Lease; and Well Nos. 1-13 and 15-18 on the Poole (11686) Lease, (hereinafter "Ley Lease," "Poole Lease," and/or "subject wells").
2. Applicant and all other affected parties identified by the applicant, were given at least 10 days notice of this proceeding at the addresses provided by applicant.
3. Tejones appeared and presented evidence in support of the applications. Mineral interest owner June Ramirez protested the application to produce the wells on the Poole Lease by swabbing contending that Tejones has no legal right to produce the minerals. Mineral interest owner John Ley protested the application to produce the wells on the Ley Lease by swabbing contending that Tejones has no legal right to produce the minerals
4. Tejones first filed an Organization Report with the Commission in 1995, and filed its most recent Organization Report in December 2004. Tejones is currently listed as the operator of 99 wells with a total depth of 254,387 feet. Tejones submitted a \$50,000 letter of credit as its financial assurance at the time of its most recent Organization Report.
5. Tejones was recognized as the operator of the 19 wells on the Ley and Poole Leases when the Commission approved Form P-4s (Producer's Transportation Authority and Certificate

of Compliance) on April 28, 2003.

6. Tejones obtained assignments in which the prior operator, Austin Energy Operations, Inc. quit claimed to Tejones any right it possessed to operate the Ley and Poole Leases under the oil, gas and mineral leases signed in 1986.
7. Each of the original oil, gas and mineral leases sets a primary term which has now expired.
8. Each of the original oil, gas and mineral leases specifies a secondary term which extends the lease as long as oil, gas or other minerals are produced from the property.
9. Each of the original oil, gas and mineral leases specify that after the expiration of the primary term, the lease would terminate unless the lessee engaged in additional drilling or reworking operations within 30 days of the cessation of production.
10. Each of the original oil, gas and mineral leases contains a force majeure provision which provides in pertinent part: "If any operation permitted or required hereunder, or the performance by Lessee of any covenant, agreement or requirement hereof is delayed or interrupted directly or indirectly by any past or future acts, orders, regulations or requirements of the Government of the United States or of any state or other governmental body, or any agency, officer, representative or authority of any of them, or because of delay or inability to get materials, labor, equipment or supplies, on or on account of any other similar or dissimilar cause beyond the control of Lessee, the period of such delay or interruption shall not be counted against the Lessee, and the primary term of this lease shall automatically be extended after the expiration of the primary term set forth in Section 2 above, so long as the cause or causes for such delays or interruptions continue and for a period of six (6) months thereafter; and such extended term shall constitute and shall be considered for the purposes of this lease as a part of the primary term hereof."
11. Records from the Commission's Production Data Query database from January 1993 through February 2005 regarding reported production and dispositions from the Ley and Poole Leases show that the last reported production was in April 2003.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely given to all persons legally entitled to notice.
2. All things have occurred to give the Commission jurisdiction to decide this matter.
3. Tejones does not possess a good faith claim of the right to operate: Well Nos. 16, 17, and 18 on the Ley (11932) Lease; and Well Nos. 1-13 and 15-18 on the Poole (11686) Lease, Somerset Field, Bexar County, Texas.

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- a. Tejones' claim of a right to operate each of the wells and leases is based on an assignment by quit claim from Austin Energy of its rights under oil, gas and mineral leases entered into in 1986.
 - b. The primary term in each original lease has expired.
 - c. The wells have not been produced since April 2003.
4. The force majeure provisions in the oil, gas and mineral leases is not applicable after the expiration of the primary term.
 5. Under *Atkinson Gas Co. v. Albrecht*, 878 S.W.2d 236, 241 (Tex.App.-- Corpus Christi 1994, writ denied), the Commission requirement that an operator obtain a permit to produce a well by swabbing is not a force majeure event that perpetuates the lease because it was within Tejones' control to produce any of the wells by conventional methods at any time after it was recognized as the operator of the subject wells.
 - a. Tejones acquired any interest in the wells six months after the Commission adopted amendments to Statewide Rule 21 requiring operators to obtain a permit to produce wells by swabbing, bailing or jetting.
 - b. Tejones is presumed to have contracted to obtain its interests with knowledge of the applicable Commission rules and regulations.
 - c. The Commission requirement that an operator obtain a permit to produce wells by swabbing did not preclude Tejones from producing the wells by other methods.
 4. Tejones' applications do not meet the all of the mandatory requirements under Statewide Rule 21(k) because Tejones was unable to establish a good faith claim of a continuing right to operate any of the leases.

RECOMMENDATION

The examiners recommend that the applications be denied, in accordance with the attached final order.

Respectfully submitted,

Mark J. Helmueller

Hearings Examiner

Donna Chandler
Technical Examiner