

June 29, 2005

Oil & Gas Docket No. 01-0236259

APPLICATION OF SEACO PRODUCTION FOR AN EXCEPTION TO STATEWIDE RULE 21 TO PRODUCE BY SWABBING, BAILING OR JETTING, WELL NOS. 2 AND 3A, STREY, ELTON F. LEASE, LA VERNIA FIELD, GUADALUPE COUNTY, TEXAS.

Oil & Gas Docket No. 01-0236260

APPLICATION OF SEACO PRODUCTION FOR AN EXCEPTION TO STATEWIDE RULE 21 TO PRODUCE BY SWABBING, BAILING, OR JETTING, WELL NO. 1A, COVER LEASE, LA VERNIA FIELD, GUADALUPE COUNTY, TEXAS.

Oil & Gas Docket No. 01-0236261

APPLICATION OF SEACO PRODUCTION FOR AN EXCEPTION TO STATEWIDE RULE 21 TO PRODUCE BY SWABBING, BAILING, OR JETTING, WELL NOS. 1, 2, 3, & 4, DOEGE, ERNEST LEASE, LA VERNIA FIELD, GUADALUPE COUNTY, TEXAS.

APPEARANCES:

John G. Soule, Attorney
W. A. Seay, Jr., Owner
Gay Nell Hall, Bookkeeper

Seaco Production
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CONSOLIDATED PROPOSAL FOR DECISION

PROCEDURAL HISTORY

APPLICATIONS FILED:	September 3, 2003
NOTICES OF HEARING ISSUED:	March 23, 2005
HEARINGS HELD:	May 4, 2005
PFD PREPARED BY:	Marshall Enquist, Hearings Examiner
PFD CIRCULATED:	June 29, 2005

INTRODUCTION

This consolidated proposal for decision involves three applications of Seaco Production (“Seaco”) for exceptions to Statewide Rule 21 to produce by jetting seven wells on three leases in the La Vernia Field, Caldwell County, Texas. It is the examiner’s recommendation that the Commission grant authority for production by jetting.

STATEMENT OF THE CASE

The three applications discussed in this proposal for decision were originally set for hearing on April 22, 2005, but were rescheduled for May 4, 2005. For the purpose of giving notice of the applications here involved, Seaco provided the Commission with the addresses of the surface owners and mineral owners of the affected tracts. Notice by publication was not necessary. Seaco appeared and presented evidence at the hearing. No one appeared in opposition to the applications.

BACKGROUND

Effective October 2, 2002, the Commission adopted amendments to Statewide Rule 21 which prohibited swabbing, bailing or jetting as a production method for wells unless the Commission has, after notice and hearing, granted an exception to Statewide Rule 21. Statewide Rule 21(k)(1) and (2) set the mandatory and discretionary issues considered by the Commission for exceptions allowing jetting as a production method:

(1) An operator seeking an exception to allow swabbing, bailing, or air jetting of a well shall:

(A) provide the Commission with the names and mailing addresses of the mineral interest owners of record and surface owners of record of the lease on which a well for which an exception is sought is located;

(B) present evidence at the hearing establishing:

(i) the method of production proposed;

(ii) that any production is properly accounted for pursuant to §3.26 of this title (relating to Separating Devices, Tanks, and Surface Commingling of Oil);

(iii) that the proposed exception is necessary to prevent waste or protect correlative rights;

(iv) that wellhead control is sufficient to prevent releases from the well;

(v) that no pollution of usable quality water or safety hazard will result from either the proposed production method or the condition of the well; and

(vi) that the operator possesses a continuing good faith claim to the right to operate the well.

(2) In addition to the information set out in paragraph (1) of this subsection, factors that the Commission may consider in ruling on a request for an exception include:

(A) whether the well has passed a mechanical integrity test within the preceding 12 months;

(B) the estimated monthly and cumulative production from the well if the

requested exception is granted;

(C) whether production will be into an on-lease tank battery or a mobile tank;

(D) the adequacy of the financial assurance provided by the operator to assure that the well will be timely and properly plugged;

(E) whether production volume, fine sands in the reservoir, or other factors render pumping of the well impracticable;

(F) whether the reservoir from which the well produces contains hydrogen sulfide; and

(G) the operator's history of compliance with Commission rules.

On September 3, 2003, Seaco filed applications with the Commission requesting approval to produce seven wells on three leases by jetting.

MATTERS OFFICIALLY NOTICED

The examiner has officially noticed: (1) Commission production records reflecting production of oil or gas on the leases involved in this proceeding, as reported to the Commission by Seaco; and, (2) memoranda and recommendations of Field Operations contained in each of the Commission's files relating to the applications involved in this proceeding.

DISCUSSION OF THE EVIDENCE

Organization Information

Seaco first filed a P-5 Organization Report with the Commission on August 6, 1979. The examiner has officially noticed Commission "On Schedule Leases, Wells, Wellbores By Operator" records indicating that as of February 15, 2005, Seaco was the operator of 80 wells with total depth of 100,289 feet. Seaco filed its most recent organization report with the Commission on February 15, 2005. Willie A Seay, Jr. is identified as the owner.

Proposed Production Method and Proper Accounting

Seaco uses jetting as a means of production for roughly a quarter of its wells. On the three leases that are the subject of these applications, there are a total of 29 active wells. Seven are jetted, while the remaining 22 wells are on pump and producing. Seaco has no SWR 14(b)(2) wells on these leases.

The pumping wells are on a timer, allowing Seaco to jet at a time when the pumping wells are inactive. Seaco gauges the tanks prior to jetting and then gauges again after jetting is completed. This method allows Seaco, internally at least, to keep track of the amount of oil the jetted wells are producing. The wells are jetted by attaching the hose from an air compressor to the wellhead and forcing a stream of air down the annulus. This pushes the fluids at the bottom up the production tubing to the surface. At the surface, the produced liquids immediately enter a flowline and run to a lease storage tank or a gunbarrel. In every case, the produced fluids on the subject leases are captured on lease. There is no commingling with production from other leases and no temporary storage in a tank on the truck carrying the air compressor. Seaco asserts that this method of production is the cleanest

method of producing a well and does not leave a drop of oil on the ground.

Waste and Correlative Rights

Seaco asserts that if it is denied the authority to produce the wells by jetting, that it will be forced to plug them. The amounts produced by jetting are small, making it economically infeasible to equip the wells for pumping. The seven wells at issue each produce an average of only 2 barrels per month and are subject to factors that render pumping uneconomic. One problem is the entrance of fine sands into the wellbore, rapidly abrading the production equipment. Additionally, two of the wells are subject to corrosion. The Cover Well No. 1A and the Strey Well No. 3A produce a small amount of highly acidic “red water”, which has been shown by experience to severely corrode (“eat up” is the term used by Mr. Seay) the rods and pump within 30 days. Because any attempt to produce these wells on pump will result in a net loss, Seaco would be forced to plug the wells, resulting in the waste of any oil that could be recovered by jetting. The seven wells only produce 14 barrels of oil per month, but have been doing so for ten years (1,680 barrels over ten years). Their decline curve is essentially flat and Seaco believes they can produce for another ten years. Seaco also believes that the correlative rights of the mineral interest owners are protected by jetting production where operators on offsetting leases are producing reserves from the same field.

Wellhead Control

Each jetted well has continuous wellhead control, save for the brief moments when the compressed air hose is attached and removed. The wellheads are so configured that any production flows immediately into a flow line and then to a storage tank or gunbarrel (a separator for oil and water).

Pollution and Safety Hazards

As previously stated, Seaco asserts that jetting, in combination with the wellhead configuration delivering produced liquids directly to on-lease storage tanks, is the cleanest method of producing oil, and does not result in so much as a drop of oil hitting the ground. The jetted wells do not produce any gas and, thus, there is no danger of hydrogen sulfide leaks.

Good Faith Claim

At the hearing Seaco asserted that it possessed a good faith claim of a continuing right to operate for all of the properties at issue in its applications. As evidence, Seaco provided the base leases for each of the three leases, as well as copies of letters from at least one mineral interest owner of each lease stating that the lease has been in continuous production since completion of the wells and that the leases have not been terminated for lack of production.

Mechanical Integrity Tests

Although some of the wells on the three leases may be over 25 years old, none have been inactive for one year or longer. Therefore, Mechanical Integrity Tests and the submission of RRC Forms H-15 are not required.

Estimated Production Amounts

As previously stated, the amounts produced by the jetted wells are small, amounting to an average of 2 barrels of oil per month per well. This amounts to a total of 14 barrels per month for all seven wells, but the wells have maintained this rate for at least ten years, producing 1,680 barrels of oil. Because the decline curve on these wells is flat, Seaco expects the wells to produce another 1,680 barrels of oil over the next decade.

Financial Assurance

Seaco has filed financial assurance in the amount of \$50,000 pursuant to Texas Natural Resources Code §91.1042 and Statewide Rule 78(g)(1)(B) in the form of a bond, the minimum amount required based on the number of wells (80) Seaco operates. If Seaco filed financial assurance based on the total depth of all of its wells in the amount of \$2.00 per foot as provided for by Texas Natural Resources Code §91.1041 and Statewide Rule 78(g)(1)(A), it would be required to file financial assurance in the amount of \$200,578.

Seaco does not believe there should be any concern about its ability to plug its wells. Seaco does not have any SWR 14(b)(2) wells and presented an exhibit showing that, in the last three years, it has already plugged five wells on the Cover Lease and two wells on the Strey lease. Although not a subject of these three applications, Seaco also presented evidence that it has plugged seven wells on another lease it operates, the Schievelbein Lease. Seaco asserts that its record of plugged wells and the fact that Seaco does not have any SWR 14(b)(2) wells among the 80 wells it operates demonstrates that Seaco takes a proactive approach to plugging responsibilities.

Practicality of Pumping Operations

As previously stated, the jetted wells do not produce a sufficient volume of oil to justify equipping for pumping. In addition, the intrusion of fine sands and the local occurrence of a highly corrosive “red water” also makes pumping uneconomical.

History of Compliance

Seaco has no history of violations of Commission rules.

EXAMINERS’ OPINION

Statewide Rule 21 sets forth both mandatory requirements and discretionary considerations in evaluating an application to use swabbing as a production method for a well. It is the examiners’ conclusion that based on the uncontested evidence Seaco’s applications satisfy all of the mandatory requirements set forth in Statewide Rule 21 to approve its applications.

Mandatory Requirements

Statewide Rule 21 provides that an operator seeking an exception to the rule prohibiting

swabbing as a production method *must* present evidence establishing: (1) the method of production proposed; (2) that any production is properly accounted for pursuant to Statewide Rule 26 (relating to Separating Devices, Tanks, and Surface Commingling of Oil); (3) that the proposed exception is necessary to prevent waste or protect correlative rights; (4) that wellhead control is sufficient to prevent releases from the well; (5) that no pollution of usable quality water or safety hazard will result from either the proposed production method or the condition of the well; and (6) that the operator possesses a continuing good faith claim to the right to operate the well.

(A) The Method of Production Proposed: Seaco proposes to produce the wells involved in this proceeding by jetting. There is sufficient evidence of the type of equipment and procedures used by Seaco for this purpose to support the applications.

(B) Proper Accounting for Production: This mandatory consideration applies to the requirements of Statewide Rule 26 relating to Separating Devices, Tanks, and Surface Commingling of Oil. All oil produced on each lease is properly measured after being produced through a flow line to the lease tank battery. There is nothing in the evidence to suggest that Seaco does not, or will not, properly account for production by jetting on the leases that are the subject of this proceeding.

(C) Waste and Correlative Rights: Seaco has presented sufficient evidence to support its claim that jetting will result in the prevention of waste. The seven wells at issue have produced a total of approximately 1,680 barrels of oil over the last ten years and are likely to produce this amount in the next ten years. Denial of authority to produce these wells by jetting would result in the waste of at least some of this oil, and possible confiscation due to production on adjacent leases.

It reasonably may be inferred from this evidence that there are additional recoverable reserves in the subject field that can be produced by Seaco through use of jetting as a method of production. The subject wells are no longer equipped for production by pumping, and reequipping the wells for pumping production does not appear to be economical. The examiner concludes that granting of the requested Statewide Rule 21 exceptions may prevent waste of hydrocarbons. The production decline curve for these wells is essentially flat, and may remain so for the foreseeable future.

Finally, Seaco asserted that jetting authority is necessary to protect its correlative rights because operators of wells on adjacent leases would be allowed to produce their wells, potentially draining reserves from Seaco's properties. Seaco offered only anecdotal evidence that offsetting production could drain reserves from its properties which would be produced by jetting. Unfortunately, Seaco does not address a central premise behind any claim that a permit is necessary to protect correlative rights; i.e., that protection of correlative rights addresses the opportunity to recover the fair share of reserves underlying the property. There is no evidence that Seaco is being denied such an opportunity. Accordingly, the examiner can only recommend a grant of jetting authority based on prevention of waste.

(D) Wellhead Control: Seaco presented evidence that all of its wells have wellheads and are configured to flow directly into flowlines, and from there to on-lease gunbarrels or storage tanks. Seaco presented photographs of a few wells, indicating adequate wellhead control.

(E) Pollution and Safety Hazards: The evidence presented by Seaco tends to show that jetting

the subject wells will not result in pollution of usable quality water or a safety hazard. Jetting as conducted by Seaco does not inherently present a threat of oil spills. Spills can always occur from leaks in flowlines, but these are a possibility under any production method. The wells do not produce gas and hydrogen sulfide release is not a concern.

(F) Good Faith Claim: The applicant for exceptions to Statewide Rule 21 must present evidence establishing that the applicant possesses a continuing good faith claim to the right to operate the wells proposed to be produced by swabbing, bailing, or jetting. Statewide Rule 21 does not define “good faith claim,” but Statewide Rule 14 does. Pursuant to Statewide Rule 14(a)(1)(E), “good faith claim” means “A factually supported claim based on a recognized legal theory to a continuing possessory right in a mineral estate, such as evidence of a currently valid oil and gas lease or a recorded deed conveying a fee interest in the mineral estate.” Seaco presented sufficient evidence that it holds a currently valid oil and gas lease with respect to all of the leases involved in these applications.

Discretionary Considerations

Pursuant to Statewide Rule 21, the Commission *may* consider: (1) whether the wells for which exceptions are sought have passed a mechanical integrity test within the preceding 12 months; (2) the estimated monthly and cumulative production from the wells if the requested exceptions are granted; (3) whether production will be into an on-lease tank battery or a mobile tank; (4) the adequacy of the financial assurance provided by the operator to assure that the wells will be timely and properly plugged; (5) whether production volume, fine sands in the reservoir, or other factors render pumping of the wells impracticable; (6) whether the reservoir from which the well produces contains hydrogen sulfide; and (7) the operator’s history of compliance with Commission rules.

(A) Mechanical Integrity Testing: Almost all of the Seaco wells in these applications are over 25 years old, but none have been inactive for a period of one year. Consequently, MIT tests are not required to be performed.

(B) Monthly and Cumulative Production: Seaco estimated that the affected wells will produce by jetting an average of two barrels of oil per month per well and that, collectively, the seven wells will produce 14 barrels of oil per month. The wells have produced at this rate for approximately ten years, resulting in recovery of 1,680 barrels of oil. The decline curve for the wells is flat and they will likely produce another 1,680 barrels of oil over the next decade. If they do not, Seaco has a demonstrated history of plugging its non-producing wells.

(C) Production Into Tanks: Seaco jets the wells by hooking them up to an air compressor mounted on a truck. Rather than produce into a tank mounted on the truck, the wells are configured to produce directly into a flowline. All produced fluids are sent to storage tanks on-lease.

(D) Adequacy of Financial Assurance: Seaco has filed financial assurance with the Commission in the form of a \$50,000 bond. This is the minimum amount of financial assurance required by law for an operator of eighty wells. It is noteworthy that all eighty of Seaco’s wells are producing and that Seaco does not have any SWR 14(b)(2) wells.

(E) Practicality of Pumping Wells: Seaco presented credible testimony that it is not

economically practical to produce the wells by pumping due to the intrusion of fine sands and the corrosive effect of acidic waters. The evidence presented by Seaco shows that pumping production would result in a net loss based on the costs of production.

(F) Hydrogen Sulfide: The wells involved in these applications do not produce gas so there is no danger of a hydrogen sulfide release. The La Vernia (51093001) Field is not an H₂S associated field.

(G) History of Compliance: Seaco has not been the subject of any enforcement dockets.

Conclusion

Based on all of the factors that the Commission must, or in its discretion may, consider, the examiner has concluded that these applications for exceptions to Statewide Rule 21 should be approved for so long as Seaco Production remains the operator of the wells.

The examiner recommends adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. At least ten (10) days notice of the hearing in these dockets was sent to all parties entitled to notice.
2. Seaco Production (“Seaco”) first filed a P-5 Organization Report with the Commission on August 6, 1979. The Commission’s “On Schedule Leases, Wells, Wellbores By Operator” records indicate that as of January 7, 2005, Seaco was the operator of 80 wells with total depth of 100,289 feet. Seaco filed its most recent organization report with the Commission on February 15, 2005. Willie A. Seay, Jr. is identified as the owner.
3. Seaco has filed blanket financial assurance pursuant to Texas Natural Resources Code §91.1042 and Statewide Rule 78(g)(1)(B) in the form of a \$50,000 bond, the minimum amount required based on the number of wells Seaco operates. If Seaco filed financial assurance based on the total depth of all of its wells in the amount of \$2.00 per foot as provided for by Texas Natural Resources Code §91.1041 and Statewide Rule 78(g)(1)(A), it would be required to file financial assurance in the amount of \$200,578.
4. Seaco requests that the Commission grant exceptions to Statewide Rule 21 to permit Seaco to produce seven wells on three leases by swabbing as a method of production. These are Well Nos. 2 and 3A on the Elton F. Strey Lease, Well No. 1A on the Cover Lease, and Well Nos. 1, 2, 3, and 4 on the Ernest Doege Lease, all in the La Vernia Field in Guadalupe County.
5. The granting of the requested exceptions to Statewide Rule 21 will enable Seaco to produce hydrocarbons that otherwise would not likely be recovered.
 - a. During the last full year when the involved wells were produced by jetting, the wells produced an average of 2 barrels of oil per well per month.

- b. The jetted wells are not equipped to be produced by pumping. Producing the wells by pumping would not produce a positive cash flow to the operator.
 3. The seven jetted wells produce approximately 168 barrels of oil per year.
 - d. The decline curve for the seven jetted well is essentially flat.
 - e. If the requested exceptions to Statewide Rule 21 are granted, Seaco estimates that on the average, the involved wells will produce at least two barrels of oil per well per month, resulting in the production of 168 barrels of oil per year, or 1,680 barrels of oil over a decade.
6. All of the involved wells are equipped with wellheads to maintain surface control.
 7. Granting of the requested exceptions to Statewide Rule 21 will not result in pollution of usable quality water or a safety hazard.
 - a. Seaco's jetting of the involved wells will not result in any significant oil spillage. Air blown down the annulus pushes fluids up the production tubing directly into a flowline feeding into a storage tank or gunbarrel.
 - b. The involved wells do not produce gas so there is no danger of H₂S escape.
 8. Seaco has currently effective mineral leases with one or more mineral owners on each lease involved in these applications.
 9. Seaco plugs its wells as necessary when they are no longer capable of economic production. Seaco has plugged five wells on the Cover Lease and two wells on the Strey Lease in the last three years. Seaco does not have any SWR 14(b)(2) wells.
 10. Seaco has no history of prior violations of Commission rules.

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 in this hearing have been performed.
3. Seaco has a good faith claim of a current right to operate the leases and wells.
4. Approval of the exceptions to Statewide Rule 21 [16 TEX. ADMIN. CODE §3.21] requested by Seaco will prevent the waste of hydrocarbons.
5. Seaco presented sufficient evidence to justify the granting of exceptions to Statewide Rule 21.

RECOMMENDATION

The examiner recommends that the three applications be approved subject to the conditions of the Final Order.

Respectfully submitted,

Marshall Enquist
Hearings Examiner