

OIL AND GAS DOCKET NO. 02-0248613

THE APPLICATION OF SABCO OPERATING COMPANY TO CONSIDER EXCEPTION TO STATEWIDE RULE 26 FOR THE STATE TRACT 659-L NW/4 AND STATE LEASE 629-L SW/4 LEASES, MATAGORDA BLOCK 629 (4450 SD) FIELD, OFFSHORE CALHOUN COUNTY, TEXAS

Heard by: Donna K. Chandler, Technical Examiner
Mark J. Helmueller, Hearings Examiner

Procedural history

Application received:	August 7, 2006
Notice of Hearing:	August 22, 2006
Hearing held:	September 11, 2006
Transcript date:	October 11, 2006
PFD issued:	November 15, 2006

Appearances:

Representing:

Doug Dashiell
Tim Smith

Sabco Operating Company

Mickey Olmstead
Cary McGregor
Alfred Wagner, Jr.

Wagner Resources, Ltd.

Matthew Scott

General Land Office

EXAMINERS' REPORT AND PROPOSAL FOR DECISION

STATEMENT OF THE CASE

Statewide Rule 26 requires generally that liquid hydrocarbons be separated from gas and that both be measured before leaving a lease. Rule 26 also provides for exceptions wherein the Commission may approve commingling on the surface of oil, gas, or oil and gas production from more than one lease, if necessary to prevent waste, to promote conservation or to protect correlative rights.

Sabco Operating Company ("Sabco") requests surface commingling authority for the three wells it operates on two leases in the Matagorda Block 629 (4450 Sd) Field. The

three wells are the State Tract 659-L NW/4 Well No. 2 and State Lease 629-L SW/4 Well Nos. 1 and 3. The application is protested by Wagner Resources, Ltd. ("Wagner"), an overriding royalty owner in Tract 659.

The State of Texas owns a different royalty interest in each lease and the General Land Office was represented at the hearing. The GLO has no objections to Sabco's request for Rule 26 exception and allocation method. Additionally, the working interest ownership in the two wells on the State Lease 629-L SW/4 lease is not identical.

DISCUSSION OF THE EVIDENCE

Applicant's Position and Evidence

There are three producing oil wells in the Matagorda Block 629 (4450 Sd) Field: the State Tract 659-L NW/4 No. 2 and State Lease 629-L SW/4 Well Nos. 1 and 3. All are operated by Sabco. These wells have been producing since 1983 and have been produced with gas lift for several years, using purchased gas for the gas lift operations. Total production is about 10,000 BO per month for the three wells. The only gas production is associated with gas lift, not formation production.

The wells are located approximately 10 miles away from land in State waters. The facilities consist of two platforms. On one platform, there is a 15,000 barrel oil storage tank for the commingled oil. The three wellheads and separation facilities are on the other platform.

The initial operator of the leases, Kirby Exploration Company, filed an application for exception to Statewide Rule 26 on Form P-17¹ with the Commission in 1983. The application was approved and the production from the two leases has been surface commingled since that time. Allocation of production to individual wells was based on routine Form W-10 well tests.

Through several operator changes over time, the leases have been surface commingled and Form P-17's have been approved by the Commission for the various operators. Sabco became the operator of the two leases in 1997 and continued to operate the leases under the approved Form P-17 of American Exploration, the prior operator. In 2006, Wagner Resources advised Sabco that all of the P-17 filings made by the previous operators were incorrect in that they stated that commingled royalty interest ownership was the same for both leases. Sabco's investigation indicated that Wagner owns approximately 2% overriding royalty in Tract 659, but no interest in Tract 629. Sabco then filed Form P-17 for the two leases in July 2006, indicating that royalty interests in the two leases were not identical. The working interests in the two leases are also different; on the 629 lease the working interest ownership is different between the two wells on the lease. On the application for surface commingling, Sabco indicated that it intended to use periodic well

¹Application for Exception to Statewide Rule 26 and 27

tests to allocate production to each lease.

Sabco submitted production histories from the two leases from 1993 to early 2006. Water cut of production from the 629 lease is currently 94% and water cut of production from the 659 lease is currently 87%. Total fluid production from the two leases is currently about 350 BOPD and 5,000 BWPD. In 2001, the wells were worked over by Sabco and new gas lift valves were installed. Since 2002, oil production from the three wells has been over 10,000 BOPM, which is higher than any time since 1993.

From the three wellheads, the combined production flows through separation facilities, the primary separator being a large, three phase, low pressure separator. Gas is moved from the separator to a compressor system for repressurization for the gas lift system. Water is separated from the oil, treated, and disposed of in the Gulf of Mexico. The oil moves through the heater treater, and into the 15,000 barrel tank.

Besides the large, low pressure separator on the platform, there are two smaller separators on the same platform through which individual well production can be diverted. These smaller separators are used for testing individual wells for allocation purposes. The two test separators and the large, low pressure separator are normally in constant use due to the high water cut of the production and the need for longer retention time to accomplish effective separation of oil and water. The oil separated in test separator No. 1 is directed to test separator No. 2 for further separation of free water. Sabco submits that any changes to the current separating operations would create operational problems in monitoring the gas lift system. Further, the cost to install an additional separator on the platform is estimated to be \$250,000.

Sabco asserts that substantial test information from each of the three wells demonstrates that its allocation method is adequate. Sabco tested the 629 No. 1L 26 times in 2004, 32 times in 2005 and 15 times in the first quarter of 2006. The 629 No. 3 was tested 37 times in 2004, 33 times in 2005 and 16 times in the first quarter of 2006. The 659 No. 2U was tested 49 times in 2004, 35 times in 2005, and 16 times in the first quarter of 2006. Sabco compared the total actual monthly production from the three wells to the sum of the producing rates indicated by the testing of the three wells over the same time period beginning in 2006. The difference over the period of time is only 3%, indicating to Sabco that its testing procedures accurately represent of monthly production from each well. Sabco does not believe that there are any unusual fluctuations in monthly production from any of the three wells. Down time for each well is integrated into the allocation for each well.

Protestant's Position and Evidence

Wagner suggests that there are unusual fluctuations in production from the three subject wells and that Sabco's present method of allocating production to each well is therefore not an accurate representation of actual production from each well. For the 659 lease Well No. 2, Wagner analyzed the test data from 2004-2006 supplied by Sabco for the well. On average, this well was tested 3-4 consecutive days per month. For the most part,

production only differed 1-2% during the test days for the month. However, Wagner pointed to examples of significant variations in production from the well. On April 4-6, 2006, production varied between 162 and 180 BOPD. On May 7-9, 2006, production varied between 147 and 163 BOPD. Between June 9-11, 2006, the well produced 219-223 BOPD, substantially higher rates than the May testing.

Wagner requests that Sabco run production from the single well on the 659 lease through test separator No. 1 continuously, except for days that the other two wells are tested during the month. The oil production from the 659 lease would then be metered for approximately 24 days per month, resulting in a more accurate determination of actual production from the well on the 659 lease than Sabco's current allocation method of metering each well 2-3 days per month. At the least, Wagner believes Sabco should rotate producing each well through the test separator and meter every fourth day. This would give metered results for each well for at least 9 days per month, compared to the current 3 days per month.

EXAMINERS' OPINION

Statewide Rule 26(b)(3) provides the following:

The applicant must demonstrate to the Commission or its designee that the proposed commingling of hydrocarbons will not harm the correlative rights of the working or royalty interest owners of any of the wells to be commingled. The method of allocation of production to individual interests must accurately attribute to each interest its fair share of aggregated production.

(A) In the absence of contrary information, such as indications of material fluctuations in the monthly production volume of a well proposed for commingling, the Commission will presume that allocation based on the daily production rate for each well as determined and reported to the Commission by semi-annual well tests will accurately attribute to each interest its fair share of production without harm to correlative rights.

Sabco submits that its testing goes far beyond the semi-annual testing required by Rule 26 and is sufficient as the basis for allocation of production. However, Wagner Exhibit No. 1 (attached) illustrates the variations in production from the 659 No. 2 well.

Because of the fluctuations in production, the examiners recommend that the application be approved, with the condition that Sabco be required to direct the production from the 659 No. 2 well through test separator No. 1 at least 15 days per month for allocation purposes. The additional testing will insure that Wagner's interest is protected, while still allowing Sabco to test the two wells on the 629 lease each month for several days. It would not be practical to require Sabco to meter the 659 No. 2 every day of the month because of the divergent interests in the two wells on the 629 lease. Those two wells must also be tested for allocation purposes.

The recommendation of the examiners would not require Sabco to install or modify its production facilities. Sabco already regularly routes production from each of the three wells through the test separator due to capacity issues and required retention time to sufficiently separate water from the production stream.

FINDINGS OF FACT

1. Notice of this application and hearing was issued to all working interest and royalty interest owners in the wells which are the subject of the application.
2. Sabco Operating Company operates all three producing wells in the Matagorda Block 629 (4450 Sd) Field. The three wells are the State Tract 659-L NW/4 Well No. 2 and State Lease 629-L SW/4 Well Nos. 1 and 3.
3. Wagner Resources, Ltd. owns an overriding royalty interest in the State Tract 659-L NW/4 lease and no interest in the State Lease 629-L SW/4 lease. The working interest ownership in the two wells on the State Lease 629-L SW/4 is not identical.
4. The subject wells have been producing since 1983 and gas lift equipment was installed on the wells in 2001. The only gas production is associated with gas lift, not formation production. Current production from the three wells is approximately 10,000 BO per month and 150,000 BW per month.
5. The wells are located in State waters. The production facilities for the wells are on two platforms.
6. The production from the leases has been surface commingled since 1983 under authority granted by the Commission to Kirby Exploration Company. Allocation of production to individual wells has been based on routine Form W-10 well tests since 1983.
7. Wagner informed Sabco of the differing interest ownership in the two leases in 2006.
8. There are material fluctuations in production from the State Tract 659-L NW/4 Well No. 2.
 - a. On average, the well is tested 3-4 consecutive days per month through a test separator.
 - b. On April 4-6, 2006, production varied between 162 and 180 BOPD.
 - c. On May 7-9, 2006, production varied between 147 and 163 BOPD.

- d. Between June 9-11, 2006, the well produced 219-223 BOPD, substantially higher rates than the May testing.
- 9. Testing the State Tract 659-L NW/4 No. 2 more frequently than 2-3 days per month will result in more accurate allocation of production from that well.
- 10. Sabco's production facilities already have the capability to separately meter production from the State Tract 659-L NW/4 Well No. 2 at least 15 days per month, while allowing for testing of the two wells on the State Lease 629-L SW/4.

CONCLUSIONS OF LAW

- 1. Proper notice was given to all necessary parties as required by Statewide Rule 26 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.26] and other applicable statutory and regulatory provisions.
- 2. All things necessary to give the Commission jurisdiction to decide this matter have been performed or have occurred.
- 3. An exception to Statewide Rule 26, subject to the permit condition that the State Tract 659-L NW/4 Well No. 2 be tested at least 15 days per month, will not harm the correlative rights of the working or royalty interest owners of any of the wells to be commingled.

EXAMINERS' RECOMMENDATION

Based on the above findings and conclusions, the examiners recommend that the application of Sabco Operating Company for exception to Statewide Rule 26 be approved with the condition that Sabco be required to test the State Tract 659-L NW/4 Well No. 2 at least 15 days per month.

Respectfully submitted,

Donna K. Chandler
Technical Examiner

Mark J. Helmueller
Hearings Examiner