



RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL AND GAS DOCKET NO. 8A-0296035

**THE APPLICATION OF PARALLEL PETROLEUM LLC PURSUANT TO STATEWIDE
RULE 50 FOR APPROVAL OF ITS FORM H-13 EOR POSITIVE PRODUCTION
RESPONSE CERTIFICATION FOR PROJECT NO. F-16883H, CARM-ANN (SAN-
ANDRES) UNIT, CARM-ANN (SAN ANDRES) FIELD, GAINES COUNTY, TEXAS**

PROPOSAL FOR DECISION

HEARD BY: Paul Dubois – Technical Examiner
Laura Miles-Valdez – Hearings Examiner

HEARING DATE: August 19, 2015

APPEARANCES:

William Hayenga
Jerry Nevans
Shelli Nevans

REPRESENTING:

Parallel Petroleum LLC

PROCEDURAL HISTORY

Application (Form H-12) Approved:	March 18, 2011
Application (Form H-13) Filed:	March 17, 2015
Application (Form H-13) Denied:	May 18, 2015
Request for Hearing:	May 26, 2015
Notice of Hearing:	July 14, 2015
Date of Hearing:	August 19, 2015
Transcript Received:	August 31, 2015
Proposal For Decision Issued:	November 2, 2015

STATEMENT OF THE CASE

Pursuant to Statewide Rule 50 (16 Tex. Admin. Code §3.50), Parallel Petroleum LLC (Parallel) seeks Commission certification of an enhanced oil recovery (EOR) positive oil production response for its Carm-Ann (San Andres) Unit (CSAU), in the Carm-Ann (San Andres) Field, Gaines County, Texas. Parallel's application on Form H-13 was administratively denied by Commission staff because it did not meet the time constraints provided by Statewide Rule 50. Parallel's evidence shows the project demonstrated a positive production response, but the response was not within the three-year time period required by Rule 50. Parallel asserts the delay was caused by technical and logistical supply issues with essential hardware needed to implement the project. Parallel requested a hearing on the matter, at which Commission staff did not protest. The Examiners recommend denial of the application for failure to comply with the statutory filing deadline.

APPLICABLE LAW

Texas Tax Code §202.054 (g) states: "Subject to the provisions of Subsections (b) and (h) of this section, the recovered oil tax rate applies to oil on which a tax is imposed by this chapter for the 10 years beginning the first day of the month following the date the commission certifies that, in the case of an enhanced recovery project including a co-production project, a positive production response has occurred or, in the case of an expansion, other than related to a co-production project, incremental production has occurred, if the application for certification is filed: (1) not later than three years from the date the commission approves the project if the project is designated as a new or existing project other than a co-production project that uses a secondary recovery process; or (2) not later than five years from the date the commission approves the project if the project is designated as a new or existing project that uses a tertiary recovery process or is a co-production project."

Statewide Rule 50(g)(2)(A) states: "The operator of an EOR project that meets the requirements of this section shall demonstrate to the Commission a positive production response before the operator can receive Commission certification of such a positive production response. The certification date may be any date desired by the operator, subject to Commission approval, following the date on which a positive oil production response first occurred. The operator shall apply for a positive production response certificate within three years of project approval for secondary projects, and within five years of project approval for tertiary projects, to qualify for the recovered oil tax rate. The oil produced from the designated area of a new EOR project or incremental oil produced from the designated area of an expanded EOR project after the date of certification of a positive production response is eligible for the recovered oil tax rate. The operator shall apply to the comptroller pursuant to the Tax Code, §202.052 and §202.054, to qualify for

the recovered oil tax rate.”¹

Statewide Rule 50(g)(2)(C) states: “The application for the positive production response certificate shall be processed administratively. If the Commission representative denies administrative approval, the applicant shall have the right to a hearing upon request. After hearing, the examiner shall recommend final action by the Commission.”²

MATTERS OFFICIALLY NOTICED

On the Applicant’s request, the Examiners take official notice of the audio/video recording of the Railroad Commission of Texas Open Conference at which the following matter was taken up:

January 27, 2015. Item 7. O&G Docket No. 8A-0291190: Application of Apache Corporation pursuant to 16 TAC §3.50 for approval of its Form H-13 enhanced oil recovery positive production response certification for the Adair San Andres Unit, Adair Field, Gaines and Terry Counties, Texas.

http://www.adminmonitor.com/tx/rcc/open_meeting/20150127/

The Examiners further take official notice of Railroad Commission Forms (and instructions) H-12 New or Expanded Enhanced Oil Recovery Project and Area Designation Approval Application, and H-13 EOR Positive Production Response Certification Application.

DISCUSSION OF THE EVIDENCE

The Carm-Ann (San Andres) Field was discovered in 1979 when wells completed in the Queen Sand Formation were deepened into the San Andres Formation. In 2004, wells in the field were acquired by Parallel, which began infill drilling on 10-acre units. In 2009, Parallel prepared a water flood study of the field and began the process of unitization. A certificate of unitization was recorded in Gaines County, Texas, on January 10, 2011.

On March 4, 2011, Parallel submitted a Form H-12, New or Expanded Enhanced Oil Recovery Project and Area Designation Approval Application, to the Commission. Parallel proposed to water flood the unitized formation for secondary recovery of oil and gas. Parallel estimated the proposed project would result in an additional production of more than 2.4 million barrels of oil and 2 billion cubic feet of gas. The Commission approved Form H-12 on March 18, 2011; Parallel had until March 18, 2014 to file Form H-13, demonstrating a positive production response to the project. Parallel expected to see

¹ 16 Tex. Admin. Code §3.50(g)(2)(A) (emphasis added).

² 16 Tex. Admin. Code §3.50(g)(2)(C) (emphasis added).

a positive production response by March 2013.

When the Form H-12 was approved there were 58 producing oil wells in the CSAU. Parallel has since drilled new wells and converted existing producing wells to injection service. There are now 86 wells in the field: 29 injection wells and 57 producers.

In April 2014, 5,310 barrels of oil were produced on the CSAU, and the average monthly production from May 2013 through April 2014 was 5,396 barrels. A positive production response to the water flood project was observed in May 2014. In May 2014, the field produced 9,852 barrels of oil. From May 2014 through December 2014 the average monthly oil production was 9,904 barrels. On March 10, 2015, Parallel filed Form H-13, EOR Positive Production Response Certification Application. Commission staff denied the application on May 18, 2015, because the application was not filed within three years of Form H-12 approval.

Parallel argues the delayed positive production responses arises from, generally, two sources: technical project delays and logistical project delays. In particular, Parallel argues that without the logistical delays the project would have experienced a positive production response much sooner and within the statutory time requirements. These sources of delay are described in the following subsections.

Technical Project Delays

The CSAU project was designed to be analogous to Parallel's nearby Harris San Andres Unit (HSAU), located about three miles to the west. Geologically, the two units are similar in that both are secondary recovery projects from similar depths in the San Andres Formation. The produced hydrocarbons exhibit similar fluid properties, and the reservoirs exhibit similar geologic properties including a preferential permeability in the east-west direction. The HSAU project demonstrated a positive production response within about one year.³ However, there were some important differences in the two units, and Parallel anticipated the CSAU would require a longer time for a positive production response—two years or more. Generally, the San Andres Formation in the CSAU is an older and more developmentally mature reservoir than the HSAU. With respect to the HSAU, the CSAU has a lower reservoir fluid pressure, a higher water cut, and a higher gas-oil ratio (GOR). All of these factors suggest the CSAU would require a much larger water flood effort to restore formation pressure and fluid volume. While Parallel anticipated the response time would be twice as long in the CSAU, it also experienced logistical problems that further delayed the response.

Logistical Project Delays

The GSAU consisted of 14 leases on 1,480 acres of land. Following unitization,

³ Tr. 37: 22-23.

Parallel required more time than anticipated to consolidate the existing lease facilities and infrastructure to implement the water flood project. Of critical importance, Parallel experienced third-party delays in the delivery of equipment and services required for the project. The project was initiated during the height of recent activity in the Permian Basin, at a time when materials and services were in high demand and short supply. Specifically, Excel Energy was delayed six months in installing upgraded electric meter service necessary to power the injection facilities. Also, the project was designed to use two 250 horsepower horizontal pumps as the backbone of the injection system. The horizontal pumps were manufactured by GE, and the horizontal pumps were not received at the unit until 12 months after the original promised delivery date. The pumps were ordered in 2011 with a March 2012 delivery date. The pumps were delivered in September 2013.⁴

Parallel stated its filing of Form H-13 was delayed for several reasons. The positive production response was observed two months after the three-year statutory deadline. To ensure a sustained positive response, Parallel waited an additional two months for production reports to be submitted. Then, knowing it had missed the statutory filing deadline, it sought counsel on how to proceed, which took several additional months.

Parallel requests the Commission approve its Form H-13 with an effective date of June 1, 2014, the first month following the positive production response observed in May 2014. Alternatively, Parallel suggests an effective date of March 10, 2015, the date it submitted Form H-13 to the Commission. Parallel stated that it pursued this project specifically with the intention of complying with Statewide Rule 50, but logistical circumstances beyond its control caused the delay. Parallel's witness, Jerry Nevans, stated he was not aware, off-hand, of the value of the tax benefit sought through this application.⁵ With out the delay in equipment delivery and installation, Parallel believes the positive production response would have been observed well within the three year time period required by Statewide Rule 50. Parallel requests the Commission exercise what Parallel construes as the Commission's broad discretion authorized by the Texas Tax Code § 202.054(l) and approve Parallel's Form H-13 EOR Positive Production Response Certification Application.

Finally, Parallel cited three prior cases as precedents in which the Commission certified Form H-13 that was submitted outside of the statutory time periods.

EXAMINERS' ANALYSIS OF THE EVIDENCE

The Examiners agree with Parallel that the secondary recovery project convincingly demonstrated a positive production response in May 2014, two months after the three year period required to demonstrate such a response, and that the response has been

⁴ Tr. 44: 2-5.

⁵ Tr. 50: 23 - 51: 6.

sustained. The Examiners further agree that, in general, such secondary recovery projects are necessary to prevent waste of hydrocarbons and to protect correlative rights.

However, the Examiners do not find that either the Texas Tax Code or Statewide Rule 50 provide for an exception, variance, or extension of this filing period. The Examiners, therefore, cannot conclude that Parallel met the requirements of Statewide Rule 50(g)(2)(A) for its positive production response certification. Parallel argues the Commission has broad discretion under the Texas Tax Code to interpret Statewide Rule 50. Nonetheless, the Examiners cannot reach a finding of fact that Parallel's petition meets the requirements of the Texas Tax Code or Statewide Rule 50. The Examiners recommend Parallel's application be denied.

The Examiners' analysis of this matter is separated in several components: (1) the requirements of Texas Tax Code §202.054(g); (2) the Commission's implementation of Statewide Rule 50; and (3) the precedents set by prior Commission actions cited by Parallel.

Requirements of Texas Tax Code §202.054(g)

As described on page 2 above, the present matter is governed by the Texas Tax Code §202.054(g) and Statewide Rule 50(g)(2)(A), which provide a severance tax reduction for successful secondary and tertiary recovery programs. The Texas Tax Code and Statewide Rule 50 require an applicant to apply for a positive production response certification within three years of project approval of a secondary recovery process. Pursuant to Texas Tax Code §202.054(g), the recovered oil tax rate applies "...if the application is filed...not later than three years from the date the Commission approves the project if the project is designated as a new or existing project... that uses a secondary recovery process." According to the Code Construction Act, "[w]ords and phrases shall be read in context and construed according to the rules of grammar and common usage."⁶ The words "...not later than three years from the date the Commission approves the project..." in Tax Code §202.054(g) are clear and, in common usage, imply an absolute cut-off date. Further, Statewide Rule 50 clearly states that "...the operator shall apply for a positive production response certificate within three years of project approval for tertiary projects..." The Code Construction Act states use of the word "shall" imposes a duty.⁷ In this case, Parallel had a duty to file its Form H-13 "no later than" March 18, 2014, but missed that filing by one year.

Implementation of Statewide Rule 50

The Commission implements its responsibilities under Texas Tax Code §202.054(g)

⁶ Texas Gov't Code § 311.011.

⁷ Texas Gov't Code § 311.016(2).

and Statewide Rule 50(g)(2)(A) by the administration of three forms, each initiated by operator action and followed by a Commission action. Two of these forms are relevant to this case:

Form H-12, New or Expanded Enhanced Oil Recovery Project and Area Designation Approval Application

Operator Action: Submit Form H-12 to request Commission approval of the EOR project as a prerequisite to eligibility for the EOR severance tax rate reduction. Form H-12 must be submitted before injection activities begin.

Commission Action: If the H-12 is approved, the operator will be issued a Project and Area Designation Approval. The H-12 approval date starts the clock on subsequent requirements.

Form H-13, EOR Positive Production Response Certification Application

Operator Action: Form H-13 must be filed to request Commission certification that a positive production response has occurred. The operator is permitted to file once a positive production response occurs. However, the form must be filed no later than five years of project and area designation (Form H-12) approval. The operator is responsible for monitoring the project timing.

Commission Action: Commission certification of the H-13 positive production response entitles the operator to apply to the Comptroller of Public Accounts for a reduced severance tax rate for a period of time. Commission staff does not and is not responsible for notifying operators of the pending expiration of the Form H-13 filing period.

In the Parallel case, the following time line unfolded with regard to operator and Commission actions:

March 7, 2011: The Commission receives Parallel's Form H-12 for the CSAU EOR Project.

March 18, 2011: Commission staff administratively approves Parallel's Form H-12 with an effective date of March 18, 2011. Staff assigned it Project No. F-016883H and directed Parallel to file Form H-13 within three years.

March 18, 2014: The statutory deadline for filing Form H-13 passes for the CSAU EOR Project (No. F-016883H).

May 2014: Parallel observes a positive production response from the CSAU EOR

Project (No. F-016883H).

March 17, 2015: The Commission receives Parallel's Form H-13 for the CSAU EOR Project (No. F-016883H).

May 18, 2015: Commission staff administratively deny Parallel's Form H-13.

Precedents

Parallel offered three cases as precedents in which the Commission certified an applicant's Form H-13. Most recently, on January 27, 2015, the Commission found in Oil & Gas Docket No. 8A-0291190 that Apache Corporation's Form H-13 was technically complete and met the positive production response requirements of Statewide Rule 50.⁸ In the Apache case, a positive production response was observed within the statutory time period, but through administrative oversight Apache failed to file the Form H-13 in a timely manner. The Commission concluded in the Apache case that the application was technically complete, and therefore met the requirements of Statewide Rule 50. The Commission determined the appropriate certification date was July 8, 2014, when Apache filed the Form H-13. In the present matter, the situation is different in that the positive production response was not observed within the three-year time period.

On July 14, 2009, the Commission found in Oil & Gas Docket No. 08-0261255 that Kinder Morgan Company's Form H-13 met the requirements of Statewide Rule 50.⁹ In the Kinder Morgan case, the Commission found that the statutory time period began when Commission staff issued a written approval to a Form H-12 application, not when verbal approval was documented. In Kinder Morgan, the Form H-13 was therefore timely filed. In the present matter, the situation is different in that there is not dispute as to when the statutory time period began or that the operator's filing was untimely; in addition to the fact that the positive production response was not observed within the three-year time period.

Parallel also offered a case summary and Final Order for Oil & Gas Docket No. 01-0215175.¹⁰ Although the information submitted was limited, it appears the Hearings

⁸ Oil & Gas Docket No. 8A-0291190: The application of Apache Corporation pursuant to 16 TAC §3.50 for approval of its Form H-13 enhanced oil recovery positive production response certification for the Adair San Andres Unit, Adair Field, Gaines and Terry Counties, Texas.

⁹ Oil & Gas Docket No. 08-0261255: The application of Kinder Morgan CO₂ Company, L.P. for approval of Form H-13, positive production response certification, Yates Field Unit, Yates Field, Pecos County, Texas.

¹⁰ Oil & Gas Docket No. 01-0215175: The application of HCM for severance tax reduction for incremental production from its Big Foot Olmos "B" Sand

Examiner in the case recommended the application be denied because the project consisted of the drilling of additional producing wells to expand primary recovery, not secondary recovery. The Commission, however, ruled that the project did meet the requirements of Statewide Rule 50. In the present matter, there is no dispute that the operator's recovery project is secondary in nature.

The present case presents an issue not addressed in the dockets referenced by Parallel: Does a positive production response that was not observed within the three-year statutory time period, and therefore a Form H-13 could not have been timely filed, meet the requirements of Statewide Rule 50? None of the cited precedents address this particular issue. Therefore, the Examiners cannot find that the application meets the requirements of Statewide Rule 50.

Based on evidence presented and Commission precedent, the Examiners recommend the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. Notice of this hearing was given to all persons entitled to notice.
2. The Commission approved Parallel's application (Form H-12) for the CSAU water flood project March 18, 2011.
3. According to the provisions of the Texas Tax Code and Statewide Rule 50(g)(2)(A), Parallel had until March 18, 2014, to apply for a positive production response certificate.
4. The secondary recovery project demonstrated a positive production response in May 2014, outside of the three-year time frame established by Statewide Rule 50. This is not disputed.
5. Parallel experienced unanticipated logistical delays beyond its control that contributed to a delayed positive production response two months beyond the three-year statutory time period.
6. Parallel submitted a Form H-13, EOR Positive Production Response Certification Application, on May 18, 2015, approximately one year after the positive production response was observed and fourteen months after the March 18, 2014 statutory deadline expired.
7. On May 18, 2014, Commission staff denied Parallel's Form H-13 application because the form "was not filed within three years of the Form H-12 approval date (March 18, 2011)."

8. On May 26, 2015, Parallel requested the matter be set for a hearing.
9. Parallel does not dispute its failure to submit Form H-13 in a timely manner.

CONCLUSIONS OF LAW

1. Resolution of the subject application is a matter committed to the jurisdiction of the Railroad Commission of Texas. Tex. Nat. Res. Code § 81.051.
2. All notice requirements have been satisfied. 16 Tex. Admin. Code § 1.45.
3. Parallel Corporation did not meet the requirements of Texas Tax Code §202.054 (g) or Statewide Rule 50(g)(2)(A) for positive production response certification.
4. Statewide Rule 50 does not provide the Examiners with direction or discretion to amend the filing periods or otherwise recommend the certification sought by Parallel.

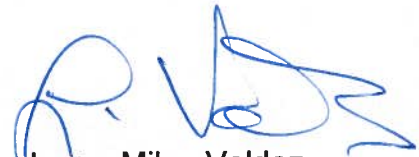
RECOMMENDATION

Based on the above findings of fact and conclusions of law, the Examiners recommend that Parallel Petroleum LLC's application for positive production response certification for the CSAU secondary recovery water flood project be denied.



Paul Dubois
Technical Examiner

Respectfully submitted,



Laura Miles-Valdez
Hearings Examiner