

October 19, 2006

OIL & GAS DOCKET NO. 03-0244755

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APPLICATION OF PREMIUM EXPLORATION COMPANY REGARDING REVOCATION OF THE PLUGGING EXTENSION FOR WELL NO. 1 ON THE ARCO-HOOKS UNIT (23716) LEASE, SPURGER (5275) FIELD, TYLER COUNTY, TEXAS.

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**APPEARANCES:**

**FOR APPLICANT Premium Exploration Company:**

R. Owen Fuqua

**FOR INTERVENER TIN, Inc.**

Jaime Nielson

Tim Tindell

**FOR The Railroad Commission of Texas:**

Reese Copeland

**PROPOSAL FOR DECISION**

**PROCEDURAL HISTORY**

**DATE OF REQUEST FOR HEARING:**

September 27, 2005

**DATE OF FIRST HEARING:**

February 15, 2006

**DATE OF SECOND HEARING:**

May 10, 2006

**PROPOSAL FOR DECISION PREPARED BY:**

Mark Helmueller, Hearings Examiner

**PROPOSAL FOR DECISION CIRCULATED:**

October 19, 2006

## INTRODUCTION

Premium Exploration Company (hereinafter “Premium”) has requested a Commission hearing to contest the proposed revocation of the plugging extension for an inactive well, Well No. 1 on the Arco-Hooks Unit (23716) Lease, Spurger (5275) Field, Tyler County, Texas (hereinafter “subject well”). The proposed revocation arose after the Commission received a complaint from the surface owner, TIN, Inc. (hereinafter “TIN”) claiming Premium’s lease had terminated. Upon receipt of TIN’s correspondence, the Commission contacted Premium concerning the well’s eligibility for a plugging extension in the absence of a good faith claim of a continuing right to operate. Premium responded that the lease was held by the payment of shut-in royalties and requested a hearing to address the revocation issue.

## PROCEDURAL HISTORY

The matter was called to hearing initially on November 30, 2005. Premium did not appear at the hearing. On December 6, 2005, Premium responded to the examiner’s inquiry concerning dismissal with a request to set a hearing after January 1, 2006 due to health issues.

On February 15, 2006, Premium and Temple Inland, Inc., the predecessor in interest to TIN, appeared for the hearing. Premium urged the matter was now moot because the Commission’s P-5 department approved the plugging extension for the subject well on December 9, 2005. The P-5 department advised that it had not determined Premium possessed a good faith claim of a continuing right to operate the well. The extension was granted pursuant to Premium’s renewal of its organization report pending the outcome of the hearing.

On March 6, 2006, the Commission filed a Notice of Appearance through its Enforcement Section of the Office of General Counsel. Premium, TIN, and Enforcement Staff Attorney Reese Copeland, appeared at the second hearing convened in this matter. TIN’s standing to participate as a complainant was not contested.

## APPLICABLE RULES

Statewide Rule 14(b)(2) provides in part:

Plugging operations on each dry or inactive well shall be commenced within a period of one year after drilling or operations cease and shall proceed with due diligence until completed. Plugging operations on delinquent inactive wells shall be commenced immediately unless the well is restored to active operation. For good cause, a reasonable extension of time in which to start the plugging operations may be granted pursuant to the following procedures.

Statewide Rule 14(b)(2)(C)(i) concerning revoking plugging extensions provides:

The Commission or its delegate may revoke a plugging extension if the operator of the well that is the subject of the extension fails to maintain the well and all associated facilities in compliance with Commission rules; fails to maintain a current and accurate organizational report on file with the Commission; fails to provide the Commission, upon request, with evidence of a continuing good faith claim to operate the well; or fails to obtain or maintain financial security as required by §§3.78 of this title (relating to Fees and Financial Security Requirements) (Statewide Rule 78).

### **MATTERS OFFICIALLY NOTICED**

The examiner took official notice of Commission records showing Premium is the operator of 17 wells with a total depth of 112,166 feet. Official notice was also taken of Commission production history records from the “Production Data Query” system for the subject well. The examiner also officially noticed the Commission mainframe records for all completions for the well from the original drilling in June 1974. Finally, official notice was taken of the Commission Form G-1 (Gas Well Back Pressure Test, Completion or Recompletion Report and Log) filed by Premium on May 11, 2006 showing the subject well was recompleted in August 2003 as a gas well in the Spurger (5440) Field. The Commission issued a certificate of compliance for the recompletion on August 14, 2006, identifying the well with RRC Gas ID No. 214183.

### **DISCUSSION OF EVIDENCE**

The subject well was drilled pursuant to a July 1974 oil, gas and mineral lease for a 213.33 acre tract between the mineral interest owner, Atlantic Richfield Company and Prudential Drilling. The lease includes a 90-day primary term, and a continuous production clause maintaining the lease in effect as long as hydrocarbons are produced in paying quantities. The lease provides for termination 30 days after the cessation of production unless the lessee commences drilling or reworking operations and prosecutes such operations with no cessation of more than 30 days. The lease further provides for extension by payments of \$200 per month for each shut-in gas well, with a maximum aggregate limit of 24 months. The lease also contains a retained acreage provision, which terminates the lease for any undeveloped acreage. The retained acreage provision allows the lease to remain in effect for the 40 acres surrounding any producing oil well and 320 acres surrounding each well capable of producing gas. A copy of the lease agreement is attached as Exhibit 1 to the proposal for decision.

The subject well was originally drilled in June 1974 by Prudential Drilling Company. It was completed in both the Spurger, E. (5050) and (5750) Fields as both an oil and gas well. In January 1979, Cambern Operating Company recompleted the well in the Spurger, E. (5500) Field.

Premium was first recognized by the Commission as the operator of the subject well on May 2, 1990. Premium recompleted the well as an oil well in the Spurger (5275) Field, (Lease No. 21911) on October 31, 1992. Premium recompleted the well as a gas well again in the Spurger, E. (5500) Field, (Gas ID No. 165925) on November 25, 1997. Premium recompleted the well as an oil well back into the Spurger (5275) Field, (Lease No. 23716) on July 15, 1999.

The well was last recompleted as gas well in the Spurger (5440) Field. Premium reportedly recompleted the well on August 23, 2003, but it did not file a Form G-1 until May 2006. Based on this recompletion, the Commission issued a certificate of compliance on August 14, 2006, identifying the well with RRC Gas ID No. 214183.

Monthly reports for the subject well indicate sporadic production of a single mcf of gas dating back to September 2003. There have been no sales of natural gas or oil from the subject well since at least September 2003, and the minimal production reported was written off for lease use.

#### *Premium's Position*

Premium first acquired the subject well at a bankruptcy sale in 1989. It acquired the royalty interest through an assignment in 1992. Premium admits the well has not produced since September 2003.

Premium offered two theories for the continued validity of the July 1974 lease. It first argues the lease remains valid under the shut-in royalty provision related to gas wells. Premium contends the subject well was a gas well effective in August 2003 after workover operations to the Spurger (5440) Field, regardless of when Premium submitted the required completion forms to the Commission. Premium then claims its ownership of the royalty interest in the subject well did not require it to actually make shut-in royalty payments to itself to perpetuate the lease.

Premium also argues that the mineral interest owner, BP America Production Company ("BP"), the successor in interest to Atlantic Richfield Company, effectively ratified the July 1974 lease through the actions of its purported agent, Dick Womack, LLC. Womack obtained an Oil and Gas Lease Option from BP for the 213.33 acre lease in April 2004. In May 2004, Womack filed an action in the Tyler County District Court for a determination that the July 1974 lease was terminated. On June 23, 2005, after a settlement of the case, an order to dismiss the suit was entered on the joint motion of Womack and Premium. Premium asserts Womack was acting as BP's agent in the lawsuit and could not have entered into the settlement absent BP's consent.

#### *TIN's position*

TIN argues the Commission has proper authority to evaluate whether Premium possesses a good faith claim of a continuing right to operate under *Magnolia Petroleum Co. v. Railroad Commission*, 170 S.W.2d 189, 191 (Tex. 1943). TIN contends that neither of Premium's theories meets the low threshold of establishing Premium's good faith claim of a continuing right to operate the subject well. TIN asserts the shut-in royalty provision is not sufficient to establish a good faith claim even if Premium's self payment theory is accepted. TIN argues this theory fails because the well has not produced since September 2003, a time period which exceeds the maximum aggregate period of 24 months specified in the lease provision.

TIN urges the second theory is not supported by the record as there is no documentation establishing Womack acted as BP's agent. The April 6, 2004 Oil and Gas Lease Option between BP and Womack does not specifically provide that Womack would act as BP's agent in any legal proceeding. Additionally, the Oil and Gas Lease Option requires Womack to indemnify, protect and hold harmless BP in any legal proceedings. TIN further notes that BP was not a party to the lawsuit and did not execute the settlement agreement. Additionally, there is no recitation in the settlement agreement in which Womack acknowledges acting as BP's agent.

TIN also independently argues Premium does not meet the requirements for a plugging extension because it failed to maintain the lease in compliance with Commission rules. TIN provided a series of photographs showing leaking tanks, and abandoned equipment at the well site.

Finally, TIN submitted an *amicus curiae* letter from Doug Johnson of BP dated June 16, 2006. Mr. Johnson states BP's position that Premium has not perpetuated a valid oil and gas lease and has no right to operate the aforementioned well. Mr. Johnson also supports TIN's position and requests the Commission cancel Premium's plugging extension for the subject well.<sup>1</sup>

#### *Staff's position*

Staff contends the Commission cannot revoke the plugging extension without making a determination concerning contract rights and title concerning the validity of the July 1974 lease. While Staff did not confirm the ultimate legal validity of any of Premium's arguments, it urges that Premium provided "evidence of a factually supported claim of a recognized legal theory" to support its continuing right to operate the subject well as defined under Statewide Rule 14(a)(1)(e).

### **EXAMINER'S OPINION**

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<sup>1</sup>Premium objected to any consideration of Mr. Johnson's letter as late and improper. The Commission Staff Attorney also objected to any consideration of the letter based on Mr. Johnson's failure to appear at the hearing after having received notice. The examiner notes BP was not a party to the hearing and is not included on the service list. The parties also confirmed at the hearing that Mr. Johnson was not subpoenaed to appear and testify at the hearing.

The objections to BP's letter are overruled. BP's letter supporting TIN's position was not considered as evidence concerning the continuing validity of the July 1974 lease. However, it was considered with respect to Premium's assertions that Womack acted as BP's agent in prosecuting and settling the Tyler County action.

The question in this case is relatively simple: Does Premium possess a continuing good faith claim to support its right to operate the well? It is the examiner's opinion that neither legal theory advanced by Premium is a factually supported claim sufficient to establish the continued validity of the July 1974 oil, gas and mineral lease.

The Commission has jurisdiction to determine an applicant's claimed possessory interest in the mineral estate when issuing a permit as held in *Magnolia Petroleum Co. v. Railroad Commission*, 170 S.W.2d 189, 191 (Tex. 1943). The Texas Supreme Court recognized in *Magnolia*:

"... the Railroad Commission should not do the useless thing of granting a permit to one who does not claim the property in good faith. The Commission should deny the permit if it does not reasonably appear to it that the applicant has a good-faith claim in the property." *Magnolia* at p. 191.

The Commission has incorporated *Magnolia's* holding in determining the eligibility of an inactive well for a plugging extension. This is reflected by the language of Statewide Rule 14(b)(2)(C)(i):

The Commission or its delegate may revoke a plugging extension if the operator of the well that is the subject of the extension . . . fails to provide the Commission, upon request, with evidence of a continuing good faith claim to operate the well....

Premium's first theory contends the July 1974 lease is perpetuated by the provision allowing for the monthly payment of a shut-in royalty for each gas well. Premium claims it is automatically entitled to extend the lease without actually making a monthly payment because it also owns the royalty interest. Premium further urges that the well qualifies as a gas well based on the recompletion of the well in August 2003 into a gas field, even though the well was carried on Commission records as an oil well until August 2006.

The perpetuation of the lease through the ostensible payment of shut-in royalties is limited to an aggregate period of 24 months. It is undisputed that there has been no production from the lease since September 2003. Under these facts, the lease can only be extended by the purported payment of shut-in royalties through September 2005. Accordingly, there is no factually supported claim to establish the continued validity of the July 1974 lease after September 2005 based on Premium's theoretical payment of shut-in royalties to itself.

Premium also claims BP ratified the July 1974 lease through its agent. Premium argues that Womack became BP's agent when BP granted Womack the lease option for the property. Premium then urges Womack's settlement of the lease termination lawsuit was an admission that Premium still has a valid lease over the 40 acres surrounding the subject well. Premium further contends Womack's purported admission is binding on BP.

The theory that the July 1974 lease was somehow ratified by the settlement agreement

between Womack and Premium is not supported by the evidence. The April 6, 2004 Oil and Gas Lease Option between BP and Womack does not specifically provide that Womack would act as BP's agent in any legal proceeding. In fact, the Oil and Gas Lease Option requires Womack to indemnify, protect and hold harmless BP in any legal proceedings. This directly contradicts the generally accepted principle of agency law that the principal is required to indemnify its agent. See *Mercedes-Benz of North America, Inc. v. Dickenson*, 720 S.W.2d 844, 858 (Tex.App.-Fort Worth, 1986, no writ). BP was not a party to the lawsuit and did not sign the settlement agreement. The settlement agreement does not contain a recitation regarding Womack's status as BP's agent. The only evidence with respect to BP's position concerning ratification is Mr. Johnson's letter advising that BP does not accept **any** theory proffered by Premium that Premium has perpetuated the July 1974 lease.

Premium has not provided factual support for either theory perpetuating the July 1974 lease. In the absence of any factually supported claim of a recognized legal theory to support its continuing right to operate the subject well, Premium's plugging extension must be revoked.

Based on the record in this case, the examiners recommend 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 this docket was sent to all parties entitled to notice. Premium Exploration Company ("Premium") appeared at the hearing and presented evidence. TIN, Inc. (hereinafter "TIN"), and Commission staff also appeared at the hearing.
2. Commission "On-Schedule Leases, Wells, Wellbores By Operator" records show that Premium is the operator of 17 wells with a total depth of 112,166 feet.
3. Premium was first recognized by the Commission as the operator of the Well No. 1 on the Arco-Hooks Unit (hereinafter "subject well") on May 2, 1990.
4. Premium recompleted the well as an oil well in the Spurger (5275) Field, (Lease No. 21911) on October 31, 1992. Premium recompleted the well as a gas well again in the Spurger, E. (5500) Field, (Gas ID No. 165925) on November 25, 1997. Premium recompleted the well as an oil well back into the Spurger (5275) Field, (Lease No. 23716) on July 15, 1999.
5. Premium reportedly recompleted the well on August 23, 2003 in the Spurger (5440) Field, but it did not file a Form G-1 (Gas Well Back Pressure Test, Completion or Recompletion Report and Log) until May 2006. Based on this recompletion, the Commission issued a certificate of compliance on August 14, 2006, identifying the well with RRC Gas ID No. 214183.

6. There has been no production from the subject well since September 2003.
7. Premium first acquired any interest in the subject well at a bankruptcy sale in 1989. It acquired the royalty interest through an assignment in 1992.
8. The subject well was drilled pursuant to a July 1, 1974 oil, gas and mineral lease for a 213.33 acre tract between the mineral interest owner, Atlantic Richfield Company and Prudential Drilling.
  - A. The lease includes a 90 day primary term, and a continuous production clause maintaining the lease in effect as long as hydrocarbons are produced in paying quantities.
  - B. The lease provides for termination 30 days after the cessation of production unless the lessee commences drilling or reworking operations and prosecutes such operations with no cessation of more than 30 days.
  - C. The lease provides for extension by payments of \$200 per month for each shut-in gas well, with a maximum aggregate limit of 24 months.
  - D. The lease contains a retained acreage provision, which terminates the lease for any undeveloped acreage. The retained acreage provision allows the lease to remain in effect for the 40 acres surrounding any producing oil well and 320 acres surrounding each well capable of producing gas.
9. BP America Production Company (“BP”), is the successor in interest to Atlantic Richfield Company, and owns the 213.33 acre mineral estate.
10. Premium did not establish a factually supported claim that the July 1974 lease remained valid under the shut-in royalty provision.
  - A. There has been no production from the well since September 2003.
  - B. The shut-in royalty provision has a maximum aggregate limit of 24 months.
  - C. The 24 month aggregate limit for perpetuating the lease by the payment of a shut-in royalty for each gas well was reached in September 2005.
11. Premium did not establish a factually supported claim that BP ratified the July 1974 lease.
  - A. The April 6, 2004 Oil and Gas Lease Option between Dick Womack, LLC (“Womack”) and BP provides that Womack would indemnify, protect and hold harmless BP in any legal proceedings.



- B. BP was not a party in the action filed by Womack in the Tyler County District Court for a determination that the July 1974 lease was terminated.
- C. BP did not execute the release and settlement agreement entered into between Premium and Womack to settle the action filed in the Tyler County District Court.
- D. The release and settlement agreement does not identify Womack as the agent of BP.

### **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. Statewide Rule 14(b)(2)(C)(i) requires an operator to establish a good faith claim of a continuing right to operate a well as a condition to obtaining a plugging extension.
4. Premium did not provide a factually supported claim of a current right to operate Well No. 1 on the Arco-Hooks Unit Lease, RRC Gas ID No. 214183, Spurger (5440) Field, Tyler County, Texas.
5. Pursuant to Statewide Rule 14(b)(2)(c)(i), the plugging extension for Well No. 1 on the Arco-Hooks Unit Lease, RRC Gas ID No. 214183, Spurger (5440) Field, Tyler County, Texas should be revoked because Premium did not provide a factually supported claim of a current right to operate the well.

### **RECOMMENDATION**

The examiner recommends the plugging extension for Well No. 1 on the Arco-Hooks Unit Lease, RRC Gas ID No. 214183, Spurger (5440) Field, Tyler County, Texas be revoked.

Respectfully submitted,

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Mark Helmueller  
Hearings Examiner