

June 5, 2007

**OIL & GAS DOCKET NO. 03-0241972**

---

**APPLICATION OF MASTERS RESOURCES, L.L.C. AND MASTERS OIL & GAS, L.L.C. TO CONSIDER A REDUCTION IN THE AMOUNT OF FINANCIAL ASSURANCE REQUIRED PURSUANT TO STATEWIDE RULE 78(g), FOR BAY WELLS IN VARIOUS FIELDS, GALVESTON AND CHAMBERS COUNTIES, TEXAS.**

---

**APPEARANCES:**

**FOR APPLICANT:**

**APPLICANT:**

J. David Hall, Attorney  
John W. Barton, Owner  
Ronald Lenser, Consulting Pet. Eng.  
Sook Lee Miller, Consulting C.P.A.  
W.F. Cowan, Consulting Appraiser

Masters Resources, LLC & Masters Oil & Gas, LLC.  
“  
“  
“  
“

**OBSERVER:**

Daryl Morgan, Landman

Texas General Land Office

**AMENDED PROPOSAL FOR DECISION**

**PROCEDURAL HISTORY**

<b>DATE OF REQUEST FOR HEARING:</b>	February 22, 2005
<b>DATE OF NOTICE OF HEARING:</b>	March 4, 2005
<b>DATE OF HEARING:</b>	April 20, 2005
<b>HEARD BY:</b>	Marshall Enquist, Hearings Examiner
<b>DATE RECORD CLOSED:</b>	October 20, 2005
<b>DATE PFD CIRCULATED:</b>	November 10, 2005
<b>INTERIM ORDER ISSUED:</b>	March 29, 2006
<b>HEARING REOPENED:</b>	April 18, 2007
<b>REOPENED HEARING CLOSED:</b>	April 25, 2007
<b>AMENDED PFD CIRCULATED:</b>	June 5, 2007

**STATEMENT OF THE CASE**

This is the application of Masters Resources, L.L.C. and Masters Oil & Gas, L.L.C. (hereinafter collectively “Masters”) filed pursuant to Statewide Rule 78(g)(5) for a reduction in the amount of financial security required for Masters’ bay wells. As of December 3, 2004<sup>1</sup>, Statewide

---

<sup>1</sup> December 3, 2004 was the date Masters’ financial assurance requirements were calculated for the purpose of preparing the renewal packet for its annual renewal. The actual requirement is determined as of the date financial assurance is filed. Financial security requirements are fluid as the number and status of wells under a particular operator may change

Rule 78 required that Masters Resources post financial security in the total amount of \$2,570,000, comprised of \$50,000 required by Statewide Rule 78(g)(1), \$60,000 required by Statewide Rule 78(g)(2)(A) and \$2,460,000 required by Statewide Rule 78(g)(2)(B). As of December 3, 2004, Statewide Rule 78 required that Master Oil & Gas post financial security in the total amount of \$3,590,000, comprised of \$50,000 required by Statewide Rule 78(g)(1), \$60,000 required by Statewide Rule 78(g)(2)(A) and \$3,480,000 required by Statewide Rule 78(g)(2)(B). The two Masters entities, taken together, would have been required to post \$6,160,000 in financial security. On February 22, 2005, Masters sent a letter to the Commission requesting a hearing be called to consider a request for a reduction, based on a certified net worth calculation, in the financial security requirements for the bay wells operated by the Masters entities.

The application was supported by the lessor of the bay lands, the Texas General Land Office. A hearing was held on April 20, 2005. Masters appeared and presented limited evidence. By letter dated June 23, 2005, the examiner notified Masters that he would be taking official notice of several Commission documents and records, and requested that Masters tender its engineer's and accountant's reports for *in camera* review. The requested reports were provided on July 6, 2005. As indicated in the June 23, 2005 letter, the examiner found it necessary to require that a portion of the full accountant's report be admitted into the record and this was done by letter dated October 20, 2005.

### **INTERIM ORDER**

At Conference on March 28, 2006, the Commissioners directed the issuance of an Interim Order requiring that Masters Resources and Masters Oil & Gas 1.) post financial security in the amount of \$3,000,000 by June 1, 2006; 2.) make a cash deposit of \$30,000 by June 1, 2006 and 15 like deposits of \$30,000 monthly thereafter; and 3.) recomplate and restore to active operation or plug two of the Masters' entities nonproducing wells by June 1, 2006 and continue to recomplate and restore to active operation or plug two nonproducing wells by the first day of each succeeding month through September 1, 2007. The Commission's P-5 Department was ordered to report to the examiner on the state of Master's compliance with the terms of the Interim Order each month. The Interim Order stated "Masters' failure to strictly comply with the terms of this Interim Order for any reason SHALL result in the termination of this Interim Order.....In the event of noncompliance, this docket will be posted for Conference with a recommendation that the Final Order be entered denying Masters' application with prejudice."

### **APPLICABLE RULES**

Statewide Rule 78(g)(2) requires the filing of additional financial security for bay wells. As

---

frequently. For example, as of November 4, 2005, the Commission's calculation of the financial security required of the two Masters entities totaled \$5,860,000, reflecting the fact that Masters had apparently brought 5 formerly inactive wells online. In order to avoid confusion, this PFD will continue to refer to the financial security obligations of the two Masters entities as of December 3, 2004.

relevant here, in addition to other financial security required under Rule 78(g)(1), an operator of bay wells must file entry level financial security of \$60,000 and an additional \$60,000 for each inactive bay well in excess of one.

Rule 78(g)(5) provides that an operator of bay and/or offshore wells may request the Commission to consider a reduction in the additional financial security requirement for inactive bay and/or offshore wells. The Rule 78(g)(5) reduction may not exceed 25% of the operator's certified and independently audited net worth for the most recently completed fiscal year less the Commission's estimate of the operator's plugging liability for all active bay and/or offshore wells.

Under Rule 78(g)(5)(A), a reduction may be approved administratively if: (1) the operator has either five or fewer bay and offshore wells or at least one-half of the operator's bay and offshore wells are producing; (2) the operator provides certification of net worth from an independent auditor who has employed generally accepted accounting principles; (3) the reduction does not exceed 25% of the operator's certified net worth less the Commission's estimate of the operator's plugging liability for all active bay and offshore wells; and (4) the operator's wells have not been found by Commission staff to be violating or to have violated any Commission rule that resulted in pollution or in any hazard to the health and safety of the public in the last 12 months. If a requested reduction is denied administratively, the operator may request a hearing to determine if a reduction should be granted.

### **MASTERS' EVIDENCE**

#### **I. Masters' Evidence as Presented at the April 20, 2005 Hearing**

Masters Resources, L.L.C. and Masters Oil & Gas, L.L.C. have the same owners (Richard H. Lee and John W. Barton, each with a 50% interest) and exist as separate entities solely to reduce the financial security required by the Commission under SWR 78. Masters Resources started in January, 1999 with the acquisition of 4,000 acres and 60 bay wells in the Redfish Reef Field. In December, 1999, Masters acquired an additional 6,000 acres with 80 bay wells. Because operators with more than 99 wells are required to post a base financial security of \$250,000, Masters found it financially less burdensome to split into two entities (the above named Masters Resources, LLC and Masters Oil & Gas, LLC), each with fewer than 99 wells and each required to post base financial security of only \$50,000.

As of December 3, 2004, Commission records indicate Master Resources was the operator of 62 wells, of which 17 were producing bay wells and 42 were inactive bay wells (Masters Resources also had 3 land wells) with a combined wellbore depth of 510,173 feet. With the \$60,000 entry level financial security required of bay well operators, plus the \$2,460,000 required for the inactive bay wells, plus the base requirement of \$50,000 for an operator of 11-99 wells, Masters Resources' financial security requirement was \$2,570,000. As of December 3, 2004, Commission records indicate Masters Oil & Gas was the operator of 80 wells, of which 21 were producing bay wells and 59 were inactive bay wells with a combined wellbore depth of 823,927 feet. With the \$60,000 entry level financial security required of bay well operators, plus the \$3,480,000

required for the inactive bay wells, plus the base requirement of \$50,000 for an operator of 11-99 wells, Masters Oil & Gas' financial security requirement was \$3,590,000. Considered together, the two Masters entities had financial security obligations of \$6,160,000. According to Masters, two of the wellbores classified by the Commission as non-producing have been plugged. If the two plugged wellbores are removed from the non-producing well listing, Masters financial security requirement would be reduced by \$120,000.

Masters is in the business of acquiring "marginal" properties. It attempts to enhance productivity and extend the economic life of wells that it acquires. With the exception of three land wells, all of Masters' wells subject to Commission jurisdiction are located on State Tract leases in the bays.

At hearing, Masters stated that it had hired an engineering consultant to produce a reserve study and an accounting consultant to produce an estimate of the fair market value of Masters. Arguing that the results of the studies were so sensitive as to require the utmost possible confidentiality, Masters presented only summary letters of each study.

The reserve study was performed by an independent third party, R.A. Lenser & Associates, Inc., (hereinafter "Lenser") which specializes in comprehensive oil and gas reserve analysis. Values were assigned to estimates of Proved Developed Reserves and Proved Undeveloped Reserves (see attached Exhibit A). According to Lenser, using definitions approved by the Society of Petroleum Engineers (SPE), Proved Reserves are those quantities of petroleum which, by analysis of geological and engineering data, can be estimated with reasonable certainty to be commercially recoverable, from a given date forward, from known reservoirs and under current economic conditions, operating methods, and government regulations. Proved Developed Reserves are expected to be recovered from existing wells including reserves behind pipe. Improved recovery reserves are considered developed only after the necessary equipment has been installed, or when costs to do so are relatively minor. Improved recovery reserves are considered producing only after the improved recovery project is in operation. Proved Undeveloped Reserves are expected to be recovered: (1) from new wells on undrilled acreage, (2) from deepening existing wells to a different reservoir, or (3) where a relatively large expenditure is required to (a) recomplete an existing well or (b) install production or transportation facilities for primary or improved recovery projects.

A value was also assigned to Total Probable Reserves and Total Possible Reserves, but Lenser's testimony indicated these last two categories were so speculative that Masters did not choose to include those categories in its final calculation of the market value of its reserves. The figures Masters relies on are those calculated for the Proved Reserves, discounted at 10% over a period of approximately 20 years.

Proved Reserves were broken down into Proved Developed and Proved Undeveloped Reserves. Proved Developed Reserves were further broken down into Producing Reserves (\$27,726,024), Shut-in Reserves (\$86,959) and Behind Pipe Reserves (\$119,615,968). Proved Undeveloped Reserves were valued at \$235,715,392. In total, Masters believes its Proved

Developed and Proved Undeveloped Reserves can be valued at \$383,144,416. It should be noted that the reserve study was completed in January of 2005, using an average of \$43.35 per BO and \$5.65 per MCF that Masters received in 2004 in its Trinity Bay Field.

The second consultant retained by Masters was an accounting firm, Lee Miller Accountants & Consultants (hereinafter “Miller” or “accounting consultant”). Miller was retained to derive the fair market value of Masters. Using the commonly accepted definition, Miller described Fair Market Value as “...the price at which a property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.”

Contingent upon the conditions set forth in the report and an accompanying Statement of Assumptions and Limiting Conditions, Miller reached the conclusion that the fair market value of 100 percent of the ownership of Masters Resources, LLC, as of December 31, 2004, is \$68,061,510. Miller also opined that the fair market value of Masters was essentially equivalent to its net worth.

Based on its estimate of fair market value, Masters requests that the Commission give it credit for 25% of that amount against the \$6.6 million financial security amount required for its P-5 renewal. As 25% of \$68,061,510 (\$17,015,377) exceeds the Commission’s requested amount of financial security, Masters suggests that it need not post \$6.6 million in financial security and should only be required to pay the entry level amount of \$50,000 for each company and the \$60,000 amount for operating bay wells, for a total of \$110,000 in financial security for each company or \$220,000 for both. If the Commission would prefer, Masters also offers to consolidate both companies into one entity, and pay the \$250,000 entry level amount plus \$60,000 for operating bay wells, for a total of \$310,000.

## **II. Masters’ Evidence as Presented at the April 18, 2007 Re-Opened Hearing Regarding Compliance with the Interim Order**

Masters was represented at the reopened hearing by Attorney David Hall. Masters represented that it was in compliance with the terms of the Interim Order.

Masters Exhibit 1 consisted of two pages. The first page was a Commission Form W-3A applied for March 13, 2006, contemplating the plugging of Well No. 116, Trinity Bay State Unit No. 1, API# 071-30160. The second page was a Commission Form W-1, applying to recomplete Well No. 116, Trinity Bay State Unit No. 1, dated April 12, 2007 but with no Commission-received stamp. Masters Exhibit 2 was a Commission Form W-1, applying to recomplete Well No. 100, Trinity Bay State Unit No. 1, API# 071-03487, also with no Commission received stamp. Drilling Permits confirms that the applications have now been received by the Commission. Master Exhibit 3 was a series of money transfer records documenting Masters’ payment of \$30,000 to the Commission for the period June 1, 2006 through February 26, 2007. Masters requested permission to late-file its Exhibits 4 and 5 and was granted one week, until April 25, 2007, to do so.

Masters represented that the reopened hearing, and its financial reduction application, were rendered moot by the sale of all the Masters wells to a company named Tekoil and Gas Gulf Coast, LLC (hereinafter "Tekoil"). Masters Exhibit No. 6 consisted of a thick stack of signed two-signature P-4s transferring Masters wells to Tekoil (Tekoil has filed a Form P-5 Organization Report, but has not yet posted any financial security, therefore the P-4 transfer of wells cannot take place). Masters Exhibit 7 consisted of a series of variously dated press releases announcing the intended acquisition of the Masters properties by Tekoil. At the time of the hearing, the acquisition had not yet closed.

On April 25, Masters delivered its late-filed exhibits to the Commission. Late-filed Exhibit 4 is a summary sheet listing 16 wells that Masters states have either been restored to production or are in process of being plugged (see Attached Exhibit B). The exhibit actually only concerns 14 wellbores as two of the wells are dual completions.

### **COMMISSION STAFFS' EVIDENCE**

#### **I. Commission Staff's Evidence as Presented at the April 18, 2007 Re-Opened Hearing Regarding Compliance with Interim Order**

At the reopened hearing on April 18, 2007, Tim Poe, manager of the P-5 Department appeared on behalf of the Commission. In addition, Keith Barton of the Commission's Field Operations Section also appeared and presented evidence.

Commission Exhibit 1, presented by Tim Poe, is a series of documents which indicates that the Masters entities have, pursuant to the Interim Order, posted the required \$3,000,000 in financial security and have made the required monthly payments of \$30,000. Other pages in the exhibit indicate the status of Masters nonproducing wells through time, including the period March 20, 2006 through April 17, 2007. According to this exhibit, the Masters companies had a total of 93 nonproducing wells on March 20, 2006. On June 1, 2006, the Masters companies had a total of 95 nonproducing wells. By April 17, 2007, the Masters companies had a total of 98 nonproducing wells. Rather than reducing the number of their nonproducing wells over time, Masters is increasing that number.

Commission Exhibit 2 is the affidavit of Guy Grossman, Director of the Houston District Office. Mr. Grossman's affidavit states, in essence, that Masters has filed 27 Form W-3As (Notice of Intention to Plug and Abandon) with the Houston District Office. Of the 27, nine have passed their expiration date with no action taken. The remaining 18 continue to be approved and active, but the Houston District Office has not received any Form W-3 (Plugging Record) from the Masters companies. On April 13, 2007, the District Office received one (1) Notice of Plugging from the Masters companies regarding Well No. 116 on Lease ID# 08004, and was advised that plugging would begin on April 16, 2007. As of the date of the affidavit, no Form W-3 had been received for any of the Masters wells. Paragraph 5 of Mr. Grossman's affidavit states, "None of the bay wells considered in this docket have been plugged to reduce the Operators' plugging liability."

Commission Exhibit 3 was presented by Keith Barton, P.E., Field Operations, RRC. In

summary, Mr. Barton's exhibit states that the two Masters companies have returned 6 nonproducing wells to active status during the period the Interim Order has been in effect.

After evaluation of the Masters companies exhibits filed at the April 18, 2007 reopened hearing, Commission staff late-filed its own exhibits 4 and 5. Commission Late-Filed Exhibit 4 is a collection of Commission documents filed by Masters and several Commission letters indicating the Masters filings could not be processed due to a lack of supporting documentation. Commission Late-Filed Exhibit 5 is a memo from Tim Poe supplementing the information staff provided at the reopened hearing, in light of the documents filed by Masters. Mr. Poe indicated that the Masters documents raised the possibility of additional compliant wells. However, even in giving Masters the benefit of the doubt, Mr. Poe could only find that nine wells had actually been restored to active status with one additional well possibly restored to active status pending the processing of paperwork documenting the recompletion. Mr. Poe stated that in the best possible case, giving Masters every benefit of the doubt, Masters may be able to claim ten wells restored to production.

Upon receipt of the Masters Late-Filed Exhibits 4 and 5, received April 25, 2007, Commission staff evaluated those documents, many of which had not been seen before. Many of those documents, such as Form G-1s (Gas Well Back Pressure Test, Completion or Recompletion Report, and Log), G-10s (Gas Well Status Report), G-5s (Gas Well Classification Report), and W-2s (Oil Well Potential Test, Completion or Recompletion Report, and Log) had only been completed and dated as of April 24 and 25, 2007, the day before and the day of their submission as late-filed exhibits in the reopened hearing. None of the recently created documents bore Commission file stamps and had not yet been submitted to the Commission for processing. Other documents were dated 2004 and had apparently never been filed with the Commission.

After several days, Commission staff found that all the above-mentioned documents were eventually filed with the Commission.

## **EXAMINER'S OPINION**

### **I. Examiner's Opinion on the April 25, 2006 Hearing**

The application of Masters for a reduction in additional financial security required by Rule 78(g)(2)(B) should be denied. To support a request for reduction of this type, the applicant is required to provide certification of net worth from an independent auditor; impliedly one who has employed generally accepted accounting principles. Instead of certified net worth, Masters provided an estimate of the fair market value of the two companies.

Statewide Rule 78(g)(5) sets out the conditions that must be met by an operator requesting a reduction in the amount of required financial security. SWR 78(g)(5)(A) describes the conditions

under which an administrative reduction may be granted, but Masters fails to qualify for the administrative reduction because it cannot meet SWR 78(g)(5)(A)(i), which requires that the operator have either five or fewer bay and offshore wells (each Masters entity has over seventy) or at least half of the operator's wells are actively producing oil and natural gas (each Masters entity has approximately 30% active wells). It is worth noting that the language of SWR 78(g)(5)(A)(ii) requires that the operator provide the Commission "...certification of its net worth from an independent auditor that has employed generally accepted accounting principles to confirm the operator's stated net worth based on the most recently available and independently audited calculation." (Emphasis added.) Administrative reductions clearly require certification of net worth by an independent auditor using generally accepted accounting principles (GAAP).

Statewide Rule 78(g)(5) provides that an operator can request a hearing for a reduction in financial security requirements

"...in an amount not to exceed the remainder of 25% of the operator's certified net worth based on the independently audited calculation for the most recently completed fiscal year minus the Commission's estimate of the operator's total plugging liability for all of the operator's active bay and/or offshore wells." (Emphasis added.)

This portion of the rule, with its requirement of certified net worth based on an independently audited calculation, is written in the language of GAAP accounting and requires the use of GAAP procedures.

The application of Masters for a reduction in additional financial security required by Statewide Rule 78(g)(2)(B) is a variation on one that has been attempted before and rejected by the Commission. In Oil & Gas Docket No. 02-0240478, American Coastal Energy, Inc. similarly requested a reduction in the required amount of financial security under SWR 78(g) and asked that the Commission adopt the standard used by the Minerals Management Service (MMS) for operators of Federal oil, gas and sulphur leases. The MMS will consider 50% of the operator's proved producing reserves in the calculation of the operator's net worth, if the operator submits: 1.) an independent third-party estimate of total producing reserves, including a reserve report breaking down proved producing reserves on a lease, reservoir and well completion basis and a cash flow spreadsheet showing anticipated production, expenses, and cash flow; 2.) reservoir depth structure maps and net sand and oil/gas isopach maps; 3.) production information for all producing wells for the last 12-month period; 4.) well test information for the last 12-month period for all producing wells; and 5.) Reservoir bottomhole pressure information, including the well the pressure was recorded in, the date the pressure was recorded, the depth in MD and TVD of the recorded pressure and the calculated bottomhole pressure corrected to reservoir datum depth.

Two things are immediately apparent in the MMS approach to valuation of net worth. First, the MMS only considers 50% of the value of a single category of reserves, that being proved producing reserves. Second, it requires submission of information sufficiently detailed that the MMS is able to arrive at its own independently calculated estimate of the quantity and production



life of the producing reserves.

Masters considerably exceeds the MMS approach of considering only proved producing reserves in calculating net worth. First, Masters would have the Commission consider the value of proved producing reserves plus shut-in reserves, behind-pipe reserves and undeveloped reserves. As shown by the summary sheet (attached Exhibit A) produced by Master's consulting engineer, proved producing reserves account for only a small fraction (approximately 7%) of the reserves Masters bases its estimation of value on. Addition of reserve categories beyond proved producing reserves inflates the value of Masters' holdings considerably. Second, Masters uses these calculations to arrive at the "fair market value" of Masters, not its net worth.

The problems with the reliability of the figures presented by Masters begin with the summary letter of the engineering consultant's findings, which contains this paragraph:

"The titles to the properties have not been examined by R.A. Lenser and Associates, Inc. nor has the actual degree or type of interest owned been independently confirmed. The data used in our estimates were obtained from Masters and were accepted as accurate. For the purposes of this report, a field inspection of the properties was not performed nor was the mechanical operation or condition of the wells and their related facilities examined. We have not investigated possible environmental liability related to the property and; therefore, our estimates do not include any costs which may be incurred due to such possible liability."

Letter format 'Summary Report of Masters' Net Reserves and Income Data', prepared by R.A.Lenser and Associates, Inc., January 26, 2005, page 6. The engineering consultant's caveats indicate that a degree of caution in relying on the results of the study is warranted.

The Commission has not adopted the MMS standard of considering the value of proved producing reserves in calculating net worth, much less Masters' expanded consideration of proved producing reserves, shut-in reserves, behind pipe reserves and undeveloped reserves in calculating the "fair market value" of the Masters entities. However, calculation of the value of its various categories of reserves is only the first step in Masters' proposed method of valuation.

Using the reserve figures and valuations provided by the engineering consultant, Masters' accounting consultant calculated the fair market value of Masters, arriving at a figure of \$68,061,510. In the course of the hearing, the accounting consultant opined that the fair market value of Masters was equivalent to its net worth.

The Summary Letter Report prepared by the accounting consultant contradicts the hearing testimony of the consultant, and begins with this paragraph:

"At your request, we have prepared this Summary Letter report, which expresses an opinion of the fair market value of 100 percent of the ownership of Masters Resources, LLC ("MAS" or the "Company") as of December 31, 2004. It is our understanding that this Summary Letter report has been prepared to assist MAS management with negotiating with the state of Texas bond requirements. Our analysis was conducted for these purposes only. It should be used for no other purpose."

(Emphasis added)

Summary Letter Report, Lee Miller Accountants, March 21, 2005, page 1. The Summary Letter quotes the commonly accepted definition of Fair Market Value, which is “...the price at which a property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.” The letter goes on to state the basis of Miller’s opinion as to the fair market value of Masters:

“Our analysis began with the receipt of certain information relating to the financial and operational performance of the Company. This information included unaudited financial statements of MAS, articles of organization of the limited liability Company, certificate of organization, bylaws of the Company and an appraisal of its oil and gas reserves performed by R.A. Lenser and Associates, Inc., an independent group of consulting and petroleum engineers and geologists.” (Emphasis added)

Summary Letter Report, Lee Miller Accountants, March 21, 2005, page 2. Unaudited financial statements do not meet the requirement of an “...independently audited calculation...” [see Statewide Rule 78(g)(5)].

In a letter dated June 23, 2005, the examiner advised counsel for Masters that he was taking official notice of several items<sup>2</sup>, requested the complete engineer’s report and accountant’s report be submitted for *in camera* review, and advised that it might be necessary to enter portions of both reports into evidence. The examiner also advised that it might be necessary to re-open to have the accounting consultant more fully explain her assertion that Fair Market Value was equivalent to Net Worth. Counsel for Masters supplied both reports for review and, rather than re-open and submit their accounting consultant for further questioning, included a letter from the consultant more fully explaining her position.

The accounting consultant offered the standard definition of Net Worth, which is “the value of assets minus liabilities”, adding that assets minus liabilities is also defined as equity. She then stated

“My valuation of the fair market value of the equity interest in Masters, owned 100% by Richard H. Lee and John W. Barton, is a consideration of what a willing buyer would pay to buy the equity interest of Mr. Lee and Mr. Barton. The property exchanging hands would be their equity interest, in other words, net worth. Based on the above, my valuation of the fair market value of the 100% equity interest is the equivalent of the valuation of net worth.

I would further like to add that given a hypothetical sale of Mr. Lee and Mr. Barton’s equity interests, with the substantive evidence behind the mineral interests owned by Masters, Masters’ mineral interests would be revalued on its books to reflect the sale value, i.e., fair market value, thereby revaluing partnership net worth.”

---

<sup>2</sup> One item officially noticed was a May 21, 2002 letter in which Masters Resources, LLC commented on the proposed amendments to Statewide Rule 78, as published in the *Texas Register* (27 Tex. Reg. 2160-2162), establishing the amount of financial security required for bay and offshore wells. Masters cannot claim to have been caught unaware by the increased financial security requirements.

Letter from Lee Miller Accountants, June 29, 2005. In layman's terms, Miller is suggesting that if a hypothetical sale of oil and gas reserve properties took place, receipt by Masters of the fair market value of the properties would result in a cash flow to Masters in the amount of \$68,061,510. The cash income from the sale would profoundly affect the balance sheet of Masters and would result, after deducting remaining liabilities, in a net worth of Masters somewhere above \$60 million. However, that hypothetical sale has not taken place, and the net worth of Masters will not reach a figure in the range of \$60 million until such sale does take place, if ever. Certainly such a sale had not taken place as of December 31, 2004, the date the consulting accountant cites as the effective date of the fair market value calculation. Net worth is normally calculated as of a specific moment in time, usually the last day of a company's most recent fiscal year, rather than an unknown future date based on the mere possibility of the sale of assets under favorable circumstances.

Statewide Rule 78(g)(5) requires that the operator's certified net worth be based on the "independently audited calculation" for "the most recently completed fiscal year." The figures presented by the consulting accountant fail in two regards. First, the figures presented by the accountant were not independently audited. As quoted above, the consulting accountant relied in part on "unaudited financial statements of MAS". Second, the sale of assets (Masters' reserves) the consulting accountant relies on has not taken place, in fact, there is no evidence it was even contemplated, therefore the figures offered by the accountant have no application to the balance sheet of the most recently completed fiscal year.

The accountant's Summary Letter mentioned that the historical financial statements and Company balance sheets for December 31, 2000 through 2004 were presented in Tab 8 of the full report. Summary Letter Report, Lee Miller Accountants, March 21, 2005, page 3. In an effort to determine the true net worth of Masters, which would be apparent on the December 31, 2004 balance sheet of the company, the examiner requested and accepted into evidence Tab 8 of the full accountant's report. The historic balance sheets demonstrate that Masters' net worth as of December, 2004 was \$1,907,485. However, even this figure is unreliable. In her introduction to Tab 8, the accounting consultant wrote

"We have compiled the accompanying historic balance sheets of Masters Resources, LLC as of December 31, 2000, 2001, 2002, 2003 and 2004.....A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements, and accordingly, do not express an opinion or any other form of assurance on them.....Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles." (Emphasis added)

Introductory Letter to Tab 8, Masters Resources Business valuation at December 31, 2004, by Lee Miller Accountants/Consultants, April 19, 2005, page 1. This means the December 31, 2004 balance sheet for Masters is a mere representation by Masters, was not certified and independently audited, and was not prepared according to GAAP procedures. Thus, the December 31, 2004 balance sheet of Masters cannot meet the requirements of Statewide Rule 78(g)(5).

Even if the December 31, 2004 balance sheet of Masters had been prepared in compliance with the standards set forth in Statewide Rule 78, Masters would still not be entitled to a reduction in its required financial security. Twenty-five percent of \$1,907,485 is \$476,871. If you then subtract the plugging liability for 38 active wells (38 times \$60,000 = \$2,280,000), the result is a negative number, (-\$1,803,129), resulting in no reduction in the financial assurance requirement for Masters.

The examiner recommends that Master's application for a reduction in the financial security required by Rule 78(g)(2)(B) be denied.

**II. Examiner's Opinion on the April 18, 2007 Reopened Hearing Regarding Compliance with the Interim Order**

The terms of the Interim Order in this docket are clear (Attached Exhibit C). The Masters companies were to post a bond in the amount of \$3,000,000 by June 1, 2006. In addition, by June 1, 2006, the two Masters entities were to make cash deposits of \$15,000 each (totaling \$30,000) in additional financial security with the Commission's P-5 Department and a like cash deposit of \$30,000 by the first day of each succeeding month until 15 such deposits had been made. The evidence is clear that Masters has, thus far, complied with this portion of the Interim Order.

The Interim Order also required the Masters companies to recomplete and restore to active operation as defined by Statewide Rule 14(a)(1)(A) or plug, including the filing of accurate and complete Commission Forms W-3A and W-3, two of the nonproducing wells shown on attached exhibits listing the wells each Masters entity was responsible for by June 1, 2006 and two by the first of each succeeding month until September 1, 2007. At the time of the reopened hearing, April 18, 2007, the Masters entities should have, by April 1, 2007, restored 22 nonproducing wells to active production, or plugged 22 wells, or totaled some combination of 22 nonproducing wells restored to production or plugged.

It is apparent from the exhibits offered by the P-5 Department that the number of non-producing wells that are the responsibility of the Masters companies have increased since March 20, 2006 from 93 to 98 as of April 17, 2007.

The evidence shows that the Masters companies have not plugged any wells, although the District Office has received a Form W-3A Notice of Intent to Plug in regard to one well, the Trinity Bay State Unit No. 1, Lease No. 08004, Well No. 116. However, as of the date of the hearing, April 18, 2007, the Commission had received no Form W-3 Plugging Report. Therefore, this well, even if plugged in mid-April, would not count against the 22 wells due to be plugged or restored to production by April, 2007. If plugged in April, it would count against the 24 wells due to be plugged or restored to active status from nonproducing status by May 1, 2007.

The Masters companies assert that they have restored to active operation or are about to plug a total of 16 wells. Even if this were true, the 16 wells claimed fall short of the 22 wells required

to be plugged or restored to active operation by April 1, 2007 under the terms of the Interim Order. On this basis alone, the Masters companies are not in compliance with the terms of the Interim Order.

The examiner hereby takes Official Notice of Commission records and mainframe screens relating to the 16 wells that the Masters companies claim to have restored to production<sup>3</sup>. An examination of the 16 wells claimed to be restored to production or plugged by the Masters companies yields the following result:

- 1.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 224, Well No. 185, API# 071 31248. The forms are dated, respectively, April 25, 2007, March 22, 2005 and April 24, 2007. The Forms G-1 and G-10 report a test conducted on March 10, 2005, predating the Interim Order. Processing for this well is delayed because the well lacks a Form P-4 and flunks its Form G-5. This was a producing well at the time of the Interim Order, thus Masters does not get credit for this well under the terms of the Interim Order.
- 2.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 204 (apparently Galveston Bay State "A"), Well No. 196, API# 071 31511. The forms are all dated April 25, 2007. They report a test conducted on November 22, 2006. Processing for this well is delayed because Masters has not filed a Form W-1, Form P-4, properly completed Form G-1, properly completed Form G-10, Form P-15 or plat. This well was temporarily abandoned at the time of the Interim Order, so despite the filing deficiencies and giving Masters every benefit of the doubt, Masters is given credit for this well.
- 3.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 246, Well No. 182, API # 071 31220. The Form G-1 is dated November 6, 2006 and reports a test on October 20, 2005. The Form G-5 is dated April 24, 2007 and reports a test on October 20, 2005. The G-10 is dated November 3, 2005 and reports a test conducted November 1, 2005. Despite the disagreement in test dates, and the fact that the test dates pre-date the Interim Order, Commission records indicate the well was restored to production after the date of the Interim Order, and then ceased production in November, 2006. The well will not become inactive again until the passage of 12 months, which is not until November, 2007. Processing for this well is delayed because the well is under a seal order which requires payment of a \$300 fee to be lifted, needs a properly completed Form G-5, lacks a Form P-4 and requires corrected production reports. Despite the filing deficiencies and seal order, and giving Masters every benefit of the doubt, Masters is given credit for this

---

<sup>3</sup> The relevant Commission Forms considered here are Form W-1 (Application to Drill, Deepen, Plug Back or Reenter), Form G-1 (Gas Well Back Pressure Test, Completion or Recompletion Report and Log), Form G-10 (Gas Well Status Report), Form G-5 (Gas Well Classification Report), Form W-2 (Oil Well Potential) and Form P-4 (Producer's Transportation Authority and Certificate of Compliance).

well.

- 4.) Masters has submitted a Form W-2 for Trinity Bay State Unit No. 1, Well No. 10, API# 071 02563. The Form W-2 is dated April 24, 2007 and reports injection of 3600 BOW on May 17, 2005. This injection pre-dates the Interim Order. This well is a saltwater disposal well with no active injection. It has not been plugged or restored to active production. Masters does not get credit for this well under the terms of the Interim Order.
- 5.) Masters has submitted a Form W-10 for Trinity Bay State Unit No. 1, Well No. 124, API# 071 31694. The Form W-10 is signed April 25, 2007 and reports a test conducted November 14, 2006. Processing for this well is delayed because this well has an H-15 violation, is overproduced, has been severed since October 5, 2006, and is producing against severance. This well was nonproducing at the time of the Interim Order, so despite the violations and giving Masters every benefit of the doubt, Masters is given credit for this well.
- 6.) Masters has submitted a Form W-2 for State Tract 343, Well No. 18, API# 167 31049. The Form W-2 is signed April 24, 2007 and reports a test conducted January 26, 2007. Processing for this well is delayed because the well has no production reported, the well lacks an amended Form W-1 and it lacks a Form P-4. Masters does not get credit for this well.
- 7.) Masters has submitted a Commission Form W-2 for the Fishers Reef Field Unit No. 1, Well No. 10, API# 071 02731. The Form W-2 is signed May 3, 2004 and reports a test conducted February 10, 2004, pre-dating the Interim Order. This well cannot be processed because it does not have a permit for the zone it is completed in and requires reclassification (it is currently classified as an oil well but last reported producing gas). This well was producing at the time of the Interim Order, and is currently non-producing, thus Masters does not get credit for this well under the terms of the Interim Order.
- 8.) Masters has submitted a Commission Form W-3A for the Trinity Bay State Unit No. 1, Well No. 116, and its completions in the Trinity Bay Field (API# 071 30160) and Trinity Bay (Frio 9) Field (API# 30160). The Form W-3A expired March 13, 2007. No Form W-3 Plugging Report for Well No. 116 has been received. Even if a Form W-3 is received, 1.) it can not be counted against the 22 wells that should have been plugged or restored to active operation by April 1, 2007, but rather against the 24 wells due to be plugged or restored to active operation by May 1, 2007, and 2.) plugging would result in the plugging of a single wellbore (regardless of the number of completions) and would only count as one well plugged under the Interim Order. Masters does not get credit for this well under the terms of the Interim order.

- 9.) Masters has submitted a Form W-3A for the Trinity Bay State Unit No. 1, Well No. 100, and its completions in the Trinity Bay (Frio 5, Central) Field (API# 071-03437) and in the Trinity Bay (Frio 9) Field (API# 071-03437). The Form W-3A expired March 13, 2007 and no Form W-3 Plugging Report has been received by the Commission. Even if a Form W-3 is received, it can not be counted against the 22 wells that should have been plugged or restored to active operation by April 1, 2007, but rather against the 24 wells due to be plugged or restored to active operation by May 1, 2007, and 2.) plugging would result in the plugging of a single wellbore (regardless of the number of completions) and would count as only one well plugged under the Interim Order. Masters does not get credit for this well under the terms of the Interim Order.
- 10.) Masters has submitted a Form G-1 for the Red Fish Reef Frio 15 Gas Unit, Well No. 184, API# 071 31238. The Form G-1 is signed August 20, 2004 and reports a test conducted July 14, 2004, pre-dating the Interim Order. A new Form G-5 and PVT test were requested by letter dated April 6, 2005 by the Commission, but the tests have not been received. This well was producing at the time of the Interim Order, and is currently non-producing, thus Masters does not get credit for this well under the terms of the Interim order.
- 11.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 225, Well No. 132, API# 071 02897. The forms are all signed April 25, 2007. They report a test conducted February 15, 2006, pre-dating the Interim Order. This well can not be processed because its lacks a Form W-1 drilling permit, lacks completion papers, lacks a Form P-4, and requires new Form G-1 and G-10 tests conducted for 72 hours rather than the 3 hours submitted by Masters. This well's production cannot be accessed by Mainframe Entry, but it is producing from the Red Fish Reef (Miocene 3400-C) Field. This well was nonproducing at the time of the Interim Order, so despite the deficiencies and giving Masters every benefit of the doubt, Masters is given credit for this well.
- 12.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 200, Well No. 195, API# 071 31485. The forms are signed April 25, 2007 and report a test conducted July 5, 2005, pre-dating the Interim Order. Processing on this well is delayed because it lacks a Form P-4, needs a new Form G-5, requires new Forms G-1 and G-10 testing over a 72 hour period rather than the 3 hour period reported by Masters, and corrected production reports. This well was producing at the time of the Interim Order and is producing today, thus Masters does not get credit for this well.
- 13.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 225, Well No. 50, API# 071 02887. The Form G-1 is signed April 25, 207, the Form G-5 is not dated and the Form G-10 is signed April 24, 2007. The forms

report a test on July 5, 2005, pre-dating the Interim Order. This well was sealed April 13, 2007, requires new Forms G-1 and G-10 with 72 hour testing rather than the 3 hour tests submitted by Masters and a new Form G-5. The well shows production from September, 2006 through March, 2007. Despite the deficiencies, and giving Masters every benefit of the doubt, this well was nonproducing at the time of the Interim Order, so Masters is given credit for this well.

- 14.) Masters states that a Commission Form W-2 will be submitted in the field for Fishers Reef Field Unit No. 1, Well No. 115, API# 071-31755. This well was producing at the time of the Interim Order, so Masters does not get credit for this well.

Upon close examination, and giving the Masters entities every benefit of the doubt, they can only be given credit for converting 5 wells from nonproducing status to producing status, far short of the 22 required by April 1, 2007 under the terms of the Interim Order. There is no evidence that the Masters companies have plugged any of the wells listed in the attachments to the Interim Order. Masters is not in compliance with the terms of the Interim Order.

Masters has also submitted Form W-1s for two wells, the Trinity Bay State Unit No. 1 Well Nos. 100F (Permit No. 637319) and 116-D (Permit No. 637312). Both permits are still in mapping, and require the re-submission of corrected plats. The permits have not yet been issued. These unissued permits have no impact on the number of wells that were due to be plugged or restored to producing status by the Masters companies by April 1, 2007.

In its final paragraph, the Interim Order states “In the event of noncompliance, this docket shall be posted for Conference with a recommendation that a Final order be entered denying Masters’ application with prejudice.” Accordingly, the examiner recommends that the applications of Masters Resources, L.L.C. and Masters Oil & Gas, L.L.C. for a reduction in financial assurance for bay wells in various fields, Galveston and Chambers Counties, be denied with prejudice.

Based on the record in this case, 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 this docket was sent to all parties entitled to notice. Masters Resources, LLC and Masters Oil & Gas, LLC (hereinafter collectively “Masters”), appeared at the hearing, and presented evidence.
2. By the application in this docket, Masters requests, pursuant to Statewide Rule 78(g)(5), a reduction in the amount of additional financial security for Masters’ inactive bay wells required by Statewide Rule 78(g)(2).
3. As of December 3, 2004,



- A. Masters Resources, LLC was the designated operator of 62 wells, of which 17 were producing bay wells and 42 were inactive bay wells. Masters Resources also had 3 land wells. Masters Resources' wells have a combined depth of 510,173 feet.
  - B. Masters Oil & Gas, LLC was the designated operator of 80 wells, of which 21 were producing bay wells and 59 were inactive bay wells. Masters Oil & Gas' wells have a combined depth of 823,927 feet.
  - C. Masters represented at the April 20, 2005 hearing that it had plugged two wells, which would reduce its financial security obligation by \$120,000.
4. Based on the number of active and inactive bay wells operated by Masters as of December 3, 2004,
    - A. Masters Resources, LLC's total financial security requirement under the provisions of Statewide Rule 78(g) was \$2,570,000, comprised of financial security required by Rule 78(g)(1) in the amount of \$50,000, entry level financial security for operators of bay wells required by Rule 78(g)(2)(A) in the amount of \$60,000, and additional financial security for inactive bay wells (in excess of one) required by Rule 78(g)(2)(B) in the amount of \$2,460,000.
    - B. Masters Oil & Gas, LLC's total financial security requirement under the provisions of Statewide Rule 78(g) was \$3,590,000, comprised of financial security required by Rule 78(g)(1) in the amount of \$50,000, entry level financial security for operators of bay wells required by Rule 78(g)(2)(A) in the amount of \$60,000, and additional financial security for inactive bay wells (in excess of one) required by Rule 78(g)(2)(B) in the amount of \$3,480,000.
  5. Masters is in the business of acquiring "marginal" oil and gas properties and attempting to enhance their productivity and extend their economic life. All of Masters' bay wells are located on State tract leases.
  6. The Form P-5 Organization Report of Masters has been delinquent since March 1, 2005.
  7. On February 22, 2005, Masters requested the hearing in this docket, as permitted by Rule 78(g)(5)(B).
  8. Masters did not provide the Commission with certification of its net worth from an independent auditor who employed generally accepted accounting principles.
    - A. Masters provided the Commission with an estimate of the fair market value of its assets (\$68,061,510) based on the value of its reserves and contended that this was equivalent to net worth.

- B. According to generally accepted accounting principles, fair market value and net worth are not equivalent.
  - C. No sale of the reserves of Masters had taken place as of December 31, 2004, the date of the most recently completed fiscal year for Masters and nothing in the record indicates that such a sale was contemplated.
  - D. The balance sheet for Masters, prepared as of December 31, 2004, was unaudited and was prepared omitting “substantially all of the disclosures required by generally accepted accounting procedures.”
  - E. The fair market value of Masters was calculated based, in part, on representations of Masters’ management which were not independently audited.
9. Masters did not present any credible evidence that the calculation of fair market value of Masters is equivalent, under the facts of this case, to the net worth of Masters.
  10. As of December 3, 2004, the Railroad Commission’s determination of Masters’ financial security obligation for its wells was \$6,160,000.
  11. Based on the number of Masters’ bay wells considered by the Commission to be active at the time of the hearing, to be entitled to any amount of reduction in the additional financial security required by Statewide Rule 78(g)(2) for inactive bay wells, Masters would be required to have net worth, certified by an independent auditor, in excess of \$35 million.
  12. Masters’ unaudited financial statement for December 31, 2004 shows a net worth of \$1,907,485. An unaudited financial statement does not meet the requirements of Statewide Rule 78(g)(5) and cannot be accepted by the Commission for calculating a reduction in financial assurance under the Rule. Even if the unaudited statement of net worth were accepted as true, Masters would still not be entitled to Statewide Rule 78(g)(5) reduction.
  13. An Interim order in this docket was signed by the Commissioners on March 28, 2006, and issued on March 29, 2006.
  14. Under the terms of the Interim Order, the Masters companies were required to post financial security in the amount of \$3,000,000 and, by June 1, 2006, the Masters companies were to make a cash deposit of \$30,000 to the Commission’s P-5 Department, and a like cash deposit of \$30,000 by the first day of each succeeding month until 15 such deposits had been made.
  15. The Masters companies are in compliance with the terms of the Interim Order regarding the posting of a \$3,000,000 bond and payment of \$30,000 per month through April 1, 2007.
  16. The Interim Order also required that the Masters companies recomplete and restore to active

- production as defined by Statewide Rule 14(a)(1)(A) or plug, including the filing of accurate and complete Commission Forms W-3A and W-3, two of the non-producing wells shown on attached exhibits listing the wells each Masters entity was responsible for by June 1, 2006 and two by the first of each succeeding month until September 1, 2007.
17. Under the terms of the Interim Order, by April 1, 2007, the Masters companies should have restored 22 non-producing wells to active production, or plugged 22 wells, or totaled some combination of 22 non-producing wells restored to production or plugged.
  18. Commission records show that the Masters companies were responsible for 93 non-producing wells as of March 20, 2006 and were responsible for 98 non-producing wells as of April 1, 2007.
  19. As of the date of the re-opened hearing regarding the Interim Order, April 18, 2007, the Masters companies had not plugged any wells.
  20. As of the date of the re-opened hearing regarding the Interim Order, April 18, 2007 and as of the date of filing late-filed exhibits, April 25, 2007, the Masters companies asserted they have restored to active, producing status, or plugged, 14 wells. This number falls short of the 22 wells required to be plugged or restored to active status by April 1, 2007 under the terms of the Interim Order.
  21. Of the 14 wells the Masters companies claim to have restored to active status or plugged, only 5 wells can be considered to have been converted from nonproducing status to active status under the terms of the Interim Order:
    - A.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 224, Well No. 185, API# 071 31248. The forms are dated, respectively, April 25, 2007, March 22, 2005 and April 24, 2007. The Forms G-1 and G-10 report a test conducted on March 10, 2005, predating the Interim Order. Processing for this well is delayed because the well lacks a Form P-4 and flunks its Form G-5. This was a producing well at the time of the Interim Order, thus Masters does not get credit for this well under the terms of the Interim Order.
    - B.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 204 (apparently Galveston Bay State "A"), Well No. 196, API# 071 31511. The forms are all dated April 25, 2007. They report a test conducted on November 22, 2006. Processing for this well is delayed because Masters has not filed a Form W-1, Form P-4, properly completed Form G-1, properly completed Form G-10, Form P-15 or plat. This well was temporarily abandoned at the time of the Interim Order, so despite the filing deficiencies and giving Masters every benefit of the doubt, Masters is given credit for this well.

- C.) Masters has submitted Commission Forms G-1, G-5 and G-10 for Red Fish Reef Tract 246, Well No. 182, API # 071 31220. The Form G-1 is dated November 6, 2006 and reports a test on October 20, 2005. The Form G-5 is dated April 24, 2007 and reports a test on October 20, 2005. The G-10 is dated November 3, 2005 and reports a test conducted November 1, 2005. Despite the disagreement in test dates, and the fact that the test dates pre-date the Interim Order, Commission records indicate the well was restored to production after the date of the Interim Order, and then ceased production in November, 2006. The well will not become inactive again until the passage of 12 months, which is not until November, 2007. Processing for this well is delayed because the well is under a seal order which requires payment of a \$300 fee to be lifted, needs a properly completed Form G-5, lacks a Form P-4 and requires corrected production reports. Despite the filing deficiencies and seal order, and giving Masters every benefit of the doubt, Masters is given credit for this well.
- D.) Masters has submitted a Form W-2 for Trinity Bay State Unit No. 1, Well No. 10, API# 071 02563. The Form W-2 is dated April 24, 2007 and reports injection of 3600 BOW on May 17, 2005. This injection pre-dates the Interim Order. This well is a saltwater disposal well with no active injection. It has not been plugged or restored to active production. Masters does not get credit for this well under the terms of the Interim Order.
- E.) Masters has submitted a Form W-10 for Trinity Bay State Unit No. 1, Well No. 124, API# 071 31694. The Form W-10 is signed April 25, 2007 and reports a test conducted November 14, 2006. Processing for this well is delayed because this well has an H-15 violation, is overproduced, has been severed since October 5, 2006, and is producing against severance. This well was nonproducing at the time of the Interim Order, so despite the violations and giving Masters every benefit of the doubt, Masters is given credit for this well.
- F.) Masters has submitted a Form W-2 for State Tract 343, Well No. 18, API# 167 31049. The Form W-2 is signed April 24, 2007 and reports a test conducted January 26, 2007. Processing for this well is delayed because the well has no production reported, the well lacks an amended Form W-1 and it lacks a Form P-4. Masters does not get credit for this well.
- G.) Masters has submitted a Commission Form W-2 for the Fishers Reef Field Unit No. 1, Well No. 10, API# 071 02731. The Form W-2 is signed May 3, 2004 and reports a test conducted February 10, 2004, pre-dating the Interim Order. This well cannot be processed because it does not have a permit for the zone it is completed in and requires reclassification (it is currently classified as an oil well but last reported producing gas). This well was producing at the time of the Interim Order, and is currently non-producing, thus Masters does not get credit for this well under the

terms of the Interim Order.

- H.) Masters has submitted a Commission Form W-3A for the Trinity Bay State Unit No. 1, Well No. 116, and its completions in the Trinity Bay Field (API# 071 30160) and Trinity Bay (Frio 9) Field (API# 30160). The Form W-3A expired March 13, 2007. No Form W-3 Plugging Report for Well No. 116 has been received. Masters does not get credit for this well under the terms of the Interim order.
- I.) Masters has submitted a Form W-3A for the Trinity Bay State Unit No. 1, Well No. 100, and its completions in the Trinity Bay (Frio 5, Central) Field (API# 071-03437) and in the Trinity Bay (Frio 9) Field (API# 071-03437). The Form W-3A expired March 13, 2007 and no Form W-3 Plugging Report has been received by the Commission. Masters does not get credit for this well under the terms of the Interim Order.
- J.) Masters has submitted a Form G-1 for the Red Fish Reef Frio 15 Gas Unit, Well No. 184, API# 071 31238. The Form G-1 is signed August 20, 2004 and reports a test conducted July 14, 2004, pre-dating the Interim Order. A new Form G-5 and PVT test were requested by letter dated April 6, 2005 by the Commission, but the tests have not been received. This well was producing at the time of the Interim Order, and is currently non-producing, thus Masters does not get credit for this well under the terms of the Interim order.
- K.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 225, Well No. 132, API# 071 02897. The forms are all signed April 25, 2007. They report a test conducted February 15, 2006, pre-dating the Interim Order. This well can not be processed because it lacks a Form W-1 drilling permit, lacks completion papers, lacks a Form P-4, and requires new Form G-1 and G-10 tests conducted for 72 hours rather than the 3 hours submitted by Masters. This well's production cannot be accessed by Mainframe Entry, but it is producing from the Red Fish Reef (Miocene 3400-C) Field. This well was nonproducing at the time of the Interim Order, so despite the deficiencies and giving Masters every benefit of the doubt, Masters is given credit for this well.
- L.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 200, Well No. 195, API# 071 31485. The forms are signed April 25, 2007 and report a test conducted July 5, 2005, pre-dating the Interim Order. Processing on this well is delayed because it lacks a Form P-4, needs a new Form G-5, requires new Forms G-1 and G-10 testing over a 72 hour period rather than the 3 hour period reported by Masters, and corrected production reports. This well was producing at the time of the Interim Order and is producing today, thus Masters does not get credit for this well.

- M.) Masters has submitted Commission Forms G-1, G-5 and G-10 for the Red Fish Reef Tract 225, Well No. 50, API# 071 02887. The Form G-1 is signed April 25, 2007, the Form G-5 is not dated and the Form G-10 is signed April 24, 2007. The forms report a test on July 5, 2005, pre-dating the Interim Order. This well was sealed April 13, 2007, requires new Forms G-1 and G-10 with 72 hour testing rather than the 3 hour tests submitted by Masters and a new Form G-5. The well shows production from September, 2006 through March, 2007. Despite the deficiencies, and giving Masters every benefit of the doubt, this well was nonproducing at the time of the Interim Order, so Masters is given credit for this well.
- N.) Masters states that a Commission Form W-2 will be submitted in the field for Fishers Reef Field Unit No. 1, Well No. 115, API# 071-31755. This well was producing at the time of the Interim Order, so Masters does not get credit for this well.
22. In its final paragraph, the subject Interim Order states “In the event of noncompliance, this docket shall be posted for Conference with a recommendation that a Final order be entered denying Masters’ application with prejudice.”

#### **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. Pursuant to §91.103 of the Texas Natural Resources Code, any person, including any firm, partnership, joint stock association, corporation, or other organization, required to file an organization report under §91.142 of the Code must execute and file with the Commission a bond, letter of credit, or cash deposit.
4. Pursuant to §91.104 of the Texas Natural Resources Code, a person required to file a bond, letter of credit, or cash deposit under §91.103 of the Code who is an inactive operator or who operates one or more wells must, at the time of filing or renewing an organization report required by §91.142 of the Code, file an individual bond as provided under §91.1041 of the Code, a blanket bond as provided under §91.1042 of the Code, or a letter of credit or cash deposit in the same amount as required for an individual bond under §91.1041 of the Code or a blanket bond under §91.1042 of the Code.
5. Pursuant to §§91.1041(b) and 91.1042(b) of the Texas Natural Resources Code, the Commission is authorized to set by rule the amount of the bond for an operator of bay and

offshore wells at a reasonable amount that exceeds the amount provided by §§91.1041(a) and 91.1042(a) of the Code.

6. Operators of bay wells are required to file with the Commission the amount of financial security provided by the Commission's Statewide Rule 78(g)(1) and the additional amount of financial security provided by Statewide Rule 78(g)(2).
7. Pursuant to the Commission's Statewide Rule 78(g)(5), an operator may request that the Commission consider a reduction in the amount of additional financial security required by Statewide Rule 78(g)(2) not to exceed 25% of the operator's certified net worth based on the independently audited calculation for the most recently completed fiscal year minus the Commission's estimate of the operator's total plugging liability for all of the operator's active bay and offshore wells.
8. Masters failed to prove that it is entitled to a reduction, pursuant to Statewide Rule 78(g)(5), in the amount of additional financial security required by Statewide Rule 78(g)(2).
9. The application of Masters, pursuant to Statewide Rule 78(g)(5) for a reduction in the amount of additional financial security required by Statewide Rule 78(g)(2) should be denied with prejudice.
10. Masters is not in compliance with the terms of the Interim Order issued in this docket on March 29, 2006.

### **RECOMMENDATION**

The examiner recommends that the application of Masters Resources, L.L.C. and Masters Oil & Gas, L.L.C., pursuant to Statewide Rule 78(g)(5), for a reduction in the amount of additional financial security required by Statewide Rule 78(g)(2), be denied with prejudice.

Respectfully submitted,

Marshall Enquist  
Hearings Examiner