

COMMISSION CALLED HEARING TO CONSIDER THE APPLICATION OF AMERICAN COASTAL ENERGY, INC., FOR A STATEWIDE RULE 14(B)(2) PLUGGING EXTENSION FOR VARIOUS OFFSHORE WELLS, SHERMAN OFFSHORE (3900) ET AL. FIELDS, CALHOUN COUNTY, TEXAS

APPEARANCES:

FOR APPLICANT:

David McCarver
Authorized Representative

APPLICANT:

American Coastal Energy, Inc.

FOR INTERVENOR:

Elaine Moore
Tim Poe

INTERVENOR:

Enforcement Section
Railroad Commission of Texas

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF REQUEST FOR ACTION:	April 28, 2006
DATE OF NOTICE OF HEARING:	May 25, 2006
DATE OF HEARING:	June 12, 2006
HEARD BY:	James M. Doherty, Hearings Examiner
DATE PFD CIRCULATED:	June 20, 2006

STATEMENT OF THE CASE

On April 24, 2006, the District Office sent American Coastal Energy, Inc. ("ACE"), notice that the subject wells had been inactive for more than 12 months and did not have a plugging extension. The notice requested ACE to inform the District Office within 15 days of ACE's plans for bringing the wells into compliance. The notice also stated that compliance could be achieved by plugging the wells or obtaining a plugging extension, and an opportunity for hearing would be afforded if the Commission did not administratively approve a plugging extension.

On April 28, 2006, ACE made a written request to the District Office for a plugging extension, which request was denied administratively. This case was then set for hearing. Hearing was held on June 12, 2006. David McCarver appeared to represent ACE, and presented evidence. Elaine Moore, Staff Attorney, appeared representing the Enforcement Section of the Office of General Counsel, and presented evidence relating to ACE's Form P-5 status.

APPLICABLE LAW

Texas Natural Resources Code §91.142 requires an organization performing operations within the Commission's jurisdiction to file a Form P-5 organization report and to re-file annually according to a schedule established by the Commission. Pursuant to §91.142, an organization that does not maintain a Form P-5 and financial assurance on file may not perform operations under the jurisdiction of the Commission, except as necessary to remedy a violation of law or Commission rules, and, on written notice, the Commission may suspend any permits held by the organization.

Statewide Rule 1 implements the statutory requirement for filing and annual renewal of Form P-5 organization reports. Pursuant to Statewide Rule 1(a)(3), each organization must maintain a current organization report with the Commission until all duties, obligations, and liabilities incurred pursuant to Commission rules, Texas Natural Resources Code, Title 3, Subtitles A, B, C, and Chapter 111 of Subtitle D, and Texas Water Code, Chapters 27 and 29, are fulfilled.

Pursuant to Texas Natural Resources Code §91.103, organizations required by §91.142 to file an organization report must also file financial assurance as required by §§91.104, 91.1041, and 91.1042.

Pursuant to Texas Natural Resources Code §89.011, the operator of a well must properly plug the well when required, in accordance with Commission rules. Statewide Rule 14(b)(2) provides that plugging operations on each inactive well shall commence within a period of one year after drilling or operations cease, unless a plugging extension for the well is approved. An organization that maintains the required financial assurance will be granted a one-year plugging extension for each inactive well it operates at the time renewal of its annual organization report is approved only if the following criteria are met: (1) the well and associated facilities are in compliance with all laws and Commission rules; and (2) the organization has, and upon request provides evidence of, a good faith claim to a continuing right to operate the well.

DISCUSSION OF THE EVIDENCE

The examiner has officially noticed from the hearing file and the Commission's On-Schedule Leases, Wells, Wellbores By Operator database that ACE currently is the Form P-4 operator of 8 offshore wellbores (12 wells) and that these are the wells for which ACE has requested a plugging

extension.¹ The examiner has also officially noticed Commission production records showing that all of these wells are inactive. With respect to all of the wells, save one, no production has been reported in the last 10 years. Production was last reported for the one exception in January 2002.

ACE's organization report and financial assurance have been delinquent since September 1, 2004. During 2004, ACE requested a reduction in required offshore well financial assurance, which relief was denied by the Commission's Final Order in Oil & Gas Docket No. 02-0240478, signed January 25, 2005. Thereafter, ACE transferred all of its wells, with the exception of the 8 wellbores still operated, to Sterling Energy, Inc., and Chroma Operating, Inc. All of ACE's employees, with one exception, went to work for Chroma, and as a part of the transaction, ACE acquired a small percentage of Chroma's preferred stock. The examiner has officially noticed the Commission's P-5 Financial Assurance Inquiry database showing that ACE's current financial assurance requirement is \$825,000.

ACE asserts that it planned to plug the subject wells about a year ago, but its plans were disrupted by Hurricane Katrina, and then by Hurricane Rita. ACE presented as an exhibit an August 9, 2005, "turnkey bid" by LIS Energy Services, LLC, New Orleans, LA, to plug the wells for \$805,036.80. ACE states that the hurricanes caused a significant increase in the price of plugging equipment, and most of such equipment, particularly liftboat and support boat equipment, was moved out of the western Gulf to work elsewhere. ACE was not financially able to carry through with its plan to plug the wells at that time, but recent discussions with LIS have led ACE to believe that pressure on equipment in the Gulf is beginning to subside. ACE asserts that it would like to proceed with its plan to plug the subject wells as soon as it can afford to do so.

David McCarver, until March 31, 2006, ACE's President and Chief Operating Officer, does not consider that ACE is any longer a real going concern. ACE has no significant producing assets, although it does claim to have an undisclosed amount of cash assets. Other than its officers, ACE's only remaining employee is a secretary/receptionist. ACE makes no claim that it continues to hold currently effective oil and gas leases covering the subject wells.

¹ The 8 wellbores are API Nos. 603 30004, 603 30214, 603 30221, 603 30238, 603 30252, 603 30254, 703 30124, and 703 30282. Some of these wellbores are multiple completions. The wells in question are the State Tract 707-S, Well No. 1U (060757), Sherman (Offshore (3900) Field, State Tract 770-S, Well No. 4 (105015), Oakville, SW (4300) Field, State Tract 771-S, Well No. 1 (108845), Oakville, SW (4300) Field, State Tract 707-S, Well No. 5 (147076), Sherman Offshore (1600) Field, State Tract 708-S, Well No. 5C (127665), Sherman Offshore (1700) Field, State Tract 708-S, Well No. 5-T (158317), Sherman Offshore (2000) Field, State Tract 719-S, Well No. 1U (131844), Sherman Offshore, W. (1700 Mio.) Field, State Tract 719-S, Well No. 1L (132259), Sherman Offshore (2900 A) Field, State Tract 596-L, NE/4, Well No. 3UT (079076), Sherman Offshore, SW. (3020) Field, State Tract 596-L NE/4, Well No. 3LT (079121), Sherman Offshore, SW. (3950) Field, State Tract 596-L NE/4, Well No. 4U (104885), Sherman Offshore, SW. (2950) Field, and State Tract 596-L NE/4, Well No. 4L (104886), Sherman Offshore, SW. (3900) Field, Calhoun County, Texas.

EXAMINER'S OPINION

Approval of plugging extensions for the subject wells is precluded by the Commission's rules. Statewide Rule 14(b)(2) provides for the granting of plugging extensions upon approval of Form P-5 renewal by organizations with the required amount of financial assurance on file. ACE does not qualify on either count, because its Form P-5 is delinquent and renewal is not requested, and ACE has no financial assurance on file. In addition, a plugging extension cannot be approved under Statewide Rule 14(b)(2) because: (1) the subject wells are not compliant with Commission Statewide Rules 1 and 78; and (2) ACE does not have a good faith claim to a continuing right to operate the wells. Accordingly, ACE's application for plugging extensions must be denied.

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. All parties affected by the relief sought in this docket were given at least ten (10) days notice of this hearing. American Coastal Energy, Inc. ("ACE") and the Commission's Enforcement Section appeared and presented evidence.
2. ACE is the Form P-4 operator of, and requests the Commission to approve Statewide Rule 14(b)(2) plugging extensions for, 8 inactive offshore wellbores, comprising 12 wells, as follows: API Nos. 603 30004, 603 30214, 603 30221, 603 30238, 603 30252, 603 30254, 703 30124, and 703 30282; State Tract 707-S, Well No. 1U (060757), Sherman (Offshore (3900) Field, State Tract 770-S, Well No. 4 (105015), Oakville, SW (4300) Field, State Tract 771-S, Well No. 1 (108845), Oakville, SW (4300) Field, State Tract 707-S, Well No. 5 (147076), Sherman Offshore (1600) Field, State Tract 708-S, Well No. 5C (127665), Sherman Offshore (1700) Field, State Tract 708-S, Well No. 5-T (158317), Sherman Offshore (2000) Field, State Tract 719-S, Well No. 1U (131844), Sherman Offshore, W. (1700 Mio.) Field, State Tract 719-S, Well No. 1L (132259), Sherman Offshore (2900 A) Field, State Tract 596-L, NE/4, Well No. 3UT (079076), Sherman Offshore, SW. (3020) Field, State Tract 596-L NE/4, Well No. 3LT (079121), Sherman Offshore, SW. (3950) Field, State Tract 596-L NE/4, Well No. 4U (104885), Sherman Offshore, SW. (2950) Field, and State Tract 596-L NE/4, Well No. 4L (104886), Sherman Offshore, SW. (3900) Field, Calhoun County, Texas ("subject wells").
3. ACE's Form P-5 organization report has been delinquent since September 1, 2004, and ACE has no financial assurance on file with the Commission.
4. ACE makes no claim that it holds currently effective oil and gas leases covering the wells for which it requests a Statewide Rule 14(b)(2) plugging extension.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued to appropriate persons entitled to notice.
2. All things necessary to the Commission attaining jurisdiction have occurred.
3. American Coastal Energy, Inc., is the operator of the subject wells as defined by Statewide Rules 14, 58, and 79 [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.14, 3.58, and 3.79] and Chapters 85 and 89 of the Texas Natural Resources Code, and is liable for the proper plugging of such wells under Statewide Rule 14 and Texas Natural Resources Code §89.011.
4. As an organization with well plugging liability that has not been fulfilled, American Coastal Energy, Inc., is required to file an annual organization report and financial assurance with the Commission pursuant to Statewide Rules 1 and 78 [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.1 and 3.78] and Texas Natural Resources Code §§91.142, 91.103, 91.104, 91.1041, and 91.1042.
5. Pursuant to Statewide Rule 14(b)(2) [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.14(b)(2)], the Commission may approve a plugging extension for a well only in the event the operator of the well has the financial assurance required by Statewide Rule 78 [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §3.78] on file with the Commission and the Commission approves the operator's Form P-5 organization report.
6. Pursuant to Statewide Rule 14(b)(2) [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.14(b)(2)], the Commission may approve a plugging extension for a well only if the well and associated facilities are in compliance with Commission rules and the operator of the well has a good faith claim to a continuing right to operate the well.
7. The application of American Coastal Energy, Inc., for Statewide Rule 14(b)(2) plugging extensions for the subject wells does not meet the requirements for approval of Statewide Rule 14(b)(2) [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.14(b)(2)] because American Coastal Energy, Inc., does not have financial assurance on file with the Commission, the Form P-5 organization report of American Coastal Energy, Inc., is delinquent, American Coastal Energy, Inc., is not in compliance with Statewide Rules 1 and 78 [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.1 and 3.78] with respect to the subject wells and their associated facilities, and American Coastal Energy, Inc., does not have a good faith claim to a continuing right to operate the subject wells.
8. Pursuant to Statewide Rule 14(b)(2) [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §§3.14(b)(2)], the application of American Coastal Energy, Inc., for Statewide Rule 14(b)(2) plugging extensions for the subject wells must be denied.

RECOMMENDATION

The examiner recommends that the application of American Coastal Energy, Inc., for Statewide Rule 14(b)(2) plugging extensions be denied.

Respectfully submitted,

James M. Doherty
Hearings Examiner