



RAILROAD COMMISSION OF TEXAS

HEARINGS DIVISION

OIL AND GAS DOCKET NO. 8A-0291190

**THE APPLICATION OF APACHE CORPORATION PURSUANT TO STATEWIDE
RULE 50 FOR APPROVAL OF ITS FORM H-13 EOR POSITIVE PRODUCTION
RESPONSE CERTIFICATION FOR THE ADAIR SAN ANDRES UNIT, ADAIR FIELD,
GAINES AND TERRY COUNTIES, TEXAS**

PROPOSAL FOR DECISION

HEARD BY: Paul Dubois – Technical Examiner
Marshall Enquist – Hearings Examiner

HEARING DATE: October 1, 2014

APPEARANCES:

William Hayenga
Brian Sullivan
Dustin Marks
Mark Henkhaus

REPRESENTING:

Apache Corporation

PROCEDURAL HISTORY

Application Filed:	July 8, 2014
Application Denied:	July 18, 2014
Request for Hearing:	July 25, 2014
Notice of Hearing:	September 11, 2014
Date of Hearing:	October 1, 2014
Transcript Received:	October 9, 2014
Proposal For Decision Issued:	December 5, 2014

STATEMENT OF THE CASE

Pursuant to Statewide Rule 50 (16 Tex. Admin. Code §3.50), Apache Corporation (Apache) seeks Commission certification of an enhanced oil recovery (EOR) positive oil production response for its Adair San Andres Unit, in the Adair Field, Gaines and Terry Counties, Texas. Apache's application on Form H-13 was administratively denied by Commission staff because it was not filed within the time constraints provided by Statewide

Rule 50. Apache requested a hearing on the matter, at which Commission staff did not protest. At the hearing Apache presented testimony from two witnesses. Twelve exhibits were entered into the record. On November 7, 2014, Apache submitted a request to reopen the hearing for the limited purpose of entering into evidence a letter and late-filed Exhibit Nos. 13, 14, 15, 16, and 17. The Examiners have admitted the cover letter and the late-filed exhibits into the record.

APPLICABLE LAW

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

Statewide Rule 50(g)(2)(A) states: "The operator of an EOR project that meets the requirements of this section shall demonstrate to the Commission a positive oil production response before the operator can receive Commission certification of such a positive production response. The certification date may be any date desired by the operator, subject to Commission approval, following the date on which a positive oil production response first occurred. The operator shall apply for a positive production response certificate within three years of project approval for secondary projects, and within five years of project approval for tertiary projects, to qualify for the recovered oil tax rate. The oil produced from the designated area of a new EOR project or incremental oil produced from the designated area of an expanded EOR project after the date of certification of a positive production response is eligible for the recovered oil tax rate. The operator shall apply to the comptroller pursuant to the Tax Code, §202.052 and §202.054, to qualify for the recovered oil tax rate."¹

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

¹ 16 Tex. Admin. Code §3.50(g)(2)(A).

After hearing, the examiner shall recommend final action by the Commission."²

MATTERS OFFICIALLY NOTICED

The Applicant requests the Examiners consider as a precedent in the present matter Oil & Gas Docket Number 08-0261255, the application of Kinder Morgan Production Co. LLC (Kinder Morgan) pursuant to Statewide Rule 50, to consider approval of its Form H-13, Positive Response Certification, for its Yates Field Unit, Yates Field, Pecos County, Texas. At the hearing the Applicant offered into evidence the Proposal for Decision (PFD) and Final Order, issued on July 14, 2009, in Docket No. 08-0261255. The Examiners take official notice of the audio/video recordings of the following Railroad Commission of Texas Open Conferences at which the Kinder Morgan matter was taken up:

June 18, 2009. Item 4. O&G 08-0261255: Kinder Morgan Production Co LLC to consider approval of applicant's Form H-13, Positive Response Certification, for its Yates Field Unit, Yates Field, Pecos County, Texas, Pursuant to Statewide Rule 50. http://streaming.aanet.org/ramgen/txrail/smil/RRC_OC061809-3.smil

June 30, 2009. Item 1. O&G 08-0261255: Kinder Morgan Production Co. LLC to consider approval of applicant's Form H-13, Positive Response Certification, for its Yates Field Unit, Yates Field, Pecos County, Texas, Pursuant to Statewide Rule 50. http://streaming.aanet.org/ramgen/txrail/smil/RRC_OC063009-0.smil

The Examiners further take official notice of Railroad Commission Forms (and instructions) H-12 New or Expanded Enhanced Oil Recovery Project and Area Designation Approval Application, H-13 EOR Positive Production Response Certification Application, and H-14 Enhanced Oil Recovery Reduced Tax Annual Report.

DISCUSSION OF THE EVIDENCE

Background

Apache's Adair San Andres Unit (ASAU) produces from the Adair Field (San Andres Formation) in Terry and Gaines Counties, Texas. The ASAU was unitized on November 27, 1962, at which time injection authority for secondary recovery was granted (Project No. F-1722). The entire unit consists of 5,338 acres. Miscible displacement tertiary recovery began in the central part of the ASAU with the Phase I carbon dioxide (CO₂) injection project in 1997.³

The miscible flood tertiary recovery project was subsequently expanded northward

² 16 Tex. Admin. Code §3.50(g)(2)(C).

³ Applicant's Exh. No. 3.

into the subject Phase II area in 2005. The Commission assigned Project No. F-01722A for the Phase II project. Apache indicated the positive production response in the Phase II area was slower than expected, probably the result of wide well spacing. Therefore, Apache and its partners prepared a plan to expand the Phase II area to a total of about 380 acres, and to reconfigure the injection and producing well locations and spacing.⁴ On January 23, 2009 the Commission received Apache's Form H-12 (New or Expanded Enhanced Oil Recovery Project and Area Designation Approval Application) for the ASAU CO2 EOR Phase II Second Expansion.

On February 10, 2009, Commission staff administratively approved the Form H-12 for the Phase II Second Expansion. The Commission assigned Project No. F-01722B for the Phase II Second Expansion project.⁵ The expansion work consisting of well conversions and new drilling commenced in June 2009 and was completed in January 2010.⁶

In August 2011, Apache observed a positive EOR production response from the Phase II Second Expansion project, which indicated a significant, sustained production increase from the established decline curve.⁷

The Present Matter

The Commission approved Apache's application (Form H-12) for the ASAU Phase II Second Expansion (miscible fluid displacement) and area designation on February 10, 2009. According to Statewide Rule 50(g)(2)(A), an operator has five years from the approval date to submit an application for a positive production response certificate. Apache submitted Form H-13, EOR Positive Production Response Certification Application, on July 8, 2014, five months after the February 10, 2014 deadline expired. Exhibit A illustrates ASAU production history and relevant project milestones.⁸

On July 18, 2014, Commission staff denied administrative approval of Apache's

⁴ Ibid.

⁵ Applicant's Exh. No. 4.

⁶ Applicant's Exh. No. 5.

⁷ Ibid.

⁸ Applicant's Exh. No. 11. Note: The date of August 2011 was stated in the project narrative on page 3 of Exhibit No. 5. The annotation on Apache's Exh. No. 11 indicates November 2011. While either date suffices, the Examiners believe Apache's intention was to identify August 2011 as the date of EOR positive production response.

Form H-13 application because the form “was not filed within five years of the Form H-12 approval date (February 10, 2009).”⁹ On July 25, 2014, Apache requested the matter be set for a hearing.¹⁰

Mr. Mark Henkhaus, Apache’s Regulatory Manager for the Permian Basin, and Mr. Dustin Marks, Senior Production Engineer, testified at the hearing. Apache does not dispute its failure to submit Form H-13 in a timely manner.¹¹ Apache does, however, believe the Commission should approve the Form H-13 Positive Production Response Certificate as a correct matter of policy.¹² Apache believes that the tertiary recovery project has unequivocally demonstrated a positive production response within the time frame established by the Rule.¹³ Further, Apache attributes its failure to timely file Form H-13 within the required five-year period primarily on administrative factors within its own organization and secondarily through some confusion associated with correspondence from Commission staff.

Apache has experienced significant growth and activity over the five year period from 2009 to 2014, and these factors contributed to a failure to properly administer projects such as the subject ASAU Phase II Second Expansion. Mr. Henkhaus testified to a number of specific contributing factors: dedicated regulatory staff increased from one person to 16 in the last two years; regional offices moved from Tulsa to Midland; Midland employment increased from 25 to 900 persons; and Apache now manages about 40 drilling rigs in the Permian Basin.¹⁴ Mr. Henkhaus testified that during this time of rapid growth and other organizational changes, the transition of individual responsibilities were often poorly handed-off from outgoing to incoming staff.¹⁵ Mr. Henkhaus also testified that he is working pro-actively with Commission staff to better manage and meet Apache’s regulatory obligations.¹⁶

⁹ Applicant’s Exh. No. 8.

¹⁰ Applicant’s Exh. No. 9.

¹¹ Tr. pg. 55, lns. 20-22.

¹² Tr. pg. 61, lns. 9-10.

¹³ Tr. pg. 25, lns. 16-23; Applicant’s Exh. Nos. 7 and 11.

¹⁴ Tr. pg. 51, ln. 5, through pg. 52, ln. 10.

¹⁵ Tr. pg. 53, lns. 20-24. Mr. Henkhaus: “*This late filing was because of a bad hand-off from previous employees to current employees and the fact that there was no regulatory oversight to know that this needed to be done until we came early this year and saw that it was late.*”

¹⁶ Tr. pg. 52, ln. 25, through pg. 53, ln. 10.

Mr. Marks joined Apache in April 2013, and has been assigned responsibility for the Phase II Second Expansion. Mr. Marks testified to his confusion with regard to the Project Nos. F-01722A and F-01722B, identifiers which were assigned by the Commission for the original Phase II project and for the Phase II Second Expansion, respectively. On March 19, 2014 Apache received a Notice of Delinquent Forms H-14 from Commission staff. The notice referenced Project No. F-01722A.¹⁷ However, with the February 10, 2009, Commission approval of the H-12 for the Phase II Second Expansion, Project F-01722A effectively ceased to have regulatory significance and was replaced by F-01722B. The H-14 delinquency notice referenced Project F-011722A, adding to Apache's confusion, as Mr. Marks and Mr. Henkhaus, who both joined Apache within the last two years, were not aware of two regulatory project numbers—F-01722A and F01722B—for what was in actuality one project on the ground.¹⁸ Regardless, the filing date was missed.

As previously noted, Apache provided the PFD and Final Order issued in Docket No. 08-0261255, in which Kinder Morgan sought approval of a Form H-13 that was initially denied by Commission staff due to being late-filed. In that case, Kinder Morgan received an H-12 approval date for its project of February 2, 2004. A little more than five years later, on February 10, 2009, the Commission received Kinder Morgan's Form H-13 for the project, a filing that was eight days late. Staff denied the certification application due to the late filing and Kinder Morgan requested a hearing. Following the hearing, the Examiner recommended the Commission deny the application, as Statewide Rule 50 provides no direction on when or whether an exception to the filing periods may be made. In public conference, however, the Commissioners unanimously voted to approve Kinder Morgan's application.

EXAMINERS' OPINION

The Examiners agree with Apache that the Phase II Second Expansion tertiary recovery project convincingly demonstrated a positive production response by August 2011, less than two years after the project went online and within the five year period required to demonstrate such a response. The Examiners further agree that, in general, such secondary and tertiary recovery projects are necessary to prevent waste of hydrocarbons and to protect correlative rights. However, the Examiners do not find that either the Texas Tax Code or Statewide Rule 50 provide for an exception, variance, or extension of this filing period. The Examiners, therefore, cannot conclude that Apache met the requirements of Statewide Rule 50(g)(2)(A) for its positive production response certification. The Examiners recommend Apache's application be denied.

The Examiners' analysis of this matter is separated in several components: (1) the requirements of Texas Tax Code §202.054(g); (2) the Commission's implementation of

¹⁷ Applicant's Exh. No. 6.

¹⁸ Tr. pg. 57, ln. 19, through pg. 58, ln. 2.

Statewide Rule 50; (3) the precedent set by the Kinder Morgan matter; and (4) communications between Apache and Commission staff.

Requirements of Texas Tax Code §202.054(g)

As described on page 2 above, the present matter is governed by the Texas Tax Code §202.054(g) and Statewide Rule 50(g)(2)(A), which provide a severance tax reduction for successful secondary and tertiary recovery programs. The Texas Tax Code and Statewide Rule 50 require an applicant to apply for a positive production response certification within 5 years of project approval. Pursuant to Texas Tax Code §202.054(g), the recovered oil tax rate applies "...if the application is filed...not later than five years from the date the Commission approves the project if the project is designated as a new or existing project that uses a tertiary recovery process..." According to the Code Construction Act, "[w]ords and phrases shall be read in context and construed according to the rules of grammar and common usage."¹⁹ The words "...not later than five years from the date the Commission approves the project..." in Tax Code §202.054(g) are clear and, in common usage, imply an absolute cut-off date. Further, Statewide Rule 50 clearly states that "...the operator shall apply for a positive production response certificate within five years of project approval for tertiary projects..." The Code Construction Act states use of the word "shall" imposes a duty."²⁰ In this case, Apache had a duty to file its Form H-13 "no later than" February 10, 2014, but missed that filing by five months.

Implementation of Statewide Rule 50

The Commission implements its responsibilities under Texas Tax Code §202.054(g) and Statewide Rule 50(g)(2)(A) by the administration of three forms, each initiated by operator action and followed by a Commission action:

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

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

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

Form H-13, EOR Positive Production Response Certification Application; and

¹⁹ Texas Gov't Code § 311.011.

²⁰ Texas Gov't Code § 311.016(2).

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

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

Form H-14, Enhanced Oil Recovery Reduced Tax Annual Report.

Operator Action: This form must be filed each year that the project is eligible for the reduced tax rate. Form H-14 must be filed within 30 days of the anniversary of the certification date of positive production response and annually thereafter.

Commission Action: Forms H-14 are forwarded to the Comptroller of Public Accounts. Commission staff notifies operators of a delinquent H-14, based on the anticipated filing date (30 days after the expiration of the five year period for tertiary recovery projects).

In the Apache case, the following timeline unfolded with regard to operator and Commission actions:

January 23, 2009: The Commission receives Apache's Form H-12 for the ASAU EOR Phase 2 Second Expansion Project.

February 10, 2009: Commission staff administratively approves Apache's Form H-12 with an effective date of February 10, 2009. Staff assigned it Project No. F-01722B and directed Apache to file Form H-13 within five years.

August 2011: Apache observes a positive production response from the ASAU EOR Phase 2 Second Expansion Project.

August 20, 2012: Commission staff notifies Apache that Forms H-14 are delinquent for Project No. F-01722A.

February 10, 2014: The statutory deadline for filing Form H-13 passes for the ASAU EOR Phase 2 Second Expansion Project (No. F-01722B).

March 7, 2014: Commission staff again notifies Apache that Forms H-14 are delinquent for Project No. F-01722A.

April 7, 2014: Apache submits the delinquent Forms H-14 to the Commission. These forms are for the time period from December 2009 through November 2013.

April 8, 2014: Apache submits corrections to two of the delinquent Forms H-14 to the Commission by e-mail. These forms are for the time period from December 2011 through November 2013.

July 8, 2014: Apache submits Form H-13 for the ASAU EOR Phase 2 Second Expansion Project (No. F-01722B).

July 18, 2014: Commission staff administratively deny Apache's Form H-13.

Apache could have applied for certification at any time after the positive production response was observed (i.e., after August 2011, but before February 10, 2014). Apache is forthright in admitting that submission of its Form H-13 Positive Production Response Certificate five months late was not timely and was due to its own internal procedures, or lack thereof (see footnote 14).

The Kinder Morgan Matter

Apache requests the Examiners follow the precedent set by the Commission in the Kinder Morgan matter (Oil & Gas Docket No. 08-0261255, entered on July 14, 2009)²¹. However, upon review of the audio and video recordings of the Commission Open Conferences when this matter was taken up (June 18, 2009, and June 30, 2009), the factual basis for the Kinder Morgan decision appears to be different from that of the Apache matter. Therefore, the Examiners find Apache's claim that Kinder Morgan is precedential as unconvincing. What follows is a time line of salient events in the Kinder Morgan matter.²²

²¹ In Oil & Gas Docket No. 08-0261255, in which Kinder Morgan was eight days late filing for its positive production response certificate, the Examiner recommended denial of the application. At Conference, the Commissioners overruled the Examiner, who returned the following Conference with a conforming Order with substitute findings of fact and a substitute conclusion of law.

²² The readers are cautioned: Relevant dates for the Kinder Morgan matter are between February 2, 2004, and July (day uncertain), 2009. Relevant dates for the Apache matter are between February 10, 2009 and July 18, 2014. The February and July dates are a coincidence and easily confused between the two cases.

February 2, 2004: Kinder Morgan filed Form H-12 for a new tertiary recovery project; the Yates Field Unit.

February 10, 2004: Commission staff verbally informed Kinder Morgan's attorney that the actual approval letter had not been generated, but that the approval of the H-12 would have an effective date of February 2, 2004.

February 27, 2004: Kinder Morgan contacted Commission staff because H-12 approval had not been received. Staff informed Kinder Morgan by e-mail that the approval letter had not been generated, but an effective date of February 2, 2004 would be set.

March 1, 2004: Kinder Morgan began injection activities for the tertiary recovery project.

July 19, 2004: Kinder Morgan received the H-12 approval letter from Commission staff. The H-12 approval was back-dated February 2, 2004, and the specified effective date of the approval was February 2, 2004.

February 10, 2009: the Commission received Kinder Morgan's Form H-13 for the Yates Field Unit, documenting a positive production response. The certification was denied because it was eight days late. After a hearing the presiding examiner recommended Kinder Morgan's H-13 certification be denied.

June 30, 2009: In Open Conference, the Commissioners acted 3-0 to overrule the examiners recommendation and certify Kinder Morgan's Form H-13 positive production response.

The Commission's decision in the Kinder Morgan case derived from facts in the record that the Form H-12 was administratively approved some time in July 2004. However, Commission staff making this approval back-dated the approval letter and effective date to February 2, 2004. In Kinder Morgan, the Commissioners found the controlling language to be: "...not later than five years from the date the Commission approves the project..."²³ That is, the Commission administratively approved the project in July 2004, not in February of that year, and therefore Kinder Morgan's Form H-13 submitted on February 10, 2009 was timely filed.

In the Kinder Morgan matter, the Commission concluded that Kinder Morgan's Form H-13 was filed within five years of the date commission staff actually and formally approved

²³

Texas Tax Code §202.054(g)

the project in writing some time in July 2004. In the present Apache matter, there is no dispute about the timing of the H-12 approval or the H-13 submittal, or the fact that Apache's H-13 was five months late.

Commission Staff Communications

Apache believes errors in communication from Commission staff contributed to its administrative difficulties in meeting its obligations under Statewide Rule 50. According to Apache, the confusion in project numbers—F-01722A and F-01722B—was shared by both Apache and the Commission's information system. The record does not reveal the details of how such projects are tracked or administered in the Commission's information systems. Consequently, there is no evidence that the Commission has ever taken upon itself the responsibility to notify operators of expiration of pending deadlines in such matters.

On August 20, 2012, Commission staff notified Apache that certain Forms H-14 were delinquent for Project No. F-01722A (the original Phase II project number, not the expansion project number which was F-01722B). This could have been a clue for Apache that something was amiss. Regardless, the Examiners conclude that the administrative errors in the August 20, 2012, H-14 delinquency notice did not cause or contribute to Apache missing the filing deadline of February 10, 2014. The March 7, 2014, delinquency notices did not cause or contribute to the missed filing either, as by then Apache had already missed the deadline. In fact, it appears as if staff's delinquency notice dated March 7, 2014 may have provided Apache with its first clue that the H-13 filing deadline had passed.

FINDINGS OF FACT

1. Notice of this hearing was given to all persons entitled to notice.
2. The Commission approved Apache's application (Form H-12) for the ASAU Phase II Second Expansion (miscible fluid displacement) and area designation on February 10, 2009.
3. The tertiary recovery project demonstrated a positive production response in August 2011, within the time frame established by Statewide Rule 50.
4. According to the provisions of the Texas Tax Code and Statewide Rule 50(g)(2)(A), Apache had from August 2011 until February 10, 2014, to apply for a positive production response certificate.
5. Apache submitted a Form H-13, EOR Positive Production Response Certification Application, on July 8, 2014, approximately five months after the February 10, 2014 deadline expired.

6. On July 18, 2014, Commission staff denied Apache's Form H-13 application because the form "was not filed within five years of the Form H-12 approval date (February 10, 2009)."
7. On July 25, 2014, Apache requested the matter be set for a hearing.
8. Apache does not dispute its failure to submit Form H-13 in a timely manner.
9. Apache experienced significant growth in activity and staffing, as well as staff turnover, which contributed to its unintentional failure to timely submit its Form H-13.

CONCLUSIONS OF LAW

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

RECOMMENDATION

Based on the above findings of fact and conclusions of law, the Examiners recommend that Apache Corporation's application for positive production response certification for the ASAU Phase II Second Expansion project be denied.

Respectfully submitted,



Paul Dubois
Technical Examiner



Marshall Enquist
Hearings Examiner