

IMPORTANT! PLEASE READ!!

NEW REQUIREMENTS REGARDING INACTIVE WELLS **(COMPLIANCE WITH HB 2259 FOR P5 RENEWAL PURPOSES)**

The 81st Texas Legislature (2009, Regular Session) enacted House Bill 2259 (HB 2259), effective September 1, 2010, establishing new requirements for oil and gas operators related to inactive wells and associated surface equipment. HB 2259 amended the Texas Natural Resources Code to address two issues related to inactive land wells: (1) the dangers posed by live electrical lines connected to inactive wells; and (2) increased costs to plug inactive wells. HB 2259 reflects the work of the Inactive Well Study Group, which included representatives of both industry and landowners. HB 2259 applies only to land wells (not to bay and offshore wells.)

Effective September, 2010, the Railroad Commission (Commission) adopted amendments to existing Statewide Rules 1, 14, 21 and 78, and adopted a new Statewide Rule 15 to add the new statutory requirements and to add the surface equipment removal and inactive well requirements set out by HB 2259. (The Commission repealed the previous Rule 15 and incorporated its requirements relating to surface casing to be left in place into Rule 14.) **Under the new requirements, all operators will be required to annually address their complete inventory of inactive wells to obtain approval of their annual Organization Report (Form P-5) renewal.**

In 2011, the 82nd Texas Legislature (2011, Regular Session) enacted House Bill 3134 (HB 3134) to address certain process issues. HB3134 provides that an operator who has complied with all P-5 renewal requirements except for those associated with HB2259 will be granted a 90-day extension to his P-5 active status in order to complete the work needed to comply with HB2259. HB3134 also provides that if an operator has been unable to achieve compliance by the end of that 90-day period, they may request a hearing on the matter. Pursuant to HB3134, the operator will be required to pay for hearing costs if they choose to request a hearing. The 90-day extension process is already in place; however rulemaking will be necessary to implement the hearing process; that rulemaking is not yet completed (as of 9/1/2011).

The information in this document is only a summary of the new requirements and should be used as an aid in completing your P-5 (Organization Report) renewal. All operators must review the relevant Statewide Rules. The Statewide Rules and all forms referenced in this document also are available through the Commission's website. The Commission will include blank forms with each operator's P-5 renewal packet.

The Commission also has placed on its website inactive well information. The Commission has created an Inactive Well Aging Report ("IWAR") query that will provide a list of all wells classified as "inactive" in the Commission's records. The information on the IWAR includes a "Shut-in Date," which is the first inactive month according to Commission records. The list provides length of inactivity based on the date you run the query, or based upon your next P-5

renewal date. (A listing of inactive wells also is included with each operator's P-5 renewal packet.)

IMPORTANT: For purposes of P-5 renewal, you must bring into compliance all wells shown as of the date your P-5 renewal packet is generated. P-5 packets are generated 3 months prior to your current P-5 expiration. For example, if your current P-5 expires at the end of April, then your P-5 packet will be generated and mailed to you in February; the listing included in that packet (and the IWAR data update in February) will include the wells for which compliance is required. A new query (separate from the IWAR query referenced above) has also been added to the Commission's website to allow operators to review the status of wells listed with their P-5 renewal and the operators progress towards HB2259 compliance.

AN AUTOMATIC 90-DAY EXTENSION OF AN OPERATOR'S ACTIVE P-5 STATUS WILL BE GRANTED IF THE OPERATOR HAS MET ALL P-5 RENEWAL REQUIREMENTS EXCEPT FOR THOSE ASSOCIATED WITH HB2259. This will provide additional time for the operator to complete the work needed to comply with the new requirements. Generally, you must file your Organization Report renewal form along with the P-5 financial security and P-5 filing fee; if the only reason why the Commission cannot approve the renewal is because you have wells that are not yet compliant with HB2259, then the 90-day extension will be automatically approved.

Overview of HB2259 requirements:

For purposes of P-5 renewal, the new requirements fall generally into two categories: Surface equipment cleanup/removal and additional plugging extension requirements. An operator can achieve compliance by plugging the well, returning the well to active operation, or by complying with all necessary steps to obtain a plugging extension.

HB2259 also prohibits the Commission from renewing or approving the Organization Report for an operator who fails to obtain plugging extensions for the operator's inactive wells and/or fails to comply with the surface equipment cleanup/removal requirements. This prohibition also includes any previous issues for which plugging extensions have been denied (such as Form H-15 delinquency or denial, field violations and enforcement issues, lack of a good faith claim to the right to operate the well, etc.)

If you do not comply with the new requirements, the Commission will be unable to renew your Organization Report or issue any permits to your organization. Your P-5 will become "Delinquent" and the Commission will begin to sever/seal your leases and wells and will ultimately initiate collection on your financial security.

A summary of the requirements for Inactive Well compliance appears at the end of this document.

Surface Equipment Cleanup/Removal:

General requirements. Depending on how long a well has been inactive, certain actions must be completed and certified to the Commission. An individual with actual personal knowledge of the physical condition of the inactive well must execute and submit to the Commission **Form W-3C** (Certification Of Surface Equipment Removal For An Inactive Well). The certification must state the following:

- 1) For wells inactive for 12 months or longer, that the operator has physically terminated electric service to the well's production site (or that the site does not have electric service).
- 2) For wells inactive at least 5 years but less than 10 years:
 - a. that the operator has emptied or purged of production fluids all piping, tanks, vessels and equipment associated with the well; or
 - b. that the operator owns the land where the well is located.
- 3) For wells inactive 10 years or longer (See also "Phase-In Information" below):
 - a. that the operator has removed all surface equipment;
 - b. that the operator owns the land where the well is located; or
 - c. that the well is associated with a Commission-approved Enhanced Oil Recovery (EOR) project and the equipment remaining on the lease is associated with that project.

The items to be certified are cumulative. For example, if the well has been inactive for 7 years, the operator must certify compliance with both #1 and #2 above.

An operator need only provide the certification as outlined above once. However, if a well is transferred to a subsequent operator, then certifications based on ownership of the land or upon EOR project approval will be nullified and the acquiring operator will be required to certify compliance in their own name. Also, if the well is returned to active operation and later becomes inactive again, the operator must recertify the well as the certifications become applicable for the new period of inactivity.

Phase-In Information. The rules provide for a five-year phase-in period for wells that have reached 10 years of inactivity prior to 9/1/2010 (i.e., those with shut-in dates of 09/2000 and earlier). The phase-in period ONLY applies to surface equipment removal; there is no phase-in for the requirement to disconnect electricity for 12-month inactive wells, or to remove surface equipment for wells becoming 10 years inactive on or after 9/1/2010. However, the wells eligible for phase-in need not have the fluids purged from lines and vessels provided that the removal action during the phase-in period also addresses any production fluids.

At least 20% of wells eligible for phase-in must be compliant with the surface equipment removal requirements at the first Form P-5 renewal date on or after 9/1/2011; at least 40% of the wells eligible for phase-in must be compliant at the Form P-5 renewal date on or after 9/1/2012; and so on until the Form P-5 renewal date on or after 9/1/2015, at which point all 10-year inactive wells must be compliant. Note that there is no penalty for early completion; any wells completed beyond the 20% required for the first year will count toward the 40% requirement in the second year.

Wells that are acquired from another operator following the 9/1/2010 effective date of HB2259 are NOT eligible for handling under the Phase-in process; those acquired wells must be addressed as outlined in the section on "Well transfers and Surface Equipment Cleanup/Removal" below.

Temporary Extensions. You may be eligible for a temporary (one year) extension to the surface equipment removal requirements if your inability to comply is solely due to safety concerns or required maintenance of the well site. If this is the case, you must include with Form W-3C a written affirmation of the facts regarding the safety concerns or maintenance. If the Commission

declines to approve your extension request administratively, you may request a hearing. (Your Organization Report renewal will not be delayed during the hearing process; however, if your request is ultimately denied, your Organization Report may be revoked.)

Well Transfers and Surface Equipment Cleanup/Removal. Transfer of a well that is part of your inventory of wells eligible for the Phase-In period will not count towards your compliance requirement. (Effectively, however, such a transfer will reduce the number of wells you are required to bring into compliance during the fifth and final year of the phase-in process.)

Additionally, the well will no longer be eligible for the phase-in treatment and the acquiring operator will be required to comply with the surface equipment removal requirement within 6 months of Commission approval of the transfer. Further, until the well has been brought into compliance, the Commission will not approve a transfer of the well to a third operator.

Plugging Extension Requirements

General requirements. Prior to the passage of HB2259, the Commission required the following for approval of plugging extensions:

- 1) that the operator has a current Organization Report;
- 2) that the operator has, and on request provides evidence of, a good faith claim to a continuing right to operate the well;
- 3) that the well and associated facilities are otherwise in compliance with all Commission rules and orders; and
- 4) for wells more than 25 years old, that the operator perform a successful fluid level or hydraulic pressure test.

HB 2259 and the new rules additionally require compliance with the surface equipment cleanup/removal requirements outlined above. (However, because failure to comply with the surface equipment requirements will also result in your P-5 renewal not being approved, the effect of failure on plugging extensions is somewhat secondary: plugging extensions will be denied for multiple reasons.) Furthermore, HB2259 and the new rules require that the operator of an inactive well submit to the Commission additional information regarding one of several options in order to gain approval of a plugging extension. The operator must indicate the selected option on new **Form W-3X** (Application For An Extension Of Deadline For Plugging An Inactive Well), and provide any necessary documentation and fees associated with the selected option. The options include:

Blanket (operator-level) options. Compliance with the additional requirement for plugging extensions can be met at an operator-level by doing one of three things:

- 1) The operator may plug or restore to active operation 10% of the number of inactive wells operated at their last Form P-5 renewal date. (Note that the wells plugged or restored to activity need not have been among the operator's inactive wells at the last Form P-5 renewal date; wells that more recently became inactive, or inactive wells that were acquired since the last renewal, may also be counted.) If the operator's Form P-5 annual cycle begins on May 1 of each year, then for the operator's Form P-5 renewal

this year, the operator would count all wells plugged or returned to active operation since May 1 of last year. If the Commission cannot verify that the operator has plugged or returned to active operation the required number of wells, the operator may need to submit additional information identifying those wells.

- 2) An operator that is a publicly traded entity may file with the Commission a copy of federal documents filed to comply with Financial Accounting Standards Board Statement No. 143, Accounting for Asset Retirement Obligations, and an original executed Uniform Commercial Code Form 1 Financing Statement, filed with the Secretary of State, that names the operator as “debtor” and the Railroad Commission of Texas as “secured creditor” and specifies the funds covered by the documents in the amount of the “cost calculation” (see below) for plugging all inactive wells held by the operator.
- 3) The operator may file a bond (Form P-5PB(2)), Letter of Credit (Form P-5LC) or cash deposit in the amount of the “cost calculation” (see below) for plugging all inactive wells, or \$2 million, whichever is less.

If you have fulfilled the requirements of one of these blanket options and wish to use it toward your plugging extensions, you would file a single Form W-3X form with your Form P-5 renewal. On the Form W-3X, you would indicate the option selected and attach any necessary supporting documentation (copies of the relevant documents, original bond/LOC forms, etc.)

Individual (well-level) options. Compliance with the additional requirement for plugging extensions can be met on a well-by-well level by filing one of five documents:

- 1) an “abeyance of plugging report” as described in Rule 15(j), along with a \$100 fee.
- 2) a statement that the well is part of a Commission-approved Enhanced Oil Recovery (EOR) project.
- 3) if the well is not otherwise required to be tested, a statement that an approved fluid level or hydraulic pressure test has been performed and submitted on Form H-15, along with a \$50 fee. (This option is not available for a well that is more than 25 years old and is required to be tested under the H-15 program, or a well that has an active injection or disposal permit and is required by that permit to undergo periodic H-5 testing.)
- 4) Additional financial security in the amount of the “cost calculation” (see below) for plugging this well; or
- 5) an escrow fund deposit in an amount no less than 10% of the “cost calculation” (see below) for plugging the well.

Applications for plugging extensions filed under an individual well option may be filed at any time. If the Commission is unable to confirm eligibility (e.g., there is no Commission record of an approved EOR project for #2, no record of an H-15 record on file for #3, no filing fee has been received for #1 or #3, etc.), then your application for extension will be denied until the discrepancy can be resolved.

Cost Calculation. Under Rule 15(a)(2), the “cost calculation for plugging an inactive well” is defined as “the cost, calculated by the Commission or its delegate, for each foot of well depth plugged based on average actual plugging costs for wells plugged by the Commission for the

preceding state fiscal year for the Commission Oil and Gas Division district in which the inactive well is located.”

The Commission will determine the average per-foot plugging cost for each Commission district based on state-funded plugging operations (excluding plugging of any bay or offshore wells) in that district. The per-foot cost will be multiplied times the depth of the inactive wellbore on Commission records; the result will be the “cost calculation” amount for plugging that well.

Because the district costs vary from year to year, the amount required under certain options (blanket options 2 and 3, and individual options 4 and 5) also may vary from year to year.

Transferring Wells to New Operators

Wells may be transferred from one operator to another operator. Once the Commission has approved the Form P-4 transferring operatorship, the prior operator will no longer be responsible for compliance with these provisions.

The acquiring operator will have 6 months from the date of Form P-4 approval to bring any inactive wells into compliance with Statewide Rule 15. The operator may comply by plugging the well, returning the well to active operation, or by applying for and being granted a plugging extension on the well. **Important: until the acquiring operator has brought the well into compliance with Rule 15, the Commission may not approve any further transfers of the inactive well to a subsequent operator.**

Following the expiration of the 6-month period after transfer, if any transferred well remains out of compliance with Rule 15, the Commission may, after notice and opportunity for hearing, revoke the operator’s Organization Report.

Further information and links

Additional information regarding HB2259 is available on the Commission’s website at:
<http://www.rrc.state.tx.us/compliance/hb2259/index.php>

All oil and gas forms are available through our website at:
<http://www.rrc.state.tx.us/forms/forms/og/alpha.php>

Please see the instructions included with Forms W-3C and W-3X.

Inactive well data for operators is available through the Inactive Well Aging Report (“IWAR”) query on the Commission’s website at:
<http://www.rrc.state.tx.us/iwar/index.php>

Inactive Well Compliance Summary

1. Review the wells on your inactive well listing (included with your P-5 renewal packet, or obtained through the online IWAR query), including the shut-in date.
2. Complete all required surface cleanup/removal:
 - a. Disconnect the electricity to any inactive well. All wells appearing on your inactive well listing have been inactive at least 12 months.
 - b. Purge all fluids from tanks, pipes and vessels for wells shut-in at least 5 years but less than 10 as of your next P-5 renewal date. (Wells shut-in 10 years or more must be brought into compliance by removal of the surface equipment; see "c" and "d" below.)

Example: If your current P-5 expires on April 30, and you are filing your P-5 renewal for the year beginning 5/1/2011, then you would need to include all wells with a shut-in date between 06/2001 and 05/2006.

- c. Remove all surface equipment from wells shut-in more than ten years where the well completed its 10th year of inactivity after 9/1/10. (Note: wells that reached their 10th year of inactivity prior to 9/1/10 have shut-in dates of 01/1998 through 09/2000. Compliance with the surface equipment removal requirements on those wells is phased in over a five-year period; see "d" below.)

Example: If your current P-5 expires on April 30, and you are filing your P-5 renewal for the year beginning 5/1/2011, then you would need to include all wells with a shut-in date between 10/2000 and 05/2001.)

- d. For wells that became 10-years inactive prior to 9/1/10, confirm that you have brought enough of those wells into compliance under the 5-year phase in period. At least 20% must be compliant as of your first P-5 renewal on or after 9/1/2011; at least 40% as of your first P-5 renewal on or after 9/1/2012; and so on. **(The phase-in period applies to surface equipment removal only; the requirement to disconnect electricity is not phased in.)**

Complete and file with your P-5 Commission form W-3C certifying compliance with the equipment removal requirements for each well or group of wells or any applicable exemption. See the instructions on Form W-3C for further information.

3. Inactive Well Extensions:
 - a. Correct any violations of Commission rules or requirements for which plugging extensions have been denied.
 - b. Choose a blanket option or individual well option(s) for obtaining a plugging extension on all inactive wells.
 - c. Complete any requirements associated with the selected plugging extension.

Complete and file with your P-5, Commission Form W-3X and any required attachments for the selected plugging extension(s).