

FINAL

A-7 – DETERMINATION OF NATURAL GAS WELL CATEGORIES FOR SEVERANCE TAX PURPOSES

a) Applicability

In accordance with Ark. Code Ann. § 26-58-128, the Director of the Oil and Gas Commission shall determine the well categories for all gas production wells, which will be used by the Arkansas Department of Finance and Administration to determine the appropriate severance tax rate for each well. All gas production wells under the jurisdiction of the Oil and Gas Commission are subject to the provisions of this rule.

b) Definitions:

- 1) “Commission” shall mean the Arkansas Oil and Gas Commission, on which the Director serves as secretary, but is a non-voting member.
- 2) “Conventional Gas Well” means a gas well that is not classified as a high cost gas well.
- 3) “Director” means the Oil and Gas Commission Director of Production and Conservation.
- 4) “High Cost Gas Well” means a gas well that:
 - A) Produces gas from any shale formation, including but not limited to the Fayetteville Shale, Woodford Shale, Moorefield Shale and the Chattanooga Shale, or their stratigraphic equivalents as described in published stratigraphic nomenclature recognized by the Arkansas Geologic Survey; or
 - B) Produces gas from any completion that is located at a depth of more than 12,500 feet below the surface of the earth, where the term “depth” means the length of the maximum continuous drilling string of drill pipe used between the drill bit face and the drilling rig’s Kelly bushing; or
 - C) Produces gas from a tight gas formation which is defined as a formation which:
 - i) Has previously been determined to be a low permeability formation by Commission Orders or field rules for Booneville and Chismville (84-2003-07), Gragg (89-2004-07), Waveland (86-2004-07), Rich Mountain (304-2006-09), Mansfield (28-2003-03), Witcherville and Excelsior (103-2005-07); and General Rule B-44; or
 - ii) Is determined by the Director to have an estimated in situ permeability of one-tenth millidarcy (0.1 mD) or less; or

- iii) Is determined to be a tight gas formation by field rule, general rule or orders approved by the Commission and issued by the Director.
 - D) Produces gas from a geopressed brine; or
 - E) Produces occluded gas from a coal seam.
 - 5) “Marginal Conventional Gas Well” shall mean a conventional gas well which is incapable of producing more than 250 Mcf per day, from all zones producing in such well, as determined by the sum of the individual deliverability rates for each zone, using one of the current wellhead deliverability rate methodologies described in subparagraph h) below.
 - 6) “Marginal High Cost Gas Well” shall mean a high cost gas well which is incapable of producing more than 100 Mcf per day, from all zones producing in such well, as determined by the sum of the individual deliverability rates for each zone, using one of the current wellhead deliverability rate methodologies described in subparagraph h) below.
 - 7) “New Discovery Gas Well” shall mean any conventional gas well for the period commencing on the date of first production and ending on the date that is 24 consecutive calendar months following the date of first production.
- c) On or before January 1, 2009, the Director shall determine the initial well category for each existing gas producing well in the State. If a well contains two or more separately metered producing zones (sources of supply), and one or more of the producing zones are different categories, the well category shall be based on which zone in the well produces the larger percentage of the total well production, based on the most recent back pressure test methodology specified in General Rule D-16. On or before January 1, 2009 the Director shall notify each producer of each existing wells determination as a:
- 1) High Cost Gas Well, including whether it is a high cost gas well producing gas from the date of first production and for a minimum period of 36 consecutive calendar months following the date of first production, unless a longer time period is granted by the Department of Finance and Administration in accordance with Ark Code Ann. § 26-58-127; or
 - 2) Marginal Conventional Gas Well; or
 - 3) Marginal High Cost Gas Well; or
 - 4) New Discovery Gas Well; or
 - 5) A Conventional Gas Well.
- d) After January 1, 2009 the Director shall determine, at the time of permitting each new well, the appropriate well category as specified in subparagraph c) above, which shall be effective the date of first production from the well. This well category determination, made at the time of the initial new well permit issuance or as amended in accordance with this subparagraph or subparagraph g) below, shall determine the well category throughout

the life of that well. Once a permit is issued, if a well is completed in two or more separately metered producing zones (sources of supply), and one or more of the producing zones are different categories, with respect to a Conventional Gas Well or a High Cost Gas Well, the well category shall be based on which zone in the well produces the larger percentage of the total well production, based on the initial back pressure tests required by General Rule D-16. The well category determination, shall determine the category for that well throughout the life of that well, regardless if other zones are produced within the well at a later date, until such time as the well qualifies as a Marginal Conventional Gas Well or a Marginal High Cost Gas Well.

- e) Following the well category determination for all existing wells on January 1, 2009, and the ongoing categorization for all new wells after January 1, 2009, the producer may request at any time, on a form prescribed by the Director, another well category determination with respect to the well category definitions specified in subparagraph c) above, in accordance with the application procedures specified in subparagraph i) below.
- f) Upon submission of the application and supporting documentation or other required information, the Director shall make a determination within fifteen (15) calendar days from the receipt of such application.
 - 1) The effective date of the well category determination request shall automatically be the first day of the next month following the postmark date the application was mailed to the Director or date of the Director's Office date stamp, if delivered in person to the Director.
 - 2) If approved by the Director, the application shall be sent via first class mail to the producer and a copy forwarded to the Department of Finance and Administration ("DFA").
 - 3) If the application is denied by the Director, the producer may appeal the Director's determination to the Commission by filing an application in accordance with General Rule A-2, A-3, and other applicable hearing procedures. If the producer does not appeal the denial, and the date of the Director's denial occurs after the effective date of the well determination request as defined in subparagraph f) 1) above, the producer may be subject to additional payment provisions in accordance with DFA procedures. If the producer appeals the denial, the effective date of the well categorization request shall remain in effect pending the outcome of the appeal.
- g) If following a review of completion reports, monthly production reports, the applicable wellhead deliverability rate, utilizing one of the current methodologies specified in subparagraph h) below, or other information, the Director determines a well is not correctly categorized, the Director shall determine the correct well category and notify the producer. The corrected well category determination shall become effective on the first day of the month following the month in which the Director notifies the producer of the corrected well category determination, unless the producer files an appeal of the Director's decision in accordance with General Rule A-2, A-3, and other applicable hearing procedures.

- h) All existing well category determinations under subparagraph c) and all new well category determinations under subparagraph d) shall be made on the basis of one of the following current wellhead deliverability rate methodologies:
 - 1) Establishing cumulative deliverability of the well utilizing test methodologies specified in General Rule D-16; or
 - 2) Calculating the cumulative deliverability of the well utilizing the most recent six month average daily rate of production for the well under actual operating conditions by dividing the total gas reported for the well by the number of days the well produced during the applicable six month period.
- i) Well Category Determination and Application Procedures
 - 1) High Cost Gas Well.
 - A) The High Cost Gas Well category shall be assigned to all existing wells on January 1, 2009, which satisfy the definition of a High Cost Gas Well in accordance with subparagraph b) 4) above. If on that date the High Cost Gas Well has a reported date of first production on or after January 1, 2006, the well shall automatically qualify for a cost recovery period for a period of 36 consecutive calendar months following the date of first production, unless a longer time period is granted by the Department of Finance and Administration in accordance with Ark Code Ann. § 26-58-127.
 - B) On or after January 1, 2009, the High Cost Gas Well category shall be assigned to all newly permitted wells that satisfy the definition of a High Cost Gas Well in accordance with subparagraph b) 4) above at the time of well categorization in accordance with subparagraphs d) and g) above. The well shall automatically qualify for a cost recovery period for a period of 36 consecutive calendar months following the date of first production, unless a longer time period is granted by the Department of Finance and Administration in accordance with Ark Code Ann. § 26-58-127.
 - C) At the conclusion of the cost recovery period, specified in subparagraph i) 1) A) and B) above, the well shall automatically be re-classified as a High Cost Gas Well no longer subject to the tax rate for the cost recovery period, and shall be subject to the applicable severance tax rate specified in Ark Code Ann. § 26-58-111(5)(D) unless an application is made for classification as a Marginal High Cost Gas Well in accordance with subparagraph i) 3) B) below. The effective date of the automatic re-classification shall be the first day of the month following the month in which the specified recovery period expired.
 - 2) New Discovery Gas Well
 - A) The New Discovery Gas Well category shall be assigned to all existing conventional wells on January 1, 2009, which as of that date, have a reported date of first production on or after January 1, 2007.

- B) The New Discovery Gas Well category shall be automatically assigned to all newly permitted conventional wells on or after January 1, 2009 at the time of well categorization in accordance with subparagraphs d) and g) above. The well category determination shall remain in effect for 24 consecutive calendar months following the date of first production.
 - C) At the conclusion of the 24 consecutive calendar months following the date of first production, the New Discovery Gas Well determination shall automatically terminate. The effective date of the automatic termination shall be the first day of the month following the month in which the actual date of termination occurred. The well shall be automatically reclassified as a Conventional Gas Well subject to the applicable severance tax rate specified in Ark Code Ann. § 26-58-111(5)(D), unless application is made for classification as a Marginal Conventional Gas Well in accordance with subparagraph i) 3) B) below.
- 3) Marginal Conventional Gas Well and Marginal High Cost Gas Well
- A) The applicable Marginal Gas well category shall be assigned to all existing Conventional Gas Wells and High Cost Gas Wells on January 1, 2009, that qualify as either a Marginal Conventional Gas Well or a Marginal High Cost gas and, which as of that date do not qualify as either a New Discovery Gas Well during the cost recovery period set forth in subparagraphs i) 2) A), and B) above, or a High Cost Gas Well during the cost recovery period set forth in subparagraphs i) 1) A) and B) above.
 - B) When a Conventional Gas Well qualifies as a Marginal Conventional Gas Well, or a High Cost Gas Well qualifies as a Marginal High Cost Gas Well, a producer may apply to the Director, for a Marginal Conventional Gas Well or Marginal High Cost Gas Well category determination. The request shall be on a form prescribed by the Director and shall include a copy of the most recent well head deliverability rate determination for all producing zones based on one of the current wellhead deliverability rate methodologies specified in subparagraph h) above.
 - C) The effective date of the applicable Marginal Gas well determination shall be the first day of the month following the month in which the producer's application was received in accordance with subparagraph f) above.
 - D) A producer shall immediately notify the Director in writing when a well, which has been previously determined to be a Marginal Conventional Gas Well no longer qualifies as a Marginal Conventional Gas Well, or a Marginal High Cost Gas Well no longer qualifies as a Marginal High Cost Gas Well. When a previously determined Marginal Conventional Gas Well becomes capable of producing more than 250 Mcf per day over a 30 day period or a well previously determined to be a Marginal High Cost Gas Well becomes capable of producing more than 100 Mcf per day

over a 30 day period, the producer shall submit a copy of the most recent well-head deliverability rates for each producing zone in the well, based on one of the current wellhead deliverability rate methodologies specified in subparagraph h) above, along with the required written notice to the Director.

- 4) Wells not classified as a High Cost Gas Well, New Discovery Gas Well, Marginal Conventional Gas Well or Marginal High Cost Gas Well, as described above, shall be automatically classified as a Conventional Gas Well subject to the severance tax rate specified in Ark Code Ann. § 26-58-111(5)(D).
- j) Failure to comply with any provision of this rule may result in the initiation of enforcement actions in accordance with General Rule A-5, including the assessment of a civil penalty not to exceed two thousand five hundred dollars (\$2500) per day for each day of the violation.