

**ENFORCEMENT ACTION AGAINST KERRY RAY SHRADER D/B/A SHRADER OPERATING (OPERATOR NO. 756000) FOR VIOLATIONS OF TEX. NAT. RES. CODE ANN. §85.166 AND STATEWIDE RULE 73(g) [16 TEX. ADMIN. CODE §3.68(g)] ON THE STURM ESTATE (24390) LEASE, WELL NOS. 1, 2, 3, 4, AND 5, VOGTSBERGER (CADDO 5140) FIELD, ARCHER COUNTY, TEXAS**

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**APPEARANCES:**

**FOR MOVANT:**

Lowell E. Williams  
Staff Attorney

**MOVANT:**

Enforcement Section  
Office of General Counsel

**FOR RESPONDENT:**

Rex H. White, Jr., Attorney  
Kerry Ray Shrader, Owner

**RESPONDENT:**

Kerry Ray Shrader D/B/A  
Shrader Operating

**PROPOSAL FOR DECISION**

**PROCEDURAL HISTORY**

**ORIGINAL COMPLAINT FILED:**

August 4, 2003

**DATE OF NOTICE OF HEARING:**

December 12, 2003

**DATE HEARD:**

January 15, 2004

**HEARD BY:**

James M. Doherty, Hearings Examiner

**PFD CIRCULATION DATE:**

February 4, 2004

**STATEMENT OF THE CASE**

This is an enforcement action brought by the Enforcement Section of the Office of General Counsel (“Enforcement”) against Kerry Ray Shrader D/B/A Shrader Operating (“Shrader”) for violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g). Enforcement alleges that Shrader produced oil from the Sturm Estate (24390) Lease (“Sturm Lease”), Well Nos. 1, 2, 3, 4, and 5 (“subject wells”), during the period October 1, 2002, through February 28, 2003, notwithstanding the fact that the certificate of compliance for the Sturm Lease had been canceled by

the Commission on September 30, 2002, and not reissued until March 28, 2003.

A hearing was held on January 15, 2004. Enforcement and Shrader appeared and presented evidence. In the complaint, Enforcement requested that a penalty of \$50,000 be imposed against Shrader. At the hearing, Enforcement submitted a trial amendment which reduced the requested penalty to \$20,000.

### **BACKGROUND**

Statewide Rule 73(b)<sup>1</sup> provides that the Commission may cancel a certificate of compliance if it appears that the operator of a well has violated, or is violating, in connection with the operation of the well, any of the oil, gas, or geothermal resource conservation laws or any of the permits, rules, or orders of the Commission. Upon receipt of information that indicates a violation, the Commission must send a notice letter to the operator, via registered or certified mail, identifying the violation and directing that it be remedied within a specified period of time which may not be less than 10 days. The notice letter must give the operator an opportunity to show compliance. TEX. NAT. RES. CODE ANN. §85.164 is substantially to the same effect.

Statewide Rule 73(g) provides that upon notice from the Commission that a certificate of compliance has been canceled, it is unlawful for an operator of a well to produce oil, gas, or geothermal resources until a new certificate of compliance has been issued by the Commission. TEX. NAT. RES. CODE ANN. §85.166 is substantially to the same effect.

TEX. NAT. RES. CODE ANN. §91.142(f) provides that if an organization operating in this state for the purpose of performing operations which are within the jurisdiction of the Commission does not maintain on file with the Commission an organization report and financial security as required, the organization may not perform operations under the jurisdiction of the Commission except as necessary to remedy a violation of law or Commission rules and as authorized by the Commission, and the Commission, on written notice, may suspend any certificates of compliance approved under TEX. NAT. RES. CODE ANN. Chapter 85.

TEX. NAT. RES. CODE ANN. §85.3855 provides that the Commission may impose an administrative penalty on a person who violates §85.166 of the Code. The amount of the penalty may not exceed \$10,000 for each violation, and the penalty must be based on (1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation; (2) the economic harm to property or the environment caused by the violation; (3) the history of previous violations; (4) efforts to correct the violation; and (5) any other matter that justice may require.

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<sup>1</sup> All references to Statewide Rule 73 and 16 TEX. ADMIN. CODE §3.68 are to the rule existing at the time of the notice of intent to sever and severance notice pertaining to the subject lease.

## **POSITIONS OF THE PARTIES**

### **Enforcement's Position**

Enforcement asserts that: (1) on August 30, 2002, the Commission sent to Shrader, via certified mail, a Notice of Intent to Cancel P-4 Certificate of Compliance and to Sever Pipeline or Other Carrier Connection (“notice of intent to sever”) for the Sturm Lease<sup>2</sup>, based on Shrader’s failure to complete renewal of his Form P-5 financial assurance packet, and gave Shrader 30 days to cure the violation; and (2) because Shrader did not cure the violation within 30 days, on September 30, 2002, the Commission sent Shrader a notice canceling the certificate of compliance for the Sturm Lease and severing the pipeline or other carrier connection for the lease (“severance notice”). Enforcement asserts further that Shrader did not cure the violation which caused the severance until March 20, 2003, and the certificate of compliance for the Sturm Lease was not reissued until March 28, 2003.

According to Enforcement, notwithstanding the severance of the Sturm Lease on September 30, 2002, Shrader continued to produce oil from the subject wells on the lease, at least during the period October 2002, through February 2003, as evidenced by Forms P-1 (Producer’s Monthly Report of Oil Wells) and Forms W-10 (Oil Well Status Report) filed with the Commission by Shrader. Enforcement argues that this was a clear violation of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g).

Enforcement argues that TEX. NAT. RES. CODE ANN. §85.3855 authorizes the Commission to impose a penalty up to \$10,000 per violation, and because the evidence shows that Shrader produced a total of five wells on the Sturm Lease while the lease was severed, a penalty of up to \$50,000 is authorized by the statute. Enforcement bases its request for a \$20,000 penalty on TEX. NAT. RES. CODE ANN. §85.3855(b)(1), which provides that the penalty shall be based on, *inter alia*, “the seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation”.

### **Respondent's Position**

Shrader asserts that although he received the August 30, 2002, notice of intent to sever the Sturm Lease, he did not receive the September 30, 2002, severance notice. He argues that he had no intent to violate TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) and would not have produced wells on the Sturm Lease during October 2002, through February 2003, if he had known of the severance. Shrader says he first learned that the lease had been severed when he received Enforcement’s complaint in this docket.

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<sup>2</sup> The parties have referred to the subject lease as the “Strum Estate” lease. This Proposal for Decision adopts the spelling used in Commission records which is “Sturm Estate”.

Shrader also argues that because he filed a Form P-5 on September 3, 2002, for the renewal period September 1, 2002, through August 31, 2003, and paid a \$500 filing fee, he had no reason to believe that the Form P-5 had not been approved prior to the filing of financial assurance by Shrader in the form of a \$50,000 blanket performance bond on March 20, 2003.

In November 2002, Shrader received three letters from the Director of the Commission's Oil & Gas Division advising Shrader to disregard October 30, 2002, notices of intent to sever three other leases operated by Shrader and stating that the issuance of new severances due to Form P-5 delinquency had been temporarily suspended pending the resolution of issues arising from a legal challenge to the Commission's P-5 renewal process. Although Shrader noted that he did not receive a similar letter relating to the Sturm Lease, he argues that he believed the suspension of severances due to Form P-5 delinquency applied to the Sturm Lease as well.

Shrader also takes the position that the September 30, 2002, severance of the Sturm Lease was a nullity because it was issued by Commission staff. Shrader believes that under TEX. NAT. RES. CODE ANN. §85.164, a lease may be severed only by Commission order signed by at least two Commissioners.

Shrader objects to the imposition of any penalty for the violations alleged by Enforcement on the ground that the Commission has not adopted a rule providing criteria for determining the penalty amount for violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g). Shrader argues further that Enforcement's request for a \$20,000 penalty is an exercise of uncontrolled discretion, in that Enforcement has failed to articulate how it arrived at this requested penalty amount. Shrader says that he has no history of prior violations, he cured his failure to complete renewal of his Form P-5 financial assurance by March 20, 2003, and no economic harm to property or environmental harm resulted from Shrader's alleged violations. Shrader believes that no penalty should be imposed and that the complaint should be dismissed.

## **DISCUSSION OF THE EVIDENCE**

### **Enforcement's Evidence**

Shrader is a sole proprietorship, and became the operator of the Sturm Lease by filing a Form P-4 (Producer's Transportation Authority and Certificate of Compliance) which was approved December 10, 1997, effective November 30, 1997. Currently, Shrader's Form P-5 Organization Report is active, and Shrader has filed financial assurance in the form of a \$50,000 blanket performance bond.

Shrader's annual renewal of his Form P-5 for the period September 1, 2002, through August 31, 2003, was due September 1, 2002. It is the practice of the Commission's P-5/Financial Assurance Unit to send operators a Form P-5 renewal packet approximately three months prior to the due date for annual renewal.

On September 3, 2002, the Commission received a Form P-5 from Shrader for the purpose of annual renewal for the period September 1, 2002, through August 31, 2003, accompanied by a filing fee in the amount of \$500. The enforcement case file contains two copies of a \$50,000 blanket performance bond for Shrader, effective January 14, 2003, one which bears no file stamp and is not signed by Shrader as principal, and the other which bears file stamps with the dates February 21, 2003, and March 14, 2003, and is signed by both principal and surety. Enforcement believes that these two file stamps resulted from initial filing without the signature of Shrader as principal and a subsequent refile of the completely executed bond. Shrader's Form P-5 for the period September 1, 2002, through August 31, 2003, and his financial assurance, were approved by the P-5/Financial Assurance Unit on March 20, 2003.

On August 30, 2002, the Assistant Director of the Permitting/Production Services Section of the Commission's Oil and Gas Division sent to Shrader via certified mail, at his mailing address listed on his most recently filed Form P-5, a notice of intent to sever the Sturm Lease, based on Shrader's failure to complete renewal of his Form P-5 financial assurance packet. This notice advised Shrader that the listed violation had to be resolved within 30 days of the date of the notice or the certificate of compliance for the Sturm Lease would be canceled and the pipeline or other carrier connection would be severed. The notice also advised Shrader that he could request a hearing to contest the determination that the certificate of compliance should be canceled and the lease severed.

Because Shrader did not complete renewal of his Form P-5 financial assurance within 30 days from August 30, 2002, as required by the notice of intent to sever the Sturm Lease, on September 30, 2002, the Assistant Director of the Permitting/Production Services Section of the Commission's Oil and Gas Division sent to Shrader, via regular mail addressed to his Form P-5 mailing address, a severance notice for the Sturm Lease. The examiner has officially noticed that the responsibility for issuance of this notice had been delegated by the Commission to Oil and Gas Division Staff. The notice advised Shrader that due to his failure to complete renewal of his Form P-5 financial assurance, the certificate of compliance for the Sturm Lease had been canceled, and directed Shrader to disconnect the pipeline or other carrier connection for wells on the lease. The severance notice stated that "All production must cease immediately." The enforcement case file contains a separate but identical severance notice dated September 30, 2002, which is addressed to both Shrader, as operator, and Teppco Crude Pipeline, L.P. as oil gatherer.

The enforcement case file contains computer regenerated duplicates of the August 30, 2002, notice of intent to sever the Sturm Lease and the September 30, 2002, severance notice regarding the Sturm Lease that were mailed to Shrader. The enforcement case file also contains a computer screen from Commission records entitled "P-4 Certificate of Compliance Cert. Letter/Cancellation/Reissue Remarks Inquiry" for the Sturm Lease containing data entries that a certified letter was issued to Shrader on August 30, 2002, regarding a "Delinquent P-5" violation, a severance of the Sturm Lease was issued on September 30, 2002, the violation was resolved on March 20, 2003, and that the certificate of compliance for the Sturm Lease was reissued on March 28, 2003.

On February 5, 2002, Shrader signed a Form W-10 (Oil Well Status Report) for the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5, and filed it with the Commission. This Form W-10 showed that the Sturm Lease wells had been tested during the period December 1-9, 2001, and that all the wells were producing. On June 28, 2003, Shrader signed another Form W-10 for the Sturm Lease wells and filed it with the Commission, indicating that the wells had been tested during the period January 1-5, 2003, and that all the wells were producing. No other Forms W-10 were filed by Shrader for the Sturm Lease during the period between these two filings.

The enforcement case file also contains Forms P-1 (Producer's Monthly Report of Oil Wells) filed with the Commission by Shrader for the Sturm Lease, covering the period September 2002, through March 2003. As pertinent to the allegations in Enforcement's complaint in this docket, Shrader reported on these Forms P-1 the production and disposition of oil from the Sturm Lease as follows:

<u>Month/Year</u>	<u>Production (BBLs)</u>	<u>Disposition (BBLs)</u>
Oct. '02	623	718
Nov. '02	552	510
Dec. '02	707	725
Jan. '03	729	711
Feb. '03	525	553

On January 15, 2003, February 18, 2003, and March 18, 2003, the Assistant Director of the Permitting/Production Services Section of the Commission's Oil and Gas Division sent letters to the oil gatherer for the Sturm Lease, Teppco Crude Pipeline, L.P., advising that a severance of the Sturm Lease had been issued September 30, 2002, but Forms P-1 filed with the Commission by Shrader for the months of November and December 2002, and January 2003, reported that Teppco had moved oil off the Sturm Lease during these months. These letters requested that Teppco advise the Permitting/Production Services Section by what authority the oil was moved and what precautions, if any, had been made to prevent future movements from the Sturm Lease. On March 24, 2003, Teppco responded to these letters by stating that Teppco had not received the September 30, 2002, severance notice, but had contacted Permitting/Production Services on March 19, 2003, and verified that the Sturm Lease was then severed. The Teppco letter advised that Teppco had taken action to prevent further movements of oil from the lease.

On November 6, 2002, the Director of the Commission's Oil and Gas Division sent three letters to Shrader respecting the Shrader's Burnett -A-, Burnett -B-, and Douglas "A" Leases. These letters advised Shrader that notices of intent to sever the leases for failure to complete Form P-5 renewal, dated October 30, 2002, had been issued in error and should be disregarded. The letters advised Shrader that the issuance of new severances due to P-5 delinquency had been temporarily suspended pending the resolution of certain issues arising from a legal challenge to the Commission's P-5 renewal process.

Without objection from the parties, the examiner has officially noticed that on October 9, 2002, the Judge of the 261st District Court in Travis County announced her decision to grant a temporary injunction in Cause No. GN202946, *Ross H. Hardwick Oil Company, Et Al. v. Railroad Commission of Texas* (“*Hardwick*”), enjoining the Commission’s enforcement of certain financial assurance and individual well bond requirements of Statewide Rules 14 and 78.

The Commission follows the practice of mailing notices of intent to sever leases to operators via certified mail, and severance notices are sent via regular mail. The Commission does not request a return receipt (green card) for these notices, and thus has no such return receipt indicating receipt by Shrader of the August 30, 2002, notice of intent to sever the Sturm Lease or the September 30, 2002, severance notice regarding the lease. It is the practice of the Commission to send P-5 renewal packets, notices of intent to sever, severance notices, monthly proration schedules, and other mailings to the operator’s mailing address as listed on the operator’s most recently filed Form P-5. If mail to an operator’s P-5 mailing address is returned to the Commission undeliverable, a “hold on mail” code is placed on the operator’s Form P-5 records. Form P-5 records relating to Shrader do not indicate that any hold on mail code was entered in such records following mailing to Shrader of the August 30, 2002, notice of intent to sever the Sturm Lease or the September 30, 2002, severance notice relating to the lease. Monthly proration schedules sent to operators do not indicate whether a particular lease has been severed or indicate a zero allowable for severed leases.

### **Respondent’s Evidence**

Shrader acknowledged receipt of his Form P-5 renewal packet from the Commission for the renewal period September 1, 2002, through August 31, 2003. Shrader testified that he signed a Form P-5 for this renewal period on August 20, 2002, and subsequently sent it to the Commission along with a filing fee check in the amount of \$500, which the Commission negotiated.

Shrader acknowledged his receipt of the Commission’s August 30, 2002, notice of intent to sever the Sturm Lease, based on Shrader’s failure to complete renewal of P-5 financial assurance. Apparently after receipt of this notice, Shrader called the Commission’s P-5/Financial Assurance Unit and was advised that he needed to file a bond as financial assurance or request a hearing. Shrader responded that he intended to file a bond. However, Shrader also stated that he received no correspondence from the Commission to indicate that his Form P-5 filing for September 1, 2002, through August 31, 2003, was not “acceptable”. He stated further that he did not understand that his Form P-5 renewal could not be approved until he filed financial assurance, indicating that he believed the \$500 filing fee he had paid would permit him to continue to operate.

Shrader recollected that he was able to obtain a bond sometime prior to January 14, 2003, after first having difficulty in locating a surety company willing to issue the bond. However, Shrader had a misunderstanding with his surety company about who would be responsible for filing the bond, and a couple

of months lapsed before the bond was sent to the Commission. In addition, the bond was first filed without any signature of Shrader as principal, necessitating a refiling. On March 20, 2003, the Commission sent Shrader a letter advising that his financial assurance had been received and placed on file. On March 28, 2003, the Director of the Commission's Oil and Gas Division sent Shrader a letter advising that the certificate of compliance for the Sturm Lease had been reissued and the pipeline or other carrier connection had been reconnected.

Shrader stated that he did not receive the Commission's September 30, 2002, notice that the Sturm Lease had been severed and he first learned of the severance when he received Enforcement's complaint in this docket. Monthly proration schedules received by Shrader from the Commission for the months during which the Sturm Lease was severed indicated that the Sturm Lease wells continued to have an allowable. In November 2002, Shrader received three letters from the Director of the Commission's Oil and Gas Division stating that October 30, 2002, notices of intent to sever Shrader's Burnett -A-, Burnett -B-, and Douglas "A" Leases for failure to complete Form P-5 renewal had been issued in error and should be disregarded. These letters stated that the issuance of new severances due to P-5 delinquency had been temporarily suspended pending the resolution of issues arising from a legal challenge to the Commission's P-5 renewal process. Shrader noted at the time that he did not receive a similar letter regarding the Sturm Lease. He acknowledged that he may have made a mistake in not inquiring of the Commission about the status of the Sturm Lease, but stated also that he assumed that the temporary suspension of severances due to P-5 delinquency applied to the Sturm Lease, as well as the other leases for which he had received letters. Shrader testified that after receipt of Enforcement's complaint in this docket, he contacted his oil gatherer, Teppco, and Teppco stated that the Sturm Lease had not been severed, apparently meaning that Teppco had not received notice of the severance.

Shrader testified that he had no history of prior violations of Commission rules and would not have produced wells on the Sturm Lease during October 2002, through February 2003, if he had known that the lease was severed.

Shrader presented Enforcement's responses to Shrader's written interrogatories in this docket. In these responses, Enforcement stated, among other things, that the amount of the penalty requested by Enforcement was based entirely on TEX. NAT. RES. CODE ANN. §85.3855(b)(1), providing that the penalty shall be based on, *inter alia*, the seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation. Enforcement also stated that Shrader's violation did not cause economic harm to property or environmental harm, except as it undermined the orderly regulation of the oil and gas industry.

#### **EXAMINER'S OPINION**

There is no controversy about the fact that the Commission canceled the certificate of compliance for the Sturm Lease and severed the pipeline or other carrier connection on September 30, 2002, and



notwithstanding the severance, Shrader continued to produce and sold oil from wells on the lease prior to the time the certificate of compliance was reissued. Neither does there appear to be any dispute about the fact that the severance of the Sturm Lease was caused by failure of Shrader to file financial assurance with its Form P-5 filed with the Commission on September 3, 2002, for the renewal period September 1, 2002, through August 31, 2003. The failure to timely file financial assurance prevented timely approval of the Form P-5 filed by Shrader and violated TEX. NAT. RES. CODE ANN. §§91.103 and 91.142 and Statewide Rules 1 and 78. The Commission was authorized to sever the Sturm Lease for this violation pursuant to TEX. NAT. RES. CODE ANN. §§85.164 and 91.142(f) and Statewide Rule 73(b). Producing a well on an oil lease which has been severed by the Commission, prior to the time the certificate of compliance for the lease has been reissued, is a violation of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g).

Shrader contends that Enforcement's complaint in this docket should be dismissed and/or no penalty should be imposed because: (1) Shrader allegedly did not receive the Commission's September 30, 2002, notice that the Sturm Lease had been severed; (2) Shrader had no reason to believe the Form P-5 he filed with the Commission on September 3, 2002, had not been accepted and had become delinquent; (3) Shrader was misled as to the status of the Sturm Lease by the November 6, 2002, letters from the Director of the Commission's Oil and Gas Division stating that previous notices of intent to sever other Shrader leases had been issued in error and should be disregarded and that the Commission had temporarily suspended new severances based on P-5 delinquency pending resolution of issues arising from a legal challenge to the Commission's P-5 renewal process; (4) Shrader was misled as to the status of the Sturm Lease by monthly proration schedules sent to Shrader during the time when the lease was severed, which indicated that Sturm Lease wells had an allowable; (5) the severance notice relating to the Sturm Lease was ineffective because it was issued by Commission staff, rather than by a Commission order signed by at least two Commissioners; (6) the Commission has not adopted a rule prescribing criteria for determining penalty amounts for violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g); and (7) Enforcement's request for a penalty of \$20,000 is an exercise of uncontrolled discretion and unsupported by any articulation of the basis for the request.

**(a) The Notice Issue**

Shrader admits he received the Commission's August 30, 2002, notice of intent to sever the Sturm Lease, which cited as the reason for the proposed severance Shrader's failure to complete renewal of P-5 financial assurance. However, Shrader denies that he received the Commission's September 30, 2002, severance notice relating to the Sturm Lease.

TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) provide that *upon notice* from the Commission that a certificate of compliance has been canceled, it is unlawful for an operator of a well to produce oil, gas, or geothermal resources until a new certificate has been issued.

The Commission's practice is to send severance notices to the operator's P-5 address via regular first-class mail, and there is no requirement of law that these notices be sent otherwise. The Commission is not required to request a signed return receipt for these notices in order to prove delivery. Statewide Rule 1(a)(8) provides that the Commission shall meet any statutory requirement for a notice to be given to an organization by mailing the item to the organization's mailing address shown on the most recently filed organization report or the most recently filed letter notification of change of address. Under the rule, notices sent by regular first-class mail are presumed to have been received if, upon arrival of the deadline for any response to the notice, the wrapper containing the notice has not been returned to the Commission, and any Commission action for which notice is required may go forward on the basis of notice provided under Statewide Rule 1(a), whether or not actual notice has been received. *Morris v. State*, 894 S.W.2d 22, 25 (Tex. App.-Austin 1994, writ dismissed w.o.j.).

There is sufficient evidence to establish that the September 30, 2002, severance notice pertaining to the Sturm Lease was sent via regular first-class mail to Shrader's P-5 mailing address. This is corroborated by the testimony of a Commission employee as to the Commission's customary practice regarding such mailings, a duplicate copy of the severance notice, properly addressed, generated from the Commission's computer records, and data entries in a "P-4 Certificate of Compliance Cert. Letter/Cancellation/Reissue Remarks Inquiry" computer screen from Commission records showing that a severance of the Sturm Lease was issued on September 30, 2002.

Pursuant to Statewide Rule 1(a), receipt of the severance notice by Shrader is presumed. Shrader's denial that the severance notice was received presents a fact issue for determination by the examiner. *Sudduth v. Commonwealth County Mutual Ins. Co.*, 454 S.W.2d 196, 198 (Tex. 1970). The credibility of Shrader's denial of receipt must be weighed in light of Shrader's self-interest and whether in January 2004, Shrader could have total recall of his failure to receive a particular piece of mail more than 15 months earlier. The severance notice pertaining to the Sturm Lease was mailed to Shrader at his correct P-5 address. Other contemporaneous Commission mailings to the same address were received by Shrader. Shrader received his P-5 renewal packet mailed to him about 90 days prior to his P-5 renewal date on September 1, 2002. He received the Commission's August 30, 2002, notice of intent to sever the Sturm Lease. He received three separate letters from the Director of the Oil and Gas Division, dated November 6, 2002, advising Shrader to disregard notices of intent to sever other Shrader leases. He received oil proration schedules from the Commission covering the months of October, November, and December 2002, and January and February 2003. All of these Commission mailings were made to Shrader at his P-5 address, and there is no plausible explanation why two separate September 30, 2002, severance notices mailed to the same address, one directed to Shrader only and the other directed to both Shrader and the oil gatherer for the Sturm Lease, would not have been received by Shrader.

In addition, the evidence shows that if the severance notice pertaining to the Sturm Lease had been returned to the Commission as undeliverable, a "hold on mail" code would have been affixed to Shrader's P-5 records in the Commission's computer system. The fact that this code was not imposed leads to a

reasonable inference that the September 30, 2002, severance notice was not returned to the Commission undelivered.

Shrader testified that after receipt of Enforcement's complaint in this docket, he confirmed with his oil gatherer that the Sturm Lease had not been severed. Since there is clear evidence that the Sturm Lease *was* severed, it must be presumed that Shrader meant that the oil gatherer, Teppco Crude Pipeline, L.P., advised that it had no notice of the severance. If Teppco gave this advice to Shrader on a date subsequent to the August 4, 2003, filing date of Enforcement's complaint, it was disingenuous. The evidence shows that a copy of the September 30, 2002, severance notice was sent to Teppco. In addition, the evidence shows that on January 15, 2003, February 18, 2003, and March 18, 2003, the Assistant Director of the Permitting/Production Services Section of the Commission's Oil and Gas Division sent Teppco three separate letters advising that the Sturm Lease had been severed on September 30, 2002, and inquiring as to why Teppco had moved oil from the lease following the severance. Nonetheless, the evidence shows that Teppco continued to move oil from the lease, not only in October-December 2002, but also during January-March 2003. On March 24, 2003, Teppco sent the Commission a letter acknowledging that it had confirmed on March 19, 2003, that the Sturm Lease had been severed and had taken action to prevent further movements of oil, *one day* prior to the date on which the P-5 delinquency which caused the severance was resolved.

The Commission gave Shrader proper notice of the September 30, 2002, severance of the Sturm Lease, and the examiner is not persuaded by Shrader's denial that the notice was received.

#### **(b) Staff-Issued Severances**

Shrader argues that the September 30, 2002, severance of the Sturm Lease was a nullity because it was issued by Commission staff, whereas TEX. NAT. RES. CODE ANN. §85.164 provides that only the *Commission* may cancel a certificate of compliance. It must be presumed that Shrader believes that a certificate of compliance for an oil lease or gas well may be canceled only by a final order signed by at least a majority of the three Commissioners.

Administrative provisions of Subchapter B of Chapter 81 and Subchapter B of Chapter 85 of Title 3 of the Texas Natural Resources Code direct the Commission to employ staff to assist the Commission in enforcing the laws relating to the production, transportation, and conservation of oil and gas and to carry out the provisions of Chapter 85 and other related laws and rules and orders of the Commission. *See* TEX. NAT. RES. CODE ANN. §81.011 *et seq.* and §85.011 *et seq.*

Statewide Rule 73(d), in effect at the time of the September 30, 2002, severance of the Sturm Lease provided that if the violations made the basis of a proposed severance were not remedied within the time period set out in the notice of intent to sever, the Commission *or the Commission's delegate*, could

cancel the certificate of compliance. The Commission lawfully delegated to the staff of the Oil and Gas Division the authority to issue the severance of the Sturm Lease.

The August 30, 2002, notice of intent to sever the Sturm Lease notified Shrader of his right to request a hearing pertaining to the proposed severance. This hearing, had it been requested, ultimately would have resulted in the issuance of a final order by the Commissioners on the issue of whether the lease should have been severed. Although Shrader admits that he received the notice of intent to sever the Sturm Lease, no hearing was requested by Shrader. Shrader thus *waived* any complaint that the lease severance was issued by staff of the Oil and Gas Division.

### **(c) The Penalty Issue**

Contrary to Shrader's assertion, the Commission is not precluded from imposing an administrative penalty for Shrader's violation of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) by reason of the fact that the Commission has not adopted a rule prescribing the factors to be considered in determining the penalty amount.

The factors on which a penalty for violation of TEX. NAT. RES. CODE ANN. §85.166 must be based are set out in TEX. NAT. RES. CODE ANN. §85.3855, and may be applied by the Commission regardless of whether the Commission has adopted a rule setting out the same factors.

Shrader's concerns about "uncontrolled discretion" of Enforcement and Enforcement's alleged failure to articulate how it arrived at its request for imposition of a \$20,000 penalty against Shrader are not well founded. Enforcement does not fix penalties for violations of statutes or Commission rules. It is the responsibility of the examiner to make a recommendation to the Commission as to whether a penalty should be imposed, and, if so, what amount of penalty is appropriate considering the factors set out in the relevant penalty statute. Ultimately, determination of the penalty issue is a decision for the Commissioners.

TEX. NAT. RES. CODE ANN. §85.3855 provides that the Commission may impose a penalty not to exceed \$10,000 per violation of TEX. NAT. RES. CODE ANN. §85.166. The amount of the penalty must be based on: (1) the seriousness of the violation, including the nature, circumstances, extent, and gravity of the violation; (2) the economic harm to property or the environment caused by the violation; (3) the history of previous violations; (4) efforts to correct the violation; and (5) any other matters that justice may require.

The Recommended Standard Penalty Schedule for Enforcement Cases ("penalty schedule") provides a standard penalty applicable to TEX. NAT. RES. CODE ANN. §85.3855 of \$1,000. The penalty schedule is provided solely as a guideline for recommended administrative penalties. The amount of any proposed penalty is to be determined on an individual case-by-case basis for each violation by the hearings examiner after consideration of all evidence submitted at the hearing. The final amount of any administrative

penalty is determined by the action of a majority of the Commissioners.

In determining the amount of any penalty to be imposed against Shrader, a threshold issue is presented as to what the evidence shows as to the number of violations of TEX. NAT. RES. CODE ANN. §85.166 committed by Shrader. The evidence establishes that Shrader produced a total of 5 wells on the Sturm Lease in violation of the Commission's severance of the lease. The examiner is persuaded by Enforcement's analysis that five violations of §85.166 were committed when Shrader produced each of five wells on the Sturm Lease while the certificate of compliance for the wells was canceled.

TEX. NAT. RES. CODE ANN. §85.166 provides that on notice from the Commission that a certificate of compliance *for an oil or gas well* has been canceled, it shall be unlawful for the owner or operator *of the well to produce oil or gas from the well* until a new certificate of compliance *covering the well* has been issued by the Commission.

Under §85.166, a violation occurs *when a well produces oil or gas* while the certificate of compliance for the well is canceled. When five wells on an oil lease are produced while the lease is severed, five violations of §85.166 are committed. It appears to make no difference that multiple wells on an oil lease may be severed by cancellation of a single certificate of compliance.

The question remains as to what amount of penalty should be imposed for Shrader's five violations of §85.166. Enforcement concedes that these violations did not cause economic harm to property or the environment, Shrader has no history of previous violations, and Shrader made an effort to correct the violation which caused severance of the Sturm Lease. The evidence establishes that Shrader cured the violation which caused the severance of the Sturm Lease by filing a \$50,000 blanket performance bond as his P-5 financial assurance, although Shrader's P-5 remained delinquent for a period of almost seven months from September 1, 2002, through March 19, 2003.

Producing oil or gas from wells for which the certificate of compliance has been canceled by the Commission is, by its nature, a serious violation because it undermines, if not flouts, the Commission's authority and orderly regulation of the oil and gas industry. In weighing the circumstances and gravity of the violations committed by Shrader, the examiner has considered Shrader's mitigation defenses that he had no reason to believe that his P-5 was delinquent and was misled as to the status of the Sturm Lease by receipt of oil proration schedules showing that the Sturm Lease wells continued to have allowables and Commission correspondence indicating that new severances for P-5 delinquency were being temporarily suspended pending resolution of a legal challenge to the Commission's P-5 renewal process.

Shrader should not have had any misunderstanding as to the delinquent status of his P-5 during the period September 1, 2002, through March 19, 2003. TEX. NAT. RES. CODE ANN. §91.103 and Statewide Rule 78 made it clear that Shrader was required to file financial assurance, which Shrader did not file along with the Form P-5 and filing fee received by the Commission on September 3, 2002. Statewide Rule 78(f)

provided specifically that performance bonds or an alternate form of financial security were required to be filed at the time of filing P-5 annual renewal.

The examiner has officially noticed that the Commission's standard Form P-5 renewal packet advises operators of the financial assurance filing requirement.

The examiner does not consider as a valid mitigating factor Shrader's claim that he received no correspondence from the Commission to indicate that the Form P-5 he filed on September 3, 2002, had not been "accepted" and that he believed he could continue to operate without financial assurance because he had paid a \$500 P-5 filing fee. The examiner has officially noticed that Shrader first filed an organization report with the Commission on September 11, 1997. By September 2002, he should have been familiar with the Commission's P-5 renewal process and the need to file financial assurance. In fact, the August 30, 2002, notice of intent to sever the Sturm Lease, which Shrader admits he received, plainly stated that the Commission was proposing to cancel the certificate of compliance for the Sturm Lease because Shrader had not completed renewal of his financial assurance. After receipt of this notice, Shrader called the Commission's P-5/Financial Assurance Unit and was advised that he needed to file a bond or request a hearing (presumably for Option 3 financial assurance approval).

The suggestion that monthly proration schedules mailed by the Commission to operators should carry some indication of any of the operator's leases that have been severed may have merit. On the other hand, because the Commission had no policy of denoting severed leases on proration schedules mailed to operators during the period October 2002, through February 2003, the fact that Shrader received such schedules indicating that Sturm Lease wells had an allowable was no basis for Shrader to conclude that the lease was not severed.

On the other hand, the examiner believes that Shrader reasonably may have been led to believe that he would be permitted to continue to produce the Sturm Lease wells by the November 6, 2002, letters he received stating that the Commission was temporarily suspending new severances based on P-5 delinquency pending resolution of a legal challenge to the Commission's P-5 renewal process. These letters referenced notices of intent to sever *other* Shrader leases, and shortly followed the Court's announcement of intention to issue a temporary injunction in *Hardwick*. The letters and temporary suspension of new severances did not apply to the September 30, 2002, severance of the Sturm Lease, which had occurred *before* the announcement of the *Hardwick* injunction, but it is plausible that Shrader did not appreciate this distinction. Even so, the November 6, 2002, letters do not explain why Shrader continued to produce the Sturm Lease wells in *October* 2002, prior to the time that the letters were received. Shrader would have been well advised to make an inquiry of the Commission regarding the status of the Sturm Lease severance after he received the November 6, 2002, letters.

The examiner has further considered that if the need to sever the Sturm Lease had occurred just a few days later than it did, it is entirely possible that the lease would not have been severed at all. The

announcement of the intention of the Court to grant the *Hardwick* injunction came nine days after the issuance of the notice canceling the certificate of compliance for the Sturm Lease based on failure of Shrader to complete renewal of P-5 financial assurance.

On the issue of the nature, circumstances, extent, and gravity of Shrader's violation, the examiner has also considered that: (1) Shrader admits that, by reason of his receipt of the August 30, 2002, notice of intent to sever that he knew the Commission intended to sever the Sturm Lease in 30 days unless Shrader filed financial assurance; (2) Shrader did not file financial assurance within 30 days of August 30, 2002; (3) Shrader continued to produce all five oil wells on the Sturm Lease after the 30 days expired; (4) Shrader produced wells on the Sturm Lease for a period of at least five months while the certificate of compliance for the lease was canceled; and (5) from October 2002, through February 2003, while the Sturm Lease was severed, Shrader produced 3,136 barrels of oil.

The penalty schedule provides a standard penalty of \$1,000 applicable to violations penalized pursuant to the provisions of TEX. NAT. RES. CODE ANN. §85.3855. The penalty schedule is merely a guideline from which the examiner may depart depending on the circumstances of a particular case, but the schedule is due some deference. An agency must act fairly and reasonably, and administer its authority so as to prevent discrimination and unequal treatment in the enforcement of a statute or rule. The penalty schedule assists prevention of discrimination and unequal treatment.

Based on the factors which the examiner is required to consider pursuant to TEX. NAT. RES. CODE ANN. §85.3855, the examiner recommends that the Commission assess a penalty in the amount of \$7,500 against Shrader for five violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 78(g). This recommended penalty is calculated on the basis of \$1,500 per violation. The examiner has departed upward from the standard penalty provided by the penalty schedule based on the nature, circumstances, extent, and gravity of the violations, including, but not limited to, the duration of the violations, the volume of oil produced, and the fact that oil was produced for at least a time when Shrader knew or should have known that the Sturm Lease was severed. The examiner has not recommended the full amount of the penalty requested by Enforcement based on the facts that: (1) no economic harm to property or the environment was caused by the violations; (2) Shrader has no history of previous violations; and (3) Shrader ultimately corrected the violations.

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. Kerry Ray Shrader D/B/A Shrader Operating ("Shrader") was given at least 10 days notice of this proceeding by certified mail. Shrader appeared at the hearing and presented evidence.

2. Shrader is a sole proprietor, and became the operator of the Sturm Estate (24390) Lease (“Sturm Lease”), Well Nos. 1, 2, 3, 4, and 5 (“subject wells”) by filing a Form P-4 (Producer’s Transportation Authority and Certificate of Compliance) approved December 10, 1997, effective November 30, 1997.
3. Shrader’s Form P-5 (Organization Report) currently is in active status, and Shrader currently has on file with the Commission a blanket performance bond in the amount of \$50,000 as financial assurance.
4. Annual renewal of Shrader’s Form P-5 and financial assurance for the period September 1, 2002, through August 31, 2003, was due September 1, 2002. Shrader filed a Form P-5 and a filing fee of \$500 with the Commission on September 3, 2002, but the Form P-5 was not accompanied by financial assurance. A completely executed blanket performance bond in the amount of \$50,000, effective January 14, 2003, was filed with the Commission by Shrader on or about March 14, 2003, and approved March 20, 2003.
5. On August 30, 2002, the Commission sent to Shrader, via certified mail addressed to Shrader’s mailing address listed on his most recently filed Form P-5, a Notice of Intent to Cancel P-4 Certificate of Compliance and to Sever Pipeline or Other Carrier Connection (“notice of intent to sever”) for the Sturm Lease. This notice advised Shrader that (a) the Commission intended to sever the lease based on Shrader’s failure to complete renewal of his financial assurance; (b) the violation had to be resolved within 30 days of the date of the notice or the certificate of compliance for the lease would be canceled and the pipeline or other carrier connection would be severed; and (c) Shrader could request a hearing to contest the cancellation and severance.
6. Shrader received the August 30, 2002, notice of intent to sever the Sturm Lease, but did not correct the violation identified in the notice by completing renewal of his financial assurance within 30 days, and did not request a hearing.
7. On September 30, 2002, the Assistant Director of the Permitting/Production Services Section of the Commission’s Oil and Gas Division sent to Shrader, via regular first-class mail addressed to Shrader’s mailing address listed on his most recently filed Form P-5, two copies of a notice canceling the certificate of compliance for the Sturm Lease and directing Shrader to disconnect the pipeline or other carrier connection for the lease (“severance notice”). The Commission had delegated to Oil and Gas Division staff the authority to issue severances notices. One copy of the severance notice was addressed to Shrader only, and the other copy was addressed to both Shrader and the oil gatherer for the Sturm Lease. The severance notice stated that all production on the lease must cease immediately.
8. The violation which caused the severance of the Sturm Lease was not corrected by Shrader until



- March 20, 2003. Shrader paid a reconnect fee to the Commission for the Sturm Lease on March 28, 2003. The Sturm Lease was severed by the Commission from September 30, 2002, until March 28, 2003, when the certificate of compliance for the lease was reissued.
9. Shrader's Form P-5 Organization Report and financial assurance were delinquent from September 1, 2002, until March 20, 2003.
  10. Shrader denies receipt of the Commission's September 30, 2002, severance notice pertaining to the Sturm Lease. However, other contemporaneous Commission mailings to Shrader at the same Form P-5 mailing address, including Shrader's Form P-5 renewal packet, the August 30, 2002, notice of intent to sever the Sturm Lease, monthly oil proration schedules for the months of October-December 2002, and January-February 2003, and three letters from the Oil & Gas Division dated November 6, 2002, relating to erroneously issued notices of intent to sever other Shrader leases, were received by Shrader.
  11. The Commission's September 30, 2002, severance notices pertaining to the Sturm Lease mailed to Shrader at his Form P-5 mailing address were not returned to the Commission undeliverable.
    - a. If mail to an operator's Form P-5 mailing address is returned to the Commission undeliverable, a "hold on mail" code is placed by Commission staff in the Commission's computerized Form P-5 records for the operator.
    - b. No hold on mail code was placed in the Commission's computerized Form P-5 records for Shrader following mailing to Shrader at his Form P-5 mailing address of the Commission's September 30, 2002, severance notices pertaining to the Sturm Lease.
  12. On November 6, 2002, the Commission sent three letters to Shrader advising that October 30, 2002, notices of intent to sever Shrader's Burnett -A-, Burnett -B-, and Douglas "A" Leases had been issued in error and should be disregarded because new severances had been temporarily suspended pending resolution of issues arising from a legal challenge to the Commission's Form P-5 renewal process. However, these letters did not relate to the Sturm Lease, and no similar letter was received by Shrader pertaining to the Sturm Lease.
  13. During the period October 2002 through February 2003, when the certificate of compliance for the Sturm Lease was canceled and the pipeline or other carrier connection for the lease was severed, Shrader produced a total of 3,136 barrels of oil from the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5.
    - a. Forms W-10 (Oil Well Status Report) filed with the Commission by Shrader, covering annual tests conducted during December 1-9, 2001, and January 1-5, 2003, reported that

Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 were producing wells. At no time between these test periods did Shrader file a Form W-10 reporting that any of these wells had been shut-in.

- b. Forms P-1 (Producer's Monthly Report of Oil Wells) filed with the Commission by Shrader for the Sturm Lease reported production of oil by Shrader from wells on the Sturm Lease for each month between October 2002, and February 2003, and reported total oil production of 3,136 barrels for these months.
  - c. Shrader did not dispute Enforcement's allegation that Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 were produced during the period October 2002, through February 2003.
14. No economic harm to property or the environment was caused by Shrader's production of oil from the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 during the period October 2002, through February 2003, or from delinquency of Shrader's Form P-5 Organization Report and financial assurance during the period September 1, 2002, through March 19, 2003.
  15. Shrader has no history of prior Commission orders entered against him for violations of Commission rules.
  16. Production of oil or gas from wells for which the Commission has canceled the certificate of compliance and severed the pipeline or other carrier connection is a serious violation because it tends to undermine the Commission's authority and the orderly regulation of the oil and gas industry. Failure of an operator to maintain a current Form P-5 Organization Report and current financial assurance is a serious violation because it poses a threat to the Commission's Oil Field Clean Up Fund and a risk of unremediated pollution of usable quality water.

#### **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. Kerry Ray Shrader D/B/A Shrader Operating ("Shrader") has been the operator responsible for compliance with TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) [16 TEX. ADMIN. CODE §3.68] with respect to the Sturm Estate (24390) Lease ("Sturm Lease"), Well Nos. 1, 2, 3, 4, and 5 ("subject wells"), since November 30, 1997.
4. Shrader violated TEX. NAT. RES. CODE ANN. §§91.103 and 91.142 and Statewide Rules 1 and

78 by failing timely to renew his Form P-5 Organization Report and financial assurance for the period September 1, 2002, through August 31, 2003. Shrader was out of compliance with these statutes and rules from September 1, 2002, until March 20, 2003.

5. The Commission gave Shrader lawful notice of its intent to cancel the certificate of compliance for the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 and to sever the pipeline or other carrier connection, and an opportunity to correct Shrader's violations, pursuant to TEX. NAT. RES. CODE ANN. §85.164 and Statewide Rule 73(b) [16 TEX. ADMIN. CODE §3.68(b)].
6. The Commission gave Shrader lawful notice of its cancellation of the certificate of compliance for the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 and severance of the pipeline or other carrier connection, pursuant to TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) [16 TEX. ADMIN. CODE §3.68(g)].
7. The Commission lawfully canceled the certificate of compliance for the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5, and lawfully severed the pipeline or other carrier connection, pursuant to TEX. NAT. RES. CODE ANN. §§85.164 and 85.166 and Statewide Rules 73(b) and 73(g) [16 TEX. ADMIN. CODE §§3.68(b) and 3.68(g)].
8. By producing the Sturm Lease, Well Nos. 1, 2, 3, 4, and 5 during the period October 2002, through February 2003, Shrader committed five violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) [16 TEX. ADMIN. CODE §3.68(g)].
9. Pursuant to TEX. NAT. RES. CODE ANN. §85.3855, the Commission may impose an administrative penalty against Shrader in an amount not to exceed \$10,000 per violation of TEX. NAT. RES. CODE ANN. §85.166.
10. Based on the seriousness of the violations, including the nature, circumstances, extent, and gravity of the violations, the lack of any harm to property or the environment caused by the violations, the lack of any history of previous violations by Shrader, and Shrader's efforts to correct the violations, Shrader should be ordered to pay an administrative penalty of \$7,500 for five violations of TEX. NAT. RES. CODE ANN. §85.166 and Statewide Rule 73(g) [16 TEX. ADMIN. CODE §3.68(g)] pursuant to TEX. NAT. RES. CODE ANN. §85.3855.

### **RECOMMENDATION**

The examiner recommends that the above findings and conclusions be adopted and the attached order approved, imposing an administrative penalty against Kerry Ray Shrader D/B/A Shrader Operating in the amount of \$7,500.

Respectfully submitted,

James M. Doherty  
Hearings Examiner