

OIL & GAS DOCKET NO. 09-0251945

**ENFORCEMENT ACTION AGAINST SKY RESOURCES, INC. (OPERATOR NO. 786408)
FOR VIOLATIONS OF STATEWIDE RULES ON THE SIKES LEASE, WELL NO. 1 (RRC
NO. 209245), NEWARK, EAST (BARNETT SHALE) FIELD, PALO PINTO COUNTY,
TEXAS**

APPEARANCES:

FOR MOVANT:

Susan German

MOVANT:

Enforcement Section
Railroad Commission of Texas

FOR RESPONDENT:

George C. Neale
Rosa L. Rohr
Jim Poage
Paul Lunsford

RESPONDENT:

Sky Resources, Inc.

FOR INTERVENOR:

Thomas C. Sikes

INTERVENOR:

Thomas C. Sikes

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE COMPLAINT FILED:

July 25, 2007

DATE OF NOTICE OF HEARING:

September 11, 2007

DATES OF HEARING:

November 1, 2007, and March 6, 2008

HEARD BY:

James M. Doherty, Hearings
Examiner

DATE PFD CIRCULATED:

April 30, 2008

STATEMENT OF THE CASE

This proceeding was called by the Commission on the recommendation of the District Office to determine the following:

1. Whether the respondent Sky Resources, Inc. (“Sky”) should be required to plug or otherwise place into compliance with Statewide Rule 14(b)(2) [Tex. R.R. Comm’n, 16 TEX. ADMIN. CODE §3.14(b)(2)] the Sikes Lease, Well No. 1 (RRC No. 209245) (“subject well”), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas;
2. Whether Sky violated Statewide Rule 8(d)(1) [Tex. R.R. Comm’n, 16 TEX. ADMIN. CODE §3.8(d)(1)] by causing or allowing the discharge of oil or gas wastes on the Sikes Lease without a permit authorizing such discharge;
3. Whether Sky violated Statewide Rule 8(d)(4)(G)(i)(I) [Tex. R.R. Comm’n, 16 TEX. ADMIN. CODE §3.8(d)(4)(G)(i)(I)] by failing to dewater, backfill, and compact a drilling reserve pit and fresh makeup water pits on the Sikes Lease within one year of cessation of drilling operations;
4. Whether Sky violated provisions of Title 3, Oil and Gas, Subtitles A, B, and C, Texas Natural Resources Code, Chapter 27 of the Texas Water Code, and Commission rules and laws pertaining to safety or prevention or control of pollution by failing to plug the subject well and/or otherwise failing to place the subject well and lease into compliance with Statewide Rules 8(d)(1), 8(d)(4)(G)(i)(I), and 14(b)(2);
5. Whether, pursuant to Texas Natural Resources Code §81.0531, Sky should be assessed administrative penalties of not more than \$10,000 per day for each offense committed regarding the subject lease and well; and
6. Whether any violations of Statewide Rules 8(d)(1), 8(d)(4)(G)(i)(I), and 14(b)(2) by Sky should be referred to the Office of the Attorney General for further civil action pursuant to Texas Natural Resources Code §81.0534.

An initial hearing was held in this docket on November 1, 2007. Subsequent to completion of this initial hearing, the examiner was advised that a posthearing inspection of the subject lease had been made by the District Office, and the parties were in agreement that the hearing should be reopened for submission of additional evidence. By agreement of the parties, the reopened hearing was held on March 6, 2008. Susan German, Staff Attorney, appeared at the hearings representing the Enforcement Section of the Office of General Counsel (“Enforcement”). George C. Neale and Rosa L. Rohr, attorneys, appeared at the hearings to represent Sky. Enforcement’s certified hearing files were received into evidence, and both parties presented exhibits and testimony.

APPLICABLE LAW

Statewide Rule 8(d)(1) provides, with exceptions not pertinent here, that no person may dispose of any oil and gas wastes by any method without obtaining a permit to dispose of such wastes. In Statewide Rule 8(a)(24), “to dispose” is defined as engaging in any act of disposal subject to regulation by the Commission including, but not limited to, conducting, draining,

discharging, emitting, throwing, releasing, depositing, burying, landfarming, or allowing to seep, or to cause or allow any such act of disposal.

Statewide Rule 8(d)(4)(G)(i)(I), as pertinent here, provides that a person may, without a permit, maintain or use reserve pits and fresh makeup water pits on the condition that reserve pits which contain fluids with a chloride concentration of 6,100 mg/liter or less and fresh makeup water pits must be dewatered, backfilled, and compacted within one year of cessation of drilling operations. Statewide Rule 8(a) defines “reserve pit” as a pit used in conjunction with a drilling rig for collecting spent drilling fluids, cuttings, sands, silts, and wash water used for cleaning drill pipe and other equipment at the well site. Statewide Rule 8(a) defines “fresh makeup water pit” as a pit used in conjunction with a drilling rig for storage of water used to make up drilling fluid.

Statewide Rule 14(b)(2) requires that a well be plugged after 12 months of inactivity, unless a plugging extension is obtained.

DISCUSSION OF THE EVIDENCE

Enforcement

Sky Resources, Inc., is a corporation. Its only officer, as listed on its Form P-5 organization report, is James R. Poage, President, Treasurer, and Secretary. The Form P-5 organization report of Sky is active, and Sky has approved financial assurance on file in the amount of \$50,000. Sky designated itself the operator of the Sikes Lease, Well No. 1 (RRC No. 209245), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas, by filing a Form P-4 (Certificate of Compliance and Transportation Authority) approved July 11, 2005, effective March 1, 2005.

On the occasion of ten District Office inspections of the Sikes Lease between August 30, 2006, and November 6, 2007, Well No. 1 on the lease was found to be equipped with pump jack and tubing and rods in casing but inactive. No production for this well has been reported to the Commission since February 28, 2006. On May 2, 2007, a Statewide Rule 14(b)(2) plugging extension for the Sikes Lease, Well No. 1 was canceled because of a Field Operations hold based on violations of Commission rules. According to a certification of the Commission’s Secretary dated March 5, 2008, no Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) has been filed or approved, and no plugging extension is in effect for the subject well. The estimated cost to the State to plug Well No. 1 is \$9,700.

An affidavit of Ramon Fernandez, Jr., P.E., Field Operations, dated September 5, 2007, contained in the certified hearing files, stated that a well that is in violation of Statewide Rule 14 must be plugged in order to prevent pollution of usable quality surface and subsurface waters. Any wellbore, cased or otherwise, is a potential conduit for flow from oil or saltwater zones to zones of usable quality water or to the surface. Holes or leaks may develop in cased wells, allowing oil or saltwater to communicate with usable quality zones or to flow to the surface. Uncased wells allow direct communication between zones and provide unimpeded access to the surface.

Five District Office inspections of the Sikes Lease between February 9, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of hydrocarbons and produced water in an area 6' x 3' x 3" under the pump jack motor for Well No. 1. An inspection on April 12, 2007, disclosed that this area had been partially covered with soil. An inspection on November 6, 2007, disclosed that this discharge was no longer visible, and the discharge area had been dug out and fresh soil put in place, so that as of November 6, 2007, no pollution was found.

Three District Office inspections of the Sikes Lease between April 12, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of produced water in an area 20' x 10' on the west side of the pump jack for Well No. 1. A soil sample was collected on April 12, 2007, which, according to a Legal Enforcement Summary Sheet in the certified hearing files, had a chlorides concentration of 2400 mg/kg. An inspection on November 6, 2007, disclosed that fresh soil was in place, and there was no remaining visible pollution in this area.

Drilling of the Sikes Lease, Well No. 1 ceased on November 23, 2004, and the well completion date was February 10, 2005. Nine District Office inspections of the Sikes Lease between August 30, 2006, and September 26, 2007, disclosed a drilling reserve pit site 30' west of Well No. 1 that had been backfilled but not completely leveled and compacted. Inspections on August 30 and October 9, 2006, disclosed that pieces of plastic liner and poly pipe were visible and partially buried in the pit area. On August 30, 2006, white crystals were observed in the northwest corner of the pit area, and as a result of recent rains, the pit area contained about two barrels of standing water that field tested for chlorides concentration of 1,200 mg/l. As of October 10, 2006, the area of white crystals had been remediated and free standing fluid had been removed. More white crystals were observed in the pit area on the occasion of inspections on January 31 and February 9, 2007, but no white crystals were reported in subsequent inspection reports dated April 12, June 7, and September 26, 2007. Soil samples were collected from the drilling reserve pit area on April 12, 2007, which, according to a Legal Enforcement Summary Sheet in the certified hearing files, had a chloride concentration of 660 mg/kg.

A July 2, 2007, letter to Sky from the District Office instructed Sky to remove soil with elevated chloride concentration from the drilling reserve pit area, properly dispose of this soil, and then backfill and compact the pit area. A further inspection of the Sikes Lease on November 6, 2007, disclosed that the drilling reserve pit area had been worked with a tractor, backfilled, and compacted. The only remaining Statewide Rule 8 issue noted on the November 6, 2007, inspection report was the presence at the drilling reserve pit site of unknown white crystals in a 3' x 5' area. According to the District Office field inspector, soil sampling is required to determine if the white crystals are salt crystals. This field inspector stated the opinion that if the crystals are salt, this would be an indicator that the pit had not been properly dewatered.

Four District Office inspections between April 12, 2007, and September 26, 2007, disclosed the site of a fresh makeup water pit located 55' to the northwest of the Sikes Lease, Well No. 1. The April 12, 2007, inspection report stated that this pit had been backfilled and compacted, but subsequent inspection reports dated June 7, July 19, and September 26, 2007, stated that a "pit"

remained at this site. On the occasion of the April 12, 2007, inspection, white crystals were observed in the pit area. Soil samples were collected, which, according to a Legal Enforcement Summary Sheet in the certified hearing files, had a chloride concentration of 42,500 mg/kg. A letter to Sky from the District Office dated May 2, 2007, instructed Sky to remove soil with elevated chloride concentrations, properly dispose of this soil, and then backfill and compact the pit area. White crystals in the pit area were observed during further inspections on June 7 and September 26, 2007. A further District Office inspection on November 6, 2007, disclosed that this pit site had been worked with a tractor, backfilled, and compacted. The only remaining Statewide Rule 8 issue noted by the inspector was a 3' x 3' area of unknown white crystals.

Four District Office inspections between April 12, 2007, and November 6, 2007, disclosed the existence on the Sikes Lease of a fenced and lined pit containing fresh water, located about 2,125' west of Well No. 1. This pit was dug in May 2005, and according to the District Office field inspector, the pit meets the Statewide Rule 8 definition of a fresh makeup water pit, because the water stored in the pit is sold to third parties to use in conjunction with drilling rigs on other leases to make up drilling fluid. Water in this pit was field tested during the inspections on June 7, July 19, September 26, and November 6, 2007, and had chloride concentrations ranging from 260 mg/l to 560 mg/l. Because this pit had not been dewatered, backfilled and compacted within one year after drilling operations on the Sikes lease concluded, the District Office instructed Sky that if the pit was going to be maintained, it would need to be permitted. Sky filed a Form H-11 (Application for Permit to Maintain and Use a Pit) on August 28, 2007. However, on January 7, 2008, Jill Hybner, Manager, Environmental Permits & Support, Technical Permitting, sent Sky a letter stating that based on the understanding that this pit is used solely for the storage of fresh water that is sold to oil and gas operators, the pit was within the jurisdiction of the TCEQ, and the Sky application was therefore being returned to Sky.

Enforcement takes the position that although the fresh water pit was converted from a fresh makeup water pit for drilling on the Sikes Lease to a storage pit for fresh water to be sold to other operators for drilling activity on other leases, and although Technical Permitting has determined that the pit does not require a permit from the Railroad Commission, Statewide Rule 8(d)(4)(G)(i)(I) requires that the pit be dewatered, backfilled, and compacted. According to the District Office field inspector, such conversions, as an alternative to dewatering, backfilling, and compacting, have been allowed only where the landowner and operator have agreed that the pit will be given to the landowner and the landowner has submitted a letter acknowledging responsibility for the pit.

The Fernandez affidavit in the certified hearing file states that: (1) any unauthorized discharge or disposal of oil, saltwater, basic sediment or other oil and gas waste is a potential source of pollution to surface and subsurface water if not remediated to prevent seepage and run-off; and (2) open reserve pits are considered a potential hazard because they could become convenient sites for illegal dumping of wastes and also because they become containers for surface run-off that increases the potential for seepage to subsurface waters.

Enforcement recommends that Sky be assessed an administrative penalty in the total amount of \$7,600, calculated on the basis of one Rule 8(d)(1) violation at \$600, two "wet" pit violations of Rule 8(d)(4)(G)(i)(I) at \$2,000 each, one "dry" pit violation of Rule 8(d)(4)(G)(i)(I) at \$1,000, and

one violation of Rule 14(b)(2) at \$2,000, and that Sky be ordered to place the Sikes Lease into compliance with Commission rules.

Sikes

Thomas C. Sikes (“Sikes”) is the landowner of the property covered by the Sikes Lease. According to Sikes, in June 2006, there was a bad spill from pits at the Sikes Lease, Well No. 1, and Sikes estimates that 1,000 barrels of fluid “went through his pasture.” Sikes believes that Sky has not properly remediated the contamination left by this spill. According to Sikes, two acres of pasture land is now “dead.” The pit areas near Well No. 1 have been “straightened out” and compacted, but Sikes does not believe that all the contaminated soil on his land has been removed. Sky has planted winter rye on the lease, but Sikes has taken photographs of areas where the winter rye is said to be dying and of areas of the lease said to have been left “barren.” Sikes is concerned with what he believes is remaining soil contamination, because of the possibility of run-off to a creek that empties into the Brazos River.

Sikes also objects to the continued maintenance of the fresh water storage pit located in the area of the Sikes Lease, Well No. 2. Sikes entered into an agreement with Sky for the drilling of a water well, but does not believe that this agreement permits Sky to continue to maintain the fresh water storage pit. Water from this pit was used as frac water for the Sikes Lease, Well No. 2, and the pit was “left there” after completion of this well. Sikes is concerned with truck traffic to and from the location of this pit, hauling fresh water sold to third parties for drilling activities elsewhere. He is also concerned that should either a child or adult, or an animal, fall into this pit, it would be impossible for them to get out. Although the pit is lined and fenced, Sikes believes that the fence is not substantial enough to withstand a severe windstorm. Sikes stated further that if Sky wants to continue to maintain and use the fresh water pit, Sky should “make a deal” with him.

Sky Resources

Sky, which has had no record of previous enforcement actions for violations of Commission rules, believes that it corrected all of the violations alleged in Enforcement’s complaint prior to the initial hearing in this docket and made a good faith attempt to comply with all of the District Office’s requests for voluntary compliance. Sky claims that without a joint inspection of the Sikes lease involving both the District Office field inspector and a Sky representative, Sky was confounded by inspection reports that continued to state that pits remained open and no visible work had been done after Sikes had spent a good deal of money to remediate problems found to exist in earlier inspections. Although a natural “dike” may have remained around a pit area and some erosion or soil subsidence may have occurred as a result of rainfall, Sky says that the pits near Well No. 1 on the Sikes lease had been backfilled and compacted at an early date, and Sky could not identify by an inspection on the ground what the District Office inspector was referring to in inspection reports as open pits or understand statements in the inspection reports that no visible work had been done.

Sky presented copies of invoices from contractors it hired to do the work necessary to correct the violations reflected in District Office inspection reports. On or about June 19, 2006, several

months prior to the first of the District Office inspection reports referenced in Enforcement's complaint, Sky engaged Service, Inc., to perform 17 hours of dozer work on the Sikes lease, at a cost of \$1,530.00, "to cover old drilling pits on Sikes lease #1 and 2." On August 14-15, 2006, also before the earliest inspection report referenced in Enforcement's complaint, Sky engaged Billy R. Kee Trucking to perform 18 hours of tractor work and 9 hours of dozer work on the Sikes lease, at a cost of \$1,655.00, "to fill and level reserve pits at Wells #1 and #2."

On April 9, 2007, Sky engaged M & C Construction for 6 hours of backhoe work on the Sikes lease at a cost of \$416.33. On this occasion, M & C "dug up dirt, cleaned up reserve area & flattened out area where reserve pit was" near Well No. 1. On April 16, 2007, Sky engaged M & C Construction to provide screening material, backhoe, and trucking service at the Sikes lease at a cost of \$715.23. On this occasion, M & C hauled in a bobtail load of screening material, "dug up mess," spread and smoothed out screening material, and hauled off ½ load of "oily dirt" from the area of Well No. 1.

On August 6 and August 23, 2007, Sky engaged Eagle Environmental Services to provide "soil treatment" service on the Sikes lease at a cost of \$18,000. Sky stated that Eagle removed and remediated soil on the Sikes lease in accordance with Commission rules and later went back to take soil samples. On October 12-13, 2007, Sky engaged M & C Construction to haul and spread fill dirt and for backhoe services on the Sikes lease at a cost of \$2,175.03. The M & C Construction invoice for these dates indicates that M & C hauled in 4 bobtail loads of fill dirt, spread this dirt, leveled up a washed out area, smoothed up the area, and hauled off "bad dirt."

By letter dated October 30, 2007, Eagle Environmental Services advised the District Office that it had performed a joint inspection of the Sikes lease with a Sky representative on October 22, 2007, and "the area was cleaned-up," including the area referenced in the September 26, 2007, District Office inspection report where it was reported that no visible work had been done. Eagle reported that the area had been tilled thoroughly, and vegetation was starting to grow in the "spill area." The letter reported further that Eagle had taken additional soil samples. A sample taken at the northeast corner of the fresh makeup water pit near Well No. 1, said to be the "source of the spill," yielded a result of 270 mg/kg chloride concentration. Another soil sample taken in a creek bed yielded a result of 220 mg/kg chloride concentration. A soil sample taken on a hill side northeast of the spill site to show native chlorides yielded a result of 160 mg/kg chloride concentration. Eagle stated that Sky had met the requirements of Statewide Rule 91 on the spill area.

Sky believes that its maintenance and use of the fenced and lined fresh water storage pit located about 2,125' west of Well No. 1 is authorized under a Water Well Agreement between Sky and Sikes effective May 1, 2005. This pit has been converted to a fresh water storage facility for water produced from a water well drilled by Sky on the Sikes lease, and the water sold there is sold to third parties who truck the water to other leases for use in drilling activities. Because this pit is no longer used as a fresh makeup water pit for drilling activity on the Sikes lease, Sky does not believe that Statewide Rule 8 requires the pit to be dewatered, backfilled, and compacted.

The May 1, 2005, Water Well Agreement between Sky and Sikes has a term of five years and for so long thereafter as Sky produces fresh water from wells on the Sikes lease. This Agreement obligated Sky to drill a water well on the lease and to pay Sikes consideration in the amount of \$250 per month, which amount Sky continues to pay Sikes each month. The Agreement granted Sky the right to lay, construct, and install water lines for the purpose of transporting and delivering fresh water produced from the water well on the Sikes lease for Sky's own use or for sale to third parties. The Agreement also granted to Sky the right to construct and maintain those other surface facilities not to exceed two acres required for the production, transportation, and delivery of fresh water produced from the water well on the Sikes lease. The fresh water storage pit does not contain any saltwater, and has never been used for anything other than storage of fresh water produced from the Trinity formation, said to be a known drinking water source in the area. This pit is lined, and Sky believes there is no possibility that the fresh water stored in the pit could pose any threat of surface or subsurface pollution.

In May 2007, the District Office sent a letter to Sky stating that Sky was required either to dewater, backfill, and compact the fresh water storage pit or obtain a permit from the Commission to maintain and use the pit. Therefore, on August 28, 2007, Sky filed with the Commission a Form H-11 (Application for Permit to Maintain and Use a Pit). On January 7, 2008, Jill Hybner, Manager, Environmental Permits & Support, Technical Permitting, sent Sky a letter stating that based on the understanding that this pit is used solely for the storage of fresh water that is sold to oil and gas operators, the pit was within the jurisdiction of the TCEQ, and the Sky application was therefore being returned to Sky. Sky believes it is unreasonable to construe Statewide Rule 8 to require an operator wishing to convert a fresh makeup water pit to a fresh water storage pit that does not require a Commission permit under Rule 8 to first dewater, backfill, and compact the pit, then re-excavate the pit and refill it with fresh water.

Sky believes that Sikes' complaints to the Commission about Sky's activities on the Sikes lease have been motivated by a desire to oust Sky from the lease so that Sikes can accept an offer from another operator to lease the same property with payment of a lease bonus to Sikes. According to Sky, Sikes is dissatisfied with the fact that Sky's oil and gas lease covering Sikes' property is held in effect by production, and Sky is unwilling to release its interest in the lease.

EXAMINER'S OPINION

Rule 8(d)(1)

District Office inspections of the Sikes lease between February 9, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of hydrocarbons and produced water affecting a 6' x 3' x 3" area under the pump jack for Well No. 1. This discharge had been remediated by the date of a further inspection on November 6, 2007. This area of pollution remained on the ground for more than seven months before being fully remediated.

District Office inspections of the Sikes lease between April 12, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of produced water in a 20' x 10' area on the west side of the pump jack for Well No. 1. This discharge had been remediated by the date of a further inspection on November 6, 2007. This area of pollution remained on the ground for more than five months before being fully remediated.

It is undisputed that Sky was the designated Form P-4 operator of the Sikes lease responsible for compliance with Commission rules with regard to these two discharges of oil and gas wastes, and Sky did not have a permit authorizing the discharges. These unpermitted discharges violated Statewide Rule 8(d)(1).

Enforcement recommends a penalty of \$600 for one violation of Rule 8(d)(1). The examiner adopts this recommendation because assessment of a penalty for one Rule 8(d)(1) violation, in the circumstances where two violations arguably occurred, gives appropriate consideration to the good faith demonstrated by Sky in achieving voluntary compliance prior to the initial hearing in this docket¹ and the relatively small areas affected by the discharges in question. The examiner finds no need to order further compliance with Commission rules regarding the Rule 8(d)(1) discharges because the November 6, 2007, inspection report indicates that these discharges have been completely remediated by Sky.

Rule 8(d)(4)(G)(i)(I)

Drilling Reserve Pit

The evidence shows that a drilling reserve pit once existed about 30' west of the Sikes Lease, Well No. 1. Drilling of Well No. 1 ceased on November 23, 2004, according to the Oil and Gas W-2/G-1 Record database. Rule 8(d)(4)(G)(i)(I) required the drilling reserve pit to be dewatered, backfilled, and compacted within one year of November 23, 2004.

The evidence presented by Sky shows that on June 19, 2006, a contractor engaged by Sky performed 17 hours of dozer work on the Sikes lease, to “cover old drilling pits” at the Sikes #1 and Sikes #2, and on August 14-15, 2006, another contractor for Sky performed 18 hours of tractor work and 9 hours of dozer work to “fill and level reserve pits” at Sikes #1 and Sikes #2. A District Office inspection on August 30, 2006, confirmed that the drilling reserve pit near the Sikes #1 had been backfilled, but disclosed that this pit was still not compliant with Statewide Rule 8 because the pit had not been completely leveled and compacted. During this inspection, it was observed that pieces of plastic liner and poly pipe remained visible and partially buried in the pit area, an area of white crystals remained in the northwest corner, and about two barrels of water were standing in one area of the pit as a result of recent rains that had 1,200 mg/l chloride concentration.

Further inspections between October 9, 2006, and September 26, 2007, disclosed that the

¹ Sky’s evidence consisting of invoices to Sky from contractors performing remedial work on the Sikes lease demonstrates that these violations were corrected by at least October 13, 2007.

drilling reserve pit had still not been completely leveled and compacted. During the inspection performed on October 9, 2006, the inspector observed that the area of white crystals noted during the August 30, 2006, inspection had been remediated and the free standing fluid had been removed. The presence of white crystals in the pit area was further observed during inspections on January 31 and February 9, 2007, but subsequent inspection reports did not mention white crystals and a soil sample collected during the April 12, 2007, inspection had chloride concentration of 660 mg/kg. The evidence presented by Sky indicates that contractors employed by Sky performed more work apparently related to the reserve pit area on April 9, 2007, April 16, 2007, August 6-23, 2007, and October 12-13, 2007. According to the District Office inspection reports, the field inspector was not satisfied that the drilling reserve pit had been completely backfilled, leveled, and compacted until the date of an inspection on November 6, 2007.

There is a dispute as to when the drilling reserve pit should have been considered to have been dewatered, backfilled, and compacted, and Sky takes serious issue with comments in some of the later inspection reports that there had been no visible work or no visible remediation of the pit area, but it is clear from the entirety of the evidence that the drilling reserve pit near Well No. 1 was not completely dewatered, backfilled, and compacted within one year after drilling of Well No. 1 was completed. This was a violation of Statewide Rule 8(d)(4)(G)(i)(I).

For this violation, Enforcement recommends a penalty of \$2,000, which is the standard penalty provided by the penalty schedule for Rule 8(d)(4)(G)(i)(I) violations on “wet” pits. The examiner is not persuaded, however, that the drilling reserve pit should be considered a “wet” pit for penalty purposes. The “wet” pit standard is not defined in the penalty schedule. The examiner construes this standard to refer to an open pit containing “wet” oil and gas waste. The drilling reserve pit at the Sikes #1 was not found to be in this category during any of the inspections referenced in Enforcement’s complaint. The only evidence that would support a contention that the drilling reserve pit remained open as a “wet” pit, is a comment in the August 30, 2006, inspection report that about two barrels of water had collected in one area of the pit area that previously had been backfilled after a recent rainfall of 1 to 1 ½ inches . These free standing fluids had been removed from the pit by the next inspection on October 9, 2006. The examiner finds insufficient basis to classify the drilling reserve pit as a “wet” pit for penalty purposes. The standard penalty provided by the penalty schedule for a “dry” pit in violation of Rule 8(d)(4)(G)(i)(I) is \$1,000, which is the penalty recommended by the examiner.

The examiner finds no need to order further compliance with Commission rules regarding the drilling reserve pit. The only violation pled by Enforcement relative to the drilling reserve pit was failure to dewater, backfill, and compact within one year as required by Rule 8(d)(4)(G)(i)(I). The November 6, 2007, inspection report confirmed that the drilling reserve pit had been backfilled and compacted, and the only remaining Rule 8 issue noted was the presence of a 3' x 5' area where unknown white crystals were observed. Enforcement did not prove the nature of the white crystals or that the drilling reserve pit presently is non-compliant with Statewide Rule 8.

Fresh Makeup Water Pit

The evidence shows that a fresh makeup water pit once existed about 55' to the northwest

of the Sikes Lease, Well No. 1. The first reference to this pit in District Office inspection reports is in the inspection report for April 12, 2007, although it is possible that earlier inspection reports classified this same pit as a reserve pit. Enforcement contends that this pit was not properly dewatered, backfilled, and compacted within one year as required by Rule 8(d)(4)(G)(i)(I).

The inspection reports regarding this pit are not entirely clear. The inspection report for April 12, 2007, indicated that the pit was backfilled and compacted, but apparently not satisfactorily in the estimation of the field inspector because the pit was shown to be in violation of Rule 8. The April 12, 2007, inspection report noted that white crystals were present in the pit area, and a photograph of these white crystals is contained in the certified hearing files. A soil sample was collected from this pit on April 12, 2007, and a Legal Enforcement Pollution Summary Sheet in the certified hearing file states that the sample had 42,500 mg/kg chloride concentration. A subsequent inspection on June 7, 2007, disclosed that the pit site remained, with white crystals present. On July 2, 2007, the District Office sent a status report letter to Sky stating that the fresh makeup water pit remained “partially backfilled with white crystals present on the soil”. This status report stated that no visible work had been done on the site, a soil sample from the site had 42,500 mg/kg chloride concentration, and Sky was required to backfill and compact the pit. Followup inspection reports for July 7 and September 26, 2007, reported that no visible remediation of the site had been accomplished.

A final inspection report dated November 26, 2007, reported that this fresh makeup water pit had been worked with a tractor, backfilled, and compacted, and the only remaining Rule 8 issue noted was a 3' x 3' area where unknown white crystals were present. This final inspection came after (1) Sky had engaged Eagle Environmental Services to provide “soil treatment” service on the Sikes lease at a cost of \$18,000 and Eagle removed and remediated soil during August 6-23, 2007; and (2) Sky engaged M & C Construction to haul and spread fill dirt and for backhoe services on the Sikes lease at a cost of \$2,175.03, and M & C hauled in 4 bobtail loads of fill dirt, spread this dirt, leveled up a washed out area, smoothed up the area, and hauled off “bad dirt” on October 12-13, 2007.

Given the fact that drilling of Well No. 1 on the Sikes Lease was completed on November 23, 2004, and considering Sky’s evidence that the first work “to cover old drilling pits” at Well No. 1 was performed on June 19, 2006, and considering further the evidence suggesting that considerable work remained to be done throughout most of 2007 to properly remove all contaminated soil and properly backfill and compact the fresh makeup water pit, the examiner concludes that Enforcement established a violation of Rule 8(d)(4)(G)(i)(I) with respect to this pit, because the pit was not properly backfilled and compacted within one year from completion of drilling operations on Well No. 1.

Enforcement apparently considers that the fresh makeup water pit is a “dry” pit for penalty purposes and recommends the standard \$1,000 penalty provided by the penalty schedule, which appears to be reasonable in the circumstances and is adopted by the examiner. As in the case of the drilling reserve pit, the examiner sees no need to order compliance with Commission rules respecting the fresh makeup water pit because Enforcement did not prove that this pit is presently non-compliant.

Fresh Water Storage Pit

Since May 2005, a lined and fenced pit containing fresh water has existed on the Sikes lease about 2,125' west of Well No. 1. Although there is evidence that water from this pit was at one time used to frac the Sikes #2, it appears undisputed that the pit has been converted to a fresh water storage pit for water produced from a water well drilled by Sky on the Sikes lease. Water stored in this pit is sold to third party oil and gas operators and trucked away from the Sikes lease for use in conjunction with drilling activity on other leases. The pit is lined and fenced and has never contained anything other than fresh water produced from the Trinity formation, which is a known drinking water source for the area. On the occasion of five inspections of the Sikes lease between April 12 and November 6, 2007, water in the fresh water storage pit tested for chloride concentration at 260 to 560 mg/l. There appears to be no realistic possibility that maintenance and use of this pit could cause any surface or subsurface pollution.

Rule 8 contains no provision which expressly requires Commission permitting of a fresh water storage pit used solely for storage of fresh water for sale to third party oil and gas operators to use in conjunction with drilling activity on other leases. When it was directed to either dewater, backfill, or compact this pit or to obtain a permit for the pit, Sky attempted to comply by filing an application for a permit with the Technical Permitting Section. Technical Permitting responded to Sky by advising that the pit was subject to the jurisdiction of TCEQ and no permit from the Railroad Commission was required.

Although this pit arguably may meet the definition of a fresh makeup water pit in Rule 8, the dewatering, backfilling, and compacting requirement of Rule 8(d)(4)(G)(i)(I) appears to relate to fresh makeup water pits used and maintained in conjunction with operation of drilling rigs for wells being drilled on the same lease. In this situation, the rule requires that the pit be dewatered, backfilled, and compacted within one year after drilling has been completed. But this requirement makes no sense in the case of a pit that has been converted to a fresh water storage pit to store fresh water for sale to other oil and gas operators for on-going and continuous drilling activity elsewhere. This pit has no further relationship to drilling activity on the Sikes lease, but continues to have a beneficial use for which no Commission permit is required. Because it appears that Sky is making a lawful use of this pit, it would be senseless to require Sky to first dewater, backfill, and compact the pit, and then immediately to re-excavate the pit and refill it with fresh water. The examiner declines to interpret Rule 8(d)(4)(G)(i)(I) in a way that would require a useless act that has no relationship to the objective to protect usable quality surface and subsurface water.

There is an apparent difference of opinion between Mr. Sikes and Sky as to whether use and maintenance of the fresh water storage pit was contemplated by the May 1, 2005, Water Well Agreement between these parties. The Commission is without jurisdiction ultimately to decide the contractual rights of the parties under this Agreement. Nonetheless, the Agreement clearly gave Sky the right to drill a water well on the Sikes lease, contemplated the sale of water by Sky to third parties, and permitted Sky to construct and maintain those other surface facilities not to exceed two acres required for the production, transportation, and delivery of fresh water produced from the water well on the Sikes lease. This Agreement is sufficient to provide Sky with at least a good faith claim of right to use and maintain the fresh water storage pit on the Sikes lease.

There is evidence that the District Office has not applied the one year dewater, backfill, and compact requirement of Rule 8(d)(4)(G)(i)(I) in the situation where the landowner wants to retain a fresh water pit as a private tank, and the landowner furnishes the District Office with a letter stating that the operator has given the pit to him and the landowner assumes responsibility. From the standpoint of protecting usable quality water, the facts presented here do not appear that much different, because what may at one time have been a fresh makeup water pit used in conjunction with drilling activity on the Sikes Lease has now been converted to a fresh water storage pit, there is a continuing beneficial use by the operator for the fresh water pit, and the operator has an agreement with the landowner providing the operator with at least a good faith claim of right to maintain and use the pit for its present purposes.

Enforcement did not prove that the continued use and maintenance of the fresh water storage pit on the Sikes lease, is a violation of Rule 8(d)(4)(G)(i)(I).

Rule 14(b)(2)

It was proved by Enforcement that the Sikes Lease, Well No.1 has been inactive for more than one year, does not have a plugging extension, and has not been plugged. According to the evidence, the well has not had a plugging extension since May 2, 2007, and the well has been out of compliance with Rule 14(b)(2) since that date. Enforcement recommends a penalty of \$2,000 for the Rule 14(b)(2) violation, which the examiner adopts because it is the standard penalty provided by the penalty schedule and appears to be appropriate in the circumstances of this case.

The examiner recommends further that Sky be ordered to plug Well No. 1 or otherwise place this well into compliance with Statewide Rule 14(b)(2). Sky should be allowed the option of placing the well into compliance by means other than plugging because it was not disputed that Sky's oil and gas lease covering the land on which the well is located has been held in effect by production of other wells, so that Sky has a good faith claim of a continuing right to operate Well No. 1, and it appears that the well has not had a plugging extension since May 2, 2007, due only to the alleged Rule 8 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. Sky Resources, Inc. ("Sky") was given at least ten (10) days notice of this hearing by certified mail. Sky appeared at the hearing and presented evidence.
2. Sky is a corporation, and its most recent Form P-5 organization report filed on July 9, 2007, listed James R. Poage as President, Treasurer, and Secretary of the corporation.
3. As an officer, James R. Poage was a person in a position of ownership or control of Sky at the time the violations in this docket were committed.

4. The violations involved in this docket are violations of Commission rules related to safety and the prevention or control of pollution.
5. Sky's Form P-5 organization report is active, and Sky has approved financial assurance on file in the amount of \$50,000.
6. Sky designated itself the operator of the Sikes Lease, Well No. 1 (RRC No. 209245), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas, by filing a Form P-4 (Certificate of Compliance and Transportation Authority) approved July 11, 2005, effective March 1, 2005.
7. Five District Office inspections of the Sikes Lease between February 9, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of hydrocarbons and produced water in an area 6' x 3' x 3" under the pump jack motor for Well No. 1. An inspection on November 6, 2007, disclosed that this discharge was no longer visible, and the discharge area had been dug out and fresh soil put in place, so that as of November 6, 2007, no pollution was found.
8. Three District Office inspections of the Sikes Lease between April 12, 2007, and September 26, 2007, disclosed that Sky had caused or allowed a discharge of produced water in an area 20' x 10' on the west side of the pump jack for Well No. 1. An inspection on November 6, 2007, disclosed that fresh soil was in place, and there was no remaining visible pollution in this area.
9. Drilling of the Sikes Lease, Well No. 1 (RRC No. 209245) ceased on November 23, 2004, and the well completion date was February 10, 2005.
10. Nine District Office inspections of the Sikes Lease between August 30, 2006, and September 26, 2007, disclosed a drilling reserve pit site 30' west of Well No. 1 that had been backfilled but not completely leveled and compacted. A further inspection of the Sikes Lease on November 6, 2007, disclosed that the drilling reserve pit area had been worked with a tractor, backfilled, and compacted. The only remaining Statewide Rule 8 issue noted on the November 6, 2007, inspection report was the presence at the drilling reserve pit site of unknown white crystals in a 3' x 5' area.
11. Four District Office inspections between April 12, 2007, and September 26, 2007, disclosed the site of a fresh makeup water pit located 55' to the northwest of the Sikes Lease, Well No. 1. On the occasion of the April 12, 2007, inspection, white crystals were observed in the pit area. Soil samples were collected, which had a chloride concentration of 42,500 mg/kg. A letter to Sky from the District Office dated May 2, 2007, instructed Sky to remove soil with elevated chloride concentrations, properly dispose of this soil, and then backfill and compact the pit area. White crystals in the pit area were observed during further inspections on June 7 and September 26, 2007. A further District Office inspection on November 6, 2007, disclosed that this pit site had been worked with a tractor, backfilled, and compacted, and the only remaining Statewide Rule 8 issue noted by the inspector was a 3' x 3' area of

unknown white crystals.

12. Four District Office inspections between April 12, 2007, and November 6, 2007, disclosed the existence on the Sikes Lease of a fenced and lined pit containing fresh water, located about 2,125 west of Well No. 1.
 - a. This pit was dug in May 2005, and although water from the pit was once used to frac the Sikes #2 well, the pit since has been converted to a fresh water storage facility for water produced from a water well drilled by Sky on the Sikes lease, and the water stored there is sold to third parties who truck the water to other leases for use in drilling activities.
 - b. Water in this pit was field tested during District Office inspections on June 7, July 19, September 26, and November 6, 2007, and had chloride concentrations ranging from 260 mg/l to 560 mg/l.
 - c. This pit has never contained saltwater or other oil or gas wastes.
 - d. This pit is used and maintained by Sky pursuant to the terms of a Water Well Agreement between Sky and Thomas C. Sikes, landowner, dated May 1, 2005. The Agreement gave Sky the right to drill a water well on the Sikes lease, contemplated the sale of water by Sky to third parties, and permitted Sky to construct and maintain those other surface facilities not to exceed two acres required for the production, transportation, and delivery of fresh water produced from the water well on the Sikes lease.
 - e. On May 2, 2007, the District Office instructed Sky that the continued use and maintenance of this pit would require a permit from the Commission. Sky filed a Form H-11 (Application for Permit to Maintain and Use a Pit) on August 28, 2007.
 - f. On January 7, 2008, Jill Hybner, Manager, Environmental Permits & Support, Technical Permitting, sent Sky a letter stating that based on the understanding that this pit is used solely for the storage of fresh water that is sold to oil and gas operators, the pit was within the jurisdiction of the TCEQ, and the Sky application was therefore being returned to Sky.
13. Sky made an effort to remediate violations on the Sikes lease alleged in District Office inspection reports.
 - a. On or about June 19, 2006, Sky engaged a contractor to perform 17 hours of dozer work “to cover old drilling pits on Sikes lease #1 and 2,” at a cost of \$1,530.
 - b. On August 14-15, 2006, Sky engaged a contractor to perform 18 hours of tractor work and 9 hours of dozer work “to fill and level reserve pits at Wells #1 and #2,” at a cost of \$1,655.

- c. On April 9, 2007, Sky engaged a contractor for 6 hours of backhoe work to dig up dirt and cleanup and level a reserve pit area near Well No. 1 at a cost of \$416.33.
 - d. On April 16, 2007, Sky engaged a contractor to spread screening material, dig up contaminated soil with a backhoe, and haul off oily dirt from an area near Well No. 1 at a cost of \$715.23.
 - e. During the period August 6-23, 2007, Sky engaged an environmental services contractor to remove and remediate contaminated soil at a cost of \$18,000.
 - f. On October 12-13, 2007, Sky engaged a contractor to haul in and spread fill dirt, perform leveling service, and haul off contaminated soil at a cost of \$2,175.03.
14. The Sikes Lease, Well No. 1 (RRC No. 209245) has been inactive for more than one year, does not have a Statewide Rule 14(b)(2) plugging extension, and has not been plugged.
- a. On the occasion of ten District Office inspections of the Sikes lease between August 30, 2006, and November 6, 2007, Well No. 1 was equipped with pump jack and tubing and rods in casing, but was inactive.
 - b. No production for Well No. 1 has been reported by Sky to the Commission since February 28, 2006.
 - c. On May 2, 2007, a Statewide Rule 14(b)(2) plugging extension for Well No. 1 was canceled because of a Field Operations hold based on violations of Commission rules.
 - d. No Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) has been filed or approved for Well No. 1.
 - e. The estimated cost to the State to plug Well No. 1 is \$9,700.
15. A well that is in violation of Statewide Rule 14 must be plugged in order to prevent pollution of usable quality surface and subsurface waters. Any wellbore, cased or otherwise, is a potential conduit for flow from oil or saltwater zones to zones of usable quality water or to the surface. Holes or leaks may develop in cased wells, allowing oil or saltwater to communicate with usable quality zones or to flow to the surface. Uncased wells allow direct communication between zones and provide unimpeded access to the surface.
16. Any unauthorized discharge or disposal of oil, saltwater, basic sediment or other oil and gas waste is a potential source of pollution to surface and subsurface water if not remediated to prevent seepage and run-off.
17. Open reserve pits are considered a potential hazard because they could become convenient

sites for illegal dumping of wastes and also because they become containers for surface runoff that increases the potential for seepage to subsurface waters.

18. Sky has no history of previous enforcement orders entered against it for violations of Commission rules.

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. Sky Resources, Inc., was and is the operator of the Sikes Lease, Well No. 1 (RRC No. 209245), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas, as defined by Statewide Rules 14, 58, and 79 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§3.14, 3.58, and 3.79] and Chapters 85 and 89 of the Texas Natural Resources Code.
4. As operator, Sky Resources, Inc., has the primary responsibility for complying with Statewide Rules 8 and 14 [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §§3.8 and 3.14], Chapters 89 and 91 of the Texas Natural Resources Code, and other applicable statutes and Commission rules respecting the subject lease and well.
5. Sky Resources, Inc., violated Statewide Rule 8(d)(1) [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.8(d)(1)] by causing or allowing the discharge of oil or gas wastes on the Sikes lease without a permit authorizing such discharge. The Sikes lease was out of compliance with Statewide Rule 8(d)(1) from at least February 9, 2007, through at least September 26, 2007.
6. Sky Resources, Inc., violated Statewide Rule 8(d)(4)(G)(i)(I) [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.8(d)(4)(G)(i)(I)] by failing to properly dewater, backfill, and compact, within one year of completion of drilling of the Sikes Lease, Well No. 1, a drilling reserve pit located about 30' west of Well No. 1 and a fresh makeup water pit located about 55' northwest of Well No. 1. The Sikes lease was out of compliance with Statewide Rule 8(d)(4)(G)(i)(I) from at least August 30, 2006, until at least September 26, 2007.
7. Enforcement did not prove that maintenance by Sky Resources, Inc., of a fresh water storage pit located about 2,125' west of the Sikes Lease, Well No. 1, used solely for storage of water produced from a water well drilled by Sky on the Sikes lease, and for sale of the water to third parties who truck the water to other leases for use in drilling activities, is a violation of Statewide Rule 8(d)(4)(G)(i)(I).
8. Sky Resources, Inc., violated Statewide Rule 14(b)(2) [Tex. R.R. Comm'n, 16 TEX. ADMIN. CODE §3.14(b)(2)] by failing to plug the Sikes Lease, Well No. 1 (RRC No. 209245), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas, within one year after operations ceased or by otherwise placing the well into compliance with Statewide Rule 14(b)(2). The Sikes Lease, Well No. 1 has been in violation of Statewide Rule 14(b)(2)

since

May 2, 2007, when the last plugging extension for the well was canceled.

9. The documented violations committed by Sky Resources, Inc., constitute acts deemed serious and a hazard to the public health and safety within the meaning of Texas Natural Resources Code §81.0531.
10. As an officer of Sky Resources, Inc., at the time Sky Resources, Inc., violated Commission rules related to safety and the prevention or control of pollution, James R. Poage, and any organization subject to the Commission's jurisdiction in which he may hold a position of ownership or control, are subject to the provisions of Texas Natural Resources Code §91.114(a)(2).

RECOMMENDATION

The examiner recommends that the attached final order be adopted requiring Sky Resources, Inc., to plug or otherwise place into compliance with Commission rules, the Sikes Lease, Well No. 1 (RRC No. 209245), Newark, East (Barnett Shale) Field, Palo Pinto County, Texas, and pay a penalty in the amount of \$4,600, calculated on the basis of one Statewide Rule 8(d)(1) violation at \$600, two "dry" pit violations of Statewide Rule 8(d)(4)(G)(i)(I) at \$1,000 each, and one Rule 14(b)(2) violation at \$2,000.

Respectfully submitted,

James M. Doherty
Hearings Examiner