

Oil & Gas Docket No. 09-0252459
Proposal for Decision
April 7, 2008

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ENFORCEMENT ACTION AGAINST SADDLE CREEK ENERGY DEVELOPMENT (OPERATOR NO. 743065) FOR VIOLATIONS OF STATEWIDE RULES ON THE FOMBY LEASE, DRILLING PERMIT NO. 630921, WELL NO. 2, NEWARK, EAST (BARNETT SHALE) FIELD, DENTON COUNTY, TEXAS.

APPEARANCES:

FOR MOVANT RAILROAD COMMISSION OF TEXAS:

Susan German, Staff Attorney, Office of General Counsel, Enforcement Section
Ramon Fernandez, Jr., Engineer, Oil & Gas Division, Field Operations Unit

FOR RESPONDENT SADDLE CREEK ENERGY DEVELOPMENT

Thomas McMurray, Attorney, Reorganization Officer

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

COMPLAINT FILED:	August 2, 2007
NOTICE OF HEARING:	October 30, 2007
DATE CASE HEARD:	January 24, 2008
RECORD CLOSED:	February 29, 2008
PFD PREPARED BY:	Mark Helmueller, Hearings Examiner
PFD CIRCULATION DATE:	April 7, 2008
CURRENT STATUS:	Protested

STATEMENT OF THE CASE

This was a Commission-called hearing on the recommendation of the District Office to determine the following:

1. Whether respondent should be required to place in compliance with Statewide Rule 8, the Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas;
2. Whether the respondent 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 comply with said statutes and Statewide Rule 8;

3. Whether the respondent should be assessed administrative penalties of not more than \$10,000.00 per day for each offense committed regarding said lease and wells;
4. Whether any violations should be referred to the Office of the Attorney General for further civil action pursuant to Tex. Nat. Res. Code Ann. § 81.0534.

Susan German, Staff Attorney, appeared at the hearing representing the Railroad Commission of Texas, Office of General Counsel, Enforcement Section (“Enforcement”). Saddle Creek Energy Development (Saddle Creek) also appeared through its attorney appointed as a reorganization officer in a Chapter 11 Bankruptcy Case and presented evidence at the hearing. Enforcement's hearing file was admitted into evidence.

Enforcement recommended that Saddle Creek be ordered to bring the lease into compliance with Commission rules, and be assessed a total administrative penalty of \$10,000.00 for the violation of Statewide Rule 8(d)(1). Saddle Creek request that the penalty amount be limited to \$5,000.00.

The examiner recommends Saddle Creek be required to either fully remediate the area or to obtain compliance through the issuance of a minor permit, a process which will necessarily consider the concerns of the affected landowners. The examiner further recommends the assessment of an administrative penalty in the amount of \$9,715.00.

DISCUSSION OF THE EVIDENCE

Organization and Permit Records

Commission records show that Saddle Creek filed its most recent Commission Form P-5 (Organization Report) on September 5, 2007. Commission records show that Saddle Creek is recognized as the operator of 4 wells with a total depth of 32,248 feet. Saddle Creek submitted a \$25,000 letter of credit as financial assurance with its last Organization Report filing. Saddle Creek is a partnership. Two individual partners are identified on its Organization Report: Charles Chandler Davis and Alan Osenbaugh.

Saddle Creek was recognized as the operator of the Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas, (“subject lease” and/or “subject well”) after filing a Commission Form W-1 (Application for Permit to Drill, Recomplete, or Re-Enter) which was issued by the Commission on December 27, 2006.

Commission Inspections and Testimony

A Commission inspection of the subject lease conducted on January 24, 2007, found an unauthorized discharge of low chloride drilling fluids diluted by rainwater from a reserve pit associated with drilling operations for Well No. 2. The spill affected an area of approximately 97,150 square feet, including flows across a driveway, through a drainage area in a pasture/hayfield, and ultimately into a small pond. A slight oil sheen was noted on the surface of a pond. The measured chloride content of the fluids was 180 ppm.

Commission inspections on January 25 and 26 indicate that Saddle Creek's initial response included putting down new gravel over a driveway which was overflowed, and using fresh water to flush solids from the low chloride drilling fluids from the drainage area in the pasture/hayfield instead of physically removing the solids. The inspections verify that the pasture/hayfield owner did not want heavy equipment to remove the solids. Additionally, the pond owner requested that the solids be left in the pond because the pond leaked.

An inspection on April 3, 2007 observed a second reserve pit overflow incident. The measured chloride content of these fluids was 444 ppm. Two more overflow incidents were documented on April 25th and May 3rd. The measured chloride content of fluids from these incidents were 360 ppm and 140 ppm, respectively. Saddle Creek's only response to these overflow incidents was the removal of some fluids from the reserve pit.

An inspection on December 11, 2007 did not observe any attempts by Saddle Creek to remediate any of the affected area. The report indicates that heavy rains in the area had washed some of the drilling mud out of affected pasture into drainage areas.

ENFORCEMENT'S POSITION

Enforcement argues that subject lease is out of compliance with Rule 8(d)(1) because Saddle Creek never properly remediated the affected area which was first documented in January 2007. Enforcement asserts that the size of the affected area, the failure to fully clean up the problem and time out of compliance are the basis for the recommended penalty of \$10,000.00. Enforcement further urges that Saddle Creek be ordered to bring the lease into compliance with Commission rules.

Staff Engineer Ramon Fernandez testified that unpermitted and unremediated discharges of oil and gas waste can contaminate the land surface, affecting the health of humans and animals, and can also result in the pollution of surface and subsurface waters. The longer it takes to clean up a spill, the greater the health and pollution hazards.

A spill cannot be allowed to naturally remediate even though in this instance there has been no evidence of pollution of usable quality water. Because low chloride drilling fluids are circulated downhole they can be contaminated. The risk of pollution results from the possible contaminants.

Field operations staff uses an affected area formula to determine the amount of the

administrative penalty requested for a violation. In this case, the affected area of 97,150 square feet was determined from the initial inspection report and sketch of the property to which the initial discharge migrated. This was multiplied by \$0.30 for a “wet” spill to arrive at a total amount of \$29,145.00. The recommended penalty was lowered to \$10,000.00 because \$29,145.00 was deemed to be a very extreme penalty. The only rationale expressed for lowering the penalty to \$10,000.00 was that the maximum statutory penalty per day for a single violation is limited to \$10,000.00.

Enforcement acknowledged Saddle Creek’s bankruptcy filing, but urged that it is appropriate to proceed with the case because the bankruptcy is a voluntary reorganization proceeding under Chapter 11 of the United States Bankruptcy Code.

SADDLE CREEK’S POSITION

Saddle Creek filed an Chapter 11 bankruptcy proceeding on June 25, 2007. Saddle Creek does not challenge the Commission’s continued prosecution of this docket, but does not necessarily agree with the position advanced by enforcement.

Saddle Creek notes that the bankruptcy and the incomplete response to the overflows resulted from significant health issues experienced by one of the two partners in the company. These health issues purportedly contributed to a financial incident where 2 million dollars was inappropriately diverted to another project. This diversion of funds created problems with Saddle Creek’s abilities to pay its vendors, including D & G Dozier which was the contractor responsible for cleaning up the initial overflow incident and removing fluids from the reserve pits to prevent recurrences.

Saddle Creek agrees that a penalty is warranted for the violation, but suggests that the amount is excessive. Saddle Creek notes it engaged in several good faith efforts which prevented recurrences during a period of torrential rains in the area. Saddle Creek also notes that the fluids involved, fresh water drilling muds, did not contaminate usable quality water. Finally, Saddle Creek has cooperated with the landowners, and in some instances, it has tailored the clean up efforts around their concerns. Accordingly, Saddle Creek suggests that any administrative penalty be limited to \$5,000.00.

APPLICABLE AUTHORITY

With certain exceptions not relevant here, Statewide Rule 8(d)(1) prohibits the discharge of oil and gas wastes by any method without obtaining a permit to dispose of such wastes.

Texas Natural Resources Code §81.0531(c) requires the Commission to consider four factors in determining the amount of an administrative penalty for a violation of Commission rules: 1) the permittee’s history of previous violations; 2) the seriousness of the violation; 3) any hazard to the health or safety of the public; and 4) the demonstrated good faith of the person charged.

EXAMINER’S OPINION

The violation of Statewide Rule 8 and Saddle Creek's responsibility for the violation is uncontested. However, there are conflicting positions on the amount of any administrative penalty. Additionally, the impact of the bankruptcy case on this docket must also be addressed. Finally, there is an issue on how compliance can be achieved.

Effect of Bankruptcy

Generally, the filing of a bankruptcy petition under either Chapters 7, 11, 12 and 13 triggers an automatic stay of all judicial and administrative proceedings against a debtor. No distinction is made in applying the automatic stay based on which Chapter the petition is filed under. *See* 11 U.S.C. § 362(a). The stay applies to governmental agencies. However, there is an exception to the broad reach of the automatic stay for proceedings by governmental units to enforce police or regulatory powers including regulations concerning environmental protection and public safety. Enforcement of judgments under this regulatory power exception is limited to non-money judgments. *See* 11 U.S.C. § 362(b)(4).

A regulatory agency may therefore order compliance with its regulations relating to safety and environmental protection, but may not order payment of damages or a monetary penalty. Although the stay precludes ordering payment of a penalty or collection activities, it does not preclude proceedings to set the amount of monetary liability for past violations of a governmental unit's regulations. This is often referred to as the "fix but not collect" rule.

In summary, when an operator has filed a petition in bankruptcy, the Commission may order compliance with its rules concerning environmental protection and public safety and may assess a penalty for past violations. The Commission may not, however, order payment of a fine for past violations or attempt to collect an administrative penalty for past violations (other than by filing appropriate claims in the bankruptcy proceeding).

Amount of Administrative Penalty

Texas Natural Resources Code §81.0531(c) requires the Commission to consider four factors in determining the amount of an administrative penalty for a violation of Commission rules: 1) the permittee's history of previous violations; 2) the seriousness of the violation; 3) any hazard to the health or safety of the public; and 4) the demonstrated good faith of the person charged. In most Enforcement cases, a standard penalty guideline has already evaluated these factors in determining the amount of the administrative penalty sought in the complaint. Enhanced penalties for violations may be sought for several criteria, including: time out of compliance; actual or threatened environmental impact; threatened or actual hazard to the public; and, reckless or intentional conduct.

Violations of Rule 8(d)(1) have a recommended penalty range from \$500.00 to \$6,000.00

under the guideline for standard penalties. This range appears to reflect both the nature of the substance discharged, and the affected area, as neither of those factors are identified elsewhere in the guideline as a basis for an enhanced administrative penalty. The penalty recommended by Enforcement in this case for the violation of Rule 8(d)(1) exceeds the guideline for standard penalties. Additionally, the calculation based on the affected area used by field operations arrives at a far higher penalty amount than the amount recommended by Enforcement.

It would appear that the discrepancy in the penalty recommended by Enforcement and the calculation on the penalty amount used by field operations is due to the fact that only two parameters are used to determine the multiplier: \$0.30 for a wet spill and \$0.20 for a dry spill. Neither of these parameters necessarily reflect the nature of the substance discharged. Because this spill involved low chloride freshwater drilling muds diluted by rainwater, the examiner recommends a “multiplier” of \$0.10 would be appropriate in light of the nature of the substance discharged. This multiplier would yield an administrative penalty of \$9,715.00, an amount roughly equivalent to amount recommended by Enforcement. Use of the \$0.10 multiplier recommended in arriving at the amount of the administrative penalty to be assessed is consistent with the factors outlined in Texas Natural Resources Code §81.0531(c).

The lower administrative penalty amount recommended by Saddle Creek is based on problems created by the actions of one of the two partners in the company. The inappropriate or problematic business practices of one of the partners in a partnership, even if there is a claim related to the health of one of the partners, is not a basis for reducing the administrative penalty amount to be assessed against the partnership as a whole. In this case there were multiple overflow events and a significant period of noncompliance associated with the discharge violation. While it is also clear that at least some good faith efforts have been made to bring the area into compliance, the examiner does not believe that Saddle Creek has provided a valid basis for a reduction in the administrative penalty amount to be assessed under the circumstances surrounding this violation.

Compliance Requirements

With respect to the provisions of a Commission Final Order requiring compliance with Statewide Rule 8(d)(1), the suspended solids in the fluids associated with the original spill are present in a significant area based on the most recent inspection. However, the evidence suggests that several landowners do not want the solids, i.e., drilling muds, removed. The concerns regarding removal range from benefits added to the affected property, to the impact on the property of removal.

There are several provisions in Statewide Rule 8 related to the disposal of wastes associated with oil and gas operations which provide some guidance with respect to this issue. Statewide Rule 8(d)(3) authorizes the disposal of low chloride drilling fluids (water based drilling fluids with a chloride concentration of 3,000 milligrams per liter or less) by landfarming: 1) on the lease where the wastes were generated; and 2) if written permission of the surface owner of the tract is obtained. Under Statewide Rule 8(d)(6)(G), the District Office may issue a minor permit to dispose of a minor

amount of waste provided the permit does not authorize an activity which results in waste of oil or gas or pollutes surface or subsurface water. The issuance of a minor permit can allow for disposal at a site other than the location where the wastes were generated. Finally, a commercial landfarm for the disposal of low chloride drilling fluids is required to obtain a permit pursuant to Statewide Rule 8(d)(6)(A).

Actual removal of the solids associated with the overflow events is certainly a manner in which compliance can be achieved. However, in light of the nature of the spill and the purported desires of the landowners, it would also be possible for Saddle Creek to obtain compliance if it secures written permission from the affected landowners to dispose of the solids on their property as part of an application for the issuance of a minor permit. Accordingly, the examiner recommends that the Final Order in this docket specifically recognize that compliance may be achieved through the issuance of a minor permit with the District Office which includes the written permission from the affected landowners.

CONCLUSION

While respondent made some effort to resolve the discharge violation, it appears clear that full compliance has not been achieved. Further efforts are required to either fully remediate the area or to obtain compliance through the issuance of a minor permit, a process which will necessarily consider the concerns of the affected landowners. Finally, the violation warrants the assessment of an administrative penalty in the amount of \$9,715.00.

Based on the record in this docket, the examiner recommends adoption of the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT

1. Respondent Saddle Creek Energy Development (Saddle Creek) was given at least 10 days notice of this proceeding by certified mail, addressed to its most recent Form P-5 (Organization Report) address. Saddle Creek appeared and presented evidence at the hearing.
2. Saddle Creek filed its most recent Commission Form P-5 (Organization Report) on September 5, 2007. Commission records show that Saddle Creek is recognized as the operator of 4 wells with a total depth of 32,248 feet. Saddle Creek submitted a \$25,000 letter of credit as financial assurance with its last Organization Report filing. Saddle Creek is a partnership. Two individual partners are identified on its Organization Report: Charles Chandler Davis and Alan Osenbaugh.
3. Saddle Creek filed an Chapter 11 bankruptcy proceeding on June 25, 2007.
4. Saddle Creek was recognized as the operator of the Fomby Lease, Drilling Permit No.

630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas, (“subject lease” and/or “subject well”) after filing a Commission Form W-1 (Application for Permit to Drill, Recomplete, or Re-Enter) which was issued by the Commission on December 27, 2006.

5. An unpermitted discharge of oil occurred on the subject lease which has not been fully remediated by respondent.
 - a. A Commission inspection of the subject lease conducted on January 24, 2007, found an unauthorized discharge of low chloride drilling fluids diluted by rainwater from a reserve pit associated with drilling operations for Well No. 2. The spill affected an area of approximately 97,150 square feet, including flows across a driveway, through a drainage area in a pasture/hayfield, and ultimately into a small pond. A slight oil sheen was noted on the surface of a pond. The measured chloride content of the fluids was 180 ppm.
 - b. Commission inspections on January 25 and 26 indicate that Saddle Creek’s initial response included putting down new gravel over a driveway which was overflowed by the mud, and using fresh water to flush the solids in the low chloride drilling fluids from the drainage area in the pasture/hayfield instead of physically removing the solids. The inspections verify that the pasture/hayfield owner did not want heavy equipment to remove the solids. Additionally, the pond owner requested that the solids be left in the pond because the pond leaked.
 - c. An inspection on April 3, 2007 observed a second reserve pit overflow incident. The measured chloride content of these fluids was 444 ppm.
 - d. Two more overflow incidents were documented on April 25th and May 3rd. The measured chloride content of fluids from these incidents were 360 ppm and 140 ppm, respectively.
 - e. Saddle Creek’s only response to the April and May overflow incidents was the removal of some fluids from the reserve pit.
 - f. An inspection on December 11, 2007 did not observe any attempts by Saddle Creek to remediate any of the affected area. The report indicates that heavy rains in the area had washed some of the solids in the low chloride drilling fluids out of affected areas.
6. Unpermitted and unremediated discharges of oil and gas waste can contaminate the land surface, affecting the health of humans and animals, and can also result in the pollution of surface and subsurface waters. The longer it takes to clean up a spill, the greater the health

and pollution hazards.

7. Under Statewide Rule 8(d)(6)(G), the District Office may issue a minor permit to dispose of a minor amount of waste provided the permit does not authorize an activity which results in waste of oil or gas or pollutes surface or subsurface water. The issuance of a minor permit can allow for disposal at a site other than the location where the wastes were generated.

CONCLUSIONS OF LAW

1. Proper notice of hearing was timely issued to the appropriate persons entitled to notice.
2. All things necessary to the Commission attaining jurisdiction have occurred.
3. Saddle Creek is the operator of the Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas as defined by Statewide Rule 14 and §89.002 of the Texas Natural Resources Code.
4. Saddle Creek has the primary responsibility for complying with Rule 8, and Chapter 89 of the Texas Natural Resources Code as well as other applicable statutes and Commission rules relating to the Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas.
5. The Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas is not in compliance with Commission Statewide Rule 8(d)(1) or Chapters 85, 89 and 91 of the Texas Natural Resources Code.
6. The Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas has been out of compliance with Commission Statewide Rule 8(d)(1) from on or before January 24, 2007 to the present.
7. When an operator has filed a petition in bankruptcy, the Commission may order compliance with its rules concerning environmental protection and public safety and may assess a penalty for past violations.
8. Charles Chandler Davis and Alan Osenbaugh are identified in Commission filings as holding a position of ownership in Saddle Creek, as defined by Texas Natural Resources Code § 91.114, during the time period of the violations of Commission rules committed by respondent.
9. The violation of Commission rules committed by respondent are related to safety and the control of pollution.
10. As partners in Saddle Creek at the time of the violations Commission rules related to safety

and the control of pollution, Charles Chandler Davis and Alan Osenbaugh and any other organization in which they may hold a position of ownership or control, shall be subject to the restrictions of Texas Natural Resources Code §91.114(a)(2) for a period of no more than seven years from the date the order entered in this matter becomes final, or sooner, if the conditions that constituted the violations herein are corrected or are being corrected in accordance with a schedule to which the Commission and the organization have agreed.

11. The documented violations committed by respondent are a hazard to the public health and demonstrate a lack of good faith pursuant to Texas Natural Resources Code §81.0531(c).

RECOMMENDATION

The examiner recommends that the above findings and conclusions be adopted and the attached order approved, requiring Saddle Creek, within 30 days of the entry of a Final Order in this matter; 1) to bring the Fomby Lease, Drilling Permit No. 630921, Well No. 2, Newark, East (Barnett Shale) Field, Denton County, Texas into compliance with Commission Rule 8; and 2) to be assessed an administrative penalty of \$9,715.00.

Respectfully submitted,

Mark Helmueller
Hearings Examiner