

OIL & GAS DOCKET NO. 03-0244199

**ENFORCEMENT ACTION AGAINST NUECES PETROLEUM CORPORATION
(OPERATOR NO. 616055) FOR VIOLATIONS OF STATEWIDE RULES ON THE J. A.
DUNAGAN SWD (20679) LEASE, WELL NO. 3, S. FELICIA (YEGUA 11160) FIELD,
LIBERTY COUNTY, TEXAS**

APPEARANCES:

FOR MOVANT:

Susan German
Bill Drury

MOVANT:

Enforcement Section
Railroad Commission of Texas

FOR RESPONDENT:

Ken Howard

RESPONDENT:

Nueces Petroleum Corporation

PROPOSAL FOR DECISION

PROCEDURAL HISTORY

DATE OF ORIGINAL COMPLAINT:

October 12, 2005

DATE OF NOTICE OF HEARING:

March 24, 2006

DATE OF HEARING:

June 22, 2006

HEARD BY:

James M. Doherty, Hearings
Examiner

DATE RECORD CLOSED:

June 29, 2006

DATE PFD CIRCULATED:

July 24, 2006

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 Nueces Petroleum Corporation (“Nueces”) should be required to plug or otherwise place in compliance with Statewide Rule 14(b)(2) [Tex. R.R. Comm’n., 16 TEX. ADMIN. CODE §3.14(b)(2)] the J. A. Dunagan SWD (20679) Lease (“subject lease”), Well No. 3 (“subject well”), S. Felicia (Yegua 11160) Field, Liberty County, Texas;

2. Whether Nueces has violated Statewide Rule 3 [Tex. R.R. Comm'n., 16 TEX. ADMIN. CODE §3.3] on the J. A. Dunagan SWD (20679) Lease by failing to post an identification sign with the required information at Well No. 3;
3. Whether Nueces has 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 or otherwise place the subject lease and well in compliance with Statewide Rules 3 and 14(b)(2);
4. Whether, pursuant to Texas Natural Resources Code §81.0531, Nueces should be assessed administrative penalties of not more than \$10,000 per day for each offense committed regarding the subject lease and well; and
5. Whether any violations of Statewide Rules 3 and 14(b)(2) by Nueces should be referred to the Office of the Attorney General for further civil action pursuant to Texas Natural Resources Code §81.0534.

A hearing was held on June 22, 2006. Susan German, Staff Attorney, appeared representing the Enforcement Section of the Office of General Counsel ("Enforcement"). Ken Howard, consultant, appeared to represent Nueces and presented evidence. Enforcement's certified hearing file was admitted into evidence. The record was held open until June 29, 2006, to receive information as to whether any bankruptcy trustee had been appointed in a pending Chapter 11 bankruptcy proceeding wherein Nueces is the debtor and the effect of the pending bankruptcy proceeding on this docket.

APPLICABLE LAW

Statewide Rule 3(2) requires that an identification sign be posted at each well site, showing the name of the property, the name of the operator, and the well number. Statewide Rule 14(b)(2) requires that a well be plugged after 12 months of inactivity, unless a plugging extension has been obtained.

DISCUSSION OF THE EVIDENCE

Matters Officially Noticed

The examiner has officially noticed Commission organization report and financial assurance databases showing that Nueces has an active Form P-5 organization report and financial assurance in the amount of \$50,000 in the form of a letter of credit.

Enforcement

The most recent Form P-5 organization report shows that Nueces is a corporation. Nueces' officers listed on this Form P-5 are Lee Lance, President, and Jamie Lloyd, Vice President, Operations. Nueces designated itself operator of the subject lease and well by filing a Form P-4 (Certificate of Compliance and Transportation Authority), which was approved August 20, 2001, effective July 1, 2001.

On the occasion of District Office inspections on April 13 and April 20, 2004, the identification sign required by Statewide Rule 3 to be posted at the site of Well No. 3 on the subject lease was missing. Six follow up inspections made between May 5, 2005, and May 30, 2006, disclosed that a sign was posted at Well No. 3, but contained an incorrect operator name.

Well No. 3 on the subject lease was permitted as a saltwater disposal well on January 15, 1991 (Permit No. 08724). Eight District Office inspections of the subject lease made between March 4, 2004, and May 30, 2006, disclosed that Well No. 3 was inactive and shut in. No injection activity has been reported to the Commission for the subject well since November 1999. No Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) has been filed or approved for the subject well, and no plugging extension for the well is in effect.

The subject well requires a mechanical integrity test annually. Commission records disclose that the last mechanical integrity test for the well was performed on July 27, 1999. A plugging extension for the well was canceled on January 12, 2005, based on Nueces' failure to perform the required mechanical integrity test. The estimated cost to the State to plug the subject well is \$7,808. On 8 occasions between March 12, 2004, and August 11, 2005, the District Office sent Nueces correspondence, notices, or copies of memoranda requesting voluntary compliance with Statewide Rules 3 and 14(b)(2) on the subject lease.

In the event of a pollution or safety violation or other emergency, incorrect, illegible or missing signs may cause delays in containing and remediating the violation or emergency and threaten the public health and safety.

Inactive wellbores 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 water zones or to flow to the surface. Uncased wells allow direct communication between zones and provide unimpeded access to the surface.

Nueces

Nueces does not dispute any of Enforcement's allegations. However, Nueces currently is the debtor in possession in a Chapter 11 reorganization proceeding, styled Case No. 05-44617, *In Re: Nueces Petroleum Corporation, Debtor*, in the United States Bankruptcy Court for the Southern District of Texas, Houston Division.¹ According to its consultant, Nueces may be required to bring the well into compliance under supervision of the Bankruptcy Court.

EXAMINER'S OPINION

The violations of Statewide Rules 3 and 14(b)(2) alleged by Enforcement are not disputed by Nueces and are clearly proved by the evidence.

The pendency of Nueces' Chapter 11 bankruptcy proceeding does not prohibit the prosecution of this action to enforce Commission rules related to safety and the prevention or control of pollution. Such actions by a governmental unit are exempted from the automatic stay provisions of 11 U.S.C. §362(a). *See* 11 U.S.C. §362(b)(4). Where there is a pending bankruptcy proceeding, the Commission may order compliance with its safety and environmental regulations, and fix the amount of suitable penalties for violations of its rules related to safety and the prevention or control of pollution, but may not order payment of penalties. *In Re: Commonwealth Oil Ref. Co.*, 805 F.2d 1175 (5th Cir. 1986), cert. denied, 483 U.S. 1005 (1987).

Enforcement recommends that the penalty for Nueces' violations of Statewide Rules 3 and 14(b)(2) be fixed at \$2,250, consisting of \$250 for one violation of Statewide Rule 3 and \$2,000 for one violation of Statewide Rule 14(b)(2). The examiner agrees with this recommendation. These penalties conform to standard penalties in the recommended standard penalty schedule for enforcement cases. Violations of Statewide Rules 3 and 14(b)(2) present a threat to public safety and a threat of pollution of usable quality water. Such violations are thus deemed serious. According to Enforcement's complaint, no prior final Commission orders have been entered against Nueces for violations of Commission rules. However, Nueces cannot be said to have acted in good faith, because it failed to respond to multiple requests from the District Office for voluntary compliance.

The examiner also recommends that Nueces be ordered to plug the subject well. The well has been inactive for almost seven years, and no mechanical integrity test has been performed on the well since July 27, 1999. In addition, there is no evidence that Nueces continues to possess a good faith claim of right to operate the well.

¹ The examiner has officially noticed that Nueces' bankruptcy petition was filed on September 9, 2005. Nueces is a debtor in possession, and no bankruptcy trustee has been appointed. It does not appear that the Commission previously was notified of this bankruptcy proceeding. On June 26, 2006, Enforcement filed copies of Nueces' Plan of Reorganization and Disclosure Statement in the bankruptcy case, and these documents were admitted into evidence. The Disclosure Statement stated that Earnest Frank Hill, Jr. (aka E. Frank Hill, Jr.) was Nueces' "initial Director" and "directs the over all corporate strategy." The Disclosure Statement stated also that Earnest Frank Hill, Jr., makes all final decisions for Nueces. The Disclosure Statement stated also that Frank Hill is the owner of 1,000 shares of stock (voting rights only) of Nueces, and no other owners were named.

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. Nueces Petroleum Corporation (“Nueces”) was given at least ten (10) days notice of this hearing by certified mail, addressed to Nueces’ most recent Form P-5 organization report address. Ken Howard, consultant for Nueces, appeared at the hearing representing Nueces and presented evidence.
2. Nueces is a corporation. Its officers, as listed on its most recent Form P-5 organization report approved April 7, 2006, are Lee Lance, President, and Jamie Lloyd, Vice President. Earnest Frank Hill, Jr. (aka E. Frank Hill, Jr.) was Nueces’ initial director and directs overall corporate strategy and makes all final decisions for the company.
3. As officers, Lee Lance and Jamie Lloyd were persons in a position of ownership or control of Nueces at the time the violations involved in this docket were committed. As a director and the person directing overall corporate strategy and making all final decisions, Earnest Frank Hill, Jr. (aka E. Frank Hill, Jr.) was a person in a position of ownership or control of Nueces at the time the violations involved in this docket were committed.
4. The violations involved in this docket were violations of Commission rules related to safety and the prevention or control of pollution.
5. Nueces’ Form P-5 organization report is in active status, and Nueces has filed financial assurance in the amount of \$50,000 in the form of a letter of credit.
6. As the result of petition filed on September 9, 2005, Nueces was, at the time of the hearing in this docket, the debtor in possession in a pending Chapter 11 reorganization proceeding styled Case No. 05-44617, *In Re: Nueces Petroleum Corporation, Debtor*, in the United States Bankruptcy Court for the Southern District of Texas, Houston Division.
7. Nueces designated itself to the Commission as the operator of the J. A. Dunagan SWD (20679) Lease (“subject lease”), Well No. 3 (“subject well”), S. Felicia (Yegua 11160) Field, Liberty County, Texas, by filing Form P-4, approved August 20, 2001, effective July 1, 2001.
8. On the occasion of District Office inspections on April 13 and April 20, 2004, the identification sign required by Statewide Rule 3 to be posted at the site of Well No. 3 on the subject lease was missing. Six follow up inspections made between May 5, 2005, and May 30, 2006, disclosed that a sign was posted at Well No. 3, but contained an incorrect operator name.
9. The subject well was permitted as a saltwater disposal well on January 15, 1991. The well has been inactive for more than one year, has not been plugged, and does not have a Statewide Rule 14(b)(2) plugging extension.

- a. On the occasion of 8 District Office inspections between March 4, 2004, and May 30, 2006, the subject well was inactive and shut in.
 - b. No injection activity has been reported to the Commission for the subject well since November 1999.
 - c. No Plugging Record (Form W-3) or Cementing Affidavit (Form W-15) has been filed or approved for the subject well.
 - d. A plugging extension for the subject well was canceled on January 12, 2005, based on Nueces' failure to perform a required mechanical integrity test on the well.
10. The estimated cost to the State to plug the subject well is \$7,808.
 11. On 8 occasions between March 12, 2004, and August 11, 2005, the District Office sent Nueces correspondence, notices, or copies of memoranda requesting voluntary compliance with Statewide Rules 3 and 14(b)(2) with respect to the subject lease and well. Nueces did not respond by placing the subject lease and well into compliance.
 12. In the event of a pollution or safety violation or other emergency, incorrect, illegible or missing signs may cause delays in containing and remediating the violation or emergency and threaten the public health and safety.
 13. Inactive wellbores 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 water zones or to flow to the surface. Uncased wells allow direct communication between zones and provide unimpeded access to the surface.
 14. No evidence was presented that prior final enforcement orders have been entered against Nueces for violation of Commission rules.
 15. Nueces has not demonstrated good faith in that it failed to respond to multiple requests from the District Office to resolve the violations that are the subject of this docket.

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. Nueces Petroleum Corporation (“Nueces”) was and is the operator of the J. A. Dunagan SWD (20679) Lease (“subject lease”), Well No. 3 (“subject well”), S. Felicia (Yegua 11160) Field, Liberty County, Texas, as defined by Commission 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, Nueces had the primary responsibility for complying with Statewide Rules 3 and 14(b)(2) [Tex. R.R. Comm’n., 16 TEX. ADMIN. CODE §§3.3 and 3.14(b)(2)], Chapters 89 and 91 of the Texas Natural Resources Code, and other applicable statutes and Commission rules respecting the subject lease and well.
5. Nueces violated Statewide Rule 3 [Tex. R.R. Comm’n., 16 TEX. ADMIN. CODE §§3.3] on the subject lease by failing to post and maintain the required identification sign at the site of the subject well. Nueces has been out of compliance with Statewide Rule 3 since at least April 13, 2004.
6. Nueces violated Statewide Rule 14(b)(2) [Tex. R.R. Comm’n., 16 TEX. ADMIN. CODE §§3.14(b)(2)] by failing to timely plug the subject well. Nueces has been out of compliance with Statewide Rule 14(b)(2) since January 12, 2005.
7. The documented violations committed by Nueces constitute acts deemed serious and a hazard to the public health, and demonstrate a lack of good faith within the meaning of Texas Natural Resources Code §81.0531.
8. This is an enforcement action by a governmental unit to enforce its rules related to safety and the prevention or control of pollution, and, pursuant to 11 U.S.C. §362(b)(4) is exempted from the automatic stay provisions of 11 U.S.C. §362(a).
9. As officers of Nueces at the time Nueces violated Commission rules related to safety and the prevention or control of pollution, Lee Lance and Jamie Lloyd, and any organization in which they, or either of them, may hold a position of ownership or control, are subject to the restrictions of Texas Natural Resources Code §91.114(a)(2).
10. As a director of Nueces and the person directing overall corporate strategy and making all final decisions for Nueces at the time Nueces violated Commission rules related to safety and the prevention or control of pollution, Earnest Frank Hill, Jr. (aka E. Frank Hill, Jr.), and any organization in which he may hold a position of ownership or control, are subject to the restrictions of Texas Natural Resources Code §91.114(a)(2).

RECOMMENDATION

The examiner recommends that the Commission adopt the attached final order providing: (1) that Nueces Petroleum Corporation shall plug in compliance with Commission rules the J. A. Dunagan SWD (20679) Lease, Well No. 3, S. Felicia (Yegua 11160) Field, Liberty County, Texas; and (2) that an administrative penalty in the amount of \$2,250 is assessed against Nueces Petroleum Corporation.

Respectfully submitted,

James M. Doherty
Hearings Examiner