

Cypress Energy Partners, L.P.
Form 10-K
March 30, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File No. 001-36260

CYPRESS ENERGY PARTNERS, L.P.
(Exact name of registrant as specified in its charter)

Delaware 61-1721523
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

5727 South Lewis Avenue, Suite 500
Tulsa, Oklahoma 74105
(Address of principal executive offices) (Zip Code)

(Registrant's telephone number, including area code): (918) 748-3900

Securities Registered Pursuant to Section 12(b) of the Act:

Common Units Representing Limited Partner Interests New York Stock Exchange
(Title of each class) (Name of each exchange on which registered)

Securities Registered Pursuant to Section 12(g) of the Act: N o n e

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was

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required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Annual Report on Form 10-K or any amendment to this Annual Report on Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

The aggregate market value of the registrant's Common Units Representing Limited Partner Interests held by non-affiliates computed by reference to the price at which the limited partner units were last sold as of June 30, 2014 was \$102,594,375.

As of March 25, 2015, the registrant had 5,913,000 common units and 5,913,000 subordinated units outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None.

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GLOSSARY OF TERMS

The following includes a description of the meanings of some of the terms used in this Annual Report on Form 10-K.

“Dig site”	The location where pipeline maintenance occurs by excavating the ground above the pipeline.
“Flowback water”	The fluid that returns to the surface during and for the weeks following the hydraulic fracturing process.
“Gun barrel”	A settling tank used for treating oil where oil and brine are separated only by gravity segregation forces.
“Hydraulic fracturing”	The process of pumping fluids, mixed with granular proppant, into a geological formation at pressures sufficient to create fractures in the hydrocarbon-bearing rock.
“In-line inspection”	An inspection technique used to assess the integrity of natural gas transmission pipelines from inside of the pipe.
“IPO”	Our initial public offering of common units representing limited partner interests in us.
“Injection intervals”	The part of the injection zone in which the well is screened or in which the waste is otherwise directly emplaced.
“NGLs”	Natural gas liquids. The combination of ethane, propane, butane, isobutene and natural gasolines that, when removed from natural gas, become liquid under various levels of higher pressure and lower temperature.
“OPEC”	The Organization of Petroleum Exporting Countries.
“Pig tracking”	The locating, mapping and monitoring of the in-line inspection pig.
“Produced water”	Naturally occurring water found in hydrocarbon-bearing formations that flows to the surface along with oil and natural gas.
“Proppant”	Sized particles mixed with fracturing fluid to hold fractures open after a hydraulic fracturing treatment.
“Residual oil”	Oil separated and recovered during the saltwater treatment process.
“Separation tank”	A cylindrical or spherical vessel used to separate oil, gas and water from the total fluid stream produced by a well.
“Settling tank”	A non-circulating storage tank where gravitational segregation forces separate liquids from solids.
“Staking”	The process of marking the location where pipeline maintenance will occur.
“SWD”	Salt water disposal.

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NAMES OF ENTITIES

Unless the context otherwise requires, references in this Annual Report on Form 10-K to “Cypress Energy Partners, L.P.,” “our partnership,” “we,” “our,” “us,” or like terms, refer to Cypress Energy Partners, L.P. and its subsidiaries.

References to:

“General Partner” refers to Cypress Energy Partners GP, LLC, a subsidiary of Holdings II;

“Holdings” refers to Cypress Energy Holdings, LLC, the owner of Holdings II;

“Holdings II” refers to Cypress Energy Holdings II, LLC, the owner of 671,250 common units representing 11.4% of our outstanding common units and 4,939,299 subordinated units representing 83.5% of our subordinated units;

“CEM LLC” refers to Cypress Energy Management, LLC, a wholly owned subsidiary of the General Partner;

“CEM-BO” refers to Cypress Energy Management – Bakken Operations, LLC, a 51% owned subsidiary of CEM LLC;

“CEM TIR” refers to Cypress Energy Management - TIR, LLC, a wholly owned subsidiary of the General Partner;

“CEP LLC” refers to Cypress Energy Partners, LLC, which became our wholly owned subsidiary at the closing of our initial public offering (“IPO”);

“CEP-TIR” refers to Cypress Energy Partners – TIR, LLC, an indirect subsidiary of Holdings, and an owner of 673,400 common units representing 11.4% of our outstanding common units, 673,400 subordinated units representing 11.4% of our subordinated units and an owner of a 36.2% interest in the TIR Entities prior to the sale of its interests to the Partnership effective February 1, 2015;

“CES LLC” refers to Cypress Energy Services, LLC, our 51.0% indirectly owned subsidiary that performs management services for 10 salt water disposal (“SWD”) facilities in North Dakota – seven of which are owned by CEP LLC. SBG Energy Services, LLC (“SBG Energy”) owns the remaining interests and CEP LLC has the right to acquire such interests;

“CF Inspection” refers to CF Inspection Management, LLC, owned 49% by TIR-PUC, controlled and consolidated by TIR-PUC;

“Partnership” refers to the registrant, Cypress Energy Partners, L.P.;

“PI&IS” refers to our Pipeline Inspection and Integrity Services business segment;

“Predecessor” refers to the accounting predecessor of CEP LLC, which is comprised of the seven North Dakota limited liability companies we acquired from SBG Energy Services, LLC;

“TIR LLC” refers to Tulsa Inspection Resources, LLC;

“TIR-Canada” refers to Tulsa Inspection Resources – Canada ULC, a Canadian subsidiary of TIR Holdings;

“TIR Entities” refer collectively to TIR LLC and its subsidiary, TIR Holdings and its subsidiaries and TIR-NDE, all of which were 50.1% owned by CEP LLC from our IPO until February 1, 2015 at which time CEP LLC acquired the remaining interests from affiliates of Holdings and now own 100%;

“TIR-Foley” refers to Foley Inspection Services ULC, a Canadian subsidiary of TIR Holdings;

“TIR Holdings” refers to Tulsa Inspection Resources Holdings, LLC;

“TIR-NDE” refers to Tulsa Inspection Resources – Nondestructive Examination, LLC;

“TIR-PUC” refers to Tulsa Inspection Resources – PUC, LLC, a corporate subsidiary of TIR LLC; and

“W&ES” refers to our Water and Environmental Services business segment.

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CAUTIONARY REMARKS REGARDING FORWARD LOOKING STATEMENTS

The information discussed in this Annual Report on Form 10-K includes “forward-looking statements.” These forward-looking statements are identified by their use of terms and phrases such as “may,” “expect,” “estimate,” “project,” “plan,” “believe,” “intend,” “achievable,” “anticipate,” “continue,” “potential,” “should,” “could,” and similar terms and phrases. Although we believe that the expectations reflected in these forward-looking statements are reasonable, they do involve certain assumptions, risks and uncertainties and we can give no assurance that such expectations or assumptions will be achieved. Important factors that could cause actual results to differ materially from those in the forward-looking statements are described under “Item 1A - Risk Factors” and “Item 7 - Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this Annual Report. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph and elsewhere in this Annual Report on Form 10-K and speak only as of the date of this Annual Report on Form 10-K. Other than as required under the securities laws, we do not assume a duty to update these forward-looking statements, whether as a result of new information, subsequent events or circumstances, changes in expectations or otherwise.

PART I

ITEM 1. BUSINESS

Overview

The Partnership is a Delaware limited partnership formed on September 19, 2013 to become a diversified Partnership serving energy companies throughout North America. We currently provide independent pipeline inspection and integrity services to producers and pipeline companies and water and environmental services with SWD facilities to U.S. onshore oil and natural gas producers and trucking companies. On January 21, 2014, we completed the IPO of our limited partner common units. As part of the transaction, affiliates of Holdings, conveyed an aggregate 50.1% interest in the TIR Entities in exchange for an aggregate 15.7% ownership in the Partnership. Affiliates of Holdings held the remaining 49.9% interest in the TIR Entities that was recently acquired by the Partnership effective February 1, 2015. As a result, the Partnership now owns 100% of the TIR Entities.

Our business is currently organized into two reportable segments: (1) Water and Environmental Services (“W&ES”) and (2) Pipeline Inspection and Integrity Services (“PI&IS”). We also have a number of other lines of business in our IRS private letter ruling (“PLR”) that would allow us to further diversify our business activities and lines of business serving the energy industry. W&ES provides SWD services to oil and natural gas producers and trucking companies and consists of the operations of CEP LLC, which owns and operates eight commercial SWD facilities in the Bakken Shale region of the Williston Basin in North Dakota and two in the Permian Basin in Texas. We generate revenue by treating produced water and flowback water and injecting the water into our SWD facilities. Results are driven primarily by the volume of water injected into our SWD facilities and the fees charged related to these services. These fees are charged on a per barrel basis and vary based on the quantity and type of saltwater disposed, competitive dynamics and operating costs. Our SWD facilities currently utilize specialized equipment, full-time attendants, and remote monitoring to minimize downtime and increase efficiency for peak utilization and are located in close proximity to existing producing wells and expected future drilling sites, making our SWD facilities economically attractive to our current and future customers. These facilities also contain oil skimming processes that remove any remaining oil from flowback and produced water that has been delivered to the sites. We then generate revenue by selling the residual oil recovered from the water treatment process. In addition to the ten SWD facilities owned by CEP LLC, our consolidated 51% subsidiary, CES LLC, provides management and staffing services for three additional SWD facilities in the Bakken Shale region, pursuant to management agreements. CES LLC also owns a 25% member interest in one of the managed wells. The W&ES segment is directly tied to oil and gas activity and is impacted by lower commodity prices and newly completed oil and gas wells.

PI&IS is comprised of the operations of the TIR Entities. Through this segment, we provide independent inspection and integrity services to various energy, public utility and pipeline companies in both the United States and Canada. Inspectors in this segment perform a variety of inspection and integrity services on midstream pipelines, midstream assets and infrastructure, gathering systems and distribution systems, including data gathering and supervision of third-party construction, inspection, and maintenance and repair projects. Results in this segment are driven primarily by the number and type of inspectors performing services for our customers and the fees they charge for those services, which depend on the nature and duration of the project.

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Our Relationship with Cypress Energy Holdings, LLC

All of the equity interests in our general partner are owned by Holdings, which is owned by Charles C. Stephenson, Jr., various family trusts, a company controlled by our Chairman and Chief Executive Officer, Peter C. Boylan III and Henry Cornell. Holdings' owners bring substantial industry relationships and specialized, value-creation capabilities that we believe will continue to benefit us. Mr. Stephenson has over 50 years of experience as a leader in the oil and natural gas industry. He was the founder, Chairman and Chief Executive Officer of Vintage Petroleum prior to its sale to Occidental Petroleum in 2006 and is currently the Chairman of Premier Natural Resources, a private oil and natural gas exploration and production company that he co-founded. Mr. Boylan has extensive executive management experience with public and private companies and also has extensive public company directorship experience. As the owners of our general partner and the direct or indirect owners of approximately 58.8% of our outstanding limited partner interests, Holdings and its affiliates have a strong incentive to support and promote the on-going successful execution of our business plan.

Business Strategies

Our principal business objective is to build a diversified Partnership serving energy customers that will allow us, over time, to incrementally increase the quarterly cash distributions that we pay to our unitholders. We expect to achieve this objective through the following business strategies:

Capitalize on compelling industry fundamentals.

W&ES. We believe that the on-going water and environmental services market will continue to offer long-term growth fundamentals and we intend to maintain our position as a high quality operator of SWD facilities despite the recent downturn in the oil and gas industry as a whole. We plan to focus on pipeline opportunities with E&P companies that will secure water for our SWD facilities. Regulations continue to increase and we have proven to our customers that we are a trusted and dependable service provider. Increasingly, we are seeing E&P companies have their central procurement and Environment, Health and Safety ("EHS") groups inspect our SWD facilities. This trend should benefit our Partnership. Although the oil and gas industry can be cyclical in nature (as is evidenced by this current downturn), our current business strategy is such that 75% - 80% of our treated water is derived from existing wells. Although new drilling activity is currently curtailed and commodity oil prices have declined significantly, our focus will remain on the produced water that is generated for the life of an oil and gas well. With curtailed drilling activity and depressed oil prices, a portion of W&ES will suffer declines in volumes and pricing until the market rebounds leading to additional drilling and completions that, in turn, generate new produced water for the life of those newly completed oil and gas wells. We intend to capitalize on the continued demand for removal, treatment, storage and disposal of flowback and produced water by positioning ourselves as a trusted, dependable provider of safe, high-quality water and environmental services to our energy customers.

PI&IS. We intend to continue to position ourselves as a trusted provider of high quality inspection and integrity services, as we believe the pipeline inspection and integrity services market offers attractive long-term growth fundamentals. Over the last few years, new laws have been enacted in the U.S. that, in the future, will require operators to undertake more frequent and more extensive inspections of their pipeline assets. These requirements are independent and not tied to the current state of the oil and gas industry as a whole. Additionally, a significant portion of the pipeline infrastructure in North America was installed decades ago and is therefore more susceptible to failure and requires more frequent inspections. We believe that increasingly stringent U.S. federal and state laws and regulations and aging pipeline infrastructures will result in increased need for inspection and integrity services and higher demand for independent, third-party inspectors capable of navigating these complicated requirements. The current energy downturn has impacted some of our customers. However, most of our clients are investment-grade, well-capitalized companies that have long lead time projects requiring our services in addition to the ongoing maintenance and integrity work on their aging pipelines. Our business is not immune to the downturn, however, we

believe that we can continue to grow organically by acquiring new customers and additional work from existing customers. We continue to grow our business development team to pursue these opportunities.

Optimize existing SWD assets. The average age of our SWD facilities was 2.3 years at the end of 2014. We estimate that we utilized approximately 45% of the aggregate estimated capacity of these facilities for the year ended December 31, 2014. Our permitted capacity is much higher than our estimated capacity. We are seeking to increase the utilization of our existing SWD facilities by attracting new volumes from existing customers and by developing new customer relationships including pipelines. In 2012, only one pipeline was directly connected to our SWD facilities. Today we have six pipelines connected to our facilities. Because many of the costs of constructing and operating an SWD facility are either upfront capital costs or fixed costs, we expect that increased utilization of our existing SWD facilities over time will lead to increased gross margin and operating cash flow in W&ES. The current downturn in the energy industry will place pressure on both the volumes we process and the prices we are able to charge.

Increase the number of pipelines connected to our SWD facilities. As more oil and natural gas producers focus on improving operational safety and reducing liability, carbon footprint, road damage and the total transportation cost associated with trucking saltwater, we anticipate that they will increasingly prefer to utilize pipeline systems to transport their saltwater directly to SWD facilities. We intend to purchase or construct, whether alone or in joint ventures, saltwater pipeline systems that connect producers to our SWD facilities or newly developed SWD facilities. We continue to focus on increasing pipeline water delivered to our facilities. Our 2014 pipeline water volumes increased 68% from 2013. As a percentage of total water volume, pipeline water was 10% in 2013 and was 17% of total water volume in 2014. We will continue to focus on these pipeline opportunities.

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Leverage customer relationships in both of our business segments. We intend to pursue new strategic development opportunities with oil and natural gas producing customers that increase the utilization of our assets and lead to cross-selling opportunities between our two business segments. Many customers of W&ES also own gathering systems, storage facilities, gas plants, compression stations, and other pipeline assets to which we can offer pipeline inspection and integrity services. In North Dakota, new inspection rules have been proposed in the legislature that may benefit PI&IS. In addition, we intend to enhance our relationships with our customers in PI&IS by broadening the services we provide, including expanding our ultrasonic nondestructive examination services and potentially offering hydro testing and nitrogen services. By cross-selling our service offerings and adding complementary service offerings, we believe that we can further integrate into our customers' operations and increase our profitability and distributable cash flow.

Pursue strategic, accretive acquisitions. We intend to pursue accretive acquisitions that will complement both W&ES and PI&IS. Both of our business segments operate in industries that are fragmented, giving us the opportunity to make strategic and accretive acquisitions. We exercised important discipline in 2014 and avoided overpaying for acquisitions. We remain optimistic that some good opportunities will present themselves in the 2nd half of 2015. We plan to expand W&ES by seeking water and solid acquisition opportunities in existing and additional high-growth resource plays throughout the U.S. that will diversify our customer base with a particular focus on pipeline opportunities directly with E&P customers, like our December 2014 SWD facility acquisition. In addition, provided certain opportunities fit with our strategic plan of expanding our business, we intend to grow PI&IS by acquiring other strategic pipeline service companies that will allow us to broaden the suite of services we offer our existing customers. In addition, we expanded our PI&IS ownership in February 2015 by acquiring the remaining 49.9% of the TIR Entities not previously owned by the Partnership.

Our Business Segments

Our business is operated in two segments: (1) Water and Environmental Services ("W&ES") and (2) Pipeline Inspection and Integrity Services ("PI&IS"). Our IRS private letter ruling ("PLR") also includes other lines of business. Our long term goal continues to be focused on diversifying the Partnership into other attractive lines of business including but not limited to traditional midstream activities, production chemicals, remote monitoring of energy infrastructure, etc. in addition to the continued build out of our segments.

W&ES Segment

Overview. Through W&ES, which specializes in water and environmental services, we own and operate ten SWD facilities, eight of which are in the Bakken Shale region of the Williston Basin in North Dakota and two of which are in the Permian Basin in west Texas. One of the North Dakota facilities was acquired effective December 1, 2014 and is connected to a pipeline with a large public E&P company's production. In addition to owning and operating the ten SWD facilities, we manage three other SWD facilities that we also built for third parties in the Bakken Shale region through CES LLC, one of which is 25% owned. W&ES is comprised of the operations of CEP LLC and its Predecessor.

Operations. W&ES currently generates revenue by providing the following services:

· Flowback water management. We dispose of flowback water produced from hydraulic fracturing operations during the completion of oil and natural gas wells. Fracturing fluids, including a significant amount of water, are originally injected into the well during the completion process and are partially recovered as flowback water. When it is removed, this flowback water contains salt, chemicals and residual oil. The drilling and completion phase typically occurs during the first 30 to 90 days following commencement of production of the life of a well. The oil and natural gas producer typically either transports the flowback water to one of our SWD facilities by truck or contracts with a

trucking company for transport. Once the water is received at the SWD facility, we treat the water through a combination of separation tanks, gun barrels and chemical processes, store as necessary prior to injection and then inject into the SWD well at depths of at least 4,000 feet. Like produced water, we assess the composition of flowback water in our facilities so that we can maximize oil separation and treat the water to maximize the life of our equipment and the wellbore. We believe our approach to scientifically and methodically filtering and treating the flowback water prior to injecting it into our wells helps extend the life of our wells and furthers our reputation as an environmentally conscious service provider.

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Produced water management. We dispose of naturally occurring water that is extracted during the oil and natural gas production process. This produced water is generated during the entire lifecycle of each oil and natural gas well. While the level of hydrocarbon production declines over the life of a well, the amount of saltwater produced may decline more slowly or in some cases, may even increase over time. The oil and natural gas producer separates the produced water from the production stream and either transports it to one of our SWD facilities by truck or pipeline or contracts with a trucking company to transport it to one of our SWD facilities. Once we receive the water at one of our SWD facilities, we filter and treat the water and then inject it into the SWD well at depths of at least 4,000 feet. We also maintain the ability to store saltwater pending injection. All of our existing facilities were constructed using completion techniques consistent with current industry practices. We periodically sample, test and assess produced water to determine its chemistry so that we can properly treat the water with the appropriate chemicals that maximize oil separation and the life of the well.

Byproduct sales. Before we inject flowback and/or produced water into an SWD well, we separate the residual oil from the saltwater stream. We then store the residual oil in our tanks and sell it to third-parties.

Management of existing SWD facilities. In addition to the SWD facilities we own or lease, we own a 51.0% interest in CES LLC, a management and development company that manages three additional SWD facilities in North Dakota. Our responsibilities in managing an SWD facility typically include operations, billing, collections, insurance, maintenance, repairs and, in some cases, sales and marketing. We are compensated for management of these facilities generally based on the gross revenue of the facilities.

The majority of our disposed saltwater volumes are derived from produced water that is generated throughout the life of the oil or natural gas well. For the years ended December 31, 2014 and 2013, produced water represented approximately 82% and 75%, respectively, of our total barrels of disposed water. This differentiates us from many competitors that focus on flowback and the associated skim oil revenue. As a region matures and the predominant activity shifts from drilling and completion of wells to production, our facilities continue to experience demand for ongoing processing of waste produced over the life of the wells.

Each of our SWD facilities are open 365 days per year. Our locations in North Dakota currently include onsite offices and sleeping quarters for our employees while they are on call. In Texas, we have an office and housing for management at our Pecos, Texas facility. We supplement our operations with various automated technologies to improve their efficiency and safety. We have installed 24-hour digital video monitoring and recording systems at each facility. These systems allow us to track operations and unloading as well as identifying the identity of customers at our facilities. We believe that our commitment to operating our facilities with sophisticated technology and automation contributes to our enhanced operating margins and provides our customers with increased safety and regulatory compliance. In the future, we anticipate that some of our SWD facilities will be run through technological automation with off-site monitoring and control. Our facilities have been inspected and approved by several of our public E&P companies that have stringent approval standards and field audits performed by their EHS groups.

The amount of saltwater disposed in our SWD facilities decreased slightly from 19.7 million barrels for the year ended December 31, 2013 to 19.1 million barrels for the year ended December 31, 2014, a decline of approximately 3% driven primarily by increased competition. Numerous new facilities opened during 2014 that compete for business with our locations.

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As of December 31, 2014, we had an aggregate of approximately 115,000 barrels of maximum daily disposal capacity in the following SWD facilities, all of which were built using completion techniques consistent with current industry practices and utilizing well depths of at least 5,000 feet with injection intervals beginning at least 4,000 feet beneath the surface. Our permitted capacity is much higher.

Location	County	In-service Date	Leased or Owned (3)
Tioga, ND	Williams	June 2011	Owned
Manning, ND	Dunn	Dec. 2011	Owned
Grassy Butte, ND	McKenzie	May 2012	Leased
New Town, ND (1)	Mountrail	June 2012	Leased
Pecos, TX (1)	Reeves	July 2012	Owned
Williston, ND	Williams	Aug. 2012	Owned
Stanley, ND			