

New Mexico Energy, Minerals and Natural Resources Department

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July 12, 2010

Mr. Gene Lee
Yeso Energy Inc.
P.O. Box 2248
Roswell, NM 88202-02248

Certified Mail No.: 7008 3230 0000 2318 8465

Re: Yeso Energy Inc., OGRID 221710
Letter of July 7, 2010

Dear Mr. Lee,

I am writing in response to your letter of July 7, 2010, in which you raise a number of concerns about the conduct of the Oil Conservation Division (OCD) in its compliance actions related to Yeso Energy Inc. (Yeso).

The Plugging of the Connie #3 and the Connie #4

Your letter claims that the OCD plugged two of Yeso's wells, the Connie #3 and the Connie #4, without authority. According to your letter, the wells were plugged pursuant to hearing order R-12930-B, which provided that the state could plug all of Yeso's wells if the wells were not transferred to another, unaffiliated operator prior to March 15, 2010. You complain that the plugging took place prior to the March 15, 2010 date provided in R-12930-B.

The Connie #3 and Connie #4 wells were plugged pursuant to an earlier order, R-12801. This order was issued on August 20, 2007. The order covered 6 wells, including the Connie #3 and the Connie #4. It required Yeso to return them to compliance within 30 days from the date of the issuance of the order, or the OCD would have authority to plug and abandon the wells. Yeso did not return the wells to

compliance. According to OCD records, these wells have been inactive since the late 1980's.

In early 2010, the OCD plugged the wells pursuant to the authority of R-12801. The cost of plugging and abandoning the wells was \$66,879.45. After deducting the amount of the two single-well financial assurances posted for those wells, the cost to the OCD is \$49,860.45. By statute, Yeso is responsible for reimbursing the OCD for its plugging costs, less the amount of the forfeited financial assurance. NMSA 12978, Section 70-2-22(E). Enclosed is a bill for \$49,860.45.

Since the March 15, 2010 date set in Order R-12930-B, the OCD has plugged other Yeso wells, and additional wells are under contract to be plugged. You can expect to receive additional invoices in the future.

Case 14294 and the Issuance of Order R-12930-A and Order R-12930-B.

In your letter you complain that you were denied a continuance of the second hearing in Case 14294 (the August 20, 2009 hearing). I can find no record of a request for a continuance of that hearing. I also can find no record of a request to re-open the case, or any other action or complaint by you regarding the hearing in that case.

I would like to provide some background information.

The first hearing in Case 14294 was conducted on March 31, 2009. The OCD's application sought a plugging order based on Yeso's failure to comply with production reporting requirements, financial assurance requirements and the inactive well rule. On the morning of the hearing, Yeso attempted to file production reports (incorrectly) and post financial assurances. However, Yeso did not appear for the hearing. Because Yeso had made some attempt to come into compliance, the OCD modified its request to the hearing examiner. Instead of asking for a plugging order (which it could still have done, based on Yeso's past non-compliance and Yeso's continued non-compliance with the inactive well rule), the OCD asked the hearing examiner to continue the case and give Yeso additional time to come into compliance. Order R-12930-A was issued on June 17, 2009. It provided that Yeso should appear on August 20, 2009 – or a date agreed upon by the OCD – and show that it had returned to compliance. If Yeso remained out of compliance, an order would be issued giving Yeso an additional six months to come into compliance or the wells would be plugged.

The OCD received no contact from Yeso asking for a different hearing date. As the August 20, 2009 date approached, the OCD sent a pre-hearing statement to Yeso to remind them of the hearing. Still, we received no response. According to OCD records, Yeso had taken no actions to come into compliance since the original hearing. Order R-12930-B, issued after the August 20 hearing, gave Yeso until March 15, 2010 to plug and abandon each well, "or transfer them to another, unaffiliated operator approved by the Division, on or before March 15, 2010. If Yeso fails to comply, the Division should be authorized to plug the subject wells and restore the wells sites, and all applicable financial assurance should be forfeited."

In summary, Yeso was given almost a year from the first hearing date to bring the wells into compliance. Even though Yeso didn't show up for the first hearing, the OCD voluntarily asked the hearing examiner to give Yeso additional time to come into compliance. And even though Yeso didn't show up for the second hearing, the resulting order gave Yeso an additional 7 months from the date of that hearing to come into compliance. During all this additional time, Yeso took no action to return the wells to compliance. In anticipation of the March 15, 2010 deadline, the OCD began the paperwork necessary for the state to plug the wells. However, no plugging was done by the OCD pursuant to Order R-12930-B until after the March 15, 2010 date.

Operator Transfer Requests

Your letter suggests that the OCD has prevented the transfer of Yeso wells to other operators. The OCD has received only one operator change request regarding the Yeso wells since the issuance of Order R-12930-B. The request was for the transfer of all Yeso wells to "Chica Energy LLC" (Chica). As explained below, the OCD expressed its intent to reject this request because it believes Chica is affiliated with Yeso, and Chica then asked the OCD to reject the request so that Chica could submit an amended application. Its amended application remains in "draft" status and has not been submitted to the OCD for approval.

Please remember that Order R-12930-B states that the well transfer must be to "an unaffiliated operator approved by the division." In addition, by rule, whenever an operator seeks to become operator of record of wells subject to a compliance order regarding inactive wells, the OCD can require the new operator to enter into an agreed compliance order setting a schedule for returning the wells to compliance.
19.15.9.9:C(2) NMAC.

The OCD had evidence that Julie Hodges, Managing Member of Chica Energy LLC, is the daughter of Gene Lee, the president/director of Yeso. The OCD alerted Ms. Hodges to its concern that Chica Energy LLC was affiliated with Yeso – she did not provide any information to counter the OCD's concern that the two entities were affiliated; eventually she acknowledged that she was Mr. Lee's daughter. When the OCD indicated it intended to deny the transfer, Ms. Hodges cancelled the financial assurances she had posted and asked the OCD's financial assurance administrator to reject the transfer. Ms. Hodges stated that she intended to request that she become operator of record for only the federal wells operated by Yeso. (New Mexico does not require financial assurances for federal wells.) OCD's records currently show an operator change form in "draft" status, to transfer Yeso's federal wells to Chica. Because the form remains in draft status, it has not been presented to the OCD for approval or rejection.

The other pending matter related to an operator change for a Yeso well is Case 14472. COG Operating, LLC (COG) applied for an order cancelling Yeso's authority as to the Dow "B" 28 Federal Well No. 1, apparently so that COG can apply to become operator of record for the well. The OCD appeared in the matter, and indicated that it did not oppose COG becoming operator of record, if COG entered into an agreed compliance order. The case was heard on May 13, 2010. The OCD has suspended plugging operations while we wait for an order to be issued in the case.

I hope my response addresses the concerns you raised in your July 7, 2010 letter. Please send a check in the amount of \$49,860.45 to my attention to reimburse the OCD for the costs it has incurred in plugging the Connie C State #3 and Connie C State #4 wells. The OCD will send additional invoices as it incurs additional costs related to the plugging and abandonment of the Yeso wells.

Sincerely,



Daniel Sanchez,
Compliance and Enforcement Manager
Oil Conservation Division

Ec, w/o attachments:

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