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November 7, 2006

VIA OVERNIGHT MAIL

Florene Davidson
Hearing Clerk
EMNRD
Oil Conservation District
1220 So. St. Francis Drive
Santa Fe, NM 87505

Re: *Amended Application of DKD, LLC for an Order Revoking the Injection Authority for the Gandy Corporation State "T" Well No. 2, Lea County, New Mexico*
Case No. 13686

Dear Ms. Davidson:

Enclosed please find enclosed the originals and requisite copies of the following documents:

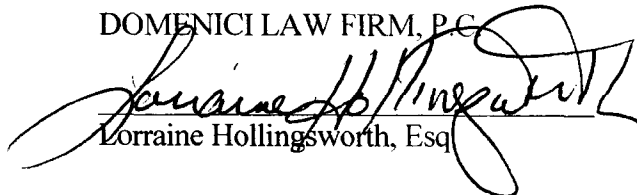
1. Application for De Novo Hearing Before the Oil Conservation Commission
2. Request for Stay of Division Order R-12649

Please return endorsed copies to our office in the enclosed stamped envelope.

Thank you for your courtesies in this matter.

Sincerely,

DOMENICI LAW FIRM, P.C.



Lorraine Hollingsworth, Esq.

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION

AMENDED APPLICATION OF DKD, LLC
FOR AN ORDER REVOKING THE INJECTION
AUTHORITY FOR THE GANDY CORPORATION
STATE "T" WELL NUMBER 2, LEA COUNTY, NEW MEXICO

CASE NO. 13686

APPLICATION FOR DE NOVO HEARING
BEFORE THE OIL CONSERVATION COMMISSION

COMES NOW Gandy Corporation ("Gandy"), by and through undersigned counsel of record, and pursuant to NMSA 1978, §70-2-13 and 19.15.14.1221 NMAC, requests a de novo hearing before the Oil Conservation Commission ("the Commission") on DKD, LLC's Amended Application requesting an Order revoking Gandy's injection authority for State "T" Well No. 2, Lea County, New Mexico. In support of the application, Gandy states as follows:

1. Gandy Corporation is the owner and operator of record of a commercial salt water disposal well, the State "T" Well No. 2 (API No. 30-025003735), located 4,290' FSL and 500' FWL, Section 6, Township 16 South, Range 36 East NMPM, in Lea County, New Mexico. The well was authorized by the Oil Conservation Division ("OCD"), pursuant to Order R-12171, dated July 9, 2004, to inject produced water between the depths of 4,810 to 6,880 feet. Gandy currently operates its State "T" Well No. 2 under the authority of Division Order No. IPI-264, dated December 19, 2005, which authorizes Gandy to increase the surface injection pressure on the well to a maximum injection pressure of 1,930 PSIG.

2. DKD operates a commercial salt water disposal well, the Watson 6 Well No 1 (API No. 30-025-34197), located 2,857' FSL and 1,417' FWL, Section 6, Township 16 South,

Range 36 East, NMPM, in Lea County, New Mexico. DKD operates its injection well under SWD-834. The well is authorized to inject produced water between the depths of 10,340 to 11,062 feet.

3. DKD is the owner of the Snyder "A" No. 1 Well (API No. 30-025-03727), located 2,319' FSL and 330' FWL, Section 6, Township 16 South, Range 36 East, NMPM, in Lea County, New Mexico. The well was initially drilled to 10,719 feet with a perforation interval at 10,652' to 10,692', and in 1960 was perforated from 10,571' to 10,582' and 10,614' to 10,649'. The last production of the Snyder "A" No. 1 Well was 32 barrels of oil between January and July 1997. In December 2002, Energen, the former owner of the well, reported to OCD the well would not blow down. In December 2005, DKD asked OCD for an extension to plug and abandon the well, and was granted an extension until June 15, 2006. The well has not been plugged and abandoned.

4. The State "T" Well No. 2 and the Watson 6 Well No. 1 are less than 2,000 feet apart. The Snyder "A" No. 1 Well is located approximately 2,000 feet from Gandy's State "T" Well No. 2, and approximately 1,500 feet from DKD's Watson 6 Well No. 1.

5. DKD filed an application requesting that OCD immediately and permanently revoke Gandy's authority to utilize the State "T" Well No. 2 for the injection of produced water for disposal purposes and require Gandy to reduce pressures in the injection formation, to plug and abandon the State "T" Well No. 2, and to repair or plug any wells determined to have been damaged by Gandy's operations.

6. In its Application, DKD asserted that it began to record consistently increasing pressure readings on its Snyder "A" No. 1 Well following Gandy's resumption of injection operations in July 2004. DKD alleged that increased pressure readings were due directly to

Gandy's operations, and alleged that Gandy's State "T" Well has a defective casing program or faulty cemented or corroded casing. DKD alleged that Gandy's operation of its State "T" Well No. 2 have resulted in violations of several statutes, have caused the plugging and abandonment of wells that were otherwise capable of producing hydrocarbons (thereby causing waste), and that there is a likelihood that Gandy's continued injection operations will cause the damage or loss of additional producing wells in the area. Gandy denied all of these allegations.

7. No other parties intervened in the case, and no other parties operating in the vicinity of Gandy's State "T" Well No. 2 and DKD's Watson 6 Well No 1 have alleged any harm to their oil and gas operations. The OCD determined in Order R-12171, that within the ½ mile area of review, there has not been production from above 10,500 feet subsurface, and that the evidence in that case (which concerned the same wells) indicated that there is likely a very small amount of moveable oil in the upper San Andres within the area.

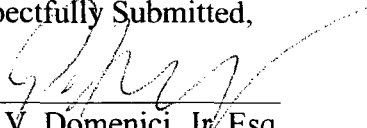
8. A hearing was held before Hearing Examiner William V. Jones on April 27, 2006 at Santa Fe, New Mexico. DKD appeared through counsel and presented testimony and evidence in support of the Application. Gandy appeared through counsel and presented testimony and evidence in opposition to DKD's Application.

9. The OCD issued Order No. R-12649 on October 24, 2006, revoking, within 30 days of the Order, Gandy's permit to inject and ordering Gandy to cease injection into its State "T" Well No. 2. Order No. R-12649 is attached hereto as Exhibit A.

10. Gandy is a party of record whom Order No. R-12649 adversely affects and, pursuant to 19.15.14.1221 NMAC, Gandy has the right to have the matter heard de novo before the Commission.

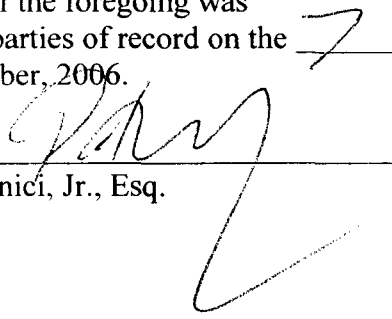
WHEREFORE, GMI requests a de novo hearing before the Commission on the Amended Application of DKD, LLC for an Order Revoking the Injection Authority for the Gandy Corporation State "T" Well Number 2, Lea County, New Mexico and requests that the matter be set for hearing before the Commission.

Respectfully Submitted,



Pete V. Domenici, Jr. Esq.
Attorney for Gandy Corporation
320 Gold Ave. SW Suite 1000
Albuquerque, NM 87102
(505) 883-6250

I hereby certify that a true and correct copy of the foregoing was served on all parties of record on the day of November, 2006.



Pete V. Domenici, Jr., Esq.

**STATE OF NEW MEXICO
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION**

**IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
DIVISION FOR THE PURPOSE OF
CONSIDERING:**

**CASE NO. 13686
ORDER NO. R-12649**

**AMENDED APPLICATION OF DKD, LLC FOR AN ORDER REVOKING THE
INJECTION AUTHORITY FOR THE GANDY CORPORATION STATE T
WELL NUMBER 2, LEA COUNTY, NEW MEXICO:**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on April 27, 2006, at Santa Fe, New Mexico, before Examiner William V. Jones.

NOW, on this 24th day of October, 2006, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

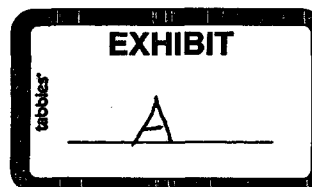
FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, DKD, LLC ("DKD"), requests that the Division immediately and permanently revoke the authority of Gandy Corporation ("Gandy") to utilize its State "T" Well No. 2 for the injection of produced water for disposal purposes. In addition DKD requests the Division require Gandy to reduce pressures in the injection formation, to plug and abandon the State "T" Well No. 2, and to repair or plug any wells determined to have been damaged by Gandy's operations.

(3) In its application, DKD states that Gandy has failed to obey many of the Division's ordering paragraphs within its current permit to inject. In part DKD states that:

(a) Gandy has failed to conduct injection operations to ensure injected fluids remain in the authorized injection intervals within the State "T" Well No. 2 and in surrounding wells;



(e) During August of 2003, the well was plugged back from the original perforations with permanent plugs set at 10,288 feet and 7722 feet, holes in the casing at 7650 feet and 4800 feet were squeezed with cement, the casing was perforated at 4320 feet and 500 sacks of cement was circulated into the 8-5/8 and 5-1/2 inch annulus. The well was then perforated from 4810 feet to 6880 feet, plastic coated tubing installed, and injection begun. Since these depths were not permitted for injection, the Division Director issued an Emergency Order shutting the well in on May 3, 2004.

(f) Gandy subsequently applied to the Division on May 11, 2004 to utilize this well for saltwater disposal through a perforated interval from 4810 to 6880 feet. DKD, as an offsetting operator of record within the NW/4 of Section 6, Township 16 South, Range 36 East, NMPM, filed a letter of objection to the application and the application to inject was set to hearing.

(g) Division Order No R-12171 issued in Case No. 13293 on July 9, 2004, gave Gandy permission to utilize this well to dispose of produced water into the San Andres and Glorieta formations from depths of 4810 feet to 6880 feet. This order contains requirements such as limiting the maximum surface injection pressure to 962 psi and retained jurisdiction for further orders as necessary for the prevention of waste, the protection of correlative rights, and the protection of fresh water.

(h) During July of 2004, an injection survey run on this well showed 23 percent of the injected fluid entering the San Andres between 4810 and 4850 feet and a small amount leaving the wellbore at 5300 feet. The majority of injected fluid was leaving the wellbore between 6210 feet and 6360 feet.

(i) During 2005, this well began pressuring up and Gandy conducted a step-rate test to establish a higher surface injection pressure limit. On December 19, 2005, the Division issued Order IPI-264 authorizing Gandy to increase the maximum surface injection pressure on the State "T" Well No. 2 from 962 psi to 1930 psi.

(5) DKD and Gandy presented testimony and exhibits at the hearing. No other parties entered an appearance in this case or supplied letters of support or opposition.

(6) As the applicant, DKD presented two witnesses who testified as follows.

(a) The State "T" Well No. 2 reached "fill-up" or finally experienced pressure in August of 2004 after injecting approximately 560,000 barrels of water. Using reservoir parameters obtained from the injection survey and the electric log on the Watson "6" Well No. 1, it is apparent that the effective porosity is very low

is concerned that high-pressure saltwater injection into the San Andres and Glorieta by Gandy will eventually corrode the casing and someday cause the casing to collapse.

(7) In its defense, Gandy presented two witnesses who testified as follows.

(a) This San Andres reservoir does have adequate porosity and thickness and is adequate for use for water injection.

(b) The San Andres has not had fluids removed from the reservoir and therefore "fill-up" calculations as used in waterflooding are not valid. Pressure will build while injecting into this type of reservoir until equilibrium is reached. It is normal for wells such as Gandy's to eventually need higher maximum allowable surface pressure limits. After the Division allowed a higher maximum pressure, more horsepower was added to the injection pump.

(c) Some of the pressure increases or spikes for the State "T" Well No. 2 are due to near wellbore effects. This is a commercial injection operation equipped with a filter system. Some trucks have unfortunately dumped damaging materials into this well and overloaded the filtration system. To remedy the situation, the well was back-flowed by approximately 3000 barrels and was cleaned out and re-perforated. Despite these efforts, the well has less injection capacity than before.

(d) The State "T" Well No. 2 has not caused waste of oil and gas resources or affected correlative rights. It is true that it appears that offset wells could have seen pressure resulting from injection water into the State "T" Well No. 2. However, casing corrosion and leaks in the San Andres have happened in this area for years prior to this well being allowed to inject and the Wolfcamp oil interval has long been depleted and wells have been inactive for years.

(e) The two Energen wells have now been plugged and abandoned and are no longer an issue. The only other well in the ½ mile area of review is DKD's Snyder "A" Well No. 1. This well is depleted in the Wolfcamp and has been inactive for some time and should be plugged and abandoned.

(f) No fresh waters are in danger from operation of this well.

(8) The following are details for the three affected wells and for the Watson, "6" Well No. 1.

(a) The Snyder "A" Well No. 1 (API No. 30-025-03727) operated by DKD is located 2319 feet from the South line and 330 feet from the West line (Lot 17) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico. It is located 1978 feet from the State "T" Well No. 2.

(c) The Snyder "A" Com Well No. 1 (API No. 30-025-34073) operated by Energen Resources Corporation ("Energen") is located 990 feet from the South line and 874 feet from the West line (Lot 18) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico. It is located 3321 feet from the State "T" Well No. 2.

(i) The Snyder "A" Com Well No. 1 was drilled in 1998, with 13-3/8 inch casing set at 398 feet and cemented with 440 sacks of cement (circulated), intermediate 8-5/8 inch casing set at 4762 feet and circulated with cement, and 5-1/2 inch set at 11,745 feet and cemented with 650 sacks of cement (top of cement by cement bond log at 8832 feet). The well was completed in the Strawn in the NE Shoe Bar-Strawn Pool as a marginal producer.

(ii) In May of 2005, the well had a casing leak and flowed water out of the tubing and casing with 630 psi shut in tubing pressure. The well's casing collapsed at 8786 feet and was ultimately plugged and abandoned in December of 2005.

(d) The Watson "6" Well No. 1 (API No. 30-025-34197) is located 2857 feet from the South line and 1417 feet from the West line (Lot 14) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico.

(i) The well was drilled in 1997 by Chesapeake Operating Inc. as a Strawn oil test. The Strawn was dry and was isolated with a permanent plug and the well was recompleted in February of 1998 into the Cisco, Townsend, and Penn Lime members of the Upper Pennsylvanian within the Townsend-Permo Upper Penn Pool. By January of 1999, these perforations were declared un-economic and were shut-in.

(ii) DKD became operator of the well and on April 26, 2002, the well was permitted by administrative order SWD-834 as an upper Pennsylvanian formation (Cisco, Townsend, and Penn Lime) injection well within the existing open perforations located from 10,340 feet to 11,062 feet. The well began injection in June of 2002 without the need for an injection pump and has always injected on a vacuum into the permitted interval through 2-7/8 inch plastic coated tubing. The annulus remains full of water treated with corrosion inhibitor and the well passes all mechanical integrity tests.

(iii) This well was cemented with 1720 sacks of cement, with a cement diverter stage tool at 8150 feet. The first (lower) stage of cement circulated and the second (upper) stage covered the Glorieta and San Andres formations with cement.

(13) This hearing brings up the question of whether waste of oil and gas occurs through saltwater disposal into largely depleted oil reservoirs. Many saltwater disposal wells are permitted into depleted oil reservoirs, but commonly only into known waterflood candidates such as the San Andres. It is known that primary recovery of oil from reservoirs under drive mechanisms other than natural water-drive is only a small percentage of the original oil in place. So the majority of oil is still present in these reservoirs after all attempts to flow or pump the wells are exhausted. These reservoirs may again be productive under the right product prices or operating costs or after using existing or future secondary or tertiary recovery technologies. In any case, until proven otherwise, they must be assumed to be a resource of the state and should be protected. It is sometimes the practice of the Division to get an opinion from a reservoir engineer prior to allowing injection into older oil reservoirs.

(14) At this hearing there were conflicting engineering opinions as to the value of remaining Wolfcamp oil in this reservoir and conflicting opinions as to whether this oil is being affected adversely by injection into the State "T" Well No. 2. There were no reservoir engineering studies presented at the hearing as to the volume of primary or secondary reserves, which currently exist for this Townsend-Permo Upper Penn Pool. Product prices are dramatically higher now than when most wells became inactive and when the Watson "6" Well No. 1 was tested in the Wolfcamp prior to its conversion to injection. There was less than adequate evidence of waste presented at the hearing and even less evidence proving this is not occurring. The long production history indicates this oil reservoir is largely depleted and likely low on pressure and below the bubble point with free gas present in the reservoir.

(15) DKD is the owner of a well which has produced from the Wolfcamp and believes Gandy's injection operations have cut-short its latest production test. The Watson "6" Well No 1 was the first water disposal well in this area of the reservoir and began injection in 2002. In late 2002, Energen had difficulty blowing down the gas in the offsetting Snyder "A" Well No 1. DKD took over the well and spent a reported \$180,000 attempting to pump test this well. DKD was not able to get high volumes of water pumped off and therefore unable to determine if oil and gas could be recovered in this well.

(16) DKD maintains there are active Wolfcamp wells beyond ½ mile from the State "T" Well No. 2 which may be affected and showed evidence that Energen's Snyder "A" Com Well No. 1, located 3321 feet from the State "T" Well No. 2, did experience a water flow from a casing leak although there was no evidence that high mud weights were required to plug the well. It is apparent that the lower San Andres injection interval has thin, high permeability layers that are capable of being a conduit for injection water over long distances.

(17) After reviewing the facts in this case the examiner finds that Gandy's injection well is equipped and cemented properly to isolate injected fluids vertically at the injection well site.

Case No. 13686
Order No. R-12649
Page 11 of 11

IT IS THEREFORE ORDERED THAT:

(1) The permit to inject which was granted in Division Order No R-12171 issued in Case No. 13293 is hereby revoked 30 days after the date of this order. Gandy Corporation ("Gandy") is thereafter ordered to cease injection into its State "T" Well No. 2 (API No. 30-025-03735) located 4,290 feet from the South line and 500 feet from the West line (Lot 12) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico.

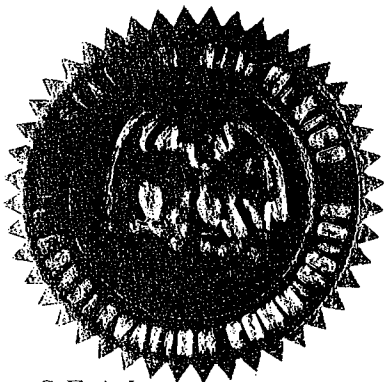
(2) If the injection well is not shut-in as ordered above, Gandy shall be subject to enforcement action including fines of 1,000 dollars per day beginning 30 days from the date of this order.

(3) The operator of the State "T" Well No. 2 may apply for a new permit to inject at an examiner hearing and after notice is provided to all affected parties [as defined in Rule 701.B.2] within 1 mile of this well. In addition, the applicant shall show evidence that all surrounding wells located within 1/2 mile and drilled to deeper horizons are either plugged and abandoned or cemented across the proposed injection interval.

(4) Any new permit to inject into this well shall have a maximum surface injection pressure equivalent to a gradient of 0.2 psi per foot over the top perforation. Relief from this pressure requirement shall be granted only after notice and hearing and after all offset wells, located within 1 mile, are shown to have cement across the injection interval.

(5) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION


MARK E. FESMIRE, P.E.
Director

**STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION**

**AMENDED APPLICATION OF DKD, LLC
FOR AN ORDER REVOKING THE INJECTION
AUTHORITY FOR THE GANDY CORPORATION
STATE "T" WELL NUMBER 2, LEA COUNTY, NEW MEXICO**

CASE NO. 13686

**REQUEST FOR STAY
OF DIVISION ORDER R-12649**

COMES NOW Gandy Corporation ("Gandy"), by and through undersigned counsel of record, and, pursuant to 19.15.14.1221.B NMAC, requests a stay of the Oil Conservation Division ("OCD") Order R-12649 ("the Order"), dated October 24, 2006. The Order was issued following a hearing held April 27, 2006 on DKD's application for an order revoking Gandy's injection authority for State "T" Well No. 2, Lea County, New Mexico. (Exhibit A, Order of the Division, Order No. R-12649, attached hereto). In support of the Request for Stay, GMI states as follows.

FACTUAL BACKGROUND

Gandy Corporation ("Gandy") is the owner and operator of record of a commercial salt water disposal well, the State "T" Well No. 2 (API No. 30-025-03735), located 4,290' FSL and 500' FWL, Section 6, Township 16 South, Range 36 East, NMPM, in Lea County, New Mexico. The well was authorized by OCD, under Order R-12171 dated July 9, 2004, to inject produced water between the depths of 4,810 to 6,880 feet. Gandy currently operates its State "T" Well No. 2 under the authority of Division Order No. IPI-264, dated December 19, 2005. Division Order No. IPI-264 authorized Gandy to increase the surface injection pressure on the well to a maximum surface injection pressure of 1,930 PSIG.

DKD operates a commercial salt water disposal well, the Watson "6" Well No. 1 (API No. 30-025-34197), located 2,857' FSL and 1,417' FWL, Section 6, Township 16 South, Range 36 East, NMPM, in Lea County, New Mexico. DKD operates its injection well under SWD-834. The well is authorized to inject produced water between the depths of 10,340 to 11,062 feet.

DKD is the owner of the Snyder "A" No. 1 Well (API No. 30-025-03727), located 2,319' FSL and 330' FWL, Section 6, Township 16 South, Range 36 East, NMPM, in Lea County, New Mexico. The well was initially drilled to 10,719 feet with a perforation interval at 10,652' to 10,692', and in 1960 was perforated from 10,571' to 10,582' and 10,614' to 10,649'. The last production of the Snyder "A" No. 1 Well was 32 barrels of oil between January and July 1997. In December 2002, Energen, the former owner of the well, reported to OCD the well would not blow down. In December, 2005, DKD asked OCD for an extension to plug and abandon the well, and was granted an extension until June 15, 2006. The well has not been plugged and abandoned.

The State "T" Well No. 2 and the Watson "6" Well No. 1 are less than 2,000 feet apart. The Snyder "A" No. 1 Well is located approximately 2,000 feet from Gandy's State "T" Well No. 2, and approximately 1,500 feet from DKD's Watson 6 Well No 1.

DKD filed an Application with the OCD requesting that the OCD revoke Gandy's authority to inject in State "T" Well No. 2 based on alleged harm to DKD's interests from Gandy's use of the well.

A hearing was held on April 27, 2006 and the OCD issued Order No. R-12649 on October 24, 2006. Pursuant to the Order, Gandy's permit to inject will be revoked within 30 days of the Order and Gandy will have to cease injection into its State "T" Well No. 2. (Exhibit A at 11, ¶1). The Order also states that, if the injection well is not shut-in as ordered, Gandy

"shall be subject to enforcement action, including fines of 1,000 dollars per day beginning 30 days from the date of this order." (*Id.* at ¶2). The Order also allows Gandy to apply for a new permit to inject, upon notice to all affected parties within 1 mile of the well and sets forth certain requirements for a new permit. (*Id.* at ¶3). Gandy filed a timely application for a de novo hearing before the Commission.

ARGUMENT

An Order of the OCD may be stayed pending de novo review before the Commission if the stay is necessary "to prevent gross negative consequences to any affected party."

19.15.14.1221.B. NMAC. A stay of a division order may be issued by the Commission upon a showing of "(1) likelihood that applicant will prevail on the merits of the appeal; (2) a showing of irreparable harm to applicant unless the stay is granted; (3) evidence that no substantial harm will result to other interested persons; and (4) a showing that no harm will ensue to the public interest." *Tenneco Oil Co. v. New Mexico Water Quality Control Commission*, 105 N.M. 708, 710, 735 P.2d 986 (N.M.App. 1986). The granting of a stay is within the discretion of the Commission and depends on the facts and circumstances of the individual case. *Id.* Gandy meets all of the requirements for granting a stay of the Order and a stay will prevent gross negative consequences to Gandy that would result from shutting down the injection well.

A. **Gandy is likely to succeed on the merits at the de novo hearing in this matter.**

In order to obtain a stay, Gandy is required to make a showing of likely or probable success on the merits. *See State ex rel. v. Director of Revenue*, 925 S.W.2d 838 (Mo. 1996)("a petitioner must make some showing of probability of success on the merits"); *Tony L. Merkert v. George H. Ryan, Secretary*, 617 N.E.2d 1373 (Ill.App. 1993)(in requesting a stay, the plaintiff must raise "at least a fair question as to the likelihood of success on the merits"); *Medical Board*

of California v. Superior Court of Sacramento, 278 Cal.Rptr. 247 (Cal.App.Dist.3, 1991)(to receive a stay, a preliminary assessment of the merits of the plaintiff's case is made in order to determine if he is likely to obtain the requested relief); *Beverly Miller Summers v. R.T. Sutton, Commissioner*, 428 So.2d 1121 (La. 1983)(indication of probable success required for stay).

Gandy has requested a de novo hearing before the Commission on DKD's Application and Gandy has a likelihood of success on the merits. As summarized by the Hearing Examiner, DKD has alleged that "Gandy has failed to conduct injection operations to ensure injected fluids remain in the authorized injection intervals within the State "T" Well No. 2 and in surrounding wells; Gandy's injection well has caused waste of hydrocarbon reserves and may cause further waste if allowed to continue injection; and Gandy's injection well has a reasonable likelihood of causing contamination of fresh water." (Exhibit A at 1-2, ¶3). Both the findings in the Order and the evidence that Gandy will present at the de novo hearing demonstrate that Gandy is likely to succeed on the merits.

Gandy is currently operating the State "T" Well No. 2 pursuant to authority from the OCD. The current permit was issued following a hearing before the OCD. After the April 27, 2006 hearing, the Hearing Examiner found that, based on the facts presented, "Gandy's injection well is equipped and cemented properly to isolate injected fluids vertically at the injection well site." (*Id.* at 9, ¶17). At the de novo hearing, Gandy will present evidence that any problems experienced in the San Andres happened in the area for years prior to the well being allowed to inject and are not a result of Gandy's operations of the State "T" Well No. 2. Therefore, Gandy is likely to prevail on DKD's allegations that "Gandy has failed to conduct injection operations to ensure injected fluids remain in the authorized injection intervals within the State "T" Well No. 2 and in surrounding wells."

The Hearing Examiner also found that "[t]here was less than adequate evidence of waste presented at the hearing and even less evidence proving that it is not occurring. The long production history indicates this oil reservoir is largely depleted and likely low on pressure and below the bubble point with free gas present in the reservoir." (*Id.* at 9, ¶14). Gandy will present evidence that State "T" Well has not caused waste of oil and gas resources or affected correlative rights. The Wolfcamp oil interval has long been depleted and the wells have been inactive for many years. Gandy will present evidence that the only well within 1/2 mile area of review for the injection well is DKD's Snyder "A" Well No. 1, which is depleted in the Wolfcamp, has been inactive for some time and should be plugged and abandoned. Gandy is likely to succeed on the merits against DKD's allegations that its use of State "T" Well No. 2 has caused or will cause waste.

DKD operates the Watson "6" Well No. 1, which is an injection well with a cement casing. Order No. R-12649 at 7, ¶8(d). The Order states that "DKD's Watson 6 Well No. 1 is one of the more recent wells drilled in this immediate area and the only well in this area cemented across the San Andreas." (*Id.* at ¶9). The Hearing Examiner specifically found that, because the Watson "6" Well No. 1 is adequately cemented, it is not in immediate danger from Gandy's injection operations. (*Id.* at ¶18). Evidence at the de novo hearing will show that, because the Watson "6" Well No. 1 is adequately cemented, it will not be harmed by Gandy's operations at the State "T" Well No. 2 and Gandy is likely to succeed on the merits on the issue of harm to DKD's injection well. DKD had a full opportunity to present evidence of harm to the Watson "6" Well No. 1 at the hearing in this matter and there is no reason to require Gandy to submit a new permit application with respect to DKD's well.

Gandy is also likely to succeed on the merits of the allegation that its operations could be a danger to fresh water because the Hearing Officer also found that, in the normal course of operations, "Gandy's operations are not a danger to fresh water." (*Id.* at 10, ¶19).

Finally, as further evidence that Gandy is likely to succeed on the merits, the Order allows Gandy to apply for a new permit to inject into the State "T" Well No. 2. (*Id.* at 11, ¶¶3, 4). The OCD's willingness to allow Gandy to file for a new permit indicates that the OCD believes that the well can be used without causing waste, without impact to correlative rights and without impacts to fresh water.

B. Gandy will suffer irreparable harm if the stay is not granted.

If Order No. R-12649 is not stayed, Gandy's authority to inject into State "T" Well No. 2, which was granted after a hearing before the OCD, will be revoked as of November 23, 2006 and Gandy will be forced to cease operations. (Exhibit A at 11, ¶1). Additionally, if Gandy does not cease operations, the Order states that Gandy will be subject to enforcement fines of \$1,000 per day beginning 30 days from the date of the Order, which is November 23, 2006. (*Id.* at 11, ¶2). If these provisions of the Order are not stayed, Gandy will be forced to cease operations, which will cause financial and operational harm and, if Gandy succeeds before the Commission, additional costs will be incurred to re-start operations. Gandy has long-standing commitments for the use of the State "T" Well No. 2 and, if they are forced to cease using the well, Gandy will suffer significant economic harm during the time that the well is not in use. The average monthly cost to Gandy as a result of the disposal well being shut down would be approximately \$47,000.00. (Exhibit B, November 7, 2006 letter from Dale Gandy, attached hereto).

A stay of the Order, on the other hand, will preserve the status quo and avoid "gross negative consequences" to Gandy. Given the fact that Gandy has demonstrated that it is likely to

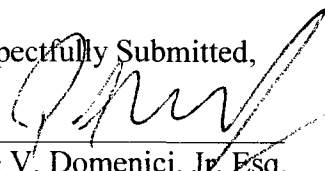
succeed on the merits during the de novo hearing before the Commission, the Order should be stayed pending the outcome of the de novo appeal.

C. There is no potential harm to DKD's interest if a stay is granted.

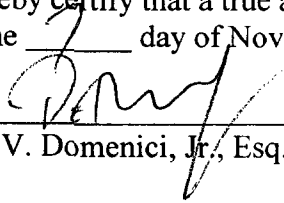
In determining whether to grant a stay, the Commission must balance the potential harm to other interested persons. *See Associated Securities Corp. v. Securities and Exchange Commission*, 283 F.2d 773 (10th Cir. 1960). There is no immediate potential harm to DKD's wells in the vicinity of the State "T" Well No. 2 because the wells have either been plugged and abandoned, are not presently being used or have been adequately cemented. (Exhibit A at 5-8, ¶¶8-10). The Order indicates that the only wells which may be of concern are those that have not been properly cemented. The Hearing Examiner specifically found that, because the Watson "6" Well No. 1 is cemented adequately, it is not in immediate danger from Gandy's injection operations. (*Id.* at ¶18). Therefore, there is little or no potential harm to DKD's interest if a stay is granted.

WHEREFORE, Gandy respectfully requests an Order of the Commission staying Order No. R-12649 and requests an expedited hearing on its request for a stay. A proposed form of Order is attached hereto.

Respectfully Submitted,


Pete V. Domenici, Jr. Esq.
Attorney for Gandy Corporation
320 Gold Ave. SW Suite 1000
Albuquerque, NM 87102
(505) 883-6250

I hereby certify that a true and correct copy of the foregoing was served on all parties of record on the 7 day of November, 2006.


Pete V. Domenici, Jr., Esq.

**STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION**

**AMENDED APPLICATION OF DKD, LLC
FOR AN ORDER REVOKING THE INJECTION
AUTHORITY FOR THE GANDY CORPORATION
STATE "T" WELL NUMBER 2, LEA COUNTY, NEW MEXICO**

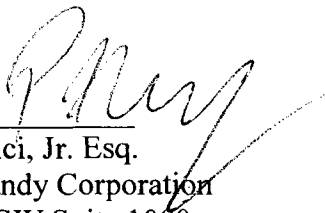
CASE NO. 13686

ORDER GRANTING STAY OF ORDER NO. R-12649

THIS MATTER having come before the Commission on Gandy Corporation's Request for Stay of Division Order R-12649, the Commission having found good cause, it is hereby ORDERED that Division Order R-12649, revoking the permit to inject which was granted in Division Order No. R-12171 issued in Case No. 13293 and ordering Gandy to cease injections into State "T" Well No. 2 (API No. 30-025-03735) is stayed pending completion of the de novo appeal before the Commission in this matter.

Oil Conservation Commission

Submitted by:



Pete V. Domenici, Jr. Esq.
Attorney for Gandy Corporation
320 Gold Ave. SW Suite 1000
Albuquerque, NM 87102
(505) 883-6250

STATE OF NEW MEXICO
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
DIVISION FOR THE PURPOSE OF
CONSIDERING:

CASE NO. 13686
ORDER NO. R-12649

AMENDED APPLICATION OF DKD, LLC FOR AN ORDER REVOKING THE
INJECTION AUTHORITY FOR THE GANDY CORPORATION STATE T
WELL NUMBER 2, LEA COUNTY, NEW MEXICO:

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on April 27, 2006, at Santa Fe, New Mexico, before Examiner William V. Jones.

NOW, on this 24th day of October, 2006, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

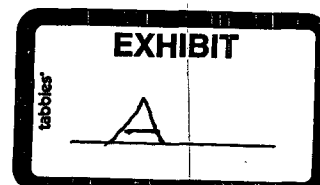
FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, DKD, LLC ("DKD"), requests that the Division immediately and permanently revoke the authority of Gandy Corporation ("Gandy") to utilize its State "T" Well No. 2 for the injection of produced water for disposal purposes. In addition DKD requests the Division require Gandy to reduce pressures in the injection formation, to plug and abandon the State "T" Well No. 2, and to repair or plug any wells determined to have been damaged by Gandy's operations.

(3) In its application, DKD states that Gandy has failed to obey many of the Division's ordering paragraphs within its current permit to inject. In part DKD states that:

(a) Gandy has failed to conduct injection operations to ensure injected fluids remain in the authorized injection intervals within the State "T" Well No. 2 and in surrounding wells;



(e) During August of 2003, the well was plugged back from the original perforations with permanent plugs set at 10,288 feet and 7722 feet, holes in the casing at 7650 feet and 4800 feet were squeezed with cement, the casing was perforated at 4320 feet and 500 sacks of cement was circulated into the 8-5/8 and 5-1/2 inch annulus. The well was then perforated from 4810 feet to 6880 feet, plastic coated tubing installed, and injection begun. Since these depths were not permitted for injection, the Division Director issued an Emergency Order shutting the well in on May 3, 2004.

(f) Gandy subsequently applied to the Division on May 11, 2004 to utilize this well for saltwater disposal through a perforated interval from 4810 to 6880 feet. DKD, as an offsetting operator of record within the NW/4 of Section 6, Township 16 South, Range 36 East, NMPM, filed a letter of objection to the application and the application to inject was set to hearing.

(g) Division Order No R-12171 issued in Case No. 13293 on July 9, 2004, gave Gandy permission to utilize this well to dispose of produced water into the San Andres and Glorieta formations from depths of 4810 feet to 6880 feet. This order contains requirements such as limiting the maximum surface injection pressure to 962 psi and retained jurisdiction for further orders as necessary for the prevention of waste, the protection of correlative rights, and the protection of fresh water.

(h) During July of 2004, an injection survey run on this well showed 23 percent of the injected fluid entering the San Andres between 4810 and 4850 feet and a small amount leaving the wellbore at 5300 feet. The majority of injected fluid was leaving the wellbore between 6210 feet and 6360 feet.

(i) During 2005, this well began pressuring up and Gandy conducted a step-rate test to establish a higher surface injection pressure limit. On December 19, 2005, the Division issued Order IPI-264 authorizing Gandy to increase the maximum surface injection pressure on the State "T" Well No. 2 from 962 psi to 1930 psi.

(5) DKD and Gandy presented testimony and exhibits at the hearing. No other parties entered an appearance in this case or supplied letters of support or opposition.

(6) As the applicant, DKD presented two witnesses who testified as follows.

(a) The State "T" Well No. 2 reached "fill-up" or finally experienced pressure in August of 2004 after injecting approximately 560,000 barrels of water. Using reservoir parameters obtained from the injection survey and the electric log on the Watson "6" Well No. 1, it is apparent that the effective porosity is very low

is concerned that high-pressure saltwater injection into the San Andres and Glorieta by Gandy will eventually corrode the casing and someday cause the casing to collapse.

(7) In its defense, Gandy presented two witnesses who testified as follows.

(a) This San Andres reservoir does have adequate porosity and thickness and is adequate for use for water injection.

(b) The San Andres has not had fluids removed from the reservoir and therefore "fill-up" calculations as used in waterflooding are not valid. Pressure will build while injecting into this type of reservoir until equilibrium is reached. It is normal for wells such as Gandy's to eventually need higher maximum allowable surface pressure limits. After the Division allowed a higher maximum pressure, more horsepower was added to the injection pump.

(c) Some of the pressure increases or spikes for the State "T" Well No. 2 are due to near wellbore effects. This is a commercial injection operation equipped with a filter system. Some trucks have unfortunately dumped damaging materials into this well and overloaded the filtration system. To remedy the situation, the well was back-flowed by approximately 3000 barrels and was cleaned out and re-perforated. Despite these efforts, the well has less injection capacity than before.

(d) The State "T" Well No. 2 has not caused waste of oil and gas resources or affected correlative rights. It is true that it appears that offset wells could have seen pressure resulting from injection water into the State "T" Well No. 2. However, casing corrosion and leaks in the San Andres have happened in this area for years prior to this well being allowed to inject and the Wolfcamp oil interval has long been depleted and wells have been inactive for years.

(e) The two Energen wells have now been plugged and abandoned and are no longer an issue. The only other well in the ½ mile area of review is DKD's Snyder "A" Well No. 1. This well is depleted in the Wolfcamp and has been inactive for some time and should be plugged and abandoned.

(f) No fresh waters are in danger from operation of this well.

(8) The following are details for the three affected wells and for the Watson "6" Well No. 1.

(a) The Snyder "A" Well No. 1 (API No. 30-025-03727) operated by DKD is located 2319 feet from the South line and 330 feet from the West line (Lot 17) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico. It is located 1978 feet from the State "T" Well No. 2.

(c) The Snyder "A" Com Well No. 1 (API No. 30-025-34073) operated by Energen Resources Corporation ("Energen") is located 990 feet from the South line and 874 feet from the West line (Lot 18) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico. It is located 3321 feet from the State "T" Well No. 2.

(i) The Snyder "A" Com Well No. 1 was drilled in 1998, with 13-3/8 inch casing set at 398 feet and cemented with 440 sacks of cement (circulated), intermediate 8-5/8 inch casing set at 4762 feet and circulated with cement, and 5-1/2 inch set at 11,745 feet and cemented with 650 sacks of cement (top of cement by cement bond log at 8832 feet). The well was completed in the Strawn in the NE Shoe Bar-Strawn Pool as a marginal producer.

(ii) In May of 2005, the well had a casing leak and flowed water out of the tubing and casing with 630 psi shut in tubing pressure. The well's casing collapsed at 8786 feet and was ultimately plugged and abandoned in December of 2005.

(d) The Watson "6" Well No. 1 (API No. 30-025-34197) is located 2857 feet from the South line and 1417 feet from the West line (Lot 14) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico.

(i) The well was drilled in 1997 by Chesapeake Operating Inc. as a Strawn oil test. The Strawn was dry and was isolated with a permanent plug and the well was recompleted in February of 1998 into the Cisco, Townsend, and Penn Lime members of the Upper Pennsylvanian within the Townsend-Permo Upper Penn Pool. By January of 1999, these perforations were declared un-economic and were shut-in.

(ii) DKD became operator of the well and on April 26, 2002, the well was permitted by administrative order SWD-834 as an upper Pennsylvanian formation (Cisco, Townsend, and Penn Lime) injection well within the existing open perforations located from 10,340 feet to 11,062 feet. The well began injection in June of 2002 without the need for an injection pump and has always injected on a vacuum into the permitted interval through 2-7/8 inch plastic coated tubing. The annulus remains full of water treated with corrosion inhibitor and the well passes all mechanical integrity tests.

(iii) This well was cemented with 1720 sacks of cement, with a cement diverter stage tool at 8150 feet. The first (lower) stage of cement circulated and the second (upper) stage covered the Glorieta and San Andres formations with cement.

(13) This hearing brings up the question of whether waste of oil and gas occurs through saltwater disposal into largely depleted oil reservoirs. Many saltwater disposal wells are permitted into depleted oil reservoirs, but commonly only into known waterflood candidates such as the San Andres. It is known that primary recovery of oil from reservoirs under drive mechanisms other than natural water-drive is only a small percentage of the original oil in place. So the majority of oil is still present in these reservoirs after all attempts to flow or pump the wells are exhausted. These reservoirs may again be productive under the right product prices or operating costs or after using existing or future secondary or tertiary recovery technologies. In any case, until proven otherwise, they must be assumed to be a resource of the state and should be protected. It is sometimes the practice of the Division to get an opinion from a reservoir engineer prior to allowing injection into older oil reservoirs.

(14) At this hearing there were conflicting engineering opinions as to the value of remaining Wolfcamp oil in this reservoir and conflicting opinions as to whether this oil is being affected adversely by injection into the State "T" Well No. 2. There were no reservoir engineering studies presented at the hearing as to the volume of primary or secondary reserves, which currently exist for this Townsend-Permo Upper Penn Pool. Product prices are dramatically higher now than when most wells became inactive and when the Watson "6" Well No. 1 was tested in the Wolfcamp prior to its conversion to injection. There was less than adequate evidence of waste presented at the hearing and even less evidence proving this is not occurring. The long production history indicates this oil reservoir is largely depleted and likely low on pressure and below the bubble point with free gas present in the reservoir.

(15) DKD is the owner of a well which has produced from the Wolfcamp and believes Gandy's injection operations have cut-short its latest production test. The Watson "6" Well No 1 was the first water disposal well in this area of the reservoir and began injection in 2002. In late 2002, Energen had difficulty blowing down the gas in the offsetting Snyder "A" Well No 1. DKD took over the well and spent a reported \$180,000 attempting to pump test this well. DKD was not able to get high volumes of water pumped off and therefore unable to determine if oil and gas could be recovered in this well.

(16) DKD maintains there are active Wolfcamp wells beyond ½ mile from the State "T" Well No. 2 which may be affected and showed evidence that Energen's Snyder "A" Com Well No. 1, located 3321 feet from the State "T" Well No. 2, did experience a water flow from a casing leak although there was no evidence that high mud weights were required to plug the well. It is apparent that the lower San Andres injection interval has thin, high permeability layers that are capable of being a conduit for injection water over long distances.

(17) After reviewing the facts in this case the examiner finds that Gandy's injection well is equipped and cemented properly to isolate injected fluids vertically at the injection well site.

Case No. 13686
Order No. R-12649
Page 11 of 11

IT IS THEREFORE ORDERED THAT:

(1) The permit to inject which was granted in Division Order No R-12171 issued in Case No. 13293 is hereby revoked 30 days after the date of this order. Gandy Corporation ("Gandy") is thereafter ordered to cease injection into its State "T" Well No. 2 (API No. 30-025-03735) located 4,290 feet from the South line and 500 feet from the West line (Lot 12) of irregular Section 6, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico.

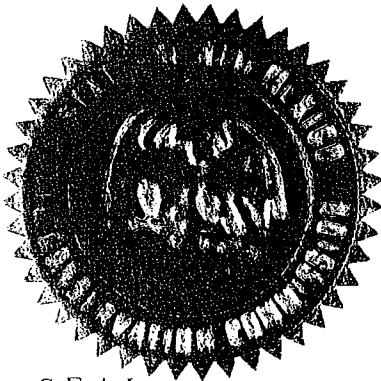
(2) If the injection well is not shut-in as ordered above, Gandy shall be subject to enforcement action including fines of 1,000 dollars per day beginning 30 days from the date of this order.

(3) The operator of the State "T" Well No. 2 may apply for a new permit to inject at an examiner hearing and after notice is provided to all affected parties [as defined in Rule 701.B.2] within 1 mile of this well. In addition, the applicant shall show evidence that all surrounding wells located within 1/2 mile and drilled to deeper horizons are either plugged and abandoned or cemented across the proposed injection interval.

(4) Any new permit to inject into this well shall have a maximum surface injection pressure equivalent to a gradient of 0.2 psi per foot over the top perforation. Relief from this pressure requirement shall be granted only after notice and hearing and after all offset wells, located within 1 mile, are shown to have cement across the injection interval.

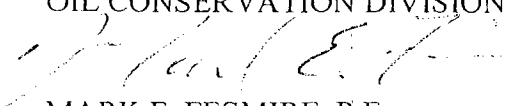
(5) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION


MARK E. FESMIRE, P.E.
Director

**GANDY CORPORATION
OILFIELD SERVICES**

P.O. Box 2140
Lovington, New Mexico 88260
505-396-0522
FAX 396-0797

November 07, 2006

Domenici Law Firm, P.C.
Attn: Loraine Hollingsworth
320 Gold Avenue SW, Suite 1000
Albuquerque, NM 87102

Dear Loraine,

The economic impact on Gandy Corporation, due to the shut down of Gandy's State T SWD. The average disposal for the last two months has run 70,000 bbls with an average disposal rate at other disposal running at \$0.50 would run \$ 35,000.00 per month. Most disposals around Lovington usually fill up around noon everyday, So the extra trucking charge would run around \$12,000.00 per month that we would incur during the month. So the average monthly cost that Gandy Corporation would incur with our disposal being shut down would run about \$47,000.00 per month.

Sincerely Yours;


Dale Gandy

