

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

RECEIVED

JUL 10 2003

Oil Conservation Division

**APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION,
THROUGH THE ENVIRONMENTAL BUREAU CHIEF, FOR AN ORDER
DETERMINING THE RESPONSIBLE PARTY OR PARTIES AND ORDERING
THE RESPONSIBLE PARTY OR PARTIES TO COMPLETE AND PERFORM
AN ABATEMENT PLAN PURSUANT TO OCD RULE 19; LEA COUNTY, NEW
MEXICO**

CASE NO. 13061

CHAPARRAL ENERGY, L.L.C.'S PREHEARING STATEMENT

Pursuant to 19 NMAC § 15.1208.B, Chaparral Energy, L.L.C. ("Chaparral") submits its Prehearing Statement.

I. Parties

1. The New Mexico Oil Conservation Division ("OCD"), through the Environmental Bureau Chief.

The OCD is represented by David K. Brooks, Esq., Assistant General Counsel of the Energy, Minerals and Natural Resources Department.

2. Chaparral Energy, L.L.C.

Chaparral is represented by the undersigned counsel, Gary W. Larson, Esq., of Hinkle, Hensley, Shanor & Martin, L.L.P.

3. Smith & Marrs, Inc.

Smith & Marrs, Inc. ("Smith & Marrs") is represented by Ernest L. Padilla, Esq., of the Padilla Law Firm, P.A.

*WVS
7/14/03*

II. Concise Statement of the Case

This case concerns the responsibility for performing abatement work at the South Langlie Jal Unit ("SLJU") in Lea County, including the completion of the Stage 1 Abatement Plan work requirements and the submission of a report. In his Application for Compliance Order ("the Application"), the OCD's Environmental Bureau Chief requests the Director to enter an order: (1) determining that Chaparral and Smith & Marrs are responsible persons with respect to subsurface chloride contamination within the SLJU; (2) requiring Smith & Marrs and Chaparral, "each, or jointly," to submit a Stage 1 Investigation Report by a date certain; and (3) imposing civil penalties for Smith & Marrs' and Chaparral's failure to comply with Rule 19.C(2) and the Notice of Violation ("NOV") issued to them by the OCD on January 13, 2003.

The following statement of the case sets out: (1) factual background regarding the history of the SLJU, the period of Chaparral's ownership and operation of the unit, Chaparral's sale of the SLJU assets to an affiliate of Smith & Marrs, Inc. ("Smith & Marrs"), and Smith & Marrs' assumption of responsibility for completing the Stage 1 Abatement Plan investigation and any subsequent OCD-required abatement; and (2) Chaparral's position regarding the relief requested in the Application. As set out below, the chloride contamination in the groundwater beneath the SLJU predates the period of Chaparral's ownership and operation of the unit. During that period, Chaparral made consistent, good-faith efforts to comply with the OCD's abatement requirements. Chaparral committed significant resources to upgrade the operating tank battery, to clean up the four abandoned tank batteries, and to remove debris and old equipment left by its predecessors, and it immediately and effectively addressed the three releases that occurred on its watch. Upon the sale of the SLJU to a Smith & Marrs affiliate, Rickey Smith Oil and Gas Company ("Rickey Smith Oil and Gas"),

Smith & Marrs unequivocally assumed the role of designated responsible person for purposes of performing abatement at the SLJU. Consequently, Chaparral reasonably assumed that Smith & Marrs would fulfill its obligations by performing the Stage 1 Abatement Plan work requirements and timely submitting a report to the OCD Environmental Bureau.

Based on these circumstances, it is Chaparral's position that: (1) the Director should deem Smith & Marrs to have primary responsibility for complying with the OCD's abatement requirements for the SLJU; and (2) the imposition of a penalty against Chaparral is neither warranted nor appropriate.

A. Factual Background

1. Brief History of the SLJU

The SLJU is located in Sections 7, 8, 17 and 18, Township 25 South, Range 37 East in Lea County. The unit is situated near the northern boundary of the City of Jal. Since 1922, oil and gas production activities have been conducted in the area that now comprises the SLJU.

In January 1999, the OCD initiated an investigation of potential chloride contamination at the SLJU. That investigation arose because the then-current operator, Bristol Resources Corporation ("Bristol"), had reported a release of produced water from a saltwater injection line south of production well # 9 and just north of saltwater injection well # 13. Apparently, the OCD's investigation also was prompted by the reports of the surface owner, Clay Osborn, that the drinking water well at his residence was contaminated. As stated in the Application, the OCD conducted further investigations of the soil and groundwater at the SLJU through March of 2000. The Application further states that those investigations revealed elevated levels of chlorides and total dissolved solids in the groundwater, and indicated "that there were tank batteries with associated

produced water and petroleum spills, an unlined flare pit and produced water line leaks located hydrologically upgradient from some of these wells."

On August 2, 2000, the OCD required Bristol to submit an abatement plan to investigate and abate contamination of the groundwater underlying the SLJU. Bristol never submitted a Stage 1 Abatement Plan. In addition to reporting to the OCD that his water well was contaminated, Mr. Osborn sued Bristol for property damage. That litigation was stayed when Bristol filed a bankruptcy petition.

2. Chaparral's Purchase of the SLJU

In mid-September of 2000, two related Chaparral entities, Chaparral Oil, L.L.C. and CEI Bristol Acquisition, purchased all of Bristol's New Mexico assets, including the SLJU, through the bankruptcy court. Bristol did not disclose to Chaparral the nature and extent of the groundwater contamination believed to exist at the SLJU, or the abatement requirements that the OCD had previously imposed on Bristol.

3. Chaparral's Efforts to Comply with the OCD's Abatement Regulations

On October 31, 2000, the OCD notified Chaparral that, as the current operator, Chaparral was required to submit an abatement plan to investigate and abate groundwater pollution at the SLJU. Chaparral immediately undertook an investigation of possible chloride contamination at the SLJU, and attempted to marshal pertinent information that had been generated by Bristol and its environmental consultant. But Chaparral's efforts to prepare an appropriate Stage 1 Abatement Plan were hindered and delayed due to its inability to obtain information and documents from Bristol.

In the course of preparing its abatement plan, Chaparral researched the history of the water quality in the area of the SLJU. It learned that elevated chloride levels had been detected as early as

the 1950s, and that there was a possibility that chloride contamination had migrated to the SLJU as a result of releases caused by off-site operators. On March 23, 2001, Chaparral submitted a Stage 1 Abatement Plan to the OCD Environmental Bureau. With the exception of one small release discussed below, all of the potential releases at the SLJU addressed in Chaparral's plan resulted from the operations of Chaparral's predecessors. Subsequently, Chaparral engaged in on-going, good-faith discussions with representatives of the Environmental Bureau to determine the appropriate scope of the work activities to be conducted pursuant to the Stage 1 Abatement Plan. Chaparral submitted an Amended Stage 1 Abatement Plan, which the Environmental Bureau administratively approved on September 7, 2001. Chaparral then provided publication notice, as well as personal notice to approximately 500 property owners, of the proposed plan.

In late October 2001, Mr. Osborn gave Chaparral verbal approval for access to begin the necessary Stage 1 work activities. Subsequently, however, Mr. Osborn changed his mind and rescinded his verbal approval. Also in late October 2001, the Environmental Bureau informed Chaparral that, because of the SLJU's proximity to the City of Jal, the Environmental Bureau had received a number of public comments on Chaparral's amended Stage 1 Abatement Plan.

Based on the numerous public comments, the Environmental Bureau informed Chaparral in January 2002 that it would have to modify its Stage 1 work plan, and two months later requested additional information from Chaparral. Following discussions with the Environmental Bureau about the scope of the Stage 1 investigation activities, Chaparral submitted further revisions to its work plan. Ultimately, the OCD approved Chaparral's Amended Stage 1 Abatement Plan in late April 2002.

Chaparral then scheduled its environmental consultant, Whole Earth Environmental ("Whole Earth"), to commence the Stage 1 investigation work in mid-June of 2002. Before Whole Earth could begin, Chaparral needed to enter into a written access agreement with Mr. Osborn. In early June, Chaparral informed the Environmental Bureau that it had been unable to reach a mutually acceptable agreement with Mr. Osborn. The Environmental Bureau gave Chaparral an extension of time until October 31, 2002, to submit its Stage 1 report.

Chaparral continued its negotiations with Mr. Osborn, albeit unsuccessfully. As consideration for granting access to Chaparral and Whole Earth to perform the Stage 1 work, Mr. Osborn sought "surface damages" for the monitoring wells and soil sampling activities of more than \$5,000 per disturbed acre, or a total amount that would approach \$400,000 over a twenty-year period. (By way of comparison, a February 2000 appraisal valued Mr. Osborn's land at about \$100 an acre). Chaparral continually informed the OCD of the status of its negotiations with Mr. Osborn, and was informed by Environmental Bureau representatives in July of 2002 that the OCD would not compel Mr. Osborn to grant access to Chaparral and Whole Earth. Despite its persistent efforts, Chaparral was unable to strike a mutually acceptable agreement with Mr. Osborn, and it requested a further extension of the deadline for submitting the Stage 1 report. The Environmental Bureau declined Chaparral's request.

4. Chaparral's Remediation and Cleanup Activities

Upon assuming control of the SLJU, Chaparral began to clean up the surface and to upgrade certain equipment. As part of that effort, Chaparral investigated and assessed the tank batteries, unlined flare pit, and produced water lines that are identified in the Application. It cleaned up the surface areas of four abandoned tank batteries, and installed new tanks and lines at the operating tank

battery, at a cost of approximately \$65,000. Chaparral investigated what the Application describes as an unlined flare pit, but determined that it actually was a vent line pit, and found no indication of a hydrocarbon release in the area. Finally, Chaparral cleared away old equipment and debris that had been left by previous operators.

During the 26 months that it operated the SLJU, Chaparral experienced three releases, all of which Chaparral immediately and effectively addressed. The first release occurred on February 13, 2001, as a result of a defective flow line from producing well # 9 to the tank battery. Approximately 7.5 barrels of a mixture of oil and water were leaked. Chaparral timely notified the OCD's Hobbs office of the release, and excavated all of the impacted soil.

The second release occurred on May 19, 2001, when approximately 65 barrels of petroleum leaked from an oil-sales line at the operating tank battery. Chaparral notified the OCD's Hobbs office immediately upon learning of the release. An OCD representative was on site when Chaparral abated and remediated the release.

The last release happened on April 20, 2002. Less than five barrels of emulsion were released from producing well # 17. Chaparral informed the OCD Hobbs office of the release, and remediated the release by excavating and replacing the impacted soil.

5. Chaparral's Sale of the SLJU to Rickey Smith Oil and Gas

In the fall of 2002, Chaparral's management decided to put its SLJU assets up for sale at an auction conducted by the Oil & Gas Asset Clearinghouse in Oklahoma City. On October 30, 2002, Rickey Smith Oil & Gas purchased all of the SLJU assets at the auction. The purchase price was approximately 10% of the fair market value of the assets. Prior to the auction, Chaparral had informed the principal of the buyer (and of Smith & Marrs), Rickey Smith, of the environmental

conditions existing at the SLJU and the Stage 1 abatement requirements previously imposed by the OCD. Chaparral had further informed Mr. Smith that the OCD's Stage 1 work requirements had not been undertaken because of the ongoing difficulties in obtaining access from Mr. Osborn.

Chaparral and Rickey Smith Oil & Gas memorialized the terms of the transaction in an Assignment and Bill of Sale ("Assignment"), which has been filed of record in Lea County. In the Assignment, Rickey Smith Oil & Gas expressly and unequivocally agreed to assume responsibility for implementing all OCD-mandated abatement at the SLJU, including the pending Stage 1 Abatement Plan work requirements.

6. Smith & Marrs Agrees to be the Designated Responsible Person for Conducting Abatement at the SLJU

On November 7, 2002, Chaparral sent a certified letter to Mr. Smith, in accordance with 19 NMAC § 15.1.19c(2), that formally notified Smith & Marrs that the SLJU was subject to an OCD-required Stage 1 Abatement Plan. Enclosed was another letter from Chaparral to Mr. Smith, which stated that Mr. Smith had been aware of the OCD's Stage 1 abatement requirements prior to the auction, and that Smith & Marrs had accepted responsibility for implementing the Stage 1 Abatement Plan. On the same date, Chaparral submitted written notification to the OCD's Director that Chaparral had sold the SLJU to Rickey Smith Oil and Gas, and that the transfer of the ownership, operation and control of the unit would be effective on December 1, 2002.

On November 13, 2002, Mr. Smith, on behalf of Smith & Marrs, wrote to the Director of the OCD and Chaparral to formally notify them that Smith & Marrs agreed to be the designated responsible person, within the meaning of 19 NMAC § 15.1.19c(2), for purposes of assuming responsibility for implementing the Stage 1 Abatement Plan work requirements, and all other actions

required by 19 NMAC § 15.51a, at the SLJU. As asserted in the Application, Smith & Marrs has not conducted any of the Stage 1 Abatement Plan work, despite its assumption of responsibility to perform the work as the designated responsible person, and despite its contractual obligations under the Assignment.

B. Chaparral's Position

It is Chaparral's position that the Director should determine that Smith & Marrs has primary responsibility for implementing the Stage 1 Abatement Plan, and all subsequent abatement, at the SLJU. After purchasing the SLJU assets from Chaparral, Smith & Marrs voluntarily represented to the Director that it agreed to be the designated responsible person for purposes of conducting the Stage 1 Abatement Plan work and all other actions required by 19 NMAC § 15.5.1.19. Under 19 NMAC § 15.1.19(c)(2), a party that agrees to be the designated responsible person "*shall assume the responsibility* to conduct the actions required" by the OCD's abatement regulations. Additionally, under the Assignment, Smith & Marrs is contractually obligated to undertake and perform all necessary actions to complete the Stage 1 Abatement Plan Work, as well as any and all subsequent abatement requirements imposed by the OCD.

Chaparral further asserts that the Director should decline the Environmental Bureau Chief's request that a penalty be imposed against Chaparral. During the 26 months that it owned and operated the SLJU, Chaparral undertook all necessary steps to comply with OCD's abatement regulations. Only six weeks after it purchased the SLJU from Bristol, the OCD notified Chaparral that it should submit a Stage 1 Abatement Plan addressing chloride contamination in the soils and groundwater at the SLJU, which had resulted from releases that occurred *prior* to Chaparral's purchase of the unit. Chaparral made diligent and good-faith efforts to assess possible releases that

might have caused the pre-existing chloride contamination, and to prepare a Stage 1 investigation plan that reasonably addressed those releases. That assessment included research into the history of the regional chloride contamination of the groundwater in the vicinity of the SLJU, and the possibility of off-site, up gradient contamination migrating onto the unit.

In April 2002, the Environmental Bureau gave its final approval of Chaparral's Stage 1 Abatement Plan. Up to that point, the approval process had been delayed for several reasons, including Chaparral's inability to obtain information and documents from Bristol, the ongoing discussions with the Environmental Bureau about the scope of the Stage 1 investigation, and the substantial number of public comments on the plan.

Chaparral then scheduled Whole Earth and a well drilling company to commence the investigation work. They could not begin work, however, because Chaparral was unable to negotiate a mutually acceptable access agreement with Mr. Osborn. Those negotiations revealed that, from Chaparral's perspective, Mr. Osborn was seeking to recover an unreasonable amount (as compared to the fair market value of the land) of "damages" from Chaparral in the form of a surface agreement, in lieu of Mr. Osborn's inability to recovery property damages in his lawsuit against Bristol.

Upon Chaparral's sale of the SLJU assets at auction, Rickey Smith Oil & Gas contractually agreed to assume responsibility for conducting all required Stage 1 abatement work, and Smith & Marrs agreed to be the designated responsible person within the meaning of the OCD's abatement regulations. Accordingly, Chaparral had a reasonable expectation that Smith & Marrs would conduct the Stage 1 Abatement Plan work and timely submit a report.

To the best of its knowledge, Chaparral did not cause any groundwater contamination as a result of its operations at the SLJU. As discussed above, Chaparral successfully abated the three

releases that occurred during the period that it owned and operated the unit, and it committed significant expenditures to upgrade the operating tank battery and to clean up the surface of the unit. In sum, Chaparral had no hand in any contamination of the groundwater underlying the SLJU.

III. Chaparral's Witnesses

1. Robert C. Lang, IV, who is Chaparral's Environmental, Health & Safety Manager. Mr. Lang had responsibility for preparing and submitting Chaparral's Stage 1 Abatement Plan, for interfacing with representatives of the OCD's Environmental Bureau, and for overseeing Chaparral's environmental compliance at the SLJU.

2. Michael Tarpley, who is Chaparral's Joint Venture Coordinator. Mr. Tarpley represented Chaparral in its sale of the SLJU assets.

3. James Miller, who is Chaparral's Operations Manager for New Mexico. Mr. Miller had management responsibility for day-to-day operations at the SLJU.

IV. Chaparral's Case Presentation

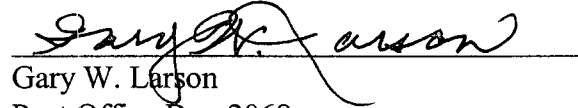
Chaparral anticipates that it will take approximately three (3) hours to present its case.

V. Unresolved Procedural Matters

Chaparral is not aware of any procedural matters that need to be resolved prior to the hearing.

Respectfully submitted,

HINKLE, HENSLEY, SHANOR &
MARTIN, L.L.P.



Gary W. Larson
Post Office Box 2068
Santa Fe, New Mexico 87504-2068
(505) 982-4554

Attorneys for Chaparral Energy, Inc.

CERTIFICATE OF SERVICE

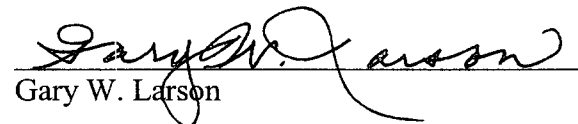
I hereby certify that a true and correct copy of the foregoing Chaparral Energy, L.L.C.'s Pre-Hearing Statement was served via facsimile transmission on the following counsel of record, on this 10th day of July 2003:

David K. Brooks, Esq.
Assistant General Counsel
Energy, Minerals and Natural Resources Department
1220 S. St. Francis Drive
Santa Fe, NM 87505

Attorney for the New Mexico Oil Conservation Division

Ernest L. Padilla, Esq.
Padilla Law Firm, P.A.
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Santa Fe, NM 87504-2523

Attorney for Smith & Marrs, Inc.



Gary W. Larson

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**STATE OF NEW MEXICO
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**APPLICATION OF THE NEW MEXICO OIL CONSERVATION
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ORDER DETERMINING THE RESPONSIBLE PARTY OR PARTIES AND
ORDERING THE RESPONSIBLE PARTY OR PARTIES TO COMPLETE AND
PERFORM AN ABATEMENT PLAN PURSUANT TO OCD RULE 19; LEA
COUNTY, NEW MEXICO**

CASE NO. 13061

PRE-HEARING STATEMENT

This Pre-hearing statement is submitted by Smith and Marrs, Inc., by and through its undersigned counsel, Ernest L. Padilla, Padilla Law Firm, P.A. as required by the Oil Conservation Division.

APPEARANCES OF PARTIES

ATTORNEY

SMITH & MARRS, INC.

Ernest L. Padilla
PADILLA LAW FIRM, P.A.
P.O. Box 2523
Santa Fe, NM 87504
(505) 988-7577

OPPOSITION OR OTHER PARTY

- 1) **NEW MEXICO OIL CONSERVATION
DIVISION**

David K. Brooks
Assistant General Counsel
New Mexico Oil
Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87505

- 2) **CHAPARRAL ENERGY, INC.**

Gary W. Larson
HINKLE, HENSLEY,
SHANOR & MARTIN, LLP
P.O. Box 2068
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(505) 982-8623

29/4/03
LWJ

STATEMENT OF CASE

APPLICATION:

The Division seeks an order determining the responsible parties with respect to subsurface water pollution existing at the South Langlie Jal Unit, in Sections 7, 8, 17 and 18, Township 25 South, Range 37 East, and ordering the responsible parties to submit a Stage I Investigation Report to the Division for approval.

OPPOSITION OR OTHER PARTY:

(1) Smith & Marrs, Inc. is the transferee from Chaparral Energy of the South Langlie Jal Unit. The effective date of the assignment was December 1, 2002. Smith & Marrs, Inc. knew that the Division had been demanding of Chaparral to comply with its environmental regulations by submitting an abatement plan. However, its position with respect to the abatement plan was that by December 1, 2002, Chaparral would have had the abatement plan in place and implemented, including the drilling of monitor wells as required by the Division. After the effective date of the assignment, Smith & Marrs, Inc. would assume compliance of the abatement plan and any further requirements of the Division.

Because of the disagreement and dispute that has arisen by and between Smith & Marrs, Inc. and Chaparral regarding this issue, Smith & Marrs, Inc. has asked for voluntary rescission of the transaction, which Chaparral has refused. Moreover, the assignment instrument has not yet been delivered to Smith & Marrs, Inc., but has apparently been recorded in the records of Lea County by Chaparral. Smith & Marrs, Inc. has complied with bonding requirements of the Division, but has not delivered a copy of the bond to the Oil and Gas Clearinghouse, through which the transaction occurred, until this dispute is resolved.

Furthermore, the Division is not apparently seeking compliance with its environmental regulations from prior operators of the property (other than Chaparral), which likely caused the environmental conditions that the Division now seeks to assess against Smith & Marrs, Inc. The economic reality is that the subject oil and gas property is in a depleted stage with marginal economics.

PROPOSED EVIDENCE

APPLICANT

WITNESSES
(Name and Expertise)

EST. TIME

EXHIBITS

Unknown

OPPOSITION

Smith & Marrs, Inc.:

Smith & Marrs, Inc. does not plan to introduce any exhibits at the hearing other than those submitted by the Division and Chaparral. It is not in possession of any pertinent documents evidencing the transaction, insofar as the December 1, 2002, abatement plan requirements of Chaparral as contended by Smith & Marrs are concerned.

WITNESSES

EST. TIME

EXHIBITS

Rickey Smith

45 min.

None contemplated at this time.

(Mr. Smith is president of Smith & Marrs, Inc.)

Chaparral Energy, Inc.:

WITNESSES

EST. TIME

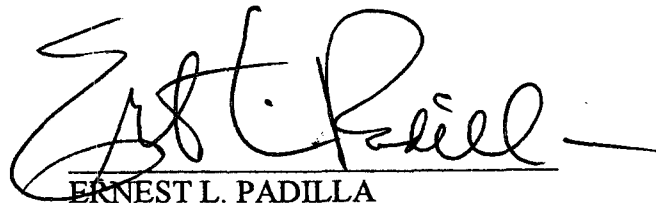
EXHIBITS

Unknown

PROCEDURAL MATTERS

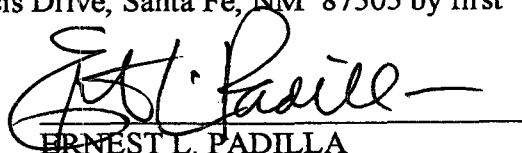
(Please identify any procedural matters which need to be resolved prior to hearing.)

None


ERNEST L. PADILLA

CERTIFICATE OF SERVICE

I hereby certify that I caused a copy of this Pre-Hearing Statement to be served upon Gary Larson, HINKLE, HENSLEY, SHANOR & MARTIN, L.L.P., P.O. Box 2068, Santa Fe, NM 87504-2068 and to David K. Brooks, Assistant General Counsel, NM Oil Conservation Division, 1220 S. St. Francis Drive, Santa Fe, NM 87505 by first class mail this 10th day of July, 2003.


ERNEST L. PADILLA

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

**APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION
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AN ABATEMENT PLAN PURSUANT TO OCD RULE 19; LEA COUNTY, NEW
MEXICO**

CASE NO. 13061

PRE-HEARING STATEMENT

PARTIES AND ATTORNEYS:

Applicant New Mexico Oil Conservation Division
Attorney David K. Brooks

Respondent Chaparral Oil, LLC
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WVJ
7/10/03

STATEMENT OF THE CASE

The OCD required Chaparral Oil, LLC ("Chaparral"), as operator of the South Langlie Jal Unit, to file an abatement plan pursuant to Rule 19 to abate ground water pollution resulting from past operations on the Unit. Chaparral filed a Stage I (investigatory) abatement plan without contesting OCD's determination that it was a responsible party and without reservation of rights. However, Chaparral wholly failed to perform under its abatement plan, and failed to file a report of investigation as and when required.

Chaparral transferred operation of the South Llagie Jal Unit to Smith & Marrs, Inc ("Smith & Marrs"). Smith & Marrs expressly assumed responsibility for the abatement plan, but likewise has wholly failed to perform thereunder, or to file the required reports.

The Division seeks an order requiring Chaparral and Smith & Marrs to perform the Stage I (investigatory) abatement plan, and to file the required report by a date certain, and assessing civil penalties against Chaparral and Smith & Marrs for their failure, heretofore, to perform and to file the required report.

WTINESSES

William C. Olson Hydrologist 1 hour 30 exhibits

PROCEDURAL MATTERS

None

RESPECTFULLY SUBMITTED,



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Resources Department of the State of
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