

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:

ORIGINAL

CASE 15277

APPLICATION OF THE NEW MEXICO OIL  
CONSERVATION DIVISION ("OCD") COMPLIANCE  
And ENFORCEMENT MANAGER FOR A COMPLIANCE  
ORDER AGAINST BLUE SKY NM, INC.,

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

May 14, 2015

Santa Fe, New Mexico

BEFORE: MICHAEL McMILLAN, CHIEF EXAMINER  
ALLISON MARKS, LEGAL EXAMINER

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This matter came on for hearing before the  
New Mexico Oil Conservation Division, Michael McMillan,  
Chief Examiner, and Allison Marks, Legal Examiner, on  
May 14, 2015, at the New Mexico Energy, Minerals, and  
Natural Resources Department, Wendell Chino Building,  
1220 South St. Francis Drive, Porter Hall, Room 102,  
Santa Fe, New Mexico.

REPORTED BY: ELLEN H. ALLANIC  
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## I N D E X

CASE NUMBER 15277 CALLED

NEW MEXICO OIL CONSERVATION DIVISION  
 COMPLIANCE AND ENFORCEMENT MANAGER  
 CASE-IN-CHIEF:

WITNESS DANIEL SANCHEZ

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	CROSS	RECROSS	FURTHER
Mr. Domenici	13	30	52

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3	CASE-IN-CHIEF:			
4	WITNESS AQEEL VIRK			
5	Mr. Domenici	DIRECT 54	REDIRECT	FURTHER
6				
7	Mr. Herrmann	CROSS 72	RECROSS 75	FURTHER 83
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## Exhibits Offered and Admitted

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1 (Time noted 1:15 p.m.)

2 EXAMINER McMILLAN: I would like to call the  
3 hearing back to order. We will be hearing case 15277,  
4 Application of the New Mexico Oil Conservation Division  
5 (OCD) Compliance and Enforcement Manager for a  
6 compliance order against Blue Sky NM Inc.

7 Call for appearances.

8 MR. HERRMANN: Keith Herrmann representing  
9 the applicant.

10 EXAMINER McMILLAN: Other appearances?

11 MR. DOMENICI: Yes. Pete Domenici  
12 representing Blue Sky.

13 MR. HERRMANN: I have one witness. And if I  
14 can just --

15 EXAMINER McMILLAN: Okay, go ahead.

16 MR. HERRMANN: Would you like an opening  
17 statement?

18 EXAMINER McMILLAN: Just get him sworn in.

19 (Whereupon, the presenting witness was  
20 administered the oath.)

21 (Discussion off the record.)

22 EXAMINER McMILLAN: Well, Blue Sky New  
23 Mexico had requested a continuance, and that is denied.

24 MR. DOMENICI: Okay.

25 MR. HERRMANN: Was there also a motion, the

1 director's officer --

2 MR. DOMENICI: There are actually two  
3 motions. One, I was named as the incorporator. We sent  
4 a stipulated order dismissing me, and I don't know if  
5 that made it back.

6 MR. HERRMANN: Yeah, it was unopposed.

7 MR. DOMENICI: It was an unopposed motion.

8 MR. HERRMANN: Yes.

9 MR. DOMENICI: And then there a motion to  
10 dismiss the officers and directors. The last hearing we  
11 did like this, we heard that at the end. But I am happy  
12 to argue that.

13 MR. HERRMANN: Well, this resolution will be  
14 the same. We didn't state a specific claim against all  
15 officers, directors, jointly and severally, so we do not  
16 oppose that motion as long as it's not removing Blue Sky  
17 themselves as the company from this hearing.

18 EXAMINER MARKS: So the motion just to  
19 not -- I don't have a copy of the motion -- (being  
20 handed a document.)

21 So the Oil Conservation Division does not  
22 oppose the motion to dismiss the officers and directors  
23 of Blue Sky as named parties to this proceeding; is that  
24 correct?

25 MR. HERRMANN: Yes.

1 EXAMINER McMILLAN: Okay. That motion will  
2 be granted.

3 MR. DOMENICI: Then the other motion --  
4 which I am not sure you have either -- was filed much  
5 earlier, was they named me, I was the incorporator of  
6 the company. And that was unopposed, but I don't know  
7 if an order ever got entered on that.

8 I think I might have even sent a stipulated  
9 order on that or a form of order. But it hasn't been  
10 resolved that I can be sure of.

11 EXAMINER MARKS: I don't have a copy of that  
12 motion. But it just names -- does the application just  
13 state that you were the incorporator?

14 MR. DOMENICI: Yes. That's the only  
15 allegation in the complaint.

16 EXAMINER MARKS: Is that factually  
17 incorrect?

18 MR. DOMENICI: No. It's just -- they don't  
19 state a claim against the incorporator.

20 EXAMINER MARKS: So there is no claim; it's  
21 just stating that you incorporated --

22 MR. DOMENICI: Well, they did state a claim,  
23 so I made a motion. I have it here. ~~It's an~~ unopposed  
24 motion to dismiss.

25 EXAMINER MARKS: I'm just trying to find

1 where it lists you as the incorporator.

2 MR. DOMENICI: It's like the second  
3 sentence --

4 MR. HERRMANN: The third paragraph of the  
5 OCD's application.

6 EXAMINER MARKS: So this is just saying that  
7 the Secretary of State -- this is what's listed on the  
8 Secretary of State's website; are you saying this is  
9 incorrect?

10 MR. DOMENICI: Well, it identifies Moe  
11 Shallot, President, Carla Petty, Secretary, me as  
12 incorporator, Ilia Shallot, director, as officers of  
13 record. An incorporator is not an officer.

14 EXAMINER MARKS: Oh, okay. So really the  
15 OCD's application should have been clearer in making  
16 certain that you were not identified as an officer, and  
17 it could have listed you as an incorporator, but it  
18 should not have listed you as an officer.

19 MR. DOMENICI: I would just have to say, my  
20 corporate attorney I talked to, who has incorporated  
21 over 1,000 corporations, and they've never been named  
22 for personal liability as an incorporator.

23 I've seen case law from other states,  
24 including one with a Rule 11 sanction for suing an  
25 incorporator as officer -- so Mr. Herrmann agreed he

1 wasn't going to oppose this motion. I don't think you  
2 should name incorporators in your compliance orders.

3 EXAMINER MARKS: You're not naming him for  
4 personal liability, are you?

5 MR. HERRMANN: No.

6 EXAMINER MARKS: Okay. So to dismiss him as  
7 an officer, you are fine with that?

8 MR. HERRMANN: Yes.

9 EXAMINER McMILLAN: So granted.

10 MR. DOMENICI: Thank you.

11 MR. HERRMANN: It if I may get started with  
12 my direct testimony?

13 EXAMINER MARKS: Are there any other  
14 preliminary matters?

15 MR. DOMENICI: Not from us.

16 MR. HERRMANN: No.

17 I have one witness, Mr. Daniel Sanchez. He  
18 has already been sworn in.

19 DANIEL SANCHEZ

20 having been duly sworn herewith, was examined  
21 and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. HERRMANN:

24 Q. Would you please state your name and title for  
25 the record.

1       A. Daniel Sanchez, Oil Conservation Division,  
2 Compliance and Enforcement manager.

3       Q. Could you briefly describe the duties you perform  
4 for the OCD?

5       A. I oversee all compliance and enforcement issues  
6 for the OCD. I supervise the district offices. And I  
7 work with various entities, the BPA, the BLM on other  
8 projects.

9       Q. And have you testified in front of the OCD  
10 hearings before in an expert capacity?

11      A. Yes, I have.

12               MR. HERRMANN: Then I would move to admit  
13 Mr. Sanchez's testimony as expert testimony.

14               MR. DOMENICI: No objection.

15               EXAMINER McMILLAN: So accepted.

16      Q. Have you researched the alleged violations  
17 against Blue Sky?

18      A. Yes, I have.

19      Q. Could you summarize them for us briefly?

20      A. Yes. It is basically that Blue Sky is in  
21 violation of a couple of OCD rules, one of them being  
22 the requirement for additional financial assurance on  
23 wells that have been inactive for more than two years.

24               There are approximately 65, I believe -- maybe  
25 not that many. But there's a total of \$368,207 of

1 additional bonding required for them to get into  
2 compliance with that rule.

3 Their inactive well count out of 80 wells is  
4 currently 65. So that's in violation of our inactive  
5 well rule, Rule 549. *Q*

6 Q. Could you identify where you are getting this  
7 information from?

8 A. Exhibit 1 is copies of -- from yesterday, but an  
9 inactive additional financial assurance report that's  
10 produced on the OCD's website. And the other one is an  
11 inactive well list that is produced and it can be drawn  
12 up on the OCD's website.

13 Q. And was this exhibit prepared by you or under  
14 your direction?

15 A. Yes.

16 Q. If we move to the inactive well list contained  
17 within Exhibit 1 -- it's the third page --

18 A. Yes.

19 Q. -- could you identify how many inactive wells out  
20 of the total number of wells Blue Sky has currently?

21 A. They have a total of 80 wells. Right now there  
22 are 65 that are inactive. Of that there are 29 which  
23 have lost their authority to inject.

24 Q. Could you please identify OCD Exhibit 2.

25 A. Exhibit 2 is a copy of the letter I sent to Blue

1 Sky on February 18th of 2014, basically letting them  
2 know that the agreed compliance order for their inactive  
3 wells that we had negotiated was active and would  
4 require them to bring six wells into compliance, whether  
5 that was through producing, plugging or TA-ing those  
6 wells. And they had until August 14, 2014, to complete  
7 the agreement.

8 There is also an attachment of that agreed  
9 compliance order for those inactive wells as well.

10 Q. And did Blue Sky meet the terms of this  
11 agreement?

12 A. No, they did not.

13 Q. Moving on to OCD Exhibit 3, could you identify  
14 that, please.

15 A. Exhibit 3 is the change of operatorship from  
16 Canyon E & P Company to Blue Sky New Mexico. And along  
17 with that, there is other information; the operator  
18 registration information that I had sent to them, prior  
19 to becoming an operator; and the list of ten rules that  
20 we review with an operator, with a new operator, during  
21 the orientation which was initialed and signed by Carla  
22 Petty, senior accounts manager for Blue Sky; and just  
23 the other general information that was sent to them to  
24 become an operator.

25 Q. And does this form include references to the

1 rules that we are alleging violations?

2 A. Yes, they do.

3 Q. So Blue Sky has a certain familiarity with the  
4 OCD rules?

5 A. Yes.

6 MR. HERRMANN: I have no further questions  
7 at this time.

8 MR. DOMENICI: Okay.

9 EXAMINER McMILLAN: Cross-examination?

10 MR. DOMENICI: Yes.

11 EXAMINER McMILLAN: Go ahead.

12 CROSS-EXAMINATION

13 BY MR. DOMENICI:

14 Q. So looking at Exhibit 2, please.

15 A. Yes.

16 Q. The deadline on that to establish compliance was  
17 August 14th, 2014?

18 A. That's correct.

19 Q. How many wells, if you can recall, had been  
20 brought back into compliance before that date?

21 A. Before that date, I do not recall any falling off  
22 the inactive well list, up to that date, between the  
23 time that the agreement came into effect.

24 EXAMINER McMILLAN: I am not clear on your  
25 question. Are you asking how many wells in that six

1 months they brought back into compliance?

2 MR. DOMENICI: Yes, sir.

3 EXAMINER McMILLAN: Okay. Thank you.

4 Q. And do you recall that prior to August 14, 2014,  
5 representatives of Blue Sky brought to you a permit  
6 application to reestablish injection authority for some  
7 of the wells that were inactive?

8 A. That's correct.

9 Q. And what was your response to Blue Sky's  
10 information that they wanted to submit that permit  
11 application prior to this agreed compliance order  
12 deadline?

13 A. That we couldn't take that into account until the  
14 financial assurance or the additional bonds had been  
15 placed into effect. That's one of our rules.

16 With the agreement as we entered into it, one of  
17 the rules that we bypassed -- to put it simply -- was  
18 the requirement for full financial assurance at the  
19 time. And we did that because Blue Sky needed at least  
20 one injection well to handle the water that was being  
21 produced from the six wells that they did have active at  
22 the time.

23 So we did allow that one permit. And that was  
24 all they requested at the time, was the one permit for  
25 those wells. And with that, they let us know that they

1 felt that they could go ahead and start working on other  
2 wells and get those producing as well.

3 Q. And do you understand, from your communications  
4 with Blue Sky or your staff, that produced water is a  
5 problem on the wells?

6 A. Yes, it is.

7 Q. And that the injection capacity is a limiting  
8 factor for being able to bring wells back into  
9 production?

10 A. Yes.

11 Q. And isn't it true, looking at Exhibit 2 -- let me  
12 ask you if this is correct. If you were under an agreed  
13 compliance order, then an operator is considered in  
14 compliance so they can file applications that would  
15 require that the operator be in compliance in order for  
16 them to be filed?

17 A. That is correct.

18 Q. That's one of the purposes for these agreed  
19 compliance orders, is so operators can make progress  
20 under the sort of six-month windows, if you will, so  
21 long as some financial assurance is placed?

22 A. That's correct.

23 Q. But just to go back to my earlier question, is it  
24 your testimony that OCD actually rejected a permit for  
25 Blue Sky to get additional injection authority before

1 August 14th, 2014 -- or rejected, by that I mean didn't  
2 accept for consideration?

3 A. That is correct. My understanding at the time or  
4 what I remember happened at the time was the packet for  
5 those injection permits came into near the end of the  
6 agreement or right after the deadline of the agreement.

7 Part of the initial agreement, whether it was  
8 informal or formal -- it's not written down in this, I  
9 don't believe -- was that the financial assurance issue  
10 be taken care of before any other injection well permits  
11 would be reviewed. And that didn't happen.

12 Q. And do you know, one way or another, if the one  
13 injection well that was put into place during the sixth-  
14 month period described in Exhibit 2 -- if that had a  
15 limited capacity?

16 A. My understanding was it did.

17 Q. And so there wasn't the ability -- do you know,  
18 one way or another, did Blue Sky have the ability to  
19 bring more wells into compliance and a place to inject  
20 that produced water?

21 A. We found out that they didn't, but this was after  
22 the fact. And if it would have been something that was  
23 brought to our attention early on in the agreement, we  
24 may have been able to look at the other options at the  
25 time.

1 But it wasn't brought to our attention until  
2 after they were informed that they hadn't submitted a  
3 status report for the completion of that agreement.

4 Q. Now, if Blue Sky -- let me just do it this way.  
5 Blue Sky is going to testify that they have that permit  
6 application ready, it is for five injection wells, it  
7 would provide capacity for a number of production wells  
8 to have -- to produce. So there would be injection  
9 wells that would come off the inactive list, production  
10 wells would come off the inactive list; is it your  
11 testimony that OCD would not be able to consider that  
12 application if this compliance order is entered?

13 A. If the additional bonding were in place, yes, we  
14 would consider it.

15 Q. But absent additional bonding, OCD would not be  
16 able to consider the application that we are going to  
17 introduce for five injection wells that would allow  
18 additional production on the site; is that correct?

19 A. That's correct.

20 Q. Now, are you aware of anything, any regulation or  
21 statute or even precedent that restrict the hearing  
22 examiner from entering the compliance order you are  
23 requesting, but authorizing Blue Sky to submit the  
24 application for those -- to permit those five injection  
25 wells, provided they bond those five wells?

1 A. Not that I am aware of, no.

2 Q. So there is nothing that would prohibit that  
3 being a term of this compliance agreement?

4 A. That is correct.

5 Q. And in your experience or based on your knowledge  
6 of this site, wouldn't that make it more likely that we  
7 would achieve the objective of the compliance order,  
8 which is that wells would come off the inactive list by  
9 either being produced or receiving their injection  
10 status?

11 A. Yes, that would be the case.

12 Q. And I think -- my understanding is -- this is a  
13 little technical, but bear with me, please, that Blue  
14 Sky has six bonds that are on wells that are not --  
15 they're not the operator for?

16 A. That's correct.

17 Q. And, therefore, those bonds would be subject to  
18 being released or removed off of those six wells?

19 A. Yes.

20 Q. And do you have any objection to those bonds  
21 being placed on these five injection wells that are  
22 subject to this permit application?

23 A. No, I would not.

24 Q. And wouldn't -- if that occurred, if the hearing  
25 examiner put that in his order, so we had bonds placed

1 on five additional wells and we had a permit application  
2 submitted, wouldn't that put the State of New Mexico and  
3 the landowner -- are these state leases?

4 A. Yes, I believe they are.

5 Q. -- and the State Land Office in a better position  
6 than they are today?

7 A. Yes.

8 Q. And I know -- well, I assume -- but you don't do  
9 injection permits or disposal well permits yourself?

10 A. No, I don't.

11 Q. Do you have any information that would lead you  
12 to believe that there would be any significant or  
13 unforeseen hurdles in having the injection authority  
14 reestablished on these wells that it had injection  
15 authority for previously?

16 A. I don't have any information you're right that I  
17 would see that would prevent that, yes.

18 Q. And if you know, and I don't know if you do, Mr.  
19 Sanchez, do you know if there are other parties that  
20 would even have to be noticed or if these wells are  
21 encompassed in such a way by the Twin Lakes unit that  
22 the notice to the current operator would be -- would  
23 have to be noticed?

24 A. Personally I don't know exactly where that would  
25 sit.

1 Q. Do you know how long it is taking currently to  
2 have these types of injection or disposal permits  
3 processed?

4 A. No. Not working on it myself, I wouldn't know.

5 Q. And looking at the well list, which I think was  
6 Exhibit 1 -- I know you have done this many years, but I  
7 don't know if you had stated that in your  
8 qualifications. How many years have you been working  
9 with OCD?

10 A. Going on 11.

11 Q. Okay. On the well list, it appears there are a  
12 large number of injection wells relative to the  
13 production wells?

14 A. Yes.

15 Q. And at one point this was -- if you know, was  
16 this a waterflood or was the injection used for  
17 production purposes?

18 A. That I don't know. I'm not sure.

19 Q. Do you know that there are a lot of water issues  
20 with production?

21 A. Yes.

22 Q. Let me have a minute.

23 MR. DOMENICI: Thank you. That is all I  
24 have.

25 MR. HERRMANN: One follow-up question.

1 RE-DIRECT EXAMINATION

2 BY MR. HERRMANN:

3 Q. Regarding the rule violations that we have  
4 alleged in Rule 8.9 and Rule 25.8 and Rule 5.9, would  
5 any of those pose hurdles to any sort of approval  
6 process at the moment?

7 A. I think they can, yes. Basically, the financial  
8 issue.

9 Q. Yes, which is tied to Rule 5.9 as well.

10 A. Yes, yes.

11 EXAMINER MARKS: I have some questions:

12 EXAMINER McMILLAN: Sure.

13 EXAMINATION BY EXAMINER MARKS

14 EXAMINER MARKS: I have some questions.

15 Mr. Sanchez, I believe you testified that  
16 Blue Sky could just place existing bonds that they have  
17 on injection wells. Where in our rules is that allowed?  
18 I am not familiar with a bond process that just allows  
19 bonds to be transferred.

20 THE WITNESS: No. My thoughts on it were if  
21 they had these bonds on wells that were no longer -- or  
22 weren't theirs to begin with where the transfer never  
23 occurred, that that just gives them the ability to pull  
24 those bonds that they have and utilize them somewhere  
25 else.

1           Whether or not they could transfer directly  
2   to a specific well or not isn't my take on it. It was  
3   just they would give them additional bonding funds for  
4   those bonds to put towards the current deficit that they  
5   have.

6           EXAMINER MARKS: So you are saying they  
7   would have financial resources possibly available to the  
8   company and they could use that however they see fit.

9           THE WITNESS: That's correct.

10          EXAMINER MARKS: Okay. You said they had --  
11   how much -- I am not sure if you covered this. How much  
12   in additional bonding does Blue Sky need at present?

13          THE WITNESS: At present, \$368,207.

14          EXAMINER MARKS: Okay. And this first  
15   compliance order was from February of 2014. Is that how  
16   long Blue Sky has been out of compliance?

17          THE WITNESS: They were out of compliance  
18   prior to that. And since they didn't move the terms of  
19   the agreement, they've been out of compliance, yes.

20          EXAMINER MARKS: Do you know how long Blue  
21   Sky has been out of compliance with the Division?

22          THE WITNESS: Really since they took over  
23   the company. Because when they took over the 80 wells  
24   that they do have, they were -- they had a deficit in  
25   terms of the additional bonding that was required; so

1 that would have been putting them out of compliance at  
2 that point. And I believe the transfer took place on  
3 September 24th, 2013.

4 EXAMINER MARKS: So since September of 2013,  
5 they have never been in compliance?

6 THE WITNESS: That's correct.

7 EXAMINER MARKS: In this compliance order,  
8 it seemed as though -- if I'm reading this correctly --  
9 Exhibit A had 63 inactive wells out of 80 at that time,  
10 and you only required six to get into compliance?

11 THE WITNESS: They had to show that they  
12 could bring six back into compliance.

13 The majority of these agreed compliance  
14 orders are entered into because an operator with a large  
15 number of wells usually has a large number of wells out  
16 of compliance, whether it was through a non-purchase  
17 from another operator or their being a new operator,  
18 taking on a company that had a lot of inactive wells.

19 We understand that they don't necessarily  
20 have the ability to go in as a start-up company and  
21 bring a large number of wells into compliance within a  
22 six-month period. So what we do is offer them a chance  
23 to bring a certain amount of wells into compliance while  
24 evaluating the rest of the ones that have been inactive  
25 to determine whether or not they could plug them or

1 bring them back on.

2 For the most part, the operators are  
3 successful in doing it. If the six-month period has  
4 gone through and they met the requirements of that  
5 initial order, then we would extend it for another six  
6 months. And that gives them a chance to take care of  
7 even more of those wells, if not the rest of them,  
8 depending on the number of inactive wells and their  
9 ability as a company to actually address the issues that  
10 they took over.

11 EXAMINER MARKS: Okay. And so of the 63  
12 inactive wells, you required six, and then how many came  
13 into compliance?

14 THE WITNESS: None.

15 EXAMINER MARKS: Okay.

16 EXAMINATION BY EXAMINER McMILLAN

17 EXAMINER McMILLAN: When was the last time  
18 either you, yourself, or someone under your direction  
19 did an inspection out here?

20 THE WITNESS: March of this year.

21 EXAMINER McMILLAN: And can you summarize  
22 their findings?

23 THE WITNESS: Sure.

24 MR. HERRMANN: There are well inspection  
25 reports at the end of Exhibit 1. You could reference

1 those.

2 THE WITNESS: Okay.

3 I don't believe every single well was  
4 inspected, but a number of them were. August of 2014  
5 and September of 2015 were the last inspection dates on  
6 them.

7 I'll just go through a few of them right  
8 now. One was the Twin Lake San Andres Unit No. 45.  
9 Comments were that the well was idle, power out to the  
10 pump jack, pump jack looks capable of operating, full  
11 line hooked up to a smaller tank trailer, 25 joints of  
12 tubing on location, hardpan in well head area.

13 Most of them were comments like that  
14 throughout. There were a number of other ones. The  
15 Twin Lakes San Andres Unit 54 is an injection well that  
16 had lost its authority. The comments were: Well sign  
17 was the wrong operator, hooked up to the injection line,  
18 and the valve open to injection.

19 Now, that would indicate that if those wells  
20 were actually injecting, they would be injecting without  
21 authority.

22 And 27 of the 29 wells that had lost their  
23 authority to inject had some note about the flowlines  
24 being hooked up and the valves being open.

25 Most of the other stuff was that, you know,

1 nothing was operating but it didn't look like it was in  
2 terrible shape, that it just needed work.

3 EXAMINER McMILLAN: But I'm looking at the  
4 No. 36, Power removed from the pump jack --

5 THE WITNESS: Yes.

6 EXAMINER McMILLAN: -- sorry -- motor  
7 removed from pump jack --

8 THE WITNESS: Yes. Power off, motor removed  
9 from pump jack, location becoming overgrown, no well  
10 sign. And that was in March of 2015.

11 EXAMINER McMILLAN: The motor removed from  
12 the pump jack, so it would be difficult to produce oil  
13 then?

14 THE WITNESS: Yes, it is.

15 EXAMINER McMILLAN: And we see that also in  
16 on No. 65.

17 And then, looking at Twin Lakes San Andres  
18 Unit No. 18, I see that the pit is empty and the liner  
19 is torn. Any other?

20 THE WITNESS: And the belt is missing from  
21 the pump jack, the power is off.

22 EXAMINER McMILLAN: But what about the  
23 liner?

24 THE WITNESS: Personally I couldn't speak to  
25 that. I didn't go through each one of these. I just

1 got these yesterday.

2 EXAMINER McMILLAN: It would appear to me  
3 that the Number 18 is -- could that be an environmental  
4 issue?

5 THE WITNESS: Yes, it could, absolutely.

6 EXAMINER McMILLAN: Have they displayed a  
7 good faith effort in trying to -- with the previous  
8 compliance order? I mean was there any form of work  
9 done or was it...

10 THE WITNESS: I never got a status report  
11 from them, so I couldn't tell.

12 EXAMINER McMILLAN: I need clarification.  
13 What do you mean?

14 THE WITNESS: Each operator under an agreed  
15 compliance order, by the end of that six-month period,  
16 has to provide me with a status report, showing the  
17 wells that were worked on, what they did to work on  
18 them, to bring them back into compliance, so I could  
19 verify on our records that they had actually met the  
20 terms of the agreement.

21 EXAMINER McMILLAN: So you are saying you  
22 never received one?

23 THE WITNESS: No, I never received one.

24 EXAMINER MARKS: These are status reports --  
25 well, where is that in the compliance order?

1 THE WITNESS: The status report could be  
2 something as simple as an e-mail, indicating the names  
3 of the wells, the EPI numbers and the activity that was  
4 performed to bring it into compliance.

5 I do the follow-up verification, on OCD  
6 online through our website, to determine whether or not  
7 they actually did what they said. And at that point,  
8 I'll follow up with them with a letter, letting them  
9 know that they either completed the agreement  
10 successfully and they can request an amendment, or I'll  
11 let them know that they didn't complete it and we  
12 wouldn't be offering an amendment.

13 EXAMINER McMILLAN: Within a six-month  
14 window, did you have any conversations with them,  
15 whether formally or informally?

16 THE WITNESS: Probably informally at the  
17 beginning of it. Yeah, I know we did informally at the  
18 beginning of the agreement. But, later on, I couldn't  
19 say. I work with so many operators that I don't  
20 remember exactly which ones I've had informal  
21 conversations with, especially that far back.

22 EXAMINER McMILLAN: So if I am  
23 understanding, if a compliance order is issued, if that  
24 is the -- they would give them six more months?

25 THE WITNESS: We can give them, depending on

1 the number of wells that are still on that inactive well  
2 list.

3 For instance, Yates, I have been working  
4 with Yates for a number of years already on this one  
5 agreement, that we've given amendments over a period of  
6 time. They had a huge number of inactive wells that  
7 they wanted to bring back in.

8 And right now they are down to probably  
9 their last three or four that have to be plugged, and  
10 they are working on right now.

11 EXAMINER McMILLAN: Would you characterize  
12 it as a good faith effort --

13 THE WITNESS: If they meet the terms of the  
14 agreement for that six-month period, they have the  
15 option to ask for an amendment if they think they're  
16 going to need it. And some of these companies with the  
17 larger numbers -- I've had agreements with Conoco, with  
18 Yates, with Apache, where they did have a larger number  
19 of wells, because they were acquiring wells from other  
20 operators at the time that were inactive. And, yes,  
21 they met the terms of the initial six-month agreement  
22 and asked for amendments until they got the wells taken  
23 care of.

24 Some of them would exceed the number of  
25 wells required for that agreement and get back into

1 compliance in that time frame.

2 MR. HERRMANN: If I can ask for  
3 clarification.

4 EXAMINER McMILLAN: Yes.

5 MR. HERRMANN: Were you asking about good  
6 faith efforts on the part of this compliance order or  
7 good faith efforts in general?

8 EXAMINER McMILLAN: In both senses.

9 THE WITNESS: In general, yes, it is a good  
10 faith effort, and we'll work with an operator to  
11 continue those agreements.

12 In this case, it didn't happen.

13 EXAMINER McMILLAN: Okay.

14 MR. DOMENICI: I will follow up whenever  
15 you're done.

16 EXAMINER McMILLAN: Okay. Go ahead. You  
17 may proceed.

18 RE-CROSS EXAMINATION

19 BY MR. DOMENICI:

20 Q. So I'm looking at an e-mail, Mr. Sanchez, that  
21 actually -- actually several e-mails that I maybe didn't  
22 look at in your file. But one is dated July 28th before  
23 this August 14th deadline.

24 And that says: Dear Mr. Sanchez, thank you for  
25 your response. I have attached a letter which outlines

1 Blue Sky's activities during the past few months. Along  
2 with the letter are some exhibits, which include  
3 exhibits related to well 29, well 85, well 29. I look  
4 forward to seeing you at a meeting on, Thursday,  
5 July 31st.

6 Does that refresh your recollection that you  
7 received communications?

8 A. I received that communication. Yes, I probably  
9 did on that one. But it wasn't the status report that I  
10 was due at the end of August.

11 I didn't receive anything that indicated that any  
12 other than the six wells that were operating at the time  
13 had been worked on or completed.

14 Q. So the attachment didn't indicate to you that the  
15 wells had been worked on, is that your testimony,  
16 Mr. Sanchez?

17 A. I went back through the inactive well list, and  
18 the number didn't come down -- and that the wells were  
19 the same wells. That is one of the things I will check,  
20 is were the ones that are currently inactive the same  
21 ones that were inactive at the time of appendix A, when  
22 was that part of the agreement. And if I am correct --  
23 and I may be wrong -- but if I am correct that's the  
24 process I used. And none of those wells had come off  
25 the list.

1 Q. Do you recall that in, say, March or April, after  
2 the agreed compliance order was put in effect, that  
3 there was a problem with the pumper manager for Blue Sky  
4 and there were actually allegations of illegal  
5 injection?

6 A. Yes.

7 Q. And that that pumper had to be terminated and  
8 that several months were lost from Blue Sky being able  
9 to make progress?

10 A. I knew there were problems with the pumper. I  
11 didn't realize that he had been terminated at that time.

12 Q. But there were serious allegations made by your  
13 staff?

14 A. Yes. As a matter of fact, one of them was that  
15 the one injection well that we did authorize was  
16 injecting over its permitted pressure. And then the  
17 rest of the wells, like I said 27 out of 29, indicated  
18 that the valves were on the on position.

19 Yes, there were serious problems.

20 Q. You don't know, one way or another, if he was  
21 terminated?

22 A. No.

23 Q. You haven't heard any complaints since that time  
24 about illegal injection?

25 A. No.

1: Q. In fact, do you recall being e-mailed an actual  
2: permit application before this agreement expired?

3: A. Yes.

4: Q. Do you know how long it takes for a consultant to  
5: prepare one of those permit applications?

6: A. No.

7: Q. Did you know if it was a complete application,  
8: did you make any judgment --

9: A. I don't review those applications, so I wouldn't  
10: know.

11: Q. So in terms of good faith -- that was the  
12: question -- Blue Sky had retained a consultant,  
13: submitted a permit application to you on or about  
14: July 28th indicating to you they were asking for an  
15: extension; do you recall that?

16: A. Yes, I do.

17: Q. And that they were going to submit this  
18: application so they could get injection authority to --  
19: and those wells would come into compliance, if the  
20: permit were issued and you start injecting, that would  
21: create compliance?

22: A. That is correct. But I believe there was a  
23: caveat to that in that the bonding was still an issue  
24: that needed to be taken care of, yes.

25: Q. I understand. But in terms of good faith?

1 That's the question --

2 A. Yes. I could see that, yes, as a show of good  
3 faith.

4 Q. And, in fact, just so we are clear, when Blue Sky  
5 took over these 80 wells, they had been in and out of  
6 bankruptcy for a half a decade at least?

7 A. I don't know how long they had been. But I knew  
8 they were in bankruptcy, yes.

9 Q. So Blue Sky willingly took on a field with many  
10 wells out of compliance; they didn't allow them to go  
11 into non-compliance?

12 A. That's correct.

13 Q. And they knew they were trying to salvage a field  
14 that might otherwise be a liability to the state,  
15 plugging being accomplished out of the plugging fund?

16 A. Correct.

17 Q. And there were no bonds, there was no blanket  
18 bond and there were no individual bonds, correct?

19 A. I do not remember at the time what...

20 Q. And then when Blue Sky signed the original agreed  
21 compliance order, they placed a blanket bond and they  
22 placed a number of individual bonds?

23 A. Yes.

24 Q. Did you consider that good faith for them to  
25 place that --

1. A. I considered that good faith to be able to enter  
2. into that agreement and for us to make that initial  
3. waiver of the requirement of additional bonding.

4. Q. And the bonds were still available?

5. A. That's correct.

6. Q. Where they wouldn't have been had Blue Sky not  
7. stepped into this unit, if you will?

8. A. That's true, yes.

9. Q. And what Blue Sky is proposing, to repeat myself,  
10. they're proposing to place bonds on these five injection  
11. wells -- and none of these wells are currently bonded,  
12. so that would increase the bonded number and decrease  
13. the unbonded?

14. A. Yes.

15. Q. By roughly \$40,000? The round number is \$8,000  
16. per well.

17. A. Yes, that's correct.

18. Q. And then that would allow Blue Sky conceivably to  
19. start injecting and bring more wells into compliance?

20. A. Yes.

21. Q. And the other thing I would like to discuss is,  
22. if that occurred, and so Blue Sky gets a permit to  
23. inject -- first of all, if Blue Sky received this  
24. permit, then this \$40,000 of bonds on these five wells,  
25. that would become available to bond other wells. Should

1 this order require that -- those bonds would come up.

2 So if Blue Sky got permission to begin injecting,  
3 they're allowed to pull the bonds off?

4 A. Once they became active, yes.

5 Q. And then that money would be available to bond  
6 other inactive wells, if the order so stated or if Blue  
7 Sky chose to?

8 A. That's correct.

9 Q. And then if wells began producing into those five  
10 injection wells and those wells had bonds, then those  
11 bonds could come off and those could be placed on  
12 inactive wells should the order require or Blue Sky  
13 choose to do that?

14 A. That's correct.

15 Q. And so, possibly, fairly quickly, if there was  
16 injection authority, we could see fewer wells requiring  
17 bonding and the bonds on currently inactive wells lifted  
18 and moved to wells that don't have bonds -- if that were  
19 allowed by the hearing examiner?

20 A. That's correct.

21 Q. And I don't know if you've ever heard the  
22 expression in the oil and gas world -- maybe you have --  
23 of what's called a "rolling bond"; have you ever heard  
24 that expression?

25 A. No, I haven't.

1 Q. Let me give you an example.

2 If a landfill has 20 acres of capacity but it  
3 faces only one acre, then the bond is for that one acre.  
4 And when that one acre is filled and the operator closes  
5 that one acre, then that bond moves to the next acre.

6 So, basically, the bond rolls. Instead of  
7 bonding the whole 20 acres, you are bonding a piece at a  
8 time and you release that bond as you bring a section  
9 into compliance.

10 So, in that sense, are you familiar with a  
11 rolling bond?

12 A. Yes, I understand the concept.

13 Q. And do you know if that is done by your mining  
14 division as sort of a regular way of doing things?

15 A. I do not know how they operate their bonds --

16 Q. Okay.

17 MR. DOMENICI: I don't have anything  
18 further.

19 EXAMINER McMILLAN: So you said you sent an  
20 application in on July 28th?

21 MR. DOMENICI: That will be our exhibit,  
22 yes.

23 EXAMINER McMILLAN: Now, if it is a Devonian  
24 well on fee acreage and you have a -- let's just say you  
25 have one mineral interest owner, you can do it in

1 30 days minimum. Anything else is going to take an  
2 extended period of time, because there has to be an  
3 in depth study to make sure that the groundwater is not  
4 going to be affected. You have to make sure all the  
5 notifications are in. You have to notify the surface  
6 and the mineral owners.

7 So getting a permit out in two days for an  
8 injection well, just going through necessary forms, is I  
9 would say nearly impossible. Like I said, unless you  
10 have a Devonian well in the middle of Lea County, the  
11 30 days is an ultra fast permit.

12 MR. DOMENICI: I understand. You  
13 understand, though, all of these wells were previously  
14 permitted?

15 EXAMINER McMILLAN: Yes, I understand that.

16 MR. DOMENICI: The reason that they lost  
17 their injection authority was because Orbit went into  
18 bankruptcy and did not -- and there was no one out there  
19 to operate these wells to keep them active.

20 So our -- and we don't have our permit  
21 writer here. But they chose the easiest ones to permit  
22 out of all these wells that would give us the most bang  
23 for the buck in terms of being able to produce another  
24 number of wells to get them active.

25 So we've thought this through. The timing

1 didn't work, because we had an operator out there who we  
2 thought was moving forward and was telling us, You have  
3 ability to inject, you're actually producing -- this  
4 will be testimony. So I don't want to testify about --

5 EXAMINER MARKS: Okay.

6 MR. DOMENICI: So we thought we were  
7 producing 35 barrels a day, when, really, once we found  
8 out from Daniel and his staff that that was probably  
9 illegal and shut it down, our production dropped  
10 dramatically and we realized we can't make it with this  
11 one well. We can't possibly meet this compliance order.

12 We need to get more injection authority. We  
13 immediately hired Permits West. Yes, we were running  
14 out of time. But we hired them, we got an application  
15 in, we asked for an extension.

16 And there's been no way to have that  
17 application considered because we have this ever  
18 increasing bond that grows because more wells go  
19 inactive. So we are in this Catch 22 that we are trying  
20 to resolve here.

21 And I think the evidence will show there has  
22 not been bad faith by my client. There has been an  
23 effort, there's a program here. We would like to work  
24 with the bond money -- we could take that \$40,000 and we  
25 could use it out of state, or anything else.

1           We are willing to have you put an order in  
2   that it has to go on to these wells. We have the  
3   application ready. We're ready for the order to say you  
4   have to submit it within a day of your order coming out.

5           There is another issue that's going to come  
6   up, which is we are buying these wells out of  
7   bankruptcy. The trustee -- and this is part of the  
8   Canyon bankruptcy. So, basically, Blue Sky Inc. came in  
9   to say let's salvage part of Canyon's failure because  
10   Canyon wells are going to be plugged.

11           And these wells are heading to all be  
12   plugged out of the plugging fund if we don't accommodate  
13   something here. Because there's nothing else on the  
14   site. The trustee cannot have a claim made against him  
15   and these are all on state land.

16           So we owe the trustee money to get clear  
17   title, not a lot. The balance is over \$200,000, and  
18   they will agree and they've authorized me to tell you,  
19   and all of you, that they will propose an offer that we  
20   pay \$67,500 immediately -- sixty-seven-five, round  
21   numbers -- \$135,000 upon approval of the bankruptcy  
22   court. They can't even give us title until it gets  
23   noticed, all the creditors who have been chasing Orbit  
24   for a decade, and this will be the last step of closing  
25   down Orbit bankruptcy.

1           So we would get title. And we don't really  
2 want title unless we can make this work as you can  
3 imagine. It doesn't do us any good to get title to a  
4 bunch of wells that are going to be plugged.

5           So we have a lot of issues. But we think we  
6 can chart our way through this if you would in your  
7 order state, Yes, you have six months to comply -- which  
8 is what their relief is.

9           In addition, if you place that 40 -- or  
10 you're required to place that 40,000 on these five  
11 wells, and we will allow you to submit this application  
12 for processing. And then our goal would be to bond all  
13 of the wells during the six months.

14           We have to give more production to have  
15 capacity to bond to get that kind of bonding. We have  
16 to show third parties -- we are not running in the red  
17 right now, so we are just producing to hold the lease.  
18 So we need to get this into the black a little bit so we  
19 can come up with \$300,000 of bonds, and we also could  
20 show a third party, just like we would show you, that  
21 this rolling concept will actually shrink the bond  
22 liability.

23           Just getting these five wells up, injection  
24 wells, would automatically take -- put 40,000 on other  
25 wells, and remove five wells. So that's 80,000 right

1 there. We've cut this down by a quarter, and if we get  
2 five or ten other wells producing -- and as soon as we  
3 submit this -- we haven't decided; we would talk to  
4 Daniel and probably the permit staff and talk to you  
5 even. I'm not sure.

6 EXAMINER McMILLAN: Phillip Goetze does --

7 MR. DOMENICI: As soon as we would submit  
8 this, we would talk to Phillip about whether we should  
9 file another one on top of it, or, say, another five  
10 wells. We are not going to ever try to put in 20 wells.  
11 We are always going to do it in small groups.

12 We already talked to Phillip. That was his  
13 suggestion, Don't bite off twenty wells. Cherry pick  
14 your best wells, least controversy, least notice,  
15 quickest likelihood of success, and then do another one  
16 after that.

17 So we need to get 10 or 15 injection wells  
18 up, get the rest producing, get everything fully bonded.  
19 And, hopefully, we would be back here in, say, six or  
20 12 months from now, sort of like Yates.

21 Or we could be like Canyon, which is the  
22 plugging fund is going to take this over, the  
23 bankruptcy, we'll walk away. We will not be able to  
24 come up with \$368,000 of bonds.

25 And, respectfully, that, I think, would

1 constitute waste. And that's another grounds, I think,  
2 for your authority. That would be a waste of this  
3 resource, to have all these pretty good quality wells --  
4 testimony will be we've done MIT tests on all of the  
5 injection wells -- or on 15 of them.

6 So we already have integrity testing on most  
7 of these injection wells. So we're not expecting  
8 problems with these injection wells in terms of the  
9 quality of the actual wells or of the data that was  
10 submitted when the entire package was permitted  
11 originally.

12 So we think we can work this through, sort  
13 of through this process actually. And it would put the  
14 state in a better position and the State Land Office  
15 than simply a compliance order that we can't  
16 realistically meet.

17 We cannot bring this field into compliance  
18 absent an agreed compliance order sometime in the next  
19 six months. And we can't do that unless we get some  
20 production going.

21 But we will move that 40,000 immediately to  
22 these. We have the permit ready to go. So that's what  
23 we would like to see in the order.

24 We would, also -- I hate to ask for too much  
25 from you or from all of you, but we need some indication

1 to tell the bankruptcy trustee that we have some chance  
2 of success so we can move forward with the trustee.

3 Otherwise, if we have to wait for your  
4 decision, then we may have to wait for the trustee, and  
5 we may have to wait to tell the trustee whether we can  
6 perform --

7 EXAMINER McMILLAN: Remember, all orders are  
8 signed by the Division director; we make the  
9 recommendations.

10 MR. DOMENICI: Certainly.

11 EXAMINER McMILLAN: I could tell you  
12 something and, simply put, it's irrelevant.

13 MR. DOMENICI: We wouldn't rely on it --

14 EXAMINER McMILLAN: My point is we make the  
15 recommendations to the director, the director at that  
16 point.

17 MR. DOMENICI: Well, I just need to let you  
18 know the urgency, because the trustee wants to notice  
19 this out quickly to get the bankruptcy closed. They  
20 want to know how it looks for us, and we want to know  
21 how it looks for us in front of OCD, by which we mean  
22 the Division director. We understand.

23 EXAMINER McMILLAN: Yes.

24 MR. DOMENICI: But, obviously, the trustee  
25 is sort of chomping at the bit. They've waited for

1 years, so I'm not sure how the sky is going to fall if  
2 they have to wait a little bit.

3 But we just want to let you know the trustee  
4 is out there. And there is sort of a side issue too,  
5 which is the trustee has title to the equipment on the  
6 Canyon wells.

7 So the trustee is conceivably -- if we don't  
8 end up working something out with them, the trustee  
9 might go out to those wells and start removing equipment  
10 that might be available for plugging.

11 So it benefits everyone, I think, to get the  
12 trustee out of the picture and make it very clear who  
13 has title to what and to let us try to make this a go.

14 EXAMINER MARKS: I have a few questions for  
15 you. But I think on that last point, there is an issue  
16 with the trustee that I don't know that we have to  
17 address in this hearing.

18 But if the trustee has title to equipment  
19 and wells are being plugged and any of the equipment is  
20 -- any operator no longer has the ability to be on  
21 certain land, for example, if the trustee holds title to  
22 equipment and no longer -- and that equipment no longer  
23 has legal right to be on for example state land --

24 MR. DOMENICI: Correct.

25 EXAMINER MARKS: -- the trustee is

1 effectively trespassing on state land. So the trustee  
2 has its own probably legal issues and the trustee should  
3 probably get that equipment off the land. But I think  
4 that is a legal issue between probably the State Land  
5 Office and the OCD with the trustee that I don't know  
6 that we need to get into in this hearing, the trustee's  
7 own legal liability that it's looking at.

8 MR. DOMENICI: But they might pass that on  
9 to us -- you know, if we wrote them a check, they would  
10 prefer that then, I think, having to address that issue.  
11 =I don't know if they would abandon it or they would  
12 assign the rights to us. But this could resolve that  
13 actually. I know it is not part of this hearing.

14 But having a path forward on the compliance  
15 issues does help. I think it will make it more likely  
16 that issues with the trustee and State Land Office and  
17 OCD will be worked out.

18 Having a six-month compliance order with  
19 nothing else in it, just a six-month compliance order, I  
20 think makes it more likely that issue will stay sort of  
21 jumbled up. I may be wrong on that.

22 I do see some benefits to having this lined  
23 out the way I said. I may be overstating it with  
24 respect to the trustee. So I apologize if I am.

25 EXAMINER MARKS: So the trustee's lien is

1 presumably for all equipment. Is Blue Sky purporting to  
2 buy in this I think -- was it two payments of \$65,000,  
3 so \$130,000 -- are they purporting to buy all wells and  
4 all equipment; I mean how would that be resolved?

5 MR. DOMENICI: There's a number of ways that  
6 could be resolved. One would be basically Blue Sky  
7 would buy the note that the trustee has. So Blue Sky  
8 could then choose what they want to foreclose on. Just  
9 like the trustee may choose --

10 EXAMINER MARKS: Uh-huh.

11 MR. DOMENICI: So that's probably how this  
12 is going to proceed. So Blue Sky would step into the  
13 trustee's shoes, although it wouldn't have some of the  
14 protections of a trustee and, also, some of the  
15 requirements. And that's why we would do this this  
16 way.

17 Right now for the trustee to do anything it  
18 has to be noticed to all the creditors, even to do what  
19 you are proposing; say we are going to go out and start  
20 taking equipment, they might have to get approval from  
21 the bankruptcy court and notify everybody.

22 So giving us the note or selling it with one  
23 approval gets rid of all the bankruptcy oversight for  
24 anything that occurs. And then we would have those  
25 rights. And we would probably exercise them primarily

1 on these exact wells. We may just abandon those liens  
2 on everything else.

3 EXAMINER MARKS: Is the note just for the  
4 equipment or for other wells as well?

5 MR. DOMENICI: No, the note is -- it's  
6 assigning lease rights, equipment rights; primarily ←  
7 those two rights.

8 EXAMINER MARKS: Okay.

9 MR. DOMENICI: So lease and equipment. And  
10 a number of leases have already been terminated.

11 EXAMINER MARKS: Okay.

12 MR. DOMENICI: So, for example, almost all  
13 the other leases, to my knowledge, have been terminated.

14 So they could assign whatever rights they  
15 have on those. Probably pretty minimal.

16 EXAMINER MARKS: And, perhaps, this is  
17 probably more for your witness to testify to, but it  
18 seems like you are saying spending \$130,000 for a  
19 company that doesn't have money to post bonds will  
20 somehow generate revenue.

21 MR. DOMENICI: It could possibly. It  
22 could -- for an investor to come in and look at this  
23 field and say, You have a compliance order, you have a  
24 permit application submitted, that you were able to  
25 overcome that, you have \$300,000 in bonds you need to

1 post in the next six months, but you have clear title to  
2 this property and you're going to hopefully get some  
3 injection authority in the next ninety days -- yes, that  
4 would help us substantially to have the likelihood of  
5 coming up with \$300,000 in bonding; as opposed to where  
6 we are today, a third party's looking at this from the  
7 outside, saying, You may not have title, you don't have  
8 authority to even request to inject, you have no way to  
9 produce your wells, so the only way you could really  
10 come into compliance is huge bonding amounts on a  
11 property you don't even have title to.

12 So, yes, it would help us substantially. It  
13 is sort of the wolf at the door. I mean, if we don't  
14 have title, we can't proceed. If we don't have ability  
15 to get some more injection, we can't proceed.

16 But we can't bite off everything. That's  
17 what Canyon tried. And that's why most of those leases  
18 are terminated and those wells are in plugging status,  
19 which we are trying to avoid.

20 But, yes, that will help us a lot, to say we  
21 have title on Blue Sky, would you want to come in and  
22 loan us some money, partner with us to post the \$300,000  
23 of bonds, get back into an agreed compliance order, use  
24 these five wells as a starting point, get five more and  
25 roll this -- and get this unit back operating.

1 EXAMINER MARKS: And how much more in  
2 addition to the \$368,000 will they need in these  
3 additional wells that they will get with the \$135,000  
4 they spend in bankruptcy, and will there be inactive ←  
5 wells?

6 MR. DOMENICI: We are only going to take  
7 these wells. So we are only going to take the same  
8 exact wells that we are talking about today, so there  
9 will be no additional liabilities taken.

10 We are not going to pay \$135,000 and take  
11 liabilities. We will take all of the wells that are at  
12 issue today, which are liabilities also, yes. But  
13 nothing else.

14 EXAMINER MARKS: Do you want to start your  
15 testimony?

16 MR. DOMINICI: I am ready whenever you would  
17 like to proceed.

18 EXAMINER McMILLAN: Let's take a five-minute  
19 break.

20 (Brief recess.)

21 EXAMINER McMILLAN: Anything further?

22 MR. DOMENICI: Not from me. It's up to --

23 EXAMINER McMILLAN: Do you have anything  
24 further for him?

25 MR. HERRMANN: I just have one question for

1 Mr. Sanchez.

2 FURTHER EXAMINATION

3 BY MR. HERRMANN:

4 Q. When we do review a permit for injection, do we  
5 review 5.9 compliance as well?

6 A. Yes.

7 Q. And is Blue Sky in compliance with Rule 5.9?

8 A. No.

9 Q. So even if they were to post bonding, that  
10 review would still be subject -- posting bonding for  
11 those specific wells, it would subject to that --

12 A. To that review?

13 Q. Yes.

14 A. Yes.

15 EXAMINATION BY EXAMINER McMILLAN

16 EXAMINER McMILLAN: You can only have two  
17 inactive wells, right?

18 THE WITNESS: In this case -- yes.

19 EXAMINER McMILLAN: I mean for 100 wells,  
20 you can only have two?

21 THE WITNESS: Uh-huh.

22 EXAMINER McMILLAN: And they have 65.

23 THE WITNESS: Yes. Just as a clarification  
24 on this whole Catch 22 issue, we've had that before,  
25 where in order for an operator to get into compliance,

1 they needed to get their injection well permitted; and  
2 they were out of compliance with 5.9, therefore, they  
3 couldn't get a permit.

4 EXAMINER McMILLAN: Uh-huh.

5 THE WITNESS: So we had to work out  
6 something, like what they are asking for but on a  
7 smaller scale than this one, to allow the permit to go  
8 through so that they could get back into compliance.

9 So it is not something that hasn't been done  
10 in the past.

11 EXAMINER McMILLAN: But not to this scale?

12 THE WITNESS: Not to this scale.

13 MR. DOMENICI: May I follow up on that?

14 EXAMINER McMILLAN: Excuse me?

15 MR. DOMENICI: May I follow up on that  
16 testimony?

17 EXAMINER McMILLAN: Sure.

18 FURTHER EXAMINATION

19 BY MR. DOMENICI:

20 Q. So was that accomplished by an order from the  
21 director indicating that the application could be  
22 considered?

23 A. Yes, I believe it was.

24 Q. Okay.

25 MR. DOMENICI: Thank you. I don't have

1 anything further.

2 MR. HERRMANN: Should I move to admit my  
3 exhibits at this moment for the record?

4 EXAMINER MARKS: Yes.

5 MR. HERRMANN: I would like to move to admit  
6 OCD Exhibits 1 through 4. Exhibit 4 is my notice  
7 exhibit that I would like to submit now.

8 MR. DOMENICI: No objection.

9 EXAMINER McMILLAN: Okay. Exhibits 1, 2, 3  
10 and 4 may be accepted as part of the record.

11 (Whereupon, OCD Exhibits 1 through 4 were offered  
12 and accepted as a part of the record.)

13 MR. HERRMANN: Give the originals to the  
14 reporter, please.

15 THE WITNESS: Sure.

16 EXAMINER McMILLAN: Has the Applicant seen  
17 Exhibit A?

18 MR. DOMENICI: They have a copy here. You  
19 don't need to look at it yet. First I want to swear in  
20 the witness.

21 EXAMINER McMILLAN: Okay. Let's have the  
22 witness sworn in.

23 AQEEL VIRK

24 having been first duly sworn, was examined and  
25 testified as follows:

DIRECT EXAMINATION

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BY MR. DOMENICI:

Q. State your name for the record, please.

A. My name is Ageel Virk.

Q. And what is your educational background?

A. My undergraduate degree is in finance and my background is in law, my graduate degree in is law.

Q. And looking at Exhibit A, what is that, please, sir?

A. This is the application for the authorization to --

EXAMINER McMILLAN: What kind of witness is he?

MR. DOMENICI: I was going to try to see if there's any objections to Exhibit A.

EXAMINER McMILLAN: We're doing this now.

Q. So describe your involvement with Blue Sky.

A. I joined Blue Sky in the end of March, April-ish, kind of handling the operations of New Mexico.

Q. March of 2014?

A. Yes.

Q. And was there an agreed compliance order in effect for Twin Lakes at that time?

EXAMINER McMILLAN: Can you please tell me your experience?

1 THE WITNESS: My experience with --

2 EXAMINER McMILLAN: Relevant to the case.

3 THE WITNESS: I have been operating -- I  
4 have been managing and operating, handling Blue Sky New  
5 Mexico since March, April-ish, 2014.

6 EXAMINER McMILLAN: What did do you before  
7 that?

8 THE WITNESS: Before that, I graduated from  
9 law school, the year before that.

10 Q. (By Mr. Domenici) And do you have any other oil  
11 and gas experience?

12 A. Yes. Since that time, I've been working with  
13 various oil and gas companies, just kind of consulting  
14 and doing other types of work.

15 Q. Be more specific, what companies and what kind of  
16 work?

17 A. Well, Blue Sky Management -- most of the work is  
18 for Blue Sky Management, kind of handling, going through  
19 the process of getting the injection permits, hiring and  
20 firing, kind of the field guys, just managing the  
21 operational side of oil and gas.

22 Q. And do you manage from a distance? Where do you  
23 live?

24 A. I live in California.

25 Q. And so did you have a contract operator or a

1 contract manager working for Blue Sky?

2 A. Yes, we did.

3 Q. What's his name?

4 A. Sorry. Currently or --

5 Q. No. In 2014.

6 A. In 2014, we had Ross Parker who was managing the  
7 Blue Sky New Mexico projects.

8 Q. And did you end up having a problem with  
9 Mr. Parker?

10 A. Yes, we did. We had a problem with Mr. Parker.

11 Q. Describe that briefly.

12 A. It was brought to our attention by the OCD and  
13 Mr. Daniel Sanchez's staff that that Ross Parker had  
14 been illegally injecting. And when we found that out,  
15 we had to -- we let him go soon after.

16 Q. Let me back up a little. So when you came on in  
17 March or so of 2014, did you have limited experience in  
18 oil and gas?

19 A. Yes. It was limited but I still had a decent  
20 amount of experience.

21 Q. And did you have any experience with New Mexico  
22 regulation or permitting?

23 A. No. I did not have any experience with New  
24 Mexico's regulation or permitting.

25 Q. And did you -- what were the wells producing --

1 when Mr. Parker was illegally injecting, what were the  
2 wells production approximately?

3 A. They were approximately producing somewhere close  
4 to 35 barrels per day, and these were reports that I was  
5 kind of receiving from Mr. Parker himself. But these  
6 were verbal communications that we would have.

7 Q. And were you aware of efforts to bring six wells  
8 into compliance during that six-month time period?

9 A. Yes --

10 EXAMINER McMILLAN: So is he a technical --  
11 what kind of expert is he?

12 MR. DOMENICI: I am not qualifying him as an  
13 expert. He is a fact witness from the company.

14 EXAMINER McMILLAN: Okay. That's --

15 MR. DOMENICI: He's just going to describe  
16 facts about the company, if that's okay.

17 EXAMINER McMILLAN: That's fine.

18 THE WITNESS: The question, if you could  
19 repeat it.

20 Q. (By Mr. Domenici:) What information -- what  
21 efforts were being made to satisfy the six wells that  
22 were supposed to come into compliance under the  
23 compliance rule?

24 A. There was a work-over that was being done. Two  
25 of the wells were included that were from the inactive

1 list, were on that work-over; and for some reason, two  
2 were not, which I found to be very strange, that we  
3 would be doing a work-over on two wells that which were  
4 not on the inactive list.

5 And those were -- that was one of the efforts  
6 that was kind of being worked on at that time.

7 Q. So was that work in progress when you stepped  
8 into your role?

9 A. Yes, that was work in progress.

10 Q. And did those two work-overs of inactive wells  
11 get completed?

12 A. Yes, those two work-overs did get completed. For  
13 those wells, they did, yes.

14 Q. And did those wells produce?

15 A. Yes, they did produce. And from the information  
16 that I received, they produced for a period and then  
17 they were shut down due to an increased water production  
18 of the wells.

19 Q. And, approximately, how much money was spent by  
20 Blue Sky in that work-over?

21 A. Approximately, probably, \$150,000.

22 Q. And, in hindsight, was that a good investment?

23 A. No.

24 Q. Explain that to the Hearing Examiners.

25 A. It wasn't a good investment because we -- the

1 contract operator had hired a drilling -- a work-over  
2 drilling rig company. I thought the rates were  
3 excessive. We ended up -- the charges, the invoices  
4 that came in were very high.

5 The parts and all of the equipment that was  
6 bought for that work-over, you know, astronomical  
7 charges, astronomical charges for this work-over that  
8 was being done.

9 And the biggest reason, two wells were worked  
10 over on that were not inactive.

11 Q. And was there the ability to dispose of the water  
12 that had been produced as a result of the work-over?

13 A. No, no.

14 Q. When you stepped in March or so, did you think  
15 there was a problem?

16 A. Yes, yes. You know -- I started realizing with  
17 my communications with Ross that -- I started sensing  
18 that there seemed to be some problem. And then I think  
19 it was about that time that the issue with illegal  
20 injection came up as well. And then soon after, we had  
21 to let him go it.

22 Q. And then you stopped -- did the production go  
23 down?

24 A. Yes, the production went down significantly.

25 Q. Because?

1       A. Because we weren't able to inject all the  
2 water that was -- dispose of the water that was being  
3 produced by the wells.

4       Q. Now, did that information give you confidence  
5 that if you did have injection authority this field  
6 would be capable of producing?

7       A. Yes. The decrease went from 35 to about, you  
8 know, single digits, maybe ten, 11.

9       Q. And is that current, more or less?

10      A. Currently, we are at about seven or eight barrels  
11 per day.

12      Q. And you're using one disposal well?

13      A. One, yes, which is the saltwater disposal well.

14      Q. And did you personally undertake efforts to talk  
15 with Phil Goetze and try to identify someone who could  
16 establish more injection capacity?

17      A. Yes. We were communicating with one individual  
18 who we were trying to kind of find someone to help us  
19 out with the injector permits, to go through the process  
20 of preparing the application.

21               We were talking to one individual. By the time  
22 they gave us a quote back, the rates were unreasonably  
23 high.

24               And I had a phone discussion with Phil, where I  
25 was just asking him, What kind of companies are usually

1 coming through your door that are filing these injector  
2 permits, and if you could suggest -- you don't have to  
3 suggest them, you can just name them and I'll kind of  
4 start calling them.

5 Q. And as a result of that, did Exhibit A get  
6 created?

7 A. Yes.

8 Q. What is Exhibit A?

9 A. Exhibit A is the authorization -- the application  
10 for authorization to inject.

11 Q. Who prepared that?

12 A. Brian Wood from Permits West.

13 Q. And which wells were selected?

14 A. The wells that were selected were -- I can list  
15 them out, 50, 59 -- they are listed in the front -- 68,  
16 70 and 88.

17 During the process, we were really trying to  
18 select wells that were -- they weren't close to our  
19 boundary lines to limit our notice, and we were just  
20 trying to select wells that would easily be able to  
21 permit.

22 And before selecting these wells, we conducted  
23 our own MIT tests to make sure they would pass MITs once  
24 the permit was received.

25 Q. And did you have an understanding that you might

1 not be able to have enough time under the agreed  
2 compliance order to have this permit considered by  
3 Mr. Goetze or whoever...

4 A. An understanding --

5 Q. Let me rephrase it. At some point did you ask  
6 for an extension for the agreed compliance order?

7 A. Yes, I did.

8 Q. And what was the reason for that?

9 A. There's multiple reasons. One, we weren't  
10 meeting our six limit and we weren't going to be able to  
11 meet it by August 14th, I think the date was, so we  
12 needed an extension to kind of -- to continue forward  
13 and try filing the application for the injection  
14 authority.

15 Q. And then did you try to receive an understanding  
16 as to how long it might take that permit to be  
17 processed?

18 A. I tried, but the answer that was given to me,  
19 that it's kind of uncertain how long it would take if  
20 there was a hearing process involved.

21 But I was told that they have hearings every -- I  
22 don't remember -- there's a timing of when hearings kind  
23 of occur and then you have to try to get on the docket.

24 Q. Are you ready to submit that application?

25 A. Yes, we are.

1 Q. Is Permits West still engaged and ready to move  
2 forward?

3 A. Permits West's invoices have been paid, and they  
4 are engaged.

5 Q. There was some discussion earlier -- but I want  
6 to make sure it comes in as testimony -- is Blue Sky  
7 prepared to agree to a stipulation in this order that if  
8 bonds are released off those six Canyon wells that Blue  
9 Sky would place those bonds or use the proceeds to buy  
10 other bonds to bond these five wells that are subject to  
11 Exhibit A?

12 A. Yes.

13 Q. And so those wells could be bonded immediately  
14 and the permit could be submitted immediately?

15 A. Yes.

16 Q. And is Blue Sky in a position to post \$368,000 of  
17 bonds in order to have Exhibit A considered?

18 A. No.

19 Q. Why not?

20 A. I have been trying to deal with bonding companies  
21 and trying to get -- you know, reaching out to different  
22 companies, trying to get the bonding amount up. But we  
23 just haven't received positive feedback where we would  
24 be able to receive this much bonding.

25 Q. How many bonds did Blue Sky place when they did

1 take over this field?

2 A. \$50,000 for the blanket and it was about \$108,000  
3 for the individual wells.

4 Q. And that bond is still in place?

5 A. Yes, it is.

6 Q. And would Blue Sky like to bond as many wells as  
7 necessary at some point to get into another agreed  
8 compliance --

9 A. Of course, yes.

10 Q. I explained as the representative of Blue Sky --  
11 how would this concept of a rolling bond work?

12 A. I think the thing is that there's 29 injectors  
13 that are all on the inactive list, roughly at \$8,000,  
14 that makes up a majority.

15 The total -- Mr. Sanchez had already testified  
16 that the total bonds due are \$368,207. And of that,  
17 \$223,000 are from the injectors, which are very  
18 important to the field. And that's why there are so  
19 many injectors there, because the field needs those  
20 injectors to dispose of the water.

21 If we are able to put up some sort of bond amount  
22 that would cover this -- at least getting this filed,  
23 because when I had initially engaged Brian Wood, my idea  
24 was we do five or six wells -- we started with six and  
25 we took one off because it was close to the boundary.

1 We moved it because we wanted to make this application  
2 very simple and easy to process and get approved. And  
3 then while this is in the approval process, we started  
4 another one of five or six. And slowly we can keep  
5 getting the injectors off the inactive list.

6 Q. And would you also get producing wells off the  
7 inactive list?

8 A. Yes. And then with that, it's difficult for Blue  
9 Sky to spend money on work-overs or, you know, to do  
10 some sort of repairs on production wells when we know if  
11 the well does produce, the water that comes from it, we  
12 won't be able to dispose of it.

13 Currently, the field is running kind of -- I  
14 mean, I guess, at maximum efficiency, the amount of  
15 water that's produced is just the right amount that can  
16 be disposed.

17 Q. From your standpoint, since you've been involved,  
18 have you tried to act in good faith with respect to OCD  
19 requirements?

20 A. Yes.

21 Q. Does that include retaining Permits West?

22 A. Yes.

23 Q. And trying to identify the best way to move  
24 forward with the permitting that's the quickest and the  
25 least controversial?

1 A. Yes.

2 Q. And are you -- I know we had some discussion, but  
3 I just want to put it in the record from a witness.

4 Very briefly, is Blue Sky trying to work things  
5 out with the bankruptcy trustee?

6 A. Yes, they are.

7 Q. And, also, did Blue Sky post a bond today with  
8 the State Land Office?

9 A. Yes, we did. We posted a bond today with the  
10 State Land Office, a surface damage bond.

11 Q. Of how much?

12 A. \$20,000.

13 EXAMINER McMILLAN: And that is a separate  
14 operating -- so we're not --

15 MR. DOMENICI: I understand.

16 EXAMINER McMILLAN: The State Land Office  
17 and the OCD are separate operating entities.

18 MR. DOMENICI: I am trying to get to the  
19 point of good faith.

20 EXAMINER McMILLAN: But that point needs to  
21 be made.

22 Q. (By Mr. Domenici:) Do you understand they are  
23 separate operating entities?

24 A. Yes, I do.

25 Q. And that bond is for State Land Office surface

1 issues?

2 A. Yes, yes.

3 Q. Just to wrap up, so is it your testimony that  
4 Blue Sky actually did place several wells in compliance  
5 during the six months?

6 A. You know, a few things happened which were  
7 unfortunate, some of them due to operator -- for  
8 example, one of the work-over wells which should have  
9 come off the list -- because I know it produced for a  
10 couple of days. And that's all a well needs to produce  
11 for before -- that should have come off.

12 The saltwater disposal well was still on the  
13 inactive list, but that should have come off the list as  
14 well. And there was I think one other one that should  
15 have come off as well.

16 Q. And there was some discussion about  
17 communications between you and Mr. Daniel Sanchez. Do  
18 you have your e-mails there that you could just  
19 summarize for the record?

20 A. Sure.

21 I had sent an e-mail to Mr. Sanchez on July 28th,  
22 2014. There's just kind of a letter requesting -- there  
23 was a letter requesting an extension and kind of  
24 highlighting -- it was -- it highlighted the reasons I  
25 was asking for that extension.

1           And in that I included invoices that we paid to  
2           the drilling/work-over company, invoices that we paid to  
3           the equipment company for those wells.

4           And it also included -- it included other stuff,  
5           other engineering companies that we paid to do work.  
6           And it also included a few pages from the injection --  
7           for the permit application for the injection authority  
8           as well.

9           Q.   And then did you meet with Mr. Daniel Sanchez?

10          A.   Yes, we did.   And that was on July 31st.

11          Q.   And did you understand that an extension would  
12          not be granted?

13          A.   Yes.   At that time, it was my understanding that  
14          there would be no extension and the permit application  
15          would not be accepted.

16          Q.   And have you tried since then to find a bonding  
17          capacity so you could enter another agreed compliance  
18          order and then have that permit application submitted?

19          A.   Yes.

20          Q.   And you have already testified that that has been  
21          unavailable?

22          A.   Right.

23          Q.   Were payments made during that time period to the  
24          trustee?

25          A.   I believe there were payments made or -- I would

1 have to double-check -- we were in default, so I'm not  
2 sure when the last payment was made exactly. We were in  
3 default with the trustee.

4 Q. Would you like -- on behalf of Blue Sky, would  
5 you like the opportunity to have an order or a  
6 recommendation perhaps from the examiner and perhaps an  
7 order from the director that would allow this permit  
8 application to be submitted and those wells be bonded  
9 and see if enough activity could take place in  
10 production that you could within a six-month compliance  
11 period come up with a bond and an agreed compliance  
12 order?

13 A. Yes, I would. I truly believe that -- I think  
14 that the holdback right now for the field in itself is  
15 the fact that it lacks the ability to dispose of water.

16 Q. Okay.

17 MR. DOMENICI: Thank you. That's all I  
18 have.

19 EXAMINATION BY EXAMINER McMILLAN

20 EXAMINER McMILLAN: So, first of all, you  
21 did work-overs on three wells? There are three wells  
22 that became active?

23 THE WITNESS: Sorry. I can clarify that.

24 There were three wells that were on the list  
25 that should have not been on the list. And what I mean

1 by "on the list" is on the compliance list. And one of  
2 them was the saltwater disposal well, which is No. 40.

3 It shows up on the list. And we had that  
4 well approved as a saltwater disposal well. And that's  
5 the only well we were using to dispose of the water. So  
6 it should have been removed.

7 But during the time of our previous  
8 operator, I don't think the proper filings were done  
9 where it came off the list.

10 EXAMINER McMILLAN: Okay. But what about  
11 the other wells?

12 THE WITNESS: The same thing with the other  
13 ones.

14 EXAMINER McMILLAN: Did you get six wells?

15 THE WITNESS: We did not get six wells. We  
16 did not get to six wells.

17 MR. DOMENICI: Your testimony is you got to  
18 three wells?

19 THE WITNESS: Yes.

20 EXAMINER McMILLAN: Okay. Here is the --  
21 have you done -- have you or anyone under your  
22 supervision at Blue Sky gone out there and done a field  
23 examination of the wells in question?

24 THE WITNESS: Which -- the wells -- we have  
25 a full-time pumper there that's out there on a regular

1 basis that's still working at the field.

2 MR. DOMENICI: What is his name?

3 THE WITNESS: David Anderson.

4 MR. DOMENICI: And how familiar is he with  
5 the field?

6 THE WITNESS: He's very familiar with the  
7 field. He's worked with the previous companies as well.  
8 And we brought him on after we let go of Ross Parker.

9 EXAMINER McMILLAN: You claim -- I want to  
10 say it for the record -- that you felt by putting in  
11 these injection wells, you'll increase production,  
12 right?

13 THE WITNESS: I do think we can increase  
14 production because -- sorry, did you want to say  
15 something?

16 EXAMINER McMILLAN: Go ahead. I'll let you  
17 finish.

18 THE WITNESS: I do think with the injection  
19 wells we can increase production because it would allow  
20 us to do other work-overs. There are some wells that  
21 I'm being informed by my pumper that need a little  
22 work to kind of bring on line, but the water that they  
23 produce is -- currently we can't handle at the  
24 field.

25 EXAMINER McMILLAN: But you are not a

1 technical witness. You're a fact witness and that's a  
2 technical statement. That statement has to be removed  
3 from the record.

4 MR. DOMENICI: What has your pumper told you  
5 about what can be done?

6 THE WITNESS: My pumper has told me that if  
7 we -- the problem my pumper has repeatedly told me is  
8 that we are not able to dispose of the water that is  
9 being produced from our producing wells.

10 MR. DOMENICI: Let me follow up -- I don't  
11 want to interrupt you, though. Just one. With respect  
12 to Mr. Parker, when you were producing 37 barrels a day,  
13 roughly, how many wells were actually producing?

14 THE WITNESS: I don't remember the exact  
15 number that was producing at that time, but it was much  
16 greater than what it is now, because those wells can't  
17 be producing now due to our limitations with the  
18 disposal of the water.

19 MR. HERRMANN: If I may.

20 CROSS-EXAMINATION

21 BY MR. HERRMANN:

22 Q. How many disposal wells do you have active on the  
23 lease right now?

24 A. Just one, which is the saltwater disposal well.  
25 It's No. 40.

1 Q. And how did you select that one for -- to -- did  
2 you select that one?

3 A. I did not personally select that one. This was  
4 selected before I was brought on, I think somewhere in  
5 2013.

6 Q. Do you know if that well has performed at what  
7 you expected it to?

8 A. I don't know what the expectation was. I would  
9 say if it's not able to handle the water -- there have  
10 been days we've had to completely shut in the field  
11 because the well is slowly just absorbing the water or  
12 run other chemicals through that well for it to absorb  
13 water.

14 Q. And what gives you reason to believe that any of  
15 these wells that you have this application for will  
16 perform at or better than that well?

17 A. Even if they perform at, it just gives us the  
18 ability to dump more water, which we can bring on more  
19 producing wells. And, maybe -- and another is we have  
20 performed MIT tests on these wells so we know they are  
21 good wells.

22 Q. Do you have estimated injection capacities on  
23 these?

24 A. I don't personally have estimated injection  
25 capacities on them, no. But they may be in the report.

1 This was done by --

2 (Witness looking through documents.)

3 Q. How many injectors are on the lease?

4 A. There are 29 injectors on the lease.

5 Q. And the rest are producers?

6 A. Yes, the rest are producers. And there's one --  
7 there's one saltwater disposal.

8 EXAMINATION BY EXAMINER McMILLAN

9 EXAMINER McMILLAN: So the 29 injectors, are  
10 they saltwater disposal or waterflood?

11 THE WITNESS: I'm sorry. Can you repeat  
12 your question?

13 EXAMINER McMILLAN: So there's one saltwater  
14 disposal well and 29 injectors that are for saltwater  
15 disposal?

16 THE WITNESS: No, the 29 injectors, they're  
17 just injectors. I think originally the saltwater  
18 disposal was also an injector, but it was permitted as a  
19 saltwater disposal well. So that's why I keep referring  
20 to it as a saltwater disposal well.

21 EXAMINER McMILLAN: So all the injectors  
22 are -- you're placing produced water back into the  
23 formation?

24 THE WITNESS: Yes.

25 EXAMINER McMILLAN: So then they are

1 saltwater disposal wells.

2 THE WITNESS: Yes.

3 EXAMINER McMILLAN: Okay. Continue.

4 FURTHER EXAMINATION BY MR. HERRMANN (cont'd)

5 Q. (By Mr. Herrmann:) So best case scenario, if the  
6 OCD were to approve this application for injection, and,  
7 again, waive the 5.9 review, how soon do you think you  
8 could return all your wells back to compliance?

9 A. I think a lot of it depends on how long it would  
10 take to get the injection application approved, because  
11 once it gets into review, we are kind of at the mercy of  
12 the OCD for approval.

13 Once the approval gets in, we have to start  
14 injecting water and then file the appropriate forms.  
15 And I think the bond is released within a month, maybe  
16 30 days after that, once the forms have been received.

17 Q. Well, I'm saying from the date you had approval.  
18 ?

19 A. From the date they're approved? From the date  
20 they are approved, I think we could -- I think if we  
21 know -- if we know that this application is going to go  
22 into review, I can also have Brian Wood at Permits West  
23 start preparing another application for more wells,  
24 which we can submit afterwards, to get them off the  
25 inactive list as well, which would remove five or six

1 more wells.

2 And then we could start looking at with our  
3 pumper production wells that we could put back on line  
4 where we would now have the ability to inject water. So  
5 when these wells come back, we are ready for the water  
6 to be injected and get them producing.

7 Q. And if these wells, the ones you have your  
8 application for, if they don't perform at or below  
9 expected capacity, what further assurance would the OCD  
10 have to continue working with Blue Sky?

11 A. I think one of the things is that if the bond is  
12 in place, and even if they perform below, then that bond  
13 can still move over to other injector wells, so we're  
14 still removing more wells off the inactive list, so we  
15 are still keeping that bond there and working at  
16 removing more wells.

17 MR. HERRMANN: No further questions.

18 EXAMINER McMILLAN: So I am trying to  
19 understand, these five wells are the first wells you are  
20 going to get going, correct?

21 THE WITNESS: Yes.

22 EXAMINER McMILLAN: If I am understanding  
23 everything, those bonds will be released and then you'll  
24 hit the next five, and so on and so forth?

25 MR. DOMENICI: Any other bonds that are

1 released will stay on the field. So if we have a  
2 production well come on line and a bond's released, that  
3 will come back on an inactive well.

4 So any released bonds will always be placed  
5 on the field until there is complete bonding. And at  
6 some point maybe we would actually have excess bonding.  
7 That would require us to have a lot of injection wells,  
8 quite a few more producing wells. But until then, the  
9 additional \$40,000 plus all these bonds would continue  
10 being moved to inactive wells.

11 EXAMINER MARKS: That all comes from the  
12 \$40,000 in liquid assets now plus the five, I believe  
13 five bonds that you will seek to release now?

14 MR. DOMENICI: Well, there is \$108,000  
15 individual bonds. So there is \$108,000 of individual  
16 bonds, so if any of those wells -- and I think one of  
17 those might have -- we should have perhaps asked to  
18 move that -- so if any of those wells become active,  
19 that bond would be placed on an inactive well.

20 The \$40,000 -- so, round numbers, \$150,000  
21 of single well bonds that will continue to be moved and  
22 the blanket bond would also stay in place.

23 EXAMINER MARKS: So when does Blue Sky think  
24 it will become compliant with ODC's rules? I understand  
25 this rolling bond concept. February of 2014 was the

1 last compliance order. When is the expected date that  
2 the company could actually come in compliance with these  
3 rules?

4 MR. DOMENICI: If I can state.

5 THE WITNESS: Go ahead.

6 MR. DOMENICI: Our goal, I think we would be  
7 okay with this in the order, is within the six months.

8 The goal would be before the six months runs  
9 out to enter an agreed compliance order, which, most  
10 likely, would have to add to the \$150,000 in single well  
11 bonds. Hopefully, we would not have to add \$368,000  
12 because we would have had 5 or 10 injection wells come  
13 off inactive, 10 to 15 production wells come off  
14 inactive, we would have \$150,000 already ready, but the  
15 bond might be another \$100,000.

16 And we would come to Daniel and say, We are  
17 ready to bond up all the inactive wells in our agreed  
18 compliance order; goes back in compliance, and moves  
19 forward.

20 So we are not asking for more than the six  
21 months.

22 EXAMINER MARKS: And this is contingent upon  
23 the \$130,000 approval in the bankruptcy -- note purchase  
24 in the bankruptcy court as well, right?

25 MR. DOMENICI: That's a contingency, but

1 we're not asking for that in terms of an order saying,  
2 You place these \$40,000 on these five wells immediately.  
3 So that's not a contingency.

4 But as far as the whole thing to work, yes,  
5 if we lose title somehow, we obviously can't come into  
6 compliance. But our goal is not to do that.

7 If we don't hold on to the title, then that  
8 would obviously cause us not be able to come into  
9 compliance. There would still be another \$40,000 in  
10 bonds in the near future. If you agree to this order,  
11 at least \$40,000 will come on.

12 EXAMINER MARKS: But with Blue Sky's current  
13 assets, it cannot come into compliance, is your  
14 testimony, unless the bankruptcy court approves the  
15 asset purchase agreement?

16 MR. DOMENICI: Correct. We wouldn't make  
17 the six-month deadline.

18 EXAMINER MARKS: But you could make some  
19 other deadline?

20 MR. DOMENICI: I don't know what would  
21 happen. I don't -- at that point it would be  
22 speculation how the title issue will play out.

23 We are trying to work through this quickly  
24 so the bankruptcy issue is behind us. And we are not  
25 contesting the six months that's been requested by the

1   OCD. We are not saying make that nine months or  
2   12 months. We are just trying to get an application  
3   considered essentially and to bond those wells with the  
4   \$40,000 that's -- and other instruments that we were  
5   able to request for these.

6                   EXAMINER MARKS: And do you have terms  
7   agreed to with the trustee?

8                   MR. DOMENICI: The trust authorized me -- I  
9   just talked to him and he authorized me to say we are  
10  working on final terms.

11                   Our proposal to him was just what I told  
12  you, we would immediately give him \$67,500. So \$135,000  
13  is the price. And the closing would be right around  
14  May 30th.

15                   They would do an expedited notice, which can  
16  be shortened from 21 days to ten days. Now if someone  
17  objects or something like that, it throws a kink in  
18  that. But in terms of the terms and the schedule, it's  
19  to close with OCD by around June 1st. We are sitting  
20  here two and a half weeks away.

21                   EXAMINER MARKS: Okay. At some point -- and  
22  I am not sure when -- we talked about the additional  
23  bonding will provide a substantial benefit to the State  
24  of New Mexico and the OCD. I am a little confused as to  
25  where that notion is coming from. And, obviously, the

1 bonding is required.

2 Can you just elaborate on that?

3 MR. DOMENICI: Sure. So the \$40,000 of  
4 bonds that are on -- I'll call them Canyon wells, those  
5 bonds could be released today to Blue Sky for any use  
6 they want. We are agreeing we would have a stipulation  
7 that that \$40,000 goes back into this field.

8 EXAMINER MARKS: But these are bonds already  
9 existing on Canyon wells, right?

10 MR. DOMENICI: They are, but my  
11 understanding is those bonds are fully releasable  
12 because they are in Blue Sky's name and they are subject  
13 to Blue Sky becoming operator or owner of those wells,  
14 which won't happen. So those bonds are essentially  
15 available for any purpose for Blue Sky. So that would  
16 add \$40,000 of security to the field.

17 And my only other point was I was trying to  
18 say when Blue Sky got into this, they placed \$150,000 of  
19 bonds on this unit that were not there, which provided  
20 some benefit, and the bonds are still there.

21 They are not growing or anything so I am not  
22 saying that that's -- that is just a continuing benefit.  
23 But if we could bring more wells into compliance, of  
24 course, and put those on inactive wells, it provides  
25 more security. In case something happens, there's

1 security on inactive wells. And there's active wells,  
2 and, theoretically, a third-party would be interested in  
3 it, as opposed to a liability.

4 EXAMINER MARKS: I am just going to ask  
5 again about the Twin Lakes Unit 18 with the torn liner.  
6 And I know you said the pumper goes -- the pumper who is  
7 the person doing the site inspections for --

8 THE WITNESS: He's the field worker, I  
9 guess.

10 EXAMINER MARKS: Are you concerned about the  
11 environmental liability with a torn liner?

12 THE WITNESS: I was not aware that the liner  
13 was torn. I haven't been informed by him, but I will  
14 look into this issue now that I have been informed.

15 EXAMINER MARKS: Do you know how often he  
16 goes to the various sites?

17 THE WITNESS: He's there on a daily basis.

18 EXAMINER MARKS: To every site -- to every  
19 well?

20 THE WITNESS: I think so. I'm physically  
21 not present in New Mexico or at the field. I'm in  
22 California. But as part of his job description he's  
23 supposed to be checking on each well and checking on the  
24 pumping units and maintaining the battery and all of  
25 that.

1 EXAMINER MARKS: Okay.

2 EXAMINER McMILLAN: So if the five wells  
3 don't work out, the whole thing -- the order will -- the  
4 order will no longer be in effect?

5 MR. DOMENICI: Oh, no. The order would say  
6 you come into compliance within six months, and, then,  
7 after that, I would assume there would be an application  
8 for a funding order on any wells that are out of  
9 compliance at that point.

10 MR. HERRMANN: May I ask a couple of  
11 questions?

12 EXAMINER McMILLAN: Certainly.

13 FURTHER EXAMINATION

14 BY MR. HERRMANN:

15 Q. When was the last time you were on the site here?

16 A. My last visit to the site was -- I think it was  
17 last year, around August, maybe September.

18 Q. Okay. Because you had mentioned that you had had  
19 issues with your previous pumper and then you just  
20 mentioned that he had not let you know about some of the  
21 conditions on the site through our reports, so --

22 A. Just to be clear, it just says torn liner. I am  
23 not sure where --

24 Q. There are some other issues, no signs and the  
25 valves open to injection, so --

1 A. Sorry. If I may interrupt.

2 The valves open to injection, that was in March  
3 when the issue with Ross Parker had occurred.

4 After that, there have been no valves open to  
5 injection at all. I mean, that's why we have an  
6 injection problem because...

7 Q. My concern is just that you did have a problem  
8 with one pumper already and you haven't been at the site  
9 yourself in over a year. So what steps are being taken  
10 to oversee your pumper?

11 A. I am going to be at the site on this visit as  
12 well.

13 Q. But not anything between these visits?

14 A. We are working very closely with the pumper. I  
15 have a great relationship with him. We talk on a  
16 regular basis. So I myself am kind of shocked that  
17 there's this issue of a torn liner. But I would like to  
18 know or if I could see that exhibit as to when that was  
19 reported or if that's from March or if that's from now.

20 EXAMINER MARKS: March 27th, 2015.

21 Q. And what do you mean by regularly talk, how  
22 often?

23 A. We talk on a daily basis.

24 Q. Daily?

25 A. Yes.

1 Q. This is partly to your proposal. Currently you  
2 have a \$50,000 blanket bond and approximately \$108,000  
3 in single well bonds and another \$40,000 that you are  
4 offering to pledge right now.

5 So our rules don't currently provide for a  
6 rolling bond of what we're discussing, but you would be  
7 willing to commit Blue Sky to keep that \$198,000  
8 continually bonded on the Twin Lakes Unit?

9 A. Yes.

10 MR. HERRMANN: I have no further questions.

11 EXAMINER McMILLAN: Just for the record,  
12 Twin Lakes San Andres Unit No. 56, it's showing a small  
13 stockpile of contaminated soil.

14 THE WITNESS: May I add a comment?

15 EXAMINER McMILLAN: Sure.

16 THE WITNESS: The field is very dilapidated,  
17 so some of these issues that we are discussing -- you  
18 know, when we first took on the field, the field was in  
19 terrible shape, terrible, terrible shape.

20 So I mean we can't say that -- I just don't  
21 want these to be used against Blue Sky in a way of  
22 saying, Hey, you guys are the ones that kind of caused  
23 this, because I know we've cleaned that place up really  
24 well.

25 My pumper, I mean, the road -- even when we

1 first brought him on, the rancher was really happy at  
2 that lease because this guy is such a hard worker. He  
3 pulls like this flat metal plow on this rugged road to  
4 make the road kind of better for everyone else that's  
5 going in and out.

6 In the morning, when he goes in, he pulls it  
7 to the location and all the way back. He pulls it back  
8 to kind of make it more even so the road is more usable.

9 I just wanted to comment on that.

10 EXAMINER McMILLAN: So this really is your  
11 first experience with operations?

12 THE WITNESS: With operations, yes. But we  
13 do work closely with a team. It's not just me who is  
14 handling the operations.

15 EXAMINER MARKS: If you take this note with  
16 all this equipment in the bankruptcy, have you inspected  
17 the equipment recently?

18 MR. DOMENICI: Are you talking about on the  
19 Twin Lakes or other equipment?

20 EXAMINER MARKS: As you said, you would have  
21 the lien to all the equipment.

22 MR. DOMENICI: You'd have to ask Aqeel. I  
23 don't know how recently.

24 THE WITNESS: The equipment, the inventory  
25 list that's provided by the trustee is -- you know, we

1 don't know the accuracy of it because it goes into  
2 detail. But there haven't been -- because these fields  
3 have just been abandoned for so long, some of them, a  
4 lot of stuff has been stripped or things are just kind  
5 of missing or just gone or have been poached over time.  
6 So we don't have a true updated list as to what's  
7 available, if that answers your question.

8 EXAMINER MARKS: I think earlier you said  
9 you'd take some of the leases or you'd take some of the  
10 equipment. What would your plan be?

11 MR. DOMENICI: None of the leases.

12 EXAMINER MARKS: None of the leases. Some  
13 of the equipment, you would take some of it --

14 MR. DOMENICI: I don't think there's a firm  
15 plan for the equipment at this point. The trustee  
16 hasn't even really said that's the way they want to  
17 proceed, is signing a note versus a settlement of some  
18 kind. If that occurred, then, probably, there would  
19 have to be like a joint inspection with the trustee to  
20 decide if that is even worth pursuing, perhaps even with  
21 the OCD. We are somewhat flexible on that, I think.  
22 That remains to be worked out.

23 I think that would be probably spelled out  
24 in the bankruptcy order. And if you want us  
25 to circulate that to you so you have an understanding of

1    how that might be proposed -- you may be getting copies  
2    anyway. That's filed in bankruptcy.

3               But we would be happy to be sure you are  
4    noticed of however that transaction reads in its  
5    proposal.

6               EXAMINER MARKS: The concern is just the  
7    resources of the company are so limited not to be stuck  
8    with another liability.

9               MR. DOMENICI: I don't think there is any  
10   intention of being stuck with another liability. I  
11   don't think the trustee is trying to push liability.

12              The trustee is trying to say, You pay us  
13   this money and you take Twin Lakes, and there are some  
14   other loose ends we need to tie up.

15              They are not trying to push liability.  
16   They're trying to tie up Twin Lakes. But they do want  
17   to get it through the bankruptcy process quickly. So  
18   that is the only reason these loose ends just have to be  
19   tied up.

20              EXAMINER MARKS: All right.

21              EXAMINER McMILLAN: I don't have any further  
22   questions at this time. Case No. 15277 will be taken  
23   under advisement.

24              MR. DOMENICI: May Exhibit A be admitted  
25   into evidence?

1 MR. HERRMANN: No objections.

2 EXAMINER McMILLAN: Exhibit A presented by  
3 Blue Sky may now be accepted as part of the record.

4 MR. DOMENICI: Thank you.

5 (Whereupon, Blue Sky Inc.'s Exhibit A was  
6 offered and accepted as part of the  
7 record.)

8 EXAMINER McMILLAN: Thank you.

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(Time noted 3:20 p.m.)

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I do hereby certify that the foregoing is  
a complete record of the proceedings in  
the Examiner hearing of Case No. \_\_\_\_\_,  
heard by me on \_\_\_\_\_.

20

\_\_\_\_\_, Examiner  
Oil Conservation Division

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1 STATE OF NEW MEXICO )  
2 ) ss.  
3 COUNTY OF BERNALILLO )  
4  
5  
6

7 REPORTER'S CERTIFICATE

8  
9 I, ELLEN H. ALLANIC, New Mexico Reporter CCR  
10 No. 100, DO HEREBY CERTIFY that on Thursday, May 14,  
11 2015, the proceedings in the above-captioned matter were  
12 taken before me, that I did report in stenographic  
13 shorthand the proceedings set forth herein, and the  
14 foregoing pages are a true and correct transcription to  
15 the best of my ability and control.  
16

17  
18 I FURTHER CERTIFY that I am neither employed by  
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21 and that I have no interest whatsoever in the final  
22 disposition of this case in any court.  
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