

## SETTLEMENT AGREEMENT

This Settlement Agreement is entered into as of the 15th day of September, 2005, by and between McElvain Oil & Gas Properties, Inc. (hereinafter, "McElvain") and the New Mexico Oil Conservation Division of the Energy Minerals and Natural Resources Department (hereinafter, "OCD").

**WHEREAS**, the OCD is the New Mexico State Division charged with administration and enforcement of the New Mexico Oil and Gas Act, NMSA 1978, §§ 70-2-1 through 70-2-38, as amended (the "Act"), and the rules promulgated under the Act, and OCD rules.

**WHEREAS**, pursuant to the Act and the rules promulgated under the Act, the Director of the OCD directs compliance with the Act and OCD rules, and assesses penalties for violations of the Act and OCD rules.

**WHEREAS**, McElvain is a domestic profit corporation doing business in New Mexico and is registered with the Public Regulation Commission under number 1574441. Its registered agent for service of process in New Mexico is John Catron, 2006 Botolph Road, Santa Fe, New Mexico, 87505. McElvain's principal address is 1050 17<sup>th</sup> St., Suite 1800, Denver, Colorado 80265. It is an active entity. McElvain's OGRID is 22044.

**WHEREAS**, OCD Rule 19.15.2.50.A NMAC (hereinafter, "Rule 50.A") provides, in relevant part, that "[d]ischarge into, or construction of, any pit ... is prohibited absent possession of a permit issued by the division ...."

**WHEREAS**, OCD Rule 19.15.2.50.C(2)(b)(i) NMAC (hereinafter, "Rule 50.C(2)(b)(i)") provides,

Each drilling pit or workover pit shall contain, at a minimum, a single liner appropriate for conditions at the site. The liner shall be designed, constructed, and maintained so as to prevent the contamination of fresh water, and protect public health and the environment. Pits used to vent or flare gas during drilling or workover operations that are designed to allow liquids to drain to a separate pit do not require a liner. (Emphasis added.)

**WHEREAS**, NMSA 1978, § 70-2-31(A) provides in relevant part, "[a]ny person who knowingly and willfully violates any provision of the Oil and Gas Act or any provision of any rule or order issued pursuant to that act shall be subject to a civil penalty of not more than one thousand dollars (\$1,000) for each violation. ... [I]n the case of a continuing violation, each day of violation shall constitute a separate violation."

**WHEREAS**, NMSA 1978, § 70-2-33(A) defines "person" in relevant part as "any individual, estate, trust, receiver, cooperative association, club, corporation, company, firm, partnership, joint venture, syndicate or other entity..."

### **A. The Badger Com 10 #1B well**

**WHEREAS**, McElvain is the operator of record of the Badger Com 10#1B well, API #30-039-27586, located at Unit Letter J, Section 10, Township 25 North, Range 02 West in Rio Arriba County, New Mexico.

**WHEREAS**, on July 8, 2004, OCD Deputy Inspector Denny Foust approved a permit in favor of McElvain on form C-103 for a lined drilling pit and an unlined blow pit at the Badger Com 10#1B well.

**WHEREAS**, McElvain conducted air-drilling operations October 8 through 10, 2004 on the Badger Com 10#1B well, discharging air, drill cuttings, and fresh water used for dust suppression into the unlined blow pit.

**WHEREAS**, on October 25, 2004, OCD Deputy Oil and Gas Inspector Bruce Martin discovered standing water in the unlined blow pit at the Badger Com 10#1B well. A plastic pipe connected the unlined blow pit to the lined drilling pit at the well. The drilling of the well had been completed and no rig was on the location.

**WHEREAS**, the design of the blow pit at the Badger Com 10 #1B did not allow all standing water to drain into the lined drilling pit.

**WHEREAS**, as a result of its investigation, the OCD issued a Notice of Violation (3-04-19), citing McElvain for knowingly and willfully violating Rule 50.C(2)(b)(i) at the Badger Com 10 #1B well by using an unlined vent or flare pit that was not designed to allow liquids to drain to a separate, lined pit.

**WHEREAS**, for those cited violations of Rule 50.C(2)(b)(i), the OCD imposed a One Thousand Dollar (\$1,000.00) civil penalty for the alleged violations.

### **B. The Elk Com 10 #1B well.**

**WHEREAS**, McElvain is the operator of record of the Elk Com 10 #1B well, API #30-039-29215, located at Unit Letter B, Section 10, Township 25 North, Range 02 West in Rio Arriba County, New Mexico.

**WHEREAS**, on September 14, 2004, OCD Deputy Inspector Foust approved a permit in favor of McElvain on form C-103 for a lined drilling pit and an unlined blow pit at the Elk Com 10 #1B well.

**WHEREAS**, on October 25, 2004, Deputy Oil and Gas Inspector Martin discovered standing water in the unlined blow pit at the Elk Com 10 #1B well. A plastic pipe connected the unlined blow pit to the lined drilling pit at the well. The drilling rig was on location and conducting repairs to continue air drilling the hole.

**WHEREAS**, McElvain discharged drill cuttings and fresh water used for dust suppression into the unlined blow pit at the Elk Com 10 #1B well on October 26 and 27, 2004.

**WHEREAS**, on October 27, 2004, OCD Deputy Oil and Gas Inspector Foust found that there was standing water in the unlined blow pit that was unable to drain into the lined pit, and that the water level at the north end of the drilling pit was over the top of the liner.

**WHEREAS**, the design of the blow pit at the Elk Com 10 #1B did not allow all standing water to drain into the lined drilling pit.

**WHEREAS**, as a result of its investigation, the OCD issued Notice of Violation (3-04-19) citing McElvain for knowingly and willfully violating Rule 50.C(2)(b)(i) at the Elk Com 10 #1B well by:

- a) using an unlined vent or flare pit that was not designed to allow liquids to drain to a separate, lined pit; and
- b) allowing the fluids in the lined drilling pit to rise above the top of the liner.

**WHEREAS**, for these cited violations of Rule 50.C(2)(b)(i), the OCD imposed a Two Thousand Dollar (\$2,000.00) civil penalty for the alleged violations.

**WHEREAS**, after OCD's investigation, McElvain:

- a) immediately emptied the blow pits of existing standing water at the Elk Com 10 #1B and Badger Com 10 #1B wells; and
- b) changed the design for their drilling locations to comply with Rule 50, to the satisfaction of OCD.


**WHEREAS**, McElvain neither admits fault or liability for the alleged violations but acknowledges it is a person as defined by NMSA 1978, § 70-2-33(A) and may be subject to civil penalties under NMSA 1978, § 70-2-31(A) if found to be in violation of OCD rules.



**WHEREAS**, based on the foregoing, the parties desire to resolve the issues raised by the Notices, without the necessity of litigation and the costs associated with litigation;

**NOW THEREFORE**, in consideration of the mutual covenants and agreements of the parties and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and for the purpose of fully and completely resolving the issues and allegations raised in the Notices, the parties agree:

1. McElvain shall pay a total of **Three Thousand Dollars (\$3,000.00)** to the OCD.
2. The **Three Thousand Dollars (\$3,000.00)** shall be paid by McElvain at the time this Agreement is executed. Payment shall be made by certified or cashier's check made payable to the "New Mexico Oil Conservation Division," and mailed or hand-delivered to the New Mexico Oil Conservation Division, Attention: Director, 1220 South Saint Francis Drive, Santa Fe, New Mexico, 87505.
3. This Agreement represents a settlement of disputed claims and is not an admission of the correctness of any position asserted by any party, or an admission of liability or of any wrongdoing.
4. This Agreement shall be construed based upon its terms and stated intent, including the recitals, and shall not be construed in the favor of one or another party based upon who may have contributed to its drafting, or on any other basis.
5. This Agreement constitutes the entire agreement between the parties, and any modification of or addition to this Agreement must be in writing and signed by all parties hereto.
6. Nonetheless and notwithstanding the above, nothing in this Agreement relieves McElvain of liability should its operations pose a threat to ground water, surface water, human health or the environment. In addition, nothing in this Agreement relieves McElvain of its responsibility for compliance with any other federal, state or local laws and/or regulations.
7. The signatories to this Agreement represent and warrant that they have full power and authority to enter into this Agreement on behalf of the parties indicated.
8. The parties acknowledge that they have been and are fully advised by competent legal counsel of their choice, that they have read this entire Agreement and fully understand its terms and conditions, and that their execution of this Agreement is with the advice of counsel and of their own free will and desire.
9. This Agreement fully and completely resolves all issues and allegations concerning the subject matter of the Notices of Violation to McElvain) (but see, para. 6, above).

**IN WITNESS WHEREOF**, the parties have executed this Agreement by their duly authorized representatives, whose signatures appear below.

By:   
for Mark Fesmire, PE, Director  
Oil Conservation Division

By:    
McElvain Oil & Gas Properties, Inc.  
Title: Vice President

Date: \_\_\_\_\_

Date: 9-26-05

McElvain Oil & Gas Properties, Inc.  
Agreed Compliance Order