

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:

APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION COMPLIANCE
AND ENFORCEMENT BUREAU FOR A COMPLIANCE ORDER AGAINST MCKAY OIL
CORPORATION, FOR WELLS OPERATED IN CHAVES AND LEA COUNTIES, NEW MEXICO. CASE NO. 15589

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

January 5, 2017

Santa Fe, New Mexico

BEFORE: MICHAEL McMILLAN, CHIEF EXAMINER
WILLIAM V. JONES, TECHNICAL EXAMINER
DAVID K. BROOKS, LEGAL EXAMINER

This matter came on for hearing before the New Mexico Oil Conservation Division, Michael McMillan, Chief Examiner, William V. Jones, Technical Examiner, and David K. Brooks, Legal Examiner, on Thursday, January 5, 2017, 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.

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APPEARANCES

FOR APPLICANT NEW MEXICO OIL CONSERVATION DIVISION
COMPLIANCE AND ENFORCEMENT BUREAU:

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1 (8:23 a.m.)

2 EXAMINER McMILLAN: Okay. Now I would like
3 to call Case Number 15589, application of the New Mexico
4 Oil Conservation Division Compliance and Enforcement
5 Bureau for a compliance order against McKay Oil
6 Corporation, for wells operated in Chaves and Lea
7 Counties, New Mexico.

8 Call for appearances.

9 MR. HERRMANN: Mr. Examiner, Keith Herrmann
10 representing the Oil Conservation Division Compliance
11 and Enforcement Bureau.

12 EXAMINER McMILLAN: Are there any other
13 appearances?

14 MR. RICHARDS: Damon Richards on behalf of
15 some of the working interest owners.

16 EXAMINER McMILLAN: Okay.

17 MR. HERRMANN: I believe Ed Mazel was
18 supposed to call in today, if the phone is working.
19 He's representing the bankruptcy trustee.

20 EXAMINER JONES: Do you have a phone number
21 for us to call him?

22 MR. HERRMANN: That, I don't know of. I'm
23 leaving that up to -- I believe Florene set that up.

24 EXAMINER JONES: What's the name again?

25 MR. SANCHEZ: Ed Mazel, M-A-Z-E-L.

1 EXAMINER McMILLAN: What we're going to do
2 now is we're going to continue Case Number 15589.

3 (Recess 8:24 a.m. to 8:37 a.m.)

4 EXAMINER McMILLAN: With that in mind,
5 we'll go back to Case Number 15589, application of the
6 New Mexico Oil Conservation Division Compliance and
7 Enforcement Bureau for a compliance order against McKay
8 Oil Corp., for wells operated in Chaves and Lea
9 Counties, New Mexico.

10 EXAMINER JONES: You already called for
11 appearances?

12 EXAMINER McMILLAN: Yes. I already called
13 for appearances. Yeah.

14 Please be sworn.

15 DANIEL SANCHEZ,
16 after having been first duly sworn under oath, was
17 questioned and testified as follows:

18 EXAMINER McMILLAN: Please proceed.

19 MR. HERRMANN: Mr. Examiner, this should be
20 a brief case. We have one witness, Mr. Daniel Sanchez,
21 and by your leave, I'll jump right into it.

22 EXAMINER McMILLAN: He needs to be
23 qualified.

24 MR. HERRMANN: I was going to lay the
25 foundation to qualify him as an expert in compliance and

1 enforcement matters related to production of oil and gas
2 in the state of New Mexico. So I will start that right
3 now.

4 DIRECT EXAMINATION

5 BY MR. HERRMANN:

6 Q. Mr. Sanchez, would you please state your name,
7 title and place of employment for the record?

8 A. Daniel Sanchez. I am the OCD's Compliance and
9 Enforcement manager in the Santa Fe office.

10 Q. Can you briefly describe the duties you perform
11 for the OCD?

12 A. Yes. I oversee the district -- various OCD
13 districts as an aspect in Artesia and Hobbs. I oversee
14 the EPA UIC program and all of the enforcement and
15 compliance issues that come up with the OCD with the
16 operators.

17 Q. Have you researched the violations that we have
18 in the application for hearing?

19 A. Yes, I have.

20 Q. And have you previously testified in an expert
21 capacity before the OCD?

22 A. Yes, I have.

23 MR. HERRMANN: We move to admit Mr. Sanchez
24 as an expert in compliance and enforcement matters
25 related to the production of oil and gas in the state of

1 New Mexico.

2 EXAMINER McMILLAN: Any objections?

3 MR. RICHARDS: No objections.

4 EXAMINER McMILLAN: So qualified.

5 Q. (BY MR. HERRMANN) Mr. Sanchez, have you
6 researched the complaint the Compliance and Enforcement
7 Bureau brought today?

8 A. Yes, I have.

9 Q. Can you please identify the operator, the OGRID
10 and its officers referencing OCD Exhibit 1?

11 A. The operator is McKay Oil Corporation. Their
12 OGRID Number is 14424. And their officers are Roy L.
13 McKay, President; Charlotte McKay, Vice President and
14 Treasurer. And I believe it's April Marshall,
15 Secretary. It was through this process here that the
16 OCD was made aware that McKay Oil Corp. is now in
17 bankruptcy. And Ed Mazel, who was supposed to be
18 calling in, is the trustee, the attorney.

19 Q. Okay. In what counties does McKay have wells
20 and approximately where are they located?

21 A. They're in Chaves and Lea Counties, and most of
22 them are in fairly remote areas of those counties.

23 Q. Do you recognize Exhibit 2?

24 A. Yes, I do. This is the exhibit showing the
25 total well count for McKay Oil Corporation, which is 21.

1 Out of those 21, 20 are currently inactive, and three of
2 those require additional financial assurance.

3 Q. What is the -- what are the amounts of the
4 financial assurance that McKay is deficient on?

5 A. For the three wells, they are \$8,650, \$9,010,
6 and \$8,400, for a total of 26,060.

7 Q. And what steps has the OCD taken to notify the
8 operator of these violations? Please reference OCD
9 Exhibit 3.

10 A. Several letters have been sent out. One on
11 June 21st, 2016, describing the 5.9 noncompliance with
12 the inactive wells. That was sent June 21st, 2016. We
13 didn't get any reply on that letter. Two other letters
14 were sent out with violations of 8.9, financial
15 assurance, one on May 25th, 2016, and one on May 18th,
16 2016. They were sent certified mail, and they were
17 received and signed for by Roy McKay. Along with those,
18 the district office sent out letters of violation, one
19 as late as June 19th of 2009 for various wells that were
20 inactive, and as recent as December 14th, 2016, same
21 issues.

22 Q. So letters from both the Santa Fe and the local
23 district office?

24 A. Yes.

25 Q. Overall, how many of the terms of Subsection A

1 of 19.15.5.9 NMAC is McKay not in compliance with?

2 A. Two, financial assurance and inactive wells.

3 Q. And what permitting restrictions are imposed on
4 operators out of compliance with Rule 5.9?

5 A. An operator may not be allowed to drill,
6 acquire, produce any additional wells and will not be
7 able to obtain any new injection permits if they are in
8 violation of that. One of the main reasons we enforce
9 5.9 is to try to assist operators who may have fallen
10 out of compliance, keep them on track.

11 Q. Another part of the rule is to prevent
12 migration of fluids, prevent waste, protect correlative
13 rights and protect fresh water?

14 A. Yes, they are.

15 Q. Of their inactive wells, what well has been
16 inactive for the longest period?

17 A. That would be the Bonnie #1 that was last
18 produced in January of 1994.

19 Q. And what was the shortest period of the
20 inactive wells -- or the most recent production from the
21 inactive wells?

22 A. That would be the Woolworth Ranch Unit #1. We
23 show the last production of that one is August of 2016.

24 Q. And of their other inactive wells?

25 A. There were three, Antelope Federal 1, 2 and 3,

1 as recent as February of 2015.

2 Q. But they do have one well that produced or had
3 production reported in August of 2016?

4 A. Yes, they did.

5 Q. What's the current status of these wells? Has
6 the OCD conducted any inspections?

7 A. Yeah. We've done some spot inspections on a
8 number of these wells where we found that some of them
9 were lacking equipment that would be helpful in getting
10 them to run, no flowlines. The equipment is in really
11 bad shape. Basically, the whole unit's -- needs a lot
12 of work.

13 Q. What's the estimated plugging cost of these
14 wells?

15 A. Based on the wells that we've been plugging
16 over the last year, the depths, we've been averaging
17 about 32,000 per the depths similar to what McKay Oil
18 has here. So for the ones that we have going here, it
19 would be similar, between 600- and \$700,000.

20 Q. So what corrective action is the Compliance and
21 Enforcement Bureau requesting today?

22 A. We're requesting that McKay Oil Corp. file its
23 financial assurance that's due within 21 days of the
24 issuance of the order in this case and commence plugging
25 their wells within 60 days.

1 Q. Or return them to production?

2 A. Or return them to production.

3 Q. In your opinion, is it in the best interest of
4 protecting the environment and correlative rights to
5 have the Division issue that requested order?

6 A. Yes, it is.

7 Q. I think we glossed over this, but could you
8 please identify Exhibit 4?

9 A. Exhibit 4 is the 5.9, compliance; Rule 8.9,
10 financial assurance.

11 Q. And could you identify Exhibit 5?

12 A. Exhibit 5 is the notice that was sent out to
13 McKay Oil Corp. This was on November 4th, 2016, when we
14 had the hearing date set for December 1st. And that
15 notice was received and signed for by Mr. Roy McKay.
16 Also, there was notice Superintendent of Insurance. And
17 on December 5th, 2016, we sent notice to Mr. Mazel also
18 about the hearing today.

19 Q. And that was after we discovered that he was
20 representing him as trustee?

21 A. That's correct.

22 Q. Were these exhibits prepared by you or under
23 your direction?

24 A. Yes, they were.

25 MR. HERRMANN: I would move to admit OCD

1 Exhibits 1 through 5.

2 MR. RICHARDS: No objection.

3 EXAMINER McMILLAN: Exhibits 1 through 5
4 may now be accepted as part of the record.

5 (OCD Enforcement and Compliance Bureau
6 Exhibit Numbers 1 through 5 are
7 offered and admitted into evidence.)

8 MR. HERRMANN: I have no further questions.

9 EXAMINER McMILLAN: Okay. Go ahead.

10 MR. RICHARDS: Yes. My name is Damon
11 Richards. I represent some of the working interest
12 owners in these wells.

13 CROSS-EXAMINATION

14 BY MR. RICHARDS:

15 Q. Did you perform any examination of the Chaves
16 County, New Mexico District Court pleading records --

17 A. No, I didn't.

18 Q. -- where the cases are filed?

19 A. No.

20 MR. HERRMANN: Mr. Examiner, at this time
21 I'm going to -- I would like to point out that no
22 prehearing statement was filed by Mr. Richards, and I --
23 we do not know the scope of his cross-examination right
24 now.

25 MR. RICHARDS: It's my understanding that

1 McKay Oil Corporation is in bankruptcy. Therefore, the
2 trustee is the one who has possession of what McKay Oil
3 Corporation has, as well as the debts. The trustee has
4 not appeared here today, and on behalf of the working
5 interest owners, since the trustee is not here to tell
6 us what he's going to do -- if the trustee's going to
7 abandon the properties, then the working interest owners
8 want to make sure that an operator is appointed who is
9 going to do what they're supposed to do. Right now
10 McKay Oil Corporation itself is in bankruptcy, and the
11 trustee is in charge of it. Therefore, McKay Oil
12 Corporation, the principals of it, as testified earlier
13 by Mr. Sanchez, they can do nothing. The trustee is the
14 owner.

15 The working interest owners want to make
16 sure that an operator is put in place, if the properties
17 are abandoned, that can comply. But right now, the
18 named operator, McKay Oil Corporation, cannot do
19 anything. The trustee's the one that has to do it. And
20 if the trustee is not going to do it, it's unfair to the
21 working interest owners to just -- to fine the trustee
22 or whatever and the trustee not pay anything and the
23 wells be taken away from them.

24 EXAMINER BROOKS: Well, the Oil
25 Conservation Division does not have the authority to

1 assess penalties. It's been so held in a previous case
2 by the New Mexico Supreme Court. So that's not an
3 issue. The only issue is an order of compliance, which
4 would have the consequence that the Oil Conservation
5 Division could do certain things, and the operator would
6 be liable to reimburse the Division for certain actions
7 that it might take. So I think -- while the issue is
8 well-taken, I see no reason you should not examine the
9 witness as to his knowledge of these facts.

10 We do have the authority, even when a
11 company is in bankruptcy, to order them to comply with
12 state law. And if they don't, then in order to take
13 possession of the property, we would have to get
14 permission of the bankruptcy court and relief from the
15 State. But we realize that. But we have to go through
16 our own procedures first. So you may proceed.

17 MR. RICHARDS: Thank you.

18 Q. (BY MR. RICHARDS) So you don't know if, on
19 April 5th, 2009, an order was entered by the Chaves
20 County District Court appointing a receiver over all
21 these wells?

22 A. No, I do not.

23 Q. And you don't know if subsequently the receiver
24 set up a company named Roswell Operating Corporation?

25 A. No. I'm not aware of that.

1 Q. And Roswell Operating Corporation operated the
2 wells until foreclosure occurred?

3 A. No. I'm not aware of that.

4 Q. None of your records show Roswell Operating
5 Corporation as the operator of record?

6 A. No. These particular wells, the operator of
7 record under our records is McKay Oil Corp.

8 Q. And then your records do show that in 2011,
9 McKay Oil Corporation filed bankruptcy, right?

10 A. Oh, we found out that when we were going to
11 hearing on December 1st, I believe it was. That was the
12 first time I was aware that they were going into
13 bankruptcy.

14 Q. So you didn't find out until December 2016 that
15 McKay Oil Corporation was in bankruptcy?

16 A. That's correct.

17 Q. Okay. And so once you found out, you got ahold
18 of the bankruptcy trustee, I guess?

19 A. Yes.

20 Q. And he has not appeared here today, correct?

21 A. That's correct.

22 Q. So would you agree with me that if a fine or
23 penalty is levied against the trustee, the trustee
24 doesn't have to pay that fine or come into compliance?

25 MR. HERRMANN: I'm going to object. That

1 is outside the scope of Mr. Sanchez' expertise.

2 EXAMINER BROOKS: I'll sustain the
3 objection.

4 Q. (BY MR. RICHARDS) Do you know what avenues are
5 left open to McKay Oil Corporation as an operator when
6 they're actually in bankruptcy, if there are any?

7 A. No, I'm not.

8 Q. How about the working interest owners?

9 A. No, I'm not.

10 MR. RICHARDS: That's all the questions I
11 have. We'll pass.

12 MR. HERRMANN: I have nothing.

13 CROSS-EXAMINATION

14 BY EXAMINER McMILLAN:

15 Q. The question I have is on OCD Exhibit 3, on
16 your inactive well list. So they're operating 21 wells,
17 correct?

18 A. Yes.

19 Q. And how many of those wells have been inactive
20 for 13 months? Isn't that the real question?

21 A. 20.

22 Q. So 20.

23 Only question, I guess, looking at the
24 Antelope Federal, those have been -- okay. All right.
25 So it's 20 of 21.

1 MR. RICHARDS: I do have some questions on
2 that in a little bit, if you don't mind.

3 EXAMINER McMILLAN: That's fine. Allow me
4 to finish.

5 Q. (BY EXAMINER McMILLAN) And did the field
6 inspections find any possible source of contamination of
7 the drinking water?

8 A. Not that were mentioned in the inspection
9 details that I got.

10 EXAMINER McMILLAN: Go ahead.

11 EXAMINER JONES: I really don't have any
12 questions.

13 EXAMINER BROOKS: No questions.

14 EXAMINER McMILLAN: You may proceed.

15 RE CROSS EXAMINATION

16 BY MR. RICHARDS:

17 Q. There was noise that was going on outside while
18 you were testifying, but I thought you indicated some of
19 the Antelope wells were produced in February 2016 and
20 August of 2016?

21 A. No. February of 2015.

22 Q. February. But you didn't say anything about
23 August of 2016?

24 A. Yeah. In August of 2016, I was mentioning that
25 the Woolworth Ranch Unit #1 had the last show of

1 production.

2 MR. RICHARDS: Thank you. There was some
3 noise outside, so I couldn't hear exactly. Thanks.

4 EXAMINER McMILLAN: Okay. If there are
5 no --

6 I have no further questions.

7 I guess final statements.

8 CLOSING ARGUMENT

9 MR. HERRMANN: Mr. Examiner, the Compliance
10 and Enforcement Bureau has presented testimony today
11 that 20 out of 21 wells operated by McKay Oil Corp. have
12 been inactive for a period in excess of one year plus 90
13 days. They also, additionally, require additional
14 financial assurance to continue operating in compliance
15 with New Mexico State laws and the rules adopted
16 pursuant to the Oil and Gas Act. We feel that a request
17 for the relief we've requested is in line with our
18 rules, will protect the State of New Mexico and is
19 within our jurisdiction. And, again, that relief is
20 that acceptable financial assurance be posted within 21
21 days, wells be returned to compliance with our
22 production Rule 19.15.25.8 NMAC within 60 days, and if
23 McKay fails to comply, that the Oil Conservation be
24 authorized to pursue compliance -- to pursue compliance
25 as authorized under our rules and our statute. And that

1 would be to plug and abandon the wells and seek
2 indemnification from the operator. And that, of course,
3 being that we obtain leave from the bankruptcy court
4 before we move to seize any McKay Oil properties.

5 CLOSING ARGUMENT

6 MR. RICHARDS: On behalf of the working
7 interest owners, especially for the Woolworth, we do not
8 believe there is any noncompliance on behalf of the
9 Woolworth well. They've indicated that it has been
10 active, that -- I don't think they have shown there is
11 noncompliance in connection with that well. On behalf
12 of those working interest owners, we would request that
13 the Woolworth well be removed from any sort of order.

14 In connection with the other wells, we
15 would request that the working interest owners be
16 granted an opportunity to determine whether or not the
17 trustee abandons these wells, that the working interest
18 owners can then appoint a new operator to come into
19 compliance. Right now they cannot do that because the
20 trustee is the one who is supposed to be in compliance
21 and has not done that. So the working interest owners
22 are basically held hostage at this time.

23 EXAMINER BROOKS: Well, I take -- I'm
24 sorry. I don't want to cut you off.

25 MR. RICHARDS: Go ahead.

1 EXAMINER BROOKS: I take it you're entering
2 an appearance on behalf of the working interest owners?

3 MR. RICHARDS: Yes, that's correct.

4 EXAMINER BROOKS: You need to get
5 identified on the record because you've appeared on
6 their behalf, and in order to be entered herein, then
7 the person who appeared would have the right to appeal
8 to the Oil Conservation Commission, so if you could name
9 the people you're appearing for.

10 MR. RICHARDS: Yes. McKay Petroleum
11 Corporation and McKay Living Trust and Shultz,
12 S-H-U-L-T-Z, Oil & Gas Properties.

13 EXAMINER BROOKS: And your name is?

14 MR. RICHARDS: Damon Richards.

15 EXAMINER BROOKS: I believe you did say
16 that before, but I'd forgotten. Thank you.

17 EXAMINER McMILLAN: Okay. So Case Number
18 15589 shall be taken under advisement at this time.

19 Thank you.

20 (Case Number 15589 concludes, 8:59 a.m.)

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1 STATE OF NEW MEXICO
2 COUNTY OF BERNALILLO

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4 CERTIFICATE OF COURT REPORTER

5 I, MARY C. HANKINS, Certified Court
6 Reporter, New Mexico Certified Court Reporter No. 20,
7 and Registered Professional Reporter, do hereby certify
8 that I reported the foregoing proceedings in
9 stenographic shorthand and that the foregoing pages are
10 a true and correct transcript of those proceedings that
11 were reduced to printed form by me to the best of my
12 ability.

13 I FURTHER CERTIFY that the Reporter's
14 Record of the proceedings truly and accurately reflects
15 the exhibits, if any, offered by the respective parties.

16 I FURTHER CERTIFY that I am neither
17 employed by nor related to any of the parties or
18 attorneys in this case and that I have no interest in
19 the final disposition of this case.

20

21

22 MARY C. HANKINS, CCR, RPR
23 Certified Court Reporter
24 New Mexico CCR No. 20
25 Date of CCR Expiration: 12/31/2017
Paul Baca Professional Court Reporters

24

25