

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

BEFORE THE OIL CONSERVATION COMMISSION

APPLICATION OF COG OPERATING, LLC FOR CANCELLATION OF
OPERATOR'S AUTHORITY AND TERMINATION OF SPACING UNITS, YESO
ENERGY, INC. DOW "B" 28 FED. WELL NO. 1, EDDY COUNTY, NEW MEXICO.

CASE NO. 14,472
De Novo

APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION, THROUGH
THE COMPLIANCE AND ENFORCEMENT MANAGER, FOR AN
ORDER AUTHORIZING THE DIVISION TO RECOGNIZE AN OPERATOR
OF RECORD FOR WELLS CURRENTLY OPERATED BY YESO ENERGY, INC.; LEA, EDDY
AND CHAVES COUNTIES, NEW MEXICO.

CASE NO. 14,547

SECOND AMENDED
PRE-HEARING STATEMENT
OF THE OIL CONSERVATION

The Oil Conservation Division (OCD) amends its pre-hearing statements in Cases 14,472 and 14,547 to add the following:

STATEMENT OF THE CASE

These two cases require the Oil Conservation Commission (OCC) to determine which operator should be recognized as the "operator of record" for three wells. To make this determination, the OCC must review the process set out in its rules for recognizing the "operator of record," interpret the language in two orders (R-12930-B and R-13294), and sort through a complicated set of facts involving multiple parties.

To assist the OCC in this task, the OCD has set out its legal position in the form of a draft order, which it is submitting with this pre-hearing statement as OCD Ex. 26. The OCD is also

RECEIVED OCD
2011 JUN 22 A 9:09

submitting the pre-filed written testimony of Daniel Sanchez, that sets out the factual basis for the OCD's case.

RESPONDENT'S PROPOSED EVIDENCE

WITNESSES:

ESTIMATED TIME:

Daniel Sanchez, OCD Compliance and Enforcement Manager 20 minutes

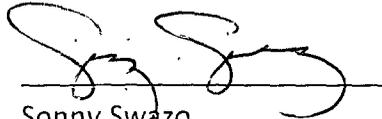
EXHIBITS:

The OCD has attached two additional exhibits that it may seek to introduce at the hearing in these cases: OCD Ex. 26 and OCD Ex. 27.

PROCEDURAL MATTERS

The OCD will seek to introduce OCD Ex. 27, the pre-filed written testimony of Daniel Sanchez. Mr. Sanchez will be present at the hearing to adopt his testimony under oath, and be available for cross-examination.

Respectfully submitted
this 22nd day of June 2011 by



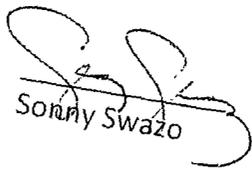
Sonny Swazo
Oil Conservation Division, EMNRD

CERTIFICATE OF SERVICE

I hereby certify that on June 22nd 2011 a copy of this pleading and OCD's additional proposed exhibits were e-mailed to:

Michael Feldewert
Ocean Munds-Dry
Holland & Hart LLP
mfeldewert@hollandhart.com
omundsdry@hollandhart.com
Attorneys for Judah Oil, LLC

Scott Hall
Montgomery & Andrews, P.A
shall@montand.com
Attorney for COG



Sonny Swazo

Draft Order Submitted by OCD

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

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

APPLICATION OF COG OPERATING, LLC FOR CANCELLATION OF
OPERATOR'S AUTHORITY AND TERMINATION OF SPACING UNITS, YESO
ENERGY, INC. DOW "B" 28 FED. WELL NO. 1, EDDY COUNTY, NEW MEXICO.

CASE NO. 14,472
De Novo

APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION, THROUGH
THE COMPLIANCE AND ENFORCEMENT MANAGER, FOR AN ORDER
AUTHORIZING THE DIVISION TO RECOGNIZE AN OPERATOR OF RECORD FOR
WELLS CURRENTLY OPERATED BY YESO ENERGY, INC.; LEA, EDDY AND CHAVES
COUNTIES, NEW MEXICO.

CASE NO. 14,547

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 o'clock a.m. on _____, 2011, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this ____ day of _____, 2011, the Commission, a quorum being present, having considered the record and being fully advised in the premises,

FINDS THAT:

(1) In Case No. 14,472 COG Operating, LLC (OGRID 229137) ("COG") seeks an order cancelling the authority of Yeso Energy, Inc. (OGRID 221710) ("Yeso") as the operator of the Dow "B" 28 Federal Well No. 1 (API No. 30-015-28676) and terminating all spacing and proration units dedicated to the well. The case is before the Commission on *de novo* review at Yeso's request.

*Before the OCC
Case 14472
Case 14547*

(2) In Case No. 14,547 the Oil Conservation Division ("Division") seeks an order authorizing the Division to recognize an operator of record for wells currently operated by Yeso.

(3) By Order No. R-13309, issued August 23, 2010, Mark Fesmire, Acting Director of the Oil Conservation Division, found that Case No. 14,472 and Case No. 14,547 arise from common facts, and that the resolution of the issues in one case will likely affect the resolution of the other case. Director Fesmire exercised his discretion pursuant to 19.15.4.20.B NMAC to direct the Oil Conservation Commission to hear Case No. 14,547, and directed that Case No. 14,547 be heard with Case No. 14,472.

(4) Due notice has been given in Case No. 14,472 and Case No. 14,547, and the Commission has jurisdiction of the subject matter.

(5) The Division, COG and Judah Oil LLC (OGRID 245872) ("Judah") appeared through counsel in Case No. 14,472 and Case No. 14,547 and presented testimony and witnesses.

(6) Division records currently identify Yeso as operator of record of the following three wells:

- Dalton Federal No. 001, 30-015-25259
- Dow B 28 Federal No. 001, 30-015-28676
- Morgan Federal No. 001, 30-005-20667

(7) The operator of record with the Division for a well is the operator responsible for regulatory filings with the Division and the entity the Division looks to first for compliance with the Oil and Gas Act and the rules of the Oil Conservation Commission.

(8) The operator of record with the Division may or may not hold the lease associated with the well, and in the case of federal wells, may or may not be the operator of record recognized by the Bureau of Land Management. The regulatory requirements for change of operator do not require the Division to consider the operator's right to operate the wells, unless the existing operator of record is not available to transfer operations to the new operator. In that situation, the new operator must provide proof of its right to assume operations.

(9) 19.15.9.9.C NMAC sets out two methods for changing the operator of record for a well:

"The operator of record with the division and the new operator shall apply for a change of operator by jointly filing a form C-145 using the division's web-based online application. Or, if the operator of record is unavailable, the new operator shall apply to the division for approval of change of operator without a joint application. The operator shall make such application in writing and provide documentary evidence of the applicant's right to assume operations. The new operator shall not commence operations until the division approves the application for change of operator."

(10) In practice, if the operator of record is unavailable, counsel for the OCD hearing examiners reviews the application for change of operator and the documentary evidence of the

applicant's right to assume operations. If counsel is satisfied that the operator of record is unavailable and the applicant has the right to assume operations, the Division gives the applicant the authority to make the change using the OCD's online system. If counsel does not approve the application, the applicant may request that the matter be set for hearing.

(11) 19.15.9.9.C NMAC provides that the director or the director's designee may deny a change of operator in certain situations. One such situation is if the wells are subject to a compliance order requiring the wells to be brought into compliance with the inactive well rule, 19.15.25.8 NMAC, and the new operator has not entered into an agreed compliance order setting a schedule for compliance with the existing order.

(12) The Dalton Federal No. 001, the Dow B 28 Federal No. 001 and the Morgan Federal No. 001 are subject to R-12930-B, a compliance order requiring the wells to be returned to compliance with the inactive well rule.

(13) R-12930-B provides, in relevant part,

"(1) Yeso Energy, Inc. [OGRID 22170] shall properly plug and abandon each of the wells ...or transfer each of said wells to another operator, not affiliated with Yeso and approved by the Division, not later than March 15, 2010.

(2) If Yeso fails to comply with Ordering Paragraph (1) with respect to any of the subject wells within the time provided the Division is hereby authorized to plug any of the subject wells with respect to which Yeso fails to comply, and to restore the well sites, as provided in Division Rules, and all applicable financial assurance shall be forfeited, as provided in NMSA 1978, Section 70-2-14."

(14) Yeso did not plug and abandon or transfer the three wells at issue by March 15, 2010.

(15) After March 15, 2010, the Division placed the wells at issue on its list of wells to be plugged.

(16) Chica Energy, LLC (OGRID 271866) ("Chica") registered with the Division as a well operator in New Mexico, and Yeso and Chica filed an on-line application to transfer Yeso's wells to Chica.

(17) The Division obtained information that the managing member of Chica was the daughter of the president of Yeso, and asked the managing member of Chica if the two companies were affiliated.

(18) Chica withdrew its application for change of operator. Although Chica expressed its intent to re-file an application to become operator of record of some of the Yeso wells, that application never came before the Division for approval.

(19) A representative of COG contacted Division Compliance and Enforcement Manager Daniel Sanchez, and expressed interest in becoming the operator of record of the Dow B 28 Federal No. 001.

(20) The COG representative spoke to counsel for the Division hearing examiners about the process for applying to become operator of record when the current operator does not agree to the change.

(21) As a result of that conversation, COG filed the application for hearing in Case No. 14,472, seeking cancellation of Yeso's authority as to the Dow B 28 Federal Well No. 1 and termination of spacing units associated with that well.

(22) COG, Yeso, Chica and the Division appeared at the hearing in Case No. 14,472.

(23) At the hearing, COG provided testimony that it intended to use the Dow B 28 Federal No. 1 Well as a salt water disposal well.

(24) On July 13, 2010, the Division issued Order R-13294 in Case No. 14,472. The order provides, in relevant part,

"(1) The Division hereby terminates the authority of Yeso Energy to act as operator of the Dow "B" 28 Federal Well No. 1 (API No. 30-015-28676) located in Section 28, Township 17 South, Range 31 East, (Unit P) NMPM, in Eddy County, New Mexico.

(2) The Division shall not plug the subject well prior to July 30, 2011 unless COG advises that it is no longer pursuing its plan to obtain the right to use this well."

(3) COG shall file an application with the Division to use the subject well for disposal operations without the necessity of a change of operator that would be ordinarily required."

(25) Yeso filed a request for de novo review in Case No. 14,472, but did not file a request to stay Order R-13294.

(26) Yeso and Chica as "sellers" entered into a purchase and sale agreement with Judah as "buyer" conveying the sellers' rights to several wells, including the Dow B 28 Federal Well No. 1 and the Dalton Federal No. 001. According to the terms of the purchase and sale agreement, the conveyance became effective August 11, 2010.

(27) Under the terms of the purchase and sale agreement, the sellers received \$10.00 in consideration. The sellers would receive additional consideration if the Dow B 28 Federal No. 1 is permitted as a salt water disposal well: \$50,000, a fee of \$.05 per barrel of water disposed into the well, and an overriding royalty of ten percent of the net revenue (after state and federal taxes or fees) attributable to oil collected by the salt water disposal operations and sold. The agreement also provided that Yeso and Chica would receive additional consideration if Judah sells the Dow "B" 28 Federal No. 1.

(28) If Order R-13294 had not terminated Yeso's authority to operate the Dow "B" 28 Federal No. 1 well, Yeso would still be unable to obtain a permit to inject into the well under its own name, because Yeso is in violation of 19.15.5.9 NMAC and the Division would not be able to approve an injection permit for Yeso. See 19.15.26.8 NMAC.

(29) On August 18, 2010 Judah and Yeso submitted an online application to transfer Yeso wells from Yeso to Judah. The application included the Dow "B" 28 Federal No. 1 and the Dalton Federal No. 001.

(30) The Division did not process the application, because Order R-13294 had terminated the authority of Yeso to act as operator of the Dow "B" 28 Federal No. 1, one of the wells covered by the application for well transfer.

(31) On August 19, 2010, the day after Judah and Yeso submitted the application for well transfer, the Division filed its application for hearing in Case No. 14,547, asking for guidance on determining the appropriate operator of record for the Yeso wells, given the language in Order R-12930-B limiting well transfers to operators not affiliated with Yeso and the language in Order R-13294 terminating the authority of Yeso to act as operator of the well (and allowing COG to apply to use the well for disposal without the necessity of a change of operator).

(32) By application dated August 17, 2010 Judah sought approval from the Division to use the Dow "B" 28 Federal No. 1 as a commercial salt water disposal well. Judah is not the operator of record of the well. The Division has not acted on the application.

(33) By application dated August 31, 2010, COG sought approval from the Division to use the Dow "B" 28 Federal No. 1 as a salt water disposal well. COG is not the operator of record of the well. However, Order R-13294 provides that "COG shall file an application with the Division to use the subject well for disposal operations without the necessity of a change of operator that would be ordinarily required." The Division has not acted on the application.

(34) Judah signed for receipt of the notice of hearing in Case No. 14,547 on August 25, 2010. That notice of hearing included a copy of the application, explaining that the Division was seeking guidance on which operator to recognize as operator of record for the Yeso wells, including the Dalton Federal No. 001.

(35) According to Judah's own regulatory filings, Judah put the Dalton Federal No.001 back on production on October 4, 2010, without becoming operator of record for the well.

(36) Judah was aware that Division rules prohibit operation of a well before becoming operator of record. When Judah registered with the Division as a well operator in 2009, the Division provided Judah with a document describing certain OCC rule requirements, which the manager of Judah signed. That list includes the statement "I understand that if I acquire wells from another operator, the OCD must approve the operator change before I begin operating those wells. See 19.15.9.9.B NMAC."

The same statement appears on the operator change applications signed by the manager of Judah on August 18, 2010.

(37) By letter dated October 6, 2010, Yeso requested to withdraw from both Case 14,472 and Case 14,547.

(38) By letter dated October 7, 2010, Chica stated that it did not want to be a party in either Case 14,472 or Case 14,547.

The Commission Concludes that:

(39) Because Yeso, the party that applied for *de novo* review of Case No. 14,472, has now withdrawn from that case, the request for *de novo* review should be denied.

(40) Order R-13294, issued in Case No. 14,472, was never stayed and remains in effect.

(41) Because Order R-13294 terminated the authority of Yeso to act as operator of the Dow "B" 28 Federal Well No. 1, Yeso has no authority to apply for an operator transfer that would recognize another operator of record for the well.

(42) The intent of Order R-13294 was to allow COG to pursue its intention to obtain the Dow "B" 28 Federal Well No. 1 for use as a salt water disposal well, and gave COG until July 30, 2011 to make its arrangements.

(43) Until July 30, 2011, the OCD should not plug the well or recognize a transfer of the well to any operator other than COG.

(44) By July 30, 2011, COG should apply to become operator of record of the Dow "B" 28 Federal No. 1 Well, following the procedure set out in 19.15.9.9.C NMAC for operator change when the current operator is unavailable. If COG fails to meet the requirements of 19.15.9.9.C NMAC by July 30, 2011, the OCD may plug the well or recognize another operator as operator of record for the well.

(45) Any operator seeking to become operator of record for the Dow "B" 28 Federal No. 1 Well must provide documentary evidence that it has the right to assume operations, as required by 19.15.9.9.C NMAC, and meet any other requirements set by rule or order.

(46) Order R-12930-B's provision allowing Yeso to transfer the Yeso wells "to another operator, not affiliated with Yeso and approved by the Division" not later than March 15, 2010, means that Yeso may not transfer the wells to an "affiliated" entity.

(47) Order R-12930-B provides that after March 15, 2010 the Division has the authority to plug any well covered by the order that Yeso had not properly plugged and abandoned or transferred to another approved operator. Order R-12930-B gives the Division the discretion to refuse to recognize any new operator of record for any of the wells covered by Order R-12930-B.

(48) If the Division chooses to allow a transfer after March 15, 2010, the Division may take into consideration whether the transfer is to an "affiliated" entity, or whether the transfer is designed to avoid the effect of Order R-12930-B.

(49) The purchase and sale agreement between Yeso/Chica and Judah creates an on-going business relationship between Yeso/Chica and Judah, under which Yeso/Chica maintain an income stream from the salt water disposal business. Yeso would not have been able to use the well for salt water disposal under its own name, because it is out of compliance with 19.15.5.9 NMAC.

(50) It is within the discretion of the OCD to deny the well transfers to Judah that would have the effect of circumventing both the language in Order R-12930-B and enforcement rule 19.15.5.9 NMAC, and condone Judah's operation of the Dalton Federal No. 001 without becoming operator of record in violation of 19.15.9.9.B NMAC.

IT IS THEREFORE ORDERED THAT:

(1) The request for *de novo* review of Case No. 14,472 is Denied.

(2) Until July 30, 2011, the OCD should not plug the Dow "B" 28 Federal Well No. 001 or recognize a transfer of the well to any operator other than COG.

(3) By July 30, 2011, COG should apply to become operator of record of the Dow "B" 28 Federal Well No. 1, following the procedure set out in 19.15.9.9.C NMAC for operator change when the current operator is unavailable. If COG fails to meet the requirements of 19.15.9.9.C NMAC by July 30, 2011, the OCD may plug the well or recognize another operator as operator of record for the well.

(4) Any operator seeking to become operator of record for the Dow "B" 28 Federal No. 1 Well must provide documentary evidence that it has the right to assume operations, as required by 19.15.9.9.C NMAC, and meet any other requirements set by rule or order.

(5) Pursuant to Order R-12930-B, the OCD has the discretion to plug and abandon the Dalton Federal No. 1 and the Morgan Federal No. 1, or may recognize a new operator of record for the wells using the procedure set out in 19.15.9.9.C NMAC for an operator change where the current operator of record is not available.

(6) It is within the discretion of the OCD to deny the well transfers to Judah, because transferring the wells under the existing purchase and sale agreement would have the effect of circumventing both the language of Order R-12930-B and enforcement rule 19.15.5.9 NMAC, and would condone Judah's operation of the Dalton Federal No. 001 without becoming operator of record in violation of 19.15.9.9.B NMAC.

(7) Jurisdiction of this case is retained for the entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on this ____ day of ____ 2011.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

1 STATE OF NEW MEXICO
2 ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
3 OIL CONSERVATION COMMISSION
4
5
6

7 APPLICATION OF COG OPERATING, LLC FOR CANCELLATION OF
8 OPERATOR'S AUTHORITY AND TERMINATION OF SPACING UNITS, YESO
9 ENERGY, INC. DOW "B" 28 FED. WELL NO. 1, EDDY COUNTY, NEW
10 MEXICO.

11 CASE No. 14,472
12 De Novo
13
14

15 APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION,
16 THROUGH THE COMPLIANCE AND ENFORCEMENT MANAGER, FOR AN
17 ORDER AUTHORIZING THE DIVISION TO RECOGNIZE AN OPERATOR
18 OF RECORD FOR WELLS CURRENTLY OPERATED BY YESO ENERGY,
19 INC.; LEA, EDDY AND CHAVES COUNTIES, NEW MEXICO.
20

21 CASE No. 14,547
22
23
24
25
26

27 TESTIMONY OF DANIEL SANCHEZ
28

29 My name is Daniel Sanchez.

30 Since November 22, 2004, I have been the Compliance and Enforcement
31 Manager of the Oil Conservation Division (Division) of the Energy, Minerals, and
32 Natural Resources Department (EMNRD).

33 My duties as Compliance and Enforcement Manager include supervising the four
34 district offices of the Division and the Environmental Bureau of the Division, and
35 overseeing the enforcement and compliance actions of the Division.

36 Since March 2009 my duties have also included overseeing the plugging of wells
37 using the state's Reclamation Fund.

38 This affidavit contains my testimony in Case No. 14,472 and Case No. 14,547.

39 The Division filed its application in Case No. 14,547 to ask the Oil Conservation
40 Commission for guidance on which operator or operators it should recognize for wells
41 currently operated by Yeso Energy, Inc. (OGRID 221710) (“Yeso”). The Division
42 entered its appearance in Case No. 14,472 because the outcome of that case may affect
43 which operator the Division should recognize for one of the Yeso wells: the Dow B 28
44 Federal No. 001.

45 **Background Regarding “Operator of Record” Status**

46 19.15.2.7.O(5) NMAC defines “operator” as “a person who, duly authorized, is in
47 charge of a lease’s development or a producing property’s operation, or who is in charge
48 of a facility’s operation or management.” The rules do not define “operator of record.”
49 But the operator the Division recognizes as the operator of a particular well or property is
50 the operator who appears in the records of the Division. The Division looks to a well’s
51 “operator of record” for regulatory filings regarding that well. The Division will also
52 look to the “operator of record” first for corrective action, if the well is out of compliance
53 with the Oil and Gas Act or the rules of the Oil Conservation Commission.

54 The Division recognizes the operator who drills a well with the Division’s
55 approval as the “operator of record” for that well until the operator transfers the well to
56 another operator under the process set out by 19.15.9.9.C NMAC. That rule sets out two
57 methods for changing the operator of record for a well:

58 “The operator of record with the division and the new operator shall apply
59 for a change of operator by jointly filing a form C-145 using the division’s
60 web-based online application. Or, if the operator of record is unavailable,
61 the new operator shall apply to the division for approval of change of
62 operator without a joint application. The operator shall make such

63 application in writing and provide documentary evidence of the
64 applicant's right to assume operations. The new operator shall not
65 commence operations until the division approves the application for
66 change of operator."
67

68 In most well transfer situations, both the current operator of record and the new
69 operator are available, and the transfer occurs through the on-line application process. If
70 both operators are in agreement regarding the transfer, the Division does not require any
71 documentation regarding the right of the new operator to operate the well. The operator
72 may have an interest in the well, or the operator may be working under contract to an
73 entity or to entities who hold an interest in the well. That means that the operator of
74 record with the Division may or may not hold the lease associated with the well, and in
75 the case of federal wells, may or may not be the operator of record recognized by the
76 Bureau of Land Management.

77 In some situations, the current operator of record is not available to transfer the
78 well through the on-line application process. For example, the operator of record may be
79 a corporation that no longer exists, or the operator of record may be a sole proprietor who
80 is deceased and no estate can be found. When the current operator of record is not
81 available, the new operator must provide proof of its right to assume operations, as
82 required by 19.15.9.9.C NMAC. Counsel for the Division's hearing examiners will
83 review the application for change of operator and the documentary evidence of the
84 applicant's right to assume operations. If counsel is satisfied that the operator of record is
85 unavailable and the applicant has the right to assume operations, the Division gives the
86 applicant the authority to make the change using the OCD's online system. If counsel

87 does not approve the application, the applicant may request that the matter be set for
88 hearing.

89 19.15.9.9.C NMAC provides that the director or the director's designee may deny
90 a change of operator in certain situations. One such situation is when the wells are
91 subject to a compliance order requiring the wells to be brought into compliance with the
92 inactive well rule (19.15.25.8 NMAC). In that situation, the Division may require the
93 new operator to enter into an agreed compliance order setting a schedule for compliance
94 with the existing order.

95 **Background Regarding the Yeso Wells.**

96 Division records currently show Yeso as the operator of record for the following
97 three wells:

- 98 • Dalton Federal No. 001, 30-015-25259
- 99 • Dow B 28 Federal No. 001, 30-015-28676
- 100 • Morgan Federal No. 001, 30-005-20667

101 *OCD Exhibit 2* is a copy of the well list for Yeso from the OCD's web site, showing the
102 three wells.

103 The Division has a long history of compliance issues with Yeso. Some of that
104 history is outlined in a letter I sent to Yeso on July 12, 2010, which is *OCD Exhibit 9*. In
105 fact, the Division has had to plug seven Yeso wells, at a cost of \$259,833.88. *OCD*
106 *Exhibit 11* shows the 7 Yeso wells the OCD has plugged, and the cost of each plugging.
107 *OCD Exhibit 10* is a letter to Yeso asking reimbursement on costs incurred in the first
108 two plugging. Yeso has not reimbursed the Division for any of the costs the Division has
109 incurred in plugging the wells.

110 What is most important to the cases before the Oil Conservation Commission now
111 is that the three wells still identified as Yeso wells are the subject of R-12930-B, a
112 compliance order issued in Case 14,294 requiring the wells to be returned to compliance
113 with the inactive well rule. A copy of that order is *OCD Exhibit 4*. The wells covered
114 by that order are identified in an earlier order, R-12930-A, which is *OCD Exhibit 3*.

115 R-12930-B provides, in relevant part,

116 “(1) Yeso Energy, Inc. [OGRID 22170] shall properly plug and
117 abandon each of the wells ...**or transfer each of said wells to another**
118 **operator, not affiliated with Yeso and approved by the Division**, not
119 later than March 15, 2010.

120 (2) If Yeso fails to comply with Ordering Paragraph (1) with respect to
121 any of the subject wells within the time provided the Division is hereby
122 authorized to plug any of the subject wells with respect to which Yeso
123 fails to comply, and to restore the well sites, as provided in Division
124 Rules, and all applicable financial assurance shall be forfeited, as provided
125 in NMSA 1978, Section 70-2-14.” Emphasis added.

126
127 Yeso did not plug and abandon or transfer the three wells at issue by March 15,
128 2010. After March 15, 2010, the Division placed the wells at issue on its list of wells to
129 be plugged.

130 Chica Energy, LLC (OGRID 271866) (“Chica”) registered with the Division as a
131 well operator in New Mexico, and Yeso and Chica filed an on-line application to transfer
132 Yeso’s wells to Chica.

133 After Chica registered as an operator, the Division obtained information that the
134 managing member of Chica was the daughter of the president of Yeso. I was concerned
135 about whether that relationship would prohibit the Division from transferring the wells,
136 because of the language in Order R-12930-B which says that the wells could be
137 transferred to “another operator, not affiliated with Yeso, and approved by the Division.”

138 I sat in on a telephone call in which we asked the managing member of Chica if she was
139 related to the president of Yeso. She initially denied that she was related to the president
140 of Yeso, and denied that the two companies were affiliated.

141 Chica later withdrew its application for change of operator. *OCD Exhibit 13* is a
142 copy of the on-line comments entered by Dorothy Phillips, our Financial Assurance
143 Administrator, showing that she rejected the application based on Chica's request, and
144 *OCD Exhibit 14* documents that rejection. Although Chica expressed its intent to re-file
145 an application to become operator of record of some of the Yeso wells, that application
146 never came before the Division for approval.

147 A representative of COG Operating, LLC (OGRID 229137) ("COG") contacted
148 me, and expressed interest in becoming the operator of record of the Dow B 28 Federal
149 No. 001.

150 I understand that the COG representative spoke to counsel for the Division
151 hearing examiners about the process for applying to become operator of record when the
152 current operator does not agree to the change.

153 COG later filed the application for hearing in Case No. 14,472, seeking
154 cancellation of Yeso's authority as to the Dow B 28 Federal Well No. 001 and
155 termination of spacing units associated with that well.

156 COG, Yeso, Chica and the Division appeared at the hearing in Case No. 14,472.

157 At the hearing, COG provided testimony that it intended to use the Dow B 28
158 Federal No. 001 Well as a salt water disposal well.

159 On July 13, 2010, the Division issued Order R-13294 in Case No. 14,472. A copy
160 of the order is *OCD Exhibit 5*. The order provides, in relevant part,

161 “(1) **The Division hereby terminates the authority of Yeso Energy**
162 **to act as operator of the Dow “B” 28 Federal Well No. 1** (API No. 30-
163 015-28676) located in Section 28, Township 17 South, Range 31 East,
164 (Unit P) NMPM, in Eddy County, New Mexico.

165 (2) The Division shall not plug the subject well prior to July 30, 2011
166 unless COG advises that it is no longer pursuing its plan to obtain the right
167 to use this well.

168 (3) **COG shall file an application with the Division to use the**
169 **subject well for disposal operations without the necessity of a change**
170 **of operator that would be ordinarily required.**” (Emphasis added.)

171
172 Yeso filed a request for de novo review in Case No. 14,472, but did not file a
173 request to stay Order R-13294.

174 COG filed exhibits in preparation for the de novo hearing in Case No. 14,472.
175 COG Exhibit 11 (J-24) is a purchase and sale agreement, with Yeso and Chica as
176 “sellers” and Judah Oil LLC (OGRID 245872) (“Judah”) as “buyer,” conveying the
177 sellers’ rights to several wells, including the Dow B 28 Federal Well No. 001 and the
178 Dalton Federal No. 001. According to the terms of the purchase and sale agreement, the
179 conveyance became effective August 11, 2010.

180 Under the terms of the purchase and sale agreement, the sellers received \$10.00 in
181 consideration. The sellers would receive additional consideration if the Dow B 28
182 Federal No. 001 is permitted as a salt water disposal well: \$50,000, a fee of \$.05 per
183 barrel of water disposed into the well, and an overriding royalty of ten percent of the net
184 revenue (after state and federal taxes or fees) attributable to oil collected by the salt water
185 disposal operations and sold. The agreement also provided that Yeso and Chica would
186 receive additional consideration if Judah sells the Dow “B” 28 Federal No. 001.

187 By application dated August 17, 2010 Judah sought approval from the Division to
188 use the Dow “B” 28 Federal No. 001 as a commercial salt water disposal well. *OCD*

189 *Exhibit 7* is a copy of the cover page of that application, with the page identifying the
190 well for which Judah is seeking injection authority. Judah is not the operator of record of
191 the well. The Division has not acted on the application.

192 On August 18, 2010 Judah and Yeso submitted an online application to transfer
193 Yeso wells from Yeso to Judah. The application included the Dow B 28 Federal No. 001
194 and the Dalton Federal No. 001.

195 On August 19, 2010, the day after Judah and Yeso submitted the application for
196 well transfer, the Division filed its application for hearing in Case No. 14,547, asking for
197 guidance on determining the appropriate operator of record for the Yeso wells, given the
198 language in Order R-12930-B limiting well transfers to operators not affiliated with Yeso
199 and the language in Order R-13294 terminating the authority of Yeso to act as operator of
200 the well (and allowing COG to apply to use the well for disposal without the necessity of
201 a change of operator).

202 By application dated August 31, 2010, COG sought approval from the Division to
203 use the Dow B 28 Federal No. 001 as a salt water disposal well. *OCD Exhibit 8* is a copy
204 of the cover page for that application, with a copy of the data sheet identifying the well at
205 issue. COG is not the operator of record of the well. However, Order R-13294 provides
206 that "COG shall file an application with the Division to use the subject well for disposal
207 operations without the necessity of a change of operator that would be ordinarily
208 required." The Division has not acted on the application.

209 Judah signed for receipt of the notice of hearing in Case No. 14,547 on August 25,
210 2010. That notice of hearing included a copy of the application, explaining that the
211 Division was seeking guidance on which operator to recognize as operator of record for

13294
12930-B

234 My first concern is the language in R-13294, which was issued in Case 14,472.
235 Case 14,472 is before the Oil Conservation Commission for *de novo* review, at the
236 request of Yeso. No one filed a motion to stay R-13294, so that order is currently in
237 effect. And after it filed its request for *de novo* review, Yeso withdrew from the case. So
238 it is unclear whether Case 14,472 is even under review.

239 R-13294 “terminates the authority of Yeso Energy to act as operator of the Dow B
240 28 Federal Well No. 1.” If Yeso has no authority to operate the well, then it appears that
241 it has no authority to transfer the well to another operator, so the Division should not
242 approve Yeso’s application to transfer the well to Judah.

243 The intent of R-13294 appears to be to allow COG to become operator of record
244 for the well. But to date, the Division has not seen an application from COG to become
245 operator of record for the well. COG has only applied for an injection permit for the
246 well, something it was directed to do by R-13294: “COG shall file an application with
247 the Division to use the subject well for disposal operations without the necessity of a
248 change of operator that would be ordinarily required.”

249 My second concern is the language in R-12930-B, which was issued in Case
250 14,294. That case is not subject to *de novo* review, and R-12930-B is a final order. R-
251 12930-B applies to the Dow B 28 Federal Well No. 001 and to the other wells Yeso still
252 operates. It orders Yeso “to transfer each of said wells to another operator, not affiliated
253 with Yeso and approved by the Division, not later than March 15, 2010,” and authorizes
254 the Division to plug any well that is not transferred pursuant to that provision. Under a
255 literal reading of the order, the Division could refuse to recognize any new operator for
256 the Yeso wells, and simply plug them. The Division would like to allow a transfer to

212 the Yeso wells, including the Dalton Federal No. 001. The notice of hearing, and Judah's
213 signed receipt, are attached to *OCD Exhibit 1*.

214 According to Judah's own regulatory filings, Judah put the Dalton Federal No.
215 001 back on production on October 4, 2010, without becoming operator of record for the
216 well. *OCD Exhibit 23* is a copy of a sundry notice filed by Judah on October 10, 2010,
217 indicating that the well was put on line October 4, 2010.

218 Judah was aware that Division rules prohibit operation of a well before becoming
219 operator of record. When Judah registered with the Division as a well operator in 2009,
220 the Division provided Judah with a document describing certain OCC rule requirements,
221 which the manager of Judah signed. That list includes the statement "I understand that if
222 I acquire wells from another operator, the OCD must approve the operator change before
223 I begin operating those wells. See 19.15.9.9.B NMAC." A copy of that signed list is
224 *OCD Exhibit 18*.

225 By letter dated October 6, 2010, Yeso requested to withdraw from both Case
226 14,472 and Case 14,547. The letter is attached to *OCD Exhibit 1*.

227 By letter dated October 7, 2010, Chica stated that it did not want to be a party in
228 either Case 14,472 or Case 14,547. The letter is attached to *OCD Exhibit 1*.

229 **Unresolved Issues**

230 1. The Dow B 28 Federal No. 001. The Division is asking the Oil
231 Conservation Commission for guidance on which operator it should recognize as the
232 operator of the Dow B 28 Federal No. 001. Both COG and Judah have expressed interest
233 in this well.

257 take place, if a well can be returned to beneficial use. But it is concerned about the
258 language stating that the transfer should be to an operator “not affiliated with Yeso and
259 approved by the Division.” If the order is concerned about affiliation, I am concerned
260 about recognizing Judah as the operator of record for the Dow B 28 Federal No. 001.
261 From the purchase and sale agreement, it appears that Judah and Yeso/Chica have set up
262 an on-going business relationship allowing Yeso/Chica to profit from Judah’s operation
263 of the well as a salt water disposal well. This would allow Yeso to get around the
264 requirements of 19.15.5.9 NMAC. Yeso would not be able to get an injection permit for
265 the well under its own name, because it is out of compliance with inactive well
266 requirements under 19.15.5.9.A NMAC. See 19.15.26.8.A NMAC.

267 2. The Dalton Federal No. 001.

268 Order R-13294 does not apply to the Dalton Federal No. 001.

269 Currently the only operator interested in the Dalton Federal No. 001 is Judah.

270 My concern is Order R-12930-B, and its language regarding transfer to an
271 operator “not affiliated” with Yeso. Again, I am concerned about recognizing Judah as
272 the operator of record for the well, given the terms of the purchase and sale agreement
273 between Judah and Yeso/Chica.

274 3. Morgan Federal No. 001.

275 Order R-13294 does not apply to the Morgan Federal No. 001.

276 Currently, no operator is interested in the Morgan Federal No. 001.

277 Order R-12930-B applies to the Morgan Federal No. 001, so I am requesting
278 guidance on whether I should consider issues of affiliation if any operator applies to
279 become operator of record for this well.

280 I, Daniel Sanchez, swear that the foregoing is true and correct.

281

282

283

284

285

286

287

288

289 Subscribed and sworn to before me this 21st day of June 2011, by Daniel Sanchez.

290

291

292

293

294

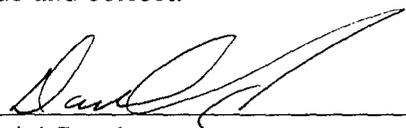
295

296

297

298

299



Daniel Sanchez
Compliance and Enforcement Manager
Oil Conservation Division



Notary Public

My commission expires:

01-09-12