

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

TESTIMONY OF DANIEL SANCHEZ

My name is Daniel Sanchez.

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

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

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

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

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

Background Regarding “Operator of Record” Status

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

The Division recognizes the operator who drills a well with the Division’s approval as the “operator of record” for that well until the operator transfers the well to another operator under the process set out by 19.15.9.9.C NMAC. That rule 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

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.

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

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.” Emphasis added.

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

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.

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

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

Chica later withdrew its application for change of operator. *OCD Exhibit 13* is a copy of the on-line comments entered by Dorothy Phillips, our Financial Assurance Administrator, showing that she rejected the application based on Chica's request, and *OCD Exhibit 14* documents that rejection. 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.

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

I understand that 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.

COG later 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. 001 and termination of spacing units associated with that well.

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

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

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

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Case No. 14,472 *de novo*
Testimony of Daniel Sanchez
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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

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

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. *OCD Exhibit 23* is a copy of a sundry notice filed by Judah on October 10, 2010, indicating that the well was put on line October 4, 2010.

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." A copy of that signed list is *OCD Exhibit 18*.

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

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 letter is attached to *OCD Exhibit 1*.

Unresolved Issues

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

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

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

The intent of R-13294 appears to be to allow COG to become operator of record for the well. But to date, the Division has not seen an application from COG to become operator of record for the well. COG has only applied for an injection permit for the well, something it was directed to do by R-13294: “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.”

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

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

2. The Dalton Federal No. 001.

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

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

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

3. Morgan Federal No. 001.

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

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

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

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

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

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Notary Public

My commission expires:

01-09-12