

OIL

Conservation

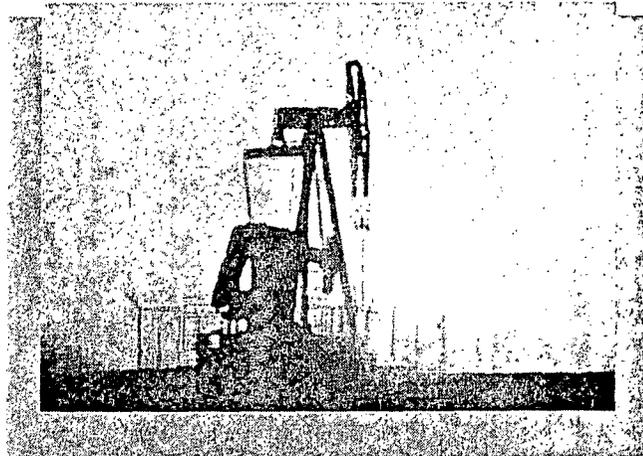
Division

(OCD)

EXHIBIT  
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## Mark Fesmire, PE

Division Director



***Mission:*** The Oil Conservation Division (OCD) administers laws and regulations relating to the oil, gas and geothermal industry of New Mexico. The Oil and Gas Act, the Water Quality Act, and the Geothermal Resources Conservation Act authorize the division to enforce primary statutory mandates.

The division is organized into four district offices and five bureaus responsible for different aspects of regulating the oil and gas industry. The district offices issue drilling permits, inspect wells and associated facilities, respond to spills, investigate violations and institute enforcement actions.

The Engineering and Geological Services Bureau processes administrative applications for exceptions to OCD rules and the staff serves as division-appointed Hearing Examiners for OCD hearings. The Environmental Bureau develops and enforces environmental regulations and programs in the oil and gas industry for the protection of New Mexico's environment. Legal Counsel assists OCD in providing legal advice and support. They also advise the OCD regarding legal and operations issues and participate in the formulation of OCD rules and proposed legislation. The Automation and Records Bureau is responsible for collecting and dispersing monthly well production and injection data, information about wells, completions, spacing, pools, operators, inactive wells, and orphan wells. It also manages data systems including OCD Online Electronic Permitting and OCD Online Imaging as well as the OCD website. This bureau also tracks statistics and oversees OCD's budget and procurement needs. The Administrative Bureau provides administrative support for the entire OCD, and is responsible for the clerical and secretarial duties required by OCD and the Oil Conservation Commission (OCC). The OCC is a three-member commission that makes rules governing oil and gas production in New Mexico.

As wells play out and become uneconomical to operate and produce, they must be plugged, primarily to protect underground sources of drinking water by preventing the migration of oil, gas and saltwater from the producing zones to shallower fresh water zones.

Occasionally, wells are left "orphaned" by a company that becomes insolvent. When that happens, plugging bond funds are often not sufficient to plug the wells that are left behind. It then becomes the state's responsibility to have the inactive wells properly plugged. One of the most important functions of the OCD is to administer the Oil and Gas Reclamation fund to properly plug and abandon these orphan wells.

## *Oil Conservation Division Accomplishments and Initiatives:*

A 2004 evaluation of OCD rules has shown that many of them were outdated and did not effectively address the challenges facing OCD and industry during the twenty-first century. On September 30 of 2005, OCD implemented the first of a series of new rules designed to update the OCD's regulatory process and improve the fairness and efficiency of OCD rules and rulemaking.

The new rules on rulemaking shortened the time necessary to promulgate rules while at the same time opening the process to more stakeholders and more members of the regulated community. These rules were then used to update the OCD rules on enforcement and compliance. The Enforcement and Compliance Rules became effective on December 15, 2005 and have been instrumental in lowering the number of non-compliant wells in the state from 2785 on January 1, 2006 to 1567 today.

A non-compliant well is a well that has not produced or injected for 15 months or more, which are not properly temporarily abandoned or for which the operator has not made other arrangements for proper disposition according to OCD rules. During periods of high equipment and manpower utilization, such as the last year, there is a tendency for operators to concentrate their limited resources on more productive wells and not address wells that need to be plugged. Wells that are not adequately monitored because they are not producing represent a threat to the water and soil resources of the state and the success of the Compliance and Enforcement Rules has significantly reduced the potential risk from this class of wells.

Part of the success of the Compliance and Enforcement rules has been the use of negotiated "Agreed Compliance Orders" in the enforcement process. The procedure involves sitting down with operator and negotiating a plan to bring their violations into compliance, drafting enforceable documents to memorialize those agreements and enforcement of those agreements in the case of failure.

During 2006, OCD began the process for rules governing surface waste management facilities and those new rules became effective on February 14th, 2007. These rules are remarkable in that this is the first time OCC has required facilities to be designed so that there will be no deliberate release of contaminants to the environment. Facilities that comply with the new rules will provide safe, well-designed and well-regulated sites for the disposal or remediation of oil field waste and allow oil and gas operators to minimize the risk of residual future liability from waste that they have generated. Under these rules, New Mexico oil and gas operators will be able to dispose of their waste in new facilities knowing that they are designed to prevent environmental contamination and the potentially crippling liability to the generator of that waste.

In 2006, OCD held the first in a series meetings with stakeholders on updating the rules for oil-field pits. OCD expects to present a comprehensive rule to the OCC for consideration in the fall of 2007.

OCD is also progressing towards paperless filing and reporting with the expansion of its on-line reporting and filing

system, OCD online. 2006 saw the addition of several new forms that may be filed on line and the extension of online production reporting to virtually all New Mexico operators. OCD expects this trend to continue in the year 2007.

Since 1986, OCD has been fielding concerns from residents and officials about a 10 acre abandoned oil treating facility located in the City of Eunice. In 2006, OCD finished the cleanup of that facility at a cost of \$2.5 Million. The site contained a 2 acre, 30 foot deep sludge pit, junk and abandoned equipment. The cost of the cleanup was borne by the Oil and Gas Reclamation fund, which is a tax imposed on petroleum production for the plugging and remediation of orphan oil and gas wells (those that have no discernible owner or responsible party) and affiliated oil and gas sites.

Lastly, during 2006, OCD began what has been a very successful collaboration with federal authorities to exchange data and inspection results on oil and gas wells on federal land. The program is intended to stagger federal and state inspections to minimize the time between visits to a well or site and to facilitate the exchange of data between OCD and federal inspectors to provide a more complete and timely inspection record for both sets of regulators. The program is funded under the federal 2005 Energy Act and is resulting in common data bases, cross training and common understanding of both agencies practices.

**Community Involvement:** For more than 70 years, oil and gas has played an important part in shaping New Mexico's economy. It is an industry on which thousands of New Mexicans have built their lives and, in return, it has provided for their families.

In the Thirties, Forties and Fifties, the oil fields of New Mexico provided more than 80% of the state's total revenue. This significant contribution has kept New Mexico an attractive place for businesses and families to locate.

In the Eighties, more than 18,000 people were employed in oil and gas related jobs. Their combined income injected an additional \$600 million into the communities of Hobbs, Artesia, Roswell, Carlsbad, Farmington and numerous smaller communities such as Eunice, Jal, Aztec and Loco Hills.

The presence of oil company offices in these cities and towns has been invaluable. Many oil and gas companies have partnered with communities to improve the local quality of life. These corporate good neighbors have contributed or assisted with dozens of city parks and sports fields, as well as museums, junior college and other school facilities, town gazebos, historic walkways and other cultural and recreational amenities.

OCD will continue to propose and support legislation designed to make New Mexico an attractive and affordable rate for oil and gas business to thrive.

*Protecting the Environment:* In keeping with the division's efforts to protect special places for their unique values, The Valle Vidal Protection Act of 2005 sponsored by New Mexico's Representative Tom Udall was signed into law by President Bush on December 13, 2006. The new law will permanently protect New Mexico's "Valley of Life" by withdrawing the area from mineral leasing. The Valle Vidal is a lush mountain basin in the heart of the Sangre de Cristo Mountains in Northern New Mexico.

Likewise, Otero Mesa is an area that encompasses approximately 1.2 million acres of Chihuahuan Desert; it is a unique place with an ecosystem that is home to rare desert grasslands, herds of pronghorn, prairie dog villages, mule deer, aplomado falcons, and more than 345 of the world's 1,500 cacti species. This is the last remnant of an untouched Chihuahuan Desert ecosystem in our country. It is important to protect and preserve Otero Mesa and its underlying ground water resources.

However, a recent federal court decision has placed the responsibility of managing the area to the Bureau of Land Management (BLM). BLM is doing Environmental Assessments (EA) work for oil and gas leasing. The OCD has promulgated rules for development in the Otero Mesa area with an emphasis on the protection of that grassland area and the water beneath it.

The new OCC rule covering surface waste management facilities was crafted to provide the utmost protection to groundwater, surface water, human health and the environment. A task force comprised of industry representatives, regulators, and landowners worked extremely hard in accomplishing this task. A similar process will take place in the writing of the new pit rule.

OCD's ultimate aim is to maximize the return to the state from the production of its natural resources while eliminating or minimizing any detrimental environmental effects.

### *New Mexico Oil and Gas Facts:*

- The oil and gas industry has a storied history in New Mexico. The first commercial well was drilled in the 1920's and the industry has grown ever since due to the efforts of, at first, a few bold men called wildcatters. Many towns sprang up, and survive today, because of the oil and gas industry.
- Oil and gas revenues, in the form of severance taxes and public land royalties, have bolstered New Mexico's General Fund since the 1930's. Gross revenues have contributed as much as 87 percent of the fund during boom times to some 25 percent in recent years.
- New Mexico is ranked third in natural gas production (behind Texas and Oklahoma) and third in proven gas reserves among all producing states in the United States. A portion of the gas is coalbed methane, in which New Mexico is first in production and reserves.
- New Mexico also is ranked fifth in crude oil production and fourth in proven oil reserves.
- New Mexico is a national leader in both production and reserves of carbon dioxide (CO<sub>2</sub>).

- As of October 2006, there were 21,222 active oil producing wells, 25,848 active gas producing wells, 433 active CO<sub>2</sub> injecting wells, 3,319 active enhanced recovery injection wells, and 603 active salt water disposal wells. Additionally, there are more than 1,600 inactive oil and gas wells that could potentially be returned to production.
- At the end of 2005, New Mexico had more than 750 oil and gas industry-related companies operating in the state. When these companies are combined with other entities that indirectly support the oil and gas industry, more than 23,000 New Mexico citizens are economically supported by the oil and gas industry.

**Production and Production Value:** As in the past, most of today's oil production occurs in the New Mexico portion of the Permian Basin in southeast New Mexico, and most of the natural gas production occurs in the New Mexico portion of the San Juan Basin in northwest New Mexico. The OCD maintains district offices in Hobbs, Artesia and Aztec to regulate the oil and gas producers in those areas.

Record, and near record, prices for both oil and natural gas continued in 2006 sustaining the oil and gas activity in the state. As of October 23, 2006, West Texas Intermediate Crude oil prices were \$57.25 per barrel and gas prices averaged nearly \$7.49 per MMBtu (Million British Thermal Units) Henry Hub.

Total New Mexico crude oil production (including condensate) in 2005 was 60.7 million barrels. New Mexico natural gas production in 2005 was 1,592 billion cubic feet (BCF).

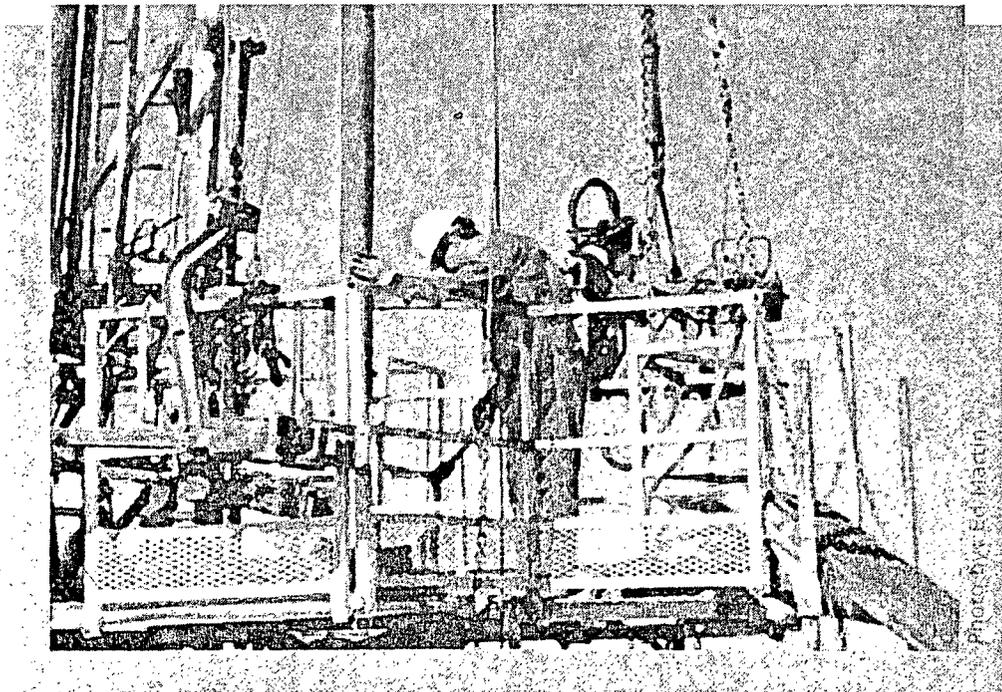


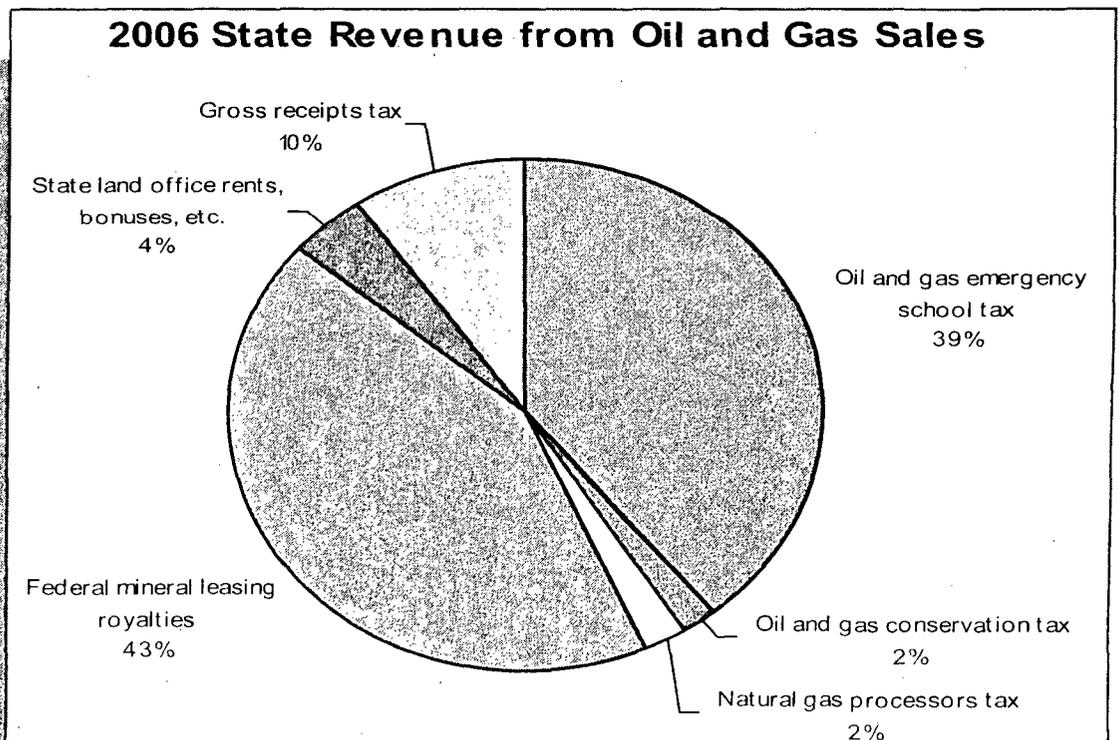
Photo by Ed Martin

# Oil Conservation Division Data and Statistics:

1) State Revenues from Oil and Gas Sales in Millions of Dollars (Taxation and Revenue Depr.)

New Mexico State Revenues from Oil and Gas Production*					
	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
<b>State general fund:</b>					
Oil and gas emergency school tax	\$205,121,207	\$229,638,624	\$297,070,343	\$386,785,907	\$491,657,374
Oil and gas conservation tax	\$10,363,501	\$10,888,867	\$14,931,771	\$19,514,983	\$24,819,553
Natural gas processors tax	\$20,270,225	\$21,077,023	\$13,477,994	\$24,321,786	\$27,268,027
Federal mineral leasing royalties	\$221,323,163	\$258,365,730	\$308,108,000	\$391,000,000	\$544,880,000
State land office rents, bonuses, etc	\$13,300,000	\$18,727,187	\$22,060,805	\$42,044,343	\$52,695,563
Gross receipts tax	<u>\$25,340,000</u>	<u>\$36,474,526</u>	<u>\$42,941,465</u>	<u>\$55,867,203</u>	<u>\$124,794,894</u>
<b>Subtotal--revenue from current production</b>	<b>\$495,718,096</b>	<b>\$575,171,956</b>	<b>\$698,590,378</b>	<b>\$919,534,222</b>	<b>\$1,266,115,411</b>
Earnings on land grant permanent fund	\$242,566,590	\$259,142,844	\$274,700,492	\$339,791,000	\$343,380,000
Earnings on severance tax permanent fund	<u>\$127,346,074</u>	<u>\$136,763,894</u>	<u>\$137,947,286</u>	<u>\$166,272,000</u>	<u>\$168,384,000</u>
<b>Total--General Fund revenue</b>	<b>\$865,630,759</b>	<b>\$971,078,695</b>	<b>\$1,111,238,157</b>	<b>\$1,425,597,222</b>	<b>\$1,777,879,411</b>
<b>Severance tax bonding fund:</b>					
Oil and gas severance tax	\$200,740,385	\$221,446,421	\$293,087,714	\$384,561,385	\$488,952,323
<b>Land Grant Permanent fund:</b>					
State land office royalties	<u>\$197,741,000</u>	<u>\$218,385,341</u>	<u>\$236,277,777</u>	<u>\$312,251,910</u>	<u>\$405,343,063</u>
<b>Grand Total all funds</b>	<b>\$1,264,112,145</b>	<b>\$1,410,910,457</b>	<b>\$1,640,603,648</b>	<b>\$2,122,410,517</b>	<b>\$2,672,174,797</b>

2) State Revenues from Oil and Gas Sales for 2006 Pie Chart (Taxation and Revenue Depr.)



3) New Mexico Oil Production (Oil Conservation Division)

Oil Production *					
	SE Crude	SE Condensate	NW Crude	NW Condensate	Total Oil
2001	59,241,407	6,786,697	1,411,523	1,748,766	69,188,393
2002	57,007,412	7,592,885	1,265,720	1,697,375	67,563,392
2003	56,089,092	7,660,358	1,164,446	1,667,163	66,581,059
2004	55,546,149	6,287,724	1,068,365	1,619,782	64,522,020
2005	53,154,173	4,967,882	1,035,450	1,564,712	60,722,217

\*Volumes are adjusted to reflect amended production reports filed with the Oil Conservation Division

4) New Mexico Gas Production (Oil Conservation Division)

Natural Gas Production *						
	SE Casinghead	SE Dry Gas	NW Casinghead	NW Dry Gas	Total Natural Gas (Includes NE) **	Coalseam Gas (Included in Total)
2001	210,561,174	388,855,612	15,411,258	1,063,737,579	1,684,079,925	539,294,789
2002	206,144,223	381,044,776	14,926,062	1,015,218,496	1,627,583,237	496,653,035
2003	210,285,920	363,401,495	15,189,000	992,771,597	1,596,508,530	479,734,181
2004	227,486,404	341,189,665	13,321,035	1,010,889,276	1,612,396,488	504,906,945
2005	224,582,419	324,712,946	13,385,378	1,005,249,580	1,592,683,780	520,331,644

\*Volumes are adjusted to reflect amended production reports filed with the Oil Conservation Division  
 \*\*Totals include gas produced in northeast New Mexico, which is not displayed in a separate column

5) Oil and Gas Production by County (Oil Conservation Division)

Oil and Gas Production by County					
	OIL			GAS	
	(Barrels)	Rank		(Cubic Feet)	Rank
Lea	35,772,334	1	San Juan	636,525,543	1
Eddy	21,475,043	2	Rio Arriba	378,805,018	2
Rio Arriba	1,266,218	3	Eddy	277,422,893	3
San Juan	1,245,749	4	Lea	243,631,159	4
Chaves	500,537	5	Chaves	28,241,313	5
Roosevelt	374,141	6	Colfax	24,753,457	6
Sandoval	78,700	7	Roosevelt	2,080,384	7
McKinley	9,478	8	Sandoval	1,210,843	8
Santa Fe	17	9	McKinley	13,170	9
Total	60,722,217			1,592,683,780	

6) Oil and Gas Prices vs. Rig Count (New Mexico Tech/ Baker Hughes, Inc.)

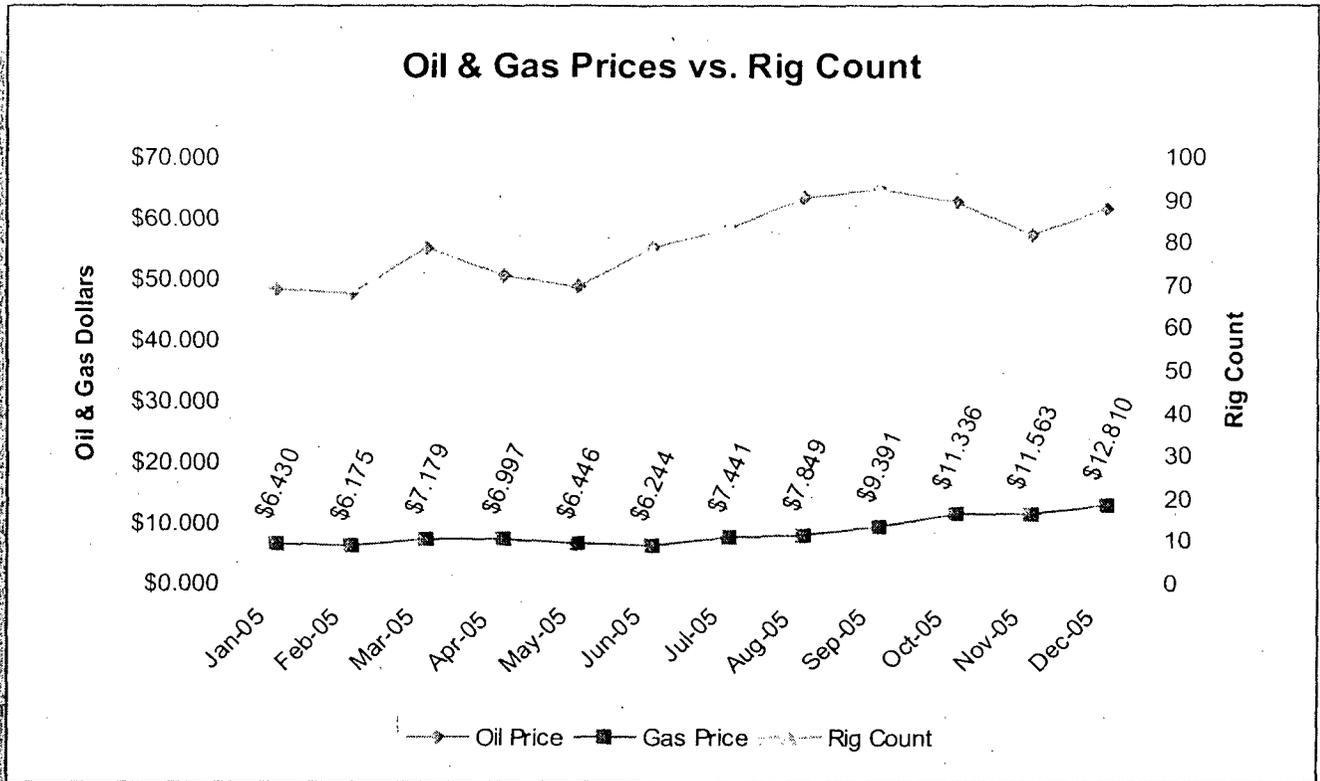


Figure 6

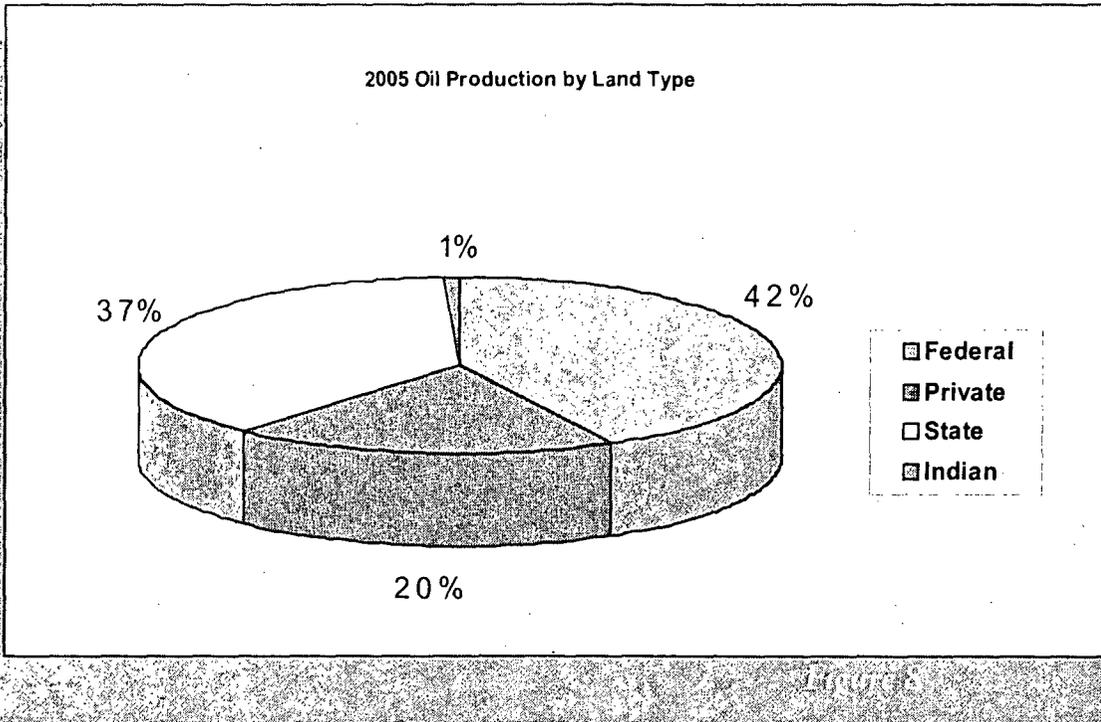
7) Wells Drilled and Completed by Type (Oil Conservation Division)

**Wells Drilled and Completed by Year by Well Type**  
First Reported Completion per Well

Year	Gas	Oil	Other	Total
2001	951	487	56	1,494
2002	825	335	62	1,222
2003	1,140	655	90	1,885
2004	1,308	558	71	1,937
2005	1,348	698	91	2,137

8)

Oil Production by Land Type (Oil Conservation Division)



9)

Gas Production by Land Type (Oil Conservation Division)

