



New Mexico Energy, Minerals and Natural Resources Department

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March 23, 2011

McDonnold Operating Inc.
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NOTICE OF VIOLATION

Re: McDonnold Operating Inc., OGRID 14372
R-3269, WFX-510

Dear Operator:

A review of Oil Conservation Division (OCD) files for McDonnold Operating Inc. (McDonnold) found the following violations. Please contact me by March 31, 2011 to schedule a meeting or teleconference to discuss McDonnold's plans to correct these violations.

1. Mechanical Integrity Test Failures.

On March 9, 2010, the following injection wells failed mechanical integrity tests:

Langlie Jack Unit No. 12, 30-025-11154
Langlie Jack Unit No. 14, 30-025-11169
Langlie Jack Unit No. 4, 30-025-11174
Langlie Jack Unit No. 17, 30-025-11276

On March 10, 2010, the OCD sent McDonnold a Letter of Violation and Shut-In Directive, requiring McDonnold to shut-in the wells until they are repaired, and requiring the repairs to be completed by June 12, 2010. A copy of the letter can be found in the well file of each well.

According to the March 10, 2010 letter, the No. 12 demonstrated communication between tubing and casing; the No. 14 had a bad wellhead leak during the pressure test; and the No. 17 had a surface leak during the pressure test.

To date, none of the four wells has been repaired.



McDonnold's waterflood permit, R-3269, specifies the approved formations for injection. WFX-510, which expanded the waterflood, provides

“[t]hat the operator shall take all steps necessary to ensure that the injected water enters only the proposed injection interval and is not permitted to escape to other formations or onto the surface.”

WFX-510 also requires the operator notify the district office if the No. 4 well (which was added to the waterflood by that order) demonstrates a failure of the tubing, casing or packer, or leaks water from around the well, “and shall take such steps as may be timely or necessary to correct such failure or leakage.”

The OCD's injection rules require injection wells to be cased so as to prevent leakage, and prevent movement of formation or injected fluid from the injection zone into another zone or to the surface around the outside of a casing string. 19.15.26.9 NMAC. The rules also require maintenance to prevent leaks, and authorize the OCD to shut-in injection wells or projects that have exhibited failure to confine injected fluids to the authorized injection zone or zones until the operator has identified and corrected the failure. 19.15.26.10 NMAC.

2. Violation of Shut-In Directive/False Reporting.

Despite the March 10, 2010 directive to shut-in the four injection wells until repaired, McDonnold has reported injection in each well through December 2011. Either McDonnold is continuing to inject into the wells despite the directive and the demonstrated failures of the wells, or it is reporting incorrectly.

3. Late Reporting.

McDonnold has not filed its C-115 reports for January 2011. The report was due March 15, 2011. See 19.15.7.24 NMAC.

4. Financial Assurances.

Each state or fee well that has been inactive more than two years requires a single well financial assurance, even if the well is also covered by a blanket financial assurance. 19.15.8.9.C NMAC. That rule has been in effect since January 1, 2008. See 19.15.8.14 NMAC.

The State A 16 #001, 30-025-24814 has not reported production or injection since April 2003, and requires a single well financial assurance. McDonnold has not posted the required financial assurance.

This violation of the financial assurance requirements puts McDonnold in violation of 19.15.5.9 NMAC (Part 5.9). Note that the OCD may revoke an injection permit after notice and hearing if the operator is in violation of Part 5.9. See 19.15.26.8 NMAC.

5. Inactive Wells.

Wells that have been inactive for more than 15 months must be plugged or placed on approved temporary abandonment status. 19.15.25.8 NMAC. The following wells operated by McDonnold are in violation of 19.15.25.8 NMAC:

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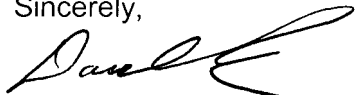
District	API	Well	ULSTR	OCD Unit	OGRID	Operator	Lease Type	Well Type	Last Production	Formation/Notes	Status	TA Exp Date
1	30-025-04408	BAY FEDERAL #003	D-35-20S-36E	D	14372	MCDONNOLD OPERATING INC	F	O	10/2008			
1	30-025-10738	CLINE FEDERAL #002	E-15-23S-37E	E	14372	MCDONNOLD OPERATING INC	F	O	11/2009	PENROSE		
1	30-025-10739	CLINE FEDERAL #003	D-15-23S-37E	D	14372	MCDONNOLD OPERATING INC	F	O	11/2009	PENROSE		
1	30-025-30870	RED CLOUD #002	M-3 -25S-37E	M	14372	MCDONNOLD OPERATING INC	P	G	04/2001	YATES SEVEN RIVERS		
1	30-025-24814	STATE A 16 #001	M-16-24S-37E	M	14372	MCDONNOLD OPERATING INC	S	O	04/2003	7 RVRS QUEEN		

This violation of the inactive well rule also puts McDonnold in violation of Part 5.9. As an operator of 36 wells, McDonnold may have no more than 2 wells in violation of the inactive well rule and still be in compliance with Part 5.9.

Again, the OCD may revoke an injection permit after notice and hearing if the operator is in violation of Part 5.9. See 19.15.26.8 NMAC.

Please contact me by March 31, 2011 to schedule a meeting or teleconference to discuss these violations, and McDonnold's plans for returning to compliance. If we do not hear from you, or if we are not able to resolve these issues, the OCD will file an application for hearing. The application may seek, among other remedies, revocation of McDonnold's injection authority based on McDonnold's violation of the terms of its injection permits, its violation of the injection rules, and its violations of Part 5.9.

Sincerely,



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