NEW MEXICO OIL CONSERVATION COMMISSION

Commission Hearing
Santa Fe, New Mexico
April 22, 1999 -- 9:00 A.M.

Name	Representing	Location
Michael Feeney	Independent	[illegible]
William F. Carr	Campbell, Carr, Berge & Sheridan	Santa Fe
[illegible]	Bingham	SF
David [illegible]	Yates Pet	Artesia, NM
Fred Hanger	NMOGA	Santa Fe
[illegible]	Kellahin & Kellahin	[illegible]
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Rick Foppiano	NMOGA / Oxy	Houston
Tom Nance	IPANM	Santa Fe

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:	)	CASE NO. 12,119
IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION TO DISCUSS THE POSSIBLE AMENDMENTS TO 19 NMAC 15.C.104 PERTAINING TO WELL SPACING AND THE NOTICE REQUIREMENTS THROUGHOUT THE RULES INCLUDING 19 NMAC 15.N	)	ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: LORI WROTENBERY, CHAIRMAN
JAMI BAILEY, COMMISSIONER
ROBERT LEE, COMMISSIONER

April 22nd, 1999
Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Thursday, April 22nd, 1999, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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I N D E X

April 22nd, 1999
Commission Hearing
CASE NO. 12,119

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D O C U M E N T S   S U B M I T T E D

	Identified
NMOGA Draft	6

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Yates Exhibits	Identified	Admitted
Exhibit 1	52	69
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A P P E A R A N C E S

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By: WILLIAM F. CARR

* * *

WHEREUPON, the following proceedings were had at 9:04 a.m.:

CHAIRMAN WROTENBERY: We've got three different packages of rule-making proposals that we've got in draft form here your notebooks. One relates to the Commission's rules on spacing, the Division's rules on spacing, Rule 104. We had also -- That's Case 12,119.

When we issued the docket we had also included under that case number possible amendments to the notice requirements of the rules. I'm announcing today that we have separated that particular part of the rule out, the notice requirements, and have docketed that under a different case number. It will be Case 12,177, the parts of the rule-making related to notice requirements.

And then we also have Case 12,169, and this is the Application of the Oil Conservation Division to amend and/or adopt tax incentive rules to implement the various tax incentives that were enacted by the Legislature this past session and signed by the Governor, just a couple of weeks ago, most of them were signed by the Governor. House Bill 11 had been signed by the Governor back in March already.

So we've got three different cases to take up today. I am at this point -- Unfortunately, Rand Carroll couldn't be here today, the Division's attorney. He has been ill this week and couldn't make it. But I've talked with him, I've talked with Lyn a little bit. And it's looking like the way that we're going to be proceeding with these rules will be like this: We'll have a working session today to review where we stand right now on the proposals. We will hear reports from New Mexico Oil and Gas Association on their review of the spacing proposal and the notice proposal. They have not had a chance to formally review the incentive proposals, but we'll kind of talk about where we stand on that in a little bit. Then we'll hear from anybody else who's interested in commenting on these pending proposals.

It's looking like we need to proceed as quickly as possible on the incentive proposals, because one of those is already in effect. The new-well incentive had an emergency clause in it, so it became effective when it was signed by the Governor the week before last. And the others will go into effect on June 19th. We hope to get the implementing rules in place as soon as possible so that the industry can take advantage of those incentives just as soon as possible.

That means if at all possible, we would like to move along and plan to adopt those rules at the next Commission meeting in May, which is going to be -- May 17th?

MS. DAVIDSON: 19th.

CHAIRMAN WROTENBERY: 19th. Wednesday, May 19th. I think that we'll be able to do that. We've got a draft to look over today. We know that there's some changes that still need to be made in this draft. But for the most part what we're doing here is codifying the requirements of the -- the provisions of the statute. So we don't think there are going to be a lot of policy issues to address, and we think we can move along pretty quickly, go ahead and -- after the discussion today.

And then we have actually -- Fred, we have a meeting scheduled next week with Frank Gray and Dick Pollard and whoever else might want to participate in that discussion, to go over the incentive proposals. I believe they're trying to set that up for next Friday if I understand correctly. And so we would like to go ahead and have this meeting today, that meeting next week, and get a proposed rule set to publish with the docket shortly, so that we will have it ready to go at the next Commission meeting in May.

Now, Rule 104, I think what we're anticipating anyway -- and Commissioners, maybe after the discussion today you'll have a better sense of what you think the timetable should be, but what we're anticipating on that is that we will listen to what NMOGA and other folks have to say here today, talk about the proposal among ourselves.

And then what I'm anticipating happening is, the Division will develop a draft proposal to circulate and actually send out with the docket, so that we would plan to take comment on that proposal at the next Commission meeting. We wouldn't plan to act at that Commission meeting, at the May meeting, but we would plan to take public comment on the proposed changes to 104 at the next Commission Meeting.

And then determine when to close the comment period. We may leave the record open for some period of time after that meeting to allow for any additional written comment that people might want to submit. Then we would plan to come back and, if everything goes well, adopt what changes we decide to adopt at the Commission's meeting in June. And that will be June -- What date, Florene?

MS. DAVIDSON: 17th.

CHAIRMAN WROTENBERY: June 17th, okay.

And then finally on the notice rules, we see that following probably a month behind the spacing rules. Since Rand had been out all week and Lyn has been doing some work for other clients this week, I have to say the Division has not had as full an opportunity as we would like to have to review the notice proposals at this stage.

So we'd like to go ahead and have the discussion today, and then meet internally and have whatever other meetings we might need to have with people who are interested in this rule-making proposal before we put together a proposed rule. And I'm thinking that the notice rules will follow a month behind the spacing rules. We'll probably set those out so that we take public comment on those rules at the June meeting, and then plan for adoption, if everything goes smoothly, in July.

That's generally the time frame that we're thinking of. Things may happen to affect that, but I just kind of wanted to tell you what we anticipate happening at this point.

Any questions or comments?

COMMISSIONER LEE: No.

CHAIRMAN WROTENBERY: Okay. In that case, why don't we go ahead and call up Case 12,119. This is the matter of the hearing called by the Oil Conservation Division to discuss possible amendments to Rule 104 pertaining to well spacing. And I'd just ask anybody, really, that wants to participate in this discussion to come on up to the tables here. I think probably Tom is going to take the lead, it looks like and...

MR. KELLAHIN: Madame Chairman, members of the Commission, my name is Tom Kellahin. I'm a Santa Fe attorney with Kellahin and Kellahin. Mr. Foppiano, Rick

Foppiano, of OXY USA, Inc., he and I are the co-chairmen of the Regulatory Practices Committee for the New Mexico Oil and Gas Association. We've been authorized by the Committee to make you the presentation of both 104 and the notice rules.

We're here assisted today by Mr. Carr of the Campbell, Carr, Berge and Sheridan law firm, particularly with regards to the notice issue and his experience on location cases.

Mr. Alan Alexander of Burlington is here from the northwest to talk about issues that may give you fact situations to describe the impact of some of the things we're doing.

We have Mr. Fred Hansen, who is the Director of the Oil and Gas Association, and he's here on behalf of the collective membership to show you and to support what we're proposing and suggesting with the various rules. So with your permission, Mr. Foppiano and I propose to sit at the table here and lead you through an outline of the issues we addressed and how we have come to some consensus on supporting various proposed changes.

You may remember that at the January 12th meeting of the Commission, we had Mr. Stogner make a presentation on Rule 104. We asked your permission and obtained your permission to continue the case to today's hearing and give the Association the opportunity to take Mr. Stogner's work product and to provide you a first working draft of how you might approach revisions to the notice rules, using Mr. Stogner's ideas and suggestions as the jumping-off point for those changes.

CHAIRMAN WROTENBERY: Sounds good.

Mr. Carr?

MR. CARR: May it please the Commission, my name is William F. Carr with the Santa Fe law firm Campbell, Carr, Berge and Sheridan, as Mr. Kellahin pointed out. I am here today representing two particular clients.

Yates Petroleum Corporation would like to call Dave Pearson, who is a petroleum engineer for Yates, who will review with you what we view to be the impact of authorization of a second well on a 320-acre gas spacing unit. We have a brief presentation on that point.

I also want you to know that I represent Louis J. Mazzullo. Mr. Mazzullo is a consultant geologist, and as you may recall, he wrote the letter to the Commission expressing his concerns about some of the rule changes.

CHAIRMAN WROTENBERY: Yeah, we've got that letter in our notebooks.

MR. CARR: Mr. Mazzullo contacted me yesterday, and he asked me to appear and advise the Commission that although he had raised a number of issues that he thought were worth consideration if the proposed rule were developed, he wanted it understood that he was not in opposition to the amendments that were under consideration to Rule 104, and he asked me to advise you of that.

CHAIRMAN WROTENBERY: Thank you.

Mike, would you come on up, please?

MR. GRAY: This Mike?

CHAIRMAN WROTENBERY: Mike Stogner. Yes, please.

MR. GRAY: Let me introduce myself. I'm Mike Gray, and I'm a landman with Nearburg Producing Company out of Midland --

CHAIRMAN WROTENBERY: Uh-huh.

MR. GRAY: And after all these distinguished gentlemen have said their piece, I'd like to make a few comments.

CHAIRMAN WROTENBERY: Sounds great. Thank you.

I was just asking Lyn if we needed to swear everybody in. I'm not sure it's necessary for this kind of work session. But just to cover all the bases, why don't we go ahead, and anybody who plans on presenting any testimony here today, would you please stand, and Steve will swear you in?

(Thereupon, the witnesses were sworn.)

CHAIRMAN WROTENBERY: Thank you. That way we're just covered.

Mike, would you please come on up and sit up here? You didn't quite make it far enough.

MR. FOPPIANO: For reference, Lori, I've put a copy of NMOGA's comments on the rule-making on the table right here for anybody that doesn't have copies of them.

CHAIRMAN WROTENBERY: Oh, okay, great. I don't know if everybody heard, but if there's anybody that doesn't have a copy of NMOGA's comments there's some available here.

MR. FOPPIANO: Good morning members of the Commission, Florene, Lyn, Steve. My name is Rick Foppiano, I'm a petroleum engineer, I work for OXY USA in Houston, and I'm here representing NMOGA. As Tom mentioned, I am co-chairman of NMOGA's Regulatory Practices Committee.

In addition to that, I have 15 years' experience -- actually over 15 years' experience, handling regulatory matters in various states where my company operates. I'm a member of the Rule 104 work group, along with Mike Stogner and others who are here today. And my comments this morning, just by way of process, are going to be focused on the sections of Rule 104 that deal with the spacing and the well-footage requirements, and that's specifically Parts B and C of Rule 104.

Rule 104 is a rather large rule, and it deals -- in addition to dealing with the requirements for spacing and density of wells, it also deals with the process of obtaining exceptions and some other matters. And we have, for at least NMOGA's purposes, tried to push those over into the notice parts of the work group that was handling those issues.

So I just wanted to mention that my comments are pretty much focused on Parts B and C, and Tom Kellahin really is going to pick up on the process of obtaining exceptions to Rule 104 footage requirements.

As Tom mentioned, in January, on the 14th, the Rule 104 work group issued its final report. Mike Stogner made that report, which I have to commend Mike on his preparation of this material. It was an excellent reference material, and quite a bit of work obviously went into it, and a very good piece of material that he put together.

And in the final report, the group issued suggestions to make some changes to Rule 104, and they were rather important and significant changes. And after that, NMOGA decided to take those changes and work through our Regulatory Practices Committee to first understand what the changes were, their impact, and then to try to find out where as an industry, or at least within NMOGA, we were with a consensus position with respect to these changes.

And so I'm here today to report on where we are with this position. We have a consensus position on these changes, and with your permission I'd like to just go through where we are as to our position on these individual changes in Parts B and C of Rule 104.

We're pleased to support the following changes to the statewide spacing requirements in Rule 104:

Changing the end-boundary setbacks on 320-acre deep gas wells in southeast New Mexico from 1650 feet to 660 feet.

Shortening the interior setbacks for 320-acre deep gas wells, and 160-acre gas wells in southeast New Mexico from 330 to 10 feet.

Reorganizing Parts B and C into requirements for oil wells and gas wells.

Allowing a second well to be drilled on the opposite quarter section for 320-acre deep gas wells in southeast New Mexico, provided notice is given to offsetting operators.

And let me just mention that this notice requirement should be considered only as a temporary measure over a limited time frame -- say two years -- and really is a tool to give the Division and industry a little information about -- if there are any unforeseen problems that might arise with this particular rule.

Also, we support changing the setbacks on 160-

acre gas wells in northwest New Mexico from 790 to 660.

We also appreciate the opportunity, as was contained in the final report, to comment on a proposal to reduce the setbacks on oil-well spacing on 40-acre oil wells from 330 feet to 220 feet. Quite frankly, we discussed the change, and no one in our Association had strong desires to see that change, and so NMOGA at this time is not recommending any change to that setback requirement.

Regarding implementation of the changes, we also have a few suggestions to address some concerns that came up through our discussions.

One, because there are some previous memos that were issued by Bill LeMay that set out some very strict limitations on when infill drilling will be allowed in nonprorated pools, as to what kind of evidence is required and when it will be granted, obviously that would be no longer applicable if these changes were made to Rule 104. So we would urge that the Division rescind those prior memos to avoid any conflict that might be set up by having those memos continued.

We would also suggest that the Division consider docketing a hearing after whatever appropriate changes are made to Rule 104 that provides an opportunity to adjust the setback limits in pools with special pool rules that contain defined setback limits. That's a mouthful. Let me just give you an example.

My company operates the Burton Flat-Morrow Gas Pool, and it has special field rules of 320-acre spacing and 660 setbacks from the side boundary and 1980 setbacks from the end boundary. All it really did was adopt Rule 104 at the time. And as a result of that, because those setbacks are defined in the special pool rules, subsequent changes to Rule 104 don't affect the spacing as set out in those special pool rules.

So we think it would be prudent to provide an opportunity for those kinds of pools to have their pool rules changed to make them consistent with statewide rules again. And there might also be some pool rules that have special pool rules that don't need to be changed. And so it seems like the best way to do that might be to docket a hearing and allow for those to be changed back to the statewide, provided no operator shows up and protests or has a problem with it.

We would also suggest that the Division provide some process for a party that is adversely impacted by a penalty that was assessed by the Division in a valid order pursuant to a contested case, to have such order reviewed in light of new Rule 104 requirements. And I suspect that there will be very few, if any, of those kinds of cases because there are very few penalties issued, and then of those penalties issued there's very few that actually have an impact on the production. So...

But if a party feels like he's -- now that the rules have changed, it's unfair for that penalty to continue, certainly a process should be provided where he could seek some review of that rule in light of the new 104 requirements.

NMOGA believes that these changes significantly streamline the rules by eliminating unnecessary applications for unorthodox locations. With the emergence of high-resolution 3-D seismic and the need to drill and exploit smaller and smaller reservoirs, the time has really come to expand the orthodox drilling window.

To give you an example, under the current rules, owners in a 320-acre spacing unit have only 20 acres of legal location area to drill -- to locate a well. And with these changes in the setbacks, if they're adopted, then that expands to 80 acres. But we're still only looking at 25 percent of the total area being the legal area. The rest of the area is still a no-man's land between the legal location window and the boundaries of the proration unit. But that's a significant increase and one that we believe would eliminate a lot of unnecessary applications.

For example, the information compiled by the

Division indicates that during 1997 and 1998, 580 applications for unorthodox locations were filed, but objections were only received in four percent of the cases. And I think clearly that argues that the time has come to change the rules, because they're obviously doing nothing more than requiring a lot of filings and a lot of exceptions that are routinely approved.

So let me just speak a little bit also about how NMOGA arrived at its position on these important changes. As I mentioned, it's a consensus position, meaning that it enjoys the support of the Regulatory Practices Committee and, indeed, the membership of the Association.

We started working on getting input on these changes when the Rule 104 work group was formed in late 1997. We have monthly meetings of our Regulatory Practices Committee, and the Rule 104 changes have been on our agenda ever since then.

Additionally, every -- when a proposal was made, NMOGA went through an extensive effort to solicit input within its membership by the sending out of a survey, posting of the proposal on its website, and clearly it's been in the minutes, which are posted on the website also.

The intent has been along to get as many concerns, as much input as possible, as early as possible, so that it could be addressed when we got to this stage.

So I wanted to mention that, and that we did as much effort as we could think of to try to get broad input.

And in fact, Mr. Mazzullo's letter was provided us by the Division so we could take that into account in our discussions of these 104 changes, and we did. That was provided to everyone in our Committee, and we reviewed Mr. Mazzullo's assertions in his letter.

The proposal that you see before you, that we communicated in a letter to you, I guess, almost about three weeks ago, is the consensus approach. It has been reached through that consensus-building process, and I just want to make sure that you are aware of that.

Let me close by thanking the Division and the Commission personnel for their leadership in this area. And in particular, I'd like to thank Mike Stogner for his leadership on the Rule 104 work group and the excellent research and work he's done on the materials and -- not only in preparing the book, but also he went through a lot of effort to come over and meet with us and walk us through the proposal and help us understand, to make sure that we knew what we were talking about. And that's always good when you're getting to this kind of stage.

These changes, if adopted, will create new drilling opportunities in New Mexico. They'll allow additional reserves to be produced that aren't being produced, and they still protect correlative rights. So we urge their adoption, we support them, and I'll be happy to answer any questions that you might have.

CHAIRMAN WROTENBERY: Any questions?

COMMISSIONER BAILEY: No, I really don't have any.

COMMISSIONER LEE: No.

CHAIRMAN WROTENBERY: I had a couple of questions. One relates to the proposal on the second well on a 320 on the southeast. What the consensus view from NMOGA is, is that for a couple of years, anyway, we should require that the operator give notice to offset operators of the property and provide, I guess, an opportunity for hearing for any offset operator who does protest. I know there was a lot of discussion on this particular point, both within the Division and within your organization. That is one alternative.

I know from talking with Mr. Stogner that there are other possible alternatives to consider, one of which would be to basically leave it up to operators in a particular pool who have a concern with a second well on 320s in that pool to come in and ask for special pool rules to address that concern.

MR. FOPPIANO: Uh-huh.

CHAIRMAN WROTENBERY: What do you see as the advantages of those various alternatives? And there may be other alternatives too, I don't know.

MR. FOPPIANO: Obviously the advantage of that approach of changing the pool rules was that it levels the playing field for everyone. And if it's pursuant to -- and I wouldn't suggest that you do it just for one hearing, but maybe after -- if there are a couple of protests in one particular area and the evidence seems pretty strong that there are some questions about the second well or some inequities that might be created by the second well, then it certainly might be prudent to initiate a review of the pool rules to determine under what conditions a second well should be drilled, if at all.

On the other hand, there might be a couple of cases where the protest is really nothing more than somebody is worried about a demand they might get to further develop an offset lease if the applicant drills his infill well. And so it's not so much an argument over correlative rights or waste; it's more of a -- well, one guy wants to drill a well and somebody really doesn't want to drill wells.

And so I think that's what the advantage of this two-year period might provide, is to see where the protests are. And perhaps during that two-year period if several protests are occurring in the same area and the Division, after reviewing that information, thinks there might be some potential for abuse, then it might be prudent to docket a field rules hearing or docket a hearing to set up some special pool rules for that area.

And that certainly might be a better call that would be made by the Division than would be made by, just say, an operator in the field. Because my concern would be -- is that, if that was initiated almost automatically, a review of the pool rules or setting up pool rules, then that might work to the advantage of a protestant, who would really want to try to -- if he's trying to shut the applicant down on drilling a second well, it just gives -- might give him another tool, because he might be able to initiate a pool-review hearing where it really isn't necessary.

So I think it's always within the Division's call to do that and certainly might be prudent in some cases, but it depends on what evidence you get through the notice and opportunity for hearing process.

So I guess I can see advantages to both, and maybe a combination of both might be a way to do it. But certainly you could do both.

MR. KELLAHIN: May I respond --

CHAIRMAN WROTENBERY: Yes, certainly.

MR. KELLAHIN: -- from a slightly different perspective?

CHAIRMAN WROTENBERY: Uh-huh.

MR. KELLAHIN: Historically, the Division has always afforded the operators in a pool the opportunity to come forward and adopt special pool rules and to amend those rules, and that has been historically the method of approach to solving any kind of increased-density well-location issue.

You might wonder why you don't see those. You can look for the last ten years, and there are not many. Two examples come to recent mind, was the extraordinary effort made by Burlington to change the Blanco-Mesaverde Pool rules to increase well density. It was a huge, huge effort. And there are not many companies that have the resources of Burlington to go through the process of finding all the interest owners in the pool, to send out some 3500 notices, to spend $20,000 and $30,000 on postage to send notices, and to develop an entire reservoir study that shows the necessity for such a change in a pool that has 5000 wells and several hundred thousand acres of property.

You don't even see it done on the small pools, because in southeastern New Mexico many operators say it's just too hard. There's a need to change the rule, and so what they do is, they do it on a well-by-well basis.

They'll ask Mr. Stogner or the Division for a well-location exception, and the offsetting people can respond more quickly on a site-specific well-by-well example within a pool, rather than devote the resources to the enormous effort to study the entire pool.

For example, Mr. Carr presented a case recently for Yates that is an example of this. It's Case 12,037, Mr. Ashley was the Examiner last month, it was the North Shoe Bar-Atoka Gas Pool. It had to do with this very topic of having a second well in a 320.

Mr. Carr filed an application in the alternative. He says, Let's change the entire pool rules for everybody, or grant simultaneous dedication and an exception for the specifics of Yates' issue in the west half of a section -- or east half of a section.

The pool operators knew about it. They said, We don't want to change the whole pool rule, we don't want to deal with it, but we will look at Yates' specific, unique need. And everybody around Yates says, This is okay. It's okay because of the unique circumstances. We can handle that. They can have that second well, it's not hurting me, let them do it.

And so what we see with the idea of a generalized second well in 320 gas is an opportunity to expedite the process so that you can have the second well at your option, and yet you afford the opportunity to the immediate offsets to register an objection saying, Wait, it's unique here, it's not appropriate, we have an odd reservoir where two wells upstructure will take reservoir energy from us and we might be prematurely watered out. In a water-drive reservoir, we might be adversely affected if you have two straws in the container, and we don't -- Let us review that.

And then the Division has the option of saying, Okay, I'll see it on a case-by-case basis. Or, wait a minute, time out, let's invite everybody in this pool here and let's talk about this.

That's the only way we could figure out how to go forward with a very important change and then make the change. We are unable to devote the time and energy to find those unique pools for which this doesn't work, or to build technical cases to show you in the 80 or the 90 percent of the pools this is okay.

And this is a generalized matter of policy, we think, procedurally. It works, it will afford protection to correlative rights to find those examples where it's harmful and yet afford the wonderful opportunity to have the second well, recognizing as we thought we would have huge debate in the industry on a second well -- holy cow, that's a big change -- virtually no debate once there was consensus that there needed to be a temporary period to provide some notice to address unique opportunity.

And that's how we got here today. We thought -- Mr. Foppiano and I thought we were walking into a committee hearing with a lot of angry people saying, We should not be doing this, this is too huge. It didn't happen. In fact, it still hasn't happened as of today. This thing has been widely circulated in the industry. It's well known about anybody that cared to look at their website, that cared to be involved in the process. The Association is huge. We invite everybody to play and participate. There's been no opposition.

CHAIRMAN WROTENBERY: Thank you.

MR. PEARSON: Could I make a brief comment on behalf of Yates Petroleum?

CHAIRMAN WROTENBERY: Certainly.

MR. PEARSON: We would support the procedure as brought forth by NMOGA. As far as some of the discussion we had with NMOGA, we were not in complete agreement, but we agreed to stand by the consensus that NMOGA has brought forth.

The primary focus for us, the benefit -- a large part of the benefit that we feel would be derived from this would come from streamlining the process in allowing operators to proceed in a predictable amount of time to continue development, prudent development, on the proration unit where a second well could be justified.

As Mr. Kellahin just eloquently made reference to the pool-rules issue, when you open things up for special pool rules it tends to create an enormous amount of uncertainty, and people will react. And our experience has been that it's almost impossible to get a pool-rules change because of that uncertainty. Even if there isn't an obvious harm that's derived from the pool-rules changes today, the change in the rules for an entire pool, generally people tend to oppose that.

In the two specific cases Mr. Kellahin has referenced, one of the reasons we chose not to pursue the alternative was because we received an objection to this pool-rules change, whereas all the operators that were immediately offset, were impacted by it, were willing to allow us to proceed with a unique case in one proration unit.

And based on that experience, we think that the process would be a lot smoother if we can deal with this on a case-by-case basis and gather some data to see how many objections there actually are to additional wells on a proration unit.

CHAIRMAN WROTENBERY: Mr. Carr?

MR. CARR: I might also add that I think that during this two-year period of time it would be interesting to see what the objections actually are, because we're going to present -- make a brief presentation, Yates is going to in a few minutes, is going to take a selected, particular situation and show you what we believe, and that is by changing the rules there's a tremendous potential for additional drilling and development and recovery of reserves in New Mexico.

And when you -- if you should accept a notice and an opportunity for objection as a part of this new rule-making, the question, really, that follows that is, to what can you object?

CHAIRMAN WROTENBERY: That was my next question.

MR. CARR: Because the fact is, if a well can be justified as necessary to recover additional reserves, just because you offset and don't want to develop your acreage shouldn't be a reason -- it shouldn't be a reason to say no, and it shouldn't be a reason to penalize.

But because this is, as Mike indicated, sort of a radical change -- that's how he described it in January -- I think there was a little uncertainty on a lot of -- just to sign off wholeheartedly, by some of the people that were involved in this process. And that's why they, as I understand it, were asking for an opportunity for notice and an opportunity to be heard. And that was the basis for that.

Now, as to the infamous case that my friend Kellahin cites, it was my idea to just change the pool rules. I have never in my life done anything in my life as poorly conceived, I guess.

(Laughter)

MR. KELLAHIN: I've got some examples.

(Laughter)

MR. CARR: I would note in response to that, that I do appreciate the fact that he was placed under oath and I was not.

(Laughter)

MR. CARR: But it did generate a tremendous amount of opposition, and it took us, if you'll look at the docket, about six months to negotiate our way through that. We learned a lot less about reservoir engineering in that case than we did about diplomacy, because we had to back out of the hole we dug.

And it's a difficult thing, notice, and you see that uncertainty that I think is the source of this request for a two-year period with notice. That same kind of concern, I think, would be a problem with pool-rule cases.

CHAIRMAN WROTENBERY: Thank you.

Anybody else want to weigh in on this question about what process to follow for the second well on a 320?

MR. GRAY: I would say, I hope if there is a hearing, if NMOGA's suggestion is accepted, that the Commission is more inclined to grant the well than disinclined. I think -- Otherwise, it will be very similar to the situation we have now, where we're -- everything is a dogfight to get another well drilled in a 320 if the Commission is not more or less inclined to grant the well rather than the exception.

MR. KELLAHIN: May I share with you some of the reasoning in the LeMay memos --

CHAIRMAN WROTENBERY: Please.

MR. KELLAHIN: -- for including additional wells?

CHAIRMAN WROTENBERY: Uh-huh.

COMMISSIONER BAILEY: Could I get copies of those?

MR. KELLAHIN: We have them. Let us distribute those, Mr. Foppiano's copies.

MR. FOPPIANO: The infamous LeMay memos.

MR. KELLAHIN: They served a useful purpose, and let me describe the background. Back in the 1980s, and in fact now, there are a great many nonprorated gas pools. And a single well in a spacing unit produces at capacity. It was becoming more common for an operator to ask for a second well, and get it, and all of a sudden have two wells to be produced at capacity.

And the senior engineer on the Division at that time, Mr. Vic Lyon, who was an expert in prorationing, suggested that having multiple wells in a single-well nonprorated spacing unit circumvented spacing. The presumption was that a single well would drain the 320, and because there was no allowable, therefore two straws had an advantage over the offsets. That was the perception. And so they issued the memo.

And we asked, what does it mean when you ask us to present clear and convincing evidence of compelling need for a second well? What in the world is that? And we asked Mr. LeMay and Mr. Lyon to explain that, and they said it was this:

It was a spacing unit in which the original well could not protect your spacing unit from offsetting production adjoining you, and therefore you needed the second well to protect yourself from offsetting drainage, because the first well was either too far removed from the competition, was in a different Morrow stringer from the pool. Morrow often has the three zones. If you're completed in the A and the offsets south of you are in the B and C and you're getting drained and you can't get there, they give you a second well.

Very unique. There are probably not three or four cases like that, that we've ever been able to prove.

The hurdle was much too high. We got into the NMOGA meetings, and everybody unanimously agreed the hurdle is much too high.

Then along came the Yates case, and the hurdle disappeared. The Yates case has nothing to do with waste. There's nothing in that record that says a second well is going to increase ultimate recovery. It simply says that it will not impair correlative rights because the offsets saw the unique structure and relationship geologically, permeability barriers and all that stuff, and says, You can have two, if you want to spend the money on two, and did, it doesn't hurt me. So it's not even a waste case.

And so we got to the Committee hearings, and everybody says, Take the hurdle down. Everybody says, Let's either have it automatic, the second well, or create a temporary notice period. There was no one in that room that says, Let's not do this.

MR. FOPPIANO: Could I add just a little bit of observation?

In Mike's report that he made in January, I think he offered what I thought was some of the best testimony about the need for the second well, and that of all the hearings and applications that Mike has seen -- which I think he sees most, if not all, of them -- were exceptions to Rule 104, he said he saw very little evidence of a well capable of draining 320 acres, and in fact it appeared to him that most gas wells in southeast New Mexico drained far less than 320 acres. And that's certainly been our experience.

And so in terms of working to adversely impact someone's correlative rights, I think that's going to be a very rare case that might occur with the second well. In fact, I think the justification for the second well is most often going to be the prevention of waste; it's going to recover reserves that aren't otherwise going to be recoverable.

However, I guess this -- I could see a party objecting if there was some reservoir out there where it's very competitive, very permeable, very homogeneous, and a second well does nothing more than accelerate the recoveries on that 320-acre unit, and the offset party feels like that acceleration is going to adversely impact their correlative rights, I can see an objection.

And hopefully that objection process will bring forth information about that particular reservoir that might, after two years, or it might in the interim give pause to the Commission to say, Well, maybe we need to look at the entire pool here, because of the unique circumstances here. But certainly in a vast majority of the cases, this is going to be a prevention-of-waste mechanism, to drill a second well.

COMMISSIONER LEE: Did you consult with the IPANM on this issue?

MR. FOPPIANO: Actually, IPANM is represented here. I will state that a lot of our members are the same as IPAA members and IPANM members, and we've heard no objections from any of the common interests, but I believe --

CHAIRMAN WROTENBERY: Tom, are you --

MR. NANCE: We're not taking any position at all. I'm here strictly as an observer at this point. But we certainly have no objections.

MR. HANSEN: And you have had -- You have copies of --

MR. NANCE: Oh, yes. Oh, yes, we've circulated copies of this throughout our board of directors, to our board of directors and our sponsors, and have had no objections.

CHAIRMAN WROTENBERY: Thank you.

MR. FOPPIANO: To follow up, Dr. Lee, we have visited also with the BLM to see if they had any concerns. Primarily one of our concerns was decreasing the setbacks. Is that going to trigger some automatic demand? And the BLM had no concerns in that area.

CHAIRMAN WROTENBERY: I think you've also visited with the staff at the Land Office as well?

MR. FOPPIANO: I have talked with an engineer at the State Land Office, who is reviewing the rules and -- It was just his opinion, but he indicated that he thought if it helped industry and caused more wells to be drilled, he thought it was probably a pretty good idea. But he also qualified that in stating that that wasn't the official State Land Office position; that was his opinion.

CHAIRMAN WROTENBERY: I had one follow-up question on the question of notice of a second well. Can you help us kind of figure out how to write that part of the rule? And the part I'm concerned about is just, what are the standards that apply if somebody does protest and it goes to hearing? How do you determine who wins? It kind of gets back to the question --

MR. KELLAHIN: If you turn to page 8 of the draft, the NMOGA draft, you'll find under sub (b) is our effort to write this. The first part is that we're dealing only with the 320 gas pools. This does nothing about changing 104.P, which limits you to a single well in a spacing unit in a nonprorated gas pool.

So it might help to edit this draft to be more specific about 640s and a limit of one well for those, and to put a note under the 160 pools and say, You get one and that's it, until we change this rule.

So we're focusing only on the optional second well. (i) of (b) makes it very specific that that second well has got to be in the opposite 160 from the parent well. And then (ii) is an effort to put the burden on the applicant and avoid administrative attention by the Division.

So it's go to like this, that if OXY thinks they want an infill well, before they file the APD they notify every operator that is around the 160 where the infill well is to go. That's their notice list. Those will be the affected parties. They will send certified mail notice, they will send them a copy of the proposed APD and the plat, and then they will wait 20 days.

When the 20-day period is up, they will file their APD with the District Supervisor, and they will attach to that APD a certificate saying that I've got waivers from my offsets or certifying that the 20-day period has expired and no objections were received. The District Supervisor looks at it, he says, I've got the sworn affidavit, they meet the requirement, it's an infill well, you approve the APD, and life goes on.

If the applicant gets an objection, then the applicant has a choice of throwing it in the garbage or filing for a hearing. And he goes to the hearing and he meets the same standard that we have historically applied, and that is a correlative-rights/waste-prevention issue, and you deal with it within the statutory concepts of those items, and you do what Mr. Foppiano said could happen: You show that you're going to be drained by the infill well, that it's unnecessary, whatever it is.

And we develop them on a case-by-case, and let's see if we do one of them, none of them or a bunch of them. And in that period if we find this is not a big problem, then you terminate the notice thing and life goes on. If it says, We've bit off a huge problem here, what are we doing? then you have a procedural safety net to say, Time out, we need to think about this again, or, We've identified those pools that require particular attention, and then you can go to the next step, deal with it one by one, deal with it on a pool basis, you use your regulatory authority and say, Wait, time out, let's get everybody in here, let's talk about what we're doing. And you take it through the process.

Yes, ma'am?

COMMISSIONER BAILEY: Should the adjoining property be unleased --

MR. KELLAHIN: All right.

COMMISSIONER BAILEY: -- then there would be no notice to the mineral owner?

MR. KELLAHIN: That's right. Now, that's a judgment for you to make. The industry's draft makes the argument that it is an offset operator who has put his money in the ground, who has actively exercised his correlative-right opportunity, and has made a commitment to production.

COMMISSIONER BAILEY: But there's still protection for drainage from unleased lands, then?

MR. KELLAHIN: The protection for the unleased land is for that owner to afford themselves of the opportunity to protect themselves and go get a wellbore. So if those owners don't act, they're going to get drained anyway and lose the opportunity for correlative rights.

If you disagree with the industry position, then you'll need to add a notice provision that adds notice to the offsetting lessees and, in the absence of a lessee, the mineral owner around the 160, and that's a policy judgment that you'll need to make. We have not suggested it here for the reasons I've just described.

MR. FOPPIANO: May I add something, a comment based on your question?

This process was a consensus process that was derived mainly to gather information and to give notice to those parties operating wells offsetting the applicant's infill well.

And if the notice was expanded to include lessees and unleased mineral interest owners, the cost of such can be such that it would present a big disadvantage to several operators and areas, because we could be talking about a very large area to try to go get the notice requirements -- or the parties identified for notice. And I suspect, just from my listening to the discussion, that that was the only reason that the parties were able to come to a consensus, was, we were able to create a notice process that really dealt more with an informational gathering type of thing, rather than trying to give the kind of notice that you'd see for an NSL. And if we did go to the NSL-type notice, industry would probably diverge on this position, and we wouldn't have a consensus position anymore.

So we only support this, there's only a consensus, because the notice is limited to just the offset operators. And I think everyone shares the same opinion, that if a party does not avail themselves of the drilling of a well, then how far should the agency to go to protect his correlative rights when he's not even got a well out there? And so when we get to the second well, that's how we justify the notice to the offset operators only.

COMMISSIONER BAILEY: However, when there is no operator out there, when it is unleased state lands, then the potential for drainage from state lands is a major concern to us.

MR. KELLAHIN: Wouldn't your immediate response be to notice your lessee and make a drainage demand letter to him --

COMMISSIONER BAILEY: That's what I'm saying. We may not have a lessee in that area.

MR. KELLAHIN: Then you would have a wonderful opportunity to extract a bonus and put it up for lease and you'd make a lot of money.

COMMISSIONER BAILEY: As soon as it's noticed.

MR. GRAY: May -- This is an issue that I was going to discuss, and that I will later, because it's a slightly unrelated issue, related to the new rule.

But with regard to notice, there's an internal notice question as well as an external notice question to the unit, and in the cases of compulsory pooling orders the wells that are drilled outside the bounds of an operating agreement, with respect to the drilling of the second well, and it's something that I was going to bring up later.

In the event the initial well was drilled under a penalty and that a party has not participated and is suffering the typical 200-percent penalty for not participating in a pool unit, obviously some notice must be given to that person for the second well, and some provision will need to be -- either a hearing or a new rule related to compulsory pooling *vis-a-vis* the rights of the parties that drilled the initial well or that elected not to participate.

MR. KELLAHIN: May I respond to Mr. Gray?

Mr. Gray raises an issue about the second well. The first answer is, if he's got a joint operating agreement for the first well, it is going to specific as to that spacing unit. It will have an Article VI in it that has subsequent-operation language in it. And so if a second well is proposed, then you have to propose it to all your working interest owners. There's a contractual solution.

For force-pooling cases, it is the general belief that the force-pooling order would be wellbore-specific. So if you had a pooling order for the parent well, and someone in the spacing unit, even the nonoperator, wants the infill well, they will have to go through the same type of process you do as a predicate for force-pooling. That is to notify everybody in the spacing unit that you want a second well and come in and get your original pooling order modified, supplemented or altered to provide for the second well.

And in doing so, the Division can address whether or not there's an unfair advantage for the owners going nonconsent in the first, consent in the second, taking that production risk-free. And the Examiners obviously would have the authority to say, Hey, here's an equitable solution, the parties debate it, you come to solution, and you go on.

So I think the mechanism is in place to address Mr. Gray's concern on both topics.

CHAIRMAN WROTENBERY: Mr. Gray, do you want to follow up on that?

MR. GRAY: Yeah, I don't think the mechanism -- Yes, there is a mechanism in place which -- and I'm not -- honestly -- I know Mr. Kellahin and Mr. Carr are a lot more familiar with the rules, but I would surmise that under the current situation where a party is pooled and is suffering a 200-percent penalty under the pooling, he's pooled as to the 320, not as to a couple of 160s within that 320, that under the current situation and under the assumption of the current rules that the well is draining the 320, that that party would suffer the full 200-percent penalty until that first well paid out.

Under the rules as proposed, the nonconsenting party, or this party suffering the penalty, could propose a second well and, under the rules proposed, could propose a second well as close as -- well, if the first well is drilled 10 feet from the centerline of the section, the party having not participated in the first well could propose a well 10 feet from the centerline on the other side, in the other quarter-quarter, in the other half section, or quarter section, and drill a well 20 feet from you, and pool you, possibly, if you're going to have to have a hearing in every case.

MR. KELLAHIN: Well, here's the protection for Mr. Gray's example: If you take an aggressive example like he's described, if there's not unanimous agreement for the second well in the pool spacing unit, what's your recourse? You come to the Division for a modified pooling rule. And if you're so aggressive as to propose a second well 20 feet from the first, don't you think it begs the Examiner to say, No, it's an unnecessary well, what in the world are you doing? It's stupid, go away.

Or you can say, I will not let you benefit by drilling an infill well and avoiding the penalty by depleting the production from the first well. What's an obvious answer? You require the production from the second well to be applied to pay off the penalty on the first. There's some nice solutions, and we'll have to work through them on a case-by-case basis.

But to suggest that we should postpone the infill well for those unusual situations where you have a pooling order and a need for a second well because we're afraid we can't answer that question, seems to be not solving the problem.

MR. GRAY: I would -- and I realize this very late in the game, and I apologize for bringing this up now, because we just thought of it two days ago, but the -- it would seem to me that in conjunction with the new proposed rule regarding spacing, that perhaps a consideration should be made for new rules regarding pooling.

MR. KELLAHIN: Mr. Gray, with all due respect -- and his question wasn't new to the Committee. We debated this on several occasions before the Committee. We had Mr. Pearce there, a former Commission attorney, and Mr. Carr and myself and others that do this frequently, and we did not see it to be an obstacle that didn't have a solution.

CHAIRMAN WROTENBERY: Mr. Carr?

MR. CARR: Trying to go back a little bit, back to where I was a few minutes ago, we might propose this, or advance the Division Committee proposal. In January, I mean, there was a recognition it was a major change. And I think the kind of questions that are being raised by Nearburg are important questions. And I think what it may require is working through the process. I mean, it's like trying to enact a statute and at the same time anticipate how it would be interpreted. And I think that's a major function of the Division hearing process.

CHAIRMAN WROTENBERY: Uh-huh.

MR. CARR: And I think when you look at pooling orders, generally you pool certain acreage for the drilling of a well and a specific location or a well at a standard location. And so yes, it pools all the lands, but generally it is for a single well.

You get into it, you're going to have to evaluate whether somebody is trying to take advantage of the guy who went out and developed the property by crowding or by just, because of the data, proposing a second well --

CHAIRMAN WROTENBERY: Uh-huh.

MR. CARR: -- and the option of leaving the penalty in place, 200 percent on the first well, 50 percent penalty or no penalty on the second, you have the option of combining the production to pay off the risk from both wells, to pay off the risk penalty in the first well before you go forward, and a lot of those things are just impossible to anticipate up front.

But the concerns are real, the concerns are legitimate. And it seems to me -- and I don't think Nearburg's saying don't do it, but I think they're making an important comment, and that is that there are going to be some things that pop up that we really can't anticipate. I mean, like the question of notice and how it relates to a state lease differently. From what Commissioner Bailey says, it may be that it is absolutely essential that notice be given to the government agency involved so that they're certain they don't have unleased minerals that are going to be drained.

And I think basically as we thrashed through all of this, the consensus was, what's being proposed is good. What's being proposed is, in fact, a regulatory, non-tax incentive that can really give this industry a shot in the arm.

And I think that was the overriding concern, where people weren't -- to the fact there could be some fallout, there could be some things, you know, that we really couldn't anticipate. I think you see it here in Nearburg's comments, you see it in the Commissioner's comment. We saw it in the Committee just being hesitant to just completely jump into the pool without a period of evaluation.

CHAIRMAN WROTENBERY: Thank you.

MR. GRAY: I might add, please don't misunderstand. We are in favor of the rule change.

CHAIRMAN WROTENBERY: Thank you.

MR. GRAY: And the -- but I do think -- and we got a little bit further than I wanted to go in that discussion, but there probably should be some consideration, there must be some consideration for notices to the nonoperating-agreement-governed parties within the unit.

CHAIRMAN WROTENBERY: Mr. Foppiano?

MR. FOPPIANO: Being an engineer, I might have a little different perspective on this issue of the pooling, but it seems like to me that the parties that -- I'm sorry, Mark?

MR. GRAY: Mike.

MR. FOPPIANO: Mike. -- that Mike is referring to will get notice, because the second well is either drilled pursuant to a JOA, and an AFE is sent out, parties have an opportunity to elect under the JOA, or it's drilled pursuant to a modified pooling order, which notice goes out and there's an opportunity for hearing on that proposal.

So the problem that he describes actually occurs today when a force-pooling order is issued for Wolfcamp-Strawn-Atoka-Morrow. The well is drilled to the Morrow, completed in the Morrow, and the operator wants to go drill a second well, in the other 160 or in the same 160, for one of the other horizons. And I mean, that same issue about those parties that elected on the first well, what about notice on the second well?

And it seems like it still comes back to, since the pooling order is for that well, he gets the -- if there's a second well out there, then a modification of the pooling order will be required, and that would take care of the notice issue that Mike is referring to.

Otherwise, it's drilled pursuant to a JOA, and all those parties are giving -- their rights are governed under that JOA anyway, the right to elect or not elect.

CHAIRMAN WROTENBERY: I appreciate all of your comments on that particular issue. I know you all thought about this issue before, but this is a new one on me so it's something that I need to give some more consideration to. I appreciate you raising that issue.

Any other questions of Mr. Kellahin or Mr. Foppiano at this point?

Mr. Gray, did you want to go ahead and make your comments?

MR. GRAY: I think I've pretty much said what I needed to say.

CHAIRMAN WROTENBERY: Have you? Okay. Okay.

Mr. Carr, did you...

MR. CARR: Now, I never play by the rules, you know, and I really would like to go ahead and put this on as a more formal presentation, and the overriding reason is, that's how we prepared it.

CHAIRMAN WROTENBERY: Okay, that's great.

MR. CARR: But we can stop and discuss any point as we go.

CHAIRMAN WROTENBERY: Okay.

MR. CARR: All right.

CHAIRMAN WROTENBERY: That sounds good.

MR. CARR: At this time I would like to call David Pearson. Dave is a petroleum engineer for Yates Petroleum Corporation, and Dave and I have successfully slipped through the LeMay memo twice in the last six months. Tell you a little bit about the...

CHAIRMAN WROTENBERY: Please go ahead.

DAVID PEARSON,

the witness herein, after having been first duly sworn upon his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your full name for the record, please?

A. David Pearson.

Q. And Mr. Pearson, where do you reside?

A. In Artesia, New Mexico.

Q. By whom are you employed?

A. Yates Petroleum.

Q. Have you previously testified before the New Mexico Oil Conservation Commission?

A. No, I have not.

Q. Could you briefly review your educational background for the Commission?

A. Yes, I have a BS, bachelor of science, in petroleum engineering from Texas Tech University.

Q. And when was your degree received?

A. 1990.

Q. And since that time, for whom have you worked?

A. I worked for seven years for Exxon Corporation in Midland, Texas, and for a year in Dallas for the Scotia Group, a consulting firm, and for the last year and a half for Yates Petroleum in Artesia, New Mexico.

Q. And at all times since graduation, have you been employed as a petroleum engineer?

A. That's correct.

Q. Are you familiar with the proposed amendments to Oil Conservation Division Rule 104?

A. Yes, I am.

Q. And has Yates participated in the New Mexico Oil and Gas Association Regulatory Practices Committee meeting when amendments to these rules were discussed and considered?

A. Yes, we have.

Q. Did you personally attend the meeting where Mr. Stogner made additional presentations to the group?

A. Yes, I did.

Q. Have you reviewed these rules and proposals and evaluated how these proposed rules would impact development of gsa reserves in southeastern New Mexico?

A. Yes, I have.

Q. Are you prepared to share the results of that work with the Commission?

A. Yes.

MR. CARR: At this time I would like to tender Mr. Pearson as an expert in petroleum engineering, only because we'd like to get it done.

CHAIRMAN WROTENBERY: He is so accepted.

Q. (By Mr. Carr) Would you briefly summarize the purpose of Yates' presentation in this proceeding?

A. Yates -- The purpose of our presentation is to try to present evidence relative to two specific sets of conditions where today we feel like the rules, and specifically the two LeMay memos, significantly hinder our ability to prudently develop the leases for which we're operator and responsible therefor, both to the State, federal lands and fee owners, for development.

We are particularly concerned with the infill well-spacing issues. We are in support and have participated in the development of a consensus through NMOGA both on the spacing and the notice rules, and we support the request, specifically are interested in supporting the request that the notice requirement be reviewed after a period of time, that we get a sense of how many protests there are and things of that sort.

Q. Does Yates Petroleum Corporation support an amendment to Rule 104 to authorize a second well on each 320-acre gas-spacing and proration unit?

A. Yes.

Q. Have you prepared exhibits for presentation in this case?

A. Yes, I have.

Q. Let's first go to the Burton Flats, and this is the pool that Mr. Foppiano discussed. And I might just note we're going to talk about a portion of this reservoir as an example.

And I might also point out that because of the LeMay memo, we have found a relatively limited number of examples we can bring and cite to you, because there are not many areas where there are spacing units -- in this case, three -- next to each other, where in fact an infill well has been drilled on a 320-acre gas unit.

Mr. Pearson, would you identify what has been marked as Yates Exhibit Number 1?

A. Yes, Yates Exhibit Number 1 is a base map showing the penetrations to the Morrow depth in the area of Township 20 South, Range 29 East. It shows a nine-section area -- there's not a convenient way to summarize that, but centered on Section 17. In that area there's relatively full development, or six of the sections, anyway, are fully developed with 320-acre proration units. Two are not completely developed.

I've drawn sort of a reference frame in the center to draw your attention to the approximately 1000-acre area, or the three proration units, that do, in fact, have infill wells drilled on them. As Mr. Carr made reference to, it's difficult to locate specific examples in New Mexico right now where there are proration units with second wells. There are a number of cases where there are wells that are offset from each other by 2600 feet, roughly the equivalent of what we're talking about. This is --

Q. What do you have here? Three standup spacing units?

A. There are three standup spacing units, that's correct, and it's a mix of federal and fee land.

The exhibit shows each of the wells with the name of the original operator, and the names -- There are several reservoirs here, and so the names have changed on the wells or on the lease name as you come from the deepest reservoir in the Morrow, the Atoka, up into the Strawn, the Delaware, and there will be another exhibit where there could be some confusion from that. So what I've done is, I've labeled each of the wells that are of specific interest in the lower left-hand corner, just with a reference number. The reference number is in the sequence in which the wells were drilled, the first well being drilled in 1974 and the last well being drilled and coming on production in 1984.

Q. As these spacing units were developed -- Run through it. Where were the original wells drilled?

A. Okay, there are three standup spacing units. The other thing that you'll note that I've annotated by hand on the base map is, in the lower right-hand corner below each well, is the date at which the well was drilled or came on production.

The three original 320-acre wells on the spacing units were in the northern part of each -- northern half of each spacing unit or the northern quarter of each spacing unit, and they're Wells Number 1, Number 2 and Number 3. One was operated by Texas Oil and Gas, now Marathon. One was operated by Yates Petroleum. And the other one was originally operated in Section 16 -- excuse me, in the west half of Section 16. It's now labeled as J.C. Williamson, but it was originally operated by Marathon or TXO and has since been sold to J.C. Williamson.

Q. So at the end of 1976 we had three standup spacing units dedicated to single gas wells in the north half of each of those spacing units?

A. That's correct.

Q. And then what happened?

A. Beginning in 1984, after about 90 percent of the gas reserves in the northern wells had been produced, there were infill wells drilled in the southern half of each of the three proration units.

Q. So the first one was in 1982?

A. I'm sorry, 1982.

Q. And that's the -- ?

A. The well labeled Number 4, which is in the west half -- the southern quarter section of the west half of Section 16.

Q. All right. Let's go to Exhibit Number 2, and I'd ask you to explain what this is. You might identify all the subparts of the exhibit.

A. Okay. Exhibit Number 2 is intended to go with the first exhibit, and what it is is a production plot for each of the six wells of interest within the frame of reference.

The production is plotted in sort of an unusual fashion, just to make the display more compact and easier to evaluate. The production is the annual production in BCF, annual gas production of each of the wells in BCF on a common time axis so that you can see the sequence of events in terms of development and the production rates when they came on production.

And over on the far left-hand side of the table you'll see reference numbers for each of the wells. On the far right-hand side, the bar is the cumulative production for each of the wells. And the bar graphs in the center of the table are the amount of gas produced each year. Just for reference, the top well there, the TXO Yates Federal Number 3, produced approximately a BCF a year in that first big year production in 1975.

Q. All right. Now, what does this show us?

A. What this shows us -- Basically, it shows two things. There are -- three things.

The primary function of the plot is to show you that there were additional wells drilled in the southern half of each of these proration units, and each of those wells came on production at rates that were equivalent to the initial production of the initial wells in the proration unit, i.e., the likelihood that there was good pressure communication between these wells on 160-acre spacing is very low.

Specifically relevant to that is the fact that all of the three original wells were producing at rates that were less than five percent of their initial production rate at the time that two of the three infill wells were drilled, and those wells produced at equivalent initial production rates to the original wells. I had to come at this from a sort of roundabout way, because there are several operators here, and we didn't have access to actual pressure data in all of the wells, which would be the better way of showing this case.

Q. Is it fair to say that basically the three original wells on the spacing units had produced most of the production available to them before infill wells were drilled on this spacing unit?

A. That's correct.

Q. The infill wells came on and, at least in two of the cases, produced at rates which were comparable to the original wells?

A. That's correct. That would be the primary point of the exhibit.

Q. Now, when we look at the pages behind that first page, those are just individual well plots from *Dwight's* that would support the bar graphs on --

A. That's correct, we included them and attached them just to show the traditional way, presenting the data too.

Q. Okay, let's go to Exhibit Number 3. Will you review that, please?

A. Exhibit Number 3 is a summary of the first two exhibits. The function of this exhibit is to demonstrate to you the additional recovery derived in this low-continuity case from putting a second well or an infill well on the proration unit.

The top part of the exhibit summarizes and presents the total for the original wells on the 320-acre proration unit. There were three wells that were drilled. The reference number is over in the left-hand column, the well name is in the center column, and the cumulative gas production -- which, for those three wells, is, in fact, the total or ultimate recovery of the wells as they've all been recompleted to other zones -- that production, total production from the original wells was about 5.1 BCF.

The second portion of the table summarizes the production to date from the infill wells drilled on the 320-acre units, and the format is the same. The left-hand column is the reference number to Exhibit Number 1. And the total production from the infill wells is actually somewhat higher than the production from the original wells. It's about 5.7 BCF. One of those wells, the Yates B.C. Williamson, is still under production today, although that 3.2 BCF number represents probably 95 percent of the reserves that will come from that well ultimately.

The ratio of the additional recovery from the infill wells to the initial recovery from a single well on the 320-acre unit is about 1.1 to 1. And the primary point of the exhibit would be to highlight that the reserves that would be wasted if we were not allowed to drill a second well on these proration units are actually greater than the reserves that were developed by the original wells in the proration units.

Q. Could you give us your opinion as to the reason for the high recoveries from the second wells on each of these units?

A. Yes, specifically it's related to the low continuity. I can speak from the pressure data that we have for the Yates wells, and we operate several wells in the area. It's related to the low continuity, and although I'm not a geologist I've been advised by our geologist that the stratigraphic complexity in this area is very high, and individual sands are difficult to correlate on 320-acre spacing, which is not uncommon in the Morrow.

Q. Because of this low-sand continuity in the Morrow, would that also apply, probably, to the Atoka as well?

A. I believe so. It's difficult -- We're getting far enough south that we're getting into an area where it's somewhat difficult to generalize about the Atoka.

Q. Because of this low continuity, then, the second well is not, in effect, competing with the first well for the same reserves; isn't that fair to say?

A. That's correct, and that would be the primary point I'd have you take away from Exhibit Number 2.

Q. What conclusions have you reached from this information on Burton Flats?

A. The primary conclusion I would reach is that it is necessary in this specific area, and based on my experience in a fairly large number of Morrow proration units, to put a second well in that proration unit to effectively drain all of the reserves that are under that proration unit.

Q. You're familiar with the Division memoranda that limit the development of these spacing units at this time with a second well, unless there are showings of extraordinary impact on correlative rights; is that correct?

A. That's correct.

Q. Mr. Pearson, based on your understanding of that memo, would any of these infill wells on the three spacing units you've just discussed be able to meet the test set by that memo?

A. No. In fact, I have particular experience with the memo, as we have recently contested two cases, successfully contested two cases related to those problems. There is not enough data available from the offset operators to show conclusively that there would be -- for us to build a conclusive case that we were suffering harm, which is one of the two criteria under the LeMay memo, from not being able to drill a second well on the proration unit in a timely fashion. It would require the offset operators to give us their -- some pressure data, which they may or may not have acquired, and it serves -- The standard that was set under the LeMay memo not only requires you to show that you are not harming someone else's correlative rights but that your rights are, indeed, being harmed too. And as a practical matter, it's very difficult to have access to all the data that you need to show that.

Q. Is it your opinion that those memos would effectively preclude the drilling of a second well on these units until after the first has been plugged and abandoned?

A. Yes, that's correct.

Q. Let's now go to the next set of exhibits, Exhibits 4 through 6, which relate to Yates' recent efforts in the Little Box Canyon. Is this involved in case it was brought before the Division and you were granted an exception to the LeMay memo?

A. That's correct.

Q. Okay, let's go, and would you first explain what has been marked as Yates Exhibit Number 4?

A. Yates Exhibit Number 4 is similar to the previous base-map exhibit. It is a base map showing the five Morrow-depth penetrations in the area, Township 21 South, Range 22 East. On this one it shows specifically Section 7 and Section 18. And I've labeled it in the same fashion.

There are three wells that are of particular relevance here. There are two Morrow sands that were developed. There's a lower Morrow sand. It was developed by the three wells that are labeled Number 1, Number 2 and Number 3. That sand has an active water drive.

The wells to the east of those three, which are not labeled, were developed to the shallower Cisco Canyon carbonate reservoir and to an upper Morrow sand. They did not encounter the lower Morrow sand that has the water drive.

Q. Let's go now to Exhibit Number 5. Would you review that?

A. Exhibit Number 5 are two of the three production plots for the wells in the area. The first one is labeled Well Number 1 in the upper right-hand corner. It's the production plot for the Yates Mescal Federal Number 1. It's important to note that all three of these wells were operated by Yates, and we were able to prevail in our attempt to overcome the LeMay memos, because we had a very complete production history and pressure history on these wells.

Ironically, the Yates Mescal Federal Number 1 and the Yates Little Box Canyon Number -- it's labeled on the map, Number 5 -- were drilled within a few months of each other.

The Yates Little Box Canyon Number 5 was not allowed to come on production because of pipeline constraints in the area at the time, and there was a series of hearings -- I'm not familiar with all the specifics -- that were related to the marginal well, and it was during the mid-Eighties when there was a collapse in the market demand. And so the Yates Little Box Canyon Number 5 was used as a monitor well in the reservoir for three or four years and was not allowed to come on production until 1986.

So we have a production history where we -- true production in Mescal Federal Number 1, there was a decline in pressure. There were pressures measured in Mescal Fed Number 1 and the Little Box Canyon Number 5 simultaneously at several points that showed a pressure decline and very good continuity between those two wells, during a period of time when the Little Box Canyon Number 5 was not producing.

But the Exhibits -- Exhibit Number 2, to go back to --

Q. Exhibit Number 5.

A. Or excuse me, Exhibit Number 5, are the two production plots, the Mescal Federal Number 1 and the Little Box Canyon Number 5, which is labeled as Well 2. The names, again, have changed out here. There was a unit that was dissolved, and so the lease name that's carried on the *Dwight's* plot is somewhat different than what's carried on the mapping.

Q. Mr. Pearson, let's take a look at Exhibit Number 4, and I would ask you to simply explain what it was you were attempting to achieve when you sought authorization to produce two wells on that 320-acre spacing unit. And you may want to also refer to the data in Exhibit 6 as you do.

A. As I've previously made reference to, there was an active water drive. The sand of interest proceeds to the south some distance, and there is an aquifer that's approximately ten times the size of the gas reservoir here. The contact with the aquifer actually occurred in the sand, which is about 50 feet thick in Mescal Federal Number 1, the initial well brought on production in the area. We began to produce the well in 1982 and produced roughly 1.8 BCF of gas out of the Morrow in that well before it watered out, as you can see on the production plots in Exhibit Number 5.

Subsequent to the recompletion of the -- or shortly before the recompletion and watering out of Mescal Fed Number 1, the Little Box Canyon well was brought on production, and we observed the continued movement of the aquifer up to an encroachment on the perforations on the Little Box Canyon Number 5.

In 1998 we began to study the area and see if there was opportunities for additional recovery, and it became apparent to us that there probably were. As a consequence of some modeling and additional geologic study, we identified that the sand probably continued to the north of the Little Box 5 location, and there was an adequate location available. However, we could not drill and produce a second well on that proration unit without -- because -- or without confronting the LeMay memos.

The objective of putting a second well on the proration unit was twofold. First one was the obvious one, i.e., move farther upstructure and get away from the water contact.

The need for simultaneous dedication, or a second well on the proration unit, came from controlling the influx of the aquifer. A common procedure in management of gas wells on active aquifers is to try to dewater the aquifer and lower the abandonment pressure on the residual saturation of the gas in the aquifer. It's fairly uncommon in New Mexico because we just don't have that many water-drive reservoirs. It's very common on the Gulf Coast of Texas and Louisiana, where they have a lot of gas on water-drive reservoirs.

And because we had -- it was controlled by one operator, we had a very detailed pressure history and were able to construct a case that showed Examiner Stogner that we would, in fact, lose reserves if we were not allowed to produce both wells under that proration unit.

Q. In that proration unit, by producing both wells concurrently in this 320-acre spacing unit, in fact, you were able to produce the northernmost well by continuing to produce the southernmost well at the same time; is that right?

A. That's correct.

Q. And what you were able to achieve by being able to implement these development and operation techniques was to increase the ultimate recovery from this spacing unit?

A. That's correct.

Q. In Burton Flat, the example showed reserves that were delayed by a rule that allows only one well on a spacing unit, and the LeMay memos, correct?

A. Correct.

Q. Does this case show you that there are circumstances where that memo and this rule actually caused a waste of reserves, reserves that cannot later be recovered?

A. That's correct. If you didn't produce both wells under this proration unit simultaneously, you would not be able to recover approximately 500 to 600 million cubic feet of gas that would be recovered otherwise by the new updip well.

Q. And Exhibit 6 is the summary of the information on this spacing unit?

A. That's correct.

Q. And what does it -- What conclusion can you reach?

A. The conclusion that you can reach is that there's a total of about 1.5 BCF of reserves, additional reserves, that were developed on this proration unit as a function of having a second well on the proration unit.

Q. Is 1.5 BCF a commercial Morrow well?

A. Yes.

Q. If these properties had not been under the control of one operator, would you have had the data necessary to bring this case to the OCD?

A. No.

Q. If you had not been able to get the exception to this memo, would those 1.5 BCF gas reserves have been wasted?

A. They would have been, because the second well would not have been economic to drill, based simply on the reserves. Based on the additional distance or height we could gain above the presence of the water level from the aquifer influx in the Little Box Canyon Number 5, we didn't think that the reserves would be economic to justify drilling a well.

Q. It should be apparent. Summarize Yates' recommendation concerning the LeMay memos.

A. Yates would like to see the LeMay memos either withdrawn or superseded by this ruling granting an infill well on a proration unit. We have considerable experience in a number of places where we feel like this would allow us to drill relatively low-risk wells that cannot be developed today because of the standards, the high standard or the hurdle that's set by the LeMay memos.

Q. And what is Yates' recommendation concerning the proposed amendment to Rule 104 to authorize a second well on each 320-acre gas-spacing unit?

A. We would like to see that adopted as soon as possible.

Q. Who would benefit, in your opinion, from the adoption of this rule?

A. Ironically, the two most significant beneficiaries would be the royalty owners, and probably the -- "ironically" maybe is not the right word, but the two most significant beneficiaries would be the royalty owners and the service industries in the state.

You know, it's an economic decision for the operator as to whether they put a second well on a proration unit, but the royalty interest owner doesn't bear any risk in terms of getting an infill well on a proration unit.

Obviously, the operators, if the wells were successful, would also be beneficiaries. But the obvious -- or the low-risk beneficiaries are the companies that construct the wellbores and the completions and the royalty owners who don't have to outlay -- you don't see any outlay of money as a function of drilling a second well.

Q. In your opinion, will amendment of Rule 104 to authorize a second well on each 320-acre spacing unit result in the recovery of oil and -- or gas that otherwise would be left in the ground?

A. That's correct.

Q. Were Exhibits 1 through 6 prepared by you?

A. Yes.

MR. CARR: At this time, may it please the Commission, we'd move the admission into evidence of Exhibits 1 through 6.

CHAIRMAN WROTENBERY: We'll include Exhibits 1 through 6 in the record.

MR. CARR: And that concludes my examination of Mr. Pearson.

CHAIRMAN WROTENBERY: Thank you, Mr. Carr, Mr. Pearson.

Any questions, Commissioners?

COMMISSIONER BAILEY: No.

COMMISSIONER LEE: Ms. Chairman.

EXAMINATION

BY COMMISSIONER LEE:

Q. In every well you cease the production, it's because of the water, the water production is too much?

A. I'm sorry, which area are you referring to?

Q. Most of the wells you cease production, it's because the water production is too much, right?

A. Not in the Burton Flats area. In the Burton Flats area, the wells are all volumetric and produce basically just condensed water, and we saw pressure depletion and rates go away. The Little Box Canyon area, we did cease production because the water -- we ceased production because the water production loaded --

Q. Not because of pressure depletion?

A. There was some pressure depletion as well. It's a combined drive mechanism. The aquifer is about 10 or 12 times the size of the gas reservoir, so it's not a very strong -- I mean, it's a moderate- to low-strength type of aquifer.

Q. What's the pipeline pressure on the surface?

A. Pipeline pressure in the Little Box Canyon area is about -- well, it was running -- at the time that these wells were in -- There's been some additional development in the area, so the pressure has changed. At the time these wells were produced, the pressure was about 450 pounds, and we had installed compression on the two producing wells there to have their flowing-tubing pressure reduced to about 80 pounds. The current pressure is about 920 pounds. There's been some new production brought --

Q. You free-flow your gas into the pipeline?

A. No, they flow through compression.

Q. Compression.

A. Yeah. And the --

Q. Is it possible you produce it too fast?

A. It is possible. The rates -- It's unlikely. We have done some critical-rate calculations. That was part of the testimony that was entered as a portion of getting permission to force the pipeline to take the gas from the Little Box Canyon Number 5, and we showed that we were producing below what were calculated to be the critical rates.

Q. What drawdown do you have?

A. About 200 pounds.

Q. Original pressure?

A. From original, and even today, the wells are not produced at a full open choke, they're produced because it -- The Little Box Canyon Morrow sands are somewhat unusual. They're about 22- to 24-percent porosity, and depending on which well, there are cores in some of the new wells that have been done --

Q. I thought you said it's by compression, your gas is by compressor. Then why do you leave the choke down?

A. Because the way we were restricting the production rate into the compressor, was the point I was driving at, the wells were capable of delivering very high volumes. The CAOFs on the wells would be 35 or 40 million a day, and it was impractical to pay for compression, you know, obviously, to compress 20 million a day, and the wells were produced at rates between 3 and 5 million cubic feet a day, and the choice -- It's just an operational matter. We were running line heaters on them, and you could take the pressure drop.

Once the pressure was depleted, they were on compression. They were not on compression for their full life. In the early stages where there were limitations on the volume that could be delivered into the pipeline, the wells were produced under chokes. And at no point during the life did the production rates exceed about 5 million cubic feet a day.

Q. Is this well fractured?

A. No.

Q. No fracture. They why -- You know there's an aquifer there. Why are you doing the compression?

A. The compression was not installed until the reservoir pressure became low enough that we were not able to continue to deliver the rates. Once the well started loading up, we added the compression to help it lift the water. It produced -- If you'll look at the second exhibit in Exhibit 5, you can see the life history, where there's been a great deal of water from the well.

Q. The first -- Exhibit 1, the one, two, three, four, five, six, can you roughly tell me what's the pressure, initial pressure?

A. The initial pressure was about 4000 p.s.i.

Q. 4000. That's one? That's for one?

A. For each of the wells. I don't have a pressure measurement on those wells, I'm just estimating from the --

Q. Different time, all have one, 4000 p.s.i.?

A. I don't know. My conclusion that they would all have the same initial pressure is drawn by the relatively similar rates at which they produced when they were brought on production. Part of the difficulty that we're dealing with, with the LeMay memos is, if the offset -- if you don't operate all of the wells, you don't necessarily have access to that pressure data. The State doesn't require you to report accurate pressure data in New Mexico, and --

Q. I'm with you.

A. Okay. The number I'm quoting was measured in our wells, and is roughly what the gradient would be in that area.

The abandonment pressure in our wells was about 1200 pounds. The sand quality here is nowhere near what it is at Little Box Canyon. If we succeed in dewatering the aquifer there, we expect to abandon that at about 500 or 600 pounds.

COMMISSIONER LEE: Thank you, I have no questions.

CHAIRMAN WROTENBERY: Thanks. Anything else?

Thank you, Mr. Pearson.

Mr. Carr --

MR. CARR: Thank you very much, that concludes our --

CHAIRMAN WROTENBERY: -- did you -- Anything else you wanted to --

MR. CARR: No.

CHAIRMAN WROTENBERY: -- to present? We could swear you in.

MR. KELLAHIN: Please do.

MR. FOPPIANO: Tom has a yearbook he wants to pull out.

(Laughter)

MR. CARR: You understand that in the past Mr. Kellahin has offered our high school yearbook, and I would just like to go on record as stating that I did have hair at that time --

(Laughter)

MR. CARR: -- but that if he ever tries it again, I've got some rebuttal out of that yearbook.

(Laughter)

MR. CARR: Thank you.

CHAIRMAN WROTENBERY: Is there anybody else that wanted to make a comment or present some information on --

MR. GRAY: Yes, I'm -- I hate to go back to that old issue.

CHAIRMAN WROTENBERY: Well, come on up.

MR. GRAY: Okay. And I'm Mike Gray with Nearburg Producing Company.

And having had a little bit more time to think about this while the other testimony was going on, it's my understanding that the Commission's proposed rule would not require hearing; is that correct? For a second well in a 320?

CHAIRMAN WROTENBERY: It wouldn't require a hearing in all cases. I mean, what we're thinking about now is allowing the optional second well. But the issue is, do we require any notice? If so, to whom? If we do include a notice provision in the rule, as Mr. Kellahin laid it out, what NMOGA is suggesting, it would be the operator that would provide the notice, and if somebody did object, then the operator would have to decide, I guess, whether to proceed or to come in and ask for a hearing. If somebody did object then, yes, the only way to go forward with getting approval of the second well would be to go to hearing.

MR. GRAY: Okay. And then barring objection, if there is no objection, the location could be administratively approved by the District Office?

CHAIRMAN WROTENBERY: Yes, the operator would submit evidence that they had, in fact, given whatever notice we ultimately decide is required if we go that way, and then we've got that information. Then yes, it would just be handled at the District level.

MR. GRAY: Okay. And then in the case that I questioned where you have the initial well with a nonparticipating party under a pooling penalty, the location, now, that's proposed possibly by that party is now a legal location, approved by the District Office, and I wonder -- It would seem to me that it's either uncommon or unheard of for the Commission to disallow the pooling of a well at a legal location historically, or penalize the person that is putting up the risk money for that well, which could be the person that did not participate in the initial well.

CHAIRMAN WROTENBERY: And here -- this is one --

Like I mentioned earlier, I'm going to have to think this one through. I don't know, Mike, can you help us out on this one, or Tom, if you want to...

MR. KELLAHIN: Let me see if I can phrase the question --

CHAIRMAN WROTENBERY: Okay.

MR. KELLAHIN: -- and then Mr. Stogner can fix it after I mess it up.

Right now, you can file an APD.

CHAIRMAN WROTENBERY: Uh-huh.

MR. KELLAHIN: If it's a standard location, you can get it approved. That doesn't get you the well drilled. You have to, independently of that process, consolidate your interest, either voluntarily or with a pooling order.

I envision the same system for the infill well. The optional second well gets permitted, there's no opposition, you get authorization to drill the infill well. But you can't drill it yet until you have the unanimous agreement of your interest owners pursuant to contract. Or you come back in and get a pooling order for the second well or amend the pooling order for the first well to add in the second well.

And in that second process, then, you can come and oppose Yates, or whoever it is, and say, Despite the fact you have an approved APD, this is not a necessary well. It's too close together, it's rate acceleration, we don't want it. And you have a hearing process to resolve that dispute.

MR. GRAY: But in the instances -- even if -- in the instances where all parties are in agreement to drill the well, it gets drilled whether it's unnecessary or not.

MR. KELLAHIN: Sure. So what's your question?

MR. GRAY: So the -- My question is, will the Commission make a determination that a well drilled at a legal location as a second well on a 320, under all of the rules and provisions of the new rules, approved by the District Office, is it likely that they will disallow the drilling of that well?

MR. KELLAHIN: Only if you have failed to consolidate the interest owners on a voluntary basis for the drilling of that well. It becomes your choice on how you invest your money, and the regulators are not involved. Is that a problem?

MR. GRAY: Well, they're involved in the first instance --

MR. KELLAHIN: In what way?

MR. GRAY: -- when the first well is drilled, and Party A elects not to participate in the well --

MR. KELLAHIN: All right, you're confusing me.

MR. GRAY: Yeah.

MR. KELLAHIN: Are you giving me a hypothetical that involves an instance of compulsory pooling?

MR. GRAY: Yes, a hypothetical. A well is drilled, and Party A elects -- with a 50-percent interest --

MR. KELLAHIN: Okay.

MR. GRAY: -- elects not to participate in that well.

MR. KELLAHIN: Okay. Here's your protection: Your protection is not worrying about getting the second -- the infill well APD approved or not. We see that all the time. Both you and Yates and others will go out and get an approved APD before --

MR. GRAY: Correct.

MR. KELLAHIN: -- they start the pooling process.

MR. GRAY: Correct, I'm not concerned about that.

MR. KELLAHIN: Well, so you shouldn't be about the infill well, because you already know that that APD doesn't mean a thing to you until you get a force-pooling order that links all the interests together.

MR. GRAY: I agree.

MR. KELLAHIN: All right. So if you have an infill well that's even permitted, you have to come modify the original pooling order. And it's at that point Mr.

Stogner can say, I don't care if you've got an approved APD, you're not going to do this; it's wasteful, violates correlative rights, you're taking advantage of the fact you went nonconsent on the parent well, you cannot do that.

MR. GRAY: Okay, what -- Okay, in the instance, then, that the party that participated and paid for the initial well sees a need to drill another well in the same -- that would drain the same reservoir --

MR. KELLAHIN: Uh-huh.

MR. GRAY: -- in that instance, then, the party having not participated in the first well would simply have the absolute right to participate in the second well.

MR. KELLAHIN: Same pooling scenario that you've learned over the years, is, if you think it's a necessary well, you propose it, you still have to come before the Division, amend your pooling order and test your proof. And if the opponents being pooled say, Wait a minute, you know, this is not necessary, we're right back to the same page and the same issues, then you win or lose based upon the evidence.

MR. GRAY: Right. In your experience, how many times has the Commission not allowed a well to be drilled under a pooling order at a legal location?

MR. KELLAHIN: This is a new process, and so that's not the topic. You know, you've asked me a question that doesn't respond to the issue. If the question is whether you drill the second well in the infill situation, you can raise that within the context of the pooling order as a necessary activity.

MR. GRAY: Yes.

MR. KELLAHIN: It's a new topic.

MR. GRAY: Okay, so it will -- Everything will be precedent, or a new precedent, in that regard, barring any changes of the rules regarding pooling orders?

MR. KELLAHIN: Well, sure.

MR. GRAY: Okay.

MR. KELLAHIN: In what way --

CHAIRMAN WROTENBERY: You may till, you know, think about this more and maybe follow through with Tom and Rick and Fred a little bit on that particular issue. Certainly I'll be, the same with Mike and the staff, try to kind of work out some of these scenarios that might come up and --

MR. GRAY: All right.

CHAIRMAN WROTENBERY: -- make sure I understand them fully, this particular issue and how it plays --

MR. GRAY: Thank you.

CHAIRMAN WROTENBERY: -- out under the new rules that -- Thank you. Oh, I'm sorry?

MR. FOPPIANO: I was just going to make one comment.

CHAIRMAN WROTENBERY: Yes.

MR. FOPPIANO: We have discussed this issue of the force-pooling orders --

CHAIRMAN WROTENBERY: Uh-huh.

MR. FOPPIANO: -- and as I mentioned, it comes up right now in the context of subsequent operations in other formations that have already been pooled --

CHAIRMAN WROTENBERY: Uh-huh.

MR. FOPPIANO: -- and I think it should not affect what we're doing here, but ultimately, particularly after this change is made, I think it would be -- it's probably timely to have a discussion to look at force-pooling again and look particularly at the subsequent-well issues, because others of us who have operated in other states have gone through the pooling by the wellbore and pooling by the unit, I've elected on the first well, do I get a second election on the second well?

It's a big issue, and particularly in the context of just subsequent well operations, be they an infill well, be they a well drilled to another horizon that was penetrate by the first well, the problem or the issue is still there. And it may well be timely to have a look at the compulsory-pooling law and see if some changes need to be made and the orders that are issued in the compulsory pooling procedure.

CHAIRMAN WROTENBERY: Thanks, Mr. Foppiano.

MR. GRAY: Thank you.

CHAIRMAN WROTENBERY: Thank you. You did a nice job of cross-examining Mr. Kellahin.

(Laughter)

MR. KELLAHIN: I'll send you a bill for it.

MR. GRAY: And I as well. Thank you.

CHAIRMAN WROTENBERY: Thank you, Mr. Gray.

MR. KELLAHIN: I've known Mike for a lot of years, and we have nice debates, so it's -- it was all done in friendship.

CHAIRMAN WROTENBERY: Mike, did you have anything you wanted to add to this discussion today?

MR. STOGNER: No.

CHAIRMAN WROTENBERY: Okay. I don't think there's anything else from anybody. I'm looking around. It seems like -- Oh, Alan, did you -- Okay.

MR. ALEXANDER: No, I did not.

CHAIRMAN WROTENBERY: Okay. Fred? Okay, thanks.

Where do we go from here? I'm thinking that what the Oil Conservation Division staff will do will be to get together shortly after this meeting, sometime early next week, probably, and review the information that we have received today and put together a proposal incorporating probably the bulk of the recommendations that we've got here today.

I'm still not sure what our proposal will look like on the notice issue, on the second well on 320s. That's something we'll need to explore and decide how we want to lay it out in a proposed rule. And then we will send that -- publish that draft and send it out with the docket and plan to schedule this matter for the Commission's hearing in May and take testimony, formally take testimony on that proposal.

I'm not going really asking for any action on the part of the Commission today, but I just guess I want to know if the Commission feels comfortable with that approach.

COMMISSIONER BAILEY: Uh-huh.

COMMISSIONER LEE: (Nods)

CHAIRMAN WROTENBERY: Okay, good. Then I think that will take care of the discussion on Rule 104 today.

Why don't we take a ten-minute break here before we come back and talk about notice and also incentives?

Okay, thank you.

(Thereupon, these proceedings were concluded at 10:50 a.m.)

* * *

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Commission was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL April 23rd, 1999.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002