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6-3-99

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

IN THE MATTER OF THE APPLICATION
OF CHESAPEAKE OPERATING, INC.,
FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO. CASE NO. 12186

RESPONSE TO CHESAPEAKE'S MOTION TO QUASH

AMERISTATE OIL & GAS, INC. ("Ameristate"), through its undersigned attorneys, hereby responds to Chesapeake Operating Inc.'s ("Chesapeake") Motion to Quash Subpoenas Issued at the Request of Ameristate Oil & Gas, Inc. The Motion to Quash should be denied because the data subpoenaed is relevant to a major issue in this case–why Chesapeake has changed the proposed location of the well at issue in this case, and because the data subpoenaed is not protected as a trade secret.

I. CHESAPEAKE HAS CHANGED THE PROPOSED LOCATION OF ITS WELL

Chesapeake submits that "the only issue is whether Chesapeake or Ameristate will operate the well proposed by Chesapeake." (Chesapeake's Motion to Quash at 1). Chesapeake is wrong. Chesapeake has changed the location of the well proposed in the application which is the subject of this case. The Division and Ameristate must decide whether the proposed location of the well as stated in Chesapeake's application is will protect Ameristate's correlative rights. Neither the Division nor Ameristate can do so unless Chesapeake produces the data sought by Ameristate's subpoena.

Chesapeake has moved its well location. Initially, it discussed with Ameristate a

proposed well location different than that which is represented in Chesapeake's Application in this matter. In its application filed May 26, 1999, Chesapeake proposes its Boyce 1-15 well at a location 1650 feet from the north line and 660 feet from the east line in Section 15, T16S, R35E, NMPM, Lea County, New Mexico. (*See* Application, filed May 26, 1999; *see also*, letter from Lynda F. Townsend of Chesapeake Operating to Mark K. Nearburg of Ameristate Oil & Gas, March 22, 1999 (attached hereto as Exhibit 1)).

Contrary to Chesapeake's representation, the issue in this case is not who is going to be the operator of the well proposed by Chesapeake. Rather, to protect its correlative rights, Ameristate is attempting to examine the data which will illustrate why Chesapeake changed its well location. Before this Division can force pool Ameristate's interest, and impose a penalty upon Ameristate for refusing to join the well, the Division must give Ameristate due process. That due process includes notice and an opportunity to be heard. Meaningful due process in this case means giving Ameristate the opportunity to examine and question the data upon which Chesapeake is basing its decision to locate a well, move that well, and use the Division's police powers to force Ameristate's interests into that project.

II. THE DATA SUBPOENAED IS NOT PROTECTED FROM DISCOVERY AS A "TRADE SECRET'

Chesapeake's refusal to produce that data is premised upon its assertion that the Division's policy, and the regulations of every other state and federal agency, hold confidential the type of information at issue. That argument is at best misleading.

Chesapeake asserts that this Division's policy has been to refuse to force parties to produce seismic information. Chesapeake is wrong. The recent cases in fact reveal a different policy--if the applicant used the data, it must produce it. See Order No. R-10891, Finding 7, September 26, 1997.

Furthermore, the confidentiality rules at issue cannot be abused to circumvent parties' constitutional rights or this Division's statutory duties. In fact, all that the rules are designed to do is protect from the dissemination of such information **to the public**. The clearest illustration of this point is found in an opinion from the Interior Board of Land Appeals, **Yates Petroleum Corp., et. al.**, 131 IBLA 230 (1994). In **Yates**, as here, the party resisting discovery argued that federal regulations which prohibit the release of "confidential information" to the public similarly prohibited the release of information to the opposing party. The IBLA explicitly rejected that contention: "the guiding regulations differentiate between disclosure of claimed confidential information to the general public and release of such information to the parties in a proceeding before the Department and require that a person requesting disclosure to a party establish that disclosure of the material is prohibited by law." **Yates**, 131 IBLA at 239. (emphasis in original).

In this case, far from proving that the disclosure of the information is prohibited by law, Chesapeake has illustrated that due process ***requires*** that disclosure. Chesapeake has moved its well location. Now, when Chesapeake refuses to disclose the data supporting its

choice of a well location when required to do so by the Division. By doing so, Chesapeake is preventing Ameristate and the Division from determining whether the well location which made it into Chesapeake's application is the one which is most likely to prevent waste and protect correlative rights.

In making that determination, the Division, and Ameristate, are entitled to look at all relevant information. Either Chesapeake relied upon the seismic information in picking its well location, or that information does not support the proposed well location. If the former is the truth, then Chesapeake is now trying to mislead the Division. If the latter is the truth, then the Division should carefully analyze the withheld data to determine the extent of the error in the proposed well location.

The information is relevant to the Division's statutory inquiry in this case. Therefore, it should be produced, regardless of whether Chesapeake actually relied upon it in determining the proposed well location.

Even Courts which hold that a trade secret or other confidential information is subject to some measure of protection still require that the information be produced. The production is simply subject to an appropriate protective order. For example, in ***Garcia v. Peeples***, 734 S.W.2d 343 (Tex. 1987), a personal injury plaintiff sought to discover manufacturing information that the defendant felt consisted of "trade secrets." The Texas Supreme Court ordered that the documents were properly discoverable, relying upon the policy that:

> [M]odern discovery rules were designed to "make a trial less a game of blind man's bluff and more a fair contest with the basic issues and facts disclosed to the fullest practicable extent." [***United States v. Proctor & Gamble Co.***], 356 U.S. 677, 682, 78 S.Ct. 983, 986. This court recognized that goal of discovery and pointed out that "the ultimate purpose of discovery is to seek the truth, so that disputes may be decided by what the facts reveal, not by what facts are concealed." ***Jampole*** [***v. Touchy***], 673 S.W.2d [569], at 573 [(Tex. 1984)].
>
> Unfortunately, this goal of the discovery process is often frustrated by the adversarial approach to discovery. The "rules of the game" encourage parties to hinder opponents by forcing them to utilize repetitive and expensive methods to find out the facts . . . The truth about relevant matters is often kept submerged beneath the glossy denials and formal challenges to requests until an opponent unknowingly utters some magic phrase to cause the facts to rise.

Garcia, 734 S.W.2d at 347 (citation omitted). It is remarkable that, in this case, Chesapeake has engaged in precisely the sort of gamesmanship condemned by the ***Garcia*** court. Chesapeake has refused to produce the relevant data.

Instead of endorsing the deception of Chesapeake, the Division should enforce its subpoena, which orders that the data be produced. Any concerns about confidentiality can be easily and appropriately handled through the entry of a protective order. As the ***Garcia*** court noted, instead of prohibiting the discovery, "[o]ut of an abundance of caution, the trial court, after determining which documents are true trade secrets, can require those wishing to share the discovered material to certify that they will not release it to competitors or others who would exploit it for their own economic gain. Such an order would guard GMS's proprietary information, while promoting efficiency in the trial process." ***Garcia***, 734 S.W.2d at 348.

Chesapeake states that no protective measures will be sufficient to protect Chesapeake's trade secret from disclosure. Once again, Chesapeake is wrong. Ameristate seeks information relevant to the particular spacing unit proposed in Chesapeake's Application. The Division can order that the data produced be limited to that which reflects the substructure of that spacing unit, and that it be used for no purposes other than Ameristate's participation in the hearing in this matter.

If Chesapeake is right, and its proposal is the best one to protect all parties' correlative rights in the area, then no well other than Chesapeake's will be drilled on the subject spacing unit, and Ameristate's review of the subject data will be of no consequence. On the other hand, if Chesapeake is wrong, and it is exploiting Ameristate's correlative rights, then Ameristate and the Division should be allowed to review the data and reach an informed decision. Either way, the Division can reasonably limit the disclosure of the data in a manner which protects Chesapeake's purported "trade secret," while discharging the Division's duty of preventing waste and protecting correlative rights.

Indeed, the Courts that have considered the issue have ordered the production of documents originally withheld on the basis of "trade secrets." ***See generally*** James J. Watson, J.D., Annotation, Discovery of Trade Secret in State Court Action, 75 ALR 4th 1009 (1990) ("discovery of a trade secret is allowed upon establishment of the requisite foundation therefor, subject to such conditions as the court, in its discretion, impose for the preservation

and protection of the rights of the owner of the secret which is to be disclosed"). All that Ameristate is required to show is that the information is relevant to the issues and necessary to the determination of the case. ***See Watson***, 75 ALR 4th at 1028. As noted above, the only way that the Division and Ameristate can determine the extent to which the original well location was incorrectly sited, and the extent to which the new well location is incorrect, is to examine the data requested. Having made that showing, it is imperative that the data be disclosed. To do otherwise is to make a mockery of the Division's duty to ensure that Ameristate's correlative rights are protected.

Under any construction of the Division's rules and applicable statutes, the seismic data should be made available to Ameristate: 1) because the confidentiality provisions cited do not apply to deprive parties of information necessary to the presentation of their case; 2) because the Division can fashion appropriate limitations on the use of the data; 3) because the Division cannot discharge its duties of determining whether Ameristate's correlative rights are protected; and 4) most importantly, because Ameristate has a constitutional right to review the data.

III.
UNLESS SEISMIC DATA IS PRODUCED, AMERISTATE'S DUE PROCESS RIGHTS WILL BE VIOLATED

Ameristate owns oil and gas interests in the proration unit which Chesapeake seeks to have pooled by its Application. In New Mexico an interest in oil and gas is a constitutionally protected property right. These interests are subject to all of the protections afforded by the New Mexico and United States Constitutions. ***Uhden v. New Mexico Oil Conservation Comm'n.***, 112 N.M. 528, 530, 817 P.2d 721,723 (1991).

Furthermore, correlative rights are unique property rights. ***Cowling v. Board of Oil, Gas and Mining***, 830 P.2d 220, 225 (Utah). When the Division affects a party's correlative rights, it must ensure that such action complies with its duties to protect that party's constitutionally-protected rights. ***Uhden***, 112 N.M. at 530, 817 P.2d at 723; ***Santa Fe Exploration Co. v. Oil Conservation Comm'n.***,114 N.M. 103, 113,835 P.2d 819, 829.

Federal courts have decided that the New Mexico Oil Conservation Commission proceedings are entitled to recognition as valid proceedings by the federal courts. ***Amoco Production Co. v. Heimann***, 904 F.2d 1405, 1415-17 (10th Cir. 1990). However, that approval is premised upon the presumption that the Division's proceedings meet due process standards which include the ability of adversely affected parties to present evidence and cross-examine witnesses. The right to confront and cross-examine witnesses applies to administrative proceedings where an interest protected by the Due Process clause is at stake.

See ***Doe v. United States Civil Service Comm'n.***, 483 F. Supp. 539, 579 (S.D.N.Y. 1980) (*citing* ***Morrisey v. Brewer***, 408 U.S. 471, 489 (1972)).

Without the opportunity to review the underlying seismic information upon which Chesapeake based its decision to locate and move a well in the spacing unit, Ameristate's due process rights to cross-examine Chesapeake will be denied. As it stands, Ameristate faces the deprivation of constitutionally protected property rights in an administrative hearing because it is denied the right to review the data used to make the decision of where to locate the well proposed in Chesapeake's application. If this data is not made available to Ameristate, its due process rights will be violated and any subsequent Order from the Division will be invalid as to Ameristate's interests.

CONCLUSION

This case is a classic example of what happens when the compulsory pooling statute is used to deprive other owners of their mineral interests without due process of law. Ameristate seeks, and Chesapeake refuses to produce, seismic data. If Chesapeake has accurately honored this information in its interpretation of the reservoir and location of the proposed well, why is it afraid to produce that information?

Respectfully submitted,

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& SHERIDAN, P.A.

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ATTORNEYS FOR AMERISTATE
OIL & GAS, INC.

CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of June, 1999, I have caused to be hand-delivered a copy of our Response to Motion to Quash in the above-captioned case to the following named counsel:

W. Thomas Kellahin, Esq.
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_____
Paul R. Owen

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LAND DEPARTMENT
LYNDA F. TOWNSEND, CPL/TSA
LANDMAN

March 22, 1999

VIA CERTIFIED MAIL

Mr. Mark K. Nearburg
Ameristate Oil & Gas, Inc.
1211 W. Texas
Midland, TX 79701

Re: Chesapeake's Boyce 1-15, Well Proposal
E/2, Section 15-16S-35E
Lea County, New Mexico

Dear Mr. Nearburg:

Chesapeake Operating, Inc. hereby proposes to drill the Boyce 1-15 well to a total depth of 12,100' to test the Morrow formation. The well will be at a legal location of 1650' FNL and 660' FEL in the E/2 of Section 15-16S-35E. You are the record title owner of 97.1625 net mineral acres of the 320 acre unit.

Attached is Chesapeake's AFE reflecting estimated dry hole costs of $711,000 and completed well costs of $1,016,000. Chesapeake offers you the opportunity to participate in the drilling of the Boyce 1-15 well with a working interest of 30.363281%. Should you elect to participate, please return the executed AFE along with a check in the amount of $215,882.93 for your proportionate share of dry hole costs by April 30, 1999. Upon receipt, a Joint Operating Agreement will be forwarded for your signature.

If you have any questions or require any additional information, please do not hesitate to give me a call.

Very truly yours,

Lynda F. Townsend

Lynda F. Townsend