

NEW MEXICO OIL CONSERVATION DIVISION

STATE LAND OFFICE BUILDING

STATE OF NEW MEXICO

CASE NO. 10513

IN THE MATTER OF:

The Application of Hanley Petroleum,
Inc., for Determination of Reasonable
Well Costs, Lea County, New Mexico.

BEFORE:

MICHAEL E. STOGNER

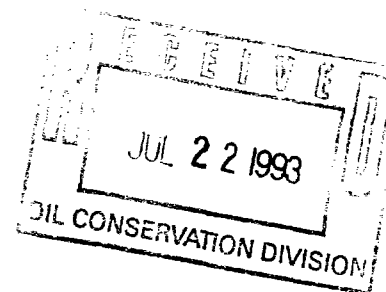
Hearing Examiner

State Land Office Building

Thursday, July 1, 1993

REPORTED BY:

CARLA DIANE RODRIGUEZ
Certified Court Reporter
for the State of New Mexico

**ORIGINAL**

A P P E A R A N C E S

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BY: **W. THOMAS KELLAHIN, ESQ.**

ALSO PRESENT:

HINKLE, COX, EATON, COFFIELD & HENSLEY
Post Office Box 2068
Santa Fe, New Mexico 87504-2068
BY: **JAMES BRUCE, ESQ.**

1 EXAMINER STOGNER: Hearing will come to
2 order. I'll call Case 10513 at this time.

3 MR. STOVALL: Application of Hanley
4 Petroleum, Inc., for determination of reasonable
5 well costs, Lea County, New Mexico.

6 Mr. Examiner, this case was commenced
7 at the last hearing. At that time an exhibit was
8 presented which caused some certain anxiety, I
9 guess, or interest, and the case was continued to
10 resolve certain matters.

11 It was continued to this docket in the
12 absence of knowing quite what to do with it. I
13 think, at this point, when both counsel are
14 present, we need to continue it again, and I
15 recommend that we do so for four weeks, to give
16 Counsel time to make a plan. Or do we need to do
17 it for two and then reschedule? It won't be
18 heard at the next docket, but do we need to
19 reschedule it for the next one, and then have a
20 plan?

21 MR. KELLAHIN: Let's just schedule it
22 for the next one, and between then it will force
23 us to find a plan.

24 MR. BRUCE: That's fine.

25 EXAMINER STOGNER: Okay. With that,

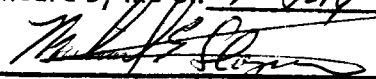
1 this case will be continued to the 15th of July,
2 at which time--

3 MR. STOVALL: It will be continued
4 again, according to a plan submitted by Counsel,
5 after they've identified the issues or discussed
6 the issues involved in the case.

7 EXAMINER STOGNER: So be it.

8 (And the proceedings concluded.)
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17 I do hereby certify that the foregoing is
18 a complete record of the proceedings in
19 the Examiner hearing of Case No. 10513,
20 heard by me on 1 July 1993.

21 
22 _____, Examiner
23 Oil Conservation Division
24
25


1 CERTIFICATE OF REPORTER

2
3 STATE OF NEW MEXICO)
4 COUNTY OF SANTA FE) ss.

5
6 I, Carla Diane Rodriguez, Certified
7 Court Reporter and Notary Public, HEREBY CERTIFY
8 that the foregoing transcript of proceedings
9 before the Oil Conservation Division was reported
10 by me; that I caused my notes to be transcribed
11 under my personal supervision; and that the
12 foregoing is a true and accurate record of the
13 proceedings.

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

19 WITNESS MY HAND AND SEAL July 19, 1993.
20

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22 
23 CARLA DIANE RODRIGUEZ, RPR
24 CCR No. 4
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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION
IN THE MATTER OF THE HEARING)
CALLED BY THE OIL CONSERVATION)
DIVISION FOR THE PURPOSE OF)
CONSIDERING:) CASE NO. 10513

APPLICATION OF HANLEY PETROLEUM INC.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: David R. Catanach, Hearing Examiner

June 18, 1993

Santa Fe, New Mexico

This matter came on for hearing before the
Oil Conservation Division on June 18, 1993, at the Oil
Conservation Division Conference Room, State Land
Office Building, 310 Old Santa Fe Trail, Santa Fe, New
Mexico, before Deborah O'Bine, RPR, Certified Court
Reporter No. 63, for the State of New Mexico.

ORIGINAL

I N D E X

June 18, 1993
 Examiner Hearing
 CASE NO. 10513

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MICHAEL LeMOND

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A P P E A R A N C E S

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BY: JAMES G. BRUCE, ESQ.

1 EXAMINER CATANACH: At this time we'll call
2 the hearing back to order and call Case 10513,
3 application of Hanley Petroleum, Inc., for
4 determination of reasonable well costs, Lea County,
5 New Mexico.

6 Are there appearances in this case?

7 MR. KELLAHIN: Mr. Examiner, I'm Tom
8 Kellahin of the Santa Fe law firm of Kellahin and
9 Kellahin, appearing on behalf of the applicant, and I
10 have two witnesses to be sworn.

11 EXAMINER CATANACH: Other appearances?

12 MR. BRUCE: Mr. Examiner, Jim Bruce from
13 the Hinkle law firm, representing Santa Fe Energy
14 Operating Partners, L.P., and I have one witness to be
15 sworn.

16 EXAMINER CATANACH: Any other appearances?

17 Can I get the three witnesses to stand and
18 be sworn at this time?

19 (Witnesses sworn.)

20 EXAMINER CATANACH: Mr. Kellahin, just so I
21 know where we are, on the prehearing statement you
22 listed a number of exceptions and indicated the only
23 one in question is the casing cost issue?

24 MR. KELLAHIN: Mr. Bruce and I have met
25 again this morning, and I have misunderstood the

1 status of the audit exceptions between Santa Fe and
2 Hanley. If I may have you turn to that prehearing
3 statement, it serves as a checklist of the remaining
4 items in dispute. And if you'll provide me an
5 opportunity, I'll give you a quick summary.

6 EXAMINER CATANACH: Hang on just a minute.

7 MR. KELLAHIN: We're here today to ask the
8 Division to resolve the remaining audit exceptions
9 that the parties are unable to resolve for
10 themselves. As the prehearing statement indicates,
11 this was a compulsory pooling dispute between the two
12 parties, each seeking to pool the other. As a result
13 of a Commission hearing, Santa Fe prevailed over
14 Hanley. Santa Fe was designated the operator. The
15 Commission accepted Santa Fe's AFE on the well.

16 As a result of granting Santa Fe
17 operations, Hanley's corresponding request for forced
18 pooling was denied, and their AFE was denied.
19 Thereafter then Santa Fe submitted to Hanley an AFE
20 pursuant to the pooling order, and Hanley made an
21 election to be a consenting working interest owner
22 under the pooling order. The AFE that was submitted
23 to Hanley by Santa Fe was for a total completed
24 producing well of approximately \$722,000.

25 Thereafter, completion costs, actual costs

1 were reported to Hanley by Santa Fe upwards of
2 \$893,000. There was a cost overrun of the AFE of some
3 \$170,000. That overrun then triggered a request by
4 Hanley to audit the actual well costs to determine if
5 they were reasonable. The parties have attempted as
6 best they can to expedite this process for you. We
7 have agreed among ourselves to an audit of the well
8 costs pursuant to COPAS auditing bulletin
9 instructions.

10 Mr. LeMond, who is my first witness, is a
11 Certified Public Accountant, he's the comptroller for
12 Hanley, and he conducted the audit for the well
13 costs. He's got a lot of paper here, but we propose
14 to go through it rather quickly and get you down to
15 the remaining audit exceptions, which are still in
16 dispute.

17 If you'll look at the prehearing statement
18 that I filed, I can show you what remains. When the
19 request for hearing was filed, the Exception No. 1 had
20 not been allowed. Subsequently, I believe last week,
21 Santa Fe has accepted that exception, and so you can
22 forget about the 271 bucks.

23 The next one, that's also been granted,
24 there's \$490. Exception 3 is still in dispute. It's
25 a small item; it has to do with how to calculate sales

1 tax discounts. No. 4 were legal expenses for the
2 hearing. That exception has been granted, so you can
3 forget about that item. That is not in dispute
4 anymore. Item 5 is a hearing expense item which
5 Hanley objected to. Santa Fe has agreed to remove
6 that from the cost; so that is not in dispute.

7 Mr. LeMond has determined in his opinion
8 that there is 22 sacks of mud that were not used on
9 the well. And so this item is in dispute. Santa Fe
10 says it's a reasonable cost. We say it's not. So
11 there's 4400 bucks to resolve.

12 There remains a dispute under No. 7 as to
13 the amount of tubing used in the well. And then
14 finally the big item has to do with No. 8. It deals
15 with the issue of collapsed casing, and it's an
16 expense item of about \$92,000.

17 We have resolved everything else except
18 those items. There's four items left to resolve.

19 Mr. LeMond here is going to present to you
20 his audit exceptions, his documentations, and give you
21 the basics of his reasons. The actual details of his
22 report are in writing, though, and are submitted to
23 you in writing, and we don't propose to have him read
24 them to you. They'll be in the record, and you can
25 read his explanations.

1 Then Greg Wilkes is our drilling engineer,
2 and he's here specifically to address the issue of who
3 should pay for the cost and services for the collapsed
4 casing. And that's our presentation.

5 MR. STOVALL: Mr. Kellahin, let me just ask
6 you before you start, rather than interrupt you,
7 looking at those items, I think Exception No. 3 ought
8 to be a relatively simple one, I would assume. I
9 assume the first witness can do some -- I can envision
10 how you could make a calculation to determine whether
11 or not that's a correct item or not.

12 MR. KELLAHIN: That's an easy proof item,
13 and it's here for you to resolve, and you can decide
14 who's right about that.

15 MR. STOVALL: Just kind of so I know what
16 to anticipate, does COPAS address unused items? Is
17 that something you need to go into when you discuss
18 the exceptions? Are you familiar with -- I'm asking
19 you; I can't, again, ask the witness because he's not
20 even on the stand yet. I'm just asking you if you're
21 familiar enough with it. If you're not, let's go on
22 and do it. I don't want to take up a lot of time on
23 it.

24 MR. KELLAHIN: I think we better address
25 that to Mr. LeMond, who is an expert in that area. I

1 can tell you what my recollection is, but he's the
2 expert for that.

3 MR. STOVALL: Okay.

4 MR. KELLAHIN: Okay? I'd like to call at
5 this time Michael LeMond.

6 EXAMINATION

7 BY MR. KELLAHIN:

8 Q. Would you please state your name and
9 occupation?

10 A. Michael LeMond, Controller for Hanley
11 Petroleum, Midland, Texas.

12 Q. Describe for us your education, sir.

13 A. Graduated Texas Tech University, 1977,
14 B.B.A., Accounting, CPA.

15 Q. Are you a Certified Public Accountant,
16 registered in any state?

17 A. The State of Texas.

18 Q. And do you currently practice your
19 profession as a Certified Public Accountant?

20 A. No. I practice in the industry but not in
21 public accounting.

22 Q. For whom do you work?

23 A. Hanley Petroleum, Inc.

24 Q. And in what capacity?

25 A. As their Controller.

1 Q. As their Controller, have you undertaken an
2 audit of the well costs of the Santa Fe Energy
3 Operating Kachina "8" Federal No. 2 Well that's the
4 subject of this hearing?

5 A. Yes, sir.

6 Q. Have you applied the standards of your
7 profession in making that audit and in examining the
8 costs involved in that well?

9 A. Yes, sir.

10 Q. Based upon that audit, have you reached
11 certain professional conclusions and opinions about
12 the reasonable costs involved in that well?

13 A. Yes, sir.

14 MR. KELLAHIN: We tender Mr. LeMond as an
15 expert Certified Public Accountant with expertise in
16 audit of reasonable well costs.

17 EXAMINER CATANACH: Is there any
18 objection?

19 MR. BRUCE: Just one question, if I could.
20 How many joint interest audits have you conducted?

21 THE WITNESS: One.

22 MR. BRUCE: I would object to his being
23 qualified as an expert. I don't mind him testifying
24 as to what he did at that audit, but I question his
25 expertise as an auditor.

1 MR. STOVALL: Auditors offered or an
2 individual is offered as an expert if they are going
3 to render opinion based upon certain facts within an
4 area of expertise.

5 MR. KELLAHIN: Oh, absolutely.

6 MR. STOVALL: Let me finish this, because
7 I'm not sure if it's really critical in here. Is it
8 correct that Mr. LeMond is -- we're going to get into
9 the crossover between what is an accounting activity
10 and when does it become an expert opinion. My sense
11 is that whether or not he is qualified as an expert
12 may not be critical to his testimony and may not limit
13 his testimony.

14 MR. KELLAHIN: I think there's an issue
15 ahead of that; the fact that he has conducted an audit
16 of this well as his only experience in that area
17 simply goes to the weight of his testimony and not to
18 the admissibility of him as an expert. And I think
19 that's typical of all the experts we provide to you.
20 Whether the geologist has provided geology on a single
21 well or 15 wells simply goes to the weight of his
22 experience and credibility as opposed to admitting him
23 as an expert. And that's the standard for experts in
24 District Court.

25 MR. STOVALL: My response to that is I

1 believe that statement is correct. I'm not sure that
2 I'm going to get into true opinion. I'm not sure how
3 critical that distinction is. What I'm going to
4 recommend to the Examiner is that we qualify
5 Mr. LeMond at this time. I ask you now, do you wish
6 to make a continuing objection to that?

7 MR. BRUCE: I'll just leave my objection.
8 Stand, and I understand what the Division
9 is --

10 MR. STOVALL: The only thing I would say,
11 if there's any testimony which would be in the nature
12 of expert testimony, as opposed to his testimony about
13 what he did with his specific thing, you might point
14 it out for us.

15 Q. (BY MR. KELLAHIN) Describe for us the
16 activity that you undertook in conducting the audit of
17 the well costs for the Kachina "8" Federal No. 2 Well.

18 A. Well, we contacted Santa Fe, told them that
19 we would like to come to Houston and do the joint
20 interest audit. They agreed to let us come. We did
21 the work, vouched the records, whatever we deemed
22 necessary to get the audit done. We wrote a report.
23 We provided that to Santa Fe. They provided a
24 response. We responded to their response. They
25 provided us another response, and now we're here.

1 Q. Let's go through the documentation at this
2 point, Mr. LeMond, and have you identify some of these
3 things for the record. In order to provide a
4 chronology so that the examiner can understand how
5 this evolved to its present status, let me start with
6 what is marked as Hanley Exhibit No. 1. Would you
7 identify that for us, please.

8 A. This is Santa Fe Energy Resources, Inc.,
9 original AFE that they provided when they were first
10 preparing to drill the well.

11 Q. The item interest specifically with regards
12 to the protection casing string, can you identify for
13 us on that display the item that is shown on that
14 AFE? I think if you look under "Tangible Well Costs,"
15 look down to about the third line.

16 A. Okay. For protection casing?

17 Q. Yes, sir.

18 A. For \$36,804.

19 Q. Yes, sir. And what is set forth on the AFE
20 as the kind and description of that material?

21 A. Okay. 8-5/8 inch, 24 pound, K-55 casing.

22 Q. After that is Exhibit No. 2. Would you
23 identify that exhibit for us?

24 A. This is Hanley Petroleum's proposed AFE
25 when they were applying to the Division to be operator

1 of the well. It's some \$50,000 less than the AFE
2 which you see under Exhibit 1, Santa Fe's.

3 Q. One of the items in dispute is the casing
4 material, Exception No. 8. When we look at the Hanley
5 AFE Exhibit No. 2, look down and find the intermediate
6 casing, what is described by Hanley as their proposal
7 for the intermediate casing when we deal with the
8 8-5/8's material?

9 A. 8-5/8 inch, 24 pound, J-55, and 8-5/8 inch,
10 32 pound, J-55.

11 Q. All right. The 32 pound versus the
12 24 pound is an item of dispute between the two
13 companies?

14 A. That's correct.

15 Q. The total well costs estimated by Hanley
16 for the well were what, sir?

17 A. \$667,782.

18 Q. All right. Let's get to Exhibit 3 and have
19 you identify this for us.

20 A. This is a comparison that was done
21 comparing Hanley's proposed AFE with Santa Fe's
22 original AFE.

23 Q. Again, this is an exhibit out of the
24 compulsory pooling hearing that shows a comparison
25 between the two operators in each of their proposed

1 AFE's?

2 A. Yes, sir.

3 Q. All right, let's move along. Exhibit
4 No. 4, what does this represent?

5 A. This represents a facsimile copy of total
6 well costs through May 4, '92, that Santa Fe provided
7 to Hanley.

8 Q. What does that show as the total cost
9 reported to you at that time?

10 A. \$893,715.93.

11 Q. Let's turn now to Exhibit No. 5. What is
12 this?

13 A. This is the audit report that was prepared
14 as a result of the work that was done by Hanley at
15 Santa Fe's offices in Houston.

16 Q. Who prepared the report, and who did the
17 work?

18 A. I prepared the report. The work was done
19 by a gentleman named Neal Fisher and me.

20 Q. Have you reviewed the entire report and
21 satisfied yourself that the calculations, conclusions,
22 and information displayed in the report are accurate
23 and true to the best of your knowledge?

24 A. Yes, sir.

25 Q. Let me have you turn to the report and show

1 us the specific items of what you've done.

2 A. Okay. Audit Exception 1 had to do with an
3 expense report that we didn't believe was chargeable
4 to the account for \$271.75.

5 Exception 2 had to do with invoice coding
6 errors of \$490.89. Both of those were granted by
7 Santa Fe, and so they're not in dispute any longer.

8 Exception No. 3 has to do with calculation
9 of sales tax on discounts. That item of \$69.51 is
10 still in dispute. Item 4, with regard to legal
11 expenses, and Item 5, regarding expense reports, both
12 of those items related to the hearing earlier have
13 been granted by Santa Fe and are no longer in
14 dispute.

15 Item 6 with regard to drilling mud that was
16 incorrectly charged to the joint account is still in
17 dispute. That total is \$4,428.60. Exception 7 of
18 \$1,346.80 on 2-7/8 inch tubing is still partially in
19 dispute, and then Audit Exception 8 of \$91,670.10 on
20 the 8-5/8-inch casing is still in dispute.

21 Q. When we look at the dollar amount, is there
22 any disagreement with regards to each of those dollar
23 amounts, as opposed to whether the amount, if at all,
24 is chargeable?

25 A. On one of those, there is a dispute about

1 the dollar amount on the 2-7/8-inch casing. That's
2 Audit Exception 7. And on the rest of them, it's a
3 dispute about whether the amount is chargeable at all
4 or not.

5 Q. Having completed the audit report, how did
6 you communicate your audit exceptions to Santa Fe?

7 A. Via this report that's identified as
8 Exhibit 5.

9 Q. What, if any, response did you receive back
10 from Santa Fe with regards to your audit report?

11 A. Well, we received a response on December
12 11. That's marked as Exhibit 6. That was their first
13 response to our audit report.

14 Q. Let's go through Exhibit 6 now, and let's
15 talk specifically about what is displayed as item
16 Exception 3, the sales tax discount.

17 A. Okay.

18 Q. Without a lot of complexity, can you
19 summarize for us what is the difference? Describe for
20 us the dispute over that item.

21 A. Well, Hanley Petroleum prepaid well costs.
22 We sent cash to Santa Fe ahead of time so that they
23 could pay items early and receive early payment
24 discounts. This item surrounds New Mexico's gross
25 receipts tax on that discount. We paid it early. We

1 think we're due a discount on the sales tax portion of
2 the early pay discount. And that's supported by
3 Exhibit --

4 Q. No. 8?

5 A. No. 8, yes.

6 Q. Let's get this out of the way. Let's go to
7 Exhibit 8 and talk about this.

8 A. Okay.

9 Q. What is your verification that you believe
10 you are correct then that the calculation of the
11 credit is appropriate?

12 A. Well, under the State of New Mexico
13 Taxation and Revenue Department regulations, we've
14 taken a page out of that book that talks about gross
15 receipts --

16 Q. Do you have the regulations before you
17 there?

18 A. Yes. We have taken a copy of a page out of
19 this book, discussing gross receipts and what's
20 included and what is not. And if you look toward the
21 middle of the page, it's highlighted in yellow, it
22 says, "Gross receipts excludes cash discounts allowed
23 and taken," just like it excludes government gross
24 receipts tax under B for leased vehicles, several
25 other items.

1 So we maintain that gross receipts tax
2 should be excluded from cash discounts.

3 Q. What's attached to the first page of
4 Exhibit 8, which is the statutory reference? What's
5 the rest of this?

6 A. We have attached the invoices in question.
7 There are two invoices that are related to this
8 exception, and we've attached copies of both of those.

9 Q. All right, let's go on to the next item.
10 Let's talk about Exception 6, which is the dispute
11 over 26 sacks of drilling mud.

12 A. Okay.

13 Q. I'm going to let you find the exhibits that
14 document that item, but give us a summary of what it
15 is that's in dispute over that issue.

16 A. Okay. This is Exhibit 9. And the item
17 that is in dispute is some drilling mud that's
18 referred to as Drispac. The first page of Exhibit 9
19 outlines the original audit exception at the top of
20 the page, and towards the middle of the page it shows
21 Santa Fe's response to that exception.

22 And the basic dispute has to do with the
23 fact that we bought so many sacks of that mud. There
24 were actually 36 sacks purchased, and only 14 sacks of
25 Drispac were used, according to the daily tower

1 reports which were signed by five people independent
2 of the mud vendor. Now, Santa Fe comes back and
3 maintains that the mud reports say that all of the
4 Drispac was used.

5 Those mud reports -- copies of those mud
6 reports are toward the back of Exhibit 9, and while
7 they do show some use of drilling mud, they do not
8 address Drispac. They address another product called
9 Staflo. The only place that any use of Drispac is
10 identified is in the drilling reports on October 7 of
11 '91. And on that particular report, and a copy is in
12 this exhibit, it shows that 14 sacks of this mud were
13 used.

14 So we're asking for an exception -- so
15 we're asking for refund of the cost of 22 sacks.

16 Q. Because it appears to you that that
17 material was not used?

18 A. That's correct.

19 Q. In looking through the material package
20 here, the invoices and documents --

21 A. Right.

22 Q. -- have you highlighted one of those in
23 yellow to show the examiner which item you're looking
24 at?

25 A. Yes. There's one on October 7. It's about

1 three-fourths of the way through the packet.

2 MR. KELLAHIN: I apologize that these are
3 very difficult to read, Mr. Examiner, but Mr. LeMond
4 has highlighted one of those entries for you.

5 THE WITNESS: And it's hard to see -- the
6 color of the original report was dark enough that it
7 was hard to get a good copy of it.

8 MR. KELLAHIN: We'll take a moment and find
9 that.

10 THE WITNESS: You can see October 7, '91,
11 written kind of at the top of the page in the white
12 area.

13 Q. (BY MR. KELLAHIN) So that your testimony
14 is clear on this issue, describe for me again what is
15 indicated on this page that's highlighted with the
16 yellow.

17 A. What is indicated is the use of 14 sacks of
18 Drispac. It's the only place that we could find any
19 use of that product in all of these drilling reports.
20 And these are all of the drilling reports for the
21 drilling of this well. Each of those were signed by a
22 representative of Santa Fe and then four
23 representatives of the drilling contractor.

24 Q. And you can't find, then, any documentation
25 received from Santa Fe as to another 22 sacks of

1 Drispac?

2 A. No, sir.

3 Q. Is the price per sack, the \$201.30, a price
4 in dispute?

5 A. Not that I know of. We have not heard that
6 that particular number is in dispute.

7 Q. And so you've simply taken 22 sacks times
8 the price per sack, and that gives you the \$4,400?

9 A. Yes, sir. In fact we've done a calculation
10 to come up with that price per sack, which ties into
11 the invoice -- the invoice is on the fifth page of the
12 exhibit. The calculation to come up with the price
13 per sack is on the third page of the exhibit.

14 Q. The narrative that you've just provided on
15 this issue has been reduced to writing, and that's
16 attached in written fashion, beginning with the second
17 page of Exhibit 9?

18 A. Yes, sir.

19 Q. And then following that is all the
20 supporting documentation on that issue?

21 A. Yes, sir.

22 Q. Let's go to the next issue and talk about
23 Exception 7, which is the dispute over the amount of
24 tubing used in the well. Okay? Describe for us what
25 that dispute is.

1 A. Well, there was so much tubing used in the
2 well, and that amount is supported by the third page
3 of Exhibit 10.

4 Q. Let's find Exhibit 10. Turn to the third
5 page, and tell me what the third page is.

6 A. The third page is a report to the Oil
7 Conservation Division. And if you look in the upper
8 right-hand corner of that report, it indicates that
9 this is a corrected report.

10 Q. Okay.

11 A. And if you look down toward the middle,
12 right-hand portion of the page, you will see tubing
13 depth of 11,027 feet.

14 Q. Okay.

15 A. And so that indicates that 11,027 feet of
16 tubing was used in this well. Now, Santa Fe has come
17 back -- or let me back up a little bit.

18 The amount of tubing charged to the well
19 exceeded 11,027 feet by 370 feet, and we have a
20 reconciliation on Page 4 of the exhibit to support
21 that. It's kind of a handwritten reconciliation. And
22 that reconciliation is supported by documentation on
23 the fifth page of the exhibit from Vantage Tubulars,
24 as well as material transfers which follow that are
25 Santa Fe's material transfers.

1 So we have reconciled the use of what was
2 charged for 2-7/8-inch tubing to what was actually
3 used, and we came up with a 370-foot overcharge to the
4 joint account.

5 Q. And that was reduced to what dollar amount?

6 A. That was reduced to \$1,346.80. Now, on the
7 response from Santa Fe that I received Monday of this
8 week, they indicated that there was a joint of this
9 tubing on the ground at the well site. We didn't know
10 about that when we did the audit. And that's fine,
11 we're willing to give in on one joint of pipe on the
12 drill site. So that reduces the exception to
13 \$1,231.63.

14 Q. Let me have the number again.

15 A. \$1,231.63. That's at the bottom of page 2
16 of Exhibit 10.

17 Q. Is there any dispute over the price per
18 joint of tubing that was charged to the well?

19 A. No, sir, there isn't. Santa Fe is
20 proposing that the morning reports -- yes, if you look
21 at the middle of Page 1 of Exhibit 10, they're saying
22 that the morning completion reports support more use
23 of the tubing, but I maintain, or we maintain that the
24 report that should carry more weight in this case is
25 the report that's sent to the Oil Conservation

1 Division on Page 3 of the Exhibit 10. And that shows
2 a lesser amount of tubing used.

3 Q. And that remains a dispute that you and
4 your corresponding individual with Santa Fe have not
5 been able to resolve?

6 A. Yes, sir.

7 Q. The morning completion report you've
8 highlighted in yellow on the first page of 10, it says
9 the average joint is 31.49 feet long?

10 A. Yes.

11 Q. Are you using the same length of joint in
12 your calculation when you turn back to the corrected
13 completion report?

14 A. Well --

15 Q. Is there a dispute in arithmetic is what
16 I'm asking you?

17 A. Well, Santa Fe is basing their calculation
18 on joints used, and we're basing our calculation on
19 actual footage used. And in all of the documents, the
20 actual footage used is available. In the Vantage
21 Tubulars invoice it shows actual footage used. In the
22 material transfer records of Santa Fe's actual footage
23 is available there as well. It's just easier to tie
24 down the actual footage because of partial joints.

25 Q. Santa Fe says that there were, what, 357

1 joints used?

2 A. Yes, sir.

3 Q. And if you use 31.49 feet per joint, you're
4 going to have a well that's more than, what, 300 feet
5 deeper --

6 A. Yes, sir.

7 Q. -- in terms of the tubing used than
8 actually exists?

9 A. Yes, sir.

10 Q. Turn now with me to how you have documented
11 Exception No. 8.

12 A. Exception No. 8 --

13 Q. Before we talk about the documentation,
14 describe what that issue is.

15 A. The issue concerns a hole in the casing.
16 And what we've done here is, when we were doing the
17 audit, we identified invoices that we knew for sure
18 were attributable to the repair resulting from that
19 hole in the casing. And we have made a summary sheet,
20 which is the first page of Exhibit 11, which outlines
21 the individual invoices comprising the ones that we
22 identified as resulting from the hole in the casing.
23 And then we have made copies of each of those
24 invoices, which follow and support that first page of
25 Exhibit 11.

1 Q. A dispute exists between Santa Fe and
2 Hanley over the strength of this casing material that
3 was used in the well?

4 A. Yes, sir.

5 Q. Santa Fe used 24 pound --

6 A. Yes, sir.

7 Q. -- per foot strength of casing material,
8 and your company has recommended the use of 32 pound?

9 A. Yes, sir.

10 Q. We'll let the engineer talk about how to
11 resolve that issue. I want you to tell me as an
12 accountant what the value is that's applied to that
13 issue. Okay?

14 A. Okay.

15 Q. How did you come up, then, with the
16 \$91,670.10 value as to that item?

17 A. Okay. While we were at Santa Fe doing the
18 audit, we had the opportunity to look at any invoice
19 that applied to this well that we wanted to, and we
20 were able to identify certain invoices that applied to
21 the repairs resulting from this hole in the casing.
22 And that's what we have here. We've gone through and
23 identified those invoices and made copies of them, and
24 they are the ones that support the cost resulting from
25 repair.

1 Q. When we look at Exhibit No. 11, what are we
2 looking at?

3 A. We're looking at a summary page of the one,
4 two, three, four, five, six, seven invoices that make
5 up that amount, and then we are looking at individual
6 invoices behind that cover page that support it.

7 Q. Is there a dispute between you and Santa Fe
8 as to the calculation of that amount?

9 A. No, sir.

10 Q. The dispute is between whether Santa Fe
11 should pay 100 percent of that cost or whether Hanley
12 should pay their 50 percent?

13 A. Yes, sir.

14 Q. But in terms of crunching the numbers,
15 there's not a difference in the value as to that item?

16 A. No, sir.

17 Q. Let's go back now. After your audit
18 report, Exhibit 5 -- Exhibit 6 now, what does that
19 represent?

20 A. Exhibit 6 represents the first response to
21 our audit from Santa Fe.

22 Q. And they describe their response to each of
23 these items that we've talked about this morning?

24 A. Yes, sir.

25 Q. Following that is an Exhibit 7. What is

1 that, sir?

2 A. That is our response to Santa Fe's response
3 to the audit. And that was some, oh, 12 days later.

4 MR. STOVALL: What does 7 look like? Hold
5 it up, Tom.

6 MR. KELLAHIN: It's one page.

7 MR. STOVALL: Here it is.

8 Q. (BY MR. KELLAHIN) And then Exhibit 8 is
9 specifically as to the gross receipts issue?

10 A. Yes, sir.

11 Q. Nine has to do with the drilling mud issue?

12 A. Yes, sir.

13 Q. Ten is your response as to the --
14 documentation on the tubing issue?

15 A. Yes, sir.

16 Q. And then 11 is the documentation on the
17 collapsed casing pricing?

18 A. Yes, sir.

19 Q. Having completed your audit and seen the
20 responses of Santa Fe to your Audit Exception, what,
21 in your opinion, is the total amount of credit that
22 Hanley is entitled to if all the adjustments are made
23 as you seek to have them made?

24 A. Including the adjustments that they've
25 already given us?

1 Q. No, sir, the ones in dispute that are
2 remaining. Are they correctly reflected in the
3 prehearing statement that we filed and as shown on the
4 exhibits?

5 A. They are, with the exception of the
6 adjustment to -- they went ahead and gave us part of
7 the adjustment on exception No. 7. And then we're
8 also giving in -- it depends on how you look at it,
9 but there's one joint of tubing on the well site that
10 we're giving in to and we're willing to pay for.

11 Q. And with that concession, then, you're
12 asking for compensation or reimbursement of the \$1,200
13 plus as to that item?

14 A. Yes, sir. So the total approaches
15 \$100,000.

16 MR. KELLAHIN: That concludes my
17 examination of Mr. LeMond. We move the introduction
18 of Exhibits 1 through 11.

19 EXAMINER CATANACH: Exhibits 1 through 11
20 will be admitted as evidence.

21 MR. BRUCE: Mr. Examiner, if I could just
22 have three or four minutes to mark exhibits before
23 cross-examination?

24 MR. STOVALL: Sure. One thing I can see
25 that is going to -- let me ask him a question, if you

1 don't mind, Jim, because it might help make sure we're
2 talking to the right person about the right things.

3 MR. BRUCE: Sure.

4 EXAMINATION

5 BY MR. STOVALL:

6 Q. Do you know on the invoice -- let't talk
7 about the gross receipts tax, and get that out of the
8 way.

9 A. Okay.

10 Q. Do you know what amount was paid on those
11 invoices? There's some marking up on the invoices,
12 the discounts?

13 A. Right.

14 Q. Let me start off with the premise that the
15 statute or the rules are there, and they speak for
16 themselves, and my understanding of how you would
17 normally work is to take 2 percent off the bottom
18 line, and then the vendor goes back and has to
19 recalculate the tax. Is that how you would understand
20 it?

21 A. Yes, sir.

22 Q. Do you believe that was done?

23 A. No, sir.

24 Q. What do you think happened in terms of how
25 it was actually paid?

1 A. We think that they actually paid the full
2 amount of the tax before it was recalculated to
3 reflect the discount. So they went ahead --

4 Q. Let me look at the exhibit and ask you,
5 because I think that will help me --

6 A. Okay.

7 Q. Do you remember which one it is?

8 Yeah, here it is, okay. I'm looking at
9 Exhibit 8. Let's look at the first invoice, the
10 second page of Exhibit 8.

11 A. Okay.

12 Q. The vendor at the bottom has typed in -- I
13 assume that is the vendor's typing?

14 A. Right.

15 Q. It says, "Less 2% Discount Amounting To
16 \$750.79."

17 A. Right.

18 Q. Now somebody has written in there, "Vendor
19 incorrectly calculated discount. Discount \$788.33."

20 A. Right.

21 Q. Do you know who wrote that in?

22 A. I did.

23 Q. Is \$750.79 the total of the items, not
24 including tax, 2 percent of the total of the items not
25 including tax?

1 A. Yes, sir.

2 Q. And the difference is 2 percent of the tax?

3 A. Yes, sir.

4 Q. Do you know whether that -- what amount --
5 and I think I know the answer to this question, it's
6 probably pretty obvious -- but do you know how much of
7 that tax was paid to the State of New Mexico?

8 A. No, sir, I wouldn't have any way of knowing
9 because the vendor is the one who paid that tax to the
10 State of New Mexico.

11 Q. That's the answer I expected. That one is
12 not worth taking any more time on. I understand how
13 you got there.

14 The mud item -- the part of casing item is
15 that there's an engineering dispute within the
16 company; so I assume you pretty well covered what you
17 know about it?

18 A. Yes, sir.

19 Q. The mud and tubing items, are you in a
20 position to -- I mean, you've looked at the reports,
21 but you are not in a position, I assume, to testify as
22 to any field evidence of how much of either was used,
23 other than the reports that were submitted to your
24 company, the drilling reports and OCD reports?

25 A. Yes, sir, that's all I have.

1 Q. Okay.

2 A. And I consider that to be the best
3 available evidence.

4 Q. I understand what you consider.

5 A. Right.

6 Q. So it wouldn't be very helpful to go back
7 and try to ask you to verify by some direct knowledge
8 of what happened in the field whether those reports --
9 which of those is more reliable?

10 A. No, sir. I think that only Santa Fe could
11 do that.

12 Q. Okay. Do you know if Hanley had anybody on
13 the location?

14 A. I don't know for sure.

15 MR. STOVALL: That's all I have.

16 MR. BRUCE: I still need a couple of
17 minutes.

18 (Recess.)

19 MR. BRUCE: Thank you for the time, Mr.
20 Examiner.

21 EXAMINATION

22 BY MR. BRUCE:

23 Q. Mr. LeMond, you've been handed some exhibits
24 marked Santa Fe Exhibits A through E, and I'm not
25 going to spend a lot of time going through them, but

1 looking at what's marked Santa Fe Exhibit A, is that a
2 copy of the second response that Santa Fe Energy sent
3 to you? I think you indicated that you had received a
4 response on Monday of this week, Monday or Tuesday of
5 this week?

6 A. Yes, sir, it is.

7 Q. I really only have two questions on that.
8 First of all, when you were talking about Exception 6,
9 which had to do with drilling mud, you --

10 MR. STOVALL: Mr. Bruce, we don't seem to
11 be looking at the same Exhibit A.

12 MR. BRUCE: Did I mess it up? Let me give
13 you my correct, Mr. Examiner -- I took them out of
14 order. They were out of order, and I obviously
15 continued the mistake here.

16 MR. STOVALL: For the record, Exhibit A is
17 a letter dated -- on Santa Fe Energy Resources
18 letterhead dated June 10, 1993, to Hanley Petroleum,
19 Inc.; is that correct?

20 MR. BRUCE: That's correct.

21 I'm sorry, Mr. Examiner.

22 Q. (BY MR. BRUCE) Let me start over again,
23 Mr. LeMond. I'm sorry. Santa Fe Exhibit A is a
24 letter dated June 10, 1993, from Santa Fe Energy
25 Resources, Inc., to Hanley Petroleum, Inc.; is that

1 correct?

2 A. Yes.

3 Q. And I think you stated that is the second
4 audit response that you received from Santa Fe, which
5 you had referred to earlier?

6 A. Yes, sir.

7 Q. Now, let's look back at Exception 6, which
8 had to do with the drilling mud. I believe you stated
9 that your records show that only 14 sacks of Drispac
10 mud had been used?

11 A. Yes, sir.

12 Q. Did the materials you examined and this
13 audit response show that 34 sacks of mud overall had
14 been used?

15 A. Well, the only thing that these showed me
16 was that 34 sacks of Staflo had been used, which is a
17 separate product.

18 Q. Okay, 34 sacks of Staflo had been used?

19 A. Or some number. If 34 is the right number,
20 then --

21 Q. Whatever. You're saying it shows some
22 amount -- the records you examined and this second
23 response showed that 14 sacks of Drispac had been
24 used, and a certain amount of Staflo had also been
25 used?

1 A. Yes, sir.

2 Q. That's all I wanted to ask on that one.
3 Now, on -- and I just wanted to verify now on Audit
4 Exception 7, what you are saying is that one joint is
5 left on the ground and 12 joints had been returned to
6 wherever?

7 A. Well, there may be one joint on the ground,
8 and that's fine, and we're willing to pay our fair
9 share of the cost for that one joint on the ground.
10 The accounting records indicated that 12 joints were
11 returned to Santa Fe's yard or whatever through
12 material transfer, and that is addressed in our
13 reconciliation that's included with my exhibit on that
14 particular exception. That would be Exhibit 7, or,
15 I'm sorry, Exhibit 10, Exception 7.

16 Q. I just wanted to clarify from this what
17 exactly was in dispute.

18 A. Right.

19 Q. Next would you just look at Santa Fe
20 Exhibit B, which is a letter from Hanley to Santa Fe
21 with an AFE attached. Have you seen that before, Mr.
22 LeMond?

23 A. Yes, sir, I believe I have.

24 Q. And if I can summarize, it's from Mr.
25 Rogers, who's a vice president at Hanley, is he not?

1 A. Yes, sir.

2 Q. Electing to go as a consenting party under
3 the Oil Conservation Commission compulsory pooling
4 order; is that correct?

5 A. To the best of my understanding, that's
6 correct.

7 Q. And he also enclosed a signed AFE, did he
8 not?

9 A. Yes, sir.

10 Q. And to the best of your knowledge, did
11 Hanley sign the original AFE for the proposed well?

12 A. Yes, sir.

13 Q. Does this appear to be a true copy of that
14 AFE?

15 A. Yes, sir.

16 Q. Do you recognize Mr. Robbins' signature?
17 You're not sure?

18 A. I'm not sure about that.

19 Q. But an AFE was signed?

20 A. Yes, sir.

21 Q. Let's skip over to Santa Fe Exhibit D,
22 which is another letter with an AFE. It's a
23 Supplemental AFE, is it not, Mr. LeMond?

24 A. That's what it says at the top of the
25 document. It appears to be.

1 Q. And this one pertains to a couple of extra
2 cost items, if you look down at the bottom. It
3 pertains to a problem with the casing, does it not? I
4 think if you look right below Mr. Robbins' signature?

5 A. Yes, sir.

6 Q. And it also pertains to an additional
7 stimulation that was done?

8 A. I see that written there, yes.

9 Q. Okay. What is the amount of this
10 Supplemental AFE?

11 A. It says \$847,583.

12 Q. Which is an increase of approximately
13 \$125,000 over the original AFE, is it not?

14 A. That's what it says.

15 Q. And Hanley did sign the Supplemental AFE?

16 A. I mean it says Hanley signed it, but I
17 didn't sign it.

18 Q. Do you dispute that Hanley signed the
19 Supplemental AFE?

20 A. I don't dispute it. I do not dispute it,
21 but nor do I confirm it because I didn't sign it.

22 MR. BRUCE: Mr. Examiner, I can bring my
23 engineering witness up here who has possession of the
24 correspondence file between Hanley and Santa Fe, and
25 we have the original signed AFE among the parties,

1 But I think if you look at Exhibit D, you see that
2 Hanley approved the expenditure for the 8-5/8-inch
3 casing collapse, and at this point, with respect to
4 the 8-5/8-inch casing, I would move that that issue be
5 dismissed from this hearing.

6 In my opinion, by signing the AFE, Hanley
7 agreed to the type of the charge for that casing
8 collapse problem. Hanley audited those costs, there
9 is no dispute over the \$92,000, plus or minus, that
10 the casing collapse cost, but Hanley approved it.
11 They might not have liked it, but they approved it.
12 And I would ask that any further issues regarding that
13 issue be dismissed from this proceeding.

14 MR. KELLAHIN: I'm not sure I followed
15 Mr. Bruce's argument. Okay?

16 Which AFE are you looking at to support
17 your legal argument that Hanley has approved the
18 expenditure of money for the collapsed casing? I'm
19 sorry, Jim, I'm confused.

20 MR. BRUCE: Exhibit D.

21 MR. KELLAHIN: Is this the expenditure
22 authorized to repair the collapsed casing?

23 MR. BRUCE: Yes, sir.

24 MR. KELLAHIN: After the casing collapsed;
25 right?

1 MR. BRUCE: It was after the casing
2 collapsed. The engineer can testify to that.

3 MR. KELLAHIN: Okay. I have a response
4 when you're ready, Mr. Examiner.

5 EXAMINER CATANACH: Go ahead.

6 MR. KELLAHIN: The issue is whether Santa
7 Fe has used substandard engineering practices for the
8 casing design. This AFE is not relevant to that
9 issue. The fact that Hanley approves the repair of
10 the well that has collapsed is simply out of necessity
11 something they had to do. You can't walk away from
12 the well because the casing has collapsed. You've got
13 to approve the repair. And that's what this is. It's
14 approving the AFE to fix the well that it was Santa
15 Fe's responsibility to drill properly in the first
16 place.

17 So that's my first issue, is that this AFE
18 does not support Mr. Bruce's legal argument that this
19 constitutes some type of contractual consent on that
20 issue. It doesn't weigh the dispute on the collapsed
21 casing.

22 The other point is, an operator under a
23 forced pooling act, by approving an AFE, does not
24 waive his opportunity to later contest the reasonable
25 well cost. If you agree with Mr. Bruce on that issue,

1 then you will always preclude someone in Hanley's
2 position from ever disputing whether Santa Fe has
3 acted properly with regards to these well costs and
4 expenses.

5 We're not talking about the conventional
6 issue where operators sign a Joint Operating
7 Agreement, and everybody initially agrees on this
8 well. The police powers of the State of New Mexico
9 were used against us to put us into this well. Santa
10 Fe is at a higher standard to at least design and
11 drill and case this well, meeting the customs and
12 practices of the industry. Our engineering proof is
13 that they designed to a substandard casing collapse
14 safety factor, and for that we are entitled to credit
15 on the \$90,000 item in issue.

16 Mr. Bruce's argument about the AFE misses
17 the point. It's not an issue. It doesn't resolve
18 that matter. And we would request that you rule
19 against his motion.

20 MR. BRUCE: One word in response,
21 Mr. Examiner. They were under no obligation to sign
22 that AFE. They were already a consenting party under
23 the compulsory pooling order. I think this AFE
24 supersedes the terms of that order with respect to
25 this expense item.

1 MR. STOVALL: I knew you'd get one of these
2 one day.

3 MR. KELLAHIN: You got it now.

4 MR. STOVALL: Let me throw out my
5 understanding, then. Number one, I think there is,
6 certainly as far as this Commission is concerned, some
7 question as to, in general terms, outside the context
8 of a forced pooling, as to what kind of legal
9 obligation the signing of an AFE creates. If I'm not
10 mistaken, AFE stands for Authorization for
11 Expenditures. We, as an owner in this property,
12 authorize an expenditure on that property.

13 It's based on estimates, is that correct,
14 ahead of time going in?

15 MR. KELLAHIN: Um-hm.

16 MR. STOVALL: Now, the original question
17 arises is if somebody signs an AFE, have they joined a
18 well, and we're not concerned with that here. We're
19 now in a situation where we've got an order, and if I
20 remember the language of our standard forced pooling,
21 and I think this contains such language, it says the
22 operator provides an AFE. Based upon that AFE, that
23 estimated expense, the pooled party elects whether to
24 go nonconsent or consent. In this case, they've
25 elected to go consent.

1 The order then provides that -- some
2 additional things. It says that consenting party pays
3 costs 30 days in advance, and is provided with costs
4 and gets a chance to challenge actual well costs.

5 MR. KELLAHIN: We're trying to beat the
6 risk factor.

7 MR. STOVALL: Right, I understand that.
8 Now the question arises is on a subsequent AFE, and
9 one in this case specifically sent out to address
10 additional costs incurred as a result of an untoward
11 downhole event, without discussing the responsibility
12 for that event, does that bind that party who signs
13 that AFE, or having gone consent and paid their costs
14 in advance, can they say, "No, we don't approve of
15 those expenditures. We think they're improperly
16 incurred, and we don't approve of their charge to the
17 joint account"?

18 And I assume Mr. Bruce is saying by signing
19 the subsequent AFE, it has a different legal effect
20 than signing the original AFE, in that it says yes, we
21 approve of those specific charges.

22 MR. KELLAHIN: And I think you've framed
23 the legal issue, is whether by signing the AFE, Hanley
24 has waived the dispute or simply authorized the repair
25 of a well that's in trouble. And it's a legal issue.

1 I don't think there's any dispute about the facts.
2 It's the meaning of what was done.

3 MR. STOVALL: Let's get that clear. And I
4 understand why this witness has not stated or cannot
5 state that in fact Hanley did sign the amended AFE or
6 subsequent AFE. Is there any dispute that it was
7 signed by Mr. Robbins for Hanley?

8 MR. KELLAHIN: I'm not aware of any, and
9 I'll take it on faith that Jim has the original.

10 MR. BRUCE: I do have the original AFE,
11 which I can submit --

12 MR. STOVALL: So we don't have to get into
13 a shouting contest over that one.

14 MR. KELLAHIN: I assume it was signed.

15 MR. STOVALL: It's just a question of what
16 is the effect of it?

17 MR. KELLAHIN: That's exactly right.

18 MR. STOVALL: I don't know.

19 MR. BRUCE: We're going to be here for the
20 engineers, regardless, I take it.

21 MR. KELLAHIN: I don't know. We can sit
22 here and write memos on it if you want, but somebody's
23 got to decide that.

24 MR. BRUCE: If the Division -- I don't
25 think if the Commission or the Division decides to

1 reserve the issue, fine, we can go on and finish the
2 hearing, but I would like a decision sometime on that
3 issue.

4 MR. STOVALL: I think one of the things --
5 let me come back to it. One of the things that
6 concern -- I think it takes on a different nature than
7 the original AFE because there is some knowledge upon
8 which it is based.

9 MR. BRUCE: It was after the fact.

10 MR. STOVALL: I guess one of the issues
11 that I would certainly want to see addressed is some
12 -- I mean, the argument, Mr. Bruce's argument is it
13 is in the nature of a contract. It is the promise.

14 MR. KELLAHIN: Well, it's more than that.
15 It's the characterization of what that contract
16 commitment is.

17 MR. STOVALL: And that would be the next --
18 which leads me to the -- applying some basic contract
19 law is, do we need to know the context in which --
20 obviously, the document does not speak for itself if
21 it is a contract. You've got to go to parol evidence
22 to -- we'll throw out lawyer terms, just so you guys
23 remember I'm a lawyer.

24 MR. KELLAHIN: Here's the problem, Bob, and
25 I think what we need to do is -- I guess I'm surprised

1 by the issue and how to resolve it is to bring
2 Mr. Robbins over here because there is an ambiguity in
3 what this means. You can't read the face of this
4 document and figure out what they're doing, and you've
5 got to go to parol evidence, and neither one of us is
6 prepared today to bring the witnesses.

7 I think we may need to continue this and
8 bring the right people back here to explain what this
9 subsequent AFE at least meant to them.

10 MR. STOVALL: I think that's pretty
11 material.

12 MR. KELLAHIN: Me, too.

13 MR. STOVALL: I understand the engineering,
14 and there's an allegation on Hanley's part that Santa
15 Fe did not act prudently.

16 MR. KELLAHIN: You may not get to that
17 issue if you have decided this one.

18 MR. STOVALL: Exactly, if you have a
19 contract. Obviously, you knew you had collapsed
20 casing when you sent out the AFE to repair collapsed
21 casing. What knowledge was there and did that
22 constitute an acceptance?

23 And I'm almost inclined to say if that is
24 dispositive of the case, do we want to spend an hour
25 plus or a couple hours listening to engineers discuss

1 the prudence of the operation when in fact that may be
2 a moot point.

3 MR. KELLAHIN: Let me propose this to you.
4 We build these things overnight to present to you. I
5 think this is an issue of importance. It seldom comes
6 up before the Division on what to do with these well
7 cost hearings, and I am certainly agreeable to
8 continuing the case. Let Mr. Bruce and I do a little
9 research on that, and let's he and I talk about who to
10 bring back as principals on that issue, and we'll just
11 complete the hearing later and move on.

12 MR. BRUCE: Mr. Examiner, I didn't mean to
13 cause quite this much, but I was not aware of the
14 signed AFE's until late Wednesday.

15 MR. STOVALL: I understand. We have had
16 discussions, and you weren't in on them yesterday,
17 Jim, about the way the process works, and this is what
18 happens. I've reinforced my remarks from yesterday,
19 but I'm kind of inclined to think that may be a real
20 critical piece of this.

21 MR. KELLAHIN: Well, there's substantial
22 money involved. The issue is of importance to the
23 Division. The parties have been fussing with this for
24 months, if not years. Another two --

25 MR. BRUCE: About two and a half years.

1 MR. KELLAHIN: Another two and a half weeks
2 or a month is not going to make any difference, and
3 you get a better result if Mr. Bruce and I do have
4 some time to put it together for you. So I request we
5 continue the case at this point, and we'll agree on a
6 date to bring it back and move forward with this
7 issue.

8 EXAMINER CATANACH: What do you want to do,
9 Mr. Bruce?

10 MR. BRUCE: I think that's probably -- let
11 me talk with my witness for a minute.

12 (Thereupon, a discussion was held
13 off the record.)

14 EXAMINER CATANACH: Did you gentlemen reach
15 an agreement?

16 MR. KELLAHIN: I don't know what we've
17 reached, Mr. Examiner, except to say on the record
18 that at this point Hanley requests that the case be
19 continued. And at least for purposes of this case,
20 let's continue it to, I guess the July 1st docket,
21 with the understanding that Mr. Bruce and I need to
22 find out when we can bring it back to you.

23 As an examiner, you've already heard part
24 of this case. I think it's unfair to Mr. Stogner to
25 ask him to rehear what you've already heard. For

1 purposes of today's docket, I would request that the
2 case be continued, and that Mr. Bruce and I then will
3 get back to you on when we propose to bring this back
4 to you for consideration.

5 EXAMINER CATANACH: Are you in agreement
6 with that, Mr. Bruce?

7 MR. BRUCE: Unfortunately, not really, but
8 let me just state Santa Fe's position. Like I said,
9 this has gone on for two and a half years. I guess
10 our position is if you rule in favor on this one, it
11 really does away with a lot of this hearing.
12 Alternatively, if you ruled in favor of us on the
13 engineering matters, it makes this AFE issue not
14 necessary for you to decide.

15 MR. STOVALL: I don't hear strong
16 opposition to continuance from Mr. Bruce, Mr.
17 Examiner. I'm not agreeing that he's conceding
18 either.

19 I think the point -- I'm concerned. I
20 think this AFE situation is a fairly important one,
21 and this is one that may come up again. I think that
22 needs to be -- I think there needs to be some
23 clarification from this Commission as resolution of
24 some of those -- the issues that are raised by that.

25 I'm not particularly -- I don't

1 particularly want to recommend that we listen to two
2 hours of engineering testimony which may or may not be
3 dispositive of this case. I think in this particular
4 case, we need to keep the horse in front of the cart
5 and decide whether there is a place for a dispute with
6 respect to the prudence of operations before we
7 determine -- look at the prudence issue, itself.

8 Again, the urgency is -- there is no
9 urgency. Nobody is going to stop acting because of a
10 continuance in this case. I'd recommend we continue
11 it at this time.

12 EXAMINER CATANACH: With respect to the
13 resolution of the AFE issue, Mr. Kellahin, would you
14 propose to bring Mr. Robbins in?

15 MR. KELLAHIN: I think that's an obvious
16 response, that either Mr. Robbins or Mr. Rogers needs
17 to come and explain his company's position with
18 regards to executing those documents. I think they're
19 ambiguous on their face as to what the intent was.
20 And, quite frankly, I had not anticipated this issue,
21 and we're going to have to bring an additional witness
22 to address this problem.

23 MR. STOVALL: Let me ask you one thing just
24 in terms of utility, is there any sense in either a
25 formal or informal sort of prehearing conference

1 within the next week or so to identify what the issues
2 are so we know what we're going to address?

3 MR. KELLAHIN: I think Mr. Bruce and I can
4 accomplish that between ourselves. It's possible we
5 may be able to stipulate as to substantial portions of
6 the fact. I think this really may boil down to a
7 legal issue, and we may be able to stipulate a lot of
8 this out of the way.

9 EXAMINER CATANACH: I think at this point
10 we'll grant Mr. Kellahin's request for continuance and
11 see what we can come up with.

12 MR. STOVALL: Continue it to July 1st, and
13 then set a date, is that what you --

14 MR. KELLAHIN: That's my proposal.

15 MR. BRUCE: If that's your decision, it may
16 have to be continued a couple extra weeks.

17 MR. STOVALL: Yeah. The only reason for
18 that date is because we don't know a particular date
19 in the future. And if it looks like it may be
20 something -- you know, if it looks like it is going to
21 get into some lengthy evidentiary presentation, we may
22 want to schedule it for a special date.

23 MR. KELLAHIN: Again, Mr. Bruce and I can
24 look at this.

25 EXAMINER CATANACH: Continue it to July 1st

1 then.
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CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)

) ss.

COUNTY OF SANTA FE)

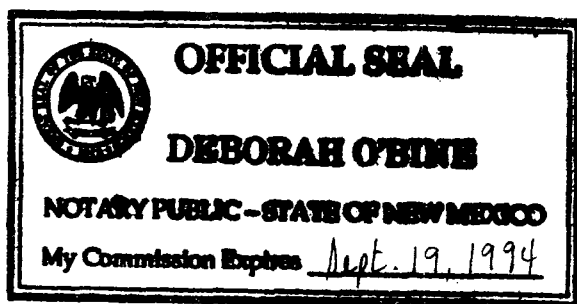
I, Deborah O'Bine, Certified Shorthand Reporter and Notary Public, HEREBY CERTIFY that I caused my notes to be transcribed under my personal supervision, and that the foregoing transcript is a true and accurate record of the proceedings of said hearing.

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, July 10, 1993.

Deborah O'Bine

DEBORAH O'BINE
CCR No. 63



I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 1053, heard by me on June 17, 1993.

David R. Catant, Examiner
Oil Conservation Division

NEW MEXICO OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
STATE OF NEW MEXICO
CASE NO. 10513

IN THE MATTER OF:

The Application of Hanley Petroleum,
Inc., for Determination of Reasonable
Well Costs, Lea County, New Mexico.

BEFORE:

MICHAEL E. STOGNER

DAVID R. CATANACH

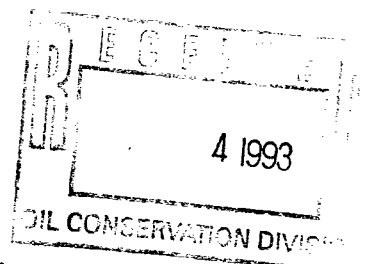
Hearing Examiners

State Land Office Building

Thursday, September 23, 1993

REPORTED BY:

CARLA DIANE RODRIGUEZ
Certified Court Reporter
for the State of New Mexico



ORIGINAL

A P P E A R A N C E S

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I N D E X

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E X H I B I T S

	Page Marked
Exhibits submitted/Not marked	11

1 EXAMINER STOGNER: The hearing will
2 come to order. I'll call next case, No. 10513.

3 MR. STOVALL: Application of Hanley
4 Petroleum, Inc., for determination of reasonable
5 well costs, Lea County, New Mexico.

6 EXAMINER STOGNER: Call for
7 appearances.

8 MR. KELLAHIN: Mr. Examiner, I'm Tom
9 Kellahin with the Santa Fe law firm Kellahin and
10 Kellahin, appearing on behalf of the Applicant,
11 Hanley Petroleum, Inc.

12 MR. BRUCE: Mr. Examiner, I'm Jim
13 Bruce, representing Santa Fe Energy Operating
14 Partners, L.P.

15 EXAMINER STOGNER: Any other
16 appearances? Mr. Stovall.

17 MR. STOVALL: Mr. Examiner, this case
18 has previously been heard by Examiner Catanach.
19 It ran into an unusual question which the parties
20 wish to address.

21 And I believe, at this time, it would
22 be appropriate for Examiner Catanach to continue
23 to hear the case. There will be no witnesses,
24 but rather than having two Examiners on the
25 record, I think it would be easier for everyone

1 if Examiner Catanach does his thing.

2 EXAMINER CATANACH: Let the record
3 reflect that I am present and will hear the
4 case.

5 MR. STOVALL: It's my understanding, we
6 have an issue. The issue that arose at the
7 original hearing on this matter was a--well, let
8 me back up and do some preliminaries.

9 This case is a challenge to well costs
10 in a force pooling case by Hanley against a well
11 operated and drilled by Santa Fe. Hanley has
12 challenged certain costs, the most significant of
13 which is the cost to repair a separated casing,
14 if I'm not mistaken.

15 During the course of examination of
16 witnesses, Santa Fe presented an AFE for the
17 casing repair, which was signed by Hanley, and it
18 became an issue whether or not that AFE was, in
19 fact, an acceptance of those costs by Hanley,
20 they having raised the issue of whether or not
21 the separation of casing was a result of improper
22 operations and whether that was waived by virtue
23 of the fact they signed the AFE to repair the
24 casing.

25 Is that a fair statement of where we

1 are at this point, gentlemen?

2 MR. KELLAHIN: There's one more AFE,
3 Mr. Stovall. There were at least two AFEs that
4 are potentially relevant. One was the AFE that
5 Santa Fe submitted to Hanley after the issuance
6 of the pooling order. That itemized AFE had
7 proposed to Hanley the use of casing, the
8 strength of which was in dispute.

9 That AFE was signed and returned by
10 Hanley to Santa Fe. So, there's that AFE and
11 then there's the AFE for the subsequent hearing.

12 MR. BRUCE: The only thing I would add,
13 in this case Hanley did elect to participate
14 under the compulsory pooling order.

15 MR. STOVALL: What that raises now is
16 the issue of whether or not Hanley can challenge
17 those costs, and does an AFE, in fact, bind the
18 party and constitute an acceptance of costs, or
19 what is the effect of an AFE? And that is an
20 issue that has never been determined by the
21 Commission.

22 It's a legal question, and I think the
23 parties have agreed that what needs to be done at
24 this point is resolve that issue, because if that
25 is resolved in Santa Fe's favor, there's no point

1 in going forward with the engineering aspects of
2 whether or not the casing was, in fact, proper.
3 Is that correct?

4 MR. BRUCE: That's my position, yes,
5 Mr. Stovall.

6 MR. KELLAHIN: When we left this case
7 on the 17th of June, that was the issue framed
8 for Mr. Bruce and I. We have since looked at
9 what we think are documents that are relevant,
10 and he and I have stipulated to the
11 correspondence and documents that we want you to
12 consider.

13 In addition, he has consented to my use
14 of an affidavit from my landman, detailing
15 Hanley's position about the AFEs, and then each
16 of us have prepared written memoranda to submit
17 this afternoon for you to take this under
18 advisement and consider what you want to do.

19 MR. BRUCE: Mr. Kellahin has a
20 stipulation of admissibility with nine documents
21 attached to it. We would just submit those right
22 now and then submit the briefs by this
23 afternoon.

24 MR. STOVALL: What will happen is,
25 today these various documents that have been

1 referenced will be submitted by stipulation, the
2 Examiner and the Division will review the briefs
3 and supporting exhibits, and will issue a ruling
4 as to whether or not, in fact, that AFE
5 constitutes acceptance of both the original
6 casing--the first AFE constitutes acceptance of
7 the original casing, and the second constitutes
8 an agreement to pay the costs of repair. Is that
9 correct?

10 MR. BRUCE: Yes.

11 MR. STOVALL: And if it is decided in
12 Hanley's favor, then an issue left to be resolved
13 with respect to the casing issue is whether or
14 not it was prudent operating practices to use the
15 casing as specified.

16 MR. KELLAHIN: And if that's the
17 result, then, we need to come back for the
18 evidentiary hearing that addresses that issue.

19 MR. STOVALL: And if it is resolved in
20 Santa Fe's favor, then the issue of whether or
21 not the casing was appropriate and prudent is
22 moot, and that issue is resolved by the legal
23 interpretation of the effect of the AFE.

24 Now, there were some other much lesser
25 cost items that were to be considered in that

1 challenge. Have those been resolved, or are
2 those still open?

3 MR. BRUCE: Those are still open, but,
4 I mean, this is a 90,000-dollar item, and the
5 others, I think, total \$4,000 or \$3,000. Is that
6 correct, Mr. Kellahin?

7 MR. KELLAHIN: [Indicating.]

8 MR. BRUCE: I think, before we move on
9 those, because some of those may involve
10 engineering testimony also, I think this should
11 be decided.

12 MR. STOVALL: In other words, this is
13 not dispositive of all issues in the case? was my
14 only question. There may still need to be some
15 additional technical testimony?

16 MR. BRUCE: Very minor, yes. Not to
17 the same extent as if we have to present
18 engineering testimony on the casing itself.

19 MR. STOVALL: With that in mind,
20 Examiner Catanach, I recommend that you take
21 under advisement the issue of whether or not the
22 execution, or the effect of the execution of the
23 AFEs by Hanley, accept into the record the briefs
24 and supporting exhibits.

25 And I understand Mr. Bruce actually

1 will file his brief by the close of business
2 today.

3 MR. KELLAHIN: I'm ready to file mine
4 now, if that's all right.

5 MR. STOVALL: As long as you don't
6 mind, we'll let you do it, Mr. Kellahin. An
7 order will be issued addressing the AFE question,
8 and then we'll proceed based upon that order.

9 So it's partially taken under
10 advisement, I guess.

11 EXAMINER CATANACH: Are those admitted
12 as evidence, Mr. Stovall?

13 MR. KELLAHIN: The memorandum should
14 not be. The affidavit of Mr. Rogers ought to be
15 marked as an exhibit. In addition, we have, by
16 stipulation, identified the nine documents.
17 They're not yet marked because I simply forgot
18 the sequence of exhibit numbers, but they could
19 be placed on the stipulation and incorporated
20 into the record as additional exhibits.

21 MR. STOVALL: These are items that were
22 not submitted at the time of the original
23 hearing, is that correct?

24 MR. KELLAHIN: They had been submitted
25 but not yet admitted, and some of them may be

1 admitted, but that gets them all in one package.

2 MR. STOVALL: We may have to reference
3 the transcript to get numbers.

4 MR. BRUCE: For purposes of the brief,
5 I think I referred to those as Exhibits 1 through
6 9.

7 MR. STOVALL: How about if we call them
8 A through I, or whatever the appropriate letter
9 is? That way, by using a letter distinction,
10 they won't be confused by any other exhibits.

11 MR. KELLAHIN: It doesn't matter to
12 me. I don't know how Mr. Bruce has organized his
13 brief, but he and I have been using a sequence in
14 numerical order, on the stipulation.

15 MR. STOVALL: Okay. With that, and
16 recognizing we may have to come back at some
17 point on the record and clarify what exhibit is
18 what, I think you can admit them as
19 Exhibits--let's call it this way, referenced in
20 the stipulation of admissibility submitted by the
21 parties, by paragraphs 1 through 9, the exhibits
22 are described, and the exhibit numbers are left
23 blank for the moment, so we can have a reference.
24 Does that make sense.

25 EXAMINER CATANACH: That sounds fine.

1 I would hate to have to repeat that.

2 MR. STOVALL: That's why we've got a
3 court reporter. She takes it all down so we
4 don't have to repeat it.

5 EXAMINER CATANACH: Mr. Stovall, are
6 we, at this time, taking the case under
7 advisement, or are we continuing the case and
8 issuing an interim order?

9 MR. STOVALL: I guess we can say we're
10 continuing the case, but taking the issue of the
11 effect of execution of AFEs under advisement.
12 And this case will be continued. The record will
13 be left open, but it will not be continued to a
14 date specific.

15 The order addressing the AFE question
16 will then have to specify a procedural schedule
17 for addressing the additional issues, depending
18 on what they are.

19 EXAMINER CATANACH: So, it's my
20 understanding we have to get an interim order
21 out, and then we will, at that point, decide
22 whether to reopen it, call the parties back, or
23 dismiss the case?

24 MR. STOVALL: Well, it won't be
25 dismissed. It may be resolved by that order.

1 And there are the additional items, the other
2 \$4,000 worth of--including things like sales tax
3 on cement, and there were minor items that may
4 still need to be addressed.

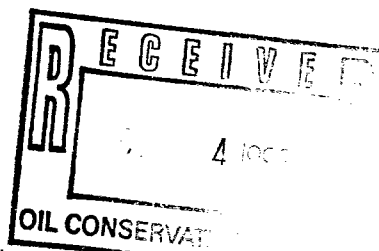
5 My sense is that there will be two
6 orders in this case, one on the AFE issue and
7 then a final, dispositive order.

8 EXAMINER CATANACH: Okay. Is there
9 anything further?

10 MR. BRUCE: No, sir.

11 EXAMINER CATANACH: There being nothing
12 further, we'll take this case under advisement.

13 (And the proceedings concluded.)
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I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. _____,
heard by me on _____ 19____.

_____, Examiner
Oil Conservation Division

1 CERTIFICATE OF REPORTER

2
3 STATE OF NEW MEXICO)
4) ss.
COUNTY OF SANTA FE)

5
6 I, Carla Diane Rodriguez, Certified
7 Court Reporter and Notary Public, HEREBY CERTIFY
8 that the foregoing transcript of proceedings
9 before the Oil Conservation Division was reported
10 by me; that I caused my notes to be transcribed
11 under my personal supervision; and that the
12 foregoing is a true and accurate record of the
13 proceedings.

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

19 WITNESS MY HAND AND SEAL September 30,
20 1993.

21
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24 CARLA DIANE RODRIGUEZ, RPR
25 CCR No. 4