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. 11,792
APPLICATION OF DOYLE HARTMAN, OIL OPERATOR, FOR AN ORDER CLARIFYING ORDER NO. R-6447 AND REVOKING OR MODIFYING ORDER NO. R-4680-A OR, ALTERNATIVELY, FOR AN ORDER TERMINATING THE MYERS LANGLIE-MATTIX UNIT WATERFLOOD PROGRAM, LEA COUNTY, NEW MEXICO	)	ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

PREHEARING CONFERENCE

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

June 30th, 1997

Santa Fe, New Mexico

This matter came on for prehearing conference before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Monday, June 30th, 1997, 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

June 30th, 1997
Prehearing Conference
CASE NO. 11,792

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* * *

WHEREUPON, the following proceedings were had at 2:05 p.m.:

EXAMINER STOGNER: This matter will come to order. Please note today's date, June 30th, 1997.

Mr. Carroll, for the record, would you call this matter?

MR. CARROLL: Application of Doyle Hartman, Oil Operator, for an order clarifying Order No. R-6447 and revoking or modifying Order Number R-4680-A or, alternatively, for an order terminating the Myers Langlie-Mattix Unit waterflood program, Lea County, New Mexico.

EXAMINER STOGNER: At this time I'll call for appearances.

MR. GALLEGOS: Appearing on behalf of Doyle Hartman, Gene Gallegos and Michael Condon, Gallegos Law Firm, Santa Fe, New Mexico.

EXAMINER STOGNER: Other appearances?

MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of the Santa Fe law firm of Kellahin and Kellahin, appearing in association with the law firm of Campbell, Carr, Berge and Sheridan and Mr. William F. Carr. We collectively represent OXY USA, Inc., in opposition to the Applicant.

EXAMINER STOGNER: Any other appearances?

We're here at this time to consider some motions.

MR. CARROLL: We have a number of motions to

consider today, and I think probably the first motion we should consider is the Motion to Disqualify Counsel, since Counsel might be arguing the other motion.

So I believe it's Mr. Hartman's motion to disqualify?

MR. CONDON: Yes. We received this morning a response to the Motion to Disqualify, which I've had a chance to look at. I obviously haven't had a chance to prepare anything in response, and I don't know if the Examiner has had an opportunity to review the response.

Our position is very simply this: OXY has put Mr. Carr into this case as a witness by filing a Motion to Dismiss which cites as their primary authority for their theory of unitization that they're advancing in this case, i.e., that the Order R-6447 only unitized some interests and not all interests in the unit.

The only document they cite in the Motion to Dismiss is Mr. Carr's transmittal letter. We believe that Mr. Carr is a witness because he was counsel for Getty in connection with the 1980 proceeding, has knowledge about whether the unit agreement and the unit operating agreement were ever amended in connection with that proceeding; also that he has knowledge as a witness based upon the transmittal letter from Mr. Ramey following the submission of the ratification forms confirming the 75-percent

ratification of Mr. Ramey's letter, and we've attached that as one of the exhibits in our response to the Motion to Dismiss, wherein Mr. Ramey references that Order R-6447 unitized all interests in the Myers Langlie-Mattix Unit.

Mr. Carr was the recipient of that letter, and of course we find no evidence in the record that Mr. Carr wrote Mr. Ramey and tried to correct that characterization about the effect of Order R-6447.

For all those reasons, we believe Mr. Carr is a necessary witness. Obviously, to the extent that he testifies or that a jury could reasonably determine that his testimony is adverse to OXY, i.e., anything that he did or did not do in connection with the 1980 proceeding, refutes or conflicts with the position advanced by OXY in this proceeding.

He is a necessary witness to the extent that the is the recipient and the sender of various correspondence. He is the only person who can testify about some of those matters, and I think realistically he's probably the only person here today, subject to the subpoena power of the Division, that we could reasonably depend on to bring before the Division to testify about some of these matters.

We have no idea where the individuals from Getty Oil Company are presently and have no idea how we might go about getting them. We realize that in its response today,

OXY kind of offhandedly contended that it would be no problem to find those individuals. That hearing was 17 years ago, and we have no idea where anybody else connected with the Getty application is today.

Like I say, Mr. Carr is subject to the subpoena power of the Division and can be brought before the Division as a necessary witness whose testimony is potentially harmful to OXY in connection with this proceeding. His testimony is not cumulative, as the testimony in the *Chappelle* case was, where the Supreme Court upheld a denial of a motion to disqualify.

And to some extent Mr. Carr, by signing the pleadings in this case and indicating what the, quote, intent, close quote, of the 1980 application was, has put his own veracity in question.

We don't believe that you can come in before the Division and essentially testify without being subject to cross-examination on what the nature of the 1980 proceeding is, and by signing any of the pleadings in this case, Mr. Carr is essentially doing that.

We have the utmost respect for Mr. Carr and don't advance this motion lightly, but we do think that under the circumstances that he should be disqualified. There's certainly no prejudice to OXY in this case.

And please understand, this is not a motion to

disqualify the law firm at this point in time; it's a motion to disqualify Mr. Carr, who will be a necessary witness. And there are other members of the Campbell firm who can ably step in, in connection with this proceeding.

EXAMINER STOGNER: Mr. Kellahin?

MR. KELLAHIN: Gentlemen, we filed this morning a response on this issue. It's approximately ten pages long. I don't know if you've had an opportunity to review or examine the summary we have provided in that filing.

Before you can reach the issue of Mr. Carr's participation, I would like to refresh your memory and to provide information about the background of this very issue.

If you've looked at the motion and response -- the OXY response and Hartman's Motion to Disqualify Mr. Carr, you'll find that Hartman's Application arises out of a dispute over OXY's right and remedies for Hartman's failure to pay his share of unit expenses incurred by OXY as the operator of this unit, in which Mr. Hartman owns a working interest.

By way of background, in 1973 Skelly formed this unit for secondary recovery. They formed it with the agreement of the working interest owners at that time. Hartman's predecessors-in-interest were among the working interest owners who voluntarily committed their interest to

those units.

That unit was approved by the Commission in 1973. It was approved by the Commissioner of Public Lands and the USGS at that time, now the Bureau of Land Management.

That operating agreement provided the unit operator with broad rights and cumulative remedies in the event a working interest owner subject to the agreement, like Mr. Hartman, defaults in the payment of his share of unit expenses.

OXY has invoked its rights and remedies under the agreement and has sued Mr. Hartman in court to collect his share of the expenses that he's obligated to pay.

To avoid the scope of those remedies, Hartman has now filed in the present Application, seeking administrative relief. And as part of that strategy, they're seeking to deprive OXY of representation by Mr. Carr.

Hartman's disqualification motion arises out of the following facts.

In 1975, the New Mexico Legislature adopted the Statutory Unitization Act.

In 1977 Getty succeeded Skelly as operator of the unit.

In 1980 Getty filed an application with the Commission under that Act in order to compel, with the

police powers of the State of New Mexico, certain uncommitted royalty interest owners who were not committed. Mr. Carr represented Getty in that proceeding before the Division.

An order was issued by the Commission in 1980. Some 17 years ago, that matter was final.

What Hartman is seeking to do now is to go behind that order, the finality of that order, and what he is urging is that Mr. Carr now is somehow a material witness for examination in the case today.

If you've looked at the memorandum provided, you can see that there's some controlling authority. There's *Chappelle vs. Cosgrove;* it's a New Mexico case. That sets the standard for the application of the answer to this question. The answer is, Hartman's motion must be denied.

The New Mexico Supreme Court recognized that a party like OXY has a right to counsel of its choice. Parties like Hartman abuse the lawyer-as-witness rule to disrupt opposing parties' trial preparation. They are strictly limited to a certain set of standards. First, they must show three tests are met.

The first test, the attorney's testimony is material to an issue in the case.

Second, the evidence to be elicited by the attorney's testimony is not available from another source.

And three, testimony is potentially prejudicial to his client's case.

Hartman has made no such showing, Mr. Stogner. Hartman defines the material issue in which Carr will testify as Getty's application for statutory unitization in 1980 and the evidence presented in that hearing, other statutory unitization cases that Mr. Carr has presented, the drafting and presentation of the legislation on the Unitization Act that was adopted.

Mr. Carr's testimony is not material to any issue to any issue before this Division. According to Hartman, material issues to which Mr. Carr will testify concern whether OXY has violated the Statutory Unitization Act and Order 6447 by suing Hartman pursuant to the remedies in the operating agreement.

All evidence sought is immaterial to this issue. Hartman is trying to re-examine issues that were the subject of the 1980 Getty application. It's immaterial because this agency has no authority to reopen or reconsider or re-examine a final order entered some 17 years ago.

We cite case authority that supports that proposition. Mr. Carr's testimony is immaterial as a matter of law.

Made no showing that he is a necessary witness.

Under *Chappelle*, Hartman must offer proof that Mr. Carr's testimony is unavailable from any other source. Mr. Hartman offers nothing but self-serving statements. There are no proof in his pleading.

All information that's relevant to the issue in 1980, Mr. Carroll, is available in the files of the Division. That matter is closed. The documents that he refers to, the correspondence that Mr. Carr has issued to the Division is there. It serves no purpose for us to go back and re-examine the case that was done by Mr. Nutter and the Commission some 17 years ago.

In addition, Hartman has made no showing that Carr's testimony is going to be prejudicial to OXY. In fact, he can't make his point on any of the basic requirements.

What I think we ought to be doing here is not having a conference about discovery. We should not be attempting to disqualify opposing counsel. We should go to the merits of the Motion to Dismiss, which is an effort by Mr. Hartman to attack the validity of orders issued by this Commission 17 years ago and more than three years.

We believe the motion to disqualify Mr. Carr is frivolous and ought to be denied.

MR. CONDON: May I have a short reply?

EXAMINER STOGNER: Mr. Condon?

MR. CONDON: Just a couple of points, Mr. Stogner.

First of all, I didn't realize that we were going to address the substantive issues of the Motion to Dismiss in connection with the Motion to Disqualify, or my presentation would have been substantially longer. Suffice it to say that we will address those issues in connection with the Motion to Dismiss when that is argued.

Mr. Kellahin contends that there is nothing material that Mr. Carr will testify about. Well, the only basis offered in support of that Motion to Dismiss for OXY's contention that the predecessors-in-interest of Mr. Hartman were not unitized by Order R-6447 was Mr. Carr's transmittal letter. So if Mr. Carr has nothing material to offer, then there is no basis for the Motion to Dismiss, and you ought to go ahead and deny that right now.

Finally, Mr. Kellahin contends that we haven't proven that Mr. Carr's testimony will be prejudicial to OXY. That's not the standard. The standard is potentially prejudicial.

Obviously, there are things that Mr. Carr may testify about, and of course we don't know this until we take his deposition or put him under oath and find out what he has to say, but they could be prejudicial to OXY's position in this case, they could contradict some of the

positions OXY has already taken.

He is a necessary witness. He was present at the creation of this unit by statutory unitization. He was a recipient and a sender of correspondence on that. His testimony is not going to be cumulative.

Of course, at this point we can't prove that anything -- that there are going to be no other witnesses who can testify about this. I can tell you that we are not aware of any of the former Getty employees or witnesses who are subject to subpoena power by the Division. Obviously if OXY has information about their whereabouts, we'd be happy to consider that.

But we do think that he is a material witness, his testimony will not be cumulative. Some of the things -- for instance, why he did or didn't do certain things in response to the letter from Mr. Ramey -- are matters that only Mr. Carr can testify about.

And so for those reasons, we believe we have met the standard in the *Chappelle* case. Mr. Carr should be disqualified.

MR. CARROLL: Mr. Kellahin, is Mr. Carr going to testify on behalf of OXY?

MR. KELLAHIN: No, sir. He's an integral part of our litigation team. Without Mr. Carr's assistance, we are inadequately represented before this Division, and it's

necessary and essential that he continue to participate.

This is an incredibly important decision for the agency, for us, because it goes directly as an attack against the statutory unitization order, all the orders issued by this agency in any form and fashion, and I need Mr. Carr's assistance.

By way of comment, when Mr. Hartman filed his complaint against Sirgo in 1991, raising virtually all these same issues against Sirgo that he's now contending exist against OXY, Mr. Carr represented Sirgo before this Commission, without objection from Mr. Hartman.

We think the problem here is, they're making allegations. And if you look carefully at the *Chappelle* case, it requires them to tender proof, not to make allegations. Their motion is flawed.

MR. CARROLL: Well, was Mr. Carr listed as a witness in one of the court actions?

MR. KELLAHIN: They claimed to try to make him a witness, but he is not a witness, we don't intend to call him as a witness. He's simply an attorney that represented a client before this agency in a past proceeding. Are we all now going to be subject to disqualification because we've appeared before you before?

MR. CARROLL: Well, my memory fails me, I guess. I thought Mr. Carr was listed as a witness for OXY in one

of these matters.

MR. KELLAHIN: Not by me, sir.

MR. CARROLL: Okay.

MR. CONDON: We do intend to call him, no question about that --

MR. CARROLL: And --

MR. CONDON: -- in the court proceedings and in this proceeding.

MR. CARROLL: And what type of -- What's the testimony you intend to elicit from --

MR. CONDON: Well, there are a number of things, Mr. Carroll.

First of all, confirming the correspondence back and forth, asking why, given OXY's theory of unitization that they're advancing in connection with the Motion to Dismiss, Mr. Carr never wrote back to Mr. Ramey to correct his characterization of the nature of Order R-6447.

Questions about what happened in connection with the 1980 statutory unitization proceeding, the most important one being, were the unit agreement and the unit operating agreement ever amended? Were they ever amended to conform with Order R-6447 in connection with that proceeding? And if so, what happened to those amended agreements? And if not, why not?

MR. CARROLL: Well, doesn't the record speak for

itself? Isn't the record complete enough to decide this issue?

MR. CONDON: Well, I don't know. I mean, it may be. But the problem is, we don't know without having an opportunity to question someone who was connected with the Getty application in 1980 to determine if, in fact, those agreements were ever amended and, if so, what happened to them. We don't know.

We do know that the agreements that are part of the case file in 6987, the 1980 proceeding, were, as far as we can tell, the same unit agreement and the same unit operating agreement that were presented to the Commission in 1973, when the waterflood project and the unit agreement were first approved.

Now, our question is, did Getty recognize in connection with the 1980 proceeding the need to revise the unit agreement and the unit operating agreement to include a nonconsent provision for carrying any working interest owner, as required by the order? Were they relying on the order?

If they did revise those agreements, what happened to those revised agreements? Because they never made their way into the file.

MR. CARROLL: Or into Mr. Hartman's hands?

MR. CONDON: Well, they've never been, as far as

we can tell, provided to any of his predecessors-in-interest in any of the files that he inherited in connection with his assignments.

(Off the record)

MR. CARROLL: Okay, at this time we'll deny the Motion to Disqualify Mr. Carr, and we'll deal with the subject -- the issue of him possibly testifying as a witness for Hartman later.

Next, we'll move on to the Motion to Dismiss. I believe that's OXY's motion?

MR. KELLAHIN: Yes, Mr. Carroll.

MR. CARROLL: So you can go first on this one, Mr. Kellahin.

MR. KELLAHIN: Thank you, sir.

I'm here to ask you to take your time to review the pleadings, the motions and the memorandums, and to think carefully about this, because what you do in this case is going to have a profound effect on all of your past 40-plus-some statutory unitization cases, and those you decide in the future, as well as all other cases before this agency.

We have presented to you a Motion to Dismiss, and in that document, which was filed on May 23rd, we've set forth the basic components of that Motion. Attached to it are Exhibits 1 through 20.

This morning we supplemented that filing in two ways. We have provided you a separate exhibit book, which is marked 21 through 44, which, in combination with the two filings, represents our exhibits in support of our motion.

In addition, we have filed this morning OXY's Reply in Further Support of the Motion to Dismiss. It is this document.

You'll find when you read the memorandum that we've filed today that it is our position that Mr. Hartman is wrong on the facts, that he's wrong on the law, he's wrong about the Division orders, he's wrong about the Division process, he's wrong.

If you agree with OXY's position, then this irrelevant paper war stops and we are left with the one single issue which should remain out of this mess of stuff.

This case goes to the very core of the agency's management of this Act and all cases, past and future, before this agency.

Mr. Hartman misinterprets the Act, attacks the unit orders, attacks the unit contracts. He's asking you 17 years later to examine the Act that was adopted by the State of New Mexico for implementation by the Oil Conservation Division. He's asking you to re-examine the cases that Mr. Nutter and others did when they heard some of these original cases. He's asking you to re-examine the

order that Mr. Nutter wrote. He wants you to tell us 17 years later that Mr. Nutter did not do it right.

This case is not hard; this is just Hartman. This is a war, a barrage, on all issues.

I respectfully request that you take your time, think this through, because not only does this go to the heart of the statutory unitization system, it goes to the very soul of your regulatory process.

Mr. Examiner, this is a death-penalty case. If you agree with Hartman, you will give him and everybody in his position the hangman's noose which can be used to strangle the regulatory process and kill the ability of the industry to rely upon the finality of your orders. Because if you set aside orders that are 17 years old, three years old, after they were adjudicated, then none of your orders are ever final. You will invite everybody to go back and at any time readjudicate all the orders that you, Mr. Catanach, Mr. Stamets, Mr. Nutter, and even Elvis Utz declared to be final.

The sand in Hartman's statutory unitization hourglass ran out 17 years ago, when his predecessors ratified the 1980 order and reconfirmed the 1973 contracts, which were unchanged.

The sand in his 1994 waterflood project hourglass ran out three years ago when, after adequate notice,

Hartman chose not to participate or appeal and thereby failed to exhaust his remedies and defaulted.

The prohibition against collateral attacks, the exhaustion doctrine, the doctrine of collateral estoppel, are all related to and are like the judicial doctrine of *res judicata*, in that they are concerned with prevention of litigation of an issue already judicially decided and with requiring parties to raise their claims in a timely fashion.

Whether these orders are right or wrong, whether today you come to any other conclusion, is not relevant. These orders are final as to Hartman. The Division must not reward Hartman's lack of diligence or to change contracts which for 17 years have remained unchanged. His Application must be dismissed.

When you get through this barrage of paper you're going to find, Mr. Stogner, that the issues in this case are simple.

OXY properly applied for and obtained Division approval of the expanded waterflood project after notice and hearing.

Hartman had notice of the issues to be decided, had the opportunity to participate in the hearing and appeal the resulting order. Hartman chose not to participate and not to appeal. He may not now come before

the agency and challenge the propriety of the Division orders, findings and mandates in that decision.

Once a party is given notice of a proceeding and fails to appear at that proceeding or fails to timely challenge the results, that party may not later question those results.

The focus of Hartman's Application is the contention that the Statutory Unitization Act incorporates a special type of nonconsent provision into the private contracts agreed to by his predecessors back in 1973. Hartman is not satisfied with the payment provisions of the operating agreement which were found to be fair, just and reasonable by the Division in 1980.

From Hartman's perspective, what the operating agreement is missing is a provision that allows him to take advantage of projects that are successful, but also to avoid the risk associated with other projects in the unit. Hartman wants the right to wait for three years to see if a project will be successful and refuse to pay the costs of those projects which do not satisfy his expectations.

In short, Hartman wants the Division to find that the unit operating agreement contains a different paying provision than it does. Such a request, gentlemen, is simply not within the jurisdiction of the Division.

Hartman and his predecessors agreed to the terms

of the operating agreement. He is bound by their action. The Division has found those terms to be just and reasonable.

Hartman now seeks to reopen, rewrite those terms, 24 years after his predecessor agreed to those terms, 17 years after the Division passed on those terms and his predecessors ratified them, and three years after Hartman passed on the opportunity to question the waterflood project.

The Division must not reward Hartman for his lack of diligence. His Application must be dismissed.

With the exception of one issue that I will describe for you in a moment, Hartman has not properly pled that issue, but all other issues raised by Hartman must be dismissed simply as an effort by Hartman to create a partial defense to the fact that he is indebted to OXY as unit operator for more than $700,000, and he won't pay his debt.

We have some displays, Mr. Examiner, that I would like to show you that illustrate the chronology of activity in the unit so that you can place in context some of the factual components upon which the Motion to Dismiss is founded, and if you desire me to continue, I'd like to begin to do that at this time.

(Off the record)

EXAMINER STOGNER: Please continue, Mr. Kellahin.

MR. KELLAHIN: I want to attempt to take you through some of the basic factual components. We have provided a complete recitation of the relevant facts in the first portion of our Reply to the Motion in Support of the Motion to Dismiss. You'll find those on pages 2 through 18 of the document that was filed this morning, this one. It provides a complete factual summary.

We have provided in that fashion because we have substantial disagreement with what Hartman characterizes to be his statement of undisputed facts.

In fact, a great many of those statements are disputed.

Do you have a copy of this, Mr. Examiner?

EXAMINER STOGNER: You're referring to the Reply, as opposed to the list of exhibits?

MR. KELLAHIN: Yes, sir.

EXAMINER STOGNER: Yes, I do have that.

MR. KELLAHIN: The first display that we have before you, Mr. Examiner, that's -- there's a large copy of it here on the easel, and then there's a -- I've distributed a series of smaller copies of the display.

These are marked for the record as a continuation of the numbering sequence in which we've already filed our exhibits in support of the Motion, and this starts with

Number 46.

You can see on the display that there is a red-dashed outline. That red-dashed outline was the 1973-proposed unit area. It had something slightly in excess of 9900 acres.

In addition, there's a small footnote that shows there's a well status as of December of 1973, and that is the starting point of the unit. This is when Skelly in 1973 is beginning to formulate a voluntary unit among the interest owners that held these interests at that time.

We've given you some tract numbers; you see the numbers in circles. Those will correspond to the identification of tracts under the unit agreements, and it gives you an illustration, then, of how to walk your way through the different tracts, should you decide to do so.

Mr. Hartman contends in his pleadings that the 1980 statutory unitization order changed the boundary, changed the parties, and subtracted acreage. Simply not true.

What he has failed to realize, and what we are here to demonstrate for you, is that in 1994 the acreage is voluntarily reduced to 9000 acres, and you know why. You can see the yellow tracts. They're simply tracts for which there could not get voluntary agreement. Those interest owners would not commit to the unit, so they represented

windows in the original unit outline. They are excluded.

You can see how the exhibit is constructed. There is the red-dashed outline, and you can see all the yellow tracts that are not committed are either outside the boundary, or remain windows in the unit.

Again, we've shown the same well count from December of 1973. The acreage is now down to just slightly over 9000 acres.

All right, Exhibit 48. Exhibit 48 is the proposed Skelly 80-acre fivespot waterflood plan. This is what they were discussing in 1973 when they came before the Commission to talk about secondary recovery. This is the proposed plan. You can see how the pattern is distributed in the unit.

Now, this was the plan, it was the concept. It was not fully executed, but this was the general configuration of the plan.

Again, the well count has not changed on this exhibit; we're still using the December, 1973, plan.

All right. We come to 1976. This is still pre-1980 statutory unitization activity. In 1976, the voluntary commitment of tracts by the interest owners is increased. We pick up 300 acres. And you see why, it's obvious. Tract 50, which is in pink, is incorporated voluntarily into the unit in 1976.

And this is the way that unit has been since 1976. The boundary hasn't changed, the tracts haven't changed, it has not changed.

We get to Exhibit 50. This is the status of the unit in 1980 when Getty is coming before the Commission for statutory unitization.

You can see the coding. It's the conventional coding that we normally display before you. You can see what wells are converted to injection, you can see the new wells.

This is what was occurring in the statutory unitization time frame within the unit.

All right, Rick, let's go to the next one.

Fifty-one. The time frame for this is 1986. We've jumped ahead. Texaco is now the unit operator. And Texaco initiates a pilot 40-acre fivespot plan. The concept is to test the feasibility of reducing the injection patterns from 80-acre fivespot to 40-acre fivespot, and you can see where they were testing the concept. All right.

Fifty-two, we're jumping ahead to the 1994 hearing. This is the 1994 hearing where OXY is the operator at this time. And based upon the initial successes of Texaco, based upon the 1991 Sirgo-generated Scott Hickman reservoir study which encouraged and

advocated the downspacing of the waterflood pattern, this is what OXY came to the Division to hear, this is the case you heard. Examiner Stogner, this is what we presented to you in 1994.

You can see within the unit area, the area shaded in yellow, we're looking at 760 acres. And it's a pilot project to do several things.

It's a project to get the EOR tax credit for the enhanced oil recovery portion of the project; it's an application to ask you to specifically approve 16 new injection wells, subject to an 800-p.s.i. surface pressure limitation; and to provide appropriate approval pursuant to the underground injection control rules.

The last display shows you the well count in June of 1997, and it tracks by color code the various injection orders that this Division has approved for use in the unit.

The Hartman filings leave the misimpression that there is one pressure limit on these wells. In fact, that's not right. You can see by color code what's occurred here.

In 1973, when Order R-4680 was issued -- you can see the wells in blue -- there's no injection limit on those wells, and none of the orders since then have changed the limit on the blue wells. There are no surface pressure limitation on those wells.

In 1994, when we came before you for approval of the 16 new injection wells, you specifically excluded changing the pressure on any of the blue wells that were controlled by R-4680.

So you issued 4680-A, and the wells in pink have a surface injection pressure limitation of 1800 pounds.

There is discussion in the various filings about an administrative injection order. It is WFX-460. Those wells have a different pressure limitation. You can see where they're scattered. They have a 900-p.s.i. injection pressure limitation.

You can see that certain of those wells, subject to the administrative order, were changed by step-rate test, and they are color-coded differently.

And then finally there are some isolated examples where there were further administrative orders changing specifically -- or authorize injection specifically as to two wells.

We have identified for you in the blue tract, that box -- that represents the Myers 30 well which Hartman claims is subject to some kind of water infiltration, and that's where it's located so you can see where it is in the unit.

When you look at the documents in 1973 -- we're looking at the operating agreements and the unit agreements

in 1973 that were submitted for the original approval of the unit -- you're going to see some provisions in the unit operating agreement that the parties are examining.

There is a Section 11.5. It provides that under that provision the unit operator may collect, from a party who is not paying his bills, the opportunity to take his share of production. And you'll see that it's without prejudice to any other existing remedies.

You're going to find, when you look at the documentation, there are nonpayment of joint-interest billing remedies, for example, where a working interest owner fails to pay his bills. The unit operating agreement provides the operator with three options. You've got the option to bring suit to collect on the unpaid expenses, with or without foreclosure, you've got a second option, which we outline in the memorandum, to net out or net-bill his indebtedness, keep his share of production in the unit, and yet not as your exclusive remedy. You can go get his deficiency with other recourse.

And then finally, three, the operator can foreclose on the interest and he loses his entire interest in the unit.

Additionally, you'll find that Article 17 allows the operator under the operating agreement -- allows any working interest owner in the operating agreement to simply

withdraw from the agreement. He gets to the point in time where he doesn't want to participate anymore, he simply surrenders his interest.

Let me show you what we're requesting.

Let's start with the 1994 orders. OXY is asking you to declare Hartman's Application to be an inappropriate collateral attack on a valid and final order issued in 1994.

OXY is asking you to find that Hartman had adequate notice of the 1994 hearing, which had involved a request by OXY for approval of these 16 injection wells within a limited area of the unit, an order of reduction in the water injection pattern to 40 acres, and to approve the tax credit.

OXY is asking you to find that Hartman had the opportunity in the 1994 hearing where he could have raised issues he is now asserting. He could have raised them then, but not now. His allegation that the 1994 project was an amendment of the statutory unitization order.

He could have raised then, but not now, his allegation that OXY failed to comply with the Act.

He could have raised then, but not now, his allegation that the 1994 project amounted to an improper redevelopment of a waterflood project.

He could have raised then, but not now, his

allegation that the Division should not have approved the 1800-p.s.i. surface pressure limitation on these 16 new injection wells.

OXY is asking you to find that Hartman failed to exhaust his administrative remedies and waited too long to raise these issues. It's too late, and he's in default.

Mr. Hartman is in default because of his past involvement and actions in the unit. He's demonstrated that in 1980, that was the time to raise these issues.

In May and again in June of 1991 he filed application seeking to enjoin Sirgo from replacing Texaco as the operator of the unit, contending the same basic issues that he's now asserting against OXY. He's an active player in this unit. He acquired his interest in 1986 and he's been actively involved, he's watching what's going on.

Sirgo files a report with the Division in 1991 that the operator usually files. Mr. Hartman was quick at the trigger. He was here to file his objections. He knows what's going on.

In April of 1994, OXY provided Hartman with an AFE about changing the injection pattern, which is based in part on the success of Texaco in the Scott Hickman study.

In August and September Hartman and OXY are exchanging correspondence. Mr. Hartman doesn't like the project, and he wants to swap out acreage.

In November of 1994, OXY filed for approval with the Division this EOR application. We sent a copy of the Application to Mr. Hartman. It details that link, the scope and the purpose of the request. It's one of the documents in the exhibit book. You can read that and see that it's full and complete notice to him of what we're about to ask. He doesn't like that project. Here we are asking for approval of that project, and he doesn't come.

He knew about the project, he knew about the Division hearing. He could have appeared to raise these issues about statutory unitization, about the project, about the surface injection pressure limitation, and he chose to default.

The Division approved the project, he gave up his opportunity to complain, and that was the time to contend that the Division and OXY had somehow not handled properly the statutory unitization of involuntarily committed interest owners who had a royalty position in certain tracts in 1980.

But not now, not after the Division had approved the project, not after the necessary working interest owner approval, not after OXY spent the money, and not after he got to see the results.

OXY is asking you to find that Section 70-7-9 of the Act, which deals with amending unit plans, was not

applicable to the 1994 project. That's one of Mr. Hartman's contentions. We're asking you to find that Section 9 out of the Act doesn't apply. There was no change in the boundary of the unit, no change in the working parties, their percentages, no change in the royalty parties or their percentages, no change in the participation formula or the parameters.

I've already described for you what that application was about. That, if you'll look at your past history, is how we have handled amendments of the waterflood orders. They had been amended without requiring amendments of the statutory unitization orders that may apply to that unit.

If you say that it is an amendment of the statutory unitization orders in this case, then you put at risk all other statutory unitization orders where the working interest owners change the injection pattern, institute other changes in technology to increase secondary oil recovery or to convert the project to CO_2 injection.

If you do what Mr. Hartman asks you to do, you're going to be in direct conflict with your decision in the Phillips case. Order R-6856-B is the Phillips statutory unit. That unit was in place, and we have repeatedly modified and amended their waterflood orders without disturbing the unitization, the statutory unitization

orders. And why? Because we've correctly interpreted, and you have found, that those aren't amendments pursuant to 70-7-9.

Let's look at the 1980 statutory unitization case.

OXY asked you to find that Hartman's predecessors, and therefore Hartman, were not parties who were forced into this unit by the 1980 statutory unitization order. You don't have to talk to Mr. Carr, you don't have to talk to anybody. You can read the order, read the transcript, look at the testimony and see what was done.

That case dealt with the statutory unitization of certain royalty interests who had never voluntarily committed. It did not deal with committing working interest owners who had not failed to commit.

And you see what the interest, the 1980 order, specifically does not amend the 1973 contracts. You can look at Mr. Wood's testimony in the transcript. He specifically testifies that he's not changing the boundaries, and he's not changing these contracts.

Mr. Hartman's position is that the Act mandates a special type of nonconsent carried-interest provision which limits the debt-collection remedies in this 1973 contract and provides the nonconsenting working interest owner with

a perpetual and exclusive -- Exclusive is the trigger here.

He says it's exclusive and that he gets to decide what happens, and if he decides that exclusive language in this contract it limits the operator right to collect for nonconsenting working interest owner share, and it limits it only to future production, despite the fact that the 1973 contracts approved by the Division in 1980 found that a different nonexclusive limited carrying provision was fair, reasonable and just and that it, in fact, complied with the Act.

Unfortunately for Mr. Hartman, he's wrong. He's adding language to the Act which is not there. He's asking you to attack the 1980 orders and reinterpret and rewrite the contracts.

Mr. Hartman's predecessors had the opportunity to raise those issues. The 1980 order was ratified by the working interest owners from whom Mr. Hartman obtained his interest. The 1980 order entered, Mr. Nutter and the people involved on staff and with the Commission examined the 1973 operating agreement and found that they were just and reasonable. They didn't require any additional terms be written into the contract.

We're focusing on 70-7-7F, the 7F provision. We've dealt with this before. You can look at this case and the other statutory unitization cases, and it reveals

that the statute merely requires that the Division find that the approved unit operating agreement contain carrying provisions which are just and reasonable.

The Act does not mandate -- 7F does not mandate any particular type of carried interest. The 1980 order found that provision to be just and reasonable, and Hartman is not now entitled to anything more than the contract the order the statute provides.

Mr. Hartman is arguing that the Division's finding that the 1973 operating agreement's paying terms are just unreasonable is only valid if an unqualified carried-interest provision with a nonconsent provision and no other recourse is accepted. That's not what they did.

I've forgot exactly where the Statutory Unitization Act is in the filings, and it might be helpful just to have a copy of it.

Hartman is wrong because the 1980 statutory unitization of these certain royalty owners makes this nonconsent debate meaningless. We were unitizing the royalty owners, and by his own admission Hartman is not in that category. They ratified and joined all these agreements.

I'll ask you to take time to review your decisions in the Marathon *Tamano* case -- it's cited in the materials -- Pelto's *Twin Lake Unit* case, other cases we've

analyzed in the memorandum, and to remember how the nonconsent provisions of 7F have been interpreted to be applicable by the agency.

The nonconsent election described in 7F of the Act has been specifically held by this agency to apply only to working interest owners who failed to initially commit their interest to the unit. And you've correctly analyzed that issue.

What you're doing is right. What was done here is right. We have by analogy, and you have by discussions on the record in these cases, made the connection between compulsory pooling and forcing people into a unit.

In the force-pooling situation, we're going after specific working interest owners who won't commit. Everybody else signs a voluntary agreement. That voluntary agreement has all kinds of additional nonconsent provisions, other provisions, lots of things. Those people are committed under those agreements.

There are people that won't join. They're forced in by the police powers of the State of New Mexico, and you're exercising that opportunity to make the project successful. And we treat them differently, because if they're forced in by the State powers of New Mexico, their liability ought to be limited to their share of production from that well without recourse to their assets in other

places, while the people that have committed to the agreements can't simply bail out on the way down; they can't leave somebody holding the bag for the cost of the well. So you have two different categories.

That same analogy, that same rationale, applies to the unit concept, where we're dealing with the forced unitization of certain interest owners.

When you look at 7F, it doesn't specifically specify the kind of provision, this unique provision Mr. Hartman wants applied. It simply leaves the option open to the contracting parties to draft one of more of these carrying provisions. It could be any kind of way. Williams and Meyers says these carried interests doesn't specifically define a certain type of agreement, but simply serves as a guide in preparation of documents.

We ask you, sir, to find that the Act does not mandate the type of carried-interest provision Hartman wants. OXY asks you to find that Order R-6447 did not prescribe the type of carried-interest provision Hartman wants. OXY asks you to affirm your prior interpretations in the Pelto case and others that 7F means any working interest owner who fails to contractually join the unit is to be carried on a nonconsent basis which the Division finds to be fair and reasonable.

Look at the way 7F is constructed. It says you

can find it in the documents or you can prescribe it in the order. Look at 7F. It doesn't mandate a particular type of carried-interest provision.

We've got a number of cases cited where you take 7F and you direct it right at the category of working interest owners where you need to compel them into the unit, and you do so on terms that are consistent with force pooling.

If you mandate, as Hartman suggests that you should, this special, exclusive carrying provision with this nonconsent component, you're going to create havoc with what we're doing in these units.

Let me illustrate for you the practical problem of his point of view.

Assume that OXY has 50 percent of a proposed waterflood unit, Texaco has 40 percent, Yates has 10 percent. OXY and Texaco agree and voluntarily sign a unit agreement which provides either you pay your share of unit expenses. Even if the unit ultimately is only marginally successful, and even if the remaining production is not sufficient to ultimately pay all the unit costs, you're on the hook for the balance. And if you don't, your other choice is simply to surrender your tracts to the unit and get out of the unit. That's the deal between Texaco and OXY.

Yates has 10 percent, and they refuse to commit, and they're forced into the unit by statutory unitization order. Well, what are going to be the limits on Yates's financial exposure? They're not in for the long ride. If they don't commit, all they forfeit is their share of future production. We treat them that way because that's fair to let them off the hook and not take nonunit assets to pay a debt that they didn't want to commit to initially. But once you're in, you've got to stay in for the ride.

What happens to Texaco if they now, having voluntarily committed, want to recharacterize their position and take advantage of what Yates was allowed to do? Are you going to let Texaco, late in the life of one these projects, after they made the expenditure of the initial investment, to simply say, Well, king's X. I realize that we've got a big AFE here to do something else in the unit. I'm forecasting I may not have enough unit production to pay for those costs. I want the Yates solution, I want out.

And so are you going to let everybody out of these units late in the life? Who's going to be around to pay the bills?

Are you going to change the contracts that these parties signed committing to pay those costs? You haven't up to now, and I see no reason to start that in the future.

OXY asks you to find that the Division, 17 years after the fact, is not going to modify the 1973 contracts.

Mr. Hartman, as I've described, wants to use this re-interpretation of this prior unitization order so that he has a partial defense for his failure to pay his bill.

Even though the statute does not require, the agreements do not provide and the Division did not find such a provision, Hartman now seeks to have you read that provision into these agreements.

At some point these orders must be final, and these orders are final. They are final as to Hartman. And Hartman is not in the position to attack these orders.

The one issue that I suggest to you survives: Hartman has raised the contention that water he says was found in the Yates formation must have come from the unit's injection project, and so he attacks the 1994 order and asks that you set it aside.

Mr. Stogner, it does not matter to you, sir, if the pressure approved in 1994 is 300 p.s.i. or 300,000 p.s.i. If there's substantial evidence of water infiltration into another formation, which is proven capable of producing recoverable hydrocarbons, will be adversely affected, and if that infiltration is caused by a waterflood injection fluid moving into another formation, then you must take appropriate action.

But you don't go back and re-litigate your 1994 order. You don't go back and open that up and take it apart and re-examine it. You move forward.

And so I am suggesting to you, sir, that you dismiss Mr. Hartman's attempt to set aside this valid and final injection order and instead you docket a case in this fashion. We suggest that it be phrased this way:

> The Division on its own motion, in order to determine appropriate action, if any, hereby requires Hartman to appear and show cause that water being injected into the Langlie Mattix Pool by OXY-operated Myers Langlie-Mattix waterflood project pursuant to Division-authorized injection has migrated into the Yates formation and has caused recoverable gas reserves in the Yates formation to be wasted which would otherwise have been produced by Hartman's Myers "B" Federal Well Number 30.

That's what we need to do in this case. We need to not spend our time examining orders that are final. We ought to focus on our attention on those matters that are relevant today, and there's no reason to give anyone the opportunity in Mr. Hartman's position to relitigate final orders.

And with the exception of that one water issue, all this is is an effort by Hartman to create a partial defense to the fact that he's indebted to OXY.

Let's dismiss this Application.

Thank you.

(Off the record)

EXAMINER STOGNER: Mr. Condon?

MR. CONDON: Yes, sir. Yes, Mr. Gallegos was going to begin the response. We're going to bifurcate it. Mr. Gallegos is going to deal with issues related to Order R-6447, and I'll deal with the issues related to R-6488.

EXAMINER STOGNER: Okay, Mr. Gallegos?

MR. GALLEGOS: Let me, if I may provide some materials so that we can follow along here. It's not as imposing at looks.

This is a set for the reporter.

I've provided opposing counsel with copies of that notebook earlier today.

MR. KELLAHIN: If it is appropriate, Mr. Examiner, I have an objection to one of the exhibits that Hartman has filed in support of his position.

EXAMINER STOGNER: Is that included in this green book at this time?

MR. KELLAHIN: Yes, sir.

MR. CARROLL: What exhibit is that?

MR. KELLAHIN: It's found behind Exhibit Tab 23. It's the affidavit of Craig W. Van Kirk.

MR. GALLEGOS: Well, why don't we deal with that when we come to that?

MR. CARROLL: Yeah, we will.

MR. KELLAHIN: All right.

MR. GALLEGOS: I think maybe if it's put in context, maybe Mr. Kellahin won't be quite as excited about it.

Let me begin by referring back to old experiences that I couldn't help but think about today.

The first week or two of law school in moot court, or if you've ever been in debate, one of the things that you're told early on is, don't use a straw-man argument; it's a dead giveaway. It tells everybody that your case is no good.

What we have heard today almost totally is a classic straw-man argument, stated in six, ten, twelve different ways by Counsel in an effort to take this Examiner, take this Commission away from what Hartman is really asking.

We have heard that -- then, not now; collateral attack; it's too late; the orders are final. Everything but the merits.

The fact of the matter is, when you look through

that attempt at distraction, we are here, Doyle Hartman is here, for enforcement -- for enforcement -- of Order 6447 and for enforcement of the New Mexico Statutory Unitization Act. It is enforcement of the law and enforcement of the Commission order that we ask, because both are being violated.

Indeed, this operator, OXY, is thumbing its nose at the Commission orders and the law. And in the argument that you've just heard, there has been almost -- in the total time of the argument, almost no reference to the law or to the provisions of Order 6447. And when it was referred to, it was only by a characterization and not with a look at the actual wording of the order and, in fact, a multitude of statutory unitization orders, and not with a look at the actual wording of the law.

Mr. Examiner, we're going to take you to those words and to what has really gone on here and address the real merits, because Hartman stands for enforcement. It is OXY who is trying to avoid that.

And let me set the scene by telling you as succinctly as I can what our position is and what should be the position of this Commission.

Number one, this Commission is a creature of statute. When the Legislature delegates the police powers of this sovereign state to the Commission, it does and it

must do so, setting forth certain conditions and standards. Otherwise, that delegation is unconstitutional.

The Commission orders on the -- some 38 or 40 statutory unitization cases that this body has heard -- we submit that the Commission orders have attempted, by the wording of those orders, to recognize the conditions placed by the Legislature on the use of that police power.

Thirdly, we say that the standards or conditions that are stated in the law and that are stated in your orders have the force and effect of becoming the terms and conditions that govern the unit operations, whether or not the wording of a private agreement contains those same terms.

It should come as no surprise that a Commission order and the statute is entitled to force, and it is entitled to govern the rights of the parties above a private-agreement term and, indeed, above a letter of transmittal from counsel, which has been the linchpin of the argument about this is a fish-and-fowl unit, partially unitized.

But if there is any concern, if one has any concern about the imposition of terms and conditions by reason of the Commission orders on operators and nonoperators, comfort is provided because in the enactment of this statute, the Legislature has required that after

the Commission enters an order and says, Here's statutory unitization, you can have your statutory unit and we can force in parties for you, but it's under these terms and conditions, and your unit operating agreement has to provide the following, here's the order; there is then a ratification and approval procedure which has not been mentioned at all by OXY, a procedure which then distributes the order and says, Now, you interest owners, if you want to go forward under these terms and under these conditions and these provisions, we have to have 75 percent of the cost-bearing interests and 75 percent, at least, of the non-cost-bearing interests ratified.

"Ratify", the definition of "ratify" in the law, is to adopt, to say "that is mine, I embrace it, I agree to it." That's what "ratification" means. And we have that, of course, in the case of the Myers Langlie-Mattix Unit.

And finally we are here to tell you -- and what we've said so far, I think, is very fundamental -- and we're here to make one more point that I think anybody in the industry in the last 40 years would have considered settled and beyond argument, and that is that a party who has the right to be carried, who elects to be nonconsent and be carried, cannot be sued.

To be carried, and instead to be sued and have a judgment enforced in court, are two mutually exclusive

statuses, mutually exclusive conditions. To carry someone is to bear their share of the expense and to recover that by receiving their share of the revenue from the production which would otherwise be allocated to them. That, by definition, is what "nonconsent" and "carried" means.

And we are hearing today of, I submit to you, animals that have never been known to the oil and gas industry. One is a unit that is partially statutory; certain people who haven't committed, they are statutorily unitized and others are not. I have looked in every treatise, every source of law, and you will find voluntary units and you will find statutory units, but you won't find a mix, a hybrid.

And by the same token, it is well settled, the industry knows, this Commission knows, what it is when you're in a nonconsent position. And to come in and say, Well, we have a certain carried-interest provision but it's a carried -- We carry you, but we can drop-kick you, we can take you to court and sue you. That's the 180-degrees antithesis of being carried.

What we have, to try and help set the scene, because it -- To me, it became a very interesting issue. To tell you the truth, I was at first -- I thought it was humorous, and then afterwards I thought, well, this is an interesting idea, when I read the Motion to Dismiss of OXY,

this idea that only a few noncommitted interests were statutorily unitized and everybody else was not. It really raised my curiosity as to the whole process that's gone on here and what has happened before this Commission and what's happened in the law.

If you take out this spreadsheet, I'll go through it quickly, and then we have some tabs that underlie the information that's shown here.

I start out on the left by pointing out that pre-1970 there were -- actually, there were 28 states, at that time, that had statutory unitization acts. New Mexico was a come-lately in 1975 when it adopted its Act.

And at that time there were the states that I've shown on the left that had, within their statutory unitization laws, provisions that read substantially the same as 70-7-7. In fact, Kansas reads almost word for word exactly like our Act. And there was one difference, and that's Montana, where there's proof that if the legislature wants to provide that the carried election applies only to those who are not cooperative and who don't join, they can say that in their statute. Ours does not say that, of course, nor do the ones that are listed above Montana.

It's also interesting that there was a -- The American Petroleum Institute, in 1970, came out with a model unit operating agreement, not a statutory unit, but

just a model unit operating agreement. And I have that under Tab 1. And basically what it does is, it provides in Article 11 for the right to bring suit. There is -- If you don't pay, if the working interest owner doesn't pay, the operator can bring suit. That's at page 12.

I actually found later, after I prepared this form, that there was a 1961 model form of unit operating agreement, not statutory unit but just unit operating agreement, which has the exact language. This is close, the 1970 form, and it's used in many of your cases here, Mr. Stogner. But the 1961 agreement is the one that OXY came in with later in 1973.

So you have these old agreements that were designed for use for voluntary units, not statutory units, and it provides certain procedures for budgets and billing and so forth and that the operator can bring suit.

Now, in 1973 Skelly comes forward with the Myers Langlie-Mattix Unit. There are two applications, two proceedings. Repeatedly, OXY here in this proceeding and in its papers has said that in 1973 the Commission approved the unit agreement and the unit operating agreement. That is wrong. The unit operating agreement was never addressed in either of the cases that came before this Commission, 5086 and 5089, in 1973.

At Tab 2 you find Order 4660, which addresses

only the unit agreement, very briefly, and says that, "provided however, that notwithstanding any of the provisions contained in said unit agreement, this approval shall not be considered as waiving or relinquishing, in any manner, any right, duty, or obligation which is now or may hereafter be, vested in the Commission to supervise and control operations for the exploration and development of any lands committed to the unit and production of oil or gas therefrom."

Nothing concerning the unit operating agreement. And, by the way, nothing in our oil and gas law at that time that provided that the Commission had any authority to approve unit agreements or unit operating agreements. There were a number of statutes in effect, and I cite this later, where the law of the state did provide that. Ours was silent in that regard.

And then of course Order 4680, Mr. Examiner, is a typical order under C-108 application as allowing a waterflood to go forward, allowing waterflooding to take place.

In 1974 the American Petroleum Institute came out with a model unit operating agreement for statutory units, for statutory unitization. That's at Tab 4. This is an interesting document. It seems to have not been very appealing to the operators who came forward later in New

Mexico for use in spite of what our law provided.

But this form of agreement, when you go over to Article 11, which is designed for statutory units, at page 12, provides in Section 11.5 nothing concerning the right to bring suit, there is no right to sue. And Footnote 4 in 11.5 tells the user that certain language should be inserted in those states where a working interest owner elects to be carried or otherwise financed.

And later, on page 13, in Section 11.6, Footnote 3, the same thing. Colorado, Kansas -- And by the way as I've said before, Kansas's statute, very similar to ours, to the credit of Mr. Carr, who I understand worked on the drafting of the statute. No bringing-of-suit wording in this agreement, which was a model of the API to be used for statutory unitization, and, in fact, the direction to insert specific wording if your particular statute in your jurisdiction provided for working interests having the right to be carried.

In 1975 our Statutory Unitization Act came into being. It was Chapter 65, 16-14-1 back in those days. It's been recodified.

In 1976, the first statutory unitization case came on before this agency under the Statutory Unitization Act of New Mexico. The operator and applicant, Burke Royalty Company, presented the 1970 form unit operating

agreement, the old form that provided the right to sue.

Tab 6 reveals the order that was entered by the Commission. The file shows that the Examiner in that case was Mr. Stamets, the Commission counsel was Mr. Carr. It would be interesting to be able to ask some questions of Mr. Carr about this case. But it seems that the pattern was set by that first order.

If one reads it -- and you probably don't want to take the time now -- the order took issue and was not satisfied with the participation formula that was contained in the unitization agreement, and established a differing formula.

The order, when it came to the question of the unit agreements, on page 6 at paragraph 12 -- bearing in mind, this is an applicant who's come forward with the old 1970 form, right to bring suit, no right to be carried, and the order says, "...the Double L Queen Unit Agreement and the Double L Queen Unit Operating Agreement, amended in accordance herewith, provide for unitization and unit operation of the subject portion of the Double L Queen Pool upon terms and conditions that are fair, reasonable and equitable and include:..."

And then you read the subparagraphs on page 7, which are essentially right out of Section 70-7-7 of the statute, including, of course, a provision for carrying any

working interest owner.

That became the pattern, Mr. Examiner, really from that time forward. And there's a few, very few, exceptions. Some of those that are noteworthy we'll bring to your attention. But that became the pattern. It went on and on with agreements that did not provide anything regarding a nonconsent or a carried interest, or not -- certainly not the carried interest specified by the statute, but the order adopting the language of the Act.

In 1980, along came the Getty case in 6987, which I'll refer to in more detail under the second tab in this notebook. It was the sixth case that had come before this Commission after the Act had come in.

An interesting case came before the Commission in 1982. It's the Travis Penn Unit case, brought by Yates Drilling Company. George Yates, represented by Bob Strand, testified. And at Tab 7 we'll find the testimony. Mr. Pearce by then was counsel for the Commission. You'll see at page 3, George Yates, the president of Harvey E. Yates Company, was testifying.

And a discussion starts under the questioning of his own counsel at page 10 where the question is asked:

Mr. Yates, in the original unit operating agreement, which is Exhibit Number Two, there was no

provision in there for non-consent operations. Was this at the request of the interest owners at the meeting in February?

ANSWER: It was. At that time, as I said, we had unanimous support of the group with the unit...

Let me interrupt to say, unanimous support. This wasn't a question here of anybody not being committed.

...We didn't anticipate any non-consent operations.

QUESTION: Mr. Yates, it's my understanding under the statutory unitization provisions of New Mexico law that if any order is entered in this matter it will be required that a -- that provisions be included in that order relating to the recovery of costs from parties who do not consent to operations under the unit and also a provision relating to the interest of such parties being assigned as to the other parties until such costs are recovered.

Do you have any recommendations for the Division as to non-consent provisions for additional drilling on the unit and any penalties or additional charges for operating as to non-consent owners?

He goes on to recommend a nonconsent provision,

and that it's a "300/100-percent nonconsent provision for additional drilling."

Under cross-examination, Mr. Stamets, at page 13, starts with Mr. Yates on the same subject. I won't read all of that, but think it's interesting on page 14 where Mr. Stamets asks Mr. Yates, "Okay, now the law does require that we have a provision in the order..." -- and you note, "in the order" -- "...for carrying any working interest owner limited, carried, or net profits basis payable at production upon such terms and conditions determined by the Division to be just and reasonable and allowing appropriate charged interest for such service payable out of the owner's share of production.

"What would that interest rate be?"

And they go on a discussion of an appropriate interest rate.

Now, the order in that case, Order R-6947, notes two things that I think are of interest here, or two or three things that are of interest.

First of all, in the Travis Penn case, very much like the Myers Langlie-Mattix case, Travis Penn was already a pre-existing unit. There had already been orders of the Commission entered before this application for statutory unitization that had approved the unit agreement and that had approved flooding activity. So this is an existing

unit, people have already been in voluntarily.

The order recognizes -- at page 3 it starts with the usual pattern of fair, reasonable and equitable provisions. But then it says, "the Travis Penn Unit Agreement and the Travis Penn Unit Operating Agreement do not contain provisions for carrying any working interest owner on a limited, carried or net profits basis." Paragraph 18, page 4.

Paragraph 19, "That the unit operation should be subject to such provisions as set out on Exhibit 'A' attached to this Order." And attached to the order is a provision that looks very much, and I think will sound very much to the Examiner like provision from your joint operating -- common joint operating agreement language that provides for nonconsent for subsequent -- or for operations of less than all working interest owners.

You have there the parties recognizing that unit operating agreements must contain carried interest provisions recognized by the applicant, recognized by his attorney, recognized by the Commission.

Now, down the line you will have a number of cases where the applicant and, indeed, the applicant's counsel, have not called out to the Examiner's attention the provisions of the unit operating or the lack of the provisions that conform to the statute.

I would suggest to you that if there is any unclarity, any room for argument because of that, it's because the Examiners of this Commission have been disserved by the applicants and their representatives in many instances where they simply said, Well, we have a unit agreement, unit operating agreement, it conforms to the statute, there it is, and it goes on.

But be that as it may, the orders that create the unit have invariably recited the carried interest provision, and thereby that becomes part and parcel of the unit operation and the unit plan.

Another case that's interesting, and I don't want to take too much time with it, another case that's interesting is the one in 1987. It's the Twin Lakes San Andres case. Pelto Oil came forward. It probably will bring some memories back to Examiner Stogner. It was the first case after 70-7F was amended to provide a 200-percent penalty in the case of nonconsent owners.

And in that case, indeed, there was some discussion in the transcript, and Mr. Bruce, representing the Applicant, wrote to Examiner Stogner -- that letter appears at Tab 11 -- in which he suggests that an Oklahoma case might be of assistance to the Examiner, because they have been applying the penalty provision for some time.

He does say in his letter, in contrasting it with

what the Oklahoma order provided that, quote, "One difference is that the Oklahoma case provides for penalties throughout the period of unit operations, whereas Pelto Oil Company only requests a penalty with respect to initial unit outlays," end quote.

And essentially, that's what came forward in the order, where the order at Paragraph 18, page 4, set forth the standard provision reciting that the unit agreement would have a provision for carrying any working interest owner and so forth, and then providing that uncommitted owners would be subject to a 200-percent penalty.

I can't note that particular order without observing what I would call the reverse logic that you're hearing from Oxy in this case. That is to say, in the Twin Lakes case you have a situation that says, We're going to come down harder on the people who didn't cooperate. In other words, if you didn't sign up, if you didn't cooperate, you're subject to the 200-percent penalty.

The irony here is that OXY says if you didn't cooperate, the people we had to statutorily unitize, they get the right to go nonconsent. The folks who cooperated and signed up, they can never go nonconsent, no matter what we propose, no matter how foolish or imprudent we want to make a capital investment or operate this unit, they can never go nonconsent. But the guys who didn't come along

with us, they can. Essentially the opposite of what was done in the Twin Lakes case.

And finally, the Central Corbin Queen case is a case brought by OXY. And I thought what was interesting there, and I think you might want to look at, is that the unit operating agreement that OXY presented in that case in 1990 follows a format -- If you look back at 1984, the first case I saw that form of agreement pop up was back in the old Eunice Monument case.

But the unit operating agreement in OXY's Corbin Queen case has a provision that you begin to see in a number of other cases. And the language there is under Tab 13 -- No, actually that particular language of Section 39, if you refer back to Tab 9, if you -- Tab 9 shows this format, what I call the Section 39 language, unit operating agreement. It's at page -- It's not copied too clearly but I think that's page 18. Anyway, Section 39.

What this provision says, and it's over -- OXY presented it to the Commission in its behalf in the Corbin Queen case. What this provision says is essentially this: We operators have gone through these things and we've had to go out and we've had to sign up people in some of these units with thousands of acres. We've got hundreds of working interest owners and hundreds if not thousands of royalty owners. We come in for statutory unitization, we

get an order of statutory unitization, and then we have to go back out and go through that process all over again. It's costly, it's time-consuming, it holds us up.

And what they wrote into this document, it says we only have to do it once and that everybody, when they sign up and sign the agreement, they recognize that this agreement -- and I quote the language -- "This Agreement and/or the Unit Operating Agreement shall be amended in any and all respects necessary to conform to the Division's order approving statutory unitization."

So what had happened in the past, and what happened in the Myers Langlie-Mattix case is, to accomplish that amendment of the private contract documents, they had to go out and get the ratifications. Now they are saying, and OXY itself using a form that says, instead of going to all that trouble, when you sign up you're saying that when the Commission enters orders and provides certain terms and conditions, we already deem our agreements amended to conform to those orders, and you don't have to go get the ratifications.

The hearing transcript in that case, portions of it are attached because it's interesting to see that the 1974 form unit operating agreement was presented there by OXY. That's an agreement that omits, does not include, the right to sue provision. It follows the 1974 form, except

it does not incorporate the footnote requirements.

And in that particular case Examiner Stogner and Counsel Stovall took up with Mr. Kellahin and his witness the question about -- just the one we're dealing with here. Page 132, Mr. Stovall asks the witness, who I think was a Mr. Dickenson, I believe, "Is there a provision in either the Unit Agreement or the Unit Operating Agreement for carrying of nonconsenting parties? I'll preface that by saying that I didn't find one as I skimmed through it?"

The witness answers, "No, sir, there isn't. And the only reference I would make to that would be that under the Statutory Unitization Act in 70-7, provision (F) it does say that in the event you have a nonconsenting working interest party, that they could be subject to cost, 100 percent plus 200 percent..." and so forth.

Mr. Stovall goes on to say, "My interpretation of that statutory provision is that the Unit Agreement or Unit Operating Agreement needs to have that provision for carrying included in it. Would you been [*sic*] willing to amend the Agreement?"

Mr. Kellahin interjects, "No, sir." Instead of the witness being able to answer, Mr. Kellahin provides us the answer. "No, sir. Mr. Stovall, we've made the conscious decision not to seek the nonconsent provisions that apply in the statute and it's been intentionally

deleted from the operating agreement."

Mr. Stovall says, "So, in effect the nonparticipating interest would be carried at no penalty?"

Mr. Kellahin, "That's right."

And then at Tab 15 we have Order Number 9336, entered by the Commission here, and it provides the usual language, although the Commission, in spite of what Mr. Kellahin volunteered for his client, the Commission went ahead and provided that as to those parties who didn't participate in the unit, who had not agreed in writing to participate in the unit, that there would be the 200-percent penalty.

In each and every one of these orders, Mr. Examiner, invariably, there is the language -- and I just point to it on page 6 of this particular case which you heard -- and that is wording that says either verbatim or to this effect, "Since persons owning the required statutory minimum percentage of interest in the unit area have approved or ratified the Unit Agreement and the Unit Operating Agreement, the interests of all persons within the unit area..." -- that is, *all* -- "... persons within the unit area are hereby unitized whether or not such persons have approved the Unit Agreement or the Unit Operating Agreement in writing."

Now what I would like to do, and it may be an

appropriate time for a break -- what I would do next is turn to the specific instruments and documents that are in the Myers Langlie-Mattix case, in 6987 case, that are under Tab 2. But I wonder if this wouldn't be a good time for a break?

EXAMINER STOGNER: I concur. Let's take a ten-minute recess at this time.

(Thereupon, a recess was taken at 3:50 p.m.)

(The following proceedings had at 4:10 p.m.)

EXAMINER STOGNER: Mr. Gallegos?

MR. GALLEGOS: Thank you, Mr. Examiner. I'm at the second tab in the book, and what I have provided at the tabs that are numbered 17 are the key documents from the Case 6987.

I'm sure both you, Mr. Examiner, and Counsel will want to take a close look at those, and I don't want to take the time to be reading from them here. But if one looks at these documents, in many instances prepared by the applicant, then Getty, and its counsel, you will find nothing, in no wording, in no place will you find the support for this idea of, first of all, we just wanted to be a little bit unitized back in 1980. Sort of like we just wanted to be a little bit pregnant. Didn't want to have everybody statutorily unitized, everybody subject to the Act, just a few royalty owners.

The application speaks broadly in terms of statutory unitization of the entire acreage and all the mineral interests. The transcript gives no hint at any place that we don't want certain provisions called for by the statute to govern us, we don't want statutory unitization for almost everybody or those who have signed up, we only want it for it for a few. There is nothing like that. It was a well kept secret at that time.

Makes one want to echo Mr. Kellahin's words of, Why not raise it then, not now, that really all OXY, or Getty, wanted was to statutorily unitize 13 or 14 royalty interests and not affect anybody else, that really -- that it had a construction regarding what the requirements of 70-7-7 were and brought it right out at that time, laid it on the table.

If there is anything such as a collateral attack or a time to -- or an attempt to reconstruct history, it's on the part of the operator of this unit. Because there is only one piece of paper in that entire file of 6987 that lends any support whatsoever to the theory that's being advanced now, 17 years later, and that's Mr. Carr's transmittal letter on June 19th, 1980, which is at Tab 18, where he says, Well, here's our application, we seek an order unitizing certain small royalty interests, thereby enabling Getty to enter lease-line agreements and implement

operating practices which will extend the life of this unit.

And I'm not too sure that that really means anything different from, here's a statutory unitization application, but to say one of the reasons why we want unitization on a compulsory basis is because these interests are outstanding.

But there certainly was the opportunity for Getty at that time to have come forward with the theories that it now espouses in behalf of its motion. I submit to you, had it come forward and said, We don't really want to have carried interests provided by 70-7, and we really want to have this hybrid unit where we're just a little bit unitized under the statute, this Commission would have turned down the application. The Commission would have said, You're statutorily unitized, you're unitized, everybody, and if you're going to invoke the police powers of this state to get the benefits that you want, to bring in people who have not committed, to be able to yield greater revenue, make lease-line agreements, then you've got to take it the way the Legislature says the unit operations are going to be conducted. That's part of the conditions.

Nothing was said at that time that we don't want that. Only today we're to be told we're to interpret these

documents to mean something different.

One provision of the order, 6447, is on the demonstration board in front of you because it's at the provision that says, very clearly, When the persons owning the required percentage of interest have approved or ratified the Unit Agreement and Unit Operating agreement, the interests of all persons within the unit are unitized, whether or not such persons have approved the unit agreement or the unit operating agreement in writing.

At 17D we have an example of the ratification and approval, and if I might, I'm going to provide a set, because those are not -- those ratifications and approvals are not, so far as I've been able to find, in the Commission files. What you find in the Commission file in Case 6987 are exhibits back from the approval of 1973. But these were provided to the State Land Office and the Bureau of Land Management.

And it gives you some idea when you see that stack -- there's a divider in there, a colored-paper divider, that divides it between working interest owners and royalty interest owners, roughly half and half. But it's a job getting those ratifications.

At 17D you see the language of the ratification, an example. And that ratification recites that the parties, the interest owners, acknowledge "...receipt of

copies of said New Mexico Oil Conservation Commission Order Number R-6447..." And Order R-6447 recites the mandatory conditions required by Section 70-7-7, including, of course, 7F.

And it says they acknowledge "...receipt of copies of the order, the Unit Agreement and Unit Operating Agreement and further acknowledges that the plan for unit operations prescribed in said documents has been ratified and approved and unconditionally delivered on the date set out hereinbelow."

Now, what we are dealing with is an operator who is recognizing that that order had to become part of the terms between it and the unit operators on a mandatory basis.

And the reason I've put up the statute that we've talked about so much, but we haven't given that much attention to the wording -- Before you is 70-7-7, and it is interesting to note that the introductory sentence of that provision of the statute uses the word "shall" three times.

It reads, "The order providing for unitization and unit operations of a pool or part of a pool *shall* be upon terms and conditions that are fair, reasonable and equitable and *shall* approve or prescribe a plan or unit agreement for unit operations which *shall* include..." And then, of course, Subparagraph F is quoted in here for you.

"Shall" means must, a mandate. It has to be included in those terms.

And it's interesting in the ratification that this operator, Getty, sent out to the working interest owners that it uses the term, acknowledging that the plan for unit operations prescribed in said documents has been ratified and approved, and the documents refer to and include Order Number 6447.

That language and the language of the statute is what Hartman is here saying Getty has violated by bringing suit and denying his right to go nonconsent.

Let me ask now if we could turn to the material under Tab 3.

OXY relies heavily on the comparison between statutory unitization and compulsory pooling. It says, This is the analogy that really does it for us.

Well, let's look at that analogy. Our compulsory pooling statute is found at 70-2-17, and that statute -- which is probably all too familiar to this Examiner, the many cases that have been heard -- refers to situations where you're dealing with one well, one spacing unit, there is no requirement, no minimum percentage of working interest owners' approval or any royalty interest owner approval.

You can have -- You can force pool, conceivably,

everybody but the operator. No minimum approval. You're talking about, typically the case involving primary recovery, and it provides that cost disputes for those that are force-pooled can be, in effect, arbitrated by the Commission.

Now, what's interesting there is that if you want to take the analogy of compulsory pooling all the way, then it completely supports the position that Hartman has taken in this case. The standard joint operating agreement that you will find in the files, typically the 1982 form that is commonly used, has been commonly used for years by the clients of the counsel for the operator here, as you well know, provides that those who are signing up are signed on for one specified well, the initial development.

And then the standard operating agreement language, which appears at Tab 19B -- Tab 20, I'll get back to 19B, Mr. Stovall's letter. Tab 20. And I'm sure, Mr. Examiner, you're very familiar with this kind of language. But basically what you have, it says, Okay, we sign up, we sign on for your initial development, you're going to drill this well.

After that, if you decide to do something else, if you decide to drill another well, you've got certain -- you're going to go enter a dry hole, you're going to do certain other operations, that comes under subsequent

operations.

And you have to give notice to everybody, whether they sign on voluntarily or were force-pooled. You've got to give notice to everybody, give them the AFE, give them the opportunity to see whether it's something that's worthwhile, whether they want to invest their money in it or not.

And if they don't, you go to operations by less than all parties. It's very comparable to the situation we're dealing with here. And then you can be nonconsent and be carried, and the consenting parties carry the parties who elect not to participate in that further development, and the operating agreement may provide for a certain percentage above the actual 100-percent cost or the risk factor, testing and so forth, and the compulsory pooling, the -- for the initial well, the Commission can set a risk factor.

And by the way, bear in mind that that is a risk factor as opposed to the penalty that is set forth in the statutory unitization statute.

So if you want to take the compulsory pooling analogy to its logical conclusion, then you say, Yes, the people here signed on, Hartman's predecessor, Texas Pacific, signed on for an 80-acre fivespot development that was clearly described, that was to be accomplished in

approximately 15 years, that would consist of these expenditures and these efforts, and sign on for that.

And what's more, in 1980 when the matter came on for statutory unitization, there was an additional provision, that now we're going to expend an additional $1.6 million, of which we're going to save $600,000 because of the efficiencies of unitizing these outstanding interests, we're going to spend a million dollars, we're going to do certain things, we're going to recover 500,000 more barrels of oil, and when you've signed your ratification, it could be said logically you signed on for that.

The rub is, OXY is saying, You signed on forever. And now when those things that were done, that people said they understood, this is going to be the operation, this is going to be the expense, this is going to be the investment, and we think this will be the return -- now, in 1994, they come forward and say, We have a redevelopment plan.

Those things we proposed before and that Skelly proposed and then Getty proposed, those have been done and now we have a redevelopment plan that's very different, and you can't -- whether you like it or not, you can't go nonconsent.

Well, if you follow what happens in force pooling

and under the standard agreement, then that position is entirely erroneous. If the compulsory pooling principle is to apply here, then we have the situation of subsequent operations, and if OXY has started in 1994 an ill-conceived, unprofitable, expensive, poor-result plan that Mr. Hartman could see in 1994 was destined for that outcome, then he has the right to go nonconsent and they don't have a right to go in through his checkbook forever, no matter what they do.

Bear in mind here, the implication is that Mr. Hartman is some sort of a deadbeat, a defaulter. Well, if it goes to a merits hearing, Mr. Carr could be one to testify that Mr. Hartman pays bills and pays them fully and on time.

But bear in mind that this interest that we're talking about, this 4.8 percent, paid its way for 20 years. For 20 years it paid every billing. And eight of those years were under Mr. Hartman.

Only when OXY comes up with this operation that now in three years would have Mr. Hartman with a 4.8-percent interest, 4.8 percent, less than 5 percent, owing $750,000 in three years, gross that up. $15 million to a hundred percent in three years and nothing basically to show for it. Mr. Hartman's revenues are a third of that in the oil sales in that period.

It is said by OXY's counsel, You've signed up, you've got to pay.

We say, If you're the operator you've got a duty to be able to sell people on what you're doing, demonstrate that it's worthwhile, demonstrate that it's a good investment, or they're entitled to turn you down. They're entitled to say, No, that's a bad deal, thumbs down, we're going nonconsent. When they do, they lose their revenue. Mr. Hartman recognizes that. OXY is entitled to the revenue. They lose their revenue. But if they think it's worthwhile, then they can spend their money on it and they can have the revenue of the parties who decide to go nonconsent.

Now, under the statutory unitization laws, I come back to some principles that I stated at the beginning. And that is, it is very clear -- and I cite the cases at page 2 of this outline -- that the Oil Conservation Commission and this Division is a creature of statute. *Continental Oil Company vs. the Oil Conservation Commission* says it's a creature of statute expressly defined, limited and empowered by the laws creating it.

And when the Legislature delegates its power, the boundaries of that authority must be defined and followed. In New Mexico, action taken by a governmental agency must conform to some statutory standard or intelligible

principle. I cite the authority for that.

But I think two cases that will help the Commission here, because they're statutory unitization cases, they're from other states grappling with some of the similar issues, are the ones I cite in my outline, one from Wyoming and one from Kansas, bearing in mind that Kansas has a very, very similar statute.

In *Cook vs. Wyoming Oil and Gas Conservation Commission* you had a situation where you had an existing unit and there was a tract outside of the unit in which an interest was held by a party named Cook. That tract with the well on it was benefitting from the flood operations that were being carried on inside the unit. It was in communication with a reservoir that was being flooded and benefitting.

The operator came in seeking an amendment, which, of course, under our statute too -- and that's, I think, why you have the amendment provision where you have to come in, if you do it properly, aside from what has been said about the Phillips case or whatever that is. Under our statute if you want to change what you're doing you have to follow the amendment procedure of Section 9.

The operator came in and sought an amendment to enlarge the boundaries of the unit to take in that Cook tract. The Examiner heard the evidence and found

everything in favor of increasing the boundaries, but he left open the question of approval of the interest owners, because the commission in Wyoming had theretofore interpreted their statute as requiring 100-percent approval. And guess what? Mr. Cook wasn't about to approve.

The Wyoming commission went back, held a hearing and reconsidered the matter and decided that the proper interpretation of their statute was that 80-percent approval was what was needed to meet the statutory standard. And the Wyoming court said, Even if what they had said before may have been unclear or may have been incorrect, it was proper for the commission to take that position, then, because you have to do -- the commission is legally required to enforce the law as it's been drafted by the legislature.

And that is, I think, Examiner Stogner, a lesson here. Whether there has been a failure on these parties to bring forward the unit agreements that -- or unit operating agreements that have the language required, whether the Commission has said, You've got to go out and change your agreement, as opposed to saying, We put it in our order and that's good enough, if there's been anything in the past that has left the door open or a question, then this Commission has to enforce the law as written.

And I do agree with one thing that's said today, and that is that this case -- in fact, this Motion can, and probably will, have a profound consequence on all of the other -- or most, not all, but most of the other 36, 38, 40 statutory units.

Because if the Commission does not say that when we put in our order this language, that that has the force and effect of prescribing that there must be the right for a party to be carried and for the other parties to recover that share of expense from his or her revenue, if you don't say the orders mean that, then the law has not been followed, the unit operating agreements are in force that lack those carried provisions are, I submit to you, in violation of the law, are unenforceable or void, and you really have created a serious question as to the effect of operations.

The result here that will bring the stability that should exist is to say when we say these things in our orders, just as the statute says, we are prescribing those terms that apply.

On that point, Mr. Examiner, I think the case that is most instructive is *Parkin vs. State Corporation Commission*, a 1984 Kansas case. The situation in that case was the following:

There was a unit that was created under Kansas'

statutory unitization act. Gulf started the unit, had a pilot project, and it did not go well. It was not a successful operation.

Gulf and all the other working interest owners sold out all of their working interests to -- I don't remember the name of that -- Mesco? Some of the parties here will probably recognize that particular operator, is why I'm looking for the -- Misco Industries, Misco Industries, which it sounds like as you read the opinion, was sort of a junk operator.

Misco proceeded to remove and sell tank batteries, pumping units, some of the piping and so forth, but would just keep the unit sort of perking along, and over a period of time drilled three wells that showed little performance.

The unit agreement, the unit agreement specified that the unit could be terminated only upon agreement of 65 percent or more of the working interest approval. Of course, Misco was sitting there with 100 percent.

The royalty owners under this 5800-acre unit came in and said, Commission, Corporation Commission of Kansas, this is not a prudent operation, they're not complying with the requirements of the state law regarding conservation, protection of correlative rights. We want the unit terminated.

The corporation commission said, No, the private agreement of the parties says 65 percent. So no matter what the situation is, we can't terminate.

It went to the district court, and the district court affirmed the lower -- the commission, the corporation commission.

On appeal to the Supreme Court of Kansas, the supreme court said, importantly, to begin with, language that I think is most applicable here. "The unit in this case is not one created by contract; it is one imposed by the Corporation Commission under authority of law."

And that is true with the Myers Langlie-Mattix and every other unit created under New Mexico Statutory Unitization Act.

Supreme Court of Kansas goes on to say, "Only the Corporation Commission can impose unitization upon unwilling interest holders and then only pursuant to the statutes designated above. As Chief Justice Schroeder observed in his dissent in *Mobil Oil Corp. vs. Kansas Corporation Commission*, '[T]he Commission's authority to *compel* unitization is governed strictly by statute."

The court went on to say, "The Corporation Commission has statutory authority to amend or modify its unitization orders, and to terminate unit operations...the Corporation Commission remains the ultimate authority and

may terminate compulsory unitization if it determines that unit operations are not being carried on in a prudent manner or that the purposes of the act, as set forth in K.S.A. 55-1301, cease to be served."

The statute, the authority of the Commission overrides whatever may appear in the private agreements, and that has been the practice here. That has been your practice. The practice of this Commission has been the correct one, to impose the conditions of the statute by its order which creates the statutory units.

Let me say, on the analogy between the force pooling and the statutory unitization, I don't want to take any more time than I have, but at 19B there's a very interesting letter written in November of 1990 by then Counsel Bob Stovall to Jim Bruce in which the very argument or issue is addressed of why force pooling and statutory unitization are two very different circumstances, two very different animals under the law.

Mr. Stovall's letter also says, "Under statutory unitization, the Division approves an agreement for the unit operation which must include many provisions including a provision for carrying working interests..."

Finally, on the denial of this Motion to Dismiss, Mr. Examiner, which should be the result here, on the denial of that motion, under Tab 3 we have just set forth

as a sampler or just a demonstration for the Commission that on hearing on the merits, if need be, because it also could be a result that this Commission would say, Not only do we deny the Motion to Dismiss, but we are prepared to enforce our Order 6447, and we can tell you now by our decision that OXY must permit interest owners to go nonconsent when they make that election.

But if the decision is simply to deny the Motion to Dismiss and to hear the matter on the merits, we have at Tab 4 [*sic*] an affidavit of Professor Bruce Kramer, who's a co-author of "The Law of Pooling and Unitization", and Mr. Kramer's -- Professor Kramer's affidavit would demonstrate that he would testify that under our statutory unitization there must be a nonconsent provision. The OCC orders prescribed such provisions in these units, including the MLMU, and that a nonconsent provision means exactly what it's broadly understood to mean, and that an operator can't bring suit against somebody who has made that election.

Also at this tab [*sic*] is the Van Kirk affidavit, which is just a demonstration to say that if the matter is heard on the merits, there would be testimony brought forth concerning water out of zone, matters of that sort, custom and practice in the industry, and that we would have at least the testimony of former Division Examiner Richard Stamets in support of the Hartman position and Counsel

Robert Stovall, and probably the testimony of Mr. Carr, which, I submit, would of necessity be in support, at least in certain instances, of the position taken by Mr. Hartman in this proceeding.

That, Mr. Examiner, is our position regarding the Motion to Dismiss of OXY.

Mr. Condon will address the issues that surround the 1994 EOR application and the other matters that are at issue here this afternoon.

EXAMINER STOGNER: Mr. Condon?

MR. CONDON: Mr. Stogner, I'm going to try to be briefer than I originally intended to be, but hopefully not briefer than I need to be to get the points across.

Lest the Division have lost sight of what our Application is about by the presentation that was made in support of the Motion to Dismiss, let me just remind you what we're asking for with regard to Order 4680-A, which was entered in 1994.

We are contending that Order R-4680-A is void in two respects, and I'm going to address the easy one first. It's the issue that Mr. Kellahin has to some extent conceded is a viable issue in this case, and that is issues relating to possible water out of zone and what we contend, and what we think we will be able to prove at a hearing on the merits, are excessive surface injection rates.

OXY brought up this Exhibit 53, which talks about Injection Order R-4680 as having no injection limit, and Mr. Kellahin then told you that therefore there is no limit on the injection pressure authorization for those wells that were part of the waterflood as of 1973, when that order was entered. And I submit that that is absolutely wrong and that you know that's wrong.

Because in 1977 Mr. Ramey entered an order -- I believe it's Order Number 3-1977, and I'll get a copy over to you first thing in the morning -- which set a surface injection pressure limitation for all injection wells in Lea County of .2 p.s.i. per foot of depth.

And I believe we also in this room, everybody who's familiar with waterflood operations, knows why that injection pressure limitation was imposed, and that is because operators of waterfloods began to run into problems with water flows shortly after the waterflood operations started, to the point where the Division actually set up committees of operators of waterfloods in Lea County to investigate the cause of this waterflow problem, which had not occurred in these areas prior to the onset of waterflood operations.

So it is our contention that by the Division's own orders, by 1977, absent some showing by the operator that a higher pressure would not cause water to escape the

authorized injection zone or fracture that zone or escape into other formations or onto the surface, that there was an injection pressure limitation of .2 p.s.i. per foot of depth, which here in the MLMU is approximately 700 p.s.i. surface injection pressure.

In fact, OXY is familiar with that, because in the Skelly Penrose EOR application which was also processed in 1994, Mr. Catanach entered an order authorizing kind of a similar project to the EOR project, Mr. Stogner, that you approved in Case Number 11,168, what I call the 1994 application, and limited the surface injection pressure to something that is essentially comparable to .2 p.s.i. per foot of depth for the surface injection wells that came on with that program.

Now, our first contention as to R-4680-A is that in authorizing a surface injection pressure maximum up to 1800 p.s.i. that order is void, because there is absolutely no evidence in the record of that case that supports a surface injection pressure maximum of 1800 p.s.i.

And I'm sure I don't have to remind you or anybody at the Division that the Division's findings are required to be supported by competent evidence and that an order which is based upon a lack of substantial evidence in the record is void. Void orders are subject to collateral attack simply because they are void, "void" meaning they

have no legal force and effect.

Therefore, you cannot prop up a void order by complaining that somebody didn't come into a previous proceeding and point out that OXY was failing to support its maximum surface injection pressure request with competent evidence.

We have been through the exhibits that were submitted in that case. There is no evidence in the exhibits that we can find that supports a surface injection pressure of 1800 p.s.i.

We have looked at the transcript in that case. There is no reference to 1800-p.s.i. surface injection pressures in the transcript. In fact, when Mr. Kellahin sent over a proposed order in that case, he asked for a maximum surface injection pressure authorization of .2 p.s.i. per foot of depth. And somehow in the process between when that proposed order came over and when the order in that case was actually issued, an 1800-p.s.i. surface injection pressure maximum was authorized.

Absent some showing by the operator that their -- that pressures above the .2 p.s.i. per foot of depth will not cause water to escape the authorized injection zone, there is no basis for the Division to approve a request for a surface injection pressure over and above the .2 p.s.i. per foot of depth. These were wells that prior to 1994 had

not been on injection, therefore couldn't have been subject to step-rate tests at that time.

There is absolutely no evidence in the record supporting the 1800-p.s.i. surface injection authorization, and therefore the order is void.

That's our first argument as to the legal effect of Order R-4688. All you need to do with respect to that part of the Motion is to simply revoke the 1800-p.s.i. authorization for those wells.

If OXY wants to come in and put on evidence that they believe supports a surface injection pressure above .2 p.s.i. per foot, they can do that.

But what they can't do is violate the .2 p.s.i. per foot authorization and maximum by simply somehow getting that authorization in an order without offering any competent or substantial evidence that supports it.

Now, our second position with respect to Order R-4680-A is that that order is void because OXY failed to comply with the mandates of the Statutory Unitization Act in 1994 in connection with their proposal.

What I want to show you -- And I put this up a little bit early. Let me take it down for a second. I'll get back to this in just a second.

OXY raises a number of things that happened after 1973, and after the approval of that original plan of unit

operations. And they referenced you the 1976 unit expansion, they referenced you to a Texaco pilot 40-acre fivespot plan. And the reason they're doing that is, they're trying to create the impression for you that what happened in 1994 was not a change in the plan of unitization for this unit.

We have included in the materials that are in your book -- and it's the first tab, I believe, under Part V, with the initial secondary recovery study for the Myers Langlie-Mattix Unit that was prepared by Skelly in 1968, prior to the 1973 proceedings.

And if you turn to page 11 -- It's not page 11, excuse me. There is a portion of this that talks about the plan of operations, and what it is essentially telling you under the plan of operations is that this is a plan, as OXY has recognized here in this one exhibit, for an 80-acre fivespot waterflood plan.

Now, the questions about what has happened since 1973, between 1973 and 1994 with respect to various plans that have been implemented by the unit operator, that's a red herring. You don't need to be concerned about any of that.

The only question that is proposed by our Application in this case is, was the 1994 plan an amendment to the plan of unitization for the Myers Langlie-Mattix

Unit?

If it is, Section 70-7-9 requires that the amended plan of unitization and the amended plan of operation be approved in the same manner as the plan of unitization and the plan of operation were approved in connection with the 1980 statutory unitization proceeding, which requires specific findings that are set out in Section 70-7-6 of the statute, also requires that the operator go through the ratification process that is prescribed by statute.

And in order to call to your attention what happened in 1994, let me read you from OXY's own application where they describe the application as seeking expansion of the unit by means of a significant change in the process used for the displacement of crude oil. They went from an 80-acre fivespot waterflood plan in this project area to a 40-acre fivespot project plan. And they talk about needing authorization for the necessary changes to convert the waterflood project from an 80-acre fivespot pattern to a 40-acre fivespot pattern. The amended plan sought recovery, in part, of some primary reserves.

We contend that that, in itself, required approval of all of the working interest owners because it changed the tract participation factors that were approved in the original unit agreement, because those original

tract participation factors were based in large part upon primary recovery.

And when you come in with a significant change in the plan of operation and the plan of unitization and you are a statutory unit, then you are required to comply with the provisions of the statute and to go through the statutory process. It doesn't matter whether other operators have or have not complied with the statute. Perhaps they have, perhaps they have not. That's not the issue before you.

The issue before you today is whether OXY complied, and we contend they did not.

The order in 1994, the R-4680-A order, does not contain any of the findings required by 70-7-6. It's undisputed that there was no ratification process. They essentially amended the plan of unitization but ignored the mandates of the statute again, and I'll just leave it at that.

And I will say this: Mr. Kellahin and OXY have advanced the argument in support of their Motion to Dismiss, but somehow the Division is required to overlook the procedural irregularities in the entry of Order R-4680-A, because Mr. Hartman did not show up at that hearing. And I would submit that that is attempting to put the shoe on the wrong foot. It is the operator's

obligation to submit a proper application to the Division.

In this particular case the other irregularity that we've cited in the pleadings is the failure of the 1994 application to even reference Order R-6447.

OXY now agrees that at least as to some people Order R-6447 applied, and Order R-9708, which the Division entered after the passage of the Enhanced Oil Recovery Act, requires that those applications reference the orders approving the units. And it is undisputed that the 1994 application submitted by OXY does not even reference Order R-6447.

We believe that we will be able to show you at a hearing on the merits that that's because they probably weren't even aware of Order R-6447 when they filed the 1994 application.

So for those reasons -- and I will just cite to you a couple of cases for the proposition that a void order is subject to collateral attack: *Groendyke Transportation vs. New Mexico State Corporation*. That's 79 New Mexico 60 and 439 P 2nd 709, 1968. And I'll get you copies of all of these cases tomorrow morning. *Continental Oil Company vs. the OCC*, which has already been cited. *The New Mexico Board of Pharmacy vs. The New Mexico Board of Osteopathic Medical Examiners*. And *Mechem vs. City of Santa Fe*.

All those cases stand for the proposition that to

the extent you've got a void order, it doesn't matter what anybody did or did not do, that order is void, it is subject to collateral attack at any time by any person.

And you can't prop it up by arguing Mr. Hartman should have shown up in 1994 and corrected the procedural irregularities which OXY caused by filing its application and processing that application in the manner that it did.

Now, the other issue that we've asked for and that really hasn't been addressed much in the argument -- First let me just address this issue where OXY has conceded that the issue of water out of zone is properly before the Division in this case.

However, what they've done is, they've tried to shift the burden. They say, You should recognize that water out of zone is an issue, but force the nonoperator to come in and show you evidence that there's water out of zone. Well, I submit that is absolutely putting the cart before the horse and putting the burden on the wrong party.

Order R-4680-A contained a requirement, and I'll read it to you, something that OXY seems to have forgotten.

Two, the Appli- -- This is in the dispositive findings of the order. The Applicant shall take all steps necessary to ensure that the injected water enters only the proposed injection interval and is not permitted to escape to other formations or onto the surface. Mr. Stogner is

more than familiar with the language.

It is the operator's obligation to ensure that the water stays in the authorized injection zone. It is the operator who has the records in this case that we have asked for, but that OXY has resisted providing to us, regarding the operations of the unit, the wells in question, well files. They have objected to every discovery request that we've made. And I doubt, no matter what the ruling of this Division is, that we're going to get all of the documents in a timely manner that we've asked for.

But really, it is the operator's obligation to show you that water is staying in zone.

And what we have provided you already, albeit without access to OXY's files -- and as we've pointed out in the Response to the Motion to Dismiss, many of these issues involve documents and proof that is solely within the possession, custody and control of OXY. We have shown evidence already that there is water out of zone.

I wish OXY would have used their dot to locate Mr. Hartman's well in connection with the infill program that was approved in 1994. If you superimpose Exhibit 53 over Exhibit 52 and go down here to Section 5, you will find that the Myers B Federal Number 30 well is right in the middle of the infill drilling program that was approved

by the 1994 order.

Now, this is a well -- and we've included copies of the sundry notice that Mr. Hartman filed with the Division and the BLM -- this is a well which previously, previous to waterflood operations, or at least to the expansion program, had not produced any significant water but then encountered water in the Yates zone upon Mr. Hartman's attempt to re-enter the well and put it back on production in 1996.

Again, OXY complains that these are somehow matters that Mr. Hartman should have raised in the 1994 application, and OXY contends that that 1994 order is somehow *res judicata* or collateral estoppel as to some of the issues that we've raised in this Application.

Now, I don't know if OXY's recognition today for the first time that the water-out-of-zone issue is a proper one for the Division to determine is a recognition that that order does not preclude the Division from enquiring into water out of zone in connection with waterflood operations. I doubt if an operator really, in the State of New Mexico today, after the history that we've had in the last 20 years, with problems with waterfloods could make that argument with a straight face.

But be that as it may, this is a proper matter for the Application, and it is a matter where the burden

should be put on OXY, once there is any showing that there is water out of zone, to come in and confirm for the Division, making its records available to Hartman and his experts for review, and to the Division for their independent review, to confirm that, in fact, there is not a problem with water out of zone as a result of the Myers Langlie-Mattix Unit, and perhaps particularly as a result of the 1994 expansion program which was approved by Order R-4680-A.

Now, those are the two bases that we contend make Order R-4680-A void: One, no evidence supporting the surface injection pressure authorization of 1800; two, failure to comply with the mandates of the Statutory Unitization Act in implementing a program which represents a change in the plan of unitization for the Myers Langlie-Mattix Unit.

The third aspect of our request is a request that the Division look at the performance of this unit, particularly since the approval in 1994 of this redevelopment program, and determine whether this Myers Langlie-Mattix Unit should be terminated as a secondary waterflood operation.

We really haven't heard anything about that today on this issue, and I don't want that to get lost in the process.

It's difficult to imagine how OXY could argue that Mr. Hartman waived that issue by not showing up at the 1994 hearing because, of course, our argument here is not that you improvidently granted approval for the program. Our argument is, now that we've had three years of operation of this program, it is time to look at the program to determine, number one, if the program meets the representations that were made to you in terms of actual operation; number two, whether the unit is being operated prudently or not -- and if you determine that the unit is not being operated prudently, we submit that you do have the authority to terminate the unit -- and finally, to determine whether unitized substances are being produced in a quantity sufficient to repay the cost of same, which of course goes back to a provision in the unit agreement that OXY cites to you in support of its Motion to Dismiss, i.e., OXY's argument is, this is a private-contract issue, whether this unit is really producing sufficient unitized substances to justify its continuation is a private issue.

And again, I would cite to you the *Parkin vs. State Corporation Commission of Kansas* case which Mr. Gallegos referenced a minute ago, which says, "The Corporation Commission has statutory authority to amend or modify its unitization orders, and to terminate unit operations...It is the regulatory body which has expertise

in the field, which has competent staff advisors, and which may employ consultants when that becomes necessary...The Commission is in the best position, when called upon to do so, to determine whether 'unit operations' upon statutorily unitized oil and gas leases are being carried on in good faith and whether the unit is being prudently operated and developed."

It is your prerogative to make that determination, and we ask you to do that in connection with this proceeding.

To sum up, let me point out that on a Motion to dismiss you should not be trying to resolve factual disputes. If there is a factual issue which you believe exists, which goes to the question of whether you believe that this Application should stand, then you need to set this matter for a full evidentiary hearing.

There still has not been an evidentiary hearing in this matter with witnesses, although, as you can see, the parties have substantially developed the record.

The question is, is there any set of circumstances upon which Hartman can prevail in this Application?

And we submit on the basis of Mr. Gallegos's presentation that clearly Hartman should prevail on the issue of enforcing Order R-6447 and the unambiguous

provision for carrying any working interest owner, not any working interest owner who had not voluntarily agreed to unitization prior to unitization, and that on the question of Order R-4680-A it is void, it is subject to collateral attack, and on the question of whether the Division should terminate unit operations, that is a matter that ought to be set for full evidentiary hearing after we have an opportunity to determine what documents OXY has in its file regarding their own internal assessment of unit operations. They had not challenged our contention that this unit since 1994 has been uneconomical, and it would be very interesting to see exactly what their internal analyses show and what the analyses of their independent auditors, whom we believe they have looking at the unit right now, will show.

MR. KELLAHIN: May I close debate on my motion? I need about five minutes.

EXAMINER STOGNER: Mr. Kellahin, five minutes.

MR. KELLAHIN: Thank you, Mr. Stogner.

We have responded to Mr. Gallegos's and Mr. Condon's arguments today in the memorandum. It deals extensively with this issue. There are a couple of points I want to bring to your attention.

If you look at Mr. Gallegos's reproduction of 7F on the board over there, you'll see that there is a

difference in phrasing.

You see the word "carrying" in the first line, and you see the word "carried"? Those are not synonymous, they're disjunctive.

7F requires that the document shall contain a provision for carrying, and it provides three different types of carrying provision options: You can have a carrying interest provision on a limited basis, on a carried basis, or on a net-profits basis.

And when you drop down to the middle of the paragraph where you see "carried" again, the two "carrieds" are linked.

What we have in the 1973 agreements that the Division approved in 1980 is a carrying provision. That carrying provision is on a limited basis. The limitation is that it's nonexclusive. It's the second option in the contracts. We have that.

What Mr. Hartman is attacking is the fact that our contracts don't have a "carried" provision, which he contends is the only one that can be applied when you interpret 7F. Well, that's not true. 7F provides three different types of carrying provisions. He wants you to mandate that it is a carrying provision on a carried basis. That's not what we did, that's not what happened. He's wrong on that point.

Mr. Stogner, Mr. Carroll, you don't have to take my word that OXY is right. You don't have to take Mr. Carr's word that OXY is right.

I'll ask you to rely upon the scholarly opinions of a highly respected professor of oil and gas law. He eats and breathes and teaches and lectures and writes about oil and gas law on a full-time basis continually. He edits the bible for oil and gas law. He's one of the current authors of Williams and Meyers' treatise on oil and gas law. He is not only an academic expert, he is also a practical expert like you, because he has sat where you are sitting now. He has been a commissioner, he has decided cases, he has struggled with problems like this.

And he says these cases are final as to Hartman, they are final and cannot be attacked by Hartman, that there is no merits to his claim, that it would be silly to do anything other than dismiss Hartman's attacks on these orders and these contracts.

Professor Pat Martin is the editor of Williams and Meyers' treatise on oil and gas law. He is the authority for this position. He says OXY is right and Hartman is wrong.

That concludes my closing.

MR. CARROLL: Either side can answer this question. Has the project approved in 1994 paid out, or

what's the current status? Is it one-third? It's paid out one-third?

MR. KELLAHIN: I can't tell you.

MR. GALLEGOS: The information we'd have is that on a straight operating expense basis the project at last look was ahead about $100,000 and has paid nothing on the capital investment.

MR. CONDON: $100,000 on the unitwide basis.

MR. GALLEGOS: On the unitwide basis. That's just the expense over revenue. Nothing applied to capital investment, which is, I think about $7 million now, but I'm sure OXY would have more exact figures.

MR. CARROLL: I thought $15 million had been spent, or is that what's planned to be spent?

MR. GALLEGOS: $15 million -- If you take what Hartman has been billed in the last three years, which is the period he's refused to pay, gone nonconsent, his share is $750,000. That's for 5 percent, approximately.

That's what -- so what I'm saying, Mr. Carroll, if you gross that up -- Call it 5 percent that he has; it's 4.8. But if you gross that up, that's $15 million billed in three years.

MR. CARROLL: And then Mr. Condon, I believe you found -- you did find a reference to the 1800 p.s.i.? Where did you finally find the --

MR. CONDON: Where it was -- and this is kind of interesting. Not in the form of the application itself. When OXY sent out its notice of the Application, it sent two packages. The first was a copy of the Application and the Form C-108 with no exhibits.

Then in a second package the C-108 came with about 40 or 45 pages of attachments, and those are -- I attached a copy of the entire thing to the Response to the Motion to Dismiss. It is Exhibit Y. I'll just -- I'll pull it out and show it to you. It's in this document. And if you go all the way to the very end of the document, go to the very back, there's a very last page of the document that says, "Maximum injection pressure, 1800 p.s.i.; average injection pressure, 1200 p.s.i."

And I believe there was also included -- Oh, a legal notice that was apparently published for one day in the Hobbs paper, that included a reference to 1800 p.s.i., in the legal notice.

That is -- now, those are in -- That is in the C-108, buried in the last couple of pages of the C-108, but not in the Application itself, not in the record or in any of the exhibits that were introduced in support of the application and the hearing in December of 1994.

I would also point out, as this application was being received by Mr. Hartman, we started our two-week

trial against Texaco on the claim that Texaco's waterflood operation in the Rhodes Yates Unit had watered out a lease of Mr. Hartman's.

OXY just happens to be an interest owner, we believe, in the Rhodes Yates Unit and filed this application at a time when it knew or should have known that Mr. Hartman was going to be in trial. That was a two-week trial that concluded with a jury verdict on December 8th in Mr. Hartman's favor.

MR. CARROLL: So the 1800 p.s.i. appeared in the advertisement that appeared in the Hobbs paper?

MR. CONDON: That's what we understand.

MR. CARROLL: Did it appear in the advertisement on the OCD docket?

MR. CONDON: No, no, it did not.

MR. CARROLL: I don't know which one of you did the research on the old unitization cases before the OCD, but I had a question regarding the Travis Penn agreement.

MR. GALLEGOS: Right.

MR. CARROLL: I read something in those documents that there's a unanimous agreement among all the interest owners, so why was that case brought for statutory unitization?

MR. GALLEGOS: Because -- I'm not sure I can answer that. The transcript is available. But because I

suppose the parties wanted the benefit of having the statutory unitization that provides other benefits, agreements that they could make and that sort of thing. I really don't have an answer for that. I just know that Mr. Yates says in there that he's had everybody agreed.

It's a good question.

MR. CARROLL: If we agree with Mr. Hartman and give effect to the nonconsent or graft the statutory language of 70-7-7F onto the unit operating agreement, what would the effect of that be?

And Mr. Hartman has received --

MR. GALLEGOS: The effect would be, the proceeds received by Mr. Hartman during the time period that we're talking about for oil would be payable to OXY. He has escrowed those proceeds and put them in a separate account because they belong to OXY, and they would be payable to OXY.

And of course, henceforth the revenue from the oil would be payable to OXY. He's also received no revenue for gas and has an imbalance there. Any gas production that's attributable to his interest in sales for this time period would be payable to OXY as well.

MR. CARROLL: Until payout.

MR. GALLEGOS: Until payout.

MR. CARROLL: And the order didn't provide a

penalty provision; is that correct?

MR. GALLEGOS: Correct.

MR. CONDON: There was no penalty provision in the statute as of 1980 when this Application was filed. The penalty provision was added in 1986.

MR. CARROLL: And Mr. Kellahin, you said under the unit operating agreement OXY had three options --

MR. KELLAHIN: Yes.

MR. CARROLL: -- as to what to do?

MR. KELLAHIN: Yes, they do, sir.

MR. CARROLL: Did that second option you talked about --

MR. KELLAHIN: Yes.

MR. CARROLL: -- is that, in effect, a right of setoff, or what was that second option?

MR. KELLAHIN: Let's look at the option. It's in the --

MR. CARROLL: And then my follow-up question is why OXY didn't exercise that right of setoff, rather than allowing the revenues to be paid to Mr. Hartman and then billing him for his costs.

MR. KELLAHIN: When you look on page 5 of our Reply for the Motion to Dismiss, there are three options there.

It's my understanding that OXY attempted to

exercise all of those options in various combinations over the course of conduct here, including the option to take Mr. Hartman's share of production, and that as they attempted to do so, he changed purchasers in a frustration of that effort.

MR. CARROLL: So OXY attempted to keep his share of revenue?

MR. KELLAHIN: Yes and he would not allow us to do that.

MR. CONDON: Could I respond to that, Mr. Carroll, because --

MR. CARROLL: Sure.

MR. CONDON: -- that's absolutely not true.

Prior to 1995, September of 1995, Mr. Hartman had never designated a purchaser for his oil. The arrangements for the purchase of his share of production for the unit were being controlled by the operators, including OXY, including -- We believe the evidence will show OXY was controlling the sale of Hartman's share of production before they became the unit operator.

And of course, there is a provision in the unit agreement that requires the operator, if they are disposing of a nonoperator share of production, to sell it at not less than the prevailing market price in the area for like production.

Now, from May of 1994 when Hartman went nonconsent until September of 1995, while OXY was still in control of the production, what they were doing was netting Mr. Hartman out, expenses less revenue, and cutting him a check for the net.

In September of 1995, Hartman for the first time designated a purchaser for his share of production, because up to that point all he was being paid was the, quote, posted price by OXY and by other purchasers that were designated by OXY.

And so immediately upon designating Scurlock as the purchaser, he got at $2-a-barrel increase in the price that he received for his oil, which, if you think about it from an operator like OXY's point, if they were being forthright and acting in good faith, they would be happy with that increase because it would mean that his production was paid off -- or his share of unit expenses would be paid off sooner by getting -- achieving a higher price.

At no time in connection with Mr. Hartman's designation of Scurlock did OXY ever write Scurlock and claim that they had the right to enforce any lien on Hartman's share of production. In fact, they didn't do anything following Mr. Hartman's designation of Scurlock until they filed this lawsuit in March of 1997.

MR. CARROLL: It's my --

MR. KELLAHIN: Mr. Carroll, I'm not able to respond, so I can neither affirm nor deny what he said. That is the debt-collection litigation portion of the case, for which I have not been involved.

MR. CARROLL: Okay. It's my understanding Mr. Hartman was notified of the 1994 hearing, did not enter an appearance and object in that case. His response was basically go nonconsent, and --

MR. CONDON: Which he had already done, as of --

MR. CARROLL: He had done that --

MR. CONDON: -- November of 1994, yes.

MR. CARROLL: So in the preliminary correspondence prior to the Application, Mr. Hartman tried to exercise his right to go nonconsent?

MR. CONDON: That's correct.

MR. KELLAHIN: That is not correct, Mr. Carroll. He never used the words, "I'm going nonconsent." He was discussing about not participating in the project.

MR. GALLEGOS: There's two letters --

MR. CONDON: If I could, there is a letter in the file that we included in our response to the Motion to Dismiss.

OXY didn't have any trouble in 1994 understanding what Mr. Hartman was trying to do. There was a letter from

Jerry Crew. It's attached as Exhibit F to our Response to the Motion to Dismiss, to Carol Farmer at Hartman's office, that says, Under the terms of the unit operating agreement dated January 1, 1993, working interest owners do not have a nonconsent option for such capital projects, referring to the 1994 redevelopment --

MR. KELLAHIN: Mr. Carroll, that was not your question. You asked whether Hartman had told OXY he was going nonconsent. The phrasing of all his letters saying he chose not participate.

MR. CARROLL: Okay.

Now, in -- Mr. Kellahin, you can answer this question. The statutory application, applications, where you're -- the only parties that haven't agreed are, let's say, small royalty interests --

MR. KELLAHIN: Yes, sir.

MR. CARROLL: -- do you notify all the interests, or just -- do you notify just the small royalty interests you're trying to statutorily unitize?

MR. KELLAHIN: We only notify currently -- My recollection is, we notify those parties we're trying to involuntarily commit to the unit, and we don't bother to notify all those consenting parties that already committed to the agreements.

EXAMINER STOGNER: Mr. Kellahin, Mr. Condon

referred to a memorandum by Joe Ramey, 3 of 1977. Are you familiar with that memorandum?

MR. KELLAHIN: I don't have a copy before me. I thought there was -- I thought -- Mr. Condon has characterized this as an order. My recollection, it was simply a memorandum. I forgot the date of it, and it talked about .2 p.s.i. being a guideline.

What I have found in our search is that the District Office of the Division, schedules for the mechanical integrity tests of these injection wells show none under the authorized pressure limitation for each of these wells.

When I talked about those that had no pressure limitation within the project, that's to what I'm referring.

So if there's -- The generalized memorandum, the .2, we contend, cannot take priority over specific orders issued by you that authorize us to inject at something other than the .2 guideline.

EXAMINER STOGNER: Mr. Condon, do you have a copy of that? I thought -- I was looking for that.

MR. CONDON: I looked for it here, I've got it at my office. I'll get that over to you first thing in the morning.

EXAMINER STOGNER: Okay.

MR. CONDON: And in fact, in the Texaco case that I referred to, we also discovered some orders from the Division Office in Hobbs citing operators for exceeding the .2-p.s.i.-per foot depth limitation on surface injection pressures in the operation of waterfloods in this area, and I'll get you copies of some of those orders also.

(Off the record)

MR. CARROLL: Mr. Kellahin, I take it the last submittal --

MR. KELLAHIN: Yes, sir.

MR. CARROLL: -- I notice the esteemed Professor Martin in the office, I believe. This deals strictly with the construction of this section of the statute?

MR. KELLAHIN: No, sir, it deals with the collateral attack that Hartman is taking on the 1994 order and 1980 order, and I would like to mark that as whatever our last exhibit was. I've lost track of the number.

MR. CARROLL: So this is --

MR. KELLAHIN: 54.

MR. CARROLL: This doesn't deal with your argument regarding the "carrying"/"carried"?

MR. KELLAHIN: That is not included in Professor Martin's affidavit. If you would like him to respond to that, I'm happy to have him supplement his affidavit.

My discussion about the use of "carrying" is not

contained in his affidavit.

MR. CARROLL: Yeah, if you could get that. You lost me on the "carrying"/"carried". I'll have to read the transcript, but I'd love to have a law professor dissect that.

MR. KELLAHIN: We will ask Professor Martin to do that for us.

MR. CARROLL: And you can get Professor Kramer --

MR. GALLEGOS: I think we need an English professor too.

MR. CONDON: I think they need to start a new book just on this case.

MR. KELLAHIN: I assume Professor Martin will, in fact, put it in the book.

(Laughter)

MR. CARROLL: Is he going to write it, or is he going to have Professor Kramer write it?

MR. KELLAHIN: I believe he edits the book, and we'll see how it turns out.

EXAMINER STOGNER: We're still on the record.

We're going to take a five-minute recess at this point.

(Thereupon, a recess was taken at 5:30 p.m.)

(The following proceedings had at 5:40 p.m.)

EXAMINER STOGNER: This matter will come to

order.

One quick question. Has the District been notified of water encroachment into the Yates formation off that Number 30 well?

MR. HARTMAN: I think a sundry notice has been filed.

MR. CARROLL: A sundry notice was filed.

EXAMINER STOGNER: Okay.

MR. HARTMAN: BLM and the OCD.

MR. CARROLL: Have you heard back from them?

MR. HARTMAN: No, not that I know of.

EXAMINER STOGNER: At this time, before we get into the other matters, I want to expound a little bit on the 1800 p.s.i.

There is no finding pursuant to that order justifying 1800 p.s.i., and at this time I will rescind that portion of it and include the normal wording of the .2 p.s.i., unless it can be shown that step-rate tests at higher pressure is needed.

Also, District notification has been done. I'll expect some cooperation at this point between both operators at the District level to see that proper action be taken to find out where that water is coming from, where there will be tracer surveys.

Now, then, as far as the request for dismissal,

that will be denied at this point and an evidentiary hearing will be given in this matter, and the scope of that will include the prudency of operation and, if need be, the additional water encroachment issue.

Which brings us up to -- Well, let's see, you had something else, I believe, about the legal --

MR. CARROLL: Yeah, whether a nonconsent provision is imposed by the Statutory Unitization Act on interests that are voluntarily committed prior to unitization. I was ready to rule on that prior to Mr. Kellahin's last argument regarding the "carried"/"carrying" so I'll defer ruling on that until I receive the follow-up memorandums.

EXAMINER STOGNER: I believe there's some question about discovery.

MR. CONDON: Yeah, could I address that, Mr. Stogner? It was my motion.

EXAMINER STOGNER: Yes.

MR. CONDON: We filed a Motion for Discovery, Interrogatories and Request for Production. Subsequent to that time, we sent over a subpoena to be issued to OXY, requesting that they produce certain documents. They really kind of relate to a couple of broad categories of information. One, well files and other -- you know, any analyses or tests that have been performed that relate to

the question of water out of zone as a result of MLMU operations.

Also, we've asked for OXY's files to the extent that they relate to either their interpretation or a recognition of a right to go nonconsent in connection with statutory units.

Part of the problem that we're going to have preparing for an evidentiary hearing on these matters is, of course, that a lot of the documents that will either support or refute our Application are within OXY's custody and control, and we need access to those documents and we need to get our experts access to those documents before we have the evidentiary hearing.

What I would like to do, I have -- I think I brought with me copies of what we requested in terms of the subpoena. And I don't know what happened to the subpoena. I sent it over, and I don't know if it was just never issued because this hearing was scheduled, but I never got a call. And maybe that was my fault for not following up.

But we did submit a subpoena to secure production prior to the date of this hearing. I would have liked to have had that, but since we've already gone on -- There are obviously documents that we would like to have, and I think we're entitled to, in connection with the operation of this unit.

And I don't know if you're -- if you're now -- I mean, what I can do is simply send over a subpoena. But if now we're going to have to fight with OXY about whether documents that relate to the waterflood performance and water out of zone and their interpretation of the unit agreement are going to be -- if we're going to have a fight over that, then maybe we ought to just go ahead and hear the Motion for Discovery.

But I do think that the documents that we've requested -- and we've also asked interrogatories that are basically interrogatories that request that OXY identify individuals who are -- you know, have responsibility for various aspects of unit operations. We also asked for the identification of individuals who had responsibility for the 1994 application, because if there's going to be an evidentiary hearing on those issues, we would like to know who to subpoena.

I don't think we need --

MR. GALLEGOS: May I interrupt? Maybe we should first make an attempt with Counsel for OXY, I think, to see if we can arrive at some agreement on discovery in light of the ruling that there is going to be an evidentiary hearing. I would suspect with Mr. Kellahin and Mr. Carr we'll have some cooperation. And then -- We proceed that way, and then if we have some difficulties, bring it before

the Examiner.

MR. KELLAHIN: Mr. Examiner, Mr. Carroll, I need some clarifications on a couple of points.

MR. CARROLL: Okay.

MR. KELLAHIN: I was going to offer that before you decide on discovery, that it's the custom and practice of counsel, once we frame the issues, to decide to what extent we can cooperate in exchanging data that they have and that we might have.

It appears to me that you're not ready to decide the 1980 portion of this Application, which means whether or not Mr. Hartman does or does not have this nonconsent election concept.

MR. CARROLL: No, I believe we're ready to rule after we receive those memorandums, and I don't think the discovery is necessary regarding the --

MR. KELLAHIN: Well, that's what I'm asking for clarification. As to those issues, with regards to all that information, discovery could take place based upon what you decide to do.

So I'm suggesting that discovery be postponed as to those issues involved with regards to the interpretation, construction of 7F in its Application --

MR. CARROLL: That's fine.

MR. KELLAHIN: -- in this unit.

MR. CARROLL: That's fine.

MR. CONDON: Yeah, we don't have any problem with that.

MR. KELLAHIN: My understanding, I need clarification on the decision with regards to the water encroachment.

It would appear to me that it should be limited in scope using the area-of-review concept that we have in place in the C-108 process where we should define an area of likely source of encroachment, and I would suggest that you use a half-mile radius of investigation around the Hartman 30 well, and we would confine our attention to that portion of this unit project that deals with that issue.

MR. CONDON: Could I respond to that?

We do not agree with that. We think the issue of water out of zone is potentially a unit-wide problem. The Division certainly has responsibility for the entire unit in terms of potential water-out-of-zone problems.

And of course, the question of water out of zone really goes to the whole question of the prudency of the operation of this unit. If there is water out of zone throughout the unit, it is evidence of an imprudent operation and evidence of an ongoing violation of the Division's orders, rules and regulations, and ought to be something that is discoverable and that's at issue if the

Division is going to enquire into whether this unit should be terminated.

MR. KELLAHIN: Let me respond by suggesting that we need to focus the discovery concerning the well in which he claims there's out-of-zone encroachment. It will be our position that the water he finds in the Yates is inherently in the Yates and is not attributable to any activity of the waterflood project.

To advance that in an evidentiary hearing, I see no reason that we have to examine and investigate all the injection wells, operations and programs in any other area, other than within a half-mile radius of the well in which he claims he has some encroachment.

EXAMINER STOGNER: Well, let me limit it further. I'm just interested in getting, if there is, any encroachment into that well stopped. That's all I'm interested in right now, finding out if, a), there is encroachment -- and that's where your operations are going to come in, to show that it is water from somewhere else -- and of course, looking at, as he stated, area of review, probably even limited to just the nearby wells.

MR. KELLAHIN: I would suggest --

EXAMINER STOGNER: There's one blue one in there that looks like it would be the prime suspect at the District. But this is a District situation, and that's

what I'm interested in, in getting that stopped and getting the remedy straightened up right now.

MR. KELLAHIN: I agree with you, sir, that's what --

EXAMINER STOGNER: As far the --

MR. KELLAHIN: -- we'll focus on.

EXAMINER STOGNER: As far as taking it beyond that, that could enter into it. But beyond any other scope than what is already out there, or what is potential out there, a well in which some gas is making some additional water, we need to stop that at this point.

And that was my reasoning to bring that up at this time and to rescind the 1800 p.s.i. It can go even further on that --

MR. KELLAHIN: No, I understand you exactly, Mr. Stogner, and I think that's an appropriate way as a first-step examination of the claim of encroachment, is to let us step first within this small area of review and look at the problem, if there is one.

MR. CONDON: Mr. Stogner, could I point out one thing to you?

Attached at Tab 25 to the notebook that we gave you today is a document generated by Sirgo in 1992 when Sirgo was arguing with Texaco over unit operations. And if you turn to the -- on the eighth page, the very bottom

paragraph of the eighth page reads as follows:

During this period, Texaco, at Sirgo's request, conducted step-rate test in the field on injection wells to determine if Texaco's overinjection practices have fraced any injection wells constituting the adjustments requested by Sirgo. These suspicions were confirmed in two of the first four tests. A modified list of wells were submitted to Texaco for testing, but Texaco never completed the work...

Now, that is evidence of possible problems with other, unspecified at this point, injection wells that obviously as of 1992 did not include this redevelopment program area.

EXAMINER STOGNER: Mr. Condon, do you know of any other wells that are being watered out?

MR. CONDON: I don't, that's --

EXAMINER STOGNER: Okay.

MR. CONDON: -- but that's why we're asking --

EXAMINER STOGNER: Let's let that go at this point, then, Mr. Condon. Thank you very much.

MR. KELLAHIN: One last point of clarification, Mr. Stogner.

EXAMINER STOGNER: Yes, sir.

MR. KELLAHIN: It would assist us if you would take an opportunity to issue an order that explains what you meant by going forward with an evidentiary hearing concerning the prudency of operations. That is generalized and not yet specified by you and would guide us in organizing our discovery to have you describe for us the scope and the intent of the examination as to that concept and issue.

(Off the record)

MR. CARROLL: How soon are the parties ready to go to hearing, then?

MR. KELLAHIN: Depends on how you frame the scope of inquiry with regards to this prudency-of-operation concept. If it is limited to an evidentiary hearing focusing on the 30 water operations and whether those are prudent, then I would expect that we could exchange documents and complete discovery within 30 to 60 days.

MR. GALLEGOS: I think that -- You know, I basically agree with Mr. Kellahin. My notes said, "scope and prudency of operation and water encroachment", and we may have one view of scope and prudency of operation and OXY have another. So I think it would be helpful to know what you have in mind a little more specifically.

EXAMINER STOGNER: So as far as the dates, let's hold off on that, and --

MR. GALLEGOS: Yes, sir.

EXAMINER STOGNER: -- I believe we can negotiate that out, when would be the best time.

MR. KELLAHIN: And if we would --

EXAMINER STOGNER: I don't know what my schedule is either.

MR. KELLAHIN: Yes, sir. And if it would help you to understand the magnitude of the decision you're making when you talk about prudency of operations, if it would afford you any assistance, I would be happy to send you my point of view, at least as a checklist of items to consider when you begin to address that kind of topic.

MR. CARROLL: We would appreciate the same list from --

MR. GALLEGOS: Sure.

MR. CARROLL: And how soon can I expect that -- the follow-up memoranda on construction of Subsection F?

MR. KELLAHIN: I would think within a week.

MR. GALLEGOS: That would be fine.

(Off the record)

MR. CARROLL: Is there anything else we need to take care of?

MR. KELLAHIN: Let me ask Counsel --

MR. GALLEGOS: I have one thing that's basically housekeeping.

The version of the notebook we gave to the reporter I have marked as Exhibit A to this hearing, and the ratification is Exhibit B, and then this financial performance item I've marked as Exhibit C. I'd like to ask that they be part of the record.

That would be A, Mr. Stogner.

EXAMINER STOGNER: Okay --

MR. KELLAHIN: Mr. Examiner, there is an objection as to the affidavit of the petroleum engineer attached to the Hartman presentation. He's an engineer, and he attests in the first few pages -- I believe it was items 4, 5 and 6, if I'm not mistaken, and he opines legal conclusions with regards to the consent/nonconsent concept. I believe that's beyond his expertise to reach an affidavit opinion on those items.

EXAMINER STOGNER: Okay, which tab is that?

MR. CONDON: 23.

MR. KELLAHIN: 23, Mr. Examiner.

MR. CARROLL: Mr. Kellahin, we'll take note of that in giving weight to that testimony.

MR. KELLAHIN: In addition, we would move for admission of our Exhibits 1 through 54

EXAMINER STOGNER: Okay, Exhibits 1 through 54 --

MR. KELLAHIN: OXY exhibits.

EXAMINER STOGNER: -- OXY's, will be admitted at

this time in the record, and Hartman's Exhibits -- what? -- I believe A, B and C will be admitted at this time, noting the objection from Mr. Kellahin at this point.

Anything further at this time?

MR. CARROLL: To make things clear now, the parties will wait for Examiner Stogner to issue an order clarifying what the scope of the evidentiary hearing is --

MR. KELLAHIN: Yes, and you --

MR. CARROLL: -- and the parties will get together to discuss the discovery and then they'll report back.

MR. KELLAHIN: Well, there's a predicate to all that. You've given us an opportunity for us each to submit to you for consideration our concept of the components for prudent operation, and that submittal has to have a time frame to it --

MR. CARROLL: Uh-huh.

MR. KELLAHIN: -- after which, then, you will issue an order deciding how you are describing what you mean by examining the operations within the unit, and how are they confined or brought.

MR. CARROLL: So you can submit the list within a week?

MR. KELLAHIN: Yes, sir.

MR. GALLEGOS: Yes, sir.

EXAMINER STOGNER: Okay.

MR. KELLAHIN: If -- Let's get a specific date. We've got the July weekend coming in. Would the 10th of July be too unreasonable?

We will submit Mr. -- Professor Martin's affidavit and our proposed description of prudent operations on July 10th if that's satisfactory.

MR. CARROLL: And do the parties want to commit to a certain time frame after Mr. Stogner's order to report back to the Division as to how you're coming on discovery?

MR. KELLAHIN: I think it's too -- It's premature until we see what he does, because once he does it we can then get together and talk about how much of this we can do voluntarily.

So if you'll defer that --

MR. GALLEGOS: Well, I'd suggest that if the Examiner has a prerogative in the order, say, report back to me in X days, that's what we'll do.

EXAMINER STOGNER: What kind of a time frame would you -- Well, there again, it depends on --

MR. KELLAHIN: It depends on what you tell us.

EXAMINER STOGNER: Okay. I'll take note of that, put a time frame to it.

In the meantime, subsequent to July 10th --

MR. KELLAHIN: Yes, sir.

EXAMINER STOGNER: -- if you see something on your schedule that I need to take into account, if you'll let me know, such as a hearing or court case out of town or something appreciate that.

Then with that, we're adjourned for today.

(Thereupon, these proceedings were concluded at 6:00 p.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 Division 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 July 3rd, 1997.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 1998