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December 15, 2004

David Catanach
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 13348; application of Marbob Energy Corporation for compulsory pooling, Eddy County, New Mexico

Dear Mr. Catanach:

Pursuant to your request, this letter sets forth what my clients (collectively referred to herein as "Iverson") seek in the above case. Before those matters are addressed, I would like to note that Marbob's witness and Marbob's attorney often referred to Mr. (Julian) Ard as an interest owner. That is incorrect: The specific working interest that they were referencing is owned by Mrs. Mary T. Ard, individually and as Trustee of Edward R. Hudson Trust 4, and is the wife of Julian Ard.

There are two primary items which Iverson requests to be addressed in the pooling order to be issued in this case:

I. **Operatorship: Iverson proposes that Hudson Oil Company of Texas not be appointed operator of the well.**

II. **Iverson requests the order include certain provisions providing for Data, Information & Access; Drilling & Completion Expenditures; and the Copas form of Accounting Procedures for Joint Operations, all of which will enable Iverson to effectively monitor the drilling and completing of the well and to protect its substantial investment.**

A summary of Iverson's position relative to these two items is as follows:

I. Operatorship: Iverson proposes that Hudson Oil Company of Texas not be appointed operator of the well. This issue was raised in the pre-hearing statement filed by Iverson in this matter and was addressed extensively in the testimony given by Iverson's witness, the exhibits presented as evidence, cross-examination of Marbob's witness, and my closing statement. The basis of the Iverson's position is as follows:

A. Hudson Oil Company of Texas does not own an interest in the proposed pooled area.
As indicated by Marbob's witness, Mr. Raye Miller (an officer of Marbob – Secretary/Treasurer), Hudson Oil Company of Texas owns no interest in the proposed pooled area. (Page 37 of the Transcript.) The Joint Operating Agreement proposed by Marbob and submitted into evidence as "Exhibit 2" reflects that Hudson Oil Company of Texas owns no interest. The relevant language of Article V.B.1 of the referenced Joint Operating Agreement reads as follows:

Resignation or Removal of Operator: *Operator may resign at any time by giving written notice thereof to Non-Operator. If Operator terminates its legal existence,* ***no longer owns an interest hereunder in the Contract Area*** *(my emphasis), or is no longer capable of serving as Operator, Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor.*

Therefore, according to the terms of the October 1, 2004 Joint Operating Agreement (Marbob's "Exhibit 2") Hudson Oil Company of Texas should not serve as Operator since it does not own an interest in the proposed well. The A.A.P.L. Form 610 – Model Operating Agreement - 1982, the form utilized by Marbob, is widely used in the industry.

B. The 1997 Litigation between Iverson and Hudsons:
Presently Edward R. Hudson, Jr., William A. Hudson II and E. Randall Hudson III are principals and officers of Hudson Oil Company of Texas. As evidenced by Iverson Exhibit 1, in 1997, on this very lease, Iverson sued Edward R. Hudson, Jr., William A. Hudson II, and E. Randall Hudson III (hereinafter referred to as the "Hudsons") for imprudent operations; fraud and express misrepresentation regarding operations including billing for improper operating expenses and overcharges; intentionally, willfully and negligently failing to perform as a prudent operator; and by breaching the special fiduciary relationship that existed between the Hudsons and Iverson for many years. In the Settlement of the lawsuit (also a part of Iverson Exhibit 1), the Hudsons' Operatorship was terminated as to rights for all depths below the stratigraphic equivalent of the base of the San Andres Formation, identified at a depth of 4,230 feet on the Compensated Neutron/Lithodensity log date October 9, 1988 for the BTA Oil Producers 8809 JV-P Puckett Well No. 1; such well being located at 1,880 FNL and 1,880 FEL of Section 25, Township 17 South, Range 31 East, N.M.P.M., Eddy County, New Mexico. **Now, Marbob is insisting that Iverson accept Hudson Oil Company of Texas as operator, which, in essence, would nullify the effects of the resolution of the referenced lawsuit.**

C. Hudson Oil Company of Texas has no experience in completing a deep Morrow Well and has drilled only one deep well, in which they never tested four (4) potentially significant Morrow zones, but completed the well in a shallower oil zone.

D. It is evident from Marbob's testimony Hudson Oil Company of Texas' lack of experience in drilling and completing deep gas wells.

1. Marbob's witness indicated Marbob has never participated in any well (shallow or deep) with Hudson Oil Company of Texas as Operator. (Page 40 of the Transcript.)

2. Marbob acknowledged that they were not familiar with the size and nature of Hudson Oil Company of Texas' technical staff and were not aware of how many wells they had drilled. (Page 33 of the Transcript.)

3. Marbob's witness indicated he was only aware of one well that Hudson Oil Company of Texas had drilled and it was in Section 13, south of the proposed pooled area. (Page 33 of the Transcript.)

E. Iverson is very distressed over the confusion as to the identity of operator. Marbob consistently referred to the proposed operator as "Hudson & Hudson," rather than Hudson Oil Company of Texas. As was complained of in the referenced 1997 Litigation, Edward R. Hudson, Jr., William A. Hudson II, and E. Randall Hudson III operated through W.A. & E.R. Hudson, Inc., and from time-to-time they have operated as various other entities. Iverson believes the purpose of this practice is to intentionally create confusion, as it has in this case, and is an effort by Hudson Oil Company of Texas to limit their liability as Operator, by attempting to shield their individual interest or their interest in various other entities. This confusion is demonstrated in the following references:

1. Marbob's witness acknowledged that the company they are naming as Operator, Hudson Oil Company of Texas, does not own an interest in the proposed well, but Marbob's witness went on the say, *"but I believe there are numerous parties from that Exhibit Number 2 who are related to Hudson Oil Company of Texas. I believe Edward R. Hudson Trust 2, Trust 3, the Javalina Partners, the Zorro Petroleum, virtually*

everybody with a 616 Texas Street address is probably related. You might also note that there are many companies who have an operating entity that operates for them, and all of their interests, for liability purposes, are held in other entities." (Page 37 of the Transcript.)

2. To further add to the confusion as to which Hudson entity is being proposed as Operator, Marbob's attorney indicated in his closing the following: *"The only issue seems to be whether or not Hudson and Hudson of Texas should be the operator. Here we're proposing that the well be operated by them, and we submit it's as proper for us to designate them as an independent drilling arm of our company."* (Page 75 of the Transcript) **Please note the reference to Hudson & Hudson of Texas as opposed to Hudson Oil Company of Texas. Also, does "being an independent arm of Marbob" mean that Marbob will be ultimately responsible?**

3. When Marbob's witness was questioned as to what would be Iverson's remedy if Hudson Oil Company of Texas conducts imprudent operations, he replied, *"I don't know, I'm not a lawyer, you are."* (Pages 37 & 38 of the Transcript.)

4. In an effort to determine who will be in control of drilling and completing operations, I posed the following question to Marbob's witness: *Q. So it sounds like the majority of people there would be Marbob or Marbob contract personnel? A. I don't believe that that's unreasonable to assume. That's the agreement that we have with Hudson. And it's not in writing, but, you know, obviously they can change that. They're operator."* (Page 34 of the Transcript.)

5. Marbob's witness further testified that Marbob's geologists, engineers, field supervisor, drilling superintendent and gas marketer will be used by Hudson Oil Company of Texas. However, it has not been explained how the costs of these Marbob employees will be borne. The Pooled working interest owners are not privy to the verbal agreement between Marbob and Hudson Oil Company of Texas, which by Marbob's witness's own admission, can be changed at any time. By the following testimony responding to a question posed by me, Marbob's witness indicated Marbob's level of involvement, which included issuing the daily drilling report:

"Q. And would any Marbob supervisory personnel be used on this well?"

"A. Yes, sir, I believe that the consultant that we're using for the drill site work will actually be utilized. I believe our drilling superintendent will be the first party that he calls if there's a problem. I believe that our geologists will be actually following the well on a daily basis, the mudloggers will actually be reporting directly to them, and I believe that there is certainly the chance that we'll actually be issuing the daily reports out of our office, just because of the time limits of information, directly to all of the non-op parties, rather than it actually coming out of Hudson, since they're in Fort Worth." (See Page 34 of the Transcript.)

6. In response to my question, *"Who will be in control of the costs on this well? Hudson or Marbob?"*, Marbob's witness responded as follows: *"Hudson is the operator. They have actually – under the way our agreement has worked with Premier, which we described to them and they seem to have no problem of, we'll actually approve the invoices by the parties who are on site to make sure, you know, that they're proper. And then they'll be forwarded to Hudson for payment. Hudson will actually pay the invoices and then bill the parties."*

7. By Marbob's witness' testimony, Marbob acknowledged that they had prepared the proposed Joint Operating Agreement and the AFE and had directly handled all of the negotiations with other working interest owners, while Hudson Oil Company of Texas did not. Marbob acknowledged that the AFE had been prepared by them based on their experience, not Hudson Oil Company of Texas. Furthermore, while Marbob indicated that Hudson Oil Company of Texas had approved the proposed Joint Operating Agreement and the proposed AFE, no executed copies of the same have ever been furnished to Iverson, and to our knowledge, none have been furnished to the Division. Additionally, Hudson Oil Company of Texas has not furnished Iverson with a drilling procedure on how they propose to drill this deep Morrow gas well.

Considering all of the factors outlined in items 1 through 7 above, if Hudson Oil Company of Texas is named Operator, who actually will be in control of how the expenditures are made; who actually will be responsible for supervising the drilling and completion operations; who actually will the Pooled Working Interest Owners look to for liability for imprudent operations; and who actually will assume the fiduciary responsibility of the prepayment that will be made by the Pooled Working Interest owners as will be required by an order in this case is uncertain: Marbob, Hudson Oil Company of Texas, the Hudsons, Hudson & Hudson of Texas, Javalina Partners, Zorro Petroleum, Edward R. Hudson Trust 2, Edward R. Hudson Trust 3, or some other entity?

8. There is no proven economic impact for having Hudson Oil Company of Texas named as Operator based on the royalty rate reduction, which Hudson Oil Company of Texas **may** receive on oil production. Please note that the Department of Interior can cancel the royalty reduction program on this lease at any time.

(i) There is no oil production below the stratrigraphic equivalent of 4230 feet as identified above in the immediate eight-section area surrounding the proposed pooled area, and in fact, there is not sufficient oil production within several miles to justify being offset. Additionally, Marbob admitted that they did not anticipate any shallow oil below 4230 feet. (Page 32 of the Transcript.)

(ii) In response to a question of whether Marbob included any oil production in its own internal economic analysis, Marbob's witness indicated "*We don't do internal economic analysis, we just look at the prospect.* (Page 33 of Transcript).

(iii) *Article XV. A. Priority of Operations* of the proposed Joint Operating Agreement (Marbob's Exhibit 2) specifies that once the well is drilled to the objective depth and the parties cannot agree to the sequence of further operations, that an attempt to complete the well at the objective depth or objective formation will be first priority, and then proposals to plug back and attempt completion above objective depth, will be considered in ascending order. Additionally, *Article VI. B. 1.*, allows only proposals to plug back dry holes or a well "*not then producing in paying quantities*". Therefore, in the unlikely event that oil is discovered, it would be at shallower depths than the Morrow objective. The deeper commercial production would be produced first, leaving the shallower oil to be produced sometime in the future, possibly some five to ten years in the future after the deeper zones no longer produce in paying quantities. The value of any possible shallower oil production must be substantially reduced by discounting to present value for the period of time the deeper commercial production is being produced.

Thus, this matter has no proven economic impact and should not be the sole basis of awarding operations.

Therefore, in summary, Hudson Oil Company of Texas should not be named Operator for the following reasons:

1. **Because both Marbob's testimony and Exhibits reflect that Hudson Oil Company of Texas has no interest in the proposed pooled area and Hudson Oil Company of Texas should not serve as Operator by the terms of the proposed Joint Operating Agreement.**

2. **Because of the Hudsons' history of litigation regarding fraudulent and imprudent operations.**

3. **Because the Hudsons' Operatorship on this lease was terminated as to the deep rights in the Settlement of the 1997 litigation.**

4. **Because of Hudson Oil Company of Texas' lack of experience in drilling and completing deep Morrow gas wells.**

5. **Because of the confusion and uncertainty evidenced by Marbob's testimony as who will actually be supervising the drilling and completing of the well; who actually will be held**

responsible for imprudent operations; who actually will be responsible and in control of how expenditures are made; and who actually will assume the fiduciary responsibility of the prepayment that will be made by the Pooled working interest owners.

In conclusion, Iverson feels the proposal of naming Hudson Oil Company of Texas as Operator is a sham; to name Hudson Oil Company of Texas as Operator for no valid reason, owning no interest in the well, while Marbob remains, in fact, the Operator. As is specified in the A.A.P.L. Form 610 – Model Form Operating Agreement – 1982, the form utilized by Marbob and which is utilized throughout the industry, a party owning no interest should not serve as Operator. Allowing such a situation will severely diminish the accountability of Hudson Oil Company of Texas to the Pooled Working Interests Owners. Furthermore, should the Hudson Oil Company of Texas be named Operator, it will make subsequent audits as to the reasonableness of the drilling and completion costs very difficult to determine and potentially very contentious.

II. Iverson requests the order include the following provisions to enable Iverson to effectively monitor the drilling and completing of the well and to protect its substantial investment.

A. Data, Information and Access.

Each Pooled working interest owner shall have access to the area hereby pooled at all reasonable times, at its sole cost and risk to inspect or observe operations, and shall have access at reasonable times to information pertaining to the development or operation thereof, including Operator's books and records relating thereto. Operator shall furnish each of the Pooled working interest owners with copies of all forms or reports filed with governmental agencies, daily drilling reports, well logs, tank tables, daily gauge and run tickets and reports of stock on hand at the first of each month, and shall make available samples of any cores or cuttings taken from any well drilled pursuant to this Order. The cost of gathering and furnishing information to each Pooled working interest owner, other than that specified above, shall be charged to the Pooled working interest owner that requests the information.

B. Drilling & Completion Expenditures.

All Pooled working interest owners agree to all of the reasonable and necessary expenditures for the drilling of the subject well. When the subject well has reached the base of the Morrow formation, an approximate depth of 12,700 feet, and all tests have been completed, the Operator shall give immediate notice to the Pooled working interest owners, along with the results of all tests. The Pooled working interest owners receiving such notice shall have forty-eight (48) hours (exclusive of Saturday, Sunday and legal holidays) in which to elect to participate in the setting of casing and the completion attempt. Such election, when made, shall include consent to all reasonable and necessary expenditures for the completing and equipping of the subject well, including necessary tankage and/or surface facilities. Failure of any Pooled working interest owner receiving such notice to reply within the above fixed period shall constitute an election by that Pooled working interest owner not to participate in the cost of the completion attempt. Within 30 days after the expiration of the notice period, Operator shall pay pooled working interest owners that went non-consent on the completion attempt the amount of the advance attributable to its share of completion expenditures. Operator is hereby authorized to withhold the following costs and charges from production attributable to the pooled working interest owner that went non-consent at completion point:

- The proportionate share of reasonable well expenditures for the completing and equipping of the subject well, as hereinabove defined, and
- As a charge for the risk involved in completing the well, 200% of the above costs.
- The Operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the completion costs.

C. The Copas form of Accounting Procedure for Joint Operations.

The Applicant submitted as Exhibit 5 the Copas form of Accounting Procedure for Joint Operations and in its testimony requested that certain provisions be adopted. (Pages 14 & 15 of the Transcript.) Iverson requests that the order include the following language:

The "Accounting Procedure Joint Operations" as submitted by Applicant, as Exhibit 5 shall be incorporated in its entirety.

Finally, we note that Marbob, in its closing argument, tried to minimize the interests represented by me at the hearing, by saying that the Iverson Trusts had agreed to the JOA. In order to make that argument, Marbob ignores the fact that Marbob was the party who refused to accept the signatures of the Iverson Trusts on the JOA, in an effort to force all parties to sign. The working interest represented by the objectors at hearing is approximately 24%, which is a substantial interest deserving the protection of the provisions in the pooling order specified above.

We appreciate your consideration of our comments and requests. Please call me if you have any questions or need any additional information.

Very truly yours,

James Bruce

Attorney for Mary T. Ard, W.W.I. 1990 Trust,
S.J.I. Jr. 1990 Trust, The P.I.P. 1990 Trust,
Iverson III, Inc., S.J. Iverson Trust, and
Edward R. Hudson Trust 4

cc: William F. Carr