

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION COMMISSION FOR THE)
PURPOSE OF CONSIDERING:)

CASE NO. 13,069

APPLICATION OF THE NEW MEXICO OIL)
CONSERVATION DIVISION THROUGH THE)
ENGINEERING BUREAU CHIEF FOR ADOPTION)
OF A NEW RULE RELATING TO COMPULSORY)
POOLING AND PRESCRIBING RISK CHARGES)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

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

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Oil Conservation Division

June 12th, 2003

Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Thursday, June 12th, 2003, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

STEVEN T. BRENNER, CCR
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I N D E X

June 12th, 2003
Commission Hearing
CASE NO. 13,069

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* * *

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* * *

1 WHEREUPON, the following proceedings were had at
2 9:33 a.m.:

3 CHAIRMAN WROTENBERY: And that brings us to Case
4 13,069, the Application of the New Mexico Oil Conservation
5 Division through the Engineering Bureau Chief for adoption
6 of a new rule relating to compulsory pooling and
7 prescribing risk charges.

8 We heard some evidence in this case at the May
9 15th hearing, and we are ready to continue this morning,
10 Mr. Brooks.

11 MR. BROOKS: Very good. I believe my witnesses
12 have been sworn previously, so I would recall Michael
13 Stogner.

14 And I believe you have copies of the exhibits, do
15 you, Mr. Stogner?

16 MR. STOGNER: Yes, I do.

17 MR. BROOKS: I'm wondering if Mr. Brenner can
18 inform me of what exhibits have been admitted at the
19 previous hearing. You do not have the --

20 COURT REPORTER: No.

21 MR. BROOKS: -- that information readily
22 available? Very well, at the conclusion of this hearing,
23 as a precautionary measure, I will tender all the exhibits
24 into evidence unless they were not admitted at the previous
25 hearing.

1 CHAIRMAN WROTENBERY: Okay, thank you, Mr.
2 Brooks. I was looking to see if I had a list, and I don't
3 believe I have one with me.

4 MR. BROOKS: Okay, very good.

5 For your reference, Mr. Stogner, I plan to start
6 this morning on page 5 of the note sheet that you and I
7 have worked out.

8 MICHAEL E. STOGNER,
9 the witness herein, having been previously duly sworn upon
10 his oath, was examined and testified as follows:

11 DIRECT EXAMINATION

12 BY MR. BROOKS:

13 Q. You will recall at the previous hearing we
14 discussed the risk penalties or, to be more accurate, risk
15 charges that were proposed for adoption by the Division,
16 and also the proposals that have been made by the work
17 group, and I believe we attempted to cover that area in
18 some detail. All of these risk charges apply to a defined
19 term, which we have called well costs.

20 And now what I want to do is look at that portion
21 of the proposed rule, which is Exhibit Number 1 in this
22 case, that deals specifically with the definition of well
23 costs. That portion of the proposed rule appears in the
24 two paragraphs that follow numbered paragraphs 1, 2 and 3
25 in subsection A of the proposed rule.

1 Now, I believe we identified at the previous
2 hearing OCD Exhibit Number 2. Do you have Exhibit Number 2
3 there? That was an excerpt from the statute.

4 A. That one I do not have.

5 Q. Well, I will show you my copy, and I will ask you
6 to read into the record the portion of
7 Exhibit Number 2 which is outlined in green ink on the copy
8 that I showed you.

9 A. "Such pooling order of the Division shall make
10 definite provisions as to any owner or owners who elect not
11 to pay his proportionate share in advance for a *pro rata*
12 reimbursement solely out of production to the parties,
13 advancing the cost of the development and operation, which
14 shall be limited to the actual expenditures required for
15 such purpose, not in excess of what are reasonable but
16 which shall include a reasonable charge for supervision and
17 may include a charge for the risk involved in the drilling
18 of such well, which charge for risk shall not exceed 200
19 percent of the nonconsenting working interest owner's or
20 owners' *pro rata* share of the cost of drilling and
21 completing the well."

22 Q. Okay, thank you. I want to call attention to two
23 concepts in there. First of all, it says that -- This is
24 the statutory provision under which we operate in the
25 compulsory pooling area, correct?

1 A. That's correct.

2 Q. Okay. It says that the reimbursement to the
3 owner or owners who -- the reimbursement to the parties who
4 pay for the well will be limited to the actual expenditures
5 required for such purpose, and "such purpose" appears to
6 refer back to the preceding line here where it says costs
7 of development and operation.

8 Then in the next clause it says "not to exceed
9 200 percent". When it's talking about the risk penalty or
10 risk charge it says "the charge for risk not to exceed 200
11 percent of the nonconsenting working interest owners' *pro*
12 *rata* share of the cost of drilling and completing the
13 well."

14 Now, in industry parlance, is there a difference
15 between cost of drilling and completing the well and cost
16 of operation that is reasonably well understood in the
17 industry?

18 A. Well, I believe that the cost of development and
19 operation, these are recovered out of the nonconsenting
20 parties' share --

21 Q. Right.

22 A. -- and then the cost of drilling and completing
23 the well that is the base of which is -- the -- multiplied
24 by the assigned percentage to compute the risk charges.
25 These are two separate formulations in the Oil and Gas Act.

1 Q. Exactly.

2 A. Okay.

3 Q. Now, but the cost of development and operation as
4 that would be understood in the industry, that's a broader
5 category? Does that not include costs that would not be
6 included in the cost of drilling and completing?

7 A. I don't believe so, no.

8 Q. What about operating costs? The drilling party
9 is entitled to recover their operating costs?

10 A. Oh, yeah, they're entitled to -- yes, their
11 operating -- sorry I'm a little slow here today. Yeah,
12 they're entitled to recoup their drilling costs.

13 Q. And their operating?

14 A. And their operating, yeah.

15 Q. So when it says costs of development and
16 operation, that's a broader concept than costs of drilling
17 and completing?

18 A. Yeah, that's correct, that's correct.

19 Q. Because it includes the ordinary expenses
20 associated with operating the well once it's put on
21 production, correct?

22 A. Yes.

23 Q. Okay, I'm sorry, I --

24 A. We're kind of starting in the middle here, and
25 I'm --

1 Q. Yeah.

2 A. -- getting my train of thought back.

3 Q. Okay. In the Oil and Gas Act they do not use the
4 expression "well costs" that we use and define in Exhibit
5 1?

6 A. That's right.

7 Q. But since "well costs", as used in Exhibit 1, is
8 the factor which we multiply by 200 percent, or whatever
9 number the Commission eventually comes up with to get to
10 the charge for risk, then we would be adopting an improper
11 rule if the phrase "well costs" was not at least arguably
12 equivalent to the phrase "cost of drilling and completing
13 the well", which is what we have the authority to use as a
14 standard under the governing statute, correct?

15 A. Yes.

16 Q. Okay. Now, let's talk about well costs.

17 A. Okay.

18 Q. This term "well costs" is a term that we have
19 customarily used in OCD compulsory pooling orders, is it
20 not?

21 A. That is right, yes.

22 Q. And we've used it in the sense of being the
23 factor which is used to compute the risk charge, correct?

24 A. Yes.

25 Q. As well as being the amount that the pooled party

1 has to advance if they choose to participate in the well?

2 A. Yes.

3 Q. Now, are you generally familiar with the
4 understanding in the oil and gas industry of what
5 constitutes drilling and completion costs?

6 A. I believe so.

7 Q. So I will call your attention to the first
8 sentence of the well-cost definition, which reads, "'Well
9 costs' mean all reasonable costs of drilling, reworking,
10 diverting, deepening, plugging back and testing the well,
11 completing the well in any formation pooled by the order
12 and equipping the well for production."

13 That sentence refers to the cost of drilling and
14 completing, but it also uses some additional words.

15 Now, is there any cost included in the sentence,
16 "'Well costs'...", that is not a cost of drilling and
17 completion -- except possibly workover? I'm going to ask
18 you specifically about workover next. But other than that,
19 the costs of drilling, diverting, deepening, plugging back
20 and testing the well and completing in any formation
21 pooled, would that all be reasonably accepted in the
22 industry as being costs of drilling and operation?

23 A. Yes, I believe it is.

24 Q. Drilling and completion, I'm sorry.

25 A. That's right, the drilling and completion phase

1 of it.

2 Q. Now, what about workover costs? That's a broad
3 category, is it not?

4 A. That's a very broad category.

5 Q. Can you explain to us some of the things that
6 customarily would be included in the phrase "workover"?

7 A. Well, "workover" can mean, really, lots of
8 things, re-entering a well to clean it out, maybe put new
9 perforations in the same zone, it could even mean putting
10 perforations in a different zone, refracturing the well,
11 the perforations that you have, perhaps acidizing. The
12 word "workover" is just a broad, broad sense. In fact, I
13 think it can even be used as deepening.

14 Q. Now, deepening would clearly be cost of drilling,
15 right?

16 A. I believe that it would be. Now, this would be
17 deepening in an existing well. So the word "workover" has
18 lots of connotations and lots of terms.

19 Q. Reperforating would at least arguably be
20 completion costs, because perforating in the first place is
21 part of completion operations?

22 A. That's right, but it can also be covered as
23 workover.

24 Q. Right. And so some of the things that might be
25 called workover expenses would fairly clearly be drilling

1 and completion costs, right?

2 A. Yes.

3 Q. But there are some things, like cleaning out a
4 well, that arguably might not be called drilling costs,
5 correct?

6 A. That's right.

7 Q. So there might be some question, then -- and I'm
8 really bringing this to the attention of the Commission,
9 merely so they would be alerted to it, because -- I'm not
10 asking the Commission to exceed their statutory powers --
11 there might be some question when we define well costs as
12 including workover costs, whether or not we're including
13 something that is not fairly within the statutory language,
14 correct?

15 A. That's correct.

16 Q. Okay. Now, next call your attention to the next
17 sentence of that same paragraph, which reads, "If, however,
18 any well was previously completed in another formation or
19 bottomhole location or was previously abandoned without
20 completion, well costs as to such well shall mean only the
21 reasonable costs of re-entering, deepening, diverting or
22 plugging back the well, completion or pooled formation or
23 formations and, if necessary, re-equipping the well for
24 production, unless the Division determines that an
25 allowance of all or some portion of the historical costs of

1 drilling is just and reasonable due to particular
2 circumstances."

3 I'm on page 5, item number 58.

4 A. Okay, got you, I'm caught up with you now.

5 Q. Okay. Is that sentence in accordance with the
6 way we have treated compulsory pooling cases involving re-
7 entry situations in the past?

8 A. Yes, it is.

9 Q. And is that a uniform treatment of that
10 situation --

11 A. Yes.

12 Q. -- as far as you know?

13 A. Yes, it is.

14 Q. Okay. The next sentence reads, "If, however, a
15 well was previously..." No, I'm sorry, that's the one I
16 just read.

17 A. Yeah.

18 Q. Sorry. Going on to page 6, then --

19 CHAIRMAN WROTENBERY: Mr. Brooks, when you refer
20 to page 6 what are you --

21 MR. BROOKS: This is --

22 CHAIRMAN WROTENBERY: -- referring to?

23 MR. BROOKS: -- some notes that I've prepared,
24 that --

25 CHAIRMAN WROTENBERY: Okay.

1 MR. BROOKS: -- I've been over with the witness.
2 And if we hadn't had this long skip between our initial
3 preparation and today I would be better organized and I
4 wouldn't have to do this, but --

5 CHAIRMAN WROTENBERY: Okay.

6 MR. BROOKS: -- neither of us is as clear on
7 where we are as we perhaps should be.

8 Q. (By Mr. Brooks) Now I'm going to call your
9 attention to the final sentence in that grammatical
10 paragraph. We're at the bottom, now, of page 1 of Exhibit
11 1, and it's about six lines, seven lines up, starts in the
12 middle of the line, "As to any interest owner who elects
13 not to pay its share of well costs associated with a
14 specific well in advance as provided in the applicable
15 order, well costs shall include cost of any subsequent
16 reworking, diverting, deepening, plugging back, completion
17 or recompletion of that well undertaken prior to the time
18 that the amount of such nonconsenting owners' share of well
19 costs and applicable risk charge have been recovered from
20 such nonconsenting owners' share of such production."

21 Do you understand that this provision deals with
22 expenditures -- or purports to deal with expenditures
23 undertaken after an initial completion?

24 A. Yes.

25 Q. Now, we have not dealt with that in the

1 compulsory pooling orders in the past, have we?

2 A. Not to any degree, no.

3 Q. Our compulsory pooling orders essentially are
4 silent about how you treat expenditures that occur after
5 the well is completed?

6 A. That is right, it's usually -- The only thing
7 that's ever mentioned is if it's an existing well --

8 Q. Right.

9 A. -- to be deepened or recompleted.

10 Q. So this is a new provision, not a codification of
11 existing practice?

12 A. That's right.

13 Q. Okay. Of course, we do have a provision in the
14 existing compulsory pooling order that the operator can
15 recover the operating expense of it, the nonoperator's
16 share of production?

17 A. That's right.

18 Q. But he would only get dollar-for-dollar
19 reimbursement and wouldn't get any risk charge on what was
20 treated as operating expense, correct?

21 A. That's correct.

22 Q. But under this proposed rule, the operator would
23 get a risk charge on certain defined categories of expenses
24 that were incurred after the initial completion?

25 A. That's correct.

1 Q. Okay.

2 CHAIRMAN WROTENBERY: Mr. Brooks, in that case,
3 how do we determine whether those costs are reasonable?

4 MR. BROOKS: Madame Chair --

5 CHAIRMAN WROTENBERY: There is a procedure --

6 MR. BROOKS: I'm sorry, go ahead.

7 CHAIRMAN WROTENBERY: -- for the original well
8 costs that we've been accustomed to dealing with in our
9 compulsory pooling orders. But in this category of
10 subsequent well costs, how do you give the interest owner
11 who has elected not to pay its share of well costs notice
12 of those costs and an opportunity to question whether
13 they're reasonable?

14 MR. BROOKS: Madame Chairman, I think that would
15 have to be dealt with in the order, and it would have to be
16 dealt with by an additional paragraph. You know the way
17 the order is presently drawn, the orders we normally use,
18 they say that upon completion the operator files his costs,
19 and I think we would have to add a provision that when the
20 operator incurs additional well costs subsequent to
21 completion, then after incurring those costs they would
22 have to file those costs, the nonoperators would have a
23 chance to object, and in the event of objection the
24 Division would determine reasonable costs as in other
25 cases.

1 CHAIRMAN WROTENBERY: Okay, thank you.

2 Q. (By Mr. Brooks) Now, I've already asked you
3 about workover expenses, so I will go on to the top of page
4 7 of our outline, and I'm also going to page 2 of Exhibit
5 1. The sentence at the top of the page 2 reads, "Well
6 costs shall also include reasonable costs of drilling,
7 completing, testing and equipping a substitute well if in
8 the drilling of a well pursuant to a compulsory pooling
9 order the operator loses the hole or encounters mechanical
10 difficulty rendering it impractical to drill to the
11 objective depth and the substitute well is located within
12 330 of the original well and drilling thereof is commenced
13 within 10 days of the abandonment of the original well."

14 Now, again, this is a concept we've never dealt
15 with on a -- except perhaps in particular cases before.

16 A. Just particular cases.

17 Q. Right. And Mr. Carr and Steve Smith assure me
18 there's at least one case in which we've dealt with that
19 subject before at the Division level, but I understand not
20 at the Commission level. But do you understand the concept
21 involved here?

22 A. Yeah, in this case if a hole is started or a well
23 is started and it gets, oh, down past, let's say the first
24 casing string and you twist the drill collars off, or
25 perhaps the casing collapses for whatever reason, the hole

1 cannot be finished, then the practice is to bring
2 everything out and skid the rig while you have it,
3 literally move the drilling rig over to a substitute
4 location, start over again, and then that first hole is
5 cemented the best way, and a workover rig. But this is
6 what this is referring to, is those problem holes where
7 something happens.

8 Q. Now, under our existing compulsory pooling
9 orders, it would be ambiguous as to whether or not, if this
10 scenario arose, the operator could recover -- or whether or
11 not the cost-recovery provisions and risk-penalty
12 provisions would apply to that existing well in the absence
13 of an amended order by the Division, correct?

14 A. That's correct.

15 Q. And a lot of times in this situation, would it
16 not -- or would there be a substantial saving to the
17 operator in skidding the rig over rather than releasing the
18 rig and having to bring another rig in after they've got an
19 amended order?

20 A. Oh, of course, there's be -- the expenses would
21 be quite a bit.

22 Q. So from an efficiency standpoint, there would be
23 some gain in having this provided in the initial order?

24 A. Yes, I believe it will.

25 Q. Okay. Now, if the substitute hole were drilled

1 at a location close to the original one and to the same
2 objective formation, would it be reasonable to say that the
3 cost of drilling the original hole to failure, plus the
4 cost of drilling the substitute hole could be considered,
5 quote, costs of drilling and completing the well --

6 A. Yes, I believe --

7 Q. -- within the statutory meaning?

8 A. Yes, I believe so.

9 Q. Okay. I next call your attention to the final
10 grammatical paragraph in subsection A of the proposed rule.
11 It's the second paragraph appearing on page 2 of Exhibit 1.
12 It reads, "As an applicant for compulsory pooling shall not
13 be required to present technical evidence justifying the
14 risk charge provided in this subsection."

15 In our normal procedure in compulsory pooling
16 hearings, there's a significant portion of the hearing
17 devoted to technical evidence justifying the risk penalty?

18 A. Yes, it is, anywhere from a half to three-
19 quarters of the testimony.

20 Q. And does it usually involve the applicant
21 bringing a witness whose testimony would not otherwise be
22 necessary?

23 A. Yes.

24 Q. Because normally they have a landman, or land
25 person, to testify to the title and notice requirements,

1 correct?

2 A. That's right, usually a compulsory pooling case
3 has first the landman, an expert in the leasing, to present
4 the testimony, and then an engineer and/or a geologist.

5 Q. And the primary if not the exclusive purpose of
6 the engineer or geologist would be to testify to the risks
7 involved?

8 A. That is correct, and the applicable well costs.

9 Q. Okay. Given that scenario, would it save the
10 Division a considerable amount of time if we adopted this
11 provision that they would not have to present this
12 technical evidence in cases where the standard risk
13 penalties were adopted?

14 A. Yes, it would.

15 Q. Would it save the operators a significant amount
16 of expense not to have to bring these additional witnesses?

17 A. That is correct, that would cut down a lot on
18 expenses and travel.

19 Q. And just to reiterate what was testified to us at
20 the previous hearing, in fact, in making recommendations to
21 the Director, you and the other Examiners are not governed
22 primarily by the testimony in each particular case but are
23 governed primarily in practice by the rules of thumb that
24 we have talked about in the previous cases, the 200-percent
25 rule, the 156-percent rule and the 100-percent rule. Is

1 that fair to say?

2 A. That's correct.

3 Q. And having analyzed the orders that I've written
4 during the time when I was doing compulsory pooling orders,
5 I used the same rules, correct?

6 A. That's correct.

7 Q. Okay. Have there been very many cases in which
8 there has been a controversy or dispute between the parties
9 over what should be the applicable risk charge in a
10 compulsory pooling case in your experience?

11 A. Just my experience, no, there hasn't been very
12 many at all, just a handful.

13 Q. There was a big fight over the 156-percent rule
14 when it was first adopted for the Fruitland Coal, correct?
15 Or not a big fight, but there was a lot of testimony?

16 A. There was a lot of testimony. I didn't consider
17 it a big fight, no.

18 Q. No, there wasn't anybody on the other side,
19 except you.

20 A. Just me, yes, and Mr. Catanach.

21 Q. But in your experience generally, that has not
22 been the focus of controversy in compulsory pooling cases?

23 A. No, that's one of the last things to be --

24 Q. Usually, when --

25 A. -- when there is in this whole thing. I mean,

1 when there is a conflict, that's the last thing to be
2 considered.

3 Q. Usually when there's a conflict it's about one
4 wants to drill one place and one wants to drill another, or
5 about who wants to -- who can operate --

6 A. That's -- the majority of the conflicts are from
7 those two questions, yes.

8 Q. Okay. Now let's go to the next paragraph of the
9 proposed order, which is paragraph 1 of section -- numbered
10 paragraph 1 of subsection B to exceptions, and this
11 paragraph reads, "At the request of applicant, any
12 applicant for compulsory pooling order who seeks a
13 different risk charge than that provided in subsection A of
14 this section shall so state in its application, a copy of
15 which shall be served on each person required to be
16 notified of the filing of the Application and shall have
17 the burden to prove the justification for the risk charge
18 sought by relevant geologic or technical evidence."

19 Now, let us assume that the Commission succumbs
20 to the blandishments of the -- Burlington and others, and
21 adopts an across-the-board 200-percent risk penalty. Would
22 there be any need for this numbered paragraph 1?

23 A. Not unless for some reason they wanted to have a
24 less than 200 percent. I don't see any reason --

25 Q. It's very unlikely that the Applicant would come

1 up here to urge us to give them less money than they would
2 be entitled to under the Rule, correct?

3 A. That's right. But who knows, they might have a
4 different mindset sometimes.

5 Q. Now, looking at numbered paragraph B.2, that
6 permits a responding party to ask for a greater -- to ask
7 for a lesser risk penalty, correct?

8 A. That's correct.

9 Q. And it provides for notice?

10 A. Yes, it does.

11 Q. And there's another provision in here which
12 provides for a continuance in certain situations. Now,
13 when we have responding parties to compulsory pooling
14 hearings, sometimes those are parties who are not very
15 familiar with our rules; is that correct?

16 A. That is correct.

17 Q. And they may come here on the day of the hearing
18 and request the opportunity to contest the risk penalty
19 without having alerted anyone in advance?

20 A. That has happened, yes.

21 Q. And if that happens, if the operator had to have
22 their witness on standby in case somebody showed up to
23 oppose the risk penalty, it would kind of defeat the
24 purpose of our rule?

25 A. That's correct, you'd have to bring them up and

1 they'd have to be in here, even though they wouldn't give
2 testimony.

3 Q. And that problem would be avoided by this rule
4 that gives the operator the -- in fact, the option to
5 demand a continuance if he has to defend the risk penalty?

6 A. That's correct, that would give everybody a
7 chance to come in prepared, or to work out a solution on
8 the side.

9 Q. Mr. Stogner, do you believe that the adoption of
10 this rule would serve the interests of prevention of waste
11 and protection of correlative rights?

12 A. I believe that Rule 35 as represented by Exhibit
13 Number 1 would do that, yes.

14 MR. BROOKS: In case I have not already done so,
15 I want to offer into evidence Exhibits Numbers 1 through 6

16 CHAIRMAN WROTENBERY: Any objection? Then OCD
17 Exhibits 1 through 6 are admitted into evidence.

18 MR. BROOKS: And at this time I will pass the
19 witness.

20 CHAIRMAN WROTENBERY: Any questions from the
21 people in the audience?

22 Commissioners?

23 I do want to follow up a little bit further on
24 the one sentence that's at the bottom of page 1 of OCD
25 Exhibit 1, and I'm not sure whether to ask this question of

1 Mr. Stogner or Mr. Brooks or the other members of the
2 compulsory pooling work group, actually.

3 MR. BROOKS: Well, I will note --

4 CHAIRMAN WROTENBERY: This sentence --

5 MR. BROOKS: -- that Mr. Patterson, my next
6 witness, will also address this, so --

7 CHAIRMAN WROTENBERY: Oh, okay, so do you think I
8 should hold my question?

9 MR. BROOKS: No, I'm not saying you should hold
10 your questions, but I'm saying you may want to also ask
11 them of Mr. Patterson.

12 CHAIRMAN WROTENBERY: Oh, okay. Well, I just
13 would like a little more background. That particular
14 sentence was not part of the Application as it was
15 originally filed. It was added sometime between the filing
16 of the Application and the --

17 MR. BROOKS: That may well be --

18 CHAIRMAN WROTENBERY: -- preparation of this
19 exhibit --

20 MR. BROOKS: -- correct, I --

21 CHAIRMAN WROTENBERY: -- and --

22 MR. BROOKS: -- don't recall exactly what the
23 sequence of events was on that.

24 CHAIRMAN WROTENBERY: Okay, and I'll just note
25 that it addresses one category of interest owner and one

1 category of subsequent operations, and I'm just a little
2 puzzled about why it's necessary to include that sentence
3 in this rule-making, and if so are there other categories
4 of subsequent operations and other categories of interest
5 owners that we need to address in a similar way? And so --

6 MR. BROOKS: Yeah --

7 CHAIRMAN WROTENBERY: -- I'll --

8 MR. BROOKS: -- I think that --

9 CHAIRMAN WROTENBERY: -- rely on you --

10 MR. BROOKS: -- perhaps Mr. Patterson --

11 CHAIRMAN WROTENBERY: -- to tell me when the
12 appropriate time --

13 MR. BROOKS: -- can explain that --

14 CHAIRMAN WROTENBERY: -- to get into that
15 discussion would be.

16 MR. BROOKS: -- better than I can, because this
17 provision is taken from a concept that appears in the joint
18 operating agreement, and he's going to testify somewhat
19 about the coordination of the operating agreement.

20 CHAIRMAN WROTENBERY: Okay, then I'll hold my
21 questions then --

22 MR. BROOKS: Okay.

23 CHAIRMAN WROTENBERY: -- until Mr. Patterson
24 comes back up.

25 I don't believe we have any further questions of

1 Mr. Stogner, then.

2 Thank you very much, Mr. Stogner, for your
3 testimony.

4 MR. BROOKS: Okay, we'll call Randy Patterson.

5 RANDY G. PATTERSON,

6 the witness herein, having been previously duly sworn upon
7 his oath, was examined and testified as follows:

8 DIRECT EXAMINATION

9 BY MR. BROOKS:

10 Q. Good morning, Mr. Patterson.

11 A. Good morning, Mr. Brooks.

12 Q. I believe --

13 CHAIRMAN WROTENBERY: Good morning.

14 Q. (By Mr. Brooks) I believe we've gone through all
15 the preliminaries in the previous hearing, so I will jump
16 right into the substance at this point.

17 We talked at the previous hearing about the work
18 group, the compulsory pooling work group that has been
19 organized under the auspices of the OCD and of which you
20 and I are members. And the compulsory pooling work group
21 reached a consensus on certain items.

22 Now, first of all, looking at the concept of this
23 rule, which is to prescribe the risk charge which the
24 Division is authorized -- to exercise the Division's
25 discretion to fix a risk charge in compulsory pooling

1 orders by rule rather than on a case-by-case basis as it's
2 been done on the past, is this something on which there is
3 a consensus among the work group?

4 A. Yes, sir, there was a consensus on that idea.

5 Q. And was the work group in favor of that concept?

6 A. Yes, sir, the work group was unanimously in favor
7 of that idea.

8 Q. And would this -- You heard Mr. Stogner's
9 testimony as to the format of the compulsory pooling
10 hearings, and he expressed the opinion that it would save
11 the industry time and money if they were not required to
12 present technical testimony on risk at each compulsory
13 pooling hearing. Do you agree with that?

14 A. Yes, sir I do agree with that, and the work
15 group agreed with the statements that were made by Mr.
16 Stogner that it would simplify the process of force-pooling
17 hearings and would eliminate the necessity of testimony
18 that becomes redundant after hearing after hearing.

19 Q. Are you aware of any opposition within the oil
20 and gas industry to this concept?

21 A. No, sir, I'm not aware of any.

22 Q. Can you think of any reason why any discrete
23 segment of the industry might oppose this concept?

24 A. No, I have not heard of anyone or become aware of
25 anyone that would oppose a standardization of -- and

1 simplification of the process.

2 Q. Okay. With that I will go on, then, to page 4 of
3 our outline. Looking at the definition of well costs, the
4 definition of well costs encompasses the final grammatical
5 paragraph on page 1 of Exhibit A and the initial
6 grammatical paragraph on the top of page 2 of Exhibit A.

7 Did we spend quite a bit of time in the work
8 group discussing the particulars of the well-cost
9 definition?

10 A. Yes, sir, we went over nearly every word of that
11 paragraph.

12 Q. Now, there was some disagreement with some words
13 and clauses, correct?

14 A. There were some disagree- -- well, I wouldn't say
15 disagreements, some negotiating and discussion of the
16 words, but a consensus was reached by the group on the
17 well-cost definition that's being presented here.

18 Q. And does this -- Yeah, that was going to be my
19 next question. Does this definition represent a fair
20 consensus among the work group?

21 A. Yes, sir, it does.

22 Q. Now, before I go on, I want to identify -- and I
23 may have done this in your previous testimony, but I want
24 to be sure I don't neglect to do it now. I have here
25 Exhibits 7 and 8, which are the two versions of the model

1 form operating agreement excerpts. Do you have those in
2 front of you?

3 A. Yes, sir, I do. I have my copies that I've
4 highlighted.

5 Q. Now, the AAPL model form operating agreements are
6 pretty much an industry standard as being the basis, the
7 foundation of operating agreements that people negotiate in
8 the industry, are they not?

9 A. Yes, sir, those are the ones that are widely used
10 in the industry and almost nearly exclusively used in New
11 Mexico.

12 Q. And people modify them?

13 A. Yes, they do.

14 Q. Depending on what the parties agree on in
15 specific instances?

16 A. That's correct, they are modified.

17 Q. But then nearly always, the operating agreement
18 is an AAPL form with some modifications?

19 A. That is correct.

20 Q. Now, Exhibits 7 and 8 are different editions.

21 Can you tell us about the different editions, the 1982 and
22 1989 editions?

23 A. Yes, there were actually four printed forms of
24 the operating agreement beginning in 19- -- I believe -56
25 was the first one. 1977, it was revised. Then again it

1 was revised in 1982, and the last revision made by AAPL,
2 the American Association of Petroleum Landmen, was in 1989.

3 The earlier models -- the 1956 is never used
4 anymore. The 1977, which has been modified and updated to
5 terms nearly the same as the 1982, is used still, but the
6 most frequently used are the terms contained in the 1982
7 and the 1989 form. The 1982 form is by far the most
8 frequently used. The 1989 form is much more wordy, and
9 landmen tend to stay with the 1982. The 1989 is not widely
10 used, however you see it a certain percentage of the time.

11 Q. And I think you said Yates likes the 1977 form?

12 A. We use the 1977 because we have used it all these
13 years since 1977, although it's been modified to nearly the
14 same terms as in the 1982.

15 Q. The 1982 form is the one that's in most common
16 use, in your opinion, in New Mexico now?

17 A. Yes, sir, that's correct.

18 Q. And I believe there were some comments made at
19 the work group that there was too much lawyer input in the
20 1989 form.

21 A. The -- Each of these forms were written by a
22 committee within the American Association of Petroleum
23 Landmen, and drawing landmen from all over the United
24 States to write these forms.

25 The last revision, for some reason, was --

1 overwhelmingly the committee was attorneys for major
2 companies, and therefore the attorney-type language came
3 into the operating agreement that is just not widely used
4 by the industry, and that's why that comment was made.

5 Q. However in substance, so far as the provisions
6 we're talking about, they're very, very similar?

7 A. They are very similar as far as these provisions,
8 that's correct.

9 Q. Okay. First of all, I'm going to look at Exhibit
10 Number 1, and again I will read the first sentence of
11 Exhibit Number 1 which says, "'Well costs' shall mean all
12 reasonable costs of drilling, reworking, diverting,
13 deepening, plugging back and testing the well, completing
14 the well in any formation pooled by the order and equipping
15 the well for production."

16 And then I will call your attention to lines 21
17 through 24 on numbered page 6 of Exhibit Number 7.

18 A. The 1982 form.

19 Q. Right. And is the formulation in the proposed
20 rule almost word for word except for the change to apply
21 only to completions in a unitized formation -- or pool
22 formation, is it identical to the formulation in Exhibit
23 Number 7?

24 A. In the 1982 form the costs and expenses are
25 practically identical, with the exception of the word

1 "diverting", which is not included in the 1982 form, and
2 also the language that you referred to, the formation
3 pooled by the order.

4 Q. Now looking at the 1989 form, pages 7, numbered
5 page 7 -- and I'm saying numbered page because these
6 exhibits are excerpts and they don't have the full
7 operating agreement, but numbered page 7, lines 14 through
8 17, now that is about the same as the previous form except
9 it includes the word "sidetracking", correct?

10 A. Yes, sir, that is correct. The 1989 form is the
11 same language, with the inclusion of the word
12 "sidetracking" and also the inclusion of the word
13 "recompleting".

14 Q. Now, the word "sidetracking" would be somewhat
15 similar to the word "diverting" that's used in Exhibit 1,
16 correct?

17 A. That's right. We chose the word "diverting" in
18 our work group because it is more of an inclusive term than
19 just "sidetracking", as is used in most of the operating
20 agreements.

21 Q. "Sidetracking" would tend to imply that the
22 bottomhole location is not changed?

23 A. That's correct.

24 Q. Whereas, "diverting", you might still be going
25 for the same formation, but you might change your

1 bottomhole location somewhat?

2 A. That's right, you might be doing a lateral of
3 some type or a diverted bottomhole location.

4 Q. Okay, very good. Now -- Oh, was there a
5 consensus in the work group on the definition of -- the
6 basic definition as set forth in the first sentence of the
7 grammatical paragraph at the bottom of page 1 of Exhibit 1?

8 A. Yes, the language of the first sentence was
9 agreed by all the parties of the work group, and it does
10 represent a consensus.

11 Q. Now, I will introduce also this issue of
12 completing in a formation pooled by the order. Sometimes
13 there's differing ownership between formations in a well,
14 correct?

15 A. That's a possibility, that's correct.

16 Q. So there might be a necessity to compulsory pool
17 one formation you're looking at, and there might be full
18 agreement on another formation?

19 A. That's right.

20 Q. And it wouldn't be fair to charge the compulsory-
21 pooled parties if there was no production from the -- or if
22 there was production from the -- Well, if there's no
23 production they wouldn't be charged anyway, so I'm going
24 off on a rabbit trail there.

25 But it wouldn't be fair to charge them for the

1 cost of completing any formation in which they own no
2 interest, correct?

3 A. That's right, the intent in adding that language
4 was to make this well cost apply to the particular
5 formation that is controlled by the order.

6 Q. Now I'll call your attention to the second
7 sentence of the well-cost paragraph on page 1 of Exhibit 1,
8 and I won't read it again, to avoid repetition, but that
9 sentence introduces the concept of a re-entry, and it says
10 that historical costs will not be allowed, but only the
11 costs associated with re-entry and completion would be
12 allowed?

13 Q. Now, Mr. Stogner has said that that's the way the
14 OCD has always done things. Is that also something that
15 the work group reached a consensus on?

16 A. Yes, it is, and the work group agreed that that
17 was a customary procedure, that historical costs, unless
18 there was some extenuating circumstance, do not enter into
19 the cost, the AFE cost, of a re-entry or a reworking of a
20 wellbore.

21 Q. And of course we've provided for that particular
22 circumstance by the provision that the Division has the
23 authority to allow historical costs or some portion thereof
24 in a particular case?

25 A. That's correct.

1 A. Now, the next sentence, "If a well is completed
2 in two or more pools having diverse ownership or a
3 different risk-charge percentage, the order shall provide
4 for allocation of well costs between the pools."

5 We talked about the situation where there was a
6 completion in a pool that was not in a formation that is
7 not pooled by the order. Here we're talking about
8 completion in multiple formations, all of which are pooled
9 by the order but in which some parties own differing
10 percentage interests, so there may be parties in one that
11 are not in the other, correct?

12 A. That's correct, differences of ownership can
13 occur because of basic lease ownership or it could occur
14 because of different sizes of spacing units up and down the
15 hole.

16 Q. Now, in another case in which I was involved, a
17 landman testified that there is no industry-standard method
18 of dealing with that situation where there are differing
19 percentage ownerships in different formations, but the cost
20 allocation is just handled by negotiation in those cases;
21 is that a fair statement?

22 A. That's true. In negotiated cases -- I mean, in
23 wells that are drilled that are not force-pooled, normally
24 when you have differences of ownership you negotiate with
25 the parties and decide before the well is completed or

1 drilled that the allocation will be made in a certain
2 manner. And so it is usually a negotiated situation.

3 Q. And so that's the reason why we in the work group
4 decided we'd just leave that for a case-by-case resolution?

5 A. That's correct. And of course you would expect
6 testimony as to why a certain allocation should or should
7 not be made.

8 Q. Okay. And that brings us to the provision that
9 the Chairman had asked about previously, which has to do
10 with costs associated with essentially recompletion for --
11 something equivalent to recompletion, that occur subsequent
12 to the initial completion of the well. After the operator
13 presumably has returned his schedule of actual well costs
14 under the compulsory pooling order, then he may go in and
15 have some occasion to do something else to the well which
16 is in the nature of a recompletion. You understand that
17 concept?

18 A. Yes, sir.

19 Q. Now, can you explain in response to Chairman
20 Wrotenbery's question why the work group elected to deal
21 with that concept in this proposed rule?

22 A. Yes, sir. We had a considerable conversation
23 about that, and in fact, as I recall, this was brought by a
24 member of the work group that this should be included,
25 because it is a standard in the industry that the

1 subsequent costs are included when a person has not paid
2 their way in a well.

3 And if you would refer to both the 1982 and the
4 1989 operating agreements, there are specific provisions in
5 those agreements that state that subsequent operations
6 would be added to the costs in a nonconsent situation. And
7 I would point you to the 1982 form, line 28 --

8 Q. And that is Exhibit 7?

9 A. -- Exhibit 7, page 6 of the operating agreement,
10 and line 28, which states, An election not to participate
11 in the drilling or deepening of a well shall be deemed an
12 election not to participate in any reworking or plugging
13 operation proposed in such well to which initial
14 nonconsenting election applied that is conducted at the
15 time prior to full recovery by the consenting parties of
16 the nonconsenting's recoupment account.

17 And that states that those subsequent charges
18 would be added to that recoupment account and then paid out
19 in the nonconsent.

20 Moving over to the exhibit -- I believe it's 8,
21 the 1989 form -- you see similar language on line 27 of
22 page 7 that states that those subsequent costs would be
23 added to the recoupment account, and actually in the 1989
24 form provides a blank there where an additional amount can
25 actually be charged. The one that I pulled from my file

1 states a 500-percent nonconsent-type cost recovery.

2 So it is a standard in the industry that those
3 subsequent charges, prior to the recovery of the risk cost,
4 should be added to the account and then should be recovered
5 at the risk cost of the original nonconsent.

6 Therefore, it was the request of the parties of
7 the work group, and again it was the consensus of the work
8 group, that this paragraph should be added to bring the
9 compulsory pooling risk cost in line with what is done
10 under negotiated and agreed operating agreements.

11 Q. Now, the Chairman raised two questions about this
12 sentence, and one was that it deals with only certain types
13 of costs. The costs that it deals with, I believe under
14 the language, is any subsequent reworking, diverting,
15 deepening, plugging back, completion or recompletion of
16 that well, undertaken prior to the time that the entire
17 amount of the nonconsenting owner's share of well costs, et
18 cetera, is recovered.

19 Now, is there a reason for treating subsequent
20 costs of reworking, diverting, deepening, plugging back,
21 completion or recompletion differently from other expenses
22 such as what you pay the pumper to go out and look at the
23 well every month?

24 A. That is handled under operating agreements in
25 different ways, but usually the operations cost are a

1 single-time recovery that would be paying the pumper --

2 Q. Yeah.

3 A. -- and the day-to-day operations cost are a
4 single recovery or 100-percent recovery.

5 Q. Replacing -- just noncontrollable equipment --

6 A. Right, correct.

7 Q. -- that you just do on a routine basis?

8 A. But, these charges, reworking, diverting,
9 deepening, plugging back, completion, again involve a risk
10 similar to the original risk that was taken in the well,
11 and that is geological risk, mechanical risks and all the
12 things that we discussed at the previous hearing.

13 Q. Under an operating agreement, as customarily
14 used, the consenting parties, the parties who elected to
15 pay their share of the well costs of the original drilling
16 and completion, would have a separate election whether or
17 not to participate in the subsequent rework, recompletion,
18 deepening, et cetera, expenses, would they not?

19 A. That is correct, the consenting parties would
20 have a proposal and an election, just as if it were a new-
21 drilled, new well, and they could actually elect to go
22 nonconsent at that point. However, the nonconsenting
23 parties, similar to the force pooled parties under this
24 order, would not have that election under the provisions of
25 the operating agreement, and those charges are rolled into

1 their already existing risk penalty account.

2 Q. Okay. And that formula that is adopted in the
3 operating agreement, in the standard -- the customary form
4 of operating agreement, is what we are attempting to put
5 into this rule?

6 A. Yes, sir, that's correct.

7 Q. So that subsequent capital costs incurred in the
8 well, which would be drilling and completion costs under
9 the terms of the Oil and Gas Act, would be subject to a
10 risk charge even if they were incurred subsequent to the
11 completion of the well?

12 A. That is correct.

13 Q. And that risk charge would be recovered out of
14 the nonconsenting working interest owners' interest in
15 production?

16 A. That's correct.

17 Q. But the operating expense, which would be the
18 other category of expense that would be incurred subsequent
19 to completion, would, as at present, be recovered only 100
20 percent and would not go into the computation of the risk
21 charge, correct?

22 A. Yes, that's correct.

23 Q. Now, is the committee working on a modification
24 of our Order which would introduce the concept for any
25 pooled working interest owner who elects to participate and

1 puts up his money for the original well, that like in the
2 operating agreement, that working interest owner would have
3 another election for a subsequent completion? Is that
4 something we're talking about in the work group?

5 A. The work group is presently considering that
6 issue, along with others.

7 Q. Yeah, but we haven't reached a resolution on that
8 issue?

9 A. That's correct.

10 Q. But we do have -- We are in agreement, there is a
11 consensus in the work group that the nonconsenting pooled
12 parties should, one, not be allowed an election to
13 participate in a subsequent completion unless and until its
14 share of original drilling expenses has been recovered,
15 correct?

16 A. That is correct.

17 Q. And two, that those additional completion
18 expenses, like the original completion expenses, should be
19 rolled into the account which is the basis for determining
20 risk charge?

21 A. Yes, that those costs should be rolled in and be
22 subject to the risk charge as -- under the original charges
23 were made.

24 MR. BROOKS: Okay. Because the Chairman had
25 special questions about this particular part of the rule,

1 would the Commissioners like to examine the witness on this
2 issue before we go on through the rest of the rule, or
3 would you like to defer that until I've completed the
4 examination of the witness?

5 CHAIRMAN WROTENBERY: I think Mr. Patterson
6 answered most of my questions. I do have a couple -- just
7 a drafting question --

8 MR. BROOKS: Okay.

9 CHAIRMAN WROTENBERY: -- because the list of
10 costs in this particular provision does not cover all of
11 the costs that are mentioned in the first sentence of the
12 definition of well costs. And I can understand perhaps why
13 drilling is not included, but what about testing, what
14 about equipping the well for production? What about the
15 language about completing the well in any formation pooled
16 by the order? There was just some language in that first
17 sentence that does not appear in this subsequent-operations
18 sentence.

19 MR. BROOKS: It probably does need some
20 tinkering, particularly with regard to testing, I think
21 that clearly should be in here. And the concept that it
22 applies only to a completion or recompletion in a pooled
23 formation probably should be in here. Drilling, of course,
24 would be covered in deepening. And the reason equipping
25 was not put in was the assumption that the well is probably

1 already equipped for production if it's been completed, but
2 of course there may be --

3 CHAIRMAN WROTENBERY: Although you may have some
4 special --

5 MR. BROOKS: -- additional equipment --

6 CHAIRMAN WROTENBERY: -- equipment that's
7 required --

8 MR. BROOKS: -- yes, there may be additional
9 equipping --

10 CHAIRMAN WROTENBERY: -- for different --

11 MR. BROOKS: -- costs involved.

12 CHAIRMAN WROTENBERY: So I would just suggest
13 that the work group look at that sentence again from a
14 drafting standpoint --

15 MR. BROOKS: Okay.

16 CHAIRMAN WROTENBERY: -- just to make sure
17 everything is --

18 MR. BROOKS: Okay, very good.

19 CHAIRMAN WROTENBERY: Thank you.

20 Q. (By Mr. Brooks) I asked Mr. Stogner about this
21 matter of workover expenses, and I've also discussed the
22 issue with you as to whether workover costs is fairly
23 included within the term drilling and completion costs. I
24 got the impression that your opinion is not necessarily
25 entirely the same as Mr. Stogner's, so I will ask you to

1 comment on that issue.

2 A. Well, similar to some of the comments that I made
3 in the last session, anytime that you go to workover a
4 well, whether you're going to merely re-treat a zone that's
5 presently perforated or if you're going to open new
6 perforations or actually recomplete in a different zone,
7 you always encounter mechanical risks, you always have the
8 opportunity for a piece of equipment to go wrong. You
9 encounter risks there.

10 If you're talking about opening more
11 perforations, even though you may have the benefit of the
12 geological logs and such, you have -- you don't know what's
13 there until you've actually opened it up, perforated it to
14 see, is it really gas, is it really oil, is it really
15 water? So you have an amount of geological risk also.

16 And so our opinion there is that there is a risk
17 associated with rework, workover, any of those categories
18 that you want to put this in, and therefore we agreed with
19 the work group and the work group was in consensus that
20 these costs should be added into the risk-penalty category.

21 Q. And do you believe that they are sufficiently
22 similar to completion costs that it would be fair and
23 reasonable in the industry to consider the costs associated
24 with workovers to be within the terminology used by the
25 Legislature in the Oil and Gas Act when they said that the

1 risk penalty would apply to drilling and completion costs?

2 A. In my opinion, it would be.

3 Q. Okay, thank you. Now, I believe you covered this
4 a minute ago but just to be sure, why, in your opinion,
5 should the risk penalty apply to subsequent completion
6 costs of the categories that are dealt with in this
7 sentence, as well as to initial drilling and completion
8 costs? What are the risk factors involved in this type of
9 operation?

10 A. For a subsequent operation, again, you have --
11 you always have a mechanical risk, anytime you go in a
12 hole, if you're going to recomplete, you have a certain
13 amount of geological risk, that the production -- that
14 there's a misindication on a log, that you really have
15 water instead of producible hydrocarbon. There is -- those
16 -- Just a second. Those risks in any sort of a rework or
17 recompletion situation always exist.

18 Q. Okay. Now going to the paragraph at the top of
19 page 2 of Exhibit Number 1, this is the paragraph that
20 deals with the substitute well where you skid over and
21 start a new well. The language there was basically
22 language that you submitted, correct?

23 A. That is correct. After our discussion within the
24 work group, there was a request by one of the work group
25 members that we consider substitute well language because

1 of the possibility of losing a hole and the additional
2 costs involved in the necessity to come back and get an
3 amendment of an order or do a new force pooling,
4 particularly in more recent orders where a location is
5 specified. If you go to skid the rig over, you've changed
6 the footage location of your well. And so there was a
7 specific request by one of the members to consider
8 substitute-well language.

9 Substitute-well language is very common in the
10 industry. It is many times added to operating agreements.
11 It is usually in any type of a farmout or exploration
12 agreement arrangement where there is a well required to be
13 drilled, so that if you lose a hole you have the
14 opportunity to skid the rig and start a new well, without
15 having to go back and renegotiate, or go back in this case
16 and have an order amended to make the force pooling
17 effective.

18 And so therefore I volunteered to pull some
19 language out of agreements that we have, and I submitted it
20 to Mr. Brooks, and this was the paragraph, then, that
21 resulted from that discussion and was agreed to and was a
22 consensus of the work group.

23 Q. Now, this is not a provision that is encountered
24 in the model form operating agreement, correct?

25 A. This -- No, a substitute well provision is not in.

1 the printed form. However, as I stated, it is many times
2 added in Article 15, subsequent -- or additional provisions
3 in an operating agreement.

4 Q. And where you have farmouts or area-of-mutual-
5 interest agreements, things of that kind where the parties
6 agree to participate jointly in an exploratory well, you
7 almost always have that type of provision, do you not?

8 A. It's nearly always in those agreements.

9 Q. Okay. So it's something that the industry is
10 extremely familiar with?

11 A. That's correct.

12 Q. And in your opinion would this provision be in
13 the interest of the prevention of waste and protection of
14 correlative rights?

15 A. Yes, sir, it would, and as Mr. Stogner testified,
16 it would be a -- much reduce the cost to a company to be
17 able to not have to release a rig and come back to Santa Fe
18 for a subsequent order and then hire a rig back on and move
19 it back onto location. It would greatly reduce that cost.

20 Q. Okay. Mr. Patterson, I believe either with Mr.
21 Stogner or with you I had covered all of the provisions of
22 this order that -- or of this rule that we're asking the
23 Commission to adopt and pointed out to them where there is
24 possibly some disagreement and where there is consensus,
25 and also where there could be arguments about whether or

1 not it's in accordance with the statutory language. Is
2 there anything else you would like to bring to the
3 attention of the Commission with regard to this proposed
4 rule?

5 A. Well, I think just as a final comment I would
6 like to state that as a representative of Yates Petroleum
7 Corporation and I believe as a representative of the work
8 group, all of us felt that this was a good rule for the
9 Commission to put into effect, that it will eliminate extra
10 work and will eliminate redundant testimony. It's a good
11 use of procedures that are already customary to the
12 industry, and it's a good way to streamline the OCD
13 process, and we recommend the adoption of this rule.

14 Further, as I stated in the previous hearing, we
15 recommend, and it was the consensus of the work group, that
16 all of the risk penalties be stated as 200 percent and not
17 the graduated 200-, 156- and 100-percent as is currently
18 written. And again, I restate that was a consensus of the
19 work group. And from our company we would also recommend
20 that the Commission adopt the rule in that matter.

21 MR. BROOKS: Very good. Exhibits 7 and 8, I
22 believe, are the excerpts from the operating agreement.
23 Exhibits 9 and 10 are the -- which you identified, Mr.
24 Patterson, at the previous hearing, are the sign-in sheets
25 from the two meetings of the work group.

1 THE WITNESS: Correct.

2 MR. BROOKS: At this time I will tender into
3 evidence Exhibits 7, 8, 9 and 10, if I have not already
4 done so.

5 CHAIRMAN WROTENBERY: Any objection?

6 Okay, Exhibits from OCD Numbers 7 through 10 are
7 admitted into evidence.

8 MR. BROOKS: Pass the witness.

9 CHAIRMAN WROTENBERY: Questions?

10 COMMISSIONER BAILEY: No questions.

11 COMMISSIONER LEE: (Shakes head)

12 CHAIRMAN WROTENBERY: Oh, Mr. Kellahin, did you
13 have a question?

14 EXAMINATION

15 BY MR. KELLAHIN:

16 Q. Mr. Patterson, let me go back to the first page
17 of the proposed rule change. This draft has got the risk
18 factor subdivided into certain categories. Did the
19 Committee talk about subdividing the risk between a wildcat
20 or a development well?

21 A. No -- Well, we may have talked about the concept
22 of wildcat and development wells. However, I don't recall
23 that anyone on the committee wanted -- or the work group,
24 wanted to create any differentiation as far as risk penalty
25 between those two types of wells.

1 Q. So I'm correct in understanding that having the
2 opportunity to talk about the various ways to subdivide and
3 categorize risk, it was the committee's agreement to make
4 the risk 200 percent, regardless of the formation or the
5 type of well being --

6 A. That's right.

7 Q. -- proposed?

8 A. That's correct.

9 Q. When a party is pooled and is given the 30-day
10 election period in which to pay their share of the costs of
11 the well in order to escape the penalty factor, what is the
12 practice of the industry with regards to how much money is
13 paid? Do you pay your proportionate share of the total
14 completed estimated costs, or some component of those?

15 A. That has been a question, I believe, within the
16 industry on several occasions, and it's my understanding
17 that the completed well cost, or the total completed AFE is
18 what is to be submitted to the operator by a force-pooled
19 party if he intends to participate in the drilling of the
20 well or the proposed operation.

21 Q. That too is my understanding. When you go to the
22 infill situation like we have in the Morrow and other
23 pools, did the Committee address what to do about the risk
24 factor component on the infill well?

25 A. Well, again, it was the consensus of the

1 committee that the risk factor should be 200 percent across
2 the board, and that is customary within the industry, as I
3 stated last time we were here, that a 300-percent
4 nonconsent, which is equivalent to a 200-percent risk
5 charge under force pooling is --

6 Q. I don't know if I made myself clear. I'm talking
7 about the infill well.

8 A. An infill well.

9 Q. Okay, if you send me a proposal for the parent
10 well and my choice is to go nonconsent on the parent well,
11 what happens when it comes to giving a new election and
12 imposing a penalty on the infill well?

13 A. Oh, well, it was the consensus of the committee
14 that everyone, every owner within the -- working interest
15 owner within the pooled area will have the opportunity and
16 will receive a proposal to drill that second well. I'm
17 sorry, I misunderstood your question.

18 Q. As to the infill well, then, I will have a new
19 election?

20 A. Yes, you would have a new election, even though
21 you did not participate in the first well.

22 Q. And under that process, then, the default penalty
23 is going to be the maximum 200 percent for the infill well?

24 A. That's correct.

25 Q. And if a party chooses to oppose those levels of

1 penalty under any of these combinations, under this rule
2 change you could be the responding party and ask the
3 Commission to hear you on that issue?

4 A. Yes, that's provided in the proposed order that
5 you could request the Division to alter that 200 percent.

6 Q. Let me ask you about the committee's work in
7 allocating the risks and costs associated between pools.
8 Did the committee talk about how the COPAS bulletins handle
9 a procedure for allocating costs between two pools?

10 A. Are you talking about when you have different
11 ownerships, say, in the lower part as opposed to an upper
12 part of a well?

13 Q. I was going back to Mr. Brooks' question about
14 pooling interests in two different pools, and let's assume
15 I may be a different party in one pool as opposed to
16 another, where their percentages are different. How do you
17 allocate the costs between those two zones?

18 A. Normally, those are negotiated and are provided
19 within the negotiated agreement, the operating agreement,
20 and the attached COPAS accounting procedure.

21 Q. So is this industry practice to have an operating
22 agreement that adopts the COPAS Bulletin Number 2 to the
23 cost allocations between multiple zones?

24 A. Yes, your operating agreement -- I hate to use
25 the word always, but I've never seen an operating agreement

1 that did not have an Exhibit C, a COPAS accounting
2 procedure, attached to that. There are various forms of
3 that Exhibit C accounting procedure, but as I say, I've
4 never seen one without one.

5 Q. I was just trying to understand how you would
6 allocate the costs between two pools. And so there's a
7 COPAS bulletin that gives you a format to at least address
8 that problem with your parties?

9 A. Yes, that is correct.

10 Q. The Committee's notion is that regardless of
11 formation, then, it's going to be the maximum 200 percent?

12 A. That's correct.

13 Q. Let me ask you about development costs. There's
14 language in the statute that talks about the parties
15 advancing the costs of development of the well. Am I
16 correct in understanding that neither the industry nor the
17 Commission awards an applicant for, say, its exploration
18 costs for geology or seismic? That's not part of the --

19 A. To my recollection, I've never seen the Division
20 award costs for seismic or G-and-G preliminary costs prior
21 to the drilling of the well.

22 Q. So when we look at a proposed AFE that's
23 submitted to the parties, that AFE is, I think, exclusively
24 devoid of those exploration -- up-front exploration costs?

25 A. Yes, that's -- that would be a correct statement.

1 Q. How is surface equipment handled?

2 A. Surface equipment, under a negotiated operating
3 agreement, is handled in different ways. In past years,
4 surface equipment was charged at 100 percent of value
5 because it's tangible. However, in the last five years, at
6 least five years, and particularly after the advent of the
7 1989 operating agreement, those surface equipment penalties
8 have risen -- have been changed to 200 and sometimes 300
9 percent. And I refer to the 1989 operating agreement
10 because that operating agreement provides a blank to be
11 filled in, and that blank nowadays is normally filled in at
12 200 -- at least 200 percent.

13 Q. So what's the proposal as to surface equipment,
14 that under a pooling order, you would be able to recover
15 those costs --

16 A. Those costs --

17 Q. -- in proportion to the interest owner's share of
18 those costs?

19 A. Under the proposed -- The equipping of the well
20 is part of well costs under the last paragraph of Part A,
21 there on the first page, and the cost of equipping the well
22 is part of well costs that would be subject to the risk
23 penalty.

24 Q. Okay. So --

25 A. Risk charge.

1 Q. -- let me make sure. The risk charge would be
2 charged not only against what I call the downhole cost but
3 would also be charged against the surface equipment?

4 A. That is correct, under this proposal.

5 Q. Okay.

6 A. And that was the consensus of the group.

7 Q. Let me ask you about the subsequent operations
8 agreement. Under an operating agreement, if you and I
9 contract to commit our interest to the well and you're the
10 operator, and an operation is proposed, then I get an
11 election as to that wellbore?

12 A. If you were a --

13 Q. A consenting party.

14 A. -- a consenting party, you have that election.

15 Q. If I'm a contracting consenting party under the
16 operating agreement and there's subsequent operations, I
17 get to make an election as to those subsequent operations?

18 A. That's correct.

19 Q. Under this force-pooling order, if I'm initially
20 nonconsent under the pooling order, you give me the pooling
21 order and I default and elect not to pay you, then I'm
22 nonconsent for the costs of the original well, and I'm also
23 nonconsent as to subsequent operation costs? I don't get a
24 new election?

25 A. That's correct. But that's the same way that it

1 is under the operating agreement. That's different from
2 the first statement that you made.

3 Q. Under an operating agreement, do I get a new
4 election for subsequent operations?

5 A. If you are a consenting party, you do. But if
6 you are a nonconsenting party you do not.

7 Q. I think we're saying the same thing. If I'm in
8 an operating agreement and I'm a consenting contracting
9 party and I've paid for the well originally, and we get
10 down and you elect to do subsequent operations that are
11 outside the scope of that AFE, I get a new election?

12 A. That's correct.

13 Q. And if I'm a pooled party and I choose not to pay
14 you under the pooling order and I go nonconsent initially
15 on the well, if there are subsequent operations, I'm still
16 nonconsent?

17 A. That's correct.

18 Q. If I'm a pooled party and I pay my share of the
19 initial well and there are subsequent operations on that
20 well, do I now get a new election on those operations?

21 A. Under this new rule I believe that you would,
22 yes, because you would be getting a new proposal, yeah.

23 MR. KELLAHIN: Thank you.

24 CHAIRMAN WROTENBERY: Thank you, Mr. Kellahin.

25 MR. BROOKS: A few questions by way of follow-up?

1 CHAIRMAN WROTENBERY: Certainly.

2 FURTHER EXAMINATION

3 BY MR. BROOKS:

4 Q. First of all, Mr. Kellahin asked you some
5 questions about whether the amount that was paid -- that
6 had to be paid with an election was the completed AFE,
7 drill and complete, as opposed to what's customarily called
8 the dryhole AFE that's drill and plug if you decide not to
9 complete. Now under this rule it is the drill and
10 complete, correct?

11 A. That is my understanding of the consensus of the
12 group, that's right.

13 Q. That's always been the way it's been under New
14 Mexico force pooling orders --

15 A. That's --

16 Q. -- as far as --

17 A. That's what I remember.

18 Q. Now, but that is different from the operating
19 agreement, correct?

20 A. Under the operating agreement you are not
21 required to pay prior to the drilling, as you are under a
22 force pooling order. The operator may request prior
23 payment, but there's not a requirement as under the
24 compulsory pooling order.

25 Q. And we did talk about that specifically, about

1 the undesirability of the OCD becoming a collection agency,
2 did we not?

3 A. Absolutely, that is correct.

4 Q. But what I was really trying to get to, under the
5 standard form of operating agreement, a contractual
6 nonconsenting -- a contractual consenting party, not a
7 contractual nonconsenting party but a contractual
8 consenting party, consents only to the cost -- to pay his
9 share of the cost of drilling to depth, correct?

10 A. Right.

11 Q. And then there is a separate election. The
12 contractual consenting party can elect to consent and pay
13 his share of the cost of completion or can nonconsent for
14 his share of the cost of completion?

15 A. That is correct.

16 Q. But we don't have that concept in this rule?

17 A. That's right.

18 Q. And we don't have it in existing force pooling
19 practice?

20 A. That is right, that's correct.

21 Q. Okay. Now, the second question I wanted to ask
22 you was about this COPAS bulletin that Mr. Kellahin
23 referred to. We did not discuss that specifically at all
24 with the committee, did we?

25 A. No, I don't recall us talking about the

1 accounting procedure or allocation under that particular
2 document.

3 Q. But certainly to the extent that the industry
4 evolves standards for dealing with this cost-allocation
5 situation, that would be something that could be placed in
6 evidence before the Division to deal with that situation
7 under the powers granted in this rule, correct?

8 A. Yes, and I believe that in circumstances during
9 force pooling hearings when an operating agreement is
10 placed into evidence, they normally contain an Exhibit C
11 accounting procedure attached to them.

12 Q. Well, yes, if I understood Mr. Kellahin
13 correctly, this COPAS bulletin he refers to is probably
14 something else that's not a part of the normal COPAS
15 accounting procedure; is that correct, Mr. Kellahin?

16 MR. KELLAHIN: Yes, it's not the same. The
17 exhibit attached to the operating agreement has an
18 accounting procedure on it.

19 THE WITNESS: Right.

20 MR. KELLAHIN: What I'm asking you is that the
21 COPAS group has issued a bulletin number 2, and the
22 Division has accepted and asked an accounting procedure
23 that subdivides costs between formations if there's a
24 difference in ownership.

25 THE WITNESS: Okay.

1 MR. KELLAHIN: Are you aware of the COPAS --

2 THE WITNESS: Yes, I am aware of the COPAS
3 bulletins, and I misunderstood your question. I thought
4 you were referring to the accounting procedure Exhibit C,
5 but the COPAS group has issued extensive guidance to the
6 industry, which is followed throughout the industry through
7 these bulletins.

8 MR. KELLAHIN: Are you aware of the Commission
9 and Division orders that have accepted those bulletins --

10 THE WITNESS: No, I'm not aware of those, but --

11 MR. KELLAHIN: Did the committee discuss those
12 orders?

13 THE WITNESS: No, we did not discuss COPAS
14 bulletins.

15 MR. BROOKS: Okay, thank you for that
16 clarification. There's one other matter that I'm not sure
17 has been fully addressed.

18 Q. (By Mr. Brooks) With regard to this category of
19 what I'm going to call for -- to have a broad term,
20 recompletion expenses, that is, the category of expenses as
21 to a particular well that is dealt with in the last
22 sentence of -- on page 1 of Exhibit 1, the rule deals with
23 what the nonconsenting party's situation will be with
24 regard to those expenses. The rule does not deal with what
25 the consenting party's situation will be, correct?

1 A. That is correct.

2 Q. Now as I said, the committee is working on a
3 proposal to incorporate language in the order that would
4 give the consenting parties a separate election and subject
5 them to a risk charge if they elected not to participate,
6 correct?

7 A. That is being discussed at this time.

8 Q. But we have not reached the point of making a
9 specific proposal on that?

10 A. Right.

11 Q. And it's not really because there's any
12 disagreement on the committee on the principle, it's more a
13 disagreement on how the mechanics are going to work?

14 A. Yes, without practically writing an operating
15 agreement over again, it's difficult to get all of those
16 notions into something simple.

17 Q. Now, if under this rule you had an operator who
18 wanted to do a recomplete on a force pooled well, he would
19 essentially have two options. If he had a consenting
20 compulsory pooling party who was not party to an operating
21 agreement, he would essentially have two options. He could
22 treat that as operating expense and recover only 100
23 percent of it from that consenting party's interest, or he
24 could go back to the Division and request an amendment to
25 the order to provide?

1 A. Correct.

2 Q. Now, would those be the same options that he
3 would have under the existing practice?

4 A. Yes, I believe they would be.

5 Q. So we just haven't gotten there yet, so far as
6 the status of the consenting force pooled interest in the
7 subsequent completion expenses, correct?

8 A. That's right, it has been discussed, but it
9 hasn't been formalized.

10 MR. BROOKS: I believe that's all I have.

11 CHAIRMAN WROTENBERY: Any other questions for Mr.
12 Patterson?

13 COMMISSIONER BAILEY: (Shakes head)

14 COMMISSIONER LEE: (Shakes head)

15 CHAIRMAN WROTENBERY: Thank you for your
16 testimony.

17 That's all you have of Mr. Patterson and all you
18 have?

19 MR. BROOKS: That is all that -- There's nothing
20 further.

21 CHAIRMAN WROTENBERY: Okay.

22 MR. BRUCE: I don't know if this is the time,
23 madame Chair, I just have a brief statement.

24 CHAIRMAN WROTENBERY: Certainly. Go ahead, Mr.
25 Bruce.

1 MR. BRUCE: I'm just entering an appearance today
2 on behalf of several companies. I'm entering an appearance
3 on behalf of XTO Energy, Inc., and Texakoma Oil and Gas
4 Corporation, who are operators in the San Juan Basin, and
5 they are appearing today in support of Burlington's request
6 for a 200-percent penalty in the Fruitland Coal.

7 I'm also entering an appearance on behalf of Pogo
8 Producing Company and Mewbourne Oil Company, and they are
9 here today in support of Mr. Patterson's recommendation of
10 an across-the-board 200-percent penalty for recompletions
11 and re-entries.

12 Thank you.

13 CHAIRMAN WROTENBERY: Thank you, Mr. Bruce.

14 Anybody else wish to make a statement? Mr. Carr?

15 MR. CARR: May it please the Commission, the work
16 committee's proposal that's before you today was reviewed
17 by the Regulatory Practices Committee of NMOGA at their
18 meeting in May, and I have been asked to advise you that,
19 one, they support the effort of the Commission to adopt
20 compulsory pooling rules. They were in unanimous agreement
21 that requiring the presentation of technical evidence in
22 support of the 200-percent risk penalty was unnecessary.
23 There was also unanimous agreement that the penalty should
24 be 200 percent across the board for new drilling, reworking
25 wells and also for wells in the Basin-Fruitland Coal Gas

1 Pool.

2 There was also agreement that a 200-percent
3 penalty was an appropriate penalty. That is, the level was
4 correct. They felt it was high enough to be a meaningful
5 penalty but lower than what you would typically get when
6 you entered into negotiations with other operators, and
7 therefore it would still be more attractive for an operator
8 to reach a voluntary agreement and simply start filing a
9 pooling application. So there was also agreement that the
10 level of the penalty was correct.

11 I also have a statement from BP America, Inc., or
12 Amoco Production Company. It closely parallels the
13 position of NMOGA. Mr. Hawkins is a member of the NMOGA
14 Committee as well. I would like to leave copies for just
15 inclusion in the case.

16 CHAIRMAN WROTENBERY: Thank you, Mr. Carr.

17 Anybody else?

18 Mr. Kellahin?

19 MR. KELLAHIN: Madame Chairman, members of the
20 Commission, Burlington Resources supports and adopts the
21 recommendation of the other operators to make the risk
22 factor penalty in the Fruitland Coal Gas Pool the 200
23 percent.

24 CHAIRMAN WROTENBERY: Thank you.

25 I think we've heard from everybody now. Okay.

1 Mr. Brooks, one item. You had indicated, if I
2 can find my note, that you were going to provide an excerpt
3 of some testimony from --

4 MR. BROOKS: Yes, madam Chairman, and --

5 CHAIRMAN WROTENBERY: -- Order R-8818.

6 MR. BROOKS: -- I pay the price of -- once again,
7 of leaving things to the last minute. I did order those
8 case files and I did receive them, but I didn't look at
9 them until it came time to prepare for this hearing. And I
10 found when I looked at them that they were consolidated
11 cases with a large number of other cases, and the
12 transcript was not actually in either of the files that I
13 had ordered.

14 Therefore I would request the indulgence of the
15 Commission once again to submit those excerpts post-
16 submission, because I need now to order the case file in
17 the case that actually has the transcripts in it.

18 CHAIRMAN WROTENBERY: Okay, thank you, Mr.
19 Brooks. If you could, I guess, get that excerpt in within
20 two weeks, would that be a possibility?

21 MR. BROOKS: That would be acceptable.

22 CHAIRMAN WROTENBERY: Okay.

23 MR. BROOKS: Also in response to the Chairman's
24 request that we tinker or rework the language on reworking,
25 I would request that a similar period of time be allowed so

1 that we can consult with the members of the Committee by
2 e-mail and hopefully reach a consensus on fairly minor
3 modifications of that language, which then we could submit
4 to the Commission.

5 CHAIRMAN WROTENBERY: Okay, that would be
6 helpful.

7 Would you also just briefly summarize for the
8 Commission the parts of Rule 35 where we have total
9 consensus and also identify those sentences where there may
10 still be some difference in viewpoint?

11 MR. BROOKS: I will do that. So far as I know,
12 however, the only parts of -- and anyone here who wishes to
13 correct me, please do so.

14 So far as I know, it is -- the only thing in
15 which we do not actually have consensus is the provisions
16 for the 156-percent and the 100-percent cost recoveries in
17 certain events, that the work group, with the exception of
18 the OCD representative, I believe, all agreed that they
19 wanted the 200-percent across the board, although of course
20 as to the 156-percent there were a number of operators
21 present who had no opinion on that since they don't operate
22 in the Fruitland Coal. But I believe that everyone that
23 operates in the Fruitland Coal was in consensus on wanting
24 200 percent, and everybody on the committee was in
25 consensus on wanting 200-percent on existing wells.

1 I do not believe there were any other areas where
2 there was not consensus.

3 CHAIRMAN WROTENBERY: I didn't remember any, but
4 I wanted to make sure I caught everything.

5 We will be asking the Division and the work group
6 to help the Commission and Commission Counsel out by
7 preparing a draft order in this particular case.

8 Commissioners, let me ask you this. As far as
9 the form of the draft order, we could ask for two versions
10 of the order, one that contains the provisions that reflect
11 the Commission's historical practice and provide different
12 risk charge for wells in the Basin Fruitland Coal and for
13 existing wells, with findings to support that continuation
14 of that historical practice, or we could, if the Commission
15 is ready to make a decision on that particular point, just
16 request an order that adopts a 200-percent risk charge
17 across the board.

18 I think Dr. Lee told us where he stood on that
19 particular point at the last hearing. My question is,
20 would you like to think about that particular issue a
21 little bit more and see the two provisions -- Okay, in that
22 case what we would like to see is one draft order that
23 contains the 156-percent risk penalty factor for the Basin-
24 Fruitland Coal and the 100-percent risk factor for the
25 existing wells, with findings to support the continuation

1 of that practice. And then we'd like to see a different
2 version of the order that would adopt a 200-percent risk
3 factor across the board.

4 MR. BROOKS: Very good, I will --

5 CHAIRMAN WROTENBERY: Is that --

6 COMMISSIONER BAILEY: I think it's appropriate in
7 view of the last case we heard.

8 CHAIRMAN WROTENBERY: Uh-huh, okay.

9 MR. BROOKS: I will undertake that.

10 CHAIRMAN WROTENBERY: Okay. Thank you very much.
11 Would that help you out, Ms. Leach?

12 MS. LEACH: Sure. Send it to me, please.

13 MR. BROOKS: I will do so.

14 CHAIRMAN WROTENBERY: Okay. And I believe with
15 that request we could take this matter under advisement
16 then.

17 MR. BROOKS: Very good.

18 CHAIRMAN WROTENBERY: I will say, if we can get
19 those materials within the next couple of weeks then we can
20 make every effort to try to take final action in this case
21 at the next Commission hearing.

22 MS. LEACH: You had one other case you were going
23 to take final action on because the attachment wasn't --

24 MR. BROOKS: Correct.

25 CHAIRMAN WROTENBERY: Right, and let's take a

1 short break so that Mr. Brooks can get the attachment on
2 the amendment to Rule 705.

3 MR. BROOKS: Thank you.

4 CHAIRMAN WROTENBERY: Thank you.

5 (Thereupon, these proceedings were concluded at
6 10:49 a.m.)

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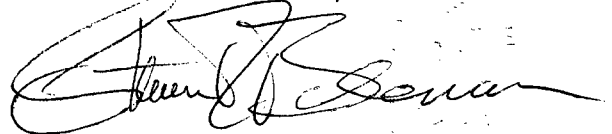
CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL June 13th, 2003.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 16th, 2006