STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:	)	
APPLICATION OF DEVON ENERGY CORPORATION FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	)	CASE NOS. 13,603
APPLICATION OF LCX ENERGY, L.L.C., FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO	)	and 13,628
	)	(Consolidated)

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

ORIGINAL

BEFORE: DAVID R. CATANACH, Hearing Examiner

February 16th, 2006

Santa Fe, New Mexico

These matters came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, February 16th, 2006, 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.

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I N D E X

February 16th, 2006
Examiner Hearing
CASE NOS. 13,603 and 13,628 (Consolidated)

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A P P E A R A N C E S

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* * *

WHEREUPON, the following proceedings were had at 8:58 a.m.:

EXAMINER CATANACH: Okay, we're here this morning to hear presentations and/or arguments in a motion that has been filed in -- there's two cases involved, Case 13,628, which is the Application of LCX Energy, L.L.C., for compulsory pooling; and also Case 13,603, the Application of Devon Energy Corporation for compulsory pooling.

I believe these are competing pooling applications, and a subpoena has been issued in one of the cases, and a motion to quash has also been filed. We're here this morning to hear the arguments in these cases. And please, if you guys would identify yourselves...

MR. HALL: Mr. Examiner, Scott Hall, Miller Stratvert PA, Santa Fe, on behalf of LCX Energy, L.L.C.

EXAMINER CATANACH: Okay.

MR. CARR: William F. Carr with the Santa Fe office of Holland and Hart, L.L.P. We represent Devon Energy Corporation.

EXAMINER CATANACH: Okay. And I believe the subpoena was issued to LCX on behalf of Devon, right?

MR. CARR: It was issued to Devon, directing LCX to produce certain material, yes, sir.

EXAMINER CATANACH: And LCX has filed a motion to quash; is that correct?

MR. HALL: We filed a motion to quash, and Mr. Carr has responded to that. I don't see the need to file a written reply unless you direct me to do so, and I'll be more than glad to -- more than happy to do that. But I think we can argue this today.

EXAMINER CATANACH: Yeah, I don't think that's necessary. I think we can just argue it.

MR. HALL: Okay. If I might give you some context to the dispute and some of the background that precipitated the dispute, LCX, as will be explained in further detail at the hearing on the merits of the two Applications, drilled a well, a horizontal Wolfcamp well, in the west half of Section 6 in Township 17 South, Range 25 East, in Eddy County. It was drilled on an expedited basis in order to preserve several expiring leases that LCX controlled.

LCX working interest control in the west-half unit is approximately 65 percent; Devon owns 35 percent in the west-half 320-acre unit. And it is correct that the well was not proposed to Devon before the well was commenced, and we'll explain the reasons for that in further detail at the hearing on the merits. But this well is one of several that have been drilled by -- Wolfcamp wells, that have been drilled by LCX and its predecessor Parenco.

By way of background, LCX acquired the Parenco properties west of Artesia -- which is, we understand, a hot Wolfcamp play right now -- in April of 2005, and Dever Energy acquired LCX, and once it did its inventory discovered it had several expiring leases in the Wolfcamp play and undertook a very aggressive drilling program. This is one of those wells. And as I said, the well was drilled to preserve the leases.

You should also know -- and I doubt even Mr. Carr knows this, but Devon owns 100 percent of the interest in the east half of the same Section 6. And Devon has recently staked and permitted its Canadian State 6 Number 1 well, which will be a Wolfcamp horizontal drill, located, I believe, 660 feet off the east side of the section. So it's two mirrored wells here. That's important for you to know, because it establishes irrefutably that Devon is a competitor. And as I said, Devon has little or not experience that we're aware of in the Wolfcamp, particularly with these horizontal Wolfcamp drills and completions.

Now, further context. You look at the two competing Applications, they are identical. Both parties see, to pool the west half of the unit, both parties agree that the well location is appropriate, they're both proposing at the same location, both parties are proposing

the same unit configuration, the standup west-half unit, and both parties are proposing a 200-percent risk penalty assessment.

The only difference between the two Applications is, Devon seeks to have the Division remove LCX as operator, apparently because of perceived offense of not having proposed the well before starting the well. So that's something that we'll hash out at the hearing on the merits, but it gives you some context for our motion to quash.

Now, when we received the subpoena and ran through the items that were requested -- we can discuss those individually, but when we formulated our motion to quash, we tried to bear in mind the Division's precedent orders for disputes of this nature and what the Division has done in the past to resolve these disputes.

And in my estimation, what has developed over the past few years is that the Division has adopted a policy that it will uphold motions to quash, adopting a relevance standard. In other words, someone seeking to compel the production of information materials must demonstrate some sort of relevance.

And the latest pronouncement on that rule that I'm aware of is from the Mewbourne-Chesapeake dispute, and I'll provide you with a copy of Order R-12,343-A. That,

again, involved a subpoena for well data and a motion to quash. And if you will turn to paragraph 15 of that order, it sets forth what I understand to be the applicable standard, the legal standard, for resolving these disputes. And that says, the subpoenas must be directly relevant or likely to lead to the discovery of evidence relevant to the issues raised in the Application.

You go back and look at the Applications in this case. There is no geologic issue here. There is no dispute as to the risk penalty here, within the parameters of Rule 35, anyway. I believe Devon may attempt to seek a reduction in their risk penalty, but not for any sort of technical reasons, not for any sort of geological reasons.

If you look at the prehearing statements, the amended prehearing statement that Devon had filed, it's apparent what their case will be. They're going to come before you and complain about the lack of advance negotiations before the well was started. None of their witnesses are technical witnesses. They have a land consultant, and they have Raye Miller from Marbob, who's been qualified in the past as a practical oilman.

But it's clear from that, Devon is not making a technical challenge to the risk penalty. And so why is the request for well data relevant to their Application? I don't think they can establish that is. So under what --

the Division's prior pronouncements, I think the motion to quash ought to be granted.

We could go through these items one by one, and I can explain to you what we've done to satisfy some of Devon's request. They have asked for, in their item number 1, documents relating to the decision to drill the 17-25 Federal com well. That's the subject well. And we believe -- You know, it's not clear what they want there, but we believe that we've provided them with that information.

If you will look at our Exhibit Number 3, it's a letter dated January 6th from LCX to Devon's landman, Meg Muhlinghause. And attached to that letter, enclosed with that letter, was a standard Form 610 operating agreement.

The Exhibit A -- We've briefed the exhibit to you. The Exhibit A to the operating agreement outlines all the interest in the proration unit. And if you look at page 2 of that Exhibit A, it will outline all the specifics on each and every lease, and you can see that several of these leases have expiration dates of November, October, I believe, and so we think that ought to satisfy Devon's request for information relating to the decision to drill, just to preserve leases. So we think we've satisfied that one.

Number 2, they've requested well logs, completion reports, and this is where we're really going to try to

draw the blind here. It's obvious that Devon, not having had much experience in the Wolfcamp, is trying to go to school on LCX's efforts on its well, even though we don't think it's relevant at all to Devon's Application.

They're competitors. We think under a circumstance like that where they're competing, we have a right to maintain confidentiality. LCX and its partners have paid for well information and log data, and they're not going to give it up for free.

Further, if we deny the motion to quash, that would require you to disregard the provisions of Rule 1105, in our view. If you look at 1105.C, it's been a rule -- it's been on the books for a long time. It allows an operator to hold well-log information confidential for up to 90 days after the well was completed. That's a hard rule to get around in the context of a motion to quash, I believe, and particularly in a competitive situation like this.

Devon has made the point that even though the well is not drilled on any of its acreage -- it's drilled solely on LCX-controlled acreage -- that because the well is drilled anywhere within the proration unit is, it's drilled for the benefit of all the interest owners in the proration unit.

Well, I disagree with that. And I think we made

that point before in the context of the Mewbourne-Samson-Chesapeake case. We cited to the Division in the context of the motion to quash in that case that, really, geologic data, well data, seismic data are confidential and proprietary, they're protected trade secrets, and they belong to the owners of the minerals.

And the case which we cited to the Division, which we believe the Division relied on, is the City of Northglenn vs. -- I'm sorry, the -- *Jack Greinburg vs. City of Northglenn* case, and I have copies of that here for you.

If you'll look at page 7 of that case, I've highlighted some language in there that reiterates the basic holding of the case that it's proprietary, confidential data, belongs to the mineral interest owner and not to the parties, and it's worthy of trade-secret protection. And I believe that's what the Division basically adopted when it issued the order denying the motion to quash in the Chesapeake case.

Going back to the subpoena request, item number 3, again, Devon's requesting a -- pressure data, flow data and that sort of thing, and that is largely unavailable to date. And again, we think that's confidential as well.

Number 4, they're asking for production information. That's not available yet.

Number 5, they've asked for monthly production

information on all other Wolfcamp wells drilled or operated by LCX, and we simply make the point that they can get that from ONGARD or OCD's data online if they like. It's really not relevant to this case, in our view, and it's readily available to them from public sources.

Item 6 -- and they're asking for geologic data, geologic maps, et cetera. Again, same objection we made before. We believe that's confidential and proprietary. We don't believe there's a geology issue involved in this case, frankly.

Number 7, they've asked for petroleum engineering data and studies. Same objection to that.

Number 8, they're asking for information presented to the OCD or BLM. We have produced that to them this morning, to the extent we could understand the request. We've given them the APD information, and we've marked that as Exhibit 1, so we've complied with that.

Item 9, they're asking for documents concerning ownership. They're asking, in particular, for title opinions. We believe we've given them previously information responsive to that. If you'll look again at the Exhibit A to the JOA, which is part of our marked Exhibit 3, that shows them all the ownership information they should need, and it's available from public land records as well.

We're not going to give up title opinions. The New Mexico Court of Appeals has recognized the confidentiality of title opinions in the case of *Skaggs v. Conoco, Inc.* The case citation for that is 125 NM 97, 1998 case. I have a copy of that case for you.

Lastly, Devon's asking for all exhibits which we'll present at the hearing. That hasn't been determined with finality yet, but I believe it's going to consist almost exclusively of correspondence back and forth between LCX and Devon, and Devon -- as well as an AFE. Devon already has all that.

Finally, Mr. Examiner, to indicate how forthcoming LCX has been to Devon in trying to obtain their voluntary participation in the well, if you'll look back at our Exhibit 3, it was a transmittal for a number of items in addition to the joint operating agreement.

What I have marked as Exhibit 2 is a compilation of daily drilling reports and daily rig reports, which shows accruing cost information, it also shows casing and cementing information in tremendous detail. It says a lot about how this well has been drilled and completed. Devon can learn a lot about that.

So to say that Devon -- to say that LCX has not been forthcoming is incorrect. I think Devon has gotten more than the average pooled party would have gotten or

would be entitled to, to allow it to make an informed decision here.

That concludes my presentation.

EXAMINER CATANACH: Thank you, Mr. Hall.

Mr. Carr?

MR. CARR: May it please the Examiners, we know what we're talking about here is a situation where LCX acquired a property interest, went out, drilled a well on a dedicated spacing unit, failed to contact other interest owners in the spacing unit about the well, and did not provide any data on the well until after the well had been drilled, logged and tested.

We all know that under the Rules of the Division you can pool before or after you drill. But that does not mean that if you go out and drill first, that the regulatory scheme doesn't apply or somehow is modified. We have LCX, an operator who has drilled first, before they entered into any negotiations with other interest owners in the spacing unit. It's a strategy that we will show they have used in other circumstances.

And it's a strategy that, if approved by the Oil Conservation Division, will be used by others. It's going to result in operators getting first well data and then contacting other interest owners to engage in what is supposed to be good-faith negotiation.

I believe that if you approve this you will be, in fact, writing off part of the compulsory pooling process. You're going to be eliminating what I believe is a statutory precondition to exercising the police power of this State to take the interest from one owner and give it to another to operate. And what I'm talking about there is the requirement for good-faith negotiations between the parties.

If you don't stop this, owners can drill, gather data, then negotiate. They will have data that they will not make available to others.

It's like playing Russian roulette with someone. They may be selling you a dry hole, but they know where the bullet is and you do not.

We don't believe that's the Division's intent or the intent of the Oil and Gas Act, and we don't believe that there are no consequences on an operator who simply goes ahead and drills. If I'm wrong, everyone should drill first, ignore the OCD, ignore the other operators, and then kick the process in after the fact.

LCX drilled on a 320-acre spacing unit in which Devon holds the working interest on 120 acres. We suggest that by doing this, they drilled for all. Because no matter what happens, Devon's 120 acres will be dedicated to the well, and the data that is acquired is data acquired

for all.

They didn't notify Devon until three weeks after drilling commenced. They did file the APD, and it's dated July 21st, 2005. It was approved by the BLM September 14th, 2005, and received by the OCD on September the 16th.

So they had known for months, when they commenced drilling on October the 7th, of the other interest owners in the spacing units, but they didn't contact them. The very first contact was October 28th, three weeks after drilling commenced.

And they didn't say, Oh, we've made a mistake and we're under the gun, we may have a lease expiring. They simply called Devon and said, We'd like to drill a horizontal well on this acreage.

And Devon said, Well, send us a well proposal and an AFE.

They didn't send those documents until two weeks after the well was drilled, logged and tested. This is how forthcoming LCX has been, contrary to what Mr. Hall has indicated. And because of a lack of response from LCX, we knew the well was drilled, we couldn't get any information, we filed a compulsory pooling application on November the 15th, and only after that did LCX file. We received nothing, not one piece of paper, from LCX until November the 23rd. This is how forthcoming they were, after the

well was drilled.

And we stated that to go forward in this compulsory pooling case, we needed data on the well. We needed the data they had so there could be good-faith negotiations, we needed it to prepare for a hearing, and without it we could do neither. There would be no meaningful negotiation, and we couldn't prepare.

So we asked for the logs, the test data, the test -- the title data, which they had, and have, and they declined. So we obtained a subpoena, and then they filed a motion to quash.

I have a few comments that are general comments on the data we seek.

First of all, when we talk about for whom the data was acquired and who the mineral interest owners are that are affected, I will tell you that it includes everyone in the dedicated spacing unit, because Devon as a working interest owner with 35 percent of this well is either going to pay for the well directly by deciding to participate, or they're going to pay out of production if pooled. And since we're going to pay for the data, we think we're entitled to see the data and we're entitled to go into good-faith negotiations with everyone coming in on the same playing field.

As to compulsory pooling, we all know that a

precondition to a pooling order is a finding that the parties cannot reach agreement. The OCD has traditionally read that to mean good-faith negotiations. Where one party ignores the other and drills before even contacting them, acquires log data, test data, other information on the well, they've got to share that data, or we simply are not able to engage in good-faith negotiations.

It is Russian roulette. Here's the pistol, you've paid for 35 percent of it, put it to your head and pull the trigger. And we know what we've got, but if you've got the chamber with the bullet, you just bought a dry hole. And I think that is on its face unjust and unfair in the circumstances where someone has run out ahead of the game. They're taking advantage of the system, and that is something you have to stop.

There are also some correlative-rights issues. You know, correlative rights is the opportunity to develop the reserves under your acreage. And you avail yourself of that opportunity by drilling a well or by committing your interest to a well drilled by someone else, either under a -- in a spacing unit or a unit. But the opportunity means, it seems to me, at a minimum you are allowed to participate in the process.

Mr. Hall says, Oh, there's no issue here, we're all going to have the same spacing unit, same well. Well,

of course we have the same well and the same location; it has been drilled. It would be economic folly to think now, if we have an alternative location, if they have acted imprudently in drilling as they have, that we would now plug their well if we assume operations and drill another.

Their judgment whether or not they've acted as a prudent operator will be shown in large part by this data and whether or not they have properly developed the property and it is relevant. We simply have been excluded from any role. We have not been able to participate in negotiations, we have not been able to propose alternative locations. We were unilaterally cut out of process, we were denied an opportunity to effectively participate in how our minerals will be developed. And we'll be here in two weeks to talk about the risk charge and talk about what happens when someone runs ahead of the game and actually assumes the risk before contacting other interest owners.

And so they file a motion to quash, and we were looking at item 2, logs and completion reports, and item 3, reservoir pressure information, item 6, geologic data, item 7, engineering studies. And one of the issues in this case is whether or not LCX is a prudent operator. And the information from all of those will lead to relevant information on that point.

And I would point out that the objection they

raise to all of these was that it was proprietary. It was confidential, business and privileged trade secret information. Proprietary, I would suggest, and since we're going to pay for it, it is proprietary, and it belongs to us as well as them. And when we're in the same well, we're not competitors in that well, we ought to be making prudent decisions and developing the reserves.

And as trade secrets, Mr. Hall has provided you with a copy of the order entered in the Chesapeake case. And in that case Chesapeake didn't want to share data because they considered data they had acquired by drilling on someone else proprietary and trade-secret information. And in finding 17 of that order, the Division found that the trade secret privilege was only available, and I quote, if the allowance of the privilege will not tend to conceal fraud or otherwise work an injustice.

That's what the Division found. And they said, Chesapeake, you can't go drill on somebody else's land in a spacing unit and then use that data against the co-owners in that spacing unit.

I will tell you right now, if you authorize one operator to go out on a spacing unit where I own 35 percent of it, acquire data that I'm going to have to pay for, and then use it against me, that's unjust, and the trade-secret privilege does not apply.

We asked for data on other Wolfcamp wells operated by LCX. They said, Oh, we're going to take a ride on LCX. I'll tell you, we're not going to do that. And they say, Well, it's burdensome, it's not calculated to lead to the discovery of relevant evidence. They can get it from a web page.

Well, I tried that. I found very, very few LCX operations in the Wolfcamp whatsoever. And if they're so knowledgeable and so experienced in New Mexico in developing the Wolfcamp, it's curious to me that they have only two or three wells in 2004 and have completed a number of wells but have no production for them at the current time. And we would like current production information because we think it directly bears on whether or not they should be able to operate a well in which we own 35 percent of the interest.

The documents of title. I'm concerned that when we pay our AFE share, either directly or out of production, we're going to be paying for their title work. And I would suggest that if we're paying for it, we're entitled to it.

I would also tell you that it's going to show you that LCX knew that Devon had an interest in this spacing unit way back -- July, months and months before they talked to us. But they elected not to talk to Devon, as they've elected not to talk to other operators as they go forward

with developing the Wolfcamp formation. Until we get this data, we can't prepare. Until we get this data, there can be no meaningful negotiations for the development of this property, no good-faith negotiations, and that's a precondition to a pooling order.

And for that reason we ask you to deny the motion to quash and direct LCX to produce the data we seek in a timely fashion so we can be prepared to go forward on March the 2nd.

EXAMINER CATANACH: Thank you, Mr. Carr.

Do you have anything?

MR. BROOKS: Not really.

EXAMINER CATANACH: I think what we'll do, gentlemen, is consider what we've heard today and issue a written decision on the motions. And hopefully do that in the next day or so, hopefully by tomorrow anyway. I know you guys need time to prepare for the March 2nd hearing, so we'll try and get that out as quickly as we can.

Anything further?

MR. HALL: No, sir.

EXAMINER CATANACH: Okay, this motion hearing as adjourned then.

(Thereupon, these proceedings were concluded at 9:30 a.m.)

* * *

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 13603 heard by me on February 16, 2006 13603.

David K. Catanach, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL February 17th, 2006.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 16th, 2006