

1 STATE OF NEW MEXICO
2 ENERGY AND MINERALS DEPARTMENT
3 OIL CONSERVATION DIVISION
4 STATE LAND OFFICE BLDG.
5 Santa Fe, New Mexico

6 23 October 1986

7 COMMISSION HEARING

8 IN THE MATTER OF:

9 Cases 9015, 9016, 9017, and 9018,
10 all of which concern amendments
11 to present rules and adoption of
12 new rules in the numbered cases
13 as listed.

CASES
9015
9016
9017
9018

14 BEFORE: Richard L. Stamets, Chairman
15 Ed Kelley, Commissioner

16 TRANSCRIPT OF HEARING

17 (REPORTER'S NOTE: Chairman Stamets' opening com-
18 ments concerning each of these cases may be found
19 at the commencement of the previous transcript on
20 this date for Cases 9009 through 9014.)

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Mr. Dennis Wehmeyer	
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VICTOR T. LYON

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1
2 REPORTER'S NOTE: At this time the following proceedings
3 were had prior to the closing of the previous case, as an-
4 nounced by Chairman Stamets.)

5 MR. STAMETS: It will be Cases
6 915, 16, 17, and 18, and these are all on the Division's mo-
7 tion.

8 Case 915 would be adoption of
9 new rules 315, 413, and 903.

10 9015, I am advised.
11 9015, rules 315, 413, and 903
12 to establish a gas priority production schedule.

13 Case 9016, the Division's own
14 motion for adoption of a new Rule 414 to regulate sales of
15 gas by separate owners in a well.

16 Case 97 -- 9017, for amendment
17 of Rule 902 to provide for notice by purchasers to producers
18 when purchasers are unable to take gas in accordance with
19 the provisions of such rule.

20 And 9018, to amend Order R-
21 8170, specifically the amendment of Rule 10(a), 11(a), and
22 11(b) of the General Rules for prorated gas pools in New
23 Mexico to provide for two-year balancing periods and for
24 twelve times over produced limits for the prorated gas pools
25 in northwest New Mexico; and I would as at this time for ap-

1 pearances in these cases.

2 MR. TAYLOR: May it please the
3 Commission, I'm Jeff Taylor, Counsel for the Division and we
4 will have three witnesses, I believe.

5 MR. STAMETS: Thank you, Mr.
6 Taylor

7 Mr. Nutter.

8 MR. NUTTER: Dan Nutter, Bass
9 Enterprises Production Company.

10 MR. BRUCE: Jim Bruce, repre-
11 senting BHP Petroleum and (Americas) Inc.

12 MR. DUKE: I'm Jonathan Duke of
13 Keleher and McCleod, representing Gas Company of New Mexico.
14 We will possibly have one wit-
15 ness.

16 MR. STAMETS: Thank you.

17 MR. HALL: Scott Hall from the
18 Campbell & Black Law Firm.

19 We're appearing on behalf of
20 Amoco Production Company, Blackwood & Nichols, Exxon Company
21 USA, Unocal Corporation, Union Texas Petroleum Corporation,
22 and Yates Petroleum Corporation.

23 Mr. William Clark and Mr.
24 Charles Blackwood will offer comments on behalf of Blackwood
25 and Nichols.

1 Amoco Production Company has
2 several witnesses here available today, as does Yates Petro-
3 leum Corporation.

4 MR. STAMETS: Ernie

5 MR. PADILLA: Mr. Chairman,
6 Ernest L. Padilla, Santa Fe, New Mexico, for John P. Hendrix
7 Corporation and Michael Klein.

8 MR. STRAND: Robert Strand,
9 Roswell, New Mexico, appearing for the Independent
10 Petroleum Association of New Mexico, Doyle Hartman of
11 Midland, Texas, and Alpha Twenty-One Production Company,
12 Midland, Texas.

13 We will have 0 witnesses but I
14 do wish to make a statement.

15 MR. STAMETS: Other apperances?

16 MR. STOVALL: Robert Stovall of
17 Farmington, representing -- not to be outdone by Campbll &
18 Black -- C & E Operators, Inc., Dugan Production
19 Corporation, La Plata Gathering Systems, Inc., Turner
20 Production Company, A. R. Kendrick, and Merrion Oil & Gas.

21 MR. LITTLE: Curtis Little, I'm
22 appearing on behalf of the United States.

23 MR. STAMETS: Thank you.
24 Warren?

25 MR. CURTIS: Warren Curtis with
Northwest Pipeline.

1 MR. KELLAHIN: Mr. Chairman,
2 Tom Kellahin of Santa Fe, New Mexico, appearing on behalf of
3 Tenneco Oil Company, Mr. Lewis B. Burleson, and Phillips
4 Petroleum Company.

5 MR. HOCKER: R. L. Hocker for
6 Cities Service Oil and Gas Corporation.

7 MR. CRUMP: Charles Crump on
8 behalf of DEPCO, Inc.

9 MR. STAMETS: Yes, sir.

10 MR. KENDRICK: H. L. Kendrick,
11 El Paso Natural Gas Company.

12 MR. GREY: Charles Grey with
13 Sun Exploration and Production Company.

14 MR. WEHMEYER: Dennis Wehmeyer
15 with Texaco.

16 MR. COOTER: Paul Cooter with
17 the Rodey Firm, with Dennis Morgan appearing on behalf of
18 Southern Union.

19 MR. STAMETS: Any other appear-
20 ances?

21 I'd like to have all of those
22 who may be witnesses or who will be witnesses stand and be
23 sworn at this time.

24

25

(Witnesses sworn.)

1
2 We will recess this hearing,
3 then, until 1:00 o'clock.
4

5 (Thereupon the noon recess was taken.)
6

7 MR. STAMETS: This morning we
8 had most of the appearances but maybe one or two who were
9 missing at that time.

10 Is there anybody who did not
11 get a chance this morning to enter their appearances in any
12 of these gas cases this afternoon?

13 MS. SUSTAITA: Minnie Sustaita
14 with ARCO.

15 MR. STAMETS: Anybody else?
16 All right, Mr. Taylor, you may
17 fire when ready.

18 You may proceed, Mr. Taylor.

19 MR. TAYLOR: I'd request that
20 the record reflect that the witness has been previously
21 sworn and qualified in a previous case today.

22 MR. STAMETS: The witness is
23 sworn and he is considered qualified.
24
25

1 VICTOR T. LYON,

2 being called as a witness and having been previously sworn
3 upon his oath, testified as follows, to-wit:

4
5 DIRECT EXAMINATION

6 BY MR. TAYLOR:

7 Q Mr. Lyon, are you familiar with the
8 proposed rules 315, 902-B, and 903?

9 A What has been your involvement in the
10 development of these proposed rules?

11 A Well, I have participated in some of the
12 gas committee work that has been going on for the past year,
13 and there has been some discussion that -- that the priority
14 schedule, which had been in effect for several years, was
15 not incorporated into the rules. It was just on the basis
16 of memoranda, and that we needed to upgrade its status to
17 put it -- to give it a rule status.

18 Q And what is -- could you tell us what the
19 purpose of these rules are?

20 A Well, the purpose of the rules is -- is
21 to prevent waste, primarily, and to protect correlative
22 rights, in that there are certain categories of wells which,
23 if shut in, could result in waste; such as wells with water
24 drive and making high water cuts, and other types of wells
25 which could suffer damage and loss of reserves if they were

1 shut in, and also there is a problem of dry gas in some in-
2 stances squeezing casinghead gas off the market, and it's
3 very difficult to shut in casinghead gas without shutting in
4 the oil that the casinghead gas is derived from, and there-
5 fore we feel it is necessary to prevent waste and promote
6 the production of oil that casinghead gas be given priority.

7 And there are other types of wells, such
8 as downhole commingled wells, which gas zones with oil
9 zones, that the oil would be inhibited, and therefore we
10 felt that it was necessary to give them a higher priority
11 so that just plain vanilla gas wells would be the first
12 wells to be curtailed in a curtailment situation.

13 Q So it's my understanding that a listing
14 (a) through (d) here relates to -- or in Rule 903 it's (1)
15 through (4) -- relates to the likelihood of waste if the
16 various types are shut in with waste least likely in (a) and
17 least likely in (d).

18 A Right.

19 Q Is that the reason for that particular
20 list?

21 A That's right. Priority (1) would be the
22 wells first to be curtailed, followed by priority (2), and
23 then priority (3), and the last wells to be shut in would be
24 priority (4), which is hardship gas wells.

25 Q Do you have anything further to add to

1 your testimony?

2 A Well, we have changed all of these rules.
3 I think they are identical, but those priorities are needed
4 in -- in all three places.

5 Q And the priorities here are virtually
6 identical to that outlined in the memorandum of the Direc-
7 tor.

8 A Yes, as I recall they are identical.
9 There may be some very small changes.

10 Q Do you recommend adoption of this rule?

11 A Yes, I do.

12 MR. TAYLOR: That's all we have
13 in this matter, Mr. Chairman.

14 MR. STAMETS: I'm wondering if
15 we might move things along a little more quickly if we would
16 allow for all the direct testimony in these cases first and
17 then allow for cross examination after we have everything on
18 the table.

19 Is there any objection to that
20 procedure?

21 MR. TAYLOR: The only thing is
22 we were thinking possibly it might make a clearer record if
23 we went rule by rule.

24 MR. STAMETS: Well, you might
25

1 be right.

2 MR. TAYLOR: Or at least or-
3 ganized by particular subject matter.

4 MR. STAMETS: Then we probably
5 should allow for -- well, although, Mr. Taylor, I'm not
6 sure, if there's a chance we're still going to come back
7 here in a month we're still going to have a fouled up re-
8 cord.

9 If we come back in a month
10 we're still going to have a record that will be hard to fol-
11 low.

12 MR. TAYLOR: It's up to you and
13 the reporter, I guess.

14 Let's try and go rule by rule
15 then until we've run out of -- are apparently going to run
16 out of time.

17 Are there questions of this
18 witness?

19 Mr. Kellahin.

20

21 CROSS EXAMINATION

22 BY MR. KELLAHIN:

23 Q I'm not sure I understand, Mr. Lyon,
24 whether your testimony has included anything other than the
25 four category priority portion of the rule changes.

1 My question is under Rule 903 there are
2 some sub-sections B and C. You've not addressed any of your
3 direct testimony to either one of those sub-sections.

4 Am I clear in understanding that you're
5 confining your comments to the categories shown under that
6 rule under Subheading A?

7 A That's all I had testified to and I'm
8 sorry I neglected to say anything about paragraphs B and D
9 in the Rule 903, and I believe that is added language and my
10 recollection is that is taken directly out of the statute.

11 We had some people who requested it be
12 put into the rule and we have proposed to do so.

13 Q And who proposed that those be added into
14 the rule, do you recall?

15 A Well, the, drawing on my recollection, I
16 believe it was Mr. Manning who requested that be in there.

17 Q When you say drawn from a statute, you're
18 taking it from the ratable take section of the Common
19 Purchaser Act.

20 A I believe that's right.

21 Q Do you see any reason why that language
22 ought to appear in the priority schedule?

23 A I preceive that it was put in there be-
24 cause it may very well have an impact on the operation of
25 the priority schedule.

1 Q Have you determined what, if any, impact
2 that might be?

3 A Well, I think that anything I said would
4 be conjectural.

5 Q Let's then talk about the priority sche-
6 dule itself.

7 Are there other categories or subdivi-
8 sions of types of gas that might be added into the priority
9 schedule? For example, would it be reasonable to segregate
10 out casinghead gas so that casinghead gas produced out of
11 waterflood, pressure maintenance projects, might have a
12 level of priority ahead of regular casinghead gas?

13 A There have been some proposals to that
14 effect and I personally feel that casinghead gas per se
15 should have an exceedingly high priority.

16 Q Do you see a reason for dividing the cas-
17 inghead gas into further categories?

18 A We have had some discussion about adding
19 enhanced oil recovery gas in there on a par with hardship,
20 and I have in my briefcase a presentation that shows where
21 there could possibly be some waste occur if -- if an enhan-
22 ced recovery project were to be shut in or curtailed, and
23 this is just me as Chief Engineer talking and not -- I'm not
24 talking for the Division, but feel that we could, perhaps,
25 change Category (4) to include in the hardship cases those

1 enhanced recovery projects which can demonstrate that there
2 is a likelihood of waste occurring should that project be
3 curtailed.

4 Q Was there any discussion in the study
5 group with regards to the establishing a classification for
6 gas produced in associated pools as a separate category?

7 A I think there was some discussion about
8 it.

9 Q Do you have any comments or opinions
10 about that type of gas having a separate classification in a
11 priority system?

12 A I feel that it is appropriate to include
13 associated gas wells with -- with the casinghead gas.

14 Q And that's where you would place that
15 type of gas in the schedule? It would be with casinghead
16 gas and not as a separate category?

17 A Yes.

18 Q Casinghead gas and associated pools?

19 A Yes.

20 MR. KELLAHIN: Thank you, Mr.
21 Stamets.

22 MR. STAMETS: Other questions of
23 Mr. Lyon?

24 Mr. Chavez.

25

1 QUESTIONS BY MR. CHAVEZ:

2 Q Mr. Lyon, how will the OCD determine
3 whether an operator is violating the regulation?

4 A I presume that the -- probably the best
5 way is on the basis of complaints.

6 MR. CHAVEZ: That's all I have.

7 MR. STAMETS: Are there other
8 questions of Mr. Lyon?

9 MR. DUKE: Jonathon Duke for
10 Gas Company of New Mexico.

11

12 CROSS EXAMINATION

13 BY MR. DUKE:

14 Q Mr. Lyon, my first question, is Rule 903
15 and the associated rules meant to address the problems of
16 casinghead gas more than hardship gas?

17 A 903 which?

18 Q Well, 903 and 315, the priority lists.

19 A I think it's meant to address all cate-
20 gories of gas.

21 Q Should the OCD receive complaints from
22 casing gas -- casinghead gas producers?

23 A Well I can't speak for the entire Divi-
24 sion because I don't see everything that comes into the
25 Division. To my recollection, I have not seen any complaint

1 about casinghead gas being curtailed, but we had a threat of
2 casinghead gas being curtailed and I'm not aware how that
3 has been resolved, if it has been resolved.

4 Q Referring to Rule 903, Subsection (b), in
5 your opinion does this subsection -- does this subsection
6 allow a pipeline to -- I don't want to say violate -- but
7 does it give exceptions to the priority list if, say, a
8 casinghead gas presents an operational problem to a
9 pipeline?

10 A Well, I can see that it might apply in
11 that situation, but if you're asking for a legal conclusion,
12 you're asking the wrong person.

13 Q Well, let me ask you, what is the purpose
14 of Subsection (b)?

15 A At the request of one or more parties on
16 that committee we added the statutory language into the
17 rule. It's going to be there whether we put it in the rule
18 or not but you don't have to go to the statute to find it,
19 because there it is.

20 Q Thank you, that's all.

21

22

CROSS EXAMINATION

23 BY MR. STAMETS:

24 Q Mr. Lyon, Subsection (c) of 903, as I re-
25 call, is not in the statutes. Would -- it seems to me that

1 this is an addition which would require that the purchaser
2 advise the operator when there was some condition which was
3 preventing him from complying with that. Is that not cor-
4 rect?

5 A Well, was your question in regard to Par-
6 agraph (c) or (b)?

7 MR. DUKE: (b).

8 A Okay, I thought perhaps I'd misstated my-
9 self in response to his question.

10 Now, your comment again, please?

11 Q On Paragraph (c), that's -- that's not in
12 the statute, is that correct?

13 A That is correct.

14 Q But this would require that if the pur-
15 chaser was not able to purchase in accordance with the
16 priority schedule that he'd have to contact the operator and
17 tell him why.

18 A That is correct.

19 Q And if it was something the operator
20 could do something about, he would have the opportunity, I
21 presume, at that time to do that.

22 A Correct.

23 Q And one might assume that if the operator
24 volunteered to correct that and the purchaser still chose
25 not to take in accordance with this schedule, that then that

1 purchaser might be in violation of this rule?

2 A Correct.

3 Q Okay.

4 MR. STAMETS: Mr. Sexton.

5 MR. SEXTON: If the Division is
6 going to monitor this but if they aren't notified at the
7 same time as the operator, it looks to me like it would be
8 much easier for us to monitor it if we were notified at the
9 same time as the operator.

10 MR. LYON: I think that's a
11 good point.

12 MR. STAMETS: Mr. Little?

13 MR. LITTLE: Under (b) would it
14 not be that the wording "under a pressure" could mean a high
15 pressure or low pressure or fluctuating pressure and then
16 the words after that "under any other conditions", that
17 covers a lot of country and if the switcher had a hangover,
18 or his girlfriend was in town and he didn't feel like going
19 to the field, that's another condition.

20 I think you really ought to
21 take another look at that.

22 MR. LYON: You might contact
23 your legislator and ask him to rewrite the law.

24 MR. LITTLE: All right.

25 MR. STAMETS: Mr. Padilla.

CROSS EXAMINATION

BY MR. PADILLA:

Q Mr. Lyon, in Sub-category or Part (a) of the rule -- correction, Part (3) of the rules for selling casinghead gas, where would a well categorized as an oil well by virtue of, or categorized as a gas well by virtue of a GOR in an oil pool fall?

Would it fall within casinghead gas category?

A A gas well in an oil pool would reclassify the gas well because of its high gas/oil ratio?

Q Yes.

A The -- I would consider that casinghead gas.

Q Do you know of your own personal knowledge or involvement in the committee whether Sub-part (b) of the rule will apply to interstate pipelines?

A As far as I'm concerned it applies to everything in the State of New Mexico that we have jurisdiction over, including wells connected to interstate pipelines.

Q With respect to Part (b) of the rule, would the Division have any problem with qualifying that Sub-part (b) to apply strictly to the ratable take statute?

1 A Well, I'd have to know why you're
2 requesting this, because I don't -- I don't see the purpose
3 of your question.

4 Q Well, what I'm getting at is that the --
5 in my opinion, reading the rule and reading the statute, the
6 rule may encompass more than what the statute does insofar
7 as applicability to what a pipeline company may actually --
8 or how a pipeline company may construe this rule.

9 In other words, my question is directed
10 toward the ratable take statute under which the statute is
11 bound, SubPart (f) of the statute, as I understand it, and
12 according to the way I read this rule, especially the words
13 under any other condition could apply to anything.

14 So what I'm asking is -- and commenting
15 at the same time -- is whether or not the Division would
16 have any problem to qualifying that rule in order to make it
17 apply to the ratable take statute.

18 A Well, is there some qualification in the
19 statute which you interpret due to its placement in the
20 statute and so forth?

21 Q Well, it's the ratable take statute, and
22 I don't have any problem with the rule insofar as it applied
23 to taking ratably. I think we're bound by that and we would
24 have to change the law, as you suggested, through the Legis-
25 lature; however, if we stick that same statute in the rule

1 it would seem that a pipeline company could construe it to
2 apply to other things other than ratable take.

3 Q Well, I suppose another approach to it
4 would be just to change the wording of Paragraph (b) and say
5 that the purchasers shall take the gas in accordance with
6 this schedule and the ratable take -- ratable take statute.

7 Q Well, I think I would advocate that, at
8 least to quality that it would apply to the rule the same as
9 the statute if we're going to incorporate this kind of lan-
10 guage into this rule, or eliminate it entirely. I would
11 prefer that.

12 MR. STAMETS: I would hope be-
13 fore this hearing concludes that someone will put on some
14 testimony to show what terrible things this paragraph will
15 do because it would be in here, and how leaving it out would
16 change the impact of this rule.

17 MR. TAYLOR: Mr. Stamets, we
18 have another witness, Bob Manning, and I think he's going to
19 do that.

20 MR. MANNING: You're sure op-
21 timistic.

22 MR. PADILLA: Mr. Chairman, I'm
23 simply trying to restrict the applicability of this rule to
24 the ratable take, as I read the ratable take statute. I
25 don't want to ask Mr. Lyon to -- what his legal opinion is.

1 I think this is a matter of law as to how this rule would
2 apply, and I'm cautious about the kind of questions I want
3 to ask Mr. Lyon. (Not clearly understood) on how this rule
4 will be construed, but I would think it's a matter of law as
5 to how this thing (inaudible) but I certainly don't -- I
6 think that if there's a problem with it, then we ought to
7 (inaudible).

8 MR. STAMETS: Your name, sir.

9 MR. BLACKWOOD: Mr. Stamets,
10 I'm Charles Blackwood, Blackwood & Nichols Company, in Okla-
11 homa.

12 I can give you, I believe, a
13 horrible example --

14 MR. STAMETS: Mr. Blackwood,
15 are you going to present your testimony?

16 We will let you give an example
17 but I'd like for you to put it into direct testimony rather
18 than cross examination of this witness.

19 MR. BLACKWOOD: All right. In
20 cross examination I have one question.

21
22 QUESTIONS BY MR. BLACKWOOD:

23 Q If this is already in a law, and this was
24 not recommended by the Committee, I'd like to make a little
25 bit of testimony here that Section (b) and (c) were not re-

1 commended by the Committee. They were recommended by minor-
2 ity person on the Committee, and --

3 MR. STAMETS: Mr. Blackwood --

4 MR. BLACKWOOD: -- on the Com-
5 mittee --

6 MR. BLACKWOOD: Mr. Blackwood,
7 I must insist that direct testimony be put in as direct tes-
8 timony in order for us to conclude this hearing to the de-
9 gree that we can today.

10 And we will certainly allow you
11 an opportunity to do that.

12 MR. BLACKWOOD: Whenever it's
13 appropriate.

14 MR. STAMETS: Thank you.

15

16 CROSS EXAMINATION

17 BY MR. STAMETS:

18 Q Mr. Lyon, I know you're not a lawyer, but
19 that doesn't stop other engineers --

20 A Really doesn't stop me, either.

21 Q -- and also I would assume that you have
22 read the U. S. Supreme Court decision in the Transcontinen-
23 tal versus Mississippi Oil and Gas Board.

24 A Yes, I have.

25 Q And also your -- your testimony was that

1 you believe that this rule would apply to interstate pipe-
2 lines.

3 A Yes, sir.

4 Q In Transco versus Mississippi was the im-
5 plication there that states cannot tell interstate pipelines
6 what to do if the impact is to increase the cost to con-
7 sumers?

8 A When you added that last statement, yes,
9 it did.

10 Q Is it conceivable that in order for an
11 interstate pipeline to comply with this priority schedule,
12 that they would wind up perhaps having to take more expen-
13 sive gas?

14 A Yes.

15 Q And would that increase the cost to the
16 consumer?

17 A I think it would have to.

18 Q So in your engineering/lawyer opinion,
19 the it -- would you say that we need Paragraphs (b) and (c)
20 in order for this rule to overcome the problems raised in
21 Transcontinental versus Mississippi?

22 A Well, I really don't have a strong
23 opinion either way, whether it needs to be in the rule or
24 not. It is in the statute and if there is any controversy
25 between parties, purchaser and seller, on this point they

1 are going to read that section of the statute to you over
2 and over and over.

3 It's there and to me it is willy-nilly
4 whether you put it in the rule or not.

5 MR. STAMETS: Are there other
6 questions of this witness?

7 MR. DRAPER: Mr. Chairman, Del
8 Draper.

9

10 CROSS EXAMINATION

11 BY MR. DRAPER:

12 Q Mr. Lyon, the notice of hearing for to-
13 day makes reference to the applicability of this rule for
14 marketing affiliates. It doesn't mention anything about
15 marketing affiliates in the rule itself.

16 Can I assume that a marketing affiliate
17 would be considered a purchaser just asking another pur-
18 chaser?

19 A That's my view, yes, sir.

20 MR. STAMETS: In response to
21 that question, Mr. Lyon, are you indicating that you would
22 consider El Paso Natural Gas Company and El Paso Marketing
23 as separate entities for implementation of these rules?

24 A I don't know whether I ought to answer
25 that before I confer with you or not, but I view them as one
and the same.

1 MR. STAMETS: Okay, so you would
2 consider that -- all right, I understand. The -- the
3 associated entities are essentially the same in your view.

4 MR. STAMETS: Are there other
5 questions of this witness?

6 Mr. Hall.

7

8 CROSS EXAMINATION

9 BY MR. HALL:

10 Q Just one question, Mr. Lyon. You were
11 asked a question by the Chairman as to your familiarity with
12 the Transco decision.

13 I'd like also to know if you are familiar
14 with some ten or fifteen other cases that have rejected ar-
15 guments made by gas purchasers where they have made argu-
16 ments of commercial impracticability where their producers
17 have compelled them to take gas and if you are familiar, how
18 do you reconcile those two views?

19 A Well, to begin with I have not read the
20 -- I don't know what cases you're talking about.

21 Q (Two case names not understood by repor-
22 ter.)

23 A No, I have not read those.

24 MR. STAMETS: Are there other
25 questions?

1 chairman of a committee that considered this rule?

2 A Yes, sir, I served as Chairman of the
3 SubCommittee Number Three that considered this rule.

4 MR. TAYLOR: Mr. Chairman, I'd
5 tender the witness as an expert.

6 MR. STAMETS: The witness is
7 considered qualified.

8 Q Would you like to give us just a brief
9 description of how the committee came about making this re-
10 commendation, what was considered and what went on at the
11 committee meeting?

12 A We met on August the 12th and all member
13 of the committee were present with the exception of Mr. Gene
14 Motter, and we also had several guests there, you being one
15 of them, and some other people, Mr. Lyon was another one,
16 some other people from the Commission.

17 We had -- Exxon appeared there with a
18 couple -- as a couple of guests on this committee.

19 And we kicked around the priority of what
20 we thought the priorities should be, how they should be set
21 out and outlined, and as Mr. Lyon pointed out, we kicked out
22 -- kicked around also the associated gas and we even com-
23 mented to some extent on it to perhaps we could carry over-
24 age and underage if it became burdensome, as the associated
25 gas did, and, however, we did not come with that recommenda

1 tion.

2 We also noted or we also voted, as Mr.
3 Blackwood stated back here, he was partially right. We also
4 voted as to whether or not we should put in Rule -- or make
5 it part of Rule 903, Paragraph (b) and (c).

6 With the guests voting there, then it be-
7 came a majority of not putting it in; otherwise it would
8 have probably been a split vote.

9 Now, after thinking about this and talk-
10 ing about this, I submitted my recommendations to the Chair-
11 man, Mr. Carr. I submitted the -- our report to him, and in
12 the report I noted that the Committee expressed a desire to
13 submit the recommendations for the priority of gas without
14 Section (b) and (c).

15 Further in the report I said it is the
16 recommendation of the Chairman of the Subcommittee Number
17 Three that the following be adopted. I probably should have
18 added something to that, the recommendation of the Chairman
19 and another couple of people, that that should be in there,
20 but I left it out and went ahead and submitted it that way.

21 Now, in this report that I sent to Mr.
22 Carr, I added three paragraphs to the bottom of it that per-
23 tain to my thinking with respect to Paragraph (b) and (c).

24 One paragraph I said with respect to the
25 Chairman's recommendation that (b) and (c) in Rule 903 be

1 added to the Committee's recommendations, the producers of
2 gas stated that they did not fully understand what Paragraph
3 (b) and (c) meant, and for this reason preferred to delete
4 these two paragraphs.

5 Now the Chairman pointed out to the Com-
6 mittee that Paragraph (b) was quoted from the New Mexico
7 Statute verbatim and he therefore felt that it should be
8 added to Rule 903 for the edification of those who read and
9 work with your rules and not with the statutes.

10 Now, we've kidded a lot around here this
11 morning about lawyers and engineers each acting in one way
12 and the other, but most of the technical people that deal
13 with the rules and regulations do not know that Paragraph
14 (b) is in the statute, and whether it's in the rule or not,
15 as Mr. Lyon pointed out, you're still going to be under it.

16 I put it there for the edification of the
17 technical people, the non-lawyers, the engineers, the geolo-
18 gists, and those other technical people to -- to show them
19 where that is in there. I believe it's necessary to be in
20 there. I think this is the only way that we can prorate,
21 and when I say "we" I'm speaking for the industry. I'm not
22 speaking for El Paso Natural Gas. We have another speaker
23 for El Paso Natural Gas in a minute.

24 I think that's the only way that the in-
25 dustry can effectively prorate gas in New Mexico and remain

1 legal on it. I believe that we must consider Paragraph (b).
2 I notice, though, that the Commission left one thing -- or
3 added one thing to Paragraph (c) that was not in there.
4 They want the notification to the operator in writing, which
5 was added to Mr. Stamets' October the 1st memorandum. That
6 was not recommended, that it be in that.

7 Now, what Paragraph (b) means, I don't
8 know, I wasn't in on the law making of this -- of this
9 thing. I've talked to a lot of engineers who do not know
10 what it means. I've talked to one or two lawyers that do
11 not know what it means; however, it's there and it's
12 something that must be considered, and in view of what Mr.
13 Stamets discussed up here a moment ago, I think that it
14 would behoove us to leave that in there as some sort of a
15 legal mechanism -- I really don't know how to say this -- I
16 guess just come out bluntly and say it -- to skirt the
17 Mississippi-Transco case for the interstate pipelines to a
18 certain degree.

19 I believe that's about all I have to say
20 about that.

21 Q Well, so I take it the Committee was kind
22 of split but you liked (b).

23 A Well, I wasn't by myself. I may have
24 said, I may have been -- said it was me, protecting some
25 others, but I wasn't by myself.

1 Q Do you have anything further to add?

2 A No, sir, I don't believe I do.

3 MR. TAYLOR: I guess that's all
4 I have.

5 MR. STAMETS: To this point
6 we've been relatively free allowing non-lawyers to question
7 these witnesses. Since we have so many interested people in
8 these cases, I think that we're going to have to insist that
9 the cross examination, direct examination be done by
10 attorneys this afternoon and if you're out of an attorney,
11 there are plenty of them here and you can find one to
12 represent you.

13 We would, of course, accept the
14 -- any of the parties to direct statements either at the
15 close of the hearing or in writing after the hearing.

16 With that in mind, then, we
17 will see if there are any questions of this witness.

18 Mr. Padilla.

19

20 CROSS EXAMINATION

21 BY MR. PADILLA:

22 Q Mr. Manning, in SubPart (b) of this rule,
23 what do you think "or any other condition" means?

24 A Well, that's a tough one, isn't it? I
25 think you heard that before.

1 I suppose that if someone used the idea
2 of any other condition, I would hope that the aggrieved per-
3 son or parties would ask for a hearing and come in much like
4 we do now, anyway. We operate not as a police force with
5 the Commission but more as a judicial body, is my idea of
6 it.

7 So if some party said, well, this is
8 other condition, then I hope that the aggrieved party on it
9 would ask for a hearing and come in with -- and the Commis-
10 sion would take, or the Division would take testimony and
11 decided what that is.

12 That, I can't -- I can't answer that
13 specifically, Mr. Padilla. I can elaborate a little bit
14 here on how I can foresee this rule working.

15 A pipeline, an extensive pipeline that
16 has trunks in various directions, may come up to where it
17 has to curtail downhole commingling or -- well, downhole
18 commingling. Then in another area it has casinghead gas,
19 but in the area that -- where it is wanting to curtail down-
20 hole commingling, it does not have any casinghead gas, then
21 if they curtailed downhole commingle and continued to pro-
22 duce the casinghead gas in the other area, I would say (b)
23 would allow them to do that; and, conversely, if they need
24 to curtail casinghead gas in some area where they do not have
25 downhole commingling and in the other area where the downhole

1 commingling is left on, I can perceive that Rule (b) would
2 allow them to do that.

3 Q Do you think that that little discussion
4 you just gave us encompasses more than the ratable take sta-
5 tute allows?

6 A Well, I may have a different idea of what
7 ratability is than some of the other people. I do not think
8 this part here will affect ratability.

9 I do not perceive it affecting
10 ratability. I think it makes the division legal for, say,
11 the XYZ Pipeline to shut in casinghead gas over here where
12 -- and have downhole commingled gas over here.

13 Q Well, it seems to me what you're saying
14 is that you extend beyond an economic -- or you extend into
15 a pipeline's economic condition, is that --

16 A I don't understand the question.

17 Q Well, if it's unprofitable to take
18 casinghead gas or unprofitable to take downhole commingled
19 gas, then the pipeline company can make a determination
20 based upon economics and curtail it, is that what --

21 A Well, certainly economics is in the -- is
22 in the statute.

23 You realize, Mr. Padilla, that every
24 pipeline, whether it be interstate or intrastate, is under
25 tremendous pressure to take the cheapest gas. They're under

1 the -- the interstate is under pressure from FP -- FERC, I'm
2 sorry. FERC, their major distributor, and the consumer, and
3 also the intrastates are under this same tremendous pressure
4 to take the least cost gas.

5 Q I understand that from the Federal side.
6 I'm asking this question from the State Oil and Gas Conser-
7 vation Act.

8 My original question to you was whether
9 or not you go beyond the ratable take statute when you apply
10 this rule to almost any condition that could apply out in
11 the field.

12 A Well, I don't -- it certainly wasn't put
13 in there for that and if it does do that it's -- it's going
14 to have to be, I guess, altered or changed to some extent,
15 and I certainly don't advocate the alteration or changing of
16 this.

17 Q Well, as I understand your testimony, you
18 originally didn't want to put this SubPart (b) in there to
19 begin with, is that correct?

20 A The Committee didn't, right. The -- the
21 consensus of the Committee, let me put it that way.

22 Q Wouldn't then the -- would you have any
23 objection to going back to follow strictly under the statute
24 and let the court apply the statute as that statute may be
25 seen by the court?

1 A Well, certainly you could -- you could do
2 that, Mr. Padilla, and you could still achieve the same re-
3 sults.

4 (b) is in here for the edification of the
5 technical people and also to remind the people that we're
6 going to try to stay legal, and "we" being the State of New
7 Mexico and the Division; try to remain legal. It is not --
8 I really don't know what you're driving at. I am not an at-
9 torney and I don't see the legal ramifications of it.

10 Q Well, you can understand that this rule
11 may, by your very own testimony, may apply to other condi-
12 tions that may not necessarily fall under the ratable take
13 statute. Do you understand that?

14 A Well, yes, but if -- is this -- is 903
15 under the ratable take statute?

16 Q No, but the language is, the language
17 that you say was --

18 A Well, the language that we put in there
19 refers to 903, Rule 903.

20 Q I'm not going to argue with you, Mr. Man-
21 ning. I think I've made my point.

22 A Okay.

23 Q I still think it's a matter of law.

24 A All right, sir, I appreciate your com-
25 ments.

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CROSS EXAMINATION

BY MR. STAMETS:

Q Mr. Manning.

A Yes, sir.

Q We need to put some outer limits on this. Let's say that one of these -- I'm never sure of whether a high priority well is one that's the last one cut off or the first one cut off, but those that enjoy the benefit of this rule, let's say one of those had -- had gas that was 50 percent nitrogen. Would that be one reason why you could not move that gas satisfactorily?

A Yes, sir, it could be.

Q Let's --

A It's very expensive to extract the nitrogen from the methane.

Q Let's talk about your -- your switcher out there and he's got a hangover that day, is that -- is that one of those conditions whereby you cannot economically and satisfactorily take that gas?

A Well, not if I know about it; not if I know about his hangover and what he's doing, it certainly isn't.

Q All right, let's talk about the hard one here.

1 Let's suppose that you're trying to fol-
2 low this schedule and you find out that all your casinghead
3 gas is \$15.00 a thousand and you're selling gas out in Cali-
4 fornia at \$2.00. Can you take that \$15.00 gas?

5 A No, sir, we cannot.

6 Q So that would be one of those other con-
7 ditions.

8 A It would be another -- a condition also
9 tied in to economically, the word economically, in here.

10 Q Is it possible that the pipeline, in at-
11 tempting to live up to this priority schedule, would run in-
12 to conditions where following it to the letter would in-
13 crease your cost to consumers?

14 A Yes, sir, it is, very true.

15 Q Now Mr. Lyon suggested that the Division
16 should consider El Paso Natural Gas Company and El Paso Mar-
17 keting as one entity for purposes of this rule.

18 Do you have an opinion on that?

19 A Yes, sir, I do. I --

20 Q And you're speaking now as the Committee
21 Chairman, not as --

22 A Not as -- that's correct.

23 Q Thank you.

24 A Not -- I may -- Mr. Kendrick may get up
25 and say something different, I don't know, but anyway, -- I

1 think he is going to say something different -- but anyway,
2 let me -- El Paso in their -- El Paso Gas Marketing is
3 rather unique as compared to other gas marketing shadow
4 pipelines, if you please, or affiliated entities, or what-
5 ever you want to call them.

6 El Paso Gas Marketing obtains a market
7 which is not available to El Paso Natural Gas. El Paso
8 Natural Gas cannot touch that market that El Paso Gas
9 Marketing takes, and it's because of the price of gas.

10 Now, it obtains the market and then it
11 runs back out and obtains a supply for that market, and then
12 it will tell the market, you can either transport that gas
13 by El Paso Natural Gas or you can transport it by Transwest-
14 ern, but you are going to pay the tariff on it.

15 Now, I would certainly be remiss if I
16 didn't admit that El Paso Natural Gas would prefer to do the
17 transportation of it, but it's not tied and set in concrete
18 that they will. Transwestern may do it.

19 Then the market then pays the tariff and
20 El Paso Natural Gas then leases a small portion in that
21 pipeline based on that tariff to move this gas that is owned
22 by a market in California that is put together by El Paso
23 Gas Marketing.

24 For that reason El Paso Gas Marketing and
25 and El Paso Natural Gas are two separate entities.

1 Q Thank you.

2 MR. STANETS: Are there now
3 other questions of this witness?

4 Mr. Stovall.

5

6 CROSS EXAMINATION

7 BY MR. STOVALL:

8 Q Let me ask you, number one, there seems
9 to be some controversy around paragraph (b) of this. Could
10 you perhaps limit paragraph (b) to end after the first
11 appearance of the word "gas", prior to the phrase "of a
12 quality or under a pressure, et cetera, et cetera"?

13 A "Any person to purchase gas"? "Nothing
14 in this rule shall be construed or applied to require
15 directly or indirectly any person to purchase gas"?

16 Q Right.

17 A In there? Certainly you could end it
18 there.

19 Q Then you could eliminate paragraph (c).
20 It wouldn't become a problem, then, you wouldn't need
21 paragraph (c).

22 A Well, I think paragraph (c) is necessary
23 inasmuch as the producer is entitled to be notified when he
24 has a well affected in the -- in the priority scheme, so I
25 don't know, you may reword (c), then.

1 able to shut it in.

2 If he doesn't like the price, shut it in.

3 If he likes the price, sell it.

4 Now, let's take for instance a pipeline
5 in the northwest and the pipeline in the northwest says
6 we've got a market for some gas and the Division comes up
7 here and says, and we're -- and the pipeline is selling all
8 of its gas out of the northwest, and the Division comes in
9 and says, well, no, you can't -- you can't go down there in
10 the southwest and get any gas.

11 Number one, we can't move it to where it
12 ought to be. This is preventing it from happening.

13 And number two, the market may disappear
14 before we can make arrangements. These markets, a thirty day
15 market is a good market nowadays in gas, and the market may
16 completely erode before you -- you get time to make arrange-
17 ments to move it up through northwest and then back down and
18 around.

19 So I think that he should be given every
20 opportunity to sell his gas, and if it's necessary in taking
21 gas well gas down in southeast and having gas well gas in
22 the northwest shut in, I think he ought to be -- that should
23 be allowable to him.

24 Q Well, then let me stop you there. I
25 think I understand what you're saying.

1 Rule 315 applies to producers. Is it
2 your understanding that that rule applies to producers with
3 respect to their own wells or does that apply to producers
4 with respect to all wells?

5 A To producers with respect to all wells.

6 Q In other words, reading the Rule 315
7 that's on the -- one that was attached to the memorandum
8 that went out, the October 1st memorandum, to prevent waste
9 producers shall, to the extent permitted by operation of
10 Rule 903, observe the following priority production sche-
11 dule.

12 A Well, I interpret that to mean just that
13 gas that he, the producer controls that he has to do that.
14 Each individual producer.

15 Q All right. Mr. Manning, if in fact,
16 based on your answer to my previous question a pipeline can
17 take essentially that gas which it wants to purchase at the
18 particular price at which it's offered, why do we need these
19 rules, if we've created an exception to the rules under
20 those pricing conditions that we're concerned with? Why do
21 we need to promulgate Rule 903 and Rule 315?

22 A Well, I think we're going to need that on
23 the priority of gas, those priority of gas rules. You've
24 been throwing exceptions at me. I think the preponderance
25 of the gas that's moved is going to move just slick with

1 these rules without the exception part of it.

2 Q How is that going to change the way gas
3 is being purchased and sold in New Mexico from the way the
4 situation exists today?

5 A Well, I think Mr. Lyon, didn't he testify
6 that we were -- that we did have the memorandum from Mr. Joe
7 Ramey that pretty well set out what these priorities were
8 and by and large most of the pipelines were observing these
9 priorities. We're just making them legal.

10 Q Okay, I understand that but now we're al-
11 so building in an exception to them if the conditions are
12 such that you --

13 A Well, we also had exceptions, we had ex-
14 ceptions before, too, sir.

15 Q I understand that. I asked --

16 A And -- and they were just haphazardly
17 handled in -- by the pipelines and by the producers in my
18 mind. Some producers won't shut in when you tell them to
19 shut in and violate their neighbor's correlative rights.

20 Q And you think these rules will help pre-
21 vent that.

22 A Yes, sir, I certainly do. I hope they
23 do. If they don't, I may retire.

24 Q Okay, in other words, you were discussing
25 the -- the role of El Paso Gas Marketing in the process of

1 getting gas from the wells to the end user.

2 A Yes, sir.

3 Q And if I understood you correctly, El
4 Paso Gas Marketing buys gas in the field at the well on a
5 spot market basis on a monthly contract.

6 A Yes, sir.

7 Q And where do they sell that gas?

8 A Sell it in California markets, SoCal,
9 PG&E, when they buy it. Incidentally, PG&E's not buying any
10 now, or today.

11 Q Would you classify the sale from the pro-
12 ducer to El Paso Gas Marketing as an interstate or an intra-
13 state gas sale?

14 A I think it has to be an interstate sale.
15 It's an interstate sale.

16 Q But is not that transaction -- that par-
17 ticular transaction taking place entirely within New Mexico?

18 A Not any more than any other interstate
19 pipeline is taking. The gas is purchased in New Mexico,
20 sold in California, transported through Arizona. That makes
21 it interstate, doesn't it?

22 Q Who's paying the transportation on that?

23 A SoCal, paying the tariff.

24 Q And in other words, they're taking deliv-
25 ery in New Mexico --

1 A They're what?

2 Q Taking delivery in New Mexico and --

3 A No, they are not taking delivery in New
4 Mexico. They're taking delivery at the middle of the
5 Colorado River.

6 Q That's the point of delivery that's
7 specified in your contract?

8 A Sir?

9 Q I really mean in El Paso Gas Marketing's
10 contract with SoCal --

11 A Yes, sir.

12 Q -- delivery at that point, and the price
13 is what? How is the price determined?

14 A The price is determined by bidding in
15 California on the board with SoCal.

16 Q Is that the price at the Colorado border
17 -- at the Colorado River, is that the --

18 A The price plus the tariff that SoCal pays
19 is the price that they have to pay for the gas. They say
20 gas at a certain price plus tariff.

21 MR. STOVALL: I have no further
22 questions.

23 MR. STAMETS: Mr. Chavez.

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QUESTIONS BY MR. CHAVEZ:

Q Mr. Manning, is the purpose of this rule this priority schedule to allow discrimination between wells?

A No, sir, it is not.

Q When there aren't -- when there aren't -- when all conditions are equal, such as price, quality of gas, and pressures, then the pipeline has a direction of which way to go as far as curtailment, is that the point?

A Yes, sir, and that ideally is the way we would like to see them, and industry would like to see them, operate.

Q Okay, as a parallel, could you perhaps draw a parallel between that and something that in the past has been known as affirmative action; this is a parallel so that all other considerations being equal Well No. 4 has a higher priority of staying on than No. 3, No. 2, and then No. 1, and that's the only purpose of this priority schedule?

A That's right.

Q Okay. Then when conditions are unequal the schedule just does not necessarily apply.

A Well, I certainly think it would behoove a pipeline to apply it as close as they possibly can, even

1 if they are unequal, but we're just saying there is going to
2 come a time they're not going to be able to do it to the
3 letter. Someone is going to be denied the opportunity to
4 sell some gas.

5 Q Mr. Manning, how was the purchaser de-
6 fined for this rule? That would be the first taker of gas
7 or the actual purchaser, should it be, say, somebody out of
8 state, or how was that interpreted by the Committee?

9 A You know, I'm going to have to confess my
10 mind has drawn a blank. I have been in two other states and
11 we have about four definitions of purchaser and I've got to
12 say at this time I do not recall.

13 MR. CHAVEZ: That's all I have.

14

15

RECROSS EXAMINATION

16

17 BY MR. STAMETS:

18 Q Mr. Manning, in response to an earlier
19 question relative to how an operator would respond to Rule
20 315, of course I'd also point out that this is proposed as
21 an identical rule for Rule 413, you indicated that he would
22 have to look at his entire body of wells when he was follow-
23 ing the shut-in tables, but let's say that we've got a pro-
24 ducer down in southeast New Mexico and some of his wells are
25 connected to El Paso and some to Transwestern and some to

1 Phillips, some to Gas Company, and the only one with a prob-
2 lem this week is -- is El Paso.

3 We -- we wouldn't require him to shut in
4 his Gas Company wells before his El Paso casinghead wells,
5 would we?

6 A I sure hope not. It wasn't intended to
7 be that way.

8 Q So we'd be looking at an individual --
9 we'd be looking at the system that the problem was on.

10 A Correct. You don't punish everybody
11 because someone has a problem.

12 Q So it might be well to try and work some
13 language into this rule that will clarify that.

14 A Well, I am very reluctant to recommend
15 that. I have just spent sixty days in your neighboring
16 state, Mr. Stamets, working on a committee down there and we
17 finally threw the towel in and we got absolutely nowhere
18 trying to work up some of that language.

19 Q As much time as you spent over there you
20 ought to be able to just whip it off without any --

21 A Wait a minute, wait a minute --

22 Q -- like Mr. Lyon did with the --

23 A We've got another guy here we can put on
24 the stand that was over there with me, too, and he can do
25 some testifying here on that.

1 MR. STAMETS: Are there other
2 questions of Mr. Manning?

3 Mr. Hall.

4 CROSS EXAMINATION

5 BY MR. HALL:

6 Q Mr. Manning, I want to make sure I heard
7 you correctly.

8 I believe you stated earlier that the
9 meaning of Rule (b) as stated now in the proposed rule is
10 somewhat unclear. Is that what you said?

11 A I said the Committee, the producing arm
12 of the Committee, and with some attorneys, said it was sort
13 of unclear to them. It was unclear, not sort of, unclear to
14 them.

15 Q All right. And likewise I think you said
16 you weren't around at any sort of rule making proceeding on
17 the original form of this rule as it exists now --

18 A This is not a rule. This is a statute.
19 I said I wasn't around the law making when they made the
20 law, the statute, when they passed it. I wasn't --

21 Q You're not familiar with what was discus-
22 sed at that time and the reasons for --

23 A No, sir. No, sir, I am not. I'm not a
24 lawyer.

25 Q (Inaudible) Would you agree with the

1 premise that -- the premise behind that statute, the rule,
2 was simply that pipelines were afraid that they might be
3 compelled to spend money, i.e. on a compressor or dehydrator
4 or treating plant in order to take gas under the ratable
5 take statute from, say, a marginally economic well?
6 Wouldn't that be a reasonable premise for --

7 A That may be a reasonable premise to you.
8 I don't know that it's necessarily a reasonable premise to
9 me.

10 Q Do you disagree with the premise at all?

11 A I really, as I stated before, I do not
12 know what was behind the -- the Legislative action on this,
13 so I really don't know.

14 Q All right. Now, with respect to 903(a)
15 of the proposed rules, wasn't the original language of that
16 to permit waste of New Mexico gas in periods of low demand,
17 isn't that correct?

18 A Probably was. I seem to recall something
19 like that.

20 Q Was that language deleted?

21 A Yes, sir, it was purposely deleted.

22 Q Would you know why?

23 A Yes, sir, as I recall, we deleted that
24 language because we all felt like that the gas was going to
25 bounce back and we were trying to promulgate rules that

1 would be applicable in any situation. Now whether we did or
2 not is something else.

3 Q So the Committee intended that such a
4 rule be applicable in periods of high demand as well low
5 demand --

6 A High and low demand, if I recall cor-
7 rectly, and that's what we discussed.

8 Q Notwithstanding demand should not be a
9 consideration at all.

10 A The what?

11 Q Demand should not be a consideration at
12 all.

13 A Well, to the extent of whether it's high
14 or low. Now the varying degrees of low and the varying de-
15 grees of high, that could be something else, you know. We
16 may have to end up, if things continue to go downhill we may
17 be back in here next month trying to recommend some rules
18 for promulgation to take care of something that we haven't
19 even thought about now.

20 Q Well, doesn't the fact that that language
21 was deleted indicate to you that perhaps the Committee was
22 more concerned with matters wrapped up with waste and cor-
23 relative rights than it was market demand?

24 A I don't -- I don't necessarily think so.
25 I really don't. I think we were concerned about all of

1 them; maybe, to what degree I don't know, but we were cer-
2 tainly concerned about all of them.

3 Q Can you conceive of any instances where
4 Paragraph (b) of the proposed rule might be utilized in such
5 a way as to defeat the other primary statutory goal of the
6 Oil and Gas Act, preventing waste?

7 A No, but I bet I could hire a good lawyer
8 that could come up with it, and show me on that, and I'm
9 sure I've -- in all the years that I've been in this, I have
10 never been able to recommend a rule and have it promulgated
11 that someone couldn't get around it some way or another, and
12 I have developed the idea of, well, do it the best you can
13 and then let the courts or the Commission or the Division
14 handle -- handle the rest of it on whether they're getting
15 around the rule or not.

16 Certainly we did not recommend these
17 rules to give one or another the advantage of circumventing
18 the rules.

19 Q The rule on prevention of waste?

20 A The rule on prevention of waste and pro-
21 tection of correlative rights.

22 Q Let me ask you if these rules were in
23 fact enacted, what type of proof would you anticipate a pur-
24 chaser might offer on the issue of economic impracticabil-
25 ity, and also let me ask you how the -- how do you envision

1 the Oil Commission or a Hearing Examiner treating such
2 rules?

3 In other words, what sort of mechanisms
4 exist in the OCD now for analyzing raw economic data?

5 A Well, they examine raw economic data on
6 forced pooling and whether they come right out and recognize
7 it as raw economic data on 90 percent of the things they
8 examine economics is lurking there in the background.

9 Q Well, what sort of evidence would a pro-
10 ducer put on towards that end?

11 A Well, --

12 Q I'm sorry, not a producer but a pur-
13 chaser?

14 A Well, a purchaser would put on, I think,
15 and I'm reaching back on some experience in some other
16 states and where that has been put on, I think they're going
17 to go in there and show that, through testimony, that unless
18 the price of gas is such and such, these people are going to
19 shut in this, go to alternate fuels, or do something else.

20 Now I have seen that done, more especial-
21 ly down on the gulf coast of Texas where they're serving the
22 industrial load down there.

23 A Union Carbide man, Vice President of
24 Union Carbide, got up and testified that if the price of gas
25 changed five cents, went five cents a thousand higher, Union

1 Carbide would shut the plant down.

2 Well, it went five cents higher, and sure
3 enough, they shut the plant down.

4 So the man convinced me that he, you
5 know, that they would do that.

6 So I think they would come in here and
7 maybe show some sort of that testimony. I don't believe --
8 I believe they could show that it was -- the market
9 conditions in California -- well, I speak of California --
10 the market conditions everywhere, not just California, I'm
11 just more familiar with the market conditions in California.

12 Q Would you anticipate a hearing like that
13 to be run more or less along the lines, say, of a public
14 utilities commission hearing? Have you had the pleasure of
15 participating in one of those?

16 A I don't believe -- I wouldn't recommend
17 that it go into a public utilities hearing committee, or
18 hearing, public utilities hearing, but I would, I think some
19 of the same raw data would probably be presented. It was in
20 the -- it was in the neighboring state.

21 Q Well, did the committee take into
22 consideration the present capability of the Oil Conservation
23 Division to handle that type of information?

24 A You know, I don't think we did.

25 Q Okay. Let me ask you another question.

1 I'd like to read you some language that I
2 would suggest be incorporated into SubParagraph (b). I'd
3 like to know whether or not you would feel it would be
4 inappropriate to incorporate this language.

5 The language is, this section is not
6 intended to relieve purchasers from performing their
7 existing contracts.

8 A I don't recommend it. I don't -- I don't
9 -- I don't say you shouldn't put it in there, either, but I
10 just don't -- I don't think that was doing what (b) was
11 originally put in there for.

12 Q So you're objecting to the inclusion of
13 that?

14 A No, sir, I just said I didn't recommend
15 it.

16 I'm not objecting to it; if -- if you
17 feel like that is a language that should be in there,
18 certainly make your recommendations.

19 Q Thank you, Mr. Manning.

20 A Yes, sir.

21 MR. STAMETS: Mr. Kellahin.

22 MR. KELLAHIN: Thank you, Mr.

23 Chairman.
24
25

CROSS EXAMINATION

1
2 BY MR. KELLAHIN:

3 Q It's always a pleasure to have you here,
4 Mr. Manning, and I'll try to be brief.

5 A I'm fixing to get it. I'm fixing to get
6 it.

7 Q You never disappoint me, Mr. Manning.
8 I'll have to confess to you I've been
9 caught up in your testimony and I forgot the point some
10 thirty minutes ago that I was going to inquire of, so bear
11 with me if grapple through my thoughts.

12 The question was presented to Mr. Lyon
13 awhile ago in the notice for this case that the rule, or the
14 application of the rule to purchasers was to include also
15 the application of the rule to purchasers with marketing af-
16 filiates, and I believe Mr. Lyon in response to Mr. Stamets
17 said that he would consider, for example, El Paso Natural
18 Gas and El Paso Gas Marketing as one entity.

19 Now, starting at that point, sir, can you
20 explain to me what, if anything, the Committee recommended
21 with regards to gas purchasers with affiliate companies,
22 such as El Paso?

23 A As I recall, Mr. Kellahin, the Committee
24 never mentioned shadow pipelines, or affiliates, or any-
25 thing like that.

1 I have -- when Mr. Lyon was testifying on
2 that I searched my memory and I could not come up with any-
3 thing that -- where we addressed that. We were trying to
4 hammer out a priority of takes. Now if -- I have the
5 minutes from the meeting, if you would allow me to look at
6 them, I'll run through them real quick and see if that ever
7 came up.

8 They were not recorded in the minutes, or
9 it was not recorded in the minutes, Mr. Kellahin.

10 Q Under the current procedure for
11 determining whether you would have one or two purchasers in
12 the El Paso and the El Paso Gas Marketing scenario, how are
13 we currently treating those? Are they each separate
14 entities or separate purchasers under the prorationing and
15 ratable take rules?

16 A Yes, sir, they are. The way that we
17 treat them now, El Paso Natural Gas does all of the
18 nomination but -- and the reason for that, Mr. Kellahin, is
19 because of the short fuse that they're on. If I remember
20 correctly, the opportunity to sell, of a producer to sell in
21 the gas marketing runs from about the 25th of the month to
22 about the 10th of the month. So we're on a short fuse there
23 and not knowing really what the market is and what we can
24 do, El Paso Natural Gas does do the nomination for El Paso
25 Gas Marketing.

1 Q Is that intended to continue if the ap-
2 plication of these rules would treat that purchaser as one
3 entity?

4 A Well, you know, I'm here, you know, for
5 the industry, supposedly, and I'm getting a little bit out
6 of it. I -- I really don't know what El Paso intends to do,
7 but I would submit to you that El Paso and El Paso Gas Mar-
8 keting is going to meet their demand somewhere. Now they're
9 going to get that gas because that's the only way they make
10 their money, is by transporting gas and getting it to a mar-
11 ket.

12 So if it is denied them here in New Mex-
13 ico they certainly will go to Oklahoma where there, I can
14 assure you, sir, is an abundance of gas.

15 Q I didn't make myself clear, Mr. Manning.
16 My --

17 A Okay.

18 Q My question is not -- and I simply
19 selected El Paso as an example for which I have some famil-
20 iarity, but I was concerned about whether a purchaser will
21 make a nomination for the purchaser and the marketing affil-
22 iate, then, will be treated as a separate entity under rat-
23 able take to make its own nominations.

24 A I don't -- I don't think so. I don't
25 think it's necessary, really. I, like I say, on the short

1 fuse that you're on on spot market gas, I don't believe you
2 have time to do all that, because you realize that the nom-
3 ination's got to be in about six weeks before you actually
4 start -- you get the allowable and get to take it toward
5 your allowable.

6 So I don't think so.

7 Q You would ahve no objection, then, to
8 having the ratable take and the priority rules apply to El
9 Paso Natural Gas and El Paso Gas Marketing, then, as one en-
10 tity.

11 A Well, they're not.

12 Q So they have to take ratably.

13 A They're not one entity. That's the prob-
14 lem, not this one. They are not one entity. One has one
15 market and another has another market. One has one supply
16 source; another has another supply source.

17 The only common thing they have is when
18 they transport that gas through El Paso.

19 Now if the gas goes through Transwestern,
20 then they don't have anything in common.

21 Q In my own simple way, Mr. Manning, I'm
22 having trouble understanding how to keep them separate when,
23 for example, a gas producer will sell gas to the Gas Market-
24 ing Company, a certain quantity, and yet at the same time
25 that quantity is being used to offset the take or pay obli-

1 gations of that same producer under his contracts with El
2 Paso Natural Gas, and that's the fact situation I'm working
3 with, so I don't see how we can treat them separately when
4 they don't pay off --

5 A I think, Mr. Kellahin, I think that's a
6 legal question. I'm qualified up here as an engineer. I'm
7 -- I don't -- I'm not into that part of it, no, sir.

8 Q Thank you, sir.

9 MR. STAMETS: Are there other
10 questions?

11 Mr. Stovall.

12 MR. STOVALL: Mr. Chairman, let
13 me ask a question along the line of Mr. Kellahin's, since he
14 brought it up.

15
16 RECROSS EXAMINATION

17 BY MR. STOVALL:

18 Q Do you know --

19 A Don't dance me around that same Maypole,
20 will you?

21 Q Do you know whether El Paso Gas Marketing
22 is purchasing gas other than from sellers, contract sellers
23 to El Paso Natural Gas?

24 A Yes, sir, we are.

25 Q All right, to what extent (unclear)?

1 A It is not as large an extent as we would
2 like but our problem is getting personnel out there to buy
3 this gas, getting the gas released, and we're also looking
4 for other markets to -- or we, El Paso Natural Gas Marketing
5 is looking for other markets.

6 Q So if I as a gas producer were to come to
7 a gas purchase representative of El Paso Natural Gas and of-
8 fer them some new gas that was currently undedicated, I
9 mean, excuse me, of Gas Marketing, and offer them some new
10 gas that was currently undedicated, would they be inclined
11 to take that gas, do you think?

12 A I certainly to believe they would be in-
13 clined to take that gas if the contract's provisions are
14 favorable.

15 Q Which contract provisions?

16 A The contract provisions you're going to
17 make with them on your gas.

18 Q Are those gas purchase representatives
19 different personnel than those that represent El Paso
20 Natural Gas?

21 A We have some that are purchasing in El
22 Paso Gas Marketing, and of course, we have our own, but
23 you've got to realize, we haven't bought any new gas since
24 July the 1st, 1982, and some of ours in El Paso Natural Gas
25 assist and help on the other. They interface, but we do

1 have Gas Marketing people that do that, and also that sell,
2 that sell the gas, too.

3 MR. STOVALL: No further
4 questions at this time.

5 MR. STAMETS: Any other
6 questions of this witness?

7 He may be excused.

8 Mr. Taylor, we'll move on with
9 your direct in Case 9016.

10 Mr. Nutter, do you have a
11 question?

12 MR. NUTTER: No questions, Mr.
13 Stamets. I wanted to make some comments on that last case
14 before you move on.

15 MR. STAMETS: Well, given how
16 long we're taking getting through these things, I believe
17 we're going to have to get the direct case out first before
18 we go on to other comments and other direct testimony.

19

20

CASE 9016

21

22

23 MR. TAYLOR: I'd like the
24 record to show that the witness has already been sworn and
25 qualified.

25

1 VICTOR T. LYON,

2 being previously sworn and qualified, and being still under
3 oath, testified as follows, to-wit:

4
5 DIRECT EXAMINATION

6 BY MR. TAYLOR:

7 Q Mr. Lyon, are you familiar with the pro-
8 posals of Case 9016, being new Rule 414?

9 A Yes, sir.

10 Q Would you please explain your involvement
11 with proposed Rule 414?

12 A Well, I haven't been involved that much
13 except that it seems to me there was a seminar in Albuquer-
14 que, or somewhere, where a former commissioner from
15 Louisiana, Mark, Pat Mark (sic), had made some comments
16 about the situations where there were problems with split
17 stream connections, and Mr. Stamets had passed that to me
18 and, you know, immediately a reaction formed in my mind as
19 to what we ought to do in a similar situation here.

20 Shortly after that there were some com-
21 plaints from producers that they were involved in wells
22 where a portion of the ownership was producing gas and other
23 portions of the ownership was not producing gas, and Mr.
24 Stamets referred this to a committee and he included in it
25 the solution that I had proposed and asked them to discuss

1 it and they did not come up with any single recommendation.

2 So we have proposed three alternatives of
3 a Rule 414.

4 Q Seeing that there was no concensus from
5 the committee and therefore there may be very little agree-
6 ment after this, would you briefly go through each alterna-
7 tive and tell us the advantages and disadvantages of each?

8 A All right, in Alternative 1 it says where
9 there are spearate owners in a well no gas sales may com-
10 mence or may be made from such well until all owners have
11 agreed to a single well operator with authority to commit
12 100 percent of the gas therefrom.

13 The well operator must provide the Divi-
14 sion with a statement attesting to such agreement before any
15 allowable will be assigned or before any authorization to
16 produce will be made.

17 And -- and that's one approach. I see a
18 problem with that approach because there may be more than
19 one gas contract in that well and I'm not sure that that
20 operator has authority to administer it in that manner. I
21 see a possible conflict of the contracts.

22 Alternative No. 2 says where there are
23 separate owners in a well no gas sales may commence or be
24 made from such well unless such owners have entered into a
25 gas balancing agreement. Such balancing agreement must pro-

1 vide for each owner to receive his just and equitable share
2 of the gas from the wells covered -- well or wells covered
3 thereunder.

4 The well operator must provide the Divi-
5 sion with as tatement attesting to such agreement before any
6 allowable will be assigned or before any authorization to
7 produce the well -- to produce will be made.

8 There -- there's a problem in this one in
9 that, and this is true in all of these alternatives, we are
10 not aware of what wells have split stream connections per
11 se. We may get separate -- well, we get production reports
12 from -- from the operator. He may differentiate that but we
13 roll that gas production into one figure. We assign one al-
14 lowable; we get -- have one production figure.

15 So we're not aware when this situation is
16 going on and the only way we can become aware of it is of
17 somebody complains and the way we would operate under this
18 condition is that upon receiving the complaint that the well
19 is being produced and certain parties are not receiving
20 their share of the production or the proceeds, then we would
21 shut the well in and advise the operator that this well will
22 be shut in until you have entered into a gas balancing
23 agreement.

24 Alternative No. 3 says where there are
25 separate owners in a well and where there is no gas balanc-

1 ing agreement providing for each such owner to receive his
2 just and equitable share of the gas therefrom, no individual
3 owner may sell a volume of gas in any month greater than
4 his percentage interest in the wells current allowable or
5 purchaser's per well allocation.

6 In pools with assigned allowables the
7 volume to be sold may be determined by multiplying the ap-
8 propriate percentage interest times the allowable.

9 In pools without assigned allowables the
10 volume to be sold will be that volume which is produced in
11 that period of time found by multiplying the number of days
12 in the month by the appropriate percentage interest.

13 The problem with this approach is that,
14 as I said before, in our computer program, in our accounting
15 program, and the proration schedules, we have one operator,
16 we have one well, we have one allowable. We have production
17 from one well.

18 The only way that we could administer
19 anything like that is -- would be to give -- grant a per-
20 centage of the allowable to that well rather than 100 per-
21 cent of the allowable. We cannot take -- we cannot account
22 for separate owners in a well; that's the operator's
23 responsibility.

24 We cannot account for the revenue stream
25 out of the proceeds from that well or the allocation of gas

1 from that well. Our system is not set up to do it and I
2 certainly do not recommend that we try to change our system
3 to where we can do it.

4 Q Would you perceive that there is a prob-
5 lem relating to these proposals? I mean that these propo-
6 sals are in response to problems that people spoke to us
7 about?

8 A Yes. Well, I think there's a problem
9 here and I think we need to address it, but I think we need
10 to address it in a way which is practical and which we, un-
11 der our system, can handle, and I think that -- that our Al-
12 ternative No. 1 could -- could operate, provided there is
13 not a conflict in contracts, provided that the operator, and
14 there should be an operator for each and every well, pro-
15 vided the operator has the authority to sell the gas for all
16 interests, then that's a good alternative.

17 In the absence of that, I think we would
18 need to go to Alternative 2 and require a gas balancing
19 agreement, and otherwise, people are going to have their --
20 their assets under that well sucked right out from under
21 them, and no legal recourse except just to sue the operator
22 for malfeasance, or something of that sort.

23 Q What would be the Division's alternative
24 if interest owners in the well refused for some reason to
25 sign such balancing agreement, or any one interest owner?

1 A I'm not sure we have authority to do this
2 but I think that we should adopt a standard gas balancing
3 agreement and if people will not agree, then we should say
4 you will not produce this well without a balancing agree-
5 ment, and if you want to produce the well, this is your bal-
6 ancing agreement.

7 Q If they don't have one otherwise?

8 A Right.

9 Q Well, is that your recommendation or what
10 recommendations do you have regarding these alternatives?

11 A I recommend that we adopt either Alterna-
12 tive 2 or a combination of Alternatives 1 and 2. I do not
13 think that Alternative No. 3 is practical.

14 Q Is that all you have in this matter?

15 A Yes, sir.

16 MR. TAYLOR: That's all we
17 have, Mr. Chairman.

18

19

CROSS EXAMINATION

20 BY MR. STAMETS:

21 Q Mr. Lyon, without some sort of method of
22 dealing with this is it possible that an individual owner's
23 correlative rights in a single well would be violated?

24 A Yes, a very definite probability.

25 Q To -- in order for this Commission to en-

1 force Alternative No. 1, I think it's been suggested that a
2 minority interest owner, someone with 2 percent or half a
3 percent, might not want to go along with everybody else and
4 therefore there would be no 100 percent agreement. Would it
5 be appropriate for there to be a statute such as we have for
6 compulsory pooling for the compulsory pooling of the inter-
7 est in a well for sales?

8 A I think that may be necessary.

9 MR. STAMETS: We'll take about
10 a fifteen minute recess here and come back at 3:00 o'clock
11 and resume.

12
13 (Thereupon a recess was taken.)

14
15 MR. STAMETS: Please have
16 everybody quiet down a little, please, so we can proceed
17 with the hearing.

18
19 ROBERT STOVALL,
20 being called as a witness and being duly sworn upon his
21 oath, testified as follows, to-wit:

22
23 DIRECT EXAMINATION

24 BY MR. TAYLOR:

25 Q Will you please state your name and place

1 of employment and position for the record?

2 A My name is Robert G. Stovall. I am cur-
3 rently employed by Dugan Production Corporation as Land Man-
4 ager and General Counsel.

5 Q Would you briefly explain your educa-
6 tional and work experience?

7 A I have Juris Doctor's degree in law from
8 the University of Denver, which I received in 198 -- 76.
9 I've practiced law for ten years. I'm licensed in the State
10 of Colorado and the State of New Mexico.

11 My most current employment has been with
12 Dugan Production for the past two years in oil and gas law
13 and specifically in practice before the Commission.

14 Q And are you familiar with the matters
15 contained in Case 9016 relating to Rule, proposed Rule 414,
16 4-1-4?

17 A Yes, I am.

18 MR. TAYLOR: Mr. Chairman, I
19 tender the witness as an expert.

20 MR. STAMETS: Mr. Stovall, were
21 you the chairman of the committee that worked on Rule 414?

22 A I was and still am.

23 MR. STAMETS: Yes, the witness
24 is considered qualified.

25 Q Would you please explain or just briefly

1 detail the workings of the committee and what the proposal
2 were or how they were arrived at?

3 A Well, I was named chairman of the commit-
4 tee at the -- I think it was the June 12th or June 14th
5 meeting called by Mr. Stamets. I made the mistake of asking
6 a question and he said, fine, you'll head the committee that
7 will answer that.

8 Fortunately I had several volunteers
9 agree to participate and join in that operation.

10 Initially we discussed the issue by way
11 of correspondence. I recommended that we get some ideas out
12 in the open by mail. We did. I have a number of letters
13 between the parties which I will not admit into the record
14 but certainly anybody who'd like to see them is welcome to.

15 Out of that correspondence basically
16 three ideas evolved.

17 One was to do nothing.

18 The second one was a variation of alter-
19 native -- of the conceptual idea of the second alternative
20 under the hearing today; and the third idea was a concep-
21 tualization of the third alternative in the hearing today.

22 Subsequent to sending that letter out,
23 Mr. Stamets requested that I add a conceptualization of Al-
24 ternative No. 1 to the discussion.

25 After a series of correspondence it be-

1 came clear that we didn't have any strong concensus for any
2 one of the alternatives, so this past Monday we met at Albu-
3 querre International Airport with good attendance at the
4 meeting, and discussed the options.

5 At that meeting it was generally agreed
6 ty all concerned that there was probably no legitimate way
7 that you could compel anyone to accept one operator as the
8 seller of 100 percent of the gas stream. We did not feel
9 that either the Commission or any other agency could require
10 anyone purchaser to give up his rights to contract his gas,
11 or any one seller, excuse me, to give up his rights to con-
12 tract the gas to any other party.

13 There was also a general discussion re-
14 garding the authority of the Commission to promulgate rules
15 regarding the sale or split sales that we, as we've called
16 it, of gas from a single wellstream. There's, I think, a
17 legitimate legal question as to whether that is within the
18 jurisdiction of the Commission; however, we operated on the
19 assumption for the purposes of the committee meeting that it
20 was within their jurisdiction in an effort to try to come up
21 with a rule which was workable.

22 As I say, we decided Alternative 1 really
23 was not acceptable. It just simply impaired the rights of
24 any -- of any operator, working interest owner, too severe-
25 ly.

1 Alternative No. 2 conceptually sounded
2 like a good idea. As it is written, we fear the problem
3 that once again you could have an operator or a working in-
4 terest owner hold out, not be willing to sign a gas balanc-
5 ing agreement, and thereby prevent a well from flowing at
6 all.

7 Alternative No. 3 we discussed as it was
8 written and we found it was highly impractical to work.
9 There were lots of administrative problems in it. How would
10 it be enforced; how would it be determined; how would we de-
11 termine at what point or on what basis you can measure any
12 particular working interest owner's share, and we further
13 discovered and determined that Alternative 3 didn't resolve
14 the problem of gas balancing. It simply reduced it, per-
15 haps, by reducing the flow of gas from the well.

16 Alternative 3 did have some merit from
17 the standpoint of operators in that it did have the effect
18 of reducing the flow of gas into the marketplace, which
19 might have some impact on the supply and demand equation;
20 however, we quickly determined that that was not within the
21 jurisdiction of the Commission and that that was not a valid
22 reason for enacting any form of Alternative 3.

23 We discussed alternatives to the propo-
24 sals, in particular, Conoco presented a well thought out
25 version of Alternative 2, which required less than 100 per

1 cent of the working interest owners to agree to a gas balan-
2 cing agreement in order to make that gas balancing agreement
3 a valid part of the well operating agreement or well opera-
4 tion in the absence of an operating agreement.

5 That proposal suggested that there be
6 some sort of voting procedure established in conjunction or
7 in line with those procedures established in the joint oper-
8 ating agreement, or, if there is no joint operating agree-
9 ment, voting procedures, an agreement which would require 75
10 percent of the voting interest in a well encompassing at
11 least two parties in the well.

12 We discussed that at some length, found
13 some problems with that.

14 Also discussed a proposal, a conceptual
15 idea, where if 100 percent of the gas stream were produced
16 by less than 100 percent of the working interest owners,
17 rather than gas balancing there be a cash balancing in the
18 form of an escrow or some other mechanism, there being some
19 real concern on the part of some working interest owners
20 that even with a gas balancing agreement they might never be
21 able to recover either their gas or their money.

22 We then discussed the problem in a gen-
23 eral sense as to what is the extent and nature of the prob-
24 lem. Those operators with experience in multiple ownership
25 wells have indicated that generally speaking they do not

1 have at this time a major problem. Many operators are send-
2 ing out gas balancing agreements for approval by the par-
3 ties. In some cases there is pro rata production. At least
4 at the moment they don't perceive a problem which demands
5 regulatory solution.

6 The problems that were perceived were not
7 solved by the regulatory solutions as proposed and as dis-
8 cussed by the Committee.

9 What are going to be the terms of a gas
10 balancing agreement. I think Mr. Lyon testified earlier
11 that the State would propose a gas balancing agreement. We,
12 the operators on the committee, kind of discussed that and
13 weren't sure that we could go along with a State mandated
14 agreement.

15 We did agree that it's something that
16 needs watching; that's it something that we ought to keep an
17 eye on.

18 At this time we are recommending, and
19 it's not the unanimous decision of the committee but it is
20 the majority decision of the committee, that the Commission
21 take no action and in fact we would recommend that this case
22 be dismissed.

23 We further got a commitment from the com-
24 mittee members that they would be willing to continue to
25 serve on such a committee, we'll continue to correspond and

1 meet, if necessary, to discuss the problem should it become
2 more severe or should some workable, realistic solution be-
3 come available or apparent. We're not closing our eyes to
4 it. We just don't see the immediate solution as being in
5 the regulatory area and therefore recommend no action.

6 As I say, that's not unanimous and there
7 may -- there will be some committee members who will, per-
8 haps, recommend alternatively, but I would believe a strong
9 majority of the committee would agree, support that recom-
10 mendation.

11 Q Do you have anything further to add to
12 your testimony?

13 A That wasn't enough? No, I think that's a
14 fairly complete summary of what went on.

15 MR. TAYLOR: That's all we have
16 in this matter, then, Mr. Chairman.

17
18 CROSS EXAMINATION

19 BY MR. STAMETS:

20 Q Mr. Stovall, I asked Mr. Lyon a question
21 about whether or not split sales without some (unclear)
22 agreement or some way of getting the operators not selling
23 to be able to sell his share, whether that would result in
24 violation of correlative rights.

25 A That question came up, too, and the

1 question that we asked in response to that was what are your
2 correlative rights? Are they the opportunity to sell or the
3 actual right to participate in the proceeds from the sale of
4 the stream of gas? Do you own a part of each molecule or
5 do you own a proportionate share of all the molecules in the
6 ground.

7 To the best of my knowledge that question
8 has not been legally determined in New Mexico.

9 The one area where there is some concern
10 and where I personally feel some concern would be in the
11 case of a working interest owner who is unable to obtain any
12 sort of gas purchase contract for his gas and therefore does
13 not have the opportunity to sell, primarily due to market
14 conditions.

15 Q Are you saying that in the situation
16 where -- we have today, where there are -- is a spot market
17 available and the percentage of owners in the well choose to
18 join in the spot market and another percentage choose to not
19 join, that their -- everybody's correlative rights have been
20 protected because they all had the opportunity to sell, to
21 produce?

22 A I believe that is a feeling which has
23 some strong support among -- I don't have -- I'm not sure
24 that I could define correlative rights quite that closely.
25 Yes, I believe that an operator who elects not to sell, a

1 working interest owner who elects not to sell at the current
2 price or under the current market conditions, he does have
3 that opportunity and hopefully he will be taking the risks,
4 or recognizing the risks that are incumbent with the deci-
5 sion not to sell, and those become business judgment risks.

6 MR. STAMETS: Are there other
7 questions of Mr. Stovall?

8 Mr. Chavez.
9

10 QUESTIONS BY MR. CHAVEZ:

11 Q Mr. Stovall, you stated that you had
12 difficulty coming up with the concept of whether a working
13 interest owner owns a share of each molecule or a
14 proportionate share of the total volume of gas. Did you try
15 to draw any parallels between working interest ownership and
16 perhaps royalty interests and see how the -- perhaps the
17 royalty interest owner owns a share of every bit that comes
18 out and perhaps a working interest ownership may be parallel
19 to that?

20 A We discussed that and kind of made that
21 analogy. We didn't spend a lot of time on it, but I think
22 most of us feel that the working interest owner is in a
23 somewhat different position because he is in a decision mak-
24 ing position where the royalty owner really, as long as he's
25 not taking royalty in kind and actually selling his own gas,

1 really isn't in that position. He's kind of in a different
2 relative position to what he can do.

3 Q Other than for the decision making
4 ability, though, does the analogy fit pretty well?

5 A I'd rather not -- I don't know. I really
6 -- I can see some ways in which it does but I wouldn't -- I
7 wouldn't say that the working interest owner and the royalty
8 owner are in parallel or strongly comparable or identical
9 positions, no.

10 Q Mr. Stovall, what is the -- in the
11 absence of a balancing agreement, what is done to, say, bal-
12 ance production on a well that's produced to abandonment and
13 there hasn't been a balancing agreement and say a small in-
14 terest owner has not participated in the sales. How would
15 that balance?

16 A Am I representing the seller who sold or
17 the seller who hasn't sold?

18 I think -- I think there's, to my know-
19 ledge there has been been again no legal determination in
20 that area.

21 I am not aware of any significant case in
22 where a well which is out of balance without a balancing
23 agreement, has -- has produced to depletion or has ceased to
24 produce for whatever reason, which has resulted in litiga-
25 tion that has had to determine the rights of various parties

1 and I'm afraid if I took -- tried to make some sort of legal
2 opinion, I would be recommending a course of action which I
3 would be hesitant to do in this particular context.

4 Q Absent an actual case, without a balanc-
5 ing agreement, hypothetically what procedure would you fol-
6 low to protect the correlative rights of a person who did
7 not participate and then the well had produced to depletion,
8 when his gas had been produced?

9 A I would assume that, assuming again that
10 the parties couldn't reach some sort of amicable or agreed
11 upon solution, litigation would be the ultimate solution.
12 It would end up in the courts, and I think that's a strong
13 motive for the parties to enter into a gas balancing agree-
14 ment. As I pointed out to the committee and as I've pointed
15 out to clients in private practice, I would much rather be
16 in a position to control the solution and ultimate result
17 rather than to leave it in the hands of a judge.

18 Q Absent a balancing agreement, how would
19 force pooled parties, say, who are not locatable, how are
20 their rights protected in a situation where they have been
21 force pooled, and perhaps there may be heirs that may come
22 up later or not available, what happens to the proceeds from
23 the production at that well?

24 A I'm glad you asked that question. We
25 discussed that, too, and that is the one instance in which

1 we feel that perhaps as part of the forced pooling proce-
2 dures, perhaps a balancing agreement should be submitted.

3 The problem we ran into, primarily we
4 concentrated on the rule proposals as they were presented.
5 One of the problems we ran into with that concept is most
6 gas balancing agreements are exhibits to a joint operating
7 agreement and in the case of compulsory pooling cases, no
8 joint operating agreement is usually presented. There are
9 specific factors, elements that go into a joint operating
10 agreement which are determined by the Commission but there
11 actually isn't a joint operating agreement as such, so we
12 were concerned that we were now proposing a rule to require
13 an exhibit to an agreement that didn't exist.

14 I think that's an area that probably does
15 create some concern and may need some more attention early
16 on, because I think that owner who is forced into a well
17 really does have some legitimate concerns and there may be
18 some correlative rights problems which need to be addressed.

19 But we did not come up with a -- with a
20 solution to that at this time.

21 Q Okay, going back to one of my earlier
22 questions, absent a balancing agreement, say, where the --
23 there's a minority interest owner who isn't known and has
24 not participate in the sales, does the operator of the well
25 who has made all the gas sales and collected all the

1 revenue, has that operator kept all the revenue as revenue
2 belonging to them at that time?

3 A Are you -- are you proposing that as a
4 hypothetical?

5 Q I'm talking about an actual practice.

6 A Okay, it may not be the operator who's
7 actually selling the gas. I think that's one thing that we
8 need to be aware of is that the operator of the well may not
9 be the seller of the gas. There may be a nonoperating in-
10 terest owner who is selling one hundred percent of the
11 stream.

12 The question which I think you're raising
13 is what duty might that working interest owner who's selling
14 owe to the other owners in the well who are not selling, and
15 probably the best analogy would come from the partnership
16 law concept of accountability and that the nonselling owners
17 might require an accounting of that selling owner. I think
18 there is, you know, there's a little bit of concern that
19 maybe he's not the operator because I think the operator has
20 some very strong duties to his non-operating working inter-
21 est owners, but if the seller is not an operator, is there
22 some sort of constructive trust or some sort of fiduciary
23 type relationship which is created whereby that selling
24 working interest owner is liable in an accounting to the
25 nonselling working interest owners?

1 Q That's the question.

2 A That is a very good question and I do not
3 believe that there is an answer to it.

4 If I were representing a non-selling
5 working interest owner, that is the approach I would take in
6 the absence of a gas balancing agreement.

7 Q In actual practice do the selling inter-
8 est owners account for any of the unsold or noncontracted
9 volumes of the gas to make some kind of balance towards the
10 end of the life of a well, to your knowledge?

11 A Well, I would -- to my knowledge, I don't
12 know. I guess the best I could say is that all operators
13 have to report volumes, and presumably you could go back and
14 trace proceeds and volumes and make some sort of accounting.

15 I don't know that each and every operator
16 maintains a balancing statement in the absence of a balan-
17 cing agreement that requires it or not. I simply don't
18 know.

19 Dugan Production, I'm speaking for them,
20 that's where my experience is, is not in that position at
21 the moment. We get together with our working interest own-
22 ers and make a determination whether we're going to sell or
23 not and so we account for 100 percent of the stream.

24 In those wells in which we are not the
25 operator and in which there we are less than 100 percent

1 working interest owner, I really don't -- I know of at least
2 a couple cases where there is balancing agreements and I
3 know a good many of those wells we have received balancing
4 agreements for acceptance by the -- from the operator.

5 So from direct experience I can't answer
6 your question as to what operators do in general.

7 Q Okay, so there may be different manners,
8 then, of handling that.

9 A Absolutely. One of the concerns we've
10 got with balancing agreements, and perhaps this will shed
11 some light for you on why we don't necessarily feel these
12 rules help, is, for example, most of the balancing
13 agreements that I've seen to date require a cash balancing
14 at the end of the life of the well.

15 Well, that doesn't give any assurance to
16 a non-selling working interest owner that the selling
17 working interest owner will have any money to make that cash
18 balance at the end, and I think that's a major concern.
19 I've heard some war stories, if you will, from several
20 people where there's working interest owners who are
21 becoming substantially out of balance, you know, eleven,
22 twelve, fifteen years out of balance with less than a year's
23 production, and will they have the money to make the cash
24 balance if in fact the well depletes before they get back
25 into production balance, is not addressed in most gas balan-

1 cing agreements and so the real problem, the economic
2 problem that exists, still exists even with a gas balancing
3 agreement.

4 MR. CHAVEZ: That's all I have.

5 MR. STAMETS: Are there other
6 questions of Mr. Stovall?

7 MR. CURRENS:

8

9

CROSS EXAMINATION

10 BY MR. CURRENS:

11 Q Yes, sir, if I understood correctly, your
12 concept, or at least the major portion of your concept hav-
13 ing to do with correlative rights, it deals with partially
14 with the opportunity for marketing production, and the --
15 and that -- and you get an answer that perhaps there was
16 some denial or diminution of correlative rights if one of
17 the small owners did not have the opportunity to sell, or
18 owner in the well had the opportunity to sell. Am I roughly
19 on the right track with what you were saying there?

20 A Yeah, roughly.

21 Q Okay.

22 A I mean the committee didn't try to ana-
23 lyze that question very --

24 Q Yes, I understand that and I understood
25 that you were talking about your concept of correlative

1 rights.

2 In the event that 100 percent agreement
3 between all of the working interest owners in the well would
4 require in order to obtain an allowable and therefore a con-
5 nection to sales, and some owner failed to agree, wouldn't
6 that be a denial of the correlative rights of all of those
7 other owners because they did not obtain an allowable. If
8 this kind of rule, like Alternative 1, were adopted, then
9 one owner, by not agreeing to sell, causing the well to re-
10 main shut in, and perhaps with offset production, wouldn't
11 that be a denial of their correlative rights because they
12 did not then have the opportunity to sell.

13 A Yes, and that's one of our -- that was
14 our concern primarily with Alternative 2.

15 Q I thought you were coming back in that
16 direction with what you said but I was a little unclear --

17 A Yeah.

18 Q -- because the question had been asked in
19 the other direction.

20 A Yeah, correct. I agree.

21 Q As far as a person being shut in, then
22 their correlative rights are impaired as well.

23 A Correct.

24 MR. CURRENS: Thank you.

25 MR. STAMETS: Are there other

1 questions of the witness?

2 Mr. Strand.

3

4

CROSS EXAMINATION

5 BY MR. STRAND:

6

Q Mr. Stovall, did your committee give any
7 consideration to whether possibly the gas purchasers have
8 some obligations related to correlative rights?

9

A Not -- we looked at it from a
10 producer/working interest owner perspective. We did not
11 look at this rule as it's direct regulatory affect of gas
12 purchasers, although we recognize it certainly would affect
13 them in some sort of way.

14

Q But probably shouldn't some consideration
15 be given to whether they had some obligations? They are the
16 ones who are taking the gas.

17

A That's certainly something that could be,
18 you know, considered in future discussions regarding some
19 such similar rule would be held. We did not look at it from
20 that perspective, no, I don't think that --

21

Q I would certainly request that your com-
22 mittee do that.

23

24

25

RE CROSS EXAMINATION

1
2 BY MR. STAMETS:

3 Q Mr. Stovall, along that line, on Alterna-
4 tive No. 3, where the producer could only sell his percent-
5 age of a well at any one time, I'm a little unclear as to
6 why that's not workable. If I've got a well in a Blanco
7 Mesaverde Pool and the allowable is 10-million this month
8 and I own 10 percent of the well, it would seem to me that
9 I'd know that I could sell 1-million this month.

10 A Given that simple state of facts, yes, we
11 could probably -- I mean you could probably figure that that
12 way, and in the prorated pools that's not -- not as diffi-
13 cult.

14 In the non-prorated pools there are some
15 other problems, you know. Time may not necessarily be the
16 factor that determines it, and do I get to practice engine-
17 ering now when I get into this?

18 Q Peel free.

19 A Some of the things that have been men-
20 tioned is the effect of pressure build-up as a result of
21 shut in. The first few days are going to be the more pro-
22 ductive.

23 As I understand in the southeastern
24 fields perhaps more than in the northwestern fields deple-
25 tion occurs more quickly, so even if you reduced production

1 to ten days a month or three days a month, you're still
2 going to be depleting the reservoir and you -- you're essen-
3 tially going to run into the same gas balancing problem and,
4 as I pointed out, I think, the -- all that does, what that
5 really does is affect the flow of stream into the market.
6 It does not create an automatic balancing, if you will.
7 There is still the question of how much gas is left in the
8 ground and who gets it and when and one party is going to be
9 overproduced in a sense.

10 Q Would that tend to make that fifteen
11 years over -- overproduced on their share harder to accom-
12 plish for a small interest owner?

13 A Oh, yes. It would, it would help to al-
14 leviate that type of situation, because they wouldn't be
15 producing -- I mean we have an example in one case and it
16 got resolved quickly. It didn't become a major problem,
17 where the purchaser was reallocating production as a result
18 of contract price negotiations to where a seller who owned
19 less than one percent of the well, something in the neigh-
20 borhood of three -- .3 to .5 percent of the well, was sell-
21 ing 100 percent of the gas stream and I didn't do the cal-
22 culations but it occurred to me that within three to four
23 hours that purchaser was going to be fairly well out of bal-
24 ance. That purchaser -- I mean that seller, excuse me.

25 That seller was a retired military person

1 living in -- somewhere in Pennsylvania. We had some real
2 concerns about that in recovering over production.

3 Q So if this retired military man in Penn-
4 sylvania sells 100 percent of the well, and absconds to
5 South America with the money with an exotic dancer from the
6 club down the street, there's little likelihood that the
7 other owners in that well would ever get their money for the
8 gas that was produced.

9 A Sure, and that was an extreme case and it
10 was resolved by the working interest owners going to the
11 purchaser and pointing out the severe problems that could
12 arise in that circumstance, and the practice was stopped al-
13 most immediately. That problem was avoided by discussion
14 between the parties and negotiations and correspondence.

15 Q Is it also possible that in a case like
16 that that the other owners could come to the Oil Conserva-
17 tion Division or the Commission and ask for relief?

18 A I don't know under what authority at the
19 moment.

20 I would -- I think, again, if I were rep-
21 resenting a client, I would probably be inclined to go to
22 the courts, because I'm not sure and perhaps some of the at-
23 torneys here who are more familiar with the entire gamut of
24 your authority would be able to answer that better, but I
25 don't know of any basis upon which I'd bring that to the

1 Commission.

2 MR. STAMETS: Are there other
3 questions of this witness?

4 He may be excused.

5 I think we can move on, then,
6 to Case 9017.

7
8 CASE 9017

9
10 VICTOR T. LYON,

11 being called as a witness and having been previously sworn
12 and being still under oath, testified as follows, to-wit:

13
14 DIRECT EXAMINATION

15 BY MR. TAYLOR:

16 Q Mr. Lyon, in Case 9017 are you familiar
17 with proposed Rue 902?

18 A Yes, sir.

19 Q Would you please explain the purpose of
20 the rule?

21 A Well, the purpose of the addition of Par-
22 agraph (d) to Rule 902 is essentially the same as we discus-
23 sed in Case 9015. I don't know whether everybody is aware
24 of the fact that the existing Rule 902 (c) is the same lan-
25 guage that we have in proposed Rule 903 (d) and the addition

1 of the Rule 902 (d) is essentially the same as we proposed
2 in 903 (c).

3 So it is in effect, 903(c) is the lan-
4 guage of the ratable take statute which we added in Rule
5 903, and the proposed addition of Paragraph (d) is that in
6 the event the purchaser is unable to take the gas, then he
7 is required to notify the producer, the operator of the
8 well.

9 Q I got lost in the numbers but what you're
10 saying is that this essentially serves the same purpose as
11 903(c) except that purchaser will notify the well owner or
12 operator when they're not going to be taking ratably --

13 A Right.

14 Q -- or when they're just not taking any
15 priority production?

16 A Rule 902 deals with ratable take.
17 Paragraphs (a) and (b) say that the purchaser shall take
18 ratably.

19 Existing Rule 902 (c) says that -- to
20 quote the language of the statute says that he is not going
21 to be required to take this gas if he cannot practically use
22 the gas.

23 Then the addition of Paragraph (d) says
24 that if he elects not to take that gas due to the provisions
25 that are available to him from the statute, then he must

1 notify the operator in writing.

2 Q And is --

3 A So that he's on notice that I'm not tak-
4 ing your gas ratable because it doesn't qualify for the gas
5 that I can take practically.

6 Q And thus the purpose is, as in 903 (c),
7 to give the operator notice so that he may either correct
8 the correct the deficiency in the gas or come to the Commis-
9 sion and complain that purchaser is not taking ratably.

10 A Or take whatever action he feels is ap-
11 propriate.

12 Q Do you have anything further to add to
13 this case?

14 A No, that's all.

15 MR. TAYLOR: That's all we have
16 in this matter, Mr. Chairman.

17 MR. STAMETS: Do you feel that
18 the addition of this language might help the Division deal
19 with Transcontinental versus Mississippi decision problems?

20 A Yes, I certainly do.

21 MR. STAMETS: Are there any
22 other questions of the witness?

23 Mr. Duke.

24

25

1 CROSS EXAMINATION

2 BY MR. DUKE:

3 Q Mr. Lyon, please indulge me for a couple
4 of questions.5 Under SubSection (d) how often would pur-
6 chaser be required to notify the producer of a non-ratable
7 take?8 A Well, I think that each time that he
9 fails to take non-ratably. In other words, if he says, I'm
10 cutting you off for this reason, I think that notice is good
11 until the well goes on again.12 If the well goes on again and he cuts him
13 off again, he should notify him again.14 Q Now, would there be an opportunity for
15 the purchaser to have a non-ratable purchase but then make
16 it up, say, in later months on an annual basis and avoid the
17 notification in that way?18 A Well, it depends on the situation of the
19 well. If it's in a prorated pool and it's permissible under
20 the rules, yes, he could do that.21 If it's in a nonprorated pool I'm not
22 sure what his rights are and if it's casinghead gas, well,
23 you know, we don't -- we don't grant back casinghead gas.
24 They have an allowable for the month and when the allowable
25 -- when the month is gone that allowable is gone.

MR. DUKE: Thank you.

REDIRECT EXAMINATION

1
2 BY MR. TAYLOR:

3 Q Then you're saying that it might apply
4 differently for different types of wells and certain wells,
5 for instance, the casinghead, it would be required to notify
6 them every time you did not take ratably during the month if
7 between the time you notified them you started taking the
8 gas ratably, but if it's a gas -- if it's a well where
9 you're allowed to balance over -- over a period of time,
10 over twelve months, for instance, you would not necessarily
11 have to give that notice every time you were not taking gas
12 from the well.

13 A Well, I think there are situations where
14 you have a situation that occurs from, you know, period-
15 ically, and if he's -- if he's aware of this situation, then
16 I don't think that your notice requirements are as great as
17 if it is an entirely new reason for not taking ratably.

18 I think you have to look at the indivi-
19 dual situation, but generally I'd say each time -- each
20 time the well goes back on production and then is cut off
21 again that he's entitled to new notice.

22 Q Do you have any idea of the type of bur-
23 den this would put on pipelines to give written notice, for
24 instance, how often this happens, how many wells they put on
25 and off, since I assume that most pipelines follow the rules

1 and do take ratably, is this something that's going to hap
2 pen all the time?

3 A In today's times I think it could be
4 quite a burden and it could happen fairly often.

5 Q Okay, thank you.

6 MR. STAMETS: Any other ques-
7 tions of the witness?

8 Mr. Stovall.

9

10 CROSS EXAMINATION

11 BY MR. STOVALL:

12 Q The question, if I understand my engineer
13 correct, is are you talking about a prorated well, whether
14 the period you look at is the proration period, the gas well
15 proration period, or the casinghead gas proration period,
16 rather than just looking at an on-and-off, daily on-and-off
17 type situation?

18 A What I mentioned in the proration period
19 was a question relating to somebody being able to make up
20 the production by later overproduction, and in a prorated
21 pool you have a proration period and if it's casinghead gas
22 you've got a monthly allowable. On unprorated gas I'm not
23 sure where you stand.

24 MR. STOVALL: That's all.

25 MR. STAMETS: Interesting ques-

1 tion, both of those questions from Mr. Duke and Mr. Ken-
2 drick there.

3 MR. KENDRICK: Excuse me, let
4 me try to fill in here.

5 MR. STAMETS: Well, let me --
6 let me see if I've got this correctly.

7 I think I understand but when
8 we're talking about a purchaser, if he's unable to take all
9 the gas, as long as he's taking ratably, treating everybody
10 with equal wells equally, then there's no -- no violation;
11 he doesn't have to tell anybody anything. It would only be
12 when he began to discriminate between comparable wells taht
13 that there would be an obligation -- in the same pool --
14 that there would be an obligation to advise the producer of
15 what the problem was.

16 MR. KENDRICK: But the pur-
17 chaser is not certain as to whether or not he's going to im-
18 pose on ratable take until the end of the proration period
19 so that the gas well, prorated gas well situation can be a
20 not a day-to-day thing but for a year.

21 For a casinghead gas well situ-
22 ation it would be for the proration period, which is a
23 month, so the day-to-day switching is not the time of
24 notice.

25 MR. STAMETS: I'm not the wit-

1 then, and we'll move on for testimony in Case 9018.

2
3 CASE 9018

4
5 VICTOR T. LYON,

6 being called as a witness and being considered still under
7 oath, testified as follows, to-wit:

8
9 DIRECT EXAMINATION

10 BY MR. TAYLOR:

11 Q Mr. Lyon are you familiar with the
12 matters in Case 9018?

13 A Yes, to a certain extent.

14 Q And this involves proposed amendments to
15 Rules 10(a), 11(a), and 11(b) of Order R-8170?

16 A Right.

17 Q Okay, we'll just kind of go through all
18 of those in one group, I hope.

19 What -- could you explain your
20 involvement in the proposed rules?

21 A Well, I haven't been involved in these
22 particular proposed amendments. I didn't even know that
23 they were on the docket until I got back from vacation.

24 I'm not sure exactly how these rules were
25 generated. I know that they were designed to provide more

1 flexibility in our proration system.

2 We have pressures from all sides that
3 we're not being flexible enough, that we're not letting
4 special marketing programs proceed; we're shutting in wells
5 that are going hell-for-leather with the market and they
6 want to keep supplying it, and that sort of thing.

7 We have built up some large imbalances,
8 particularly in the northwest portion of the state, and by
9 extending the proration periods permitting larger amounts of
10 overproduction, particularly, and by suspending cancellation
11 of underproduction, and so forth, we are, we hope, being
12 more responsive to -- to the unusual gas marketing situation
13 that we have now and the demands being placed on us by both
14 pipelines and producers.

15 Q Does this emanate somewhat from action by
16 the Federal Energy Regulatory Commission, which has moved a
17 lot of gas to spot markets, which some producers believe
18 they're being hampered from entering that market because of
19 ratable take and allowable pools that may limit their --
20 their production during a proration period?

21 A I suspect that that is a factor there,
22 yes.

23 Q Do you -- why do you believe the proposed
24 amendments would help solve the problems that you've
25 described?

1 A Well, it will help some people who have a
2 better market to continue to produce that -- into that mar-
3 ket for a longer period of time without having to shut in
4 their wells.

5 And on the other hand, for those who are
6 not fortunate enough to have that kind of market, it will
7 allow them to accumulate underproduction without having it
8 cancelled with the hope that sometime in the future their
9 luck may change and they can make up that underproduction.

10 Q So wells that either the owners may
11 choose to shut them in or because various other problems
12 they are not producing gas, that they would be allowed to
13 produce that gas at a later period than they would now.

14 A Right.

15 Q Could you explain what other measures the
16 Division's either considered or that it can take which would
17 help ameliorate the situation you've describe here?

18 A Yes. I have done a lot of thinking about
19 this gas situation since I've -- well, before I came with
20 the Division and a lot more since I came with the Division,
21 and in order to lay a background for this I may have to do a
22 little -- go back into history a little bit, but some of you
23 may have been here when -- when I was a member of a panel on
24 gas proration and gas marketing activities, and so forth, in
25 January of 1985, in which I pointed out the differences in

1 allowable, proration, transportation, and so forth, of crude
2 oil as opposed to natural gas, and it dealt primarily with a
3 lot of the history in the natural gas industry, starting off
4 with the fact that gas is gas and oil is liquid and it can
5 be transported by truck and by rail and all that sort of
6 thing, whereas a pipeline being gas, in order to have a mar-
7 ketable quantity you're going to have to jam it into a pipe-
8 line. You've got to have a pipeline to move gas.

9 In order to build the pipelines we had to
10 have capital and we had to have approval to lay interstate
11 pipelines and we had to -- the pipelines had to go to the
12 FEC and show them that they had reserves dedicated to it and
13 that here was a market at the other end of the pipeline and
14 all that sort of thing, and so we had long term pipelines,
15 or long term gas contracts, and that prevailed for a long
16 time until the Supreme Court got to messing around in our
17 affairs and in the Phillips decision decided that FEC had to
18 prorate the -- or had to set the price of gas at the well-
19 head, and we've been in serious trouble ever since.

20 But ultimately what the industry told the
21 Court and told the Commission, our over supply of gas went
22 away and we had a shortage of gas, and we still had control-
23 led prices and FEC was setting vintages of prices and we had
24 all different arrays of prices and then with the NGPA of
25 1978 they really put on a show and we had about 26 or 30

1 different price levels and categories, and a big demand for
2 gas and they began to release -- let the price of gas go up
3 and people could offer contracts at above market clearing
4 levels because they could roll it into their mix and stay
5 within -- keep their weighted average cost of gas, "WACOG",
6 in line with -- with the market, and probably the biggest
7 problem in settling or getting the gas market straightened
8 out now is everybody's concerned about take or pay clauses.

9 The producers are doing everything they
10 can to -- to hold the purchasers' feet to the fire to those
11 contracts and the purchasers are doing everything they can
12 think of to -- to litigate or get out of those responsibili-
13 ties, and it is such a big issue with everybody that -- that
14 nobody's thinking very seriously about correlative rights
15 and prevention of waste, and that's our responsibility.

16 So I can understand that with prices to-
17 day, with competition from other energy sources, outside gas
18 foreign gas, all of the competitive forces in there, that
19 there -- the prices available for people today are far below
20 their expectations, far below their contract levels, far be-
21 low what they had figures on when they drilled the wells,
22 and a lot of people have and I think they should have the
23 right to shut in their wells and wait for the market to im-
24 prove, and I think that they're being able to do that would
25 help to balance the supply and demand of gas to where per-

1 haps we could look for a more stable market and demand, and
2 I'd like to preserve that right for them. I believe in in-
3 dividual rights and contract rights, too.

4 On the other hand, I don't like to see
5 people who have market restrained from meeting that market,
6 provided that we can protect the rights of their neighbors
7 and so what I have proposed, what I have dreamed up and
8 would like to offer as a step that we could take to this
9 group is what I've termed a gas bank, and it might expedite
10 this if I'd just read this memorandum that I had written to
11 Mr. Stamets earlier.

12 Q Should I ask you the question first?

13 A Okay.

14 Q Would you describe your gas bank plan?

15 A Very good, I'm glad you asked that ques-
16 tion.

17 In the current chaotic gas market situa-
18 tion there are strong forces at work which threaten our pre-
19 sent system and subject the Division to criticism for being
20 too inflexible. The parties are now in several different
21 camps with divergent interests and views.

22 One of the things I forgot to mention in
23 my preamble was that FERC and California in particular are
24 doing everything that they can do to tear apart the intra-
25 structure that I previously described of the long -- long

1 term contracts, dedication of gas which might tend to hold
2 the price of gas up, and they're trying to drive the price
3 of gas down, and I think they're trying to treat the gas
4 market as if it were an oil market and I don't believe we're
5 ready, I don't believe that we have the infrastructure in
6 place to do what we -- with gas what we can do with oil. We
7 may get there some day but I don't think we're there.

8 If you'll look at the fact that crude oil
9 goes to a refinery and the refinery -- there are not that
10 many refineries, probably less than 200 refineries in the
11 United States, and you just need to get that crude oil to a
12 refinery. Well, the refineries, to make gas marketable to
13 the ultimate consumer are located out in the field and
14 there's thousands of them over the country and when the gas
15 leaves the tailgate of those gasoline plants then they have
16 to go into a pipeline which is still under this old long
17 term dedication contract business and it goes to thousands
18 and thousands of ultimate consumers and I don't think that
19 we have the infrastructure yet to fully implement the deliv-
20 ery of gas on a completely spot market basis.

21 Now I may be completely wrong but that is
22 my perspective of the situation now.

23 The traditional interstate pipeline car-
24 rier/purchaser is caught in competition with other gas look-
25 ing for a market as well as competing fuels. FERC Order 436

1 has invited the segregation of the services into carrier and
2 purchaser/reseller. The effect of thirty years of price
3 controls and seven years of NGPA has created an amazing ar-
4 ray of prices and contract obligations. The intense pres-
5 sure to reduce WACOG has brought about much contract renego-
6 tiations but a larger exposure to take-or-pay liability as
7 well.

8 The producers are torn between selling
9 gas at little or no profit versus shutting in gas to await a
10 more favorable market. It seems that a producer should have
11 the right to postpone the sale of gas rather than "give it
12 away" at today's prices. It also seem that an operator
13 should be able to take advantage of a special sale which he
14 has developed through diligence and hard work. These ac-
15 tions, however, tend to disrupt our system by causing exces-
16 sive overproduction and underproduction.

17 We recently suspended the reclassifica-
18 tion of wells which would have reduced the underproduction
19 and increased allowables to wells which are overproduced
20 (and those which are underproduced but still nonmarginal.)

21 It is recommended that we consider creat-
22 ing a gas bank to accommodate both extremes of this dilemma.
23 Gas would be "banked" in two ways.

24 Number one, is front end bank. An oper-
25 ator could elect to shut in his wells and bank his allow

1 able. No allowable would be assigned to his well until he
2 opts to resume production. The allowable would be distri-
3 buted to the wells opting to continue production and should
4 be larger for the remaining wells since there are fewer
5 wells to distribute that allowable to.

6 At such time as the "banked gas" opera-
7 tor elects to resume his production he would be assigned the
8 allowable as before but would also be given access to the
9 "bank account" accumulated during shut in. This account
10 would be the allowable given each month to a nonmarginal
11 well of equal acreage and/or deliverability which produced
12 during the "banking" period.

13 This "bank account" could be rolled in at
14 a rate requested by the account owner during up to five pro-
15 ration periods, and that's an arbitrary number.

16 Number Two is the back-in bank. An ope-
17 rator who is denied his market share due to lack of market
18 rather than lack of deliverability, and I have a lot of sym-
19 pathy for an operator who's tied to a purchaser whose market
20 has gone to hell, and his neighbors are producing like crazy
21 and he's sitting there producing little or nothing, and I
22 hate to see his allowable cancelled when it isn't really his
23 fault that this well didn't produce; he's a victim of cir-
24 cumstances.

25 An operator who's denied his market share

1 due to lack of market rather than lack of deliverability
2 could, upon request to the Division, have the cancelled al-
3 lowable placed in the "bank" for the period of time the mar-
4 ket is "in distress".

5 We have this system to a certain degree at
6 the present time in that a well which is classified marginal
7 and suffers cancellation of underproduction can have that
8 underproduction restored as he makes it up by subsequent
9 overproduction. That's a limited program. This proposal
10 would restore cancelled allowable to the nonmarginal wells
11 which are unfortunate in having a purchaser who has a small-
12 er relative market than other purchasers in the same pool.

13 And this essentially is the "bank" that
14 I would propose.

15 I think it would help the people who want
16 to sell gas by giving them a higher allowable that they
17 could share the gas, when they could share the gas among
18 themselves and the people who elect to be shut in would not
19 -- would not receive allowable at that time, it would be in
20 the "bank" and so either of these alternatives, I think,
21 would help to be more flexible.

22 I noticed in Foster's report of October
23 20th that Ray Burns says that as they relax control of the
24 industry the states must pick up and assume this, this bur-
25 den, and they must be more flexible.

1 And this all I'm trying to do, is to set
2 up a program where we can be more flexible. We can let peo-
3 ple shut in their wells if they think the time is going to
4 come when they can get a better price for their gas and then
5 if they're able, and I have reservations that people who
6 build up a bank account are going to be able to get all that
7 gas out of the bank, but I'd like to provide them the oppor-
8 tunity, and that's -- that's all we're doing, is trying to
9 provide them an opportunity.

10 And so I think, you know, either or both
11 of the programs that are proposed in this case would serve
12 to be more flexible under our system and still maintain the
13 control that we must have in order to meet our statutory ob-
14 ligations to prevent waste and protect correlative rights.

15 Q How does your gas bank plan correspond to
16 the rule changes proposed in this case and what other rule
17 changes, or what rule changes would be necessary to imple-
18 ment the plan under your gas bank plan?

19 A Well, as far as the -- what has been pub-
20 lished and printed on the docket here, the only changes we
21 need to make is what is proposed here, and this, as I pre-
22 viously said, would give the opportunity of people to get
23 their wells more overproduced and to let people to accumu-
24 late more underproduction, which, hopefully, could be made
25 up before it's cancelled under our balancing and cancelling

1 rules.

2 In the gas bank thing, we would have to,
3 I think, write some additional rules setting up the bank and
4 how it's going to operate.

5 Q In the interests of preventing waste and
6 protecting correlative rights and at the same time allowing
7 more flexibility for operators, producers, to meet the mar-
8 ket, do you recommend the proposed amendments be adopted?

9 A Yes, I do.

10 Q And further protecting correlative rights
11 and preventing waste, do you recommend creation of a "gas
12 bank" plan similar to that you described?

13 A Well, there may be a bunch of people out
14 there in the audience who are just fixing to shoot me down
15 on this thing and I'm just trying to -- to be helpful, but
16 if this meets with -- with industry approval, I would be
17 happy to put this into a rule form and submit it at a future
18 hearing.

19 Q Do you have anything further to add to
20 your testimony?

21 A I think that's all.

22 MR. TAYLOR: That's all we have
23 in this case, Mr. Chairman.

24 MR. STANETS: Mr. Taylor, do
25 you have a witness from the committee who will talk about

1 why the committee recommended these rules?

2 MR. TAYLOR: I don't think we
3 do.

4

5 (Thereupon a discussion was had off the record.)

6

7 MR. STAMETS: Mr. Lyon, your
8 "gas bank" proposal, is there any reason that these proposed
9 rule amendments -- could it work in concert with these pro-
10 posed amendments?

11 A Yes, I think it could.

12 MR. STAMETS: So that they're
13 not mutually exclusionary.

14 A Right.

15 MR. STAMETS: Mr. Hall.

16

17

18 CROSS EXAMINATION

19 BY MR. HALL:

20 Q Mr. Chairman, I would like to be able to
21 ask a question and I don't know that I have the requisite
22 expertise. I wonder if you might let my client ask the
23 question?

24

25 MR. STAMETS: Well, we'll see
if we can -- if we can shed some light on this we'll allow

1 Mr. Nearburg to ask a question.

2 Q Mr. Blackwood.

3 MR. STAMETS: Mr. Blackwood,
4 I'm sorry.

5 MR. BLACKWOOD: I would like to
6 complement Mr. Lyon on his gas bank. I did -- I've been
7 sitting here all day trying to say something or get someone
8 to listen, trying to let it be known that in the protection
9 of correlative rights the State of New Mexico has an obliga-
10 tion and all they want, as we went through these rule chan-
11 ges, we were cancelling allowables, cancelling allowables,
12 cancelling allowables, and I think in previous years allow-
13 ables have been cancelled when wells were incapable of pro-
14 ducing the amount of gas assigned to them.

15 We now have another situation
16 which is relatively new and that's that perfectly capable
17 wells are not being allowed to produce anything because of
18 contractual problems and if those wells' allowables are can-
19 celled on a regular basis, the State of New Mexico is de-
20 priving the owners of those wells of their property rights
21 and I feel that the State of New Mexico is likely to get in
22 a really big problem over this. I for one will help them get
23 in it, if I have to.

24 I think Mr. Lyon's suggestion
25 of a gas bank is a very good suggestion. It will protect

1 not only the property rights of the owners but the Commis-
2 sion's job of trying to protect correlative rights.

3 I think in order to go to a gas
4 bank, though, you're going to have to go through and let it
5 apply to all of these different areas. Every time you talk
6 about no allowable will be assigned or no allowable can be
7 cancelled, this gas bank has got to take precedence and be
8 the most important factor. If it's not, if it comes in as
9 an idea at the end, and not worked in as these rule changes
10 are applied, you're going to have a bunch of problems. I
11 can cite a few, but I think -- I think you're understanding
12 it, but if you look at these rules you can very easily see
13 where whenever you cancel somebody's allowable not because
14 his well is incapable of producing it but because his pipe-
15 line company has shut him in, and then you refuse to rein-
16 state his allowable, you've stolen his property.

17 I think Mr. Lyon's idea (un-
18 clear) to that very cleverly and I think -- I think it needs
19 to be put forth at least. I think virtually all of these
20 rules we're talking about this afternoon may need to go back
21 to their committees and -- and the idea that no allowable
22 will ever be cancelled by reason of a well being shut in for
23 market conditions rather than ability to produce.

24 A Thank you, Mr. Blackwood, appreciate your
25 comments and I -- I think that you're due some recognition

1 in that the letter that you wrote in response to some of the
2 problems that Mr. Stamets had asked for some input from had
3 a lot to do with my thinking on this, and I appreciate your
4 comments in that letter.

5 MR. STAMETS: Mr. Kellahin.

6 MR. KELLAHIN: Thank you, Mr.
7 Chairman.

8
9 CROSS EXAMINATION

10 BY MR. KELLAHIN:

11 Q Mr. Lyon, why don't we simply suspend
12 prorationing in the State of New Mexico?

13 A I don't think we can do that under the
14 statute.

15 Q What is the purpose of the prorationing
16 order in the statute?

17 A Well, it's to allocate the gas among the
18 wells in each field, in each pool.

19 Q And also to balance those interests on a
20 periodic basis so that correlative rights are protected.

21 A That's true.

22 Q So there's not drainage between tracts.

23 A Right.

24 Q How long has the Commission utilized the
25 annual balancing period in its proration rules?

1 MR. NUTTER: That's correct, it
2 was back in the seventies.

3 A I stand corrected.

4 Q All right, sir. In terms of balancing on
5 an annual basis, if a well is underproduced at that time,
6 you talked about the cancellation of the underproduction,
7 what happens to that underproduction? Is it simply wiped
8 off the books or is it redistributed among the wells in that
9 pool?

10 A In past years it was redistributed. It
11 is no longer redistributed.

12 Q And what point in time did the Division
13 stop making the redistribution?

14 A As of the effective date of the Order
15 8170.

16 Q And that's the '86, 1986, February, or-
17 der.

18 A Yeah, I think it was effective April 1st.

19 Q Are there any other states that you're
20 aware of, Mr. Lyon, that have increased the balancing period
21 to a time comparable to the one you're suggesting of a two
22 year period?

23 A Not that I'm aware of.

24 Q In terms of the overproduction ratio,
25 how long has the Commission been utilizing the six times

1 overproduction ratio for a well that's shut in?

2 A The -- that was in the original rule.

3 Q What is the purpose of having those two
4 elements working together in terms of balancing correlative
5 rights and prevention of waste?

6 A Well, obviously, the reason is that if a
7 well gets very far overproduced it needs to be curtailed so
8 that the neighboring wells can have an opportunity to -- to
9 protect themselves.

10 Q These suggested changes you're making in
11 the rule would then, as I understand it, not be a solution
12 to the problem. It simply postpones the period of time in
13 which we would have to balance the wells.

14 A That is correct. All it does is give us
15 more flexibility to let people who have a market meet the
16 market.

17 Q Does it not also, sir, increase the risk
18 of violation of correlative rights by increasing the period
19 of time in which the balancing will occur and also increas-
20 ing the extent to which overproduced wells must come back
21 into balance?

22 A In my opinion it does.

23 Q It does or does not?

24 A It does.

25 Q Have you made an analysis of the impact

1 of the proposed change in term of New Mexico's share of the
2 gas markets?

3 A No, I have not. I'm -- I'm not exactly
4 sure how I'd go about it.

5 Q All right, let's take for example the
6 current rules that we have without the proposed changes.

7 Are the current rules inhibiting in your
8 opinion New Mexico's ability to share in the gas market?

9 A Well, I don't think so, but a lot of peo-
10 ple are telling us they do.

11 Q And if we take those rules and allow the
12 shut-in wells to stay out of the current market and to con-
13 tinue to accrue underproduction without balancing for a two
14 year period, what does that do to the New Mexico market?

15 A The shut-in wells?

16 Q Yes, sir.

17 A I don't -- I don't follow your question.
18 Perhaps I didn't understand it.

19 Q All right, sir, I didn't make myself
20 clear.

21 Those wells that are producing into the
22 market now, their allowables are based upon the actual takes
23 from that pool for the prior month.

24 A No.

25 Q No?

1 A No.

2 Q They do balance those eventually, though,
3 with actual takes taken from the pool?

4 A The wells that are producing --

5 Q The allowable for the wells that select
6 or choose to produce into the market --

7 A Yes.

8 Q -- those allowables are eventually
9 reflective of the actual takes from the pool.

10 A Well, they -- they produce the wells.
11 They're given an allowable. If they overproduce the allow-
12 able then they become overproduced; if they underproduce,
13 they become underproduced.

14 Q And that allowable is fixed based upon
15 that pool's share of the market.

16 A Yes.

17 Q And as the wells continue to get overpro-
18 duced and have to be shut in, then the subsequent allowables
19 that are shared or assigned to the pool continue to dimin-
20 ish. That volume goes down, does it not?

21 A No. That well still gets an allowable
22 while he's shut in and the allowable goes to -- to reduce
23 his overproduction.

24 Q What is the impact, if you know, on the
25 severance and other taxes collected by the State of New Mex-

1 ico under the current system versus the proposed change?
2 Have you made any type of analysis?

3 A I don't see that there should be a
4 change. I think that there is a market for gas and one way
5 or another we're attempting to meet that market, and as you
6 know, the severance tax on gas is on a unit basis rather
7 than a percentage basis and not only for that reason but for
8 other reasons this Division should not be concerned about
9 the price paid for gas except for one thing. If the price
10 of gas is too low, we're going to be looking at the abandon-
11 ment, the early abandonment of wells and the loss of reser-
12 ves, and that should be from a conservation viewpoint, our
13 only concern about the price of gas.

14 As State employees, we have to, natural-
15 ly, look at it a little bit differently, but under our
16 statutory mandate price should not be a factor.

17 Q The taxes based upon a unit basis will be
18 directly reflective on the volume of gas produced out of our
19 market -- or out of our pools for New Mexico.

20 A That is correct, and we would like to be
21 able to put as much gas as we can into that market for that
22 reason.

23 MR. STAMETS: Let me point out
24 that in reaching a decision in any case that the Commission
25 has to be guided by its statutory responsibilities and those

1 deal with prevention of waste and protection of correlative
2 rights and the only place that price is mentioned in the Oil
3 and Gas Act is in the ratable take section and that's not
4 what we're considering in this case here today.

5 Are there other questions of
6 the witness?

7 Mr. Hall?

8

9

REXCROSS EXAMINATION

10 BY MR. HALL:

11 Q With respect to 10(a) (1) and 10(a) (2),
12 you state that the underproduction carried forward is only
13 good for two prospective proration periods.

14 Why is that, first of all, and then
15 secondly, is there any reason why that can't be carried for-
16 ward to a period exactly coterminous with the actual (un-
17 clear)? In other words, can all the underproduction be made
18 up?

19 A Well, I believe the current rule carries
20 that forward one proration period and we're extending that
21 to two, and the reason that we can't carry that forward, you
22 know, till the end of time, is that it can get to be such a
23 huge number that it distorts the allowables process.

24 If you -- if you've looked at the situa-
25 tion up there in Kansas, they're dealing with a situation

1 like that and they're trying to get out of it.

2 Q Let me ask you, what was it limited to
3 just two proration periods as opposed to three or four?

4 A Well, as I say, if you -- if you keep
5 compounding this thing, you're dealing with a prodigious
6 amount of underproduction and it gets to the point there's
7 no way you could ever make it up.

8 Q Thank you.

9 A And that's one reason I'm proposing the
10 gas bank. I'm trying to put into a gas bank that gas
11 there's a chance of making up, but gas that is -- allowable
12 that's cancelled because the well does not have the ability
13 to produce it, I think should be cancelled.

14 MR. BLACKWOOD: Excuse me,
15 that's -- that's (unclear) the question. We're talking
16 about two different kinds of gas. I don't think we have an
17 argument about the allowable cancelled because wells are un-
18 able to produce.

19 A Right.

20 MR. BLACKWOOD: I know everyone
21 here seems to have the opinion that all wells have the op-
22 portunity to produce, but that is incorrect. Many wells
23 have been given no opportunity to produce anything in any
24 market and for those wells to lose their allowable when they
25 have the capacity would be great tragedy.

1 That's what I'm talking about.

2 A Yes, I agree with you and that's the dif-
3 ference in the two approaches. As I understood it he was
4 talking about Rule 10(a) and you see, from our records with-
5 out input from the operator, we have no way of distinguish-
6 ing between underproduction accruing because of inability to
7 produce versus that which is a victim of the market.

8 MR. STAMETS: Mr. Chavez?
9

10 QUESTIONS BY MR. CHAVEZ:

11 Q Mr. Lyon, isn't the opportunity available
12 through the regular hearing process for an operator to come
13 before the the Division and request reinstatement of under-
14 production when he feels that the wells have had their
15 underproduction cancelled due to other conditions besides
16 their ability to produce it?

17 A Yes, that's true. We have had a few
18 cases like that. I haven't been aware of that many cases
19 that have been approved.

20 In years past the Commission was not very
21 flexible about that.

22 MR. STAMETS: Other questions?

23 The witness may be excused.

24 I would believe then that aside
25 from the testimony from the committee which we will have to

1 then hear on the 20th, that that's the direct case in all of
2 these cases and then we would be ready to go back and start
3 over and hear any support for or opposition to each one of
4 these proposals, beginning with Case 9015.

5 Mr. Nutter.

6 MR. NUTTER: Case 9015 related
7 to Rules 315, 413 and 903. I fail to see how this rule
8 protects correlative rights of anyone. We've adopted a
9 system of prioritization (sic) (unclear). That's not
10 to protect correlative rights. That's just to say which
11 order wells are going to shut in and the wells aren't even
12 in the same types of pools, necessarily.

13 The statement says to prevent
14 waste and of New Mexico gas and although I don't see how it
15 protects correlative rights, I certainly don't see, either,
16 how it prevents waste. Gas wells, in the first place, are
17 all in one group whereas the old priority system had several
18 categories of gas wells, there's no protection here
19 whatsoever for low marginal wells, and you'll recall that
20 both of the gubernatorial candidates made a big point at the
21 New Mexico Oil and Gas Association meeting of wanting to
22 take some action to protect marginal wells, to keep them
23 from being abandoned, and now this seems to be a step in
24 just the exact opposite direction.

25 The next category would be the

1 wells that are commingled for a gas well, a gas zone and an
2 oil zone are commingled in a wellbore. This is not at all
3 (unclear) either. I had the occasion just very recently of
4 looking at a well that was commingled in the wellbore. The
5 oil zone made 23 barrels of oil in a whole month. The gas
6 zone, or there was a large amount of gas produced in the
7 well but no breakdown as to which of the two zones it came
8 from. This particular well offsets a gas well in the same
9 pool as the gas zone in this well, which was denied a hard-
10 ship classification and has been shut in for several months
11 but the operator is spending between \$4000 and \$5000 a month
12 trucking the water away, whereas the commingling well right
13 next door that produces 23 barrels during the month period
14 of time is producing gas and draining the well that's shut
15 in.

16 So there's no protection of
17 correlative rights there.

18 Now with respect to Section (b)
19 of the proposed Rule 903, Mr. Manning said that that's in
20 there for the edification of the technical people that
21 weren't acquainted with the statutes.

22 Actually (b) in the statute is
23 a pipeline saving clause through the ratable take statutes
24 but Section (a) of Rule 903 has nothing to do with ratable
25 take. So I don't see how you can take a portion of the rat-

1 able take statute, cite it verbatim in a rule which has no-
2 thing to do with ratable take and say that it's taken dir-
3 ectly from the statute and therefore is applicable to the
4 section.

5 With respect to 903(c) it ap-
6 pears to us that this provides the purchasers with a new
7 mechanism even in addition to the Transco decision, which
8 will the blessing of the OCD provide them with some sort of
9 protection for a new contemplated breach of contract.

10 With respect to Rule 902, I
11 have to say the same thing. Again it just provides them
12 with a new mechanism to give them some new additional pro-
13 tection for contemplated breach of contracts.

14 With respect to Case 9016, as
15 to the three alternative ways of taking care of split owner-
16 ship in the wells, I believe that if any rule is necessary
17 at all it should be a rule which is a combination of all
18 three alternatives. If the operators or owners of the well
19 are agreeable to allowing one of the operators or owners to
20 act for them in signing the contract for the sale of gas, so
21 be it. They should be allowed to.

22 If all of the owners in the
23 well are agreeable to some sort of gas balancing agreement
24 that's acceptable to all of them and they want to send --
25 give an affidavit to the Commission that this is their de-

1 sire, so be it, allow them to do so.

2 But in the absence of either
3 one of those two, you should have some regulation or some
4 rule that would prevent all of the sales being attributed to
5 a minority interest owner in the well.

6 So there has to be some means
7 of accounting for and balancing the takes.

8 As for Alternative 1 and 2, al-
9 so I don't believe, if you should adopt either one of those,
10 there is any reason whatsoever to withhold allowable if the
11 prerequisite agreements have not been signed and delivered
12 to the Commission. Maybe it would stop the sales from the
13 well, yes, but to stop an allowable from accruing, no.

14 I believe that's all I have at
15 this time.

16 MR. STAMETS: Is there any par-
17 ty who wishes to put on any testimony in Case 9015?

18 Mr. Duke.

19 MR. DUKE: Mr. Chairman, I'm
20 not certain of the procedure here. Could we have leave to
21 submit a comment or a brief stating our position in the
22 interest of saving time?

23 MR. STAMETS: Yes.

24 MR. DUKE: I think we would
25 just as soon do that.

1 MR. STAMETS: Okay.

2 We would provide at least two
3 weeks for submittal of comments on any of these proposals by
4 any of the parties here today, if they chose to do that at
5 this time.

6 MR. BLACKWOOD: May -- I'd just
7 like to state that Mr. Nutter expressed my opinions on 9015
8 when he said that Section (b) and Section (c) apparently do
9 nothing but give pipeline companies another out in avoiding
10 their contractual obligations.

11 I would recommend that (b) and
12 (c) be omitted.

13 MR. STAMETS: Does anyone else
14 have anything they wish to offer today in Case 9015?

15 MR. KELLAHIN: Am I correct in
16 understanding that this case will be continued to the Novem-
17 ber docket?

18 MR. STAMETS: Only if we have a
19 request that it be continued to the November docket.

20 MR. KELLAHIN: I would so move.

21 MR. STAMETS: All right, we
22 will continue Case 9015 to the November docket.

23 How about Case 9016, anyone
24 have anything that they wish to offer today in 9016?

25 Anybody want a continuance of

1 9016?

2 A SPECTATOR: Mr. Chairman, we
3 request it.

4 MR. STAMETS: All right, we
5 will so continue it.

6 How about the next case, 9017?

7 A SPECTATOR: Same response.

8 MR. STAMETS: Same response,
9 and obviously, we have to continue 9018.

10 So we will do that.

11 Does anyone here today have
12 anything they wish to offer in any of these cases?

13 MR. KELLAHIN: May I have just
14 a moment, Mr. Chairman?

15 MR. STAMETS: Yes.

16 MR. DUKE: Mr. Stamets, on your
17 two weeks for comment, with these cases all being continued
18 to November 20, are the comments to be in within two weeks
19 from now or --

20 MR. STAMETS: I think what we
21 should do is just put king's X on that and see what happens
22 at the November hearing.

23 Yes, Commissioner Kelley says
24 that if anyone has any comments that they could submit,
25 which they'd recommend as possible provisions to these

1 rules, if we could have those ahead of time for analysis of
2 the Division staff, that, I think, would help speed things
3 along at the hearing.

4 SPECTATOR: Would you set a
5 date?

6 MR. STAMETS: A date?

7 SPECTATOR: As to when you
8 would desire those comments?

9 MR. STAMETS: Well, let's see,
10 this is the 23rd -- well, let's see, two weeks from next
11 Monday, whatever date that is.

12 MR. HOCKER: Mr. Stamets, when
13 you asked if anyone had anything to offer, would that
14 include statements or are we talking about testimony still?

15 MR. STAMETS: Either one. If
16 you don't plan to be back here in November, I'd say make
17 your statement now.

18 MR. HOCKER: I'd like to make a
19 comment at this time.

20 MR. STAMETS: Feel free, Mr.
21 Hocker.

22 MR. HOCKER: First, with regard
23 to Case 9016, which has the split stream Alternatives 1, 2,
24 and 3, I'd first like to make a comment to a question made
25 to Mr. Stovall, and he might respond to it, that was why not

1 Number 3?

2 In looking at Number 3 I'm not
3 yet willing to give up the possibility that even absent a
4 gas balancing agreement there won't be some kind of balan-
5 cing agreement upon completion of the well, and if that's
6 the case, all parties to that well will be to their detri-
7 ment if in fact it's an allocated field, a prorated well,
8 and the production from that well might be one half of what
9 all the other wells in the field will be, and there is a gas
10 balancing, all parties would suffer, so it seems to me that
11 by using Number 3 you may be increasing an inequity rather
12 than reducing it.

13 The fact is, I would make that
14 statement about all three alternatives and would suggest
15 that they not be adopted.

16 On the other hand, I would like
17 to say a good word for the priorities. There was some com-
18 ment that these priorities do not serve prevention of waste.
19 In some cases I certainly believe that they do.

20 It would seem to me that the
21 highest priority, No. 4, the hardship well, is supposed to
22 be solely based on (inaudible) and therefore it should have
23 the highest or the most -- greatest ability to put gas in
24 the market.

25 It seems to me that when you

1 have casinghead gas as the next, it is somewhat a waste pre-
2 vention measure then, too, because you have then helped re-
3 duce the incentive to go ahead and produce the oil and let
4 the gas go where it may.

5 I know that we're not supposed
6 to (unclear) gas, but nevertheless there's an incentive
7 there to produce the oil and by not giving priority to
8 casinghead gas there may be a waste of that casinghead gas,
9 at least to some extent.

10 So I support your proposal for
11 priorities.

12 MR. STAMETS: Thank you, it's
13 nice to hear a kind word.

14 Mr. Strand.

15 MR. STRAND: Mr. Examiner, I
16 just have a question.

17 Do you anticipate that these
18 committees will be meeting before November 20th?

19 MR. STAMETS: I certainly hope
20 so.

21 MR. STRAND: I just wonder how
22 I could be put on a committee, particularly Mr. Manning's.

23 MR. STAMETS: He's right over
24 here and what you do is, you walk over and see him.

25 MR. STRAND: I would request to

1 be put on that committee, Mr. Manning.

2 MR. MANNING: I'll take that
3 under advisement.

4 MR. STAMETS: Also, anybody
5 who'd --

6 MR. MANNING: I'm kidding about
7 that.

8 MR. STAMETS: Anybody who'd
9 like to work with Vic Lyon to flesh out the gas bank should
10 visit with him immediately after the hearing.

11 Mr. Currens, did you have some-
12 thing you wanted to say?

13 MR. CURRENS: Well, I did until
14 we wound up with a continuance and I may want to say some-
15 thing else after we have the next session of this hearing,
16 so I think I'll wait.

17 MR. MANNING: If you're going
18 to say something like Hocker, just don't say anything.

19 MR. STAMETS: In that event, we
20 will continue all four of those cases until the November
21 20th hearing. All right, we'll continue it, then, until
22 that time.

23 MR. MANNING: Mr. Chairman, I
24 would like to say that Paragraph (b) certainly served its
25 purpose. I certainly brought to attention to a bunch of

1 people that didn't know it existed in the statutes and now
2 they're aware of it, and so whatever happens to it, it cer-
3 tainly served its purpose.

4 MR. STAMETS: Okay, thank you,
5 Mr. Manning.

6 We'll recess this hearing until
7 9:00 o'clock in the morning.

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(Hearing recessed.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY the foregoing Transcript of Hearing before the Oil Conservation Division (Commission) was reported by me; that the said transcript is a full, true, and correct record of this portion of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR

1 NEW MEXICO OIL CONSERVATION COMMISSION
2 STATE LAND OFFICE BUILDING
3 STATE OF NEW MEXICO
4 CASE NO. 9018

5
6 IN THE MATTER OF:

7
8 Case 9018 Being Reopened Pursuant to
9 the Provisions of Division Order
10 No. R-8170-~~P~~^F, Which Order Temporarily
11 Amended Rule 11(b) by Providing for
12 a 12-times Overproduction Limit for Gas
13 Wells in Northwest New Mexico.

14
15
16 BEFORE:

17 WILLIAM LEMAY, Chairman
18 GARY CARLSON, Commissioner
19 State Land Office Building
20 March 12, 1992

21
22 REPORTED BY:

23 CARLA DIANE RODRIGUEZ
24 Certified Shorthand Reporter
25 for the State of New Mexico

ORIGINAL

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1 CHAIRMAN LEMAY: We shall come back to
2 order and call Case No. 9018. Case No. 9018 is
3 being reopened pursuant to the provisions of
4 Division Order No. R-8170-F, which order
5 temporarily amended Rule 11(b) by providing for
6 12-times overproduction limit for gas wells in
7 Northwest New Mexico, et cetera.

8 And I would like to have appearances in
9 Case 9018.

10 MR. STOVALL: Robert G. Stovall of
11 Santa Fe, representing the Division, and my
12 witness didn't get bored and go home, so I have
13 one.

14 CHAIRMAN LEMAY: Good. Additional
15 appearances in Case 9018. Mr. Kellahin?

16 MR. KELLAHIN: Mr. Chairman, I'm Tom
17 Kellahin of the Santa Fe law firm of Kellahin,
18 Kellahin & Aubrey, appearing on behalf of
19 Meridian Oil, Inc., and I have one witness to be
20 sworn.

21 CHAIRMAN LEMAY: Mr. Carr?

22 MR. CARR: May it please the
23 Commission, my name is William F. Carr, with the
24 Santa Fe law firm, Campbell, Carr, Berge &
25 Sheridan. I would like to enter my appearance

1 for Amoco Production Company. I'm appearing in
2 association with Mr. Eric Nitcher.

3 I also would like to enter my
4 appearance for Union Oil Company of California,
5 doing business as Unocal. We do not intend to
6 call a witness, but Mr. Craig Van Horne with
7 Unocal will make a statement.

8 CHAIRMAN LEMAY: Any witnesses for
9 Amoco?

10 MR. CARR: One witness.

11 CHAIRMAN LEMAY: Additional appearances
12 in Case 9018?

13 MR. PEARCE: May it please the
14 Commission, I'm W. Perry Pearce of the Santa Fe
15 office of the Law Firm Montgomery & Andrews,
16 appearing in this matter on behalf of Phillips
17 Petroleum Company, and I do not have a witness.

18 CHAIRMAN LEMAY: Thank you, Mr.
19 Pearce. Additional appearances in the case?

20 Will those witnesses that are going to
21 give testimony please stand and raise your right
22 hand.

23 [The witnesses were duly sworn.]

24 CHAIRMAN LEMAY: Thank you. You may be
25 seated.

1 Mr. Stovall, you may proceed.

2 MR. STOVALL: I would call Mr. Van
3 Ryan.

4 LARRY VAN RYAN

5 Having been first duly sworn upon his oath, was
6 examined and testified as follows:

7 EXAMINATION

8 BY MR. STOVALL:

9 Q. Would you please state your name and
10 temporary place of residence?

11 A. My name is Larry Van Ryan. My
12 temporary place of residence is Santa Fe, which I
13 hope is soon my permanent place.

14 Q. And how are you employed, Mr. Van Ryan?

15 A. I'm employed by the Oil Conservation
16 Division as the chief petroleum engineer.

17 Q. And your duties as chief petroleum
18 engineer include managing the gas proration
19 system and are you familiar with that system?

20 A. Yes, sir.

21 Q. Are you prepared to make a
22 recommendation with respect to the continuation
23 of the 12-times overproduced rule?

24 A. Yes, I am.

25 MR. STOVALL: Mr. Chairman, Mr. Van

1 Ryan, probably along with Mr. Kendrick and Mr.
2 Lyne is the closest thing we've got to an expert
3 in gas proration, and I'd offer him as an expert
4 in that capacity.

5 CHAIRMAN LEMAY: Oh, I think his
6 qualifications are acceptable, after he went
7 under the fire of the--

8 MR. STOVALL: Oh, I think his
9 qualifications are great, I think the system is
10 tough to be an expert in.

11 CHAIRMAN LEMAY: Well, he comes close,
12 as close as anybody.

13 Q. (BY MR. STOVALL) Mr. Van Ryan, are you
14 familiar with the application and you have
15 testified that you are familiar with the
16 application and the reopening of the case to
17 determine whether the 12-times overproduced limit
18 should be retained in the San Juan Basin prorated
19 gas pools.

20 Do you have any recommendation as to
21 whether that limit should be retained or not?

22 A. Yes, I do.

23 Q. What is your recommendation?

24 A. My recommendation is that we continue
25 with the 12-times overproduced rule for the

1 northwest area of the state. My reasonings for
2 that are that in view of the current problems
3 with gas marketing being done by individuals as
4 opposed to however it was performed in the past,
5 where we had one or a few purchasers out of the
6 basin and they were able to take care of the
7 market, we're still in a state of flux and we're
8 not real sure of how people will react to being
9 able to sell their gas. We need the flexibility
10 of the 12-times overproduced to allow for this
11 situation.

12 There's also a situation where the
13 pipeline capacity in the San Juan Basin is being
14 increased substantially, and it's potentially
15 possible that these wells in the San Juan Basin
16 will be able to produce quite a bit more gas with
17 this increased capacity.

18 Not knowing the results of that or of
19 the gas marketing in a positive manner, we would
20 recommend that 12-times overproduced gives the
21 operators a flexibility to adjust to these two
22 uncertainties.

23 Q. Is there any reason not to continue the
24 12-times overproduced limit?

25 A. Since we're now ineffective, but I

1 don't see that it's caused any additional
2 problem, no, sir.

3 Q. Would you recommend that it be
4 continued for, say, another two-year period, as
5 it has been done in the past, or should we just
6 make it permanent and come back and change it
7 when conditions dictate the need for a change?

8 A. I think we should extend it for a
9 two-year period and review it again at that
10 period of time. If we have a better handle on
11 gas marketing and the pipeline capacity effects
12 on the additional wells in the San Juan Basin,
13 then at that time we could make further
14 recommendations.

15 MR. STOVALL: Nothing further of this
16 witness.

17 CHAIRMAN LEMAY: Questions of the
18 witness?

19 EXAMINATION

20 BY COMMISSIONER CARLSON:

21 Q. Do you have any idea how much
22 deliverability would be shut in if we went back
23 to 6-times overproduced?

24 A. I do not have a handle on how much
25 would be affected. I have heard from several

1 operators that they are concerned that a number
2 of wells would be affected, but I can't say give
3 you an exact number of wells or deliverability.

4 COMMISSIONER CARLSON: That's all I
5 have.

6 CHAIRMAN LEMAY: Thank you,
7 Commissioner Carlson. I have no questions of the
8 witness. He may be excused.

9 Mr. Kellahin?

10 MR. KELLAHIN: Thank you, Mr.
11 Chairman. I would like to call Mr. George Dunn.

12 GEORGE DUNN

13 Having been first duly sworn upon his oath, was
14 examined and testified as follows:

15 EXAMINATION

16 BY MR. KELLAHIN:

17 Q. Mr. Dunn, would you please state your
18 name and occupation.

19 A. My name is George Dunn and I'm a
20 regional production engineer for Meridian Oil,
21 Incorporated, in Farmington, New Mexico.

22 Q. In previous cases before the Commission
23 and the Division, have you testified as an expert
24 petroleum engineer?

25 A. Yes, sir.

1 Q. Summarize specifically with regards to
2 this type of case and the prorating system in
3 the San Juan Basin, what is it that you do?

4 A. I work within the production
5 engineering group which, of course, works within
6 producing the wells and tracking to produce at
7 optimum levels and in regards with how allowables
8 and prorating effects them.

9 Q. Do you work in conjunction with Mr.
10 Louis Jones of Meridian with regards to managing
11 your production, staying aware and familiar with
12 the prorating system, and the allowables
13 assigned for the production, and the prorated
14 pools of the San Juan Basin?

15 A. Yes, I do.

16 Q. Based upon your position, have you
17 developed for your company recommendations and
18 conclusions with regards to the specific topic at
19 issue today?

20 A. Yes, I have.

21 MR. KELLAHIN: We tender Mr. Dunn as an
22 expert witness.

23 CHAIRMAN LEMAY: His qualifications are
24 acceptable.

25 Q. Mr. Dunn, before we turn to the exhibit

1 package, let me have you summarize for us what
2 Meridian's position is concerning the
3 continuation of the 12-times over rule?

4 A. Our position would be to continue it at
5 12-times for two years, and then revisit it at
6 that time.

7 Q. Are you familiar with the original
8 reasons and justifications for the adoption of
9 Rule 11(b), which is the 12-times over rule in
10 the proration system?

11 A. Yes. Basically, it was originally
12 developed due to the advent of the spot market
13 and changing marketing conditions at that time,
14 and to allow flexibility to take care of that
15 situation.

16 Some of those uncertainties are not
17 necessarily the same, but we have other
18 uncertainties now that would require the same
19 flexibility.

20 Q. Describe for us the types of
21 uncertainties that have drawn you to the
22 conclusion that you need to continue the 12-times
23 over rule?

24 A. The primary one would be, as stated
25 previously, would be the expansion of the

1 pipelines and what effect that will have on
2 production in the basin.

3 In addition, there would be the effect
4 of fairly recent change to the six-month
5 allocation period, which we're still working with
6 some of the concerns and how to actually work
7 that, and also really in how to attract the
8 overproduction levels at the new six-month
9 period.

10 Q. Let me ask you to turn to what we have
11 marked as Meridian Exhibit No. 1, and identify
12 and describe that?

13 A. This is a quote out of the Cambridge
14 Energy Research Associates, and basically this
15 exhibit reiterates what you've heard quite a bit
16 recently that demand for natural gas is rising.
17 That's the main function, just another source of
18 rising demand.

19 Q. Identify and describe Exhibit 2 for
20 us.

21 A. Exhibit 2 is a quote out of the Natural
22 Gas Week, and similarly as demand increases, well
23 also has Canada's exports to the United States.
24 Again, we need to have the ability, the
25 flexibility, to compete with this Canadian gas

1 which is ever increasing.

2 Q. I would ask you to identify and
3 describe Exhibit 3.

4 A. Exhibit No. 3 is also a quote out of
5 the Natural Gas Week. Basically it describes the
6 window of opportunity that now exists for us to
7 capture more market in California, and maybe even
8 more strongly the ability to potentially keep the
9 Canadians from building additional capacity with
10 which to transport to California.

11 Q. Has Meridian developed a display to
12 show the percentage of reserves in New Mexico
13 that are produced in relation to those
14 percentages of reserves produced by other states?

15 A. Yes, we have, and that's Exhibit 4.

16 Q. Before we discuss the conclusions and
17 the inferences to draw from Exhibit 4, explain to
18 us the data. First of all, what's the source of
19 the information?

20 A. The source was from the Interstate Oil
21 Compact Commission book, and it provides data for
22 the total United States gas production, along
23 with all the states. And what we've done is
24 selected from within that data the four highest
25 gas producers, and the ones with which we would

1 be closest to direct competition with.

2 Q. When we look in the box to the right of
3 the display, is there any particular reason that
4 those states are in that order?

5 A. Basically, if you exclude offshore gas
6 from Louisiana, New Mexico would be the second
7 leading producer next to Texas. Otherwise,
8 they're third if you include offshore gas. That
9 would be the only purpose of the--

10 CHAIRMAN LEMAY: Do you mean to say
11 "producer" or "reserve holder"?

12 THE WITNESS: Producer, as a percentage
13 of reserves.

14 CHAIRMAN LEMAY: The second largest
15 producer as a percentage of reserves?

16 THE WITNESS: No, that won't work.
17 Excuse me. What I'm trying to say is, in terms
18 of rate, if you knock out offshore gas from
19 Louisiana, Texas is the only one higher than us
20 in rate. And I can crosscheck that.

21 CHAIRMAN LEMAY: I just wonder if you
22 mean the word "rate" or "reserves."

23 THE WITNESS: I don't know that there's
24 really a significant-- No, not reserves.

25 CHAIRMAN LEMAY: I didn't mean to

1 interrupt your testimony.

2 MR. KELLAHIN: That's quite all right.

3 CHAIRMAN LEMAY: I was trying to
4 correct it, if there was a mistake, correct it
5 now.

6 THE WITNESS: Basically, estimated for
7 91 is one TCF of gas production from New Mexico,
8 and we'll see--the question is really Oklahoma,
9 which is higher.

10 Q. (BY MR. KELLAHIN) What is the purpose
11 of plotting production as a percentage of
12 reserves?

13 A. Well, it it shows several things, but
14 part of it is a potential way to show the
15 relative producing of different states as
16 compared to their base. And, as you can see,
17 we're lower than the other three, and at the same
18 time we're declining where they are relatively
19 flat. Some inclines, some dips.

20 The other is that it also can give an
21 indication of reserve life.

22 Q. This plot is done for all production in
23 New Mexico and not simply the prorated gas
24 production?

25 A. That's correct. That would be total

1 production.

2 Q. When we look at the red line, then,
3 describe for us some of the events. What's
4 occurred in 1986, for example, to give us that
5 valley in the--

6 A. Primarily, that would be the uncertain
7 times when the spot market came into effect and
8 some producers elected not to sell and others
9 did. Also, there were some effects
10 from--continuing effects after that, due to the
11 proration system.

12 Q. Can you use this information to
13 determine what percentage of the display
14 attributable to New Mexico is the Northwest San
15 Juan prorated gas production?

16 A. Well, I don't know that you can use it
17 to do that, but I know it affects about 30
18 percent currently of this rate here, would be the
19 Northwest prorated gas volumes.

20 Q. As we apply this information to
21 deciding whether or not to continue the 12-times
22 over rule, how do we do that?

23 A. Well, the significance of this is that
24 with expansion, expansion itself would equate to
25 approximately 1.3 Bcf a day additional volume.

1 It could come out of the Basin. If you assume
2 that whole volume came from the New Mexico
3 portion, which is there will be other volumes
4 from other areas, but that would increase this
5 number to, at the highest, seven percent, which
6 is below pre-86 numbers.

7 At the same time, what that tells you
8 is that even at seven percent, we have
9 20-plus-year reserve life. Therefore, even from
10 that standpoint, there's lots of room to shut in
11 wells and reduce any overproduction. There's
12 lots of time.

13 Q. At what point in time on this display
14 can we find a period that predates the 12-times
15 rule?

16 A. The 12-times rule would have come in
17 effect in late 86.

18 Q. If you compare the percentage of
19 production to reserve before and after that date,
20 what has been the impact of the 12-times rule in
21 terms of that percentage?

22 A. The percentage is less since that
23 advent.

24 Q. Do you find in your analysis that the
25 flexibility of the system, by the 12-times rule,

1 would jeopardize any of the other interest owners
2 in the prorated pools that did not have the
3 high-capacity wells that were utilized in the
4 12-times over rule?

5 A. No.

6 Q. The reserves in each of these prorated
7 pools are large enough that they can handle that
8 magnitude of overproduction?

9 A. That's correct.

10 Q. And, in fact, that overproduction is
11 always accountable to the spacing unit and
12 ultimately has to be made up under current rules?

13 A. That's right.

14 Q. Let me have you turn to Exhibit No. 5.
15 Would you identify and describe that display?

16 A. Exhibit No. 5 is the 12 rate accounted
17 from 12-times overproduced wells through time,
18 for just Meridian Oil. This was the same exhibit
19 that was shown in the May 1990 hearing. I
20 believe it was May.

21 This is just an update to show where we
22 are now as a company, Meridian. We've reduced
23 from above 30 million a day to just over 5
24 million a day. It's showing we're monitoring and
25 using the system, and we'll see later that that's

1 consistent, pretty much, for the Basin, for all
2 the operators.

3 Q. Back in May of 1990, one of the
4 questions or concerns was that if we go to the
5 12-times rule, that is simply going to represent
6 a windfall for the high-capacity wells and will
7 simply jump up to that maximum ceiling, and that
8 will be the effect.

9 Have you seen that occurring under the
10 rule?

11 A. No, not at all.

12 Q. What, then, is the rule being used for?

13 A. It's being used for the flexibility to
14 produce in times where we can sell the gas. And
15 also, with changes in the system or the demand,
16 the ability to change with it.

17 Q. Currently, then, when we read the
18 display and look at December of 1991, we're
19 looking at a volume of gas for those wells, and
20 it's the volume in excess of the 12-times over
21 for the Meridian-operated wells within that
22 category?

23 A. Right. All formations.

24 Q. And what is that volume?

25 A. Just over 5 million.

1 Q. All right, let's turn to Exhibit 6.
2 Would you identify and describe that, please?

3 A. This is a plat showing the rate between
4 6- and 12-times overproduced, based on
5 deliverability (D) totals, for all formations and
6 all operators.

7 It shows the reduction again from over
8 100 million in June of 1990 to just under 60
9 million in June of 1991. We couldn't update it
10 more currently than this basically just because
11 of some of the problems in tracking when we
12 switched over to the six-month system.

13 Q. Before we discuss the display, let me
14 follow your last comment. What is the last
15 available information that you have under this
16 system to know what the status is of the wells?

17 A. Our last one would be the last
18 published book, so--well, this actually gives the
19 June of 91, would be our most current that we've
20 actually received from the State.

21 Q. Because the system has not been
22 adjusted to bring the data current, is there any
23 advantage to retaining the 12-times over rule
24 because of that?

25 A. Certainly, again, it gives room to

1 track the wells until we get the full tracking
2 systems working adequately.

3 Q. With Exhibit No. 6, we're looking at
4 that volume of gas not only for Meridian but all
5 the producers in the prorated pools in the San
6 Juan Basin?

7 A. Right.

8 Q. And it's that volume from 6-times over
9 to 12-times over?

10 A. Right. It's actually based on the D's.

11 Q. On the deliverability?

12 A. Right.

13 Q. That's the only way you can do it with
14 the current method of data?

15 A. Yeah, basically.

16 Q. Okay. What does it show?

17 A. That it's declined since June of 1990,
18 and that again, operators are trying to control
19 their production and live within the scheme of
20 the proration system.

21 Q. Not only is Meridian trying to manage
22 this as a flexible tool to produce their wells,
23 it appears to you that other operators are doing
24 the same thing?

25 A. Yes.

1 Q. All right. Let's turn to Exhibit 7.
2 Would you identify and describe that for us,
3 please?

4 A. Exhibit 7 is a rate-versus-time plot
5 for Northwest New Mexico prorated gas
6 production. In addition there are two points
7 plotted on it that are taken from El
8 Paso's--their largest high-pressure system.

9 What this plot shows is post-81 decline
10 in the prorated gas production, somewhat
11 flattening out from 83 on, but still on a
12 decline. And again we have the same dip in 86
13 that we've seen in the previous data on the
14 percent of reserves produced. In fact, these
15 have a tendency to mirror each other so you can
16 see the effect of the prorated gas on that
17 percent of production.

18 Q. All right. If you were to take Exhibit
19 7 and compare it back to Exhibit 4, what's your
20 point?

21 A. That from the 85'ish, 86 period on, you
22 can see some correlation in the rates, for
23 prorated gas production has an effect on the
24 total percentage of production for New Mexico.
25 You can see the impact of whatever happens to the

1 Northwest New Mexico prorated gas.

2 The other thing it shows, this plot, is
3 the pressures back in 1977 of 211 psi--this is
4 the main high-pressure system--up to 358 psi in
5 90. That shows the room, as expansion takes
6 place, for line pressures to drop down, and also
7 an indication of potential increased rate out of
8 the prorated pools.

9 If we were to drop down to 211, there
10 could be an increase of 4- to 500 million a day,
11 which was also presented at the last hearing, I
12 believe, by Amoco, in those kinds of ranges.

13 Q. Do you see evidence or indication that
14 the 12-times rule is working to impair the
15 marginal wells?

16 A. No. No indications at all.

17 Q. Okay. You were talking about the
18 pipeline systems. Describe for us the additional
19 capacity and the timing of that additional
20 capacity that's becoming available to the
21 prorated pools in the San Juan Basin?

22 A. Can I move to the next exhibit?

23 Q. Yes, sir.

24 A. Exhibit 8 is a summary of information
25 we have--and we checked this last week with both

1 companies--that Transwestern intends to be fully
2 operational this month. They are not fully
3 operational yet, but they intend to this month,
4 and would have the ability at some point to take
5 as much as 500 million cubic feet out.

6 El Paso would be fully operational in
7 April of 92, and an additional 800 million cubic
8 feet.

9 The significance or maybe to explain
10 some of these terms, "fully operational" doesn't
11 mean from that day they would automatically take
12 that volume out. There are lots of things that
13 would have to happen on the producer's end and on
14 the pipeline end and on the marketing end,
15 actually, to get up to these rates. We feel like
16 it will be at least, at best case, six months and
17 more like probably a year until we see the impact
18 of all these expansions.

19 And where that relates back to the
20 12-times issue is needing the flexibility to
21 adjust as we see what these expansions take
22 place--happen over time.

23 Q. If the 12-times rule is terminated and
24 the additional pipeline capacity is available to
25 the Basin, how is that market going to be

1 supplied?

2 A. Would you rephrase that?

3 Q. Sure. When you're looking at the
4 prorated pools, part of the flexibility is being
5 able to take the high-deliverability wells,
6 produce up to 12-times, and satisfy part of the
7 market demand for production out of the San Juan
8 Basin utilizing, in part, the additional pipeline
9 capacity.

10 If the rule is terminated, how is the
11 market demand for production out of the Basin
12 going to be satisfied?

13 A. Well, we could potentially see a
14 reduction in rates from the prorated pools. I
15 don't know if I could say how it would be
16 satisfied beyond that. There could be a
17 reduction because--

18 Q. Well, it would have to come from some
19 other source of supply?

20 A. True. It could come from another state
21 or Canada, or another portion of our state.

22 Q. The recommendation from Meridian is for
23 what period of time to extend the 12-times over
24 rule?

25 A. Two years.

1 Q. And the reasons for the two-year
2 extension are what, sir?

3 A. To be able to adjust to the
4 uncertainties of primarily this expansion in
5 developing--in running the prorated fields. Part
6 of that, I guess where it really comes into play,
7 is that allocations, we think, are going to be
8 tough in the near term because of these
9 expansions, and the 12-times will give us some
10 room to maneuver within those allocations while
11 we iron them out.

12 Q. And your best estimate is it will be
13 six years to more like a year, to see what's
14 going to happen with the additional pipeline
15 capacity?

16 A. Six months to a year, right.

17 Q. Let me ask you to summarize, then, your
18 major conclusions that you've set forth on
19 Exhibit No. 9.

20 A. Primarily to repeat what's been said a
21 few times, that it would provide us the
22 flexibility during a changing time period, which
23 is primarily due to the expansions but also due
24 to some of the recent changes in the allowable
25 allocations, to live within the rules and still

1 have flexibility to produce as the market or the
2 expansions change, the volumes that we can take
3 away.

4 Q. And finally, in Exhibit 10, you've
5 written down your recommendations?

6 A. Right, and that is to extend the ruling
7 for two more years, and revisit it at that time
8 to determine whether or not to drop back to the
9 six times.

10 Q. Does Meridian have the evidence that
11 the continuation of the 12-times over rule is
12 going to cause waste or impair the correlative
13 rights of anyone?

14 A. We've not seen any indication of
15 impairing the correlative rights or causing
16 waste.

17 Q. To your knowledge, has anyone
18 complained to Meridian that the 12-times rule has
19 harmed them in any way?

20 A. No, they have not.

21 MR. KELLAHIN: That concludes my
22 examination of Mr. Dunn. We move the
23 introduction of Meridian Exhibits 1 through 10.

24 CHAIRMAN LEMAY: Without objection,
25 Exhibits 1 through 10 will go into the record.

1 Are there any questions of the
2 witness? Mr. Carlson?

3 EXAMINATION

4 BY COMMISSIONER CARLSON:

5 Q. I guess I don't completely understand
6 your Exhibits 5 and 6.

7 Exhibit 5, is that the amount of
8 Meridian production or deliverability that is now
9 shut in because of the 12-times overproduced oil?

10 A. You could equate it that way also, yes.

11 Q. Okay. So if we were 6 or 2 or 1,
12 instead of 12, that decline would still be
13 there? I mean, those wells have to be shut in
14 because they're overproduced?

15 A. Those would, but then--

16 Q. I recognize that, but it would go down
17 that much no matter what?

18 A. Yes. I think I'm understanding your
19 question right. Based on controlling against
20 this 12-times overproduction, what we've done is
21 try to limit any volumes getting over that, of
22 course, and so through time we feel like we've
23 done a lot better job of it.

24 Q. In your Exhibit 6, is the
25 production--the deliverability that is now being

1 produced but would have had to be shut in if we
2 were at 6-times?

3 A. Right, based on deliverabilities.
4 That's not a direct correlation to volumes, is
5 why I keep saying deliverabilities.

6 COMMISSIONER CARLSON: I have no
7 further questions.

8 CHAIRMAN LEMAY: Thank you.

9 EXAMINATION

10 BY CHAIRMAN LEMAY:

11 Q. I need to go back and have you explain
12 Exhibit 4 a little bit again. Basically, does
13 this show that New Mexico is producing a smaller
14 percentage of its reserve than any other state?

15 A. That is correct.

16 Q. Of the states listed on here?

17 A. The states listed on here, but I can
18 also state that there's only one other state that
19 is at this level, and that's Alaska. And what
20 does Alaska do with most of their gas? It goes
21 back as gas reinjection, so they're the only
22 other state at the 4-1/2 percent level.

23 Q. And Alaska couldn't be correlated with
24 the lower 48, could they, because they don't have
25 a distribution system to market their gas?

1 A. Right.

2 Q. Do you have any idea what Canada's
3 is--Western Canada?

4 A. No, because this book did not-- Where
5 we got our data didn't carry Canada.

6 Q. Which book was this, do you remember?

7 A. Yeah, it's the Interstate Oil & Gas
8 Compact Committee Bulletin from the 1990 meeting.

9 CHAIRMAN LEMAY: Thank you.

10 Any additional questions of the
11 witness? He may be excused.

12 Anything else, Mr. Kellahin?

13 MR. KELLAHIN: No, sir.

14 CHAIRMAN LEMAY: Mr. Carr.

15 MR. CARR: Mr. Nitcher will present his
16 witness.

17 MR. NITCHER: My name is Eric Nitcher,
18 N-I-T-C-H-E-R. I'm the attorney for Amoco
19 Production Company. I have one witness, James
20 Hawkins.

21 CHAIRMAN LEMAY: He has been sworn in,
22 so I guess you can go on his qualifications, if
23 you would, Mr. Nitcher.

24 MR. KELLAHIN: We'll try and expedite
25 this.

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JAMES WILLIAM HAWKINS

Having been first duly sworn upon his oath, was examined and testified as follows:

EXAMINATION

BY MR. NITCHER:

Q. Mr. Hawkins, would you please state your name and business address for the record?

A. It's James William Hawkins. I work in Denver, Colorado, for Amoco Production Company.

Q. Have your qualifications as an expert reservoir engineer in regulatory affairs been accepted before this Commission before?

A. Yes, they have.

MR. NITCHER: I would tender Mr. Hawkins as an expert reservoir engineer in regulatory affairs.

CHAIRMAN LEMAY: His qualifications are acceptable.

Q. Mr. Hawkins, have you previously participated in the NMOCD's hearings with regard to allowables, underage and overproduction and market demand?

A. Yes, I have.

Q. Are you familiar with the NMOCD Order R-8170-F, dated July 9, 1990?

1 A. Yes, I am.

2 Q. Have you prepared any comments or an
3 exhibit in support of your testimony today?

4 A. Yes, I have.

5 Q. In order to expedite this, would you
6 explain your one exhibit to the Commission?

7 MR. NITCHER: Did the Commission get a
8 copy of this?

9 CHAIRMAN LEMAY: I don't think so.

10 A. This exhibit shows Amoco's
11 recommendation with regard to Rule 11(b) that
12 allows 12-times overproduction. My
13 recommendation is that you extend that rule for a
14 period of at least one year.

15 We've listed several concerns we have
16 that prompted us to give this recommendation to
17 the Commission. First, as has been stated
18 before, the new pipeline capacities are expected
19 to have a significant impact on production and
20 allowables. It's going to take some time for us
21 to fully understand that, and I think the time
22 frame that Meridian put forth of six months to a
23 year is probably right on target.

24 Secondly, there are still revisions to
25 the proration system that were revised about a

1 year ago that are still not fully implemented.
2 That has to do with some internal understanding
3 of underage and overproduction and how wells
4 reclassify from marginal to nonmarginal and start
5 to participate again in the allowables. And I
6 think that needs to occur before we make any
7 other changes in overproduction limit.

8 So I think just to sum it up, we
9 certainly want to have time to work out the bugs
10 of the current proration system and the changes
11 in the new pipeline capacities, before we do any
12 other changes from a proration side.

13 Q. Do you have any more comments to
14 presents today?

15 A. That's it.

16 MR. KELLAHIN: We tender the witness
17 for cross-examination.

18 CHAIRMAN LEMAY: Questions of the
19 witness?

20 MR. STOVALL: The Division would just
21 state it takes no exception to Mr. Hawkins'
22 concerns two and three, and fully understands
23 those.

24 CHAIRMAN LEMAY: Commissioner Carlson?

25 COMMISSIONER CARLSON: No questions.

1 CHAIRMAN LEMAY: I have none. Thank
2 you very much, Mr. Hawkins, you may be excused.

3 Anything else?

4 MR. NITCHER: I guess I would move that
5 the exhibit be admitted.

6 CHAIRMAN LEMAY: Without objection,
7 Exhibit No. 1 will be admitted into the record.

8 Anything else from Amoco? That's it?
9 Thank you.

10 Mr. Pearce?

11 MR. CARR: May it please the
12 Commission--

13 CHAIRMAN LEMAY: I'm sorry, Bill,
14 you've got a few more there. I'm sorry.

15 MR. CARR: We have a statement, and we
16 don't care whether Mr. Pearce goes first or not.

17 CHAIRMAN LEMAY: No, I've got you for
18 Unocal, and why don't you finish that up. It's
19 my mistake.

20 MR. CARR: Craig Van Horne with Unocal
21 will make a statement.

22 CHAIRMAN LEMAY: Thank you.

23 MR. VAN HORNE: Mr. Chairman, my name
24 is Craig Van Horne. I'm with Unocal in
25 Farmington.

1 A couple of things we wanted to bring
2 up that have already been brought up, the
3 flexibility that the 12-times offers us. One
4 thing that we did do was do an evaluation to
5 determine what the effect of going to 6-times
6 would do to us.

7 The results of the evaluation, first
8 result is, you can't adequately evaluate it until
9 you know what your allocations are going to be
10 for the next four proration periods--that's the
11 next two years.

12 Using the administrative adjustments
13 that Unocal proposed at the allocation hearing a
14 week ago, for the April through September of 1992
15 period, and then utilizing the same allowables
16 for this coming up winter, the proration period
17 that we're in right now, we estimate our
18 production of our nonmarginal capability will
19 lose seven percent just due to the gas allocation
20 system, and then another three percent if we go
21 to 6-times overproduced. And that's using the
22 allowables that we've estimated and that we've
23 proposed. Those allowables are less than the
24 loss due to the 6-times over, which goes up
25 considerably. Thank you.

1 CHAIRMAN LEMAY: Anything else, Mr.
2 Carr?

3 MR. CARR: That's all.

4 CHAIRMAN LEMAY: Thank you very much.
5 Mr. Pearce?

6 MR. PEARCE: Thank you, Mr. Chairman.
7 I have a brief statement which I have been asked
8 to make on behalf of Phillips Petroleum Company.

9 Phillips Petroleum Company supports
10 maintaining the current practice of providing for
11 a 12-times overproduction limit. The gas market
12 supplied by the prorated gas pools in
13 Northwestern New Mexico is in a period of
14 transition. In order to manage gas supply and to
15 follow the various chosen production and
16 marketing strategies, various producers in these
17 pools need the flexibility afforded by the
18 12-times overproduction limit.

19 In light of other considerable
20 instability in the dramatically changing gas
21 market, Phillips Petroleum asks that the Division
22 continue to allow the operational leniency
23 provided by Rule 11(b), as amended.

24 There is no evidence, to the best of
25 our knowledge, that the 12-times overproduction

1 limit has resulted in waste nor impaired the
2 correlative rights of any operator during the
3 period in which it's been in effect.

4 While the 12-times overproduction limit
5 has been in effect, a number of operators in the
6 Northwest New Mexico gas pools have used the
7 increased overproduction limit to better meet
8 seasonal gas market demand.

9 Although Phillips does not normally
10 follow this type of production strategy, we
11 recognize that it is one of several viable
12 business strategies that an operator may elect to
13 pursue, and we contend that such election is a
14 business decision that should be arrived at by
15 each individual operator, not imposed by strict
16 prorationing limitations.

17 Phillips currently has 15 wells in an
18 overproduced state such that they would need to
19 be shut in immediately, should the overproduction
20 limit be returned to 6-times overproduced.
21 Overproduction is exacerbated by the overall low
22 monthly pool production in the prorated gas pools
23 in the Northwest, brought on by generally low gas
24 prices in the marketplace at the current time,
25 seasonal production strategies being practiced by

1 some operators, and the build-up of pool
2 underproduction that tends to reduce the new
3 allowable assigned each proration period.

4 In summary, we recommend that the
5 practice promulgated by the Oil Conservation
6 Division of allowing a 12-times overproduction
7 limit in the amendments to Rule 11(b), be made in
8 Orders R-8170-A, D and F, be continued and made
9 permanent.

10 This statement which I will present,
11 was signed by Mr. Robert G. Flesher, Farmington
12 Area Manager for Phillips Petroleum Company.
13 Thank you, sir.

14 CHAIRMAN LEMAY: Thank you, Mr.
15 Pearce.

16 Any additional statements in Case No.
17 9018? If not, we shall take the case under
18 advisement.

19 Thank you very much. Sorry for the
20 late hour. You all went through that one nice
21 and fast.

22 (And the proceedings concluded at 6:20
23 p.m.)

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STATE OF NEW MEXICO

OIL CONSERVATION COMMISSION

IN THE MATTER OF:)	
CASE NO. 9018 BEING REOPENED)	
PURSUANT TO THE PROVISIONS OF)	CASE NO. 9018
COMMISSION ORDER NO. R-8170-C)	(Reopened)
_____)		

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: WILLIAM J. LeMAY, Chairman
WILLIAM WEISS, Commissioner

November 8, 1990
9:25 a.m.
Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission on November 8, 1990, at 9:25 a.m. at Morgan Hall, State Land Office Building, 310 Old Santa Fe Trail, Santa Fe, New Mexico, before Maureen R. Hunnicutt, RPR, Certified Shorthand Reporter No. 166 and Notary Public, in and for the County of Santa Fe, State of New Mexico.

FOR: OIL CONSERVATION	BY: MAUREEN R. HUNNICUTT, RPR
DIVISION	Certified Shorthand Reporter
	CSR No. 166

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I N D E X

November 8, 1990
Commissioner Hearing
CASE NO. 9018

PAGE

APPEARANCES

3

OPENING STATEMENT
By Mr. Stovall

4

DIVISION WITNESS:

ROBERT G. STOVALL
Sworn Testimony

9

REPORTER'S CERTIFICATE

12

* * *

No exhibits were marked during the course of this hearing.

A P P E A R A N C E S

1
2
3 FOR THE DIVISION: ROBERT G. STOVALL, ESQ.
4 General Counsel
5 Oil Conservation Commission
6 State Land Office Building
7 310 Old Santa Fe Trail
8 Santa Fe, New Mexico 87504

6
7 FOR EL PASO NATURAL GAS COMPANY: MONTGOMERY & ANDREWS, P.A.
8 Attorneys at Law
9 BY: W. PERRY PEARCE, ESQ.
10 325 Paseo de Peralta
11 Santa Fe, New Mexico 87501

10 ALSO PRESENT: FLORENCE DAVIDSON
11 Staff Specialist
12 Oil Conservation Division

12 FOR BYRAM COMPANY: MAURICE E. TRIMMER
13 112 Valley Drive
14 Santa Fe, New Mexico

15 * * *

1 CHAIRMAN LeMAY: The Commission calls Case 9018. In
2 the matter of Case No. 9018 being reopened pursuant to the
3 provisions of Commission Order R-8170-C, which order,
4 among other things, promulgated Rule 11(h) of the General
5 Rules for Prorated Gas Pools in New Mexico.

6 Appearances in Case No. 9018.

7 MR. STOVALL: Robert G. Stovall, Santa Fe, on behalf
8 of the division.

9 MR. PEARCE: W. Perry Pearce, the Santa Fe office of
10 Montgomery & Andrews, on behalf of the El Paso Natural Gas
11 Company. I do not have a witness, Mr. Commissioner.

12 CHAIRMAN LeMAY: Thank you, Mr. Pearce.

13 MR. STOVALL: Nor do I.

14 CHAIRMAN LeMAY: Let me ask what evidence or what
15 actions are going to be entertained under Case No. 9018.

16 MR. STOVALL: Okay. Rule 11(h) of the prorated gas
17 pools, to the best of my understanding of the history of
18 the case, was adopted back in the early to mid-'80s when
19 the gas bubble was around and markets for gas were
20 somewhat restricted.

21 And it was the intent of the rule that
22 operators, producers, who were unable to get their gas to
23 market, particularly gas from prorated pools, and,
24 therefore, accumulated underproduction, you might say,
25 unable to get to market, didn't have access, weren't able

1 to sell the gas -- and I'm not sure whether there was a
2 price consideration in there or not at the time -- but
3 those operators who were underproduced, this rule was
4 adopted to allow them to come back later, when the
5 anticipated market improvements occurred, to request that
6 the underproduction, which had been canceled pursuant to
7 the general rules, could be reinstated under the
8 conditions under the rule, as stated in the rule.

9 At the time the commission adopted that rule,
10 they did so with a time limit, anticipating, I believe it
11 was, five years that the market would be improved and that
12 the reasons for the rule would be eliminated.

13 To the best of my knowledge, I only have a
14 comment by one producer who had ever requested
15 reinstatement of allowable under this rule, and I believe
16 the commission denied it. I believe the denial was also
17 based on the fact that the producer had made the decision
18 not to produce rather than being eliminated from the
19 market.

20 At this time I think we don't really have any
21 substantive evidence as to whether or not the rule has
22 truly been beneficial or whether it should be continued.

23 Recommendation of the division, based simply on
24 the fact that changing it without any substantive evidence
25 might be a mistake, would be to make Rule 11(h) permanent.

1 It does not appear to have impaired anybody's
2 rights. It does not appear to have caused any problems
3 with the proration system. It also doesn't appear to have
4 benefited it. So I think the commission could go either
5 way; but as I say, the division is recommending, mostly as
6 a matter of administrative convenience, that it be made a
7 permanent part of the rules until such time as the
8 commission revisits this or any other portion of the
9 prorated rules.

10 And I would also ask that the commission take
11 note of the case heard, I believe, in October -- September
12 with respect to the proration rules and amendments to the
13 proration rules. This rule is contained in the rules that
14 were reviewed by the commission at that time; and I think
15 we can, by perhaps incorporating this record in some way,
16 put out one order which readopts the entire General Rules
17 for Prorated Gas Pools.

18 One of the things that I discovered subsequent
19 to that hearing was that the General Rules for Prorated
20 Gas Pools are contained in about three different orders,
21 and I would anticipate and hope that the commission would
22 put out a Revised Order 8170, which would contain a
23 compilation of all the amendments to the General Rules for
24 Prorated Gas Pools, and in that compilation could include
25 11(h) or delete it, as the commission directs, in an order

1 coming out of this case. It sounds convoluted, but it's
2 actually simpler than that when you get right down to it.

3 CHAIRMAN LeMAY: Thank you, Mr. Stovall.

4 Mr. Pearce, do you have any comments concerning
5 this?

6 MR. PEARCE: Just one quick question, Bob. Did you
7 say the five-year period is up? Is that why we're doing
8 this?

9 MR. STOVALL: That's why, yes.

10 CHAIRMAN LeMAY: So the division recommends that Rule
11 11(h) be made a permanent part of the gas proration rules
12 until such time as those rules are reconsidered, and then
13 this rule will be revisited along with all the rules that
14 pertain to proration; is that correct?

15 MR. STOVALL: Well, I think -- We recommended it be
16 made a permanent part of the rules; and as with any rules,
17 it's always subject to revision and modification by the
18 commission as it sees fit; but it's just rather than
19 complicate the process by putting a time limit, separate
20 and distinct from any other rules, just make it a part of
21 the rules.

22 CHAIRMAN LeMAY: Yes, I think I understand that.

23 Mr. Pearce, do you have any comments concerning
24 that procedure or that recommendation?

25 MR. PEARCE: I don't, Mr. Chairman. I have some

1 concern about no witness, and I think the division might
2 want to bring this up at an allowable hearing some time.
3 This makes me a little twitchy, I would say. I'm not
4 opposed to it. I don't necessarily think it's a bad idea,
5 and my client didn't send me over here to oppose it.

6 CHAIRMAN LeMAY: Why don't we continue the case until
7 January's allowable hearing? At that time we can
8 officially make it -- with a witness make it a part of the
9 rules. I think the concern that Mr. Pearce is raising is
10 that we're not following proper procedure here
11 incorporating this rule into the proration rules.

12 Do you have a comment on that, Mr. Stovall?

13 MR. STOVALL: My only comment is I don't know who
14 we'd use for a witness and what they'd say, because it's
15 been sitting there. If Mr. Pearce has any input, I'd love
16 to have --

17 MR. PEARCE: Take me off the record.

18 CHAIRMAN LeMAY: Let's go off the record just a
19 minute.

20 (Discussion off the record.)

21 CHAIRMAN LeMAY: We're back on the record now, and,
22 Mr. Stovall, we discussed when we were off the record what
23 the proper procedure would be to incorporate this rule
24 into the general rules; and it would be to swear
25 Mr. Stovall in as a witness, which we will do right now.

1 ROBERT G. STOVALL,
2 the Witness herein, having been first duly sworn by the
3 Chairman LeMay, testified as follows:

4 TESTIMONY

5 BY MR. STOVALL:

6 For the record I will state under oath that my
7 name is Robert G. Stovall. I am the general counsel for
8 the Oil Conservation Division. I am, in that capacity,
9 responsible for interpretation and, I guess, maintenance
10 of the rules and regulations of the division.

11 I am familiar with the rules. I am familiar
12 with the lack of history that this rule has, but I know
13 what it -- I have a belief as to what its intent was, the
14 reason for it. I previously made a statement to that
15 effect in an unsworn, lawyer's statement. I will now come
16 back and tell the commission under oath that what I said
17 to the commission in the unsworn statement was true and
18 accurate, to the best of my knowledge.

19 It is my opinion as an attorney that the most
20 efficient way to deal with this rule is to either
21 incorporate -- make it a permanent part of the General
22 Rules for Prorated Gas Pools or to allow it to expire. It
23 is my opinion, speaking as the legal counsel for the
24 division, that the rule as it is written, as it exists
25 now, has not been used in any substantive way, but that it

1 perhaps has some potential in the future to be used by
2 producers who have been prevented from selling their gas
3 by limited access to the market in the past. They may be
4 able to come back and restore the production under this
5 rule which they could not do in the absence of this rule.

6 If this rule is allowed to expire, I can see no
7 particular benefit to the general prorated gas pools.
8 With the lack of history, there could be a harm that could
9 occur. The rule, as it is written, does not cause any
10 impairment. It does not affect the manner in which
11 allowables are established. It does not affect anything
12 which would have to do with correlative rights in the
13 absence of its use, but it does offer an opportunity to
14 protect correlative rights and possibly prevent waste by
15 leaving it as part of the general rules; and therefore, I
16 would recommend that it be continued in the general rules
17 as a permanent part of the rules without any time
18 limitation or any other factor of that nature.

19 CHAIRMAN LeMAY: Thank you, Mr. Stovall. Your
20 qualifications as an expert witness are acceptable to the
21 commission.

22 Are there any questions of Mr. Stovall?

23 MR. PEARCE: Nothing, Mr. Chairman. Thank you.

24 CHAIRMAN LeMAY: If not, he may be excused.

25 Additional statements in Case No. 9018 or

1 witnesses?

2 MR. PEARCE: Nothing.

3 CHAIRMAN LeMAY: The Case No. 9018 shall be taken
4 under advisement. We stand adjourned.

5 (The foregoing proceeding was adjourned at the
6 approximate hour of 9:35 a.m.)

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1 STATE OF NEW MEXICO)
) SS.
2 COUNTY OF SANTA FE)

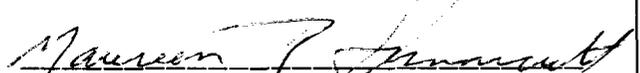
3 REPORTER'S CERTIFICATE

4
5 BE IT KNOWN that the foregoing reporter's transcript
6 of proceedings before the Oil Conservation Division was
7 taken by me; that I was then and there a Certified
8 Shorthand Reporter and Notary Public in and for the County
9 of Santa Fe, State of New Mexico; that the witnesses
10 before testifying were duly sworn to testify to the whole
11 truth and nothing but the truth; that all statements and
12 questions propounded by counsel and the Commission and the
13 answers of the witnesses thereto were taken down by me,
14 and that the foregoing 11 pages of typewritten matter
15 contain a true and accurate transcript of the proceedings
16 and testimony had and adduced upon the taking of said
17 proceedings, all to the best of my skill and ability.

18 I FURTHER CERTIFY that I am not related to nor
19 employed by any of the parties hereto, and have no
20 interest in the outcome hereof.

21 DATED at Santa Fe, New Mexico, this 29th day of
22 November, 1990.

23
24 My Commission Expires:
25 April 25, 1993


MAUREEN R. HUNNICUTT, RPR
Certified Shorthand Reporter
CSR No. 166, Notary Public

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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION
CASE 9018

COMMISSION HEARING

IN THE MATTER OF:

Case 9018 Being Reopened Pursuant to the
Provisions of Division Order No. R-8170-D, which
Order amended Rule 111 (b) of Order R-8170-A, in
Order to Take Evidence (regarding the
overproduction limits for prorated pools in
northwest New Mexico)

ORIGINAL

TRANSCRIPT OF PROCEEDINGS

BEFORE: WILLIAM J. LEMAY, CHAIRMAN
WILLIAM WEISS, COMMISSIONER
WILLIAM HUMPHRIES, COMMISSIONER

STATE LAND OFFICE BUILDING

SANTA FE, NEW MEXICO

May 24, 1990

A P P E A R A N C E S

1
2
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23 * * *
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25

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1 WHEREUPON, the following proceedings were had
2 at 10:10 a.m.:

3 CHAIRMAN LEMAY: Okay, we shall now call Case
4 Number 9018.

5 MR. STOVALL: In the matter of Case 9018
6 being reopened pursuant to the provisions of Division
7 Order Number R-8170-D, which Order amended Rule 111 (b)
8 of Order R-8170-A, in order to take evidence regarding
9 the overproduction limits for prorated pools in
10 northwest New Mexico.

11 And I will not read the entire paragraph,
12 with the approval of the Chairman. I believe it is
13 specified in the docket.

14 CHAIRMAN LEMAY: Fine. We'll call for
15 appearances in Case 9018. Mr. Kellahin?

16 MR. KELLAHIN: Mr. Chairman, I'm Tom Kellahin
17 of the Santa Fe law firm of Kellahin, Kellahin and
18 Aubrey, appearing today on behalf of Meridian Oil, Inc.

19 CHAIRMAN LEMAY: Thank you. Mr. Carr?

20 MR. CARR: May it please the Commission, my
21 name is William F. Carr with the law firm Campbell and
22 Black, P.A., of Santa Fe.

23 We represent Union Company of California, and
24 I have one witness.

25 CHAIRMAN LEMAY: Thank you.

1 MR. KIRKLAND: My name is Dave Kirkland with
2 the Gas Company of New Mexico. I'd like to make a
3 statement today.

4 CHAIRMAN LEMAY: No witnesses, just a
5 statement, Mr. Kirkland?

6 MR. KIRKLAND: That's right.

7 CHAIRMAN LEMAY: Thank you.

8 MR. EMMONS: Larry Emmons with Amoco from
9 Denver, Colorado. I would like to make a statement
10 also on behalf of Amoco.

11 CHAIRMAN LEMAY: Thank you.

12 Any other witnesses or statements?

13 MR. STOVALL: Mr. Chairman, I'm going to
14 enter my appearance on behalf of the Division, Robert
15 G. Stovall of Santa Fe, and I may have a witness
16 although we're not presenting an advocacy position in
17 this case at this time.

18 CHAIRMAN LEMAY: Okay. Will those people
19 that want to -- that will be giving testimony stand and
20 raise your right hand and be sworn in?

21 (Thereupon, the witnesses were sworn.)

22 CHAIRMAN LEMAY: Mr. Kellahin, we'll start, I
23 think, probably with you.

24 MR. KELLAHIN: Thank you, Mr. Chairman. At
25 this time I'd like to call Mr. Louis Jones. Mr. Jones

1 is a petroleum engineer with Meridian Oil, Inc. He's
2 testified before this Commission before on prior
3 occasions dealing with proration matters in the San
4 Juan Basin, New Mexico.

5 CHAIRMAN LEMAY: You've been sworn in, Mr.
6 Jones. Nice to have you here in Santa Fe again.

7 MR. JONES: Thank you.

8 MR. KELLAHIN: Mr. Chairman, I have not yet
9 marked Mr. Jones' displays. If you'll permit me to do
10 so after the hearing, we will simply mark them in the
11 order that they're stapled together with the first page
12 being marked as Meridian Exhibit Number 1, and then in
13 sequence.

14 LOUIS D. JONES,
15 the witness herein, after having been first duly sworn
16 upon his oath, was examined and testified as follows:

17 EXAMINATION

18 BY MR. KELLAHIN:

19 Q. Let me begin, Mr. Jones, by asking you, sir,
20 for the record, to please state your name and
21 occupation.

22 A. Louis D. Jones. I'm regional production
23 manager with Meridian Oil Company out of Farmington,
24 New Mexico.

25 Q. Would you summarize for us with regards to

1 the prorationing matters before the Commission this
2 morning in the case as advertised what has been your
3 past involvement in the San Juan Basin of New Mexico
4 with prorated gas pools?

5 A. I was involved in the testimony in late 1986
6 concerning the increase from the six-times overproduced
7 to the twelve-times overproduced limit for the
8 northwest portion of the state. And I've also been
9 involved on the subcommittee to review the current
10 Rules as it concerns the proration in the State of New
11 Mexico.

12 Q. Based upon your past participation and your
13 continuing study of this question, do you now have
14 opinions and recommendations to the Commission with
15 regards to the topics that are advertised for hearing
16 in this case?

17 A. Yes, I do. And as you'll see throughout my
18 testimony, I'm -- Meridian is advocating that the state
19 continue with the twelve-times overproduced limit for
20 the northwest portion of the state.

21 MR. KELLAHIN: Mr. Chairman, at this time we
22 tender Mr. Jones as an expert petroleum engineer with
23 particular expertise in prorationing matters in the San
24 Juan Basin prorated gas pools.

25 CHAIRMAN LEMAY: His qualifications are

1 acceptable.

2 Q. (By Mr. Kellahin) Mr. Jones, would you give
3 us some background, sir, as to approximately when the
4 Commission adopted the twelve-times over allowable
5 limitations for the two prorated gas pools in the San
6 Juan Basin?

7 A. Actually, it was all the prorated gas pools
8 in the San Juan Basin. That rule, temporary rule, was
9 adopted in late 1986.

10 And a little bit of history behind that is,
11 we had major changes in the gas market in 1985 and 1986
12 with the advent of the spot market. At that time, some
13 producers elected to participate in the spot market
14 while several others elected to hold their gas off the
15 market for various reasons, some of that being lower
16 prices.

17 Unfortunately, what this did under the
18 existing system was, it drove the allocations or
19 allowables down for the entire pool, and so the people,
20 producers that wanted to participate in the market,
21 they became quickly overproduced.

22 And by late 1986 there was a considerable
23 amount of gas that was over six-times overproduced, and
24 therefore shut in. And it was requested that the OP,
25 overproduced limit, be extended from the six-times to

1 the twelve-times to allow for that gas to flow and to
2 allow flexibility until the system could react more to
3 the spot market, which was a dramatic change from the
4 previous system, how it was handling all the production
5 from the pools.

6 Q. After the Commission adopted the process by
7 which the prorated pools in the San Juan Basin were
8 allowed to have its wells produced up to twelve times
9 their site allowable, to be twelve-times overproduced,
10 what in fact occurred in the Basin?

11 A. Well, it allowed additional flexibility and
12 allowed for the producers that didn't want to
13 participate to continue to participate in the market
14 and hopefully retain some of New Mexico's market share.

15 Q. In your opinion, did the implementation of
16 that change in the Rule work to the benefit of the
17 industry and to the oil and gas interest owners?

18 A. It certainly helped. There's no question
19 about that.

20 We feel like it increased the natural gas
21 production from the State of New Mexico.

22 Q. Do you see a continuing need, in your
23 opinion, for maintaining the twelve-times-over
24 procedures for the prorated gas pools in the San Juan
25 Basin?

1 A. I certainly do, and what I've tried to show
2 through a few of the graphs that we we've handed out is
3 that the market is still very unstable, that we still
4 need that flexibility for the northwest portion of the
5 state, and still feel adamantly that correlative rights
6 can still be protected, even with the twelve-times
7 overproduced limit.

8 Q. Let me have you turn, sir, to your displays,
9 and if you'll commence with the first display, identify
10 and then describe that display to us.

11 A. What I've done here is plot the United States
12 gas demand -- and that would be gas usage -- in BCF --
13 that's billion cubic feet of gas -- per year from the
14 years 1983 through 1989. And 1989 is still somewhat of
15 an estimate. I think I probably put it on the low side
16 if anything there.

17 Q. What --

18 A. These numbers --

19 Q. What's the reason to do this? What are you
20 trying to do?

21 A. Well, I want to show that the overall demand
22 for natural gas throughout the US is on the increase
23 from, let's say, pre- spot market days of normal
24 operations that I would consider from, let's say, 1983
25 through 1985.

1 And that's what I'm going to try and do, is
2 compare the 1983 through 1985 period with the 1988
3 through 1990 period now.

4 Q. When we look at the entry on the first
5 display for the year 1986, at the end of that year,
6 then, is when the Commission made its decision, based
7 upon a hearing, to allow these twelve-times over rules
8 to be implemented?

9 A. That's correct.

10 Q. Describe for us, then, what if any changes
11 there have been in the market demand for US gas
12 produced before and after the date of implementation of
13 that rule.

14 A. Well, there's no question, you can see here
15 the overall US demand is up, and most everyone is aware
16 of that. Now, whether or not that was caused by the
17 twelve-times overproduced limit, that would be real
18 questionable, but the --

19 Q. The point, sir, is that the market demand --
20 that there was a market demand that existed by the end
21 of 1986 and that since that time there is not a
22 significant difference in the market demand where
23 market demand now is less than it was before?

24 A. No, it's obviously greater than it was
25 before.

1 Q. One of the components for justifying the
2 twelve-times over was the status of the gas market?

3 A. That's correct.

4 Q. And we still have a comparable gas-market
5 situation, in fact slightly increased?

6 A. Yes, sir, when you look at it on the global
7 sense, US gas market.

8 Q. All right. What's the next display?

9 A. Okay, what I've shown here is the California
10 gas demand, and that's really gas usage. And I'm
11 showing there that we've had a dramatic increase in the
12 California gas usage from the 1983 through 1985 period,
13 all the way up through 1989.

14 Q. Explain how this is relevant to gas
15 production out of the San Juan Basin.

16 A. Well, the majority of the New Mexico gas is
17 delivered to the California market.

18 Q. Does this represent all of California's gas
19 demand?

20 A. This is all of the California usage. Now,
21 realizing that all of New Mexico's gas doesn't go to
22 California. Some of it is used within the state and
23 the east-of-California market.

24 But again, the major market of the gas in New
25 Mexico is California at this time.

1 Q. What does this information tell you?

2 A. It shows that the demand for the major market
3 for New Mexico gas is up from the 1983 through 1986
4 period.

5 Q. When we go to the next display, what is that
6 and what does it show?

7 A. Just showing the New Mexico gas production.
8 And one point to note is what occurred between 1985 and
9 1986. There was a substantial drop. And I'm happy to
10 say, too, that we see from 1988 to 1989, we've seen an
11 increase in gas production.

12 Q. What is the source of this information?

13 A. This is from the MOGI's numbers. In fact, we
14 have an update for 1989, being -- I believe it was 860
15 BCF for the year, so those are --

16 Q. That's the State of New Mexico, as opposed to
17 simply the San Juan Basin?

18 A. That's right. This is the entire State of
19 New Mexico.

20 Q. What conclusion do you reach from examining
21 this information insofar as it's relevant to this case?

22 A. Well, I wanted to show here that the New
23 Mexico production is on the uptake again and that it is
24 beginning to meet the demand of, you see, the US market
25 and the California market.

1 Q. Turn to the next display, and identify and
2 describe that display.

3 A. All I've done on this one is plot the percent
4 -- It says percent of California demand.

5 What it is, is the New Mexico total state
6 production as a percent of the total usage in
7 California, and you can see at one time close to 60
8 percent -- if all of New Mexico gas went to
9 California -- could meet almost 60 percent of their
10 total demand.

11 And it's dropped significantly over the last
12 several years, but I'm glad to say we've had the uptip
13 again in 1989.

14 Q. Again, how does this help you understand and
15 reach a conclusion about the continuing necessity of
16 the twelve-times-over rule?

17 A. Well, I think it shows here that we still
18 need the flexibility, that the demand is there, and we
19 shouldn't be trying to over-restrict the prorated pools
20 in the state, and certainly allow them the flexibility
21 to meet the current demands there.

22 Q. Turn to the next display and identify and
23 describe that.

24 A. This is a percent of the United States demand
25 or usage. And again, the -- Just taking the entire

1 State of New Mexico's production and divided by the
2 United States total demand.

3 And again, you can see where it's dropped,
4 all the way through 1988, with an uptake back again in
5 1989. So again, beginning to regain some of that
6 market share, which I'm happy to report.

7 Q. If you would turn now to the next page, which
8 will be numbered Exhibit Number 6 --

9 A. Yes.

10 Q. -- could you identify and describe that
11 exhibit?

12 A. These are the allocations for the two major
13 pools in the San Juan Basin, northwest portion of the
14 state, the Mesa Verde and Dakota, from 1983 through the
15 year 1990. And the 1990 number is projected.

16 As you can see, before the advent of the spot
17 market, from 1983 through 1985, our average allocation
18 was 313 BCF per year.

19 With the advent of the spot market in 1986,
20 allocations dropped dramatically. I've discussed that
21 a little bit earlier, why that happened. Producers
22 became severely overproduced. Twelve times was
23 enacted.

24 In 1987 there were some administrative
25 adjustments made, probably over-reacted to it. But

1 then, back from 1988 through 1990 -- And I will use
2 that period to compare with 1983 through 1985 -- if you
3 look at that period between 1988 and 1990, that
4 averages 262 BCF per year, or a 16-percent reduction
5 from the 1983-through-1985 period.

6 And the reason I use those two periods is
7 because we've shown demand, not only in the United
8 States, but also in the California, the major market,
9 is up. Yet the allocations for the major pools in the
10 northwest portion of the state are still down.

11 I will note in 1990 there's been some
12 changes, working with Vic Lyons. You can see the
13 allocations are up to a level, I think, or certainly
14 getting to the point where they're acceptable. I think
15 the subcommittee has worked. Vic Lyons has done a
16 tremendous job to increase those allocations and make
17 them again manageable.

18 However, I want to point out that the system
19 still has some instability, and we need the flexibility
20 of the twelve-times overproduced limit.

21 Q. Turn to Exhibit Number 7, which is the next
22 page, and identify that for us.

23 A. All this is, is the raw numbers that were
24 plotted, in case somebody wants those, for each one of
25 the previous plots that you've seen.

1 Q. Let's specifically direct your attention now,
2 Mr. Jones, to how Meridian Oil, Inc., has managed its
3 operations under the twelve-times-over rule.

4 And to aid you in that presentation, if you
5 will direct your attention now to the next page, which
6 is Exhibit Number 8, first of all, identify it for us
7 so that we understand how to read the display, and then
8 tell us the conclusions you've reached.

9 A. Well, this plots the volume that would be
10 generated from the wells that would be over twelve-
11 times-overproduced that Meridian Oil, Incorporated,
12 operates in the San Juan Basin.

13 You'll see the MOI -- That stands for
14 Meridian Oil, Incorporated -- All Formations, northwest
15 portion of the state.

16 On the Y-axis or left-hand side, you'll see
17 the available volume in MCF per day. Down on the
18 X-axis, you'll see the 1989 and 1990 by month. Also
19 hidden in the bars are the number of wells that would
20 be shut in twelve-times overproduced.

21 Q. Explain, then, how this specifically relates
22 to those wells and the volumes in excess of the volumes
23 that would be generated if you produced gas up to the
24 six-times rule.

25 A. Well, what we're showing on this plot is that

1 Meridian Oil, Incorporated, is continuing to manage its
2 overproduction and to bring it back in line from the
3 twelve-times overproduced, shut the wells in and
4 manage.

5 And you'll notice that even that dropped over
6 the winter period where we had a moratorium. We're
7 very proud of that.

8 Now, the drop is due to additional management
9 and also due to higher allocations that have been seen
10 over the wintertime. So it's not all management, but I
11 will say that there is quite a bit in there.

12 The point we're trying to make here is that
13 there was a major concern that from the -- When the
14 Commission allowed the producers to go from six-times
15 to twelve-times overproduced, that everyone would just
16 produce up to that limit and abuse it. And I want to
17 show here that that's not the case; we're managing it.

18 Now, what's going to be shown on the next
19 plot is that obviously some of the volumes that came in
20 under the twelve times now have to be in the six-to-
21 twelve-times range. Quite a few of the -- Quite a bit
22 of the volume.

23 Q. So that the reading of the display is clear,
24 look at the Y-axis for me. Start with January, 1989,
25 the first entry. It says 194. The 194 is what, sir?

1 A. 194 wells would make up that total that would
2 be twelve-times or greater overproduced, and of those
3 194 wells, they would have a producing capability of
4 60,000 MCF per day.

5 Q. All right. That is the total producing
6 capability of those 194 wells?

7 A. That is correct.

8 Q. Now, how can we identify and demonstrate the
9 incremental gas that is managed between the six-times
10 and the twelve-times? Can we see that on this display
11 or do we --

12 A. No --

13 Q. -- have to go to the other display?

14 A. -- we have to go to the next display.

15 Q. Let's do that.

16 Exhibit Number 9, then, is what, Mr. Jones?

17 A. What we've shown here is the total volume
18 from all operators, not just Meridian, that would fall
19 in the six- to twelve-times overproduced range for the
20 northwest portion of the state, from all formations.

21 Now, this varies a little bit from the
22 previous plot because, first of all, it's all
23 operators.

24 Second of all, it's just the total
25 deliverability. I didn't have all of the producing

1 capabilities of everyone else's wells. I did for
2 Meridian, but not for everyone else. So we just
3 totaled deliverabilities, which would more than likely
4 overstate the true capacity.

5 But what I'm going to show here is, there
6 still is a significant volume between -- You see on the
7 X-axis 5 of 89, which would be May of 1989 proration
8 book.

9 Q. So the entry at the bottom of the first
10 column says 8905, that is --

11 A. That is May --

12 Q. -- the May, 1989, proration schedule?

13 A. That's the May of 1989 proration schedule.

14 And all we did was to total up all formations and all
15 operators, the total D that would fall between the six-
16 to twelve-times overproduced limit.

17 And we did the same thing for May of 1990,
18 and that's your bar to the right.

19 The point being here is that you can see
20 almost 220 million a day of deliverability. All
21 operators and all formations would fall in the six- to
22 twelve-times overproduced range and would be a risk of
23 shut-in if the Commission fell back to the six-times
24 overproduced limit.

25 Q. If the operators were not utilizing that

1 volume of gas being generated above the six-times over
2 number, what would you see in the data?

3 A. These wells would be -- This would be
4 additive, on top of the twelve-times that would from
5 all operators and all formations.

6 All of this gas here would automatically be
7 shut in , if we went from twelve-times to six-times
8 overproduced.

9 Q. Have you satisfied yourself, then, that the
10 wells in the prorated pools in fact have the capacity
11 to produce the gas in excess of the six-times
12 limitation?

13 A. Yes.

14 Q. If the operators were not utilizing the
15 flexibility afforded them by the twelve-times over,
16 what kind of data would you see? What would you
17 observe?

18 A. I think you would observe that, first of all,
19 the total New Mexico gas production would be lower
20 because the six- to twelve-times volumes would be shut
21 in.

22 And at the same time, with gas production
23 being lower out of those prorated pools, you would more
24 than likely see lower allocations, and then you would
25 have that spiralling effect.

1 So again, I think it's afforded to increase
2 New Mexico State's production and also increase the
3 allocations for the pools and allow the operator the
4 flexibility to produce that gas during some of the
5 higher-demand months and higher-priced months.

6 Q. Have you seen any evidence that the operation
7 of the proration system using the twelve-times over has
8 caused the violation or the impairment of correlative
9 rights of anyone with interest in this -- in these
10 prorated gas pools?

11 A. Not to my knowledge. When you look at the
12 major pools in the northwest portion of the state, they
13 are very large, they are tight gas sands, reserve lives
14 in many cases in excess of a century.

15 I don't feel like it's a problem in the
16 northwest portion of the state, and that was discussed
17 in detail in late 1986 and a major concern in late
18 1986. And I still feel like it -- because of the very
19 large reservoirs, tight gas sands and long-life
20 reserves, it still should not be an issue.

21 MR. KELLAHIN: That concludes my examination
22 of Mr. Jones, Mr. Chairman. We would move the
23 introduction of his Exhibits 1 through 9.

24 CHAIRMAN LEMAY: Without objection, Exhibits
25 1 through 9 will be admitted into the record.

1 be yes, we could operate under that scenario, but only
2 if it was a step-down phased in, and that we had
3 reasonable allocations.

4 Because obviously what's going to happen is,
5 even if you go through that phase-in period, a lot of
6 that gas is going to be shut in to help manage and pull
7 it off -- to bring her down to the six-times
8 overproduced limit.

9 I feel like we should eventually do that.
10 The point I'm trying to make now is that the market is
11 still so unstable, and people are in and out of the
12 market and participating. Our system hasn't addressed
13 all of the problems yet.

14 I'm not sure -- And we talked about it
15 yesterday. There's not a perfect system out there.

16 I still feel we should continue with the
17 twelve-times and review that, maybe, on a yearly basis,
18 because I still feel comfortable that the market is
19 instable enough and we still need that flexibility.

20 Q. If we were to step-down, do you have a
21 recommendation over what period of time we should step-
22 down to the six?

23 A. I would say at least a year, and preferably
24 longer.

25 Again, prefacing that -- to try and maintain

1 allocations because of the problem with the spiralling
2 downward effect.

3 Q. With the moratoriums that have been granted
4 historically, and with the six-times over from the
5 twelve-times over, I guess my question is, do you see
6 added flexibility, all other variable factors aside,
7 meaning the step-down and all?

8 Say we -- Say we've already stepped-down, and
9 there's no loss of allowable. Do you see any added
10 flexibility to Meridian with the twelve-times over
11 versus the six-times over?

12 A. We still would have some added flexibility,
13 yes, sir.

14 Q. So there's the plus there to the twelve?

15 A. Yes, sir.

16 CHAIRMAN LEMAY: Additional questions of the
17 witness?

18 He may be excused. Let's take a 15-minute
19 break.

20 (Thereupon, a recess was taken at 10:30 a.m.)

21 (The following proceedings had at 10:50 a.m.)

22 CHAIRMAN LEMAY: Take our seats, we'll
23 continue.

24 Mr. Kellahin, do you have anything
25 additional?

1 MR. KELLAHIN: No, sir.

2 CHAIRMAN LEMAY: Thank you. Mr. Carr?

3 MR. CARR: May it please the Commission, at
4 this time we would call Mr. Paul West.

5 PAUL T. WEST,

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

8 EXAMINATION

9 BY MR. CARR:

10 Q. Mr. West, will you state your full name and
11 place of residence?

12 A. Paul T. West, Farmington, New Mexico.

13 Q. By whom are you employed and in what
14 capacity?

15 A. UNOCAL Corporation, as District Production
16 Manager.

17 Q. Have you previously testified before the New
18 Mexico Oil Conservation Commission?

19 A. No, I have not.

20 Q. Would you briefly review your educational
21 background and then summarize your work experience?

22 A. I have a BS in civil engineering from New
23 Mexico State. I've worked for UNOCAL for 21 years in
24 engineering, managerial roles of oil and gas
25 production, midcontinent, West Coast and Alaska.

1 Q. Does your current area of responsibility with
2 UNOCAL include the San Juan Basin in northwestern New
3 Mexico?

4 A. Yes, it does.

5 Q. And are you familiar with the prorationing
6 rules for the prorated pools in that portion of the
7 state?

8 A. Yes, I am somewhat familiar.

9 Q. Are you familiar with the impact these
10 wells -- or these rules, have on UNOCAL's properties
11 that they operate in the proration pools in the San
12 Juan Basin?

13 A. Yes, I do.

14 MR. CARR: May it please the Commission, at
15 this time we would tender Mr. West as an expert witness
16 in petroleum engineering.

17 CHAIRMAN LEMAY: His qualifications are
18 acceptable.

19 Q. (By Mr. Carr) Mr. West, would you briefly
20 state what UNOCAL's purpose is in testifying in this
21 case today?

22 A. To support maintaining the overproduction
23 allowance at twelve-times allowable.

24 Q. Have you prepared certain exhibits for
25 presentation in this proceeding?

1 A. Yes, I have.

2 Q. Would it be perhaps more convenient for you
3 to move down to the projector and review these
4 exhibits --

5 A. Yes.

6 Q. -- by presenting them on the screen?
7 Would you first show Exhibit Number 1,
8 identify this exhibit, and then explain to the
9 Commission what this exhibit is intended to show?

10 A. This is a plot of incremental lost
11 production. It's a scenario looking at comparing what
12 would have happened had we been restricted to six-
13 times overproduction allowance in the first of 1989,
14 versus what actually did happen with our twelve-times-
15 over allowance.

16 Q. And what do you have on the Y-axis?

17 A. On the Y-axis I have the daily production,
18 millions of cubic foot daily.

19 Q. And this depicts 1989, which is the last full
20 year that you have to report?

21 A. That's right, the last full year of
22 allocation information that we have.

23 Q. Okay. Could you just summarize exactly what
24 this does show?

25 A. What it does show is that -- these are --

1 This is the production that we would have had to
2 curtail with the six-times over. And we think it's
3 reflective of what would happen at any point in time
4 that we're hit with that kind of a reduction.

5 And as you can see, we start out in the early
6 part of the scenario with 2 million cubic foot per day
7 that would be shut in due to overproduction.

8 This -- It increases up to 9 million and back
9 down again. For the full year we'd be talking about
10 around 5.3 million a day, which represents 33 percent
11 of what our actual production for 1989 was.

12 Q. And this shows the impact on UNOCAL's
13 operations in the San Juan Basin if there was a one-
14 time reversion from the twelve-times overproduced limit
15 to the six-times overproduced limit?

16 A. That's correct.

17 Q. Do you have anything further to present from
18 Exhibit Number 1?

19 A. No, I do not.

20 Q. Let's go now to UNOCAL Exhibit Number 2, and
21 again I would ask you to identify this and review it
22 for the Commission.

23 A. This shows the actual production for 1989,
24 and this is what we contend we would lose 33 percent
25 of.

1 The reason for presenting this slide is to
2 again show the flexibility of what twelve-times over
3 allows us. As you can see, we do fluctuate production
4 quite dramatically through the year. In this
5 particular year, we're down as low as about 9 million a
6 day from the prorated pools and as high as around 23
7 million a day.

8 The point being, is that we do use the
9 overproduction allowance to fluctuate our deliveries
10 with demand, rather than using it for anything other
11 than that.

12 Q. And this, like the Meridian testimony, shows
13 that UNOCAL is using this flexibility to manage their
14 production, not just produce an extra volume?

15 A. That's correct.

16 Q. All right. Let's move now to UNOCAL Exhibit
17 Number 2-A, and I would ask you to identify that,
18 please.

19 A. This is just taking a look at the well count
20 in our prorated pools, and we -- And this is, again,
21 looking at 1989. We had approximately 166 nonmarginal
22 prorated wells.

23 The number of wells that we actually
24 curtailed in 1989 because we were coming up to the
25 twelve-times over numbered 17.

1 Looking at the same scenario that was shown
2 in the first slide, had we been curtailed at six-times
3 over, there would have been an additional 74 wells that
4 would be shut in due to overproduction, and this
5 represents 45 percent.

6 And the only point in this is to again show
7 that we are using the tool as a flexibility tool.

8 Had I come here and said that this number was
9 zero with six-times over, I think it would indicate
10 that we didn't even need the twelve-times over versus
11 six. On the contrary, if I were saying that we were
12 going to shut in 90 or 100 percent of them, it may
13 indicate that we used the extra allowance more as a
14 windfall rather than as a flexibility tool.

15 I think in the actual percentage that you
16 should be at, it would probably depend on what kind of
17 a market demand would just go through. But I would
18 contend that we should be somewhere in the midrange,
19 and that's in fact where we are.

20 Q. All right, Mr. West, let's then move to
21 UNOCAL Exhibit Number 3.

22 A. This just illustrates our contention of the
23 advantages of having a twelve-times overproduction
24 allowance, and basically it is just providing
25 flexibility, and two points in this regard.

1 And of course it does, as I've tried to
2 illustrate in the other exhibits, give us the
3 opportunity to fluctuate deliveries with seasonal
4 demands. Secondarily, it also provides a buffer that
5 we need, just due to the complexities of the system.

6 Just in tracking, in keeping up with
7 overproduction, there are some awkward things we have
8 to go through in that we don't really learn our
9 allocation for a particular month until we've started
10 into the month. I think we normally get ours about the
11 tenth day.

12 We've had to make a nomination from what gas
13 we're going to sell a week or so before the first of
14 the month.

15 And then the overproduction, of course, is
16 two months arrears of state records. So we have to
17 track first through estimated production of where we're
18 at, because we don't get our volume statements from the
19 transporter until like the 40th day after we produce
20 the gas.

21 So through the awkwardness of handling this,
22 there is some amount of the overproduction that is
23 eaten up just in the fact that it's an awkward system
24 to manage, and only above, sometimes, overproduction
25 are we able to use as a true fluctuator to get to our

1 market position.

2 Q. In your fluctuating deliveries, you respond
3 to seasonal demands. Are you looking only at the
4 volumes that you can sell, or do pricing factors also
5 come into play?

6 A. Price does come into play. We're trying to
7 maximize price, to optimize revenues to ourselves or
8 working-interest owners, royalty owners and the state.

9 This is the big benefit that we get, of
10 course, in playing the flexibility game, is a higher
11 realized price.

12 Q. Now, let's go to your next exhibit which is
13 marked UNOCAL Exhibit Number 4.

14 A. This points out some of the things that we
15 feel are key impacts of the reduction, impacts of
16 reducing overproduction allowance.

17 And basically, the big thing is reducing the
18 production level. As I show in the first slide, there
19 is a severe production loss in the first year after a
20 proposed reduction, and we feel like that is a severe
21 thing.

22 We may also be at risk of losing some
23 production down the road from that, but it would depend
24 on the scenarios and if Murphy's Law controls, which it
25 normally does, as far as getting the box to work.

1 The six-times over would again affect us
2 beyond twelve months.

3 And a big factor also I show here as risk of
4 losing the market share by not delivering the gas in a
5 particular year.

6 Mr. Jones' testimony, I think, indicates that
7 it's not really a risk; it's more of a certainty that
8 that will happen. And I think that the one key thing
9 here is that we ought to look at a growing West Coast
10 demand.

11 There are other pipelines being proposed. I
12 think we haven't seen anything yet, as far as
13 competition, and this is a much more important thing, I
14 think, down the road. If we're not in a position to
15 deliver gas, we're probably certain to lose our market.

16 Q. All right, let's now go to Exhibit Number 5,
17 and using that exhibit would you summarize UNOCAL's
18 recommendations to the Commission?

19 A. Our recommendations are to leave the
20 overproduction allowance at twelve times for the
21 northwest. We feel that for the reasons I mentioned
22 that this is an important thing. We do feel that the
23 proration system does still have some inequities in it,
24 and these need to be corrected.

25 But I think one thing we do support, we would

1 be supportive of the increase in the twelve-times,
2 although I think in our particular case we feel like
3 that we are probably offered in our position an
4 adequate amount of flexibility with twelve.

5 So I think one thing that we really feel is a
6 detriment is that this thing has -- jumped up and down
7 through the current proration program.

8 We'd like to see it left alone and fixed at
9 that point, because anytime, whether it's -- it's
10 happened over a time period of whatever, I think that
11 there are going to be some early-on production losses
12 as a result of jumping it up and down.

13 And finally, we would support changing the
14 proration system itself. Amounts of overproduction is
15 kind of a small issue in that regard. We would like to
16 undergo drilling and developing more gas in the basin.
17 We have a large amount of undeveloped gas.

18 The proration system itself is kind of an
19 obstacle to being able to -- to drill wells. We feel
20 like the system ought to offer incentives for
21 development of gas rather than detriments.

22 The same thing is true of lower energy
23 reservoirs where we want to install compression.
24 That's also capital-intensive, and is again -- There's
25 no incentive within the proration system to allow that.

1 And I think, finally, it's -- Just on the
2 impact on the economic limit of the wells, the
3 proration system seems to kind of play a negative role
4 in that by putting restrictions on even very marginal
5 wells to where they are still restricted at the point
6 in time where a well can't be worked over because of
7 economics, because the allowable won't allow you to
8 make enough income on that.

9 And I think just stretching the life of the
10 well, if we're talking about prorating 100-, 200-MCF-a-
11 day wells less, that we're taking tight gas in, we're
12 taking a lot from a well that may be 25 or 30 years,
13 we're stretching it to 50 years plus. And if something
14 goes wrong with the well in that 25- to 30-year-period
15 out to whatever life is imposed on that, well, if you
16 had a casing problem you just can't afford to redrill
17 it.

18 Q. Mr. West, in your opinion does the twelve-
19 times overproduction limit serve a useful or beneficial
20 role in the prevention of waste and the protection of
21 correlative rights in the San Juan Basin?

22 A. Yes, it does.

23 Q. Does the twelve-times rule, in your opinion,
24 help make New Mexico gas available to meet the
25 interstate gas market demand?

1 A. Yes.

2 Q. Now, would you just briefly state in
3 conclusion UNOCAL's concern about reducing the twelve-
4 times overproduced limit to the six-times limit?

5 A. Number one is not being able to realize an
6 optimum price by reducing some flexibility. And
7 secondly, the major impact on production in the short
8 term after such reduction occurred.

9 Q. Were Exhibits 1 through 5, including Exhibit
10 2-A, prepared by you?

11 A. Yes, they were.

12 MR. CARR: At this time we would offer into
13 evidence UNOCAL Exhibits 1 through 5.

14 CHAIRMAN LEMAY: Without objection, Exhibits
15 1 through 5 will be admitted into the evidence, into
16 the record.

17 Any additional --

18 MR. CARR: That concludes my direct
19 examination of Mr. West.

20 CHAIRMAN LEMAY: Thank you. Questions of Mr.
21 West?

22 Commissioner Weiss?

23 EXAMINATION

24 BY COMMISSIONER WEISS:

25 Q. Could a well be produced in 25 years?

1 A. In some cases, yes, I believe so. In some
2 cases, no.

3 Q. And then is there any effect on the length of
4 the shut-in time on the production? You mentioned the
5 cycling.

6 A. In other words, well damage due to shut-in?
7 Yes, there is a factor there, especially wells that
8 have water production are more sensitive to damage if
9 they are left idle.

10 COMMISSIONER WEISS: Thank you.

11 CHAIRMAN LEMAY: I just have a couple
12 questions.

13 EXAMINATION

14 BY CHAIRMAN LEMAY:

15 Q. I understand your testimony, Mr. West, is
16 that it does aid you in providing the flexibility you
17 need to manage your gas supply system and the markets
18 you serve.

19 Have you had any -- any problems --
20 correlative-rights issues is what I'm thinking of -- in
21 terms of having capacity in the pipelines, not being
22 able to access capacity?

23 Or, what I'm thinking of is those that do not
24 have, maybe, the market power of some of the bigger
25 companies, not being able to access their markets in

1 times of high gas prices, because maybe you all hold
2 off your good wells and really turn them loose during
3 that time.

4 A. No, I don't see that as an issue. Of course,
5 UNOCAL is in the position right now of producing and
6 shipping all the allocation we receive, so I may not be
7 qualified to answer the question as far as a company
8 that does not do that.

9 Q. Well, our concerns, of course, are
10 correlative rights and waste.

11 A. Right.

12 Q. And the testimony to date, of course it helps
13 you manage the system.

14 Our concern that we might have is that in
15 managing your system to maximize, of course, your
16 profit and therefore deliverabilities during the high-
17 price months, that there may not be adequate capacity
18 for other operators to do the same with the twelve-
19 times over.

20 A. I don't see that in a correlative-rights
21 issue. We, of course, have been able to move all the
22 gas. I think we've been in the same position to market
23 gas as others, and we've been in a position to be able
24 to market that over the last few years here, since we
25 have started selling gas on the spot market.

1 If we get into a time that we're
2 transportation-limited, which may well be the case, I
3 cannot see any correlative-rights problem between
4 producers.

5 Because we do have a growing amount of
6 unprorated gas, anything that restricts the production
7 on a prorated pool, I see as a correlative-rights
8 impact on the prorated pools, and that, I believe, does
9 happen.

10 If there is gas that is able to move while
11 other is restricted, I believe there's a correlative-
12 rights issue for the prorated owners being told.

13 Q. Now, those are probably issues beyond the
14 scope of this particular hearing, but it...

15 A. Right.

16 Q. The coal-seam gas, if it's backing out some
17 of the prorated gas, would be another issue that -- I
18 don't know how the twelve-times over would affect that
19 issue.

20 A. Yeah, it should not.

21 CHAIRMAN LEMAY: Okay. I have no further
22 questions.

23 Does anyone else have any further questions
24 of the witness?

25 If not, he may be excused.

1 Do we have any other direct testimony in this
2 case? Mr. Stovall?

3 MR. STOVALL: Call Mr. Vic Lyon.

4 VICTOR T. LYON,

5 the witness herein, after having been first duly sworn
6 upon his oath, was examined and testified as follows:

7 EXAMINATION

8 BY MR. STOVALL:

9 Q. Mr. Lyon, would you please state your name
10 and place of residence?

11 (Off the record)

12 THE WITNESS: I'm Victor T. Lyon. I reside
13 in Santa Fe.

14 Q. (By Mr. Stovall) And how are you currently
15 employed, Mr. Lyon?

16 A. I'm a consulting petroleum engineer under
17 contract with the Oil Conservation Division.

18 Q. And duties under that contract include review
19 of the proration system and the effect of the OCD Rules
20 on gas production in New Mexico?

21 A. Essentially the management of the gas
22 proration system.

23 Q. And have you previously acted in that
24 capacity as an employee of the Oil Conservation
25 Division?

1 A. Yes.

2 Q. You are familiar with the proration rules of
3 the system and particularly the overproduction limits
4 in northwest New Mexico?

5 A. Yes, I am.

6 MR. STOVALL: I offer Mr. Lyon as a qualified
7 expert in gas proration in the OCD system.

8 CHAIRMAN LEMAY: His qualifications are
9 acceptable.

10 Q. (By Mr. Stovall) Mr. Lyon, let me ask you
11 first, have you -- Have you made any sort of study or
12 analysis of the effect of the twelve-times
13 overproduction limit on production in the northwest
14 pools?

15 A. Yes, I have. And let me -- Let me point out
16 that I was the witness who originally recommended to
17 the Division, to the Commission, that we adopt the
18 twelve-times-over rule.

19 I did that with some trepidation and some
20 uncertainty, because I think that it was a serious
21 departure from what we have done traditionally, and
22 also it became very apparent at the outset that there
23 was going to be some controversy in that the southeast
24 pools did not enjoy the same overproduction limit.

25 Consequently, I have been looking during that

1 period of time to try to evaluate whether or not
2 twelve-times overproduction was justified in the
3 northwest pools.

4 Q. Mr. Lyon, you've heard the testimony of the
5 previous witnesses in this case, have you not?

6 A. Yes, I have.

7 Q. And are there any comments which you wish to
8 make in respect to that -- to their testimony? They've
9 testified basically in support of the twelve-times
10 limit and maintaining that limit. Is there anything
11 specifically with respect to the evidence which you
12 wish to comment on?

13 A. Well, I think not.

14 I was just talking to Mr. Jones about his
15 last exhibit in his display, and I'm a little concerned
16 that the amount of deliverability subject to curtailment
17 for 1990 is higher than it is in 1989.

18 I have not really rationalized what the
19 purpose -- what the reason for that is. But I have
20 prepared an exhibit which is just a copy of some of the
21 working papers that I used, trying to evaluate how
22 we're doing in keeping pools in balance, and I have
23 prepared that for presentation.

24 I might also say that I'm the Chairman of the
25 Gas Proration Rules Committee, and I appreciate Mr.

1 Jones' kind words about the work of the Committee. And
2 I think the Committee has done a good job.

3 It really doesn't impact too much this
4 particular hearing, except that there are some changes
5 which have been made recently, relatively recently, and
6 there are some changes which may be made through the
7 work of that Committee, which could have some impact on
8 this question.

9 But the twelve-times over was adopted with
10 the issuance of order R-8170, which was effective April
11 1st, 1986.

12 Q. Let me -- You've referred to an exhibit, and
13 I will note that the copies which have been given to
14 the Commission are marked as OCD Exhibit Number 1, and
15 I have not marked the additional copies which have been
16 distributed to participants in this hearing. But you
17 have only one exhibit, and that's this tabulation of --
18 Pool Imbalance, it's labeled at the top; is that
19 correct?

20 A. Yes.

21 Q. Simply -- Just to start out, would you just
22 simply explain how you -- as you read across, what
23 information is contained on the exhibit?

24 A. Well, the -- This is a tabulation for each of
25 the prorated pools in New Mexico. And the way I have

1 approached this, the left-hand column is the pool name.
2 And then I have the month for which the data is
3 represented.

4 Q. Now, let me stop you right there and make
5 sure that we're reading this correctly. It appears to
6 me that you've reported -- Is that an annual figure for
7 December, 1986, and December, 1988, or is that a
8 month -- monthly figure for those months?

9 A. This is looking at the status of the pool
10 on -- at the end of that month.

11 Q. Okay. And then when you reach 1989 you're
12 reporting for -- What is that? Every four months, it
13 appears? Is that correct?

14 A. Well, yes. In 1989 it goes -- I've pared it
15 down to quarterly data, January, May, September -- or,
16 not quarterly, but classification period. And then I
17 did not put the 1990 in, for January, 1990, but the
18 last three months are January-February month of 1990.

19 Q. Okay. Now, if you continue across the
20 headings?

21 A. Okay, the status column, which is the third
22 column, shows the status of the pool, over- or under-
23 produced at the -- at the last entry for each pool in
24 the proration schedule.

25 The next column -- Now if a pool is in

1 balance, if the pool status is exactly zero but there
2 are overproduced wells and there are underproduced
3 wells, for every MCF that's overproduced, there must
4 also be an MCF underproduced --

5 Q. So --

6 A. -- and so --

7 Q. Go ahead.

8 A. -- I have got from the computer the total
9 amount of overproduction in each pool, and in order to
10 balance to the status, there has to be the amount of
11 underproduction shown in the column to the right of
12 that, which is column 5.

13 Now, the total imbalance is the sum of the
14 overproduction and the underproduction, which is shown
15 in column 6. The total is about --

16 Q. So if I read this correctly, if I may
17 interrupt you again to make sure we're clear here, if
18 the status column has a minus sign in front of the
19 number that indicates that the gross overproduction
20 exceeds the gross underproduction, and the pool is in a
21 net overproduced status?

22 A. Correct.

23 Q. And if there's no sign in front of the
24 number, it's just the opposite?

25 A. Correct.

1 Then I've tabulated the number of
2 overproduced wells in the pool in column 7, and in
3 column 8 the number of excessively overproduced wells
4 which -- actually proration units -- which is more than
5 six times over in the southeast and more than twelve
6 times over in the northwest.

7 Then I have shown the F1 factors, the number
8 of nonmarginal units, and in the northwest pools the F2
9 factors, and the sum of the AD factors, and calculated
10 the total pool allowable from those factors, which is
11 shown in the next-to-the-last column.

12 And then the pool imbalance is shown in the
13 right-hand column, which is the total imbalance divided
14 by the average pool allowable.

15 Q. So in other words, if we're looking at the
16 Atoka Penn, December, 1986, the imbalance -- you go to
17 the number from the total imbalance column, 99,562,
18 divide that by the average allowable column, 77- --
19 72,313 --

20 A. Correct.

21 Q. -- equals your number of 1.377; is that
22 correct?

23 A. Correct.

24 Q. Now, Mr. Lyon, without going into major
25 detail, now that we know how to read this tabulation,

1 what conclusions can you draw from it?

2 A. Well, I can see from the data that there have
3 been some times when the pools were rather badly out of
4 balance. I'm looking particularly at the last entry
5 for each pool, which is the status at the end of the
6 balancing period, which was March 31st, 1990.

7 And I averaged these up, upstairs, and then
8 didn't bring my figures with me. But the southeast
9 pools average about, oh, two-and-a-half to three times
10 out balance. And the northwest pools average something
11 like four-and-a-half times out of balance.

12 With a twelve-times-over limit, you might
13 expect that the northwest would be twice as much out of
14 balance because, after all, they can have twice as much
15 overproduction and twice as much underproduction.

16 But it is not that much of a difference. It
17 is greater, it is more out of balance, but it is not
18 twice as badly out of balance as the southeast is.

19 Q. What does that tell you?

20 A. Well, it tells me it could be worse.

21 Q. Does it give you any -- Are you able to draw
22 any -- form any opinions about the effectiveness in
23 terms of, say, the flexibility that's been testified
24 to?

25 A. I would -- I would like to say something

1 about the word "flexibility" that they used. A well
2 has a lot of flexibility, provided you keep your well
3 reasonably in balance. But if you keep your well
4 continually overproduced, you lose that flexibility.

5 And the people who have the most overproduced
6 wells are the first ones to come in here and say,
7 golly, you're not treating us right. We need that well
8 on.

9 But they don't say that they've already
10 produced well over their share of the gas, and they
11 want to produce still more than their share.

12 Q. Are you saying, if I understand you
13 correctly, are you saying that what they do is, they
14 hit the twelve-times limit and then just stay right up
15 somewhere in that neighborhood; when they get
16 overproduced over twelve times, they shut in and then
17 as soon as they come under, they...

18 A. That's my observation, yes.

19 Q. Now, is that observation -- What is that
20 observation based upon?

21 A. Well, it's based on looking at these pools
22 every month. And to some extent -- The pools in the
23 northwest are so massive that I can't get out my little
24 calculator and do things with it like I can in the
25 southeast. I've got to rely on the computer.

1 I have asked the computer people to prepare
2 me a list of the prorated gas pools and the wells
3 therein and the days produced reported on the C-115.
4 That is not shown on the C-111; it's shown on the
5 C-115.

6 And just out of curiosity, to see how well
7 Order R-8441 is being observed, which is the priority
8 order, I would hope to see in these printouts that the
9 marginal wells and the underproduced wells would be
10 produced every day of the month.

11 I have not had a chance to go very far into
12 this printout, but I'm disappointed in what I have seen
13 so far.

14 Q. You're finding that's not the case from what
15 you've seen; is that correct?

16 A. Yes. And I think that there is a temptation
17 for people to produce their best wells to meet the
18 market demand, and ignore the wells that are marginal
19 or underproduced, and that is contrary to the purposes
20 of gas proration and is contrary to protecting
21 correlative rights, which is our responsibility, and
22 I'm concerned about that.

23 Q. Do you recommend, then -- Or let me ask you,
24 what is your recommendation with respect to the
25 continuance of the twelve-times overproduction limit?

1 A. I really have doubts that they need the
2 twelve-times overproduced if they operate their wells
3 properly.

4 I was very heartened by Mr. Jones' display
5 that showed that the degree of overproduction of their
6 wells is declining this year. It did not do that last
7 year, and I think maybe Mr. Jones was not the manager
8 at that time. But he has done a very good job, I
9 think, of bringing that situation under control.

10 But I'm not sure that everybody is doing
11 that.

12 Q. Do you have a recommendation, if the
13 Commission were to decide to return to the six-times
14 overproduction limit, as to how they should perhaps
15 approach that in a matter to -- an equitable manner, so
16 as not to cause the shut-in of a substantial number of
17 wells in northwest New Mexico?

18 A. Well, I think it certainly should be
19 staggered at -- If we do go back to the six times. And
20 I do recommend that we go back to six times. And I'm
21 not saying right now, but I do recommend that we go
22 back to six times.

23 And it should be staggered in such a way that
24 that can be done gradually, because it -- I don't
25 believe it's fair to ask those people to shut their

1 wells in immediately to get back to six-times
2 overproduced.

3 Q. Did you have any specific proposal, or are
4 you just recommending that it be a gradual reduction?

5 A. I don't have anything specific. I would say
6 something like in two to three months go to eleven-
7 times, and in two to three months go to ten-times, and
8 stagger it in that way, so that it doesn't impact --

9 Q. Phase it out over a period of two to three
10 years --

11 A. Yes.

12 Q. -- it sounds like what you're -- Is that
13 correct?

14 A. Right.

15 I would also like to point out that through
16 the work of the Committee, we have made some changes
17 which I think have made vast improvements in the
18 proration system and made the system much more
19 responsive to market demand and to protecting
20 correlative rights, in that in the same order that gave
21 the twelve-times overproduced we also put a rule in
22 there that said a well, a marginal well that
23 overproduces its monthly allowable will be reclassified
24 to nonmarginal.

25 And the result of that was that we had a

1 consistent -- a constantly changing number of
2 nonmarginal units in nearly every pool. And it made a
3 situation of severe uncertainty.

4 We have administratively changed that
5 reclassification period, and it has done wonders, I
6 think, for the allowables, and will continue to do good
7 things for the allowables.

8 And with those changes, I think perhaps there
9 may be less reason to have the twelve-times over.

10 And also, we've taken one other step that I
11 hope will help to improve the protection of correlative
12 rights.

13 There is a rule -- and I don't have my set of
14 rules with me. But in the making up of overproduction,
15 a nonmarginal well is able to carry its overproduction
16 from one proration period into the following proration
17 period, and it is to be made up during the following
18 proration period. If it is not made up, then the well
19 is to be shut in until that overproduction is made up.

20 Now, that's in the existing Rule. It has
21 been in the Rule ever since the Rules were adopted.

22 In -- The main schedule is a strange beast.
23 That's the end of the proration period. We do the
24 balancing, cancellation through balancing, and we do
25 the reclassifications and so forth.

1 And one of the peculiarities about the May
2 proration schedule is that the pool status shown for
3 each pool is not correct, because it does not subtract
4 the allowables that have been canceled.

5 And so in order to get a correct pool status,
6 I have to get a printout from the computer telling me
7 how much was canceled.

8 But also in the May schedule -- and it's the
9 only schedule that this appears in -- there is a column
10 there called "Curtailed After." And the page in the
11 front of the proration schedule explaining the symbol
12 says, "Curtailed After column: Volume in this column
13 instructs the pipeline and/or operator to shut in the
14 subject proration unit for the length of time which
15 would be required to produce this volume."

16 And we've had some calls at the office, and
17 Rick Brown, our man who administers this program, has
18 misinformed some people and told them they have a year
19 to make that up. That is not true.

20 The Rule says that the well is to be shut in,
21 unless shut in until that amount is made up.

22 And this year we have sent out letters to
23 people who had an item in that column and advised them
24 to shut in the well. We've never done this --

25 Q. Does that have anything --

1 A. We've never done this.

2 Q. Let me interrupt you for just a minute. What
3 is the relationship between that and the twelve-times
4 limit? I mean that's a --

5 A. Well --

6 Q. -- that's a different aspect of the system,
7 is it not?

8 A. Not really. Not really, because people have
9 ignored that item in the proration schedule in the
10 past, and so they have kept their wells badly
11 overproduced, which reduces their flexibility.

12 MR. STOVALL: I have no further questions of
13 Mr. Lyon at this time.

14 CHAIRMAN LEMAY: Are there some questions of
15 Mr. Lyon?

16 Mr. Kellahin?

17 EXAMINATION

18 BY MR. KELLAHIN:

19 Q. Mr. Lyon, I'm concerned about your last
20 comments with regards to how the system functions in
21 terms of wells that are overproduced and how individual
22 operators may manage within the system.

23 Let me ask you, sir, do you see any
24 indication at all that Meridian is doing other than
25 preferentially shutting in those overproduced wells and

1 producing their allowables or the pool production out
2 of the marginal wells?

3 A. I have not examined the data on Meridian's
4 wells.

5 Q. The system is structured in such a way that
6 operators are encouraged to do that, are they not?

7 A. Well, it does if we shut in the wells that
8 are excessively overproduced.

9 Q. There is no restriction if a well is
10 classified as a marginal well; they can produce at its
11 capacity?

12 A. That is right. And as far as I'm concerned,
13 it should be, one hundred percent of the time.

14 Q. When we look at the twelve-times production
15 limitation in terms of pool balancing, let me make sure
16 I understand. I don't pretend to understand very much
17 about this, but let me see if I can understand a few of
18 the essential components.

19 When we talk about twelve-times production
20 limitation, there's a twelve-times-over component, but
21 there correspondingly is a twelve-times-under
22 component, is there not?

23 A. Well, if a well becomes twelve-times
24 underproduced it's reclassified to marginal under the
25 administrative changes that we introduced last August.

1 Q. And its underproduction is then canceled?

2 A. Right.

3 Q. So regardless of whether we're pool balancing
4 in a pool that allows the six-times number or the
5 twelve-times number, there is a mechanism to control
6 not only the overproduced wells but the underproduced
7 wells?

8 A. Yes.

9 Q. Isn't part of the choices you make as an
10 administrator with a goal for pool balancing one of how
11 rapidly wells are classified or reclassified from
12 marginal to nonmarginal and vice-versa?

13 A. Would you say that again?

14 Q. Yes, sir. When we're looking at pool
15 balancing, one of the critical components of how
16 quickly you get that pool in balance will be how
17 quickly you take a well that is marginal and reclassify
18 it to nonmarginal or vice-versa?

19 A. Yes.

20 Q. Another way that you can balance your pool
21 would simply to be assigning more allowable to the
22 pool?

23 A. Not necessarily.

24 Q. But that would be one of the ways that you
25 could bring your balancing back into a number that you

1 judge is more appropriate?

2 A. Well, if a pool is overproduced we can and we
3 do put in additional allowances, because just that data
4 alone, the fact that the pool is overproduced,
5 indicates that we haven't given them enough allowable.

6 Q. My point is -- and let me see if you agree --
7 there are a number of components to the entire system.
8 The change of each of those components in relation to
9 another will determine whether the pool is balanced
10 within a given period?

11 A. Well, the pool is composed of the wells in
12 the pool, and the only wells that we are really looking
13 at are the nonmarginal wells, and each one of those
14 wells is a component. Some are underproduced and some
15 are overproduced. And the sum total of all those wells
16 gives the status of the pool.

17 Q. At this point have you documented any time
18 sequence in which to step down the twelve-times over
19 to, say, the six-times over for the San Juan Basin
20 prorated gas pools to see what would be the impact over
21 time as you reduced the overproduction rule?

22 A. Well, I haven't looked at it from that
23 particular aspect. I did respond to Mr. Stovall's
24 question about staggering the change from twelve times
25 to six times.

1 Q. My question to you is, in response to Mr.
2 Stovall you suggested a time frame, and I want to find
3 out if that is a guess on your part or whether you've
4 actually studied and determined how that time period
5 ought to be implemented and what that time period ought
6 to be.

7 A. Well, I think that the time period should not
8 be more than two years. And I certainly don't think
9 that we should step it down to one-time overproduction
10 each month. I think that's too severe, because a well
11 couldn't do that except by a complete shut-in.

12 Q. Do you see any evidence, from your
13 perspective in looking at this question, that the
14 twelve-times-over rule has not accomplished the
15 objectives for which it was originally implemented?

16 A. I'm not sure what the objectives were.

17 Q. Mr. Jones testified earlier that the
18 objectives were to add flexibility to the system in
19 order to meet the market demand that existed for gas
20 produced out of the San Juan Basin.

21 A. Then I think it has not accomplished its
22 objective.

23 Q. Because the number wasn't high enough?

24 A. No, because most of the wells stayed so far
25 overproduced that they don't have any flexibility.

1 Q. Have you specifically looked at any
2 information that Mr. Jones has provided on that
3 question in support of his testimony today?

4 A. Well, the last page of his exhibit gives me
5 very much concern about that.

6 MR. KELLAHIN: Thank you, Mr. Lyon.

7 CHAIRMAN LEMAY: Mr. Carr?

8 MR. CARR: Just a couple of questions, Mr.
9 Lyon.

10 EXAMINATION

11 BY MR. CARR:

12 Q. If we could go to the last page of your
13 exhibit, I just don't understand the figures, actually.

14 If we go -- We've got the first column, which
15 is the date. Then the status is -- is the second
16 column.

17 Are those cumulative figures? What are those
18 figures in that column?

19 A. You're talking about column number 3?

20 Q. First thing would be like Basin Dakota, then
21 we have December, 1986, then we have a number.

22 A. Right.

23 Q. What is that -- What are the figures in that
24 column?

25 A. That is the pool status.

1 Q. Is that a cumulative figure?

2 A. That is shown as of -- This figure appears in
3 the February, 1987, schedule, which shows the status of
4 the pool at the end of December, 1986.

5 Q. And so if we have a number out here that says
6 February, that would in fact be -- would reflect the
7 status of the pool two months prior to that time, or is
8 that actually for February --

9 A. No, the months listed here are the actual
10 months that -- At the end of that month, that was the
11 status of the pool. But it's shown in the proration
12 schedule for two months after that.

13 Q. If we go like to the Blanco Mesa Verde Pool,
14 the second pool, and we go down to September, what that
15 shows is that the pool was overproduced in September;
16 is that correct?

17 A. Yes.

18 Q. And we go back above that to May and we would
19 see that the pool was underproduced in May. Is that --

20 A. Yes, I think that was a direct result of the
21 changes that we made in our rules or -- for
22 reclassifying wells.

23 Q. Okay. And so when you look at these figures,
24 we see a -- in the case of the Blanco Mesa Verde, the
25 pool going from underproduced to overproduced from May

1 through September, are there other factors that you
2 would take into consideration, like perhaps a rule
3 change, that might explain that?

4 A. Yes.

5 Q. And if you were in fact seeing the operators
6 managing their production, you would anticipate certain
7 months where the pool would be overproduced and other
8 months when, correspondingly, it would come back more
9 into line; isn't that right?

10 A. Right. When we're in a -- When we're in a
11 program where we aggressively move wells out of the
12 nonmarginal status into the marginal status, we can
13 shut in an overproduced well, excessively overproduced,
14 but that overproduction stays on the books.

15 When we reclassify a well that's
16 underproduced, that underproduction is gone, and so the
17 pool becomes in a more overproduced status.

18 Q. Now, we've got these figures in 1989, May,
19 September, January, February and March. Why were these
20 particular months selected?

21 A. Well, I had a big, long worksheet for the
22 entire year, 1989. And I thought, well, you know, I'd
23 pick a month which appears to represent some fair
24 representation of the classification period, and I
25 would just print that month, just to shorten the

1 worksheet.

2 And then for the current year I have an entry
3 for each month.

4 Q. You're looking at curtailing or moving back
5 toward a six-times overproduced figure. Is the
6 Division considering any other administrative
7 adjustments or changes to the prorationing system for
8 those pools at the same time? Are you considering
9 increasing allocations or anything, or is it going to
10 simply be a reduction independent of anything else that
11 you're looking at for those pools?

12 A. I'm not sure I understand your question.

13 Q. Well, if you're going from a twelve-times
14 overproduced status back to a six-times overproduced
15 status, are you looking at that independent from
16 everything else that might be being considered
17 concerning proration units in the San Juan Basin?

18 A. Well, I'm looking at the whole package, the
19 whole program. I want the program to work just as well
20 as it can in accomplishing our statutory obligations.

21 Q. And as you move from six -- twelve times back
22 to six times, there are other administrative
23 adjustments that could be made if it does seem to be
24 that in fact you are entering a downward spiral in
25 terms of excess to market or -- Isn't that correct?

1 A. Well, yeah, there are things that we can do.

2 It might interest you to know -- You notice
3 that all of the northwest pools are overproduced at the
4 end of March. And I think in every one of those pools
5 I put in a larger administrative adjustment than the
6 allowable that was generated by the production for the
7 month of June. I did that last night.

8 Q. My question, though, goes one step farther,
9 and that is, if you're an operator and you're concerned
10 about the overall effect to the system, is the place to
11 become active on the Prorationing Committee? Is that
12 the place where you can most effectively stay abreast
13 of what's happening and how these adjustments are being
14 made?

15 A. Well, I don't think so. I don't believe I
16 communicate to them any more than I do to anybody else,
17 except just what comes up in discussions at those
18 meetings.

19 Q. So that we're in a position of watching the
20 monthly schedule and hoping, right?

21 A. Yeah.

22 CHAIRMAN LEMAY: Is that -- Oh, sorry.

23 Any more questions, Mr. Carr?

24 Yes, sir?

25 MR. RICHARDSON: I'm Dale Richardson with

1 Columbus Energy.

2 I'm confused on something when you're
3 referring to correlative rights, six- and twelve-times
4 overproduced. I think maybe you can help me here.

5 In the southwest, what is the average life of
6 a well, a gas well?

7 THE WITNESS: I don't --

8 MR. RICHARDSON: I mean the southeast.

9 THE WITNESS: I really couldn't speak to the
10 average life of a well. I know that --

11 MR. RICHARDSON: Are you saying ten years or
12 five years? Twenty?

13 THE WITNESS: Well, I know that those -- The
14 prorated pools in Lea County have been producing well
15 before we started gas proration in 1954.

16 MR. RICHARDSON: But there are some wells
17 down there that have a lot shorter life than that and
18 which are prorated and using the six-times over --

19 THE WITNESS: I expect you have that in the
20 northwest too.

21 MR. RICHARDSON: Help me out, I don't know
22 what you -- which formation you'd be referring to.

23 THE WITNESS: Well, you just said wells, and
24 you can --

25 MR. RICHARDSON: Prorated.

1 THE WITNESS: You can find a sorry well
2 anywhere.

3 MR. RICHARDSON: My point here is that I
4 think the wells in the northwest would have two, three,
5 possibly four times the life of wells in the southeast.
6 I don't know what number that would be. It just came
7 up to me, and I'm trying to compare why twelve times
8 northwest, why six times in the southeast.

9 I think that with the long life of the wells
10 in the northwest -- There's some Dakota wells I feel
11 real comfortable are going to last 50-plus years.

12 THE WITNESS: I don't -- I don't question
13 that at all. As a matter of fact, in the hearing
14 that -- when the Commission authorized the infill wells
15 up there, the witness said that the life of those wells
16 was in excess of a hundred years.

17 MR. RICHARDSON: All right. Based on that,
18 then, what would -- Why would twelve times be a
19 protection of correlative rights if we're not -- if
20 that drainage -- based on the drainage that can occur
21 with the twelve-times overproduction?

22 THE WITNESS: I really can't see that has
23 much to do with it.

24 MR. RICHARDSON: Well, you mentioned that it
25 did.

1 THE WITNESS: No, you did.

2 MR. RICHARDSON: No, you said you wanted to
3 protect correlative rights, and you suggested we go
4 back to six times.

5 THE WITNESS: Well, I think with twelve-times
6 over there is more of an opportunity to drain your
7 neighbor's gas.

8 MR. RICHARDSON: Are you talking about a
9 hundred-year life or twelve-times over?

10 THE WITNESS: Well, I'm talking about this
11 month and next month and next year. There isn't
12 anything that we can do that can say, okay, by the time
13 this well is finally plugged that it can only produce
14 so much gas. Those wells are in competition with each
15 other, each day, each week, each month, each year.

16 MR. RICHARDSON: Well, the point I was trying to
17 make is, I feel confident that the twelve-times -- a
18 well being twelve-times overproduced in tight Dakota
19 sand will not affect the overall reserves of my
20 neighbor's well. I just -- For some reason, I just
21 can't accept that.

22 THE WITNESS: Well, that's up to you. I've
23 given you my opinion.

24 CHAIRMAN LEMAY: Additional questions?

25 Mr. Stovall?

1 MR. STOVALL: I just have one if we have no
2 further -- Again, from a procedural standpoint, I'd
3 like to point out that if there are any engineers or
4 experts in the audience, they are welcome to present
5 their opinions as well. I was kind of flipping my role
6 back to the Commission attorney position for a moment.

7 FURTHER EXAMINATION

8 BY MR. STOVALL:

9 Q. Just one question. In response to Mr. Carr
10 you've stated that -- I think he asked you if in order
11 to keep input or find out what's going on as far as the
12 adjustments, et cetera, that the operator just had to
13 wait and see what the proration schedule says.

14 I don't -- That's not entirely correct, is
15 it? Can't the operator participate in the -- what we
16 call the nomination hearing in the month, and if they
17 have reasons where administrative adjustments should be
18 made in a given pool, that they can participate and
19 recommend those and support them with evidence?

20 A. That's true. And sometimes they -- On rare
21 occasions they do come in and present testimony, and we
22 listen to them, and if their information is compelling
23 we do something about it.

24 Q. So it is an interactive process in which the
25 operators in a -- any pool that is prorated and subject

1 to the Order -- can have input into the levels of
2 allowable that are granted for that pool?

3 A. Absolutely.

4 MR. STOVALL: Nothing further.

5 CHAIRMAN LEMAY: Commissioner Humphries?

6 EXAMINATION

7 BY COMMISSIONER HUMPHRIES:

8 Q. Mr. Lyon, the reason you suggest going from
9 twelve times back to six is -- or are what? What do
10 you hope to accomplish?

11 A. I think that the pools will be in better
12 balance if we went back to six-times over. I really do
13 not think that they need twelve times if they manage
14 their wells properly.

15 Q. Could you help me a little bit with "in
16 better balance"? I mean, what I'm struggling with here
17 are -- Are we somehow or another protecting correlative
18 rights better, or are we preventing waste of resource
19 in this case, and does balance then provide protection
20 of correlative rights or prevention of waste?

21 A. Well, Mr. Humphries, the -- In establishing
22 the rules for the pool, we set up a proration formula
23 which is supposed to represent a means of distributing
24 gas so as best to protect correlative rights. And if
25 we could have a situation where every well produced its

1 allowable, and only its allowable, and produced all of
2 its allowable each month, then we would come as close
3 as we could ever get to protecting correlative rights.

4 As you depart from that, then I think that
5 you create situations where you are doing a little bit
6 less than protecting correlative rights.

7 And we have -- We have these checks and
8 balances in there, that if a well gets overproduced,
9 it's supposed to make up that underproduction -- that
10 overproduction -- by underproducing his well in
11 subsequent months.

12 And that's what our system is all about, is
13 to make sure that people have an opportunity to produce
14 their fair share. And if they produce less than their
15 fair share, we give them an opportunity to overproduce
16 their well so that they can get in balance. And if
17 they don't, then we cancel their allowable. If they're
18 overproduced, they get excessively overproduced, we
19 shut them in.

20 Q. Well, at this point, do we then see that
21 either resource is being wasted or correlative rights
22 are being damaged by the twelve-times overproduction?

23 Do we have substantial information to lead us
24 to believe that we have in fact impaired somebody's or
25 perhaps abused somebody's correlative rights?

1 A. I'm afraid I got lost in your question.

2 Q. Well, I mean, I understand the theory of
3 trying to balance it. I think I understand why the
4 Division has gone through the exercise of trying to
5 establish it.

6 We have seen fit to change that to twelve-
7 times overproduction allowance for -- under certain
8 controlled circumstances, and the recommendation I hear
9 from you is that we go back to six times.

10 And now I'm just asking, are we basing this
11 recommendation on concern about the process, or are we
12 basing the recommendation on the concern about actual
13 numbers where we believe that somebody's correlative
14 rights have been damaged or taken?

15 A. Well, I think there are really two bases for
16 it: There is a continuing controversy between
17 northeast and southwest -- north -- southeast and
18 northwest operators, that they want the overproduction
19 limit the same. And I don't think it's proper to go to
20 twelve times in the southeast, and I really do not
21 think that the northwest needs twelve-times over.

22 Now, that's my personal opinion, and -- But
23 there has always been a problem of imbalance in the
24 northwest.

25 Q. As you suggested, this declining percentage

1 or rate of overproduction, I believe Mr. Carr and Mr.
2 Kellahin asked you if we had determined some factual
3 way, I guess, or some weight of information that we
4 would use to justify the declining overproduction. In
5 fact, do we have those figures?

6 A. I'm not sure what figures you had in mind,
7 but I'm confident we don't have them.

8 Q. That's what I was concerned about.

9 And then the last question is, do we have the
10 deliverability available if we step back from twelve
11 percent -- or twelve-times overproduction, regardless
12 of the tension between two separate areas of the state
13 which may or may not be founded on good information,
14 only perception, do we have the ability to meet demand,
15 or would we find ourselves regulatorily curtailing
16 production from New Mexico again on westbound gas?

17 A. Well, I --

18 A. Can we speak with certainty that if we step
19 back from twelve times, that New Mexico can meet all of
20 its calls to deliver gas and not be in a position where
21 we, by application of formulas and by application of
22 numbers, could not meet the demand for gas and find
23 ourselves curtailing delivery westbound because of a
24 formula?

25 A. Well, in the first place, the last -- I guess

1 every year that I have been here, there has been a
2 moratorium on shut-in during the peak-demand periods.
3 And during this time, many, many wells get way, way
4 overproduced. I mean many times over twelve-times
5 over.

6 So that's one safeguard that we have utilized
7 to make sure that we have the delivery capacity to
8 supply California's demands.

9 And that's another reason that I think that
10 we should step this down very gradually, rather than
11 abrupt -- an abrupt change.

12 Now, you know, the Commission may not want to
13 change the twelve-times over. That is just my
14 recommendation, that as soon as we practicably can, we
15 ought to go to six times. But that's up to you
16 gentlemen.

17 But if we do go back to six times, I think we
18 should move it down very gradually so that we do not
19 impede the deliverability of gas to our markets.

20 Q. Can you describe the threshold for us?

21 A. Threshold of what?

22 Q. Whereby an application of reduction of
23 overproduction allowables, if this is the right word,
24 that we can feel comfortable that we can meet calls for
25 New Mexico gas?

1 A. I think so --

2 Q. And at six times, are we at a safe threshold?

3 A. Let me point out that in the last year, we
4 have reclassified to marginal about half of the wells
5 in the San Juan Basin. Half of the wells have been
6 reclassified to marginal.

7 Now, bear in mind that marginal wells have no
8 limit whatsoever on their production, none.

9 Q. No regulatory limit?

10 A. No regulatory limit, just the ability of the
11 well to produce into the pipeline.

12 So as we reduce the number of nonmarginal
13 wells, which are the wells which are subject to
14 curtailment, there are more wells that are going on
15 that are not subject to curtailment.

16 Q. So would that give us a level of comfort that
17 at six-times overproduction, we can meet all demands
18 for gas?

19 A. Well --

20 Q. Or would we find ourselves sort of scrambling
21 around for a period of 30 days and leave ourselves open
22 to the criticism that, well, there you've went again,
23 you didn't provide us gas when you said you would?

24 A. I'm sure that there are situations that could
25 arise where we might not be able to do that. I don't

1 know. You tell me what the conditions are, and maybe I
2 can give you an answer for it, but --

3 Q. Well, I -- I as a Commissioner would rather
4 have a threshold and a level of comfort where instead
5 of being -- at this level, we can still meet all
6 demand, given the capacity of the pipeline for gas.

7 And we won't find ourselves having, by
8 application of a formula, curtailed production,
9 whether it's for one day, one week or one month, which
10 in my opinion gives us a very difficult posture to
11 describe when we're arguing our position about equal
12 access to the California market.

13 A. Well, the only time I can imagine that
14 arising is at a time in the winter, like we had in
15 December, when the Director gave the moratorium. And
16 if we can't make it with a moratorium then, you know,
17 just forget it. We just -- We do not have an
18 inexhaustible supply of gas, we do not have unlimited
19 deliverability.

20 But if there's a moratorium and nobody is
21 shut in, then we ought to be producing at capacity.

22 COMMISSIONER HUMPHRIES: Thank you. I don't
23 have any further questions.

24 CHAIRMAN LEMAY: Commissioner Weiss?

25

EXAMINATION

1
2 BY COMMISSIONER WEISS:

3 Q. What's the penalty for overproduction?

4 A. Shut the well in.

5 Q. Then I don't understand how -- how come
6 overproduction doesn't go away, if the well's shut in.

7 A. Well, it's shut in until it's less than the
8 overproduction limit, except in this -- in this
9 curtailment where the letters that we sent out saying
10 you're -- You did not make up your overproduction last
11 proration period, so shut the well in until it is made
12 up.

13 Q. Well, if that system worked, would twelve-
14 times overproduction be all right, if the
15 overproduction problems were taken care of by the
16 operator, shutting the well in whenever they chose to
17 balance things out? And maybe some kind of a penalty
18 to make sure that that happened?

19 A. Well, we have never assessed a penalty. I
20 suppose we could. But, you know, all we'd like for
21 people to do is, when they get excessively overproduced
22 and the schedule shows them to be, that they would shut
23 in their wells.

24 Q. We would like them to, but the problem,
25 apparently, is they don't like to, so we have to --

1 A. Well, of course they don't like to.

2 Q. Yeah, so maybe there's a way to persuade
3 them, and then that would give the flexibility for
4 these peak periods.

5 A. Yeah, well -- Of course, everybody has not
6 always been completely cooperative. There's one well
7 in there -- I was reviewing them at the time we had the
8 moratorium, and there was one well that was forty times
9 over.

10 Q. So somehow or another, that needs to be
11 corrected, because I understand correlative rights.

12 A. We notify the people in the proration
13 schedule itself, and we also write them a letter and
14 tell them, Your well's overproduced excessively, now
15 shut it in until it's --

16 Q. But if there was a mechanism to insure that
17 this overproduction problem was balanced out, then
18 would the twelve-times over, or whatever the producers
19 seem to want, would that be -- In your mind, would that
20 be okay?

21 A. I'm not sure I understood your question.

22 Q. If there were no overproduction problems, if
23 the producers did honor your letters when you sent them
24 out and did, in fact, shut the well in and get rid of
25 the -- their overbalance, or whatever the terminology

1 is -- would the twelve-times overproduction factor be
2 okay? And that would provide the flexibility you're
3 looking for?

4 A. Well, we have had pretty good cooperation
5 with the operators overprodu- -- or shutting in their
6 wells. But as soon as it gets less than twelve-times
7 over, well, they open them up again.

8 Q. Well --

9 A. Lots of times, not always.

10 Q. Well, then, the problem doesn't go away? It
11 just gets --

12 A. No, it does not go away.

13 Q. How do you make it go away?

14 A. I don't know that it will ever go away. It
15 just seems to be the nature of the beast that people
16 who have better wells get their wells overproduced.

17 Q. But if they got that balance down to zero,
18 wouldn't that be -- It would have gone away, right?

19 A. Yeah, they've got that much more flexibility.

20 Q. And that's the whole thing. So if that
21 happens, you could have the twelve times.

22 A. But they don't do that. They --

23 Q. I understand that, and therein lies the
24 problem, at least to me.

25 A. That's right, that's right.

1 COMMISSIONER WEISS: That's the only
2 questions I have.

3 CHAIRMAN LEMAY: Additional questions of the
4 witness?

5 If not, he may be excused.

6 Is there any additional direct testimony to
7 be presented?

8 I have two letters, one from Columbus, one
9 from Gas Company. I understand you're going to read
10 statements? These will be part of the record.

11 In essence, Columbus supports the twelve-
12 times over and has some questions about the proration
13 system and its change. That's a separate issue.

14 Gas Company, as I understand it, is
15 advocating six-times over.

16 But at this point, Mr. Kirkland, would you
17 like to make a statement concerning Gas Company's
18 position?

19 MR. KIRKLAND: Yes, I would.

20 Mr. Chairman, I appreciate the opportunity to
21 come before you and provide some information that may
22 help you to answer this question.

23 And as we understand the question, it was to
24 resolve the issue of whether the twelve-times
25 overproduction limit is beneficial in preventing waste

1 and protecting correlative rights, as well as making a
2 supply of gas available to meet interstate and
3 intrastate demands.

4 When we looked at the question, we looked at
5 the Gas Company's market and the number of wells that
6 were overproduced by the factor of six or more on the
7 Gas Company system.

8 And what we found is that approximately 40
9 million per day, which represents about twelve percent
10 of Gas Company's deliverability, is overproduced by a
11 factor of about nine months.

12 On that basis, we feel that Gas Company can
13 support the return to the six-times overproduction
14 limit as the twelve-percent deliverability not being
15 significant for Gas Company of New Mexico.

16 If the Commission were to adopt the six-times
17 overproduction limit, we recommend that that be done
18 immediately so as to allow the overproduction of this
19 40 million to be made up during the summer months.

20 We would like to point out, however, that if
21 that is done it may require the need, again, for a
22 moratorium on the shut-ins, so that Gas Company of New
23 Mexico can serve its intrastate and interstate markets
24 during the winter months.

25 Now, regarding the question of timing, we

1 feel that in the event that a phased-in approach is
2 taken by the Commission, one year is a reasonable
3 period of time to allow these wells to make up their
4 overproduction.

5 That's the essence of what we put in the
6 letter to you. That's all I have.

7 CHAIRMAN LEMAY: Thank you, Mr. Kirkland,
8 appreciate that. This will be part of the record.

9 Let's see, Mr. Emmons with Amoco, you have a
10 statement to make, sir?

11 MR. EMMONS: Rather than read the statement,
12 I'll just try to summarize it quickly.

13 Basically, Amoco does support the twelve-
14 times overproduction limit.

15 To answer your specific questions that were
16 raised in -- on the docket in the Notice, Amoco
17 believes there is no significant difference between the
18 six-times and twelve-times limit in regard to
19 protection of correlative rights and prevention of
20 waste.

21 As Mr. Lyons said, maybe twelve times is not
22 as good as six times, but there's no hard evidence to
23 say that twelve times is that much worse than six
24 times.

25 Twenty-four times may not be any worse than

1 twelve times or six times. We just don't have the hard
2 facts to say how badly that's impacting correlative
3 rights.

4 So I believe there is no significant
5 difference in the weight of the six-times and twelve-
6 times limit.

7 In fact, if you look at the February gas
8 sales, your difference in the wells that were seven-
9 times overproduced up to twelve-times overproduced
10 actually provide an additional 17 percent of your gas
11 sales for the month of February, or an additional 4.6
12 BCF.

13 I think that could -- you could draw a good
14 analogy there that we would probably lose that amount
15 of gas sales if you reduced it to six-times
16 overproduced.

17 As to the pool being out of balance,
18 underbalanced -- If it's underbalanced pools, you're
19 going to have overproduced wells.

20 I think you saw with Mr. Lyons' documents
21 that the San Juan Basin pools are currently in an
22 overproduced status on a monthly basis, so I don't know
23 how that directly applies to your question on the
24 northwest portion of the prorated pools.

25 However, I think, as everyone else has

1 stated, that it's due to the changing of the gas market
2 that's caused the imbalance problems, plus the
3 reclassification of wells.

4 The Gas Proration Committee, Gas Proration
5 Rules Committee, has made some proposals and, if
6 adopted, I think it would go a long way towards
7 correcting those problems.

8 One additional problem you have is that, as
9 Mr. Lyons said, if you go over twelve-times
10 overproduced you shut those wells in.

11 In the month of February, those wells that
12 were more than twelve-times overproduced supplied an
13 additional five percent of gas sales, which equated to
14 approximately 1.5 BCF of gas. Under the Rules, that
15 would no longer be available to market, because they
16 would be shut in, which could exaggerate your
17 underproduced problem for pool balancing.

18 As to a transition method -- and this kind of
19 leads into it -- although we do not recommend going to
20 a six-times overproduced limit, if you were to go to
21 that you could use up fifty percent of your allowable,
22 allow it to be phased in by just only allowing a
23 certain percentage of the allowable, rather than going
24 one -- dropping down by one-time. That's just another
25 alternative.

1 But I'd like that expanded. Even if you take
2 it at the twelve-times limit and remain at the twelve-
3 times limit, those wells that go over twelve-times
4 overproduced or wells that have gone past the second
5 proration period and are required to make up the
6 overproduction, which is -- I'm not sure that became
7 clear in Mr. Lyons' testimony.

8 If you're twelve times overproduced and you
9 stay there beyond the second proration period, you're
10 shut in until it's all made up. You don't drop back to
11 within twelve times; you're shut in.

12 So there is a balancing mechanism within the
13 Rules as they're currently written.

14 However, what I would like to say is that
15 there's no real reason to shut them in. You can still
16 bring it into balance by just reducing the allowable
17 to, say, 50 percent.

18 The benefits you receive is that you don't
19 have a dramatic impact on pool imbalance, because when
20 you shut it in you make a major change in the pool
21 itself. You also allow the operator to maintain a
22 consistent gas supply and also are able to maintain
23 additional revenue to the State, all while you're still
24 bringing it all back into balance within a reasonable
25 time frame.

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Thank you.

CHAIRMAN LEMAY: Thank you.

Additional comments, statements in the case?

We shall hold the record open, again, 15 days
for additional comment, close the record and take the
case under advisement.

Thank you, gentlemen.

(Thereupon, these proceedings were concluded
at 12:15 p.m.)

1 CERTIFICATE OF REPORTER

2

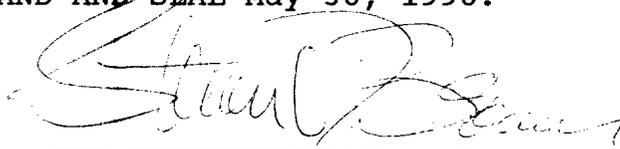
3 STATE OF NEW MEXICO)
 4 COUNTY OF SANTA FE) ss.

5

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

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

16 WITNESS MY HAND AND SEAL May 30, 1990.

17 

18 STEVEN T. BRENNER
 19 CSR No. 106

20 My commission expires: October 14, 1990

21

22

23

24

25

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION COMMISSION
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO

17 November 1988

COMMISSION HEARING

IN THE MATTER OF:

In the matter of Case No. 9018 being CASE
reopened pursuant to the provisions 9018
of Division Order No. R-8170-C, which
order amended certain rules of the
General Rules for the Prorated Gas Pools
of New Mexico.

BEFORE: William J. Lemay, Chairman
William M. Humphries, Commissioner

TRANSCRIPT OF HEARING

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A P P E A R A N C E S Cont'd

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1 MR. LEMAY: Call Case Number
2 9018.

3 MS. JACOBBER: In the matter of
4 Case Number 9018 being reopened pursuant to the provisions
5 of Division Order No. R-8170-C, which order amended certain
6 rules of the general rules for the prorated gas pools in
7 New Mexico contained in Order No. R-8170-A, applying to the
8 northwest New Mexico only, including provisions permitting
9 northwest area gas wells to produce until twelve times
10 overproduced and permitting northwest area underproduced
11 and overproduced gas wells to make up such imbalance over
12 two successive proration periods.

13 The Commission shall consider
14 rescinding Rules 11(b)(1) and 11(b)(2) contained in Order
15 No. R-8170-A and reinstating Rule 11(b) as contained in
16 Order No. R-8170 to the end that allowed overproduction
17 shall be consistent in all prorated pools in the state.

18 MR. LEMAY: Call for appear-
19 ances in Case 9018.

20 Mr. Kellahin.

21 MR. KELLAHIN: Mr. Chairman,
22 I'm Tom Kellahin of the Santa Fe law firm of Kellahin,
23 Kellahin & Aubrey, appearing on behalf of Tenneco Oil Com-
24 pany, Meridian Oil, Inc., and Conoco.

25 MR. LEMAY: Thank you.

1 MR. LUND: Mr. Chairman, I'm
2 Kent Lund on behalf of Amoco Production Company. We would
3 like to make a statement.

4 MR. LEMAY: No witnesses, just
5 a statement?

6 MR. LUND: Yes.

7 MR. LEMAY: Additional appear-
8 ances?

9 MR. DUKE: Mr. Chairman, I'm
10 Jonathan Duke of the Keleher & McLeod law firm in Albuquer-
11 que. I'm representing Gas Company of New Mexico and Sun-
12 terra Gas Gathering Company. It's spelled S-U-N-T-E-R-R-A.

13 MR. KATIRGIS: My name is
14 Stergie Katirgis. I'm with Union Texas Petroleum and I'd
15 just like to make a statement.

16 MR. LEMAY: Will you spell
17 your last name, sir?

18 MR. KATIRGIS: (Spelling) K-A-
19 T-I-R-G-I-S.

20 MR. LEMAY: Thank you. Union
21 Texas?

22 MR. KATIRGIS: Yes.

23 MR. LEMAY: Additional appear-
24 ances?

25 Would those witnesses who are

1 -- yes, sir?

2 MR. HERING: My name is Bill
3 Hering with Unocal. We would like to present a statement.

4 MR. LEMAY: No witnesses?
5 Okay, additional appearances
6 in the case?

7 Would those giving testimony
8 please stand and raise your right hand?

9
10 (Witnesses sworn.)

11
12 MR. LEMAY: Mr. Kellahin.

13 MR. KELLAHIN: Thank you, Mr.
14 Lemay.

15 Mr. Chairman, my three clients
16 support the continuation of the twelve times overproduced
17 number and the two year balancing period.

18 I'm going to present two wit-
19 nesses to you this morning.

20 The first witness is Mr. Louis
21 Jones, a petroleum engineer with Tenneco Oil Company who
22 will make a presentation about his company's situation in
23 the San Juan Basin.

24 My second witness is Mr.
25 Richard Fraley who is also a petroleum engineer with

1 Meridian Oil, Inc. He will make a presentation on behalf
2 of his company and then finally, at the conclusion of the
3 hearing, I'd like to call upon my witness from Conoco to
4 make a statement, Mr. Hugh Ingram, to make a statement at
5 the conclusion.

6 I'd like to call Mr. Louis
7 Jones at this time.

8 MR. LEMAY: Fine.

9 MR. KELLAHIN: Mr. Chairman,
10 Mr. Jones' exhibits on behalf of his company are -- the
11 originals of those exhibits are for the view graph. I have
12 made photocopies of those exhibits. I apologize to you
13 that they are not colored. I think with explanation we can
14 follow the uncolored copies as you see the other copies
15 shown on the screen.

16
17 LOUIS D. JONES,
18 being called as a witness and being duly sworn upon his
19 oath, testified as follows, to-wit:

20
21 DIRECT EXAMINATION

22 BY MR. KELLAHIN:

23 Q Mr. Jones, for the record would you
24 please state your name and occupation?

25 A I'm Louis D. Jones, Division Production

1 Manager for Tenneco Oil Company.

2 Q Insofar as this case is concerned, Mr.
3 Jones, would you describe for us what is your general area
4 of responsibility for your company?

5 A Well, I'm the Production Manager for the
6 Rocky Mountain Division. We have responsibility of thir-
7 teen states. In New Mexico our primary production, ob-
8 viously, is in the San Juan Basin, northwest portion, and I
9 am responsible for all production operations for Tenneco
10 Oil Company in our region.

11 Q Would you summarize for the Commission
12 what has been your educational background?

13 A I graduated from Texas Tech University
14 in 1976; had twelve years with Tenneco Oil Company, and I
15 am a Registered Professional Engineer in the State of
16 Texas.

17 Q Did you testify on behalf of your com-
18 pany in the hearing of this particular case, it was 9018,
19 heard back on November 20th of 1986?

20 A Yes, I did.

21 Q And that was the hearing in which the
22 Commission originally considered the subject of allowing
23 the four prorated pools production in northwestern New
24 Mexico to go to as much as twelve times overproduced?

25 A That's correct.

1 Q And you were an advocate of that rule
2 change at that time, were you not, sir?

3 A Yes, I was.

4 Q And did you subsequently testify before
5 the Commission on March 5th of 1987 when the continuing
6 discussion of that rule was the subject of that hearing?

7 A Yes, I did.

8 Q And were you an advocate at that time
9 of the twelve times overproduced rules?

10 A Yes.

11 Q Subsequent to that hearing, Mr. Jones,
12 have you and your company continued your studies and oper-
13 ations under and with the rules that are the subject of the
14 case today?

15 A Yes, we have.

16 Q What is your position today with regards
17 to those rules, Mr. Jones?

18 A As far as 11(b) is concerned, we would
19 love to see the twelve times overproduced limit continued.
20 The twelve times limit was placed in effect in late -- or
21 at least recommended in late 1986, because of, obviously,
22 the change in the market. It was a dramatic change in the
23 spring of '86 and no longer were able to obtain the nomi-
24 nations from all the purchasers. Allocations dropped dra-
25 matically. Several producers, including Tenneco, became

1 severely overproduced and this was a short term fix to go
2 from six times to twelve times in the northwest portion of
3 the state.

4 At that time, again it was stated to be
5 a short term solution until, hopefully, the market condi-
6 tions returned as they were, let's say, pre-fall of '86,
7 and to be reviewed at, obviously, this hearing today.

8 I contend that the twelve times should
9 stay in effect. Some of the information I'll show in just
10 a second will show that allocations have dropped again in
11 '88 and they're very similar to '86 and major producers,
12 such as Tenneco in the northwest portion of the state are
13 severely overproduced one more time.

14 Twelve times is just a short term solu-
15 tion. I think we should keep it in effect until we come up
16 with a longer term solution for the current market.

17 MR. KELLAHIN: We tender Mr.
18 Jones at this time, Mr. Chairman, as an expert petroleum
19 engineer.

20 MR. LEMAY: His qualifications
21 are acceptable.

22 Q Let me have you discuss for us, Mr.
23 Jones, the change in the market and the production in rela-
24 tion to that market as it occurred in the spring of 1986
25 that resulted, then, in the implementation or the adoption

1 by the Commission of the twelve times overproduction rules.

2 A Well, back in the spring of '86 the
3 primary purchaser of gas in the San Juan Basin, and I'll
4 concentrate my statements, obviously, in the northwest
5 portion of the state, El Paso ceased to take producable gas
6 and went to a spot market situation, and were not nomin-
7 ating to the OCD volumes, because they weren't sure what
8 the volumes would be. It wasn't through any fault of their
9 own.

10 Under the current proration system, as
11 it existed at that time, then the allocations dropped
12 dramatically; again companies became overproduced; and they
13 needed that twelve times just to continue to produce, num-
14 ber one, and also to add the flexibility to look for longer
15 term contracts, not just the month to month spot market
16 contracts, and that was the other reason the twelve times
17 overproduced number was enacted. Again, a short term solu-
18 tion.

19 Q Have you an opinion, sir, as to whether
20 or not that short term solution ought to continue to be a
21 part of the rule as it affects the current market?

22 A I would recommend that the twelve times
23 be continued but be reviewed in one or two years, again,
24 until we can have the system in place that the majority of
25 the producers feel comfortable with.

1 Q Have you had an opportunity to analyze
2 the production and integrate it with the operation of the
3 proration rules and have you prepared that data and analy-
4 sis in the form of certain exhibits and displays?

5 A Yes, I have. In fact, why don't I go
6 through those right now, if I could.

7 Q All right, sir, let's do it.

8 A Okay, what we're showing here is the
9 Mesaverde and Dakota allocations in the San Juan Basin.
10 These are the two major prorated pools that make up the
11 majority of the production.

12 What I've shown here is the total allo-
13 cation for each of the pools, the blue being the Mesaverde;
14 the red being the Dakota; for each year, '85, '86, '87,
15 and '88 is a projection, but we do have numbers through
16 November. So just one more month.

17 What I do want to show is the total
18 allocations, and this is in BCF per year, the dramatic
19 change from 1985 to '86 as people became severely overpro-
20 duced, and then from '86 to '87 when there were some ad-
21 justments made in an effort to alleviate the overproduced
22 situation, and back from '87 to '88, the dramatic drop of
23 allocations.

24 I really don't want to compare '87 to
25 '88 but more compare to, let's say, free spot market,

1 reasonable market demands, let's say '88, or excuse me, '85
2 versus '88. It's still over a 30 percent drop from '85 to
3 '88.

4 Again, '86, a very, very low year for
5 allocations. '88's going to be the same way.

6 MR. KELLAHIN: Mr. Chairman,
7 this hard copy of this display is marked as Tenneco Exhibit
8 Number One.

9 Q All right, sir, let's go to Exhibit
10 Number Two, Mr. Jones.

11 A This is a pie chart, the same percent-
12 age. This is Tenneco company-operated gas production from
13 the San Juan Basin. Our approximate capacity, 330-million
14 cubic feet of gas per day.

15 What I've shown here is the gas that is
16 less 6 times overproduced; the blue being the sliver that
17 would be 6 to 9 times overproduced; 9 to 12 times in the
18 yellow; so the red, plus 12 times overproduced. This gas
19 is, in fact all of this gas is currently shut in but as per
20 the rules and regulations, even if we wanted to, all the
21 gas in red would have to be shut in.

22 That amounts to 18 percent, or approxi-
23 mately 60-million a day of our total capacity.

24 Q Define for us capacity as you've used
25 it, Mr. Jones.

1 A This is not deliverability as per the
2 state deliverability tests. This is what we consider a
3 true wellhead sales capacity.

4 Q All right, sir, let's go on to Exhibit
5 Number Three.

6 A One thing I really want to point out,
7 because we're in the same situation a lot of other produ-
8 cers are not only in the San Juan Basin but throughout the
9 state, because of the spot market. Our total capacity may
10 be 330-million a day but what are we able to market on the
11 spot market?

12 Our marketable capacity is 200-million a
13 day. Again, this is Tenneco company-operated production in
14 the San Juan Basin. We have a marketable capacity of 200-
15 million a day, or 60 percent of our total capacity. Of
16 that, 130, the difference between the marketable and our
17 true capacity, why isn't it marketable? It really boils
18 down to wells that are not released by El Paso, and we
19 cannot market those wells, and wells that have multiple
20 working interest owners that do not care to participate in
21 the spot market, and Tenneco has a cutoff of 75 percent
22 participation. If all working interest owners want to
23 participate in a said well, their interest, all the inter-
24 est combined doesn't equal 75 percent, or greater, then
25 that well is not marketable.

1 So as you can see, only 60 percent of
2 our true capacity is marketable. So now when we look at
3 the overproduced situation as a percent of our marketable
4 capacity, it's almost 30 percent.

5 The same colors here. The green is less
6 than 6 times; the blue is 6 to 9 times; the yellow being 9
7 to 12; and the red now being close to 12 times overpro-
8 duced.

9 So right at 30 percent of our marketable
10 capacity in the plus 6 times overproduced state.

11 Q That translates to what volume of gas,
12 marketable gas?

13 A Approximately 60-million a day. It's a
14 little bit less than that and I'll show you that on the
15 next graph.

16 Q Let's go to the next graph, Exhibit Num-
17 ber Four.

18 A Instead of percentages these are volume
19 numbers, just a bar chart of gas that would be greater than
20 6 times overproduced, Tenneco company-operated production
21 in the San Juan Basin, and what I've shown is July of '88
22 and October of '88

23 As of October of '88 we have close to,
24 slightly under 16-million a day that would be greater than
25 6 times overproduced. We have almost 24-million a day

1 that's greater than 12 times overproduced.

2 And one thing I really want to point out
3 here, the difference between July and October. There was
4 only one month when we produced these volumes that will be
5 greater than 9 times overproduced, yet the volume increased
6 dramatically. That's the way the allocations were set up.
7 It's a 12-month running average and as the higher alloca-
8 tions from 1987 came off, the running average continued to
9 drop; we became more and more overproduced while our wells
10 were shut in; a very important point, because we prioritize
11 our wells that we produce to the spot market by proration,
12 just like El Paso is doing. We have a gas marketing system
13 that does that.

14 We knew we were looking at some prob-
15 lems in July. We began to shut these wells in, yet the
16 problem has resulted.

17 Q Let's take a moment, Mr. Jones, and ex-
18 plain to us the basis upon which we see the acceleration in
19 the number of wells that are reaching or approaching 12
20 times overproduced, and in fact are not producing that
21 volume of gas. What is the cause of that?

22 A Again it's that 12-month running average
23 and in 1987, as I showed earlier, you have the higher allo-
24 cations and as those higher allocations are pumped from
25 that 12-month running average, that 12-month running aver-

1 age continues to drop and your well can stay shut-in and if
2 that 12-month running average drops, it becomes more and
3 more overproduced.

4 Q Let's go to Exhibit Number Five.

5 A I want to concentrate on the major pro-
6 rated pool in the San Juan Basin. I'm just picking one
7 here to make a point. This is the Mesaverde, Blanco Mesa-
8 verde, San Juan Basin, and what I've shown here, we've gone
9 from April of 1987 through November of 1988.

10 What I've shown here, these black arrows
11 are the tri-annuals for the reclassification period. This
12 shows the number of nonmarginal wells in red; the number of
13 marginal wells in blue during this time period I mentioned
14 earlier.

15 As you can see, when you come into the
16 tri-annuals, the number of nonmarginal wells is fairly high
17 and continues to drop through that tri-annual, until at the
18 beginning of each one it jumps back up. But what I'm try-
19 ing to point out here is that particularly during the sum-
20 mer months where the spot market is obviously the most ac-
21 tive, because you traditional takes, the number of nonmar-
22 ginal wells happens to be the highest because these wells
23 produced during the wintertime, then were reclassified to
24 nonmarginal. The point to be made here is that all of the
25 allocation for the pool, the nonmarginal allocations are

1 going to these wells during the summertime, of which
2 several, I won't even say the majority, but certainly many
3 of them are not participating in the market. So the allo-
4 cations are going to wells that are not participating in
5 the market.

6 Q Let's talk for a moment, Mr. Jones,
7 about how pool allocations are set back to individual pro-
8 ducing wells under the current Division policy of estab-
9 lishing allowables for those wells. What is the mechanism
10 by which those wells are being given an allowable?

11 A Well, Vic may be able to correct me
12 here, under the new system it takes the previous month's
13 production and then uses a seasonal factor to come up with
14 the allocation for the total pool, let's say in this case
15 the Blanco Mesaverde Pool, and then that allocation is
16 divided up to the majority to the nonmarginal wells and then
17 a small portion to the marginal wells, the point being here
18 that if you have that lower allocation and there -- this
19 allocation is assigned to all wells, particularly several
20 that are not producing, then you have lower and lower allo-
21 cations and what I call a death spiral that is going to
22 occur, become more and more overproduced, just very simply
23 is -- you have a portion of the Basin that's going to pro-
24 duce, a portion that is not.

25 Tenneco's in that same situation. If the

1 allowables continue to drop -- or let me back up a little
2 bit.

3 Let's say we have allocations that are
4 -- allocations that are equal to the production. The wells
5 that are producing then receive the total allocation along
6 with wells that aren't and in a sense they're not -- this
7 continues to ratchet down as the wells become more and more
8 overproduced. I know it's a little difficult to -- I kind
9 of get turned around myself, but what it boils down to a
10 lot of the allocations are going to wells that are not pro-
11 ducing to the market.

12 Q Am I correct in understanding that the
13 current method by which the Division assigns allowables is
14 to take the previous month or two actual production from
15 the wells and use that as a factor by which then a subse-
16 quent month's allowable is set for that proration unit?

17 A That's correct.

18 Q What is the relationship, if any,
19 between setting allowables based upon actual prior produc-
20 tion and the market demand for that production from that
21 spacing unit?

22 A I see no correlation at all.

23 Q Do you have a market demand for produc-
24 tion from your wells that currently is not being met or
25 satisfied by the allowables being assigned to those wells?

1 A Yes, I believe we do. We have a solid
2 percentage that was greater than 12 times and of course the
3 volume would be much greater if you dropped it back to 6
4 times.

5 We have a market for that gas. When you
6 look at what is reasonable market demand, in 1988 the mar-
7 ket demand for natural gas in California is greater than
8 it's ever been in previous years. It's a matter of that
9 market's share. We have a market for all of our gas. We
10 could market -- we could open up every one of our wells
11 right now and market it. It's just price (unclear).

12 Q In trying to establish allowables that
13 more closely met the anticipated market demand do you have
14 a prior year's historical production that in your opinion
15 more closely meets what you see to be the market demand in
16 the rest of 1988?

17 A I don't have a good -- I don't have the
18 solution but certainly I would pick 1985 as a year that we
19 could go back and match allocations and that was (unclear)
20 the year right before the major changes in the market.

21 Q What are the reasons that would lead
22 you to that opinion, Mr. Jones?

23 A I truly believe that the market demand
24 is greater now than it was in 1985. We need to pick a --
25 pick up certainly a starting point and that would be one.

1 Q Is Tenneco in a situation with a signi-
2 ficant portion of its production that it is a primary bene-
3 ficiary of the 12 times overproduced rule in relation to
4 wells that you have that are truly accruing underproduc-
5 tion, for example?

6 A Well, as I showed earlier, we have a
7 good percentage of our wells that are accruing underpro-
8 duction and what we're looking for is the ability, the op-
9 portunity to produce the wells that we're capable of moving
10 to the market to meet the market demand, and we need the 12
11 times rule to stay in affect; again a short term fix; that
12 is not the solution. The solution, or what I consider a
13 reasonable allocation to meet the true market demand for
14 that pool.

15 Q Let's turn now, sir, to Exhibit Number
16 Six.

17 A To give you an idea of the percentages
18 of allocations versus total capacity or deliverability,
19 this is the Blanco Mesaverde Pool again, San Juan Basin.
20 We show the period from April of 1987 through November of
21 1988.

22 I'll explain each one of these curves.

23 The red being the nonmarginal deliver-
24 ability of the Mesaverde Pool from the proration book; the
25 green being the nonmarginal allocations to that pool during

1 this period from month to month; and the blue being the
2 nonmarginal actual production. As you can see, I'll point
3 out that the total capacity of the nonmarginal wells in the
4 Mesaverde is about 30 BCF per month -- BCF per day plus or
5 minus.

6 The allocations in 1987 were much
7 higher, slightly higher than production during that period,
8 however a dramatic change was made in 1988, as I've shown
9 earlier, and the allocations have dropped dramatically, in
10 some cases below production, and less than 50 percent of
11 the true capacity of the Basin of the nonmarginal wells.

12 So that's saying that if I have a well
13 that I can market, I can only produce it, well, 50 percent
14 the time or less without becoming overproduced.

15 I don't think that truly reflects market
16 conditions.

17 Q Let's talk for a moment about the con-
18 tinuation of the 12 times overproduction rule and its rela-
19 tionship to your ability to meet or help you meet your mar-
20 ket demand for your product.

21 Is there a relationship between that
22 rule and market demand?

23 A Well, the 12 times, let me restate my-
24 self, is -- was in place as a quick fix to allow people to
25 have the flexibility to meet the longer term market.

1 But the problem we're going to have
2 without the higher allocations, the allocations stay at
3 this level, even with the 12 times overproduced limit,
4 three more months and we're back to where we are right now.

5 Actually, let's say we -- let's say we
6 increase this from 12 times, current, 12 times to 18 times;
7 six more months overproduced limit, three months or less
8 we're back in the same boat we're in right now, so that's
9 not the solution.

10 The only suggestion I have is that we
11 certainly continue the 12 times until we're able to match
12 up with allocations that I feel truly meet market demands,
13 more -- more responsible ones than that, I'll say.

14 Q Describe for us, Mr. Jones, what con-
15 straints the current system has upon your ability to at-
16 tract long term contracts from suppliers in California or
17 otherwise?

18 A The problem is that we're not sure what
19 the allocations are going to be. You can see what happened
20 in '87 versus '88.

21 If I can't predict what's going to hap-
22 pen here in future years, then it's going to be very diffi-
23 cult for me to commit to long term markets.

24 Now, let's say I have that 200-million a
25 day that's available to market, I could only truly commit

1 right now less, maybe half of it, 100-million a day, to a
2 long term market, because I'm not sure what the allocation
3 will be. We need to have some set allocations to allow
4 some of the producers to plan their long term, dependable,
5 day-to-day, then you can be a dependable supplier.

6 Q When you talk about a long term market
7 or a long term contract, what period of time are you dis-
8 cussing?

9 A A year or greater.

10 Q Do you have an opinion, sir, as to
11 whether the continuation of the 12 times overproduction
12 rules will give an unfair advantage to those owners pro-
13 ducing under that formula, an unfair advantage over other
14 interest owners in these prorated reservoirs in northwest
15 New Mexico?

16 A I do not. In fact, that was a concern
17 of the producers in the southeast portion of the state;
18 however, we felt that correlative rights would not be
19 damaged in the northwest portion for two reasons: Number
20 one, it was a tight gas province and you didn't see the
21 drainage across the lease lines and it wasn't as much of a
22 problem; plus in the San Juan Basin we have long lived
23 wells, in most cases plus 20 years, so 12 times overpro-
24 duced limits is somewhat insignificant when you're looking
25 at 20 years to make it up, 20 years or more.

1 Q For those wells where you've taken the
2 opportunity to produce those wells up to a 12 times over-
3 produced number, have you received complaints or objections
4 by any offset owner that their property was being subject
5 to drainage?

6 A We have not that I am aware of.

7 Q In your discussion, Mr. Jones, we've
8 used the words "market demand". Would you define that term
9 for us as you've used it this morning?

10 A What I call reasonable market demand is
11 a need for the end use of natural gas, in our case primar-
12 ily in the California market.

13 Q The Commission has a statutory defini-
14 tion for reasonable market demand, which I'll read to you,
15 Mr. Jones.

16 It's in Section 70-2-3 and it's in Sub
17 E. It says, "The words 'reasonable market demand' as used
18 in here with respect to natural gas shall be construed to
19 mean the demand for natural gas for reasonable current re-
20 quirements for current consumption and for use within and
21 outside the state..."

22 Having read that to you, is that defini-
23 tion consistent with how you have applied that term in your
24 preparation and your testimony today?

25 A I believe it is.

1 his Exhibits One through Six.

2 MR. LEMAY: Without objection
3 Exhibits One through Six will be admitted with a request
4 that Exhibit Six be supplied to us with color because (not
5 clearly understood) can't differentiate it without color.

6 A We will.

7 MR. LEMAY: Just get it when
8 you can.

9 A We'll get it to you.

10 MR. LEMAY: Thank you. Addi-
11 tional questions of the witness?

12 Mr. Lyon?

13

14 QUESTIONS BY MR. LYON:

15 Q I'm Vic Lyon, Chief Engineer for the Oil
16 Conservation Division.

17 Mr. Jones, did you say that you were on
18 the committee that reviewed the proration rules and recom-
19 mended the changes that were adopted by Order R-8170-A?

20 A I was originally assigned to that com-
21 mittee but I had a substitute.

22 Q As I understand it, you said that you
23 and your company were advocating changing the rules to per-
24 mit 12 times overproduction for the wells in the San Juan
25 Basin, is that right?

1 A That's correct. We supported that.

2 Q And do you recall what the committee or
3 what your company felt would be accomplished by making that
4 change in the rules?

5 A What would be accomplished is it would
6 allow Tenneco to market some of the gas that was plus 6
7 times overproduced at that time and it was a quick fix, so
8 to speak, until we were able to get our hands around, at
9 least the committee's recommendations, get their hands
10 around the new market, so to speak, and how to create a
11 system that would handle the spot market.

12 Q Do you have any evidence to show that --
13 the things that would be accomplished by that change have
14 been accomplished?

15 A Certainly it increased or enhanced our
16 ability to market gas in 1986 and '87 and continues to do
17 so in '88, because if we go back to the 6 times overpro-
18 duced limit at this time, I've showed the volumes that
19 would be affected and would be shut in and not marketable.

20 Q Do you have any data as to whether you
21 have more wells or less wells that are overproduced greater
22 than is permitted by the rules now as compared to before we
23 made the change in the rules?

24 A I compared back to 1986, November of '86
25 versus November of '88. Our situation is not quite as

1 severe, the producing situation, as it was in 1986.

2 Q So you believe that there are fewer
3 wells which are shut in because of excessive overproduc-
4 tion?

5 A That is correct.

6 Q In 1986 you mentioned excessive overpro-
7 duction in the pools as to prorated pools in San Juan
8 Basin. Did you not comment on that?

9 A Yes.

10 Q Are you commenting about excessive over-
11 production in Tenneco's properties only or the pool as a
12 whole?

13 A Well, obviously I was testifying for
14 Tenneco and our situation, but I am aware of other produ-
15 cers in the basin that have wells that are overproduced,
16 certainly between -- well, not only plus 12 times overpro-
17 duced but also between 6 and 12 times.

18 So I'm not advocating that the entire
19 basin is overproduced because, as I showed earlier, we have
20 40 percent of our volume that we don't even market, cannot
21 market on the spot market.

22 Q 40 percent of your volume?

23 A That's correct.

24 Q You cannot market?

25 A Has not been marketed, that's correct.

1 Q And does -- is that represented by those
2 wells that are shut in for overproduction plus those that
3 due to nonconsenting owners under those wells you are not
4 able to produce into the market?

5 A The 40 percent does not include the
6 overproduced wells.

7 Q That's quite a large volume.

8 A Yes, sir, because we have --

9 Q Well, what is the reason for the 40
10 percent you can't market?

11 A Well, we have two reasons; actually
12 probably more than two, but two major ones are El Paso has
13 not released these wells to the spot market primarily NGA,
14 or old gas, and the other is multiple working interest own-
15 ers that have not consented to sell their gas on the spot
16 market. Again we have the 75 percent participation cutoff
17 where the well will not flow. That's the majority of the
18 40 percent.

19 Q You would -- you would agree, would you
20 not, that all of the San Juan Basin pools as a whole are
21 underproduced.

22 A Yes, I would, depending -- I mean under-
23 produced versus -- versus what?

24 Q Well, on the net basis, the over/under
25 status in the San Juan Basin Pools are considerably under

1 produced and not overproduced.

2 A Again, that's a function of the alloca-
3 tions that are given.

4 Q Well, if a pool is in balance, if you
5 have overproduced wells, you must then have underproduced
6 wells whose aggregate underproduction totals the aggregate
7 overproduction.

8 A I'll agree that the pool is underpro-
9 duced. Again, it is a function of the allocations given
10 and the reason it is underproduced is because you have
11 several operators that are not moving their wells to the
12 spot market. When you look at 40 percent of our available
13 volume, that's included in that.

14 What I'm looking -- what the operators
15 should be doing is attempting to receive reasonable allo-
16 cations for the wells that can move to the market.

17 Q Well, what -- would you agree that per-
18 haps the -- a good part of the difference is that Tenneco
19 has -- has been able to get a better market than their
20 neighbors?

21 A To answer that question, have we pro-
22 duced more than our fair share, I would say no.

23 If you go back and compare our produc-
24 tion, in 1985 totals it's lower. The market demand in
25 California it's greater, in my opinion, than it was in

1 1985, and our production is lower, yet we're probably one
2 of the most overproduced companies in the San Juan Basin.
3 That doesn't make sense.

4 Q Well, if you're -- if you're overpro-
5 duced and your neighbors are underproduced, how can you say
6 that you haven't had your fair share?

7 A I consider a fair share is a percent of
8 reasonable market demand.

9 Q Well --

10 A If they shut in, if they shut in, does
11 that mean I shut in every time?

12 Q No, it doesn't mean that, but the fact
13 that you're overproduced does not -- does that not indicate
14 that you've had more than your share of the production from
15 the pool?

16 A It depends on the allocations. If the
17 allocations are reasonable I would not believe we would be
18 overproduced.

19 Q And what would you call reasonable allo-
20 cations?

21 A I would at this time recommend 1985
22 totals.

23 Q All right, if we -- if we allocated 1985
24 allowables do you think the overproduction or underproduc-
25 tion would be different?

1 A The overproduction would certainly be
2 lessened and the overproduction would be increased. (sic)

3 Q The underproduction would be consider-
4 ably increased, wouldn't it?

5 A That is correct.

6 Q But doesn't --

7 A But it's the total -- a totally differ-
8 ent market than it was in 1985. Everyone had the oppor-
9 tunity to participate and everyone did participate; totally
10 different market.

11 Q If -- if the Division were to do that do
12 you think that we would be protecting correlative rights?

13 A I believe you still could, yes, sir.
14 You afford the opportunity to produce.

15 Q Now, you recognize that people -- the
16 wells that are not producing at all should be classified
17 marginal and they carry no overproduction or underproduc-
18 tion.

19 A That's correct.

20 Q So the underproduction is not represent-
21 ed by people who have shut in their wells. It's represent-
22 ed by wells that are producing but don't have the same mar-
23 ket for their gas as Tenneco.

24 A Well, we have several of our wells, as I
25 mentioned earlier, are shut in.

1 Q Why?

2 A Because we -- they're not marketable at
3 40 percent.

4 Q You're talking about the 40 percent.

5 A Yes, we're in the same boat. All I'm
6 advocating is we need reasonable allocation for the wells
7 that we're able to market. If we don't get them, then it's
8 again, I think, just a dead spot or I'll call it a shut in
9 spot.

10 Q Tenneco has evidently done an excellent
11 job of finding markets for their gas. Have you ever con-
12 sidered sharing the market with any of your neighbors?

13 A No one's asked.

14 Q Looks like --

15 A We're -- our primary markets are the
16 LDC's in California and everyone has the ability to market
17 their gas to those LDC's. We don't have many individual
18 users we market our gas to.

19 Q I believe that in 1986 there was instal-
20 led a moratorium on reclassification of wells. Do you re-
21 member that?

22 A Vaguely.

23 Q And in one of your exhibits you showed a
24 fluctuation of the count of nonmarginal and marginal wells,
25 and I think you commented that -- that there is allowable

1 going to wells that -- that shouldn't have it because those
2 wells are not producing their allowables.

3 A Well, the case in point here, if you
4 look at the Exhibit Number Five, we had a very good winter
5 this last year. Several of the wells that have not moved
6 to the spot market and probably won't move, were turned on;
7 therefor were reclassified from marginal to nonmarginal.
8 You see the jump in April. Those wells probably never will
9 participate in the spot market. I won't say all of them
10 but let's say a portion of them.

11 Then during the summer months when the
12 allocations are lower you have more nonmarginal wells that
13 are not participating in the spot market and what that does
14 is it lowers the true allocation to wells that are partici-
15 pating.

16 Q Referring to your Exhibit One, you com-
17 mented that the allowables went down in 1986 and I think
18 that, so far as my understanding, was problems with the
19 market in California and a transition from traditional gas
20 sales to spot markets and the fact that a number of wells
21 could not be released to the spot market.

22 A That was part of the reason, that's
23 correct.

24 Q And that the allowables went up consid-
25 erably in 1987.

1 A That's correct.

2 Q And are you aware that in May of 1987
3 that there was a very, very large adjustment made in the
4 allowables which increased those allowables three to five
5 times the average monthly allowable?

6 A I was aware of that, yes, sir.

7 Q And you are aware of the fact that --
8 that overproduction, times over, is based on the average of
9 the 12 months prior allowable.

10 A Yes, I am.

11 Q So that as long as that May, 1987 allow-
12 able was in a 12-month period, you had a higher OP limit --

13 A That's correct.

14 Q -- than you did afterwards.

15 A That's correct. That's why you saw the
16 major change, too, and will continue to see the change, I
17 pointed out from I believe it was Exhibit -- Exhibit Four.
18 You see the change from July to October. I'll again repeat
19 that the majority of this gas was not on line; however, we
20 became more and more overproduced because of exactly what
21 you mentioned.

22 Q Now, referring to Exhibit Six, one of
23 the -- your -- I think that top line is red showing the
24 deliverability.

25 A That's a combination of all the nonmar-

1 ginal (unclear).

2 Q Now that line seems to fluctuate from
3 month to month. Is that due to the fact that you have
4 added up the deliverabilities shown in the proration sched-
5 ule and plotted the number on your chart?

6 A That's correct.

7 Q And as wells are reclassified from mar-
8 ginal to nonmarginal, then, or from nonmarginal to mar-
9 ginal, those wells drop out and that deliverability is not
10 included in your total.

11 A That's correct.

12 Q What confidence do you have or what
13 degree of confidence do you have that that deliverability
14 represents the true deliverability of the pool to put gas
15 in the pipeline?

16 A I think the combinations of deliverabil-
17 ity shown here is probably slightly inflated.

18 Q And of course you don't show on there
19 the deliverability of wells that are marketed.

20 A No, sir, but we do have that available.

21 MR. LYON: I believe that's
22 all.

23 MR. LEMAY: Any other ques-
24 tions of the witness?

25 Commissioner Humphries.

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QUESTIONS BY MR. HUMPHRIES:

Q It's your contention that regulatory mathematics are creating supply questions; that New Mexico can't supply by regulatory prohibition to a long term contract to the California market.

A I'm saying it's hindering the ability to move that gas to long term contracts, particularly the total amount to be able to commit.

Q And that by the application of mathematics and proration formulas that it will self-defeat, I think you used the word "death spiral". Is that -- and your contention is that that's strictly mathematical, that there is an adequate demand for at least Tenneco's product at the other end of the pipeline.

A Yes, sir, I believe there is.

Q And that these rules keep Tenneco and perhaps other companies, then, from developing long term contracts to supply New Mexico gas.

A Yes, sir.

Q Have you had to turn down contract offers?

A Yes, sir.

Q In what -- what amounts?

A Well, since July we became aware of the

1 proration problem as the allocations continued to drop and
2 we took gas off the market, did not market that gas. Ob-
3 viously the wells that were plus 12 times overproduced
4 stayed, we were unable to market those.

5 But we took the wells that were plus 9
6 times overproduced off the market altogether and we went to
7 the (unclear).

8 Q But again that's, in your opinion that's
9 caused strictly by proration formula, not by your ability
10 to supply the gas or the demand for the gas.

11 A Yes, sir, I believe that.

12 Q Can you make an estimate of -- well, I
13 don't want to ask that. And this is since July of 1988?

14 A Well, this is when we became concerned
15 as the allocations continued to drop and as Vic mentioned,
16 you started dropping the high allocations from 1987 on,
17 then what it does is lower your ultimate production limit,
18 and that's when we became concerned as the allocations
19 dropped.

20 I do want to point out, too, that in
21 October we withdrew quite a bit of gas from the market be-
22 cause of price. Meridian, I believe, did the same thing.
23 And if you use the formula that is currently in place, the
24 allocation reflected from October's production will be
25 extremely low. It doesn't reflect market demand.

1 Q And your contention is that in July,
2 1988, Tenneco was forced to make a decision to voluntarily
3 -- not voluntarily -- regulatorily limit their production

4 A Well, obviously regulatorily on the plus
5 12 times but we voluntarily removed the gas in some cases
6 plus 6 times and other cases plus 9 times.

7 Q Now, --

8 A Because we were concerned about the in-
9 creasing overproduced situation.

10 Q Were these reduced volumes that Tenneco
11 could offer, were they spot market sales or contract sales?

12 A No, they were spot market.

13 Q So you didn't have a long term contract
14 at that point. You were taking advantage of the spot mar-
15 ket.

16 A Yes, sir.

17 Q And then you say that there is another
18 volume of gas that you have in your ability to supply that
19 you can't supply for regulatory reasons.

20 A That's correct.

21 Q Can you give me estimates of which --
22 which amount of your reduction in sales is spot market re-
23 duction and which amount by you opting not to take the op-
24 portunity to sell because of price, and how much is held
25 off. You used the term 40 percent but I had the feeling

1 that that included all of Tenneco's voluntary or limiting
2 factors.

3 A First of all, of the gas we were able to
4 market, we call marketable, when I say that, that's to the
5 spot market or a long term contract that we've signed with
6 an end user in California or an LDC in California. That
7 volume that would be in question that I showed earlier was
8 about the 60-million a day. That would be the plus 6 times
9 overproduced. Of that about 20-million was plus 12 times
10 overproduced and we were unable to move it. And then
11 roughly 20 and 20 would be, I showed it on the pie chart,
12 roughly 20 and 20 would be 6 to 9 times and then 9 to 12
13 would be the other 20. So it, simply put, we have 20 from
14 6 to 9; 20 from 9 to 12; and plus 12 would be another 20;
15 for a total of 60, plus or minus. I don't have any numbers
16 exactly in front of me or on the exhibits.

17 Q I apologize if I'm over-complicating
18 this, but out of the pie, 100 percent of your ability to
19 produce, voluntarily you're choosing not to produce some.

20 A Let me -- it's not quite that simple.
21 Let me back up a little bit.

22 Starting in July, depending on the spot
23 market price from month to month, we made a conscious deci-
24 sion how much gas to hold off the market in that 6 to 12
25 times area. As we saw the allocations dropping, then we

1 pulled that volume off the market. If we had a fairly low
2 price, like in October we pulled all of that volume off the
3 market. If we saw a fairly high price, like we saw in
4 September, we marketed everything up to 12 times overpro-
5 duced.

6 But obviously with the concerns of the
7 lower allocations we made that decision month to month on
8 how much of that volume to move to the market as we con-
9 tinued, number one, to look at the price and also see the
10 continuing allocations and what they're going to do. If we
11 saw the allocations increase, then it would give us much
12 more confidence to move more gas to the market of that
13 200-million a day that I consider truly marketable, and
14 when I say that, that's on the spot market, not under of
15 our traditional sales contracts that we have at the time.

16 Q How much of that 40 percent is produced
17 from sales contracts?

18 A Well, all of our wells are under tradi-
19 tional sales contracts today. And only the 200-million a
20 day that we have is on temporary release from those con-
21 tracts that we're able to market.

22 Q And the other 40 percent you can't get a
23 temporary release for or you can't get 75 percent produca-
24 bility.

25 A That's correct.

1 Q Is it -- is it your contention, then,
2 that Tenneco, under normal circumstances, you probably
3 can't speak for any other companies, but under normal cir-
4 cumstances, given your contracts and your traditional and
5 spot market ability to market your product, could sell up
6 to that 60 percent then every day.

7 A Depending on if the allocations were
8 higher, absolutely.

9 MR. HUMPHRIES: Okay. I have
10 nothing further.

11 MR. LEMAY: Mr. Lyon?

12
13 QUESTIONS BY MR. LYON:

14 Q Mr. Jones, you mentioned that you had a
15 cutoff point for when you would produce your wells, your
16 gas into the spot market, and apparently other operators
17 have -- have a cutoff point, also. Perhaps the reason for
18 the disparity of your -- Tenneco being overproduced and the
19 other, or most of the other operators being underproduced,
20 is that they have a higher cutoff point at where they would
21 sell their gas. Do you think that's true?

22 A No, sir.

23 Q What do you think?

24 A Because the wells that we're producing
25 to the market now we have greater than 75 percent, in most

1 cases 100 percent participation, and with the current
2 allocations they're becoming more and more overproduced.
3 I'm not talking about the entire pool, I'm talking about
4 the one well with a volume of gas that could be available
5 to the market.

6 Q But the underproduced wells in the pool,
7 and you will admit, will you not, that there is a prepon-
8 derance of underproduced wells rather than overproduced
9 wells.

10 A And we have several of those, yes, sir.

11 Q And what is the reason that they're not
12 producing any more?

13 A As far as our wells, the 40 percent, I
14 think I've covered the reasons for that. All the other
15 operators, I'm sure, are in the same -- several of the
16 other operators are in the same boat we are, as far as
17 working interest owners, release from contract, et cetera.

18 Q Thank you.

19

20 QUESTIONS BY MR. LEMAY:

21 Q Mr. Jones, I just have a couple ques-
22 tions.

23 You referred early on to a long term
24 solution or a longer term solution. Does that basically
25 involve higher allocations for those prorated pools in

1 northwest New Mexico?

2 A Yes, sir.

3 Q Referring to your 40 percent, and also
4 our regulatory function to afford the opportunity for each
5 operator to produce, I'd like to just concentrate on that a
6 little bit.

7 Is it not a business decision on the
8 part of Tenneco to not produce those wells where you have
9 less than 75 percent willingness to go to market? In other
10 words, could you not produce those wells and take the pos-
11 ition that you were only producing your percentage of the
12 gas and that the remainder, the nonconsenting parties would
13 have their gas left in the reservoir?

14 A We could do that, yes, sir. We would
15 say severely over balanced in that case.

16 Q So would that not be an opportunity to
17 produce and that you have chosen not to produce because of
18 that business decision that you made?

19 A Yes, sir.

20 Q Would it also not be an opportunity to
21 produce the NGA gas that is not released by El Paso because
22 there -- isn't there a provision that you can get that gas
23 released from the FERC because of generic abandonment that
24 they recently enacted?

25 A I'm really not sure.

1 Q I was trying to concentrate on the 40
2 percent. The implication was that you could not produce
3 that gas and I'm just trying to lay out a scenario where
4 you could produce it but you choose not to because of
5 either the business risk of producing where you have less
6 than 75 percent of the formal application to FERC for
7 generic abandonment, and the decision not to produce it
8 because of price.

9 A That's correct.

10 MR. LEMAY: Additional
11 questions of the witness?

12 If not, he may be excused.

13 And, Mr. Kellahin, do you have
14 an additional witness?

15 MR. KELLAHIN: Yes, sir.

16 Mr. Chairman, at this time I'd
17 like to call Mr. Fraley, a petroleum engineer with Meridian
18 Oil, Inc.

19

20 RICHARD FRALEY,
21 being called as a witness and being duly sworn upon his
22 oath, testified as follows, to-wit:

23

24

DIRECT EXAMINATION

25 BY MR. KELLAHIN:

1 Q Mr. Fraley, for the record would you
2 please state your name and occupation?

3 A My name is Richard Fraley. I'm the
4 Regional Production Engineer and Supervisor for Meridian in
5 Farmington.

6 Q You're softly spoken, Richard, would you
7 speak up for us?

8 A Okay.

9 Q Take a moment and describe for us your
10 educational background.

11 A I received a Bachelor of Science degree
12 in geological engineering from Colorado School of Mines in
13 1979.

14 Q Subsequent to graduation, Mr. Fraley,
15 would you describe your employment experience as a petro-
16 leum engineer?

17 A I've worked as a reservoir engineer, a
18 production engineer and I've been a joint interest engineer
19 and supervisor throughout my eight years of industry exper-
20 ience.

21 Q Have you testified before the Oil Con-
22 servation Division on other matters before this?

23 A Yes, I have.

24 Q And have you done so in your capacity
25 either as a reservoir engineer or a petroleum engineer?

1 A Yes, I have.

2 Q Describe for us specifically what it is
3 that you do for Meridian Oil Company insofar as gas prora-
4 tioning in the northwestern part of New Mexico is concern-
5 ed.

6 A The Production Engineering Department is
7 responsible for the production and maintenance of the wells
8 that Meridian operates in the San Juan Basin, which is on
9 the order of 5000 wells, and in addition we monitor sales
10 and production from those wells, and we interact with the
11 marketing group and provide estimates to them of what we
12 think we can market.

13 Q Are you familiar with the prorationing
14 rules of New Mexico, Mr. Fraley?

15 A Yes, I am.

16 Q And what is your position and your com-
17 pany's position in this case?

18 A Our position, not to elaborate any more
19 on what Mr. Jones spoke of, but we are in support of Tenne-
20 co's recommendation to continue the 12 times overproduct-
21 ion.

22 Q Does Meridian Oil, Inc., have wells that
23 are overproduced under the current system?

24 A Yes, we do.

25 Q And you also have a significant number

1 of wells that are carried in an underproduced status, do
2 you not?

3 A Yes, we do.

4 MR. KELLAHIN: We tender at
5 this time Mr. Fraley as an expert petroleum engineer.

6 MR. LEMAY: His qualifications
7 are acceptable.

8 Q Mr. Fraley, I'd like to direct your
9 attention to your Exhibit Number One and before we discuss
10 your conclusions and what that exhibit shows you, show how
11 to read it first of all.

12 Q Okay. This is a plot showing the wells
13 that Meridian operates in the San Juan Basin. And what
14 I've plotted is the amount of production that we have shut
15 in in terms of million cubic feet per day versus time
16 through the year 1988, and in addition the number of wells
17 that we have shut in in the San Juan Basin associated with
18 that volume. As you can see, in October we were up to
19 about 50-million cubic feet a day shut in and in excess of
20 200 wells.

21 Q You talk about shut in, you're looking
22 at the 12 times overproduction of limitation?

23 A Yes, that's correct.

24 Q And that's plotted on the red line of
25 the display?

1 A Yes, it would be the upper line on those
2 -- I guess all the copies are colored.

3 Q What conclusion do you reach from an
4 analysis of that information?

5 A Well, what we're attempting to show here
6 is that again the amount that we have shut in due to over-
7 production at 12 times has increased through time through-
8 out the year and I'll show on the next plot that our sales
9 have decreased through this period of time and even with
10 that decrease in sales we have seen an increase in shut in
11 due the 12 times overproduction.

12 And the other thing I'd like to point
13 out here, well, first off, that's a result again, as Mr.
14 Jones alluded to, as a result of the way that the alloca-
15 tions are currently being done.

16 As I indicated earlier, we operate in
17 excess of 5000 wells in the San Juan Basin but to give you
18 a better idea of our production, roughly 70 percent of our
19 production comes from about 20 percent of our wells. In
20 other words, you have a preponderance of good wells that
21 account for a large portion of your production.

22 20 percent represents roughly 1000 wells
23 so when we shut in in excess of 200 wells we are shutting
24 in, obviously, a large portion of our production and it af-
25 fects our ability to market significantly.

1 Q What are the reasons that you have re-
2 commended to the Commission the continuation of the 12
3 times overproduction.

4 A Again I want to reiterate what Mr. Jones
5 said, and that is that this is obviously not a long term
6 solution but a short term fix that needs to be studied. I
7 think for one reason, we need to continue to market the gas
8 from the San Juan Basin so that New Mexico can continue to
9 capture a large portion of the market demand in California;
10 (not clearly understood) obviously with the continuance
11 even at 12 times we're restricting what we're able to flow
12 to the market, and we would also recommend that this be
13 studied first (not clearly understood) recommend that even
14 12 times overproduction be continued.

15 Q Let's turn to your Exhibit Number Two,
16 Mr. Fraley. Please identify what you've displayed on that
17 exhibit.

18 A Exhibit Two is a plot of Meridian's
19 actual sales again from wells producing in the San Juan
20 Basin. The value for that is in million cubic feet per day
21 and that's indicated by the area under the line.

22 Q You'll have to help us, describe the
23 display because I think there's only one or two copies that
24 are colored.

25 A Right. The lower dashed in portion

1 again represents actual sales. The portion that I've
2 indicated potential sales is that gas that we have not been
3 able to market as a result of the overproduction. In other
4 words, that, in essence, reflects the value from Exhibit
5 One, and what we're saying is that our sales have dropped
6 through time over the summer for a couple of reasons.

7 Number one, the pipeline companies have
8 had a number of shut in calls throughout the summer months.
9 Demand was less during the summer, but again we feel we
10 would have increased sales through that time if we had been
11 able to produce those wells that are shut in.

12 Q Give us some sense of the impact of the
13 12 times rule on your company, Mr. Fraley, if the Commis-
14 sion should terminate that rule.

15 A What I've indicated here, as you'll
16 note. through time the wedge, what I call the wedge of po-
17 tential sales is increasing and is again because of the gas
18 being restricted due to overproduction.

19 If we were to go from 12 times overpro-
20 duced today to 6 times overproduced just for the wells re-
21 presented within that wedge, we would go from having the
22 wells shut in on the average of 2.6 months to get back
23 within the limits, to a period of 8.9 months, and we would
24 probably have in excess of 75-million cubic feet per day
25 shut in for that 9-month period.

1 I'd like to point out that this wedge
2 does not include currently those wells between 6 and 12
3 times overproduced. The time I had to study this did not
4 allow me to look at that, but I would estimate that we
5 would end up with in excess of under -- of under
6 100-million cubic feet per day shut in for those additional
7 wells and that on the average these wells would be shut in
8 for about a year.

9 The significance of this is that we
10 would have severe ramifications through winter, particu-
11 larly, of 1989, as it would limit Meridian's ability, and
12 also the State of New Mexico's ability to produce gas dur-
13 ing these peak months. It's very hard to pick up new mar-
14 kets once they're lost. We're trying very aggressively to
15 sell our gas, as is Tenneco, and we feel it's imperative
16 that New Mexico hold on to that share and be able to supply
17 gas to the markets in California.

18 Q Mr. Fraley, are you aware of any com-
19 plaints expressed to you or heard by you that the 12 times
20 overproduction number is allowing such a large volume of
21 production to be produced to the detriment of adjoining
22 properties so that drainage is occurring?

23 A No, I have not.

24 Q Do you see any correlative rights prob-
25 lem with the continuation of the 12 times overproduced --

1 A No, I don't.

2 Q Let's look at October of '88, is it, --

3 A Yes.

4 Q -- on one of your displays there?

5 A Yes.

6 Q What is occurring in Meridian to cause
7 that production number to drop so drastically.

8 A Again the production drops in October
9 are as a result of our choice not to choose gas -- or not
10 to sell gas for that month. The spot sales price was so
11 low that we decided to hold back some of our volumes. The
12 volume that was sold reflects those volumes that were com-
13 mitted to longer term contracts.

14 Q What will happen, then, to your future
15 allowables once the actual restricted production, your vol-
16 untarily restricted production for October, has been imple-
17 mented into the prorationing of allowable system? What's
18 going to happen?

19 A I think it would reduce our sales again.
20 As I indicated, the amount of overproduced gas increased in
21 October despite the fact that we cut our sales roughly in
22 half, and I think that would continue to follow.

23 Q Do you concur with Mr. Jones that there
24 is not a current method utilized by the Division that accu-
25 rately reflects market demand with these set allowables?

1 A Yes, I would agree with that.

2 MR. KELLAHIN: That concludes
3 my examination of Mr. Fraley.

4 We'd move the introduction of
5 Exhibits One and Two.

6 MR. LEMAY: Without objection
7 Exhibits One and Two will be admitted into the record.

8 Questions of Mr. Fraley?

9 Mr. Lyon.

10

11 QUESTIONS BY MR. LYON:

12 Q Mr. Fraley, I've -- if you mentioned it,
13 I did not remember, what you did before you came with Meri-
14 dian, who you worked for?

15 A I worked for Superior Oil Company and
16 Mobil Oil in the capacity of reservoir engineer.

17 Q As I recall, at the time that the com-
18 mittee met to consider changing these rules to adjust --
19 make some adjustments to the new situation in the gas mar-
20 keting, Meridian, as it's constituted today, didn't exist,
21 is that right?

22 A That's probably correct, yes.

23 Q So you probably did not have anybody
24 that attended those -- those meetings.

25 A Not to my knowledge.

1 Q And as I understand your testimony, you
2 feel that the 12 times over has accommodated the need to
3 move gas to the market through spot market or otherwise.

4 A I think it has helped on certain terms
5 that I indicated, even with the 12 times, obviously, I
6 would agree with Louis in that it is even currently re-
7 stricting our ability to market gas.

8 Q In regard to your perception of market
9 demand, do you believe that market demand has dropped from
10 September to October of 1988?

11 A No, I don't think the market demand has
12 dropped. Again that reflects our sales, but it does not
13 reflect the fact that we voluntarily chose not to market
14 gas for that month.

15 Q Would you agree with me that market
16 demand to a large extent depends on the price of gas?

17 A I think from the standpoint of an oil
18 company it depends on price of the gas. It doesn't change
19 the fact that there is a demand from the end users.

20 Q But apparently there was -- there was
21 not a demand or a price for gas at a price that you were
22 willing to accept, that was --

23 A That's correct.

24 Q -- equal to September.

25 A That's correct. Some of that was not

1 only market and price driven but in addition some of the
2 costs associated with transporting the gas through the
3 pipelines were such that we chose not to market the gas.
4 In other words, the net price to us was such that we chose
5 not to market.

6 Q Your Exhibit One shows a considerable
7 volume, a considerable number of wells that are shut in for
8 excessive overproduction.

9 A That's correct.

10 Q Are you familiar with Meridian's prac-
11 tices of flowing wells, selecting to flow the wells to be
12 flowed?

13 A Yes, I am.

14 Q Do you know whether or not Meridian's
15 marginal wells are producing to their maximum capacity?

16 A We adjust monthly based on knowing,
17 obviously, which wells are 12 times overproduced. We shut
18 them in. We try to flow wells at that point in time to
19 meet our market and we flow whichever wells we feel is
20 necessary to meet the market demands.

21 Again, we restrict flow on wells primar-
22 ily based on whether or not they're subject to additional
23 sales or whether or not we have what we deem to be adequate
24 volume participation.

25 We don't have a firm 75 percent limit

1 but we certainly look at what our over and under balance
2 situation is with any of our partners.

3 Q Do -- do you make an attempt, a con-
4 certed attempt, to produce the wells that are underpro-
5 duced?

6 A To whatever extent that meets our mar-
7 ket, yes, we do.

8 Q Do you realize that if you help to meet
9 the market with your marginal wells and your underproduced
10 wells, that you can save your overproduced wells for use
11 when they are needed at the peak demand periods?

12 A Well, that's correct, but as I indi-
13 cated, 70 percent of our production comes from 20 percent
14 of our wells, so you have a large number of poor producing
15 wells that in essence are much harder to keep on for an
16 entire month. If you turn on a well that's making, say, 50
17 MCF a day, and you hope to flow that well all month, the
18 pipeline comes along and, say, picks the flow line, you
19 could very easily shut that well in. It would not be turn-
20 ed on again until you had some field personnel go to the
21 well. So in a sense it is much harder to meet market de-
22 mand with what I would consider to be marginal wells.

23 Q Well, that's true, but they can contri-
24 bute, can't they?

25 A They do contribute.

1 Q And the production that they -- the gas
2 that they produce isn't charged against your overproduced
3 wells.

4 A That's correct.

5 Q Matter of fact, it reduces the amount of
6 the production you need from your overproduced wells.

7 A Yes, but I reiterate, it's very diffi-
8 cult to produce those wells on a sustained basis.

9 Q Well, I'm sure that there -- it takes an
10 effort when there are times you have to shut those wells in
11 but are you aware that in the days when -- before the in-
12 terstate pipelines role became changed, that El Paso had a
13 policy that they kept marginal wells on at all times?

14 A No, I wasn't aware of that and I imagine
15 their personnel situation was much different than ours is
16 today.

17 MR. LYON: That's all I have.

18 MR. LEMAY: Additional ques-
19 tions?

20 Commissioner Humphries?

21

22 QUESTIONS BY MR. HUMPHRIES:

23 Q Mr. Fraley, is Meridian's total produc-
24 tion up or down, the volume?

25 A Versus what point in time?

1 Q 1987.

2 A 1987 --

3 Q January through October, 1987.

4 A I would estimate it's somewhat down from
5 what it was in 1987.

6 Q Did you estimate that or are you sure of
7 that?

8 A I'm estimating that. I don't happen to
9 have the figures before me.

10 Q So could you tell us sometime today be-
11 fore this hearing is over whether your projection is up or
12 down?

13 A I can find out, yes.

14 Q Total volume, not dollars, volume.

15 A Yes.

16 Q You said something that I want to be
17 sure that I wrote it down right; that spot prices being
18 down were what drove your decision not to market gas in
19 this period --

20 A Well, I --

21 Q -- beginning September, 1988.

22 A I clarified that by indicating that
23 really the net price to us at the wellhead is what dic-
24 tates --

25 Q Okay, so it's an economic decision, not

1 a production ability --

2 A Yes, it is.

3 Q -- decision or a demand decision.

4 A Yes, that's correct.

5 Q And again you're stating something very
6 similar to what the previous witness stated, that number of
7 overproduced wells becomes a mathematical function, even
8 though you shut them in, your overproduction continues.

9 A That's correct. Again it's a function
10 of how the allocation is done.

11 Q Have you ever spoken to Mr. Lyon or
12 members of the OCD staff about alternate formulas that may
13 avoid that particular scenario?

14 A Personally I have not.

15 Q Have you ever sat down and tried to
16 create such a formula?

17 A No, I have not.

18 Q And I understood you to say that about
19 70 percent of your production is from about 20 percent of
20 your 1000 -- 5000 wells in the San Juan Basin, is the way I
21 understood it, is that right?

22 A Yes, that's correct.

23 Q So even under the current situation you
24 still have about 80 percent of your 20 percent producing,
25 is that right? You still have some 800 out of 1000 wells

1 producing.

2 A Yes.

3 Q So the 200 wells involved, again that's
4 pretty much a voluntary decision based on price that Meri-
5 dian has made, net back price.

6 A Well, what I indicated is that those 200
7 wells that are shut in obviously reflect a significant
8 amount of our production. The remaining 70 percent of the
9 wells -- or excuse me, 80 percent of the wells probably do
10 not make up anywhere close to what those 200 wells make up.

11 Q So again regardless of the 70/30 split
12 on good wells versus marginal wells or low producing wells,
13 your decision has been economically driven more than as a
14 resulting limitation of this product -- this formula.

15 A It's economically driven. It's driven
16 by the amount of inflow that gets in the pipeline on turn-
17 ing wells on and off due to their (not clearly understood)
18 and it's driven by, again, as I indicated, we have what we
19 consider to be potential sales, which are those wells shut
20 in due to being over 12 times overproduced at this point in
21 time.

22 Q And you couldn't make that potential
23 sale up by some other volume then just from your 70 percent
24 marginal wells. You couldn't have made that potential sale
25 up if you decided that even though the economics weren't as

1 good as you would like it to be, you could have still made
2 the sale and supplied the demand, if there were a demand.

3 A You can make it up, but as I indicated,
4 it's much more difficult to make it up and you can't make
5 it up as consistently as you can with your better wells,
6 obviously.

7 Q Do you deal with marketing Meridian pro-
8 ducts or just delivering them when somebody tells you to?

9 A Primarily delivering. We have a market-
10 ing group that handles the marketing.

11 Q Is it your opinion that Meridian could
12 enter into some longer term contracts but has been preclud-
13 ed from that for fear of inability to supply because of
14 regulatory limitations?

15 A I think that has limited us, yes. Ob-
16 viously it's increasingly limiting us because we have in-
17 creasing volumes that are restricted, so it's more severe
18 now than it was, obviously, the first of the year.

19 Q Do you know if Meridian attempts to
20 enter into long term contracts or prefers to take the risk
21 of the spot market?

22 A We market a larger percentage of our gas
23 on the spot market but we go after as long term contracts
24 as we can receive. We'll sign contracts for a month, for
25 six months, or whatever we can get. I don't know what the

1 split is.

2 Q So that's maybe not really in your area
3 of responsibility.

4 A No, it's not.

5 Q Thank you. I don't have any further
6 questions.

7

8 QUESTIONS BY MR. LEMAY:

9 Q Mr. Fraley, again it may not be in your
10 area. Do you have any idea of what percentage of your gas
11 is marketed in California to the core market to those
12 grandfathered contracts out there that cannot be interrup-
13 ted?

14 A No, I do not.

15 Q Does -- does -- do your wells on Exhibit
16 One and Two also include your coal seam gas as well as your
17 prorated fields that you produce from?

18 A Yes, sir, they do.

19 Q You don't know what percentage of your
20 gas stream right now is coal seam gas or is from prorated
21 fields?

22 A Our daily coal seam production right now
23 is on the order of 40-million cubic feet a day.

24 Q Are you keeping that on even though
25 there's low spot prices or are you shutting some of that

1 in, too?

2 A We keep that on preferentially.

3 Q This is very disturbing in October, be-
4 cause Tenneco, of course, made the same decision and there
5 is basically no gas flowing out of the San Juan Basin. I
6 can understand reasons not to sell based on price. We also
7 heard that most of the large industrial customers in Cali-
8 fornia were switching to fuel oil because of low crude
9 prices and that probably drives the spot price even lower.

10 Is that a decision that Tenneco makes on
11 a month by month basis, whether to sell into the spot mar-
12 ket depending upon alternate fuel prices or whatever is
13 offered out there in California?

14 A Well, again, speaking for Meridian, we
15 look at the price on a month to month basis and the gas
16 that we have available from month to month and make a deci-
17 sion again as to whether or not we feel like we can make
18 money selling that month at that price.

19 Q Recognizing that a decision to shut in
20 San Juan Basin production by major producers will affect
21 the allowables two months hence, do you have any recommen-
22 dation to the Commission as to how that can or should be
23 treated where there is a conscious effort or a conscious
24 decision not to sell?

25 A Again I don't have a formula prepared

1 today to discuss. I think the 12 times overproduced as
2 currently in effect helps somewhat but I'm not prepared to
3 offer anything further today.

4 Q Well, with this scenario we'd shut in
5 the whole basin because there's no -- no production that's
6 easily adjusted. I'm concerned that a decision not to pro-
7 duce affects our allowables and how that interplays, even
8 though you have the opportunity to produce, you choose not
9 to, and that's why I was maybe fishing for an idea.

10 A I share your concern but again I don't
11 have anything to offer today.

12 MR. LEMAY: I would like to
13 recall Mr. Fraley after a short break. Commissioner Hum-
14 phries would like his '87-'88 comparison if it's possible
15 for you to get that in the break, and then we'll conclude
16 with closing statements.

17 Mr. Kellahin?

18 MR. KELLAHIN: I believe
19 there's some --

20 MR. LEMAY: Oh, we have some
21 other --

22 MR. KELLAHIN: -- other, so
23 perhaps during the rest of the testimony this morning we'll
24 have a chance to --

25 MR. LEMAY: Fine, that's fine.

1 Well, we can excuse Mr. Fraley and call
2 him back for that portion, and then let's take a break and
3 come back with some testimony from someone else here.
4

5 (Thereupon a recess was taken.)
6

7 MR. LEMAY: The hearing will
8 come to order.

9 Mr. Fraley, you have been ex-
10 cused. Hopefully we can get that last statement of yours
11 into the record, the question that Commissioner Humphries
12 asked.

13 MR. FRALEY: Okay, I'd like to
14 provide the numbers. For sales for Meridian, 1987, this is
15 100 percent flowed from the wells, we averaged 373.1-mil-
16 lion cubic feet per day for 1987.

17 1988 through September we have
18 averaged 382.8-million cubic feet per day.

19 So there's an increase of
20 roughly 9-million, or closer to 10-million cubic feet per
21 day of sales in 1988.

22 MR. HUMPHRIES: Thank you.

23 MR. LEMAY: Are there addi-
24 tional questions of Mr. Fraley? If not he may be excused.

25 Do you have any additional

1 witnesses, Mr. Kellahin?

2 MR. KELLAHIN: No, sir.

3 MR. LEMAY: Okay, Mr. Duke,
4 you would like to present some direct testimony?

5 MR. DUKE: Yes, thank you.

6 Gas Company of New Mexico
7 calls Mr. Buster Orbison to the stand, please.

8

9 W. J. "BUSTER" ORBISON,
10 being called as a witness and being duly sworn upon his
11 oath, testified as follows, to-wit:

12

13 DIRECT EXAMINATION

14 BY MR. DUKE:

15 Q Mr. Orbison, please state your name and
16 your business address for the record?

17 A W. J. "Buster" Orbison. 1400 Louisiana,
18 Albuquerque, New Mexico.

19 Q Where are you employed and in what capa-
20 city?

21 A With Gas Company of New Mexico. I am
22 Director of Gas Acquisitions and Contract Management.

23 Q Mr. Orbison, would you briefly summarize
24 your educational and professional experience for us?

25 A I have a diploma from LaSalle Extension

1 University in business management and attended University
2 of Northern Arizona. I do not have a degree.

3 I have been in the industry in excess of
4 thirty years, having joined the Gas Company of New Mexico
5 predecessor in 1958 in a sales capacity, and remained in
6 that area of marketing, I was Division Marketing Manager in
7 1968, at which time I moved back to New Mexico from other
8 transfers that I had had in that first few years and was
9 Area Manager from our distribution operations, headquarter-
10 ed in Clovis, New Mexico, and was responsible at that time
11 for the operation of seven towns with a distribution func-
12 tion, transmission functions, compressors, irrigation,
13 rural irrigation system that was operated from that place.

14 In 1977 I moved into the gas supply area
15 of our company and have worked in that area both in Dallas,
16 in Roswell, New Mexico, where I have a gas purchasing
17 office, to my current position in Albuquerque.

18 Q Have you previously testified before the
19 OCD or other regulatory bodies?

20 A I've had testimony entered before the
21 OCD but I have not testified before them.

22 I have testified before the Federal
23 Regulatory Energy Commission and before the New Mexico Pub-
24 lic Service Commission, and before the Construction Trades
25 Industries Board in New Mexico.

1 MR. DUKE: Mr. Chairman, we
2 would like to tender Mr. Orbison as an expert in this case.

3 MR. LEMAY: His qualifications
4 are acceptable.

5 Q Mr. Orbison, in this case you're testi-
6 fying on behalf of Gas Company of New Mexico, is that
7 correct?

8 A That's correct.

9 Q Please briefly describe the gas company
10 and its function as a public utility.

11 A Gas Company of New Mexico is an unincor-
12 porated division of Public Service Company of New Mexico.
13 Through a management contract, the Gas Supply Division of
14 Gas Company of New Mexico, operates for Sunterra Gas
15 Gathering Company, and I serve the same functions for Sun-
16 terra Gas Gathering Company that I do for Gas Company of
17 New Mexico.

18 Gas Company of New Mexico has approxi-
19 mately 22-to-2300 wells connected to its various gathering
20 systems, both it and Sunterra. Gas Company of New Mexico
21 and Sunterra both have gas processing treatment plants and
22 numerous compression facilities, main line transmission
23 into the various towns served, with the exception of those
24 towns that are served solely by interstate pipeline and we
25 describe as our remote locations.

1 Q So you're testifying on behalf of the
2 company that gathers gas and transmits the gas and operates
3 an LDC, is that correct?

4 A Yes, that's correct.

5 Q Does Gas Company currently have wells
6 under contract that are subject to shut in?

7 A Yes. At the end of September we had
8 approximately 100 wells subject to shut in connected to our
9 system.

10 Depending upon the weather we would pro-
11 ject that we may have as high as 250 wells in excess of 6
12 times overproduced and approximately 180 wells 12 times
13 overproduced, those representing, perhaps, the stronger
14 wells connected to our system.

15 That projection through March of 1989.

16 Q Could that affect Gas Company's ability
17 to serve its winter load?

18 A Yes, we believe it could. We may have
19 great difficulty serving our firm New Mexico load if gas
20 allocations from the prorated pools are reduced.

21 Q Mr. Orbison, to your understanding what
22 has caused these wells to become shut in?

23 A Well, obviously, many reasons have been
24 discussed. I think that if you have to carry it to the
25 ultimate, it would result from fundamental changes within

1 the industry itself.

2 MR. DUKE: Mr. Chairman, I
3 would like to identify Gas Company Exhibit One.

4 Q Mr. Orbison, would you describe Exhibit
5 One for us on the overhead, please?

6 A I think that it accurately portrays the
7 producer marketing relationship, that, on the top, existed
8 and functioned for quite a number of years prior to Order
9 380 or to some extent prior to the 1978 initiation of the
10 NGPA.

11 That purports to show that producers had
12 as a method of sales a sometimes gatherer, not always, but
13 almost always a pipeline who almost always sold to a dis-
14 tributor, except in the case of a few large, significantly
15 large, end users, and that that distributor sold to an end
16 user and that the contractual and production arrangements
17 of that entered into over a period of years, they worked.

18 Much disruption occurred from, in my own
19 opinion, regulatory changes, perhaps they were inevitable
20 economically, I'm not convinced of that.

21 The bottom line, I think, represents
22 rather accurately the producer-marketing relationship that
23 exists today. The producer may sell to a broker and/or a
24 clearing house initially, who may go through a gatherer.
25 At that time he could probably impose another marketer, but

1 then to the pipeline, and perhaps then another marketer,
2 and then to the distributor and then to the end user.

3 The purpose of this chart is to show
4 that those interrelations exist for almost every entity in
5 the industry today and that represents a fundamental and
6 probably long term change in the industry that our con-
7 tracts nor our regulations were designed to cope with.

8 Q As this has chanced over time, has Gas
9 Company's role also changed?

10 A Yes. The role of Gas Company and ob-
11 viously the interstate pipelines has changed from what it
12 used to be, a traditional merchant function, to a transpor-
13 tation function. Because of this change Gas Company has
14 experienced a decreasing load but continued to be forced to
15 supply that.

16 Q We are now showing Exhibit Two. We'll
17 have to show this in part, I guess. We'll show the top
18 part first.

19 What does Exhibit Two represent, Mr.
20 Orbison?

21 A Exhibit Two represents the total market
22 that Gas Company of New Mexico experienced in 1978 and then
23 as we will show in a moment, the lower portion of that
24 chart representing those same segments of our customer
25 classification for the ending of 1987.

1 The significant points to be realized
2 from that are, first of all, that the 1987 pile, excuse me,
3 pie, is well over twice the size of the 1987 pie.

4 Q '78.

5 A Our market in 1978 represented in excess
6 of 107-billion cubic feet. Our market at the end of 1988
7 represented 55-billion cubic feet. In fact, our 1988
8 budgeted sales represent 43-billion cubic feet, approxi-
9 mately.

10 The industrial load represented on the
11 upper chart, or on the upper pie, is in excess of 53.6 per-
12 cent. That is now represented as an amount of total load
13 less than 3 percent and represents the most significant de-
14 crease in our system load, which the intent of the chart is
15 to project that and I think that it does.

16 Q The small wedge here?

17 A Yes, the small wedge representing 3.3
18 percent is the remaining industrial load.

19 In essence, most of those customers who
20 volumetrically could gain from the type of bypass, have
21 done so in the period since 1984 when contract carriage was
22 implemented in New Mexico. I believe it was the first
23 state in the union to have implemented contract carriage as
24 a mandated regulation.

25 Q Now, Gas Company has not only lost a

1 great portion of its load but it appears that the composi-
2 tion of that load has changed drastically, is that right?

3 A Yes. Our residential load, as you can
4 see by the chart, represents the greater portion of our
5 market, it and the small commercial customers. Those cus-
6 tomers are extremely low load factor. The industrials,
7 which have to some extent disappeared, represented the high
8 load factor, so, in essence, we now have a seasonal custo-
9 mer and it requires that our winter supply requirements are
10 8-to-10 times that of the rest of the year.

11 Q What has Gas Company done in response to
12 this changing load that it's faced with?

13 A We have, during the off peak sales,
14 moved gas into the spot market in order to achieve some
15 stabilization in our takes and to allow continued operation
16 of our gathering systems, our compression facilities, and
17 our gas treatment plants.

18 Q Has there been a large participation in
19 this spot market, to your knowledge?

20 A Not really. The lack of participation
21 in the spot market has brought about a significant reduc-
22 tion in the volume of gas, though, that is available from
23 the three major prorated pools which can be allocated among
24 those producers who are participating.

25 This volume has decreased by as much as

1 50 percent of the capacity in some of these pools for those
2 producers who are participating.

3 Our company would estimate that the
4 volumes available to the remaining participating producers
5 during our winter demand may be insufficient and certainly
6 after our winter demand, absent any change in what we see
7 today, it would be insufficient to continue to support the
8 operation of our facilities in some cases.

9 Q Why don't you explain how that affects
10 operations of the facilities?

11 A Well, as most people who have become gas
12 buyers are aware, it is impossible to plan a gas system de-
13 picting where the good wells are going to be found sometime
14 later. So systems are designed as best they can with an
15 estimate of where the gas is going to be and what the vol-
16 umes are that are going to be handled. Those systems re-
17 quire separate gathering trunks from small gathering sys-
18 tems connected to the wells whereby we have considerable
19 horsepower, considerable compression, moving that gas into
20 central gathering trunks which then are brought into a con-
21 fluence before the treatment plants in order to give that
22 gas pipeline quality status, which we can deliver to our
23 customers.

24 That is very sensitive to the volume of
25 gas that flows through the system and if you took as an

1 example one of those systems which required, if I may hypo-
2 thetically state, 10-million cubic feet a day for the sys-
3 tem to function because of its design and its pressure
4 regulations, pressure requirements, and all you had was 5-
5 million a day of underproduced wells, it would be very
6 difficult for us to dispatch those wells on a basis of be-
7 ing well specific. When volumetric through-put reduces the
8 operation of our system, and any other pipeline system, it
9 becomes extremely difficult and it is not a thing that is
10 generally discussed a great deal in regulatory proceedings,
11 such as this. Perhaps it is not as well recognized as we
12 in the gathering industry think that it is, but it is a
13 great restriction on our ability and our flexibility to
14 move gas.

15 Q Would you summarize your recommendations
16 on behalf of Gas Company of New Mexico, as well as Sunterra
17 Gas Gathering Company?

18 A Yes. We have three recommendations that
19 we believe would be worth consideration.

20 First, we, as the previous two witnesses
21 have done, we recommend that the OCD consider maintaining
22 the two year balancing period and leave in place the 12
23 times allocation threshold before wells in the northwest
24 are shut in.

25 Transition that the industry is strug-

1 gling through, we believe, warrants this continued leeway.
2 The problems that brought that about have no in large
3 measure disappeared.

4 Secondly, we are aware that there were
5 many, many perceptions that were brought to these proceed-
6 ings two years ago and were entered into suggestions that
7 were given to the two separate committees pursuing these
8 matters two years ago prior to the hearing, and many of
9 those perceptions have now been clarified to a large
10 measure. There is, perhaps, a better understanding even
11 though transition is still facing us, change is still
12 facing us, there is a little bit better level of what those
13 forces are, a little better understanding of that today
14 than there was at that time.

15 Because of that fundamental and long
16 term change in the industry, we would strongly recommend
17 that the OCD appoint a blue ribbon committee to develop and
18 recommend an allocation system under proration that would
19 serve the legislative mandate of the OCD but would also
20 allow our production systems to function adequately in
21 these future business plans that are beginning to jell and
22 to coalesce.

23 Finally, I would recommend that changes
24 in the current administrative allocations be considered to
25 allow a more efficient short term response to the market

1 demands that are available for New Mexico gas producers to
2 serve.

3 Q Do you have anything else to add, Mr.
4 Orbison?

5 A Yes. We applaud the marketing efforts
6 that have been underway by the OCD staff and the industry;
7 witness the recent trip by Governor Carruthers, led by
8 Governor Carruthers, including Chairman Bill Lemay, who
9 have attempted to solidify this concept of New Mexico
10 production as the supply of choice for California. The
11 proration program's primary goal after it satisfies its
12 legislative mandate ought to be to continue providing mar-
13 ket stability and to protect its correlative rights, as
14 well.

15 There is one further point we would like
16 to -- to leave, and that's recognition and gratitude, also,
17 that the Director and Commission staff, for their continued
18 willingness to serve as a clearing house for the multitude
19 of proposals that have been offered in our quest to match
20 our proration system to the ever changing industry, and we
21 are aware of that and grateful for it and want to continue
22 to be a process -- part of that process.

23 Thank you.

24 MR. DUKE: Mr. Chairman, I
25 don't believe I have any further questions.\

1 I would offer into evidence
2 Gas Company of New Mexico Exhibits One and Two.

3 MR. LEMAY: Without objection
4 Exhibits One and Two will be admitted into the record.

5 Additional questions of Mr.
6 Orbison?

7 Mr. Lyon.

8
9 QUESTIONS BY MR. LYON:

10 Q Mr. Orbison, your Exhibit Two shows that
11 you've lost almost all of your industrial load and that has
12 taken approximately 50 percent of your total load, which is
13 what you're supplying today.

14 A Yes.

15 Q You may have mentioned it but I failed
16 to catch it, in your lower chart, what does the T and B
17 stand for?

18 A I'm sorry, I didn't clarify that. That
19 is transportation and brokerage. In the 1987 time frame
20 there was still a few remaining brokerage sales being made
21 that were prior to the effect of House Bill 444, which pro-
22 hibited Gas Company from doing any brokerage type sales of
23 New Mexico gas.

24 Q Okay, thank you. I know that you did
25 not make a comparison or you do not show a comparison for

1 the situation that existed at the time of the committee
2 meeting, or the committees were meeting in 1986.

3 A Yes.

4 Q If you have the data I'd like you to
5 give me a more firm answer and if you don't have the data
6 I'd like your estimation of whether your pie charts on
7 Exhibit Two were representative of the conditions in 1986.
8 In other words, were we still in a transition stage in 1986
9 or was the lower chart approximately representative of the
10 conditions in 1986?

11 A Mr. Lyons, I believe it would be some-
12 what representative of the conditions in 1986. The devel-
13 opment of marketing and brokerage methods throughout the
14 industry was just beginning to solidify and become work-
15 able in a greater extent. There was perhaps a multitude of
16 people who had entered that business and those who were
17 good enough to survive were beginning to show up as the
18 leaders.

19 So there's still a lot of transition
20 occurring in the '86 to '87 time period inasmuch as the
21 spot market really did not exist prior to the August/Sep-
22 tember time frame of 1985. That was a very rapid response
23 basically on the part of the industry to try to take advan-
24 tage of the competitiveness that the FERC had introduced
25 into the industry.

1 Our situation was very similar to that.
2 We were seeing a considerable amount of bypass occurring
3 and during that same year legislation and regulatory re-
4 strictions and assistance and rules were being promulgated
5 and initiated which affected our ability to respond to the
6 market. That part is not clearly shown in the 1986 time
7 frame but it is representative in 1987 results of that
8 chart.

9 So transition was occurring through that
10 period.

11 Q Okay, thank you. And did I understand
12 you to say that in September, the end of September, you had
13 100 wells that were 12 times overproduced or was that 6
14 times overproduced?

15 A 12 times overproduced, I believe is cor-
16 rect, yes.

17 Q Do you have a recollection as to how
18 many wells were more than 6 times overproduced in 1986?

19 A Mr. Lyons, it's approximately 250. I do
20 not have the exact figure in mind but I do have it on a
21 study on my desk in Albuquerque.

22 Q So the number of wells that are subject
23 to shut in because of overproduction has been reduced since
24 1986 by going to 12 times over?

25 A The problem with a direct answer to that

1 to say yes, is that the wells that are currently subject to
2 shut in are the stronger producers and would represent a
3 significantly greater portion of production than would
4 those wells that are significantly underproduced. We
5 experienced the same thing that has been mentioned here
6 this morning in that those weaker wells or those marginal
7 wells by their ability are underproduced often because of
8 pressure problems and other factors. But the ones that are
9 shut in are normally the stronger wells that have been on
10 the market longer.

11 Q This may be a little difficult, but
12 based on your perception of our current system and current
13 levels of allowables, and so forth, would it be your --
14 would you expect the number of wells that are subject to
15 shut in to increase or decrease by this time next year?

16 A Our projections of what would occur
17 absent any change in our existing system would indicate
18 that we would have nearly all of the participating, by par-
19 ticipating I mean those participating in markets other than
20 our 3-month commodity purchase, would be almost entirely
21 subject to shut off and would have at that time drastically
22 reduced the ability of our Sunterra Gathering Company to
23 participate in the spot market and would have also created
24 very drastic problems in the operation of our systems and
25 our treatment plants, and I'm talking about jobs and poten-

1 tial shut in of those operations.

2 Q If I understand your -- your answer
3 correct, you're in a sort of death spiral as Mr. Jones
4 referred to it, that either you need a higher allocation or
5 indeed more wells to supply your demands. Is that a fair
6 analysis?

7 A Because of the need to supply a market
8 that is still significantly strong during the winter
9 months, it is weather sensitive, it is 8 to 10 times
10 greater than our summer load, which is still in supply. We
11 have done a number of things, but the problem that we're
12 faced with in long term contracts, we have not had a sig-
13 nificant release program; it has not been necessary through
14 the Sunterra group. It has been merely a cooperative ef-
15 fort of the participating producers to reprice to a level
16 that accommodates the spot market. Those participants
17 being shut in would mean that a reduction will occur in the
18 gas that is available and it would not long remain
19 available to us to our belief, because of the increased
20 efforts on FERC's part to insure that gas not flowing will
21 be freed up to the market and a significant number of those
22 contracts under Sunterra are jurisdictional contracts,
23 certificated contracts, and under one form or another could
24 probably be made available to the market and not available
25 to the New Mexico consumer. We have strong concerns about

1 that.

2 To say that we would need more wells, I
3 am aware that as you look around for the commodity buyers
4 in the industry today, there almost aren't any. We are for
5 three months of the year, maybe four. El Paso Natural has
6 become almost exclusively a transporter. They have hardly
7 any -- I understand that there were zero nominations for
8 the month of October for commodity gas from their -- from
9 their system, and those producers who are not participating
10 and I'm sure they have their own reasons why, I understand
11 they have, but nonetheless, that nonparticipation, even if
12 it's 5 percent, means that we will not flow that well to
13 the market under a cooperative effort with the operator
14 because our contract would require that a price consider-
15 ably greater than the spot market price might be -- that
16 might be the exposure we faced. So to continue the spot
17 market it isn't feasible that we could -- we could go get
18 additional wells for that purpose. To release the volume
19 that we currently have would mean we could not serve the
20 New Mexico customers a firm load during the winter absent
21 some very uncertain attempts to purchase long term gas in
22 the face of an uncertain settlement of El Paso's rate case
23 as to what firm transportation is going to be and who's
24 going to handle allocation of that. It is not a known fact
25 at this time. So there are so many unknowns and inconsis-

1 tencies that our concern is that change must occur some way
2 over the next year or so to cause the market that is
3 available and it appears predominantly to be the spot
4 market. Those long term contracts that I understand have
5 been entered into by SoCal and by PG & E, witness the one
6 that is listed in the industry journals as 100-million a
7 day long term from Enron, or the Sun 500-million a day that
8 SoCal is purported to have signed up in long term con-
9 tracts. I'm not aware of any of that is New Mexico gas in
10 any significant quantities.

11 I am very concerned, Mr. Jones has been
12 and other speakers, that our ability to be in fact a pro-
13 ducer of choice for California market is very dependent on
14 our ability to cause our proration system to function with-
15 in that. I wish I were smart enough to give you a pink
16 pill that was the answer, Vic, and I understand the effort
17 that's gone into to trying to find one. We believe that
18 one has to be found, though.

19 MR. LYON: Thank you very
20 much.

21 MR. LEMAY: Additional ques-
22 tions of the witness?

23

24 QUESTIONS BY MR. LEMAY:

25 Q Mr. Orbison, just a couple. Have you

1 had any excess problems, excess to capacity in your system
2 at all?

3 A To capacity on the system we operate?

4 Q Yeah, for firm deliveries? Have you
5 been bumping suppliers or anything?

6 A No, sir, our capacity has not been a
7 constraint so far, other than for (not understood) type
8 items that (not understood).

9 Q One other question, probably unrelated,
10 but within your market as defined in 1978 and '87, let's
11 look at '87. Do you have any idea what percentage of that
12 market is fuel switchable?

13 A Practically none would be my -- my off
14 the top of the head estimate, inasmuch as you have already
15 bypassed the industrial customers, those that are repre-
16 sented are normally very small, daily purchase capabilities
17 and would not be subject to fuel switching.

18 MR. LEMAY: Additional ques-
19 tions of the witness?

20 If not, he may be excused.

21 Thank you, Mr. Orbison.

22 Let's wrap it up with state-
23 ments. Mr. Kellahin, do you want to at this point have
24 Conoco's statement?

25 MR. KELLAHIN: That's accept-

1 able to me, Mr. Chairman, if you'd like to have --

2 MR. LEMAY: Fine.

3 MR. KELLAHIN: -- Mr. Ingram
4 make his statement on behalf of Conoco.

5 MR. INGRAM: I'm Hugh Ingram
6 for Conoco from Hobbs, New Mexico.

7 Conoco believes that Order No.
8 R-8170 (C) was a timely and effective order which allowed
9 producers in the State of New Mexico to sell more gas to
10 the interstate gas market.

11 We agree with the findings in
12 Order No. R-8170 (C), Paragraph 13, which says that the
13 lower permeability and pressure communication between wells
14 which prevails in the gas reservoirs of the San Juan Basin,
15 a greater imbalance can be tolerated without endangerment
16 of correlative rights.

17 We believe that Order R-8170
18 (C), Paragraph 13 is supported by the findings of Order
19 R-6388, which recognizes the need in many cases for special
20 price incentives because of tight formation and further
21 supported by Orders R-5878, 1670-P, 1670-V, all of which
22 recognize the need for additional wells on a proration unit
23 because of the tightness of some formations.

24 Conoco therefor supports the
25 recommendation for continuation of Order R-8170 (C) for at

1 least another year. Such an extension will continue to
2 allow more New Mexico gas to be sold on the interstate
3 market and will not impair anyone's correlative rights.

4 MR. LEMAY: Thank you, Mr.
5 Ingram.

6 Mr. Lund, statement for Amoco?

7 MR. LUND: Thank you, Mr.
8 Chairman.

9 I'm Kent Lund with Amoco and I
10 guess the thing that I conclude from hearing all three
11 witnesses, who I thought were all excellent, is that this
12 is a very serious and complex problem and the gas market-
13 ing conditions that existed in '86 continue, are similar
14 now or even worse, and kind of put us in a box, as was dis-
15 cussed by the witnesses, to try to determine the current
16 allocation system.

17 Now, the 12 times overproduced
18 rule was used as a temporary solution back in '86 and I
19 think that the only evidence that's been presented indi-
20 cates that it must be continued for some additional time
21 period, a year or two, while we look at some of the longer
22 term solutions.

23 And since 1986 there has been
24 some extensive industry reliance on that 12 times overpro-
25 duced rule, in order to meet the spot market conditions

1 no evidence or it's doubtful that that can make up the
2 underproduced gas.

3 The allocation system, as many
4 witnesses indicated, it, you know, it works well in theory
5 with the traditional market, but unfortunately, we think
6 that there are some problems with it in practice now.
7 Everybody is working real hard on it and doing a real good
8 job, but it doesn't really reflect the current, present,
9 and future market conditions. That's the problem. And as
10 Mr. Jones indicated and also the gentleman from Meridian,
11 you've got that ratchet down problem if there's a problem
12 with moving gas in any particular month, that ratchets down
13 your allocation in subsequent months and exacerbates the
14 problem.

15 So we all realize we've got a
16 big problem and everybody wonders what's the solution and
17 there's probably a pretty broad range of solutions.

18 One would be to eliminate pro-
19 rationing and I'm not going to advocate that now, only that
20 it's something that we need to consider.

21 Another solution would be to
22 revise the allocation system either with the Division's
23 discretion to increase allocations based on expected mar-
24 keting conditions or something else.

25 Amoco advocates the study

1 committee, I think, as Mr. Orbison suggested, a blue ribbon
2 committee. I understand that in the past there were study
3 committees, I don't know if they were formal or informal,
4 to look at these problems and it didn't work. We're coming
5 off a real successful example of a subcommittee with the
6 coal gas production in which that Division and industry
7 committee was very successful in the setting of rules.

8 In the interim we've got to
9 look at solutions to increase the allocations and Amoco
10 respectfully recommends the continuation of the 12 times
11 overproduction rule for a year or two and then establish a
12 study committee to look at the long term solutions.

13 And in conclusion I might
14 point out that the only evidence that's been provided today
15 advocates continuation of the 12 times overproduction rule.
16 There is no evidence that a violation of correlative rights
17 is occurring and so we respectfully recommend that the 12
18 times rule be continued and a study committee be appointed
19 and an Amoco representative will be happy to serve.

20 Thank you.

21 MR. LEMAY: Thank you, Mr.
22 Lund.

23 Union Texas, a statement. MR.
24 Katirgis.

25 MR. KATIRGIS: Union Texas

1 Petroleum wishes to go on record with the following state-
2 ments.

3 Due to the mechanism of the
4 prorationing rules the pool allowables are balanced by
5 actual production. An operator who chooses not to parti-
6 cipate in the spot market lowers the pool allowable for all
7 the operators, as we've heard several people say. It
8 forces the operators who wish to participate in the spot
9 markets to eventually shut in production. These lower
10 allowables also have a negative impact, obviously, on the
11 state revenue at a time when they need it.

12 Each operator has to make his
13 own decisions on the economics involved, based on cash
14 flow, current value of reserves, et cetera. Since it is a
15 financial decision, we don't think one company's business
16 decisions should adversely affect other companies.

17 We believe that where a market
18 exists in which all producers can participate if they
19 choose to do so, that those who choose to do so should not
20 be penalized.

21 Currently there is little data
22 to support that 12 times overproduction violates the cor-
23 relative rights any more than 6 times. Both are arbitrary
24 numbers. Those who are participating in the spot sales
25 will be forced to shut in many more wells if you do go down

1 to 6 times overproduction, and the northwest part of the
2 state, where reservoirs are tight, permeabilities are
3 lower, it makes more sense to have higher overproduction
4 limits, whereas in the southeast part of the state reser-
5 voirs are much more permeable, a lower production limit --
6 overproduction limit makes more sense.

7 Different parts of the state
8 with different reservoir characteristics should have dif-
9 ferent proration rules.

10 Union Texas Petroleum recom-
11 mends that temporary Rule R-8170 as amended for 12 times
12 overproduction be continued. We realize again that this is
13 a short term solution and we feel a long term solution is
14 needed and Union Texas Petroleum will be happy to partici-
15 pate on any type of study group to help find a solution.

16 MR. LEMAY: Thank you very
17 much, sir.

18 Mr. Hering for Unocal.

19 MR. HERING: Basically the
20 statements that I'd like to make have been made already by
21 others. We're relatively new in the basin and we have 300
22 completions that we operate and we have a number of those
23 wells shut in. In fact we have 43 wells shut in.

24 I'd basically just like to go
25 on record that Unocal is in support of the continuance of

1 the 12 times overproduction.

2 MR. LEMAY: All right, sir,
3 additional testimony, additional statements in Case 9018?

4 Yes, sir, Mr. Lyon.

5 MR. LYON: May I make the
6 statement just to complete the record and bring to every-
7 body's attention something that exists. I may be the only
8 one here who's aware of it.

9 Mr. Ingram's statement called
10 this to my mind. The order which extended the overproduc-
11 tion limit to 12 times in the San Juan Basin is Order No.
12 R-8170 (A).

13 Order R-8170 (C) created Rule
14 1108 where allowable could be restored but it also
15 rescinded the two year makeup period that was provided in
16 R-8170 (A), and so I think that an order entered in this
17 case should address whether we go back to the 2-year period
18 or the current status is that there is a one year makeup
19 period.

20 MR. LEMAY: Thank you. Addi-
21 tional statements in Case Number 9018?

22 If not, the Commission shall
23 take the case under advisement.

24 Thank you, gentlemen.

25 (Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C. S. R. DO HEREBY
CERTIFY that the foregoing Transcript of Hearing before the
Oil Conservation Division (Commission) was reported by me;
that the said transcript is a full, true and correct record
of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR

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I N D E X

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4 VICTOR T. LYON

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2

MR. LEMAY: We'll call next
Case Number 9018, the gas bank.

4

5

6

MR. TAYLOR: In the matter of
the hearing called by the Oil Conservation Division on its
own motion to consider the amendment of Order No. R-8170.

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I'm Jeff Taylor, Counsel for
the Division, and I believe -- it's my understanding at
least part of the appeal in this case has been dismissed,
and we do not propose to put on any testimony except on the
gas bank, but there's also the question of the 12 times
overproduced and the make-up period. We do not propose to
put on testimony in that matter, but we will address the gas
bank.

15

16

17

MR. LEMAY; Can we go off the
record for a minute?

18

19

(There followed a discussion off the record.)

20

21

22

MR. LEMAY: We'll go back on
the record now and the Case 9018 has been called and we now
call for appearances in Case 9018.

23

24

25

MR. CARR: May it please the
Commission, William F. Carr, Campbell and Black, P. A., ap-
pearing on behalf of Doyle Hartman, and I have one witness

1 with very short testimony.

2 MR. LEMAY; Okay, any other ap-
3 pearances?

4 MR. KELLAHIN: Mr. Chairman,
5 I'm Tom Kellahin of Santa Fe, New Mexico, appearing on be-
6 half of Tenneco Oil Company.

7 I have one witness to be pre-
8 sented.

9 MR. LEMAY: Okay.

10 MR. HALL: Mr. Chairman, Scott
11 Hall with the Campbell & Black law firm, appearing on behalf
12 of Blackwood and Nichols, Exxon Company, USA, UniCal Corpor-
13 ation, Union Texas Petroleum Corporation, Yates Petroleum
14 Corporation.

15 We have no witnesses today.

16 MR. LEMAY; Okay. Other ap-
17 pearances?

18 MR. PEARCE: W. Perry Pearce of
19 the Santa Fe law firm of Montgomery and Andrews, appearing
20 on behalf of Amoco Production Company.

21 MR. LEMAY: Mr. Nance?

22 MR. NANCE: Mr. Chairman, on
23 behalf of El Paso Natural Gas Company, my name is John
24 Nance.

25 El Paso will have no witnesses.

1 MR. LEMAY: And appearances?

2 Yes, sir.

3 MR. DUKE: I'm Jonathan Duke of
4 Keleher and McLeod, Albuquerque, New Mexico, representing
5 Gas Company of New Mexico.

6 We don't anticipate having any
7 witnesses.

8 MR. TAYLOR: Jeff Taylor, Coun-
9 sel for the Division and we'll have one witness.

10 MR. LEMAY: Okay. Appearances?

11 MR. MORGAN: Dennis Morgan on
12 behalf of Southern Union Exploration Company, and we have
13 witnesses.

14 MR. LEMAY: Any other witnesses
15 or testimony or statements?

16 We'll call at the end for those
17 who want to make a statement later, certainly can.

18 MR. INGRAM: On behalf of Cono-
19 co, Inc., I'm Hugh Ingram.

20 MR. LEMAY: Those witnesses
21 will please stand.

22

23 (Witnesses sworn.)

24

25 MR. LEMAY: Thank you. Be

1 seated. Mr. Taylor.

2 MR. TAYLOR: I'd request the
3 record to show that my witness has previously been sworn and
4 qualified.

5
6 VICTOR T. LYON,
7 being called as a witness and being previously sworn upon
8 his oath, testified as follows, to-wit:

9
10 DIRECT EXAMINATION

11 BY MR. TAYLOR:

12 Q Mr. Lyon, although we're previously pre-
13 sented this case to the Commission, could you just briefly
14 review the past history and recommendations that have been
15 made on this case to these other hearings?

16 A Yes, sir. The proposal of the gas bank
17 arose out of the tremendous disruption of the gas produc-
18 tion, gas marketing, gas transporting system, and as I think
19 has been aptly demonstrated this morning, the issue of take
20 or pay is so large that people really are not able to agree
21 on hardly anything that anybody proposes in regard to gas
22 allowables, gas taking or anything else.

23 There are people who feel that the price
24 being paid for gas today is -- is wasteful. Matter of fact,
25 there was -- this was mentioned in the committee hearing

1 yesterday in the State Capitol, that some of our legislators
2 feel that it is wasteful to sell gas at -- at the prices
3 that are being paid today, and of course people who -- whose
4 operating costs are more than the revenue coming in from
5 their gas well are shutting those wells in; other people
6 feel that they should not be contributing to the over-supply
7 of gas by continuing to produce. There are people who have
8 decided that the best thing to do is to just get out there
9 and produce all the gas you can get and there are special
10 marketing programs that have come in, the spot sales, the
11 market is just in a complete disarray and there are people
12 that for one reason or another either can't produce because
13 the -- their pipeline, who used to be the purchaser, is no
14 longer their purchaser and they don't have a purchaser, and
15 there are all kinds of situations, and one of the problems
16 that's caused by all these wells that are shut in, whether
17 it's because they can't get a market or whether they don't
18 want to take advantage of what market there is, is that as
19 long as those wells stay on the proration schedule, we have
20 to give them allowable and they're not going to use that
21 allowable but there are other people who -- who do want to
22 use the allowable and market their gas that could use that
23 allowable but it goes to wells that are not going to produce
24 it.

25 And also the -- the impact of this thing

1 could help to begin to balance the supply and demand of gas,
2 which, since there is such an excess of supply at the time
3 has severely undercut the price that the gas draws in the
4 market.

5 And in trying to find some way to address
6 these issues and get the allowable to wells who want to mar-
7 ket, I conceived the idea of the gas bank and it has two
8 parts. The primary part would be that people who cannot or
9 do not wish to participate in the market would notify us and
10 we would put those wells into the primary gas bank. Those
11 wells would not receive an allowable during the period
12 they're in that bank.

13 And the allowable available to the pool
14 would then be distributed among those wells who wish to par-
15 ticipate and can participate in the market. This would give
16 them a larger allowable.

17 The second part of the bank is where we,
18 when we cancel allowable and they request that it be put in-
19 to the secondary gas bank, that allowable could be rein-
20 stated at some later time when they are able to produce that
21 in additional -- in addition to the allowable that they
22 would receive at that future time.

23 The proposal was discussed in committee.
24 after discussion I developed it into proposed rules, which
25 have been placed into the record, and it more clearly de-

1 scribes how the bank would -- would operate.

2 When allowable is drawn out of the bank,
3 we placed limits on that allowable so that it would not un-
4 necessarily restrict the allowables of those wells which
5 have continued to produce during the period that some wells
6 were in the bank.

7 I did not receive any -- any support at
8 previous hearings. We thought that perhaps it was because
9 people did not really understand what the bank did, and so
10 the overall committee that addressed priorities, gas ban-
11 king, long term solutions of the gas problem, considered the
12 gas bank, and I've prepared exhibits and explained them --
13 explained to them how the bank would work, and I still did
14 not receive any support from that committee, at least on the
15 primary gas bank. There was some support for the secondary
16 gas bank.

17 I'm not sure that the people that the gas
18 bank was primarily designed to assist were represented on
19 that committee, but it is my recommendation to the Commis-
20 sion that unless there is somebody who likes the gas bank
21 and wants to use it that we drop it.

22 And there was an alternative to the gas
23 bank which was sent out by Memorandum No. 1-87, which has
24 another approach to it and I've -- I would certainly say
25 that this approach is much more in keeping with our current

1 system of issuing allowables and administering them, and I
2 might just read this because it isn't that long.

3 This is proposed Rule 10(a)(1). Begin-
4 ning April 1, 1986, and that's not a misprint, that is 1986,
5 and for a period of five years thereafter, unless further
6 extended by the Director, the Director may reinstate allow-
7 able to wells which suffered cancellation of allowable under
8 Rules 10(a) or 13(b) or loss of allowable due to reclassifi-
9 cation of a well under Rule 13(a) if such cancellation or
10 loss of allowable was caused by non-access or limited access
11 to the average market demand in the pool rather than inabil-
12 ity of the well to produce.

13 Upon petition, together with a showing of
14 the circumstances which prevented production of the nonmar-
15 ginal allowable, and evidence that the well was capable of
16 producing at allowable rates during the period in which re-
17 instatement is requested, the allowabe may be reinstated in
18 such amounts as to avoid curtailment or shut-in of the well
19 for excessive overproduction.

20 Such petition shall be approved adminis-
21 tratively or docketed for hearing within 30 days after re-
22 ceipt in the Division's Santa Fe Office.

23 And I think that -- that the proposed al-
24 ternative would preserve opportunities of people who were
25 disadvantaged during these times to come in and make up that

1 allowable, and it also will preclude our reinstating allow
2 able that cannot be made up.

3 And I believe that's all I have to say.

4 Q Just briefly, then, if I understand these
5 gas bank proposals, in the past make-up periods for such un-
6 derproduction were aimed particularly at wells that were un-
7 able to make their allowable.

8 These are aimed at wells that could make
9 their allowable but for reasons of market demand may not
10 have access to the market or can't -- can't sell enough gas
11 to make their allowable, and this rule is designed to allow
12 a longer make-up period for those wells yet still protect
13 correlative rights of those owners and other owners.

14 Is that correct?

15 A I think that's a fair statement, yes.

16 Q Would there be any other rule changes ne-
17 cessary to implement the gas bank plan?

18 A Well, the gas bank plan would require the
19 inclusion in Order R-8170 of Rule 20 -- I think it's Rule
20 20, A, B, C, and D, and E. I don't happen to have that in
21 front of me right now.

22 Q Let's see if I have any other questions.
23 I know -- I have a question here as to how this would affect
24 prorationing but I think something that you also want to
25 talk about is the impact of the market on our current method

1 of nominations and setting allowables, so would you address
2 that briefly?

3 A On the nominations?

4 Q Correct. Proceed, Mr. Lyon.

5 A Ever since the spot market came into
6 being I have been concerned about the ability to get mean-
7 ingful nominations because spot market so frequently is for
8 short periods of time, for a month or two months, and it
9 seems that my concerns have been borne out, particularly
10 when El Paso, I think beginning the first of January, stop-
11 ped nominating for the spot market that they were serving,
12 so we're not receiving nominations for that.

13 I don't have an awful lot of confidence
14 in the nominations that we are getting.

15 I have been working on a system where we
16 could use past production, the most recent production, and
17 historical data on seasonal demands to set allowables based
18 on those data, just the most recent month's production and
19 its relationship to the month which is coming up in histori-
20 cal, seasonal fluctuations.

21 And by so doing we should end up with the
22 result that we are issuing as allowable all of the gas
23 that's produced. We may not be in balance from one month to
24 the next, but as we progress through the year we should be
25 allocating allowable equal to production.

1 As I see the system, it would -- when we
2 get to the balancing period, we would make adjustments to
3 see that the allowable that has actually been assigned is
4 equal to the production and make adjustments to make it so.

5 And this is not going to change the sit-
6 uation that for every MCF of overproduction there's an MCF
7 of underproduction and consequently we're going to have to
8 have balancing, just as is presently called for under the
9 rules.

10 And it is my recommendation that the Com-
11 mission adopt this type of allowable setting in lieu of nom-
12 inations so long as we continue in a period where purchasers
13 and nominations are so -- so vague and I think incomplete.

14 Q I know we want to draw this to a close,
15 but what you're saying is that the --

16 MR. KELLAHIN; Mr. Chairman,
17 I'd like to interpose an objection to this line of question-
18 ing. I was surprised by this whole question of the adjust-
19 ment in the way the nominations are made; it's certainly
20 beyond the scope and call of this case.

21 I am well aware that there
22 needs to be something done with the nominations, or at least
23 the way the Director exercises his discretion. If you would
24 like to have that hearing I would appreciate an opportunity
25 to have it heard at a different time.

1 MR. LEMAY; Mr. Kellahin, I
2 will uphold your objection with this comment, that Mr. Lyon
3 is testifying as to how the gas bank would work; as a side
4 issue the nomination process is also involved in the gas
5 bank, and from that point of view it's germane for the tes-
6 timony to be briefly stated in the record; however, we're
7 not debating at this point whether the nomination process is
8 right or not. This is only a point of information. As we
9 interpret the rules, the Director has a great amount of dis-
10 cretion in setting allowables and we take nominations into
11 consideration.

12 So because it does not make a
13 rule making, order making, procedure, this was only a point
14 of information and I would advise counsel to maybe wrap it
15 up and just leave it at that; not necessarily take testimony
16 concerning the pros and cons on changing our nomination pro-
17 cess.

18 Is that what you were referring
19 to?

20 MR. KELLAHIN: Yes, sir, and
21 thank you for the clarification.

22 At such a point as the Director
23 or Commission wants to have industry's input in how to exer-
24 cise your discretion in a nominating portion of the problem,
25 we'll be delighted and more than willing to give you some

1 suggestions.

2 MR. LEMAY: Thank you.

3 MR. TAYLOR: I'd like just to
4 clarify, Mr. Chairman, this is not a rule making, not a
5 change in our nominations, we are not proposing to what Mr.
6 Kellahin just got excited about, we are just --

7 MR. LEMAY: No, that was for --

8 MR. TAYLOR: -- (not under-
9 stood) --

10 MR. LEMAY: -- clarification.

11 MR. TAYLOR: -- a problem.

12 MR. LEMAY: No, no, there
13 wasn't. There was a fine line drawn from the gas bank to
14 the allowables and that's why I -- I will accept the minimum
15 amount of testimony and I think we've had enough right now
16 in that procedure.

17 MR. TAYLOR: And that's all we
18 have of Mr. Lyon.

19 MR. LEMAY: Thank you. Any
20 questions of Mr. Lyon? Cross examination from anyone?

21 MR. HALL: Yes, Mr. Chairman.

22

23 CROSS EXAMINATION

24 BY MR. HALL:

25 Q Mr. Lyon, you used the term average mar-

1 ket demand in your proposal. I wonder if you could elabor-
2 ate what you mean by that. How is average market demand --

3 A This is in the alternative?

4 MR. KELLAHIN: Which proposal
5 is that?

6 MR. HALL: The gas bank.

7 MR. KELLAHIN: There is three
8 of them.

9 MR. HALL: 187.

10 A Now you're talking about Rule 10(a)(1) in
11 line 1, 2, 3, 4, 5, 6, line 7, where you have --

12 Q Yes.

13 A Where there -- where the cancelation or
14 loss of allowable was caused by non-access or limited access
15 to the average market demand?

16 Q Yes.

17 A Yeah.

18 Q Would you elaborate on that? What do you
19 mean by average market demand?

20 A I would interpret average market demand
21 to be the allowable to the well.

22 Q Further down in that same proposal it
23 states that to petition you must show the circumstances
24 which have prevented production. How extensive did you con-
25 template that the evidence must be in order to grant a suc-

1 cessful petition? Could you elaborate?

2 A I would think that what we would receive
3 in most cases would be that a well was permitted to produce
4 one or two days during a month and it produced that much.
5 If you were to extrapolate that to a full months production,
6 that it would have exceeded the allowable.

7 Q In other words, the petitioner wouldn't
8 have to go beyond that to inquire into the market demand or
9 marketplace (not understood).

10 A I don't -- I don't think we'd be as
11 tough on that type of presentation as we are for somebody
12 asking for a hardship gas well classification.

13 Q Okay. Mr. Lyon, in your opinion when
14 would be the appropriate time for a producer to petition for
15 -- would it be at the time the allowables are cancelled or
16 when the wells are 6x or 12x overproduced?

17 A I think if he were to do this timely so
18 as to prevent any unnecessary curtailment or shut-in, that
19 at such times as he gets one or two months overproduced,
20 that he would come in and make his showing that his well is
21 eligible to have the allowable restored so that we could
22 plug that in at such time as the well is excessively over-
23 produced without the underproduction being restored, so that
24 he could continue to produce without interruption.

25 MR. LEMAY: Mr. Lyon, was it

1 your intent to -- for the alternative for the reinstatement
2 of allowable to be an administrative process or a commis-
3 sion-hearing process? Or a division-hearing process?

4 A I would expect it to be administrated.

5 MR. LEMAY: Any other questions
6 of Mr. Lyon? Yes, sir, Mr. Nance.

7 MR. NANCE: Thank you, Mr.
8 Chairman.

9

10 CROSS EXAMINATION

11 BY MR. NANCE:

12 Q Mr. Lyon, you have made these statements
13 that with respect to spot market purchases El Paso has
14 discontinued making nominations for volumes for the spot
15 market since the first of this year.

16 Do you know that that's the case
17 specifically with regard to spot market purchases being made
18 by El Paso Gas Marketing Company, as well?

19 A Well, I was informed of gas -- El Paso
20 Gas Marketing Company went out of existence.

21 Q That's (not understood). We -- I think
22 it may be a fair statement that El Paso Gas Marketing
23 Company was proposed to be discontinued, but that's not
24 actually the case.

25 A Well, you haven't told me about it until

1 now.

2 Q My understanding is that El Paso Gas
3 Marketing Company continues to exist and that specifically
4 with regard to spot market purchases made by El Paso Gas
5 Marketing nominations continue to be made.

6 A Well, I do know that the allowables for
7 the San Juan Basin or the nominations for San Juan Basin
8 were down about 97 percent in January.

9 Q I don't have any (not understood) on
10 that.

11 A At least that's what Harold Garcia told
12 me.

13 MR. LEMAY: Thank you. Any
14 other questions of the witness? Mr. Kellahin.

15 MR. KELLAHIN: Thank you, Mr.
16 Chairman.

17

18 CROSS EXAMINATION

19 BY MR. KELLAHIN:

20 Q Mr. Lyon, is the intent of the proposed
21 rule broad enough to include the situation where the opera-
22 tor has a producing nonmarginal gas well, he has an actual
23 connection into a pipeline system, and that operator fails
24 to produce his allowable because he voluntarily elects not
25 to do so because of price?

1 A No.

2 Q All right, sir, thank you.

3 MR. LEMAY: Any other questions
4 of the witness?

5 If not, the witness may be ex-
6 cused.

7 Mr. Carr, do you have a --

8 MR. CARR: At this time I call
9 Mr. Nutter.

10 May it please the Commission, I
11 would request that the record reflect that Mr. Nutter re-
12 mains under oath and that he has previously been qualified
13 as an expert witness in petroleum engineering and regulatory
14 matters.

15 MR. LEMAY: Yes, his qualifica-
16 tions are accepted.

17
18 DANIEL S. NUTTER,
19 being called as a witness and being previously sworn upon
20 his oath, testified as follows, to-wit:

21

22 DIRECT EXAMINATION

23 BY MR. CARR:

24 Q Mr. Nutter, are you familiar with the Oil
25 Conservation Division proposals concerning creation of a gas

1 bank as set out in Case 9018?

2 A Yes, and also I guess I'm familiar with
3 the proposed amendment in lieu of the gas allowable bank
4 that I've heard here this morning for the first time.

5 Q Will you be presenting any testimony this
6 morning concerning time periods for making up underproduc-
7 tion?

8 A Yes.

9 Q Is Mr. Hartman an operator who likes the
10 gas bank and plans to use it?

11 A He doesn't like the gas bank.

12 Q Does he plan to use it?

13 A No, I don't think so.

14 Q Now you have reviewed the proposal.

15 A Yes, I have.

16 Q What effect in your opinion would
17 implementation of the gas bank have on producers who are
18 operating in a pool in an advanced state of depletion?

19 A Well, I think the first effect that it
20 would have, it would set the operators up for a big
21 disillusionment down the road.

22 They're going to be putting this gas in
23 the bank and when they go to the bank to withdraw it,
24 they're going to find out they've got Confederate money in
25 there and it's not really worth a lot.

1 Q And why is that?

2 A Because if you're going to -- the gas
3 bank has such an infinity period of time in which to operate
4 and drainage is going to be occurring during that period of
5 time, particularly in southeast New Mexico where the perme-
6 abilities are greater than they are in the northwest, and if
7 you've sat there with your gas allowable in storage for
8 five years and go to get it, you're going to find your bank
9 account doesn't have anything in it. It's all been drained
10 away.

11 Q In your opinion would adoption of the
12 proposal protect the correlative rights of interest owners?

13 A No, I don't think it would protect cor-
14 relative rights because it would give them this false sense
15 of security in which they are being -- under which they are
16 being drained.

17 I think also that it's going to impair a
18 producer's ability to attempt to make take-or-pay settle-
19 ments with the pipeline because the pipeline is going to
20 tell them you've got your production stored there. We
21 haven't deprived you of any production and you're going to
22 get it one of these days; therefore we're not subject to
23 take-or-pay.

24 And I think it could be disastrous.

25 Also, in the past the Commission or the

1 Division has on numerous occasions, because of market condi-
2 tions of a temporary nature, suspended the balancing periods
3 for the gas pools in New Mexico, but it's always been that
4 they suspend it for the overproduction as well as the under-
5 production, and here you're talking only about the underpro-
6 duction, putting it in storage. You're not addressing the
7 overproduced wells at all.

8 Q So, Mr. Nutter, what is your recommenda-
9 tion to the Commission?

10 A That the gas bank be dismissed and as far
11 as the alternative is concerned, that we heard presented
12 here this morning, there's already provision that when your
13 well is reclassified as a marginal well and your underpro-
14 duction is cancelled, all you have to do is write a letter
15 and get that underproduction reinstated.

16 Now what this would be covering would be
17 the underproduction that you entered into a proration period
18 with and it wasn't produced during the succeeding year.

19 Now, we've always heard that you have two
20 years in which to make up underproduction. It's the under-
21 production that's accrued during the year and then you have
22 the subsequent year to produce it. So, it's that underpro-
23 duction that you've entered the proration period with that
24 might be subject to cancellation a year later if it hasn't
25 been made up, and that's the only thing that this would

1 really address that isn't available just by simply writing a
2 letter now and I think that in many cases this probably
3 could e handled under the existing rules by a letter, also.

4 So I don't see any sense in -- or any
5 necessity for an amendment of these rules at this time.

6 MR. CARR: We have nothing
7 further

8 MR. LEMAY: Are there any
9 questions of Mr. Nutter?

10 You're excused, Mr. Nutter.
11 Thank you.

12 Any other witnesses at this
13 time?

14 MR. KELLAHIN: Yes, Mr.
15 Chairman.

16 MR. LEMAY: Mr. Kellahin.

17 MR. KELLAHIN: Mr. Chairman, I
18 would like to call Mr. Louis Jones of Tenneco as a petroleum
19 engineer and as a witness in this case.

20 MR. LEMAY: Okay.

21 MR. KELLAHIN: Mr. Chairman, we
22 appeared on behalf of Tenneco at the November 20th hearing,
23 1986, which resulted in the order entered in this case on
24 December 4th.

25 While the notice of hearing for

1 this case does not clearly indicate to us that this is our
2 hearing in response to granting our application for rehear-
3 ing, we have been so notified. We agree to that and con-
4 sent, with your permission, to go forward with our comments
5 and testimony on that prior order.

6 I would like to make it clear
7 that Tenneco did not then and does not now seek to oppose
8 the twelve times overproduced provision of that order that
9 was entered and applies to the northwest portion of the
10 State of New Mexico.

11 Our testimony today addresses
12 itself to the market situation, production in the San Juan
13 Basin, and our focus is in on the question of the balancing
14 period and whether or not there are several options avail-
15 able to the Division on how to handle the rebalancing
16 periods.

17 With those comments and with
18 your permission, I'd like to proceed with my witness.

19 MR. LEMAY: Please do so.

20 MR. KELLAHIN: I've marked as
21 proposed Tenneco exhibits, Mr. Chairman, documents for Mr.
22 Jones to identify and authenticate. They are Exhibits One
23 through Eight. With your permission, I'd like to make a
24 distribution of those exhibits.

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LOUIS B. JONES,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q Mr. Jones, for the record would you please state your name and occupation?

A I'm Louis B. Jones with Tenneco Oil Company. I'm Division Production Engineer out of Englewood, Colorado.

Q Would you describe for the Commission what has been your educational background and work experience?

A I graduated from Texas Tech University in 1976 with a BS in petroleum engineering.

I've been employed by Tenneco Oil Company for ten years now and I'm a registered professional engineer in the State of Texas.

Q Would you describe for the Commission what it is that you do for Tenneco Oil Company insofar as it affects its operations in the State of New Mexico?

A Well, I am the head of the Production Engineering Department for the Rocky Mountain Division of

1 Tenneco Oil Company and I'm responsible for the production
2 in the San Juan Basin, primarily, northwest portion of the
3 state.

4 We operate 2286 completions that has the
5 estimated capacity of 365-million cubic feet of gas per day.
6 This would represent approximately 25 percent of the basin's
7 total capacity and slightly over 11 percent of New Mexico's
8 total gas capacity.

9 Q Did you testify on behalf of your company
10 in the hearing held by the Division in this case back on No-
11 vember 20th, 1986?

12 A Yes, I did.

13 Q And pursuant to your employment as a pet-
14 roleum engineer, have you made a study, Mr. Jones, of the
15 New Mexico gas production for the years '84, '85, and '86?

16 A Yes, sir, I have.

17 Q And have you studied the total production
18 from the San Juan Basin during that period of time?

19 A Yes. And in addition, sir, have you
20 studied El Paso Natural Gas Company's total takes from the
21 San Juan Basin?

22 A Yes, I have.

23 Q And do you know, sir, the estimated Cali-
24 fornia gas demand during that period of time?

25 A Yes.

1 Q In addition, sir, do you know El Paso's
2 total transportation of gas into the California market?

3 A An estimate, yes, sir.

4 Q And are you aware of and have you made a
5 study of the San Juan Basin share of the El Paso' total
6 transportation system?

7 A Yes, I have.

8 Q Are you, as an operator, Tenneco Oil
9 Company, involved in certain of the prorated pools in the
10 San Juan Basin, New Mexico?

11 A That's correct. The majority of our
12 production, 70 to 80 percent of it, is -- comes from the
13 Mesaverde and the Dakota Pools, both prorated pools in the
14 San Juan Basin.

15 Q And are you familiar with and have you
16 made a study of the gas proration rules of this Commission
17 as they apply to the San Juan Basin?

18 A Yes, I have.

19 MR. KELLAHIN: Mr. Chairman, we
20 tender Mr. Jones as an expert petroleum engineer.

21 MR. LEMAY: His qualifications
22 are accepted.

23 Q Mr. Jones, let me direct your attention
24 to what we have marked as Tenneco Exhibit Number One. You
25 have indicated to me earlier that you have made a study for
the years '84, '85, and '86 of the New Mexico gas production.

1 Would you describe for us what conclusions you have reached
2 with regards to New Mexico's gas production during that
3 period of time?

4 A Yes. I'll be focusing on the northwest;
5 however, this first exhibit discusses New Mexico's total gas
6 production and this was taken from the New Mexico Oil and
7 Gas Association newsletter. It essentially said that the
8 gas production has dropped 23 percent and that's from '85 to
9 '86 and that's going from 893 BCF, which is billion cubic
10 feet of gas, to 688 BCF. That was again a 23 percent
11 decline and that's the lowest level since 1957, almost
12 thirty years ago.

13 Q Let's turn to Exhibit Number Two, Mr.
14 Jones, and have you first of all identify for us the exhibit
15 before you explain it; identify the exhibit and tell us how
16 you prepared it.

17 A Okay. Now all this is, now you'll see
18 "Tenneco" up in the left. This is from all producers into
19 all pipelines out of the San Juan Basin.

20 You'll see it's a little difficult to
21 read here because I don't have the colored bar chart for
22 you, but the first bar, the majority of it will be El Paso
23 Natural Gas takes. Then you'll have Southern Union/ Gas
24 Company of New Mexico, Northwest Pipeline, and just a little
25 sliver on top, which would equate to about a line, would be

1 all others.

2 On your lefthand margin there you have
3 essentially million cubic feet of gas per day and then we
4 show '84, '85, and '86 actual statistics, as we know them.

5 Q What do the letters "RMD" mean on the ex-
6 hibit?

7 A That's just the Rocky Mountain Division
8 for Tenneco. Again this is all producers, all pipelines,
9 not Tenneco-operated production.

10 Q In studying the total gas production from
11 the San Juan Basin during this 4-year period, what does this
12 information show you?

13 A Well, it shows that production from '85
14 to '86, and I think that's what we will emphasize at this
15 time, has dropped 25 percent from '85 to '86.

16 Q Do you know, sir, what portion of the San
17 Juan Basin production is New Mexico's total production?

18 A In 1986 it was right at 45 percent of New
19 Mexico's total production.

20 Q And between '85 and '86, then, your in-
21 formation shows there has been decline in the San Juan Basin
22 production of about 25 percent?

23 A That's correct.

24 Q All right, sir, let's turn to Exhibit
25 Number Three and have you first of all identify this exhibit

1 and then describe what it means.

2 A Okay. Again, Tenneco and the Rocky Moun-
3 tain Division, you'll see it on all of the bar graphs here.
4 It's not just Tenneco Production, that's all producers.

5 It's El Paso Natural Gas takes from the
6 San Juan Basin and this includes not only traditional but
7 spot market volumes, particularly in '86 when the spot mar-
8 ket came into -- into being.

9 On your left margin again you have mil-
10 lion cubic feet of gas per day and we have statistics from
11 '84 through '86.

12 You'll notice, too, from '85 to '86 El
13 Paso's total takes out of the San Juan Basin have dropped 34
14 percent.

15 Q When we compare Exhibit Two to Exhibit
16 Three, what can you conclude?

17 A Well, obviously, if the total production
18 from the San Juan Basin dropped 25 percent and El Paso's
19 dropped 34 percent, that they've been taking less than their
20 previous percent of the San Juan Basin.

21 Q Turn now, Mr. Jones, to Exhibit Number
22 Four and have you again identify and then describe the exhi-
23 bit.

24 A Okay. This is the California Gas Sup-
25 plies and Supplies really could mean demand in this case.

1 This is all of the natural gas used within the State of Cal-
2 ifornia and that includes gas that's produced within the
3 State of California. And on your lefthand margin you have
4 billion cubic feet of gas per day and again '84/'85 and '86
5 estimate. We don't have '86 actual but we do have an '86
6 estimate.

7 Q When you compare the estimated California
8 gas demand from '85 to '86, what does this information show
9 you?

10 A The total gas demand in California has
11 dropped 6 percent from '85 to '86 estimate.

12 Q Do you have estimates in terms of billion
13 cubic feet of gas as to what that impact is?

14 A Well, that would be right at .3 BCF per
15 day, or 300-million cubic feet of gas per day, whichever way
16 you want to say it.

17 Q All right, sir. Let's turn to Exhibit
18 Number Five, Mr. Jones, and have you identify and then de-
19 scribe this exhibit.

20 A Well, this El Paso's total deliveries in-
21 to California, El Paso Natural Gas.

22 Again on your lefthand margin, million
23 cubic feet of gas per day, '84, '85, and '86 estimate. I
24 want to note, too, that this includes total transportation,
25 not just their purchases on their system, but their trans-

1 portation into California, and that '86 again is an esti-
2 mate.

3 Q And what percentage has El Paso's total
4 transportation of gas into California dropped from '85 to
5 '86?

6 A From '85 to '86 again I estimated 5 per-
7 cent.

8 Q All right, sir, and let's turn now to Ex-
9 hibit Number Six and have you identify and describe that ex-
10 hibit.

11 A This is just a percent of the California
12 market. El Paso's percent for 1984, '85, and '86 estimate,
13 essentially using the numbers that you've just seen on these
14 previous bar graphs.

15 As you can see, in '84 El Paso had 48
16 percent of the total California market, all gas burned in
17 California.

18 In '85 it's dropped to 42 percent, and
19 '86 estimate stayed flat at 42 percent.

20 Q All right, sir, let's turn now to Exhibit
21 Number Seven and have you identify and describe that exhi-
22 bit.

23 A Well, this is the San Juan Basin as a
24 percent of El Paso's system, and this is just the gas that
25 El Paso will take from the San Juan Basin and this is de-

1 rived from the previous bar graphs that you've seen, '84,
2 '85, and '86 estimate.

3 You can see that the San Juan Basin made
4 up 42 percent of El Paso's system in 1984, but in '86 esti-
5 mate it only made up 28 percent of their total system.

6 Q All right, sir, let's turn to Exhibit
7 Number Eight and have you identify and describe that exhi-
8 bit.

9 A I'm just carrying it one step farther
10 here as San Juan Basin deliveries into El Paso system as a
11 percent of the total California market.

12 You can see the San Juan Basin was 20
13 percent of the total California market in 84. In '86 esti-
14 mate it was down to 12 percent.

15 I'd like to --

16 Q Would you just summarize for us, Mr.
17 Jones, with regards to all eight of your exhibits, what this
18 information now shows you as a petroleum engineer exper-
19 ienced in such matters, particularly with regards to New
20 Mexico's share of the gas market?

21 A Well, now you see that several of these
22 bar graphs are just San Juan Basin, but again, San Juan
23 Basin makes up a good portion, 45 percent of the New Mexi-
24 co's total gas production, along there you see there that
25 New Mexico's total gas production dropped 23 percent from

1 '85 to '86 and it shows here, too, that we've lost that mar-
2 ket share, and I think we need to make some adjustments to
3 the current rules and regulations to encourage production,
4 to increase production in the State of New Mexico.

5 Q And have you examined the current prora-
6 tioning rules as they apply to the San Juan Basin?

7 A Yes, I have.

8 Q And you're familiar with the change that
9 the Commission made as a result of the December order?

10 A Yes.

11 Q The 12-times overproduced number?

12 A Yes, I am.

13 Q And you're aware of the suggested change
14 with regards to the balancing period?

15 A Yes. That's the 2-year balancing period?

16 Q Yes, sir. Do you have some opinions and
17 recommendations, Mr. Jones, as to what the Commission might
18 do to create an incentive for producers to continue to par-
19 ticipate in the market so that New Mexico can continue to
20 preserve its share of the gas market and at the same time
21 protect the correlative rights of those operators that can-
22 not or choose not to participate under current market condi-
23 tions, so that their correlative rights won't be damaged?

24 A Absolutely. We need allocations that
25 really accurately reflect the current market demand. I

1 don't think we had them in 1986. Our allocations were down
2 30 percent.

3 Tenneco's production was down 15 percent
4 from '85 to '86 and we're farther overproduced than we've
5 ever been. We have seen some relief in the last few months,
6 hopefully heading in the correct direction.

7 As far as the balancing period is con-
8 cerned, the temporary rule gives a 2-year balancing period
9 or essentially a 3-year period to make up that underproduc-
10 tion.

11 I'm concerned that the underproduction,
12 and so is Mr. Lyon, I'm sure, that the underproduction will
13 accumulate to enormous proportion and we need to do some-
14 thing about that as far as making it manageable under the
15 current system, and I recommend that we just make certain
16 adjustments to the system to be able to manage that under
17 production.

18 Q Are you satisfied and do you have the
19 opinion, Mr. Jones, that the prorationing scheme or system
20 of handling allocation of market demand or share is still a
21 usable and suitable system?

22 A It's usable with adjustments. The system
23 has worked for over 30 years and will continue to work for
24 over -- probably 30 more, as long as we adjust to this tre-
25 mendous change in the market we've had over the last year.

1 Q The Commission took a first step with re-
2 regards to making some temporary adjustments back in December
3 when they authorized 12-times overproduction for wells in
4 the San Juan Basin.

5 Did you concur in that as a first step?

6 A Absolutely. To give you an idea, we have
7 currently 38 percent of our production or, excuse me, of our
8 capacity, which is over 6-times overproduced.

9 Q With regards to the establishment of al-
10 lowables that realistically reflect market demand, the Divi-
11 sion has changed that procedure January of this year, where-
12 by they no longer strictly adhere to pipeline nominations.
13 You're aware of those adjustments, are you not?

14 A Yes, I am, and, of course, as Vic Lyon
15 had said earlier, it's impossible to use the nominations now
16 because of the system as it is.

17 Q Do you believe that the Division's Direc-
18 tor, in exercising his discretion to set allowables for Jan-
19 uary, February, and I guess January and February are the on-
20 ly allowables we've set this year.

21 A March.

22 Q March has been set also? Have the allow-
23 ables that have been set now in your opinion reflect a fur-
24 ther step that makes the system more manageable and work-
25 able?

1 A Yes, sir, that is correct.

2 Q Let's talk now, Mr. Jones, about what you
3 understand to be the various other options that have been
4 proposed or considered in the various study groups and meet-
5 ings that you have attended with regards to this subject.

6 A Okay. I think all the options here I'll
7 throw out, and it includes the overproduced portion, but I
8 think everyone is agreed on the 12-times and we are certain-
9 ly for that at this time, able to -- certainly allow us to
10 produce.

11 We need to encourage producers to parti-
12 cipate in the market, not to continue to lose market share,
13 and also be able to manage the system as it is so we don't
14 have these huge underages accumulate. That would be one op-
15 tion.

16 Another option is the gas bank proposal
17 that Mr. Lyon proposed. I think it also does not encourage
18 producers to get out there and produce their gas and again
19 there's a false sense of security, and also it would be very
20 difficult to administer.

21 We also could go to a one-year balancing
22 period and I think that would be more in line with being
23 able to manage our underproduction, just like we had it be-
24 fore the December 1 rule change, where you would have one
25 year for your underproduction to accumulate into your prora-
tion period, one year to make that up.

1 Another possibility would be the 2-year
2 balancing period with a 12-times underproduced limit.

3 Q Let's describe what is currently occur-
4 ring with regards to underproduction and the balancing per-
5 iod as it exists now.

6 We currently have, prior to the December
7 order, what has been called a 1-year balancing period and
8 Mr. Nutter described that as being a first proration period,
9 which, if you were out of balance or carrying underproduc-
10 tion, you would have the subsequent year, then, to make up
11 that underproduction.

12 A That's correct. And under the new rule
13 change you'd have two years to make that up, so essentially
14 a 3-year period to make up or work your -- not really to
15 work your underproduction off but to accumulate and make it
16 up.

17 Q Under the proposed December order that
18 would have allowed a 3-year period for balancing of under-
19 production, what is your concern with regards to that length
20 of time in which to balance underproduction?

21 A Again, I believe my -- the major concern
22 is that it is like a gas bank. We do need to encourage pro-
23 ducers to participate in the market, number one.

24 Number two is to be able to make the cur-
25 rent system more manageable so we don't have these huge im-

1 balances, so we can end up balancing the pools again when
2 all the producers return and participate in the market.

3 Q Regardless of when the balancing period
4 ends under current rules, what happens to any underproduc-
5 tion that has not been balanced?

6 A It will be cancelled.

7 Q Now the last option you discussed with us
8 just now and a suggestion that I believe occurred, is that
9 in combination with a 12-times overproduced number that we
10 carry a maximum of 12-times underproduced?

11 A Well, first of all, I believe -- I feel
12 like we should have a 1-year balancing period; however, in
13 lieu of that, another option would be the 2-year along with
14 a 12-times underproduced limit.

15 When a well became 12-times underpro-
16 duced, instead of adding more and more underproduction every
17 month, it would stay at that 12-times underproduced.

18 Q So that if a well continued to accrue
19 more than 12-times underproduction, 12-times would be the
20 maximum it could accrue.

21 A That is correct.

22 Q All right. Among all those choices,
23 what, in your opinion, is the most reasonable choice in or-
24 der to make a temporary adjustment in the prorationing sys-
25 tem so that producers are encouraged to continue to produce,

1 that New Mexico's share of the gas market continues to be
2 preserved, and at the same time those operators choosing to
3 accrue underproduction would not have their correlative
4 rights violated?

5 A I believe both of the last two proposals
6 that were made, the 1-year balancing period and/or the 12-
7 times underproduced limit would be acceptable and work --
8 we'd be working in the direction of increasing market share
9 again.

10 Q Under the first proposal with regards to
11 a 1-year balancing period, what, if anything, would you re-
12 commend the Commission do in terms of the underproduction?

13 Are we going to cancel or are we going to
14 to carry it forward?

15 A It would work just like it was in the
16 previous rules and regulations. After the 1-year period,
17 that production is cancelled; however, you're still -- you
18 still can come in front of the Commission and petition the
19 Commission to reinstate your allowable if in fact you have
20 been discriminated against for access to a pipeline.

21 Q And that's available under current rules,
22 is it not?

23 A That is correct.

24 Q Do you have any additional comments or
25 recommendations you'd like to make to the Commission on this

1 subject matter, Mr. Jones?

2 A Not at this time.

3 MR. KELLAHIN: Thank you, Mr.
4 Chairman.

5 We would move at this time the
6 introduction of Tenneco Exhibits One through Eight.

7 MR. LEMAY: The exhibits are
8 accepted.

9 Are there any questions of Mr.
10 Jones?

11 Mr. Taylor.

12

13 CROSS EXAMINATION

14 BY MR. TAYLOR:

15 Q Mr. Jones, you seem to be saying that --
16 well, you're saying that we have a loss of market share out
17 of the San Juan Basin into California, and I think in part
18 you want to attribute that to the way the OCD rules work;
19 they do not encourage production.

20 A In part.

21 Q Is there -- are other explanations for
22 loss of share of New Mexico gas in the California market
23 possibly a regulatory preference for Canadian gas by the
24 California (not understood) or the large amount of energy
25 dedicated gas that's in New Mexico that cannot now be sold

1 on the spot market?

2 A Absolutely, that's a part of it. As a
3 matter of fact, if you -- if you look at El Paso's drop, 34
4 percent, from '85 to '86, there are essentially three
5 reasons for that.

6 Number one, El Paso did not take any tra-
7 ditional gas from the San Juan Basin, or very little, except
8 maybe hardship, from April of '86 through October of '86.

9 Number two, you had producers that did
10 not participate in the spot market, either voluntarily or
11 involuntarily.

12 And then, number three, and this is the
13 position I'm speaking of, you had producers that became so
14 overproduced they pulled their gas off the market because
15 they were unable, they were not afforded the opportunity to
16 produce.

17 So, yes, sir, that's just a part of it.

18 Q So there are other reasons than purely
19 (not understood).

20 A Yes.

21 Q If someone, say, offset you and they have
22 NGA gas which can't be sold on the spot market, how would
23 your system protect their right to be able to sell that gas
24 when they do get an (not understood) and are able to sell
25 it while in the meantime you are selling it?

1 A I still feel they have the option to come
2 to the Commission for reinstatement of allowable. I have no
3 other -- I have no other, I guess, suggestions on how to
4 sell that gas. That's up to them. If they can't get a re-
5 lease there's nothing anyone else can do.

6 Q So you're saying that, I assume, that if
7 they don't get a release, that you would sell their gas out
8 of their wells?

9 A Well, if -- if in fact there is drainage.
10 You can also take the flip side of that and say, just 'cause
11 I have offset NGA or old gas, that means that I can't pro-
12 duce any of my gas? That's not fair either.

13 MR. TAYLOR: That's all the
14 questions I have.

15 MR. LEMAY: Any other questions
16 of Mr. Jones?

17 If not, what we will do is take
18 a recess for lunch, convene at 1:30 and at that time we'll
19 hear statements and closing arguments by attorneys and hear
20 the final case.

21 Unless there are any other wit-
22 nesses. Did I miss any witnesses that wanted to give testi-
23 mony in the case?

24 Okay, we'll adjourn till 1:30.

25

(Thereupon the noon recess was taken.)

1 MR. LEMAY: Okay, we'll recon-
2 vene Case Number 9018.

3 Having heard all the prepared
4 testimony, we will not take statements by the attorneys.

5 We'll start with Mr. Kellahin
6 for Tenneco.

7 MR. KELLAHIN: Thank you, Mr.
8 Chairman. I will keep my comments short. We would like to
9 request that you grant in this case a 10-day period to pro-
10 vide additional written comments by participants with re-
11 gards to anything else they might have in mind on the gas
12 bank and the balancing period.

13 We think that the Commission
14 has taken the necessary first steps to help us adjust in
15 minor ways the prorating rules as best we can to help us
16 address the market conditions that are occurring affecting
17 State of New Mexico gas production.

18 We very much appreciate and
19 commend the Commission for the steps you've taken and would
20 urge you to take just a few more adjustments.

21 The first one that you're ob-
22 viously familiar with is the 12-times overproduction number
23 for the San Juan Basin. That was a temporary adjustment
24 that allowed those operators that are currently producing
25 into the spot market the opportunity to continue to produce

1 and therefore preserve New Mexico's eroding share of that
2 gas market.

3 In addition, we think you have
4 taken responsible action in determining how to set allow-
5 ables; in January, February, and March of this year it is
6 apparent to all of us that the historical nominating proce-
7 dures used by the pipelines are no longer reflective of
8 reasonable market demand and that you've exercised your dis-
9 cretion to set allowables more realistically and to continue
10 to encourage participation in that gas market.

11 The part of the case that we're
12 concerned about today the balancing period and the question
13 of the gas bank. I think the gas bank, as Mr. Lyon said, is
14 experiencing great difficulty in attracting any kind of fol-
15 lowing and you have yet to hear any endorsement today, and
16 I don't expect you will.

17 We do not think it's necessary
18 to develop and adopt a gas bank, which is in effect an en-
19 tirely new system, and as Mr. Nutter said, you simply are
20 generating counterfeit money that doesn't help you, anyway.

21 We concur. We think a gas bank
22 is not necessary.

23 The question that we've discus-
24 sed around is what happens with the balancing period. It is
25 my understanding that the proposal to have in effect a 3-

1 year period to come into balance, the rule itself will say a
2 2-year period but we all know that's going to be a 3-year
3 period. The reason that was suggested is that with an ex-
4 tended period it was thought that it will allow those opera-
5 tors that are not currently producing to have an extended
6 period of time to make up the underproduction they were ac-
7 cruing on their wells and somehow protect their correlative
8 rights.

9 We see that a little differ-
10 ently and we think that that length of time for balancing
11 provides too large an opportunity to allow underproduction
12 to dig a very, very deep hole in the gas production situa-
13 tion and you never get in balance. You're on a rollercoas-
14 ter that becomes a very high and low ride.

15 We think that you ought to stay
16 with the historical way of handling that and make the ad-
17 justments and balancing more quickly so the rollercoaster
18 ride is not so drastic. If you stay with the rule prior to
19 December it is a 1-year balancing period, which in effect
20 gives an operator two years to make-up his underproduction.
21 At the end of that period we would recommend that the under-
22 production be cancelled and the allowable be redistributed
23 in the pool the way we did for many, many years.

24 We think that historic 2-year
25 period is an adequate, legal way to allow those operators

1 with underproduction, who are staying off the market, to
2 produce their gas and thereby protect their correlative
3 rights.

4 There is not a soul here today
5 that's provided you any testimony that that current rule is
6 somehow inadequate and has failed to protect correlative
7 rights. You've not been given any testimony or evidence
8 that will allow you to do anything else than to go back to
9 the prior rule. You are bound to consider and reach your
10 judgment based upon the Continental Oil case. You might
11 want to look at that again because it sets forth some very
12 strict guidelines in what you will do in changing existing
13 proration rules. We've got rules now. The burden is to
14 show that those existing rules do not adequately protect
15 correlative rights. There's not a bit of evidence in this
16 case that shows that.

17 The contrary is that a longer
18 balancing period, as suggested by the staff, in fact is
19 something no one wants and would violate correlative rights.

20 We, on behalf of Tenneco, think
21 that the adjustment you've made up to now in terms of the
22 12-times overproduced, using your discretion to set
23 allowables more realistically in line with market demand,
24 are enough adjustments for now and we ought to let that
25 system work and see if it reacts correctly to the situation

1 without extending the balancing period because we see no
2 reason to do so.

3 We appreciate the opportunity
4 to appear before you and thank you for your time and consid-
5 eration.

6 MR. LEMAY: Thank you, Mr. Kel-
7 lahin.

8 Next we'll call Mr. Carr.

9 MR. CARR: Very briefly, we are
10 concerned that if you adopt the gas bank that in fact cor-
11 relative rights will be impaired for when the time comes to
12 withdraw from that bank little or nothing may be there. We
13 think it's unwise.

14 We also are concerned about
15 what we believe Mr. Lyon stated in his testimony as to who
16 would have the opportunity of banking underproduction. We
17 think that if, in fact, you adopt the rule and approve a gas
18 bank system in New Mexico, that it should be available to
19 any operator even if he is accumulating underproduction be-
20 cause he has voluntarily elected not to sell on the spot
21 market. We think anything else would create severe inequi-
22 ties and should not be included in your order.

23 MR. LEMAY: Thank you. Next
24 we'll hear from Mr. Taylor.

25 MR. TAYLOR: Mr. Chairman, the

1 Division on behalf of the committee that studied this would
2 just recommend that the rule remain as it is, which is two
3 years makeup period which was adopted at the same time that
4 the 12-times overproduction was adopted.

5 At that time there was testi-
6 mony on behalf of the committee that they were recommending
7 a 12-times overproduction in the San Juan Basin and a 2-year
8 makeup period. I do not believe that today there was suffi-
9 cient testimony to overturn that.

10 Certainly Tenneco gave the im-
11 pression that the rules here are -- are causing problems for
12 us as far as our market share, but I think their testimony
13 was not that strong insofar as the witness admitted there
14 are other reasons why New Mexico is having a problem with
15 the market share. Among those are California rules, FERC
16 rules, and the dedicated gas problem.

17 And we would just urge that the
18 rule as adopted in December remain in place.

19 MR. LEMAY: Thank you.

20 Mr. Hall, for quite a few com-
21 panies.

22 MR. HALL: Mr. Chairman, I have
23 no comments either in support of or against the proposal.

24 I have one client, a Mr. Bill
25 Clark, who would like to give a comment on behalf of his com-

1 pany. Do I understand the Commission will be taking com-
2 ments at the end of these.

3 MR. LEMAY: Would you like to
4 put those comments in the record now?

5 MR. HALL: If we may.

6 MR. LEMAY: Please.

7 MR. CLARK: I'm William Clark,
8 the Operation Manager for Blackwood & Nichols of Durango,
9 Colorado. We operate wells in the San Juan Basin and I ap-
10 preciate your letting me comment here.

11 We are not opposed or against,
12 as we stated on November 20th on the 12-X. On the 24-month
13 makeup period we feel that it's a logical extension of the
14 12-X and so it's doubling one part, doubling both parts,
15 would give us a reasonable time to make that gas up.

16 I have personally been quite
17 involved in the gas bank discussions and am very much in
18 favor of what we see proposed here today and what I'd like
19 to share with you here is a little bit of gas market and
20 operator's perspective my company experienced during 1986.

21 In January, February, and March
22 we had what I would call traditional sales of both old and
23 new gas, NGA and NGPA gas.

24 In April, we were given an of-
25 fer from El Paso Natural Gas Company to accept a release to

1 sell our NGPA, or new gas, into spot markets because they
2 didn't have a market for it.

3 This is new. We don't know
4 what to do. We leave our wells shut-in; we talk with our
5 working interest owners and try to come up with a policy of
6 what we're going to do. This situation remains in effec-
7 tive. Traditionally in the past few years summer sales have
8 been very low; however, during this year, from May through
9 October, El Paso, under the disguise of this WACOG average,
10 does not take any gas from our wells in the San Juan Basin,
11 whether they're old or new. We do not accept a spot market
12 release so we don't sell any new gas through any spot market
13 activities.

14 Income, October 31st, 1986, El
15 Paso comes out and says we are having a -- basically a new
16 well scheduling policy and at that time scheduled old wells
17 with low position numbers and new wells with high position
18 numbers and what we had seen through October -- excuse me,
19 through November and December, January, February, and cur-
20 rently in the new schedule in March, is all of our old wells
21 are staying on; all of our new wells are staying off.

22 Okay. We're in negotiations
23 with our obtaining a release from El Paso to be able to get
24 spot market production. We haven't been able to achieve
25 that yet.

1 Into mid-January El Paso says,
2 if you're selling on the spot market we want to recall these
3 wells back to the traditional market; January 15th you may
4 turn on your wells.

5 In our particular case we did
6 not -- were not active in the spot market and January 15th,
7 due to the big snowstorm that came in, we were given an op-
8 portunity to turn our wells back on full Commission price,
9 those wells that had been off for nine months. This went on
10 till February 2nd and El Paso came back and said, shut all
11 your new wells in.

12 We continue now with the old
13 wells producing. El Paso reserves this recall to call this
14 gas to the traditional market. As I see it, they're wanting
15 to buy low price gas and leave our new gas and saying, you
16 take care of it, sell it on the spot market, however we
17 still want to have it in our hip pocket if we need it. So
18 it's very much in their favor.

19 We have in 1986 and continuing
20 right now, a very dynamic gas market for my company and I'm
21 sure for other organizations that are much more familiar
22 with spot market activities, it has been around for a long
23 -- more than 1986. I'm not sure exactly when it began but
24 it was new to us and became a very -- the game in town.

25 We wanted to say okay, we want

1 to participate in this game.

2 I very much support the gas bank
3 from the standpoint that while we're watching the market de-
4 velop, watching the seasonal loads and seeing what's going
5 to happen, we're accruing allowable, allowable that is jus-
6 tifiably for us to produce as our share of the market. We
7 are very concerned if you want to cancel that allowable. We
8 think it's very reasonable to give this 24-month makeup
9 period. 1987 doesn't look to be a good sale year for gas
10 again when I have to sell this year's allowable plus last
11 year's allowable, another 12 months, I think, is very
12 reasonable.

13 I would bring to you in clos-
14 ing, if I could reference the Tenneco Exhibit Number Five,
15 it's EPNG Deliveries to California. This we see that from
16 1985 through 1986, that El Paso system-wide drops 5 percent.
17 El Paso coming out of the San Juan Basin drops what appears
18 to me about 30 percent. I can't read the exact numbers but
19 the '85 value is a little over four digits and the '86 value
20 is about 3-1/2. So we see a 5 percent drop in El Paso's
21 market but a 35 percent -- or excuse me, a 30 percent in the
22 specific San Juan Basin.

23 I would wish to point out for
24 you that it's two reasons, that the WACOG of the San Juan
25 Basins are higher and that the gas, El Paso is shifting and
taking gas from other markets.

1 Two, that the producers, opera-
2 tors, small people, not being familiar with the spot market,
3 were not anxious to jump in with both feet as some other
4 larger companies have, and for this reason supporting -- or
5 again, using this as an example, saying we are -- deserve
6 and are entitled to that allowable, please don't cancel us;
7 give us a mechanism, the gas bank, where we can come back
8 and get that allowable plugged back in.

9 And finally, in closing, there
10 was a comment in reference saying that take-or-pay claims
11 would be harmed by the gas bank procedure. There -- the
12 pipeline companies saying you have that gas bank, you can go
13 ahead and you haven't really lost it. I would disagree with
14 that from the standpoint that we need the gas bank and if we
15 do come to contractual settlement with our pipeline com-
16 pany, we're going to need our allowables that were justifi-
17 ably ours in 1986 to be able to make this excess gas, the
18 makeup gas, as most take-or-pay contracts specifically our
19 says that if they don't take it during this year, they have
20 a 5-year makeup period. Well, I'm going to need my allow-
21 ables in the future to produce the gas then when I'm going
22 to need this gas bank allowable to be able to produce my
23 makeup gas if that comes to pass.

24 Thank you.

25 MR. LEMAY: Thank you.

1 We'll now hear from Mr. Pearce
2 for Amoco?

3 MR. PEARCE: Nothing, Mr.
4 Chairman, thank you.

5 MR. LEMAY: Mr. Nance, for El
6 Paso.

7 MR. NANCE: Mr. Chairman, thank
8 you.

9 There are only a couple of
10 points that El Paso would like to make.

11 First, from the Tenneco exhi-
12 bits that were presented, El Paso is really not in a posi-
13 tion at this point to vouch for or deny the accuracy of the
14 figures that Tenneco has presented but we would like to in-
15 dicate that -- that they are not figures that we had pro-
16 vided or that we were familiar with before the -- the exhi-
17 bits were put together.

18 With respect to the specific
19 proposal as far as the gas bank is concerned, El Paso feels
20 that the existing proration rules, if they're allowed to
21 work, are the means that are already available to correct
22 problems that may exist in the system and our primary posi-
23 tion is that such a gas bank rule should not be necessary.

24 If the Commission determines
25 that a gas bank rule is nonetheless appropriate and such a

1 rule should be adopted, El Paso's preference would be for
2 the alternative that's presented in Memo 1-87, as opposed to
3 the primary and secondary structure for a gas bank.

4 Thank you.

5 MR. LEMAY: Thank you.

6 Mr. Duke, Gas Company?

7 MR. DUKE: Thank you, Mr.
8 Chairman. Two quick points.

9 First of all it was mentioned,
10 I believe, that the 12-times provision was needed to facili-
11 tate the spot market and I want to make clear that from Gas
12 Company's point of view the increase to 12-times is abso-
13 lutely necessary to serve our New Mexico (unclear) and we
14 express our gratitude to the Division for that.

15 Also, I'd like the Division to
16 be cognizant of your obligations to know of market realities
17 when you're fulfilling your obligations on correlative
18 rights, preventing waste. There is a spot market, things
19 are changing. We need to take account of these factors.

20 MR. LEMAY: Thank you.

21 Mr. Morgan?

22 MR. MORGAN: We have no com-
23 ment.

24 MR. LEMAY: Thank you.

25 Mr. Ingram, for Conoco, I guess?

1 Do you want to make some comments?

2 MR. INGRAM: Yes, I have a com-
3 ment. I'm Hugh Ingram with Conoco and Conoco's position is
4 that producers who deliberately and willingly withhold pro-
5 ducable gas from the market should not be allowed to parti-
6 cipate in a gas allowable bank. We, however, would have no
7 strong objection to producers participating upon showing to
8 the Oil Conservation Division that they're unable to find a
9 market for their gas.

10 Concerning the 12-month balan-
11 cing period, Conoco supports Tenneco's recommendation that
12 the 12-month balancing period be adopted. We believe that
13 that would provide the most benefit to producers as well as
14 to help the State of New Mexico recapture some of the gas
15 production that we feel has been lost in recent months.

16 Thank you.

17 MR. LEMAY: Thank you.

18 Are there any other comments in
19 the audience? Yes, sir.

20 MR. HOCKER: If the Commission
21 please, my name is R. L. Hocker. I'm a petroleum engineer
22 for Cities Service Oil & Gas Corporation in Tulsa, Oklahoma.

23 First I'd like to make a
24 comment that I have no position with regard to the 12 and 24
25 month periods that have been discussed in the northwest part

1 of the state.

2 I would try to reaffirm, I be-
3 lieve, that the gas bank alternatives and everything apply
4 statewide and I think that's correct. The way I read the
5 proposal it would not be limited to the northwest but in-
6 clude the entire state.

7 With regard to that, at the
8 conclusion of the previous hearing in which a gas bank was
9 brought up, Mr. Lyon encouraged some of us to try to make
10 comments and send them to him.

11 Cities Service did furnish a
12 comment to him, which is dated January the 7th, and 1-87 the
13 memo was dated January the 9th and I think that these two
14 proposals crossed; certainly they were independent. We were
15 unaware of the 1-87, as it's been termed, alternative.
16 Cities Service is not really in favor of a gas bank; how-
17 ever, we would be in favor of the 1-87 memo or the proposal
18 that Cities Service made which could be used in lieu of
19 that.

20 I made some copies of that and
21 would offer them for whatever use anybody would like a copy.

22 MR. LEMAY: I'd like to have it
23 a part of the record.

24 MR. HOCKER: Yes, sir.

25 MR. LEMAY: Would you like to

1 read that for the benefit of the --

2 MR. HOCKER: I'd be very short.

3 MR. LEMAY: It is short and
4 we'd like to hear it.

5 MR. HOCKER: And it's phrased
6 more or less as the alternative was before the last and not
7 in rule form but rather as a method, not as a rule.

8 "An alternative to the proposed
9 gas bank would be a change in the rule -- to the rules which
10 would allow for reinstatement of allowable cancelled during
11 a prior three year period. The rule would be effective Ap-
12 ril 1, 1987.

13 Under this plan, underproduced
14 wells would be reclassified and allowables cancelled as con-
15 templated by the rules. However, any operator could peti-
16 tion the Division for reinstatement of allowable cancelled
17 during the prior three years provided the well has an over-
18 produced status at the time of petition. No hearing would
19 be required.

20 To qualify an operator would
21 have to demonstrate that the well is capable of nonmarginal
22 production. The well would have a maximum of three years
23 from reinstatement to produce the nonmarginal allowable and
24 the reinstated allowable."

25 I would agree with Mr. Nutter

1 that we do need some kind of a cutoff, that the fact that
2 you can reinstate forever might in some way influence a gas
3 purchaser to think that he didn't have any urgency in taking
4 the gas promptly. We'd like to urge the purchasers to take
5 the gas as promptly as possible. That's the reason for the
6 three year period.

7 Three years is perfectly arbit-
8 rary. It's not a judgment. I think one year is not enough
9 and maybe five is too much and three is some place in be-
10 tween.

11 Nothing further. If you have
12 any questions, I'd be glad to answer them.

13 MR. LEMAY: We appreciate your
14 testimony, Mr. Hocker, or your statement, I should say.

15 Are there any other statements
16 in this case?

17 MR. RICHARDSON; My name is
18 Dale Richardson and I'd like to ask the Commission if
19 there's been any consideration given towards marginal wells.
20 I'm a working interest owner in some wells in the northwest.
21 Drainage is going to occur and there's -- there's no ban-
22 king, there's no chance to make that gas up, and I think
23 there ought to be some consideration for it.

24 MR. LEMAY: For what, sir? I
25 didn't --

1 MR. RICHARDSON: For marginal
2 wells.

3 MR. LEMAY: For marginal wells.
4 What would be your recommendation?

5 MR. RICHARDSON: I don't have
6 one. I've looked at it. I don't know what to recommend.

7 There's going to be drainage
8 occur in correlative rights. I do not have a recommenda-
9 tion. Maybe someone in here --

10 MR. LYON: Are you talking
11 about the priority schedule or some other consideration?

12 MR. RICHARDSON: Well, if you
13 don't have an opportunity to produce your marginal wells,
14 what -- what are you going to do? You're going to lose your
15 gas.

16 MR. LEMAY: Is that -- the
17 reason you can't produce it is because there's no market
18 available?

19 MR. RICHARDSON: Right.

20 MR. LEMAY: Because some of the
21 proposals we've heard here today address that issue where
22 the allowable would be available in the future for produc-
23 tion if no market exists for you today.

24 MR. LYON: Could I ask you
25 whether your wells are marginal because they don't have the

1 ability to produce the allowable or are they denied access
2 to the --

3 MR. RICHARDSON: Well, either
4 case.

5 MR. LEMAY: If there's an al-
6 lowable assigned to the well that would not be marginal, but
7 we've looked at the situation where the marginal wells, if
8 they can make the allowable they're reclassified.

9 MR. RICHARDSON: Right, and
10 what if they can't make the allowable, hold a marginal sta-
11 tus and you cannot produce those wells. And offsets, you
12 could be drained by your offsets.

13 There's no consideration -- I
14 don't think that -- I don't have any answer to it.

15 MR. CLARK: May I make a com-
16 ment on that?

17 MR. LEMAY: Yes, please.

18 MR. CLARK: There is a vehicle
19 available where you can come in and ask for a reclassifica-
20 tion of a well. I've heard the opinion expressed that if I
21 had a well in a pool that became marginal because of lack of
22 market demand, I would be in on the Commission's doorstep
23 requesting that that well be reassigned as a nonmarginal in
24 spite of the fact that it can't make its allowable so that
25 it would be getting an allowable, and that is available.

1 MR. RICHARDSON: I see. Then
2 that will take care of it, I believe.

3 MR. LEMAY: Thank you, Mr.
4 Richardson.

5 Any other comments concerning
6 Case 9018?

7 If not, the Commission will
8 take this case under advisement.

9

10 (Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY the foregoing Transcript of Hearing before the Oil Conservation Division (Commission) was reported by me; that the said transcript is a full, true, and correct record of this portion of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO

20 November 1986

COMMISSION HEARING

IN THE MATTER OF:

The hearing called by the Oil Con- CASE
servation Division on its own motion 9018
to consider the amendment Order No.
R-8170.

BEFORE: Richard L. Stamets, Chairman
Ed Kelley, Commissioner

TRANSCRIPT OF HEARING

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Further appearances listed on Pages 2 thru
3, inclusive.

- 1 For Phillips Petroleum,
2 Lewis B. Burleson, &
3 Tenneco:
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8 For Independent Petroleum
9 Assn. of New Mexico,
10 Doyle Hartman, and
11 Alpha Twenty-One Prod.:
12
13 For Amoco Production Co.,
14 Blackwood & Nichols,
15 Exxon Company USA,
16 Union Texas Petroleum,
17 Unocal Corp., Yates
18 Petroleum Corp., Mobile
19 Producing Texas and
20 New Mexico, and Columbus
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MR. STAMETS: And take up next Case 9018 and ask Mr. Fields to come up and he will be sworn.

(Witness sworn.)

MR. STAMETS: Mr. Taylor, we have Mr. Fields on the stand and he's sworn. Do you have some questions for him?

JOE H. FIELDS,
being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. TAYLOR:

Q Will you please state your name, place of employment, and position for the record?

A My name is Joe Fields. I work for Northwest Pipeline and I'm Manager of the Marketing Department.

Q Mr. Fields, have you previously testified before the Commission or its examiners and had your credentials accepted?

A No, I have not.

1 Q Would you then briefly outline your edu-
2 cational and professional experience for us?

3 A I worked for El Paso Natural Gas for nine
4 years in the Reservoir Engineering Department and in Gas
5 Purchases.

6 I've been with Northwest Pipeline for
7 five years in Gas Purchases and in Marketing.

8 I have a business degree from the Univer-
9 sity of Texas, El Paso, and an MBA from Sul Ross State Uni-
10 versity in Alpine, Texas.

11 Q And you're familiar with the matters in
12 Case 9018?

13 A Yes.

14 MR. TAYLOR: Mr. Commissioner,
15 I tender the witness as an expert.

16 MR. STAMETS: He is considered
17 qualified.

18 Q Mr. Fields, this case involves proposed
19 amendments to Rules 10(a), 11(a), and 11(b) or R-8170, is
20 that correct?

21 A That's correct.

22 Q And you -- your purpose in testifying is
23 you have since the last hearing served on the committee that
24 was considering these amendments.

25 A That's correct.

1 Q Could you please give us a brief summary
2 of the considerations that the committee has looked at in
3 reviewing these proposed rules?

4 A Yes. Initially the charter of the com-
5 mittee was to analyze any impediments to production, move-
6 ment of gas to the spot market, and recommend to the Oil
7 Conservation Division a possible remedy.

8 Several different things were looked at
9 and it was decided that really the only one the committee
10 should address was a change, a potential change in the pro-
11 duction rules in that several of the other matters were al-
12 ready being considered by different committees.

13 To that end we came up with recommenda-
14 tions to the Division that would entail in Rule 10(a), which
15 deals with the status -- the underproduction of wells in all
16 parts of New Mexico, northeast and southeast, and in Rule
17 10(b) -- excuse me, and 11(a) in the overproduction, to re-
18 commend that in northwest New Mexico the time period to cure
19 an over or an under production situation would be extended
20 from one year to two years.

21 The second recommendation was in Rule --
22 in Rule 11(b) that deals with the number of times a well can
23 be overproduced prior to being shut-in, we recommended that
24 that be changed from 6 times overproduced to 12 times over-
25 produced.

1 And at the same time we recom-
2 mended that this should be for either a two year period of
3 time or at least some date certain to see if it was
4 necessary other than just for a short period of time to cure
5 a problem that currently existed that might be -- go away
6 with a change in the need for gas in a market area.

7 Q And just to kind of summarize the reason
8 for this was, as I understand it, the committee felt that
9 producers were -- were complaining or stating that there
10 were problems with the rule, or some were stating there were
11 problems with existing rules that prohibited them from fully
12 meeting the spot market or being able to really compete
13 there and it was felt this would be a useful proposal to
14 meet those problems or --

15 A That's correct, and since the perception
16 was that becauser of the nature of the spot market that with
17 the rules that were currently in place, they were too
18 limiting on a producer's ability to participate in that spot
19 market on other than maybe just a month by month basis. So
20 hopefully, this will give the producer the chance to
21 participate over a longer period of time.

22 Q And is it your recommendation on behalf
23 of the committee that this rule be adopted?

24 A It is.

25 Q Do you have anything else in this case?

1 A No, I believe that's all.

2 MR. TAYLOR: That's all we
3 have, Mr. Commissioner.

4

5 CROSS EXAMINATION

6 BY MR. TAYLOR:

7 Q Mr. Fields, do you recall in the discus-
8 sions of the committee why this rule was recommended only
9 for the San Juan Basin and not for the southeast part of the
10 state?

11 A My understanding was that because of the
12 difference in the nature of the wells in the two different
13 areas, being that in southeast New Mexico the wells were
14 relatively shorter lived wells than in northwest New Mexico,
15 that we might cause a problem by extending these time limits
16 in southeast New Mexico where a producer might never be able
17 to make up the gas that would otherwise be made up in a one
18 year of the 6 -- 6 times overproduced rules, as opposed to
19 northwest New Mexico where the wells are longer lived wells
20 and we felt like there was a longer time to balance in that
21 area.

22 Q Now, you indicated that this proposal, or
23 at least the Committee felt that this proposal would give
24 producers the opportunity to commit to a spot market over an
25 extended period. Is this sort of necessary in order to make

1 sales on the spot market or for a portion of the spot mar-
2 ket?

3 A I think to date that most of the spot
4 market sales have been month to month type sales, but that
5 potentially is changing. Some of the end users are looking
6 for longer term commitments and this would give, we felt
7 like this would give the producers a chance to participate
8 in that type of market if it came up.

9 MR. STAMETS: I just got the
10 signal that we've got to go up to the roundhouse, so much as
11 I regret leaving this, I suspect we'll be gone for about an
12 hour and everybody is free for at least that long. We will
13 not start before 2:30 or as soon thereafter as we're able to
14 get back from the budget hearing.

15

16 (Thereupon a recess was taken.)

17

18 MR. STAMETS: The hearing will
19 please come to order.

20 Let's see, seems like I wasn't
21 quite through with my questions of Mr. Fields, but I'm not
22 sure that I remember any more what they were.

23 We'll allow for other questions
24 for Mr. Fields. The questions should relate to committee
25 work, not to Northwest Pipeline's practices and policies.

1 Are there questions of Mr.
2 Fields?

3 If there are no questions, he
4 may be excused.

5 MR. FIELDS: Thank you.

6 MR. STAMETS: As long as we're
7 here, we might as well allow Mr. Lyon to tell us about the
8 gas bank.

9
10 VICTOR T. LYON,
11 being previously called and sworn as a witness, and remain-
12 ing under oath, testified as follows, to-wit:

13
14 DIRECT EXAMINATION

15 BY MR. TAYLOR:

16 Q Mr. Lyon, you testified in this hearing
17 on October 23rd on Rule 9018, did you not?

18 A Yes, I did.

19 MR. TAYLOR: We'd like to re-
20 cord to show that the witness has already been sworn.

21 MR. STAMETS: It will so show.

22 Q Would you please describe your gas allow-
23 able bank plan as proposed Rule 20, referring specifically
24 to the changes that you've made in the proposal since the
25 last hearing?

1 A At the hearing last month I presented
2 some testimony in regard to the gas bank and there were some
3 -- some people who had expressed an interest in working with
4 me and writing rules for the gas bank.

5 We formed a committee and in order for
6 them to understand what I was trying to do, I put my ideas
7 into the form of rules and mailed that set of rules to them
8 before we had our meeting.

9 We met on the afternoon of November 12th.

10 Q Would you -- excuse me. Would you off-
11 hand happen to have a list of who was on the committee or
12 who attended the meeting, just so --

13 A Yes. The committee members were Darwin
14 Vandergraff with the NMOGA; Louis Jones with Tenneco, al-
15 though he was not here, he had a substitute; Dan Wehmeyer
16 with Texaco; Bill Clark with Blackwood and Nichols; H. L.
17 Kendrick with El Paso Natural; Buster Orbison with Gas Com-
18 pany of New Mexico; David Boneau with Yates Petroleum; and
19 Lillian Eaton with Northwest Pipeline, who was not able to
20 make the meeting, and I served as chairman.

21 As is my usual procedure, I did not allo-
22 cate enough time for that group to come to any real conclu-
23 sions. We had some very meaningful discussions. They
24 raised problems that I hadn't thought of and some problems I
25 probably don't have any answers to, but it ended up that I

1 did not feel that we were making any great amount of pro-
2 gress since we had the mixed membership. I think any time
3 you get producers and purchasers trying to agree to some-
4 thing, you're in for a long, long discussion and probably a
5 lot of disappointment.

6 In response to some of the -- well, I
7 might mention that the rules that I mailed out to the com-
8 mittee were attached to the notice of the hearing, I be-
9 lieve, and after our meeting I sat down and tried to address
10 some of the questions that were raised in that meeting and
11 this has been -- the revised rules were back there at the
12 table where you sign in for your appearance, and constitutes
13 Rules A-6, B-7, and C-3.

14 I also added to those rules what I con-
15 sider to be the minimum record-keeping that would be invol-
16 ved in administering a gas bank.

17 I think I testified last month that the
18 purpose of the bank is to, number one, provide a means where
19 people could take their wells off the market because it ap-
20 pears that -- well, I think it's pretty certain that we
21 have a surplus of gas deliverability in this country. Cer-
22 tainly we have a surplus of deliverability in New Mexico.

23 There are producers who may not want to
24 participate in the market today or they may not be able to
25 get into the market today, and if they should elect to take

1 their wells off the market, it would free up allowable to
2 wells who want to participate in the market, and if we pre-
3 serve that allowable to be made up at a later date, then
4 both sides could be satisfied, those who don't want to put
5 their gas on the market and those who can't put the gas on
6 the market, but they will not have lost it and the allowable
7 that they would have received will be distributed to those
8 who want to participate in the market today.

9 So I think it helps both those people.

10 If -- if we continue as we are now, the
11 allowable will be distributed. Some of it will go to wells
12 that are not producing or can't produce, can't produce be-
13 cause they don't have market, and then it will accumulate
14 underproduction and that underproduction will be cancelled
15 and so supposedly they've had their opportunity but there's
16 a question in my mind have they really had an opportunity to
17 protect their correlative rights by producing their wells
18 into a market.

19 And it, as I say, it provides a larger
20 allowable to the wells that do want to produce and have a
21 market for the gas.

22 That's the primary purpose for the prim-
23 ary gas bank, which are described in the rules in Section A.

24 In response to a question that was raised
25 in a committee meeting is the paragraph 6 that says, "Except

1 as provided in C-3 below, a gas well previously placed int
2 he primary gas bank shall not be admitted a second time to
3 the bank after election has been made to place the well back
4 on production, unless approved after notice and hearing."

5 I do not think that it serves our purpose
6 if people jump in and out of the bank. It makes a big prob-
7 lem in record keeping. It, I think, defeats the purpose of
8 the bank to begin with.

9 So if they -- if they put their well in
10 the bank and at some time down the road they want to put it
11 back on production, then we can handle that.

12 Now, Paragraph C-3, which was referred
13 to, came from another question in the bank as to the
14 availability of gas in high demand times, emergency times,
15 so I provided in Paragraph 3 of Section C, "Gas may be
16 withdrawn from either the primary or secondary gas bank
17 during emergency conditions when additioan gas supplies are
18 needed to meet market demand. During such periods the
19 amount of gas produced from a banked well will be charged
20 against the accrued bank account."

21 So that if we need that gas in times of
22 emergency, they can take it out of the bank. We'll deduct
23 the bank balance and they'll go back into the bank shut-in
24 for the primary and they will retain their allowable in the
25 second -- secondary bank.

1 I added Paragraph 7 to Section B to pre-
2 clude people from yo-yoing from one bank to another. Where
3 I said, "Underproduction restored from the primary gas bank
4 and then cancelled for failure to produce, shall not be eli-
5 gible for placement in the secondary gas bank."

6 And other than those changes, the rules
7 are as was mailed out with the notice.

8 Q Thank you, Mr. Lyon. I know that this is
9 a fairly complex subject but because of the fact that there
10 were a lot of questions raised at the meeting about exactly
11 how we might make this work in an efficient and utilitarian
12 manner, I think we better discuss maybe a couple of those
13 and I'm sure the audience will raise some others with us.

14 But one question that was raised at the
15 meeting was what kind of -- this apparently is aimed at pro-
16 tecting correlative rights of all the people who may not
17 have a market at this point in time and it avoids the loss
18 of their allowable, which, as I understand the system as it
19 now works, they would lose that allowable at a certain point
20 in time.

21 A Right.

22 Q But also I think we ought to make it
23 clear that there is no guarantee that if they keep that gas
24 in the bank that if there is drainage of reserves, or some-
25 thing else, the Commission is not here to guarantee that

1 that gas may be there eventually, is that correct?

2 A That's true, just as we can't guarantee
3 that everybody is going to get all of the gas under his tract,
4 we can't guarantee that he'll be able to make up the under-
5 production that he has put in the bank. We do not, as I
6 envision it, we will not give any priority to a well who has
7 been in a bank and has accumulated underproduction, other
8 than the priority that we discussed in the eaerlier case
9 where underproduced wells would -- would have a priority
10 over overproduced wells.

11 There was another approach to taking the
12 gas out of the bank where we would -- we would deduct from
13 their bank account as they overproduced the well, which is a
14 logical thing to do except that they don't have the priority
15 of the underproduction, and of course, we haven't adopted
16 the priority rules at this time.

17 But a lot of the provisions that I have
18 in this are arbitrary. They are a system that I think could
19 be administered but it's not the only way it could be admin-
20 istered, and I'm certainly willing to -- to discuss alterna-
21 tives to the thing and we did discuss alternatives in our
22 committee meeting, and incidentally, I did tell the commit-
23 tee that I would report to the Commission at this hearing
24 that we were unable to -- to come to any agreement as to the
25 proper form of the rules or even that the rules are needed,

1 and my purpose in presenting the rules to the Commission and
2 to the audience at this time is to show them the way I anti-
3 cipate that the bank would work, and if nobody expresses any
4 interest in setting up these banks and using the banks,
5 we'll just silently pass this into oblivion.

6 Q If I recall the meeting, I think we also
7 agreed that we would seek a continuance on this case because
8 of the failure of the committee to have enough time to come
9 up with some more --

10 A That is true. I certainly feel that we
11 need at least two weeks time for people to -- to offer their
12 comments and certainly if anybody is interested, then, in
13 having these rules, I'd like some support for them in the
14 fact or by statements that they have wells that they would
15 like to put into the bank, because if nobody is going to put
16 wells in the bank, there's no sense in having a bank.

17 Q Another topic of discussion that I recall
18 at the meeting was the question addressed in A, part A-3 of
19 this rule, and that relates to how the gas is going to be
20 repaid into your account or how you can produce that gas,
21 and wasn't it, as I recall it, at the meeting there was some
22 question by Mr. Garcia, the Data Processing Department, that
23 the way it's worded now could be a real hardship on the ca-
24 pacity of us to keep track of what was owed and who could
25 produce it and stuff like that and that there might be a

1 preferred method of allowing that bank allowable to be made
2 up.

3 The thing I recall is that it wouldn't be
4 required to be made up in any fraction of a month. Maybe it
5 could just be there and you would have a certain amount of
6 time time to make it up.

7 Would you address the discussion on that
8 point?

9 A Right. Paragraph 3 says that, "At any
10 time an operator may elect to commence or resume production
11 from a well which has been placed in the primary gas bank."
12 That's a statement.

13 "Upon notice to the Santa Fe office of
14 the Division" -- "Santa Fe office of the Division before the
15 20th day of the month the well on the first day of the month
16 following said notice will be given its allocation under the
17 proration formula and in addition shall have credited to it
18 an amount of underproduction equal to its full accrued bank
19 account multiplied by a fraction, the numerator of which is
20 one and the denominator of which is twice the number of
21 months the well remained in the bank."

22 If a well was in the bank for twelve
23 months, then we would restore as underproduction 1/24th of
24 the accrued bank account, which is the allowable that was
25 assigned during those 24 months to a well of equal acreage
and/or deliverability.

1 And one of the things we discussed, as I
2 mentioned before, was why not just let the well overproduce
3 and the overproduction will be charged against his bank ac-
4 count, and as I also pointed out, if we adopt the priority
5 rule, that method would not give the well any priority over
6 any other well, so that he's -- you know, he's going to have
7 to fight to get that allowable back.

8 Q Okay, and one -- just one other thing
9 that I remember being discussed at the meeting and which,
10 I'm sure is the most, one of the most controversial aspects
11 of this rule, is that we had comments that essentially this
12 is going to just turn the San Juan Basin into a storage area
13 and the people will leave their gas in the ground and that
14 we -- essentially we won't be producing any, which I just --
15 the comment I heard was thought it was to nobody's benefit.

16 And currently the rules act to require
17 you to either produce your gas in your appointed time or
18 lose that underproduction and somebody else would be allowed
19 to produce that gas.

20 Would you just briefly discuss that --
21 that point that was made and how this gas bank rule relates
22 to that?

23 A Well, it -- it's my opinion that there
24 are wells that are shut-in up there now either because the
25 price is too low or there's not enough demand for the gas,

1 and those -- those wells, as they accumulate underproduction
2 and we go into balancing periods, are going to have that al-
3 lowable cancelled, and I've just been seeking some way that
4 I can preserve that allowable to a time when conditions im-
5 prove and they can make up that production they were not
6 able to make during these times of low demand.

7 Q So basically you're saying that this rule
8 is aimed primarily at allowing those producers who have no
9 market, who have nowhere they can sell that gas right now,
10 to -- to hold on to that allowable until such time as they
11 can sell their gas to a market.

12 A Right.

13 Q Okay. Do you have anything further to
14 add in this case?

15 A I don't believe so.

16 Q And do you recommend adoption of this
17 rule?

18 A Well, I don't recommend adoption of it
19 right now because I don't think the people have had enough
20 time to look at it and digest it and see whether or not they
21 like it or not.

22 I would like some feedback from the in-
23 dustry to see whether they feel that this is a needed pro-
24 gram. When we find that it is needed, there are some of
25 these things that I have put together out of my head that I

1 need to get with -- with our people that have to put this
2 into effect and keep records on the computer, and so forth,
3 and I'm sure it can be done. I don't know whether we can do
4 it with the people that we have now. I think it's going to
5 increase the work load on the Division and we'll have to --
6 to feel our way along to see how we can make this workable,
7 but I would like to have some expression from industry now
8 as to whether or not this is something that we need before
9 we spend any more time on it.

10 Q Okay, thank you.

11 MR. TAYLOR: That's all we have
12 in this matter.

13 MR. STAMETS: Mr. Lyon, if I
14 understand your testimony at this time, the Division does
15 not know if it has the personnel time available to make the
16 gas bank system work, is that correct?

17 A That's what Mr. Garcia indicated at our
18 committee meeting and he should know.

19 MR. STAMETS: So we clearly
20 need some time to -- to review that.

21 When you talk about a contin-
22 uance of this case, I presume you're talking about a contin-
23 uance of the gas bank portion only.

24 A Yes.

25 MR. STAMETS: In light of the

1 continuance of this portion, we would allow Mr. Lyon to be
2 questioned but it's possible that you might want to instead
3 of questioning Mr. Lyon simply volunteer yet again to work
4 with him on trying to flesh this out.

5 Mr. Kelley and I were discus-
6 sing when we might be able to have another hearing, looking
7 at January the 8th and 9th, and we could bring this portion
8 of this case back at that time, and so with that, we will
9 allow Mr. Lyon to be questioned.

10 Are there any questions of the
11 witness?

12 There being none, he may be ex-
13 cused.

14 Oh, we have one question to
15 ask.

16 MR. BRATTON: Don Bratton
17 again.

18
19 QUESTIONS BY MR. BRATTON:

20 Q Mr. Lyon, is this gas balancing portion
21 going to apply statewide or is this only intended for the
22 northwest part of the state?

23 A The gas balancing?

24 Q Or the gas bank?

25 A Well, it's intended for all the prorated

1 pools in New Mexico, and I say it's intended only for pro-
2 rated pools because that's the only pools that get allow-
3 ables where we can store allowable in the bank.

4 I can see where it could happen that it
5 might cause people to ask that additional pools be prorated,
6 and if that's -- if that's the case, well we can do that.

7 MR. STAMETS: Other questions
8 of Mr. Lyon at this time?

9 He may be excused.

10 Does anyone wish to have --
11 present any testimony now relative to the proposals to allow
12 for 12 times overproduction or 24 months to make up underage
13 and overage in the San Juan Basin?

14 Mr. Stovall.

15 MR. STOVALL: Call Mr. Ken-
16 drick. Note that Mr. Kendrick was previously sworn in this
17 case at the original hearings and was qualified.

18

19 A. R. KENDRICK,
20 having been previously called and sworn upon his oath, and
21 remaining under oath, testified as follows, to-wit:

22

23 DIRECT EXAMINATION

24 BY MR. STOVALL:

25 Q Again I ask you, Mr. Kendrick, are you

1 familiar with Case 9018 and the proposed rule regarding pro-
2 rationing?

3 A Yes, sir.

4 Q What's your opinion of the rule?

5 A At this time I don't think the extension
6 of overproduction to 12 times the average allowable is jus-
7 tified. I have not found on any docket where any producer
8 or purchaser has been called to task for failing to shut in
9 a well for being 6 times overproduced.

10 My clients have wells that have not been
11 offered the opportunity to produce in the spot market. It's
12 my belief that if those wells that have been overproduced 6
13 times their average allowable, and so identified in the gas
14 proration schedule, are shut-in, more wells will be afforded
15 the opportunity to produce and we will learn then whether or
16 not we need to go a 12-month 24-month program.

17 Right now I don't think anyone knows.

18 Q The wells that you spoke of that have not
19 been allowed the opportunity to produce into the spot mar-
20 ket, do you know if they're so called NGA jurisdictional
21 wells or whether they're newer wells under the NGPA?

22 A Some of the wells are NGPA wells that
23 have not been nominated for the spot market.

24 Q Mr. Kendrick, were you previously invol-
25 ved in a study regarding the proration rules which took

1 place prior to this process, sir?

2 A Yes, sir.

3 Q Did you look at the situation in that
4 committee work?

5 A Yes, sir. For more than a year our gas
6 proration rules study committee looked at the gas proration
7 rules and there was no strong support from any operators re-
8 presentatives for a longer period than 6 times a current al-
9 lowable.

10 Q Are you aware of any situations where the
11 12 times overproduced would benefit any operator or aid in
12 the protection of correlative rights and prevention of
13 waste?

14 A Not at this time.

15 Q A comment was made by Mr. Fields. I be-
16 lieve you were present this morning for -- I mean earlier
17 this afternoon when he testified -- with respect to the mar-
18 keting situation and the fact that we're now looking at --
19 at third party end user purchasers getting into the purchas-
20 ing of gas directly from the field, and I believe he testi-
21 fied, if I understood him correctly, that -- that allowing a
22 higher level of overproduction would enable deliveries to
23 that market, enable to continue service to that market,
24 which is what these purchasers are seeking.

25 Do you believe that to be true?

1 A We don't have any evidence of that. We
2 have not had any wells that were forcibly curtailed or any-
3 one that's been penalized for failing to curtail their wells
4 that were overproduced, so we don't know whether the 12-
5 months, 24-months, program is needed.

6 Q Could you envision a situation where you
7 could bump up against the curtailment under either the 6
8 times or 12 times overproduced under the new market condi-
9 tions stated here?

10 A Yes, sir, any -- any situation can be --
11 can reach a maximum position and emergency orders may have
12 to be issued to correct the situation to get out of it, but
13 right now we don't have any evidence that the 12-months pro-
14 gram is needed.

15 Q If a -- if a producer were under a con-
16 tract with an end user and he bumped up against either the
17 6 times or the 12 times overproduced rule and were forced
18 to shut in, what impact would that have? Would it differ
19 between the two, as far as you can see?

20 I realize we're speculating because we
21 don't know what --

22 A We're speculating, but if someone has a
23 well that is approaching that situation he has the opportun-
24 ity to come and -- before this Commission and ask for excep-
25 tion to the rules for -- on an individual well basis.

1 Q Do you have any recommendations as to
2 what the Commission might do rather than adopt this rule to
3 alleviate some of the problems that could occur under the
4 existing proration rules?

5 A Yes, I think if the 6 times overproduced
6 wells were curtailed, it would let this Commission and the
7 staff learn whether or not the 12-months rule was really
8 justified.

9 Q Well, in other words, let the rules in
10 place see if they work before you go change them, is that
11 what you're saying?

12 A Yeah, let's enforce what's there and find
13 out what happens.

14 Q Is there anything further you'd like to
15 add with regard to this case?

16 A I think we need to study this program for
17 a longer period of time. The gas bank concept apparently on
18 its own has limits for the amount of overproduction or un-
19 derproduction that would be accrued, and in light of the
20 continuance of the gas bank program, I think that the 12-
21 months, 24-months program should be continued along with it.

22 Q At first blush would you see any problems
23 between having -- changing this rule in the manner proposed
24 and implementing the gas bank rule, that there are some in-
25 consistencies or potential conflicts between the rules?

1 A I don't -- I don't think that there's
2 anything that can get us into any more trouble than we're
3 already in.

4 Q Would there be -- would there be a danger
5 in enacting this rule now without further study and without
6 further evaluating the approval of the gas bank proposals?

7 A I believe there is, because if we jump in
8 deeper without knowing how deep we're in now, we may be back
9 next year to jump into a deeper hole.

10 So let's find out where we are and what's
11 necessary before we make these type of moves.

12 Q So your recommendation is to continue
13 this -- this hearing, this rule for a period a time to allow
14 further evaluation?

15 A Yes.

16 Q Is that correct?

17 A Yes, and carry it in concept with the gas
18 bank concept.

19 Q And look at the whole thing as -- as a
20 package rather than as separate pieces.

21 A Yes.

22 MR. STOVALL: I have no further
23 questions.

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CROSS EXAMINATION

BY MR. STAMETS:

Q Mr. Kendrick, did you ever ask anybody with the Oil Conservation Division what action they may have taken relative to 6 times overproduced wells?

A No, but I have not seen where --

Q Thank you, that's all --

A -- anything has been docketed.

Q That's all that I asked. So you don't know what the Oil Conservation Division has done about the 6 times overproduced wells.

A To my knowledge no one has been chastised.

Q When was the gas proration study completed that you were referring to earlier in your testimony?

A I think the testimony was presented on December the 4th, 1985.

Q Have conditions in the gas market changed since then?

A Some, yes.

Q If the proposals are adopted, will there be any waste?

A I'm not sure that there would be waste or that there would not be waste. I don't know.

1 Q So you can't tell us that there would be
2 any kind of waste if the proposals were adopted.

3 A That's correct.

4 Q How would correlative rights be harmed if
5 the proposals were adopted?

6 A Let me compare gas prorationing with oil
7 prorationing.

8 In oil prorationing if we overproduce
9 this month, we are required to curtail production next month
10 to compensate for the overproduction.

11 The proration of gas, due to handling and
12 storage problems, is somewhat more difficult, so in the ear-
13 ly days the concept of allowing 6 months production as over-
14 age or underage, was considered a fair imposition upon each
15 owner's rights within the pools, because of the handling fa-
16 cilities.

17 To date there is no evidence of the 6
18 times over rules having been enforced, so we don't know that
19 we need 12 months overproduction.

20 Q Mr. Kendrick, is there any evidence that
21 they haven't been enforced?

22 A Yes, sir, there are wells that have been
23 produced for five and six months with an asterisk in the
24 schedule; that asterisk being the code that the well was 6
25 times overproduced and should be shut-in, according to the

1 code page in the schedule.

2 Q Have you brought that to the Division's
3 attention?

4 A Yes, sir.

5 Q To who? Whose attention?

6 A To Mr. R. L. Stamets. To Mr. Frank
7 Chavez.

8 Q When did you do that?

9 A I think the letter to Mr. Stamets was
10 dated on June the 30th, 1986.

11 Q And have you inquired as to what's hap-
12 pened since then?

13 A I did not get an answer to my letter.

14 Q Did you ask for one?

15 A No, sir, I thought it was common courtesy
16 to answer a letter.

17 Q You might be right. How would -- I'd
18 still like to get back to the question here, how are correl-
19 ative rights going to be harmed if these rules are adopted?

20 A If wells are allowed to overproduce 6
21 months or 12 months, there is the possibility of drainage
22 from the offset tracts without compensatory drainage to make
23 up for that.

24 Q If the wells are required to come back
25

1 into balance over the next 24 months, why would there be
2 drainage which would not be compensated for in that next 24
3 months?

4 A Once the gas is sold it can't come back
5 to the lease.

6 Q Obviously that gas doesn't come back to
7 the lease, but there can be compensated production from
8 nearby leases.

9 A If -- if the gas reserves are still
10 there, it can.

11 Q Well, is there any doubt in your mind
12 that -- that 12 months old production is -- is going to re-
13 sult in that kind of drainage in the San Juan Basin?

14 A Yes, sir, in some instances it can hap-
15 pen.

16 Q Where?

17 A In the Blanco-Mesaverde Pool and in the
18 Basin-Dakota Pool.

19 Q What are the lifetimes of the wells in
20 those pools?

21 A The lifetimes of those wells is long but
22 the productivity from some of those wells is tremendous.

23 Q Are we talking about -- so what you're
24 saying is 6 times overproduced is no problem in the San Juan
25 Basin.

1 12 times overproduced, all of a sudden we
2 have all pools becoming just totally out of balance and cor-
3 relative rights being damaged?

4 A No, sir. I believe if you'll review my
5 testimony, I testified that we had agreed that a 6-months
6 imposition was necessary because of the record keeping and
7 the handling of natural gas.

8 12 months is doubling what we agreed to
9 as the reasonable imposition.

10 Q Where did the 6 times overproduced limit
11 come from, Mr. Kendrick?

12 A It came with the early proration orders
13 in the middle fifties and apparently was because of the pro-
14 ducing and storage problems of natural gas as compared with
15 producing and storing oil.

16 Q How long was the gas proration period
17 then?

18 A Six months.

19 Q How long is the gas proration period now?

20 A 12 months.

21 MR. STAMETS: Any other ques-
22 tions of this witness?

23 Mr. Taylor.

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CROSS EXAMINATION

BY MR. TAYLOR:

Q Mr. Kendrick, you stated something in reference to overproduction, that the Commission or Division should hold a hearing on -- on operators who are 6 times overproduced.

Do you know that the Division used to send out letters to overproduced operators ordering them to shut-in their wells?

A Yes, sir. In fact, I sent some.

Q And do you know if that practice is still carried on or not?

A From looking at the gas proration schedule, if it is carrying it on, it is apparently not being observed.

Q Did you, while you were working for the Division or the Commission, ever have any comments or position on whether those letters should or should not be sent out by the Commission?

A Yes, sir.

Q What was that?

A That they should go out.

Q By whom?

A By the Oil Conservation Division.

1 Q But here in Santa Fe?

2 A Here in Santa Fe or at the District Of-
3 fice, whoever happened to have the personnel and the time to
4 provide those notices.

5 MR. TAYLOR: I'd like the Com-
6 mission to take notice, judicial or administrative notice,
7 of the fact of whether or not anybody has done that. I be-
8 lieve that letters have probably gone out to overproduced
9 operators in the last two months.

10 MR. STAMETS: I'm not certain
11 that that's germane to this case but --

12 MR. TAYLOR: Well, I think it's
13 germane to Mr. Kendrick's testimony.

14 MR. STAMETS: (Unclear) Mr.
15 Lyon questioned about that momentarily.

16 Q Mr. Kendrick, have you heard any produ-
17 cers at meetings state that the reason they can't get into
18 the spot market is because the 6 times overproduced rule
19 does not allow them enough flexibility to sign contracts
20 guaranteeing the sale of a certain amount of gas in a cer-
21 tain amount of time?

22 A No, sir.

23 Q So as far as you know the producers are
24 not having any trouble being able to meet the spot contract
25 demands because of any rules of the Division. You haven't

1 heard anyone say anything about that?

2 A I realize that all of the producers in
3 the San Juan Basin are having problems of not being able to
4 produce their gas, but I have not heard anyone say that be-
5 cause the 6 times overproduced rule was being enforced that
6 no one -- or that anyone was unable to meet a contract.

7 Q Have you heard anybody -- anyone say that
8 because of the existence of the 6 month overproduced -- 6
9 times overproduced rule that they were unwilling to sign
10 such contracts because of their inability to guarantee such
11 deliverance?

12 A No, sir.

13 Q You stated that the 6-months rule -- or 6
14 times overproduced rule is all right, but if we double that,
15 we've got a problem.

16 As I remember the testimony of the repre-
17 sentative of the committee, their recommendation was based
18 upon reservoir characteristics which would allow those wells
19 to be overproduced to a greater extent without draining, un-
20 duly draining other areas around, is that not the testimony
21 or do you understand that to be the characteristics of those
22 reservoirs?

23 A The interpretation I got from that testi-
24 mony was that the wells in the San Juan Basin could stand
25 further overproduction than those in the southeast part of

1 New Mexico, but not that the reservoir characteristics in
2 the San Juan Basin would be such that 12 months overproduc-
3 tion would not impair correlative rights.

4 Q And is the rule not focused so that the
5 overproduction would be in the San Juan Basin rather than in
6 the southeast?

7 A Yes. The request is to make the focus in
8 the San Juan Basin but it does not imply or does not say
9 that no correlative rights will be impaired.

10 Q So what you're saying, your objection to
11 this rule is that 12 times overproduction would allow
12 violation of correlative rights --

13 A Yes, sir.

14 Q -- in the San Juan Basin?

15 A Yes, sir.

16 MR. TAYLOR: That's all I have.

17 MR. STAMETS: Are there
18 questions of Mr. Kendrick?

19 He may be excused.

20 Does any other party wish to
21 put on testimony?

22 MR. KELLAHIN: Yes, sir.

23 MR. STAMETS: Mr. Kellahin.

24 MR. KELLAHIN: Mr. Chairman, on
25 behalf of Tenneco Oil Company I'd like to call Mr. Louis

1 Jones.

2 MR. STAMETS: Thank you. Has
3 Mr. Jones been sworn in this case?

4 MR. KELLAHIN: No, sir, he's
5 not. He was sworn in October, if that's --

6 MR. STAMETS: Yes, that's fine.

7

8 LOUIS D. JONES,
9 being previously called and sworn and remaining under oath,
10 testified as follows, to-wit:

11

12 DIRECT EXAMINATION

13 BY MR. KELLAHIN:

14 Q Mr. Jones, for the record would you
15 please state your name and occupation?

16 A Louis D. Jones, Division Production
17 Engineer, Tenneco Oil Company, out of Englewood, Colorado.

18 Q Mr. Jones, would you describe for the
19 Commission what has been your educational background?

20 A Graduated from Texas Tech University in
21 1976; employed by Tenneco Oil Company for ten years and I'm
22 also a Registered Professional Engineer in the State of
23 Texas.

24 Q Mr. Jones, would you describe for the
25 Commission what functions you perform in your current capacity

1 with Tenneco Oil Company?

2 A I am head of the Production Engineering
3 Department that certainly maintains all of our production
4 out of the Rocky Mountain Division that includes the San
5 Juan Basin and Williston Basin, along with Green River Basin
6 and thirteen -- total of thirteen states production.

7 Q Focusing in on Tenneco Oil Company's in-
8 terest in the San Juan Basin, would you describe for the
9 Commission what interest that is?

10 A Well, Tenneco currently operates 2286 com-
11 pletions in the San Juan Basin, with a total gross capacity
12 of 365-million a day. That's approximate, and that equates
13 to 25 percent of the Basin's current capacity, plus or
14 minus.

15 MR. KELLAHIN: Mr. Chairman, at
16 this time we tender Mr. Jones as an expert petroleum en-
17 gineer.

18 MR. STAMETS: He is considered
19 qualified.

20 Q Mr. Jones, have you and your staff had an
21 opportunity to review the proposed rule that the Division
22 staff has docketed before the Commission today in Case 9018?

23 A Yes, I have.

24 Q For the Commission would you describe
25 what Tenneco's current situation is in the San Juan Basin

1 concerning its production and its marketing?

2 A Well, as far as our overproduction, and I
3 think that's what needs to be discussed at this time, Mr.
4 Kendrick said he knew of really no problems. I can certainly
5 tell you of some of the problems that we have.

6 As of September's proration data we have
7 248 wells shut-in 6 months overproduced, or over 25 percent
8 of our total capacity.

9 Q I'm sorry, how many wells was that?

10 A 248.

11 Q And what share of your capacity is that?

12 A Approximately 25 percent. I'll also make
13 a note, that's total Basin; that's all transporters.

14 To the Gas Company of New Mexico we'll
15 have over 50 percent of our total capacity shut-in 6 months
16 overproduced.

17 Q What is the impact of the current prora-
18 tioning orders and rules of which the existing rules are in
19 part? What is the impact on Tenneco of the current rules?

20 A Well, obviously, the gas market has chan-
21 ged and it started in April of this year with the spot mar-
22 ket. Allowables have been reduced considerably because of
23 the people that did not want -- the producers that did not
24 want to participate on the spot market.

25 We elected to participate in the spot

1 market and have become considerably overproduced because of
2 the reduced allowables as an effect of the producers staying
3 off the spot market.

4 Q Mr. Fields testified earlier this after-
5 noon that the intended purpose of the proposed rule change
6 was to give operators encouragement for the continued parti-
7 cipation in the spot market, and were you here to hear that
8 testimony?

9 A Yes, I was.

10 Q What affect does the proposed rule chan-
11 ges have on Tenneco's ability to compete or to produce into
12 the spot market?

13 A Well, as far as the proposed rule chan-
14 ges, and that being the 12-month overproduced allowable and
15 the 2-year balancing period, first of all, Tenneco would
16 certainly be in favor of the 12-month overproduced proposal.
17 It would certainly give us a short term fix to our long term
18 problem.

19 However, the Rule 10 states that produ-
20 cers will have two years to make up that underproduction and
21 to me that's simply going in the direction of a gas bank and
22 we need to encourage all the producers to stay on the market
23 to make sure that New Mexico does not lose its market share
24 into California.

25 Q Does the proposed rule as drafted accom-

1 plish for Tenneco's purposes the intention that the study
2 committee had when they drafted the rule?

3 A I really do not believe at this time, no.

4 Q Can you describe for us, Mr. Jones, what
5 disadvantages may exist with regards to the implementation
6 of this rule as proposed?

7 A Again I think the disadvantage is allow-
8 ing people to bank their gas. Instead of a 1-year make up
9 period you'll a 2-year make up period. That encourages peo-
10 ple to stay off the spot market.

11 Let's say that you're going to lose that
12 allowable in the State of Oklahoma or Texas, and you have
13 producers that have production in Oklahoma, Texas, and New
14 Mexico, if you're allowed to bank or to be able to make up
15 that allowable sometime in the future, you're going to pro-
16 duce the gas from Texas and Oklahoma versus New Mexico,
17 where you can leave it and bank it. I think that's a real
18 problem and New Mexico could lose its market share.

19 Q Do the proposed rules help New Mexico re-
20 tain its market share of gas produced out of the San Juan
21 Basin?

22 A I certainly think the 12 times proposal
23 will help. It's a short term fix; however, to maintain and
24 certainly maintain, hopefully increase its market share, New
25 Mexico, we're going to need higher allowables for the people

1 that do want to produce, so the people that want to partici-
2 pate in spot market are afforded the opportunity to produce.

3 Q Mr. Jones, let me direct your attention
4 now to the specific portions of the rule and ask you to
5 comment on how you might recommend further changes in the
6 proposal in order to result in accomplishing the purpose in
7 which the rule was originally intended.

8 Let me direct your attention first of all
9 to the question of whether wells ought to be allowed to be
10 produced no more than 6 times overproduced versus the 12
11 times overproduced.

12 A I certainly think that the 12 times would
13 -- I would be in favor of the 12 times overproduced.

14 Q With regards, then, to the balancing
15 period being extended from one year to two years, what are
16 your comments on behalf of your company?

17 A I think we should be against that. When
18 I say "we", all the producers in the San Juan Basin, to en-
19 courage production into the market.

20 Q What is the disadvantage, then, of allow-
21 ing the balancing period to be increased from one year to
22 two years?

23 A It allows them to continue to carry their
24 underproduction versus losing it; either produce it or lose
25 it. They have the opportunity to produce it at this time.

1 Q The rule change also includes the cancel-
2 lation of the overproduction at the end of the balancing
3 period. Do you have any comments or recommendations with
4 regards to how the underproduction at the end of the balan-
5 cing period ought to be handled?

6 A Well, I think bottom line we need to in-
7 crease allowables for the producers that do want to partici-
8 pate in the market.

9 To do that, to increase allowables, the
10 underproduction should be re-allocated to the producers that
11 want to participate, and versus waiting the entire year, I
12 feel like they should be re-allocated at the end of the pro-
13 ration period versus having another year to make it up.
14 That would increase allowables for the people that did want
15 to produce on the market. And I'll make a comment, too,
16 about market demand. I know Mr. Lyon had discussed the
17 down-turn in demand and there's no question that there has
18 been. But I do want to point out, too, that the San Juan
19 Basin as a part of El Paso Natural Gas system, its percent-
20 age has dropped, as far as its market share, has dropped 15
21 percent over the last -- from '85 to '86.

22 And that's its market share, not its pro-
23 duction.

24 Q Within the existing rules as we have them
25 now, Mr. Jones, do you have any recommendations as to how

1 the allowables for these wells might be adjusted in order to
2 give them higher allocation?

3 A I think allowables can be adjusted to
4 meet the demand and certainly afford the opportunity for the
5 producers to produce on the spot market.

6 I think at this time we are not afforded
7 that opportunity. We're six months or 6 times shut-in on a
8 great portion of our capacity, as I mentioned earlier.

9 Q Mr. Lyon discussed the banking concept
10 awhile ago in making his presentation. At this time, Mr.
11 Jones, can you describe for us to what extent Tenneco might
12 be willing to participate in such a banking program?

13 A I don't feel like the gas bank is a good
14 idea for the producing in the San Juan Basin. I think that
15 the -- again that producers that do what to participate
16 should be afforded the higher allowables and individuals
17 that do not want to produce, they have that opportunity to
18 produce during the proration period. At that time, then,
19 they lose that allowable.

20 Q In conclusion, then, Mr. Jones, would you
21 summarize for us what your company's position is with re-
22 gards to whether or not the Commission ought to adopt the
23 proposed rule as presented before the Commission today?

24 A No, sir, I do not believe it's in the
25 best interest of Tenneco or the producers in the basin. I

1 think that this should be continued. Again I have a propo-
2 sal that I think the bottom line is we need to increase al-
3 locations from the basin of people that do want to produce.
4 You'll see this, as we're 6 months overproduced in northwest
5 -- or excuse me, Gas Company of New Mexico's system. They
6 cannot meet their winter demand at this time. That's been
7 told by -- told to us by representative of Gas Company of
8 New Mexico, without waiving the proration rules,
9 the 6 months overproduced situation.

10 MR. KELLAHIN: I have nothing
11 further, Mr. Chairman.

12 MR. STAMETS: Are there ques-
13 tions of Mr. Jones? Mr. Taylor.

14

15 CROSS EXAMINATION

16 BY MR. TAYLOR:

17 Q Mr. Jones, Mr. Kendrick testified that
18 permitting 12 times overproduction in the San Juan Basin
19 would result in the violation of correlative rights. Do you
20 agree with that?

21 A No, sir.

22 Q Why not? Can you give us your opinion of
23 why that would --

24 A I certainly think because of the long
25 lives of the San Juan Basin wells that this is not a -- not

1 a problem.

2 Q Certainly I think we all agree that we
3 want to sell gas here, but one of the problems that we're
4 trying to cure with this rule is the fact that there just
5 isn't the market here that there was a year or two ago, and
6 you say everybody needs to get out there and sell gas, but
7 if everybody in the San Juan Basin agrees to get out there
8 and produce gas, can they all sell it? How do they do it?
9 Isn't it true that maybe Tenneco has some marketing oppor-
10 tunities because of its size that smaller producers might
11 not have and how could we make these rules serve so that
12 they don't lose that opportunity --

13 A I certainly think that we just need for
14 afford everyone the opportunity to produce. If you do not
15 have the opportunity to produce, unable to connect with a
16 pipeline, then you can certainly come to the Commission and
17 ask for reinstatement of your allowables.

18 If you are -- if you do not want to pro-
19 duce because of price, you have had the opportunity to pro-
20 duce and that's all we feel is the definition of correlative
21 rights, is the opportunity to produce.

22 Q So you think that those cases in which
23 there's no market for producers ought to be dealt with more
24 on a case by case basis rather than a rule.

25 A Actually, yes, sir, versus having the op-

1 portunity to produce and not accepting it because of price,
2 and we believe that's the majority of the gas out there
3 that's off the market.

4 MR. STAMETS: Mr. Stovall.

5

6 CROSS EXAMINATION

7 BY MR. STOVALL:

8 Q Mr. Jones, do you -- you're talking about
9 the opportunity to produce, and that individual decision
10 will be made by the producer, is that not correct?

11 A That's correct.

12 Q Whether or not to produce?

13 A That's correct.

14 Q And is not the corollary the opportunity
15 not to produce?

16 A That's correct.

17 Q And do you think that this -- your propo-
18 sal to increase the allowable for production and shorten the
19 make-up period, or not lengthen the make-up period, impairs
20 the operators' opportunity not to produce?

21 A No, sir, I think they still have that op-
22 portunity to produce.

23 Q Don't they run the risk that you'll sell
24 their gas?

25 A Not if they're out there and they have the

1 same opportunity that we have.

2 Q Well, they don't, though, because they're
3 losing their opportunity --

4 A When will -- when will they not have that
5 same opportunity if they're not connected? And, yes, they
6 can come to the Commission.

7 Q No, I'm not talking about the noncon-
8 nected thing. I understand the problem there. I'm talking
9 about the producer who is connected and elects not to pro-
10 duce for whatever reason.

11 A He had the opportunity. Correct?

12 Q He had the opportunity but does he have
13 the opportunity not to produce, if he doesn't produce, he
14 will in fact lose his right to sell that gas.

15 A That's correct.

16 Q Does that give him the opportunity not to
17 produce, fair, and protect his correlative rights in the
18 process?

19 A He has the opportunity to produce and
20 protect his correlative rights.

21 MR. STOVALL: No further ques-
22 tions.

23 MR. TAYLOR: I have one other
24 question.

25 MR. STAMETS: Mr. Taylor.

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REXCROSS EXAMINATION

BY MR. TAYLOR:

Q Could you -- you said that the San Juan Basin's market share was down 15 percent. Is that -- could you explain that? Is that their market share of the El Paso --

A Okay, in actuality, to give you an idea of the percentages here, when I say 15 percent, that was of the total volume versus percentage of El Paso Natural Gas system.

San Juan Basin total deliveries were 42 percent in '84, 40 percent in '85, and 31 percent estimated in '86, and that gas is being displaced by other spot gas in Oklahoma and Texas.

Q Thank you.

CROSS EXAMINATION

BY MR. STAMETS:

Q Mr. Jones, has the gas marketing situation changes since January of 1985?

A Yes, sir.

Q In what ways?

A With the advent of the spot market, with El Paso not accepting they must take NGPA wells, with a

1 really total disregard of the traditional gas taking system
2 as we knew it.

3 Q What's the extent of the spot market to-
4 day out of New Mexico? Do you know -- have a figure for
5 that?

6 A I don't have the exact numbers right now,
7 but it's probably close to -- El Paso's system would prob-
8 ably be close to a Bcf per day.

9 Q What would that be, 50 or 60 percent of
10 what El Paso is taking out of New Mexico?

11 A Yes, sir.

12 Q So now the traditional market which we
13 developed these rules and regulations for is half or less of
14 what's happening and the spot market is -- is the majority?

15 A Yes, sir.

16 Q If the rules were changed to allow 12
17 times overproduction but with only 12 months to make up the
18 overproduction, are we apt to wind up a year from today with
19 another whole crop of wells having to be shut-in because
20 they don't have enough time to make up their overproduction?

21 A Only if the underproduction was not real-
22 located.

23 Q So what you're -- well, let me ask you
24 this question.

25 If in its pool balancing calculations

1 that the Division does monthly, if the Division threw out
2 the underage and only considered the overage, plus the nomi-
3 nations, would that tend to ameliorate the situation where
4 the allowable is not going to the producers who want to pro-
5 duce?

6 A It would certainly help alleviate the
7 problems.

8 MR. STAMETS: If anybody here
9 knows whether that could be done without a hearing I'd cer-
10 tainly appreciate hearing about it.

11 Are there other questions of
12 Mr. Jones?

13 Mr. Kellahin.

14
15 REDIRECT EXAMINATION

16 BY MR. KELLAHIN:

17 Q Mr. Jones, Mr. Stamets asked you about
18 the nominations. How is the current nomination procedure
19 established and who makes the nominations?

20 A The pipelines make the nomination to the
21 districts.

22 Q Do you see it necessary to change any of
23 the rules or regulations to allow someone other than the
24 pipeline to make nominations upon which the allowables are
25 then set?

1 A I certainly think that we need to not on-
2 ly consider the nomination but also the 6 times overproduced
3 to add to make adjustments to that nomination to allow the
4 producers to produce that do want to participate in the mar-
5 ket; afford them the opportunity.

6 Q You talked about Tenneco's significant
7 share of that current spot market, Mr. Jones. Does the pro-
8 posed rule the Commission has before it now in its current
9 form encourage Tenneco to continue to participate in that
10 spot market?

11 A The 12-month rule would certainly help to
12 give us a short term reprieve; however, with the allocations
13 being so low for the pools, it would be two or three months
14 before we're back in the same situation in many of our
15 wells.

16 MR. KELLAHIN: I have nothing
17 further, thank you.

18 MR. STAMETS: Mr. Hall.

19

20 CROSS EXAMINATION

21 BY MR. HALL:

22 Q Mr. Jones, I wonder if you might state
23 your opinion on whether or not the 12 times overproduced
24 proposal and 1 year make-up period would affect correlative
25 rights?

1 A No, sir, I do not believe that. I be-
2 lieve we need to afford the producer the opportunity to pro-
3 duce.

4 MR. STAMETS: Other questions
5 of the witness?

6 He may be excused.

7 Do you have another witness,
8 Mr. Kellahin?

9 MR. KELLAHIN: Yes, sir. He
10 says no.

11 MR. STAMETS: Okay. Does any-
12 one else have any testimony they wish to offer in this case?

13 I'd like to ask Mr. Lyon a
14 couple of additional questions. You probably ought to come
15 up front where they can hear the response, Vic.

16

17 VICTOR T. LYON,

18

19 being recalled for further questions, testified as follows,
20 to-wit:

21

22 CROSS EXAMINATION

23 BY MR. STAMETS:

24 Q Mr. Lyon, is the Division doing anything
25 about 6 times overproduced wells?

1 A Yes, sir, at -- at your direction.
2 Harold Garcia was requested to furnish a list of wells which
3 were 6 times overproduced in the San Juan Basin and letters
4 were prepared to the purchaser or transporter and the pro-
5 ducers calling their attention that they were 6 times over-
6 produced and were producing in violation of our rules.

7 In addition there was a memorandum sent
8 out with the proration schedules calling to people's atten-
9 tion that the asterisk in the proration schedule next to the
10 -- the figure of the accumulated overproduction meant that
11 the well was 6 times overproduced and that the well must be
12 shut-in until it was less than 6 times overproduced.

13 Also, I made a review of the well -- of
14 the pools in southeast New Mexico, determined those wells
15 which were 6 times overproduced and still continuing to pro-
16 duce, wrote letters to the producers and the pipeline com-
17 panies advising them they were in violation of the rule and
18 for them to either shut the wells in or show cause why they
19 should not be shut in.

20 Q Do you recall the approximate number of
21 wells involved both in the northwest and southeast in that
22 letter writing campaign?

23 A In the southeast there were approximately
24 a dozen wells and in the northwest I don't remember, but I
25 signed the letters in your behalf during your absence to

1 Alaska, and it seems to me there were something like a dozen
2 letters involving 30 or 40 wells.

3 Q Do you recall what the sense was of the
4 majority responses that we got?

5 A Well, I had some people that responded
6 either in letter or by phone that they -- I actually had
7 some people that asked me what a proration schedule was.

8 And most of them said they were not aware
9 that that asterisk was there and what it meant. And they,
10 most of them apologized and said they would try and get in
11 balance.

12 Q So there are something on the order of 60
13 wells out of how many prorated wells?

14 A I don't know, there must be 4000 in the
15 San Juan Basin.

16 MR. STAMETS: Frank, how many
17 prorated wells in the basin, do you recall?

18 MR. CHAVEZ: Proration units
19 total we have about 4000.

20 MR. STAMETS: And many of those
21 have two wells on them, so it would be 6-to-10,000 --

22 MR. CHAVEZ: There are 3000
23 have two wells.

24 MR. STAMETS: So we're looking
25 at 6-to-10,000 wells in the San Juan Basin, a couple

1 thousand in the southeast, maybe, and we had 60 wells that
2 were in violation of 6 times overproduced?

3 A Right.

4 Q Does it sound like there's massive viola-
5 tion of the 6 times overproduced rule?

6 A Not massive. There apparently are some
7 problem cases, but I would point out that that -- that's the
8 only way that we can protect correlative rights is if people
9 who have produced considerably more than their share of the
10 gas allowable, that they should be shut-in.

11 Q Mr. Lyon, you've been around gas prora-
12 tion business for many, many years. If I remember correctly,
13 you were in on writing some of the very earliest, if not the
14 earliest, rules, is that correct?

15 A That's right.

16 Q Have these rules been the same since the
17 early 1950's or have they changed periodically?

18 A The 6 times over was put into the orig-
19 inal rules for the southeast New Mexico prorated pools in --
20 on January 1st, 1954.

21 Q What about the rules themselves, though,
22 have they been actually static all those years or have they
23 changed in light of changing conditions?

24 A There have not been that many changes in
25 the rules themselves. We have codified and recodified to --

1 to provide a single document that gives all of the proration
2 rules of all the prorated pools.

3 But there really has not been that much
4 change in the rules themselves other than we've varied the
5 length of proration periods. We have, particularly in the
6 northwest, we have (unclear) the balancing periods because
7 of periods of great imbalance and continuing demand. This
8 has happened several times over the period of proration.

9 Q Are there a couple of infill orders in
10 the San Juan Basin?

11 A Yes. Certainly the infill orders in
12 Blanco-Mesaverde and the Basin-Dakota.

13 Q Would you say that the rules have been
14 responsive to changing times?

15 A Right.

16 Q What about violation of correlative rights,
17 do you believe that correlative rights would be violated in
18 the San Juan Basin if the 12 months overproduction and 24
19 months make-up proposals were adopted?

20 A Because of the length of time we've had
21 this 6 times over rule it seems a departure from -- from our
22 accustomed practices, but we're in unusual times. Certainly
23 the evidence in the -- in the infill -- in the cases resul-
24 ting in the infill orders in Blanco-Mesaverde and the Basin-
25 Dakota, it showed that on a poolwide basis average figures,

1 that the communication, pressure communication between wells
2 was minimal in most cases, so that this would indicate that
3 there is not going to be immediate drainage across lease
4 lines because of extending this period.

5 MR. STAMETS: Are there ques-
6 tions of Mr. Lyon?

7 You'd think after two or three
8 times that I could remember your name and I'm going --

9 MR. BRATTON: Don Bratton.

10 MR. STAMETS: Bratton. I'm
11 sorry, Mr. Bratton.

12

13 QUESTIONS BY MR. BRATTON:

14 Q Mr. Lyon, do you feel like correlative
15 rights would not be protected in the southeastern part of
16 the state if this rule were adopted statewide?

17 A I don't think anybody has proposed that
18 we go to 12 times over in the southeast, and I don't think
19 it would be a good idea in the south.

20 Q Well, as a working interest owner in
21 wells in southeastern New Mexico, I'm not sure that my in-
22 terest will be served by allowing a competitive advantage to
23 the spot market for wells in the northwest as opposed to
24 wells in the southeast.

25 A Well, in normal times, Mr. Bratton, I

1 certainly would agree with you, and it distresses me that we
2 have such a disparity and such turmoil in the markets today.
3 It -- I remember the good old days and they really were good
4 old days when we could police these rules through the pipe-
5 lines and accomplish a good job of it.

6 And I wish we were back in those days,
7 but we're not.

8 MR. STAMETS: Are there other
9 questions of this witness?

10 He may be excused.

11 Does anyone have any further
12 testimony they'd like to offer at this time?

13 Mr. Hall?

14 MR. HALL: I have one witness,
15 Mr. Charles Blackwood. I believe he needs to be sworn.

16 MR. BLACKWOOD: I was sworn in
17 in November but I'll --

18 MR. STAMETS: You mean in
19 October?

20 MR. BLACKWOOD: October, yeah.

21 MR. STAMETS: If you were
22 sworn, you're sworn now.

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CHARLES BLACKWOOD,
being called as a witness and having been previously sworn,
testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. HALL:

Q For the record state your name.

A Charles Blackwood.

Q And how are you employed, Mr. Blackwood?

A I'm employed by Blackwood & Nichols Company as the Managing General Partner.

Q Do you operate in New Mexico?

A Yes, we do.

Q Where is your area of operation?

A In the San Juan Basin about 40 miles east of Farmington, New Mexico.

Q All right. Mr. Blackwood, do you operate any Section 104 wells?

A Yes, we do.

Q How many?

A Approximately 70.

Q All right. Have you had an opportunity to produce those wells since last April?

A From -- from April through October we've

1 had no opportunity to produce the 104 category wells.

2 Q And why is that?

3 A I don't know. That gas is priced lower
4 than spot market. It would seem logical that we would have
5 had an opportunity to sell some of it.

6 Q Mr. Blackwood, would you have an opinion
7 upon the 12 times overproduced proposal?

8 A I think that raising the limits from 6
9 times to 12 times would make it possible for correlative
10 rights to be impaired easier than it is with the 6 times
11 rule.

12 Q Do you have anything further to add?

13 A Only in the way of comment. My -- my
14 company does have wells shut-in that are directly across
15 from Tenneco wells producing, and that we think a drainage
16 problem is beginning to occur. We don't have a strong case
17 at this point but if this problem continues for many more
18 months we think we will have a strong drainage case.

19 Q So will the likelihood of drainage in-
20 crease with the longer duration of the period?

21 A Yes, with the longer duration of the --
22 of the ability to produce 12 times over instead of 6 times
23 over.

24

25

CROSS EXAMINATION

1
2 BY MR. STAMETS:

3 Q Mr. Blackwood, is the Section 104 gas NGA
4 gas?

5 A Yes.

6 Q We have a representative of El Paso out
7 in the audience today and if I mis-state this I certainly
8 hope that he'll stand up and say no, no, you're wrong.

9 El Paso's held a number of meetings late-
10 ly and my understanding is that they may intend to abandon
11 their purchasing procedures wherein they took from pools on
12 a weighted average cost basis, and now intend to flow the
13 NGA gas to the market.

14 And assuming, as I think we must at this
15 point, or assume for this question, assume that the reason
16 your NGA gas did not flow is it was in a pool that had a
17 high weigh cost, and that now El Paso is going to take the
18 NGA gas, do you feel like you're going to be in a better
19 position?

20 A If you'll recall my testimony, I only
21 stated our NGA wells were shut in from April through Octo-
22 ber.

23 Within the last two weeks El Paso has
24 called for some of that gas and we are producing at this
25 point gas from these wells, but we were unable to produce

1 any gas from April through October, and that's a rather ar-
2 bitrary decision, as far as I'm concerned. That gas could
3 have been produced at a cheaper rate than the spot market
4 gas they were buying.

5 Q El Paso, as I recall, also has an appli-
6 cation in with the FERC to allow for a month-by-month aban-
7 donment of NGA gas so that it could flow to the spot market.

8 If that application should be approved by
9 FERC, would that give you an opportunity to participate in
10 the market which you do not have at the present time?

11 A Yes, yes, it would.

12 Q Do you have an opinion as to whether or
13 not you would take advantage of that market?

14 A We would be willing to take advantage of
15 the market if El Paso would not insist on us waiving all of
16 our contractual rights in order to do so.

17 Q Okay.

18 MR. STAMETS: Are there other
19 questions of this witness?

20 Mr. Kellahin.

21

22 CROSS EXAMINATION

23 BY MR. KELLAHIN:

24 Q Mr. Blackwood, you talked about your
25 wells in relation to the spot market under the current

1 rules.

2 Will the adoption of the proposed rules
3 in this case encourage you to participate in that spot mar-
4 ket or will it make any difference at all?

5 A I don't think it will make any differ-
6 ence.

7 Q Are you for the proposed rule change in
8 any way?

9 A I don't have a strong opinion as to this
10 rule change. I think I would be slightly opposed to it be-
11 cause of the possibility of the extended production period
12 could, I think, impair some correlative rights down the way,
13 but that's -- I'm not strongly opposed to it. I'm not
14 strongly in favor of it.

15 Q You don't see that --

16 A I just want to -- we -- the reason I
17 asked to come up here was that the Tenneco representative
18 seemed to infer that all of us had indeed had opportunities
19 to sell our gas and the only reason that we're not selling
20 gas is because we chose not to, and that's why I'm here, to
21 refute that statement.

22 Some of us have not had an opportunity to
23 sell gas for reasons unknown to us.

24 Q Does the proposed rule change -- I guess
25 what I'm trying to say is you're uncomfortable with the 12

1 times overproduced number because you don't see that as any
2 solution to the problem; it simply makes a deeper hole for
3 us to get out of.

4 A Yes, that's right.

5 Q So am I correct in understanding that you
6 don't see this rule change as one that benefits you to
7 thereby continue to produce gas from your wells?

8 A I don't see that it would benefit me and
9 I think that the -- if -- I don't think it would hurt me
10 particularly, with the possible exception of some drainage
11 occurring around the boundary of our unit.

12 Q Thank you, Mr. Blackwood.

13 MR. STAMETS: Mr. Stovall.

14

15 CROSS EXAMINATION

16 BY MR. STOVALL:

17 Q Just one question, Mr. Blackwood. You
18 heard the Tenneco proposal to increase the over allowable
19 production but not to increase the make-up periods. Do you
20 feel that that would impair your correlative rights or --

21 A Yes, I do. I think that would impair
22 correlative rights because I don't believe that wells have
23 -- if a well is -- falls greatly behind, it's not going to
24 have the opportunity to make-up a whole year's underproduc-
25 tion in one year. It's going to take a longer period of

1 time for wells to make up their underproduction.

2 MR. STAMETS: Any other ques-
3 tions? Mr. Taylor.

4

5 CROSS EXAMINATION

6 BY MR. TAYLOR:

7 Q If Tenneco's wells were shut-in because
8 of the 6 times overproduced rule, do you feel that that
9 would aid you in being able to produce your wells?

10 A I think it's possible, yes.

11 Q Would it have aided you during the period
12 from April to October, do you feel?

13 A I have no idea why we weren't -- it's --
14 it's hard for me to understand why our low price wells were
15 kept shut-in during that period.

16 Q Thank you.

17 MR. STAMETS: Any other ques-
18 tions of this witness?

19 He may be excused.

20 Does any other person desire
21 to put on testimony in this case?

22 Are there statements in this
23 case?

24 Mr. Kellahin.

25 MR. KELLAHIN: Mr. Chairman, we

1 would request that the Commission deny the Division's pro-
2 posed rule change for this particular rule for a number of,
3 I think, very important reasons.

4 First of all, the intended pur-
5 pose for which the rule is supposed to provide some relief
6 doesn't accomplish that purpose. The only testimony you
7 have before you today is from the operators that are sup-
8 posed to have benefitted by the rule change and not a one of
9 them has said that the rule change benefits them.

10 In fact, the rule change, to
11 benefit from participation in the spot market, one of the
12 major participants in that spot market was Tenneco and they
13 have told you unequivocally that that rule change as drafted
14 does not allow them to continue to participate in that mar-
15 ket.

16 So it doesn't accomplish the
17 intended purpose.

18 We also believe that further
19 study is not going to get us a solution. We certainly could
20 recommend a continuance and have the case heard again in
21 January. We think we would be largely in the same position
22 we are now.

23 We think this is a difficult
24 problem for which this doesn't provide an appropriate solu-
25 tion. It's simply the opportunity to make the problem big-

1 ger, to allow the wells to get overproduced and in greater
2 numbers, and it affords the opportunity for drainage, viola-
3 tion of correlative rights in trying to bring these wells
4 back into balance.

5 We think there are adequate
6 rules now within the rules and regulations of the Commission
7 to make adjustments in the nominating procedures, to reset
8 allowables for the wells in the pool, and to solve the kind
9 of problems that this rules is intended to ease.

10 We believe for those reasons
11 the Commission ought to deny the motion for approval.

12 MR. STAMETS: Other statements?

13 MR. TAYLOR: Mr. Chairman.

14 MR. STAMETS: Let's see if
15 there are any other supporting or opposing statements.

16 MR. VERQUER: I'm Charles Ver-
17 quer with Caulkins Oil Company. We have a number of wells
18 up there that are going with Gas Company, offset by Tenneco,
19 a few things like that.

20 Our company objects to this
21 changing that because of drainage and waste. Any time you
22 relieve the pressure on one side of that lease you're going
23 to migrate gas away. This is never going to be produced
24 without drilling more wells or something like that to be
25 able to produce. It will migrate away from our wells toward

1 them; whether they ever get it or not is highly question-
2 able, but it will migrate.

3 I think it's a question of
4 waste situation to leave that go and we shouldn't extend it.
5 I think, if anything, it should be cut.

6 That's all I have to say.

7 MR. STAMETS: Are there any
8 other statements?

9 Yes, sir, in the back.

10 MR. LUGAR: I'm David Lugar on
11 behalf of Conoco, which is a major in the San Juan Basin al-
12 so participating in the spot market.

13 We do not feel that the rule as
14 proposed would benefit Conoco. We do believe it would re-
15 quire further study.

16 I would like to make one clari-
17 fication and that is that I also believe each owner has been
18 afforded the same opportunity to produce.

19 Those wells Mr. Blackwood re-
20 ferred to were NGA wells that were shut in and did not par-
21 ticipate in the spot market. Tenneco, Conoco, and many other
22 producers at the time did not produce NGA wells into the
23 spot market (not clearly understood).

24 So I don't believe that any
25 person was discriminated against by participation in it.

1 MR. STAMETS: Any other state-
2 ments? Mr. Taylor?

3 MR. TAYLOR: Mr. Chairman, I
4 would just like to ask the Commission that you do not
5 dismiss the rule at this time and certainly while both at
6 the committee meeting and here we've discussed the fact that
7 the correlation of various parts of this rule may still need
8 some ironing out, I think we're all aware of the criticism
9 the OCD is taking because of the supposed or real problem
10 that our rules are causing producers not getting into the
11 market, and I think to dismiss this rule at this time would
12 be premature. I think we need to study this.

13 I think the committee, certain-
14 ly on the 12 times overproduced, the experts on that commit-
15 tee recommended that based upon their findings there would
16 be no violation of correlative rights, and I think we heard
17 Tenneco say that at least that portion of the rule would
18 benefit them in being able to meet the market. I think
19 other producers would agree with that.

20 While there may be a problem
21 with how the gas bank, the 12 times overproduced, and other
22 parts of the rule may work together, I think that it's cer-
23 tainly premature to dismiss any effort at this time to try
24 to amend our rules to bring them up to the situation that's
25 happening in the market today.

1 I think we all agree that the
2 market with FERC Rule -- Order 436 and possibly 451, is much
3 changed from what it was when these rules were made and cer-
4 tainly there's a need on the part of us as the Oil Conserva-
5 tion Division and other states to look at their rules to see
6 how they may be hindering the producers from competing in
7 the market that is developing today.

8 MR. STAMETS: Mr. Stovall.

9 MR. STOVALL: I would move that
10 you not adopt the rule today. Now whether it be dismissed
11 or continued, I think, is not particularly important to us.
12 The matter is going to be studied. The operators are going
13 to want to study it and I believe the Commission will prob-
14 ably continue to watch it.

15 I would urge that any action in
16 enacting a rule be deferred for at least sixty days, and
17 whether you dismiss the case and start over with a new pro-
18 posed rule, a new case, or whether you continue this case
19 for sixty days doesn't particularly make a difference but
20 there's enough fundamental differences and feelings about
21 this that I certainly would urge you not to adopt a rule at
22 this time.

23 MR. STAMETS: Any other state-
24 ments?

25 Last week I had a producer

1 stand and look me in the face and say that in essence you're
2 not going to find any answers from the industry, you're
3 going to have to make some decisions, and he was clearly
4 right.

5 What the Commission is going to
6 do is effective December 1 change the rules for the San Juan
7 Basin to allow 12 times overproduction.

8 We are also going to approve
9 the 24 months make-up periods except the effective date for
10 that portion of the rules will be March 1, 1987, which will
11 allow any person who has a better idea to present that bet-
12 ter idea and have it be effective for the next gas proration
13 period.

14 Failing the presentation of a
15 better idea, then you will know what the rules will be for
16 the end of this year and for the next two proration years.

17 We will continue that portion
18 of this case dealing with the gas bank until the January 8th
19 Commission Hearing. Is that the date? January 8th Commis-
20 sion Hearing.

21 We will be instructing the Di-
22 vision staff that prepares the gas proration schedules of
23 this change and hopefully it can be incorporated in the next
24 -- in the December proration schedule.

25 With that, then, we will con-
clude proceedings in Case 9018.

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY the foregoing Transcript of Hearing before the Oil Conservation Division (Commission) was reported by me; that the said transcript is a full, true, and correct record of this portion of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR