

1 STATE OF NEW MEXICO
2 ENERGY AND MINERALS DEPARTMENT
3 OIL CONSERVATION DIVISION
4 STATE LAND OFFICE BUILDING
5 SANTA FE, NEW MEXICO

6 23 September 1987

7 EXAMINER HEARING

8 IN THE MATTER OF:

9 Application of Mesa Grande, Ltd., CASE
10 for an order pooling all mineral 9225
11 interests in the Gavilan-Mancos
12 Oil Pool underlying a certain 640-
13 acre tract of land in Rio Arriba
14 County, New Mexico.

15 BEFORE: David R. Catanach, Examiner

16 TRANSCRIPT OF HEARING

17 A P P E A R A N C E S

18 For the Division: Jeff Taylor
19 Attorney at Law
20 Legal Counsel to the Division
21 State Land Office Bldg.
22 Santa Fe, New Mexico 87501

23 For the Applicant:
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MR. CATANACH: Call next Case 9225, application of Mesa Grande, Ltd., for an order pooling all mineral interests in the Gavilan-Mancos Oil Pool underlying a certain 640-acre tract of land in Rio Arriba County, New Mexico.

Applicant has requested that this case be continued to the Commission Hearing docket for October 15, 1987.

(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

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 9225, heard by me on Sept 23, 1987.
David R. Catanzano, Examiner
Oil Conservation Division

1 STATE OF NEW MEXICO
2 ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
3 OIL CONSERVATION DIVISION
4 STATE LAND OFFICE BLDG.
5 SANTA FE, NEW MEXICO

6 15 October 1987

7 COMMISSION HEARING

8 IN THE MATTER OF:

9 Application of Mesa Grande, Ltd. for CASE
10 an order pooling all mineral inter- 9225
11 ests in the Gavilan-Mancos Oil Pool
12 underlying a certain 640-acre tract
13 of land in Rio Arriba County, New
14 Mexico;

15 and
16 For compulsory pooling and a non- CASE
17 standard oil proration unit, Rio 9236
18 Arriba County, New Mexico.

19 BEFORE: William J. LeMay, Chairman
20 Erling A. Brostuen, Commissioner
21 William R. Humphries, Commissioner

22 TRANSCRIPT OF HEARING

23 A P P E A R A N C E S

24 For the Division: Jeff Taylor
25 Attorney at Law
Legal Counsel to the Division
State Land Office Bldg.
Santa Fe, New Mexico 87501

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27 & Mesa Grande Resources Attorney at Law
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32 Attorney at Law
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35 Austin, Texas 78701

A P P E A R A N C E S C O N T ' D

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For BMG Drilling Corp.
& Dugan Production Co.
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Kent J. Lund
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2 REPORTER'S NOTE: The following first statements by Mr.
3 Lopez and Mr. Lemay are included in the transcript in the
4 prior case.

5
6 MR. LOPEZ: While I'm on my
7 feet I might suggest to the Commissioner that also on behalf
8 of the two Mesa Grande clients I'm representing, that we
9 would request Cases 9225 and 9236 be continued to the next
10 regularly scheduled Commission hearing in November.

11 MR. LEMAY: Thank you, Mr.
12 Lopez. I think we can deal with 9225 and 9226 at this time.

13 9225 is the application of Mesa
14 Grande Limited for an order pooling all mineral interests in
15 the Gavilan-Mancos Oil Pool underlying a certain 640-acre
16 tract of land in Rio Arriba County, New Mexico.

17 Case Number 9236 is the appli-
18 cation of Mesa Grande Resources, Inc. for compulsory pooling
19 and a nonstandard oil proration unit, Rio Arriba County, New
20 Mexico.

21 Without objection those two
22 cases -- did you ask for their dismissal or extension?

23 MR. LOPEZ: No, I extended to
24 the next hearing of the Commission.

25 MR. LEMAY: Without objection

1 those two cases will be extended to the November date for
2 the Oil Conservation Commission hearing.

3 It will be so done.

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5 (Hearing concluded.)
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Sally W. Boyd CSR

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2 ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
3 OIL CONSERVATION DIVISION
4 STATE LAND OFFICE BLDG.
5 SANTA FE, NEW MEXICO

6
7
8 19 November 1981

9 COMMISSION HEARING

10 IN THE MATTER OF:

11 Application of Mesa Grande, Ltd. for
12 an order pooling all mineral interests
13 in the Gavilan-Mancos Oil Pool under-
14 lying a certain 640-acre tract of land
15 in Rio Arriba County, New Mexico.

CASE
9225

16 and

17 Application of Mesa Grande Resources,
18 Inc. for compulsory pooling and a non-
19 standard oil proration unit, Rio Arri-
20 ba County, New Mexico.

CASE
9236

21
22 BEFORE: William J. Lemay, Chairman
23 Erling A. Brostuen, Commissioner
24 William R. Humphries, Commissioner

25
TRANSCRIPT OF HEARING

A P P E A R A N C E S

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MR. LEMAY: We'll call the following two cases, Cases 9225 and 9236.

Application of Mesa Grande for an order pooling all mineral interests in the Gavilan-Mancos Oil Pool and 9236, application of Mesa Grande Resources for compulsory pooling, nonstandard oil proration unit, Rio Arriba County.

Is there a motion to continue these cases until the December 17th hearing?

Mr. Kellahin and Mr. Lopez?

MR. KELLAHIN: Mr. Chairman, we have filed a motion with regards to those forced pooling cases that I am prepared to discuss and lay before the Commission for consideration as to what guidance you'll give us in advancing those cases. I don't propose to present any witnesses today, if that's acceptable.

MR. LEMAY: Mr. Kellahin, it is. I think what we discussed was off the record we would discuss some of the parameters involved in these cases and what we had brought up; however, I just wanted an extension date for these cases at this point. We could dismiss Sally and go on informally from there.

Is that acceptable?

MR. KELLAHIN: I've inquired of

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my witnesses their availability the week before Christmas. I can twist some arms and get them here. I would prefer to have it in January, if possible. We're at your mercy and we'll do what you ask us to do, but the December 17th hearing is most difficult for my people.

MR. HUMPHRIES: Can I help that out?

MR. LEMAY: Mr. Commissioner, please do.

MR. HUMPHRIES: That's the second day of the grazing fee hearings and although I'm sure they'd both be enhanced by hearing at the same time, I'm sort of going to be consumed on the 17th. I forgot to tell you that.

MR. LEMAY: Well, with -- if I could retract a little bit on the Curtis Little hearing, if we can extend that to the January docket, is that acceptable with you, Mr. Stovall?

MR. STOVALL: I don't think we have any problem with that.

MR. LEMAY: Okay, then we will do the same with these, with Cases 9225 and 36, if that's acceptable with Mr. Lopez to extend these cases to the January hearing and then after we go off the record, discuss a little bit the parameters of what we're going to be hearing?

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MR. LOPEZ: Under the circumstances, of course I agree.

MR. KELLAHIN: Mr. Chairman, if I am to make a formal presentation of my motion in the case I would very much like to have the record preserved on that. If you would like to simply discuss informally what the issues are, I'm happy to do that but at some point I would like to put that motion on the record.

MR. LEMAY: Okay. I need to make a call. Let's take about five minutes here. Then we can come back and discuss this thing informally.

(Thereupon a recess was taken followed by a discussion off the record.)

MR. LEMAY: This will be a hearing of Case 9225 and 9236.

MR. LOPEZ: Mr. Chairman, my name is Owen Lopez with the Hinkle Law Firm in Santa Fe, New Mexico, appearing on behalf of Mesa Grande, Limited, and Mesa Grande Resources, Inc.

MR. KELLAHIN: Mr. Chairman, I'm Tom Kellahin of the Santa Fe law firm of Kellahin, Kellahin & Aubrey, appearing on behalf of Sun Exploration and Production Company and Dugan Production Corporation.

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MR. LEMAY: Are there additional appearances in these cases?

Who wants to start, Mr. Lopez? Mr. Kellahin?

MR. LOPEZ: Well, I thought we weren't going to say anything until January.

MR. LEMAY: Well, I need a motion to extend this.

MR. LOPEZ: Oh, well, go ahead.

MR. KELLAHIN: Mr. Chairman, I would request that these two cases be continued to the January hearing of the Commission and that you take under consideration my motion with regards to the dismissal and continuance of the forced pooling cases.

In that regard we would request permission of the Commission to file a memorandum brief of legal authority on the issues involved in the case.

As we see them, the major issues to resolve are the language in the June, 1987 order that resulted in the reduced allowables in Gavilan-Mancos. It's the June '87 order.

Within the context of that order, it's R-7407-E, on page 5 and on page 4, Rule 2 and its subsections had specifically exempted certain spacing and proration units that were originally established on 320 ac-

1
2 res.

3 We believe the Commission needs
4 to on its own motion open that rule for subsequent hearings
5 on the same docket with these pooling cases so that the Com-
6 mission may decide and direct us and clarify what it was in-
7 tended to do with the exemption of those spacing units.

8 Once that issue is discussed,
9 we believe that there are also issues involved in the com-
10 pulsory pooling case and among those issues is what direc-
11 tion you must take in consolidating the two 320's into a 640
12 in a producing well and how to allocate the costs of that
13 well and that investment among the parties. That is an is-
14 sue in the forced pooling statutes that we want to address
15 and we will do so my memorandum to you, and we propose that
16 all those issues be consolidated, the three hearings to be
17 heard at the same time.

18 MR. LEMAY: Thank you, Mr. Kel-
19 lahlin.

20 Mr. Lopez, anything that you'd
21 like to add?

22 MR. LOPEZ: Mr. Chairman, we'll
23 join in the continuance of the case to the January hearing
24 under the circumstances that we've been apprised of today.

25 We have filed our response to
Mr. Kellahin's motion.

1
2 We join the postponement of the
3 hearings on the basis that we do think that Rule 7407-D is
4 ambiguous.

5 Mesa Grande's position is that
6 the statutes are manifestly clear as to what the -- what the
7 Commission must do and we will also submit a memorandum
8 brief that we would object to opening up the compulsory
9 pooling cases to considering irrelevant testimony when the
10 statutes are so clear, but our memorandum will address that.

11 MR. LEMAY: Thank you, Mr.
12 Lopez.

13 We shall continue Cases 9225
14 and 9236 to the hearing of the Commission which will be held
15 on January 21st.

16 I'd also request from both of
17 you, Mr. Lopez, Mr. Kellahin, that you expand a little on
18 your October 26th letter, Mr. Kellahin, and your November
19 16th letter, Mr. Lopez, in briefs concerning the issue of
20 the options that we had as a Commission concerning forced
21 pooling when the spacing unit is enlarged.

22 MR. LOPEZ: And when do you
23 want the brief?

24 MR. LEMAY: By January 10th, if
25 that's the date that you agreed to.

MR. KELLAHIN: Yes, sir.

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MR. LEMAY: Is there anything additional concerning these cases?

If not, they will be continued to the January 21st hearing.

(Hearing concluded.)

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Sally W. Boyd CSR

NEW MEXICO OIL CONSERVATION COMMISSION

COMMISSION HEARING

SANTA FE, NEW MEXICO

Hearing Date JANUARY 21, 1988 Time: 9:00 A.M.

NAME	REPRESENTING	LOCATION
Boeh Hahn	Byrum	Santa Fe
George Mallon, Jr.	Mallon Oil Co	
David Mikesh	Mallon Oil Co	
Curtis Hoffman	Stuhle Law Firm	Santa Fe
L. Sant	Mesa Grande, Ltd.	Tulsa
G.B. Hueni	Bergeson & Assoc.	Denver, Co.
W.T. Kelbourn	Kelbourn Kelbourn & Aubrey	Santa Fe
Victor Lyon	OCD	Santa Fe
F. Chavez	OCD	Hefec

NEW MEXICO OIL CONSERVATION COMMISSION

COMMISSION HEARING

SANTA FE, NEW MEXICO

Hearing Date JANUARY 21, 1988 Time: 9:00 A.M.

NAME	REPRESENTING	LOCATION

1 STATE OF NEW MEXICO
2 ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
3 OIL CONSERVATION DIVISION
4 STATE LAND OFFICE BUILDING
5 SANTA FE, NEW MEXICO

6 21 January 1988

7 COMMISSION HEARING

8 IN THE MATTER OF:

9 Application of Mesa Grande, Ltd., CASE
10 for an order pooling all mineral 9225
11 interests in the Gavilan Mancos
12 Oil Pool underlying a certain 640-
13 acre tract of land in Rio Arriba
14 County, New Mexico.

15 BEFORE: William J. LeMay, Chairman
16 Erling Brostuen, Commissioner
17 William R. Humphries, Commissioner

18 TRANSCRIPT OF HEARING

19 A P P E A R A N C E S

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21 Attorney at Law
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26 For Sun Exploration and W. Thomas Kellahin
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A P P E A R A N C E S

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I N D E X

GENERAL DISCUSSION

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I N D E X

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4 LARRY SWEET

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MR. LEMAY: We'll go back to Case 9225.

At the last meeting of the Commission we requested briefs in this matter, which were submitted by -- by both attorneys.

At this point what we'd like to do is hear some oral arguments as to the statute in this matter, whether this Commission has legal jurisdiction to do what it did in Order R-7407-E, which was to establish 640-acre spacing units in the Gavilan Mancos Pool, and then allow for a second well in that pool, and then I want to quote this, and then added part of Rule 2 and provided further that proration units formed prior to the date of this order are hereby exception to this rule.

Whether we can, in our jurisdiction, do this is not defined, so if that's acceptable with both counsel, we'd like to hear some -- some oral arguments as to the statute in this matter.

MR. KELLAHIN: Mr. Chairman, for the record, I'm Tom Kellahin, Santa Fe, New Mexico, appearing in association with Mr. Allen Tubb, an attorney for Sun Exploration and Production Company. He and I both represent Sun Exploration and Production Company.

This issue was brought forward

1 to the Commission at a hearing scheduled in November on the
2 19th of November. The point that we're in the discussion
3 now is rather an unusual way to get to the issue you've as-
4 ked. It comes about as a result of initially Mesa Grande
5 Resources and Mesa Grande, Limited, filing compulsory pool-
6 ing cases as one of the methods in which to determine
7 whether or not existing wells in the Gavilan Mancos, that
8 were drilled prior to the June, '87 order, that's Order R-
9 7407-E, whether those wells then, and how they will be con-
10 verted into 640-acre spacing.

11 Mesa Grande, in the Loddy case,
12 which is the one left on the docket for today, is not the
13 operator. That was a well drilled by Jerome McHugh and pur-
14 chased subsequently by Sun when they took over McHugh's in-
15 terest in the Gavilan.

16 Mesa Grande, and others, owned
17 the interest in the east half of the section that is cur-
18 rently undeveloped. Sun, and others, have the developed
19 320.

20 The issue before you is to what
21 extent Order R-7407-E has affected what happens with those
22 spacing units. The statute you referred to is 70-2-18, is
23 cited as an appendix to our memorandum that we submitted to
24 you back on the 11th of January.

25 The Commission has specific

1 authority, I think Mr. Lopez and I both concurred that the
2 Commission has specific authority to change the spacing in
3 these pools, and that once a spacing is increased the effec-
4 tive date of that spacing change will determine how the pro-
5 duction is to be shared. For example, on June of '87, when
6 the spacing change occurred, went from 320 to 640, the new
7 owners, then, in the 320 that was undeveloped, would be par-
8 ticipating in the production from that date forward. It is
9 my position that you should not and could not make that ad-
10 justment retroactive. The statute didn't include that.

11 If that was as simple as it
12 was, then we would not be here; however, Order R-7407-E, in
13 Rule 2, in the order provision which we have emphasized in
14 our memo to you, has what we have called some grandfathering
15 language. In Rule 2 language was contained to change the
16 spacing to 640's, and then we have in the order language
17 which says, and further -- "and provided further that prora-
18 tion units formed prior to the date of this order are hereby
19 granted exemptions to this rule."

20 That has given us no end of
21 confusion and discomfort about what we are supposed to do
22 now with those spacing units that were drilled prior to the
23 June order. We have sections in which there are two Gavilan
24 Mancos wells. We have sections in which there are but one,
25 and there are sections where there are none.

1 That finding, or that order
2 provision, is significantly different than the language used
3 by the prior commission when this pool went from 40's to
4 320's. An argument is made in our memorandum that the lan-
5 guage used by the prior commission would have left no doubt
6 in anyone's mind that you must take those 40-acre spaced
7 units and transform it into 320's. Had that language been
8 repeated in the June, '87 order, there would have been no
9 dispute, disagreement, or difference of opinion among law-
10 yers. The language, obviously, is different.

11 Our concern in raising this
12 question is not that we have any disagreement with 640-acre
13 spacing for that pool. That's the position we have asserted
14 for years now. The difficulty is that that language in
15 there has caused us difficulty not only with working inter-
16 est owners in the section but with mineral owners, royalty
17 owners, and the fur will fly when we change that existng
18 320-acre unit for the Loddy, by example, cut the income
19 stream for the royalty owners in half, and they say why did
20 you do it? We say because of the spacing change in the June
21 order and they look at it and say, you can't do that, it's
22 exempted.

23 We need some help in understand-
24 ing what the Commission intended by the language in Rule 2.
25 We know the mineral owners and the royalty owners are very

1 concerned about Gavilan. We had them here en masse in the
2 March and April hearings. They came with their lawyers and
3 their video cameras. This won't go away and it's not simply
4 a controversy or a difference of opinion between Sun and
5 Mesa Grande about what to do. There are a bunch of these
6 out there.

7 To answer your question, within
8 Section C of 70-2-18, in the very same sections that talk
9 about making spacing changes it also provides in C that non-
10 standard spacing and proration units may be established by
11 the Division and all mineral and leasehold interest owners
12 in any such nonstandard spacing unit shall share production
13 from that unit from the date of the order establishing the
14 nonstandard unit.

15 The argument then is the very
16 order entered in June did what's allowed in Sub-C, exempted
17 them.

18 Mr. Lopez, in his memo says you
19 can't do it. He cites, I believe it's Rule 104. I believe
20 it's B, Subsection B he cites, and he says there is an ad-
21 ministrative procedure for creating nonstandard gas spacing
22 units. He cites that for authority for the proposition that
23 you cannot have nonstandard oil units.

24 I disagree with Mr. Lopez on
25 that point. The Commission in this very pool has created

1 And that's not a task to be
2 easily accomplished. We've set forth in our memorandum some
3 very difficult hurdles in amending that language. Our re-
4 search shows us and leads us to believe that you can change
5 these permanent special rules only on the predicate that
6 there's been a substantial change in condition and that is
7 the case law.

8 We've also talked about using
9 the device of a nunc pro tunc order to clarify, change, cor-
10 rect, or explain what is in error. That is normally used by
11 the Commission to correct typographical errors, obvious mis-
12 takes that are contained within the scope of -- of the order
13 itself, where anyone reading that order says, hey, this --
14 that's an obvious error, and they fix it.

15 Changing the language of Rule 2
16 is difficult and I cannot recommend to you any foolproof,
17 sure, quick fix. I think the solution that's the least ris-
18 ky is to docket on the Commission's own motion, as we re-
19 quested back in November, a hearing with appropriate notice,
20 and have all parties the opportunity to discuss this issue
21 and then subsequently have the Commission enter detailed
22 findings and revised Rule 2.

23 Now Exhibit Six to our memoran-
24 dum contains some proposed language for amending Rule 2.
25 The way it is drafted, it simply would exempt only those

1 spacing units, only those sections which contain two wells.
2 Now if that was the intent, Exhibit Six is a way to do it
3 and it would not have exempted, then, only those sections
4 which have one well in it.

5 Perhaps that needs further dis-
6 cussion, revision, but it's at least a suggestion for you
7 and in the context of a properly called hearing. We've got
8 to involve more parties in this issue than Mesa Grande and
9 Sun in order to have any hope of having a record that would
10 be defensible on that question.

11 Should you resolve that issue
12 and amend that rule, and should there be no subsequent ap-
13 peal by any royalty owner, mineral owner, or anyone else
14 that had an interest in that case, it would be certainly
15 more comfortable to me than the position I'm in today.

16 We believe that this is an in-
17 surmountable hurdle that must be resolved before we can ad-
18 dress the forced pooling issues.

19 Within the context of the for-
20 ced pooling issue, that's just the procedure by which we
21 need the Commission's attention on how it is we are to share
22 the remaining reserves in these existing producing wells on
23 some equitable, fair way that compensates the original own-
24 ers for the investment made and yet does not penalize the
25 new owners for participation in that remaining production;

1 at the same time does not give those new owners a windfall
2 by participating in that investment, and that's an issue, if
3 we get that far, we're prepared to discuss because that is-
4 sue is not confined only to this case. If we're moving to
5 640 spacing for those sections that currently have one well
6 in them, that issue is going to be a pivotal issue in how we
7 negotiate with the rest of our owners when Sun is the opera-
8 tor and the non-operator. We've got to have some direction
9 and guidance about how to properly allocate costs between
10 the new owners and the original owners.

11 Mr. Lopez argues and cites for
12 you the prior Mallon decision which involved a well up in
13 Seciton 12, I think it was a Johnson well. We believe that
14 decision does not resolve this matter and at such point as
15 you're ready for discussion on that, I'll be happy to talk
16 to you about it.

17 By way of introduction, though,
18 I believe in answer to your question, Mr. Chairman, that
19 you're fully within your statutory authority, within your
20 rules and regulations, to respace the pool on 640's and
21 either concurrently in that order or separate and apart from
22 that order, grant nonstandard oil proration units.

23 You've certainly done it and
24 you can continue to do it within the scope of your author-
25 ity.

1 MR. LEMAY: Thank you, Mr. Kel-
2 lahin.

3 Mr. Lopez.

4 MR. LOPEZ: Thank you, Mr.
5 Chairman, Commissioner Brostuen.

6 I frankly find the position
7 taken by Sun to be preposterous and I believe that Mr. Kel-
8 lahin's argument tortures and obfuscates the clear issues
9 before the Commission.

10 I will try to be mercifully
11 brief and I know that you've reviewed our briefs and read
12 them. I'll just bring some points that I did not mention in
13 the brief to bear on my oral argument at this time.

14 I'd begin by saying that it is
15 axiomatic, really, that agencies are creatures of statute
16 and are bound by the statute that creates them.

17 Mr. Kellahin, both in his brief
18 and in his argument, deftly ignored the clear requirements
19 in Section 18 that are cited in the brief, that said that
20 once a proration unit is increased in size the Commission
21 shall require the working interest owners in that increased
22 unit to participate and have the authority to force pool.

23 This reminds me of one of those
24 instances as we ask, is we is or is we isn't. We believe
25 that we clearly is and that we now have 640-acre spacing

1 which was urged on the Commission by Sun in the first in-
2 stance and now they try to seek to avoid its application.

3 As I pointed out in my brief,
4 we feel that it is to torture the language of Rule 2 to not
5 interpret it in accordance with the clear mandate of the
6 statute. In fact, after the order came out, I had Jim Bruce
7 in our office contact the staff of the Division and their
8 response with respect to specifically Rule 2, and the re-
9 sponse was it means that you either have the option to drill
10 a well or to pool and that's clearly what I think the intent
11 of the statute is.

12 Mr. Kellahin states that it is,
13 if there's any doubt, which I don't -- I think that there is
14 clear case authority that says that if there's ambiguity in
15 a rule it will have to be interpreted in accordance with the
16 mandate of the statute.

17 I don't think there was any am-
18 biguity intended by the rule but I think by Mr. Kellahin's
19 tortuous logic he has created ambiguity, and if that's the
20 case, that it could be easily remedied by a nunc pro tunc
21 order making it clear what the language was and can go back
22 to the original language in 7407 with no adverse effect on
23 anyone.

24 The Commission hasn't had any
25 other forced pooling cases before except the one I cited in

1 my brief, which involved Mesa Grande and Mallon and I'd like
2 to state at this point that -- some cases I failed to men-
3 tion in my brief and the principle of law that applies is
4 that agencies must follow their own rules, orders, and regu-
5 lations.

6 As I pointed out, Case 8900,
7 involving the very same pool, under almost identical simil-
8 arities and increasing from 40 to 320, Mesa Grande and Mal-
9 lon had a forced pooling case. As the Commission may be
10 aware, I represented both Mesa Grande and Mallon at the ini-
11 tial hearings in the case and when they both approached me
12 with respect to what the order required and what the law
13 was, having advised both of them that I couldn't represent
14 them because of the conflict, but Mr. Mallon I see is pres-
15 ent here in the room today and so is Mesa Grande, I said,
16 George, I said, they have the right to do it under the law
17 and that's the way it is, and I told Mesa Grande you can do
18 it, and that's indeed what happened.

19 And that's clearly our position
20 today and I think the Commission is bound by that decision
21 because the case law clearly says that the agencies must
22 follow their own rules, orders, and regulations.

23 With respect to Mr. Kellahin's
24 argument on nonstandard units, sure you can form nonstandard
25 units and often it has to be the case, especially where you

1 have problems with standard section lines and what have you.

2 The statute again is clear,
3 though, that you can't form a nonstandard unit if there's
4 any objection. We're objecting. We're saying we're entit-
5 led to be pooled in the well. That's always been the case,
6 all the nonstandard units he points out there was no objec-
7 tion to.

8 With respect to the penalty
9 provision, I would first point out that what risk has Sun
10 had with the well? They didn't drill it. They bought the
11 properties from McHugh, so to say that Sun directly has any
12 risk involved in the well is just not accurate because they
13 had nothing to do with the drilling of it.

14 It is also clear in the statute
15 that the penalty only applies to nonconsenting interest own-
16 ers. We are a consenting interest owner. We are here today
17 prepared to put on two witnessess to indicate the efforts we
18 made to voluntarily join, just like any other compulsory
19 pooling case, and to be entitled to share in the proceeds of
20 the production since the date of the order, and we don't go
21 back to the date of the drilling and we've never so alleged.
22 That is the standard operating procedure of the Commission
23 forever. It's what's been done in this pool. Sun is clear-
24 ly aware of it, and their whole position today is prepos-
25 terous and tortuous.

1 comment on precedent from my own personal case that will
2 tell you what went on before in an exact set of circumstan-
3 ces.

4 MR. LEMAY: Okay. What we plan
5 to do with this is first to look at the legal arguments on
6 what -- what jurisdiction the Commission has in this case,
7 and then from that point, when we get into the specific case
8 of forced pooling, whether we're going to address that or
9 not will also have to be decided by this Commission.

10 MR. MALLON: I would like to
11 say I think Mr. Kellahin has summarized the situation ex-
12 tremely well. This case is a much broader perspective than
13 this. It is creating other problems out here with land own-
14 ers and royalty owners. Matter of fact, we're caught in --
15 Sweet has come to force pool us on -- under this order, and
16 you know, I'm willing to let him in the well. In that par-
17 ticular case I think that's an appropriate spacing in the
18 section we're drilling. The problem is there's really no
19 format to let him in the well.

20 MR. LEMAY: We recognize that
21 --

22 MR. MALLON: Okay.

23 MR. LEMAY: -- and in fact
24 that's the reason we want to look --

25 MR. MALLON: Yeah --

1 MR. LEMAY: -- first, to find
2 the jurisdiction that the Commission has, the leeway it has,
3 and from that point to go on to -- to redefine what we
4 meant, if that's necessary. So we'll kind of take this one
5 step at a time. For that reason, if both Mr. Lopez and Mr.
6 Kellahin will entertain some questions.

7 Mr. Lopez, you mentioned that
8 we cannot form a nonstandard unit with objection. Is -- is
9 there any rules or anything that match that up? I thought
10 we could form nonstandard units even with objections.

11 MR. LOPEZ: Not as I read the
12 statute and not as I understand the Commission to have ap-
13 plied its decision making. I cited it in my brief in point
14 two.

15 The Rule 104-D on page 4, an
16 applicant in seeking a nonstandard unit must present written
17 consent in the form, it should be, sorry about that, of
18 waivers from all offset operators.

19 MR. LEMAY: That would be for
20 administrative approval. I think if it was taken to -- to
21 hearing you could form a nonstandard unit even with objec-
22 tions.

23 MR. LOPEZ: I'm not aware of
24 any cases (unclear).

25 MR. LEMAY: Are you aware of

1 some cases in that regard, Mr. Kellahin?

2 MR. KELLAHIN: I can't -- I'm
3 not prepared to cite you the specific case, Mr. Chairman,
4 but I concur that the waiver consent requirement is only ne-
5 cessary for the administrative approval of a nonstandard
6 unit and if you set it for notice and hearing you could
7 grant one over objection. I believe that's occurred in the
8 Jalmat Gas Pool with Mr. Hartman and Conoco have done that
9 for Mr. Burleson.

10 I would have to search to see
11 if I could find a nonstandard oil proration unit done where
12 there was a contest, but I know it's been done in the Jalmat
13 Gas Pool.

14 MR. LEMAY: Thank you. I might
15 at this point just ask Mr. Lyon, Vic Lyon, with the Commis-
16 sion, if he has any recollection of cases of establishment
17 of nonstandard proration units over objections from offset
18 operators.

19 MR. LYON: I was -- I was
20 searching my mind for such an occurrence and I do recall the
21 one that Mr. Kellahin mentioned, with Doyle Hartman that
22 were opposed by Conoco. It wasn't purely the nonstandard
23 proration unit. There were a number of wells with joint de-
24 dication of the unit involved there also. It was not purely
25 a -- just a nonstandard proration unit.

1 MR. LEMAY; Just a second, off
2 the record, just to clarify for the Commissioner what we're
3 doing.

4
5 (Thereupon a discussion was had off the record.)
6

7 MR. LEMAY: For clarification,
8 I think for our purpose more than anything in trying to come
9 to grips with this, we're back on the record, and I think
10 what I said, the statement, and provided further that prora-
11 tion units formed prior to the date of this order are hereby
12 granted exception to this rule. I was characterizing a
13 literal interpretation of those words by the Commission, not
14 in conjunction with the statute, not in conjunction with
15 previous order, just what we did with that -- with that
16 statement.

17 That evidently has caused the
18 confusion; one, whether we could say that and do that, and
19 two, whether that was only an option that existed at the
20 time of two consenting parties agreed to drill separate
21 wells.

22 There seems to be some confu-
23 sion what we can do and, also, I don't think that statement
24 bears any confusion as I read it, but in conjunction with
25 the rest of the order it can cause confusion.

1 MR. LOPEZ: Okay, I can address
2 the first point, I guess, this way.

3 If you interpret that, and I
4 don't think your staff did, but if that's your reading to-
5 day, then I think it's clear and we're ready to go right to
6 the courthouse and I think we'll get a summary decision on
7 it, that it is contrary to the statute and you can't do
8 that, because if you increase --

9 MR. LEMAY: That's what we want
10 to address.

11 MR. LOPEZ: -- if you increase a
12 spacing unit, you must require everybody to join in the new
13 increased spacing unit. That's never been an issue and I
14 think, as I pointed out, it's really ironic that Sun here,
15 who asked for the 640's, now doesn't want to abide by the
16 standard oil rule, the statute that's always been on the
17 books.

18 MR. KELLAHIN; Mr. Lopez mis-
19 states our position here, Mr. Chairman. That's not our po-
20 sition.

21 MR. LEMAY: Well that, okay, so
22 that's the thing we want to address now, is the fact that --
23 that contrary to statute you created -- your interpretation
24 of that is that if you enlarge a proration unit, that you're
25 obligated to allow forced pooling in the existing wells, I

1 take it.

2 MR. LOPEZ: Exactly, I don't
3 think there's any question about that.

4 MR. LEMAY: I'd just like op-
5 posing counsel just to address that particular issue. Do
6 you agree with that or disagree with that, Mr. Kellahin?

7 MR. KELLAHIN: Oh, I definitely
8 disagree with Mr. Lopez' interpretation.

9 For Commissioner Humphries
10 benefit, forget a moment the specifics of forced pooling.
11 We're discussing what the Commission has done with the lan-
12 guage of Rule 2 in the June, '87 order. That language is
13 significantly different than was used when we changed this
14 pool from 40's to 320's. That language in the prior order
15 back in '84, cited in the memorandum, makes it absolutely,
16 abundantly clear that you had to move from 40's to 320's,
17 and that would have been the position we were in now with
18 the June order had it not included that last phrase in Sub-
19 section A of Rule 2.

20 Our difficulty is not what us
21 sophisticated lawyers and operator understand the staff to
22 interpret that to mean. Our very real concern, one shared,
23 I think, by Mr. Mallon, is that we've got mineral owners and
24 royalty owners who are going to sue us and say we cannot
25 change the Loddy Well to 640 because of that very literal

1 meaning of this order.

2 MR. LEMAY: Well, is it fair to
3 say then that the very literal meaning of that Subsection A
4 under Rule 2 is in violation of what the statute says and
5 what -- what pervious orders have directed us -- or by us
6 for the operators to do in that field?

7 MR. KELLAHIN: No, sir, it does
8 not violate the statute.

9 You can do that because in Sub-
10 section C of that very same statute which Mr. Lopez refers
11 to it says you can exempt them. You can create nonstandard
12 units. And the literal reading of that order is that con-
13 currently with making 640-acre spacing, you created non-
14 standard spacing units for certain of the wells.

15 MR. LEMAY: So in your inter-
16 pretation, if we went right from there to the courthouse,
17 you would defend the position that the Commission has the
18 right to grandfather in all existing proration units and
19 that's not contrary to statute?

20 MR. KELLAHIN: That's right.

21 MR. LEMAY: Okay.

22 MR. KELLAHIN: And that's what
23 they did, and that, unfortunately, is the problem because
24 you may not have intended to do that.

25 MR. LEMAY: Okay. Well, what

1 we intended and what we did not, we can discuss that but --

2 MR. KELLAHIN: All right, sir.

3 MR. LEMAY: -- the literal
4 reading of this subsection is what I'm concerned about.

5 MR. LOPEZ: Well --

6 MR. LEMAY: Mr. Lopez.

7 MR. LOPEZ: Thank you, excuse
8 me, I just think the literal meaning of the statute is con-
9 trary to Mr. Kellahin's position.

10 MR. LEMAY: You're in disagree-
11 ment there, I see.

12 MR. LOPEZ: (Unclear,)

13 MR. LEMAY: Well, we're going
14 to get -- Mr. Humphries.

15 MR. LYON: Mr. Chairmn, Victor
16 T. Lyon. In regard to your prior question, I was searching
17 my mind too far back. I'm not sure of the status of the
18 order but there is an order that has been written, I think,
19 this week where there was a proposed two nonstandard
20 proration units where there are governmental lots in there
21 which cannot conform to the standard quarter quarter section
22 size, and there was a protest and the order has been writ-
23 ten, I don't know whether you've signed it, that -- approv-
24 ing those nonstandard units over the objection.

25 MR. LEMAY: I remember the

1 order and I thank you.

2 Mr. Lopez. Mr. Humphries?

3 MR. HUMPHRIES: Yeah, let me
4 ask, maybe I don't understand why it could -- first, I be-
5 lieve, the initial order said 640-acre spacing including the
6 option for two wells but that it had to be held to the 640-
7 acre proration allowable. Am I right?

8 MR. LOPEZ: Correct.

9 MR. HUMPHRIES: And the ques-
10 tion in the Loddy No. 1 in Section 20 is what's happening to
11 the rights on the east half of Section 20 with only the Lod-
12 dy No. 1.

13 MR. LOPEZ: Correct.

14 MR. HUMPHRIES: There are unan-
15 swered royalty rights and potential working interest rights
16 that are in that question. Is not an option, then, to allow
17 the drilling of the second well but to hold the proration
18 and the production allowables to the same for the 640
19 unit? If, I mean, if that is a -- an acceptable solution to
20 Mesa Grande, what, it appears to me, that Sun argues about
21 is their investment, and true, they were not the first risk
22 taker, I suppose, as it was a McHugh well, but in the second
23 option, then, Sun does -- does not wish to allow Mesa Grande
24 into a producing well, is the way I interpret it. Maybe I'm
25 taking too much away from the --

1 MR. LOPEZ: We couldn't agree
2 with you more and that is exactly what happened after the
3 first order and what -- the way we understood, and under-
4 stood the staff to understand the meaning in Rule 2. That
5 would be no problem and I think that is acceptable to have
6 the option to either, as I said, drill or pool. We are pre-
7 pared today to put on evidence to show that it would be un-
8 economical to drill a second well and it would be not only
9 to Mesa Grande but to Sun. We think the statute is mani-
10 festly clear that -- that you must require the 640 to be
11 pooled and I think there's never been any question in any-
12 one's mind that there always exists the option to drill a
13 second well or infill if the Commission so rules, and there
14 hasn't been any objection of the parties on that rule.

15 MR. LEMAY: Mr. Lopez, yeah, in
16 that regard let me ask one additional question.

17 It's been discussed that
18 there's always an option to drill a second well. Whose op-
19 tion is that? Is it the option of the people in the nonpro-
20 ducing 320 or is it the option of the -- of all people col-
21 lectively within the 640?

22 Who -- who has that option? Is
23 that a point of disagreement?

24 MR. LOPEZ: I don't think
25 that's a point of disagreement. I think it's a good point,

1 though. I think the practice has been to allow it to be the
2 working interest owners in the nondeveloped spacing unit
3 that was pushed in, but I think it would make more sense
4 that it be the combined ownership of the entire proration
5 unit.

6 MR. LEMAY: And taking that one
7 step further, is that a vote of the majority interest within
8 the 640 or is it a vote of the majority interest within the
9 320?

10 MR. LOPEZ: It would be the
11 640, I guess, according to the operating agreement that we
12 --

13 MR. SWEET: The operator would
14 have the right to (inaudible). If it was on 640 spacing the
15 operator would have the right to propose a second well (in-
16 audible) and then the -- the -- I shouldn't answer.

17 MR. LEMAY: That's fine. But
18 for the record, --

19 MR. LOPEZ: Mr. Sweet.

20 MR. LEMAY: -- Mr. Sweet with
21 Mesa Grande.

22 MR. SWEET: I'm Larry Sweet,
23 Manager of Mesa Grande, Limited.

24 It's my understanding that the
25 640-acre proration unit is formed for the Loddy area, the

1 way we interpret it, the operator would have an option to
2 to propose the drilling of a second well, and once the
3 operator made that proposal, Sun in this case, (not clearly
4 understood) operator of that unit sent out AFE's to working
5 interest owners, at that point in time, that the
6 Authorization for Expenditure by the working interest
7 owners, they would elect to pay their share of the second
8 well to be drilled on that 640-acre prortion unit or they
9 could go nonconsent and be subject to a penalty under the
10 operating agreement was was executed by the working interest
11 owners in that unit.

12 MR. HUMPHRIES: Is the east
13 half of Section 1 completely leased by Mesa Grande?

14 MR. SWEET: The east half of
15 section --

16 MR. HUMPHRIES: I mean the east
17 half of Section 20, excuse me, the section that's in
18 question in this.

19 MR. SWEET: Mesa Grande,
20 Limited, owns 190 acres in the east half of Section 20. I
21 believe 10 acres are owned by Arriba Company, Limited, who
22 is represented here today, and my recollection is that
23 Atlantic Richfield Company owns 40 acres and, if I'm
24 correct, I believe Sun and Dugan own the remaining balance
25 of the east half of Section 20, approximately 40 acres.

1 That should be 80 outright to Sun.

2 MR. LEMAY: One question on
3 this. This goes back to the basics of an operating agree-
4 ment. Generally you would sign an operating agreement on
5 the proration unit that was created prior to this order, so
6 you would have operating agreements covering the east half
7 and the west half, on the operating agreements I would see.
8 If you combine that, which operating agreement will prevail
9 for the 640?

10 MR. SWEET: The people (un-
11 clear) 640, a new operating agreement would have to separate
12 Sun and all the others (unclear), and the -- that's my opin-
13 ion. ARCO is not in the Sun well. We are not in the Sun
14 well, and Arriba Company, Limited --

15 MR. LEMAY; But you see, we're
16 trying to back up into the question of who has the option.
17 If the option lies under the 320 you're going to have con-
18 flicting operating agreements. If it lies with -- with
19 either the -- the -- with either 320, then you could get
20 agreement or at least you could go to an operating agree-
21 ment, but basically, when we enlarge a spacing unit in an
22 area we don't have an operating agreement covering that en-
23 larged unit.

24 MR. SWEET: We don't have an
25

1 operating agreement on the east half 320, either, because
2 there's not a well there.

3 MR. LEMAY: That's correct;
4 that's right.

5 MR. LEMAY: Mr. Humphries.

6 MR. HUMPHRIES: Is that -- is
7 the east half 100 percent Federal minerals? Is that 100
8 percent Federal lease?

9 MR. SWEET: I don't believe so.
10 We have the ownership but I'm not sure who the original les-
11 sor was.

12 MR. HUMPHRIES: Well, Mesa --
13 Mesa Grande has the Federal lease. You're designated as the
14 Federal Invader. I suspect that means that that part of it
15 is a Federal lease.

16 But the remaining 130 acres is
17 unknown?

18 MR. SWEET: I show it as fee
19 acreage. It would be 120 fee and 200 -- our leasehold owner-
20 ship plat shows that the northeast quarter is Federal and
21 the northeast of the southeast is Federal. The remaining
22 balance is fee.

23 MR. HUMPHRIES: And the fee
24 owners at this point are not even making an argument about
25 this forced pooling, only Mesa Grande.

1 MR. LOPEZ: I suspect they're
2 probably not even aware of it, which I think brings up an
3 excellent point. If the statute and the application of the
4 order are not interpreted as we urge that they be viewed,
5 then what happens to us? Are we then forced to drill an
6 uneconomic, imprudent well in the east half of 320 because
7 we can't do what we're supposed to do?

8 I mean, if that's where we are,
9 then -- then you're absolutely right in raising the issue as
10 are we going to have an attack now from fee owners because
11 we're not drilling a well on 320 because they won't allow us
12 into the 640 proration unit that they asked to have
13 established.

14 MR. KELLAHIN: Mr. Chairman,
15 you minimize that potential for a royalty owner dispute by
16 the notice and an opportunity for hearing which apparently
17 they do not have, to be involved in this very dispute.
18 They're not represented in this matter.

19 To get back to an earlier point
20 about who has the option, we think that's an intriguing
21 problem. Is it the operator or is it any working interest
22 owner? It appears to me that Mesa Grande wants it both
23 ways. In the Sun well they're the non-operator yet they
24 want in that well. In the Federal Invader they say, hey,
25 we're the operator so we get to choose whether we force pool

1 you or not. They dismissed that forced pooling case and
2 what do you do then with that creature out there in the Fed-
3 eral Invader acreage. Is that a 640 or a 320 now?

4 As Governor King used to tell
5 us, this is a box of Pandoras. The more you talk about it
6 the deeper it gets.

7 MR. LEMAY: I certainly can
8 agree with you.

9 MR. LOPEZ: I -- I --

10 MR. LEMAY: Mr. Lopez.

11 MR. LOPEZ: I take issue with
12 that. That mischaracterizes what we've said.

13 We have said that as far as the
14 Invader is concerned, we welcome them aboard, pay your way,
15 join, but if they don't want to do it, that's fine, too,
16 that's their option. There's no issue as to options here.

17 With respect to the issue be-
18 fore the Commission today we've said Sun remain operator.
19 Make your decision. That's not at issue either.

20 It's just obfuscation.

21 MR. HUMPHRIES: Mr. Lopez,
22 would you describe to me again Mesa Grande's Federal lease
23 description?

24 MR. LOPEZ: Yes. The northeast
25 quarter and the northeast of the southeast.

1 MR. HUMPHRIES: The northeast
2 quarter and the northeast of the southeast.

3 MR. LOPEZ: Right.

4 MR. HUMPHRIES: And the map
5 that was supplied to us by Mr. Kellahin, have you looked at
6 that?

7 MR. LOPEZ: I have. I have it
8 right here.

9 MR. HUMPHRIES: That would then
10 leave -- the -- oh, I'm okay, never mind. I see. I had my
11 description wrong.

12 So the Federal Intruder Well
13 that was initially proposed would have been in the northeast
14 quarter of the southeast quarter of 20.

15 MR. SWEET: I have the exact
16 location. I believe the location is in the southeast quar-
17 ter of Section 20 and I don't recall the exact location.

18 MR. HUMPHRIES: And at that
19 point there was no operating agreements with the royalty
20 owners on the other 120 acres?

21 MR. LOPEZ: At the time you
22 proposed the well.

23 MR. HUMPHRIES: At the time you
24 proposed the Federal Intruder.

25 MR. SWEET: The Federal Intrud-

1 er was proposed in July of 1986, I believe. Operating
2 agreements were circulated at that time for the drilling of
3 the well.

4 Mesa Grande, Limited, signed
5 the AFE to participate in a well in the east half of Section
6 20 in July of 1986. At that time, or around that time,
7 McHugh proposed the drilling of a well on the Section 19,
8 which is 187-acre proration unit along the western boundary
9 of the Gavilan.

10 Mr. Kellahin pointed out
11 correctly that that is a nonstandard proration unit. Mesa
12 Grande, Limited, approved the AFE in the middle of 1986 for
13 the drilling of that well, which was called the 4-0 Well.
14 The history of the Gavilan is full of peaks and troughs.
15 Shortly after our approval had been made for the development
16 of Section 19 and to spend money for this development of the
17 east half of Section 20, there were a series of hearings at
18 the Commission in August, I believe, and September of 1986.
19 There were five days of testimony that was basically spread
20 through a couple of months timetable.

21 At that time the Commission
22 issued an order curtailing production rates in Gavilan. We
23 elected also at that time to try to put things in
24 perspective. We were participating, as a lot of other
25 people, and Mallon included, were participating, in an

1 engineering committee and geological committee, trying to
2 determine what was best for the reservoir.

3 We did not drill the well. The
4 McHugh well was formally abandoned, I don't recall the date,
5 it was formally abandoned at a later date. That's the
6 Section 19 well. I don't know if Mesa Grande (not clearly
7 understood) location, but we elected due to regulatory
8 uncertainty in the allowables and the continuing saga of
9 what's going to happen to us in Gavilan and what's best for
10 Mesa Grande, Limited, and what's best for the field, we (not
11 clearly understood) the drilling of that well.

12 When the orders -- we had five
13 days of testimony here on March 30, 31st, through April 3rd
14 of 1987. The order came out on June 8th. We did study the
15 reservoir between the time that we elected not to drill the
16 Intruder up to the Gavilan hearings, and in fact, not only
17 Mesa Grande, but Mallon and Mobil, Amoco, Kodiak Petroleum,
18 Koch Oil, participated in a comprehensive study by somebody
19 that was independent of the group to tell us what was best.
20 Mr. Hueni made that presentation and the Commission then
21 heard his presentation as well as Sun's, Mr. Greer's,
22 (inaudible).

23 So the order came out and you
24 heard the evidence presented to you during that Commission
25 hearing in March and April and the order was issued on June

1 8th, effective June 8th. At that time we consulted counsel
2 as to what Rule 2 means. We have a limited, and other peo-
3 ple, I'm sure Sun has undeveloped acreage in the Gavilan
4 Pool that is on 320's and where there's an adjacent 320 well
5 that's producing.

6 So our counsel advised us that
7 Rule 2, according to our counsel's interpretation according
8 to the law means that the undeveloped acreage owner has the
9 right to drill a well in his undeveloped 320 or participate
10 on a 640 tract. We elected in this case to offer to parti-
11 cipate, paying our share of the well costs for the Loddy and
12 we understand Sun has an investment in the Loddy. We under-
13 stand also they didn't drill the well, but we tried to do
14 that.

15 I understand Sun's concern that
16 the order is confusing. We're in a situation where we have
17 300 -- we have acreage scattered over the field on 320-acre
18 plots, that we have either at one time or another, for the
19 Intruder, for instance, and the (unclear) well, were going
20 to drill. They elected not to because of the reduced allow-
21 able situation. That's not the only reason, oil prices were
22 down in mid-1986. The regulatory (not clearly understood.)

23 So when the recent order was
24 issued, Rule 7407-E, I contacted Mr. Lopez and asked him
25 what it means. And after checking with people I guess they

1 checked to determine what the order means literally, by
2 abiding by the statutes, means that we have the right to
3 participate or drill. In the Loddy Well, or in that area,
4 the 640, we desire to participate and offered to do so and
5 pay our way and we have not come to any agreement, obvious-
6 ly, and that's where we are today. That in capsule gives
7 you the history of kind of where we were, Mesa Grande, Lim-
8 ited, and where we are today.

9 We do have undeveloped acreage
10 and as Mr. Mallon knows, we have some acreage offsetting the
11 well that we also have an interest in close to their well
12 and we talked to Mr. Mallon and we said this is the way we
13 understand it. We then -- we were adversaries when we first
14 met because of forced pooling on the Johnson Federal, and
15 according to our interpretation, and I'm not a lawyer, I
16 want to make sure of that on the record, that's what we're
17 -- that's all we're trying to do.

18 MR. HUMPHRIES: Your remaining
19 acreage is approximately 200 acres.

20 MR. SWEET: Yes, 190 acres we
21 own in Section, the east half of 20.

22 MR. HUMPHRIES: So that the 10
23 acres is out of the south --

24 MR. SWEET: That's Arriba
25 Company. That's a 200 acre tract and we own 95 percent of

1 that 200 acres and Arriba Company, I believe, owns 5 percent
2 of that.

3 MR. HUMPHRIES: Okay, then the
4 remaining south half of the southeast quarter of 20 is
5 Sun's?

6 MR. SWEET: Our records
7 indicate Sun and Dugan.

8 MR. TUBB: Sun and Dugan.

9 MR. HUMPHRIES: Sun and Dugan,
10 80 acres.

11 MR. TUBB: 80 acres.

12 MR. HUMPHRIES: And ARCO's got
13 40. So -- and no one at this point has talked to Arriba,
14 ARCO, and Sun and Dugan. Well, Sun and Dugan are obviously
15 already taking this into consideration.

16 So we have 200 acres, 240 acres
17 left that has to be dealt with regardless of what happens
18 here, unless we're just assuming that these people are taken
19 along with whatever happens.

20 MR. LOPEZ: The royalty owners,
21 is that correct?

22 MR. HUMPHRIES: The remaining
23 owners of the east half of Section 20.

24 MR. LOPEZ: Oh, yeah, they'd be
25 taken along with (inaudible).

1 MR. HUMPHRIES: Is Sun's propo-
2 sal that Mesa Grande drill a well in the east half?

3 MR. KELLAHIN: No, sir, our
4 proposal is that the Commission must change the language in
5 Rule 2 as it exists now or they cannot continue with the
6 forced pooling case because the interpretation Mr. Lopez as-
7 serts for you leads me straight to the courthouse to try to
8 defend your order against the mineral owner that now has his
9 income stream cut in half, and it's a position I don't think
10 I can defend for you. Unless there is further findings and
11 clarification and explanations on the record, the staff
12 opinion about the interpretation of that order does me no
13 good before a District Court. There's got to be action by
14 this Commission, and without something further, the literal
15 meaning of those words to some royalty owner that's had his
16 income cut in half, is that that proration unit is exempt
17 and I'm stuck.

18 MR. HUMPHRIES: And you're pre-
19 sently paying these other (unclear)?

20 MR. KELLAHIN: We're currently
21 paying on a 320. We have not reformed and paid on 640 thus
22 far, pending a decision by the Commission what to do.

23 MR. HUMPHRIES: You're paying
24 on the entire east half of Section 20?

25 MR. KELLAHIN: No, sir, it

1 would be on the west half of 20 for the Loddy Well.

2 MR. HUMPHRIES: Okay, so no-
3 thing at this point is being done as far as Mesa Grande's
4 interests, ARCO's interests. What about your remaining in-
5 terests in it, are they paid?

6 MR. KELLAHIN: It's not being
7 paid, either. It will have to go back and be adjusted as of
8 June of '87, if we can clarify and correct Rule 2. Now
9 that's an accounting thing; you can do that. It's done all
10 the time, but it's not taking place.

11 MR. LOPEZ: I might respond to
12 that.

13 My feeling is that I could sug-
14 gest that one of the reasons they wouldn't want to do any-
15 thing about the 80 acres in the east half is because they've
16 succeeded in establishing a 640, which by the Commission's
17 own order is capable of draining the whole thing and there-
18 for the only one squeezed out would be the balance of the
19 east half.

20 The other aspect of the case
21 that I requested you to (unclear) is that so be it, if there
22 is that much confusion with respect to the literal meaning
23 of the rule, there shouldn't have been, and therefor, and
24 there really isn't or wasn't until we got into this very
25 hassle, and therefor the obvious solution is to adopt the --

1 because I -- I don't think the Commission knew what it was
2 doing when it did it, but without -- with all due respect,
3 and therefor, -- because I really feel like it violates the
4 statute -- and therefor do a nunc pro tunc and adopt the or-
5 iginal language of 7407.

6 But at least because we spent a
7 lot of money and we have a lot of evidence, and if we get an
8 adverse ruling, let us put on our evidence so at least we'll
9 have a record to go up to the District Court with.

10 MR. LEMAY: Mr. Roybal has some
11 questions here.

12 MR. ROYBAL: Thank you, Mr.
13 Chairman. I've think part of what Mr. Lopez was addressing
14 and part of what counsel really are arguing about, there are
15 many complex issues in the disagreement over some of the
16 procedural options that are available to the Commission, and
17 I'd like to ask counsel to perhaps focus in on each other's
18 preferred option and that would be asking Mr. Kellahin to
19 address a nunc pro tunc and Mr. Lopez to address the Commis-
20 sion's authority to reset or to reopen the rule for hearing
21 at this date. I think the last thing Mr. Lopez said perhaps
22 suggested that possibility, making a record on the rule that
23 we're discussing, and that -- that seems to lead into Mr.
24 Kellahin's suggestion of reopening that, that rule for hear-
25 ing, noticing it, and just approaching it that way.

1 MR. KELLAHIN: Mr. Roybal
2 states our position. It's the one we stated for you in No-
3 vember.

4 A quick nunc pro tunc fix is no
5 fix. It doesn't give me the substance of due process notice
6 to the other working interest owners' complaint, to the roy-
7 alty owners, to the rest of the operators in the pool, which
8 are going to be governed and dictated by the precedent es-
9 tablished in this case.

10 Broader notice to those people
11 minimized the potential that we'll have adverse parties left
12 on the sidelines who after the fact, after the money is re-
13 allocated and spent and sent will complain that for lack of
14 notice we must then, Sun, as operator, continue to pay them
15 as if their interest had not been diluted. We have to pay
16 twice. That's the exact problem the Commission got into
17 with the Edwards case, Edwards and McHugh. Edwards sued
18 McHugh when it went from 40's to 320's. They said lack of
19 notice to Edwards in a District Court decision here in Santa
20 Fe County, Edwards was entitled to payment because he didn't
21 participate in that hearing.

22 That's the trap we're trying to
23 stay out of here. So I'm' suggesting that the procedure to
24 make it at least comfortable to make the change is one where
25 we have the Commission on its own motion docket a hearing,

1 send out notice as broadly as possible, and we let the other
2 lawyers, Mr. Pearce and some of the others, come in here and
3 discuss how to resolve it. Build a record with factual
4 findings and modify Rule 2.

5 My point is, until that's done,
6 we can't proceed to the forced pooling issue.

7 MR. LOPEZ: Well, it seems to
8 me, if there's that much concern, sure, let's go ahead and
9 advertise an amendment to the Rule 2, because I don't think
10 I heard Mr. Kellahin saying that it was read the way he
11 literally reads it in violation of the statute, and give
12 notice to all the other people.

13 But let's go ahead and hear
14 this case, because everybody's here, and we certainly have
15 notice and we know what we're arguing about, and we've gone
16 to a lot of expense to bring a lot of people here, they've
17 done a lot of preparation and are ready to testify, and we,
18 I think, are at least entitled to build a record.

19 Go ahead and advertise, it's
20 done all the time when we hear the evidence ahead of the ad-
21 vertisement, see who shows up at your next hearing, I'd ven-
22 ture to say no one will, and if there's no evidence, then go
23 ahead and adopt the record of these proceedings and to sup-
24 port your amendment of the rules to be in conformity with
25 the statute.

1 MR. HUMPHRIES: When you say no
2 one will, well, wouldn't that lead me to believe that you've
3 already talked to Arriba Oil Company and ARCO and basically
4 they're saying we'll go along with whatever happens?

5 MR. LOPEZ: No, I'm not saying
6 that. I'm saying that our position is so manifestly clear
7 and correct that there's not going to be any argument. What
8 I'm saying is that --

9 MR. KELLAHIN: Because I'm
10 right we don't give notice to the rest of the world.

11 MR. LOPEZ: -- (interrrupted)
12 and I think everybody would have understood it to happen
13 that way regardless. I think a lot of people haven't even
14 read the rule.

15 MR. HUMPHRIES: Can I ask you
16 specifically, then, have you talked to the remaining royalty
17 interest?

18 MS. TALLMADGE: Mr. Humphries,
19 I'm here on behalf of Arriba Company and we do support Mesa
20 Grande's position. We understand that we'll be bound to go
21 along with whatever the Commission decides in this case but
22 we support Mesa Grande's interpretation of the rule and
23 agree that really the statute must prevail, the rule must be
24 interpreted to (unclear) to the statute as interpreted by
25 Mr. Lopez' argument.

1 MR. HUMPHRIES: So the only un-
2 represented lessee or royalty owner here at this point is
3 the Federal government and ARCO.

4 MR. LEMAY: It appears to be.

5 MR. HUMPHRIES: Neither of
6 which are capable of taking care of themselves, I presume.

7 MR. LEMAY: Mr. Kellahin, quick
8 question. Would you be prepared to cross examine or hear
9 the testimony and put on your own witnesses in the case as
10 it is advertised, setting the record? What's your viewpoint
11 on that?

12 MR. KELLAHIN; On proceeding
13 with the case as it is now?

14 MR. LEMAY: Yes.

15 MR. KELLAHIN: I'm prepared to
16 go forward at the direction of the Commission, Mr. Chairman,
17 if you want to get into the compulsory pooling aspects.

18 One thought, is while we dis-
19 cussed Rule 2, it's going to be of great help for other sim-
20 ilar situated wells apart from this forced pooling case, to
21 establish what is to be the reasonable basis for investment
22 and participation in a well, and that certainly could take
23 evidence and have discussion on that issue and you could
24 take it under advisement and not act on it until we have
25 some directions in Rule 2.

1 I certainly would like to take
2 this opportunity, it's a unique one, to have only this case
3 on the docket. I think if we were to continue it, who knows
4 where it will end up.

5 So I'll be happy to go ahead.

6 MR. LEMAY: Is there any other
7 questions or comments or general statements pertaining to
8 the -- the initial issue, which was as stated, whether we
9 had the authority to do what we did, the statutory author-
10 ity.

11 MR. HUMPHRIES: If we knew what
12 we were doing.

13 MR. LEMAY: If we knew what we
14 were doing. And otherwise the underlying sly question of
15 whether we knew what we were doing.

16 MR. BROSTUEN: I'd like to ask
17 Mr. Lopez a question.

18 Regarding the -- the portion of
19 Rule 2 in Part A, that proration units formed prior to this
20 order are hereby granted exception to this rule, you are
21 saying then that that does not meet the requirements of the
22 Subsection C under 70-2-18 regarding nonstandard spacing or
23 proration units; that we are not following the provision of
24 the statute in incorporating these words into the order. Is
25 that what you're saying?

1 MR. LOPEZ: I'm saying that
2 you're not following 71-2-18-A, which says any Division or-
3 der that increases the size of a standard spacing or prora-
4 tion unit for a pool, or extends the boundaries of such a
5 pool, shall require dedication of acreage to existing wells
6 in the pool in accordance with the acreage dedication re-
7 quirements of said pool, all -- and all interests in the
8 spacing or proration units that are dedicated to a second
9 well shall share in production from the effective date of
10 the said order.

11 And that's our position.

12 MR. BROSTUEN: You do not feel
13 that --

14 MR. LOPEZ: And -- go ahead.

15 MR. BROSTUEN: -- Subsection C
16 or Section C provides an exception to that?

17 MR. LOPEZ: Only with the
18 waivers of all offset operators and it doesn't address that;
19 under Rule 104-E-2 of the Commission rules.

20 MR. BROSTUEN: Thank you.

21 MR. LEMAY: At this time we'd
22 like to adjourn for 45 minutes. We want to discuss this
23 thing back and forth so we'll reconvene at 11:15 and at that
24 time what we'll do is -- is have some direction for you all.

25 It's my understanding -- off

1 the record, Sally.

2
3 (Thereupon a discussion was had off the record
4 and the hearing was in recess.)

5
6 (Thereafter at the hour of 11:50 a.m. the hearing
7 was continued as follows, to-wit:)

8
9 MR. LEMAY: The meeting will
10 come back to order.

11 What we've decided to do is at
12 1:30 we'll hear the case as advertised, Case Number 9225.

13 At some later date we may
14 readvertise that case as maybe an exception to a rule
15 doesn't come out or as a more appropriate language in there
16 that would pertain to some rule or some clarification that
17 will come out with a Rule 2-A, a Gavilan hearing.

18 In terms of did we as a
19 Commission mean what we say, or said --

20 MR. LOPEZ: Well, I ought to --
21 I apologize.

22 MR. LEMAY: -- or in terms of --

23 MR. LOPEZ: I'm not sure you
24 thought you'd create all this hassle with what you did.

25 MR. LEMAY: -- or in terms of

1 what -- what the staff had interpreted that to be, we
2 thought that none of it was for clarification purposes but
3 also for -- for some testimony as to procedures. We want to
4 keep this very narrow now, as far as reopening the Gavilan
5 hearing. We don't want five days on Rule 2, 2-A, of hearing
6 testimony, but we feel it's appropriate to reopen that, to
7 address that, that specific point.

8 We'll do that for the February
9 docket. Hopefully we can confine testimony and statements
10 to very specific issues as to what we meant by that.

11 MR. LOPEZ: Could we ask Mr.
12 Lyon to state into the record what his intention was with
13 the language at some point today, because I think that --

14 MR. LEMAY: It really is not
15 the intent. We asked the Commissioners in this sort of dis-
16 cussion we had what they meant by that and three of the Com-
17 missioners intent that would govern that rule and not the
18 statute in drafting it up, whatever Vic decided was appro-
19 priate language, he may have meant one thing but we as com-
20 missioners signed that document meaning maybe something en-
21 tirely different.

22 So it's really a commission
23 finding that is important in this and not the staff inter-
24 pretation.

25 With that in mind so that, you

1 know, we can prepare for this, how long do you think -- off
2 the record a minute, Sally.

3

4 (There followed a discussion off the record.)

5

6 (Thereupon the noon recess was taken and the
7 hearing was resumed at 1:30 p. m.)

8

9 MR. LEMAY: The meeting shall
10 resume with Case 9225, application of Mesa Grande, Limited,
11 for an order pooling all mineral interests in the Gavilan
12 Mancos Pool underlying a 640-acre tract.

13

Mr. Lopez.

14

15 MR. LOPEZ: Yes, Mr. Chairman,
we're ready to proceed.

16

17 MR. LEMAY: Appearances in the
case, you for Mesa Grande and Mr. Kellahin?

18

19 MR. KELLAHIN: Yes, Mr. Chair-
man, I'm appearing on behalf of Sun Exploration and Produc-
20 tion Company.

21

22 MR. LEMAY: Are there addi-
tional appearances? Yes, ma'am.

23

24 MS. TALLMADGE: Anne Tallmadge
for Arriba Company.

25

MR. LEMAY: So noted, thank

1 you. Additional appearances in the case?

2 If not, we shall begin, Mr.
3 Lopez.

4 MR. LOPEZ: Mr. Chairman, it
5 may be helpful before I bring up the first witness to indi-
6 cate to the Commission that Mr. Kellahin and I and Sun and
7 Mesa Grande, have at least reached agreement on a certain
8 aspect of the issues that you've been addressing; namely, I
9 think, and Tom's here, of course, it appears today we both
10 support the proposition stated by Mr. Lyon this morning,
11 that the rule should read to be that there's an effective
12 640 as of the date of the order, June 8th, but that the
13 operator of any well on the tract remain operator and that
14 the only exemptions be those 640's on which there are two
15 producing wells dedicated to two separate 320's --

16 MR. LEMAY: Or four 160's.

17 MR. LOPEZ: Yes. All right.
18 Where we disagree is in the aspect of whether there should
19 be a penalty imposed on consenting working interests that
20 have not participated in a well prior to the date of the or-
21 der.

22 He has his arguments and we
23 have our arguments. If you wish, I could tell you what our
24 argument is now but -- and it might be groundwork to show
25 you where we're coming from with our evidence.

1 MR. LEMAY: Why don't we do
2 that, just a summary of your positions before witnesses are
3 called; that will give the Commission a better idea where
4 you're going.

5 MR. LOPEZ: But to further my
6 thought, we are also in agreement with respect to nonconsen-
7 ting interest owners, that they should be subject to a pen-
8 alty by virtue of the pooling order and I think we agree
9 that it can be 200 percent, which is the maximum allowed by
10 the Commission.

11 So the really narrow issue on
12 which there seems to remain disagreement is with respect to
13 the penalty assessment against consenting working interest
14 owners and our position is that the -- I guess they are
15 several-fold.

16 First, that's the way it has to
17 be because that's what the statute provides. The statute
18 only permits the Commission to assess penalties against non-
19 consenting interest owners and it is silent on whether that
20 is before or after the well is drilled, so it must be inter-
21 preted to be all inclusive and by the fact that the statute
22 is so specific that as a logical result it means that there
23 is no penalty to be assessed against consenting interest
24 owners in the proration unit.

25 That's our first point.

1 Our second point is that the
2 practice of the Commission has historically been not to assess
3 penalties against such working interest owners. We
4 cited the very case in point in this pool, Mallon-Mesa Grande
5 case, that's historically, it has been my understanding,
6 been what the Commission has always done when it has increased
7 the size anywhere in the state.

8 Finally, we state that there is
9 good reason for that being the way it is because -- and --
10 and that being the way it is that any consenting owner can
11 come in on the date of the order and pay his pro rata share
12 of the original well cost, and that there should be no other
13 penalty whatsoever applied because, first, the operator of
14 the well benefitted alone for his 320 from all the production
15 prior to the June 8th order.

16 In most cases, if not -- in only
17 rare cases it's not the case -- but clearly in the vast
18 majority of the cases, the well has drained an area of larger
19 than 320 acres; therefore, the offsetting 320 that wants
20 to join in the well has been drained, and we know that
21 that's the case because I don't think there's any disagreement
22 by the parties that there's pervasive pressure communication
23 throughout the reservoirs.

24 And that we also believe that
25 it makes administrative sense beyond just the reason that

1 the operator has already been compensated, but it makes ad-
2 ministrative sense because if that's the way it is, we can
3 settle every 640 in the pool without coming before the Com-
4 mission because everybody will be either -- will be in the
5 deal but they'll either go consent or nonconsent and they
6 could just size it up as of that date and it's a fact of
7 life that every operator in the pool is sitting on both
8 sides of this fence, there are wells they want in and there
9 are wells that they have that they don't want others into.

10 So it's going to cut both ways
11 so the ultimate damage is going to be -- is all going to
12 balance out in the end, and if you assess a penalty, you're
13 going to effectively have a hearing on every 640 because
14 each 640 that has a well on it has a different story to tell
15 and the Commission doesn't need to hear that.

16 So essentially for those
17 reasons we believe that -- that our position on this is the
18 correct one and I think we are prepared to put on evidence
19 today which shows you that even by joining in their well or
20 force pooling our way into their well, which we don't have
21 disagreement about now, they ought to be paying us a penalty
22 for what they've drained. This is where we stand, vis-a-
23 vis, this whole story, so --

24 MR. LEMAY; Is that going to be
25 part of your recommendation that Sun pay Mesa Grande a pen-

1 alty for allowing you to join?

2 MR. LOPEZ: Well, I just thought
3 you ought to get a little bit of pleasure.

4 MR. LEMAY: Thank you, Mr.
5 Lopez.

6 Mr. Kellahin.

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

9 We're looking for a solution,
10 Mr. Chairman, that is broader and can be applied beyond the
11 facts of this particular case.

12 As I said earlier this morning,
13 this particular forum and the way the case has come to you
14 simply is a convenient way to examine and to give us guid-
15 ance on what to do when we move from 320's to 640 spacing.

16 Mr. Lopez is correct that Sun
17 continues to now, and always has, supported 640-acre spacing
18 for this pool. We would urge you to adopt changes in Rule 2
19 that allow for those sections which only had one well down
20 prior to the June order to move to 640 spacing. We have no
21 problem with taking those sections that had two wells at
22 that time and exempting those. We believe that the estab-
23 lished equities for those instances where there are two
24 spacing units in a single section is so fixed that to try to
25 rededicate that entire section, then, on 640 spacing with

1 two wells is really too difficult to accomplish.

2 Those two-well sections would
3 be sharing a common 640 allowable. I think there is enough
4 governing mechanisms for those to be legitimate exemptions.

5 When we get to the question of
6 how to balance the equity for the original owners of the 320
7 for their developed acreage, and what is fair compensation
8 to them, to allow the new owners now to participate in the
9 remaining production, I find it difficult to accept the
10 notion that those new owners can come in and participate in
11 the remaining production by simply paying their share of the
12 original cost of that well that may have been drilled sev-
13 eral years ago. It gives those parties a windfall, in my
14 opinion, so that they have an opportunity to realize the
15 kind of investment they're making in a producing property.
16 They have a greater advantage over the original investors,
17 who took their investment, risked their money, when there
18 was no well in the section.

19 I don't think the Mallon cases
20 gives us an entire solution. The Mallon case order is at-
21 tached in our exhibit book. The discussion in that case
22 centered around the presentation that Mr. Mallon's witnesses
23 presented in which he also wrestled with the concept of al-
24 lowing the new owners to participate in proven production.
25 They presented that case in the format of considering a

1 turnkey contract on the well.

2 In that situation under the
3 turnkey contract if they assume that the contract for price
4 had assumed the drilling risks that the working interest
5 owners and operator would normally have assumed, and they
6 came up with a value. They said that a fair way to -- to
7 adjust the equities was to take the turnkey contract and
8 take 100 percent of the intangibles in that analysis and as-
9 sign that as an additional bonus to be paid by the new own-
10 ers for participation.

11 In the order entered by the
12 prior commission in this case, they went through and ana-
13 lyzed the compulsory pooling statute and they examined the
14 last section, which we have identified in our brief, where
15 the -- where the statute, Subsection C on Page 9 of the rule
16 book, it's the end of the first full paragraph on that page,
17 and what it does, it describes what the Commission may do in
18 those instances where they have a nonconsenting working in-
19 terest owner. That applies where there's a pooling order,
20 notices are sent out, and those working interest owners fail
21 to make their payment to participate in the well. They are
22 deemed to have elected to go nonconsent.

23 Under the statute the Division
24 has the authority to allow the operator then to recover out
25 of production not only that nonconsenting party's share of

1 the cost of the well, but an additional factor up to two
2 more times, the 200 percent factor.

3 In entering the order, the --
4 Mr. Stamets, on behalf of the prior commission, said that he
5 would not -- felt he could not use that risk factor penalty
6 as an additional bonus to apply to the consenting owners
7 that want to come into the well after it's completed and
8 producing.

9 If you'll note Finding 20 of
10 that order said that Mallon did not present any other alter-
11 native and it says, in the absence of other proposals for a
12 reasonable charge against Mesa Grande for the investment
13 made on its behalf by the applicant, no such charge should
14 be authorized.

15 It's within the context of that
16 finding that we're asking you to consider additional compen-
17 sation to the original owners that provide that a fair and
18 equitable return on the investment they made on behalf of
19 parties in Mesa Grande's position.

20 Our witness proposes to outline
21 to you half a dozen different alternatives, each one of
22 which is free of risk. None of those will give you a risk
23 factor penalty that concerns Mr. Lopez. We've omitted that
24 from the analysis. We're not saying take the risk factor
25 penalty out of the air and apply it to Mesa Grande. We are

1 saying, though, that among those options are such things as
2 escalating the original costs of that well based upon an
3 interest factor; compensating the original owners, then, for
4 the value of the investment made. Well, that's an easy cal-
5 culation. We could pick a conservative annual interest rate
6 and whatever you want to do.

7 Another way to analyze it, and
8 our witness will discuss it, is to simply see what it would
9 cost to drill this well in today's dollars; again helping to
10 compensate the original owners in the developed tract for
11 having made the investment and to mitigate or reduce the
12 windfall that the new owners now get in order to make their
13 contribution in a producing well. We believe it is unfair
14 to let those people participate in a producing well by mak-
15 ing the same dollar amount investment as the original owners
16 made. We think that equity could be balanced separate and
17 apart from the risk factor penalty.

18 If you analyze it in terms of
19 the current cost of a well of this type, perhaps that is a
20 fair way to make the assessment of costs and require the
21 contribution to be made based upon their percentage share of
22 the actual well costs of a well that could be drilled in
23 June of '87. That certainly is a reasonable analysis of it.

24 Another choice is to analyze
25 the property based upon the remaining recoverable reserves;

1 the true, standard engineering calculation that Mr. Hueni
2 and Mr. Sweet and Mr. Mueller commonly do. Our witness will
3 talk about that for you and he'll tell you why he's rejected
4 that because it does not serve as a generic model that gives
5 us the kind of administrative ease that Mr. Lopez is seek-
6 ing. But we're going to discuss that for you because it
7 will show you the kinds of things that can happen if you try
8 and put a value on the remaining reserves, just so that you
9 have some idea that that concept really doesn't work very
10 well in this reservoir.

11 The last choice for a solution
12 is to average what it would cost to recently one of these
13 wells. We think the advantage to that procedure is in aver-
14 aging current well costs we tend to minimize a well cost
15 that's unreasonably low and one that's unreasonably high so
16 that parties in Mesa Grande's position, as Sun is in other
17 wells in this field, has the advantage of receiving their
18 share of that production based upon what the average of ac-
19 tual well costs is. That removes the speculation about
20 AFE's and it puts the original well cost in current dollars,
21 which I think is necessary.

22 And I think the witness will
23 eventually tell you what his personal recommendation is on a
24 choice of formulas, but I think it bears re-thinking by this
25 Commission in light of the Mallon decision, to determine

1 whether or not you want to again approve the concept for
2 this pool, that all you have to do is pay 50 percent of the
3 original cost. We contend that that that somehow doesn't
4 feel right, it's not comfortable, it represents a windfall
5 that really ought to be adjusted (unclear). It's on that
6 issue that Mr. Lopez and I have a disagreement. We'll at-
7 tempt to confine our proof as to that notion. I believe
8 he's correctly stated what he and I have discussed earlier,
9 that apart from this election period for the consenting
10 owner to pay what is an equitable share of the well costs,
11 that after that expires that anyone in that position is
12 deemed a nonconsenting owner, is subject to the 200 percent
13 risk factor penalty. I'm not talking about changing opera-
14 tors, adjusting operating costs or overhad rates, it's sim-
15 ply the narrow issue of what the Commission thinks is fair
16 and reasonable in this situation where you're not dealing on
17 the same level. You've got new owners coming into a produc-
18 ing well atmosphere.

19 MR. LEMAY: Thank you, Mr. Kel-
20 lahin.

21 Ms. Tallmadge, do you care for
22 any opening statements?

23 MS. TALLMADGE: Thank you, Mr.
24 Chairman, but I don't have any opening.

25 MR. LEMAY: Are you going to

1 have any witnesses, Ms. Tallmadge?

2 MS. TALLMADGE: No.

3 MR. LEMAY: You may proceed,
4 Mr. Lopez.

5 MR. LOPEZ: Okay. Mr. Chair-
6 man, before I start, I guess the witness hasn't been sworn,
7 either.

8 MR. LEMAY: Do you want to
9 swear in all witnesses at this time? Do you want to stand
10 and raise your right hands?

11

12 (Witnesses sworn.)

13

14 MR. LEMAY: You may continue.

15 MR. LOPEZ: Mr. Chairman, it
16 came to my attention over the lunch hour that perhaps to
17 solve some of the administrative problems that you all face
18 we should request that we be given an exception in the for-
19 ced pooling case to Rule 2-A of the order and I have no ob-
20 jection to doing that; however, I want it understood that,
21 of course, we believe that the order ought to read in con-
22 formity with the meaning of the statute and in light of the
23 fact that we no longer have any disagreement on -- as to
24 what it ought to be, which is apparently different than what
25 the Commission intended, if that's correct, at any rate I

1 don't think there should be any disagreement unless the Com
2 mission has seen it a different way, that however we adver-
3 tise the rule to be amended, that the result that at least
4 we see at this time, and unless the Commission sees it dif-
5 ferently, we don't expect others to see it differently,
6 either.

7 MR. LEMAY: I might say, just to
8 address those issues briefly, because we discussed them, and
9 it probably is not accurate to assume that, there again,
10 that we said something that we didn't intend to say, because
11 that particular 2, Rule 2-A will be addressed at a future
12 hearing like we agreed; however, I would -- we do appreciate
13 your -- your statement that in the event that we said what
14 we intended to say, and that we do grant the early proration
15 units -- or that we exempt all existing proration units,
16 then this case can be readvertised as an exception to that
17 rule.

18 MR. LOPEZ: Right, but of
19 course, that's not the result either of us are urging this
20 morning.

21 MR. LEMAY: I understand.

22 MR. LOPEZ: Okay. Thank you.

23 MR. KELLAHIN: Mr. Chairman, we
24 would not want you to intentionally or unintentionally make
25 this an unusual instance in the reservoir where we'd come to

1 a solution on the Loddy Well that's separate and apart from
2 solutions for other spacing units, and by whatever we've
3 done just now, I don't want this to be an unusual example
4 which we're committed to once you tell us what it is you're
5 doing with Rule 2.

6 MR. LEMAY: I understand, Mr.
7 Kellahin, thank you.

8 We -- we could adopt the policy
9 that any 640-acre tract with one well on it, that we would
10 entertain a case for an exception to our rule; otherwise
11 that would be a separate proration unit of 320 acres. I
12 think that's an option that the Commission could have, if
13 you understand what I'm saying there. We intended to exempt
14 or grandfather in all existing proration units and that any
15 operators who desired to participate in the one well could
16 bring their case before this Commission or even at the Divi-
17 sion level, and request an exception to the rule.

18 MR. LOPEZ: You -- you could do
19 that. That's not what at least we would recommend but --

20 MR. LEMAY: Neither one of you
21 at this point would recommend that approach?

22 (Not clearly understood).

23 MR. LOPEZ: I understand.
24 Okay.

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LARRY SWEET,

being called as a witness and being duly sworn upon his
oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. LOPEZ:

Q Would you please state your name and
where you reside?

A My name is Larry Sweet and I reside in
Broken Arrow, Oklahoma.

Q By whom are you employed and in what
capacity?

A I'm employed by Mesa Grande, Limited, and
I am General Manager of that entity.

Q Have you previously testified before the
Commission and had your qualifications accepted as a matter
of record?

A I have.

Q Would you explain to the Commission which
exhibits you're going to testify --

A I --

Q -- to. We have just one exhibit and it's
an entire book and it has different tabs.

A Yes, sir, I will present testimony in

1 regard to the information listed behind Tabs B and C.

2 Q And was that information compiled under
3 your direction?

4 A Yes, it was.

5 MR. LOPEZ: I tender Mr. Sweet
6 as an expert.

7 MR. LEMAY: His qualifications
8 are acceptable.

9 Q I would ask you to turn to the first doc-
10 ument under Tab A and explain what it is.

11 A Well, the document under Tab A is just a
12 --

13 Q I mean B.

14 A -- is just an index and --

15 Q I mean I meant Tab B, sorry about that.

16 A All right, and I will turn to Tab B,
17 which is the geology of the area.

18 The first correspondence here is from Mr.
19 Allen Emmendorfer, a geologist with Mesa Grande Resources,
20 Inc., in Tulsa.

21 The -- I instructed Mr. Emmendorfer to
22 prepare for me a geological analysis of the east half of
23 Section 20, which is the area that we are going to be dis-
24 cussing today.

25 I don't intend to read this letter. I

1 just want to highlight a couple of points.

2 One, that the Gavilan Mancos Oil Pool
3 produces from a fracture sequence of interbedded sandstons,
4 siltstones, and shales, commonly known as the Niobrara or
5 Gallup interval. Natural fracturing can occur anywhere
6 within a 600+ foot section in the Niobrara interval, which
7 is present on the eastern side of the San Juan Basin.

8 In the Gavilan Mancos Oil Pool, much of
9 the analysis in the field has shown that the majority of
10 field-wide production comes from the Niobrara A and B inter-
11 vals and to a much lesser extent from the Niobrara C zone.

12 We would show that the stratigraphic con-
13 tinuity of the Niobrara A, B, and C zones within the Gavilan
14 Mancos Oil Pool has never been really at issue, and that all
15 the acreage under the east half of Section 20 lies within
16 the geological boundaries of the Gavilan Mancos Oil
17 Pool.

18 Q Okay, would you explain what the next do-
19 cument under the tab is?

20 A The next map under Tab B is a structure
21 map in the general Gavilan area that includes severa differ-
22 ent pools. This structure map was presented to the Commis-
23 sion on October 15th, 1987, as Exhibit C-1 in regard to Mesa
24 Grande's geologic testimony for Cases No. 9226 and 9227.
25 Those cases pertained to a buffer zone testimony in regards

1 to the expanded West Lindrith Pool and the Gavilan Mancos
2 Pool.

3 There's only a couple of key things I
4 would like to point out on this map. It is contoured on the
5 top of the Gallup or Niobrara A Zone. Tops were picked for
6 the most part from the Gavilan geologic subcommittee work.
7 It's contoured on 50-foot interval.

8 Starting from the east, the steeply
9 dipping monocline, which represents for the most part the
10 West Puerto Chiquito Pool, the Gavilan area feature is
11 centered in the area of Township 25 North, Range 2 West, and
12 the westernmost boundary of the Gavilan Mancos would be --
13 is -- dividing it from the West Lindrith Pool is the
14 township line dividing Range 2 West from Range 3 West.

15 The area that we are considering today is
16 Section 20, which is shown in yellow, which is inside the
17 Gavilan Mancos (unclear.)

18 Q Would you turn to the next map and
19 explain what it shows?

20 A The next map is a structure map again
21 with Section 20 primarily in the center of this. We're
22 trying to focus on Section 20 and the surrounding vicinity.

23 As noted on the map, there are two cross
24 sectional traces, A-A' and B-B'. Those traces -- A-A' is a
25 northwest/southeast trace and B-B' is a southwest/northeast

1 trace across this area.

2 Also shown on this map are the Loddy No.
3 1 Well location as well as surrounding wells in the 9-
4 section area.

5 Q Okay, would you turn to the next plat or
6 cross section?

7 A This cross section is a stratigraphic
8 cross section along the A-A' trace as shown on the preceding
9 map. The -- we've highlighted here in -- in a darker shade
10 of green the Niobrara A and B Zone intervals and an area
11 above the Niobrara A which previous testimony has indicated
12 fracturing extends into. The lighter color green is the
13 Niobrara C Zone interval. We note that the vertical limits
14 of the Gavilan Mancos Pool are shown for the Sun ET No. 1
15 Well. Those limits would be approximately 7430 feet to --
16 excuse me, 6430 feet to 7430 feet.

17 These wells are located approximately a
18 mile and a quarter from each other. We would suggest that
19 there is stratigraphic continuity between these -- these
20 wells.

21 Q All right, will you turn to the next
22 document and review that?

23 A The next map is a stratigraphic cross
24 section B-B' as shown to you in the earlier map. Again the
25 darker shade of green is primarily the Niobrara A, B, Zones.

1 The lighter shade of green is the Niobrara C Zone. This
2 tracer runs from the Full Sail No. 3 Well, Janet No. 3 Well,
3 both wells operated by Sun. It is a southwest/northeast
4 trace across Section 20. We will note on this cross section
5 as -- as the other cross section that the log, electric log
6 characteristics are very similar and that there's strati-
7 graphic continuity between these wells.

8 Q Now would you turn to the first plat un-
9 der Tab C.

10 A The first tab under -- or the first map
11 under Tab C is a map showing the existling proration units
12 in the area. There are at least four in the area around
13 the Loddy No. 1 Well location. The Full Sail No. 1 --
14 should be Full Sail No. 4 Well, operated by Sun, is a well
15 on 187-acre proration unit, which is denoted in the color
16 blue.

17 The yellow color denotes existing 320-ac-
18 re proration units of which the Sun Full Sail No. 3, Sun
19 Full Sail No. 1, Sun ET 1, the Sun Full Sail No. 2, Sun
20 Janet No. 2, Sun Janet No. 3, and Sun Beeks Babbit No. 1
21 Wells are located.

22 We have colored the Loddy Well partially
23 yellow and partially red. The red denotes 640-acre prora-
24 tion units, which is Section 16. A well has been drilled
25 there by Reading & Bates named the Ingram Federal No. 4316,

1 which is shown on the map.

2 There's another color here, which is a
3 light green. That's a 505-acre proration unit. Mesa Grande
4 Resources is the operator of that proration unit, which is
5 developed by the Brown No. 1 Well.

6 There are -- Section 20 is yellow, white,
7 and Section 19 has white. White denotes that there are no
8 wells drilled. Section 19 is approximately 100 -- 187-acre
9 tract. The east half of Section 20 is a 320-acre tract.
10 The cross hatched red, yellow, and white in Section 20 is the
11 reason we're here today.

12 Q Will you explain the next plat?

13 A The next plat is a leasehold ownership
14 plat of Section 20. Our records indicate that Sun Explora-
15 tion and Production Company own 89.7 percent working inter-
16 est in the Loddy Well and Dugan Production has 10.3 percent
17 interest in that well. That is currently a 320-acre prora-
18 tion unit.

19 The ownership of the east half in Section
20 20 is shown. The blue represents acreage owned by Mesa
21 Grande, Limited, and Arriba Company, Limited. The 40-acre
22 tract located in the northwest of the southeast of Section
23 20 is owned by ARCO and we believe that Sun and Dugan own
24 the remaining 80 acres located in the south half of the
25 southeast quarter of Section 20.

1 In the event that a 640-acre proration
2 unit is formed, the interest breakdown is shown in this ex-
3 hibit. In approximate numbers Mesa Grande, Limited, would
4 own 29.7 percent of the proration unit. Arriba Company,
5 Limited, 1.6 percent; Dugan, 6.7 percent; ARCO, 6.25 per-
6 cent; and Sun, 55.8 percent.

7 Q Would you now describe the next document,
8 which is the July 8th letter to Ms. Lisa Shea?

9 A Yes, I will. When the New Mexico Oil
10 Conservation Commission issued Order No. R-7407-E, it was
11 our understanding that the undeveloped acreage owner had an
12 option to drill or participate in a well. This was the
13 first correspondence that I mailed to Sun Exploration and
14 Production Company in regard to our position in this matter.
15 We offered to pay our share of the drilling and completion
16 costs for the Loddy No. 1 Well and participate in the
17 production from the date of the order, rather than drilling
18 a well in the east half of Section 20.

19 We asked for a 15-day response from them.

20 The next correspondence is to Mr. Frank
21 Syfan of Sun, dated August 18th, 1987, and basically
22 requesting that, again, we would like to voluntarily commit
23 our acreage, or our undeveloped acreage in the east half of
24 20, to the Loddy No. 1 Well in accordance with our
25 understanding of the Order No. R-7407-E.

1 We asked that -- to provide us with a re-
2 sponse and notified them that we would prefer to participate
3 in the well in accordance with the terms of July 8th, 1987,
4 correspondence, which -- which we'd pay our share of the
5 well cost and if Sun would accept that we would withdraw our
6 compulsory pooling application.

7 Q Did you ever receive a response?

8 A No. I did talk to -- we subsequently
9 filed the August 20th -- or filed our application August
10 20th with the Commission.

11 We did talk to Mr. Syfan. We exchanged
12 phone calls several times. He was chasing me and I was
13 chasing him. We finally talked late August, early Septem-
14 ber. We discussed the issues and we did -- we did talk in
15 Farmington at a meeting called the Commission and I don't
16 recall whether it was on West Lindrith questions in Farming-
17 ton or whether it was a Gavilan. Anyway, we discussed sev-
18 eral things at that time, but basically no formal response
19 other than they were not going to allow us to participate,
20 in a verbal, since it was never received from Sun.

21 The following letters that are shown here
22 are just notification letters to the appropriate parties
23 that the application was filed and one is addressed --
24 they're all dated September 18th, 1987. One is addressed to
25 Sun Exploration and Production and one to Arriba Company,

1 one to ARCO Oil & Gas, and one to Dugan Production Corp.,
2 and one to Kindermac Partners, and one to GWR Operating Com-
3 pany.

4 Now I'd like to point out to the Commis-
5 sion that the last two here, we -- we weren't quite sure of
6 the ownership in September of the Kindermac interests or GWR
7 Operating Company but we subsequently learned that they had
8 sold their interest, I believe, to Sun and that's the reason
9 those parties were not shown on the leasehold plat that was
10 provided to you earlier.

11 Q Does that conclude your testimony?

12 A Yes, it does.

13 MR. LOPEZ: I have no further
14 questions.

15 MR. LEMAY: Mr. Kellahin.

16 MR. KELLAHIN: Yes, Mr. Chair-
17 man, thank you.

18

19 CROSS EXAMINATION

20 BY MR. KELLAHIN:

21 Q Mr. Sweet, your degree is as a petroleum
22 engineer, is it not, sir?

23 A It is.

24 Q And I think you described yourself as the
25 manager of Mesa Grande, Limited?

1 A I did.

2 Q What do you do in a general way, sir?

3 A I manage the total affairs of the part-
4 nership.

5 Q In exercising your management decisions
6 will you make a decision about Mesa Grande's participation
7 in the Loddy Well?

8 A I will make a decision about Mesa Grande,
9 Limited's participation in the Loddy Well after consulting
10 the various parties involved.

11 Q Are you familiar with the general format
12 used by the Commission in compulsory pooling orders?

13 A I'm learning about that.

14 Q We're talking about the time period in
15 which Mesa Grande as an anticipated voluntary participant
16 under the pooling order would have a period in which to ten-
17 der some sum of money to the operator of the Loddy Well for
18 participation in the production from June of '87.

19 Do you have an opinion as to what would
20 be a reasonable period of time for you to make that decision
21 and make that payment?

22 A In the event we were --

23 Q Successful with a forced pooling order,
24 yes, sir.

25 A -- successful? Yes, I have an opinion.

1 Q And what is that?

2 A I would say that our decision could be
3 made within a couple of weeks.

4 Q Would it be fair to say that fifteen days
5 after notice of that election period you could make a deci-
6 sion on either paying or not paying your share?

7 A I think that's a fair statement.

8 Q And then after that period of time am I
9 correct in understanding that should you not make that pay-
10 ment, then Mesa Grande would be a nonconsenting owner for
11 which then their share of the costs can be recovered out of
12 production plus a 200 percent penalty factor?

13 A I think that's a fair representation, Mr.
14 Kellahin. We would -- we would abide by the timing as set
15 forth under any order issued by the Commission on making
16 that election.

17 Q I was interested in what time frame that
18 you needed to make that decision and you told us about a
19 couple of weeks.

20 A We probably could make that in a couple
21 of weeks.

22 Q Your proposal to Sun was that you pay
23 your proportionate share of the original costs of drilling
24 and completing the Loddy Well?

25 A Yes, it was.

1 Q When was that well drilled and completed,
2 do you recall, Mr. Sweet?

3 A To the best of my recollection, which
4 maybe I shouldn't rely on it that way, I believe the Loddy
5 Well was drilled in 80 -- 1985. Most of the production, I
6 believe, started in 1986.

7 Q Is it your intent and request by this
8 application to have a pooling order, if entered, apply not
9 only to allow Mesa Grande to participate in the well but all
10 the other owners in the west half to participate?

11 A We do not speak for all the owners in the
12 west half. Our -- therefor we filed an application for Mesa
13 Grande, Limited.

14 To me it makes sense to have a 640 spac-
15 ing unit and let the participants in the undeveloped elect
16 whether they will participate or go nonconsent.

17 Q That's my concern, Mr. Sweet, is whether
18 or not we're intending to accomplish simply the pooling of
19 your 190 acres into the well and leave ARCO and Arriba and
20 the others out there to -- to resolve it for themselves?

21 A I'm not asking them to resolve it for
22 themselves. We did provide all the working interest owners
23 notice of the case and, obviously, ARCO will make their own
24 decision, as well as Sun and Dugan and Arriba.

25 Q My question, sir, is it would not be more

1 expeditious if the order entered would apply not only to
2 giving Mesa Grande an election but all the rest of those
3 owners the same kind of election on the same terms?

4 A I think it would be more expeditious.

5 Q Do you know, sir, what the original costs
6 of the Loddy Well are?

7 A I do not.

8 Q Do you have an approximation of what
9 those costs are?

10 A Would you like for me to guess?

11 Q I want you to give me what your under-
12 standing of those costs are.

13 A I know we received -- excuse me -- we
14 received an AFE from McHugh on the Full Sail Wells in 1986
15 and if I recall correctly, that AFE was approximately
16 \$450,000. Since the proposed Four O's well, located in
17 Section 19 is in essence an offset to the west of the Loddy,
18 I would suggest that \$450,000 might be a reasonable number.

19 Q Well, in writing your July, '87, letter
20 you have proposed to pay your proportionate share of the
21 drilling and completion costs for the Loddy well. Am I
22 correct in assuming that you had some general range for
23 those costs and what your investment would have to be for
24 participation?

25 A We don't know what the Loddy cost. We

1 have no interest at -- at this time in the well.

2 I do know that well costs vary and I do
3 see AFE's from various operators. The current AFE's that
4 have been circulated, I'd say there's a range from \$450 to
5 \$525,000.

6 Q It's your desire to have an opportunity
7 to participate in the Loddy Well rather than drill a new
8 well in the east half of the section?

9 A It is at this time.

10 Q Have you made any determination of what
11 you might expect to pay for drilling a new well in the east
12 half of this section?

13 A Yes, I have.

14 Q And what is that amount?

15 A The cost for a new well?

16 Q Yes, sir.

17 A We've estimated \$500,000 to drill and
18 complete.

19 Q And I believe you've told us that you're
20 unwilling to make that type of investment in the east half
21 of the section for a new well?

22 A At this time our understanding is we can
23 elect, the undeveloped acreage can elect to participate or
24 drill. Our election would be to participate (not clearly
25 understood) unit.

1 Q Have you made any type of analysis, Mr.
2 Sweet, to determine whether or not it will give you an
3 acceptable return to invest your percentage share of the or-
4 iginal costs of the Loddy Well as opposed to drilling a new
5 well?

6 A We have made an assessment. Mr. Hueni
7 will address that.

8 Q All right, are you familiar with the con-
9 clusions of that assessment?

10 Do you have an amount that you could
11 either expend for a new well or for participation in the
12 Loddy Well which would give you an acceptable return?

13 A No, I don't understand your question, Mr.
14 Kellahin.

15 Q My question is, I believe you've made an
16 analysis to determine amount of money you could expend in
17 order to realize a return on the remaining recoverable re-
18 serves from the section, have you not?

19 A We've made an analysis as of June 8th.

20 Q Of 1987.

21 A Right, (not clearly understood).

22 Q Based upon that analysis, then, what
23 amount of money would you have available to either contri-
24 bute into the Loddy Well or participate in a new well in or-
25 der to reach an acceptable return on your investment?

1 A I don't know that exact dollar amount. I
2 do know that it is our -- will be our testimony that expen-
3 ding a half a million dollars to drill an additional well in
4 the east half of 20 is not economical.

5 Q Spending \$500,000 in the east half, now
6 are you talking about your percentage share?

7 A I'm sorry, that's 100 percent, \$500,000.

8 Q All right, \$500,000 is 100 percent?

9 A Yes, that's correct.

10 Q Have you attempted to quantify that in
11 terms of your percentage in the Loddy Well as reduced to a
12 640 spacing?

13 A To quantify that, no, I don't believe
14 that we have.

15 Q Do you know, Mr. Sweet, whether or not
16 you can contribut your 29 percent of the original cost of
17 the Loddy Well without simply throwing your money away? Are
18 you going to get something back for it?

19 A Are we going to get something back for
20 our investment?

21 Q Yes, sir.

22 A Well, I would hope so.

23 Q Have you determined what you will get
24 back for your investment?

25 A We've looked at two scenarios, both on
100 percent basis.

1 Q All right, sir, and what do those show?

2 A I'll refer that to Mr. Hueni. They are
3 in here, in the book.

4 Q In making your decisions and recommenda-
5 tions as manager for Mesa Grande, Limited, Mr. Sweet, have
6 you determined the price above which you could not pay in
7 order to participate in the Loddy Well?

8 A We have not made that decision.

9 MR. KELLAHIN: Thank you, Mr.
10 Chairman.

11 MR. LEMAY: Thank you, Mr. Kel-
12 lahin.

13 Additional questions of the
14 witness?

15

16 QUESTIONS BY MR. LEMAY:

17 Q I've got one, Mr. Sweet. I understand
18 the Loddy Well's a pretty good well. Have you got an esti-
19 mate of what it came in at, what it was making during that
20 period of time?

21 A We have that information to show you.

22 Q The reason for that question was did you
23 make a conscious decision in 1986 not to drill a well in the
24 east half of Section 20?

25 A Well, we made a decision to drill a well

1 in the east half of 20 in 1986. There were several events,
2 as I tried to explain earlier, several events that took
3 place during that timeframe that deferred our decision-
4 making to drill.

5 There -- one, which was a major one, was
6 the change in the allowables situation at Gavilan. There
7 were lots of people, highly respected people, making state-
8 ments of what was going to happen to us if we didn't curtail
9 production. We -- we took -- took it serious and at that
10 point in time, again I'm not saying our decision to defer is
11 totally based upon regulatory environment, but prices in
12 mid-1986 were depressed, too, so there were several things
13 happening at that timeframe.

14 We did approve the well to be drilled
15 prior to the orders issued. At that time we decided to wait
16 to see what was going to happen here, and we did additional
17 studies on the reservoir, as has been testified to by -- by
18 both Sun and our -- our side of the table which were presen-
19 ted in the March of '87.

20 Q Is it fair to say, then, you really in-
21 tended to drill the well but circumstances presented them-
22 selves which mandated you delay that decision or --

23 A That's fair to say.

24 Q -- put it away somewhere?

25 A Yes, sir, that's fair.

1 Q Thank you.

2 MR. LOPEZ: Call next Mr.
3 Hueni.

4 MR. LEMAY: You may be excused.

5 MR. SWEET: Thank you.

6

7 GREGORY B. HUENI,

8 being called as a witness and being duly sworn upon his
9 oath, testified as follows, to-wit:

10

11 DIRECT EXAMINATION

12 BY MR. LOPEZ:

13 Q Will you please state your name and where
14 you reside?

15 A Yes. My name is Gregory B. Hueni. I
16 reside at 11420 West 27th Place, Lakewood, Colorado.

17 Q By whom are you employed and in what
18 capacity?

19 A I'm employed by Jerry R. Bergeson &
20 Associates as a consulting petroleum engineer, and I'm Vice
21 President of the firm.

22 Q Have you been retained by Mesa Grande,
23 Limited, to advise and testify on their behalf in this case
24 today?

25 A Yes, I have.

1 Q I believe, Mr. Hueni, you have testified
2 before the Commission previously and have discussed the Gav-
3 ilan Mancos Pool at length?

4 A Yes, I have.

5 Q And I think you've also had your creden-
6 tials accepted as a matter of record?

7 A Yes, I have.

8 MR. LOPEZ: I would tender Mr.
9 Hueni as an expert witness in these matters.

10 MR. LEMAY: His qualifications
11 are acceptable.

12 Q Would you please turn to the first map or
13 plat under Tab B and explain it?

14 A Yes. The first map under Tab D is a map
15 showing a 9-section area in Township 25 North, Range 2 West.
16 The Section 20, containing the Loddy Well, is shaded in yel-
17 low. For each of these individual wells that are shown on
18 this 9-section area we've shown the initial date of comple-
19 tion, the initial test rate in terms of barrels of oil per
20 day production, along with the amount of gas produced in MCF
21 per day and the amount of water produced.

22 Also in conjunction for each well we've
23 shown the cumulative production values for oil production
24 and for gas production as of October, the end of October,
25 1987.

1 This particular exhibit shows that the
2 Loddy No. 1 Well was completed in September of 1985, tested
3 at a rate of 420 barrels of oil per day with 160 MCF of gas.

4 By the end of October, 1987, it had pro-
5 duced a cumulative volume of approximately 15,000 barrels of
6 oil and 96.2-million cubic feet of gas.

7 There are several other wells shown on
8 this particular exhibit. Several of these wells are wells
9 that precede the drilling of the Loddy Well, including the
10 Janet No. 2 Well in the southeast quarter of Section 21,
11 which was completed in July of 1983. That well has cumula-
12 tive production of 107.5-thousand barrels and 173.4-million
13 cubic feet of gas.

14 In the northwest quarter of Section 28
15 there is a Sun-operated ET Well, completed in September of
16 1983, which has cumulative produced 84.8-thousand barrels of
17 oil and 150.9-million cubic feet of gas.

18 And then also down in the southeast cor-
19 ner of Section 29 we have the Full Sail No. 1, which was
20 completed in June of '84 and has produced 136.7-thousand
21 barrels of oil and 159-million cubic feet of gas.

22 Not, I guess, by coincidence, the wells
23 that have been -- the older wells in the pool are the ones
24 that tend to have the greatest accumulated production.

25 Q Okay. I'd now ask you to turn to the

1 next plat and explain what it shows.

2 A The next plat is the same 9-section area.
3 It shows for each of the individual wells the October, 1987,
4 monthly production rates expressed in barrels of oil per
5 day, MCF of gas per day, and gas/oil ratios.

6 The oil and gas productions, the daily
7 rates, have been obtained by the taking the monthly produc-
8 tion volumes and dividing by the reported days on produc-
9 tion, so these represent the capacity production rates for
10 the individual wells.

11 If we focus in Section 20 on the Sun Lod-
12 dy No. 1 Well, we see the well produced 77 barrels of oil
13 per day, 330 MCF of gas per day, with a GOR of 4,300 stand-
14 ard cubic feet per stock tank barrel.

15 If we focus then, particularly on the
16 southeast area of Section 20, southeast quarter of Section
17 20, which would perhaps be a potential location to be drille
18 don 320-acre spacing, we see that that particular location
19 is surrounded by the Loddy No. 1 Well, which we've just dis-
20 cussed, it's also an offset to the Sun Janet No. 3 Well in
21 the northeast or northwest quarter of Section 21, which pro-
22 duces at a rate of 20 barrels of oil per day, 40 MCF of gas
23 per day, and a 2000 GOR.

24 Another offset is the ET No. 1 Well in
25 the northwest of Section 28, which is producing 3 barrels of

1 oil per day, 211 MCF per day, with an 80,000 GOR.

2 And then the final offset is in the
3 northwest quarter of Section 29. It is the Full Sail NO. 3
4 Well, which had a reported production of 14 barrels of oil
5 per day, 53 MCF per day, and a gas/oil ratio of
6 approximately 4000 standard cubic feet per stock tank
7 barrel.

8 The Full Sail No. 3 Well, there is a
9 question in my mind regarding the GOR. The previous month
10 the GOR had been reported at 56,000 standard cubic feet per
11 stock tank barrel. We have no information as to whether the
12 current GOR reflects some change in the operating policy for
13 the well or perhaps an error in the reported gas volumes
14 produced.

15 In conclusion, we see that the location
16 that would exist in the southeast quarter of Section 20 is
17 offset by one well that is of fair quality, the Loddy No. 1,
18 fairly good quality, and offset by wells then of much poorer
19 quality. So it is certainly not certain what -- what type
20 of well would be found in the southeast quarter of Section
21 20.

22 Q Now referring to the next plat, would you
23 explain that?

24 A The next plat is also a map showing the
25 9-section area with October, 1987, monthly production

1 reported by well.

2 In this case we're reported the barrels
3 of oil produced, the MCF of gas produced, and the number of
4 days on production.

5 We have included this particular map be-
6 cause it is much easier to see from this particular map
7 which wells are affected by allowable restrictions. Under
8 the restricted allowable case where the allowables have been
9 restricted to 400 barrels of oil per day with a 600 GOR on
10 320-acre spacing, the maximum monthly gas production volume
11 that would be permitted would be approximately 7,200 MCF, so
12 if we reviewed then the wells that would be allowable lim-
13 ited under the restricted allowables, we would see that the
14 Sun Beeks Babbit No. 1 Well in the northeast of 17 would be
15 allowable restricted, as would the Mesa Grande Resources
16 Brown No. 1 in the southwest quarter of that same section.
17 The Sun Loddy No. 1 is restricted by that particular allow-
18 able scenario, and also then the Full Sail No. 3, although
19 it was not restricted, although it indicates that it would
20 not be restricted, earlier gas production numbers indicate
21 that that well probably would indeed be restricted.

22 And finally, the Full Sail No. 2 over in
23 the southwest -- or southeast quarter of Section 28 is a re-
24 stricted well.

25 Under the restricted allowable scenario a

1 640-acre proration unit would remove any allowable re-
2 striction allowing the Sun Loddy No. 1 Well to produce at a
3 higher rate under that type of allowable scenario.

4 The statewide rules of -- that were --
5 that were in effect for the last few months of allowing on a
6 640-acre spacing a rate of 1280 barrels of oil per day and
7 2.4-million cubic feet per day, none of these wells is re-
8 stricted under that scenario.

9 Q And that's because of the 640 spacing as
10 opposed to the 320.

11 A That is because of the 640 spacing but
12 even at -- under 320 spacing under the statewide field
13 rules, there would be no restrictions.

14 Q Will you now discuss the next diagram?

15 A Yes, we've looked at the production char-
16 acteristics of wells in the vicinity of the Loddy No. 1
17 Well. It's been our opinion in previous testimony that we
18 believe -- and the production and pressure information ac-
19 cumulated since the last hearing has done nothing to alter
20 that opinion -- that basically the Gavilan Mancos Pool pro-
21 duces from a fractured reservoir that is in excellent pres-
22 sure communication.

23 What we have shown here is a total pro-
24 duction from this area that we believe communicates pres-
25 sure-wise and I'd have to point out this includes some pro-

1 duction from the wells in the Canada Ojitos Unit that border
2 along the eastern edge of the Gavilan Mancos Pool, as well
3 as including production from Canada Ojitos Unit B-32 and B-
4 29.

5 We see on a total field basis, we have
6 plotted here on a semilogarithmic plot of rate versus time,
7 oil production, which is shown by the triangles, and then
8 gas/oil ratio performance is shown by the x's. And we see
9 the build-up in production from 1983 to a peak in 1986 in
10 Gavilan Pool production, followed then by a dropoff in pro-
11 duction and then there is a depressed period in the early
12 part of 1987 at about 3000 barrels a day, followed by the
13 lifting of the allowable restrictions in July of 1987, and a
14 return of production up to approximately 5,400 barrels of
15 oil per day in October of 1987.

16 The cumulative production from this com-
17 municating area is 4.93-million stock tank barrels.

18 We also note that with the return to a
19 high rate of production on a field-wide basis, we've had no
20 increase in gas/oil ratios, with the latest month gas/oil
21 ratio being reported as 3,300 standard cubic feet per stock
22 tank barrel.

23 The performance that we attribute to this
24 Loddy area has to be construed in light of the individual
25 field performance and that's the reason that we have -- have

1 presented this field performance curve.

2 Q Okay, would you now turn to the next
3 document under this tab.

4 A Following the plot of production and gas-
5 /oil ratio we have a tabulation of that same information for
6 the field as a whole. And then following that we have in-
7 cluded the same information, production plots and production
8 tabulations for the wells in this 9-section area.

9 We don't propose to review each of these
10 individual wells. I would, however, like to turn -- the
11 first well behind the field total is the Reading & Bates In-
12 gram Federal 4316. I don't propose to review that one, nor
13 the Beeks Babbit No. 1 Well, which is the second well, not
14 the third well, which is Mesa Grande Brown No. 1, but I
15 would like to focus for just a second on the Mesa -- or on
16 the Sun Exploration Loddy No. 1 Well, which is the well
17 which is the fourth in the sequence.

18 Once again we have plotted daily produc-
19 tion, barrels of oil per producing day, which is a capacity
20 type rate, and gas/oil ratio. We're on semilogarithmic
21 paper. We have a scale from -- on the lefthand side, the
22 bottom axis is 1, then we go -- first horizontal line is 10
23 barrels a day and the second horizontal line is 100 barrels
24 a day or 10 squared.

25 The barrels of oil per producing day are

1 shown by the diamonds or the solid diamond figures. The
2 gas/oil ratio is shown by the x's. Once again we would note
3 that the latter months of '87 reflect the elimination or the
4 testing period at which rates were returned to field-wide
5 allowable -- statewide allowable rates, and we see an in-
6 crease in production rate for the Loddy No. 1 and at that
7 same time an attendant decrease in the gas/oil ratio for
8 that particular well.

9 Once again we -- we are led to conclude
10 that if the Loddy No. 1 Well is allowed to produce at a
11 higher rate, whether it's because it's now on 6 -- because
12 it would potentially be on 640-acre spacing, or whether
13 there is a return to the statewide allowables, that that
14 does appear to be a more efficient type of operation than
15 the restricted allowable scenario for that particular well.

16 Q Do you wish to discuss any of these other
17 diagrams?

18 A No, we have included the production
19 curves for the remaining wells in the 9-section area and
20 under Tab H we have provided for the Commission's use the
21 same information for all wells in this -- in this pool,
22 including once again a total plot of the -- for the pool
23 itself, but we have all the individual wells included in --
24 under Tab H.

25 Q Okay. Does that conclude your testimony

1 under this Tab D.

2 A Yes, it does.

3 Q And now let's turn to the first document
4 under Tab E and have you explain that, please.

5 A Yes, the first document under Tab E is a
6 plot of reported pressure measurements taken for wells in
7 the Gavilan Mancos Pool and the offsetting Canada Ojitos
8 Unit Area Pool, and we've attempted to identify the indivi-
9 dual wells by a color coding and by use of different sym-
10 bols.

11 We have plotted this pressure, which is
12 corrected to a datum of +370 feet subsea. We've plotted it
13 versus total field cumulative oil production, expressed in
14 thousands of barrels.

15 The points that are on the far righthand
16 side reflect points taken in November of 1987. The points
17 that are then the next set of points inward from that are
18 points taken in July of 1987.

19 We would look then to the extrapolation
20 of those trends of pressures back to a point of zero field
21 cumulative oil production, which would then represent the
22 initial pressure in the field which we have estimated based
23 on this type of graph at approximately 1800 psi, and then we
24 would also look at, for example, the wells that are in the
25 Loddy area and we would see the Loddy No. 1 Well, which is

1 shown by the red line. It has x's with a bar across the top
2 of the x. That is the Loddy No. 1, and we would see, then,
3 beginning at approximately 1.8-million barrels of cumulative
4 production, we would see the pressures recorded for the Lod-
5 dy Well, and we would see that the Loddy No. 1 pressure was
6 initially drawn down from the initial field pressure and that
7 as production has occurred in the field that the pressure
8 decline in the Loddy has -- has followed the general trend
9 in field pressure decline.

10 Other wells in this 9-section area in-
11 clude the Full Sail Wells. Those wells are shown in blue
12 and once again we can see that those wells show pressures
13 which are initially drawn down and tend to follow the field
14 pressure decline.

15 The conclusion that we've drawn previous-
16 ly from this graph and the one that is still, we believe,
17 accurate, is that there is excellent pressure communication
18 among the various wells in the Gavilan Mancos Pool, that the
19 pool is functioning as a single entity with respect to pres-
20 sure decline.

21 Q I'd ask you now to turn to the next graph
22 and explain it.

23 A The next graph focuses in. It's the same
24 type of graph. It is well pressure corrected to a +370 foot
25 subsea datum expressed in psi plotted against cumulative oil

1 production and it is once again the field cumulative oil
2 production expressed in thousands of stock tank barrels, but
3 all we've included on this particular graph are the wells
4 that are in this 9-section area. The reason that we have
5 attempted to include this is that particularly at this per-
6 iod of time when there was approximately 2-million barrels
7 of oil production, we see that there were several pressure
8 tests that were taken in this 9-section area and we see that
9 -- that at approximately that time there was no more than
10 about a 50 psi difference between the various wells, the
11 pressures reported for the various wells.

12 So we have concluded once again that this
13 entire 9-section area is in excellent pressure communica-
14 tion.

15 Q Will you go to the next document?

16 A The next plot is a plot of the Loddy
17 measured well pressure corrected to the +370 foot subsea da-
18 tum plotted against the Loddy No. 1 cumulative oil produc-
19 tion. The rightmost point on this plot is the value that
20 was recorded in November of 1987. The middle point is the
21 July, 1987, reading, and then the remaining points are pres-
22 sures that were taken basically between September of '85
23 when the well was initially completed and December of 1986
24 when the well was really first placed on production, and
25 what we see from this is the fact that the Loddy No. 1 is

1 not an isolated well; that its pressure has been affected by
2 offsetting production and once again, when we reflect on
3 where the offsetting production was, it was basically from
4 wells that were to the east of Section 20; therefor, if the
5 Loddy has been affected by production from those wells to
6 the east of Section 20, we would have to conclude that the
7 east half of Section 20 has been affected by this same -- by
8 offset production, as well.

9 Q Now would you turn to the first plot un-
10 der Tab F, or the only plot under Tab F.

11 A Okay. In order to -- to analyze the
12 viability of a second well in Section 20, we have gone back
13 to work that we had performed in conjunction with the March,
14 1987 hearing. At that time we had -- we believed we had a
15 method of predicting future performance under various field-
16 wide operating scenarios. One was a case of restricted pro-
17 duction limiting the field to approximately 3600 barrels of
18 oil per day, and a second case at which we turned to a
19 statewide allowable system which we call the 7200-barrel of
20 oil per day field depletion case.

21 We have shown the production that has oc-
22 curred since -- since the -- the hearing, and we've shown
23 also our projections on there. We have done this simply to
24 indicate that we believe that the projections that we had in
25 our prior study have been confirmed, at least with the pro-

1 duction that's available to date, although it's -- it's a
2 very limited amount of production, but basically we are fol-
3 lowing pretty -- pretty close to the predicted field deple-
4 tion case under the high rate case and also our gas/oil ra-
5 tios are -- would be very close to what we predicted, as
6 well.

7 Now, if we accept the validity of that --
8 of that particular study, then we would return to the con-
9 clusions that we had in that study, that the Gavilan Mancos
10 Pool that communicates contains approximately 55-million
11 barrels that we would expect approximately a 17 percent re-
12 covery factor, leading to a recovery of about 9.4-million
13 barrels.

14 Since we have cumulative produced 4.9-
15 million barrels, we have, then, a remaining production of
16 approximately 4.5-million barrels.

17 We stated at the last hearing, and it's
18 still our opinion, that wells will share in that remaining
19 reserve based on their -- their percentage of the total
20 field production, such that we see that inasmuch as the Lod-
21 dy No. 1 Well currently produces about 77 barrels of oil per
22 day, that represents about 1.5 percent of the total field
23 production and we would expect, therefor, for that well to
24 recover approximately 1.5 percent of the field remaining re-
25 serves.

1 barrel of \$17.75 was the value that was used, or that was
2 being received in June of 1987, as was the \$1.80 per MCF gas
3 price.

4 From that we arrive at revenues which
5 then comprise the remainder of those sets of -- of those
6 rows.

7 Then we go down to the third set of rows
8 and we see there, shown there, we show by year the net
9 severance tax. We show the advalorem tax, the operating
10 cost, allowing us to arrive at a net total income from which
11 we would subtract off any required investment, to arrive at
12 a net cash flow on a period by period basis, which could
13 then be accumulated and discounted.

14 We show several economic yardsticks at
15 the bottom of the -- at the bottom of the page.

16 This first evaluation is for the Loddy
17 No. 1. It assumes no restrictions. Basically it would cor-
18 respond to the formation of a 640-acre proration unit under
19 restricted allowables, current restricted allowables, or it
20 would correspond to a return to statewide allowables.

21 We show that -- on this particular exhi-
22 bit that that we expect the Loddy to recover a remaining ap-
23 proximately 86,000 barrels of oil and approximately 371-mil-
24 lion cubic feet of gas.

25 Under the cumulative net cash flow we ex-

1 pect that to generate approximately \$1.63-million.

2 That is the case of the Loddy No. 1 Well
3 without a second well being drilled in that particular sec-
4 tion.

5 The second set of economics is the analy-
6 sis of the Loddy No. 1 Well and it assumes then a second
7 well is drilled in Section 20. The -- the assumption that
8 has been made here is that the second well that's drilled in
9 Section 20 is going to affect the surrounding wells. Basic-
10 ally it will have the greatest impact on the performance of
11 the Loddy No. 1, the Janet, offsetting Janet Well, the off-
12 setting ET Well, and the offsetting Full Sail No. 3 Well.

13 But because the Loddy Well is the best of
14 those four wells, it's basically going to affect the pro-
15 duction performance of the Loddy No. 1 more than it will any
16 of the other wells and, in fact, it represents, then, 80
17 percent of the second well's production is attributed to the
18 Loddy No. 1 Well, reducing, then, how much the Loddy No. 1
19 Well recovers.

20 Once again perhaps it's clearer, but in
21 this scenario of this field that communicates very adequate-
22 ly already, the drilling of the additional well does not in-
23 crease any recovery from the field. It simply redistributes
24 recovery among wells.

25 So this represents, then the redistribu-

1 tion of recovery for the Loddy No. 1 and if we were to look,
2 then, under the gross liquid production column, we would see
3 that the 86,000 barrels of oil that had been produced under
4 the first scenario will be reduced to 58.8-thousand barrels
5 and the 370-million cubic feet of remaining gas production
6 will be reduced to 252-million.

7 When we go through and we analyze then
8 the value of that production, we see that the net cash flow,
9 the total net cash flow, is approximately \$878,000, a reduc-
10 tion from the 1.36-million barrels attributed to having just
11 a single well on that lease.

12 The final economic case is for -- is our
13 -- is our, let's say, median estimate for how the well, a
14 second well drilled in Section 20 might perform.

15 If you will recall, that southeast quar-
16 ter is surrounded by the Loddy No. 1, which was a 77-barrel
17 a day well, but it was also surrounded by a 20-barrel a day
18 well, a 14-barrel a day well, and the 3-barrel a day well.
19 Through a simple averaging process we said that a median es-
20 timate of the way the second well in Section 20 might per-
21 form would be that it might start off at 30 barrels a day.
22 As a consequence, if it starts off at 30 barrels a day and
23 follows our projection of how the field is expected to de-
24 cline, that well will recover no more than approximately
25 29,000 barrels of oil. It will recover approximately 163-

1 million cubic feet of gas.

2 We go through once again the revenue that
3 that production generates. We look at the severance tax and
4 the ad valorem tax, the operating expense attributed to that
5 well, to arrive at a total income, but now we have an
6 investment of \$500,000, leading us then to a cash flow that
7 starts off in the first year negative \$383,000, and over the
8 period that we anticipate to be the life, that investment is
9 never recouped. It is a negative \$85,000.

10 So what we -- what our estimate is that
11 based on the current state of the wells as of June, 1987,
12 that the southeast quarter of Section is a very risky loca-
13 tion. It very well could result in a loss of income to any-
14 body drilling that particular location, but not only would
15 it result in a loss of income to the people drilling that
16 location, it will also result in a loss of income to the
17 ownership in the west half of Section 20, because some of
18 the production that will come to that undrilled location
19 will come from that west half of Section 20.

20 So what we see in conclusion is that
21 since we are simply redistributing income between wells,
22 that there is no material benefit to anybody in drilling an
23 additional well in that eastern half of Section 20.

24 Q Were the exhibits under Tabs D, E, F, G,
25 and H prepared by you or under your supervision?

1 A Yes, they were.

2 MR. LOPEZ: I would tender Mesa
3 Grande Exhibit One, this entire book.

4 MR. LEMAY: Without objection,
5 Exhibit One will be entered into the record.

6 Q Is it your opinion that the granting of
7 Mesa Grande's application is in the interest of the preven-
8 tion of waste and protection of correlative rights?

9 A Yes, it is.

10 MR. LOPEZ: That concludes my
11 questions.

12 MR. LEMAY: Thank you, Mr.
13 Lopez.

14 Cross examination?

15 MR. KELLAHIN: One moment, Mr.
16 Chairman.

17 Mr. Chairman, I have no ques-
18 tions of the witness.

19 MR. LEMAY: Are there questions
20 from the audience?

21

22 QUESTIONS BY MR. LEMAY:

23 Q Greg, I just have a couple of quick ones.
24 Looking at Exhibit D, your -- your first one, why would you
25 want to drill a well in the southeast corner of 20? I would

1 think the northeast would be closer to that Brown Well,
2 which is a better well?

3 A Certainly that, that would be stated. I
4 mentioned the southeast corner simply because that main-
5 tained the spacing pattern that was -- that would put it the
6 maximum distance from any existing well.

7 Certainly consideration would have to be
8 given to moving in that same direction.

9 Q I just thought since there are some good
10 wells you'd want to stay awar from the poor ones.

11 A I think that's -- that's true. Certainly
12 one consideration would be if you're redistributing produc-
13 tion and this is a Mesa Grande Resources well, if they put
14 their well in the vicinity of the Mesa Grande Brown No. 1
15 Well, they may be just taking production from one well to
16 feed the other well.

17 Q Another question I did have was you lost
18 me somewhere where you said the -- the 1.5 percent of the
19 total field production could be allocated to the Sun Loddy
20 No. 1; however, it hasn't produced that. It's only produced
21 15,000 barrels.

22 Is that assuming it started off at an
23 earlier point in time?

24 A That is the remaining -- their share of
25 the remaining production based on their current rate as com-

1 pared to the total field rate. So in other words, they cur-
2 rently have 1. -- their current rate represents 1.5 percent
3 of the field.

4 Q Nothing to do with cumulative production.
5 It has to do with --

6 A No, it has nothing to do with cumulative.
7 It's only --

8 Q -- a percentage of rate of --

9 A Right, it's going from this time onward,
10 outward, to see basically how that particular area will per-
11 form. That's what we're trying to focus on.

12 Q I don't have anything further.

13 MR. LEMAY: If there are no ad-
14 ditional --

15 MR. LYON: May I?

16 MR. LEMAY: Mr. Lyon.

17

18 QUESTIONS BY MR. LYON

19 Q Mr. Hueni, looking at -- at the three
20 economic analyses under Tab G, I notice that you've allo-
21 cated some production for the undrilled location in 1987.

22 A We -- we ran all of our analyses assuming
23 that -- that -- that what we were trying to compare was the
24 situation as it existed in June of 1987. In reality, ob-
25 viously that well has not been drilled. It would not be

1 capable of being drilled for a couple months, and probably
2 wouldn't be on line for several months beyond that, and
3 therefor, this location might not recover the production
4 that we've shown, shown here.

5 Q Okay. Adding the estimated recovery from
6 two wells in Section 20, that totals to what, 98,000?

7 A The remainig production would total -- it
8 would be the 58.8-thousand barrels plus 29,000 barrels,
9 which would be approximately 88,000 barrels.

10 Q And with one well you would estimate
11 you'd produce only 86,000 barrels, is that right?

12 A That is correct, without any restric-
13 tions. One of the -- yes, that's -- that's correct. That's
14 what we have shown -- shown here.

15 Q And the difference between the 86,000 and
16 the 88,000, do you think that's going to be recovered from
17 Section 20 or will that come from all the wells surrounding
18 this one?

19 A It's my opinion that -- that a second
20 well drilled in Section 20 will affect all of its offset
21 wells but the one that it will affect the most will be the
22 one that would be the best, which is by far and away the
23 Loddy Well, which is, but it will have some minor impact on
24 -- some of its oil will come from -- also from the Janet
25 Well, the ET Well, and the Full Sail No. 3 Well.

1 I think that would be my opinion.

2 Q In connection with Mr. LeMay's question,
3 would your analysis be any different if you had located the
4 well in the northeast?

5 A Yes. Yes, it very well could be
6 different. In fact, the way we arrived at our median
7 initial rate was simply to look at the rates of the
8 individual wells surrounding it. So if we went to the
9 northeast area, we would look at maybe some different wells.
10 We incorporate the influence of the Brown No. 1 Well and --
11 that well in particular.

12 Q Do you think if you drilled it there that
13 you'd recover your money or are you still looking at a (not
14 clearly understood)?

15 A I think you might recover your money but
16 I think, once again, it will be recovered at the expense of
17 the other wells.

18 MR. LEMAY: Any additional
19 questions of Mr. Hueni?

20 If not, he may be excused and
21 we'll take a recess, fifteen minutes.

22
23 (Thereupon a recess was taken.)

24
25 MR. LEMAY: We'll resume with

1 Case 9225.

2 Mr. Kellahin? I'm sorry, Mr.
3 Lopez?

4 MR. LOPEZ: With Mr. Kellahin's
5 permission and the other two commissioners, may we excuse
6 Mr. Hueni, who is driving back to Denver?

7 MR. KELLAHIN: Mr. Chairman, at
8 this time I would call Mr. Ken Mueller. He's a reservoir
9 engineer for Sun Exploration and Production Company. He's
10 been previously sworn.

11

12 KENNETH MUELLER,
13 being called as a witness and being duly sworn upon his
14 oath, testified as follows, to-wit:

15

16 DIRECT EXAMINATION

17 BY MR. KELLAHIN:

18 Q Mr. Mueller, for the record would you
19 please state your name and occupation?

20 A Kenneth Mueller. I'm District Reservoir
21 Engineer with Sun Exploration and Production Company in Den-
22 ver, Colorado.

23 Q Mr. Mueller, would you summarize for the
24 Commission your educational background?

25 A I have a BS degree in petroleum engineer-

1 ing from Texas A & M University.

2 Q In what year, sir?

3 A 1979.

4 Q Subsequent to graduation, would you sum-
5 marize your work experience for the Commission?

6 A In May of '79 I went to work for Sun in
7 Midland, Texas, as a reservoir engineer. I worked there un-
8 til the summer of 1982, where I was transferred to Dallas
9 into our Reservoir Simulation Department. And then in May
10 of 1986 I was transferred to Denver as District Reservoir
11 Engineer.

12 Q Have you previously testified as an en-
13 gineer before the Oil Conservation Commission of New Mexico?

14 A Yes.

15 Q You testified in Sun's presentation on
16 the buffer gas allowable portion of the discussion of the
17 hearings on the (unclear) Gavilan Pool back in November
18 19th, I believe?

19 A Yes.

20 Q Mr. Mueller, are you familiar with the
21 types of economic analysis that petroleum engineers perform
22 to analyze and evaluate investments and ventures in oil and
23 gas wells?

24 A Yes.

25 Q Were you present in the hearing room to

1 hear Mr. Hueni make his economic analysis of the profitabil-
2 ity of the Loddy Well?

3 A Yes.

4 Q And you understood that analysis?

5 A Yes.

6 Q Is the methodology used by Mr. Hueni in
7 applying an analysis to this reservoir one that is typical
8 and standard methodolgy used by engineers such as you and
9 Mr. Hueni?

10 A Yes, it is.

11 MR. KELLAHIN: At this point,
12 Mr. Chairman, we tender Mr. Mueller as an expert reservoir
13 engineer.

14 MR. LEMAY: Mr. Mueller's qual-
15 ifications are acceptable.

16 Q Mr. Mueller, with regards to this speci-
17 fic application by Mesa Grande, what were you asked to do by
18 your company?

19 A I was asked to look at the Loddy produc-
20 tion data, cost, expenses, determine an evaluation of the
21 property and its remaining reserves, and to determine a
22 method by which to allocate equitable costs.

23 Q As you understand the factual situation,
24 what was your particular task in trying to come up with a
25 method to allocate the reserves and the income among owners?

1 A It was basically the method that should
2 be something that would provide a fair and equitable payment
3 by both parties for the worth of the property.

4 Q When you're talking about the equitable
5 allocation between the parties, are you referring to those
6 block of owners that participated in the original well in
7 the west half of the section versus the new owners contribu-
8 tion that they will make in the east half of that section?

9 A Yes.

10 Q What information or data did you gather
11 in order to form a basis for your study?

12 A I've looked at the production data of the
13 well, the pressure data that's been recently gathered on the
14 well; expenses from our financial information statements;
15 and an average or typical cost to drill a well.

16 Q Based upon your studies, Mr. Mueller,
17 have you determined possible methods of analysis in order to
18 determine possible methods of analysis in order to allocate
19 the costs and income of the well between the interest owners
20 in the east half and the west half?

21 A Yes. In all, I've looked into or con-
22 sidered six total such evaluations to -- in order to deter-
23 mine a fair and equitable cost.

24 Q Mr. Mueller, were you able to determine
25 what in your opinion are the reasonable, actual costs orig-

1 inally expended for the drilling, completion, and equipment
2 -- equipping of the Loddy No. 1 Well?

3 A Yes.

4 Q How did you go about obtaining that in-
5 formation?

6 A Sun's records on the actual drilling and
7 completion costs of the Loddy Well came from McHugh, and
8 they were very sketchy.

9 John Roe with Dugan provided me some of
10 his information on the billings that they had received off
11 that well and from those billings we were able to use
12 Dugan's original working interest in that well and determine
13 an actual drilling and completion cost for the well of
14 \$440,000.

15 Q Based upon your reconstruction of the in-
16 formation available to you, the total actual cost of the
17 well was what, sir?

18 A \$440,000.

19 Q And the well was completed in -- at what
20 time?

21 A September, 1985.

22 Q That \$440,000 of expenditure represented
23 the cost for what?

24 A That was drilling, completing, and all
25 the way up to getting the well on production.

1 Q It included surface equipment and what-
2 ever installation was necessary in order to produce the well
3 into tanks or into a pipeline?

4 A Yes.

5 Q Among the alternatives that you've exa-
6 mined as possible ways to allocate the costs equitable among
7 the east half and the west half have you considered Mesa
8 Grande's proposal to simply take the original costs of the
9 well and divide them on a 50/50 basis among the owners in
10 the east and the west halves of the property?

11 A Yes, I've looked into that.

12 Q Do you have a recommendation or opinion
13 as to whether or not the Commission should adopt that analy-
14 sis as the basis upon which to allow the east half owners to
15 acquire an interest in and participate in the production of
16 the Loddy Well?

17 A One-half of the 440, or \$220,000 payment
18 is inequitable and an unfair payment for a well such as the
19 Loddy.

20 Q What is the reasons for having that opin-
21 ion, Mr. Mueller?

22 A It does not adequately compensate the
23 original owners of the well. It provides a windfall to the
24 east half of the section. It doesn't account for the dif-
25 ference in a current day well cost as opposed to a well two

1 years old. It just doesn't account for a time value of
2 money in there or a return on the original investment to the
3 owners who took the risk.

4 Q As another alternative for allocating the
5 costs and the income between the two sets of owners, have
6 you made a reservoir evaluation analysis and an economic
7 calculation with regards to the Loddy Well?

8 A Yes, I have.

9 Q Let me turn, sir, to your exhibit book
10 and we will simply identify some of this information before
11 we talk about your analysis.

12 The first page of the exhibit book is
13 simply a cover sheet.

14 The next page is a surface area plat
15 showing the properties involved. We've already talked about
16 the area.

17 You've enclosed a copy of a portion of
18 the Order R-7407-E, have you not, Mr. Mueller?

19 A Yes.

20 Q All right, let's go beyond that and the
21 first display, then, says Lease-Loddy?

22 A Yes.

23 Q All right. What is the purpose of tha
24 display?

25 A This is a graph of monthly production for

1 the Loddy Well. The oil is the upper dark line and the gas
2 production monthly is the dashed line.

3 It basically shows back in '85 you can
4 see that there was some production in October but substan-
5 tially most of the production has been in 1987.

6 Q Describe for the Commission the type of
7 reservoir evaluation and economic analysis that you per-
8 formed on the Loddy No. 1 Well.

9 A It's basically the way a typical analysis
10 for determining the worth of a property is done, where you
11 have a reserve evaluation and then an economic analysis of
12 those reserves.

13 Q Is that information indicated on the ex-
14 hibit after the display of the production information on the
15 Loddy Well?

16 A Yes, it is.

17 Q All right. Before you discuss the speci-
18 fic information that you observed from making this analysis,
19 describe for us the method used.

20 A Well, there's two ways I've evaluated the
21 remaining reserves. One was by a decline curve analysis and
22 then also the other was by plotting reservoir pressure ver-
23 sus cumulative production.

24 Taking that -- those -- those two reserve
25 estimates, I singled out the one I felt comfortable with and

1 then you develop basically a schedule of remaining produc-
2 tion. You apply your operating expenses against your total
3 oil income and it comes up with a value for the property at
4 company, or at our 100 percent interest in the west half,
5 our net cash flow is \$459,000 and if you discount that net
6 cash flow by an interest factor of 15 percent, you come up
7 with a 15 percent net present value of \$342,000.

8 Q At what point in this calculation, if at
9 all, do you take into consideration the actual cost of the
10 well?

11 A It's not taken into consideration in a
12 continued operations case like I have run here.

13 Q What happens if you have to share 50 per-
14 cent of that current interest with the owners in the east
15 half of the section?

16 A That's the second set of economic para-
17 meters shown there, and you can see that the west half loses
18 50 percent of the oil and 50 percent of the gas to the east
19 half. These -- it reduces the net cash flow to \$363,000 and
20 the 15 percent net present value to \$304,000.

21 Q I notice there's an asterisk next to the
22 Pooled Interest and then the asterisk says "includes payment
23 of \$220,000. . .?"

24 A Yes. In that analysis, it was basically
25 an analysis of -- for the west half and it -- and I included

1 a payment of \$220,000 up front net to the west half in -- in
2 this analysis.

3 Q All right. If we assume the original
4 well cost of \$440,000, approximately --

5 A Yes.

6 Q -- 50 percent of that is \$220,000.

7 A Yes.

8 Q If we subtract that out of the net cash
9 worth for that interest, am I correct in reading this to say
10 that those interest owners will still receive an additional
11 \$363,000?

12 A No, that \$220,000 is included in that new
13 cash flow.

14 Q Okay, so what additional sums will they
15 receive on this analysis over and above the investment of
16 \$220,000?

17 A It would be \$140,000.

18 Q And what rate of return would that give
19 them?

20 A For the west half?

21 Q Yes, sir.

22 A It actually ends up in a loss of
23 \$100,000, or close to \$100,000.

24 Q Now let's take a moment and have you take
25

1 Hueni's exhibit book, if you will, sir, and go to Tab G in
2 which Mr. Hueni has made his three forecasts under three
3 various scenarios.

4 How does, in a simplistic, generalized
5 way, now, Mr. Mueller, how does Mr. Hueni's forecast differ
6 from the forecast that you've made?

7 A There's two major differences here is in
8 his reserve estimates. He's estimated that the Loddy Well
9 will recover 86,000 barrels remaining. My estimate was --
10 is more along the range of 56,000 barrels. I have a total
11 of over 200,000 MMCF remaining and he's got 370-million
12 cubic feet of gas remaining.

13 Q If we assume Mr. Hueni is correct in his
14 calculation and methodology, and if look down, then, at the
15 bottom of the first of the forecasts, and that's the one on
16 the Loddy No. 1 with no restrictions, if we look at the bot-
17 tom righthand corner and look at the information displayed
18 just below the words "present worth date first of 6-87". Do
19 you see the entire below that?

20 A Yes.

21 Q The first entry shows \$1.36-million?

22 A Yes.

23 Q And what does that number represent?

24 A That number represents the total monies
25 on a continued operation case that the Loddy Well will --

1 will make over its lifetime.

2 Q That number has not yet had subtracted
3 from it the actual costs of the well, has it?

4 A No.

5 Q If we take 50 percent of the actual costs
6 of the well, as well as 50 percent of that value that he's
7 attributed under this analysis, what will be the additional
8 sum of money that the west half, the east half owners will
9 realize above and beyond the initial investment of \$220,000?

10 A They will see -- over \$220,000 they will
11 see in investment, a return on their investment of \$460,000,
12 plus or minus.

13 Q Approximately how many times will they
14 get that initial investment back?

15 A That would be -- they're going to receive
16 a net cash flow of \$680,000 according to this evaluation,
17 and that would be a threefold, or over threefold, of their
18 \$220,000 payment.

19 Q Let's further examine Mr. Hueni's analy-
20 sis in terms of the discounted percentages he's used. Would
21 you go through each one of those and explain to us in your
22 opinion what happens to the ownership interest and the pro-
23 fitability of this project insofar as their concerned?

24 A Okay. What they're proposing is to pool
25 basically the east half and the west half; therefor the east

1 half at like a 15 percent net present value, which would be
2 the interest rate applied to the net -- net cash flow, which
3 total net cash flow, that net present value is a million and
4 what they would be receiving in a pooled case is one half of
5 that or \$500,000.

6 Q What additional contribution above the
7 \$220,000 amount, the initial investment for that interest,
8 what additional amount of money could be contributed by
9 those interest owners and still have a 15 percent rate?

10 A They could contribute almost 300 or up to
11 \$300,000 and still maintain above a 15 percent rate of re-
12 turn.

13 Q From Sun's position and economic analysis
14 is a 15 percent rate of return a reasonable and fair rate of
15 return on an investment such as this?

16 A Coming into proven production, yes, I be-
17 lieve so.

18 Q Having reviewed Mr. Hueni's analysis,
19 what is your opinion about Mesa Grande's position that they
20 ought to only be required to contribute 50 percent or their
21 proportionate share of the original costs of this well in
22 order to return an investment such as this?

23 A They're getting a windfall.

24 Q Have you examined, Mr. Mueller, any other
25 possible methods by which we might determine an allocation

1 of costs and revenue between the interest owners in the
2 west and east half of the section?

3 A Yes. Another method that I used was to
4 determine what a typical current well cost is.

5 Q Have you had prepared an exhibit that
6 displays that information, Mr. Mueller?

7 A Yes.

8 Q Tell us the exhibit page?

9 A The next exhibit. Up at the top lefthand
10 corner it says Authority for Expenditure - Drilling.

11 I asked our drilling engineer to prepare
12 an AFE estimate for a typical 8000-foot well in the Gavilan
13 Pool.

14 Q And what would be the total cost of that
15 well if drilled now?

16 A If drilled, completed, and equipped, it
17 would be \$698,000.

18 Q How would you propose, if the Commission
19 chooses to utilize this analysis as a method for allocation,
20 how would you propose that it be implemented?

21 A That this would be the current well cost
22 used in determining the share or allocation of costs into
23 pooling into these wells.

24 Q What are the advantages, if any, Mr.
25 Mueller, to utilizing this method as a way to allocate the

1 costs?

2 A Well, the first advantage is it takes in-
3 to account the time value of money. This is a 1987 estimate
4 and it is not 1985 dollars. It's a -- it basically repre-
5 sents a fair cost for a current day investment.

6 There -- in a drilling AFE there is no
7 consideration of risk given and it also offers a standard
8 cost for future pooling cases.

9 Q Do you recognize any disadvantages with
10 utilization of this as the method to allocate the costs and
11 the income?

12 A Yes. There's a disadvantage in it in
13 that it is only an estimate and does not reflect actual cost
14 of any well now.

15 Q Have you considered any other possible
16 ways by which we might allocate on a fair and equitable
17 basis the cost of this investment made by the original own-
18 ers on behalf of the new owners and then the sharing of
19 future production?

20 A Yes, the third method that I -- that I
21 considered would be an interest rate adjusted well cost.

22 Q And have you made those calculations and
23 displayed them as a form of exhibit?

24 A Yes. On the following exhibit after the
25 AFE, entitled Interest Adjusted to Original Well Costs.

1 Q All right, describe for us how you made
2 the calculations?

3 A Okay. The well was completed November of
4 '85 and June of '87 is 21 months since completion. Using
5 the estimated well cost of \$440,000 I assumed a 9 percent
6 interest rate factor, which is .75 percent monthly, and if
7 you take the \$440,000 and escalate the .75 percent for 21
8 months gives you a value of \$514,000.

9 Next, to get a range, I assumed a 12 per-
10 cent interest rate. That rate would be 1 percent monthly
11 and doing the same calculation yields a value of \$542,000.

12 Q Had we applied a 15 percent interest
13 rate, can you approximate for us what the total costs esca-
14 lated of the original well would be?

15 A Probably that 15 percent would be another
16 \$30,000 on top of the -- on top of that \$542,000.

17 Q If this method is adopted by the Commis-
18 sion, how would it be implemented?

19 A You'd take the original well cost of a
20 well, set some standard interest rate, and then bring that
21 original well cost up to present value dollars by doing this
22 same sort of calculation.

23 Q Then at that point you could take their
24 proportionate share of those escalated costs using the
25 interest rate applied and require, then, the payment of that

1 sum for participation in future production.

2 A Yes.

3 Q Do you see any advantage to using this
4 system in order to have and apply as a reasonably easy cal-
5 culated basis for participation in this well, as well was
6 other wells in this pool?

7 A It's more equitable than just one-half of
8 the \$440,000. It offers a method of determining present day
9 dollars as opposed to two, three year old dollars, and it
10 helps to reach a more equitable means of determining a cost
11 of allocation.

12 Q Are there any disadvantages to this
13 method that you can recognize Mr. Mueller?

14 A In the case of the Loddy it still does
15 not adequately compensate the original owners of the well
16 and therefor is not equitable in all cases.

17 Q Well, does this method of calculation in-
18 clude any type of risk factor?

19 A No, there is no risk calculated.

20 Q All right, sir, let's turn now to another
21 method of analysis that you have considered, and I believe
22 you've captioned that as Average Well Cost Analysis?

23 A Yes.

24 Q Describe for us what you're trying to
25 convey with this type of analysis.

1 A What I tried to do rather than using just
2 an estimate of what a well would cost in current day dol-
3 lars, these are costs, AFE costs and the cost from final re-
4 port of the latest three Canada Ojitos Wells that were drill-
5 led in the area.

6 Q All right, sir, and what back-up
7 information do you have that supports the summary sheet?

8 A The three AFE's that we had received from
9 Benson-Montin-Greer are attached showing the total drilling,
10 completion and equipment cost that he had AFE'd us for, and
11 the last page is the summary of each final report that we
12 had received from Al Greer, showing the total cost of each
13 well at final report.

14 Q Does this method of analysis include any
15 type of risk factor?

16 A No, these are actual costs.

17 Q If we applied the actual costs of the
18 well and averaged them out, what are the advantages and
19 disadvantages of utilization of this analysis for allocation
20 of the interests in this well?

21 A Using an average, you get a more
22 representative sample of what a typical well is. Also these
23 are actual verifiable costs. There -- it would be a fair
24 and equitable means of cost allocation in that it represents
25 current day well cost. It provides a fair payment to the

1 original owners of the Loddy Well.

2 Q Mr. Lopez argued awhile ago that the ad-
3 vantage that the new owners might gain by simply paying only
4 their share of the original well costs is compensated
5 already by the original owners in the 320 because they get
6 to keep production prior to the change in the spacing order
7 and therefor that is compensation enough.

8 A No, the Loddy Well had not paid out prior
9 to June of '87 and in fact most of its remaining recovery,
10 especially if we go by this book rather than mine, is yet to
11 be recovered. The cumulative production as of June 1st, '87
12 was just under 7000 barrels of oil and just over 44-million
13 cubic feet of gas.

14 Q Among all these choices, Mr. Mueller,
15 which one do you in your opinion believe is the most fair
16 and equitable?

17 A I like averaging the current day well
18 cost. It's an actual cost. It's current day dollars. That
19 represents the monies somebody would have to expend or have
20 at risk and what a current day well might recover.

21 Q Were the exhibits represented in Sun Ex-
22 hibit Book Number One prepared or compiled under your direc-
23 tion and supervision?

24 A Yes.

25 Q And the information you obtained from the

1 unit operator as to costs in your opinion are accurate and
2 correct to the best of your knowledge?

3 A Yes.

4 MR. KELLAHIN: Mr. Chairman, we
5 move the introduction of Sun Exploration and Production Com-
6 pany's exhibit book, identified as Exhibit Number One.

7 MR. LEMAY: Without objection
8 Exhibit One will be admitted into evidence.

9 MR. KELLAHIN: That concludes
10 my examination of Mr. Mueller.

11 MR. LEMAY; Thank you, Mr. Kel-
12 lahin.

13 MR. LOPEZ: Could I have just a
14 second?

15
16 CROSS EXAMINATION

17 BY MR. LOPEZ:

18 Q Okay, Mr. Mueller, I'm ready now. I
19 think Mr. Kellahin asked you the question as to whether or
20 not it is true that Sun would get to keep the proceeds of
21 production up until the date of the order on June 8th, 1987.
22 That's correct, isn't it?

23 A Yes.

24 Q And you said it produced about --

25 A 7000.

- 1 Q -- barrels of oil and --
- 2 A 44-million cubic feet.
- 3 Q --44-million cubic feet.
- 4 A 44-million.
- 5 Q So let's assume 7000 barrels at, say,
- 6 \$15.00 a barrel. How much is that? That's about --
- 7 A 105.
- 8 Q 105,000 even, and 44-million cubic feet,
- 9 let's say \$1.50, mas o menos, --
- 10 A Okay, 66,000.
- 11 Q 66,000, so --
- 12 A 171,000 total.
- 13 Q 171,000 total. And you're not going to
- 14 give back half of that if Mesa Grande is allowed to force
- 15 pool their way into your well, are you? I mean that's not
- 16 contemplated under scenario --
- 17 A No.
- 18 Q -- we've discussed in this hearing, is
- 19 it?
- 20 A The order is ~~not~~ retroactive.
- 21 Q All right, and we haven't requested that.
- 22 Do you -- it is your opinion that the Loddy No. 1 Well is in
- 23 pressure communication with the other surrounding wells in
- 24 thke pool?
- 25 A Yes.

1 Q And therefore is it your opinion that it
2 in fact is draining an area larger than 320 acres?

3 A Yes.

4 Q And so to the extent that it has drained
5 the east half of Section 20 up to the date of the order,
6 Mesa Grande would not be compensated for that drainage
7 either, would it?

8 A No, not from the Loddy.

9 Q Okay, I'd like for you to refer to Mr.
10 Hueni's first economic exhibit number the Tab G which he
11 discussed, and just walk through a suggestion that I have
12 here.

13 Let's agree that, just for the purposes
14 of argument, that the present discounted value of 50 percent
15 of the future production from the well is million dollars.
16 Okay, (Not clearly understood). So if Mesa Grande is al-
17 lowed to participate in the well under the order, Sun would
18 get to realize half of that, correct, for --

19 A Yes.

20 Q -- half a million. Okay. Now, we add to
21 that half the actual well cost, or 220,000, so now we're up
22 to 720,000, and then in addition to that, Sun gets to retain
23 the 171,000 that you said might be a reasonable figure for
24 production (not clearly understood). So that gets us up to
25 almost 900,000, right? (unclear)

1 A Assuming this economics -- assuming these
2 economics are correct.

3 Q All right.

4 A That's the assumption we're working on.

5 Q (Interrupting) Just for discussion pur-
6 poses.

7 If Mesa Grande were allowed to drill a
8 well or decided to drill a well or were allowed to in the
9 east half of Section 20, then the present discounted value
10 to Sun would be 677,000 referring to the second exhibit, as-
11 suming that this analysis is correct. Is that correct?

12 A Yes.

13 Q So isn't it true that if Mesa Grande were
14 allowed to force pool their way into the well and did not
15 drill a second well, isn't Sun approximately \$200,000 plus
16 ahead, not to mention the benefit of having enjoyed the
17 drainage from the east half?

18 A No.

19 Q Well, that would include the benefit of
20 the drainage but you would receive under my first scenario
21 approximately \$900,000 and under the second scenario with a
22 second well only \$677,000.

23 A Yeah, if you assume these econmics are
24 correct.

25 Q Okay.

1 A My economics say differently.

2 Q Okay. Now let's talk about the generic
3 problem of the pool as a whole.

4 Isn't each 640 that has one well now
5 existing on it going to have a different kind of story? I
6 mean the production history, the capability of the well, how
7 good the well is --

8 A The actual cost to drill.

9 Q -- each interest is going to be differ-
10 ent, and do you think if we got all the operators in the
11 pool together we could reach a consensus on which one of
12 your proposals would be the best or the right way to go?

13 A I think so.

14 Q You don't think it would be difficult to
15 decide whether we're going to do it on certain -- well, let
16 me ask this. I notice that you used Canada Ojitos Unit
17 wells. Didn't you have any information with respect to the
18 recent completions in the Gavilan Mancos Pool?

19 A No. We're not a party in any recent Gav-
20 ilan well other than the Amoco Syfert (sic) Well and when I
21 was looking into the cost we had received, or invoices we
22 had recently received on that well, that's a recent comple-
23 tion, it's ridiculously low.

24 Q Well, let's just talk about trying to de-
25 velop a consensus on whether operators could arrive on what

1 they thought would be a fair representation of the average
2 well costs.

3 You heard Mr. Sweet testify that they
4 would circulate an AFE at a well cost of \$500,000. That's
5 considerably different than well costs of \$632,000. Do you
6 think it would be difficult to reach a consensus by the
7 operators depending on their own operating practices as to
8 what a fair representation of the well costs ought to be?

9 A Well, my spread in that calculation is
10 from 550 to over 700. You can determine an average well
11 cost.

12 Q Who would you have determine what the
13 average well costs should be, the Commission?

14 A The Commission would be fine.

15 Q Based on what information?

16 A Submitting some recent well costs.

17 Q I think you said with respect to your
18 third alternative that it would not be equitable in all
19 cases, the interest rate adjustment. Isn't it true that no
20 formula would be equitable in all cases because in each in-
21 stance there's a different situation involved?

22 A Yes, but the interest rate formula that's
23 -- unless there's a way of determining a good, sound inter-
24 est rate to use, having backing for it some how, is less
25 equitable than using verifiable costs.

1 MR. LOPEZ: No further ques-
2 tions.

3 MR. LEMAY: Thank you, Mr.
4 Lopez.

5 Are there additional questions?
6 Mr. Chavez, of our Aztec Of-
7 fice.

8
9 QUESTIONS BY MR. CHAVEZ:

10 Q Mr. Mueller, I'm Frank Chavez in the Oil
11 Conservation Division Aztec Office.

12 Do you think it is important for the pro-
13 tection of correlative rights that the east half -- for the
14 owners in the east half to participate in the production
15 from the Loddy Well?

16 A The east half is being drained.

17 Q Is that a yes, that they should partici-
18 pate somehow?

19 A Either that or develop the acreage. The
20 acreage needs to be developed whether it's pooling or
21 drilled. We're not -- we're not objecting to pooling. All
22 we're saying is that based upon old costs the west half is
23 not adequately compensated.

24 Q Okay, so you're -- for purposes of cor-
25 relative rights, then, if I understand you're proceeding

1 from what you say, then, the biggest problem is actually how
2 the financial situation will be worked out as to what would
3 be the correct well costs to pay, is that correct?

4 A Yes.

5 Q I didn't fully understand your testimony
6 on drilling a well in the east half. Would there be --
7 could there be an economical well drilled in the east half?

8 A According to Hueni's calculation, no. To
9 use an average well in that area, Reading & Bates has
10 recently brought in a 45-to-50 barrel a day well northeast
11 of there and west of there. There's -- there's a
12 possibility of drilling an economical well in the east half.

13 Q Now you said there would be a loss to the
14 people in the west half were the application approved as it
15 was submitted and you gave a figure for that. What was --
16 do you recall what that figure was?

17 A I don't understand the question.

18 Q There'd be an economic loss to the
19 working interest in the east half -- I'm sorry, in the west
20 half if the applicaiton was approved.

21 A \$100,000.

22 Q You said there would be an economic
23 benefit to those in the east half and what was that number?

24 A Based on Hueni's calculation it would be
25 over \$300,000. Based on mine it was about \$100,000.

1 Q You said that averages out, is that what
2 you're looking at?

3 A Yes.

4 MR. CHAVEZ: Okay, that's all I
5 have. Thank you.

6 MR. LEMAY: I've got a couple
7 quick ones.

8

9 QUESTIONS BY MR. LEMAY:

10 Q Was it my understanding that you said
11 that there was no risk factor taken into account in the AFE?

12 A That's correct.

13 Q I show both the Benson-Montin-Greer AFE's
14 along with your AFE as having a contingency factor of 10
15 percent on your AFE and I think it's a contingency factor on
16 the BMG is 25,000. Isn't that generally mechanical risk
17 factor?

18 A I don't know if that would be considered
19 risk. Contingencies are basically saying that's about as
20 best as we can estimate it, plus or minus so many dollars.

21 We have a contingency on almost every AFE
22 we send out.

23 Q But it's my understanding that contin-
24 gency, it's always a plus contingency; there's no negative
25 contingency involved. It's -- it's for some risk factors

1 involved. I don't know. That's just my interpretation of
2 it.

3 MR. KELLAHIN; Mr. Chairman.

4 MR. LEMAY: Yes.

5 MR. KELLAHIN: The reservoir --
6 the drilling engineer that prepared that actual AFE is
7 sitting right here and perhaps he could answer that question
8 for you about what contingency is applied.

9 I realize that he hasn't been
10 sworn. It's Mr. Steve Stearns and if you'll allow him, I'm
11 certain he can respond to that question.

12 MR. LEMAY: Is there -- if you
13 would, I'd appreciate it.

14 MR. STEARNS: The contingency
15 we use in our AFE is at the bottom. I usually use 5 or 10
16 percent based upon the amount of work that's done in the
17 area.

18 Mostly what -- when we get our
19 run back after the end of a well, our computer run that
20 tells exactly what cost went into each category, the
21 majority of the contingency is usually taxes, which I have a
22 hard time getting ahold of in different states. I work in
23 nine different states and each state has a different city,
24 county, and state tax, and the majority of that dollar
25 amount is always, the big majority of it is taxes, but that

1 contingency is just in there for things that I didn't have a
2 blank to put it in.

3 MR. LEMAY: So according to
4 Sun's AFE they do not -- it's not a mechanical risk factor.

5 MR. STEARNS: No, we --

6 MR. LEMAY: Some independents
7 consider that a mechanical risk factor.

8 MR. STEARNS: Our AFE's just
9 strictly in our district are within plus or minus 10 per-
10 cent. Our actual well costs will be within 10 percent, plus
11 or minus, the last couple years.

12 MR. LEMAY: Thank you. I ap-
13 preciate that clarification.

14 I've heard no testimony as far
15 as an operating agreement and costs, recurring costs, such
16 as fixed overhead fees. Has an operating agreement been
17 submitted to other parties in the east half of Section 20?

18 MR. KELLAHIN: Mr. Chairman,
19 that's -- the operating costs are shown on one of the
20 exhibits. I apologize for not drawing your attention to
21 that.

22 It's shown after the tabulation
23 or the plot of production from the Loddy Well, where Mr.
24 Mueller has identified the spud and completion date and then
25 he shows the operating expenses on a monthly basis.

1 MR. LEMAY: Thank you, Mr.
2 Kellahin. I was referring less to the actual operating
3 expenses as to the administrative overhead charge. General
4 in forced pooling orders we -- we tend to put in what is a
5 justifiable charge for operating expenses, and that's
6 usually an item where the pooled party, as well as the
7 pooling party, will give some kind of testimony concerning
8 that. What's acceptable, in other words.

9 MR. KELLAHIN: Perhaps Mr.
10 Lopez and I can stipulate on an amount for that. It really
11 wasn't the focus of the proof today and perhaps we could
12 submit that at a later time.

13 MR. LEMAY: I understand but if
14 we're going to issue an order I think naming Sun, who I
15 assume wants to be operator in here, there should be some
16 sort of agreement concerning operating expenses.

17 MR. BROSTUEN: Are you through?

18 MR. LEMAY: Yeah, go ahead.

19

20 QUESTIONS BY MR. BROSTUEN:

21 Q Mr. Mueller, just a point of clarifica-
22 tion, one thing you said early in your testimony, you said
23 the 50/50 split or cost share between the west half and the
24 east half would not compensate the original owners of the
25 well.

1 Are you talking about Sun or are you
2 talking about McHugh? Are you talking about compensating
3 them out of this -- I'm not assuming that was the intent.

4 A Sun.

5 Q That is Sun, so you're -- you're --

6 A Yes.

7 Q -- as far as you're concerned, Sun and
8 McHugh are the same.

9 A I've tried to say west half and east
10 half. Yes, Sun, as the west half.

11 Q Okay, thank you.

12 MR. LEMAY: Thank you.

13

14 QUESTIONS BY MR. LEMAY:

15 Q Additional question, Mr. Mueller.

16 You mentioned we're looking in terms of
17 -- of taking this type of a case and extending it maybe be-
18 yond the current confines of Section 20. Would Sun, as an
19 operator in the field, if they were on the other side of the
20 issue, if they were trying to force pool their way into,
21 we'll say a well that Mesa Grande, Limited, was operator of,
22 would they accept any one of the three scenarios that were
23 presented here?

24 In other words, cost plus 9 percent; an
25 averaging of current well costs; or -- or some approach

1 along the lines that you've been suggesting to the Commis-
2 sion?

3 A Yes, we would be receptive to that be-
4 cause basically it gives us a basis for evaluating whether
5 we want to consent to come into that well or nonconsent and
6 not come into it; just as Mesa has had problems pinning
7 down, as we have, on this well, our records on this well
8 were pretty bad from McHugh, pinning down what kind of costs
9 are they pooling. They've had to assume half a million dol-
10 lars we're paying for our well out there. That's -- if you
11 set a cost that everybody can decide on as to whether they
12 want to consent or nonconsent.

13 Q Is it fair to say an independent general-
14 ly can drill and operate wells cheaper than majors can?

15 A Yes, most of their AFE's are lower than
16 ours.

17 MR. LEMAY: I have no further
18 questions.

19 Is there any other questions?

20 Mr. Lyon.

21

22 QUESTIONS BY MR. LYON:

23 Q I forgot what I was going to ask. Mr.
24 Mueller, on your estimate that the owners in the west half
25 would receive \$100,000 less, that's the net revenue on the

1 proposed settlement cost and dividing the revenue after the
2 pooling is -- is accomplished, is that correct?

3 A Yes, we'd have \$100,000 loss.

4 Q Have you given any consideration to the
5 impact on your revenue and profit if a second well was drilled
6 on the section in the east half?

7 A No.

8 Q I'm sorry, I can't think of anything else
9 right now.

10 MR. LEMAY: Mr. Chavez?

11

12 QUESTIONS BY MR. CHAVEZ:

13 Q One more clarification, Mr. Mueller, and
14 Mr. Lyon expressed it and I still don't understand.

15 Are we talking about an actual \$100,000
16 loss or \$100,000 less revenue that would occur if the application
17 were approved?

18 A It would be \$100,000, it was \$95,000 some
19 odd, about \$100,000 less net cash flow. It's not total revenue
20 because out of total revenue we have operating expenses
21 and everything like that, taxes. It's net cash flow, so I
22 don't know if that answers your question or not.

23 Q In a sense it does. What I'm trying to
24 get at is would you still have a rate of return that was,
25 say, satisfactory or at least not -- wouldn't suffer a

1 financial loss if the application were approved.

2 A We would still have a positive cash flow.
3 It would not be as great as what we have now or with the
4 additional \$100,000.

5 Q Thank you.

6 MR. LEMAY: Mr. Lopez.

7

8 RECROSS EXAMINATION

9 BY MR. LOPEZ:

10 Q It was Sun that did request the 640-acre
11 spacing (unclear) for that well. Is that right?

12 A Yes.

13 Q And isn't it also true, Mr. Mueller, that
14 -- that in terms of determining whether a offset working
15 interest owner that wants to participate in the existing
16 well, the decision to go consent or nonconsent is always be-
17 fore when the Commission adopts a penalty mechanism whether
18 for participation along any of the alternatives you suggest
19 or whether it's done on the basis of pro rate well cost.

20 A I'm not understanding your statement or
21 --

22 Q Well, isn't --

23 A -- question.

24 Q -- isn't it the same situation whether a
25 nonparticipating, working interest owner elects to partici-

1 pate, isn't the decision to go consent or nonconsent always
2 before whether or not the Commission adopts a rule that has
3 a penalty factor as you suggested or whether they allow that
4 person to participate by paying just the actual share of the
5 well cost?

6 A Well, you -- when you make the election
7 all you've seen is somebody's AFE so far and know that
8 there's a 200 percent nonconsent penalty.

9 Q What I'm suggesting is it's just a matter
10 of where we draw the line.

11 A Okay. Yeah.

12 MR. LEMAY: Additional ques-
13 tions?

14 Mr. Commissioner.

15
16 QUESTIONS BY MR. HUMPHRIES:

17 Q On the page where you outlined costs, you
18 put operating expenses less taxes, \$2,740 a month.

19 A Yes.

20 Q Does that have G & A and overhead in it
21 for Sun?

22 A Yes, there is overhead in that.

23 Q Is there a built-in profit figure for Sun
24 in that?

25 A No, that's basically our District expense

1 divided by the number of wells we operate, I believe, is how
2 it's allocated out.

3 Q When Sun evaluated these properties, I
4 suspect they did it in order to purchase them I suspect they
5 did it on a well-by-well basis, is that right?

6 A I don't know. I was not involved with
7 that acquisition evaluation.

8 Q Would it be useful to you or -- it would
9 be useful to this Commission to know, I suspect, what Sun
10 evaluated the Loddy No. 1's present net value at at that
11 time and then to see if those numbers are consistent with
12 maybe Mr. Hueni's or some of the numbers that are set forth
13 here, because basically what we're talking about is predic-
14 tions of future value, future production, net value. At
15 sometime I suspect Sun made a prediction or an estimate of
16 what the present value of that well on future reserves or
17 present reserves, so the future income in several different
18 price scenarios would have probably been one of the evalua-
19 tion mechanisms that Sun used, that I believe would have
20 probably been a little bit elaborate than this, is that cor-
21 rect?

22 A It's a different -- it's a financial run
23 rather an economic analysis run.

24 MR. HUMPHRIES: I have no fur-
25 ther questions.

1 MR. LEMAY: Okay, the witness
2 may be excused if there are no further questions.

3 Do you want a short statement
4 or do you want to just --

5 MR. KELLAHIN: Well, I'd like
6 to make a statement.

7 MR. LEMAY: Sure. Any closing
8 statements. Mr. Kellahin.

9 MR. KELLAHIN: In response to
10 Commissioner Humphries inquiry about the acquisition value
11 placed upon the property, it was rather a complex transac-
12 tion involving Mr. McHugh's interest in lots of wells and we
13 apologize for not being able to reconstruct that in a mean-
14 ingful fashion.

15 The reason we chose not to pur-
16 sue that presentation is to try to come up with a system
17 that was simple and workable and avoided the kinds of things
18 that were presented today, Mr. Hueni's book, Mr. Mueller's
19 work, an entire economic analysis on every well based upon
20 the individual interest owners investment. I think that's
21 really a complicated thing and it doesn't give me any com-
22 fort to have to come before you and try to argue that every-
23 time we want to pool acreage into an existing well.

24 It's really not the solution we
25 are hoping for. it can be done but you can see that gentle-

1 men of Mr. Mueller and Mr. Hueni's competence can approach
2 it from a different point of view and come up hundreds of
3 thousands of dollars apart.

4 It doesn't help a lot. What
5 we're suggesting to you is that the method used whereby the
6 new owners simply contribute their share of the original
7 cost of the well is a windfall to those owners. They get to
8 participate on the same basis and for the same amount of
9 money as the original owners that drilled the well.

10 None of the solutions we have
11 posed for you have a risk factor built into it. We've pur-
12 posely not done that because of the finding of the prior
13 Commission of the Mallon case. The way the statute is writ-
14 ten to avoid argument on that question.

15 We invite your attention,
16 though, to that Mallon order to Finding No. 20 in which the
17 Commission told those parties that they didn't give them any
18 other choices and the Commission very much wanted to make a
19 reasonable assessment of costs to give the original owners
20 compensation for the investment they'd made on behalf of the
21 new owners. It's right there, and those parties did not do
22 that. The only thing they gave the prior Commission was the
23 turnkey proposition which we've discussed which has built
24 into it inherently the mechanical risk.

25 We've forgotten that, gotten

1 away from the risk factor. What we're simply asking you to
2 do is to give us a solution that is generic and that applies
3 in all instances. The fact that there's been some prior
4 production in this well certainly does not compensate the
5 original owners for that investment.

6 We think it's reasonable to
7 look at escalating the original costs. You can apply any
8 standard you want, I think, out of the public information.
9 It's within your discretion to apply a percentage if you
10 choose that as a method.

11 Mr. Mueller says that he likes
12 the comfort of actual well costs that are current as of June
13 of '87. It gives him a lot of comfort. Those are actual
14 numbers, they're not estimates, they are actual numbers, and
15 what he does is he takes the step farther and he averages
16 actual costs. Again gets you off the rollercoaster,
17 flattens out, and it makes it reasonable. We are putting,
18 then, the investment that the new owners make in terms of
19 '87 dollars and not on '85 dollars.

20 Perhaps you can think of
21 another way that works; we certainly invite some solution.
22 We would like you to consider this not only for solution in
23 this case but, as Mr. Mueller said in response to a
24 question, Sun is on both side of this. We're going to have
25 to do this one way or another for a whole bunch of these

1 wells and we really do need some guidance from the Commis-
2 sion, which we hope you'll give us.

3 MR. LEMAY: Thank you.

4 Mr. Lopez.

5 MR. LOPEZ: Thank you, Mr.
6 Chairman. I'll try to be brief. I think I made my points
7 in my opening statement.

8 But preliminarily, I hope that
9 I'm -- I'm again going to reiterate -- I hope we are all in
10 agreement that we believe (not clearly understood) as of
11 June 8th all 640-acre spacing units in the Gavilan Mancos
12 are that, indeed, and that the nonparticipating working in-
13 terest owners will get to share in production as of that
14 date, and that there is an established 200 percent noncon-
15 sent penalty for nonconsenting participants.

16 The issue then becomes, as we
17 said earlier, only one of whether there is a mechanism for
18 determining any extra payment beyond the pro rata share of
19 the well cost for a working interest owner seeking to join
20 in the well.

21 Mesa Grande has said that there
22 are four reasons why the way it has been done should remain
23 in effect, and that is pro rate payment of the actual cost.

24 The first reason is because the
25 law requires it.

1 The second reason is because
2 precedent has established it.

3 The third reason is because
4 it's logical and equitable.

5 And the fourth reason is be-
6 cause it will -- it will enhance administrative administra-
7 tive ease.

8 On the first part, the statute
9 clearly says that a penalty shall be assessed against a non-
10 consenting working interest owner in this kind of unit.

11 It does not address whether a
12 penalty can be assessed against a consenting owner, as I
13 mentioned earlier, and it doesn't address whether the well
14 was drilled before or after the order increasing spacing
15 units went into effect.

16 By logical result, if the pen-
17 alty is applied against a nonconsenting, then a penalty can-
18 not be applied against a consenting working interest owner.

19 The second point is, as I
20 pointed early this morning, the Commission is bound to fol-
21 low its own rules and regulations and orders. There is an
22 order already entered in this case, the Mallon-Mesa Grande
23 order, which is identical in almost every respect except
24 that it issued after 7407 rather than 7407-E, and it was the
25 language in the Rule 2-A that has caused the confusion, but

1 as Mr. Lyon said, that when he drafted it, it may not have
2 been the Commission's intention, but as he drafted the lan-
3 guage, that's what he thought they intended.

4 So based on precedent I think
5 the Commission would have to have good cause and good reason
6 to vary from that and I haven't heard it.

7 The third reason we said is be-
8 cause it's logical and equitable. As we've said, the opera-
9 tor of the well has already got to enjoy all the production
10 proceeds up to the date of the order. The operator of the
11 well has also got to enjoy (unclear) in the drainage of the
12 well from the other half of the 640. That should be enough
13 to compensate for the risk involved.

14 It is also true that in this
15 pool we have many 640's that have only one well drilled on
16 them and in each instance the equities are going to vary and
17 there are going to be instances in the pool where Sun is in
18 the exact shoes of Mesa Grande. If there's any windfall to
19 be gained, they will gain the windfall, so in the ultimate
20 balance it seems both logical and equitable that the pooling
21 order issue and that there be no penalty applied because in
22 the long run it will all come out in the (unclear.)

23 The final reason, we feel that
24 the law, precedent, and logic and equities should be fol-
25 lowed is because if you do it that way, you're not going to

1 have any problems with deciding which formula it should be,
2 whether it should be the income formula, wether it should be
3 the interest formula, at what interest, and if it's going to
4 be average well cost, how many wells, how recent the wells,
5 and a difference between \$500,000 and \$700,000 to complete a
6 well, you'll avoid all those arguments, all those disagree-
7 ments. If the order issues as I suggest, everybody's going
8 to either participate or not participate in each 640. You
9 can go consent or nonconsent and it's my prediction you
10 won't hear another word out of anybody.

11 For those reasons I would sug-
12 gest that you (not clearly heard.)

13 MR. LEMAY: Thank you, Mr.
14 Lopez, and your concern to make our job easier.

15 Ms. Tallmadge.

16 MS. TALLMADGE: Mr. Chairman, I
17 have a very brief comment to offer on behalf of Arriba Com-
18 pany, Limited.

19 Arriba as a working interest
20 owner in the east half of Section 20 concurs with and fully
21 supports the position offered by Mesa Grande, Limited, in
22 this case.

23 With regard to the assessment
24 of additional charges tantamount to a penalty against any
25 working interest owners, Arriba is also willing to abide by

1 any order issued by the Commission and set for the timeframe
2 in which to give consent or nonconsent to participation in
3 the well; however, I strongly feel that there is no legal or
4 equitable justification for charging the additional cost or
5 penalty to consenting working interest owners. I think the
6 (not clearly understood) of the statement and precedent
7 adopted by the Commission in the Mallon case establishes
8 this and I would urge that the position of Mesa Grande, Lim-
9 ited, be adopted and that the Commission enter its order.

10 MR. LEMAY: Thank you very
11 much.

12 Are there additional statements
13 in the case?

14 If not, the Commission will
15 take the case under advisement and the hearing is adjourned.

16

17

(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