

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:) CASE NO. 12,008
)
APPLICATION OF ROBERT E. LANDRETH FOR A)
DETERMINATION OF REASONABLE WELL COSTS,)
LEA COUNTY, NEW MEXICO) ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

BEFORE: RAND L. CARROLL, Division Counsel

June 12, 1999

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, RAND L. CARROLL, Division Counsel, on Monday, June 12th, 1999, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

June 12th, 1999
Examiner Hearing
CASE NO. 12,008

	PAGE
EXHIBITS	3
APPEARANCES	4
ARGUMENTS TO DIVISION COUNSEL	
By Mr. Carr	5
By Mr. Kellahin	23
By Mr. Carr	37
QUESTIONS BY MR. CARROLL	40
REPORTER'S CERTIFICATE	51

* * *

E X H I B I T S

Applicant's	Identified	Admitted
Exhibit 1	-	5
Exhibit 2	-	5
Exhibit 3	-	5
Exhibit 4	42	5
Exhibit 5	-	5
Exhibit 6	-	5
Exhibit 7	-	5
Exhibit 8	-	5
Exhibit 9	11	5
Exhibit 10	12	5
Exhibit 11	-	5
Exhibit 12	-	5
Exhibit 13	13	5
Exhibit 14	14	5
Exhibit 15	15, 26	5
Exhibit 16	-	5
Exhibit 17	-	5
Exhibit 18	-	5
Exhibit 19	17	5
Exhibit 20	17	5
Exhibit 21	-	5
Exhibit 22	-	5
Exhibit 23	-	5
Exhibit 24	31	5
Exhibit 25	17, 31	5
Exhibit 26	-	5
Exhibit 27	-	5

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A P P E A R A N C E S

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* * *

1 WHEREUPON, the following proceedings were had at
2 2:05 p.m.:

3 MR. CARROLL: This special hearing will be called
4 to order. On the docket it's Case Number 12,008,
5 Application of Robert E. Landreth for a determination of
6 reasonable well costs, Lea County, New Mexico.

7 I'll call for appearances.

8 MR. CARR: May it please the Examiner, my name is
9 William F. Carr with the Santa Fe law firm Campbell, Carr,
10 Berge and Sheridan. We represent Robert E. Landreth in
11 this case.

12 MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of
13 the Santa Fe law firm of Kellahin and Kellahin, appearing
14 on behalf of Santa Fe Energy Resources, Inc.

15 MR. CARROLL: Okay, it's Landreth's Application,
16 so I guess, Mr. Carr, you'll go first.

17 MR. CARR: Yes, sir.

18 May it please the Examiner, initially I would
19 like to note that Mr. Kellahin and I have stipulated a
20 number of documents which can and will represent the record
21 in this matter, and I would initially move the admission of
22 the stipulated Exhibits 1 through 27.

23 MR. CARROLL: Okay, and these exhibits will be
24 accepted into the record.

25 MR. CARR: May it please the Examiner, Robert E.

1 Landreth is here today asking the Division to determine
2 what charges may be withheld from his working interest
3 pursuant to a Division compulsory pooling order.

4 Mr. Landreth owns working interest in the south
5 half of Section 28, Township 22 South, Range 34 East.

6 In late 1996, Santa Fe proposed to drill the
7 Gaucho Unit Well Number 2 on this acreage. No voluntary
8 agreement could be reached, and Santa Fe obtained a
9 compulsory pooling order covering the south half of this
10 section.

11 Mr. Landreth's interest is subject to this
12 compulsory pooling order.

13 This order pools the south half of Section 29,
14 dedicates this pooled unit to the Gaucho Unit Well Number
15 2, and it also permits Santa Fe to withhold from production
16 a 200-percent charge for the risk involved in drilling the
17 well.

18 Before the well was -- Before Santa Fe completed
19 drilling the well, the Gaucho Number 2, Santa Fe and
20 Landreth reached an agreement whereby Landreth would
21 participate in the well with one-quarter of his working
22 interest, or a total working interest of 9.375 percent, and
23 be subject to the compulsory pooling order as to the other
24 three-quarters of his interest, 28.125 percent.

25 Because Landreth elected not to participate in

1 the drilling of the Gaucho Unit well Number 2 with this 28-
2 percent working interest, his interest was nonconsent and
3 subject to the pooling order.

4 Santa Fe drilled the well, took the risk, and
5 plugged and abandoned the Gaucho Number 2 well.

6 Thereafter, it drilled another well, the Gaucho Unit Well
7 Number 2-Y, a successful Morrow well on this spacing unit.

8 We are here today because Santa Fe seeks to
9 charge against Landreth's interest in the Gaucho Unit Well
10 Number 2-Y the cost incurred in drilling and plugging the
11 unsuccessful Gaucho Well Number 2, the well in which
12 Landreth did not participate with a 28-percent working
13 interest.

14 If Santa Fe had not proceeded and drilled a
15 second well, there would be no question that Landreth would
16 pay none of the costs involved in the drilling of the
17 Gaucho Number 2.

18 Yet, because Santa Fe drilled another well on the
19 pooled unit, Santa Fe now seeks to impose a penalty and
20 charge Landreth for two wells.

21 We are here because Santa Fe's actions are not
22 supported by the agreements of the parties or the
23 provisions of the Division's compulsory pooling order.

24 The issues that Landreth will present are these:

25 As to the actual costs, the question is whether

1 or not under the Division's Order, can Santa Fe withhold
2 the costs it incurred in drilling and plugging the Gaucho
3 Unit Well Number 2, out of production from another well,
4 the Gaucho 2-Y?

5 In other words, the question is this: Can the
6 costs of the Gaucho 2 after it was abandoned be charged
7 against a working interest which was not committed to that
8 well?

9 As to the risk penalty, the question is whether
10 or not Santa Fe can collect a risk penalty out of
11 Landreth's share of production from the Gaucho Unit Well
12 2-Y for 200 percent of the costs incurred in the drilling
13 of the unsuccessful well, when the order at issue does not
14 authorize a risk penalty to be withheld out of production
15 from the Gaucho 2-Y.

16 There also is a third issue, which has recently
17 come up, and the question there is, does the Division order
18 impose a risk penalty on non-risk items?

19 Recent accounting data show that a risk penalty
20 perhaps was being imposed based on the cost of the gas
21 production unit, glycol dehydration unit and separators.
22 That has just recently come up. Mr. Kellahin and I have
23 discussed it. We will pursue that issue, and we will not
24 be arguing that today. We're hopeful we can resolve that
25 matter.

1 Santa Fe also earlier this year raised, in a
2 motion to dismiss that was denied by this Division, a
3 contention that the joint operating agreement constitutes a
4 voluntary agreement covering all of Mr. Landreth's interest
5 and that agreement therefore divests this Division of
6 jurisdiction over this matter.

7 I would like to first address that last point,
8 the point concerning the effect of the joint operating
9 agreement, because it really is a threshold question that
10 must be resolved before we get to the other issues
11 presented by this Application.

12 Landreth submits there is no voluntary agreement
13 between the parties which covers all of its interests. We
14 assert that you have jurisdiction to decide the issues
15 which are presented to you by our Application. We contend,
16 and we have always contended, that over 28 percent of our
17 working interest was not committed to the Gaucho 2 or 2-Y
18 wells that has remained subject to the Division's
19 compulsory pooling order.

20 Santa Fe, however, now contends that this joint
21 operating agreement covering the interest committed by
22 Landreth also is a voluntary agreement covering all of
23 Landreth's working interest in the unit.

24 We submit the suggestion is absurd. It is an
25 attempt to avoid review of the issues presented to you by

1 Landreth's objection to the well cost.

2 So the threshold issue for you is to determine
3 whether or not there is a contract and to determine whether
4 or not the Division has jurisdiction to decide this matter.

5 In a case decided by our Court of Appeals in
6 1995, one we all know, *Cibas vs. the New Mexico Energy*
7 *Minerals and Natural Resources Department*, the Court of
8 Appeals found that administrative agencies retain authority
9 at all times to examine and make findings concerning its
10 own jurisdiction. This subject, of course, to review by
11 the courts.

12 And in this case it is our position that you
13 clearly have authority to determine whether your order
14 applies to the costs assessed against Landreth by Santa Fe,
15 explicitly under this subject pooling order.

16 Furthermore, in making a determination as to the
17 effect of the agreements, it is important that you realize
18 that in deciding whether or not a writing is a full and
19 complete expression of parties' intent, it is important
20 that agreements and negotiations prior to or
21 contemporaneous with the adoption of the writing also be
22 considered.

23 Santa Fe contends Landreth has committed all of
24 its interests to the Gaucho wells, and they attempt to do
25 this by focusing you strictly on provisions in Exhibit "A"

1 to the joint operating agreement.

2 We submit that when you review the briefs, you
3 will find that this approach is incorrect under New Mexico
4 law.

5 And it's incorrect under general principles of
6 contract law for, very simply stated, a writing itself
7 cannot prove its own completeness.

8 In 1998, the case *Stock vs. Grantham*, our Court
9 of Appeals found that even with an unambiguous contract, an
10 agency looks to the documents surrounding the execution of
11 the contract to see if it says what the parties claim it
12 actually does, here to see if the JOA says what Santa Fe
13 contends.

14 So we have to look at the events that surround
15 the execution of the operating agreement, and in this
16 regard I would direct your attention to Document Number 9
17 in the exhibit book. Document Number 9 is a letter dated
18 March 28th. This is a letter written by Mr. Landreth,
19 which memorializes an agreement between the parties.

20 If you look at the first paragraph of this
21 exhibit, it reads as follows:

22

23 In line with your letter of March 24, 1997 and
24 our related conversations and agreement, please be
25 advised that I elect to participate in the drilling of

1 the captioned well, to the extent of 25% of my 37.5%
2 working interest...

3

4 -- and this is the important part --

5

6 ...with the balance to be subject to the Compulsory
7 Pooling Order in effect for this well.

8

9 This is the clearest statement in any of these
10 documents of the agreement between the parties as to how
11 they elected their property interests should be handled.

12 The order -- This letter goes on to note that Mr.
13 Landreth paid \$116-plus thousand dollars to participate in
14 the well, and then it goes on to discuss the need for an
15 operating agreement for the pooled interest. This is the
16 agreement between the parties that Mr. Landreth believes
17 remains in effect on this date.

18 If you go to Exhibit Number 10, this is a letter
19 from Santa Fe to Landreth dated March 31, 1997, and you
20 should be advised that the parties have different
21 interpretations as to the meaning of this letter.

22 This letter concerns the abandonment of the
23 Gaucho Number 2 and the drilling of the Gaucho Number 2-Y.
24 It gives Landreth the opportunity to elect to participate
25 in the new well with his 9.375-percent committed interest.

1 It treats -- Santa Fe treats with this letter, the Gaucho
2 2-Y as a new and a separate well and gives Landreth the
3 opportunity to once again elect whether or not to
4 participate in that well.

5 Santa Fe contends that because it says at the
6 bottom, "For your information, the current well ownership
7 is as follows", and then recites the ownership, that by
8 accepting this recitation, Landreth has, in fact, agreed
9 that all of his interests now will be subject to a joint
10 operating agreement, and that simply is not true.

11 And the reason it isn't true is the percentages
12 set out at the bottom of page 1 are correct. There was a
13 pooling order in effect. All but 9.375 percent of the
14 interest was -- of Mr. Landreth's interest, was subject to
15 pooling. And the 9.375 percent is the interest which he
16 had voluntarily committed to this well.

17 Furthermore, it is the only interest which he
18 had, which he had available to then commit to the drilling
19 of the Gaucho Number 2-Y.

20 The letter is correct, it does not supersede or
21 constitute a new agreement overriding the agreement of
22 March 28th.

23 I'd like you now to look at Exhibit 13. Exhibit
24 13 is a letter from Mr. Landreth dated April 15, 1997.

25 Prior to writing this letter, Mr. Landreth had

1 contacted Santa Fe about a joint operating agreement for
2 the interest he had committed to the well, and Santa Fe had
3 supplied a draft of an operating agreement to him. The
4 purpose of this letter is to clarify some of the provisions
5 in that joint operating agreement.

6 If you look at paragraph 2, the numbered
7 paragraph at the bottom of the page, Landreth is writing to
8 Santa Fe and says,

9
10 It is understood that with respect to Article
11 VI-A, for the purposes of my joinder, the Initial Well
12 shall be the Gaucho #2 or #2-Y...

13
14 This is significant, because he is noting here
15 that his joinder is -- that he is -- the operating
16 agreement is for the purpose of his joinder, joinder to
17 9.375 percent in two wells, the Gaucho 2 and then later in
18 the Gaucho 2 well [sic]. And he notes that for this
19 purpose the initial well -- and under this section you have
20 to have an initial well within a set period of time -- is
21 either the Gaucho 2 or the Gaucho 2-A [sic].

22 If we then go to the next exhibit, on April 21st
23 Santa Fe writes Mr. Landreth, and it accepts the
24 clarifications he proposes to the joint operating
25 agreement.

1 Then we get to Exhibit "A". Exhibit "A" is found
2 behind Tab 15.

3 I think it's important to note that the documents
4 we've just reviewed, the March 28 agreement, the March 31
5 option to again participate in another well, and the
6 letters April 15th, and the response from Santa Fe, are the
7 context within which this document was drafted.

8 Santa Fe says Exhibit "A" is the basis for a new
9 agreement between the parties. This is simply absurd.
10 Santa Fe's interpretation of this document conflicts with
11 the agreement dated March 28th, and the letter from Mr.
12 Landreth.

13 What this says is that Mr. Landreth's 28-percent
14 interest, if you accept Santa Fe's opinion, is not still
15 subject to the compulsory pooling order. Furthermore,
16 Santa Fe's interpretation is inconsistent with the
17 agreement of the parties concerning clarification of the
18 JOA.

19 On April 15th, Mr. Landreth advised Santa Fe that
20 the JOA would apply for purposes of his joinder. It
21 identified the initial well as the Gaucho 2 or the Gaucho
22 2-Y, and Santa Fe accepted these clarifications.

23 We submit that in an attempt to avoid review of
24 the real issues in this dispute, Santa Fe is very simply
25 reading too much into the language in Exhibit "A". It sets

1 out the interests of Mr. Landreth, it shows Landreth with
2 9.375 percent pre-payout interest, and his 37.5 working
3 interest after Santa Fe recoups the actual cost and risk
4 charges which were authorized for the Number 2 well by
5 Order 10,764.

6 When Exhibit "A" is reviewed in the context of
7 the negotiations of the parties and their agreements, this
8 cannot be construed as forming a new contract. At best, it
9 is ambiguous.

10 Although Santa Fe now finds that the parties have
11 an agreement to voluntarily develop this acreage covering
12 all of Landreth's interest, that simply is not what they
13 previously thought, it is not what their attorneys advised
14 them was their relationship with Mr. Landreth.

15 You see, Santa Fe changed its story. Only last
16 winter when it appeared that this Application was going to
17 hearing did Santa Fe change its argument, did it contrive
18 the issue of a voluntary agreement, the argument it now
19 advances.

20 Landreth has not changed his position, and his
21 actions are consistent throughout with that position, which
22 is, he has a 28-percent working interest, which is subject
23 to your pooling order.

24 On April the 24th, 1998, he wrote the Division
25 concerning the fact that he had not received an itemized

1 schedule of actual well costs. In that letter he states he
2 is a force-pooled party. That's Document 19.

3 And Santa Fe apparently agreed in Document 20,
4 for they sent the actual well costs to him on May 4th, and
5 their letter states that this is being done pursuant to the
6 provisions of NMOCD Compulsory Pooling Order Number 10,764.
7 They agreed there was an order pooling his interest.

8 All this aside, however, I believe the best
9 evidence of the position of Santa Fe can be found in
10 Document Number 25. Document 25 is the original Division
11 Order title opinion prepared for Santa Fe by its attorneys,
12 Turner and Davis. It's dated October 6th, 1997, five
13 months after the JOA was signed.

14 It notes that in preparing this, Santa Fe's files
15 were reviewed, and from the text of this opinion it is
16 clear they reviewed the joint operating agreement and the
17 agreements between the parties.

18 What did Santa Fe's own attorneys tell them?

19 On page 3, at the top, following an asterisk
20 right below Amerada Hess, they acknowledge the existence of
21 the Division's compulsory pooling order.

22 On page 7 of the agreement, they reference and
23 discuss the operating agreement, noting when it was
24 executed by Mr. Landreth.

25 And on page 8 of the agreement, they discuss the

1 compulsory pooling order which is at issue in this case.

2 If you go to the middle of that paragraph, four
3 or five lines down, there's a sentence that starts with the
4 word "pursuant". This is what Santa Fe's attorneys told
5 them about their relationship with Mr. Landreth. It says,

6

7 Pursuant to the terms of this order...

8

9 -- the compulsory pooling order --

10

11 ...Robert E. Landreth elected to participate in the
12 drilling of the subject well with respect to an
13 undivided 18.75% working interest in the SE/4 of
14 Section 29, or an undivided 9.375% working interest in
15 the proration unit for the subject well, and to be
16 force pooled as to an undivided 56.25% working
17 interest in the SE/4 of Section 29, or an undivided
18 28.125% working interest in the proration unit for the
19 subject well.

20

21 Santa Fe's attorneys recognized Landreth's
22 28.125-percent working interest and recognized it was
23 subject to the Division's compulsory pooling order. This
24 pooling order has not been replaced by a voluntary
25 agreement of the parties and the conduct of Santa Fe, and

1 the statements of its own legal counsel confirm that point.

2 Santa Fe, with this argument, has gone to great
3 lengths to avoid Division review of the subject compulsory
4 pooling order. And the reason, very simply, is that the
5 language in that order is clear, it means what it says.
6 And when the language in an order is clear, the Division
7 must enforce it as written.

8 So let's look at the order. And when we do, we
9 believe that you will find that this compulsory pooling
10 order does not authorize the imposition of a risk penalty
11 on the Gaucho Unit Well 2-Y or the withholding of costs
12 associated with the Gaucho Number 2 out of the proceeds
13 from the Gaucho 2-Y.

14 MR. CARROLL: Mr. Carr --

15 MR. CARR: Yes?

16 MR. CARROLL: -- I'm going to have to make a
17 phone call.

18 MR. CARR: Yes.

19 MR. CARROLL: This is definitely going to go over
20 2:30, and I've got to --

21 MR. CARR: All right.

22 MR. CARROLL: -- reschedule this next meeting.

23 (Off the record at 2:25 p.m.)

24 (The following proceedings had at 2:27 p.m.)

25 MR. CARROLL: I apologize. You may proceed.

1 MR. CARR: What we need to do now is look at the
2 compulsory pooling order, and we submit that this order
3 doesn't authorize the imposition of a risk penalty for
4 production from the Gaucho 2-Y, nor does it authorize
5 withholding costs associated with the Number 2 well out of
6 proceeds from the 2-Y.

7 The reason is, the language in the order is
8 clear, it means what it says. And our courts tell you that
9 when the language in an order is clear, you must enforce it
10 as written.

11 In 1998 our Court of Appeals in *High Ridge vs.*
12 *Hinkle Joint Venture* found that you must apply an order as
13 written and not insert words or depart from its commonsense
14 meaning.

15 They went on to say that when the language is
16 clear, you may not construe the order to include by
17 implication that which is not clearly within the express
18 terms of the order.

19 To impose a risk penalty on the 2-Y you would
20 have to include by implication language which simply is not
21 there.

22 And they also cite a case, *TBCH, Inc., vs. City*
23 *of Albuquerque*, in support of this position. That case
24 involved an ordinance that said exotic dancers had to have
25 an opaque covering. That was the language in the city

1 ordinance.

2 The city took an action because TBCH, Inc., used
3 make-up as an opaque covering, and the City of Albuquerque
4 lost because the Court found that you cannot add to the
5 regulation in a legal proceeding. If you want to change
6 what it says, you have to go back and amend the underlying
7 ordinance or order or rule.

8 So what does this Order say? And it's really
9 standard boilerplate language.

10 In Order paragraph 1, it simply orders that all
11 mineral interests, whatever they may be, from the surface
12 to the base of the Morrow formation, underlying the south
13 half of Section 29, Township 22 South, Range 34 East, NMPM,
14 Lea County, New Mexico, are hereby pooled, standard
15 provision.

16 Later in that paragraph it says, Said unit is to
17 be dedicated to Applicant's proposed Gaucho Unit Well
18 Number 2. And then in bold print, the Division provided
19 the API number, API Number 30-25-33682.

20 The Order then, in Paragraph 7, again, a standard
21 paragraph, provides that the operator is hereby authorized
22 to withhold the following costs and charges from
23 production. And Subpart B says, As a charge for the risk
24 involved in the drilling of the well, 200 percent of the
25 pro rata share of reasonable well costs. And it goes on.

1 This Order pools the south half of Section 29.
2 It dedicates this unit to the Number 2 well. It authorizes
3 a risk penalty to be held out of production from this well,
4 the Gaucho 2. It gives its -- it identifies the well by
5 that name and by number. It imposes a penalty on a single
6 well.

7 And the language in the order is clear. It
8 authorizes a risk penalty for one well, the Gaucho 2. It
9 could not be more specific. It even provides the API
10 number for the well. It says the Gaucho Number 2, it gives
11 the API number. And the Gaucho Unit Number 2-Y is not the
12 same well, and it bears a different API, number 30-25-
13 34026. These are two different wells.

14 Under New Mexico law, this Division must apply
15 its own Order as that Order is written. It may not
16 construe the Order to include by implication that which is
17 not clearly within its express terms, and its express terms
18 do not provide for a risk penalty from the 2-Y well.

19 Santa Fe may not now withhold costs from the well
20 in which Landreth elected not to participate from the
21 production of another well.

22 Landreth elected to participate with only part of
23 its working interest. He's a much smaller operator than
24 Santa Fe, and this is what he could do.

25 If Santa Fe is allowed to withhold out of

1 production from the Gaucho 2-Y costs and a 200-percent
2 penalty based on those costs, on the costs of the 2-Y, the
3 well in which Landreth did not participate and which Santa
4 Fe abandoned, then Landreth will pay 93.75 percent of the
5 cost of both wells out of his share of production from the
6 Gaucho 2-Y.

7 While paying 93.75 percent of the costs of both
8 wells, he would pay 131 percent of the cost of the Gaucho
9 2-Y, for by piling on wells to compute a risk factor under
10 this Order, Santa Fe would take from him \$2,417,000 for his
11 interest in this spacing unit. He would pay, in essence,
12 all the costs.

13 The facts here are unique since part of
14 Landreth's interest was committed and part was not.

15 Deciding this case will require an interpretation
16 of the underlying agreements of the parties and the
17 compulsory pooling Order at issue.

18 But on how these documents are evaluated, the law
19 is clear. And when the facts are applied to New Mexico
20 law, the specific facts of this case, including the
21 applicable agreements and orders, dictate the outcome of
22 this case in favor of Mr. Landreth.

23 MR. CARROLL: Mr. Kellahin?

24 MR. KELLAHIN: Thank you, Mr. Carroll.

25 We have submitted to you Santa Fe's brief on this

1 topic. Mr. Carr and I have utilized the same exhibits and
2 come to substantially different conclusions.

3 If I don't comment on some of the items in the
4 memorandum, it's not that we are abandoning those items.
5 My effort is to be precise and concise this afternoon and
6 direct your attention to an outline of how we have
7 approached the case.

8 The problem is this: Santa Fe commenced drilling
9 the Gaucho 2 well -- we call it the original well -- which
10 was lost when the drill string separated about 3700 feet.

11 They continued operations by skidding the rig 75
12 feet and drilling the Gaucho 2-Y. We call that in our
13 brief the substitute well. It was completed at a depth of
14 more than 13,000 feet in the Morrow formation as a very
15 successful Morrow gas well.

16 When an original well fails under these
17 circumstances, the substitute well is a continuation of the
18 operations commenced on the original well. The problem is
19 that Landreth accepts this fact as to 9.375 percent of his
20 working interest but argues to the contrary as to the
21 balance of that interest, 28.125.

22 Let's examine his purpose.

23 What was his purpose in splitting his interest
24 between the joint operating agreement and the compulsory
25 pooling order? Was it done so he could later argue the

1 costs of the substitute well could not be used to pay for
2 his share of the original well? The answer is no.

3 What he originally planned to have happen did
4 happen. What he now wants to avoid cannot be avoided. He
5 planned to have 28 percent of his interest subject to cost-
6 plus-200-percent nonconsent penalty for both the original
7 well and the substitute well, and with 28 percent of his
8 production from the substitute well being used to pay for
9 all those costs and penalties.

10 Whether the joint operating agreement replaced
11 the pooling or whether the compulsory pooling order applies
12 to both wells does not matter. Either way, Landreth loses,
13 because the substitute well is simply a continuation of the
14 operations commenced on the original well, and by his own
15 actions is equitably estopped from arguing to the contrary.

16 There's a section in our memorandum with regards
17 to the Landreth admissions. Succinctly, there are four
18 separate exhibits which show Landreth's admissions.

19 Despite these admissions, Landreth now contends
20 that the compulsory pooling order only covers the original
21 well, that the pooling order expired and that by skidding
22 the rig and redrilling the well, 28 percent of his interest
23 in the substitute well is not subject to the compulsory
24 pooling order or the joint operating agreement, and that
25 none of his share of the production from the substitute

1 well can be used to pay his share of the cost and the
2 penalty of the original well.

3 That's the problem. Here are the issues as I see
4 them.

5 First of all, does the Division have jurisdiction
6 to interpret the contract, the intent of the parties in
7 making this contract, or should that matter be resolved by
8 the Courts?

9 If the Division asserts jurisdiction, then the
10 Division must decide, did the joint operating agreement,
11 including the revised Exhibit "A", which is dated April
12 21st of 1997 -- It's Exhibit 15 -- did those replace the
13 compulsory pooling order as the affected Landreth interest?

14 If Santa Fe's JOA and this revised Exhibit "A"
15 did that, then the Division must grant Santa Fe's Motion to
16 Dismiss, because on April 30th, 1997, after the date of the
17 compulsory pooling order, and after subsequent letters of
18 March 31st, then Landreth signed and accepted the joint
19 operating agreement, including the revised Exhibit "A".
20 And in doing so, he agreed to the drilling of the
21 substitute well and agreed that he was participating as to
22 19 percent and going nonconsent on the remaining portion,
23 which is the 28 percent, on both wells,

24 If the Division decides the JOA replaced the
25 pooling order, then this case before the Division is over.

1 If not, then the Division must decide if the compulsory
2 pooling order applies to the original well and the
3 substitute well.

4 And finally, the Division will have to decide if
5 the compulsory pooling order will be consistent with oil
6 and gas case law concerning substitute wells.

7 The fundamental problem is the examination of
8 Exhibit "A". When we look at Exhibit "A", behind Exhibit
9 15, which is Exhibit "A" to the operating agreement, look
10 at it and see what you think it says. If this is not
11 intended to cover the 2 well, why does the caption include
12 both wells? It includes the Number 2 and the 2-Y. You see
13 it in the caption under the initial well.

14 The contract area is subdivided into two parts.
15 Part A is the north half, part B is the south half. And so
16 when you look at part B, you can see the calculation. It
17 says working interest after payout of 300 percent. After
18 that occurs, on both those wells, Mr. Landreth's interest
19 is restored to the full 37 1/2 percent.

20 Look what's happened to his column before the
21 payout, before the payout of the Gaucho 2 and the 2-Y well,
22 plus the 300 percent. It's 9.375. That's what he intended
23 to do, and that's what happens.

24 So if you believe the operating agreement and
25 what he did with his course of conduct with Santa Fe, you

1 can look at this exhibit, and the only conclusion you can
2 come to is that as to both wells, he wanted 28 percent of
3 it nonconsent.

4 You'd have to figure out how to rewrite this to
5 make it do what Mr. Landreth wants. But when you look at
6 what it says, it's doing what we contend. So if the
7 operating agreement applies, it takes care of the whole
8 interest that he has, all the pieces, and it substitutes
9 for the pooling order.

10 We have gone to great length to detail for you in
11 our memorandum the relevant facts as we see them. And as
12 you go through those -- and I'm not going to read those to
13 you; you can read them yourself -- critical things happened
14 in a very short period of time.

15 In September of 1996, the well is proposed.
16 Landreth's got 37-percent interest.

17 By February 14th, the Division has entered a
18 force pooling order granting a pooling application to Santa
19 Fe.

20 On the 17th, in accordance with that pooling
21 order, 17th of 1997 [sic], Landreth gets an AFE and notice
22 of his election to participate.

23 March 4th, they commenced drilling the Gaucho 2.

24 March 21st, Landreth acknowledged that he knew
25 the Gaucho 2 was being drilled and asked Santa Fe to extend

1 his election period. They agree to do that, they extend
2 his election period.

3 On March 24th, while at 3700 feet, they lose
4 circulation. The drill string separates.

5 On the 24th, they have extended his election to
6 March 28th.

7 By the 28th -- this is the part of the letter
8 that Mr. Carr has focused on, March 28th letter -- it talks
9 about his desire to split out his interest between the
10 pooling order and the joint operating agreement.

11 Now it becomes important for your decision about
12 the continuation of operation to see what's going on here.

13 On March 31st, Santa Fe formally advises Landreth
14 of its intention to abandon the Number 2, skid the rig and
15 redrill the 2-Y, and they say this redrill is proposed
16 under the existing JOA and AFE.

17 On April 1st, he returns a signed concurrence
18 about abandonment and the redrill. He asks for
19 modifications.

20 By April 8th, they forward the modifications to
21 him.

22 The original well is abandoned on the 31st.

23 They skid the rig and spud again on the 4th. And
24 the substitute well, then, is commenced in time to save Mr.
25 Landreth's lease. It would otherwise have expired on June

1 30th. They're certainly acting in his best interest and on
2 his behalf to protect this 37-1/2-percent interest. It's
3 one continuous operation as we move through the sequence of
4 the two wells.

5 On April 21st, Santa Fe wrote Landreth stating,
6 Your clarifications to your override and as to the Gaucho 2
7 and 2-Y well as being your initial well under the JOA are
8 acceptable. And they go through this, they describe it for
9 him.

10 And when you look at Exhibit 15, you see what's
11 happened. Santa Fe and Southwestern, before payout of the
12 penalty, their interests are bumped up to 45 percent,
13 because they're taking the risk and carrying the cost and
14 taking that burden. And after the payout, their interest
15 drops back down to 25 percent.

16 On April 30th, Landreth accepts the JOA,
17 including the final revised Exhibit "A".

18 On the 18th of June the well is completed. It's
19 a terrific well.

20 And then on the 18th of March of 1998, a year
21 later, the independent auditors are doing their work. And
22 it's not until April 24th of 1998, some 12 months after the
23 well was completed, and with the knowledge of this ongoing
24 audit, that Mr. Landreth now complains about the cost
25 associated with the Number 2 well.

1 When you look at Exhibit 24, 24 is all the
2 documents on the daily drilling reports. They show a
3 running chronology of costs. When you read through this,
4 you're going to see the smooth transition of operations
5 from the 2 to the 2-Y, the continuing accumulation of all
6 those costs. Mr. Landreth gets this report, and nothing
7 happens until a substantial period later.

8 Mr. Carr made reference to the title opinion.
9 The Turner title opinion, if you choose to rely on it to
10 decide this case, then you can read that opinion, Exhibit
11 25. You can conclude, then, if you agree with the opinion,
12 that the compulsory pooling order applies to the substitute
13 well. Despite Mr. Landreth's efforts now to distance
14 himself from the compulsory pooling order, that very title
15 opinion that Mr. Carr has cited to you is specific as to
16 the 2-Y well.

17 Look at the caption on the first page. They're
18 doing title work on the 2-Y well. That's the substitute
19 well. And when you read the Turner opinion and you look at
20 the title opinion on page 8, they have a section on
21 compulsory pooling proceedings. There's no doubt in the
22 author's mind of that title opinion that he has concluded,
23 despite Landreth's protestations to the contrary today,
24 that the compulsory pooling order, in effect, applies to
25 the substitute well.

1 So Turner has read the same order that Mr. Carr
2 has read and come to the conclusion that, no, Mr. Carr is
3 wrong, that this pooling order applies to the substitute
4 well.

5 And then it does what Mr. Carr didn't tell you.
6 The second thing it does is, it takes 28.125 percent of
7 Landreth's interest in the substitute well and it subjects
8 it to the 300-percent reimbursement to Santa Fe and
9 Southwestern.

10 You can take your time and read through it. I've
11 read it a dozen times. I get to no other conclusion than
12 what I've just described for you.

13 The other thing it doesn't address, however, is,
14 that opinion does not address whether the costs of the
15 original well can be paid with production out of the
16 substitute well.

17 If you're going to use the Turner opinion, then
18 you ought to use it all. If you're going to use it, then
19 you cannot selectively adopt part of the opinion and ignore
20 the part that Mr. Landreth doesn't bring to your attention.
21 You can't ignore the part that as to the 2-Y Turner
22 concludes that Santa Fe and southwestern get the 300-
23 percent reimbursement, and you can't escape the conclusion
24 that they think the pooling order applies to the substitute
25 well.

1 Now, I've come to a different conclusion. I
2 think the compulsory pooling order has been replaced by the
3 sequence of events surrounding the execution of the revised
4 Exhibit "A" to the joint operating agreement, and I have
5 detailed for you in the memorandum how I got there, and you
6 can read it for yourself and decide if you agree with me or
7 not.

8 The reason I said that it doesn't matter whether
9 you follow the line of reasoning through the joint
10 operating agreement or the compulsory pooling, you're going
11 to come to a point where you have to decide if the
12 substitute well is a continuation of operations commenced
13 on the first well. I really think that's the pivotal
14 question for you, Mr. Examiner.

15 If the Division decides that the joint operating
16 agreement didn't replace the pooling order, then we get to
17 the issue about continuation.

18 If you decide that it has replaced -- one or the
19 other, that one is replaced or not, you still get to this
20 continuation concept.

21 Recognize, however, that Landreth has already
22 conceded that the substitute well is covered by the
23 compulsory pooling order, and we cite to you examples of
24 where he's made those kind of admissions, but he now
25 contends that you can't take the production from the

1 substitute well and pay for the costs of the first well.
2 That's what he's saying.

3 Well, you can't if it's a continuation of
4 operation. We believe it's fair and reasonable.

5 And we've got a case that I think is right on
6 point. It's *Steinkuehler vs. Hawkins Oil Company*. It's an
7 Oklahoma Appeals case decided in 1986, and I'll give you a
8 copy here in a minute. It decided the continuation-of-
9 operation issue against Mr. Landreth's position.

10 The Court addressed this fact situation:

11 Hawkins was the operator, subject to a lease from
12 Steinkuehler. Steinkuehler's lease to Hawkins would have
13 expired on December 27th of 1982 if Hawkins didn't commence
14 drilling operations prior to the end of the primary term
15 and drill the well to completion. You've seen those kinds
16 of leases all the time.

17 All right. On the 21st of December, six days
18 before the lease expires, Hawkins spuds the well. It's
19 targeted for 6000 feet. But on January 2nd, he has to
20 abandon the well when he loses circulation at 4800. Drill
21 pipe got stuck, and he had to leave it.

22 He then skids the rig over 50 feet, and on
23 January 5th he drills the substitute well, which is
24 completed on February 3rd, for production at about 6000
25 feet.

1 Steinkuehler claims the lease had expired.

2 Hawkins claimed that by skidding the rig and commencing the
3 substitute well, it was a continuation of operations.

4 Hawkins lost before the District Court.

5 The Court of Appeals agreed with Hawkins, though,
6 and stated among other things that because the original
7 well never reached its intended bottomhole target, it was
8 neither a dry hole nor a completed well, and Hawkins was
9 simply continuing operations commenced on the original well
10 when he skidded the rig and drilled the substitute well.

11 Then the facts get interesting. The Court ruled
12 in favor of Hawkins, despite the fact that each well was
13 considered as a separate wellbore by both the regulators
14 and by Hawkins. Following the regulations, he filed APDs
15 for each of the wells. They had separate well files on
16 them like we do here. Hawkins called them different wells.
17 And despite the fact that subsequent to the abandonment of
18 the original well, Hawkins went to the Commission and
19 obtained a compulsory pooling order against Steinkuehler
20 for the substitute well.

21 Here's what influenced the Court. The Court was
22 influenced by these facts out of all of those:

23 That the original well was originally abandoned
24 solely because of technical difficulties, which made it
25 infeasible to continue at the same hole site, and they were

1 influenced because there was no commencement of drilling of
2 a second well in the classic sense, because drilling
3 operations on the second well were necessary to get to the
4 original target.

5 They said because the first wellbore did not get
6 to the target, that you could continue operations by
7 skidding the well and drilling the second well.

8 Those are Santa Fe's circumstances. I won't
9 repeat them to you. But there's a case that we think is on
10 point, that helps you decide what is fair and equitable in
11 this case.

12 In conclusion, Mr. Carroll, we think the
13 fundamental problem with Landreth's argument is that it
14 simply doesn't matter whether the compulsory pooling order
15 is in effect or not. He cannot escape the simple fact that
16 either, a), by signing the joint operating agreement and
17 approving its revised Exhibit "A", his entire 37-1/2-
18 percent interest is subject to that operating agreement.
19 And by doing so, then, he has conceded that the costs and
20 the penalties for both wells can be paid for by production
21 from the substitute well.

22 If you don't follow that, the only other thing
23 that could happen is that Santa Fe's drilling of the
24 substitute well was a continuation of operations commenced
25 on the original well. And by admitting that the compulsory

1 pooling order is still in effect for the substitute well,
2 he has conceded that the costs and penalty for both wells
3 can be paid for out of production from the substitute well.

4 Santa Fe should not be punished, Mr. Examiner,
5 for selecting a course of action that saved Mr. Landreth's
6 lease, resulting in a very successful wellbore and for
7 which Mr. Landreth assumed no risk for 28 percent of his
8 working interest. He got exactly what he bargained for.

9 Thank you.

10 MR. CARROLL: Okay, I have some questions.

11 MR. CARR: I could also respond on a couple of
12 points, if I could?

13 MR. CARROLL: Sure, Mr. Carr, go ahead.

14 MR. CARR: I think it's important to note that
15 while we appreciate Santa Fe trying to act to save Mr.
16 Landreth's lease, they already had an arrangement whereby,
17 drilling prior to the expiration of the lease, they derived
18 substantial benefits, and we believe this is another after-
19 the-fact way to posture the facts in this case.

20 Mr. Landreth isn't taking the position that the
21 acreage is not pooled; that's what the order says. All
22 interests, whatever they may be, under the south half are
23 pooled. And I think that's an important point to remember.

24 But we believe under New Mexico law you must read
25 and enforce the order as it is written. And it authorizes

1 a risk penalty for a specific well, the Gaucho Number 2.

2 And when you apply this New Mexico law to this
3 order, only one conclusion can be drawn, and that is, you
4 have authorized a risk penalty for one well. And if you
5 would like to do something different, or if Santa Fe would
6 have liked to have done something different, the order
7 needed to be amended, but it was not.

8 And now they're piling on wells and calculating a
9 risk penalty, taking it to far in excess of what it
10 reasonably should be.

11 Executing -- Mr. Kellahin says Mr. Landreth has
12 agreed that the 2-Y is continuous development, because he
13 signed and ratified the March 21 letter. That's a letter
14 that says, do you want to join in the 2-Y?

15 We view that as an admission by them that it was
16 not a continuous operation. If it was a continuous
17 operation, why did they come back to us and ask us again if
18 we would like to join, in their words, a new well? It
19 isn't an admission of continuous operations; it, in fact,
20 is exactly the opposite.

21 Mr. Kellahin talks about estoppel. He talks
22 about how we should be estopped because Exhibit "A" to the
23 joint operating agreement references the 2 and the 2-Y.

24 Again, you can't review Exhibit "A" in the
25 context of the four corners of that individual document;

1 you have to go back to the April 15th document from Mr.
2 Landreth. And you can see that they include the 2 and the
3 2-Y, because under Article VI-A of the operating agreement
4 you need to identify before a set date what the initial
5 well actually was. And Mr. Landreth said use one or the
6 other in his letter of April 15th.

7 You have to give a contextual reading to Exhibit
8 "A". And if you do not, you're simply being led into
9 error.

10 Look at the Turner title opinion. We agree that
11 your order pooled this land. No dispute on that.

12 But Mr. Kellahin admits that even that title
13 opinion is silent on using costs from the Number 2 to
14 calculate the penalty on the Number 2-Y, and that is the
15 issue in this case. And when you look at that issue in the
16 context of the clear language of the pooling order, Mr.
17 Landreth wins.

18 Mr. Kellahin has found a great case,
19 *Steinkuehler*, I think it is, *vs. Hawkins*. There's one
20 difference that distinguishes that case.

21 In the *Steinkuehler* case, there was no existing
22 pooling order with specific language defining how a risk
23 penalty could be calculated and against which it could be
24 applied.

25 You are a creature of statute. Your powers are

1 expressly defined and limited by the laws that empower you
2 to act. And when you go to those laws and when you apply
3 them of the facts of this case, you cannot impose the risk
4 penalty and assess the costs in the manner that Santa Fe is
5 doing.

6 MR. CARROLL: All right, I have some questions.
7 Some of these questions can be answered by both of you.

8 First, what were the costs of the original well,
9 the 2, Number 2?

10 MR. KELLAHIN: It will be shown on page 8 of our
11 memorandum, Mr. Carroll, subsequent to the audit.

12 MR. CARROLL: About \$700,000?

13 MR. KELLAHIN: In numbered paragraph (29), it's
14 just short of \$700,000. 2-Y is a little over \$1.6 million.

15 MR. CARROLL: Mr. Carr, does Mr. Landreth object
16 to the skidding over to drill the 2-Y? Did he not think
17 that was necessary?

18 MR. CARR: We approved that as to the interests
19 with which we were participating in the well by
20 executing --

21 MR. CARROLL: So there's no contention that Santa
22 Fe was an imprudent operator --

23 MR. CARR: We're not saying they're an imprudent
24 operator --

25 MR. CARROLL: -- in abandoning the wellbore and

1 skidding it over 75 feet?

2 MR. CARR: No, we do not. We're saying, though,
3 that the charges that are being applied Mr. Landreth are
4 improper and not authorized by the underlying order.

5 MR. CARROLL: So Mr. Landreth is contending that
6 the order does not apply to the 2-Y?

7 MR. CARR: We're saying that the order does not
8 authorize withholding a risk penalty out of production from
9 the 2-Y. It identifies a different well, it applies to a
10 different well.

11 If they had wanted to do that, the order had to
12 be amended. It is simply outside the clear language of the
13 order.

14 MR. CARROLL: So as to the 28 percent, then, Mr.
15 Landreth would get a free ride on the second well?

16 MR. CARR: He would pay his proportionate share
17 of the costs incurred in drilling the second well out of
18 that 28-percent working --

19 MR. CARROLL: Out of production.

20 MR. CARR: Out of production.

21 MR. CARROLL: So there's no risk?

22 MR. CARR: There would be no risk penalty,
23 because none was authorized.

24 MR. CARROLL: Mr. Kellahin, what's -- Under the
25 facts and circumstances of this case, what was the

1 practicality of getting an amended order to include the 2-Y
2 well? How practical was that? How possible was that?

3 MR. KELLAHIN: Well, when you look at the
4 sequence of the sundry notices -- I need to find where we
5 -- Yes, behind Exhibit Tab 4, if you'll turn to the second
6 document, there's a sundry notice dated 3-30-97. You can
7 see the sequence in here.

8 The report on the 30th of March that on -- The
9 well was spudded on the 4th of March, and by March 24th --
10 Yes, on March 24th, at 3783 feet, they've lost the drill
11 string.

12 They extended his election period.

13 And then on the 31st they have abandoned the
14 location and skidded the rig, and they commenced drilling
15 the Number 2 well on the 4th.

16 So there's -- Let's see, at the most, there is 10
17 days, 10 days between knowing the wellbore is being lost
18 and skidding the rig over and starting the new well, if I
19 calculated that right.

20 MR. CARROLL: Mr. Carr, is it your client's
21 position that the drilling operation should have been
22 suspended while Santa Fe came back in here to get an
23 amended order?

24 MR. CARR: No, but it's our position that they
25 should have sought an amended order if they intended to

1 start applying a risk penalty to more than one well

2 MR. CARROLL: And they could --

3 MR. CARR: -- and --

4 MR. CARROLL: -- after the fact?

5 MR. CARR: They absolutely could have, with
6 horizontal wells. We came back, and the -- when they were
7 first doing horizontal wells over and over again, because
8 what happened in the ground didn't match what was on paper.

9 We filed an application. There was almost
10 without exception never any testimony. It was a revised
11 advertisement, and the order was entered.

12 But the order says what the order says, and
13 that's the fact in this case.

14 MR. CARROLL: And that involved the same acreage
15 being pooled?

16 MR. CARR: Yes, it was the same acreage, it was
17 the same wellbore. But there was a difference in
18 circumstance when the well was being drilled. It didn't
19 match what had been previously approved.

20 And during the early days of horizontal hearings,
21 orders were specific, and they were amended almost
22 routinely because you couldn't drill like the order
23 provided.

24 So there is a procedure. You file the
25 application, you give notice, no objection, it's granted.

1 And in this circumstance, that's probably what
2 should have happened if, in fact, there was an intention to
3 tack wells -- to pile them on, to run up the risk penalty.

4 Mr. Landreth is being given tremendous credit for
5 having a divine scheme to somehow take Santa Fe. But the
6 truth of the matter is, he paid his share, he tried to deal
7 in good faith, and then he got a bill for the whole
8 project --

9 MR. KELLAHIN: May I respond --

10 MR. CARR: -- because wells were --

11 MR. KELLAHIN: May I respond, Mr. Carroll?

12 MR. CARROLL: Sure.

13 MR. KELLAHIN: It's form over substance, Mr.
14 Carroll. Come back in here and file the amendment, you're
15 back here on the same issue with regards to reasonable well
16 costs. We're at that issue. That's the merits and
17 substance of it.

18 Remember what his purpose was. His purpose was
19 to take 28 percent of it and go nonconsent on both wells,
20 and that's what he did.

21 However, you go through the paperwork, you find
22 that is his intent and purpose. And now he's to escape the
23 risk factor penalty on 28 percent of the substitute well?
24 If I heard Mr. Carr right, I believe that's what he's now
25 arguing.

1 MR. CARR: The truth of the matter is, Mr.
2 Landreth did intend to go nonconsent to the extent of 28
3 percent on both wells, but in doing that, he --

4 MR. CARROLL: But now --

5 MR. CARR: -- in doing that, when he did not
6 participate in the Number 2, and that well was plugged and
7 abandoned, I think he had every right to assume that that
8 wasn't going to then be rolled into a subsequent well,
9 because he did not participate, he did not take the risk on
10 the first well. And when that well was plugged and
11 abandoned, he shouldn't now be assessed out of another
12 well, the share of costs, the 28 percent of that first
13 well, plus that, times 200 percent.

14 He wanted to go nonconsent. Twice he elected to
15 participate, and the rest of it was nonconsent. And each
16 time I think it was reasonable to assume that you weren't
17 just going to let Santa Fe drill and drill and drill and
18 then tack every cost onto it when they ultimately get a
19 well that can produce.

20 MR. CARROLL: Mr. Carr, in your experience, what
21 does the "Y" designation mean on the 2-Y? How come this
22 well wasn't called the Number 3?

23 MR. CARR: I have no idea. I think it is a
24 replacement well, is the general -- I think. I'm not
25 positive on that.

1 MR. CARROLL: That's my understanding of what the
2 Division policy is if it's a replacement well, they put a
3 "Y" or an "X" after the --

4 MR. CARR: But it's a separate well. And there's
5 a separate API number. It is not the same well. And when
6 you pool --

7 MR. CARROLL: Well, not for API purposes, no.

8 MR. CARR: You also pooled for a well, the costs
9 of the well. It didn't say risk penalty shall be set based
10 on the costs incurred in drilling wells on this tract.
11 That would be like nonconsent on a development program
12 within a voluntary producing unit, and that's not what
13 we --

14 MR. CARROLL: Well, it's my understanding your
15 client intended to go nonconsent on the 2-Y well, but is
16 now contending that he wants to avoid the risk penalty that
17 is associated with the nonconsent?

18 MR. CARR: He wanted to go nonconsent -- He went
19 nonconsent on the 2-Y. That interest was under an order.
20 The order does not provide for a risk penalty on those
21 costs, it just does not.

22 MR. CARROLL: Mr. Kellahin, I've looked at this
23 Exhibit "A", the numbers you referred to, and it seems to
24 be consistent with going consent on nine-point-whatever
25 percent and nonconsent with the 28 percent. I'm going to

1 have to look at it further to --

2 MR. KELLAHIN: Well, I think we're saying the
3 same thing, Mr. Carroll, that as to both --

4 MR. CARROLL: Well --

5 MR. KELLAHIN: -- as to both wells, he's going
6 nonconsent on 28 percent, and he's --

7 MR. CARROLL: But it's consistent with that 28
8 percent being subject to the compulsory pooling order,
9 isn't it?

10 MR. KELLAHIN: Well, and that's the conclusion
11 that Turner got. The Turner title opinion says the pooling
12 order applies to the 2-Y, and Mr. Landreth's interest is
13 subject to cost plus 200 percent as to 28 percent of his
14 interest in the substitute well.

15 The one thing the Turner opinion unfortunately
16 doesn't address is taking production from the substitute
17 well and paying for the costs of the Number 1.

18 Now, I've read them differently, and my argument
19 is to the contrary, but I acknowledge the title opinion
20 says the pooling order is still in effect as to the 2-Y and
21 concludes more than Carr wants it to conclude. It gives
22 them the penalty.

23 MR. CARROLL: Mr. Carr, I'd like to look at these
24 numbers you gave me. You said if -- under Santa Fe's
25 reasoning and the way they want to file this, Mr. Landreth

1 would be paying 93.75 percent of both wells and 131 percent
2 of the 2-Y well?

3 MR. CARR: Correct, that's correct.

4 MR. CARROLL: Now, what would those figures be if
5 Mr. Landreth's arguments are accepted here and he avoids
6 the risk penalty on the 2-Y?

7 MR. CARR: I haven't calculated those, but I
8 could -- I will provide --

9 MR. CARROLL: Let's see, on the 2 he paid nine-
10 point-something percent of \$700,000 --

11 MR. CARR: Yeah, he would pay 37.5 percent on the
12 2-Y.

13 MR. CARROLL: And he would only pay 9.7
14 percent --

15 MR. CARROLL: -- 9.7 on the initial well,
16 correct, like he would if he had been nonconsent with a 28-
17 percent working interest in that well and it was drilled
18 stand-alone.

19 MR. CARROLL: Let's see. \$70,000 is about 10
20 percent of that.

21 And then on the 2-Y he'd actually only be paying
22 37 1/2 percent then, correct?

23 MR. CARR: Correct, that's correct.

24 MR. CARROLL: So that's about a third of -- So
25 the total of both is what? 2.344?

1 And according to Santa Fe, counting everything
2 but withholding from production, he would be paying \$2.4
3 million of the 2.344 total cost?

4 MR. CARR: Correct.

5 MR. CARROLL: And under your reasoning, he would
6 be paying approximately \$670,000 of the 2.344?

7 MR. CARR: Correct.

8 MR. CARROLL: Which is about 25 percent of the
9 well --

10 MR. CARR: And that's --

11 MR. CARROLL: -- even though he owns 37 1/2
12 percent?

13 MR. CARR: But that's because he was nonconsent
14 in a well that was not successful, plugged and abandoned.

15 MR. CARROLL: Right, right, I'm just looking at
16 the overall picture.

17 MR. CARR: Yeah, that's right, and your numbers,
18 subject to check by me, though, are correct.

19 MR. CARROLL: All right, I think that's all the
20 questions I have.

21 Interesting facts, interesting issues.

22 And I will endeavor to get an order out in the
23 next month or two. I would like to read the transcript
24 before -- Maybe I won't need it after reading the briefs
25 and the exhibit book.

1 I appreciate you showing up today, I appreciate
2 you showing up.

3 And with that, this hearing is adjourned.

4 MR. CARR: Thank you.

5 (Thereupon, these proceedings were concluded at
6 3:10 p.m.)

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19
20 I do hereby certify that the foregoing is
21 a complete record of the proceedings in
22 the Examiner hearing of Case No. 12008
23 heard by me on 6/14/99 12:00
24 *Rand Carr*
25 Off Conservation Division

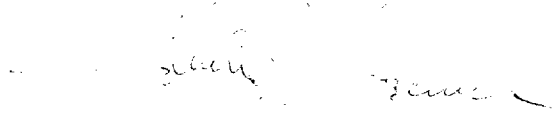
CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL June 16th, 1999.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002