

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

**IN THE MATTER OF THE APPLICATION
OF CHESAPEAKE OPERATING INC.
COMPANY FOR COMPULSORY POOLING
LEA COUNTY, NEW MEXICO**

CASE NO. 12186

**CHESAPEAKE OPERATING INC.'S
MOTION TO QUASH
SUBPOENAS ISSUED AT THE REQUEST OF
AMERISTATE OIL & GAS, INC.**

OIL CONSERVATION DIV.
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CHESAPEAKE OPERATING INC. ("Chesapeake") by its attorneys, Kellahin & Kellahin, hereby moves the Division to Quash a Subpoena Duces Tecum issued by the Division on May 18, 1999 at the request of William F. Carr, attorney for Ameristate Oil & Gas, Inc. ("Ameristate") in Case 12186 which commands Chesapeake to appear at 8:15 AM, Thursday, May 27, 1999 before the Division and to produce documents set forth in the Subpoena Duces Tecum.

As grounds for its Motion to Quash this subpoena, Chesapeake states the following:

THE ULTIMATE ISSUE

Chesapeake and Ameristate are actively competing with each other in the exploration for oil and gas in Lea County, New Mexico. Each has filed a compulsory pooling case where the only issue is whether Chesapeake or Ameristate will operate the well proposed by Chesapeake.

BACKGROUND

On March 22, 1999, Chesapeake sent to all working interests owners and unleased mineral owners a written well proposal, including an AFE, for its Boyce "15" Well No. 1, to be drilled in Unit H of Section 15, T16S, R35E, NMPM, Lea County, New Mexico.

On April 29, 1999, Chesapeake filed a compulsory pooling application against Ameristate and others seeking to pool the E/2, NE/4 and E/2NE/4 of this section for its Boyce "15" Well No. This case is set for hearing on May 27, 1999.

On May 18, 1999, Ameristate filed a competing compulsory pooling application against Chesapeake and others seeking to be declared operator of the well proposed by Chesapeake and pooling the same acreage for a well at the same location as proposed by Chesapeake. This case is set for hearing on June 10, 1999.

Ameristate filed its application without first making its proposal to the working interest owners and without making any effort to reach a voluntary agreement with Chesapeake.

On May 18, 1999, Ameristate sought to subpoena from Chesapeake the following:

- (1) Chesapeake's confidential and proprietary 3-D seismic data which Chesapeake as developed or had access to concerning its Boyce "15" Well No. 1 which was obtained by Chesapeake at considerable expense none of which is relevant to the risk factor penalty issue or any other issue before the Division in this compulsory pooling case.
- (2) any reservoir simulation data

- (3) any petroleum engineering data
- (4) any conventional geologic data
- (5) any seismic data
- (6) all hearing exhibits

ISSUES RELEVANT TO THESE COMPULSORY POOLING CASES

The relevant issues before the Division in these compulsory pooling cases are:

- (1) pre-hearing negotiations between Chesapeake and Ameristate
- (2) interest ownership in spacing unit
- (3) geologic data if Ameristate had proposed a well at a different location-not relevant here.
- (4) information concerning dates wells proposed.
- (5) overhead rates for supervision (discussed below)
- (6) proposed risk penalty (discussed below)
- (7) significant differences in AFE (discussed below)

EVIDENCE RELEVANT TO THESE ISSUES

The evidence relevant to these issues is:

- (1) Ameristate has in its own possession and control, communications with Chesapeake which demonstrate Chesapeake's willingness to negotiate a voluntary agreement

- (2) ownership records for Ameristate are within its own control or are matters of public record.
- (3) geologic data if Ameristate has proposed a well at a different location which is not an issue in this case because Ameristate seeks to operate the well proposed by Chesapeake.
- (4) information concerning dates each well was proposed are a matter of record already known to Ameristate.
- (5) overhead rates for supervision are not resolved by a search of Chesapeake's files but by Ameristate doing its own homework and using widely known information in the industry and available to Ameristate
- (6) proposed risk penalty (discussed below)
- (7) significant differences in AFE (none, only Chesapeake has proposed the costs of this well).

SUBPOENAS SEEK PRODUCTION OF IRRELEVANT DOCUMENTS

Having failed to reach a voluntary agreement for its proposed Boyce "15" Well No. 1, Chesapeake has filed a request with the Division for a compulsory pooling order against Ameristate and others. A compulsory pooling case is not an excuse for Ameristate to have access to Chesapeake's proprietary and confidential geophysical, geologic and engineering data. The production of Chesapeake's data is irrelevant to the issues in the pooling cases:

- (a) Chesapeake seeks a pooling order providing options to participate or to be a carried interest subject to a non-consent penalty.
- (b) The Division is authorized to approve a maximum 200% risk factor penalty in pooling cases. Chesapeake seeks the adoption of the maximum penalty.
- (c) publicly available geologic data conclusively demonstrates at this time that this well justifies the maximum penalty.
- (d) Ameristate's own records will reflect that in 1998 it drilled its Carlisle "15" Well No.1 at a location in the NW/4SE/4 of this same section which was plugged as a dry hole.
- (e) Chesapeake does not dispute and Ameristate cannot dispute the undisputed fact that because of the proximity to Ameristate's dry hole, the maximum penalty factor is justified.
- (f) the subpoena seeks to obtain Chesapeake's confidential, proprietary geologic and engineering data none of which is relevant to the risk factor penalty issue.

**AMERISTATE SEEKS CHESAPEAKE'S SEISMIC DATA
WHICH IS CONFIDENTIAL IN NATURE
AND DESERVES TO BE PROTECTED
AS A TRADE SECRET**

Chesapeake has seismic data which is the confidential business information and the trade secrets of Chesapeake. Although the Division is not required to strictly adhere to the New Mexico Rules of Evidence,¹ Rule 11-508 of the New Mexico Rules of Evidence provides:

¹ OCD Rule 1212 provides in part: "In general, the rules of evidence applicable in a trial before a court without a jury shall be applicable, **provided that such rules may be relaxed, where, by so doing, the ends of justice will be better served.**" (emphasis added).

"a person has a privilege, which may be claimed by him or his agent or employee, to refuse to disclose and to prevent other persons from disclosing a trade secret owned by him if the allowance of the privilege will not tend to conceal fraud or otherwise work injustice..."

The basic purpose of this privilege is to foster technological advances and innovations. Although there is no definition of "trade secret" contained within the rule, an often cited definition from the **Restatement of Torts**, Section 575 Comment b (1939) is informative:

"A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which give him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other devise, or a list of customers..."

In addition, it is instructive to note that Congress in drafting the Freedom of Information Act ("FOIA"),² which requires that every agency of the United States make available to the public certain information, found justification for withholding certain types of information from the public, including two specific types: (1) trade secrets and other confidential information, and (2) confidential geological and geophysical information.

One of the major incentives for gas exploration is the opportunity to obtain exclusive knowledge concerning potential gas or oil reserves. Without the additional incentive of having this seismic data remain confidential, Chesapeake's exploration would

² **5 American Law of Mining** Section 186.01 (Matthew Bender 1994).

be compromised. Such information meets the definition of a trade secret defined above because it is information which Chesapeake is using in its exploration business, and which gives it an opportunity to obtain an advantage over competitors who do not have this seismic data.

DISCLOSURE OF TRADE SECRETS PERMITTED IN LIMITED INSTANCES

Although the trade secret privilege is not absolute, the courts have recognized a qualified evidentiary privilege for trade secrets and other confidential commercial information. **Covey Oil Co. v. Continental Oil Co.**, 340 F.2d 993 (10th Cir 1965).

When deciding the issue of whether to require disclosure of a trade secret and if so under what circumstances, the Division is faced with the following issues:³

(1) What is the need for disclosure?

Will disclosure of this type of information significantly aid the Division in fulfilling its functions? In this case, Ameristate pretends to "need" Chesapeake's data so Ameristate can contest whether Chesapeake or Ameristate operates this well. However, that "need" is not relevant to any issue to be decided by the Division. The seismic data is not needed by the Division in order to decide the risk factor penalty, because the presence or absence of the seismic data does not change the risk. The seismic data is not

³ **Pennzoil Co. v. Federal Power Commission**, 534 F.2d 627 (5th Cir. 1976).

needed by either Ameristate or the Division in order to decide who operates this well. There is no dispute over the well location--it is a standard well location which both Chesapeake and Ameristate want.

While there is no doubt Ameristate and Chesapeake's other competitors will find this seismic data very valuable, the question remains whether any of this data serves any purposes in this pooling case. The answer is no. Even if seismic data influenced the selection of the location for the Boyce "15" Well No. 1, Ameristate's own compulsory pooling application seeks a well at the same location as Chesapeake's Boyce "15" Well No 1. In addition, Ameristate wants the same spacing units as proposed by Chesapeake. So where is the disputed issue that makes it necessary for Ameristate to have Chesapeake's proprietary data?

(2) What is the danger to the owner of the trade secret in requiring disclosure?

Because Chesapeake and Ameristate own other mineral interests in the immediate vicinity, the disclosure of Chesapeake's confidential data will in fact give Ameristate either (a) a competitive advantage in other tracts in which they own interests and/or (b) establish a commercial value for purposes of selling or trading their interest to others.

In this case, the seismic data is not relevant to the Division's decision in a compulsory pooling case and can serve only to harm the business interests of Chesapeake. Ameristate has considerable interests in this area, including other potential spacing units in this immediate vicinity. It is without doubt that Ameristate is a competitor of

Chesapeake. The disclosure of the seismic data to Ameristate would allow it to obtain an unfair advantage to the detriment of Chesapeake. This information was developed at great cost and is of a type not normally released to the public or to uncommitted investors and would cause substantial competitive harm if released. In **Pennzoil Company v. Federal Power Commission**, 534 F.2d 627 (5th Cir. 1976) the United States Court of Appeals held that the Federal Power Commission had abused its discretion when it required disclosure of trade secrets including confidential geophysical information. The Court remanded the case because the Commission failed to demonstrate that disclosure of this information would serve a legitimate regulatory function.

The disclosure of Chesapeake's seismic data in these cases does not serve any legitimate compulsory pooling function of the Division. See **70-2-17(C) NMSA (1979)**. In **Amerada Hess Corp.**, 50 FPC 1048 (1970), the Federal Power Commission held that:

"The general disclosure of proprietary reserve data would have an inhibiting effect on future exploration of natural gas reserves so speculators could equally benefit with those producers when they make geological and geophysical expenditures"

(3) Are there alternative means of obtaining the same or similar information without requiring disclosure?

To require disclosure of seismic data in this case would be a substantial departure from prior decisions by the Division. Even in cases where seismic data is relevant to an issue, the Division has respected requests for the confidentiality of seismic data and has

allowed applicants and opponents to rely upon conclusions based upon 3-D seismic study/data without disclosing any of the data.⁴

If Ameristate believes it needs such information, then it can go out and purchase its own seismic study. There is no reason for them to receive it free of costs from Chesapeake.

(4) How adequate are the protective measures available to the Division?

The second sentence of Rule 11-508 requires the Court (the Division) to take "such protective measures as the interests of the holder of the privilege and of the partes and the furtherance of justice may require".

In this case, it will not be possible for the Division to take adequate measures to protect Chesapeake's trade secret from disclosure. No type of confidentiality agreement will protect Chesapeake in this case. The very act of turning over any part of this data to Ameristate will allow it to use the information to assess the potential of its other properties.

⁴ For Example, See OCD Case 11724 (Gillespie-Crow)

**AMERISTATE SEEKS DOCUMENTS
AVAILABLE IN PUBLIC RECORDS**

Ameristate wants geologic and petroleum engineering data which is currently available to it in the public record, including but not limited to Division case files and records.

Ameristate is asking Chesapeake to prepare Ameristate's case and to do Ameristate's research. All relevant data is already available to Ameristate either in public records or in Ameristate's possession. Chesapeake has no obligation or duty to do homework for Ameristate.

**AMERISTATE SEEKS CHESAPEAKE'S
CONFIDENTIAL BUSINESS RECORDS**

Ameristate seeks production of Chesapeake's internal economic/engineering documents concerning estimates of costs analysis which are not relevant.

Chesapeake has no obligation to make or provide documents to assist Ameristate in deciding if it desire to participate in this well or to be involuntarily pooled.

They seek documents to help it make that decision or to market its interest neither of which is relevant to any decision the Division must make in this case.

AUTHORITY FOR EXPENDITURE

"AFEs"

The Division's compulsory pooling orders provide a procedure for determination of the reasonableness of the actual costs of the well.

If Ameristate is concerned about its share of actual costs, then it has prematurely raised this issue. The Division's pooling orders provide an opportunity "after the well is drilled and completed" for any pooled party to request a reasonable well cost determination hearing. That determination is not made from searching Chesapeake's files but rather by Ameristate going out into the industry, obtaining its own estimates, quotes and preparing its own estimates of reasonable well costs.

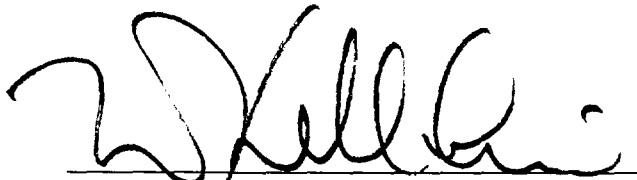
CONCLUSION

This is a plain vanilla compulsory pooling case in which Ameristate is seeking to unnecessarily obtain confidential seismic data so that it can give itself a competitive advantage in other tracts in which it own interests and establish a commercial value for it. Ameristate has already conceded that (a) Chesapeake has made the only well proposal; (b) Chesapeake's location is acceptable to Ameristate; (c) Chesapeake's proposed spacing units are acceptable to Ameristate; and that (d) Ameristate wants to participate in Chesapeake's well. The only thing Ameristate wants is to be declared the operator of this well.

Chesapeake has no obligation to provide confidential seismic data to assist Ameristate in deciding if it desires to operate this well. It seeks documents to help it make that decision or to market its interest neither of which is relevant to any decision the Division must make in these cases.

Regardless of Ameristate's motives, the discovery of Chesapeake's trade secrets is not relevant to any issue in these pooling cases and would be an abuse of the Division's powers.

Respectfully submitted,



W. Thomas Kellahin
Kellahin & Kellahin
P. O. Box 2265
Santa Fe, New Mexico 87504

CERTIFICATE OF SERVICE

I certify that a true and correct copy of the foregoing pleading was hand delivered to opposing counsel this 26th day of May, 1999 as follows:

William F. Carr, Esq.
Campbell Carr Berge & Sheridan
110 N. Guadalupe Street
Santa Fe, New Mexico 87501



W. Thomas Kellahin