

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

IN THE MATTER OF THE HEARING CALLED BY	)	
THE OIL CONSERVATION DIVISION FOR THE	)	
PURPOSE OF CONSIDERING:	)	
	)	
APPLICATION OF ENERQUEST RESOURCES, LLC,	)	CASE NOS. 12,845
FOR STATUTORY UNITIZATION, LEA COUNTY,	)	
NEW MEXICO	)	
	)	
APPLICATION OF ENERQUEST RESOURCES, LLC,	)	and 12,846
FOR APPROVAL OF A WATERFLOOD PROJECT	)	
AND QUALIFICATION OF THE PROJECT AREA	)	
FOR THE RECOVERED OIL TAX RATE PURSUANT	)	
TO THE ENHANCED OIL RECOVERY ACT, LEA	)	
COUNTY, NEW MEXICO	)	
	)	(Consolidated)

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

ORIGINAL

BEFORE: DAVID R. CATANACH, Hearing Examiner

May 16th, 2002

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, May 16th, 2002, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

\* \* \*

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I N D E X

May 16th, 2002  
Examiner Hearing  
CASE NOS. 12,845 and 12,846 (Consolidated)

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Lynx	Identified	Admitted
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\* \* \*

## A P P E A R A N C E S

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FOR VINCERO OIL AND GAS, INC.; DREKA, INC.; VANCE PAYNE;  
ROBERT S. CRAINE; MURRAY E. HELMERS; THE FISCHER FAMILY  
PARTNERSHIP; CASCADE ENERGY CORPORATION; J.H. ROSSBACH,  
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(Continued...)

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## A P P E A R A N C E S (Continued)

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\* \* \*

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1           WHEREUPON, the following proceedings were had at  
2   9:06 a.m.:

3  
4           EXAMINER CATANACH: All right, at this time we're  
5 going to hear arguments on a motion that concerns Cases No.  
6 12,845, which is the Application of EnerQuest Resources,  
7 LLC, for statutory unitization, Lea County, New Mexico, and  
8 Case Number 12,846, which is the Application of EnerQuest  
9 Resources, LLC, for approval of a waterflood project and  
10 qualification of the project area for the recovered oil tax  
11 rate pursuant to the Enhanced Oil Recovery Act, Lea County,  
12 New Mexico.

13           Certain motions have been filed in these two  
14 cases, and we are going to at this time hear oral arguments  
15 on these motions.

16           I would allow Mr. Kellahin to proceed.

17           MR. KELLAHIN: Would you like to call for  
18 appearances, Mr. Examiner?

19           EXAMINER CATANACH: I will do that. Call for  
20 appearances in these motions.

21           MR. CARR: May it please the Examiner, my name is  
22 William F. Carr with the Santa Fe office of Holland and  
23 Hart, L.L.P. We represent EnerQuest Resources, LLC.

24           MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of  
25 Santa Fe, New Mexico, appearing on behalf of certain

1 working interest owners within the proposed waterflood  
2 unit. We have collectively referred to them in the  
3 pleadings as the Key family group.

4 If I may approach the court reporter, I will  
5 simply give him a list of the six individuals and entities  
6 that compose that collective group of parties.

7 EXAMINER CATANACH: Thank you, Mr. Kellahin.

8 MR. BRUCE: Mr. Examiner, I'll just read off the  
9 people I am representing in this matter.

10 I'm representing Vincero, which is V-i-n-c-e-r-o,  
11 Oil and Gas, Incorporated; Dreka, D-r-e-k-a, Incorporated;  
12 Vance Payne, P-a-y-n-e is how his name is spelled; Robert  
13 S. Craine, his last name is spelled C-r-a-i-n-e; Murray E.  
14 Helmers, H-e-l-m-e-r-s; the Fischer Family Partnership;  
15 Cascade Energy Corporation; J.H. Rossbach, Jr., R-o-s-s-b-  
16 a-c-h; and Lynx Operating Company, Incorporated, and they  
17 are working interests, royalty interests and overriding  
18 royalty interest owners in the proposed unit.

19 EXAMINER CATANACH: Okay, Mr. Kellahin, your  
20 clients are also working interests or royalty interest  
21 owners in this unit?

22 MR. KELLAHIN: Yes, sir.

23 EXAMINER CATANACH: Okay. Any other appearances  
24 in these cases?

25 Okay, Mr. Kellahin?

1 MR. KELLAHIN: Thank you, Mr. Examiner.

2 We're before you this morning to ask you to make  
3 certain decisions, one of which is, if you elect to go  
4 forward with hearing this matter at this time, Mr. Bruce  
5 and I collectively believe that this is at least a two-day  
6 technical hearing, and we would request that -- with the  
7 agreement of counsel, that a two-day special hearing docket  
8 be established for processing this case.

9 In addition, Mr. Carr and I are trying to resolve  
10 a difference of opinion about data that I have subpoenaed  
11 on behalf of my clients from EnerQuest. There has been an  
12 attempt by Mr. Carr to provide some of that information.  
13 We still need to try to resolve our differences about the  
14 balance of that information, so if we are unsuccessful at  
15 some point in time, we're going to have to approach you  
16 about the subpoena.

17 We're here this morning to supplement arguments  
18 on filings of certain motions. The motion to dismiss I  
19 filed on behalf of the Key family group was April 12th.

20 Mr. Carr filed a response to that motion to  
21 dismiss, and thereafter, on April 22nd, I filed a reply to  
22 his reply. And if you can find the April 22nd pleading I  
23 provided to you, there are some colored attachments that  
24 will give you an opportunity to visualize what I want to  
25 propose or present to you this morning.

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1           Thereafter, Mr. Bruce on behalf of his client  
2 group filed a motion to dismiss the Application, and Mr.  
3 Carr has filed a response on behalf of his client to that.  
4 So there's some five pleadings to address, and I'll let  
5 them talk about their pleadings.

6           If you'll turn to the pleading I filed on April  
7 22nd, you'll find some colored displays. If you turn to  
8 Exhibit A, the dark outline represents what EnerQuest is  
9 asking you to statutorily unitize. The heart of that  
10 current production is focused principally in the southwest  
11 quarter of Section 35. That is the remaining heart of that  
12 production. We're talking about San Andres oil production.

13           This exhibit is contained within a feasibility  
14 study that was prepared for EnerQuest by a petroleum  
15 engineer, and that EnerQuest technical report was prepared  
16 by Mr. Chris Benzer in November of the year 2000.

17           After he shows you the area to be unitized, he  
18 then displays two waterflood concepts. If you turn to the  
19 next display, you'll see what he has characterized as a 17-  
20 well injection program for the recovery of some 3.5 million  
21 barrels of oil. He proposes as an alternative to a full  
22 pool waterflood what he characterized at that time as a  
23 Phase 1 waterflood project. That is reduced to nine wells.  
24 And if you'll look at Exhibit C, you can visualize how he  
25 has contracted the waterflood.

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1           Some four days before filing the statutory  
2 unitization application -- that was filed on February 22nd.  
3 On February 24, EnerQuest submitted to my client an AFE  
4 which is shown on Exhibit E and F. E is the cover letter,  
5 and F is the cost. And if you'll see the caption of the  
6 AFE on F, you'll see that they have proposed to reduce  
7 Phase 1 to now four injection wells.

8           Those four injection wells are shown on Exhibit  
9 D. I've taken the nine-well plat of injection wells, and  
10 I've circled the four injection wells they now plan to go  
11 forward with. They advised us four days, at least by  
12 correspondence, four days to filing their application that  
13 it was now a four-well injection project. The injection  
14 wells are at the heart of the existing production. The  
15 feasibility study shows that the heart of that production  
16 is as we have shown.

17           The difficulty with what Enerquest has done is,  
18 they have prematurely started the statutory unitization  
19 process without giving us an opportunity to talk with them  
20 about why now this project has been reduced from 17  
21 injection wells to only four. We want an opportunity to  
22 examine the size and the shape of the unit.

23           If you look at the maps, you'll see that the  
24 heart of the unit production that's now controlled by my  
25 clients is surrounded within the unit area by

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1 nonproductive, depleted production. They want to add that  
2 it.

3 The motion to dismiss ought to be granted, and  
4 EnerQuest ought to be ordered to engage in what is expected  
5 under the statute. When you look at the statutory  
6 requirements for statutory unitization, you'll see a whole  
7 checklist of things that you as an Examiner have to  
8 resolve.

9 If you'll take a quick moment and look at the  
10 docket sheet for the case, there's the list. There's 20  
11 things that you have to decide as an engineer with regards  
12 to how this comes together. And the purpose in the statute  
13 to require a good-faith effort before filing is to minimize  
14 and eliminate as many of those as possible.

15 If you dismiss the case, then it requires  
16 EnerQuest to commence a process by which we can ask them  
17 about the size and the shape of this unit, they can explain  
18 to us for the first time why it's been reduced to only four  
19 wells.

20 And what is the opportunity for that recovery?  
21 Are we intended to share our remaining oil reserves with  
22 parties that should not be entitled to share in that  
23 production? We have to talk about participation  
24 parameters.

25 We are about to engage in this case where you

1 were in the West Lovington-Strawn cases. You remember  
2 that, you were the Examiner. We were all there. We did  
3 West Lovington-Strawn statutory unitization cases until it  
4 made Mr. Bruce rich and sent his kids to school, but some  
5 of us frankly got tired of it.

6 And you saw what happened to that, without -- and  
7 that was a case in which Gillespie had spent lots of time,  
8 money, effort and repeated working interest owner meetings,  
9 technical meetings, trying to minimize the areas of  
10 dispute. And by the time we came to hearing, at least we  
11 could focus on those issues that were important.

12 And that's why it's important to dismiss this  
13 case. The fact that it's been continued several times has  
14 not solved anything. We still do not know what their plan  
15 is, what they think they're now going to do with four  
16 injection wells, what the zone of injection is going to be  
17 and what our share of recovery ought to be and how they  
18 intend to do all these things. And that's the reason it's  
19 important.

20 Thank you.

21 EXAMINER CATANACH: Thank you, Mr. Kellahin.

22 Mr. Bruce?

23 MR. BRUCE: Mr. Examiner, what I've handed you is  
24 simply an affidavit of one of my clients which contains  
25 copies of the correspondence which has been mailed

1 regarding these matters, and I will get to that in a  
2 minute.

3 My clients too have filed a motion to dismiss,  
4 because there simply have not been good-faith negotiations  
5 regarding this unit.

6 Before I get to that, let me raise one issue. In  
7 Mr. Carr's response, or in EnerQuest's response to my  
8 motion, he sets out certain relevant facts. Item 2,  
9 basically at the top of the lost is, he claims that they  
10 have to move forward because Lynx Operating Company, my  
11 client, is operating a lease that's draining their acreage.

12 Now, if you'll look at Mr. Kellahin's motion  
13 again, the Exhibit A, if you'll see the Lynx, that's the  
14 Lanie Reese lease, there are three wells in the San Andres  
15 on that lease. That 40-acre lease with three wells on it  
16 is producing at the top allowable of 160 barrels a day.  
17 That allowable was increased from 80 barrels per day three  
18 years ago at the request of EnerQuest. We are simply  
19 producing at top allowable.

20 But the reason I mention the top allowable is --  
21 there are two reasons.

22 First, if EnerQuest feels it's being drained --  
23 and by the way, EnerQuest owns an interest in the Lynx-  
24 operated tract, and I should say there's no evidence of  
25 drainage -- then it can drill additional wells on its lease

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1 to increase its production to top allowable. Nothing is  
2 preventing it from doing that.

3 But more importantly, the Lynx lease is still in  
4 primary production, and it will be in primary production  
5 for quite some time. There is additional capacity on that  
6 lease. If that lease is still in primary production, why  
7 should it be unitized? The only thing that can happen is  
8 bad, because you're going to be flooding out productive  
9 zones.

10 Now, if you'll refer to the affidavit of Mr.  
11 Craine -- and in my motion I had attached these same  
12 letters, I believe. If you'll look at it, you have two  
13 letters from EnerQuest to the interest owners, a January  
14 23rd letter to the working interest owners and a February  
15 7th letter to the royalty owners. It says, Here are the  
16 unit documents, sign them, we're going to hearing. That's  
17 not negotiation, that's saying sign it or we're going to  
18 try to force you in.

19 Now, what's significant is that the clients that  
20 Mr. Kellahin and I represent are interest owners in the  
21 Lanie Reese lease and then the offsetting Lanie and Lanie  
22 "A" leases. Those are the two best leases in the proposed  
23 unit. And I don't have an exact percentage figure, but our  
24 combined interests are pretty substantial in this case.

25 You know, Mr. Kellahin mentioned one of my cases.

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1 I'll mention another one in which Mr. Kellahin and I were  
2 opposed, the Exxon Avalon-Delaware Unit. Now, we couldn't  
3 agree on that, but at least there had been two to three  
4 years of negotiations among a highly contentious group of  
5 working interest owners before we went to hearing.

6 Another case you're familiar with, the St. Mary's  
7 Land and Exploration pooling case. Now in that case, the  
8 Division looked askance at my client. St. Mary had a unit  
9 where 95-plus percent of the working interest owners and  
10 the royalty interest owners had voluntarily ratified the  
11 unit. One working interest owner with about three percent  
12 objected. One of his primary claims was, they'd only met  
13 with him once or twice. But at least they had met with  
14 him. That person was represented by Mr. Carr. They had  
15 met personally with him and gone over, and even adjusted  
16 their unitization parameters to try to meet his demands.

17 Here, EnerQuest has failed to meet even once with  
18 my clients or Mr. Kellahin's clients voluntarily to discuss  
19 this unitization. There was a meeting held in early March  
20 of this year, after the Applications had been filed, and  
21 that meeting was held with Lynx at the request of Lynx.  
22 EnerQuest didn't do anything.

23 The technical report wasn't even provided to Mr.  
24 Kellahin's clients or mine until after the application was  
25 filed. How can you make a judgment as to whether or not to

1 voluntarily join a unit until after the Application is  
2 filed?

3 Now as I said, our clients, the objectors, have a  
4 substantial interest. We don't think unitization should go  
5 forward because it's still in primary production in the  
6 heart of the unit.

7 But assuming this pool is unitized, the area to  
8 be unitized should probably be about a third of the size  
9 proposed by EnerQuest. In that case, the interests of Mr.  
10 Kellahin's and my clients increase substantially. In that  
11 case, there should be significant negotiations among the  
12 interest owners, not two letters and then the filing of  
13 applications.

14 Mr. Examiner, what we ask is, if this pool is to  
15 be unitized, let's do it right. Dismiss this case, both  
16 cases, tell EnerQuest to actually negotiate with the people  
17 involved in this unit, especially since they represent such  
18 significant interest in the unit.

19 Thank you.

20 EXAMINER CATANACH: Thank you, Mr. Bruce.

21 Mr. Carr?

22 MR. CARR: May it please the Examiner, EnerQuest  
23 Resources is here today to respond to the two motions that  
24 were filed, one by Mr. Kellahin for his group of clients  
25 that he refers to as the Key family, and the other by Mr.

1 Bruce's clients that I will refer to collectively as Lynx.

2 In their arguments they have drifted into  
3 arguments related to the merits of the underlying case, but  
4 we're here to address two motions, and both of the motions  
5 assert that in bringing this Application EnerQuest acted  
6 prematurely, and they both contend that EnerQuest did not  
7 make a good-faith effort to reach voluntary agreement for  
8 unitization.

9 A full review of the facts in this case shows  
10 that the contrary is true and that EnerQuest has made the  
11 good-faith standard.

12 What constitutes good faith is not a set of  
13 requirements that are enunciated by the parties. Good  
14 faith depends on a review of the character and the nature  
15 of the interests of the parties and the facts of the  
16 particular case. And while I believe counsel for both Lynx  
17 and the Key family agree that you must look at the facts of  
18 the individual case, in this pleadings of this case they  
19 have announced certain specific requirements which they  
20 contend must be met if you are to, in good faith, try to  
21 form a statutory unit.

22 The standards they announce are not found in  
23 statute, they're not found in rules. They say they're the  
24 result of custom and practice before this agency.

25 And in support of this, in Mr. Kellahin's reply

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1 he cites five fairly recent statutory unitization cases.  
2 He says, This is custom and practice, this is what parties  
3 should do before they come before you if they are acting in  
4 good faith, this is what's expected, this is what EnerQuest  
5 did not do.

6 Let's look at them.

7 Mr. Kellahin says you prepare a feasibility  
8 study. That we did in 2000.

9 He says you submit it to the other working  
10 interest owners. That was done in February of this year,  
11 and they admit they received it.

12 They say then you call a working interest owner  
13 meeting. Of the five cases cited by Mr. Kellahin, there  
14 were working interest owner meetings in two. There were  
15 none in three of those cases.

16 He says you then form a technical committee. Of  
17 the five cases cited, there was a technical committee in  
18 one, a large unit in the Vacuum field where it was being  
19 unitized by a number of major oil companies, Texaco,  
20 Marathon, Conoco, Phillips and Mobil. That's how they act.

21 He says you solicit voluntary joinder. That was  
22 done February the 7th by us. It was never done in the  
23 Texaco case. They talked to people, they thought they had  
24 enough to survive a post-hearing ratification of your  
25 order, there was no meeting.

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1           They say you have to have time to study the  
2       proposal, and they cite five cases, and they say, Oh, all  
3       of these cases involve long lead times. Well, they cite  
4       two cases that you're very familiar with, the Saga case and  
5       the GP II.

6           But if you look at those cases, years weren't  
7       devoted to statutory unitization, they were spent on other  
8       efforts, forming voluntary units or cooperative  
9       waterfloods. The time devoted to actually statutorily  
10      unitizing the reservoir in both cases was less than three  
11      months.

12          And Mr. Bruce accepts Mr. Kellahin's argument by  
13      reference, but in the St. Mary's case he couldn't meet the  
14      standards advanced by Mr. Kellahin. There was no working-  
15      interest owner meeting, there was no technical committee.

16          And so the very cases they cite say there are no  
17      standards that have evolved through custom and usage, that  
18      you have to go back and you have to look at the facts of  
19      the individual case, you have to look at the parties.

20          Who are they, who are these people who are  
21      complaining about our effort?

22          First we have Mr. Kellahin's client, the Key  
23      family. As he's noted, they own interest in the Lanie and  
24      Lanie "A" leases. These are operated by EnerQuest. They  
25      are now being drained by wells on the Lynx property;

1 whether they're top allowable or not, the drainage is  
2 occurring.

3           And there are certain options available to us.  
4 One is to be drained. The second is, as Mr. Bruce pointed  
5 out, to stand by and be drained. The third is to unitize,  
6 implement waterflood operations, operations which when we  
7 do get to the merits will show that the Key family get an  
8 increase of approximately 60 percent in terms of total  
9 ultimate recovery, much more than will be received by  
10 EnerQuest.

11           But if we don't do this, if we can't get the  
12 project moving quickly, EnerQuest as operator of these  
13 properties must prevent that drainage, and we are going to  
14 have to drill wells. And the AFE for those wells is  
15 \$358,000 apiece. And there's a JOA on the property that  
16 Mr. Kellahin wants his clients to have to pay their one-  
17 third share of those costs, \$400,000. Then maybe that's  
18 what they want to do, instead of going forward with  
19 unitization and reaping the benefits of that effort.

20           Then we have Lynx. Who are they? Well, Lynx is  
21 the operator who is in the best part of the reservoir.  
22 They own 40 acres, and the evidence is going to show  
23 they're draining 105. I don't think it takes a rocket  
24 scientist to understand why they'd like to delay the entire  
25 unitization process: They're draining us, they're draining

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1 the Keys, and they want to keep it that way.

2 Now, there are a number of working interest  
3 owners in this unit, but there are basically two groups who  
4 are complaining. And you have to look at those groups and  
5 you have to see, what did Enerquest really do?

6 In the fall of 2000 they prepared the waterflood  
7 feasibility study. And early this year, because of the  
8 advanced state of depletion of this reservoir, because of  
9 the drainage which was occurring, they made a decision that  
10 they needed to unitize and waterflood, and they needed to  
11 do that quickly.

12 On the 7th of February, they wrote the Key  
13 family. They sought their participation in this effort.  
14 They offered to respond to any questions, and they offered  
15 to provide information.

16 Two weeks later on the 22nd, they sent the  
17 feasibility study to them, they offered to provide  
18 additional data, they offered to answer questions and they  
19 sent an AFE for the proposed Phase 1 waterflood. Mr.  
20 Kellahin says they don't understand what the Phase 1  
21 waterflood is, but we've had meetings with them and they've  
22 never raised those questions when our technical people come  
23 together.

24 We filed our Application February the 26th.

25 In mid-March, Scott Hickman, a consulting

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1 petroleum engineer for the Key family, contacted EnerQuest,  
2 and we met with Mr. Hickman on the 26th of March. The  
3 meeting lasted approximately two hours. We reviewed the  
4 feasibility study with him, we answered his questions, we  
5 provided additional data. We offered to meet again and  
6 discuss anything or consider any proposal they cared to  
7 make.

8           Several days later, because he had expressed an  
9 interest in additional information, we provided it to him  
10 at his office in Midland. And although we had voluntarily  
11 produced documents to them and we had offered to meet  
12 again, the only response we got from the Key family was a  
13 subpoena from the Oil Conservation Division dated April the  
14 3rd. And when you look at that subpoena, most of what they  
15 sought had already been provided. But we produced  
16 additional data in response to that subpoena. Instead of  
17 asking us to continue, they filed a motion to continue.

18           But we have continued the case on three  
19 occasions, and since it was filed in February we have  
20 continued to allow additional time to run, while we're  
21 being drained, so they can review the information.

22           The problem is, they haven't contacted us again,  
23 they're not asking us questions, they're not proposing  
24 anything. They say today they want to talk, but the only  
25 place they're willing to talk is here. And we'll never get

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1 it resolved in this posture unless we talk, and if they  
2 won't talk to us outside the hearing, we have to come here.

3 We submit what we've done is clearly a good-faith  
4 effort to obtain the voluntary joinder of the Key family.

5 The Lynx effort is similar. We wrote them in  
6 January. On February the 8th we got a letter, they  
7 objected to going forward at this time, they said they  
8 needed additional time, additional data. We have provided  
9 those, we gave them the feasibility study and the AFE for  
10 Phase 1 on February the 22nd, and while they say they never  
11 even met -- Well, we met with them too.

12 We met with them on March the 5th, we provided  
13 data. We've offered to meet again, it's on the table.  
14 They have come forward with no proposal, and we had  
15 submitted additional data pursuant to the request of Mr.  
16 Bruce.

17 And then when we were hit with a subpoena by the  
18 Keys family, we provided additional data. And because it  
19 was over and above what Lynx had requested, we also  
20 voluntarily provided it to them.

21 There are continuance, there's a standing offer  
22 to meet. But they don't want to talk to us, they want to  
23 talk only here, and complain.

24 You know, I stated in my response to Mr.  
25 Kellahin's first motion that good faith is a two-way

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1 street, and I immediately drew all sorts of fire for that  
2 comment. And I guess Mr. Kellahin was right, maybe good  
3 faith is not a two-way street, because the only thing we've  
4 received from either Lynx or the Key family are complaints.  
5 Neither have accepted our offer and both continue to  
6 complain.

7           Maybe what I mean to say was, good faith should  
8 be a two-way street, because it's becoming very clear you  
9 can't meet with people who don't want to meet, you can't  
10 reach agreements with those who are not interested in  
11 achieving the benefits of unitization. You can't reach  
12 agreements with people who only want to lever their  
13 position in negotiations in which they'd like to sell you  
14 their interest, you can't reach agreements with people  
15 whose only interest is trying to continue a process while  
16 they drain you.

17           And meeting wouldn't be futile if they came to  
18 the table with something concrete to propose. Texland has  
19 done that in this very case. They were concerned about the  
20 reserves that were being allocated to certain wells,  
21 because they read the feasibility study and looked at it.  
22 We concluded they were right, and we adjusted those  
23 parameters.

24           The Key family asks you to dismiss the case.  
25 They're asking you to dismiss it because we haven't met the

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1 standards announced by Mr. Kellahin.

2 Well, I think you should remember if you dismiss  
3 this case, you must be very careful in doing so, because  
4 you're not just throwing our case out, you are adopting  
5 those standards. And they're not based on practice,  
6 they're not based on rule, they're not based on statute.

7 You would be adopting standards that, if applied,  
8 every single one of the cases that Mr. Kellahin cited in  
9 his reply brief would have been dismissed, because none of  
10 those cases meet those tests. And you'd be dismissing the  
11 case and saying, Have a working interest owner meeting,  
12 have a technical committee, in a case where we have met  
13 with both of them, where they have met and come and  
14 gathered information, where we said we'd meet again, and  
15 they have not done that, and they have never made a  
16 counterproposal to us.

17 In this case EnerQuest has exercised good faith  
18 in attempting to secure the voluntary joinder of all  
19 interest owners in this effort. That is what the statute  
20 requires. We submit we have met that test. This motion  
21 should be denied, and I concur that a special hearing date  
22 should be set when the parties come in, when we can fully  
23 explore the merits of this unit, the boundaries, the  
24 participation formula and the benefits that will be derived  
25 by each party from this effort.

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1 EXAMINER CATANACH: Thank you, Mr. Carr.

2 MR. KELLAHIN: May I respond, Mr. Catanach?

3 EXAMINER CATANACH: Briefly, Mr. Kellahin.

4 MR. KELLAHIN: Four days before the hearing, we  
5 are sent a letter that now advises us that this project is  
6 a four-well injection project. And since then we have  
7 begged and asked and requested information from EnerQuest  
8 to explain why this is now a four-injection-well project.  
9 There is nothing contained in this feasibility study that  
10 was done by EnerQuest some 18 months ago or 15 months ago  
11 that addresses that issue. It's hard to talk to these  
12 parties until they provide that information.

13 Ask Mr. Carr to show you where in that  
14 feasibility study he addresses or his client addresses the  
15 consequence of a four-well injection project. Show us  
16 where he has demonstrated with the evidence that he has  
17 presented to us that secondary recovery is feasible or  
18 potential within that four-well injection-well pattern.  
19 Demonstrate to us the logic of that boundary they propose  
20 that is far in excess of the area affected by the four  
21 injection wells, show us the basis for the participation  
22 formulas, show us the justification for that formula,  
23 justify the capital expenditures.

24 None of that stuff has been responded to. We've  
25 asked them repeatedly to justify the four well injection

1 process that this has evolved into, and they don't provide  
2 it. They must not have it.

3 EXAMINER CATANACH: Mr. Bruce?

4 MR. BRUCE: Briefly, Mr. Examiner.

5 Mr. Carr spent a while arguing, but he can't  
6 dispute the fact that the only proposals preceding the  
7 Application are one letter to the working interest owners  
8 and one letter to the royalty interest owners. All the so-  
9 called negotiations he mentions are after the filing of the  
10 Applications.

11 You know that in a compulsory pooling case a  
12 good-faith standard is also required, and in those cases  
13 more is required than negotiating after the application is  
14 filed.

15 Then EnerQuest tries to put the burden on us,  
16 when under the statute the burden is on them to conduct  
17 good-faith negotiations. We will negotiate in good faith,  
18 but according to the affidavit attached to Mr. Carr's  
19 response to my motion, EnerQuest has been studying  
20 unitization for a year and three-quarters.

21 Now my clients have had data for a month, maybe a  
22 month and a half, and all of a sudden they're supposed to  
23 have a proposal that it took a year and a half for  
24 EnerQuest to put together. That's just not proper. We'll  
25 make a proposal, but we need all the data and we need time.

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1 Thank you.

2 MR. CARR: Mr. Catanach, I could go on and on. I  
3 would just point out that they purport to be very  
4 concerned. And our question would be, where have they  
5 been? They say they will negotiate, but the only time we  
6 can engage them is here. We submit we have acted in good  
7 faith, but if you read the statute and compare what we've  
8 done, I'm convinced we have met that standard, and the  
9 motions to dismiss should be denied.

10 EXAMINER CATANACH: Mr. Carr, let's take a five-  
11 minute break here.

12 (Thereupon, a recess was taken at 9:40 a.m.)

13 (The following proceedings had at 9:55 a.m.)

14 EXAMINER CATANACH: Call the hearing to order at  
15 this time, and we'll address the motions.

16 It seems to me that the central issue regarding  
17 these various motions is whether or not EnerQuest has  
18 conducted good-faith negotiations with the various interest  
19 owners within this proposed unit.

20 And it strikes me that -- a couple things -- that  
21 the first letter that was sent by EnerQuest was dated  
22 January 23rd, 2002, to the working interest owners. And  
23 subsequent to that, an Application for statutory  
24 unitization was filed on February 26th. To me, that is a  
25 very short period of time between the onset of negotiations

1 and the filing of a statutory-unitization case.

2           The other thing that strikes me is, in the  
3 initial letter to the working interest owners, EnerQuest  
4 requests them to sign the unit agreement and the unit  
5 operating agreement, and in the same letter advises them  
6 that this matter is going to hearing on March 7th, 2002.  
7 That strikes me as very peculiar.

8           I don't believe that EnerQuest has conducted  
9 good-faith negotiations prior to the filing of this case.  
10 I believe it is their burden to conduct good-faith  
11 negotiations, and I don't believe that they have done so.

12           Mr. Carr talked about leveraging the  
13 negotiations. Well, I've seen countless times where  
14 applications for either compulsory pooling or statutory  
15 unitization have been filed, and it appears to me that that  
16 gives the applicant the leverage in negotiations. I don't  
17 believe that we're setting any standards. I'm not telling  
18 Mr. Carr what to do in terms of conducting negotiations  
19 with the working interest owners. I believe that you need  
20 to try and get with these people and conduct some  
21 negotiations.

22           You also mentioned that you can't get them to  
23 talk to you. Well, if you can't get them to talk to you,  
24 you come to me in two or three months and you tell me that  
25 you can't get them to talk to me, and I'm sure it will be a

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1 different story in the way we look at this case.

2 But with that, I will grant the motion to dismiss  
3 both Applications, the Application for statutory  
4 unitization and the Application for a waterflood project at  
5 this time. We will dismiss Case 12,845 and Case 12,846.

6 Thank you.

7 (Thereupon, these proceedings were concluded at  
8 10:00 a.m.)

9 \* \* \*

10  
11  
12  
13  
14  
15  
16  
17  
18 I do hereby certify that the foregoing is a true and correct copy of the  
19 the transcript of the proceedings in Case No. 12845, 12846  
heard by me on May 16, 2007.  
20 David R. Catant  
21 Oil Conservation Division  
22  
23  
24  
25

STEVEN T. BRENNER, CCR  
(505) 989-9317

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 May 18th, 2002.



STEVEN T. BRENNER  
 CCR No. 7

My commission expires: October 14, 2002

STEVEN T. BRENNER, CCR  
 (505) 989-9317

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

IN THE MATTER OF THE HEARING CALLED  
BY THE OIL CONSERVATION DIVISION FOR  
THE PURPOSE OF CONSIDERING:

APPLICATION OF ENERQUEST RESOURCES,  
LLC FOR STATUTORY UNITIZATION, LEA  
COUNTY, NEW MEXICO.

Case No. 12845

APPLICATION OF ENERQUEST RESOURCES,  
LLC FOR APPROVAL OF A WATERFLOOD  
PROJECT AND QUALIFICATION OF THE  
PROJECT AREA FOR THE RECOVERED OIL  
TAX RATE PURSUANT TO THE ENHANCED  
OIL RECOVERY ACT, LEA COUNTY, NEW  
MEXICO.

Case No. 12846

AFFIDAVIT OF ROBERT CRAINE

STATE OF TEXAS                     )  
  ) ss.  
COUNTY OF DALLAS                )

Robert Craine, being duly sworn upon his oath, deposes and states:

1. I am over the age of 18, and have personal knowledge of the matters set forth herein.

2. I am an officer of Lynx Operating Co., Inc. ("Lynx"), as well as an interest owner in the proposed East Hobbs (San Andres) Unit.

3. The only correspondence which Lynx and I received regarding the proposed unitization were letters from EnerQuest Oil & Gas, Ltd. ("Enerquest") dated January 23, 2002 and February 7, 2002, and letters from Holland & Hart, LLP dated February 28, 2002 and March 11, 2002. Copies of these letters are attached hereto as Exhibits A, B, C, and D.

4. The two letters from EnerQuest contained the proposed unit agreement and unit operating agreement, and requested that ratifications of the agreements be signed. They also stated that a hearing would be held on March 7, 2002.

5. I am not aware of any negotiations EnerQuest conducted with the working interest owners on the unit area or unitization parameters prior to the January 23rd letter. In February 2002, Lynx requested a meeting with EnerQuest, which was held on March 5,

OIL CONSERVATION DIVISION

CASE NUMBER \_\_\_\_\_

Lynx EXHIBIT 1

2002. That meeting was held after notice of the hearing date had been given.

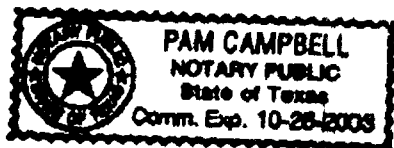
6. EnerQuest did not provide technical data to Lynx on the unitization proposal until after the unitization and waterflood applications had been filed with the Division.

  
Robert Craine

SUBSCRIBED AND SWORN TO before me this 15<sup>th</sup> day of May, 2002, by Robert Craine.

  
Notary Public

My Commission Expires:





# ENERQUEST

ENERQUEST OIL & GAS, LTD.

Certified Mail

January 23, 2002

To: Working Interest Owners

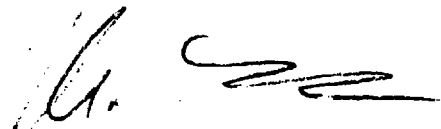
Re: East Hobbs (San Andres) Unit  
Lea County, New Mexico

Ladies and Gentlemen:

EnerQuest Oil & Gas, Ltd. hereby proposes the formation of the East Hobbs (San Andres) unit to unitize the San Andres formation for the purpose of secondary operations. The proposed unit consists of 920 acres and covers parts of Section 29, 30, 31 and 32, Township 18 South, Range 39 East, Lea County, New Mexico. I have enclosed for your review and approval a unit agreement, unit operating agreement and ratification governing the implementation and development of the East Hobbs Unit.

Please review the agreements and if everything appears correct, execute the ratification in the space provided and return to me at the letterhead address. EnerQuest plans to have a hearing with the New Mexico Oil Conservation Division on this matter on March 7, 2002, therefore your prompt attention would be appreciated. Should you have any questions or require any additional information, please feel free to contact me at (915)685-3116.

Very truly yours,

  
M. Craig Clark  
Landman

MCC/s  
Enclosure



# ENERQUEST

ENERQUEST OIL & GAS, LTD.

February 7, 2002

To: Royalty Owners

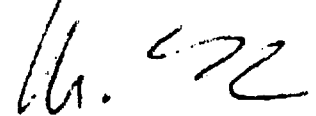
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Lea County, New Mexico

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Very truly yours,



M. Craig Clark  
Landman

MCC/s  
Enclosure



HOLLAND & HART LLP  
ATTORNEYS AT LAW

DENVER • ASPEN  
BOULDER • COLORADO SPRINGS  
DENVER TECH CENTER  
DENVER • BOULDER  
CHEYENNE • JACKSON HOLE  
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110 NORTH GUADALUPE, SUITE 1  
SANTA FE, NEW MEXICO 87501-6629

TELEPHONE (505) 966-6621  
FACSIMILE (505) 963-9043

William F. Carr

wcarr@hollandhart.com

February 28, 2002

TO: ALL INTEREST OWNERS IN THE EAST HOBBS (SAN ANDRES)  
UNIT AREA

Re: Application of EnerQuest Resources, LLC for statutory  
unitization of the East Hobbs (San Andres) Unit Area, Lea  
County, New Mexico.

Ladies and Gentlemen:

This letter is to advise you that EnerQuest Resources, LLC has filed an application with the New Mexico Oil Conservation Division seeking an order statutorily unitizing for the purpose of establishing a secondary recovery project, all mineral interests from a point 50 feet above the top of the San Andres formation to a point 50 feet below the base of the Grayburg formation, East Hobbs-San Andres Pool, underlying 920 acres, more or less, of State of New Mexico and Fee lands in the following described lands:

Township 18 South Range 32 East, NMPM

Section 29: SW/4, SW/4 NW/4  
Section 30: S/2, S/2 N/2  
Section 31: N/2 N/2  
Section 32: N/2 NW/4

Said unit is to be designated the East Hobbs (San Andres) Unit. Among the matters to be considered at the hearing on this application will be the necessity of unit operations, the designation of unit operator, the determination of the horizontal and vertical limits of the unit area, the determination of the fair, reasonable and equitable allocation of production and costs of production, including capital investment, to each of the various tracts in the unit area; the determination of credits and charges to be made among the various owners in the unit area for their investment in wells and equipment; a non-consent penalty for risk to be charged against carried working interest owners within the unit area upon such terms and conditions to be determined by the Division as just and reasonable; and such other matters as may be necessary and appropriate for carrying on efficient unit operations; including but not limited to, unit voting procedures, selection, removal or substitution of unit operator, and time of commencement and termination of unit operations.



HOLLAND & HART LLP  
ATTORNEYS AT LAW

February 26, 2002  
Page 2

This application has been set for hearing before a Division Examiner on March 21, 2002. You are not required to attend this hearing, but as an owner of the surface of the land upon which the injection well will be located, you may appear and present testimony. Failure to appear at that time and become a party of record will preclude you from challenging the matter at a later date.

Parties appearing in cases are required by Division Rule 1208.B to file a Pre-hearing Statement three days in advance of a scheduled hearing. This statement must include: the names of the parties and their attorneys; a concise statement of the case; the names of all witnesses the party will call to testify at the hearing; the approximate time the party will need to present its case; and identification of any procedural matters that are to be resolved prior to the hearing

Sincerely yours,



William F. Carr  
Attorney for EnerQuest  
Resources, LLC

cc: Robert W. Floyd  
EnerQuest Resources, LLC

HOLLAND & HART<sup>LLP</sup>  
ATTORNEYS AT LAW

DENVER • ASPEN  
BOULDER • COLORADO SPRINGS  
DENVER TECH CENTER  
BILLINGS • BOISE  
CHEYENNE • JACKSON HOLE  
SALT LAKE CITY • SANTA FE  
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110 NORTH GUADALUPE, SUITE 1  
SANTA FE, NEW MEXICO 87501-0526

TELEPHONE (505) 888-4421  
FACSIMILE (505) 883-8043

William F. Carr

wcarr@hollandhart.com

March 11, 2002

**CERTIFIED MAIL**  
**RETURN RECEIPT REQUESTED**

**TO: ALL AFFECTED INTEREST OWNERS IN THE EAST HOBBS  
(SAN ANDRES) UNIT AREA.**

Re: Application of EnerQuest Resources, LLC for statutory  
unitization, of the East Hobbs (San Andres) Unit Area, Lea  
County, New Mexico.

Ladies and Gentlemen:

This letter is to advise you that EnerQuest Resources, L.L.C. has filed an application with the New Mexico Oil Conservation Division seeking an order statutorily unitizing for the purpose of establishing a secondary recovery project all mineral interests from a point 50 feet above the top of the San Andres formation to a point 50 feet below the base of the P-5 marker in the San Andres formation, East Hobbs San Andres Pool, underlying 920 acres, more or less, of State of New Mexico and Fee lands comprised of the following described acreage:

Township 18 South, Range 39 East, NMPM

Section 29: SW/4, SW/4 NW/4  
Section 30: S/2, S/2 N/2  
Section 31: N/2 N/2  
Section 23: N/2 NW/4

Said unit is to be designated the East Hobbs (San Andres) Unit. Among the matters to be considered at the hearing on this application will be the necessity of unit operations; the designation of a unit operator; the determination of the horizontal and vertical limits of the unit area; the determination of the fair, reasonable and equitable allocation of



HOLLAND & HART LLP  
ATTORNEYS AT LAW

March 11, 2002

Page 2

production and costs of production, including capital investment, to each of the various tracts in the unit area; the determination of credits and charges to be made among the various owners in the unit area for their investments in wells and equipment; a non-consent penalty for risk to be charged against carried working interest owners within the unit area upon such terms and conditions to be determined by the Division as just and reasonable; and such other matters as may be necessary and appropriate for carrying on efficient unit operations; including, but not limited to, unit voting procedures, selection, removal or substitution of unit operator, and time of commencement and termination of unit operations.

This application has been set for hearing before a Division Examiner on April 4, 2002 at the Oil Conservation Division Hearing Room, located at 1220 South Saint Francis Drive, Santa Fe, NM 87505. You are not required to attend this hearing but, as the owner of an interest that may be affected by this applications, you may appear and present testimony. Failure to appear at that time and become a party of record will preclude you from challenging this matters at a later date.

Parties appearing in cases are required by Division Rule 1208.B to file a Pre-hearing Statement three days in advance of a scheduled hearing. This statement must include: the names of the parties and their attorneys; a concise statement of the case; the names of all witnesses the party will call to testify at the hearing; the approximate time the party will need to present its case; and identification of any procedural matters that are to be resolved prior to the hearing.

Very truly yours,



William F. Carr  
Attorney for EnerQuest  
Resources, L.L.C..

cc: Robert Floyd  
Craig Clark  
EnerQuest Resources, LLC