

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. 12,601
)
APPLICATION OF BETTIS, BOYLE AND STOVALL)
TO REOPEN CASE 12,601 AND AMEND ORDER)
NO. R-11,573 TO ADDRESS THE APPROPRIATE)
ROYALTY BURDENS ON THE PROPOSED WELL FOR)
PURPOSES OF THE CHARGE FOR RISK INVOLVED)
IN DRILLING SAID WELL, LEA COUNTY,)
NEW MEXICO)

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

May 31st, 2001

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 31st, 2001, 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.

* * *

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

OIL CONSERVATION DIV.
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I N D E X

May 31st, 2001
 Examiner Hearing
 CASE NO. 12,601

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* * *

A P P E A R A N C E S

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Albuquerque, New Mexico 87103
By: SEALY H. CAVIN, JR.

ALSO PRESENT:

RICHARD EZEANYIM
NMOCD Chief Engineer

* * *

1 WHEREUPON, the following proceedings were had at
2 10:42 a.m.:

3 EXAMINER STOGNER: This hearing will come to
4 order. At this time I'll call Reopened Case 12,601, which
5 is the Application of Bettis, Boyle and Stovall to reopen
6 Case 12,601 and amend Order Number R-11,573 to address the
7 appropriate royalty burdens on the proposed well for
8 purposes of the charge for risk involved in drilling said
9 well, Lea County, New Mexico.

10 Order Number R-11,573 was a compulsory pooling
11 order for a well, so at this time I'll call for appearances
12 in this reopened case.

13 MR. CARR: May it please the Examiner, my name is
14 William F. Carr with the Santa Fe office of Holland and
15 Hart, L.L.P. We represent Bettis, Boyle and Stovall in
16 this matter, and I have one witness.

17 EXAMINER STOGNER: Any other appearances?

18 MR. CAVIN: Mr. Examiner, my name is Sealy Cavin.
19 I'm an attorney with Stratton and Cavin in Albuquerque, and
20 we represent Sun-West Oil and Gas, Inc. And we have no
21 witnesses.

22 EXAMINER STOGNER: Are there any other
23 appearances?

24 Will the witness please stand to be sworn at this
25 time? Why don't you come on up here?

1 (Thereupon, the witness was sworn.)

2 MR. CARR: Mr. Stogner, I have just a very brief
3 statement.

4 EXAMINER STOGNER: Mr. Carr?

5 MR. CARR: Mr. Examiner, as you noted, this
6 reopened case involves a compulsory pooling Application.
7 By Order Number R-11,573, entered in Case 12,601 on April
8 the 26th of this year, the Division entered an order
9 granting an application of Bettis, Boyle and Stovall and
10 pooling certain spacing units in Section 30, Township 9
11 South, Range 33 East. The order imposed a 200-percent risk
12 penalty on those interest owners who didn't voluntarily
13 participate in the well.

14 When the application was filed, certain interests
15 were unleased mineral interests. After the application was
16 filed and prior to the time the order was entered, one of
17 the parties leased those interests, and with the lease
18 created a 27-1/2-percent royalty burden on that tract.

19 We today are before you asking you to treat the
20 property as it was when the application was filed, and to
21 treat the property as if it were encumbered with a one-acre
22 12-1/2-percent royalty, not a 27-1/2-percent royalty.

23 I will call a land witness to review the land
24 portion of the case, basically to lay out the chronology of
25 what happened, and then I have a legal argument.

1 MR. CAVIN: I don't have any opening statement.

2 EXAMINER STOGNER: Mr. Cavin?

3 MR. CAVIN: I don't have one.

4 EXAMINER STOGNER: Oh, you don't. I'm sorry, I
5 thought you said you had one.

6 Okay, let's see. Also for the record, Order
7 Number R-11,573, that was issued on April the 26th. The
8 hearing date on that was April 19th. It shows March 22nd,
9 but that was --

10 MR. CARR: The hearing date was actually the
11 19th. And also in the order, Mr. Examiner, an 80-acre unit
12 was pooled on a 40 acre unit, and I believe the names of
13 the pools were reversed in that, so that also probably
14 needs to be corrected.

15 EXAMINER STOGNER: So noted, Mr. Carr. Thank you
16 for calling that drafting error to my attention.

17 Thank you. Mr. Carr?

18 MR. CARR: At this time, Mr. Stogner, we call
19 Mark Maloney.

20 C. MARK MALONEY,

21 the witness herein, after having been first duly sworn upon
22 his oath, was examined and testified as follows:

23 DIRECT EXAMINATION

24 BY MR. CARR:

25 Q. Would you state your full name for the record,

1 please?

2 A. Yes, my name is Mark Maloney.

3 Q. Where do you reside?

4 A. I live in Roswell, New Mexico.

5 Q. By whom are you employed?

6 A. I'm an independent landman.

7 Q. And in this case what is your relationship with
8 Bettis, Boyle and Stovall?

9 A. They are my client.

10 Q. Did you do the land work that was involved as a
11 predicate to the compulsory pooling application that was
12 the subject of the original hearing?

13 A. Yes, sir.

14 Q. Did you testify at the April 19th Examiner
15 Hearing on the original pooling application?

16 A. Yes, I did.

17 Q. At the time of that testimony, were your
18 credentials as an expert in petroleum land matters accepted
19 and made a matter of record?

20 A. Yes, they were.

21 Q. Are you familiar with the Application which was
22 filed to reopen the case and address this royalty issue?

23 A. Yes, sir.

24 Q. Have you prepared exhibits for presentation for
25 today?

1 A. Yes, sir.

2 MR. CARR: Are the witness's qualifications
3 acceptable?

4 EXAMINER STOGNER: Is there any objection?

5 MR. CAVIN: No.

6 EXAMINER STOGNER: So qualified.

7 Q. (By Mr. Carr) Mr. Maloney, would you briefly
8 summarize what Bettis, Boyle and Stovall seeks with this
9 Application?

10 A. Yes, sir, we are asking for an order reducing the
11 royalty burden on Sun-West Oil and Gas lease to 12 1/2
12 percent, or 1/8, as opposed to the 27 1/2 percent that they
13 have currently burdened the interest with.

14 Q. Let's go to what has been marked for
15 identification as Exhibit Number 1. Would you identify and
16 review this, please?

17 A. Yes, sir, that is the exhibit for our McGuffin
18 prospect, the land plat which was the same exhibit that was
19 previously introduced in the April 19th hearing. The
20 yellow highlighting represents the leasehold in the west
21 half of Section 30 that Bettis, Boyle and Stovall, et al.,
22 own. The crosshatched area is our proposed well site for
23 the McGuffin "C" Number 1 well, located in Lot 3 at a
24 standard location.

25 Q. You've indicated a 40-acre tract around that

1 well?

2 A. Yes, sir.

3 Q. And that was pooled by the order entered
4 following the April 19th hearing?

5 A. That's correct, for the rights from surface to
6 the base of the Bough C formation.

7 Q. And that order also pooled Lots 3 and 4, or the
8 west half of the southwest equivalent of this section; is
9 that right?

10 A. That's right. The Bough C in here would be on a
11 40-acre, and the only other possibility for production, it
12 appears, is the San Andres, which is fairly remote, but
13 that's on an 80 in that area, the McGuffin -- Excuse me,
14 the South Flying M, I believe. Yeah.

15 Q. Would you go to what has been marked as Bettis,
16 Boyle and Stovall Exhibit Number 2 and identify this,
17 please?

18 A. These were the interests that were pooled at our
19 April 19th hearing that we sought to pool and have. Sun-
20 West Oil and Gas, Inc., with the largest interest there, a
21 3/20 mineral interest, 15 percent; Larry Kent Kirby with a
22 small interest of 1/320 or 1 acre, approximately; Thomas
23 Wiley Neal, III, Trust, again with a very small interest,
24 1/80. Those were unlocatable owners.

25 Q. Mr. Maloney, these set forth the interests that

1 were subject to pooling in the original case; is that
2 correct?

3 A. Yes, sir.

4 Q. And these are the interests as you understood
5 them to be at the time the Application was filed?

6 A. That's correct.

7 Q. What has happened to the Sun-West Oil and Gas,
8 Inc., interest since the time the original pooling
9 application was filed?

10 A. They leased their interest to Gulf Coast Oil and
11 Gas, Inc., approximately three weeks after we filed our
12 application.

13 Q. Let's go to what has been marked as Bettis, Boyle
14 and Stovall Exhibit Number 3. Would you identify this and
15 review it for the Examiner?

16 A. Yes, sir, this is a chronology of the
17 correspondence, et cetera, dealing with Sun-West, attempts
18 to lease Sun-West or obtain joinder, beginning back in
19 December, mid-December of 2000, through recent efforts on
20 our part.

21 Again, our first offer was back in mid-December,
22 a letter, followed up again, second letter, January 20th.
23 We had had several phone calls, conversations, in between.

24 Q. Were these contacts for the purpose of attempting
25 to lease the acreage and bring this tract voluntarily into

1 the well?

2 A. Yes, sir.

3 Q. And what was the issue in your negotiations with
4 Sun-West Oil and Gas, Inc.?

5 A. Primarily it was the royalty. We had offered
6 3/16 royalty and they requested 25 percent and asked for an
7 additional bonus higher than we were paying as well.

8 Q. Was a 25-percent royalty acceptable to Bettis,
9 Boyle and Stovall?

10 A. No, sir, it was not.

11 Q. What were the plans of Bettis, Boyle and Stovall
12 in terms of timing for the development of this acreage?

13 A. Well, we had hoped to get this well drilled in
14 the first quarter of this year. But again, rigs were
15 tight. We've had this matter come up, and we're still
16 waiting. Location is built, but we have plans on drilling
17 right away.

18 Q. When did you file your Application for compulsory
19 pooling?

20 A. I believe that was filed January 30th.

21 Q. And was that Application provided to Sun-West in
22 accordance with OCD rules and regulations?

23 A. Yes, sir, it was.

24 Q. And when was it provided to them?

25 A. February 6th was when they signed the notice.

1 Q. And what happened after that?

2 A. Again, I had asked for them to reconsider January
3 30th, asked for a 30-day -- excuse me, in my letter of
4 January 20th had asked for 30 days within -- for another
5 attempt here.

6 But we got notice February the 20th, I believe it
7 was, they sent a letter to you and faxed a copy to me, that
8 they had leased this to Gulf Coast Oil and Gas.

9 Q. Was that lease actually recorded?

10 A. It was not. The first time they sent it to us
11 they left off the section in the legal description. They
12 had, again, included the acreage only that we had asked for
13 in our order, Lots 3 and 4, although they owned undivided
14 mineral interest throughout the west half of Section 30.

15 I was confident that was the right acreage, but
16 they again left off the full legal description.

17 They followed up the next day with a corrected
18 copy. The lease was acknowledge, I believe, February the
19 15th, and then it was actually recorded in Lea County
20 February the 21st.

21 Q. We've got two copies of a chronology in this
22 exhibit behind those pages. Is that a copy of the oil and
23 gas lease that was recorded in Lea County on February the
24 21st?

25 A. Yes, sir.

1 Q. What did you do after this? Did you contact Gulf
2 Coast Oil and Gas Company?

3 A. Yes, sir, we did. In March of this year we sent
4 a letter, not being sure that Gulf Coast and Sun-West were
5 the same entity, but we sent a letter to Gulf Coast on
6 March the 22nd, again asking them to -- basically
7 explaining what we had done with Sun-West, where we were,
8 and informing them of the force-pooling hearing.

9 And they contacted me the following day. Again,
10 that letter was sent the 22nd.

11 And March 23rd, Mr. Spear, Shane Spear, who is
12 the president of Sun-West Oil and Gas, called and said,
13 Yeah, we're basically the same, same family ownership. I
14 think there might be little slight difference in the stock,
15 I don't know. But essentially they were the same entity.

16 Q. When you say the same entity, you mean Sun-West
17 and Gulf Coast?

18 A. Yes, sir.

19 Q. Did you discuss with them the ability of Bettis,
20 Boyle and Stovall to carry a 27-1/2-percent royalty
21 interest --

22 A. Yes, sir, in my letter to them of March 22nd,
23 which again that letter was previously submitted in our
24 April 19th hearing, but I told them that we could not --
25 25-percent royalty we couldn't carry, and we couldn't carry

1 15-percent working interest, that was not -- it was too
2 risky.

3 Q. Are the letters that are referenced in this
4 chronology letters that were introduced and admitted into
5 evidence at the April 19th hearing on the pooling
6 application in this case?

7 A. Yes, sir.

8 Q. What effort did you make after you discovered
9 that Gulf Coast had leased this property, what effort did
10 you make to determine exactly who they were?

11 A. Again, they had a Midland address, post office
12 box address. I did not know at that time of the
13 relationship between them.

14 I called a friend of mine with Mewbourne Oil
15 Company who does a lot of dealings with people in Midland,
16 and he looked it up in his directory and he called back and
17 said, I think they're the same people. They showed up in
18 *Armstrong* with exactly the same names, same post office box
19 address, same phone numbers, same --

20 Q. When you say they showed up in *Armstrong Oil*
21 *Directory*?

22 A. Yes, sir.

23 Q. And it was there that they had the same officers?

24 A. Yes, sir.

25 Q. Same address?

1 A. Yes, sir.

2 Q. Same telephone number?

3 A. Exactly.

4 Q. When you contacted Gulf Coast did you also at
5 that time talk to Mr. Spear?

6 A. Yes, again my first contact with Gulf Coast was
7 by letter, and then Mr. Spear contacted me by phone the
8 following day.

9 Q. Is this the same individual with whom you had
10 made contact when you were dealing with this in the name of
11 Sun-West?

12 A. Yes, sir.

13 Q. Could you just tell us what impact a higher
14 royalty interest will have on Bettis, Boyle and Stovall's
15 efforts to drill the well?

16 A. Well, as we previously testified, this was and is
17 a risky prospect, and we have said from the git-go that we
18 needed as high a net revenue interest as we could, that a
19 25-percent, in the opinion of our engineer, who I believe
20 in the exhibit that Mr. Stubbs previously entered into
21 testimony was -- the risk factor was just too heavy with
22 the 75 percent, that revenue interest on interest.

23 Q. Is Bettis, Boyle and Stovall Exhibit Number 4 an
24 affidavit confirming that notice of today's hearing has
25 been provided in accordance with OCD rules?

1 A. Yes, sir.

2 Q. And you have notified, as shown on Exhibit A, a
3 number of individuals; is that correct?

4 A. That's correct.

5 Q. And who did you notify?

6 A. These were the parties that were not leased of
7 record or joined at the date of our original application.

8 Q. And some of these individuals have committed to
9 the well, have they not?

10 A. That is correct, sir.

11 Q. Were Bettis, Boyle and Stovall Exhibits 1 through
12 4 prepared by you or compiled at your direction?

13 A. Yes, sir, they were.

14 MR. CARR: Mr. Stogner, at this time we move the
15 admission into evidence of Bettis, Boyle and Stovall
16 Exhibits 1 through 4.

17 EXAMINER STOGNER: Exhibits -- I'm sorry, is
18 there any objection?

19 MR. CAVIN: No, Mr. Examiner.

20 EXAMINER STOGNER: Exhibits 1 through 4 will be
21 admitted into evidence at this time.

22 MR. CARR: And that concludes my direct
23 examination of Mr. Maloney.

24 EXAMINER STOGNER: Thank you, Mr. Carr.

25 Mr. Cavin, your witness.

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

2 EXAMINATION

3 BY MR. CAVIN:

4 Q. Mr. Maloney, I wanted to ask you a few questions
5 about the April 19th hearing. I believe you testified at
6 that hearing?

7 A. Yes, sir.

8 Q. And did you review the transcript, have you
9 reviewed the transcript of that hearing?

10 A. No, I have not.

11 Q. Okay, but you prepared some of the exhibits that
12 were presented at that hearing?

13 A. Yes, sir.

14 Q. Okay. And do you remember what Bettis, Boyle and
15 Stovall was asking for at that hearing?

16 A. Yes, sir, we were trying to, again, pool all of
17 the uncommitted interests in the Lots 3 and 4 for the Bough
18 C test.

19 Q. Okay, and specifically, Sun-West interest, do you
20 remember what you were asking for at that hearing on April
21 19th?

22 A. That any interest owner either join or be pooled
23 for the drilling of that well.

24 Q. Well, weren't you essentially asking for the same
25 thing you're asking for today, that they be treated as

1 unleased interest owner?

2 A. (Nods)

3 Q. I'm sorry, you have to speak up.

4 A. Yes, sir.

5 Q. Okay. And has anything changed since that
6 hearing date, any material fact that's changed, to your
7 knowledge?

8 A. No, sir.

9 Q. Okay. Has Bettis' position changed in any way,
10 in a material sense?

11 A. No, not that I know of.

12 Q. And you testified about this at that hearing,
13 didn't you?

14 A. Yes, sir.

15 Q. Okay. Now, I was going to ask you about your
16 efforts to lease the Sun-West interest. Do you feel like
17 you made a good faith effort to obtain a voluntary
18 agreement?

19 A. Yes, sir.

20 Q. Okay, and what did you offer them?

21 A. Our original offer was \$50 an acre and a 3/16 for
22 a three-year oil and gas lease. This same tract had been
23 leased previously about four -- I believe it was four years
24 ago, and that was kind of the going rate at that time.
25 They did not lease at that time. A number of the other

1 ones had. But there were also some owners that appeared to
2 be unlocatable.

3 Q. Okay.

4 A. I guess that's a word. We asked for a title
5 opinion from the Hinkle firm in late November. As soon as
6 we had the large mineral owner who owns the surface leased,
7 we sent the offer. And again, we knew who everyone was,
8 according to Calder Ezzell's opinion, at least. We then
9 made those initial offer of \$50 an acre.

10 Mrs. McGuffin, the larger mineral owner, had
11 agreed to lease but only at \$100 an acre. So I proposed
12 the same thing to Mr. Spear and told him that since we had
13 originally sent out of offers I could go with a higher
14 bonus and treat everyone the same, but I could not go with
15 the quarter royalty.

16 And he said, Well, you know, we'd like to lease
17 but we need a quarter royalty and, again, more money. He
18 wanted \$150 an acre, as well as the higher royalty. And we
19 said we can't do this.

20 Q. Okay, so did you ever offer any more than the
21 3/16 royalty?

22 A. No, sir.

23 Q. Okay, so the 3/16 was your first offer and your
24 last offer; is that correct?

25 A. That's correct.

1 Q. Okay. Now, are you familiar with what other
2 leases go for in this area?

3 A. Only from the -- This is fairly wild area in
4 terms of Lea County. From, you know, past experience it
5 did not appear that this would be \$150-, \$200-an-acre
6 country. And again, my client here had been involved in
7 the leasing, W.T. Probandt was also involved in the prior
8 deal. He's the geologist who's -- this prospect. So we
9 were fairly familiar with that.

10 Randy Richardson who was the old landman, I think
11 you know very well in Roswell, represented Mrs. McGuffin in
12 this, and we did our negotiations with her through Randy,
13 and he said, Yes, this is -- you know, this -- more than
14 fair.

15 Q. What was the going rate four years earlier?

16 A. Fifty --

17 Q. Okay, and --

18 A. -- fifty dollars an acre.

19 Q. I'm sorry, what royalty four years earlier?

20 A. Three-sixteenths as well.

21 Q. Okay, things had not changed in that four-year
22 period, the best you know?

23 A. No.

24 Q. Okay.

25 A. There hadn't been any more discoveries or

1 anything like that.

2 Q. Now, you said it's a wild area. Are there other
3 producing wells in this area?

4 A. There's some San Andres wells just to the north,
5 Mr. Cavin, in Section 19, that I'm familiar with. I think
6 that Mr. Stubbs in the April 19th hearing testified as to
7 the other production in this area, but again I'm familiar
8 with 19 because we've also tried to work trades up there in
9 the past. It's pretty marginal San Andres production, it's
10 quite a bit of water with it. It's expensive.

11 Q. Okay. Now, so you would consider 3/16 and \$100
12 an acre as sort of your take-it-or-leave-it offer; would
13 that be a fair characterization?

14 A. Yes, sir.

15 Q. Okay. Now, can you tell me what the net revenue
16 interest is to the working interest owners as it now stands
17 with a 27-1/2-percent royalty to Sun-West?

18 A. I have not done that calculation for the purpose
19 of today's hearing, but we basically would have 83-point-
20 some percent at that 81.25. And again, the royalty on the
21 unleased interest of the Kirby and Neal was 87 1/2, leaving
22 the Sun-West interest, depending on whether it's leased or
23 unleased -- You'd have to factor that. If it was, you
24 know, 87.5, then obviously we're going to have a higher
25 NRI.

1 Q. Well, let me ask you, assuming it's a 27-1/2-
2 percent royalty, would it be fair to say that the net
3 revenue interest and the working interest owners would be
4 in the range of 78 percent?

5 A. I think that is correct.

6 Q. Okay.

7 A. Yeah.

8 Q. All right. Now, when you went out and leased,
9 did you just strictly do it off what people are paying or
10 leasing land in that area for?

11 A. I think that was certainly a consideration, yes.

12 Q. Okay, so Mr. Stubbs' report, where he gets into
13 3/16 royalty versus a quarter royalty, that was -- I mean,
14 you didn't base your leasing on his economics, did you?

15 A. No.

16 Q. Okay. Now, have you reviewed Mr. Stubbs' report?

17 A. Briefly, yes.

18 Q. Are you prepared to testify on the economics of
19 this venture today?

20 A. That I would defer to the prior testimony of Mr.
21 Stubbs, really --

22 Q. Okay.

23 A. -- yeah.

24 Q. Okay, but do you remember his testimony on the
25 rate of return that he had ascribed to these various net

1 revenue interests?

2 A. Yes, somewhat. I have to qualify that.

3 Q. Okay.

4 A. If I had a copy of it here I could probably -- It
5 seemed to me like, Mr. Cavin, that he testified that a
6 75-percent, he felt, was just too risky, and he had a risk
7 factor associated with various scenarios, you know,
8 geology, is this going to hit the pay, et cetera.

9 Q. Well, basically -- tell me if I'm wrong -- he
10 basically took an average well calculation and then came up
11 with a rate of return based on different net revenue
12 scenarios?

13 A. Yes, sir.

14 Q. Okay. And on what he says is a quarter override
15 -- and I believe he means a royalty interest probably --

16 A. Yes, sir.

17 Q. -- he indicated that the average well would
18 return 20 percent. Is that consistent with your
19 recollection?

20 A. I think that is correct.

21 Q. Okay. And that would be paying a \$150 bonus.
22 And here, you wouldn't be paying any bonus on this lease,
23 would you?

24 A. On -- ?

25 Q. On the lease that Gulf Coast now has.

1 A. No.

2 Q. Okay. And the other case he described was a 3/16
3 override. Again, I assume that he's referring to royalty;
4 would that be --

5 A. I think that you're correct there.

6 Q. Okay, and a \$100 bonus. And the rate of return
7 there is 30 percent, and again this is on an average well.
8 Is that your recollection?

9 A. Again, I would have to look at it, but --

10 Q. Okay.

11 A. -- yes.

12 Q. And he didn't give any credit in any of his
13 calculations for uphole pay or anything like that; is that
14 correct?

15 A. Again, I believe you're right.

16 Q. Okay. And did he factor in the fact that Bettis
17 would get a 200-percent penalty on the lease to Gulf Coast?

18 A. I honestly cannot recall that one.

19 Q. Okay. Now -- So just so I make absolutely sure,
20 because there was a little bit of confusion in the
21 Application as opposed to what we're discussing today, at
22 least from my perspective, you're not asking for a
23 reduction in the royalty, in essence, you're just asking
24 that it all be treated as unleased?

25 A. Well, I don't know -- I think -- At the time the

1 application was filed, it was released.

2 Q. Okay, I'm sorry, I'm asking about this
3 Application to reopen. I'm just trying to find out what
4 you're asking for here. Are you asking that it be treated
5 as released?

6 A. We're asking that the royalty interest of Sun-
7 West Oil and Gas, Inc., be treated as 12-1/2-percent
8 royalty --

9 Q. Okay.

10 A. -- as opposed to 27-1/2-percent.

11 Q. Okay, so you're not suggesting that you wouldn't
12 recognize the Gulf Coast lease in terms of what Gulf Coast
13 has? Do you see the difference?

14 A. Well, Gulf Coast -- as it stands right now, Gulf
15 Coast has 100-percent working interest in a 15-percent
16 mineral interest lease with a 27-1/2-percent royalty
17 burden.

18 Q. Yes. But what I understood is, you were asking
19 for the Division to treat this interest as being released.

20 A. I believe that is correct.

21 Q. Okay, in which case, are you trying to -- are you
22 asking that the Division ignore the lease to Gulf Coast?

23 A. Yes.

24 Q. So that Gulf Coast wouldn't have any interest
25 under what you're asking for?

1 A. I believe that -- well --

2 MR. CARR: May it please the Examiner, I believe
3 he's being asked questions that really are the legal
4 argument.

5 Our position -- I can state it -- is, we don't
6 quarrel with who holds the lease. We believe that the
7 sequence is such that it imposes an unreasonable burden on
8 the tract, and what we're looking at is what the royalty
9 burden is. We're not saying you can't lease your property
10 to anyone. Our argument will, I think, clarify this. But
11 we're saying that once you commence a pooling action you
12 can't lease it to yourself and increase the burdens and add
13 additional burdens that run in the face of what the OCD is
14 trying to do. I'll explain that in the argument.

15 But our position was correctly stated by Mr.
16 Maloney. We believe that the royalty burden should be
17 12 1/2 percent, not 27 1/2 percent, whether it's held in
18 the name of Gulf Coast or Mr. Spear and his family or held
19 in the name of Sun-West, Mr. Spear and his family.

20 EXAMINER STOGNER: Does that clarify, Mr. Cavin?

21 MR. CAVIN: Well, I think what I heard him say
22 was that the Gulf Coast lease would be ignored. Is that --
23 You would still recognize that; is that what you're
24 proposing?

25 MR. CARR: Correct.

1 MR. CAVIN: Okay, yes, sir, thank you.

2 Q. (By Mr. Cavin) Mr. Maloney, I was going to ask
3 you some questions about the two entities, Sun-West and
4 Gulf Coast. Can you remember exactly what Mr. Spear told
5 you when he was describing the two entities and their
6 relationship?

7 A. Only that they were both family companies. In
8 the directory, as I recall, Nelson was the president and
9 Shane was the vice president, and I had asked him because I
10 had leased them before about -- It was my understanding
11 Nelson was no longer president, Shane was now president,
12 and he affirmed yes, that's the same in both companies.

13 Q. Okay. I'm sorry, Armstrong directory, what does
14 that tell you? Does it tell you who the directors are and
15 the officers are, or --

16 A. Generally, yes, the president and vice president,
17 sometimes the secretary, their address, phone numbers.

18 Q. Okay. Does it tell you who the owners are?

19 A. Not necessarily.

20 Q. Okay. So you wouldn't dispute the fact that the
21 ownership is different in these two entities? Do you have
22 any basis to do that?

23 A. No, I do not. I have not checked further, in all
24 honesty, on that.

25 Q. Okay, and it wouldn't tell you that anyway --

1 A. No.

2 Q. -- Armstrong wouldn't?

3 A. No.

4 Q. And your sources in Midland couldn't tell you
5 that either, right?

6 A. No.

7 Q. Okay. Now, would it tell you that Gulf Coast is
8 a Delaware corporation?

9 A. I don't recall, I really don't. I don't think
10 so. I don't think it shows in the articles of
11 incorporation or with the State. You'd have to check with
12 the Secretary of State. As I recall, Sun-West was a Texas
13 corporation. I can't recall, again, whether Gulf Coast
14 showed as a Delaware or a Texas. I thought it was Texas.

15 Q. And how did you learn that Sun-West was a Texas
16 corporation, I'm sorry?

17 A. On their acknowledgements.

18 Q. Okay. And you don't dispute that they're
19 separate legal entities, do you?

20 A. Again, I don't really know exactly what --

21 Q. I mean, did you make any --

22 A. -- they're certainly --

23 Q. I'm sorry.

24 A. -- two different names.

25 Q. Did you make any inquiry to ascertain whether

1 they're separate legal entities?

2 A. No.

3 Q. Okay. So if I'm reading Mr. -- and I'm jumping
4 around on you, I apologize. I'm about to finish up. If
5 I'm reading Mr. Stubbs' report right, and we already
6 covered this, a quarter royalty is a 20-percent rate of
7 return on an average well, and the 3/16 royalty is a 28-
8 percent rate of return, I think you would agree with me
9 that the 78-percent net or thereabouts that you have would
10 be somewhere between those two, rate of return?

11 A. I would agree with that.

12 Q. Okay. So basically we're probably looking at 24-
13 something, roughly 24-percent rate of return?

14 A. That I can't tell you on the exact rate of
15 return, I don't recall his -- But as I recall, the 25-
16 percent, he felt, was uneconomical in today's market, with
17 the prices what they were.

18 MR. CAVIN: Okay, I have no further questions.

19 EXAMINER STOGNER: Thank you, Mr. Cavin.

20 Any redirect?

21 MR. CARR: No redirect.

22 EXAMINER STOGNER: It's obvious in reopening
23 we're going to take administrative of the previous case in
24 this particular instance.

25 MR. CARR: Yes, sir.

EXAMINATION

BY EXAMINER STOGNER:

Q. Now I don't have the previous exhibits, but did you contact Gulf Coast originally, or was it just Sun-West?

A. Sun-West.

Q. So you didn't know anything about the Gulf Coast until after --

A. No, sir, it was --

Q. Well, it's --

A. I think it was February the 20th when they faxed us a copy of the letter, and they sent it to Mr. Carr, and sent a copy of it to me, Mr. Examiner. And again, that was the first I knew of them.

Q. Okay, that was the February 15th letter?

A. Yes, sir, they faxed us on the 20th.

EXAMINER STOGNER: There being no other questions of Mr. Baker at this time, I think we're ready for closing statements, legal argument.

MR. CARR: As the Applicant, I ordinarily would go last, but I am prepared to go anytime. Would you like me to argue?

EXAMINER STOGNER: Gentlemen, I'll let you decide.

MR. CAVIN: Go ahead if you want, Bill.

MR. CARR: I'm prepared to go forward. I may

1 have a response after Mr. Cavin argues.

2 I think we ought to put this in some context.

3 This is a follow-up to a hearing, a reopened case. The
4 case was originally presented on the 19th of April. It was
5 a compulsory pooling case. And at that time notice of the
6 application was provided to Sun-West. They did not appear.

7 The order was entered in the case, but it didn't
8 address one of the questions raised, and that was, how do
9 you treat an additional burden that is placed on a property
10 subject to pooling after the Application was initially
11 filed.

12 Today I've called a land witness who provided a
13 chronology, and it is our belief that there is at least
14 overlapping if not virtually identical ownership between
15 Sun-West and Gulf Coast. They've both had notice. And
16 although we've asked a land witness to speculate, we don't
17 know. All we know is, they used the same address, they
18 have the same telephone number, they have listed in a
19 directory the same officers, and when you call either of
20 them you talk to the same person on the phone. We assumed
21 they were the same.

22 But that is not an issue that's going to be
23 determinative of what we're trying to bring to you today.
24 We're bringing to you an issue which we think is of
25 importance. It's not completely new, and I'll get into

1 that in a minute. Similar questions have been heard
2 before. But it is an issue that has a direct impact on
3 this and other pooling orders because of the precedent you
4 can set. It has a direct impact on your jurisdiction and
5 your ability to carry out your authority under the Oil and
6 Gas Act to pool properties.

7 And we are asking you to issue an amended order
8 and treat the Sun-West/Gulf Coast interest as if it is
9 burdened with a 1/8, 12-1/2-percent royalty, not a 27-1/2-
10 percent royalty.

11 And the facts that you need to consider to
12 address this issue are relatively simple. As required by
13 the Oil and Gas, the parties negotiated with one another.
14 The OCD doesn't tell them what is a good deal or what is a
15 bad deal; every company's economics are different. But you
16 require they attempt to reach an agreement. And they did,
17 they attempted. No agreement was reached.

18 And the issue in those negotiations was, how much
19 of a royalty burden could be placed on this interest and
20 still have an economic prospect for Bettis, Boyle and
21 Stovall. And they told Sun-West that 25 percent was too
22 high.

23 And it reached a point where they were prepared
24 to go forward with the well, it was set forth in the
25 letters that are in the record of this case.

1 And when they couldn't reach an agreement they
2 did what they're supposed to do, they filed an application
3 seeking an order from this Division pooling those lands.
4 They provided notice to Sun-West. Sun-West got the notice,
5 7th of February, 6th of February, one of those days, and
6 signed a return receipt. It's in the record of the case.

7 And a week later, on the 15th, having not been
8 able to reach a voluntary agreement to set a royalty rate,
9 what did they do but they leased it to another company,
10 Gulf Coast, same directors, same address, same phone
11 number, same person to talk to on the phone, and they put a
12 15-percent additional burden on the property. And all of a
13 sudden they come and say, Well, go ahead, pool us. But by
14 the way, what we couldn't reach in terms of an agreement
15 before you took it into the regulatory practice, we have
16 done by private contract. We have 27-1/2-percent royalty
17 burden.

18 We submit they contractually changed the game at
19 that time, after we were before the regulatory body.

20 I think the question here is not whether or not
21 Gulf Coast owns the working interest or Sun-West. We don't
22 care. We'll pay whoever is the rightful owner of that
23 interest.

24 But the question here, is this interest to be
25 treated, for the purposes of the pooling order, as the

1 unleased mineral interest that it was when the application
2 was filed, or as a leased interest burdened with a 27-1/2-
3 percent royalty?

4 Now, we submit that unless you agree that this
5 regulatory scheme we work in can be circumvented by a
6 private contract, that you must treat the interest as an
7 unleased mineral interest. And there is precedent for what
8 we ask. And I have the orders and I'll provide copies to
9 all of you here in a minute.

10 In a case, Number 8640 -- this is a 1985 case in
11 which Caulkins Oil Company was here. They were concerned
12 that a tract they were trying to pool had a royalty burden
13 on it that was unreasonable and would affect their economic
14 ability to drill the well. And the Oil Conservation
15 Division pooled the lands and directed the parties to
16 reduce the overriding royalty, because to do otherwise
17 would be to enter a compulsory pooling order under terms
18 that were not just and reasonable to the party who was
19 drilling the well. And I have copies of that order.

20 In 1998, Order Number R-11,109, Nearburg
21 Exploration Company was attempting to pool a tract. That
22 tract had -- One of the parties being pooled was Merit
23 Energy Company, and they had what the order says is an
24 internal net profits interest, the details of which had not
25 been disclosed to Nearburg, which might unnecessarily

1 burden Merit's working interest.

2 And what did the OCD do? Well, the OCD said that
3 they were going to treat the full working interest,
4 including the net profits interest, as being subject to the
5 cost of drilling, the cost of completion and the penalty.

6 That's what we're asking you to do here today.
7 We're saying we don't care what they do today or what they
8 did at any time after our Application was filed. But the
9 interests are fixed on that date, and your jurisdiction --
10 An operator can't go out and start playing games. If so, I
11 guess I'd advise everyone I represent to form a sham
12 company.

13 And if Mr. Cavin's clients are trying to pool
14 you, well, after you get the pooling notice, pass it to
15 yourself and carve out a big royalty or an override, or
16 create a net profits interest. And do these things because
17 the net effect is to take the burden off of you and put the
18 burden on the guy who's going to bear the risk of
19 developing the property, who's going to pay the cost, who's
20 going to drill the well. And you said in the Nearburg case
21 that that is something you cannot do.

22 And I submit that both of those -- one's a net-
23 profits interest and one's an override, neither are royalty
24 -- both of them are good precedent for the issue before you
25 today.

1 In 1997 there was a case, Branko, Inc., et al.
2 This is a case that was a complicated matter before the
3 Division and the Commission on a number of occasions. The
4 order in that case, the final order, is Order Number
5 R-10,672-A.

6 This involved a pooling case. There were
7 interests that were not of record. And at the time of the
8 hearing, Branko's counsel came in and said, There are
9 different parties you need to pool, although their
10 interests aren't of record. Here they are. Mitchell
11 Energy went ahead, stood on the pooling order and said they
12 weren't of record on the day we filed. The day you file is
13 the day that counts.

14 And the Oil Conservation Commission entered an
15 order, and it concluded that they weren't entitled to
16 notice. It finds in the conclusions of law that are on
17 pages 8 and 9 of this order -- and I have copies of this --
18 basically it notes that under New Mexico law these are
19 interests that must be recorded in the county, that they
20 were not on the day the Application was filed, and as such
21 these people were not entitled to notice.

22 We submit that that same theory applies here.
23 The interest on the day our Application was filed was
24 simply that we were dealing with an unleased mineral
25 interest.

1 Now, what do you do with an unleased mineral
2 interest? We have a pooling statute. It says where you've
3 got more than one interest in a spacing unit, where one
4 interest owner proposes to drill, has a right to drill and
5 can't reach a voluntary agreement, it says then you bring
6 an application here, and after notice and hearing, the
7 statute says, the Division shall enter an order pooling
8 said lands.

9 And we recite that over and over again to you,
10 every week I come over here and recite. It's a very easy
11 way to practice law, you only have to memorize one section
12 of statute.

13 But it goes on beyond that, and it says, and I
14 quote, "If the interest of any owner or owners of any
15 unleased mineral interest is pooled by virtue of this act,
16 seven-eighths of such interest shall be considered as a
17 working interest and one-eighth shall be considered a
18 royalty interest, and he shall in all events be paid one-
19 eighth of all production from the unit and creditable to
20 his interest."

21 The statue says if we come before you and are
22 pooling an unleased mineral owner, you treat it as 1/8-7/8.
23 And we submit in this case we came before you and we sought
24 to pool an unleased mineral interest, and that interest by
25 statute should be divided 7/8-1/8, and that after the fact,

1 when faced with that, a party cannot be allowed to run out
2 and enter a private contract to circumvent the regulatory
3 process.

4 I tried to find a case on point, and I don't know
5 if it's a reflection on me or the status of the law, but
6 the case is a 1938 Oklahoma case, it's *Patterson vs.*
7 *Stanolind Oil*, and it's 77 Pacific 2nd 83. But it's held
8 that parties by private contract, agreement or assignment
9 cannot circumvent or preclude the Corporation Commission --
10 the Oklahoma entity -- from exercising its jurisdiction and
11 authority.

12 If you let parties start passing the ball around
13 and carving out interest, I submit you're authorizing
14 private contracts, agreements and assignments to run right
15 straight in the face of your jurisdiction, and you cannot
16 allow that to happen. The numbers will always be
17 different, it may be a royalty, it may be an override, it
18 may be a production payment, but the issue is always the
19 same.

20 They're changing the game. They're trying to
21 do -- by passing it back and forth among themselves or a
22 friend or an arm's length transaction, they are still going
23 to be changing the ownership and putting additional burden
24 on the party who's going to take the risk, who's going to
25 drill the well, and who's going to actually be going

1 forward developing the minerals of the State of New Mexico,
2 and they're going to put additional burden on them in a way
3 that is outside the Act.

4 Now, Texas doesn't have a compulsory pooling
5 statute, and I would submit that there are many wells that
6 might have been drilled in Texas, had they had such an act.

7 Whether, in fact, the final numbers sift out here
8 in a way that means that this well won't be drilled, I
9 can't say for sure. But I can say what's happened here
10 after we filed our Application increased the burden and is
11 making those who want to go forward rethink this issue.

12 If a well isn't drilled, I submit to you that's
13 waste. And I submit, if you don't take your stand on this
14 case, you're opening a door that will undercut your
15 jurisdiction.

16 MR. BROOKS: What were the facts of that Oklahoma
17 case, you say?

18 MR. CARR: Sir, it's an old, old decision. I'll
19 be happy to give it to you.

20 MR. BROOKS: Okay, well, I'm sure we can get it,
21 but --

22 MR. CARR: But it is --

23 MR. BROOKS: You --

24 MR. CARR: -- obviously even older than me.

25 MR. BROOKS: -- decide it as a proposition of law

1 in which --

2 MR. CARR: Yeah --

3 MR. BROOKS: -- the one side --

4 MR. CARR: -- right.

5 MR. BROOKS: -- a case of any age for a
6 proposition of law, I'd kind of like to know if the law was
7 applied on --

8 MR. CARR: I can --

9 MR. BROOKS: -- facts that were any way similar.

10 MR. CARR: Sure, and I can provide that to you
11 along with the orders.

12 I have also, and I will admit after the hearing,
13 with the orders, a memorandum and some proposed findings.

14 MR. BROOKS: Very good.

15 MR. CARR: And I will get that case for you.

16 MR. BROOKS: Thank you.

17 MR. CARR: I looked at it, but I was looking at
18 it fast, I didn't -- and --

19 EXAMINER STOGNER: Or if you can -- It's in the
20 *Oil and Gas Reporter*, isn't it?

21 MR. CARR: Well, it's -- Pacific site. I have
22 it --

23 MR. BROOKS: It's too old to be in the *Oil and*
24 *Gas Reporter* --

25 MR. CARR: It's in an old --

1 MR. BROOKS: -- if it's 1938.

2 MR. CARR: It's an old case --

3 MR. BROOKS: They didn't start the *Oil and Gas*
4 *Reporter* until about 1951, I don't believe.

5 MR. CARR: I think that's right. It's a 1938
6 case, but we do have a copy --

7 MR. BROOKS: Okay, well --

8 MR. CARR: -- we'll get it to you.

9 MR. BROOKS: -- if you'll furnish us --

10 MR. CARR: -- I will --

11 MR. BROOKS: -- we'd appreciate it.

12 MR. CARR: Yes, sir.

13 EXAMINER STOGNER: Mr. Cavin?

14 MR. CAVIN: Yes, sir, Mr. Examiner.

15 First of all, your original order was obviously
16 well thought out and carefully considered, and there was a
17 great deal of discussion at the prior hearing on this very
18 issue. So we certainly believe that the order may not have
19 addressed it, but it in our view addressed by omission.

20 First of all I would say there was not a good
21 faith effort to obtain voluntary agreement. They simply
22 went out and found out what the biggest lease owner would
23 lease for, and they used that as their standard, and they
24 hammered that home to everyone. They didn't budge from
25 that. And in my book that's not a good-faith effort to

1 reach voluntary agreement, and I think the record will show
2 that in terms of the letters they sent and also the
3 testimony today and at the 19th hearing.

4 We of course think that the Division should stay
5 out of private contracts, and by interjecting themselves in
6 this situation, we think you'd be getting right in the
7 middle of it.

8 These are separate legal entities, one of them is
9 a Delaware corporation. They've been set up for some time
10 now. They're not sham entities. They've got different
11 ownership. One of them is a Subchapter S Corporation,
12 which is a pass-through entity, one of them is a Subchapter
13 C Corporation. They serve different purposes, the
14 ownership is different, and frankly they're separate legal
15 entities, and we can't agree that this is a sham
16 transaction.

17 We believe it would be a serious problem -- Well,
18 we think there's a serious issue on the authority of the
19 Division to reduce the royalty or treat this as unleased
20 when, in fact, it's leased at the time you're entering the
21 pooling order. And to the extent that the Division may
22 have authority, it should only be used in extraordinary
23 cases.

24 And clearly, this is an extraordinary case. By
25 their own witness, the rate of return is somewhere between

1 20 and 30 percent on these wells, and that's if you take
2 the average wells, if you don't factor in upside potential
3 and if you don't factor in the 200-percent penalty that
4 they're going to get on the lease to Gulf Coast.

5 I would also point out -- I certainly didn't come
6 prepared to rebut all of the cases that Mr. Carr has cited.
7 I would, however, speak to the Branko case, since we were
8 unfortunate enough to be on the losing side of that case
9 that went all the way up.

10 First of all, we think *Branko* is distinguishable
11 in its facts, and we think it was wrongly decided, and it
12 could be a problem for the Division.

13 Mr. Carr noted that *Branko* holds that if there
14 isn't an instrument of record, that's the controlling
15 event. And we think that is bad law. If the parties have
16 actual notice, that's really the triggering event, in our
17 view, both in courts and before regulatory forums, and
18 certainly in the public records, actual -- where a pure
19 notice state and actual notice is more important than
20 constructive notice. So we would distinguish *Branko*.

21 So in summary we believe your prior order should
22 be affirmed without modification.

23 EXAMINER STOGNER: Is there anything further?

24 MR. CARR: Very briefly. I would just note that
25 there's no limit in the Oil and Gas Act on your

1 jurisdiction, no restriction that I can find in the Act
2 that would preclude you from reducing or directing as to
3 how a risk penalty should apply to the interests that are
4 subject to one of your pooling orders. The pooling statute
5 expressly says you're pooling all interests. It references
6 royalty interest owners.

7 And so, one, you can pool them, and I think under
8 the general powers of the statute you can determine to what
9 interest the penalty will apply.

10 We're not here challenging the lease. They can
11 lease it to Gulf Coast or to anyone they want. We're
12 simply stating that when you ordered that a penalty will be
13 imposed, you should have ordered that it will apply to
14 their working interest, but that in so doing it will
15 include any royalty interest that was carved out of that
16 working interest after the date the Application was filed.

17 EXAMINER STOGNER: Anything further?

18 MR. CAVIN: Well, I would just simply note, we
19 think there are serious due-process considerations, and
20 there would be really a taking here. And so there may be
21 authority in extraordinary circumstances, but we certainly
22 don't see it here.

23 EXAMINER STOGNER: What would be a sufficient
24 amount of time to get the written comments in, gentlemen?

25 MR. CARR: I'll be happy to file mine today,

1 they're ready to be filed. And then whatever Mr. Cavin
2 needs to respond would be fine with me.

3 MR. CAVIN: Okay, maybe a week, if that would be
4 acceptable?

5 EXAMINER STOGNER: A week, that would be fine.

6 MR. CAVIN: Mr. Examiner, I'm sorry, I'm going to
7 be in Alaska next week, I apologize. I'm leaving Saturday.
8 Just skipped my mind.

9 EXAMINER STOGNER: I assume you're asking for a
10 little bit --

11 MR. CAVIN: Well, I realized as I said that, that
12 I'm thinking a week ahead, and I'm really thinking two
13 weeks ahead. I'm going to be out of the office starting
14 Saturday. So with permission I'd like two weeks.

15 EXAMINER STOGNER: Two weeks.

16 MR. CARR: If he had a work matter that was
17 bogging him down, I wouldn't object, but... I have no
18 objection.

19 EXAMINER STOGNER: Two weeks is not an
20 unreasonable amount of time.

21 MR. CAVIN: Thank you.

22 EXAMINER STOGNER: So we'll accept your written
23 comments at this time, and you have a copy prepared for Mr.
24 Cavin.

25 Mr. Brooks, is there anything further?

1 MR. BROOKS: No, I -- satisfied, await the
2 written comments.

3 EXAMINER STOGNER: With that, since there's
4 nothing further in Reopened Case 12,601, hold the record
5 open for two weeks, pending Mr. Cavin's response, which
6 we'll then take it under advisement.

7 Gentlemen, thank you very much.

8 MR. CARR: Thank you, Mr. Stogner.

9 MR. CAVIN: Thank you, Mr. Stogner.

10 (Thereupon, these proceedings were concluded at
11 11:36 a.m.)

12 * * *

13
14
15
16
17 I do hereby certify that the foregoing is
18 a complete record of the proceedings in
19 the Examiner hearing of Case No. _____,
20 heard by me on _____ 19____.

21 _____, Examiner
22 Of Conservation Division
23
24
25

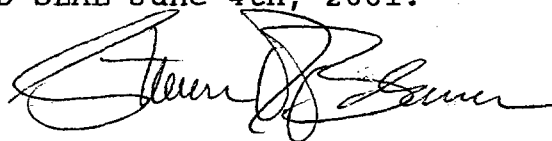
CERTIFICATE OF REPORTER

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 4th, 2001.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002