

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 CHI ENERGY, INC., FOR )  
COMPULSORY POOLING, EDDY COUNTY, )  
NEW MEXICO )

CASE NO. 13,449

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

March 17th, 2005

Santa Fe, New Mexico

2005 MAR 31 PM 1 27

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, March 17th, 2005, 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

March 17th, 2005  
Examiner Hearing  
CASE NO. 13,449

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\* \* \*

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

## FOR THE APPLICANT:

JAMES G. BRUCE  
 Attorney at Law  
 P.O. Box 1056  
 Santa Fe, New Mexico 87504

\* \* \*

## ALSO PRESENT:

Daniel A. McNabb, Interest Owner

\* \* \*

1           WHEREUPON, the following proceedings were had at  
2   8:24 a.m.:

3           EXAMINER STOGNER: At this time I will call Case  
4   Number 13,449, Application of Chi Energy, Inc., for  
5   compulsory pooling, Eddy County, New Mexico.

6           Call for appearances.

7           MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,  
8   representing the Applicant. I have one witness.

9           EXAMINER STOGNER: Any other appearances in this  
10   matter?

11          MR. BRUCE: Mr. Examiner, there is an interest  
12   owner in the audience.

13          EXAMINER STOGNER: Okay. Is there anybody in the  
14   audience that would like to appear in this matter and make  
15   a statement?

16          MR. McNABB: Yes, sir, my name is Daniel McNabb,  
17   and I'm an interest owner in this case.

18          EXAMINER STOGNER: Okay, will you be presenting  
19   any testimony? You're present- -- you're here on your  
20   behalf; is that correct?

21          MR. McNABB: Yes, sir.

22          EXAMINER STOGNER: I'll tell you what, why don't  
23   you come up here and take a seat, and that way you'll have  
24   a table that you can spread out on. We are somewhat  
25   informal here, but yet we are on the record, so I'll be

1 asking you to participate at certain times.

2 Any other appearances in this matter?

3 Just for the record, Mr. McNabb, where is your  
4 place of residence?

5 MR. McNABB: Colorado Springs, Colorado.

6 EXAMINER STOGNER: And you're a royalty or  
7 working interest?

8 MR. McNABB: I would be a working interest owner  
9 in this property. I have owned leases in this area,  
10 interests and leases in this area, for -- beginning in  
11 1985.

12 EXAMINER STOGNER: No other appearances, let's  
13 continue.

14 Mr. Bruce.

15 MR. BRUCE: If I could have my witness sworn in.

16 (Thereupon, the witness was sworn.)

17 RANDALL FORT,

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

20 DIRECT EXAMINATION

21 BY MR. BRUCE:

22 Q. Would you please state your name for the record?

23 A. My name is Randall Fort.

24 Q. And where do you reside?

25 A. In Albuquerque, New Mexico.

1 Q. What is your occupation?

2 A. I'm an oil and gas landman.

3 Q. What is your relationship to Chi Energy in this  
4 case?

5 A. I'm a landman consultant, so I consult for Chi.

6 Q. Okay, and you've worked with them on this  
7 project?

8 A. Right.

9 Q. Have you previously testified before the Division  
10 as a landman?

11 A. Yes, sir, I have.

12 Q. And were your credentials as an expert accepted  
13 as a matter of record?

14 A. Yes, sir.

15 Q. And are you familiar with the land matters  
16 involved in this Application?

17 A. Yes.

18 MR. BRUCE: Mr. Examiner, I'd tender Mr. Fort as  
19 an expert petroleum landman.

20 EXAMINER STOGNER: Any objections?

21 Mr. Fort is so qualified.

22 Q. (By Mr. Bruce) Mr. Fort, could you identify  
23 Exhibit 1 and describe what Chi Energy seeks in this case?

24 A. Yes, Exhibit is a plat of that area. It shows  
25 Section 25 there, the north half of Section 25 is the area,

1 in Township 19 South, Range 29 East, and that north half of  
2 Section 25 is what they're desiring to pool, all  
3 formations, surface to base of the Morrow formation.

4 Q. And Chi is only seeking to force pool 320-acre  
5 units; is that correct?

6 A. That's correct, right.

7 Q. Not 40s or 160s?

8 A. Right, that's correct.

9 Q. Okay. And on there, there is a little dot up in  
10 the northeast quarter, northeast quarter. Is that the  
11 location of the proposed well?

12 A. Yes, sir, that's correct.

13 Q. And what interest owners does Chi Energy seek to  
14 pool in this matter?

15 A. We seek to pool those working interest owners  
16 that are shown on Exhibit 2.

17 Q. And does Exhibit 2 also set forth their working  
18 interests in the 320-acre unit?

19 A. Yes, it does. Yes, it is.

20 Q. Okay. Now, one of the interest owners is Mr.  
21 McNabb, who's here. Is it your understanding that Mr.  
22 McNabb has signed an AFE at this point?

23 A. Yes, that's correct.

24 Q. And that he has also entered into some  
25 arrangement with Xeric Oil and Gas whereby part of his

1 interest is now owned by Xeric?

2 A. Right.

3 Q. And that Xeric has also signed an AFE; is that  
4 correct?

5 A. Correct, that's my understanding.

6 Q. At this point, no JOA has been signed between the  
7 parties?

8 A. Correct.

9 Q. Okay. Now, as we move down in time, if --  
10 assuming Mr. McNabb and Xeric and Chi do sign an operating  
11 agreement among themselves, would you notify the Division  
12 and request that Mr. McNabb be dismissed from this case?

13 A. Yes, we would.

14 MR. McNABB: I don't know whether it's proper or  
15 not --

16 MR. BRUCE: Go ahead.

17 EXAMINER STOGNER: I'm sorry --

18 MR. McNABB: -- you mentioned something that's  
19 incorrect. I at this time have not signed an AFE.

20 MR. BRUCE: Oh, I'm sorry.

21 MR. McNABB: Okay.

22 MR. BRUCE: I'm sorry, Mr. McNabb, I thought you  
23 said you had signed -- you told me the other day --

24 MR. McNABB: I am interested in doing so, once  
25 the joint operating agreement terms and conditions can be



1 completed.

2 MR. BRUCE: Okay. I'm sorry, I misunderstood you  
3 on the phone, then.

4 EXAMINER STOGNER: Okay, thanks for the  
5 correction.

6 Q. (By Mr. Bruce) Now, in looking at this list of  
7 interest owners, what records were searched in trying to  
8 locate the interest owners?

9 A. Basically searched the county records. And of  
10 course then, after we sent out letters, then we did  
11 Internet searches and phone searches, that type of thing.

12 Q. Okay, because there were a couple of -- two  
13 unlocatable interests?

14 A. That's correct, right.

15 Q. With respect to International Oil and Gas  
16 Corporation, was the Texas Secretary of State Records also  
17 contacted to see if there was a current address for  
18 International?

19 A. Right, that's right.

20 Q. Now, with respect to the people who were  
21 locatable, we'll get to this in a minute, but were proposal  
22 letters sent out to them?

23 A. Yes, they were.

24 Q. And is that marked Exhibit 3?

25 A. Yes, sir, those are Exhibit 3, exactly.

1 Q. And with respect to the locatable people, did Chi  
2 Energy also make phone calls to these people to try to get  
3 them to join the well?

4 A. Yes.

5 Q. Now -- and maybe Mr. McNabb can correct me on  
6 this, but I believe a JOA was sent to Mr. McNabb; is that  
7 correct?

8 A. That's my understanding that it was.

9 MR. McNABB: That's correct.

10 Q. (By Mr. Bruce) And also now, to Xeric Oil and  
11 Gas?

12 A. Correct.

13 Q. Okay. In your opinion, has Chi made either a  
14 good faith effort to obtain the voluntary joinder of the  
15 locatable working interest owners in the well or to locate  
16 the people who did not have a current address?

17 A. Yes.

18 Q. Could you identify Exhibit 4 and discuss the cost  
19 of the proposed well?

20 A. Yes, that is the AFE for this subject well. And  
21 as you see there, it's a 12,000-foot proposed test. It has  
22 a completed well cost of about \$1,600,000, \$1,650,000, a  
23 little over that.

24 Q. And are these costs in line with the costs of  
25 other wells drilled to this depth in this area of New

1 Mexico?

2 A. Yes, sir.

3 Q. Does Chi Energy request that Chi Operating, Inc.,  
4 be designated operator of the well?

5 A. Right, yes, sir.

6 Q. And does Chi Energy have a recommendation of the  
7 amounts which should be paid for supervision and  
8 administrative expenses?

9 A. Yes, they request \$6500 a month be allowed for  
10 the drilling well rate and \$600 a month be allowed for the  
11 producing well rate.

12 Q. And are these amounts equivalent to those  
13 normally charged by Chi and other operators in this area  
14 for wells of this depth?

15 A. Yes, they are.

16 Q. Does Chi Energy also request that these rates be  
17 adjusted periodically as provided by the COPAS accounting  
18 procedure?

19 A. Right, yes, they do.

20 Q. And if there are nonconsenting interest owners,  
21 does Chi request the maximum cost-plus-200-percent risk  
22 charge?

23 A. Yes, sir.

24 Q. And finally, were the interest owners notified of  
25 this hearing?

1 A. Yes.

2 Q. And is Exhibit 5 the affidavit of mailing to the  
3 locatable interest owners?

4 A. That's correct.

5 Q. And then is Exhibit 6 a copy of the notice  
6 published in the Carlsbad newspaper as against the  
7 unlocatable interest owners?

8 A. That's correct, yes, sir.

9 Q. Were Exhibits 1 through 6 compiled from Chi  
10 Energy business records?

11 A. Yes, sir, they were.

12 Q. And in your opinion, is the granting of this  
13 Application in the interests of conservation and the  
14 prevention of waste?

15 A. Yes, sir.

16 MR. BRUCE: Mr. Examiner, at this time I'd move  
17 the admission of Chi Exhibits 1 through 6.

18 EXAMINER STOGNER: Exhibits 1 through 6 will be  
19 admitted into evidence.

20 Do you have any other witnesses today, Mr. Bruce?

21 MR. BRUCE: No, I don't.

22 EXAMINER STOGNER: Okay, this is pursuant to some  
23 recent rules and regulations; is that correct?

24 MR. BRUCE: That is correct, sir.

25 EXAMINER STOGNER: We used to be able to -- or we

1 used to require a technical person, indeed, but that is no  
2 longer applicable --

3 MR. BRUCE: That is correct.

4 EXAMINER STOGNER: -- unless an objecting party  
5 has a problem with the overriding royalty -- I'm sorry, not  
6 the overriding royalty, the overhead charges and the risk  
7 penalty; is that correct?

8 MR. BRUCE: The risk penalty, or perhaps a well  
9 location or the overhead charges, yes.

10 EXAMINER STOGNER: Okay. Let's see, I have a  
11 couple of questions for clarification here.

12 EXAMINATION

13 BY EXAMINER STOGNER:

14 Q. What is the working relationship between the  
15 Applicant today, Chi Energy, Inc., and the proposed  
16 operator, Chi Operating, Inc.?

17 A. They're just subsidiaries of each other, just a  
18 part of the same company, basically.

19 MR. BRUCE: Chi Energy is the parent company, I  
20 believe, Mr. Examiner.

21 Q. (By Examiner Stogner) And it's a wholly owned  
22 subsidiary, Chi Operating, Inc. --

23 A. Yes, sir.

24 Q. -- of the parent company?

25 A. I believe that's correct.

1 Q. In looking at Exhibit Number 3, is this the first  
2 written correspondence with the parties to be force pooled?

3 A. (Nods) Yes. Yes, I'm sorry.

4 EXAMINER STOGNER: And Mr. Bruce, now, the  
5 Application for today's hearing was sent in on what, the  
6 22nd of February? Is that what your records show? And I'm  
7 looking at the public records at this point.

8 MR. BRUCE: Yeah, just hold on a minute, Mr. --  
9 That is correct.

10 EXAMINER STOGNER: So it was essentially a little  
11 under one month; is that correct?

12 MR. BRUCE: That's correct, Mr. Examiner. And I  
13 realize that's kind of cutting it, but I believe they have  
14 a rig in this area that --

15 Q. (By Examiner Stogner) Is that correct, do you  
16 have a rig available?

17 A. Yes, I believe that's correct.

18 EXAMINER STOGNER: All right, at this time, Mr.  
19 McNabb, do you have any questions of this witness? And I'm  
20 talking questions; at this point we're in the answering-  
21 question mode, after which I will allow you to present any  
22 testimony or have any statements that you may have.

23 But do you have any questions of the witness at  
24 this time?

25 MR. McNABB: Yes, sir, Mr. Hearing Examiner.

## EXAMINATION

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BY MR. McNABB:

Q. I was wondering if Mr. Fort could tell us if there are any geological studies or economic analyses available that Chi Energy has done on this property or on this project?

A. I believe -- it's my understanding they have, of course, done basic geology work on this prospect. But I'm -- like I say, I'm not sure if they've -- I don't think they've furnished that to everyone out there. In other words, they have done their basic geology on this prospect.

MR. BRUCE: And if I may respond, Mr. McNabb, I think the geologist on this prospect is a man named David Shatzer, S-c-h-a-t-z-e-r [sic] -- or Shatzer is probably the better pronunciation.

But if you call John Qualls, he's out of town, he's been out of town this week to discuss with them about that.

EXAMINER STOGNER: Any other questions?

MR. McNABB: No other questions.

EXAMINER STOGNER: Any follow-up?

MR. BRUCE: Just one comment, and maybe Mr. McNabb can comment on this too. I've been familiar with this township now for about five years on behalf of -- with respect to the Parkway West unit, and I believe that there

1 wasn't much exploration out here for a number of years, and  
2 just in the last couple of years there have been a few  
3 wells drilled, at least over in the Parkway West Unit, and  
4 they've been getting some pretty good results in the  
5 Morrow, some recent wells drilled by Devon Energy -- or it  
6 should be -- actually, it's Devon Louisiana Corporation,  
7 the successor to Ocean Energy. They have drilled some  
8 three or four Morrow wells and a couple of Bone Spring  
9 wells within that unit which have gotten some pretty good  
10 results.

11 It's one of those areas that has kind of lain  
12 dormant for a while, until somebody gets something good.

13 EXAMINER STOGNER: I don't have any other  
14 questions of this witness, you may be excused at this time.  
15 Please stick around in case we have any further...

16 MR. FORT: Okay.

17 EXAMINER STOGNER: Mr. McNabb, at this time if  
18 you'd like to make any statements, or do you have any  
19 papers that you'd like to present as evidence today, or any  
20 statements at this time?

21 MR. McNABB: Yes, sir, if I might --

22 COURT REPORTER: Excuse me, Mr. Examiner, maybe  
23 we should swear the witness at this point.

24 EXAMINER STOGNER: Very good, yes, for legalities  
25 I'm going to have the reporter swear you in.



1 (Thereupon, Mr. McNabb was sworn.)

2 EXAMINER STOGNER: Okay, yes, sir.

3 DANIEL A. McNABB,

4 the witness herein, after having been first duly sworn upon  
5 his oath, testified as follows:

6 DIRECT TESTIMONY

7 BY MR. McNABB: Mr. Hearing Examiner, after  
8 receiving Chi Energy's letter stating Chi Operating's  
9 proposed test, on January -- it was mailed January the  
10 28th, or it's dated January the 28th -- I responded with a  
11 letter which I dated February the 16th, and I at that time  
12 requested that Chi Energy furnish a draft operating  
13 agreement as at that time all I had been furnished was an  
14 AFE. There had been nothing else presented.

15 At that time I requested that the operating  
16 agreement include certain items as far as uniformity of  
17 interests, nonoperator's right to market gas and oil  
18 production of the equitable terms with other parties, and  
19 payment provisions which were equivalent to the payment  
20 provisions for joint interest billings.

21 Subsequent to that, just recently, I received an  
22 operating agreement, reviewed it, and returned my comments.  
23 There were some missing portions of the operating  
24 agreement, and I just received those two days ago. And I  
25 have not heard back yet as to my comments on the operating

1 agreement.

2 My comments on the operating agreement were not  
3 anything overwhelming. They're on one page of paper, so...

4 I'm at a point where I feel like I'm negotiating  
5 in good faith, and I want to get that concluded without  
6 being included in any compulsory arrangement.

7 It seems like there are two classes of parties  
8 here, parties that are interested in going forward with  
9 participating in the well and parties that can't be  
10 located, and perhaps it's appropriate for the parties that  
11 can't be located to be included in the compulsory  
12 arrangement, whereas the parties who are negotiating  
13 shouldn't necessarily fall under that compulsory type of  
14 arrangement.

15 EXAMINER STOGNER: Am I hearing that you feel  
16 that perhaps -- Would more time help?

17 MR. McNABB: Yes, it would. I would really want  
18 to see some geology on this and some information on an  
19 offset well that Chi just completed in the intermediate  
20 offsetting section to the east. It's this same prospect,  
21 it's -- referring to the exhibit that was Exhibit 1, it  
22 would be Section 30, I believe, in the northwest quarter.  
23 Immediately offsetting to the east, Chi has completed a  
24 well in the past two months, and I don't think any  
25 information has been filed on it yet.

1           So it would be, I think, important for all the  
2 interest owners to know what geological information and  
3 production characteristics are available in terms of the  
4 completion of that well.

5           EXAMINER STOGNER: Mr. Randall Fort, do you know  
6 if a rig has been scheduled? And I remind you, sir, that  
7 you're still on the witness stand here, under oath. Do you  
8 know, Mr. Fort, if a drilling rig is available and when  
9 that has been scheduled for this?

10          MR. FORT: No, sir, I don't.

11          EXAMINER STOGNER: Are there any leases that are  
12 expiring, state leases expiring?

13          MR. BRUCE: I can tell you that there are not  
14 any.

15          EXAMINER STOGNER: There's not any? Okay.

16          MR. BRUCE: Could I ask a question of Mr. McNabb?

17          EXAMINER STOGNER: You are a witness at this  
18 point, and that is appropriate.

19          MR. BRUCE: Just one question. Is it -- You  
20 haven't signed an AFE. Is it your intention that you'd  
21 like to sign a JOA and then make an election whether to go  
22 consent or nonconsent in the well?

23          MR. McNABB: Depending upon satisfactory JOA  
24 terms and conditions, I intend to consent to the well.

25          EXAMINER STOGNER: Mr. Bruce, do you think Chi

1 Energy -- What objections do you see, or is there a problem  
2 about maybe continuing this matter, at least hold the  
3 record open?

4 MR. BRUCE: I don't have a problem with holding  
5 it open until April 7th. As you know, orders don't -- for  
6 Mr. McNabb's information, orders don't get entered on the  
7 day of a hearing, Mr. McNabb. So even if the Hearing  
8 Examiner denied your request, a pooling order wouldn't be  
9 entered today.

10 MR. McNABB: I see.

11 MR. BRUCE: They take the cases under advisement,  
12 as the Hearing Examiner can tell you, and issue an order  
13 subsequently.

14 So I have no objection to continuing the hearing  
15 to April 7th, but I do know they would like to get this  
16 process moving because they do want to drill the well. But  
17 that will allow a couple of weeks, three weeks, for the  
18 parties. Is that right? Two -- Three weeks.

19 EXAMINER STOGNER: Yes, that would allow three  
20 weeks. In setting a year's schedule, always take into  
21 account, since we're on every other Thursday, of holidays.  
22 So it just so happened that that seemed the best time to  
23 make amends or to prepare for the Memorial Day weekend.  
24 That's how come we have three weeks --

25 MR. BRUCE: Yes.

1 EXAMINER STOGNER: -- and not the normal two  
2 weeks. And that happens sometimes, usually in the spring  
3 and the fall, just for scheduling purposes around the  
4 holidays.

5 At this time, I'm going to continue this matter  
6 until April 7th. If the parties -- That will allow both  
7 parties, Mr. McNabb and Chi Energy to hopefully discuss  
8 this a little longer. I made that comment about January  
9 28th, today's date. That does seem a little short, and I  
10 think this additional time could get those parties who seem  
11 to be willing to come up with a voluntary agreement to do  
12 that at this time.

13 And Mr. Bruce, I don't -- Unless you think it's  
14 necessary, Mr. McNabb, if you think it's necessary on April  
15 7th to appear at that time, you may do so, of course. But  
16 I do know that both parties have had to travel. And Mr.  
17 McNabb, I definitely appreciate your interest coming down  
18 today, especially in light of the recent snowstorms. You  
19 probably had a nice little drive.

20 MR. McNABB: I-25 was very clear and very  
21 uncrowded, so...

22 EXAMINER STOGNER: Thank goodness today was  
23 Thursday and not the hearing on Tuesday.

24 (Laughter)

25 EXAMINER STOGNER: So maybe Mr. --

1 MR. BRUCE: But I don't plan on presenting any  
2 other testimony, other than making a short statement as to  
3 whether or not Mr. McNabb and Chi Energy have come to terms  
4 on this matter.

5 EXAMINER STOGNER: Okay, at that -- the time, and  
6 seek -- the parties to keep Mr. Jim Bruce advised of that.  
7 So hopefully, Mr. Bruce, you will appear that day, and we  
8 can either take it under advisement or, if necessary, to  
9 consider any motions for continuance.

10 MR. BRUCE: Okay.

11 EXAMINER STOGNER: Unless either Mr. McNabb or  
12 Chi Energy thinks there's anything that needs to be brought  
13 up on the record at this point, I am prepared to at least  
14 close the file at this time in this matter.

15 Okay, there being none --

16 MR. FORT: That's fine.

17 EXAMINER STOGNER: -- then again the force  
18 pooling provision should be a last-ditch effort, and we  
19 definitely seek both parties to come out with a usually  
20 acceptable voluntary agreement.

21 At that time, then, we will stand in recess for  
22 about five minutes. Thank you.

23 (Thereupon, these proceedings were concluded at  
24 8:48 a.m.)

25

I do hereby certify that the foregoing is  
a complete record of the proceedings in  
the Examiner hearing of Case No. 13449,  
\* \* \* heard by me on 17 March 2005.

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

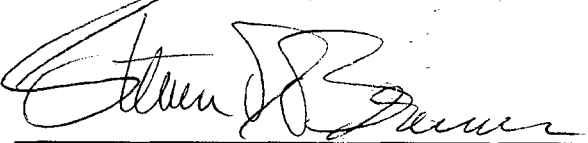
## CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL March 18th, 2005.



STEVEN T. BRENNER  
 CCR No. 7

My commission expires: October 16th, 2006