

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:

ORIGINAL

APPLICATION OF SOVEREIGN
EAGLE, LLC FOR COMPULSORY
POOLING, ROOSEVELT COUNTY,
NEW MEXICO.

CASE NO. 15224

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

December 4, 2014

Santa Fe, New Mexico

BEFORE: MICHAEL McMILLAN, CHIEF EXAMINER
GABRIEL WADE, LEGAL EXAMINER

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This matter came on for hearing before the
New Mexico Oil Conservation Division, Michael McMillan,
Chief Examiner, and Gabriel Wade, Legal Examiner, on
Thursday, December 4, 2014, at the New Mexico Energy,
Minerals and Natural Resources Department, Wendell Chino
Building, 1220 South St. Francis Drive, Porter Hall,
Room 102, Santa Fe, New Mexico.

REPORTED BY: Mary C. Hankins, CCR, RPR
New Mexico CCR #20
Paul Baca Professional Court Reporters
500 4th Street, Northwest, Suite 105
Albuquerque, New Mexico 87102
(505) 843-9241

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APPEARANCES

FOR APPLICANT SOVEREIGN EAGLE, LLC:

J. SCOTT HALL, ESQ.
MONTGOMERY & ANDREWS LAW FIRM
325 Paseo de Peralta
Santa Fe, New Mexico 87501
(505) 982-3873
shall@montand.com

FOR INTERESTED PARTIES YATES BROTHERS AND R. B. COWDEN
FAMILY PROPERTIES, LIMITED:

JAMES G. BRUCE, ESQ.
Post Office Box 1056
Santa Fe, New Mexico 87504
(505) 982-2043
jamesbruc@aol.com

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1 (9:31 a.m.)

2 EXAMINER McMILLAN: Call Case 15224,
3 application of Sovereign Eagle, LLC for compulsory
4 pooling, Roosevelt County, New Mexico.

5 Call for appearances.

6 MR. HALL: Mr. Examiner, Scott Hall
7 Montgomery & Andrews law firm, Santa Fe, appearing on
8 behalf of the Applicant. I have two witnesses this
9 morning.

10 EXAMINER McMILLAN: Any other appearances?

11 MR. BRUCE: Mr. Examiner, Jim Bruce
12 representing Yates Brothers and also R. B. Cowden Family
13 Properties, Limited, and I have possibly three
14 witnesses.

15 EXAMINER WADE: Will there be any
16 preliminary motions before the case begins?

17 MR. HALL: I have none.

18 MR. BRUCE: I have none. I'd like to
19 reserve a little time at the end to explain our
20 position.

21 MR. HALL: May we have the witnesses sworn?

22 EXAMINER McMILLAN: Why don't we swear them
23 in at the same time?

24 (Mr. Krakauskas, Mr. Lanning, Mr. Ball,
25

1 Ms. Magruder and Mr. Nobles sworn.)

2 MITCHELL "MITCH" KRAKAUSKAS,
3 after having been first duly sworn under oath, was
4 questioned and testified as follows:

5 DIRECT EXAMINATION

6 BY MR. HALL:

7 Q. For the record, state your name.

8 A. Mitchell Krakauskas.

9 Q. Would you spell that, please?

10 A. K-R-A-K-A-U-S-K-A-S.

11 Q. Mr. Krakauskas, where do you live and by whom
12 are you employed?

13 A. I live in Roswell, New Mexico, and I'm employed
14 by Strata Production Company.

15 Q. And what is the relationship between Strata and
16 the Applicant, Sovereign Eagle, LLC?

17 A. Sovereign Eagle is an affiliate of Strata.

18 Q. You're authorized to testify on Sovereign
19 Eagle's behalf then?

20 A. Yes.

21 Q. What do you do for Strata?

22 A. I'm a landman.

23 Q. And have you ever testified before the Division
24 and had your credentials as a landman established?

25 A. No, sir.

1 Q. Why don't you give the Hearing Examiners a
2 brief summary of your educational background and work
3 experience?

4 A. I've an agg business-agg economics degree from
5 New Mexico State University. I've been working for
6 strata for almost six years. I've been a landman for
7 nine years, and I'm a registered professional landman.

8 Q. Are you familiar with the application filed in
9 this case?

10 A. Yes, sir.

11 Q. And are you familiar with the lands that are
12 the subject of the application, as well as the subject
13 well?

14 A. Yes.

15 MR. HALL: At this point, Mr. Examiner, we
16 offer Mr. Krakauskas as an expert petroleum landman.

17 EXAMINER McMILLAN: So qualified.

18 Any objections?

19 MR. BRUCE: No objection.

20 Q. (BY MR. HALL) If you would, please,
21 Mr. Krakauskas, briefly summarize what Sovereign Eagle
22 seeks by its application today?

23 A. We seek to consolidate the north half of
24 Section 26, Township 2 South, Range 29 East in Roosevelt
25 County for the drilling of the Stoltenberg #2 well and

1 development of the Penn and Montoya Formations.

2 Q. Are you asking the Division to pool all
3 formations spaced on 320-acre, as well as 160-acre and
4 40-acre formations?

5 A. Yes, sir.

6 Q. And that would be the southeast of the
7 northwest for the 40-acre pools; is that right?

8 A. Correct.

9 Q. And the northwest quarter for all 160 acres
10 pooled?

11 A. Correct.

12 Q. And the north half for the 320?

13 A. Yes.

14 Q. You prepared certain exhibits for introduction
15 in this case?

16 A. Yes, sir.

17 Q. Let's look at those. If you would refer to
18 Exhibit Number 1 and identify that for us, please, sir.

19 A. This is our -- our C-101 approved and filed,
20 and our C-102 is attached as page 3.

21 Q. If we refer to the C-102, can the Examiners
22 identify the well that's the subject of this application
23 and its location?

24 A. Yes, sir.

25 Q. And is that the Stoltenberg Well #2?

1 A. Yes, sir.

2 Q. And is that a vertical well?

3 A. Yes.

4 Q. Are the surface and bottom-hole locations at an
5 orthodox location?

6 A. Yes.

7 Q. How long has Sovereign Eagle owned its lease
8 interest in the north half of Section 26?

9 A. Some of that interest was HBE, and we acquired
10 it through the purchase of Eagle Resources in 2007. The
11 remaining interest has been acquired through leasing
12 over the past two or three months.

13 Q. And if we look at the first page of the APD,
14 the C-101, when did Sovereign Eagle file its C-101, and
15 when did the Division approve it?

16 A. We filed it on October 22nd, and it was
17 approved on October 23rd.

18 Q. That's pretty good service from the Division,
19 isn't it?

20 A. Yes, sir. It was very fast.

21 Q. Let's look at Exhibit 2, if you could identify
22 that for us, please.

23 A. This is just -- has the northwest quarter on
24 pages 1 and 2 and the southwest -- I'm sorry -- the
25 northeast quarter, on page 3, this shows all the

1 unleased mineral interest owners. It shows their
2 current addresses, the original lessor, current lessor.
3 It shows some notes that we kept internally of when the
4 original leases were signed and when they were ratified,
5 and then it shows the percentage of ownership.

6 Q. All right. So if we look at the column that
7 says "Current Lessor," does that identify to the
8 Examiners each of the interest owners we're seeking to
9 pool here today?

10 A. Yes, sir, except for Lynn Waite Stoltenberg
11 Ray. Her name is in the Original Lessor column.

12 Q. Ah. Okay.

13 A. That's the only -- and the Danglade/Speight
14 Family, on page 3. They're under the original lessor.

15 Q. All right. And if you look under the column
16 that says "Miscellaneous Notes," a number of those
17 indicate the parties "will accept force pooling." What
18 does that mean?

19 A. That means they didn't object to force pooling.
20 We identified them, and they said, That's fine, go
21 ahead.

22 Q. Are you seeking to pool only unleased mineral
23 interests here today?

24 A. Yes.

25 Q. How many other interest owners did you seek

1 obtaining leases from?

2 A. We leased 24 other mineral interest owners in
3 the north half of Section 26.

4 Q. Did those 24 mineral interest owners find your
5 lease proposal and bonus to be fair and reasonable?

6 A. Yes, sir.

7 Q. Explain to the Hearing Examiners what
8 percentage of the 40-, 160-, 320-acre pools of the
9 formations is voluntarily committed to the --

10 A. Under the 40-acre pool, we have 69.88 percent
11 lease. Under the 160-acre pool, we have 69.88 percent
12 lease. And under the 320-acre pool, we have 79.53
13 percent lease.

14 Q. Does Sovereign Eagle seek the imposition of a
15 200 percent risk penalty against the unjoined [sic]
16 mineral interests?

17 A. Yes, sir.

18 Q. Does Sovereign Eagle also seek to be designated
19 operator of the well?

20 A. Yes, sir.

21 Q. Did you both participate and supervise the
22 negotiations for the various leases?

23 A. Yes, sir, I did.

24 Q. If you could explain how your company's
25 management works in that regard?

1 A. I run our land department, and I have a land
2 technician. We're a small operator. I have one land
3 technician that works for me. She does the majority of
4 our leasing. She took the leases, typed them up. I
5 reviewed everything. All communication that she got,
6 she passed by me. We discussed it before she responded.
7 And I reviewed everything that came across my desk. And
8 if you see her name on any of the exhibits, it's Grace
9 Charboneau. Her last name is C-H-A-R-B-O-N-E-A-U.

10 Q. Let's turn to Exhibit 3.

11 MR. HALL: Make sure that you have that,
12 Mr. Examiners. It's out of order in my set, but it
13 looks like --

14 EXAMINER McMILLAN: Says "6/23" on top?

15 MR. HALL: (Indicating.)

16 EXAMINER McMILLAN: Yeah. It's the same
17 one.

18 MR. HALL: Okay.

19 Q. (BY MR. HALL) Let's turn to Exhibit 3 now, if
20 you would identify that for the Examiners and explain
21 what that is.

22 A. This is a list -- a chronological list of
23 correspondence between Sovereign and the unleased
24 mineral interest owners divided up by owner.

25 Q. All right. So at the top of the list, can the

1 Examiners identify the interest owner --

2 A. Yes, sir.

3 Q. -- that these concern?

4 And at the very top, it's Yates Brothers
5 partnership. It's five pages. Does this represent all
6 of the communications, both e-mail and telephonic, that
7 your company had with the Yates Brothers?

8 A. To the best of my knowledge, yes.

9 Q. And, again, we can look and we can see the same
10 thing for the R. B. Cowden Family Properties?

11 A. Yes, sir.

12 Q. And then turn to AMAX Petroleum Corporation.
13 Let's discuss AMAX just briefly. Were you able to
14 locate anyone with AMAX?

15 A. No, sir, we were not.

16 Q. Tell us what you did to try to locate someone
17 to communicate with AMAX.

18 A. Started out, we went to the courthouse and did
19 a cursory title check, found an address that was listed
20 from the '80s or early '90s for AMAX, followed up with
21 that, sent them letters. No response. Got on the
22 Internet, looked up AMAX Petroleum, got on Wiki Corp
23 [sic], found the president, the vice president, the
24 secretary. We looked up all of those people. The
25 president had passed away a week and a half before we

1 called. The vice president was nowhere to be found. We
2 believe he had passed away a few years before. The
3 corporation was no longer in good standing with the
4 State of New Mexico, so we believe it was dissolved.

5 Q. All right. After AMAX, looking at Exhibit 3,
6 we have a chronicle of communications with Lynn Waite
7 Stoltenberg, right?

8 A. Yes, sir.

9 Q. And then also with Sue Anne Campbell?

10 A. Yes, sir. And they are sisters.

11 Q. And finally, we look at the last entries for
12 Exhibit 3. Do we see all the communications with
13 Michael Jackson Canon?

14 A. Yes, sir.

15 Q. These are the parties you were not successful
16 in obtaining leases from; is that correct?

17 A. Correct. Correct.

18 Q. With respect to Yates Brothers partnership, if
19 we look back on the first page of Exhibit 3 and look at
20 the entry for August 21, 2014, is that the date that the
21 lease was transmitted to the Yates Brothers' landman?

22 A. I believe so. Yes, sir.

23 Q. Let's turn to Exhibit 3A. Is Exhibit 3A
24 comprised of hard copies of all the e-mail
25 communications and letters back and forth between Yates

1 Brothers and Sovereign Eagle attempting to obtain a
2 lease from the Yates Brothers partnership?

3 A. Yes, sir. And it also contains all the
4 exhibits that were attached on those e-mails.

5 EXAMINER McMILLAN: Hold on a second so we
6 can follow.

7 EXAMINER WADE: I got it. I was just
8 trying to locate it.

9 MR. HALL: Okay.

10 Q. (BY MR. HALL) And if we turn to -- I tried to
11 tab all of these before we commenced the hearing. The
12 very last tab and turn to the letter dated August 21,
13 2014.

14 A. Yes, sir.

15 Q. Is that the transmittal letter for the first
16 lease proposal that was sent to Yates Brothers?

17 A. Yes, sir.

18 Q. Were you successful at obtaining a lease from
19 Yates Brothers?

20 A. No.

21 Q. Could you briefly summarize the nature of the
22 conversations with Yates Brothers?

23 A. We went back and forth. The first -- if you
24 can refer to Exhibit 3, you can kind of read through the
25 chronological order. And when we tried to contact or

1 discuss -- discuss our lease and -- you know, it started
2 out we had a difficult time getting an answer or getting
3 the lease reviewed. After it was reviewed, you know, we
4 were told that this is the worst lease that they had
5 ever seen.

6 There was -- you know, we went back and
7 asked them to revise our lease, trying negotiate the
8 terms of it. They sent us another lease form, which we
9 asked them, Can you revise our lease form? We have
10 multiple other mineral leases under this lease; we'd
11 like to remain consistent. They came back and revised
12 it. We, in turn, revised it again, accepted some of
13 their changes, couldn't accept others. We submitted
14 that to them, and then we were told, This isn't going to
15 work; let's go back to square one, we need to accept
16 their original lease. And that's kind of where we ended
17 it.

18 Q. So, ultimately, were you unable to come to
19 terms with Yates Brothers?

20 A. Yes, sir.

21 Q. And looking back to the August 21st lease
22 proposal, just tell the Hearing Examiners what were the
23 terms that were being offered.

24 A. Just the general bonus and royalty. The bonus
25 was \$25 per acre for a five-year lease and a one-sixth

1 royalty.

2 Q. And you were proposing to use a form created by
3 Sovereign Eagle; is that right?

4 A. Correct.

5 Q. Now, let's talk about the R. B. Cowden family
6 interest. Did you -- did the company negotiate with
7 those owners?

8 A. We were unsuccessful.

9 Q. Earlier you testified that you had leases with
10 24 other mineral interest owners for the spacing unit;
11 is that right?

12 A. Yes, sir, just for the spacing unit.

13 Q. And were those leases largely uniform to those
14 terms?

15 A. Yes, sir.

16 Q. Does Sovereign Eagle have an interest in
17 maintaining uniform leases for the various interests it
18 would be administering dedicated to this well and
19 spacing units?

20 A. Yes, sir, we do. We try to keep our bonus and
21 royalty payments consistent, and these are consistent
22 with all other leases that we took in the area. Some of
23 the provisions in the lease are necessary due to the
24 nature of this field, our processing costs and
25 maintaining production to our plant to be more

1 efficient.

2 Q. In your opinion, Mr. Krakauskas, has Sovereign
3 Eagle made a good-faith effort to locate and negotiate
4 with all of the unleased mineral interest owners in
5 order to obtain their voluntary joinder?

6 A. Yes, sir, we have.

7 Q. And in your opinion, the lease terms that
8 Sovereign Eagle offered for this area, are they fair and
9 reasonable?

10 A. Yes, sir.

11 Q. And in your opinion, has Sovereign Eagle acted
12 with diligence?

13 A. Yes, sir, we have.

14 Q. What is the status of the well?

15 A. The well has been drilled.

16 Q. Has it been completed?

17 A. No, sir, it hasn't.

18 Q. Let's turn to Exhibit 4.

19 A. That'll be the long -- the legal page at the
20 very back.

21 Q. Is that your AFE for the Stoltenberg #2 well?

22 A. Yes, sir, it is.

23 Q. Would you review those totals for the Hearing
24 Examiners, please?

25 A. Our projected dry-hole costs are 1,321,000,

1 with a completion cost of 673,000, for a total estimated
2 cost of 1,994,000.

3 Q. Are actual costs available to you yet?

4 A. Not at this time.

5 Q. You don't know what your actual completion
6 costs would be; is that right?

7 A. No, sir. I don't know.

8 Q. Has a decision been made to complete the well?

9 A. I believe so. That's not my decision.

10 Q. Does ownership differ as to depth?

11 A. No, sir.

12 Q. There is no need to worry about allocation
13 costs among the formation?

14 A. No.

15 Q. In your opinion, are the costs for the
16 Stoltenberg #2 in line with what's being charged by
17 other operators as close as you can get to this area?

18 A. Yes, sir. It's a very remote area. We're
19 about 35 miles from the nearest production, and to the
20 best of my knowledge, this is a fair price, going price.

21 Q. Have you made an estimate of the overhead
22 administrative costs while drilling and then producing
23 the well?

24 A. Yes, sir. The drilling overhead is \$13,660.33.

25 EXAMINER McMILLAN: Excuse me? 13 what?

1 THE WITNESS: \$13,660.33.

2 And the producing overhead is \$681.65.

3 Q. (BY MR. HALL) Now, are these rates based on the
4 Ernst & Young survey?

5 A. Yes, sir, they are, and based on an existing
6 JOA that we have on this area, adjusted for inflation.

7 Q. And what was the date of that survey?

8 A. I believe it was August 14th, 1986.

9 Q. And so the overhead rates stated in the JOA
10 have been brought forward and adjusted with inflation?

11 A. Yes, sir, in accordance with inflation.

12 Q. And that's how you get to the 13,000 --

13 A. Correct.

14 Q. -- drilling overhead?

15 A. Correct.

16 Q. Now, are these overhead charges in line with
17 what's being charged by other operators in the area?

18 A. Yes, sir, as far as I know.

19 Q. And are you recommending that these drilling
20 and producing overhead rates be incorporated into the
21 order that results from this proceeding?

22 A. Yes, sir.

23 Q. Does Sovereign Eagle request that the order
24 provide for adjustment of the overhead rates in
25 accordance with the current COPAS bulletin?

1 A. Yes, sir.

2 Q. At this time do you foresee the need to seek
3 authorization to commingle production with two or more
4 of the productive formations?

5 A. Yes, sir. We do in the Montoya and Penn
6 Formations.

7 Q. Is there an existing order for the Tule Field
8 that provides for commingling?

9 A. Yes, sir, there is.

10 Q. It will still be necessary to request a
11 downhole commingling for the single well?

12 A. Yes, sir.

13 Q. Do you anticipate being able to do that
14 administratively subsequent to this hearing?

15 A. Yes, sir.

16 Q. In your opinion, Mr. Krakauskas, would granting
17 Sovereign's application be in the best interest of
18 conservation and the prevention of waste and the
19 protection of correlative rights?

20 A. Yes, sir, I believe so. Without additional
21 production, this field risks being shut down.

22 Q. And this is a gas field; is it not?

23 A. Yes, sir. It is a gas field.

24 Q. Were Exhibits 1 through 4 prepared by you or at
25 your direction or control?

1 A. Yes, sir.

2 MR. HALL: Move the admission of Exhibits 1
3 through 4.

4 And if you'll allow me, Mr. Examiner, I'll
5 put in the notice exhibits at this time, so Exhibit 5 is
6 my Notice of Affidavit.

7 And Exhibit 6 is the Affidavit of
8 Publication for the AMAX interest, and it was advertised
9 in the Portales News Tribune twice.

10 EXAMINER WADE: To clarify, this notice
11 that is Exhibits 5 and 6 is based on the application
12 that was previously given to the OCD; is that correct?

13 MR. HALL: It's based on both. We were
14 asked to file an amended application because the well
15 had changed, 50 feet, and the well name is now
16 Stoltenberg #2. So you have notification for both.

17 The second round of the notification was
18 only to those interest owners that we are force pooling.
19 The other interests came in in the meantime.

20 EXAMINER WADE: Okay.

21 MR. HALL: So you can see my letter of
22 October 31st in there, and then there is a second letter
23 from me dated November 6th, 2014.

24 EXAMINER WADE: Exhibit 5?

25 MR. HALL: Yes.

1 EXAMINER WADE: Were you going to ask the
2 questions regarding if it is --

3 MR. HALL: I don't believe I need to.

4 I'd move the admissions of Exhibits 1
5 through 6. Is there anything I need to clarify for you?

6 EXAMINER WADE: I think we would like
7 clarification as to notice regarding the second
8 application. You know, you refer to a letter, but if we
9 can get some --

10 MR. HALL: Yeah.

11 (Exhibit Numbers 1 through 6 offered into
12 evidence.)

13 Q. (BY MR. HALL) Mr. Krakauskas, if you would
14 refer to Exhibit 5 and, in there, my letter dated
15 November 6th, 2014 --

16 A. Yes, sir.

17 Q. -- and then if you would turn back to Exhibit
18 Number 2.

19 A. Yes, sir.

20 Q. To your knowledge, were each of these interest
21 owners on Exhibit Number 2 provided with the second
22 round of notice for the amended application in this
23 case?

24 A. Yes, sir.

25 EXAMINER WADE: I'm sorry. You said every

1 mineral interest owner who got noticed?

2 MR. HALL: Everyone referenced on Exhibit
3 2.

4 THE WITNESS: All unleased mineral interest
5 owners.

6 EXAMINER WADE: All unleased mineral
7 interest owners.

8 MR. HALL: These are the remaining
9 outstanding interests reflected on Exhibit 2. There
10 were more parties identified, and that was for the first
11 round, but some of those interest owners came in and
12 delivered leases. Does that make sense?

13 EXAMINER McMILLAN: Do you have any
14 questions?

15 MR. BRUCE: Yeah, I've got questions. I
16 don't have any objection to the admission of the
17 exhibits, but I do have questions for the witness.

18 EXAMINER McMILLAN: Exhibits 1 through 4
19 will be accepted as part of the record.

20 EXAMINER WADE: You asked for 1 through 6?

21 MR. HALL: 1 through 5 -- correct, 1
22 through 6, please.

23 EXAMINER WADE: We're going to hold off on
24 5 and 6 for now.

25 MR. HALL: Okay.

1 (HEYCO Exhibit Numbers 1 through 4 were
2 admitted into evidence.)

3 CROSS-EXAMINATION

4 BY MR. BRUCE:

5 Q. Mr. Krakauskas, if the next witness would be
6 better answering these questions, let me know.

7 A. Yes, sir. Most of the technical stuff, I'll be
8 referring to David.

9 Q. Now, originally you sought to re-enter the
10 Stoltenberg #1 well, correct?

11 A. Correct.

12 Q. I think that was attempted in September?

13 A. I believe it was September. I don't know the
14 date off the top of my head.

15 Q. Okay. That's fine.

16 But it was unsuccessful?

17 A. Correct.

18 Q. Looking at the AFE, are any costs from the
19 original re-entering of the #1 included in the AFE for
20 the #2 well?

21 A. No, sir, they're not.

22 Q. And, again, if the next witness is better --
23 what is the primary zone? I know you talked about the
24 Penn and the Montoya. Which is the -- the Montoya?

25 A. I believe the Montoya, but I'll refer to David

1 on that. He can give you a better answer.

2 Q. Now, you mentioned that you leased 24 other
3 interest owners. And you might not know the answer, but
4 those parties who agreed to lease, are they
5 sophisticated in leasing in the oil and gas industry?

6 A. I can't answer as to all of them, but I can say
7 that some of them are large mineral interest owners that
8 are sophisticated in leasing.

9 Q. And were all of the people who leased aware of
10 the high post-production deductions?

11 A. I believe so. They were all notified of it,
12 and we discussed the lease with everybody.

13 Q. Now, you said this is an isolated area, but
14 there are other wells out here nearby?

15 A. Correct, operated by Sovereign. I believe
16 there are five, maybe six producing wells operated by
17 Sovereign.

18 Q. And I think two of them are the Perry well and
19 the Wendel Best?

20 A. Correct.

21 Q. And those wells are still producing?

22 A. Yes, sir.

23 Q. In looking at your Exhibit 2, you're listing
24 both interest owners?

25 A. Yes, sir.

1 Q. For both the Cowden Properties and Yates
2 Brothers, you state in here that they're not willing to
3 lease. That's not quite correct, is it? They just
4 wanted a different royalty and not be subject to the
5 post-production costs?

6 A. As I stated earlier, this was just a working
7 spreadsheet, so what Grace put in here was her
8 interpretation. It's her personal notes. It's not -- I
9 mean, by no means am I stating they'll never lease;
10 they're not going to lease. It's just -- like I said,
11 this is a working draft.

12 Q. Your drilling costs, 13,660, I just want to
13 make sure that what you're talking about is that the old
14 1986 JOA in this area, that has simply escalated, under
15 the COPAS accounting procedure from its original, up to
16 13,660 today?

17 A. Correct. That was done by our accountant
18 in-house. She keeps those numbers up-to-date regularly.

19 Q. And I want to be clear. On your lease form
20 that you sent to my clients, it provides for a deduction
21 of all post-production costs; is that correct? I
22 believe it's in Exhibit 3A, toward the back, paragraph
23 seven.

24 A. Yes, sir, it does, line 4.

25 Q. Now, on this lease you proposed to Yates

1 Brothers, it covers land outside the proposed well unit;
2 does it not?

3 A. Yes, sir, it does.

4 Q. Did Yates ever request that the southeast
5 quarter be removed from the lease?

6 A. Yes, they did.

7 Q. Did you ever agree to that?

8 A. No. I don't believe there was much discussion
9 on it. I think that we asked that they leave it in
10 there, and -- on our revision. And then I believe they
11 said they would like it removed, and then discussions
12 kind of ceased.

13 Q. Did you ever provide a well proposal itself
14 with the AFE to Yates Brothers and Cowden Properties?

15 A. No, I did not.

16 Q. This well unit is all fee land, correct?

17 A. This well unit? Yes, sir, it is.

18 Q. In this area, do you have federal and state oil
19 and gas leases?

20 A. Yes, sir, we do.

21 Q. How many other working interest owners are in
22 the well unit together with Sovereign?

23 A. In the Stoltenberg #2 well?

24 Q. Correct.

25 A. There are two other -- or two additional

1 working interest owners.

2 Q. And Sovereign and the other two working
3 interest owners, are they being -- do the same
4 post-production costs apply to them?

5 A. Yes, sir.

6 Q. And you said the #2 well has been drilled but
7 not completed?

8 A. Correct.

9 Q. In some of the correspondence, I saw something
10 about equipment rentals. What is the approximate cost,
11 do you know, of the equipment that is rented for
12 operating in this area?

13 A. I'd probably refer to David on that one.

14 Q. Is the rented equipment operated by Sovereign
15 Eagle?

16 A. No, sir, to the best of my knowledge. I mean,
17 when I'm thinking rented equipment, I'm thinking, you
18 know, used in the drilling and it's not operated by
19 Sovereign.

20 MR. LANNING: I can address that.

21 Q. (BY MR. BRUCE) I'll ask the next witness.

22 A. Yes, sir.

23 Q. You mentioned that there are four or five other
24 wells in this area besides the Stoltenberg #2, and
25 they're all operated by Sovereign Eagle.

1 A. Correct.

2 Q. Other than those wells, who is the nearest
3 operator; do you know?

4 A. I would assume it's Armstrong Energy.

5 Q. How far away, approximately?

6 A. Roughly 35 miles as the crow flies.

7 MR. BRUCE: I think that's all I have,
8 Mr. Examiner.

9 MR. WADE: Just a point of clarification.
10 You asked if a proposal and AFE had been sent to your
11 client. Which company is this?

12 MR. BRUCE: Both Yates and R. B. Cowden
13 Family Properties.

14 EXAMINER WADE: And the answer was, for
15 both?

16 MR. BRUCE: No.

17 EXAMINER WADE: No.

18 I guess what I'm not sure on, then, is the
19 notice that was sent on the second application, did that
20 also provide a -- first of all, that was sent to all of
21 the remaining unleased interest owners?

22 MR. HALL: (Indicating.)

23 EXAMINER WADE: Did that provide another --
24 a second AFE and proposal?

25 MR. HALL: You know, Mr. Wade, I can

1 address that issue at closing, or I can do it now if
2 you'd like. I'm prepared to address that.

3 EXAMINER WADE: Okay. Which do you think
4 would be easier, as the hearing progresses?

5 MR. HALL: Why don't I do it at the end.

6 EXAMINER WADE: I might have a couple more
7 questions.

8 MR. HALL: Yeah. And the point I will make
9 in my closing arguments -- and I will provide you with
10 some precedent orders, but there is no requirement that
11 mineral interest owners be provided with an AFE.

12 EXAMINER WADE: And I believe I've read the
13 motions that were previously submitted, but just to give
14 a factual --

15 MR. HALL: Sure.

16 CROSS-EXAMINATION

17 BY EXAMINER WADE:

18 Q. Regarding the re-notice for those few remaining
19 interest owners that were unleased, was a second AFE
20 well proposal, including an AFE, provided?

21 A. To the unleased mineral interest owners, no,
22 sir.

23 Q. Did any of those unleased interest owners,
24 including Mr. Bruce's clients, request a proposal or an
25 AFE? And were those provided regarding the second

1 notice?

2 A. I believe Cowdens did. But I believe that they
3 both stated they did not wish to participate in this
4 well, so my understanding was that they were not
5 required to receive an AFE or well proposal or JOA.

6 Q. So it was not sent?

7 A. It was not sent.

8 Q. If it had been sent, would any of the
9 information in the proposal, including the AFE, have
10 been different from the first time around?

11 A. From the Stoltenberg 1 and the Stoltenberg 2?

12 Q. Correct.

13 A. Yes, because the Stoltenberg 1 was a reentry.
14 It was a completely different operation than the
15 Stoltenberg 2 as far as an AFE goes.

16 Q. Prices?

17 A. Yes, sir.

18 Q. I think that's all I have.

19 CROSS-EXAMINATION

20 BY EXAMINER McMILLAN:

21 Q. In your correspondence with Yates Brothers --

22 A. Yes, sir.

23 Q. -- after the 20th of October -- because that
24 was the day it was plugged -- #1 was plugged --

25 A. I don't know that to -- I don't know the date

1 the well was plugged.

2 Q. Yeah. It was plugged on the 20th.

3 A. Okay.

4 Q. In your conversations with Yates, did you state
5 that the #1 was plugged?

6 A. No, sir.

7 Q. And how about the same question with Cowden?

8 A. No, sir. And my -- this goes back to me
9 believing that they didn't need to be provided the well
10 information because they did not wish to participate. I
11 did not think it was required. And on the 17th, you can
12 see, as Mr. Ball stated, they did not wish to
13 participate in the well.

14 EXAMINER WADE: Which 17th?

15 THE WITNESS: Oh, I'm sorry. Three days
16 prior, on October 17th, on the third line.

17 MR. McMILLAN: I have no further questions.

18 EXAMINER WADE: Would you like the
19 opportunity to redirect?

20 MR. HALL: Redirect, if I might.

21 REDIRECT EXAMINATION

22 BY MR. HALL:

23 Q. Tell the Hearing Examiner who the other parties
24 to the JOA are.

25 A. The other parts to the JOA are Eagle Oil & Gas

1 out of Dallas, Texas and Yates Petroleum Corporation out
2 of Artesia, New Mexico.

3 Q. Is Yates participating -- Yates Petroleum
4 participating in the well?

5 A. Yes, sir. I received a signed AFE from Yates
6 Petroleum acknowledging their participation in this
7 well.

8 Q. And they were provided with an AFE?

9 A. They were provided with a copy of an AFE. They
10 are under an existing JOA, and they were provided a
11 well-proposal letter, everything that we provide a
12 working interest owner before or with their AFE.

13 Q. Is Yates Petroleum Corporation in the same
14 building as Yates Brothers?

15 A. I believe so.

16 Q. Will you turn in Exhibit 3A to an e-mail from
17 Grace Charboneau to Jim Ball dated October 20th?

18 MR. HALL: I'll give you a minute to find
19 that. I didn't tab that, Mr. Examiners.

20 A. I think I go in order from newest to oldest.
21 From Grace to Jim Ball?

22 Q. (BY MR. HALL) Yes.

23 A. At 4:28 p.m.?

24 Q. Yes.

25 EXAMINER WADE: Which date?

1 MR. HALL: October 20th.

2 Q. (BY MR. HALL) And if we look at the last
3 paragraph on that page -- it's marked page 5 -- it says:
4 "We are offering for Yates Brothers or any other party
5 mineral owner to become a working interest owner if they
6 wish." Did I read that correctly?

7 A. Yes, sir.

8 Q. So that offer was communicated to Yates
9 Brothers?

10 A. Correct.

11 Q. And it's your understanding that Yates Brothers
12 indicated to Sovereign Eagle that they did not wish to
13 participate in the drilling of the well?

14 A. Yes, sir.

15 EXAMINER WADE: Neither one of us have
16 found it.

17 MR. HALL: Sorry about that.

18 THE WITNESS: It's on the -- on the eighth
19 page.

20 MR. HALL: Do you want me to approach?

21 EXAMINER McMILLAN: Sure. That would help.

22 MR. HALL: Eighth page from the top of
23 Exhibit 3 -- go to Exhibit 3A. It's eight pages in.

24 EXAMINER McMILLAN: Is it the 17th?

25 MR. HALL: 20th.

1 THE WITNESS: Right there.

2 MR. HALL: That's it, the last paragraph.

3 EXAMINER McMILLAN: Well, then the real
4 question to this is -- I'm going to read this directly.
5 "We are offering for Yates Brothers or any other party
6 mineral owner to become a working interest owner if they
7 wish." But they have to know the cost.

8 THE WITNESS: If they would have indicated
9 that they would like to participate or that may be an
10 option, I would have sent them an AFE and a proposal
11 letter. They indicated they did not want to participate
12 in the well. They did not want to be a working interest
13 owner. Therefore, I did not send that.

14 EXAMINER WADE: If they had indicated they
15 did not want to be but they still wanted to see the AFE,
16 would that have been provided?

17 THE WITNESS: Possibly.

18 EXAMINER WADE: Do you have further
19 questions?

20 MR. HALL: No, sir. I'm finished.

21 I apologize, Mr. Examiner. I know it's
22 cumbersome to leaf through these pages. I didn't get
23 that one tabbed. Sorry about that.

24 EXAMINER McMILLAN: That's fine.

25 MR. HALL: That concludes my redirect.

RECROSS-EXAMINATION

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BY EXAMINER McMILLAN:

Q. I want to make sure. There is an affidavit in there from --

A. From Grace Charboneau.

Q. Stating that Yates Brothers does not want a working interest?

A. I believe it's on that affidavit.

MR. HALL: I'd refer to the pleadings record, Mr. Examiner. There was a motion for continuance filed by Yates Brothers, and we responded to that. We filed that on October 27th, and attached to that is the affidavit of Grace Charboneau. If you look at paragraph five of that affidavit, it establishes that Yates indicated -- Yates Brothers was not interested in being a working interest owner.

We would ask the Examiners to take notice of the pleadings and affidavit and incorporate that as part of the hearing record. So that would be Sovereign Eagle's response to the motion for continuance dated October 27th, 2014 in the affidavit that's attached to that.

MR. WADE: Mr. Bruce?

MR. BRUCE: I would just state that -- and I read the paragraph that Mr. McMillan just read.

1 You'll notice the date of that. That's October 20th,
2 which is when the #1 well was PA'd, and so after that,
3 there is nothing similar in the record with respect to
4 the #2.

5 And I would also point out that when you
6 are force pooling working interest owners, under the
7 statute, it says that "any unleased mineral interest
8 that is pooled, seven-eighths of such interest shall be
9 considered a working interest." And I'll address this
10 later, but obviously when you're dealing with unleased
11 mineral owners, they have a working interest in the
12 well. Period.

13 EXAMINER WADE: I think that will be --

14 MR. BRUCE: I just wanted to make that
15 clear.

16 EXAMINER McMILLAN: Okay. Before we go any
17 further, I would like to have Exhibits 5 and 6 as part
18 of the record.

19 Any objections?

20 MR. BRUCE: No objection.

21 EXAMINER McMILLAN: And let's see --

22 EXAMINER WADE: No objection to
23 incorporating the affidavit?

24 MR. BRUCE: As long as all of the
25 motions -- my motion and my reply are incorporated

1 also --

2 EXAMINER WADE: Into the record?

3 MR. BRUCE: -- into the record.

4 EXAMINER McMILLAN: So the response --
5 Sovereign Eagle's responses will also be accepted as
6 part of the record.

7 (HEYCO Exhibit Numbers 5 and 6 were
8 admitted into evidence.)

9 MR. HALL: If there is nothing further of
10 Mr. Krakauskas, may he be excused? We'll provide
11 another witness.

12 EXAMINER McMILLAN: Yeah. Let's take about
13 a five-minute break and come back to the other witness.

14 (Break taken, 10:29 a.m. to 10:36 a.m.)

15 EXAMINER McMILLAN: I'm calling back case
16 15224.

17 MR. HALL: May it please the Examiners, we
18 call David Lanning.

19 DAVID L. LANNING,
20 after having been previously sworn under oath, was
21 questioned and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. HALL:

24 Q. Mr. Lanning, for the record, state your name.

25 A. David L. Lanning.

1 Q. Mr. Lanning, where do you live and by whom are
2 you employed?

3 A. I live in Roswell, New Mexico, and I'm employed
4 by Strata Productions and Sovereign Eagle.

5 Q. And in what capacity?

6 A. I'm the exploration and development manager.

7 Q. Would you give the Hearing Examiners a brief
8 summary of your educational background and work
9 experience?

10 A. I have a degree from Texas Tech in petroleum
11 engineering. After college, I worked two years as an
12 engineer for Unocal [phonetic], 25 years for Yates
13 Petroleum where I started as an engineer, then went into
14 the marketing department and ending up running the
15 marketing department for years. I started and was
16 president of the pipeline subsidiary Agave Energy for, I
17 think, seven years. Then I went back to become the
18 asset manager for all their Rockies assets, then vice
19 president of exploration, then chief operating officer,
20 and I also served on the board of directors.

21 I left Yates in 2008, started consulting
22 part time primarily for Strata and Sovereign Eagle,
23 which led to my position there.

24 Q. You have previously testified before the
25 Division's Examiners and had your credentials as an

1 expert petroleum engineer accepted; is that correct?

2 A. Yes. Probably 25 or 30 years ago.

3 MR. HALL: We would again tender
4 Mr. Lanning as an expert petroleum engineer.

5 EXAMINER McMILLAN: So qualified.

6 MR. WADE: And there is no objection from
7 Mr. Bruce?

8 EXAMINER McMILLAN: Any objection?

9 MR. BRUCE: No objection.

10 Q. (BY MR. HALL) Mr. Lanning, you prepared some
11 exhibits in connection with your testimony today; is
12 that correct?

13 A. I did.

14 Q. In your opinion, is there a technical and
15 economic basis to support a finding by the Examiners
16 that Sovereign Eagle's lease offer is fair and
17 reasonable?

18 A. Yes, I believe there is.

19 Q. Let's explore that. If you would refer to
20 Exhibits 7, 8, 9 and 10 and give the Hearing Examiners a
21 brief overview of the geology for the area.

22 A. Okay. Exhibit Number 7 is just a locator map
23 where you'll see the two areas located with the red
24 star. You'll see it's basically up there all by itself
25 at the corner of De Baca and Roosevelt and Chaves

1 Counties. There are six producing wells in that field,
2 one saltwater disposal well, and then there was the one
3 plugged well, the Stoltenberg #1. Sovereign acquired
4 that property in 2008 and has been the only operator
5 active in the immediate area. It is primarily a
6 gas-producing field, very small quantities of
7 condensate.

8 And the nearest -- I can't quote to you
9 exactly where the nearest production is. The major area
10 of activity in recent years has been in the area
11 directly east of the Elida, in the Peterson Field area.
12 There's been some drilling there. In fact, it just
13 concluded in recent months. Armstrong had a rig running
14 there and drilled at least five or six wells there.

15 And that area has more oil and associated
16 hydrocarbons with the gas. There is, in fact, a well
17 there that's made -- I know it's over a million. It may
18 be 2 million barrels of oil, but there's lots of oil
19 production in that area in addition to the gas.

20 So that is basically to locate you. We're
21 up in the corner of the Permian Basin. The Tucumcari
22 Basin is just north of us.

23 Exhibit Number 8 is the generalized
24 stratigraphic section of the general area there. And
25 I've got stars there located by the potential producing

1 areas that have been identified from previous wells, and
2 those are the San Andres, the Penn section and the
3 Ordovician section, which, in our area, is primarily the
4 Montoya.

5 And all of the other wells, the other six
6 producing wells, four of them produce from the Penn and
7 the Montoya sections. Two of them produce, I believe,
8 only from the Penn. And one of the wells was tested in
9 the San Andres and, I think, produced for a month or
10 two, but it's abandoned. And that was also in the
11 Stoltenberg #1 well.

12 Exhibit Number 9 is just a simple structure
13 map on the top of the Montoya. It basically shows that
14 the Tule Field is producing from a high, and that
15 basically -- that's basically what it shows you. You
16 can see the six wells. And the saltwater disposal well
17 is the Powell SWD, which is the top, on the right. The
18 Stoltenberg is directly south of that. That's the
19 Stoltenberg #1 well, and the #2 was moved over 50 feet
20 on the same pad.

21 And then Exhibit Number 10 is just a real
22 small scale of the logs from the Stoltenberg #1. And in
23 that first vacant tract there where the red indications
24 are, those are indications of potential pay intervals
25 from the Stoltenberg #1, which was the plugged well and

1 was the basis for our deciding to re-enter that well.

2 Q. Would you explain to the Hearing Examiners what
3 sort of arrangements exist in the field for gas
4 processing?

5 A. First of all, Transwestern Pipeline Company's
6 main line goes through the area approximately seven
7 miles away from the Tule Field, and because that is a
8 main line, it has very strict gas quality
9 specifications.

10 When the field was drilled in the
11 mid-'80s -- all of the wells were drilled in the
12 mid-'80s. There's been no development in the field
13 since the mid-'80s.

14 When Sovereign Eagle acquired the field,
15 the six wells were producing. I think it was about 70
16 mcf from six wells. Sovereign Eagle proceeded to
17 improve all of the facilities, start reworking all of
18 the existing wells, adding additional pay, fracking the
19 wells. And so in early 2011, I believe it was, we had
20 taken the field from 70 mcf a day up to about
21 two-and-a-half million a day. And we're getting ready
22 to start a development program, both offset infill wells
23 and some potential exploration outside the existing
24 field. Gas prices were about \$4.00 then.

25 In April of 2011, Transwestern notified

1 everybody producing on that lateral, which is called the
2 Panhandle lateral, which basically goes from Roswell to
3 Oklahoma -- that everybody producing on that lateral --
4 most of the gas on that lateral has nitrogen in it, and
5 they had always waived their quality spec of the
6 nitrogen because they were able to blend it with other
7 gases coming down that lateral. Well, flow conditions
8 changed. Gas Company of New Mexico started griping to
9 Transwestern about there was too much nitrogen, too much
10 inert gases in the gas that they were taking on to serve
11 their residential customers.

12 And so in April of 2011, Transwestern
13 notified everybody on that lateral that was out of spec
14 that they were no longer going to be able to blend
15 satisfactorily. So lots of gas got shut in primarily
16 from the Abo Field, which is primarily operated by Yates
17 Petroleum and our field, the Tule Gas Field, and there
18 was no ability to sell gas now until you remove
19 nitrogen. Removing nitrogen is not a simple process.

20 So we instituted a study to determine what
21 we wanted to do. That took about a year. So we
22 installed what is called a membrane system to remove the
23 nitrogen. At the time we started that up, gas prices
24 had dropped. Now we're caught up in the spring of 2012.
25 Gas prices were less than \$2.00 now. And we produced

1 through that membrane system for a number of months,
2 determined that it was not going to be a satisfactory
3 process.

4 We shut down the field again for several
5 months, installed a new nitrogen removal system, which
6 is called PSA, which stands for pressure swing
7 absorption process. That process also requires quite a
8 bit of additional compression for operating.

9 In addition, we had to have electricity on
10 the site. This is remote. There is no electricity. So
11 we purchased a generator set to provide electricity. We
12 also installed a JT skid, which is where you drop the
13 pressure of the gas down to remove the natural gas
14 liquids in the gas so that we could sell the natural gas
15 liquids to also help the economics of the system. So we
16 implemented all of that and started up again.

17 To answer the question that was previously
18 asked by Mr. Bruce, just the rental fees on the
19 compression that we rent, the nitrogen skid that we
20 rent, the JT skid and the stabilizer and the storage
21 tanks that are associated with the nitro --
22 natural-gas-liquid removal, our third-party rental fees
23 are approximately \$50,000 a month, and those are paid,
24 you know, by the working interest owners. In addition
25 to that, we purchased the generator set. We also have

1 dehy facilities and then just the normal gathering and
2 storage.

3 So it's been very tough trying to keep this
4 field in a producing situation that is economic so that
5 when the time comes and gas prices recover enough, that
6 we can continue, you know, with further exploration and
7 development. We are trying to keep the field alive.
8 And right now the only people that are making any money
9 on it on a consistent basis are the overriding royalty
10 interests. The working interests, you know, might make
11 money one month, lose money next month, but it is very,
12 very tough.

13 And one of the things that we did when we
14 started up the second phase of our nitrogen removal, we
15 went to the State of New Mexico, met with Elizabeth
16 Garcia who is the audit supervisor and started talking
17 about our ability to take the processing deductions both
18 from state taxes and our royalty interests.

19 And so we went through the process with
20 them, explained, you know, the whole process, everything
21 we're doing and came up with an estimated deduction
22 based on what we thought all of our charges were going
23 to be for the remainder of that year and came up with a
24 rate. And so we implemented that rate. I can tell you
25 exactly when we implemented it. May of 2013. And we

1 implemented a rate of \$2.08, and that is the rate that
2 has been in place. When we actually completed 2013 --
3 the way you do that is every year you calculate a new
4 rate based on your actual expenses, and the actual
5 expenses, because the field is just hanging on, trying
6 to produce, was much higher than the \$2.08. But we have
7 left it at \$2.08. We have not increased it. We took it
8 upon ourselves to leave it at \$2.08.

9 So basically what we're trying to do now
10 is -- the reason the Stoltenberg was drilled is we're
11 trying to maximize the efficiency of the nitrogen
12 process and skid. I mean, it is sized for approximately
13 one-and-a-half to 1.8 million a day. So that's the most
14 we can sell out of that field right now because that's
15 what the design of all of the facilities is.

16 And when we're operating at a million a day
17 or less, which is where we are right now, you're paying,
18 you know, \$50,000 a month in rental fees, in addition to
19 all your other operating costs for half as much gas, you
20 know, than you can potentially treat. So to improve the
21 economics of the field, we elected to go ahead and spend
22 the \$2 million to drill another well.

23 Q. Mr. Lanning, if we turn back to Exhibit 3A, the
24 very last three pages of that compilation --

25 A. I don't know where that is. I'm sorry. Oh,

1 yes.

2 Q. (Indicating.)

3 A. Oh, yes.

4 Q. Let me ask you: Did Yates Brothers make
5 inquiry about the gas processing arrangements for the
6 Tule Field?

7 A. Yes, they did. And this is the letter that I
8 wrote to Jim Ball, November 5th, explaining basically
9 what I just described here.

10 EXAMINER McMILLAN: Hold on. I'm trying to
11 find where you are.

12 MR. HALL: I'm sorry. It's the last three
13 pages of Exhibit 3A.

14 EXAMINER WADE: Do you think you could find
15 it faster?

16 Q. (BY MR. HALL) Let me ask you, Mr. Lanning, if
17 you know, does Sovereign Eagle have in place, through
18 its Division orders, marketing authorization letters
19 with its interest owners, a marketing arrangement in
20 accord with what you set forth in your letter to
21 Mr. Ball?

22 A. Part of the Division order has a marketing
23 order attached which talks about our ability to deduct
24 processing and marketing charges.

25 Q. All right. And Yates Brothers has signed that

1 type of Division order --

2 A. Yes, sir.

3 Q. -- and marketing arrangement with you?

4 A. Yes, they have.

5 Q. In your opinion, Mr. Lanning, do the economics
6 of your Tule Field project support a 5 percent royalty
7 interest lease?

8 A. No. I mean, the history of the Tule Field
9 since we -- I mean, when we obtained it in 2008 and the
10 leasing that was done at that time for the -- again,
11 you're looking at a remote area, a marginal field at
12 best and no activity. When we did the field -- when we
13 bought it, part of our study incorporated a five-by-five
14 township -- 25-township section, and that 25 township --
15 since the Tule Field was developed in the mid-'80s,
16 there were only two deep wells drilled in that whole
17 25-township area, and they were both unsuccessful wells.

18 I mean, this is a rank area. It does not
19 come anywhere close to justifying royalty rates or bonus
20 rates like are being paid in other parts of the Permian
21 Basin that are more active and where there has been more
22 success.

23 Q. Mr. Lanning, were Exhibits 7, 8, 9 and 10
24 prepared by you?

25 A. Yes, they were.

1 MR. HALL: At this time, Mr. Examiner, that
2 concludes my direct of Mr. Lanning. I'd move the
3 admission of Exhibits 7, 8, 9 and 10.

4 MR. BRUCE: No objection.

5 EXAMINER McMILLAN: Okay. Exhibits 7, 8, 9
6 and 10 are accepted as part of the record.

7 (HEYCO Exhibit Numbers 7 through 10
8 were offered and admitted into evidence.)

9 EXAMINER McMILLAN: Go ahead.

10 CROSS-EXAMINATION

11 BY MR. BRUCE:

12 Q. Just a few questions, Mr. Lanning.

13 I just want to clarify a few things. The
14 post-production deductions you're talking about, whether
15 working interest owners or for royalty owners, it's not
16 just the nitrogen removal. It's virtually everything
17 else?

18 A. Well, it is the whole processing arrangement.

19 Q. Okay.

20 A. It is not the gathering. It has nothing to do
21 with the gathering or separation or storage of water or
22 liquids or anything like that. It is all related to
23 nitrogen removal, the recompression of the -- when you
24 finish the nitrogen removal, you're basically at zero
25 pounds, so it's compressing the gas back up and it's

1 dropping the liquids out, trying to -- recovering the
2 natural gas liquids. Then it's recompressing the gas to
3 sales-line pressure. And then there are the indirect
4 charges associated with the two people that we have that
5 worked out in the field and supervision.

6 Q. And you said that the 50,000, approximately,
7 per month rental fees are being paid by the working
8 interests only?

9 A. Well, what you're calling all of the
10 post-production charges are paid -- they are obviously
11 being paid by the working interest owners because they
12 pay their share of rental costs, overhead, all of that,
13 and then the calculated deduction that we did with the
14 tax is what is being charged to the overriding royalty
15 interests, except the federal government.

16 Q. Okay. So the fee royalty owners who sign a
17 lease would be subject to those -- those costs, the
18 rental costs, et cetera?

19 A. Not the full costs but what we -- the portion
20 that we are charging.

21 Q. I understand what you're saying.

22 And the State Land Office has agreed to
23 these deductions but not the federal government on the
24 federal leases?

25 A. We have not talked to the State Land Office,

1 only the tax --

2 Q. Tax and Revenue?

3 A. -- tax --

4 Q. But the federal government hasn't agreed to
5 those deductions?

6 A. We didn't even approach the federal government.
7 The federal government is much more difficult to
8 understand at best, and so at this time -- we only have
9 one well that produces small quantities on part of the
10 federal lease, and so at this time, we have elected that
11 it's not worth the hassle to even talk to the federal
12 government.

13 Q. And I know the #2 well hasn't been completed,
14 but would you anticipate completing it in both the
15 Pennsylvanian and the Montoya sections?

16 A. The status of the well right now is it was
17 completed -- I mean the drilling was completed the day
18 after Thanksgiving. The rig is still on location. We
19 anticipate the rig will hopefully be moved out within
20 the next week or so. We're still in the process of
21 evaluating technical information from the well. And, I
22 mean, we will attempt completion in both the Montoya and
23 the Penn intervals.

24 Q. Getting back to the leased equipment, it's
25 leased, but Sovereign Eagle is physically operating the

1 equipment?

2 A. On a day-to-day basis, we are the ones that
3 physically operate it. Like compressors, I mean, the
4 compressor companies come out and service them, but
5 we're the one that start them and things like that. The
6 nitrogen-processing equipment we actually negotiated as
7 part of our fee, a slightly reduced fee, and we would
8 provide the operations of that equipment versus paying a
9 higher rental fee and them having a person out there.

10 MR. BRUCE: That's all the questions I have
11 of Mr. Lanning.

12 CROSS-EXAMINATION

13 BY EXAMINER McMILLAN:

14 Q. The first question I've got is your overhead
15 charges. You're asking for \$13,660.33?

16 A. That is a drilling --

17 Q. Drilling cost?

18 A. That is the drilling overhead, and that is per
19 month. And I'm not an accountant. I mean, it didn't
20 take a month to drill the well, so I don't know if
21 that's prorated based on the actual number of days of
22 drilling. I don't know exactly how that works, but
23 that's a one-time cost for the drilling of the well.

24 Q. Well, typically we've given \$7,500 as max.
25 That's been more or less the precedent that's been set.

1 So there's going -- you're going to have to supply some
2 justification for, what, 40 percent -- nearly 40 percent
3 increase.

4 A. We can provide the justification based on the
5 way she calculated it based on that operating agreement,
6 and you can judge whether or not it's acceptable. And
7 if that's the only thing that we have between us, I'm
8 sure we won't have a problem.

9 Q. Like I said, that's the first thing that I'm
10 seeing there.

11 For the AFE, these are projected costs,
12 right?

13 A. Yes.

14 Q. These aren't the actual costs, correct?

15 A. That's correct. We anticipate the completion
16 will probably take -- I mean, it's not going in
17 completing one zone. If you look at the number of red
18 intervals on that last exhibit, you'll see that there is
19 lots to test. And so we anticipate the completion will
20 probably take some period of time, so we won't know
21 final costs anytime soon. We can give you a much better
22 projection, you know, once we have all the drilling
23 costs in and we start the completion, but we won't have
24 a final anytime soon.

25 Q. So it will be part of the order that you will

1 provide -- the cost for the AP will be the actual cost,
2 because if you've drilled the well and these are
3 estimated costs, these may not be the actual costs.

4 A. We can give you, soon, actual costs of drilling
5 of the well --

6 Q. Okay.

7 A. -- but we can't give you final costs for
8 completion of the well.

9 Q. Right. But this will be updated?

10 A. Yes.

11 Q. Okay. That's what we would like to see.

12 I have no further questions.

13 MR. HALL: Brief redirect, if I might.

14 EXAMINER McMILLAN: Certainly.

15 REDIRECT EXAMINATION

16 BY MR. HALL:

17 Q. Mr. Lanning, the basis for the drilling
18 overhead rate is established by contract, the Joint
19 Operating Agreement; is that correct?

20 A. That's my understanding, yes.

21 Q. And the current rate is calculated in
22 accordance with the COPAS procedures set forth in that
23 contract?

24 A. That's my understanding.

25 Q. And Yates Petroleum Corporation is a party to

1 that JOA, correct?

2 A. Yes, they are.

3 Q. And they are participating in the well at these
4 overhead rates; is that correct?

5 A. Yes.

6 MR. HALL: Nothing further, Mr. McMillan.

7 EXAMINER McMILLAN: Okay. Thank you.

8 I have no further questions.

9 MR. HALL: That concludes our case on
10 direct. We ask that the matter be taken under
11 advisement.

12 MR. BRUCE: Well, I've got some witnesses
13 to present and a little argument at the end.

14 EXAMINER McMILLAN: Proceed.

15 JIM BALL,

16 after having been previously sworn under oath, was
17 questioned and testified as follows:

18 DIRECT EXAMINATION

19 BY MR. BRUCE:

20 Q. Will you please state your name for the record?

21 A. My name is Jim Ball.

22 Q. And who do you work for and in what capacity?

23 A. I work for Yates Holdings, LLP, and we're the
24 managing arm of Yates Brothers, which is a partnership
25 solely and separate from Yates Petroleum.

1 Q. They're not the same entity?

2 A. Absolutely not.

3 Q. Do they have offices in the same building?

4 A. No. We're in the same town a block away.

5 Q. Have you previously testified before the
6 Division as a landman?

7 A. Yes, I have.

8 Q. And were your credentials as an expert
9 petroleum landman accepted and made a matter of record?

10 A. Yes, sir.

11 Q. Are you familiar with the land matters
12 involved -- involving Yates Brothers in this case?

13 A. Yes.

14 MR. BRUCE: Mr. Examiner, I tender
15 Mr. Ball as an expert petroleum landman.

16 EXAMINER McMILLAN: So accepted.

17 EXAMINER WADE: Is there any objection?

18 MR. HALL: We have no objection.

19 Q. (BY MR. BRUCE) Mr. Ball, a lot of facts have
20 been presented.

21 MR. BRUCE: If I may, Mr. Examiner? This
22 is already in the exhibit packages (indicating), but --

23 Q. (BY MR. BRUCE) Mr. Ball, I've handed you what
24 we've marked YB, Yates Brothers, Exhibit 1. Could you
25 identify that for the Examiners?

1 A. This looks to be the letter that we received
2 for wanting to lease our interests, and it was the lady
3 that I had probably 99 percent of the contacts with.

4 Q. Grace Charboneau?

5 A. Yes.

6 Q. Did Yates Brothers ever receive a well proposal
7 with an AFE for either the Stoltenberg #1 or the
8 Stoltenberg #2?

9 A. No. And we always wondered why we didn't.

10 Q. Now, Yates Brothers is a mineral owner. Do
11 they generally lease their interests?

12 A. Yes. And we always prefer to lease, but we are
13 a working interest owner in a lot of the wells. Just
14 one example is the entire Abo; we're in that. That's a
15 lot of wells, and in some other non-unit wells.

16 Q. So in the past, Yates Brothers has participated
17 in the drilling of wells?

18 A. Yes. Not our preferred way of doing it, but --

19 Q. Well, even if you weren't going to participate
20 as a working interest owner in either the #1 or 2, is
21 receiving an AFE important to Yates Brothers?

22 A. Absolutely.

23 Q. Why?

24 A. I've got to be able to market it, especially if
25 I don't want to participate. I have to have the facts

1 so I can hit the street and over go to Midland or ask
2 COG or Yates Pet or XYZ Company. I have the right to
3 market my asset.

4 Q. And so even if you weren't participating, you'd
5 want an AFE so you could go to company XYZ and try to
6 market your interest and try to get better lease terms?

7 A. Right.

8 Q. If you don't have an AFE, it's much harder to
9 peddle your interest?

10 A. Yeah. I'd look like a fool going in and
11 saying, Hey, here's this. Well, how much is the AFE?
12 What are they going for? Is there another JOA? Is
13 there not, et cetera, et cetera? Never got it.

14 Q. And even today, when they're talking about
15 doing the Penn and the Montoya, is this the first time
16 you've heard what their target zone is?

17 A. Yes. I didn't even -- I knew -- I stumbled
18 across that on the reentry by going online when the
19 initial force pooling was going on that they had already
20 drilled -- or re-entered it and had the application for
21 plugging. It was like why are they pooling, you know?

22 As far as #2, I think I saw that they filed
23 their application, but I have not been on the site. I
24 didn't know until today that they had a rig out there
25 and were drilling.

1 Q. Now, they offered a one-sixth royalty, and
2 we'll get back to that in a minute.

3 Did Yates Brothers ever request a
4 one-quarter royalty?

5 A. I'm not sure if it was a quarter or we -- a
6 quarter came up because I think she said other people
7 had asked for a quarter, and it wasn't a quarter royalty
8 area. And I said -- I think I did. I think I said,
9 What about a quarter, no bonus? So it entered into a
10 conversation. Because I have to take all the facts once
11 I get them and take them to Mr. Yates and say, Here's
12 where we were; here's where it is. Do I have a high and
13 a low, or, you know, the typical negotiation perimeters
14 that I need. So yeah, a quarter royalty was asked, if
15 they were going to give that, but from day one, it was
16 always \$25 for the bonus and a one-sixth royalty. It
17 never deviated, and they shoved that lease form, which
18 was horrible, down my throat.

19 Q. So with respect to the lease bonus -- and at 25
20 bucks an acre, the lease bonus isn't as important?

21 A. That's not as important as the royalty. That's
22 right.

23 Q. But they never -- they refused to negotiate
24 with respect to changing the one-sixth to, say, 3/16th?

25 A. As Mitch indicated, we -- I offered -- I

1 thought my lease was great, because I offer it to
2 everybody in the industry and I never have any problem.

3 Q. The same form?

4 A. The same form. And it was a great form. I
5 mean, it gave them continuous development, all kinds of
6 nice things.

7 But the form that they gave me that they
8 wouldn't deviate from, even going back and forth, was
9 forcing me to have more than the lands that they were
10 pooling on the lease, on a five-year lease plus a
11 five-year option at their option or \$25 to pay on the
12 second five years.

13 It's like, you know, we're all pretty smart
14 if we've been in this business, and you just don't take
15 something in a known developed field that's been
16 producing since the mid-'80s and call it a rank area.
17 It's a unique thing. It's in a rank area, but it is a
18 defined, known geological asset out there.

19 Q. Producing area?

20 A. Producing since the 1980s.

21 Q. And a five-year term with a five-year option,
22 in essence, is a ten-year term?

23 A. Yeah.

24 Q. And is that uncommon in fee leases in southeast
25 New Mexico these days?

1 A. Yes, it is. And especially when you -- and
2 we'll get into that, I'm sure, in a minute -- especially
3 when you get into 52 percent deducts.

4 Q. And let's -- let's -- just very briefly, you've
5 looked at the deductions and the costs out in this
6 general area?

7 A. Right.

8 Q. Let's take their one-sixth royalty, so
9 16-and-two-thirds percent. Based on their deductions,
10 what will your actual received royalty rate be,
11 approximately?

12 A. Just a hair over 9 percent.

13 Q. So what you're looking at is 40 to 50 percent
14 deductions from the price --

15 A. I think it's 52 percent before you get into the
16 severance tax and all the --

17 Q. Severance tax, of course. Everybody pays a
18 severance tax.

19 A. Yeah. And, of course, we're a fee owner, but
20 the Feds don't get charged that. The state may have
21 made some deal with them, but we didn't make any deal
22 with them.

23 Q. So in order for you to get a one-eighth -- an
24 actual physical one-eighth royalty, the royalty in the
25 lease form is going to have to be higher than one-sixth?

1 A. Yes.

2 Q. Closer to 3/16th or a little bit more?

3 A. Yeah. I mean, you can round it close to 50
4 percent and say, you know, if you did get a quarter,
5 you'll be getting a little bit less than an eighth on
6 the current deducts.

7 Q. In the past in this area, have higher royalties
8 of leases been taken, 3/16th, one-fifth?

9 A. They have. Back in 1986, there was anywhere
10 from one-eighth, I believe, to 3/16th. I know there is
11 a fifth.

12 And this is the other bizarre thing. Grace
13 told me that there was an indication in the file that a
14 ratification was signed by a bunch of parties on a lease
15 that gave a one-fifth royalty. Well, obviously,
16 one-fifth is greater than one-sixth. So isn't it a
17 little bizarre that -- it's like, well, if there was a
18 ratification signed, it's like why are we even talking?

19 Come to find out, I guess, because of a
20 Q clause or something, those lands now need to be
21 leased, and they're offering me less than what they
22 did -- or that history has offered and participated in
23 the past. So it's a little bit of a bizarre rub to have
24 a one-fifth, and then years later, you're out there
25 drilling wells and wanting to drill more wells and

1 develop the field that you're kind of offering me less
2 than what you've given me in the past.

3 Q. Do you think that's proper?

4 A. No.

5 Q. And one thing that Mr. Krakauskas said he
6 always wants, you know, the same lease form, same
7 royalty. Is it common in fee lands in southeast
8 New Mexico to have -- where there's a bunch of fee
9 royalty owners, is it common to have different lease
10 forms, different royalty rates, different primary terms?

11 A. It's very common. And it's usually -- to
12 identify a little bit more specifics, your easier people
13 to deal with are the ones that you get at first. The
14 harder ones are as you go along, and from lease forms to
15 royalty rates to bizarre things, it's always a mix. In
16 a perfect world, yeah, it would be great if everybody
17 was the same, but it doesn't happen in fee lands,
18 especially if you've got 24 to 40 people in there.

19 Q. Is Yates Brothers requesting that it not be
20 force pooled by the Division?

21 A. I don't think we should be forced pooled. I
22 don't think we've been properly served, and -- I mean,
23 this is the first time in my -- I've been doing this
24 since 1977. I don't think anybody has force pooled the
25 company I've been with that didn't furnish me an AFE, a

1 JOA and sit down and talk about things. There was just
2 no movement -- hardly any movement. I mean, in the
3 negotiations, the little things that they changed were
4 little things. They weren't the big things. The big
5 things being more land than what you're force pooling
6 and ten-year lease and all these marketing fees that --
7 52 percent.

8 Q. And when you say more land, what they were
9 asking for was the north half -- Yates Brothers'
10 interest in the north half and southeast quarter of the
11 section whereas the well units are owned, the north
12 half, correct?

13 A. That's correct. And the remainder of that
14 section, I believe it's a state lease that they were
15 paid not too far back, \$140 an acre, in the bonus. And
16 this is offsetting it.

17 Q. Was Yates Brothers Exhibit 1 compiled from your
18 company's business records?

19 A. The letter from --

20 Q. Yes.

21 A. Yes. We received that.

22 Q. And in your opinion, is the denial of the
23 application with respect to Yates Brothers proper, the
24 denial of the application?

25 A. Yes.

1 MR. BRUCE: Mr. Examiner, I'd move the
2 admission of Yates Brothers Number 1.

3 MR. HALL: No objection.

4 EXAMINER McMILLAN: Yates Brothers Exhibit
5 Number 1 is accepted as part of the record.

6 (Yates Brothers Exhibit Number 1 was
7 offered and admitted into evidence.)

8 MR. BRUCE: I pass the witness.

9 CROSS-EXAMINATION

10 BY MR. HALL:

11 Q. Mr. Ball, if you would, please, take Exhibit
12 Number 3 from our stack of exhibits there?

13 A. Okay.

14 Q. If you look at the first five pages of that
15 exhibit, I'll represent to you that it's a chronology of
16 contacts, communications between Sovereign Eagle and
17 Yates Brothers partnership regarding leasing of Yates
18 Brothers' interest here today. Do you dispute that
19 those contacts occurred?

20 A. I think these are probably authentic.

21 Q. You and I have been doing this for decades.
22 Would you agree?

23 A. Uh-huh.

24 Q. Do you agree also that if parties can't come to
25 terms, the OCD is obliged to force pool those interests?

1 A. Uh-huh.

2 Q. You're indicating that?

3 A. Yes.

4 Q. Yates Brothers is not asking the Division to
5 dictate terms of a deal, is it?

6 A. I don't know what the outcome should be. All I
7 know is I don't think that the process has been followed
8 right. Two wells have been re-entered or drilled, and
9 really we weren't even told that. And yet we're here in
10 Santa Fe after the fact that two -- several million
11 dollar expenses have been had.

12 Q. So is the answer to my question no?

13 A. Go ahead and ask it again. Sorry.

14 Q. Is Yates Brothers partnership asking this
15 Division to dictate deal terms?

16 A. I want to -- I want to answer you right. So I
17 think the right answer is I think the state is going to
18 tell us what force pooling terms are there, but I don't
19 know what they're allowed to do or not, Mr. Hall. I'm
20 not trying to be a pain here.

21 MR. BRUCE: And I would stipulate that
22 under the pooling statutes, unlike in Oklahoma, the
23 Division cannot fix royalty rates, lease terms, basic
24 lease terms.

25 Q. (BY MR. HALL) Mr. Ball, are you here today to

1 present any technical evidence on behalf of Yates
2 Brothers that would support a 25 percent royalty
3 interest lease?

4 A. Not unless you consider the fact of the
5 marketing charges. In our opinion, it shouldn't be
6 charged to the royalty owners in the way that it's being
7 done. I was not aware until moments ago that Yates Pet
8 was a working interest owner in the Tule Field even
9 though I've been in several conversations about the Tule
10 Field with the marketing director that replaced
11 Mr. Lanning. No mention at all from Yates Pet that they
12 were working interest owners.

13 But I will tell you that their marketing
14 director says you're not --

15 MR. HALL: And I'm going to object. It
16 sounds like we're about to get some hearsay testimony
17 here.

18 MR. BRUCE: He's simply answering the
19 question asked by Mr. Hall.

20 MR. HALL: Not simply. It's hearsay.

21 MR. BRUCE: Let's just pass.

22 EXAMINER WADE: Sustained.

23 MR. BRUCE: Continue with the next one. I
24 don't think it's important to this hearing at this
25 point.

1 Q. (BY MR. HALL) Let's talk about the marketing
2 arrangements.

3 MR. HALL: May I approach the witness?

4 Q. (BY MR. HALL) Let me hand you what we've marked
5 as Exhibit 11. Do you recognize Exhibit 11?

6 A. Yes, I do.

7 Q. What is that?

8 A. That's the oil and gas Division order which has
9 a marketing agreement with it.

10 Q. And is that transmittal letter, dated February
11 26th, 2014, signed by you?

12 A. Yes, sir, it is.

13 Q. Let's turn to the marketing agreement, which
14 would be three pages in, and if you would refer to
15 paragraph M3. Let me read a portion of paragraph M3 to
16 you. It says: "All Interest Owners shall bear their
17 proportionate share of costs for transporting and
18 treating the oil and/or gas for delivery." Did I read
19 that accurately?

20 A. Uh-huh.

21 Q. And then if we turn to the signature page, is
22 that Division order and marketing agreement signed by
23 John A. Yates, Jr.?

24 A. Yes, it is.

25 Q. Was it also signed by you?

1 A. Yes, it is.

2 Q. And this marketing arrangement covers the Yates
3 Brothers' interest throughout the Tule Field; is that
4 correct?

5 A. That's correct.

6 Q. And by signing that marketing agreement, Yates
7 Brothers found the terms for sharing in the costs of gas
8 prices to be reasonable; is that correct?

9 A. When we signed this, we didn't know what they
10 were.

11 Q. Did you read it?

12 A. We did not know what they -- what the ratios
13 were when this was signed.

14 Q. Did you understand the terms of what you were
15 signing?

16 A. Yes.

17 MR. HALL: Nothing further of the witness.

18 EXAMINER WADE: I've got a couple of
19 questions.

20 EXAMINER McMILLAN: Go ahead.

21 CROSS-EXAMINATION

22 BY EXAMINER WADE:

23 Q. At any point did you or Yates Brothers -- maybe
24 this was in the testimony and I missed it -- make an
25 actual request for the proposal and the AFE?

1 A. No. I got a -- I believe it was an e-mail from
2 Mitch saying it reached a point where I think we should
3 go through our attorneys. And in my conversation with
4 my attorney, we knew that we had given -- that he had
5 style a motion that wasn't proper. And it was my
6 understanding that it was pretty obvious what the
7 problem was.

8 Q. So the simple answer is no?

9 A. So I didn't -- after I got the contact from
10 Mitch, I didn't contact Mitch or Mr. Lanning.

11 Q. Okay. I think that's all the questions I have.

12 EXAMINER McMILLAN: I have no further
13 questions of this witness.

14 MR. BRUCE: Just to follow up, a question
15 or two on redirect.

16 REDIRECT EXAMINATION

17 BY MR. BRUCE:

18 Q. Again, Mr. Ball, you didn't know that they had
19 re-entered the Stoltenberg #1?

20 A. No, not -- not until way, way back there.

21 Q. And you didn't know that they had drilled the
22 Stoltenberg #2?

23 A. Not until today.

24 Q. That's all I have.

25 EXAMINER WADE: Will you be calling another

1 witness?

2 MR. BRUCE: I will call -- yeah.

3 Can my witness be excused?

4 EXAMINER WADE: The witness can be excused.

5 EXAMINER McMILLAN: He may be excused.

6 MR. BRUCE: Call Elaine Magruder, please.

7 ELAINE MAGRUDER,

8 after having been previously sworn under oath, was
9 questioned and testified as follows:

10 DIRECT EXAMINATION

11 BY MR. BRUCE:

12 Q. Can you please state your name and city of
13 residence for the record?

14 A. My name is Elaine Magruder. I'm from Midland,
15 Texas.

16 Q. And what is your relationship to R. B. Cowden
17 Properties?

18 A. I'm one of the owners. R. B. Cowden was my
19 grandfather.

20 Q. Is it a limited partnership?

21 A. It is, a Texas limited partnership.

22 Q. Have you ever testified before the OCD?

23 A. No, I have not.

24 Q. Could you just -- I don't know that we need to
25 qualify you as an expert, but would explain a little bit

1 of your background in oil and gas?

2 A. I started with In Search [phonetic] Exploration
3 in 1977 in their land department, and then I, in '78,
4 became an independent landman and began putting deals
5 together. I became an oper- -- I drilled my first well
6 in 1982, became an operator, and I've been an
7 operator -- oil and gas operator ever since.

8 Q. Do you operate under your own name, or is there
9 an entity?

10 A. It's an entity. It's called Andector
11 Exploration Company. It is separate from the R. B.
12 Cowden Family Properties, Limited. However, they are a
13 working interest owner in some of our operations.

14 Q. So I'll get to that in a minute.

15 A. Uh-huh.

16 Q. But since 1977, have you continued your land
17 work and your operating work?

18 A. Yes.

19 Q. And with respect to R. B. Cowden's interest in
20 this well, are you familiar with the land ownership?

21 A. Yes, sir, I am.

22 MR. BRUCE: Mr. Examiner, I think I will
23 tender Ms. Magruder as an expert petroleum landman.

24 MR. HALL: We don't object.

25 EXAMINER McMILLAN: Okay. So accepted.

1 Q. (BY MR. BRUCE) Since we're getting on in the
2 day, let's -- a couple of things. Did R. B. Cowden ever
3 receive the well proposals with AFEs for the Stoltenberg
4 #1 and 2 wells?

5 A. No, sir, we did not.

6 Q. But R. B. Cowden has participated in wells in
7 the past?

8 A. Yes, that's correct.

9 Q. Is it generally like Yates Brothers, a mineral
10 owner; it likes to lease out interests?

11 A. Yes, that's correct.

12 Q. But like with Yates Brothers, does it help to
13 know the wells that are being drilled and their costs in
14 deciding whether to lease or not?

15 A. That is correct. And one of the processes we
16 go through when we get a release request, no matter
17 where it is, we look in the area of what leasing
18 activity's going on, pricing, royalty interests. And so
19 with that in mind, I looked up through the State of
20 New Mexico what the average royalty interests were, what
21 they were for the state of New Mexico. It was a quarter
22 royalty, and \$210 a net acre was the average that the
23 state had been leasing for.

24 Q. And is R. B. Cowden also concerned about the
25 operating costs in this field?

1 A. What we're concerned about is the deducts on
2 the -- on our -- the revenue that we are receiving.

3 Q. You're in a couple of other wells out here
4 operated by Sovereign Eagle?

5 A. Correct.

6 MR. BRUCE: If I may approach the bench and
7 the witness, Mr. Examiner? On top of everything else, I
8 managed to screw up my knee, too.

9 Q. (BY MR. BRUCE) Now, in looking at this, first
10 of all, the top right-hand, page 1, and if you go to the
11 second page, it says "page 7." Is this two pages out of
12 a revenue statement from your files?

13 A. These are pages from our revenue files, yes.
14 Uh-huh.

15 Q. And I notice down below -- I don't know who
16 wrote this, but it talks about the Wendel Best #1, the
17 JT McGee #1 and the Perry #1. Are those wells that
18 R. B. Cowden has owned in this area?

19 A. That's correct.

20 Q. Now, if you turn to page 7 -- it's actually
21 page 2 of the exhibit -- I notice that when you look
22 over at the column of Gross Value for this time period,
23 it's almost \$13,700, correct?

24 A. Correct.

25 Q. And the net value is only 8,205.

1 A. That's correct.

2 Q. And so if I'm doing the math right, there's
3 about 40 percent deductions from your gross revenue?

4 A. That's correct.

5 Q. In your opinion and in your experience, is that
6 fairly high?

7 A. I think it is.

8 I'd like to point out one other thing on
9 the other pages that were not given, if I may. We were
10 held in suspense for over two years, from January of
11 2012 until more recently, last May of 2014, when we
12 began receiving payments again. So we were held in
13 suspense and never paid shut-in gas rentals at that time
14 shut-in.

15 Q. Let's clarify this. Did you know when the
16 Stoltenberg #1 was re-entered?

17 A. I did not until I got the hearing notice and
18 saw it on the paperwork about the hearing notice that we
19 got from the Commission.

20 Q. Did you know the Stoltenberg #2 had been
21 drilled?

22 A. Not until today.

23 Q. Now, obviously they re-entered the Stoltenberg
24 #1, Sovereign Eagle did, before the initial hearing set
25 in this matter?

1 A. That's correct.

2 Q. So at that point, you were -- as an unleased
3 mineral owner, your interest was being carried; was it
4 not?

5 A. That's correct.

6 Q. You think that's the proper outcome of this
7 hearing, again?

8 A. I do.

9 Q. And did you or anyone on behalf of Sovereign
10 Eagle -- on behalf of R. B. Cowden Properties, did you
11 ever tell Sovereign Eagle that you absolutely wouldn't
12 participate in the well?

13 A. That was never brought up as an option for me
14 from Grace. In all of our e-mails and so forth, that
15 was never considered as an option.

16 Q. And then one final question -- and I know it's
17 probably less than three weeks, but does the drilling
18 overhead rate of 13,600 plus -- does that seem a little
19 high?

20 A. It does. Uh-huh.

21 Q. Based on you operating wells of your own?

22 A. Sure. Uh-huh.

23 Q. Was Exhibit 1 compiled from R. B. Cowden's
24 company business records?

25 A. That's correct.

1 Q. And like Yates Brothers, do you believe you
2 should be dismissed from this pooling application?

3 A. I believe so, I think for some of the same
4 reasons. Our previous lease with the Wendel Best and
5 those was for 3/16th royalty, and that was in 1991. And
6 we offered the same thing as a counteroffer, of a
7 quarter royalty and no bonus for a two-year lease.

8 And we have typically had our own lease
9 form. When Grace first contacted us, we had our
10 attorney update the lease form for New Mexico. In most
11 cases, we own a lot more of the minerals, so there were
12 some things in the lease form that she wanted us to
13 consider taking out, which we approved of. And that
14 was -- for example, when we own the majority of
15 minerals, we like to get a copy of the title opinion.
16 We like to get copies of the logs, things like that,
17 just for our historical value. We've been in the oil
18 business since 1936, R. B. Cowden.

19 Q. And that type of data would help you decide to
20 lease or decide to join in a well?

21 A. Yes, of course.

22 Q. And a request like that is normal in the course
23 of business between oil and gas operators?

24 A. That's correct.

25 MR. BRUCE: Mr. Examiner, I'd move the

1 admission of Cowden Exhibit Number 1 marked "C Exhibit
2 Number 1."

3 MR. HALL: No objection.

4 EXAMINER McMILLAN: Okay. Exhibit C1 may
5 now be part of the record.

6 (R. B. Cowden Exhibit Number 1 was offered
7 and admitted into evidence.)

8 MR. BRUCE: And I pass the witness.

9 MR. HALL: May I approach the witness,
10 please?

11 EXAMINER McMILLAN: Certainly.

12 CROSS-EXAMINATION

13 BY MR. HALL:

14 Q. I hand you what's been marked as Exhibit Number
15 11 that we discussed earlier with Mr. Ball.

16 A. Uh-huh.

17 Q. And I'll represent to you that that's the
18 Division order marketing agreement that covers the Yates
19 Brothers' interest.

20 A. This is to the Yates Brothers, and I have no
21 idea if this is correct or not because it's not our
22 entity.

23 Q. I understand that. But isn't it true that the
24 R. B. Cowden interests have signed the same Division
25 order marketing agreement as Strata?

1 A. I do not know.

2 Q. Who would know that?

3 A. Our accounting office in our -- at the office.
4 And we did -- when you brought that up earlier, we did
5 contact them -- it's lunchtime -- to try to get that.
6 Thank you.

7 Q. I'll ask you one other thing. Edwin Magruder,
8 is he the only person with signing authority on behalf
9 of the family's interest?

10 A. He is the general manager. He's 90 years old.
11 We're going through succession planning at this time,
12 and Tyler, who is with me today, has been hired by us
13 for that position. There are some other things that we
14 have power of attorneys to sign, but we do not -- when I
15 say we, that means the other owners in the limited
16 partnership. Dad typically is the signer, except for on
17 some financial things.

18 Q. All right. So you didn't have authority to
19 deal?

20 A. I did not have authority to sign a Division
21 order. I did not.

22 Q. Or a lease?

23 A. Yes.

24 What happens is often -- with Dad being at
25 his age, he often will give me -- when we get a request,

1 he'll ask me to follow up on it for him.

2 MR. HALL: All right. May we approach the
3 witness?

4 EXAMINER McMILLAN: Sure.

5 Q. (BY MR. HALL) Just to expedite things, I'm
6 going to furnish an exhibit for you to look at.

7 A. Sure.

8 Q. I hand you what we've marked as Exhibit Number
9 3 and refer to a portion that chronicles communications
10 to R. B. Cowden Family Properties.

11 A. Okay.

12 Q. Do you dispute that all those contacts
13 occurred?

14 A. I'll have to read through them, if you don't
15 mind (reading).

16 I can't speak to the contacts to Tyler, but
17 I can speak to the contacts to myself and just to
18 myself. They seem accurate.

19 Q. For the record, Tyler Nobles is your landman
20 you brought in?

21 A. Yes, that's correct.

22 Q. Will you turn to the last page, 3 of 3, to the
23 entries for the Cowden Family Properties? Beginning
24 with the entry for October 21st, there are contacts by
25 Sovereign Eagle to Tyler.

1 A. Uh-huh.

2 Q. And is it accurate to say that Cowden Family
3 had no response to --

4 A. Actually we did have a response. We responded
5 to Tyler that we were not in agreement with the lease
6 form that was provided us by Sovereign and that they
7 were not willing to, you know, come up to our -- the
8 interest that we're used to leasing and we could work,
9 you know, without a bonus and going to a two-year lease
10 that had continuous development in it. It gave them,
11 you know, some good opportunity to develop that area.

12 Q. We're in agreement that the parties simply
13 couldn't come to terms?

14 A. We could not come to terms, and I felt like
15 their motivation was to try to force pool us.

16 MR. HALL: Nothing further of this witness.

17 REDIRECT EXAMINATION

18 BY MR. BRUCE:

19 Q. Just looking at the list of the contacts with
20 R. B. Cowden, the final contact was October 23rd,
21 correct?

22 A. Uh-huh.

23 Q. And from what you know today, that was after
24 the #1 well was P&A'd and before the #2 was started?

25 A. I'm assuming so (laughter).

1 Q. And you didn't know about either well being
2 drilled or re-entered?

3 A. I didn't know about the first one being
4 re-entered until the hearing information came out or the
5 other one being drilled until today.

6 MR. BRUCE: That's all I have,
7 Mr. Examiner.

8 EXAMINER WADE: I guess I have one
9 question.

10 CROSS-EXAMINATION

11 BY EXAMINER WADE:

12 Q. The Cowell --

13 A. Cowden.

14 Q. Cowden. I'm sorry.

15 A. Yeah.

16 Q. Is Cowden a corporation?

17 A. It's a family properties limited partnership.

18 Q. So did Cowden Properties specifically request a
19 proposal, including an AFE, during this time?

20 A. We did not. We were only led to believe
21 through all of our e-mails that it was just strictly off
22 the lease request.

23 EXAMINER WADE: No further questions.

24 MR. BRUCE: I have no further questions of
25 this witness.

1 EXAMINER WADE: The witness can be
2 dismissed.

3 MR. BRUCE: That'll be our final witness.

4 MR. HALL: May I ask one additional query
5 on recross.

6 EXAMINER McMILLAN: Yes.

7 RECROSS EXAMINATION

8 BY MR. HALL:

9 Q. Let me read an e-mail from Grace Charboneau to
10 you on Wednesday, September 24th, 2014.

11 A. Let me get that, if you don't mind.

12 THE WITNESS: Tyler, do you have that
13 agreement.

14 MR. NOBLES: What date is it?

15 MR. HALL: September 24th.

16 EXAMINER WADE: It was part of your
17 Exhibit 3.

18 THE WITNESS: Can you bring me all the
19 e-mails, please?

20 September 24th are you asking about?

21 Q. (BY MR. HALL) Yes. Look at the sixth
22 paragraph, and, again, this is the e-mail to you dated
23 September 24th, 2014.

24 A. Uh-huh.

25 Q. Do you acknowledge that?

1 A. Yes.

2 Q. Do you remember receiving this?

3 A. I do remember receiving this.

4 Q. And if we look at the sixth paragraph up, first
5 sentence, I'll read that.

6 A. Uh-huh.

7 Q. It says: "We are looking to re-enter the well
8 in the month of November hopefully."

9 A. Yes.

10 Q. Did I read that accurately?

11 A. That's right. And Grace, in our very first
12 communication, said that they wanted to re-enter the
13 well, but I had not known that it had actually been
14 re-entered. It was always purported that they were
15 going to.

16 Q. Nothing further. Thank you.

17 MR. BRUCE: That ends my presentation,
18 Mr. Examiner.

19 EXAMINER McMILLAN: I have no further
20 questions of this witness.

21 MR. BRUCE: May I make like a two-minute
22 closing argument?

23 EXAMINER McMILLAN: Yes, closing
24 statements.

25

1 CLOSING ARGUMENT

2 MR. BRUCE: Mr. Examiner, what I'm handing
3 you is my original motion for a continuance. It's
4 already been made part of the record, and I just want to
5 refer to one thing.

6 I think it's pretty apparent where we're
7 coming from. I have argued that no good-faith effort
8 has been made under Order R-13165 to get the parties to
9 join in the well. I understand Mr. Hall's argument. He
10 says a mineral owner isn't a working interest owner.
11 However, if you look at the statute, the parts I've
12 highlighted, on the second page, "if the interest of any
13 owner or owners of any unleased mineral interest is
14 pooled, seven-eighths of such interest shall be
15 considered a working interest." My clients are working
16 interest owners, and they were never provided well
17 proposals, AFEs or anything. Therefore, I think they
18 should be dismissed from this case.

19 Secondly, if they were force pooled, I
20 would point out the second part of that which says:
21 One-eighth shall be considered a royalty interest, and
22 the unleased mineral interest owner shall in all events
23 be paid one-eighth of all production from the unit.

24 At least to the extent of the deduction
25 they're seeking now, I don't think this statute allows

1 50 percent deductions, and I would refer you to the
2 first part of the statute, 70-2-17: Any pooling order
3 shall be upon such terms and conditions as are just and
4 reasonable and afford the owner of each interest in the
5 unit to recover or receive without unnecessary expense
6 its just and fair share of the oil and gas.

7 Certainly in this instance, I don't think
8 that will occur if deductions are allowed to the extent
9 requested or practiced by Sovereign Eagle. And,
10 frankly, based on Mr. Ball's testimony, where a
11 one-sixth royalty basically gets you a nine percent
12 royalty, seems to me my clients would be better off
13 being pooled and being paid a one-eighth royalty under
14 statute. And just like the federal government, I don't
15 think there should be any deductions allowable against
16 them. If they are pooled, I don't even think any
17 penalty should be assessed against them because of the
18 lack of good-faith negotiations.

19 And finally I would simply point out that
20 we think the drilling operating rates are too high, and
21 if they're going to be assessed against seven-eighths of
22 my client's interest, they should be roughly cut in
23 half.

24 And that's my closing argument.

25

CLOSING ARGUMENT

1
2 MR. HALL: Mr. Examiner, Mr. Bruce and I
3 have been doing this for parts of two centuries now, and
4 as attorneys that appear before you, it's incumbent upon
5 us to provide you with the knowledge so you can make a
6 fully informed decision. We've been around longer than
7 you is what I'm trying to get at, so we're going to give
8 you the benefit of some of the historic practices of the
9 agency when it issues compulsory pooling for its mineral
10 interest owners.

11 What I've done is gone back and researched
12 that practice, and I have two orders to provide you. If
13 we go back to 1960, we see that even though the statute
14 dealing with this is largely unchanged for compulsory
15 pooling, it was the practice of the Commission -- in
16 those days, the Governor sat on the Commission and
17 signed this order. But the order I'm talking about is
18 Order Number R-1748. And if you'll look, you'll see
19 that it's an application for a nonstandard proration
20 unit. The reason that case was brought is because at
21 the time the Applicant knew that the Commission would
22 not force pool the mineral interest owner without a
23 voluntary agreement. That was just the practice in
24 those days.

25 So what they did instead was -- in this

1 case, they had a recalcitrant mineral interest owner.
2 They formed a nonstandard well, and they cut him out of
3 the well. We're not asking for that. We don't think
4 that's appropriate here because we're talking about
5 undivided interest, but that's how the Commission began
6 treating interest owners.

7 Then if you look -- go forward two years,
8 April 18th, 1962. The Commission issued a series of
9 orders on that day, and this is the very first one.
10 This is Order Number R-1250-A. It dealt with the new
11 practice implemented by the Commission for dealing with
12 the force pooling of unleased mineral interests. And
13 what the Commission did, they established some criteria
14 for you to apply. In order to pool an unleased mineral
15 interest owner, you must make a finding that there have
16 been reasonable and fair offers to lease or to obtain
17 quitclaim deeds or to communitize, whatever it takes to
18 get interests consolidated. You must also find that the
19 operator has been diligent in its efforts to form the
20 proposed proration unit.

21 You will see nowhere in this order or the
22 series of orders that were entered on that same day that
23 requires that anything other than a lease be provided to
24 an unleased mineral interest owner. There is no
25 requirement then, and there is no requirement now that

1 an unleased mineral interest owner be provided with an
2 AFE or a well proposal, because, in fact, they are not
3 working interest owners. Only after the fact that they
4 are force pooled are seven-eighths of their interest
5 treated as a working interest.

6 Mr. Bruce is wrong to suggest to you that
7 they are mineral interest -- working interest owners now
8 and thereby entitled to a lease proposal. It's not
9 true.

10 The practices established by Order Number
11 R-2150-A in effect since 1962 have continued to be
12 followed by the Division and the Commission to this day.
13 They have not been departed from. And I'm suggesting to
14 you that you should not depart with any of those new
15 requirement [sic] that mineral interest owners be
16 offered the opportunity to participate in the drilling
17 of a well.

18 I think of all the testimony you've heard
19 here today, the most important piece was the testimony
20 of Mr. Jim Ball when he said, in fact, he never did
21 request a proposal for the well or an AFE. He simply
22 admitted that right off the bat. Never had that
23 expectation.

24 So given all the evidence we've presented
25 to you today, all of the contacts with the Cowden family

1 and with the Yates Brothers, I think you have to provide
2 for force pooling of these interests.

3 And that concludes my remarks. Be glad to
4 stand for questions.

5 EXAMINER WADE: If the -- if the
6 requirement were -- were not that a working interest
7 owner requires a proposal and an AFE but let's say that
8 was broadened to where a mineral interest owner also
9 requires a proposal and an AFE, do you think that -- and
10 this has been submitted and it's now into evidence --
11 Order Number R-13165 would apply, then, to working
12 interest owners?

13 MR. HALL: And that's the distinction,
14 working interest owners.

15 EXAMINER WADE: Again, if that were not the
16 distinction, would that order apply?

17 MR. HALL: It does not. But the scope of
18 that order does not extend beyond a working interest
19 owner.

20 I'd also point out to you that, again,
21 Yates Brothers never requested a well proposal or an
22 AFE. So it's not exactly relevant. And also remember
23 Mr. Krakauskas's testimony, that he said if asked, they
24 would have provided it.

25 EXAMINER WADE: I believe he said possibly.

1 MR. BRUCE: If I could address that
2 briefly? I will use Mr. Hall's words against him. Page
3 3 of Order R-2150-A, paragraph five: "That any
4 unsevered mineral interest shall be considered a
5 seven-eighths working interest and a one-eighth royalty
6 interest for the purpose of allocating costs and
7 charges...."

8 Go to paragraph seven: "That the applicant
9 shall furnish the Commission and each known
10 non-consenting working interest owner in the subject
11 unit an itemized schedule of well costs within 30 days
12 following the date of this order."

13 If it's necessary under the terms of the
14 order, why wasn't it necessary two or three months ago?

15 MR. HALL: And, again, it's post-pooling.
16 As the statute says, pooled after the fact. Then an
17 interest owner is entitled to avoid the imposition of
18 the risk penalty by tendering its share of well costs.
19 That opportunity will be provided for in the order that
20 issues from this hearing today, but it is not a
21 precondition to hearing.

22 MR. BRUCE: And I believe that Order
23 R-13165, which was entered 47 years after Order R-2150,
24 supersedes the terms of the old order, and it talks
25 about providing to locatable parties who it intends to

1 pool an AFE. That's simple as it gets.

2 MR. HALL: And we've addressed that in our
3 response to the motion for continuance. We've briefed
4 this issue to you.

5 EXAMINER WADE: Do you feel like this is
6 something that the past briefing needs to be expanded
7 on? Is that something you'd like to re-brief, or do you
8 feel like it stands with what's already --

9 MR. HALL: I'm going to stand on the
10 current briefing.

11 MR. BRUCE: (Indicating.)

12 EXAMINER McMILLAN: I have no further
13 questions.

14 Case Number 15224 will be taken under
15 advisement.

16 MR. HALL: Thank you, Mr. Examiner.

17 (Case Number 15224 concludes, 12:02 p.m.)
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25

I do hereby certify that the foregoing is
a true and correct record of the proceedings in
the Examiner hearing of Case No. _____
heard by me on _____

_____, Examiner
Oil Conservation Division

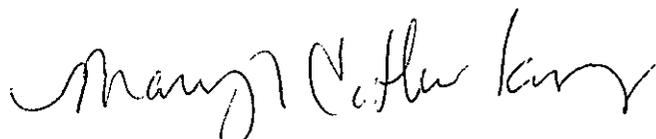
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2 COUNTY OF BERNALILLO

3
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10 those proceedings that were reduced to printed form by
11 me to the best of my ability.

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13 Record of the proceedings truly and accurately reflects
14 the exhibits, if any, offered by the respective parties.

15 I FURTHER CERTIFY that I am neither
16 employed by nor related to any of the parties or
17 attorneys in this case and that I have no interest in
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