

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

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

CASE NO. 13,724

APPLICATION OF CHAPARRAL OIL AND GAS)
COMPANY FOR APPROVAL OF A NONSTANDARD)
GAS SPACING AND PRORATION UNIT, SAN JUAN)
COUNTY, NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: WILLIAM V. JONES, JR., Hearing Examiner

June 8th, 2006

Santa Fe, New Mexico

2006 JUN 22 AM 10 06

20/27/2 EAM

This matter came on for hearing before the New Mexico Oil Conservation Division, WILLIAM V. JONES, JR., Hearing Examiner, on Thursday, June 8th, 2006, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

I N D E X

June 8th, 2006
 Examiner Hearing
 CASE NO. 13,724

	PAGE
APPEARANCES	3
APPLICANT'S WITNESS:	
<u>JAMES R.J. STRICKLER</u> (Landman)	
Direct Examination by Mr. Bruce	4
Examination by Examiner Jones	13
REPORTER'S CERTIFICATE	20

* * *

E X H I B I T S

Applicant's	Identified	Admitted
Exhibit 1	5	13
Exhibit 2	6	13
Exhibit 3	7	13
Exhibit 4	8	13
Exhibit 5	11	13
Exhibit 6	12	13

* * *

A P P E A R A N C E S

FOR THE DIVISION:

GAIL MacQUESTEN
Deputy General Counsel
Energy, Minerals and Natural Resources Department
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

FOR THE APPLICANT:

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

* * *

1 WHEREUPON, the following proceedings were had at
2 8:56.m.:

3 EXAMINER JONES: And let's call Case 13,724,
4 Application of Chaparral Oil and Gas Company -- different
5 Chaparral -- for approval of a nonstandard gas spacing and
6 proration unit, San Juan County, New Mexico.

7 Call for appearances.

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

10 EXAMINER JONES: Any other appearances?
11 Will the witness please stand to be sworn?

12 (Thereupon, the witness was sworn.)

13 JAMES R.J. STRICKLER,
14 the witness herein, after having been first duly sworn upon
15 his oath, was examined and testified as follows:

16 DIRECT EXAMINATION

17 BY MR. BRUCE:

18 Q. Would you please state your name and city of
19 residence for the record?

20 A. James Strickler, Farmington, New Mexico.

21 Q. What is your occupation?

22 A. I'm a petroleum landman.

23 Q. And what is your relationship to Chaparral Oil
24 and Gas Company?

25 A. I'm a consulting landman for Chaparral.

1 Q. Have you previously testified before the
2 Division?

3 A. Yes.

4 Q. And were your credentials as an expert landman
5 accepted as a matter of record?

6 A. Yes.

7 Q. And are you familiar with the land matters
8 involved in this Application?

9 A. I am.

10 MR. BRUCE: Mr. Examiner, I'd tender Mr.
11 Strickler as an expert petroleum landman.

12 EXAMINER JONES: Mr. Strickler is qualified as an
13 expert petroleum landman.

14 Q. (By Mr. Bruce) Now Mr. Strickler, could you
15 identify Exhibit 1 and briefly describe what Chaparral
16 seeks in this case?

17 A. The section that's colored in Section 24, 28
18 North, Range 11 West, San Juan County, New Mexico. The
19 yellow area is the northwest quarter. Chaparral and their
20 partner group owns 100 percent of this 160, and we're
21 seeking a nonstandard Fruitland Coal well unit comprising
22 the northwest quarter.

23 Q. And what is normal spacing in the Fruitland Coal?

24 A. 320 acres.

25 Q. What well does Chaparral propose to drill? And I

1 refer you to Exhibit 2.

2 A. The Sally Number 4 well. It's located 1475 feet
3 from the north line and 1635 feet from the east line of
4 Section 24.

5 Q. Now before we get into your testimony, are you
6 aware of the OCD's general policy against granting
7 nonstandard units because interest owners can't be force-
8 pooled into a well unit?

9 A. Yes.

10 Q. What is the basis for Chaparral's request for a
11 nonstandard unit?

12 A. The owners in the southwest quarter of Section 24
13 is owned by General Minerals Corporation and Ronnie L.
14 Morehead. They're a group of companies out of Oklahoma
15 City, Oklahoma, and their net revenues are quite low, 45
16 percent. For some reason they have burdened their interest
17 with a 25-percent override and a 20-percent carried working
18 interest, and when you average their group's interest, it's
19 45-percent net revenue, so the economics are quite poor,
20 even if you average in with our good net revenues.

21 Q. So it would be basically uneconomic for Chaparral
22 and its group to drill this well with the interest owners
23 in the southwest quarter?

24 A. Yes, sir.

25 Q. And we'll get into this in a minute in a little

1 more detail, but the interest owners in the southwest
2 quarter do not -- would rather not join in Chaparral's
3 proposed well; is that correct?

4 A. Yes, sir.

5 Q. Let's get into the interest ownership. What is
6 Exhibit 3?

7 A. Exhibit 3 is a copy of the title opinion,
8 drilling title opinion, rendered by Michael Cunningham,
9 Tatum, New Mexico. And the second page gives you a
10 breakdown of the ownership. The southwest quarter of
11 Section 24 is owned by Chaparral and their partners. It's
12 roughly -- it's 100 percent when you count all the group
13 and 82 percent net revenue.

14 In the ^{SW} ~~northwest~~ quarter we have -- I'm sorry, I
15 got it backwards. In the southwest quarter we have the
16 General Minerals group; in the northwest quarter we have
17 our group, Chaparral's group. And it's 100 percent, 82
18 percent net revenue. The southwest quarter is where it's
19 heavily burdened with carried working interest and
20 overrides.

21 There's a before and after payout. It's pretty
22 complicated, but suffice it to say after payout it's a 45-
23 percent net revenue interest.

24 Q. And since these matters have been of record for a
25 while, or these various burdens and assignments, you'd take

1 subject to them, do you not?

2 A. Yes, we would.

3 Q. You would.

4 And then in the northwest quarter, that is again
5 the Chaparral interest?

6 A. Correct.

7 Q. And the combined burden on that acreage is
8 substantially less, is it not?

9 A. Yes, sir.

10 Q. And what is the NRI, the net revenue interest --

11 A. 82 --

12 Q. -- of Chaparral?

13 A. -- 82 percent, 82 percent.

14 Q. Now what is the cost of the well? And I refer
15 you to Exhibit 4?

16 A. The AFE to drill and complete this 2000-foot
17 Fruitland Coal well is \$381,000.

18 Q. And is this cost in line with the cost of
19 Fruitland Coal wells drilled in this area of San Juan
20 County?

21 A. Yes, it is.

22 Q. Now in deciding to drill a well, what economic
23 standards does Chaparral use?

24 A. We look for a 36-month payout of this investment,
25 and our cutoff is generally 80 percent, so we're just

1 barely above the 80-percent cutoff.

2 Q. Okay. And based on other wells in this area,
3 this -- your proposed well is right at about that 36-month
4 payout, correct?

5 A. If it comes in as forecasted, yes.

6 Q. And if the payout is longer than that, then it
7 doesn't meet your economic standards?

8 A. Yes.

9 Q. And again, why not just force pool the owners in
10 the southwest quarter?

11 A. Well, again, we would be subject to those
12 overrides. We would have to pay those burdens on behalf of
13 the force pooled interests, General Minerals Corporation
14 and Ronnie Morehead, and that would knock our net revenue
15 interest to 63 percent.

16 Q. But you have been in touch with them regarding
17 this well?

18 A. Yes, talked to them last night, in fact.

19 Q. And you have had numerous discussions with them,
20 have you not?

21 A. Yes, I have.

22 Q. Now, they were not agreeable to drilling this
23 well at this cost; is that correct?

24 A. That is right.

25 Q. And so they said that they would go nonconsent in

1 the well?

2 A. Yes.

3 Q. And if that occurred, then you would have to bear
4 their burdens and have that very low net revenue interest
5 to recoup their share of well costs?

6 A. Yes.

7 Q. And approximately how would affect the payout?
8 Again, you said what you like to see is at least a 36-month
9 payout. Based on General Minerals group going nonconsent,
10 what would the payout be, approximately?

11 A. It would be 70 months or longer.

12 Q. And that would not meet your economics?

13 A. No, sir.

14 Q. And if that was the case, the well couldn't be
15 drilled, would it?

16 A. We would be unable to drill the well.

17 Q. And would that affect the Chaparral group's
18 correlative rights?

19 A. Yes, it would.

20 Q. Why not form a north-half well unit?

21 A. There's already a unit established in the east
22 half, and so that would not be available to us. We're in
23 the west half.

24 Q. And is that well operated by Burlington Resources
25 in the --

1 A. Yes, it is.

2 Q. -- east half?

3 Are there any other reasons for not wanting to
4 join in a well with the General Minerals group in the
5 southwest quarter?

6 A. They've had a history, we're familiar with them
7 -- our drilling engineer is familiar with them -- over the
8 last 10 or 12 years and their bill-paying habits are quite
9 poor, and so that concerns us, their financial ability is
10 not very good.

11 Q. Were the affected parties in the southwest
12 quarter notified of this hearing?

13 A. Yes.

14 Q. And is Exhibit 5 the affidavit of notice
15 regarding the mailed notice sent to these interest owners?

16 A. Yes.

17 Q. Now in looking at Exhibit 5 -- Take a step back.
18 Who owns the minerals in the west half?

19 A. The federal government.

20 Q. And in looking at Exhibit 5 the United States
21 wasn't notified, and why is that?

22 A. Because their interest is the same in both -- in
23 the entirety of Section 5 -- or the west half of Section
24 24.

25 Q. And in looking at a title opinion and the notice

1 exhibit, the Marquis Eaton interests were also not
2 notified. Does the same hold true for those people?

3 A. Yes.

4 Q. Their interest is uniform throughout the west
5 half?

6 A. Yes, yes, so they're not affected.

7 Q. And again, you have spoken with the General
8 Minerals group about this Application, have you not?

9 A. Yes, I have, and they support our position.

10 Q. They would rather be left alone to drill their
11 well whenever they want to?

12 A. Yes.

13 Q. And then Exhibit 6 is an affidavit of notice just
14 published in case there were any unlocatable interest
15 owners; is that correct?

16 A. Yes, sir.

17 MR. BRUCE: Mr. Examiner, in looking at Exhibit 5
18 I just want you to be aware of the very final pages of
19 Exhibit 5, is the notice -- material regarding notice sent
20 to Lea Ann Eaves. That was not received by her, but if
21 you'll look at the notice list, we have two addresses from
22 her, and she did receive it at one address and not the
23 other, so...

24 Q. (By Mr. Bruce) Were Exhibits 1 through 6
25 prepared by you or under your supervision or compiled from

1 company business records?

2 A. Yes, sir.

3 Q. And in your opinion, is the granting of this
4 interest in the -- of this Application in the interests of
5 conservation and the prevention of waste?

6 A. Yes.

7 MR. BRUCE: Mr. Examiner, I'd move the admission
8 of Exhibits 1 through 6.

9 EXAMINER JONES: Exhibits 1 through 6 will be
10 admitted to evidence.

11 EXAMINATION

12 BY EXAMINER JONES:

13 Q. Mr. Strickler, let me re-state and maybe you can
14 correct me if I'm wrong. It was because of the -- the
15 federal government's basic royalty burden is the same,
16 right? But it's --

17 A. One-eighth royalty, yes.

18 Q. Okay, it's 1/8?

19 A. Yes, sir.

20 Q. But the royalty -- the override royalty that the
21 southwest half working interests have granted people
22 through the years has increased the burden to how much now?

23 A. Forty-five percent, it's --

24 Q. Forty-five percent --

25 A. Well, let me -- let me break it down for you.

1 It's only -- in the title opinion, in the southwest
2 quarter --

3 MR. BRUCE: Mr. Examiner, if you could look at
4 Exhibit 3, page 2, right at the top where it lists the
5 royalty interests, the United States, and then the ORI, the
6 overriding royalty interests.

7 Go ahead, Mr. Strickler.

8 THE WITNESS: As you can see here, there's about
9 a half a dozen overriding royalty owners. But the big
10 override was created from General Minerals Corporation to
11 Vance One Limited Partnership. It affects their interest
12 only, and it's a 25-percent override. It's a very
13 unusually high override. I don't understand it, but there
14 must be some business relationship with them. Ronnie
15 Morehead's interest is a little cleaner. They have a 70-
16 percent NRI, it's still quite low. But General Minerals
17 Corporation, who we would have to deal with, their interest
18 is 46 percent, roughly.

19 EXAMINER JONES: Oh, wow.

20 THE WITNESS: And there's a carried working
21 interest as well that would increase our costs to Coal Gas
22 Mart, Inc., so there's a 20-percent carried working
23 interest.

24 Q. (By Examiner Jones) Boy, somebody made a --
25 looks like somebody went crazy there.

1 A. Well, we don't really --

2 (Laughter)

3 MR. BRUCE: And Mr. Examiner, from a legal
4 standpoint there is that carried interest, and I think we
5 take subject to that, or General Minerals would, and the
6 only way to clear something like that up is some court
7 action, possibly, you know, regarding reducing that. But I
8 don't even think that could be done, then. So that would
9 substantially slow down the process too.

10 Q. (By Examiner Jones) What about geology? Is
11 there any difference in the two locations? How come they
12 -- I mean, I noticed on the east half there's a Burlington
13 standup spacing unit.

14 A. Yes, sir.

15 Q. And is there -- Let's see here, there's a Number
16 2 well and a Number -- proposed Number 4 well over there.
17 But it's -- Oh, wait a minute, wait a minute. You guys
18 actually have a well already in your -- according to our
19 records, you have a PC-Fruitland Sand well.

20 A. Right, and this is a Fruitland Coal, so this will
21 be a new completion in this west half. I really can't
22 speak for the geology, but I can tell you that Chaparral
23 drilled a well recently, a couple of months ago, in the
24 southeast quarter of Section 13, which is the northeast
25 offset, and it encountered about 13 feet of Fruitland Coal,

1 and the well didn't complete very well. So we're kind of
2 nervous. We were expecting about 100-MCF-a-day production
3 profile, 100 to 200-MCF-a-day production profile, and it's
4 around 10 MCF a day, so we don't know if there's some
5 mechanical problems. We're trying to sort that out, so...

6 It's pretty thin coals in this area. Thirteen
7 feet is certainly sufficient, but it's not like the 30 feet
8 that you find in other areas, towards the Aztec-Farmington
9 area.

10 Q. And it looks like they frac'd that Fruitland
11 Sand, and they frac'd the PC in the Sally Number 2, but I
12 don't know how far the coals are away from the sands. Do
13 you know?

14 A. I think there's some separation, there's some
15 good separation there. I don't have a well log to give you
16 exactly, but from what the engineers told me and the
17 geologists -- and I know -- there's good separation. So we
18 think the frac will be isolated to the Fruitland Coal.
19 That's certainly our forecast.

20 Q. Now if you drilled the Sally Number 4, you're --
21 I guess you could always shut in Number 2, if it's been
22 there forever, and re-frac the PC and the Fruitland Sand.
23 That way you'd have a northwest spacing unit for those two
24 also.

25 A. That's a possibility. I think they're -- I'd

1 have to ask them to see if -- I'm sure they've thought of
2 that.

3 Q. Okay. The -- If you did combine with the
4 southwest quarter, you would actually raise their
5 economics, right? You would help them maybe drill a well
6 in the future?

7 A. Oh, perhaps. They've indicated -- They have the
8 Charlie 1 on their drillblock, and they've indicated they'd
9 like to do something with that later, in other words form a
10 southwest quarter unit and maybe recomplete a PC well, and
11 they would do that 100 percent, and they could deal with
12 all their excessive burdens internally --

13 Q. Okay.

14 A. -- with their group. And so they have plans for
15 the southwest quarter. That's why they support our
16 nonstandard proration unit, because that'll give them a
17 nonstandard proration unit in the southwest quarter later
18 on.

19 Q. Okay. Now where does it say that they support
20 your --

21 A. I don't have anything in writing. This is all
22 based on verbal conversations with Chris -- the president
23 of General Minerals Corporation.

24 Q. Okay, but they didn't oppose this --

25 A. No, sir.

1 Q. -- is that correct? They were noticed and they
2 didn't oppose this?

3 MR. BRUCE: That is correct.

4 EXAMINER JONES: Is there any other examples that
5 you can think of --

6 MR. BRUCE: I can't think of one. There are some
7 -- there have been some fights, and I think Burlington has
8 been involved in them, over some old JOAs that have some
9 onerous terms where they've tried to force pool people, but
10 I don't know what the status of those things are. But this
11 is the first case I've ever handled like this.

12 I should say, Mr. Examiner, that I think in the
13 San Juan Basin -- in southeast New Mexico, I think Mr. Carr
14 and I have both had cases where after a pooling case was
15 filed, a company went out and created substantial overrides
16 or onerous lease terms, like a 50-percent override or a
17 lease term -- or went out to their own attorneys and
18 executed a lease form to the attorney that was onerous
19 after the pooling done -- I mean after the pooling was
20 commenced, and the Division -- and that would have made the
21 drilling of the well uneconomic.

22 One was a -- and I can get you those orders. I
23 forget who Mr. Carr's client was. Mitchell Energy?

24 MR. CARR: Bettis, Boyle and Stovall.

25 MR. BRUCE: Bettis, Boyle and Stovall. And I did

1 one for -- it started out as Concho Resources, which was
2 merged into Devon Energy, and I can get you those case
3 numbers.

4 EXAMINER JONES: Well, they were a little
5 different --

6 MR. BRUCE: They were a little -- They were a
7 little different, they were a little different, in the fact
8 that the burdens were created once the pooling started, and
9 with the specific intent to prevent the operator from going
10 forward, but the net effect was the same because the
11 burdens were so high that it made it uneconomic to seek to
12 drill the well. And in that instance -- The pooling went
13 forward in those, so a nonstandard unit wasn't granted, but
14 the pooling went forward and the Division specifically
15 disallowed those interests because of how it occurred, the
16 timing of what occurred.

17 EXAMINER JONES: But the theory is that it would
18 have killed the economics of the proposed well?

19 MR. BRUCE: Yes, it would have.

20 EXAMINER JONES: I don't have anything else.

21 Okay, well thanks very much, Mr. Strickler, Mr. Bruce. And
22 with that, we'll take Case 13,724 under advisement.

23 (Thereupon, these proceedings were concluded at
24 9:18 a.m.)

25 I do hereby certify that the foregoing is
* * * a complete record of the proceedings in
the Examiner hearing of Case No. _____

heard by me on _____

STEVEN T. BRENNER, CCR

(505) 989-9317

_____, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL June 11th, 2006.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 16th, 2006