

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 CHI ENERGY, INC., CASE NO. 14353
FOR APPROVAL OF A SECONDARY RECOVERY
PROJECT AND TO QUALIFY THE PROJECT FOR THE
RECOVERED OIL TAX RATE, EDDY COUNTY, NEW MEXICO

APPLICATION OF CHI ENERGY, INC., CASE NO. 14354
FOR STATUTORY UNITIZATION, EDDY COUNTY,
NEW MEXICO

REPORTER'S TRANSCRIPT OF PROCEEDING
EXAMINER HEARING

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BEFORE: RICHARD EZEANYIM, Presiding Examiner
DAVID K. BROOKS, Legal Examiner

November 12, 2009

Santa Fe, New Mexico

This matter came on for hearing before the
New Mexico Oil Conservation Division, RICHARD EZEANYIM,
Presiding Examiner, and DAVID K. BROOKS, Legal Examiner,
on Thursday, November 12, 2009, at the New Mexico Energy,
Minerals and Natural Resources Department, 1220 South St.
Francis Drive, Room 102, Santa Fe, New Mexico.

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FOR THE NM OIL CONSERVATION DIVISION:

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FOR THE APPLICANT:

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1 MR. EZEANYIM: We'll go back into the
2 record. These two cases, I would like to combine them
3 for purposes of testimony.

4 MR. BRUCE: Yes.

5 MR. EZEANYIM: At this time we call two
6 cases, Case Number 14353, application of Chi Energy,
7 Inc., for approval of a secondary recovery project and to
8 qualify the project for the Recovered Oil Tax Rate, Eddy
9 County, New Mexico, and Case Number 14354, application of
10 Chi Energy, Inc., for statutory unitization, Eddy County,
11 New Mexico. Call for appearances.

12 MR. BRUCE: Mr. Examiner, Jim Bruce of
13 Santa Fe representing the applicant. I have three
14 witnesses.

15 MR. EZEANYIM: Any other appearances?

16 MS. MACQUESTEN: Mr. Examiner, Gail
17 MacQuesten for the Oil Conservation Division. We have
18 entered an appearance only in Case Number 14353, which is
19 Chi's application for a secondary recovery project.

20 MR. EZEANYIM: I don't know how to say it.
21 We are consolidating the case for purposes of testimony.
22 Is it important for you to present your case in that
23 waterflood project before we continue?

24 MS. MACQUESTEN: Yes.

25 MR. EZEANYIM: Is that okay with you?

1 MR. BRUCE: Yeah. Mr. Examiner, just to
2 explain on the record, there's the underlying unitization
3 on waterflood cases, and I do have three witnesses, and
4 those cases were filed in the name of Chi Energy, Inc.,
5 which is one of the working interest owners in those
6 cases. Ms. MacQuesten has a filed pre-hearing statement
7 concerning certain compliance issues of Chi Operating,
8 Inc., which is a separate corporate entity, but it is the
9 operator -- the operating entity for these wells.

10 But Ms. MacQuesten has informed me that she's
11 not interested in the underlying unitization and other
12 technical matters, and she would like to present these
13 compliance issues. That's fine. She can start with Mr.
14 Sanchez and we have brief rebuttal to that. Once that is
15 done, I believe Ms. MacQuesten would like to vacate the
16 premises and we can go about with the underlying cases.

17 MR. EZEANYIM: Okay. Go ahead.

18 MS. MACQUESTEN: If you don't mind, Mr.
19 Examiner, I'd like to explain why we have entered an
20 appearance in this case before we present testimony.

21 MR. EZEANYIM: Okay. At this point, all
22 the witnesses will have to stand, state their names and
23 be sworn in. Everybody stand up and state your name.

24 MR. SANCHEZ: Daniel Sanchez.

25 MR. QUALLS: John Qualls.

1 MR. SHATZER: David Shatzer

2 MR. WOMACK: Gary Womack.

3 (The witnesses were sworn.)

4 MR. EZEANYIM: Okay. You may proceed.

5 MS. MACQUESTEN: Mr. Examiner, the Oil
6 Conservation has entered its appearance in Case 14353 to
7 alert the Examiners to a potential problem with the
8 applicant's compliance history.

9 As Mr. Bruce indicated, Chi Energy, Inc., has
10 applied for a secondary recovery project. It's
11 interesting, though, that the operator of the wells is
12 Chi Operating, Inc. It is Chi Operating, Inc., that will
13 need the permit and authority from you to proceed. And
14 the problem is that Chi Operating, Inc., is out of
15 compliance with Part 5.9.

16 Our injection rule, Rule 26.8, provides that
17 the OCD may grant a permit for injection only to an
18 operator who is in compliance with Part 5.9. Chi
19 Operating, Inc., the operating entity for these wells, is
20 out of compliance with Part 5.9 in two respects. It has
21 too many inactive wells, and it doesn't have the proper
22 financial assurances in place.

23 If you look at Part 5.9, 5.9(A)(4) is the
24 provision that deals with inactive wells. It says that
25 an operator is out of compliance with 5.9 if it has more

1 than a certain number of wells out of compliance with
2 19.15.25.8, the inactive well rule. For an operator of
3 Chi's size, the magic number is five. Chi can have no
4 more than five wells out of compliance with the inactive
5 well rule.

6 5.9(A)(1) is the provision that deals with
7 financial assurances. It says that the operator must
8 meet the financial assurance requirements of 19.15.8.
9 That rule provides that a state or fee well inactive for
10 more than two years must have a single well financial
11 assurance, even if the operator already has a blanket
12 financial assurance in place.

13 You have attached to the pre-hearing statement
14 in this case a letter that was sent to Chi alerting them
15 to the inactive well rule violations and the financial
16 assurance violations. We found 10 wells that appear to
17 be in violation of the inactive well rule. Seven of
18 those wells also appear to need single well financial
19 assurances.

20 Now, you won't find those violations of the
21 inactive well rule or the financial assurance rule in the
22 reports that the OCD has online of inactive well
23 violations and financial assurance violations. That's
24 because our computer system only looks at the compliance
25 of wells that have reported production or injection at

1 some point in time. That is a practical problem that we
2 have with our computer system. Our computer system
3 simply cannot tell the difference between a well that's
4 been granted an APD but never drilled and a well that has
5 actually been drilled and been inactive for a period of
6 time but never reported production and injection, so that
7 a practical problem with our lists.

8 However, 5.9 doesn't rely on lists. It relies
9 on the rule violations themselves. It refers to wells
10 being in violation of the inactive well rule and the
11 financial assurance rule. What we did in this case was
12 research the well files of all the wells that Chi
13 operates that never reported production or injection, and
14 we found wells that were, in fact, drilled, but never
15 reported production or injection and have not been
16 plugged and released. Now, if a well has been drilled
17 and it's inactive, our rules require it to be plugged and
18 released. If that well is a state or a fee well and it's
19 been in existence for more than two years, it needs a
20 single well financial assurance.

21 Those are the issues we're dealing with here.
22 We put Chi on notice of those violations by letter. We
23 have a copy of that letter attached to the pre-hearing
24 statement. What we are here today to do is to alert you
25 that those problems still exist, and we ask you not to

1 approve any injection authority for Chi until they come
2 into compliance with 5.9 as to those wells that we have
3 brought to your attention.

4 MR. EZEANYIM: Thank you. Mr. Bruce?

5 MR. BRUCE: Mr. Examiner, I think a number
6 of these wells are in compliance and Chi is in process of
7 completing the other ones, and I would rather let my
8 witness testify as to the status of the wells, rather
9 than make any further argument.

10 MR. EZEANYIM: Call your first witness.

11 MS. MACQUESTEN: I call Daniel Sanchez.

12 J. DANIEL SANCHEZ

13 Having been first duly sworn, testified as follows:

14 DIRECT EXAMINATION

15 BY MS. MACQUESTEN:

16 Q. Would you please state your name for the
17 record.

18 A. Daniel Sanchez.

19 Q. Where are you employed?

20 A. With the Oil Conservation Division.

21 Q. What is your title?

22 A. Compliance and enforcement manager.

23 Q. Do your duties include supervising the
24 compliance and enforcement activities of the OCD?

25 A. Yes.

1 Q. Did you research Chi's compliance with 5.9 for
2 this case?

3 A. Yes, I did.

4 Q. How did you conduct that research?

5 A. I looked at -- I went through the well files,
6 the well lists, and just tried to identify those that
7 were reported -- well, looked at the wells that never
8 reported production or injection and pulled those well
9 files to see if the wells were actually drilled and if
10 they were plugged and released.

11 Q. Are the results of your investigation set out
12 in Exhibit A?

13 A. Yes, they are.

14 Q. Is that a letter that was sent to Mr. Jim
15 Bruce on October 15, 2009, informing Chi of the
16 violations that you found?

17 A. Yes, it was.

18 Q. Does this letter summarize what you found in
19 your research?

20 A. Yes, it does.

21 Q. Could you briefly summarize that for us?

22 A. Sure. There were 10 wells that appeared to be
23 out of compliance with the inactive well rule. They were
24 drilled but not plugged and released. Some of those
25 wells were also out of compliance with the financial

1 assurance rule because they were either state or fee
2 wells and they had been inactive for more than two years,
3 didn't have a single well financial assurance on them.

4 There were 10 that we were looking at, the
5 Elkan Number 2, the Elkan 2Y, the Footjoy 14 State Number
6 1, the In Bounds Com Number 1, the Munchkin Federal
7 Number 7, the Nicols 30 State Com Number 2, the Oxy Marsh
8 Hawk State Number 2, Salado Federal Number 1, Silver
9 Bullet Number 1, and the WC 4 Number 1.

10 Q. Is Exhibit B a copy of Chi's well list?

11 A. Yes, it is. It was printed out November 10th,
12 and it shows them having 116 wells total.

13 Q. Is this how you started your research by
14 looking at this list and determining which wells have
15 never reported production or injection?

16 A. Yes.

17 Q. And you looked at each one of those wells in
18 the well file to see the status of the well?

19 A. Yes.

20 Q. What is the significance of the highlighting?
21 There are some wells that are highlighted in yellow and
22 some also have green highlighting.

23 A. The ones highlighted in yellow were the wells
24 that we found were out of compliance with the -- they
25 hadn't plugged or abandoned or converted them. Anything

1 with green next to it is also out of compliance with the
2 additional financial assurance.

3 Q. Let me ask you, of the wells that were in
4 violation of the inactive well rule, are there some wells
5 where the wellbore is plugged but the site needs to be
6 cleaned up?

7 A. There were several wells.

8 Q. And there are some wells that the wellbore has
9 not been plugged at all?

10 A. Yes.

11 Q. To determine -- on the financial assurance
12 violations to determine whether Chi had a single well
13 financial assurance in place for the wells that needed
14 it, is Exhibit C a collection of printouts of the
15 financial assurance information for those wells that you
16 indicated still need a single well bond?

17 A. Yes, it is. It does show the type of bond for
18 each one of these was just a blanket bond. No additional
19 assurance was added to these.

20 Q. This was taken from the well search feature on
21 the OCD online?

22 A. Yes.

23 Q. And the financial assurance information is, on
24 most of these, about halfway down the page under,
25 "Financial assurance"?

1 A. Yes. Correct.

2 Q. It indicates that a blanket bond is in place,
3 but it does not indicate any single well financial
4 assurance covering that particular well?

5 A. That's correct.

6 Q. Your letter to Chi informing them of the
7 violations mentioned that some of these wells were the
8 subject of previous Letters of Violation to Chi. Are
9 Exhibits D and E copies of those Letters of Violation?

10 A. Yes, they are. Exhibit D was issued back in
11 March, on March 18, '08, it was on Elkan 2Y and the Elkan
12 2. And the other letter, Exhibit E, was issued August
13 6th of '09, and that was on Munchkin Federal Number 7.

14 Q. Just to be clear on the inactive well
15 violations, a well would not be in violation of the well
16 inactive well rule under Part 5.9 if it were under an
17 agreed compliance order; right?

18 A. That's right.

19 Q. Are any of these wells under an agreed
20 compliance order?

21 A. No.

22 Q. Are any of these wells in approved temporary
23 abandonment status?

24 A. No.

25 Q. Did Chi respond to the letter informing them

1 of these Part 5.9 violations?

2 A. Yes, they did.

3 Q. Is Exhibit F a copy of the letter to the OCD
4 received in response?

5 A. Yes, it is.

6 Q. And could you summarize Chi's response?

7 A. Basically, their response was that they were
8 working on all of them to some degree and to try to bring
9 them back into compliance. On one of them, the Nicols 30
10 State Com Number 2 was able to actually see an additional
11 sundry submitted in the well file showing a notice of
12 intent to plug, and that was approved by the district
13 office with a completion date of December 15th, 2009.

14 Q. Now that's an intent to plug?

15 A. That's correct.

16 Q. Did you see a sundry indicating that plugging
17 had been completed?

18 A. Not at this point. Part of the letter would
19 show that their well is in line for plugging at this
20 point by Chi. They do have a rig available and ready to
21 go.

22 Q. You have reviewed the well files for these
23 wells recently?

24 A. Yes, within the last week at least.

25 Q. And as a result of your most recent review,

1 did you find that any of the wells mentioned in the OCD's
2 letter should not be treated as in violation? Have any
3 of them been returned to compliance?

4 A. Not that I've seen as of this morning. Like I
5 said, they are working on some of them. Notice of intent
6 to plug does not make it in compliance, but it does show
7 that they are working towards compliance.

8 Q. If a well needs to be plugged and released, do
9 we require an approved sundry from the district office
10 indicating that the site has been released?

11 A. Yes.

12 Q. At that point, the well is coded as plugged
13 and abandoned and then it is in compliance with the
14 inactive well rule?

15 A. That's correct.

16 Q. If it's in compliance with the inactive well
17 rule by being plugged and released, we wouldn't need
18 financial assurance?

19 A. No, we would not.

20 Q. But right now we're still in a situation that
21 although Chi is working on these wells, none of them have
22 been returned to compliance at this time?

23 A. No, not at this time.

24 Q. There was one well that Chi indicated had
25 never been drilled. It's the WC 4 Number 1. I believe

1 in our letter we had some questions from the well file as
2 to what the status of the well was and whether it, in
3 fact, had been drilled. If Chi believes the well has
4 never been drilled, do they need to get the APD
5 cancelled?

6 A. Yes.

7 Q. And is that done through the district office?

8 A. I believe it is.

9 Q. Has that been done?

10 A. Not that I'm aware of.

11 Q. It still shows up on our list?

12 A. Yes, it does.

13 Q. Okay. Under Part 5.9, an operator -- let me
14 back up. Under the rule regarding injection permits, an
15 operator needs to be in compliance with Part 5.9 before
16 an injection permit can be issued; is that right?

17 A. That's correct.

18 Q. Is it the OCD's position that Chi is not in
19 compliance with 5.9 at this point?

20 A. As of now, yes.

21 Q. And when they eventually do come into
22 compliance, then 5.9 would not prohibit them from getting
23 an injection permit if they're otherwise entitled to it?

24 A. That's correct.

25 MS. MACQUESTEN: At this point I would

1 move for the admission of Exhibits A through F.

2 MR. EZEANYIM: Any objection?

3 MR. BRUCE: No objection.

4 MR. EZEANYIM: Exhibits A through F will
5 be admitted.

6 (Exhibits A through F were admitted.)

7 MS. MACQUESTEN: I have no other questions
8 for Mr. Sanchez.

9 MR. BRUCE: Just a few questions. Mr.
10 Examiner.

11 CROSS-EXAMINATION

12 BY MR. BRUCE:

13 Q. Mr. Sanchez, on the WC 4 Well Number 1, do you
14 know when that was permitted?

15 A. Back in 2003.

16 Q. How long are permits good for?

17 A. I'm thinking it's a two-year time frame.

18 Q. Wouldn't that have automatically expired?

19 A. It would have expired, but there was also
20 another piece of paper in the well file that show that
21 there was an application for a closure on a drilling pit
22 on that site back in '07, so that was another concern
23 that we had, if there was a pit that had been closed and
24 has the paperwork been filed on that.

25 Q. Have you spoken with Mike Bratcher in the

1 Artesia office about any of Chi Operating's wells?

2 A. Not recently.

3 Q: And, again, Chi -- based on the number of
4 wells Chi has, Chi Operating operates in New Mexico,
5 they're allowed to have five wells out of compliance; is
6 that correct?

7 A. That's correct.

8 MR. BRUCE: I have nothing further, Mr.
9 Examiner.

10 MR. BROOKS: No questions.

11 MR. EZEANYIM: Okay. No questions.

12 MS. MACQUESTEN: May I ask two follow-up
13 questions?

14 MR. EZEANYIM: Okay.

15 REDIRECT EXAMINATION

16 BY MS. MACQUESTEN:

17 Q. Mr. Bruce asked if an operator could have five
18 wells out of compliance and still be in compliance with
19 5.9. That relates strictly to inactive wells, does it
20 not?

21 A. Yes. I should have clarified that.

22 Q. If an operator is out of compliance in any way
23 with the financial assurance requirements, that puts them
24 out of compliance with 5.9?

25 A. That's correct.

1 Q. Even as to the single well?

2 A. Yes.

3 Q. And Mr. Bruce asked about APDs being cancelled
4 automatically after the two years has expired. Have you
5 ever seen a situation where an operator has drilled a
6 well but failed to file the paperwork showing that the
7 well has been drilled?

8 A. Yes.

9 Q. And they've drilled within the two-year time
10 period?

11 A. Yes.

12 Q. So does the district keep the APD in place
13 until some investigation can be done or the operator
14 requests that the APD be cancelled?

15 A. That, I'm not quite sure about. I think
16 that's how they would handle it, yes.

17 MS. MACQUESTEN: I have no further
18 questions.

19 MR. EZEANYIM: Based on that, I do have
20 some questions.

21 EXAMINATION

22 BY MR. EZEANYIM:

23 Q. How many wells now need the single well
24 financial assurance?

25 A. I believe there were seven.

1 Q. But they have a blanket plugging bond?

2 A. They do have a blanket bond, but that isn't
3 sufficient in the case of wells that have been out of
4 compliance or inactive for more than two years if they're
5 a state or fee well.

6 Q. Yeah. According to Rule 17, it's a single
7 well financial assurance?

8 A. Yes.

9 MR. EZEANYIM: Okay. Nothing more.

10 MS. MACQUESTEN: If I may ask this as a
11 practical question on how we should proceed in this case,
12 as we haven't had very many, I'm not sure how you want to
13 handle them. Maybe I should wait until after you finish
14 your presentation. I'm sorry, Mr. Bruce.

15 MR. EZEANYIM: Maybe you should ask the
16 question now.

17 MS. MACQUESTEN: If you determine that Chi
18 is in violation of Part 5.9, and we're not ready to make
19 that determination because we haven't heard Mr. Bruce's
20 case, but if you determine that they are in violation of
21 Part 5.9 and that a permit can't be issued until they
22 come into compliance, I wondered what process you wanted
23 to follow to determine whether they were in compliance.
24 Would the permit be simply denied and they would have to
25 re-file, or would you hold the case open until we can

1 determine they were in compliance? Again, you don't have
2 to answer that question until you reach the point that --

3 MR. BROOKS: Well, generally speaking, the
4 directions we've been given are that these cases are not
5 to be set until the issue of compliance is determined.
6 Obviously that was not followed in this case. So it
7 seems to me that we came to that determination as a
8 result of some cases that we had in the past where we
9 took them under advisement and then the noncompliance was
10 subsequently determined.

11 Though, it should not be considered as a
12 precedent for future cases in the event that we -- in the
13 event that it appears Chi is out of compliance in this
14 case, since the witnesses are here, it would seem
15 appropriate to go ahead and hear the case, but not enter
16 an order unless and until compliance is demonstrated. Of
17 course that has a disadvantage that after some point in
18 time -- we can't just carry those cases indefinitely.
19 After some point in time it will be necessary, if we
20 haven't gotten a demonstration of compliance, to go ahead
21 and dismiss that case without prejudice.

22 MR. BRUCE: Mr. Examiner, I believe we
23 address most of those issues here.

24 MR. BROOKS: Like I say, I think that
25 given where we are at this particular point in time, I

1 think that's a good -- if Mr. Ezeanyim agrees, I think
2 that's a good way to dispose of this case. Obviously,
3 it's not going to be our normal policy and we don't
4 consider that as precedent for other future cases.

5 MR. EZEANYIM: I agree with exactly what
6 you said. I'm surprised that this case came to hearing
7 today, you know, for all we do. If there is
8 noncompliance issues, that has to be figured out before
9 it goes into the docket.

10 MR. BROOKS: Our policy will be in the
11 future that if an issue of noncompliance is raised, the
12 case will be taken off the docket on the merits until the
13 issue of noncompliance is solve, either by the operator
14 coming back into compliance, or we have a hearing on
15 compliance and determine that they are, in fact, in compliance.
16 compliance. That way we avoid getting in situations
17 where we have cases under advisement that can't be
18 disposed of. But since we already have the witnesses
19 here, I really don't want to send them home and tell them
20 to come back some other day.

21 MR. EZEANYIM: I agree with that. What we
22 should have done is continue the case indefinitely until
23 we get those issues resolved, but since the witnesses are
24 here, we are going to hear the case and decide what we're
25 going to do after the case is heard. So you may proceed.

1 Do you have any other comment?

2 MS. MACQUESTEN: No, I don't. Thank you.

3 JOHN QUALLS

4 Having been first duly sworn, testified as follows:

5 DIRECT EXAMINATION

6 BY MR. BRUCE:

7 Q. Please state your name for the record.

8 A. John Qualls.

9 Q. Where do you reside?

10 A. Midland, Texas.

11 Q. Who do you work for and in what capacity?

12 A. Chi Energy, Inc., landman.

13 Q. Have you previously testified before the
14 Division as a landman?

15 A. Yes.

16 Q. And were your credentials as an expert
17 accepted as a matter of record?

18 A. Yes.

19 Q. Are you familiar with the land matters
20 involved in these applications?

21 A. Yes.

22 Q. Are you also familiar with the compliance
23 issues raised in Mr. Sanchez's letter dated October 15th?

24 A. Yes.

25 MR. BRUCE: Mr. Examiner, I tender Mr.

1 Qualls as an expert petroleum landman.

2 MR. EZEANYIM: Mr. Qualls is so qualified.

3 Q. (By Mr. Bruce) Mr. Qualls, you reviewed Mr.
4 Sanchez's letter and all the data with respect to the 10
5 wells he listed in his letter; correct?

6 A. Yes.

7 Q. We're going to submit documents today, but
8 with respect to the submission of all documents showing
9 compliance for a number of these wells, is there an issue
10 with respect to the person at Chi who generally makes
11 these filings?

12 A. Yeah. Right now she's having some health
13 problems and is in the process of coming back to work.

14 Q. So she's been out of the office off and on for
15 a while?

16 A. (Witness nods head.)

17 MR. EZEANYIM: Mr. Qualls, could you
18 please speak up so we hear what you're saying? For the
19 court reporter and for ourselves here, speak up a little
20 bit, Mr. Qualls.

21 THE WITNESS: Okay.

22 Q. (By Mr. Bruce) Now, Mr. Qualls, let's start
23 with the Elkan Number 2 and Number 2Y wells which were
24 listed on Mr. Sanchez's letter. I refer you to Exhibit
25 A, which to lead you a little bit, is the Letter of

1 Violation from the OCD regarding these wells, or at least
2 the first page of that letter; correct?

3 A. Um-hum. Yes.

4 Q. Yeah. You've got to say yes or no for the
5 record.

6 A. All right.

7 Q. Those wells were plugged and abandoned;
8 correct?

9 A. Yes.

10 Q. And under the OCD rules you also have to do
11 subsequent cleanup to the satisfaction of the OCD?

12 A. Yes.

13 Q. Has that work been done?

14 A. Yes.

15 Q. Have you been in touch with the OCD district
16 office regarding that work?

17 A. Yes.

18 Q. I see there's a note on Exhibit A about, "work
19 has been done." Have you been in touch with Mike
20 Bratcher or the people at the Division office regarding
21 these wells?

22 A. Mark Meadows has. He's talked to Bratcher and
23 the people in Hobbs.

24 Q. Mark Meadows is employed by Chi Operating with
25 respect to these enforcement issues?

1 A. Yes.

2 Q. So even though you don't have the paperwork at
3 this point because of the health issues of your employee,
4 all of the work required in Mr. Sanchez's letter has been
5 done?

6 A. Yes.

7 Q. Let's move on, going down the list. The
8 Footjoy 14 State Number 1, that is waiting on a plugging?

9 A. Yes, a rig to plug it.

10 Q. Do you have any idea of the time frame of the
11 plugging?

12 A. I'm not sure. I'd say within the next 30 days
13 we'll be able to plug both these two wells on this list.

14 Q. So the Footjoy 14 State Number 1?

15 A. And the Nicols 30 State Com Number 1.

16 Q. Should both be plugged within 30 to 45 days?

17 A. Yes.

18 Q. Now, the In Bounds Com Number 1, based on Mr.
19 Sanchez's letter, that still shows up as being operated
20 by Chi Operating. Is that any longer operated by Chi
21 Operating?

22 A. No.

23 Q. What is Exhibit B?

24 A. Exhibit B is a Change of Operator from Chi
25 Operating to Chesapeake Operating.

1 Q. And this shows, besides the Form C-104A, some
2 emails and faxes between Chi and the Division and
3 Chesapeake regarding this well?

4 A. Yes.

5 Q. All in early August of 2008?

6 A. Yes.

7 Q. And the very last page, which if you look at
8 the lower right-hand corner, is dated August 4, 2008, is
9 that information from the OCD's website showing that the
10 well -- that operatorship was changed to Chesapeake
11 Operating?

12 A. Yes.

13 Q. But you understand at this point that Chi
14 Operating still shows up according to Mr. Sanchez as the
15 operator?

16 A. Yes.

17 Q. But you assigned -- Chi Operating and Chi
18 Energy assigned their rights to Chesapeake?

19 A. Yes.

20 Q. And you don't know why this doesn't show up as
21 Chesapeake's well?

22 A. No idea. It shows up on the website.

23 Q. It showed up on the website immediately after
24 the well was transferred?

25 A. Yes.

1 Q. Then the Munchkin Federal Number 7, and it's
2 in the Division's files, that well was drilled as -- how
3 long ago was that well drilled?

4 A. I believe that well was drilled -- I'm not
5 sure exactly what year. It's been about three years.

6 Q. What type of test was it?

7 A. It was a Delaware test.

8 Q. Was it successful?

9 A. No.

10 Q. What does Chi propose to do with that well?

11 A. We're going to come up the hole and try to
12 complete the Yates Zone.

13 Q. And has Chi filed -- that well is at an
14 unorthodox location?

15 A. Yes.

16 Q. And Chi has filed an unorthodox location
17 application?

18 A. Yes.

19 Q. That well is on federal land?

20 A. Yes.

21 Q. Has it taken you quite sometime to get BLM
22 approval for the recompletion attempt?

23 A. It's taken about a year.

24 Q. Okay. Once the unorthodox location approval
25 is obtained, what is the time frame of obtaining -- or

1 recompleting that well?

2 A. We'll be ready to start any time.

3 Q. Okay. The next well is the Nicols 30 State
4 Com Number 2, and I've submitted as Exhibit C a notice of
5 intent to plug and abandon; correct?

6 A. Right.

7 Q. That shows that it was submitted in late June
8 of this year?

9 A. Right.

10 Q. What happened to that filing?

11 A. We're not sure.

12 Q. It was approved by the OCD, was it not?

13 A. Right.

14 Q. But it doesn't show up on the website?

15 A. No. It was misplaced or something, so we
16 re-filed it on October 12th.

17 Q. And it was re-filed and it does show up on the
18 OCD's website now with the later filing?

19 A. Yes.

20 Q. So even before you got the letter from Mr.
21 Sanchez, even based on the later filing, that was October
22 14th of 2009, so you had already taken steps to plug and
23 abandon that well?

24 A. Yes, sir.

25 Q. The next one is the Oxy Marsh Hawk State

1 Number 2. That well has been plugged?

2 A. Yes.

3 Q. Has it been cleaned up?

4 A. According to my knowledge, it has been, yes.

5 Q. Again, what you're looking for there is to
6 confirm the paperwork with the person in your office who
7 takes care of that?

8 A. Right.

9 Q. Then, again, the Salado Federal Number 1,
10 what's the status of that?

11 A. That well was plugged and the location was
12 cleaned up and all the paperwork was hand delivered to
13 the Hobbs district office.

14 Q. What about the Silver Bullet Number 1?

15 A. That well location was cleaned up I believe
16 two or three years ago, and Mike Bratcher was involved in
17 that, and he was getting all the paperwork on that.

18 Q. Okay. And, again, just to reiterate, what's
19 the status of the WC 4 Well Number 1?

20 A. It was never drilled. The permit expired. I
21 know we had to get it pulled back. I figured it was like
22 a federal permit where after two years it just
23 automatically expired.

24 Q. Now, once we confirm all the paperwork is
25 filed, what that leaves you with is the Footjoy 14 State

1 Number 1, which needs to be plugged; correct?

2 A. Right.

3 Q. The Nicols 30 State Com Number 2, which needs
4 to be plugged and cleaned up?

5 A. Right.

6 Q. And then the Munchkin Federal Number 7?

7 A. Right.

8 Q. And I realize there's some question about the
9 status of the paperwork, but what that means is there are
10 only three wells out of compliance in your opinion?

11 A. Right.

12 Q. And one of them -- hold on -- the Footjoy 14
13 State Number 1 would need a bond. On the other hand,
14 that is scheduled for plugging in the near distant
15 future; right?

16 A. Yes, it is.

17 Q. Again, I ask you, is Chi Energy, Inc., a
18 separate corporate entity from Chi Operating, Inc.?

19 A. Yes.

20 Q. Are you an officer of Chi Operating, Inc.?

21 A. Yes.

22 Q. Mr. Qualls, were Exhibits A through C compiled
23 from Chi's business records?

24 A. Yes.

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

1 admission of Exhibits A through C.

2 MR. EZEANYIM: Okay. Any objection?

3 MS. MACQUESTEN: No.

4 MR. EZEANYIM: Exhibits A through C will
5 be admitted. Cross-examine?

6 (Exhibits A through C were admitted.)

7 CROSS-EXAMINATION

8 BY MS. MACQUESTEN:

9 Q. Mr. Qualls, what is your time estimate for Chi
10 being in compliance with Part 5.9?

11 A. I can't hear you.

12 Q. When can Chi be in compliance with Part 5.9?
13 How long will it take?

14 A. What we've just gone over was -- the paperwork
15 has been filed on a lot of these. I don't know where it is, but
16 is, but it was filed with the office in Hobbs and in
17 Artesia on the Elkan 2, Elkan 2Y. We've got to plug the
18 Footjoy 14 and the Nicols 30. These are the only ones
19 that I can see that there's an issue with. Is that what
20 you're asking?

21 Q. Yes. Basically, I'm asking when can you have
22 all the paperwork done, all the issues resolved, any
23 wells that need to be plugged, plugged, and that one well
24 that you want to re-enter and you need an unorthodox
25 location --

1 MR. BRUCE: The Munchkin Federal Number 7.

2 MS. MACQUESTEN: Right.

3 Q. (By Ms. MacQuesten) How much time do you
4 think it will take to get that approval for the
5 unorthodox location?

6 A. I'm not sure how long it's going to take to
7 get that. That was filed a week and a half ago, two
8 weeks ago.

9 MR. BRUCE: I think it was just filed here
10 in the last week.

11 MR. BROOKS: It's not proper for the
12 Examiner to testify, but I can give you some information
13 on that. That order was written yesterday. It's in the
14 Director's in-box for signature.

15 A. As soon as we get it, we'll get started on
16 that. And as soon as we get a unit to plug those two
17 wells, we'll get started on that. I'd say within 30 to
18 45 days, those wells will be plugged.

19 Q. (By Ms. MacQuesten) Okay. Let me go through
20 these. On the Elkan wells, I understand that you knew
21 the wellbore was plugged, but your testimony today is
22 that the cleanup has also been done?

23 A. Um-hum.

24 Q. Have you talked to the district office about
25 getting the sites released?

1 A. The paperwork has been submitted to the
2 district office, and we called. I had Mark Meadows check
3 last week. They couldn't find where they had it. So we
4 resubmitted it to them again.

5 Q. Have you called the district office?

6 A. He has. I haven't.

7 Q. Have you called to arrange for a site
8 inspection to get those sites released?

9 A. Yeah. I think he did all that before.

10 Q. You think he did that?

11 A. I think so.

12 Q. Did he get a date?

13 A. I'm not sure. I'd have to check with Mark on
14 that.

15 Q. On the Footjoy well, that's one that needs to
16 be plugged. Have you contacted a plugging company?

17 A. Yes.

18 Q. And have they given you a date?

19 A. I'm not sure. You have to ask Gary that. I
20 don't know if there's an exact date yet. We have two
21 wells to plug, and when they get in line, we'll plug both
22 of them.

23 Q. The 30 to 45 days, is that after they are
24 available, or is that time period how much time you think
25 it's going to take to get a rig out there?

1 A. I'd say we could have it done in 30 to 45
2 days. It just depends on how busy they are and where
3 they are and when they can get over to our location and
4 plug the wells.

5 Q. Does that include cleaning the site?

6 A. No.

7 Q. So we need additional time to get the site
8 released and approval from the district office of the
9 site release?

10 A. I think some of the work has already been done
11 on the site, but I've got to check with Mark to make
12 sure.

13 Q. But some final cleanup would have to be done
14 after plugging?

15 A. Yes.

16 Q. So when you're saying 30 to 45 days for them
17 to plug, to actually get the site released is going to
18 take longer than that?

19 A. Probably.

20 Q. The In Bounds Well you say is not operated by
21 Chi, but it still appears under Chi's name on the well
22 list.

23 A. I don't know why.

24 Q. Have you contacted anyone to find out what the
25 situation is and get it fixed?

1 A. No. It shows up on the website that
2 Chesapeake is the operator of the well. That's the first
3 I seen of that last week.

4 Q. Do you have any plans to contact either the
5 district office or Dorothy Phillips to --

6 A. We can. I didn't know it was my
7 responsibility. We can.

8 Q. You understand that as long as the well is on
9 this well list as Chi being the operator of record, we're
10 going to assume that Chi is the operator?

11 A. Even though it says they're not?

12 Q. Yeah. This says there are. There's a
13 discrepancy that needs to be cleared up. And you may be
14 right that Chesapeake is the appropriate operator, but
15 what I'm asking you is have you done anything to clear up
16 your records?

17 A. I'll just send a copy of this to Dorothy or
18 whoever I need to and just tell them take it off our
19 list.

20 Q. Okay. The Munchkin Well, that's the one that
21 you're proposing to recomplete and waiting for the order.
22 I believe you testified as soon as you get the order, you
23 can take action on that well?

24 A. Um-hum.

25 Q. The Nicols, there's a notice of intent to

1 plug, but it's not plugged yet. It's one that needs
2 plugging?

3 A. Right.

4 Q. Oxy Well is plugged and you think it's been
5 cleaned up?

6 A. Yes.

7 Q. Have you done anything to make sure a sundry
8 notice was filed and an inspection was done to release
9 the well?

10 A. No. I'm going to check on that.

11 Q. The Salado, another situation where you think
12 the well has been cleaned up, but have you made any
13 arrangements to have the site inspected and released?

14 A. It was all done. Everything was hand . . .
15 delivered to the Hobbs office. We're trying to find out
16 where they are at this point.

17 Q. Since it became an issue a month ago when you
18 got the letter saying you have these violations, have you
19 done anything further to move it along?

20 A. We're trying to find out where the paperwork
21 is. It's already been given to them.

22 Q. Are you calling them? Are you talking to
23 anybody?

24 A. Yeah. Um-hum.

25 Q. Same situation with the Silver Bullet. It's

1 cleaned up, but we need to get the paperwork done and the
2 site released?

3 A. We need to find out where it was. It was
4 given to Mike Bratcher three years ago.

5 Q. And the WC 4 1 is the one that was not
6 drilled?

7 A. No.

8 Q. Have you talked to the district office about
9 canceling the APD?

10 A. No, but I will.

11 MS. MACQUESTEN: That's all I have. Thank
12 you.

13 MR. EZEANYIM: Redirect?

14 MR. BRUCE: I have nothing further for the
15 witness on this. He can stay up there because of the
16 subsequent testimony.

17 MR. BROOKS: No questions.

18 MR. EZEANYIM: Okay.

19 MR. BRUCE: Mr. Examiner, if I could, Ms.
20 MacQuesten asked about this. I think a lot of this work
21 has been taken care of or will be shortly, and I would
22 ask -- I mean, after we put on the technical evidence,
23 it's still going to take a number of weeks to get the
24 transcript and a hearing order issued, and I would
25 suggest that if the case could be continued after this

1 hearing to the December 17th hearing, just so we could
2 update the Division with the compliance data to show what
3 has been taken care of.

4 MR. EZEANYIM: Okay. Yeah. I wanted to
5 make a comment before you do that, because I think there
6 is a misunderstanding here. Correct me if I'm wrong.
7 Plugged and abandoned is not the same as plugged and
8 released. That's how I understand it. So you may plug
9 and abandon a well. It's not released. It's not going
10 to show, unless you do the remediation and then get your
11 sundry to the district to release the well. So when you
12 plug and abandon, don't assume it's released; is that
13 correct? Until you get the sundry before it's released;
14 right?

15 MS. MACQUESTEN: The concept is correct.
16 Normally we talk about a well being plugged and not
17 released, meaning that the wellbore plugged but the site
18 hasn't been cleaned up. What the rule requires for a
19 well to be plugged and released or plugged and abandoned,
20 is for everything to be done on the well and all the
21 paperwork submitted, the district inspects the site,
22 makes sure it's cleaned up, and then the well is
23 released. Once a well is plugged and released, it's not
24 going to show up on the well list at all. It will show
25 up in RBDMS for historical purposes, but it won't be on

1 the operator's well list anymore.

2 MR. BROOKS: To clarify a little further,
3 it is my understanding that it's not in violation of the
4 inactive well rule once the wellbore is plugged until one
5 year has past, because they have one year to get the site
6 released. So the wells that are in P&R status, for the
7 first year they're not in violation of the inactive well
8 rule. But on the other hand, they also do require -- if
9 they've been inactive for more than two years, they
10 require a single well bonding.

11 MS. MACQUESTEN: That's right.

12 MR. BRUCE: And, Mr. Examiner, Chi is
13 aware of those. I didn't have Mr. Qualls testify. He
14 could comment on it, but they have had somebody out there
15 basically full time, taking care of these issues on all
16 of their wells for some eight or nine months. So they
17 are aware of those rules and they are trying to take care
18 of it.

19 MR. EZEANYIM: If you have no more
20 comment, can you make your request again? I forgot what
21 your request was.

22 MR. BRUCE: I would ask that after we
23 present the technical evidence on the unitization and the
24 waterflood, that the case be continued to the December
25 17th hearing so that we can -- like Mr. Qualls has

1 testified, due to some health issues of the person who
2 takes care of this. There has been an absence of being
3 able to get a hold of the paperwork, and I believe we
4 could submit a lot of the data and show what has been
5 taken care of and answer a lot of the questions of the
6 Division.

7 MR. EZEANYIM: On December 17?

8 MR. BRUCE: Yes.

9 MS. MACQUESTEN: Mr. Examiner, I have no
10 objection to that process in this case. I would like to
11 point out, though, that we need to look at what processes
12 we're going to follow in this sort of case in the future,
13 because it has taken a lot of time and money for the
14 Division to make its point in this case. I have had to
15 be available on call all day today for testifying. Mr. Sanchez
16 Sanchez has had to research these wells both for the
17 original letter and then to see whether the work had been
18 done to prepare for this case. We're going to have to go
19 through the whole thing all over again a second time when
20 this is set for December 17th.

21 If operators are encouraged to get this all
22 done before the hearing, it would save the Division a lot
23 of money. It's \$5 a page for transcripts.

24 MR. BROOKS: My understanding is the
25 policy is to be that the noncompliance should be raised

1 at the earliest possible date, and once it's brought to
2 the attention of the Examiners, then the case would be
3 removed from the docket, unless the operator requests a
4 preliminary hearing on the compliance issues. We put the
5 monkey on the operator to do that, because normally when
6 an operator is out of compliance, there aren't any issues
7 to be resolved. It's just a question of them getting in
8 compliance.

9 If there are issues that have to be heard,
10 then we have to have a preliminary hearing on whether
11 they're in compliance or not, otherwise we just postpone
12 the hearing until they can make a demonstration of
13 compliance.

14 MR. BRUCE: Mr. Examiner, I also, as I
15 usually do in these cases -- once again, these cases were
16 filed under the name of Chi Energy, Inc., which is the
17 working interest owner. And certainly if it came down --
18 if they were in compliance, if Chi Operating, the
19 separate operating arm is out of compliance, then
20 certainly the Division could refuse approval to re-enter
21 wells, convert them to injection, drill injection wells.
22 But as I always do, I always file these applications in
23 the name of the working interest owner. And, you know, I
24 believe we're entitled to move forward because this is a
25 working interest owner.

1 MR. BROOKS: I think we've agreed -- I
2 think Mr. Ezeanyim and I both said we're going to move
3 forward in this case, but we don't -- but that is not to
4 be the policy for future cases. And the question is
5 going to be how does this fact get communicated to the
6 Examiners.

7 In this case, it probably wouldn't be a
8 problem because of the fact that if Chi Energy was on the
9 docket, it would probably alert people to the fact that
10 Chi Operating was probably going to be involved. But we
11 do need to know about it. That's my understanding and
12 that's the declared policy, that we get these -- flesh
13 out these compliance issues at the earliest possible
14 date, have a preliminary hearing if necessary. If not
15 necessary, simply postpone the case until such time as
16 the operator is in compliance. That's not just me
17 talking. That's been the policy that's been resolved as
18 the Division policy. It's just a question of how do we
19 get it done.

20 When you all become aware that there is a
21 compliance issue, then you should file something with us
22 as a preliminary to let us know there is, so we can
23 implement that policy. If we don't become aware of it
24 until the case is called for hearing, of course that's
25 another matter.

1 MS. MACQUESTEN: Mr. Examiner, in this
2 case, we actually notified the Examiners immediately.
3 When the application was filed, we entered an appearance
4 specifically to alert the Examiners to the fact that they
5 were out of compliance with 5.9. At that point all we
6 had done is look at the lists and found that a well
7 showed up on the financial assurance list. It wasn't
8 until later, when the case didn't go away for months and
9 months and we started to look at it, we realized there
10 was a bigger problem. We did notify -- this case was
11 filed in June. We notified the Examiners as soon as
12 possible and it's been continued month after month.

13 MR. BROOKS: I think the reason that the
14 appropriate action did not get taken in this case was
15 because of the difference between Chi Energy and Chi
16 Operating. That's probably our fault.

17 MS. MACQUESTEN: That brings us to another
18 important procedural question, because for 5.9 to work,
19 we have to know who we're dealing with. It's our
20 position that the permit gets issued to the applicant and
21 only the applicant should be able to use that permit.
22 But we have situations like this where the working
23 interest owner files the application. Before 5.9, that
24 probably wasn't a big problem, but now it is because the
25 working interest owner -- we want to know who the

1 operator is. In this case it was relatively easy because
2 the names are so similar, but it doesn't have to be that
3 way. It could be ABC company as the working interest
4 owner and XYZ is the operator of the wells.

5 MR. BRUCE: Except in this case, the
6 documents do show that Chi Operating, Inc., will be the
7 operator.

8 MR. BROOKS: There are a variety of issues
9 here, which I don't think we can solve today. I think we
10 did make a mistake here, and we'll try to avoid it in the
11 future.

12 MR. EZEANYIM: If you go to OCD online,
13 there's nothing like Chi Energy -- it's not a licensed
14 operator in New Mexico, until you go to Chi Operating.
15 That's when you start seeing things. Like I said, I start
16 think this case should not have been on the docket. If
17 you know that there is some question about compliance --

18 MR. BROOKS: It would actually be helpful
19 to us and I think to your clients, too, if you and the
20 other lawyers bringing these cases on behalf of the
21 applicants try to alert us to these issues, because the
22 sooner you get them resolved, the better it's going to be
23 for your clients, as well as everybody else.

24 MR. EZEANYIM: That's what I was about to
25 say. Once you see a compliance issue, the policy is it's

1 not even going to go on the docket. So if you want to
2 bring them anytime, make sure they are in compliance with
3 everything before it goes into the docket.

4 MR. BRUCE: I will say that, yes, this
5 case was filed months ago, and the Division did raise a
6 couple of issues. One which I think was about two wells,
7 one which Chi took care of at the time, and another one
8 where they said Chi was out of compliance, but it was a
9 well -- they said it hadn't been properly plugged and
10 abandoned, and it actually had been properly plugged and
11 abandoned, and released about five years ago from a prior
12 operator. Those matters were taken care of.

13 MR. BROOKS: If I may interject at this
14 moment, it's getting late in the afternoon, and there's
15 no dispute between the parties about the disposition of
16 this case, so maybe we should resolve the issues for how
17 we're going to handle future cases at some other time.

18 MR. EZEANYIM: That's a good point.

19 MR. BRUCE: The rest of our case is
20 actually pretty straightforward.

21 MR. BROOKS: I assumed that.

22 MR. EZEANYIM: Okay. At this point, we
23 are going to take a five-minute break and then go with
24 the case.

25 MR. BROOKS: With understanding that it

1 will be continued after the -- rather than taken under
2 advisement.

3 MR. EZEANYIM: Any objection?

4 MS. MACQUESTEN: No objection. May we be
5 released?

6 MR. EZEANYIM: Yes

7 MS. MACQUESTEN: Thank you.

8 (A recess was taken.)

9 MR. EZEANYIM: We will go back into the
10 record and continue these two cases.

11 MR. BRUCE: Mr. Examiner, I'm keeping Mr.
12 Qualls up. He's the landman. I've handed you a set of
13 land exhibits.

14 Q. (By Mr. Bruce) Mr. Qualls, briefly what does
15 Chi seek in these two cases?

16 A. We are seeking to statutorily unitize all the
17 interest in the portion of the Delaware formation
18 underlying 560 acres of federal land in Case 14354. In
19 Case 14353, we seek approval of a secondary recovery
20 project for the unit and certification of the project for
21 the Recovered Oil Tax Rate.

22 Q. What is the proposed unitized interval?

23 A. Unitized interval is the Brushy Canyon member
24 of the Delaware formation underlying the unit area. The
25 vertical limits are described as the stratigraphic

1 interval from 4,370 to 5,500 feet subsurface as shown on
2 the density neutron log for the Munchkin Federal Well
3 Number 9, located 990 from the north line, 300 from the
4 east line of Section 11, 19 South, 30 East.

5 Q. Would you identify Exhibit 1 and describe it
6 for the Examiner?

7 A. Exhibit 1 is a land plat which outlines the
8 proposed unit area and identifies the separate tracts
9 which comprise the unit area. Attached to the plat is a
10 description of the entire unit area. There are seven
11 tracts in the unit, and Chi operates all these tracts.

12 Q. Now, what is Exhibit 2?

13 A. Exhibit 2 is a proposed unit agreement. The
14 unit agreement is a standard form used by the State Land
15 Office modified to reflect that only federal lands are
16 involved. It is similar to agreements approved
17 previously by the Division. The unit agreement describes
18 the unit area and unitized formation. Unitized ^{substances} ~~surfaces~~
19 include all oil and gas produced from the unitized
20 formation. Designated unit operator is Chi Operating,
21 Inc.

22 Q. What is Exhibit 3?

23 A. Exhibit 3 is a proposed unit operating
24 agreement. It sets forth the authorities and duties of
25 the unit operator, as well as the apportionment of

1 expenses between the working interest owners.

2 Q. Does the unit operating agreement contain a
3 provision for carrying working interest owners?

4 A. Yes, in Article 11.

5 Q. Does it also provide a penalty against
6 nonconsent working interest owners?

7 A. Yes.

8 Q. Now, let's discuss the ownership of tracts in
9 the unit area. Would you just briefly describe tract
10 ownership and how you determined the names of the working
11 interest and overriding royalty interest owners in the
12 unit area?

13 A. All the working interest owners are the same
14 throughout the unit area. The overriding royalty owners
15 vary and are set out on the next exhibit and are set out on the

16 Q. Exhibit 4?

17 A. Yes.

18 Q. And Exhibit 4 is simply Exhibit B to the unit
19 agreement, is it not?

20 A. Yes.

21 Q. And the BLM requires separate tracts where
22 there is any type of difference in working royalty,
23 overriding royalty ownership in a tract?

24 A. Yes.

25 Q. Again, it's all federal land?

1 A. Yes.

2 Q. Uniform royalty interest?

3 A. Yes.

4 Q. And uniform working interest throughout?

5 A. Yes.

6 Q. And there is some -- the only slight

7 difference is in the overriding royalties?

8 A. Yes.

9 Q. Are all of the tracts in the unit producing at
10 this point?

11 A. Yes, except for 2A.

12 Q. So other than Tract 2A, all of the other
13 tracts are producing?

14 A. Yes.

15 Q. How many interest owners are there in the
16 proposed unit?

17 A. There are 11 working interest owners, one
18 royalty owner, and eight overriding royalty interest
19 owners.

20 Q. Now, what about the working interest owners.
21 Have all the working interest owners joined in the unit?

22 A. Yes, sir.

23 Q. And what is Exhibit 5?

24 A. Exhibit 5 is the ratification of the unit
25 operating agreement, and all the working interest owners

1 signed it, ratified it.

2 Q. Now, let's discuss the overriding royalty
3 owners. What is the status of their voluntary joinder of
4 the unit agreement?

5 A. On the ratification of the unit agreement,
6 everybody signed it, except -- I don't have Crescent
7 Porter Hale Foundation. They have agreed to it, but they
8 have not sent it in yet.

9 Q. They have agreed to sign it?

10 A. Yes.

11 Q. So even though this was set up as statutory
12 unit, at this point 100 percent of the overriding royalty
13 owners have signed or stated they will agree to the unit
14 agreement?

15 A. Yes.

16 Q. And does Exhibit 6 contain copies of the
17 ratification of the unit agreement by all working and
18 overriding royalty interest owners?

19 A. Yes.

20 Q. And, again, the only royalty owner is the
21 federal government?

22 A. Yes.

23 Q. Have you met with the BLM to discuss the
24 unitization?

25 A. Yes. We had a meeting with them Monday down

1 in Carlsbad and went through everything with them. They
2 gave us preliminary approval.

3 Q. They verbally preliminarily approved it. You
4 don't have a letter of preliminary approval?

5 A. No.

6 MR. BRUCE: Mr. Examiner, we will submit
7 the BLM's letter when we receive that.

8 Q. (By Mr. Bruce) So counting the BLM and
9 whenever you receive Crescent Porter Hale Foundation's
10 ratification, 100 percent of the royalty and overriding
11 royalty owners will have ratified the unit?

12 A. Yes.

13 Q. I guess it's kind of superfluous at this
14 point, but discussing efforts about the voluntary
15 unitization, first of all, are virtually all of the
16 interest owners, other than the BLM, your internal
17 partners?

18 A. Yes.

19 Q. When did you first begin looking at
20 unitization of this acreage?

21 A. Started around the middle of 2008.

22 Q. And will the engineering witness for Chi
23 discuss the parameters of the unitization?

24 A. Yes.

25 Q. What is Exhibit 7, Mr. Qualls?

1 A. Exhibit 7 contains copies of correspondence
2 sent to the interest owners in the unit area.

3 Q. This letter was only sent out about a month
4 and a half ago, but you have been in constant contact
5 with all of these interest owners for quite some time?

6 A. Yes. Everybody has been aware of everything
7 we've been trying to do since we started this back in
8 2008.

9 Q. In your opinion, has Chi made a good-faith
10 effort to secure voluntary unitization?

11 A. Yes.

12 Q. Was written notice of the unitization
13 application given to all royalty and overriding royalty
14 and working interest owners?

15 A. Yes.

16 Q. Is that reflected in Exhibit 8?

17 A. Yes.

18 Q. And all of these addresses were current, and
19 everybody received notice; is that correct?

20 A. Yes.

21 Q. Now, regarding notice of the injection
22 project, which the engineer will discuss, was notice of
23 that application given to all the pertinent parties?

24 A. Yes.

25 Q. What is Exhibit 9?

1 A. Exhibit 9 is a listing of the offset operators
2 in the Delaware formation within one-half mile of the
3 injection wells.

4 Q. So the first page highlights in blue the
5 proposed unit area?

6 A. Yes.

7 Q. And page 2 just lists all of the offset
8 operators or working interest owners within a half a mile
9 of the initial proposed injectors?

10 A. Yes.

11 Q. Is Exhibit 10 simply an affidavit of notice to
12 all of these offset operators?

13 A. Yes.

14 Q. Again, everybody was locatable so everybody
15 received actual notice?

16 A. Yes.

17 Q. In your opinion, will the granting of these
18 applications be in the interest of conservation and the
19 prevention of waste?

20 A. Yes.

21 Q. And were Exhibits 1 through 10 prepared by
22 you, under your direction or compiled from company
23 business records?

24 A. Yes.

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

1 admission of Exhibits 1 through 10.

2 MR. EZEANYIM: Exhibits 1 through 10 will
3 be admitted.

4 (Exhibits 1 through 10 were admitted.)

5 MR. BRUCE: I have no further questions of
6 the witness.

7 MR. BROOKS: No questions.

8 MR. EZEANYIM: No questions.

9 MR. BRUCE: I next call Mr. Shatzer to the
10 stand, geologist.

11 DAVID SHATZER

12 Having been first duly sworn, testified as follows:

13 DIRECT EXAMINATION

14 BY MR. BRUCE:

15 Q. Would you please state your name and city of
16 residence.

17 A. David Shatzer, Midland, Texas.

18 Q. Who do you work for and in what capacity?

19 A. Chi Energy, geologist.

20 Q. Have you previously testified before the
21 Division?

22 A. Yes.

23 Q. Were your credentials as an expert petroleum
24 geologist accepted as a matter of record?

25 A. Yes, they were.

1 Q. Are you familiar with the geologic matters
2 involved in these cases?

3 A. Yes.

4 MR. BRUCE: Mr. Examiner, I tender Mr.
5 Shatzer as an expert petroleum geologist

6 MR. EZEANYIM: He is so qualified.

7 MR. BRUCE: Mr. Examiner, Mr. Shatzer has
8 prepared a number of exhibits. I think it may be best if
9 you kept Exhibit 13, the cross-section, in front of you
10 as he's going through the first two exhibits.

11 MR. EZEANYIM: Number 13?

12 MR. BRUCE: Yes, the cross-section. As
13 he's going through the first two exhibits, it may help
14 for him to point out a few -- maybe also have Exhibits 11, 12
15 and 12, or a least Exhibit 11, 12 and 13. I think it would be best to have Exhibit 11, 12 and 13.

16 Q. (By Mr. Bruce) Anyway, Mr. Shatzer, starting
17 with Exhibit 11 and comparing it to Exhibit 13, could you
18 discuss those exhibits and the geology of this portion of
19 the Delaware formation in this area?

20 A. Yes. Exhibit 11 is a Delaware structure map.
21 It's based on the structure of a particular sand within
22 the overall package that we have production. So I think
23 probably the easiest thing would be for me to first refer
24 to the producing interval that's on the cross-section,
25 and that is -- this cross-section is a structural

1 cross-section, and we have three general intervals that
2 are oil productive in this field, and the perforations in
3 the given wells are either shown in red or in green.

4 And so, basically, there's a lower interval
5 that's called the Munchkin Sand Interval. This was the
6 interval we discovered first. Then there's a sand
7 interval that's designated the Mike Sand Interval. It's
8 in the middle portion. So some of the rest of that
9 Delaware sand above and below the Mike Sand Interval is
10 not productive. Then we have productive sands at the top
11 *Dyn* that are just below the base of the Delaware sand ~~and~~
12 ~~at~~ conformity. So we have three intervals. If you're
13 wondering, the blue markings on the side are the overall
14 intended intervals where we want to inject water.
15 Obviously injecting water into those intervals that are
16 oil productive to sweep the oil.

17 Basically, our interval -- our producing
18 interval really ranges from 4,500 to 5,100 feet
19 subsurface, and we've asked for unitization slightly more
20 than that to compensate for any structural things that
21 might happen on future wells. But, basically, 4,500 to
22 5,100 is the interval that we're talking about. For
23 purposes of the structure map, that was a map that was
24 done on the top of the Mike Sand Interval and that
25 interval is shown in purple.

1 MR. EZEANYIM: What is the unitized
2 interval? I thought Mr. Qualls mentioned the unitized --
3 what is the unitized interval?

4 THE WITNESS: The unitized interval is
5 slightly more than that, because we wanted to take into
6 consideration if a well was extremely high or low. I'm
7 saying that generally the production is between 4,500 and
8 5,100. I think we asked for, what, 4,300 to 5,500?

9 MR. BRUCE: Mr. Examiner, in the unit
10 agreement it's 4,370 to 5,500 feet, as found in the
11 Munchkin Federal Number 9 Well.

12 MR. EZEANYIM: That's what everybody
13 agreed to?

14 MR. BRUCE: Yes.

15 MR. EZEANYIM: But you mentioned 4,500 to
16 5,100.

17 THE WITNESS: Generally, that's the
18 general interval. That unitization interval was just
19 made with a little bit of extra boundaries in case of
20 differences in the wells we drilled.

21 Q. (By Mr. Bruce) Mr. Shatzer, I think maybe you
22 did mention it, but you mentioned the Mike Sand and
23 Munchkin Sandstone. Those are internal names; correct?

24 A. Yes. Those are internal names that we've
25 used. The Delaware sandstone group is made up of a

1 multiple amount of sands, not all of which are
2 productive, and these are the sands that we focused on
3 that are oil productive. So this structure map was made
4 on the top of the Mike Sand in purple on your
5 cross-section, but you can see it's a fairly tight
6 structure. The contour interval is 50 feet. We have a
7 pretty strong dip to the east, fairly strong also in the
8 south and west directions, so that we have a loss of
9 porosity in these producing sands as we go up dip, quite
10 a bit of closure, also. But it's a pretty tight oil
11 reservoir that is trapping the oil and, hence, also will
12 be a good, tight feature to sweep for water injection in
13 secondary recovery.

14 Q. The structure is one factor that went into the
15 delineation of the unit boundaries, is it not?

16 A. Yes.

17 Q. Then, also, move on to your Exhibit 12 and
18 discuss how that interplays with the structure and the
19 formation of the unit boundaries.

20 A. Right. That's the Effective Pay Isopach map
21 that I drew, and, basically, what that is noting is that
22 is the effective pay greater than 18 percent porosity on
23 the logs in these producing intervals that are oil
24 targets. In the 18 percent, there can be some oil
25 productive at slightly less than 18 percent, but 18

1 percent really high-graded and showed where our oil
2 productivity was, and so that taking those points -- and
3 it's a combination of the statistical figure of all three
4 porosity zones' net pay greater than 18 percent added
5 together.

6 So this cumulative isopach then is shown here
7 in Figure 12, and it's a contour interval of 10 feet, and
8 shows really that the best rock is, for the most part,
9 highest on the structure. We have some production out to
10 the northeast, at the Munchkin 1 site, but most of the
11 best rock and the best production comes from the
12 northwest of 12, the northeast of Section 11, and, hence,
13 corresponds fairly well with the structural outline, and,
14 again, kind of helps us define what we -- the 560 acres,
15 that we put into the waterflood unit and what we're
16 applying for today.

17 Q. Is the unit outline justified from a geologic
18 standpoint?

19 A. Yes.

20 Q. Would you anticipate that all tracts in the
21 unit will be productive from the Delaware?

22 A. Yes.

23 Q. And has the reservoir been adequately defined
24 by development?

25 A. Yes.

1 Q. Finally, is the Delaware reservoir continuous
2 across the unit area?

3 A. Yes. These three sands -- at least some of
4 these three sands are productive across the whole area.
5 The uppermost sands are not as productive in the
6 northeast corner, like around the Munchkin 1 where I have
7 a small figure, that just comes from the thickness at the
8 Munchkin Sand level. But the sum amount of these sands
9 that we're applying for are productive over the entire
10 interval.

11 Q. Are there any faults connecting any fresh
12 water zone with the injection zone?

13 A. No.

14 Q. Finally, you have Exhibit 14. Just briefly,
15 what is that?

16 A. That's a production map. It just shows the
17 production that's a little bit -- probably about two
18 months out of date, but shows that the best wells are
19 generally the Munchkin 6, Munchkin 9, those types of
20 wells that have the best thicknesss and relatively high
21 on structure.

22 Q. Were Exhibits 11 through 14 prepared by you or
23 under your direction?

24 A. Yes, they were.

25 Q. Is the granting of these applications in the

1 interest of conservation and the prevention of waste?

2 A. Yes.

3 MR. BRUCE: Mr. Examiner, I move the
4 admission of Exhibits 11 through 14.

5 MR. EZEANYIM: Exhibits 11 through 14 will
6 be admitted.

7 (Exhibits 11 through 14 were admitted.)

8 MR. BRUCE: I have no more questions of
9 the witness.

10 MR. BROOKS: No questions.

11 EXAMINATION

12 BY MR. EZEANYIM:

13 Q. Let's start with your last exhibit here, 14.

14 A. Yes.

15 Q. This is your injection permit; right? This is your

16 A. The intended injection wells are shown in the
17 purple triangles.

18 Q. Are you going to have the highest possible
19 injection permit? Maybe I can ask the engineer who
20 designed it.

21 MR. BRUCE: It would be the engineer.

22 THE WITNESS: Yes.

23 Q. (By Mr. Ezeanyim) On your cross-section here,
24 the Mike Sand, it's not a geologic name. It's just a
25 name that you use internally?

1 A. Yes, just an internal name.

2 Q. And the Munchkin, too?

3 A. Yes.

4 Q. I don't see those in the --

5 A. They're not in the stratigraphic state record.

6 Q. Just for identification purposes; right?

7 A. Yes.

8 Q. Where is the most production from, which sand?

9 A. I would say quantitatively, probably the most
10 production comes out of the Mike Sand Interval.

11 Q. And the net porosity is greater than 18
12 percent?

13 A. Yes.

14 Q. And I believe these are the wells in that unit
15 intervals?

16 A. Yes.

17 Q. Are some of these going to be converted into
18 injection wells?

19 A. I don't think any of -- wait a minute. We
20 might -- are we doing the 13 as an injection well, maybe?
21 We might. But right now these are producers, and I'm not
22 sure what our plans would be. Right now we've just shown
23 the intended injection wells and the other conversions
24 have yet to be seen.

25 Q. So those injection wells would have to be

1 drilled?

2 A. Yes. I believe there's two conversions we're
3 going to do, but every other injector at this time would
4 have to be drilled.

5 MR. EZEANYIM: Okay. Thank you very much.

6 GARY WOMACK

7 Having been first duly sworn, testified as follows:

8 DIRECT EXAMINATION

9 BY MR. BRUCE:

10 Q. Please state your name for the record.

11 A. Gary Womack.

12 Q. Where do you reside?

13 A. Midland, Texas.

14 Q. Who do you work for and in what capacity?

15 A. Chi Energy, petroleum engineer.

16 Q. Have you previously testified before the
17 Division?

18 A. Yes.

19 Q. Were your credentials as an expert petroleum
20 engineer accepted as a matter of record?

21 A. Yes.

22 Q. Are you familiar with the engineering matters
23 related to these applications?

24 A. Yes.

25 MR. BRUCE: Mr. Examiner, I tender the

1 witness as an expert petroleum engineer.

2 MR. EZEANYIM: Mr. Womack is so qualified.

3 Q. (By Mr. Bruce) Would you please refer to your
4 first exhibit, Exhibit 15 and briefly discuss the
5 production and the reservoir that we're concerned with
6 today?

7 A. This is an overview of the Benson Delaware
8 field. The first production was in February of 2001.
9 Just production numbers summarized here, original oil in
10 place calculated at 31 million barrels. Cumulative
11 production as of June 2009 as roughly 1.3 million
12 barrels, 941 million cubic feet, and roughly 1,800
13 million barrels of water.

14 Q. How many active producers are there at this
15 point?

16 A. Eight.

17 MR. EZEANYIM: Eight producing 515?

18 THE WITNESS: Excuse me?

19 MR. EZEANYIM: Eight producers producing
20 all together 515 a day?

21 THE WITNESS: Yes.

22 Q. (By Mr. Bruce) Let's move to Exhibit 16, and
23 briefly describe the production from the pool.

24 A. Which exhibit?

25 Q. 16.

1 A. Okay. This is a decline curve. It shows the
2 production with just a decline drawn on there, which
3 results in a projected ultimate recovery, primary
4 recovery, for the oil and gas.

5 Q. And the estimated ultimate is shown on Exhibit
6 15; is it not?

7 A. Yes.

8 Q. What is Exhibit 17?

9 A. Exhibit 17 is a summary of the production from
10 the field.

11 Q. This is just from an independent --

12 A. It's public data.

13 Q. Public data?

14 A. Yes, as reported to the NM OCD. A. Yes, as reported

15 Q. Was the secondary recovery project proposed as a
16 method of extending the life of the reservoir?

17 A. Yes.

18 Q. Now, pool production is still fairly
19 substantial. These are not stripper wells?

20 A. No.

21 Q. I suppose it's more in the nature of a
22 pressure maintenance project or something like that?

23 A. Yes.

24 Q. What is the drive mechanism of the pool?

25 A. Solution gas.

1 Q. And I think, Mr. Womack, you kept Exhibit 14
2 in front of you --

3 A. Yes.

4 Q. -- Mr. Shatzer's exhibit?

5 A. Yes. Okay.

6 Q. And I think, more or less, the same thing is
7 shown on Exhibit 18. Could you discuss the injection
8 pattern?

9 A. It's a modified five-spot, basically, to take
10 advantage of the pinch-out to the northwest.

11 Q. And how many initial injectors will there be?

12 A. Nine initial injectors.

13 Q. Now, all of the injectors are going to be new
14 wells, initially?

15 A. Yes.

16 Q. Do you intend to produce them for a while
17 before you convert them to injection?

18 A. Yes.

19 Q. So ultimately, do you think there will be nine
20 injectors overall?

21 A. Yes.

22 Q. And Mr. Shatzer was asked this question. Is
23 there a chance that any of the producers could be
24 converted to injection in the future?

25 A. Possibly.

1 Q. It just depends on the production?

2 A. Yes.

3 Q. How many additional barrels of oil do you
4 anticipate recovering as a result of the waterflood
5 project?

6 A. Secondary reserves are estimated at 4.62
7 million barrels.

8 Q. And was a study conducted to calculate
9 reserves to be recovered by this is secondary project?

10 A. Yes.

11 Q. Is the report summary submitted as Exhibit 19?

12 A. Yes.

13 Q. Does this report summary also contain
14 economics for the project? . . . ECONOMICS A . . .

15 A. Yes. . .

16 Q. What type of secondary recovery are you
17 projecting for the project?

18 A. The total number of barrels?

19 Q. Or the ratio of the secondary --

20 A. 1.3 to 1.

21 Q. What is estimated life of the project?

22 A. It's over 35 years.

23 Q. What additional facilities will be necessary
24 for the project besides the nine injection wells?

25 A. There will be an injection facility gathering

1 point established, which will include tanks and pumps and
2 filtration system.

3 Q. What is the total project cost?

4 A. Total project is 11.5 million.

5 Q. Will the project be economic?

6 A. Yes.

7 Q. What is Exhibit 20? Does that show proposed
8 future production?

9 A. Yes. This is a curve that shows the increase
10 in oil production as a result of the water injection.

11 Q. Is the portion of the pool being unitized
12 suitable for secondary recovery?

13 A. Yes.

14 Q. Is the project area in such a state that it's
15 prudent to apply an enhanced recovery program at this
16 time?

17 A. Yes, it is.

18 Q. Is the project economically and technically
19 feasible?

20 A. Yes.

21 Q. Will the value of the oil and gas recovered by
22 unit operations exceed the unit costs, plus a reasonable
23 profit?

24 A. Yes.

25 Q. Will secondary recovery operations result in

1 the recovery of substantially more hydrocarbons from the
2 pool that would otherwise be recovered?

3 A. Yes.

4 Q. Will unitization and secondary recovery
5 benefit the working interest and royalty owners in the
6 unit?

7 A. Yes.

8 Q. Is unitized management and operation of the
9 Delaware reservoir reasonably necessary to carry on
10 waterflood operations?

11 A. Yes.

12 Q. Because of the estimated additional
13 production, do the wells in the proposed unit, depending
14 on prices, qualify for the Recovered Oil Tax Rate?

15 A. Yes.

16 Q. Now, in the unit area, what is the tract
17 allocation? If you look at the unit agreement, is it
18 simply on an acreage basis?

19 A. Yes.

20 Q. In your opinion, is this formula -- does this
21 formula allocate produced and saved hydrocarbons to each
22 tract on a fair, reasonable and equitable basis?

23 A. Yes.

24 Q. As Mr. Qualls testified, virtually all of the
25 interest owners have agreed to this tract allocation,

1 have they not?

2 A. Yes.

3 Q. Throughout the unit, working royalty and
4 overriding royalty interests are fairly common, are they
5 not?

6 A. Yes.

7 Q. So in your opinion, this participation
8 formula, although unusual in a secondary recovery
9 operation, is fair in this instance?

10 A. Yes.

11 Q. Are there any *analogous* ~~analogists~~, Delaware, on
12 secondary recovery projects?

13 A. Yes.

14 Q. Where might they be?

15 A. There's actually three that we identified:
16 The Parkway-Delaware, the Shugart-Delaware and the
17 Avalon-Delaware.

18 Q. And have those been successful secondary
19 recovery projects?

20 A. Yes.

21 Q. Are they all -- this is a Brushy Canyon;
22 correct?

23 A. Yes.

24 Q. I believe the Avalon is more of a Cherry
25 Canyon?

1 A. Yes.

2 Q. Are the others Brushy Canyon?

3 A. Yes, and analogous to this field. Actually,
4 this sits in between the two floods.

5 Q. Oh, it does? Okay. Have they had similar
6 secondary recovery, primary recovery ratios, that you're
7 talking about here?

8 A. Yes.

9 Q. Finally, let's go to the C-108, the injection
10 application. There's a lot of data in here, and I don't
11 know that we need to go over every bit of it, Mr. Womack,
12 but generally how will the injection wells be completed?

13 A. Injection wells will be completed in the
14 correlative intervals that the producer's stimulation
15 would consist of a small acid job and small sand fractures
16 treatment.

17 Q. And will all of the injection wells be drilled
18 and completed in such a fashion as to prevent any
19 movement of fluid between zones?

20 A. Yes.

21 Q. How many wells are in the area of review?

22 A. Total wells? I don't know if you mean a
23 half-mile radius or --

24 Q. Yeah, the half-mile radius.

25 A. I'm not sure how many are in that.

1 Q. Are any of those wells P&A'd?

2 A. Yes.

3 Q. And is the plugging and abandonment data on
4 those wells in the area of review contained in Exhibit
5 21?

6 A. Yes, it is.

7 Q. And have those wells been properly plugged and
8 abandoned so as to prevent any movement of fluids?

9 A. Yes.

10 Q. Does Exhibit 21 not only contain data on the
11 wells in the area of review, but does it also contain
12 their data on when they were drilled and well
13 construction?

14 A. Yes.

15 Q. What about the injection operations? What
16 type of injection rates are you looking at?

17 A. Injection rates are estimated to be 2 to 400
18 barrels per day, per well.

19 Q. And what will be the initial injection
20 pressure?

21 A. Initial injection pressure will be based on
22 the .2 psi per foot rule.

23 Q. And if higher injection pressures are needed,
24 will Chi conduct step-rate tests in accordance with
25 Division rules?

1 A. Yes.

2 Q. Are there any sources of fresh water in this
3 area?

4 A. Yes.

5 Q. And in looking at this data, none of them are
6 within a mile of the injectors, are they?

7 A. That's correct.

8 Q. What is the source of the injection water?

9 A. Capitan Reef.

10 Q. And it's not produced water?

11 A. It's produced water from the Capitan Reef.

12 Q. Does the C-108 contain data on the
13 compatibility of the injection water with the formation
14 water?

15 A. Yes. | 15 A Yes

16 Q. Are there any compatibility problems?

17 A. No.

18 MR. BRUCE: Mr. Examiner, when you look
19 through this, the way it was -- the C-108, it was
20 prepared for each proposed injection well. You can see a
21 listing of the wells in the area of review, so after each
22 proposed injection well, you will see a listing of 4, 5,
23 6, 7 wells, some of which overlap. So when you're
24 looking through that, you'll see multiple charts
25 regarding the wells in the area of review.

1 Q. (By Mr. Bruce) In your opinion, is the
2 granting of this application in the interest of
3 conservation and the prevention of waste?

4 A. Yes.

5 Q. And were Exhibits 15 through 21 either
6 prepared by you or under your supervision or compiled
7 from company business records?

8 A. Yes.

9 MR. BRUCE: Mr. Examiner, I move the
10 admission of Chi's Exhibits 15 through 21.

11 MR. EZEANYIM: Exhibits 15 through 21 will
12 be admitted.

13 (Exhibits 15 through 21 were admitted.)

14 MR. BRUCE: I have no further questions of
15 the witness.

16 MR. EZEANYIM: Any questions?

17 EXAMINATION

18 BY MR. BROOKS:

19 Q. Would you characterize the production of the
20 existing wells as being in an advanced stage of
21 depletion? It doesn't look like it to me.

22 A. The curve is somewhat misleading just looking
23 at it, because, of course, all the wells have been
24 drilled over a period of eight years, so you can see
25 wells being added.

1 Q. It looks like it's down very little from the
2 peak production, though, that you had back in '07.

3 A. Actually, we were producing right at about a
4 thousand barrels a day in '07, and now we're at 515
5 barrels a day.

6 Q. You said the source of the fresh water -- the
7 source of the injection water is from the Capitan Reef.
8 What is the quality of that water?

9 A. It's brownish water.

10 Q. Do you have analysis reports on it in here?

11 A. Well, you know, the actual water will come
12 from a source that we haven't, you know, identified
13 exactly, other than it would be from the Capitan Reef,
14 produced water.

15 Q. You don't know who you will be purchasing it
16 from?

17 A. Not at this point.

18 MR. BROOKS: That's all.

19 EXAMINATION

20 BY MR. EZEANYIM:

21 Q. Let's stay with the water, the source of
22 water, because I have questions on that. Are you going
23 to be purchasing that Capitan Reef water from somewhere?
24 Are you going to drill wells to get the water? How are
25 you going to get the Capitan Reef waters?

1 A. By pipeline.

2 Q. You are going to be purchasing it from
3 someone?

4 A. It will be a purchase, right.

5 Q. You haven't done any water analysis on that,
6 the type of water you are going to purchase?

7 A. Not at this point.

8 Q. Did you do any water analysis on native water
9 you're going to be injecting into?

10 A. Yes. We have water analyses on our produced
11 water from the Delaware zone.

12 Q. You need to have a water analysis for the
13 water you're going to be injecting because you need to
14 compare.

15 A. Absolutely. Absolutely.

16 Q. So it's one thing that I would make sure that
17 you --

18 MR. BRUCE: We will provide that.

19 MR. EZEANYIM: Yeah. Water analysis for
20 the Capitan Reef.

21 THE WITNESS: Um-hum.

22 Q. (By Mr. Ezeanyim) Okay. Currently, how many
23 wells would be injectors? How many wells?

24 A. We're proposing nine wells, as indicated on
25 this exhibit.

1 Q. Nine wells? Then you have the area -- you
2 have the schematics here, how you are going to construct
3 those wells?

4 A. Yes. They are listed in the C-108.

5 Q. And the way you're going to construct them?

6 A. The casing programs, the wellbore diagrams.

7 Q. For all the injectors?

8 A. Correct.

9 Q. For those nine injectors, you have to generate
10 area review wells, how many do you have total of area
11 review wells for the nine injectors; do you know that?

12 A. I don't know if I understand your question.

13 Q. How many wells are within the area of review?
14 The area of review being half a mile from each of those
15 nine wells.

16 A. How many wells are in this interval?

17 Q. No. In the area of review.

18 A. I don't know how many total wells.

19 Q. You should know. That's one of the things you
20 have to know. You have to know how many wells -- for
21 each of those injectors, you have to draw half a mile,
22 and then see how many wells are within that --

23 A. Yes.

24 Q. Some of them may repeat -- like your counsel
25 said, you know, you draw another half a mile for Well

1 Number 1, Injector Number 2, up to nine, and then list
2 all the area of review, what their status is, whether
3 they are producing or plugged and abandoned or
4 temporarily abandoned. We need to review all those
5 wells.

6 A. They have been reviewed. They are listed in
7 the C-108. I didn't understand your question.

8 Q. So all of them are here for all the nine
9 wells?

10 A. Yes.

11 Q. Are all the plugged and abandoned wells given
12 to us? Are there plugged and abandoned wells?

13 A. There are two plugged and abandoned wells.

14 Q. And there are sketches in here?

15 A. Yes.

16 Q. Okay. Good. Then the other wells, they are
17 either producing or --

18 A. They're producing wells.

19 Q. Some of them in the area are producing?

20 A. In the area of review, yes.

21 Q. As far as you know, only two wells are plugged
22 and abandoned in the area of review of the nine wells?

23 A. That's correct.

24 Q. So all the information is here; right?

25 A. Yes.

1 Q. So let me see if I can see this. Okay. "Well
2 type, active oil well," okay. This tablet form is
3 related to one injector; right?

4 A. Yes. That area of review for that injector.

5 Q. Okay. Good. As you said before, there is a
6 water analysis for the Delaware formation; right?

7 A. Yes. We will submit that. I don't see it
8 here.

9 Q. Okay. Then I will write it as something you
10 need to submit. You're going to submit the water
11 analysis for the Capitan Reef and also for the --

12 A. For the Delaware produced water.

13 Q. Yes, two items.

14 A. Okay.

15 Q. None of these wells are involved in the
16 compliance issues we talked about previously? None of
17 these wells here? None of the wells in this waterflood?

18 A. That's correct.

19 Q. Okay. I want to make sure that's correct.
20 You said it's a solution gas drive?

21 A. Yes.

22 Q. Does it have a gas cap?

23 A. No.

24 Q. Don't have a gas cap?

25 A. No.

1 Q. Is it producing below the bubble point?

2 A. Yes, it is below the bubble point.

3 Q. Do you know what the bubble point is?

4 A. No. I don't have it listed here. I can
5 provide that to you.

6 Q. Do you know what the current reservoir
7 pressure is?

8 A. Current reservoir pressure is roughly 1,800
9 pounds.

10 Q. Right now?

11 A. Yes. I don't have any pressure surveys at
12 this point. I could supply one if that's required.

13 Q. I'm going to have to ask you, what is your
14 tract allocation formula? We need to have -- what is it?
15 Is it contained in your unit operating agreement?

16 A. It's just based on the cumulative production
17 here as listed on the previously submitted --

18 MR. BRUCE: It's actually just based on
19 acreage.

20 Q. So you allocate just based on acreage?

21 A. Yeah. Due to the uniform ownership.

22 Q. And 100 percent of the working interest have
23 agreed to that formula?

24 A. Yes.

25 MR. BRUCE: Yes, sir. Within a week or

1 two, it will be 100 percent of the royalty interests,
2 also.

3 MR. EZEANYIM: Okay.

4 Q. (By Mr. Ezeanyim) You mentioned there are
5 three other projects, the Parkway-Delaware, the Avalon
6 and the Shugart projects?

7 A. Yes.

8 Q. Do you have any idea of the order number that
9 established those projects?

10 A. The current status of them?

11 Q. No, not the status. Do you have any
12 information on there like the order numbers that
13 established those projects?

14 MR. BRUCE: I could get that for you.

15 A. It's also discussed in the first exhibit's also, see
16 Exhibit 19. If you go back to --

17 Q. So I can find it and write the numbers down.

18 A. Right. It's page 4.

19 Q. Page 4?

20 A. Page 4 of Exhibit 19.

21 MR. BRUCE: I can get that for you, Mr.
22 Examiner. The Avalon-Delaware was the subject of a
23 Supreme Court appeal.

24 MR. EZEANYIM: I see East Shugart. Okay.
25 So if you can give me that, let me take a look at that

1 waterflood.

2 Q. (By Mr. Ezeanyim) How many miles away are
3 they apart?

4 A. Five miles.

5 Q. But they're all in the Delaware?

6 A. Yes. Also, on page 5 of that same exhibit,
7 the water source is also discussed there. I realize you
8 do need a sample, but that source of the water is
9 discussed.

10 Q. The whole system is a closed system?

11 A. Yes.

12 Q. Let's go back to the first exhibit. You asked
13 about whether the project is going to be profitable, and
14 you said. That doesn't help me, until I see the numbers.
15 Well, I see how much it's going to cost you, but I need to
16 to know what you project to be your benefit. Your
17 counsel said, "Is it going to be profitable," and you
18 said yes. How do I know it's yes? Let's go back to that
19 Exhibit 19.

20 A. Yeah, page 5 of Exhibit 19.

21 Q. Go back to that table, Table 5. Maybe that
22 might help us. What do you call it, Benson Facility
23 capital?

24 A. Yes, Benson Facility capital. This is for --
25 the actual facility costs are listed, and that total

1 number comes to \$1.578 million, and then the 11 wells at
2 \$900,000 each.

3 Q. 900,000?

4 A. Yes. The grand total is 11.478 million.

5 Q. That's what it's going to cost you; right?

6 A. That's the estimated cost.

7 Q. What is the estimated revenue?

8 A. Estimated revenue is on page 5, the second set
9 of economics. The present worth at 10 percent, estimated
10 at \$56.2 million.

11 Q. Okay. Are you using a rate of return 40
12 percent?

13 A. Rate of return, 40 percent.

14 Q. Is that typical?

15 A. Yes.

16 Q. You were asked before, these wells are still
17 producing very well. Each of them average --

18 A. Average of about 50 -- over 50 barrels a day.

19 Q. And why are you in a haste to start the
20 waterflood operation?

21 A. We feel it's prudent just by reservoir
22 engineering standards to implement the water injection
23 before the field reaches the bubble point pressure. You
24 can see from the production curve that it hasn't. The
25 GOR is still relatively stable.

1 Q. Even though I approve of what you say, the
2 rules say you have to be advanced stage of depletion.
3 You can study a waterflood and that would give you more
4 oil, and maybe you -- so I don't disagree with your
5 proposition here, because it doesn't matter whether
6 they're in an advanced stage. But they think once it's
7 in advanced stage, then you can implement it. But you
8 might implement it before it goes into advanced stage and
9 recover more oil than you would have, but that's not
10 going to be something that's going to count against
11 somebody anyway.

12 So all these calculations are done by material
13 balance?

14 A. It was done with two different methods. The
15 actual numbers that are listed there are done by decline
16 curve analysis.

17 Q. Did you do anything by material balance?

18 A. Yes. It was a little difficult to use
19 material balance here because there is not one sand that
20 we're dealing with here. We're dealing with three
21 different sands and the thickness varies quite a bit in
22 each individual well. So decline curve analysis was we
23 felt like the most accurate way to determine the
24 reserves.

25 Q. Okay. Because you have the Mike Sand and

1 Munchkin and --

2 A. Right.

3 Q. Okay. Let me see if I have more questions. I
4 requested that you submit about three things.

5 MR. BRUCE: Mr. Examiner, I've listed a
6 couple of things, the water analyses from the Capitan
7 Reef and the Delaware, number one. The bubble point
8 pressure, and then the order numbers for the other
9 Delaware waterfloods.

10 MR. EZEANYIM: Yeah. Okay.

11 Q. (By Mr. Ezeanyim) Do you have any idea the
12 depth of the fresh water in this area?

13 A. No.

14 Q. Are there drinking water sources in this area?

15 A. Not in this area. I'm not aware of anyt in
16 drinkable water.

17 MR. EZEANYIM: Okay. If I can get more
18 additional data, maybe we'll start looking at them and we
19 might find something else we might ask you to give us.

20 But your request is to continue this case
21 until December 17th, for you to do what?

22 MR. BRUCE: Besides getting you the data,
23 and we'll get you that before the hearing, is to report
24 on the compliance issues.

25 MR. EZEANYIM: Okay. I think that's good.

1 Anymore questions?

2 MR. BROOKS: No more questions.

3 MR. EZEANYIM: Okay. That's good. At
4 this point we're going to continue these two cases, Case
5 Number 14353 and 14354 to December 17. Thank you.

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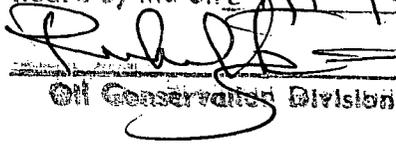
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I hereby certify that the foregoing is
a complete record of the proceedings in
the examination hearing of Case No. 14353
heard by me on 11/2/99 14354
, Examiner
Oil Conservation Division

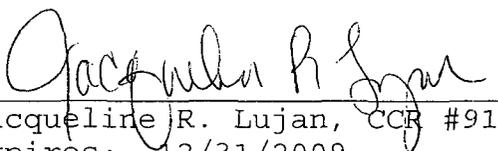
REPORTER'S CERTIFICATE

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I, JACQUELINE R. LUJAN, New Mexico CCR #91, DO
HEREBY CERTIFY that on November 12, 2009, proceedings in
the above captioned case were taken before me and that I
did report in stenographic shorthand the proceedings set
forth herein, and the foregoing pages are a true and
correct transcription to the best of my ability.

I FURTHER CERTIFY that I am neither employed by
nor related to nor contracted with any of the parties or
attorneys in this case and that I have no interest
whatsoever in the final disposition of this case in any
court.

WITNESS MY HAND this 24th day of November, 2009.


Jacqueline R. Lujan, CCR #91
Expires: 12/31/2009