

## NEW MEXICO OIL CONSERVATION COMMISSION

## EXAMINER HEARING

SANTA FE, NEW MEXICOHearing Date AUGUST 26, 1993 Time: 8:15 A.M.

NAME	REPRESENTING	LOCATION
Raye Miller	Marbob Energy Corporation	Artesia, N.M.
Maurice Thumser	Byram & Co.	SF
Curtis Anderson	Collins & Wane Inc.	Midland
Rex Howell	Collins & Wane Inc.	Houston
William F. Carr	Campbell, Carr, Fung & Jenden	Santa Fe
P. W. McCance, III	Tervaco 2 & P Inc	Midland, TX
W. T. Kelbchin	Kelbchin & Kelbchin	Santa Fe
Shelly H. Ghyro	Yates Pet	Artesia
Mike Hill	Kinkaw Oil Corporation	Austin, TX
Robert Bullock	Yates Pet.	Artesia
Joshua Wilkins	Yates Pet.	Artesia
Thomas Roberts	Tansy & Son Firm	Farmington
George Stamp	Mexican Oil	"
Scott E. DAVIS	Mexican Oil Inc	"



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. 10800

APPLICATION OF MERRION OIL & GAS CORPORATION  
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REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

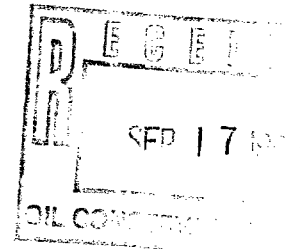
BEFORE: Michael E. Stogner, Hearing Examiner

August 26, 1993

Santa Fe, New Mexico

This matter came on for hearing before the  
Oil Conservation Division on August 26, 1993, at  
Morgan Hall, State Land Office Building, 310 Old Santa  
Fe Trail, Santa Fe, New Mexico, before Deborah O'Bine,  
RPR, Certified Court Reporter No. 63, for the State of  
New Mexico.

**ORIGINAL**



## I N D E X

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 Examiner Hearing  
 CASE NO. 10800

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

FOR THE DIVISION: ROBERT G. STOVALL, ESQ.  
General Counsel  
Oil Conservation Commission  
State Land Office Building  
310 Old Santa Fe Trail  
Santa Fe, New Mexico 87501

FOR THE APPLICANT: TANSEY, ROSEBROUGH, GERDING  
& STROTHER, P.C.  
621 W. Arrington  
Farmington, New Mexico 87401  
BY: TOMMY ROBERTS, ESQ.

CUMBRE COURT REPORTING

P.O. BOX 9262

SANTA FE, NEW MEXICO 87504-9262

(505) 984-2244

1 EXAMINER STOGNER: Hearing will come to  
2 order. Call next case, No. 10800.

3 MR. STOVALL: Application of Merrion Oil &  
4 Gas Corporation for compulsory pooling, San Juan  
5 County, New Mexico.

6 EXAMINER STOGNER: Call for appearances.

7 MR. ROBERTS: Mr. Examiner, my name is  
8 Tommy Roberts. I'm with the law firm of Tansey,  
9 Rosebrough, Gerding & Strother in Farmington, New  
10 Mexico, and I'm appearing on behalf of the applicant.  
11 I have two witnesses to be sworn in this case, and  
12 they also will be the witnesses who will testify in  
13 Case 10801.

14 EXAMINER STOGNER: Thank you for that  
15 notation, Mr. Roberts. Any other appearances?

16 Will the witnesses please stand to be  
17 sworn.

18 (Witnesses sworn.)

19 MR. ROBERTS: Mr. Stogner, as a preliminary  
20 matter, I wanted to point out that the application in  
21 this case contains the statement that we will be  
22 dealing with a standard coal gas well location.  
23 That's an erroneous statement. The advertisement,  
24 therefore, is also erroneous in that statement.

25 The applicant, Merrion Oil & Gas, intends

1 to apply for administrative approval of this  
2 nonstandard location that results from the  
3 recompletion of an existing wellbore. They have not  
4 yet initiated that application process but intend to  
5 do so forthwith.

6 EXAMINER STOGNER: Okay, Mr. Roberts.  
7 Thank you for pointing that out. As far as the  
8 advertisement goes, such notation will be put into the  
9 order. As far as readvertising, I don't think that  
10 will be necessary, but certainly perhaps a provision  
11 can be put in the order or at least brought out that  
12 it is not an orthodox location, that the  
13 administrative process will be in effect. So I think  
14 we can continue today.

15 MR. ROBERTS: I'll call my first witness.

16 CRYSTAL WILLIAMS,  
17 the witness herein, after having been first duly sworn  
18 upon her oath, was examined and testified as follows:

19 EXAMINATION

20 BY MR. ROBERTS:

21 Q. Would you state your name and your place of  
22 residence for the record, please.

23 A. Crystal Williams, Farmington, New Mexico.

24 Q. By whom are you employed?

25 A. Merrion Oil & Gas.

1 Q. In what capacity are you employed?

2 A. A landman.

3 Q. How long have you been employed by Merrion  
4 Oil & Gas?

5 A. A little over four years.

6 Q. Have you testified on any prior occasion  
7 before the Division or the Commission?

8 A. Yes, I have.

9 Q. In what capacity did you testify?

10 A. As a landman.

11 Q. Were your qualifications as an expert in  
12 the field of petroleum land work made a matter of  
13 record and accepted at that time?

14 A. Yes, they were.

15 Q. Are you familiar with the application in  
16 this case?

17 A. Yes, I am.

18 Q. Have you prepared certain exhibits to be  
19 presented in conjunction with your testimony today?

20 A. Yes. I have four exhibits.

21 MR. ROBERTS: Mr. Examiner, I would tender  
22 Ms. Williams as an expert in the field of petroleum  
23 land work.

24 EXAMINER STOGNER: Miss Williams is so  
25 qualified.



1 Q. (BY MR. ROBERTS) Would you briefly state  
2 the purpose of this application?

3 A. It is to force pool all interests from the  
4 surface to the base of the Fruitland Coal formation in  
5 the east half of Section 26, Township 26 North, Range  
6 13 West.

7 Q. And what has prompted this application? I  
8 understand that you're attempting to recomplate a  
9 wellbore. Would you give us the basic operation that  
10 is proposed?

11 A. The well is our Serendipity No. 1, which is  
12 partially recompleted. It was plugged back and  
13 perforated in December of '92.

14 Q. In what formation was the well originally  
15 completed?

16 A. It was originally completed to the Gallup  
17 in 1983.

18 Q. 1983. What is the current status of the  
19 Gallup completion?

20 A. It's been plugged back to the Fruitland.

21 Q. If you would, say it again, what is the  
22 current status of the recompletion operation?

23 A. It's plugged back to the Fruitland Coal  
24 formation and perforated, and it's currently shut in.

25 Q. Has it produced at all?

1 A. No, sir.

2 Q. When was the well plugged back and  
3 perforated in the Fruitland Coal formation?

4 A. In December of '92.

5 Q. Refer to what's been marked as your Exhibit  
6 No. 1 and identify that exhibit.

7 A. This is an area map of the San Juan Basin,  
8 in particular, the Kirtland/Fruitland outcrop map,  
9 wherein highlighted in red shows the township in which  
10 our Serendipity No. 1 well is located, and I also have  
11 noted a rough area where the Serendipity well is.

12 Q. Is this exhibit solely for the purpose of  
13 identifying the general location of this proposed  
14 activity in relationship to the producing areas of the  
15 northwest part of the state?

16 A. Yes, it is.

17 Q. Now turn to what you've marked as Exhibit 2  
18 and identify that exhibit.

19 A. This is the lease ownership plat of the  
20 Serendipity well, wherein it shows the two leases  
21 involved with the spacing of the well. I've noted at  
22 the bottom the uncommitted interest and the lease,  
23 which is the uncommitted interest owner being Phillips  
24 Petroleum with their lease interest of 3.02 percent  
25 and .756 percent of the unit.

1 Q. Would you identify the two leases that are  
2 involved in this proposed spacing unit for the  
3 Fruitland Coal formation?

4 A. They're both federal leases, lease No. NM  
5 33031 and SF 081028-A.

6 Q. Is the location of the Serendipity No. 1  
7 well marked on this exhibit?

8 A. Yes, it is.

9 Q. How is it marked?

10 A. It's the dotted line which displays the  
11 east half as the spacing.

12 Q. And the location of the well itself is  
13 marked by the dot, the black dot?

14 A. Yes, it is.

15 Q. Is it true that there is no operating  
16 agreement that would govern your relationship with  
17 Phillips Petroleum Company in accomplishing this  
18 proposed operation?

19 A. That is true, there is no operating  
20 agreement currently.

21 Q. Let's refer to what you have marked as  
22 Exhibit No. 3. Would you identify that exhibit?

23 A. This is all correspondence that I've had  
24 with Phillips Petroleum. The first letter is dated  
25 August 19, '93, wherein I sent an AFE to Phillips

1 notifying them of their costs if they participated.

2 Q. Is this AFE the same AFE that Mr. Sharpe  
3 will testify about during his testimony?

4 A. Yes, it is.

5 Q. Why don't you go ahead and proceed and  
6 identify the other items of correspondence.

7 A. The next letter in this exhibit is a letter  
8 dated August 13th of '93 where I sent a copy of the  
9 proposed operating agreement for the Serendipity well.

10 Q. Is this the operating agreement that Mr.  
11 Sharpe will talk about during his testimony?

12 A. Yes, it is. The third letter is dated  
13 February 22, '93, requesting confirmation of Phillips'  
14 acquisition of Ellwood Oil's interest.

15 And the fourth letter being January 29,  
16 1993, where we originally sent the farmout agreement  
17 to Elwood Oil Company.

18 Q. Was it your determination that Phillips  
19 Petroleum Company did acquire the interest of Ellwood  
20 Oil?

21 A. Yes, they did.

22 Q. And this is the interest which you seek to  
23 force pool today?

24 A. Yes, it is.

25 Q. Is this the extent of the written

1 communication that you have had with Phillips  
2 Petroleum Company?

3 A. Yes, it is.

4 Q. Did you have any verbal communication with  
5 any representative of Phillips?

6 A. I had numerous conversations with Frank  
7 Hulse, who is a landman with Phillips Petroleum, in  
8 trying to farm out this interest.

9 Q. Did those conversations also deal with  
10 other means of participation in this recompletion  
11 operation?

12 A. Yes, they did.

13 Q. What's the current status of your  
14 negotiations with Phillips?

15 A. They have decided that they will be selling  
16 their interest in this area in addition to our  
17 Serendipity well on the EBCO auction in October.

18 Q. And, consequently, they have decided not to  
19 make any decision with respect to participation in  
20 this recompletion operation?

21 A. Correct.

22 Q. Have they indicated to you either in  
23 writing or verbally that they have objection to this  
24 forced pooling application?

25 A. They have told me verbally they have no

1 objection.

2 Q. This correspondence indicates that your  
3 initial communications with Phillips occurred after  
4 the plugging back of the Gallup completion?

5 A. Yes, it does.

6 Q. And perforating in the Fruitland Coal  
7 formation. Why did that occur in that time sequence?

8 A. At the time the tax credit for a Fruitland  
9 Coal well was ending in December of '92, my company  
10 made the decision to do a partial recompletion in an  
11 effort to use that tax credit, and, thereafter, we  
12 proceeded with the acquisition of the interests to  
13 make up the spacing unit.

14 Q. Now, please turn to what's been marked as  
15 Exhibit No. 4 in this case and identify that exhibit.

16 A. This is notification to Mr. Frank Hulse  
17 with Phillips Petroleum dated August 3rd of '93,  
18 notifying them of forced-pool hearings for today.

19 Q. Was this letter sent by certified mail?

20 A. Yes, it was.

21 Q. Did you request a return receipt?

22 A. Yes, I did. That's the third page of that  
23 exhibit.

24 Q. Does this indicate delivery to Phillips  
25 Petroleum and acceptance by them?

1 A. Yes, it does.

2 Q. In your opinion, have the notice  
3 requirements applicable to this case been satisfied?

4 A. Yes.

5 Q. Were Exhibits Nos. 1 through 4 either  
6 prepared by you or at your direction and under your  
7 supervision?

8 A. Yes, they were.

9 MR. ROBERTS: Mr. Examiner, I would move  
10 the admission of Exhibit Nos. 1 through 4.

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

13 MR. ROBERTS: I have no other questions of  
14 this witness on Direct.

15 MR. STOVALL: Mr. Roberts, who's going to  
16 cover questions like overhead?

17 MR. ROBERTS: Mr. Sharpe.

18 EXAMINATION

19 BY MR. STOVALL:

20 Q. I want to make sure I get the sequence  
21 right on this, Miss Williams because we tend to get a  
22 little bit concerned if there's not an opportunity to  
23 join.

24 When you did the original title work, or  
25 your company did, who was the owner of the interest

1 which is the subject of this forced-pooling agreement?

2 A. When a title review was done, we were shown  
3 that Ellwood Oil owned the interest. Pat Hegarty, my  
4 boss at the time, who headed up the land department  
5 had contacted Phillips. I don't know how he gained  
6 that knowledge, but he did contact them, and they did  
7 confirm that they did own this.

8 Q. So when the January letter was sent out  
9 from Pat to Ellwood, that was just simply a farmout  
10 agreement request; right?

11 A. Correct.

12 Q. Do you know when Pat figured out that in  
13 fact Phillips may be the owner rather than --

14 A. I believe Ellwood, since they accepted that  
15 letter, I believe they may have notified him, letting  
16 them know where their interest went from that point.  
17 And from there we sent a letter to Phillips to verify  
18 that.

19 Q. That was your February 22nd letter?

20 A. Correct.

21 Q. Do you have anything back from Phillips  
22 confirming?

23 A. No, sir, other than phone conversations  
24 back and forth. That's why there's a big space  
25 between February and August.



1 Q. Did you ever actually send Phillips an AFE  
2 and an invitation to participate in this well?

3 A. Let's see. We originally -- I had just  
4 requested the farmout and then just recently sent the  
5 AFE to them. Upon phone conversations, they had told  
6 me all along that they would farm out their interest.

7 Q. But you don't have a written invitation to  
8 Phillips accompanied by an AFE to join in the well?

9 A. No, sir.

10 MR. STOVALL: Mr. Roberts, that poses a  
11 problem. Notwithstanding the conversations and oral  
12 testimony, in order to satisfy the statutory  
13 requirement of good faith negotiations -- we've been  
14 through several of these recently. It seems to have  
15 gotten a little bit sloppy in the field -- there has  
16 been -- once you ask the state to invoke its power to  
17 compel somebody else's interest to join in a well,  
18 there is an obligation that you meet, at a minimum,  
19 those statutory requirements.

20 And good faith negotiations, in my opinion,  
21 would require that you at least say, "Here's your  
22 opportunity to join, and here's what it will cost  
23 you."

24 MR. ROBERTS: Her testimony is they have  
25 sent an AFE to them recently, and they've had an

1 opportunity to review that AFE.

2 MR. STOVALL: That AFE was sent on the  
3 19th.

4 MR. ROBERTS: Right.

5 MR. STOVALL: And this is the 26th, which  
6 means it was sent after the notice. The forced-  
7 pooling action was filed, and Phillips was not -- it  
8 appears to me that at no time prior to the filing of  
9 the forced-pooling action was Phillips invited to join  
10 the well.

11 MR. ROBERTS: I guess our position in  
12 response to your concern is that, given the totality  
13 of the communications, Phillips has had the  
14 opportunity to consider for quite some time the  
15 participation in this recompletion operation.

16 There have been verbal communications,  
17 written communications. Maybe none of the written  
18 communications have specifically talked about the  
19 opportunity to participate in the well with an  
20 estimated cost summary given to them, but certainly  
21 the totality of the communications, the absence of  
22 Phillips here today to appear to espouse its own cause  
23 with respect to the proposed operation or with respect  
24 to the forced pooling I think indicates that certainly  
25 they've had every opportunity to respond.

1           The totality of the communications, again,  
2 I think indicate a good faith effort.

3           MR. STOVALL: Let me stop you right there  
4 and ask you would you tell me what the totality of the  
5 communications is? And I've heard this before, and  
6 that's why --

7           MR. ROBERTS: I think it's the written  
8 communications and the verbal communications. The  
9 written communications she has testified --

10          MR. STOVALL: We've got those in the  
11 record, right.

12          MR. ROBERTS: -- have been addressed. The  
13 verbal communications, she has testified, I believe,  
14 that the opportunity to join in this recompletion  
15 operation has been presented to them. They've been  
16 aware that they've had that opportunity available to  
17 them. They've had that knowledge for quite some time.

18          MR. STOVALL: Let me interrupt you because  
19 I understand that because, again, I've had some,  
20 unfortunately, some recent experience with this. The  
21 problem with the land person's testimony about that  
22 oral -- it's essentially hearsay communication, and we  
23 do not know the details of that communication.

24           It has been, and, as I say, for some reason  
25 we've had a number of cases following this line

1 recently. If there is not at least a -- we recognize  
2 that Phillips is an operator, and you don't have to --  
3 you don't have to hold their hand through the process  
4 and explain to them what's involved, but you do have  
5 to invite them to join the process. And I've got a  
6 great concern, again, notwithstanding whatever oral  
7 communications there are, there's always the --  
8 there's (a) the problem from a legal standpoint of  
9 what were the oral communications. I talked to him,  
10 he talked to me. The second is what did you say. The  
11 other is a substantive, "Look, here's your  
12 opportunity. Join the well or you will be force-  
13 pooled," but, unfortunately, I don't see in the record  
14 here the satisfactory indicia of the opportunity for  
15 Phillips to join the well except an AFE that was sent  
16 after the forced-pooling application was filed.

17 Based on that -- let me tell you what I  
18 have suggested as, what we have done in the past in a  
19 resolution to that is a continuation of the hearing  
20 with a requirement that you simply send a letter  
21 saying, "The case has been continued. Here's your  
22 opportunity to join. Respond in ten days."

23 MR. ROBERTS: My suggestion would be, if we  
24 were able to supplement the record with a waiver of  
25 objection to the forced-pool proceedings, would that

1 alleviate your concern?

2 MR. STOVALL: Yeah. If Phillips waived any  
3 objection to that, yeah, in some way, then --

4 MR. ROBERTS: I think our alternative would  
5 be to go ahead and submit to them the formal written  
6 offer to participate. But I think based on what I've  
7 heard Miss Williams say that Phillips has no interest  
8 in contesting this forced-pool application, have no  
9 desire to participate in the well.

10 MR. STOVALL: I understand.

11 MR. ROBERTS: If we can take care of it in  
12 that way through a waiver of objection, we propose to  
13 do that.

14 MR. STOVALL: That would be acceptable,  
15 some indication, basically a written -- as I say, when  
16 you're asking a police power of the state to in effect  
17 -- let me back up for one minute here because we're  
18 going to have another thing. Keep that in mind, and  
19 let's hold off on -- one of the concerns that I have  
20 raised in the past on it is, it's not so much the  
21 participation, because I think you have the  
22 opportunity and the right to drill the well.  
23 Virtually nothing would prevent you from being able to  
24 eventually drill the well and get that interest  
25 pooled, is when you get to a penalty provision where

1 there is in fact a taking, if you will, of property  
2 due to state action, that's when I really become  
3 concerned.

4 I assume you're going to address the  
5 penalty factor with Mr. Sharpe.

6 MR. ROBERTS: Yes.

7 MR. STOVALL: And it would appear to me on  
8 the surface, looking at the fact that this is a  
9 recompletion of an existing well, that this probably  
10 is not going to fit into the variety of formulas that  
11 have been used to arrive at what has been commonly  
12 accepted, with perhaps one major exception of a higher  
13 penalty in the Fruitland Coal.

14 Let's hear what you have to say on the  
15 penalty because one of the other solutions is to  
16 simply say, pool them without penalty, and then you  
17 don't have the taking problem.

18 MR. ROBERTS: I think our proposal would be  
19 to attempt to address the problems through a direct  
20 contact with Phillips. I think they're astute enough  
21 to know that there's an issue here involving risk, and  
22 when they have notice that a forced-pooling  
23 application is going to be considered, that's going to  
24 be one of the issues resolved. So if we can address  
25 that issue through direct communication with them that

1 indicates that they waive any objection to the  
2 issuance of an order in this case --

3 MR. STOVALL: Sure, that's fine, if we can  
4 do that, let's satisfy the --

5 MR. ROBERTS: I may be wrong. I may be  
6 optimistic about that. But judging, again, on the  
7 totality of the communications that I'm aware of, it's  
8 not unrealistic to think that that would be the way  
9 this could be resolved.

10 MR. STOVALL: I recognize how landmen  
11 operate in the world is one thing, but unfortunately  
12 when you come to the state and ask them to do  
13 something for you, there are a few little minimum  
14 standards that have to be satisfied.

15 MR. ROBERTS: Sure.

16 MR. STOVALL: That's what we are faced with  
17 once again. With that, I don't have any other  
18 questions of Miss Williams.

19 EXAMINER STOGNER: I have no other  
20 questions.

21 MR. STOVALL: Let's have Mr. Sharpe  
22 testify, and then we'll have some discussion about  
23 what you want to do. I guess this is something I  
24 can't tell you about until it comes to hearing and we  
25 find out that it hasn't been done.

1 MR. ROBERTS: Off the record, we're  
2 generally aware of the procedure that should be  
3 followed for a forced-pooling type of application.  
4 Just given all the circumstances, there was not  
5 sufficient time to get everything done in accordance  
6 with those general time guidelines. So that's why we  
7 have that problem.

8 MR. STOVALL: I understand. I understand  
9 the practical problem. We've just got a procedural  
10 due process problem.

11 GEORGE SHARPE,  
12 the witness herein, after having been first duly sworn  
13 upon his oath, was examined and testified as follows:

14 EXAMINATION

15 BY MR. ROBERTS:

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

18 A. My name is George Sharpe, and I live in  
19 Farmington, New Mexico.

20 Q. By whom are you employed?

21 A. Merrion Oil & Gas.

22 Q. And in what capacity?

23 A. I'm a petroleum engineer.

24 Q. How long have you been employed by Merrion  
25 Oil & Gas?



1 A. For three and a half years.

2 Q. And have you testified before the Oil  
3 Conservation Division or the Commission on any prior  
4 occasions?

5 A. Yes, I have.

6 Q. And in what capacity?

7 A. I was an expert witness in a case on a  
8 conversion to injection.

9 Q. And your qualifications then as an expert  
10 in the field of petroleum engineering were accepted  
11 and made a matter of record at that time?

12 A. Yes, they were.

13 Q. Are you familiar with the application in  
14 this case?

15 A. Yes, I am.

16 Q. Have you prepared exhibits to be presented  
17 in connection with your testimony?

18 A. Yes, I have. I have four exhibits.

19 Q. Mr. Sharpe, before we move in to your  
20 exhibits, could you briefly summarize the production  
21 history of the original Gallup formation completion in  
22 this well?

23 A. The well was drilled in 1983 and has  
24 produced a cumulative of around 20,000 barrels and was  
25 down to about a barrel a day, which was uneconomic.

1 We made the decision to plug back.

2 Q. Did you drill and complete this well to the  
3 Gallup formation?

4 A. Well, Merrion Oil & Gas did not drill and  
5 complete this well. They purchased this well after it  
6 was drilled and completed. I'm not sure --

7 Q. Do you recall the date of acquisition?

8 A. I do not recall the date at this time.

9 Q. Why has Merrion Oil & Gas elected to  
10 recomplete this wellbore in the Fruitland Coal  
11 formation rather than to drill a new well?

12 A. The decision was made because from Merrion  
13 Oil & Gas's standpoint, it saves us the cost of a new  
14 well. In addition, we know that there's coal in this  
15 wellbore, and we know we have a good wellbore that is  
16 capable of completion in the coal. So it minimizes  
17 the contingency costs of drilling a new well and the  
18 geologic risk that the coal may not be of the  
19 thickness and quality that exists in this wellbore.

20 Q. I want you to refer to what you've marked  
21 as Exhibit No. 5. Identify that exhibit.

22 A. It's an Authority For Expenditure, which  
23 summarizes the cost for the well. It is broken into  
24 three separate categories. Category No. 1 is Sunk  
25 Wellbore Costs, and the total of \$43,893 is a bare-

1 bones estimate of what it would cost to drill a new  
2 well and case a new well through the Fruitland Coal at  
3 1,350-foot depth.

4 The second category is titled Existing  
5 Equipment, and it is approximately \$25,920, which is  
6 the used equipment value of the equipment that's on  
7 the well and will be used to produce the Fruitland  
8 Coal.

9 Item No. 3 is Completion and Tie-In Costs  
10 for another \$47,530, and that is the future cost to  
11 Merrion Oil & Gas, if you will, at the time we  
12 undertook the workover to complete the recompletion.

13 Q. Why did you break down the AFE into these  
14 three categories of costs?

15 A. The AFE was broken down in this manner  
16 because we seek to recover the sunk wellbore costs  
17 from the Phillips Petroleum, the party we're  
18 attempting to force-pool. And those aren't costs that  
19 Merrion directly incurred for this recompletion.

20 In addition, the existing equipment are  
21 items that we are not paying money for at this point  
22 but we feel have value and we should recover.

23 The completion and tie-in costs are true  
24 future risk costs to Merrion Oil & Gas and to any  
25 additional party that would be involved.

1 Q. What portion of the completion and tie-in  
2 costs have been expended to date?

3 A. Less than \$10,000 have been spent to date  
4 to plug back from the Gallup and perforate the  
5 Fruitland Coal.

6 Q. There is a sum of money on the stimulation  
7 line item, it's \$17,500. The well has not been  
8 stimulated at this point, has it?

9 A. The well has not been stimulated, and it is  
10 unproductive and absolutely won't produce without a  
11 fracture stimulation job.

12 Q. Are there any contingencies built into this  
13 Authority For Expenditure?

14 A. There are possibly some contingencies in  
15 the completion and tie-in costs. There are no  
16 contingencies in the sunk wellbore costs or the  
17 existing equipment costs.

18 Q. In your opinion, are the costs represented  
19 on this Authority For Expenditure reasonable given the  
20 nature of the operation?

21 A. They are reasonable.

22 Q. Would you now turn to what you've marked as  
23 Exhibit No. 6 and identify that exhibit.

24 A. Exhibit 6 is a wellbore schematic of the  
25 Serendipity No. 1, showing the casing in the well,

1 showing the plug set above the Gallup perforations,  
2 showing the location of the Fruitland Coal  
3 perforations and existing tubulars in the hole.

4 Q. What's the relevancy of this exhibit to  
5 your application?

6 A. The relevancy of the exhibit is to show  
7 that the wellbore has cement to surface; that it is a  
8 wellbore with value; and that Merrion Oil & Gas  
9 deserves to be compensated for owning this wellbore  
10 with value and sharing that ownership with other  
11 parties that may join us at this time.

12 Q. Do you have an opinion as to the integrity  
13 of this wellbore? In other words, do you have an  
14 opinion as to whether the cement job is good and  
15 whether the casing is in good shape?

16 A. At the time that we plugged back from the  
17 Gallup perforations, we did pressure test the casing  
18 before perforating the Fruitland coal. I don't know  
19 to what pressure we tested it, but the wellbore did  
20 pass the pressure test.

21 Q. It appears that looking at -- from looking  
22 at this wellbore schematic that the wellbore could  
23 subsequently be opened up to the Pictured Cliffs  
24 formation. Is this potential of any value to the  
25 working interest owners?

1           A.     The Pictured Cliff formation is not  
2     productive immediately adjacent or there are no  
3     productive wells in the Pictured Cliff within a mile  
4     of this well, but certainly within township range,  
5     there are producing wells out of the Pictured Cliff,  
6     and it is a possibility that this wellbore could be  
7     used for the Pictured Cliff formation also, which is  
8     deeper than the Fruitland Coal.

9           Q.     The next question is, would the PC be  
10    available in a new wellbore drilled to the Fruitland  
11    Coal formation?

12          A.     It would not be available in a well that  
13    was targeted strictly for the Fruitland Coal. You  
14    might penetrate the top of the Pictured Cliff, but  
15    you'd set your casing shoe in it, and it would not be  
16    available to actually perforate and produce out of.

17          Q.     In your opinion, why is it appropriate to  
18    include sunk wellbore costs and costs of existing  
19    equipment in the total cost for this recompletion  
20    operation?

21          A.     The wellbore costs are appropriate to be  
22    included for a number of reasons. The first is we  
23    feel this wellbore does have value to the party coming  
24    in. If this wellbore were not available, they would  
25    be forced to drill another well to produce out of the

1 Fruitland Coal and would have to pay the well costs of  
2 drilling that well.

3 Second, as this schematic indicates, we've  
4 got a wellbore that has at least as much and possibly  
5 more value than a new well in the fact that it's  
6 available to produce out of the Pictured Cliff  
7 formations.

8 Third, you have eliminated the geologic  
9 risk and the drilling risk, the risk that you might  
10 have problems during the drilling operations, and the  
11 risk that your formation may not be there in the  
12 thickness and quality that we know it is in this  
13 well. And those risks have been eliminated for the  
14 party coming in and participating at this time.

15 The fourth reason is that, again, Merrion  
16 is bringing to the table this well that has at least  
17 equal value to a new well and possibly greater value,  
18 and we deserve to be compensated, or, if you will, any  
19 party that now comes in and shares an ownership in our  
20 well should have to pay for the value of the  
21 wellbore.

22 An analogy would be if we owned a car that  
23 we bought at 50,000 miles and drove it to 100,000  
24 miles and had fully depreciated the car and written it  
25 off the books, that doesn't mean we have to give it

1 away. We will sell it at whatever market conditions  
2 are and whatever value it would have to someone who  
3 would want that car at that time.

4 Q. Why don't you now turn to what you have  
5 marked as Exhibit No. 7 and identify that exhibit.

6 A. Exhibit 7 is a long list of wells that are  
7 completed in the Fruitland Coal in the nine townships  
8 surrounding the Serendipity No. 1. It shows the  
9 location of the wells, the lease name, the well name,  
10 the operator, whether it's active or inactive. It  
11 shows the cum of the gas production and the gas rate  
12 from the last month that was available in Dwight's  
13 database, which is a public database service.

14 The appropriate item in here is to look at  
15 the variety of gas production rates in this immediate  
16 vicinity and note that, in particular, many of the  
17 wells very near our Serendipity well are  
18 subcommercial. And commercial in my terms would be  
19 greater than 3,000 to 6,000 Mcf per month or 100 to  
20 200 Mcf per day.

21 Therefore, there is significant risk that  
22 even after stimulation the Serendipity No. 1 will be a  
23 poor or marginal performer, and this will be an  
24 uneconomic venture.

25 Q. Can you point out as an example a well or



1 two or some of the wells that are tabulated on this  
2 Exhibit No. 7 which, in your opinion, exhibit  
3 subcommercial quantities of production or rates of  
4 production?

5 A. On page 2 of the exhibit, the Serendipity  
6 well is highlighted in its location, and italicized,  
7 and the two wells immediately above that, the Inez and  
8 the Ruby, are both producing less than 150 Mcf per  
9 month, which is less than 5 Mcf a day and obviously  
10 are uneconomic.

11 Again, there's certainly significant  
12 statistical likelihood that the Serendipity will be  
13 uneconomic.

14 Q. Then, in your opinion, is there future risk  
15 to be incurred in this recompletion operation?

16 A. Absolutely. The future costs of the -- the  
17 costs that have been incurred to date and the future  
18 costs are all at risk, and the success of the  
19 stimulation job is by no means guaranteed.

20 Q. Do you propose that a risk factor be  
21 charged against any interest owner who does not  
22 voluntarily join in the recompletion operation?

23 A. We feel that the full or the standard 156  
24 percent risk that is applied to the Fruitland Coal  
25 should be applied to the completion and tie-in cost,

1 the actual risk cost that Merrion took from this point  
2 forward, and should be applied to the full amount.

3 Q. Why would you not propose that the risk  
4 factor be charged and applied against what you have  
5 labeled on your AFE as Sunk Wellbore Costs or Existing  
6 Equipment costs?

7 A. I guess for a couple reasons. One, for the  
8 existing equipment it's inappropriate because if the  
9 stimulation does not work, then we can salvage the  
10 existing equipment at the value we have on here.

11 In addition, the sunk wellbore costs along  
12 the same lines, this wellbore has value only because  
13 we can produce it out of the Fruitland Coal. If the  
14 Fruitland Coal is unproductive, all of a sudden this  
15 wellbore doesn't have nearly as much value.

16 In addition, both of those are sunk costs  
17 that Merrion Oil & Gas is not risking at this time.

18 Q. As a final matter, I'd like you to refer to  
19 what's been marked as Exhibit No. 8 and identify that  
20 exhibit.

21 A. Exhibit 8 is an operating agreement, Model  
22 Form Operating Agreement from the AAPL that Merrion  
23 has submitted to Phillips Petroleum under which we  
24 propose to operate the subject well.

25 Q. To your knowledge, is this a standard form

1 operating agreement in common use in this area?

2 A. To my knowledge, it is.

3 Q. Who do you propose to act as the operator  
4 with respect to the recompletion operation?

5 A. Merrion Oil & Gas.

6 Q. Do you propose the assessment of  
7 supervisory charges during the recompletion and  
8 production stages of the operation?

9 A. We do propose those.

10 Q. What are they?

11 A. The cost for the drilling and recompletion  
12 would be at \$4,000 per month prorated on a daily  
13 basis. The production charges, once we begin  
14 production, would be at \$342 per month.

15 Q. In your opinion, are these rates reasonable  
16 and customary given the nature and location of this  
17 recompletion operation?

18 A. They are.

19 Q. What is the basis for your recommendations  
20 on these charges?

21 A. They are based on an Ernst & Young survey  
22 where they surveyed operators throughout the United  
23 States, and they came up with average values that are  
24 being charged in specific areas for specific types of  
25 wells.

1           Q.     In your opinion, will the granting of this  
2 application be in the best interest of conservation  
3 and result in the prevention of waste and the  
4 protection of correlative rights?

5           A.     In my opinion, it will.

6           Q.     Were Exhibit Nos. 5 through 8 either  
7 prepared by you or at your direction and under your  
8 supervision?

9           A.     They were.

10           MR. ROBERTS:   Mr. Examiner, I'd move the  
11 admission of Exhibit Nos. 5 through 8 on behalf of the  
12 applicant.

13           EXAMINER STOGNER:   Exhibits 5 through 8  
14 will be admitted into evidence.

15           MR. ROBERTS:   I have no other questions of  
16 this witness on Direct.

17           Q.     (BY EXAMINER STOGNER)   Let me see if I --

18           MR. STOVALL:   Mr. Examiner, before we  
19 start, we've got another case coming up in which  
20 Merrion is seeking to force-pool certain parties, the  
21 subsequent, next case to be heard; is that correct?

22           MR. ROBERTS:   That's correct.

23           MR. STOVALL:   Is it similar in the nature  
24 of what has happened; it's a plug-back of a prior  
25 previous producing well?

1 MR. ROBERTS: Very much. Pretty much  
2 identical factual circumstances.

3 MR. STOVALL: Pardon me?

4 MR. ROBERTS: Pretty much identical factual  
5 circumstances. We're talking about different  
6 formations of original completion and recompletion.

7 MR. STOVALL: And, Mr. Kellahin, you are  
8 representing the party in that case; is that correct?

9 MR. KELLAHIN: That's right, Mr. Stovall.

10 MR. STOVALL: Some of the -- actually, the  
11 fundamental issues in that case, the differences  
12 between the parties and the reason you're here, Mr.  
13 Kellahin, is because -- addressing some of these  
14 unique problems related to costs and allocations and  
15 risk factors?

16 MR. KELLAHIN: The same discussion you're  
17 about to have with Mr. Sharpe, we're going to have  
18 that same discussion here in a few minutes in the  
19 subsequent case.

20 MR. STOVALL: Mr. Examiner, I'm going to  
21 make a unique recommendation. You can see it coming,  
22 can't you?

23 EXAMINER STOGNER: Um-hm.

24 MR. STOVALL: Rather than us sit up here  
25 and do this once with Mr. Sharpe and then start over

1 and do it again with Mr. Kellahin, I'm going to  
2 recommend that we leave this record open, call the  
3 next case, let Merrion put on its case in that case,  
4 and have this discussion in the context of that case  
5 because I think there's no point in us sitting here  
6 and doing it once and then having you go back and do  
7 it again. I think it benefits everybody to do that.

8 MR. KELLAHIN: We would encourage you to do  
9 that. I think there's some economy of effort if we do  
10 follow that procedure.

11 MR. STOVALL: Economy of effort, and we'd  
12 focus it in the right direction with adversarial  
13 parties appearing in that. That may be the way to do  
14 it. So I think, unless, Mr. Examiner, if you have any  
15 questions, it might not be -- we can probably do it  
16 all there because we can ask Mr. Sharpe -- the record  
17 will be open in both cases, and we can ask Mr. Sharpe  
18 the same questions, and I assume the answers will be  
19 pretty consistent in both cases.

20 MR. ROBERTS: There are some basic factual  
21 differences but the concepts are identical. We'd like  
22 to get those basic factual differences on the record  
23 in the next case, and I think the questions that Tom  
24 is going to have are going to be similar to the  
25 questions you're going to have. I think it's a good

1 idea. I thought about recommending something like  
2 that in the beginning but didn't know exactly how to  
3 accomplish it.

4 MR. STOVALL: I'd kind of forgotten what  
5 the cases were about in the application, but I think  
6 that might be an efficient way to do this.

7 THE WITNESS: Can I go?

8 EXAMINER STOGNER: No, hang on just a sec  
9 here. There's one little difference I want to touch  
10 upon in this one, and then I will shut up.

11 EXAMINATION

12 BY EXAMINER STOGNER:

13 Q. This well was recompleted into the Basin  
14 Fruitland Coal. You mentioned something about a coal  
15 tax credit. What kind of influence did that have on  
16 the recompletion of this well?

17 A. A major influence.

18 Q. Can you elaborate?

19 A. Certainly it influenced the timing and was  
20 one of the reasons the recompletion was done before we  
21 got our ducks in a row on ownership and were able to  
22 get people involved from day one.

23 Q. And what was that time frame, as you  
24 understand?

25 A. The time frame was the fact that the

1 formation had to be perforated, as we understood, by  
2 December 31, 1992, for the wellbore to qualify for the  
3 tax credit.

4 Q. And was it -- you said the wellbore  
5 perforated, perforated in the Basin Fruitland Coal?

6 A. Basin Fruitland Coal, yes, sir.

7 Q. And was that accomplished?

8 A. Yes, it was.

9 EXAMINATION

10 BY MR. STOVALL:

11 Q. Since you've asked that question, I guess  
12 this actually could affect both cases, but the tax  
13 credit would inure to the benefit of all the working  
14 interest -- or all the revenue parties actually in the  
15 well, not just to Merrion; is that correct?

16 A. Yes, it would. And, again, from that  
17 standpoint, this wellbore has more value than a new  
18 well would to Phillips Petroleum.

19 EXAMINER STOGNER: With that, at least what  
20 I say at this point, since the Basin Fruitland Coal  
21 reaches out and grabs my attention that it is under  
22 the tax credit, and I'm not aware that the particular  
23 Fruitland sand in the next one is, I wanted to get  
24 that line of questioning out. With that we can --

25 MR. STOVALL: Let me ask just one more



1 question, and I think it's an issue.

2 Q. Have you addressed the issue -- assuming  
3 that you were granted a penalty, does the tax credit  
4 on that penalized revenue inure to the benefit of  
5 Phillips or to Merrion?

6 A. The penalty would be -- I would assume that  
7 Merrion would recover our costs plus the penalty, and  
8 certainly part of our revenue, I guess I would  
9 reasonably assume, would be the tax credit. So the  
10 penalty -- the tax credit revenue that was generated  
11 from that would apply to the penalty, and at that  
12 point in time, Phillips would back in as an owner of  
13 the well.

14 Q. So, in other words, to the extent that you  
15 got a tax credit, whichever side of the ledger sheet  
16 you put it on, it would either be a reduction of  
17 expense or an increase in revenue?

18 A. That's correct.

19 Q. So Merrion would not receive all of the  
20 money from Phillips' share and then the tax credit  
21 plus. Actually, Phillips would really have a  
22 beneficial result from the tax credit; is that  
23 correct? Is that what you're saying?

24 A. That would be my interpretation, but even  
25 as I say that. Merrion Oil & Gas itself does not

1     qualify for the tax credit.

2             Q.     That's not an issue because if you don't  
3     qualify for it, it doesn't come in.

4             A.     Right.

5             Q.     You've got to deal with Phillips whether  
6     you can sell it to them or somebody else or whatever.

7             A.     Right.

8             Q.     And I'm certainly not asking for you a tax  
9     opinion. I just wanted your --

10            A.     My opinion is that Merrion's full revenue,  
11     whatever we receive, and certainly if we were  
12     receiving benefit from the tax credit in any way  
13     associated with this well would go toward payout and  
14     recovery of the penalty.

15            MR. STOVALL: That answers that question.  
16     Nothing further at this time.

17            EXAMINER STOGNER: Procedurally, would we  
18     take this one under recess or incorporate the record,  
19     Mr. Stovall?

20            MR. STOVALL: I think what we do is we  
21     recess this case, build the record in either one, and  
22     then incorporate that record back into this case.

23            (Thereupon, a discussion was held  
24               off the record, a recess was taken,  
25               and Case 10801 was begun. Please

1 reference the transcript in Case 10801,  
2 page 57, Line 11.)

3 \* \* \*

4 EXAMINER STOGNER: Case 10800 will be  
5 continued to the examiner hearing scheduled for  
6 September 9, 1993.  
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CERTIFICATE OF REPORTER

STATE OF NEW MEXICO )

) ss.

COUNTY OF SANTA FE )

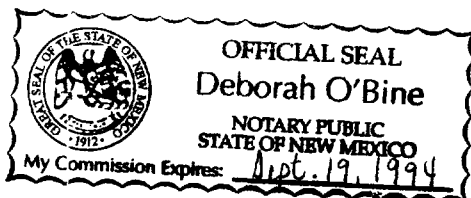
I, Deborah O'Bine, Certified Shorthand Reporter and Notary Public, HEREBY CERTIFY that I caused my notes to be transcribed under my personal supervision, and that the foregoing transcript is a true and accurate record of the proceedings of said hearing.

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, August 28, 1993.

*Deborah O'Bine*

DEBORAH O'BINE  
CCR No. 63



I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 10890, heard by me on 26 August 1993.

*[Signature]*, Examiner  
Oil Conservation Division