

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO

20 February 1986

EXAMINER HEARING

IN THE MATTER OF:

Application of Joseph S. Sprinkle CASE
for a determination of reasonable 8807
well costs, Lea County, New Mexico.

BEFORE: Michael E. Stogner, Examiner

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Oil Conservation Division:	Jeff Taylor Legal Counsel to the Division Oil Conservation Division State Land Office Bldg. Santa Fe, New Mexico 87501
For the Applicant:	Karen Aubrey Attorney at Law KELLAHIN & KELLAHIN P. O. Box 2265 Santa Fe, New Mexico 87501
For TXO:	Chad Dickerson Attorney at Law DICKERSON, FISK, & VANDIVER Seventh & Mahone/Suite E Artesia, New Mexico 88210

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MR. STOGNER: This hearing will
come to order.

We recessed as of yesterday and
now we will call Case 8807, which is the application of
Joseph S. Sprinkle for determination of reasonable well
cost, Lea County, New Mexico.

This case is continued from the
January 22nd, 1986, hearing.

Call now for appearances.

MS. AUBREY: Karen Aubrey, Kel-
lahin & Kellahin, of Santa Fe, representing the applicant.

MR. DICKERSON: Chad Dickerson
of Artesia, New Mexico, appearing on behalf of TXO Produc-
tion Corporation.

MR. STOGNER: Are there any
other appearances?

There being none, Ms. Aubrey,
Mr. Dickerson, do you have witnesses today?

MS. AUBREY: Mr. Stogner, I be-
lieve the witnesses were sworn on January 22nd when we began
this case (not clearly audible).

MR. STOGNER: And so you have
no new witnesses.

MS. AUBREY: No, sir.

1 MR. STOGNER: Mr. Dickerson.

2 MR. DICKERSON: No, the same
3 witness, Mr. Examiner.

4 MR. STOGNER: Let the record so
5 show that the witnesses were sworn on January 22nd, 1986,
6 hearing.

7 I believe we closed on the Jan-
8 uary 22nd hearing (not understood) a motion to allocate the
9 costs between the Bone Springs zone and the Morrow forma-
10 tion, is that correct?

11 MS. AUBREY: That's correct.

12 MR. STOGNER: And I have re-
13 ceived briefs from both parties concerning this motion and
14 at this time I want to consider this motion. I want to con-
15 sider that it be granted for the purpose of taking the tes-
16 timony. This is not a ruling on the merits of the motion
17 but merely to allow the testimony at this time.

18 So I will allow any testimony
19 considering allocation of costs.

20 Ms. Aubrey.

21 MS. AUBREY: Thank you, Mr.
22 Stogner.

23 MR. STOGNER: Mr. Dickerson, do
24 you have any (not clearly understood)?

25 MR. DICKERSON: Well, I have an

1 argument, Mr. Examiner. Based on that, I suppose the under-
 2 lying merits of the motion are still under examination and
 3 maybe we can reserve argument until the end of the hearing.

4 MR. STOGNER: Thank you.

5 MS. AUBREY:

6 MR. DICKERSON: Mr. Examiner, I
 7 might, as a suggestion only, at the hearing of this case on
 8 January 22nd, you will recall that TXO was requested to re-
 9 organize its Exhibit Number Two in a little more legible
 10 fashion, allocating these costs into the various categories
 11 as summarized on the front page of the Exhibit Two, and TXO
 12 has done so, and it might, for the purpose of clarifying the
 13 total cost incurred in this well, be appropriate, with your
 14 permission, the allow us to proceed along the lines of our
 15 Exhibit Three, as directed by the Examiner last time.

16 MR. STOGNER: Any objections?

17 MS. AUBREY: I have no objec-
 18 tion.

19 MR. STOGNER: Mr. Dickerson,
 20 that will be fine.

21
 22 RANDALL CATE,
 23 having been previously called as a witness and remaining un-
 24 der oath, testified as follows, to-wit:

25

1

2

REDIRECT EXAMINATION

3

BY MR. DICKERSON:

4

Q

Mr. Cate, you were on the stand at the original hearing in this matter on January 22nd, were you not?

6

7

A

Yes, I was.

8

Q

And you were requested by the Examiner to reorganize the cost materials reflected in TXO Exhibit Number Two and to present that at the continuation of the hearing today?

11

12

A

Yes, that's correct.

13

Q

And have you done that?

14

A

Yes.

15

Q

Will you refer to what we have marked and submitted as TXO Exhibit Number Three and briefly summarize what you have done with Exhibit Number Two, as far as reorganizing it and describe for everybody's benefit the manner in which this case is reorganized, this file is reorganized?

19

20

A

Okay. The sheet here that is on the front, well, it's in the first insert here, it's Sprinkle Federal No. 1, and it's got several categories, estimated cost, actual cost, adjustments, and then adjusted cost.

23

24

25

What we did, at the request of the examiner, we found all the invoices that were available and

1 other back up to come up with the exact costs that we had
2 reflected in our original Exhibit Two. And at the last
3 hearing it was shown that there were some invoices missing
4 and we have found those and on each category we have inser-
5 ted a tabulation for each category of the itemized costs
6 with the total at the bottom, which does correspond to the
7 original Exhibit Two, as we had presented it last -- last
8 hearing.

9 The -- in this time period we have also
10 found some other adjustments that needed to be made, some
11 increases, some decreases, and so the adjusted cost category
12 here, the bottom line is now \$1,106,052.35, which is roughly
13 \$1000 less than we originally came in with our actual costs.

14 Q Now it appears from reviewing your sum-
15 mary of the facts shown by this Exhibit Number Three, Mr.
16 Cate, that you have broken down the total cost into three
17 categories, drilling, completion, and production equipment
18 costs, is that correct?

19 A Yes, that's correct.

20 Q With reference to the summary again, will
21 you briefly summarize your exhibit here, the fly sheet of
22 the exhibit, for each of those categories and point out the
23 manner in which this exhibit is prepared?

24 A Okay. The -- for the adjustments we had
25 under Drilling Overhead, we had made a correction of 30 --

1 approximately \$3700, the reason being that our overhead was
2 calculated based on our rates under our joint operating
3 agreement. We went back and corrected for the Commission's
4 order, that forced pooling order, of \$4700 per month for
5 Drilling Overhead, and you'll see that under Completion
6 Overhead we've made the same deduction and also under the
7 Installation Overhead, under Production Equipment.

8 So that -- that was the adjustment for --
9 for this hearing purpose there.

10 Okay, the other differences noted between
11 Exhibit Two from the last hearing and this Exhibit Three,
12 under the drilling category of Mud and Chemicals we found a
13 credit to Hughes Drilling Company that we had taken credit
14 twice, and for this purpose of this hearing we need to re-
15 flect that we should have only taken the credit once, and so
16 we've added back the \$5400 there.

17 Under the Completion side, under Wellhead
18 Equipment in the Adjustments column, which is in the back of
19 this folder, there is a -- there's a list which discusses
20 these adjustments that we've made. It details the adjust-
21 ments. Now what they were was on Material Transfers and
22 movements. Our accountants in Dallas had put wrong prices
23 down for the materials that were transferred and the corres-
24 ponding adjustments for grade of material. So we've gone
25 back and used correct prices. There are some higher, some

1 lower, for a total adjustment of \$2718.

2 In the Subsurface Equipment we found an
3 invoice, I believe, that we had not included before, and I
4 believe what that \$2487 is for, and under production Equip-
5 ment we had a duplicate transfer made and for -- under the
6 category of Meters, and made a correction there of \$1764 de-
7 duction.

8 Also under Separation and Treating
9 there's a deduction of \$30,599. This item was brought up as
10 an exhibit under Sprinkle exhibits, with a stack pack that
11 was transferred out there and we have made the proper
12 adjustment to reflect no charge for that.

13 Q Mr. Cate, in your column headed at the
14 top Category, do the individual items of these various costs
15 of these goods and services correspond with those items as
16 set forth in Exhibit Number Two previously introduced?

17 A Yes, that's correct.

18 Q And what is -- what is the item -- or the
19 column entitled Estimated Cost?

20 A Well, that refers back to our AFE.

21 Q And the column entitled Actual Cost?

22 A The Actual Cost is what -- corresponds to
23 what we had shown as our Exhibit Two, the original account-
24 ing of this well.

25 Q From which on the individual items in all

1 these categories it can be determined variation from TYO's
2 original estimate of the cost of these items?

3 A That's correct.

4 Q And so then your column entitled Adjust-
5 ments reflects other corrections of one type or another,
6 whether an item had been omitted or whether it had been
7 charged twice, and things of that nature?

8 A That's correct, yes.

9 Q And your column entitled Adjusted Cost,
10 then reflects what?

11 A The Adjusted Cost reflects the actual
12 cost, either adding or subtracting, whichever adjustments
13 were made, and so the adjusted cost is our new, what we con-
14 sider our new total or our new actual cost column now.

15 Q Now I understand that you have discovered
16 one additional correction that needs to be made, have you
17 not, Mr. Cate?

18 A Yes, I have. It's -- if I can find it,
19 I believe it's under Stimulation on Completion, the comple-
20 tion under Stimulation. There's a charge \$1900 -- well,
21 \$1903 and I believe that that is a duplicate; it's approxi-
22 mately halfway through the invoices, and I believe that is a
23 duplicate of the acid stimulation from Western that was on
24 the page on top of it.

25 So we will need to reflect an additional

1 adjustment in that category, subtracting \$1903.65.

2 Q Now, have you again, for the purposes of
3 your testimony, Mr. Cate, reviewed these invoices and the
4 manner in which these costs and services were incurred by
5 TXO in the drilling of this well, for the purpose of expres-
6 sing an opinion on whether or not these actual well costs
7 incurred were identical with the reasonable well costs that
8 should have been incurred in drilling and completion of this
9 well?

10 A Yes, I have.

11 Q And is it your opinion that these actual
12 costs incurred were the reasonable well costs involved in the
13 drilling and completion of TXO's Sprinkle Federal No. 1
14 Well?

15 A Yes.

16 Q Mr. Cate, at the original hearing on Jan-
17 uary 22nd in here you will recall that we were embroiled in
18 a discussion regarding costs of certain tubular goods char-
19 ged to this well?

20 A Yes.

21 Q Have you made further inquiry regarding
22 costs paid by TXO and passed on to this well through this
23 Exhibit Number Three?

24 A Yes, I have.

25 Q Will you refer to what we have marked as

1 Exhibit Number Four, Mr. Cate, and identify that for us?

2 A Yes. Exhibit Number Four is Lone Star
3 1984 publication and which has the list prices in there for
4 all the casing grades and in my testimony at the last hear-
5 ing I had made mention of the February, 1983, price, and be-
6 lieving that was the last list price put out by Lone Star,
7 and that is correct. The prices in this 1984 catalog are
8 still the list prices in this 1983, and if you'll look at
9 the last page, I believe page thirty, and up at the top it
10 says that it reflects -- the list prices reflected there are
11 from the February, 1983, list.

12 Q Okay. With reference again to your Exhi-
13 bit Number Three, which of the items in the various cate-
14 gories in Exhibit Number Three, the cost of those items
15 charged to this well by TXO can be determined by reference
16 to your Exhibit Number Four?

17 A Okay. The items that can be determined
18 from this Lone Star list price are surface and intermediate
19 casing under the Drilling category.

20 Under Completion, production casing.

21 And that -- that's it. Inside this list
22 price, they don't carry that for tubular goods. Now our
23 tubing that we purchased, there's a direct invoice, that was
24 not transferred from stock or anything, that was just a pur-
25 chase, which has the exact price we paid for the tubing.

1 Q Now on your Exhibit Number Three are
2 there additional costs involved in these tubulars which are
3 charged to this well by TXO which are not set forth in the
4 price from Lone Star shown by Exhibit Four?

5 A Yes, there are. There are freight costs,
6 forklift costs, storage and handling fees, tax, and inspection,
7 drifting and testing costs, when required.

8 Q Is it necessary or is it proper for a
9 prudent operator, in your opinion, Mr. Cate, to test new
10 casing prior to introducing it into a wellbore?

11 A Yes, that's correct. Now on the surface
12 and intermediate casing generally that's not necessary. The
13 casing used is generally well within the design factors and
14 so you will not do additional testing beyond what the mill
15 has already done.

16 On the production casing it's general
17 practice, especially on deep wells, that you get a third
18 party testing outfit to verify the mill. The mill only
19 guarantees no more than a 3 percent rejection rate. That's
20 one out of 33 joints, approximately, and in our testing we
21 do find a rejection rate close to that, that number of 3
22 percent.

23 Q What is the risk involved to an operator
24 if it foregoes this testing that you're describing?

25 A Well, it could be in the case of this

1 well, after you've spent \$680,000 to get to your TD, you
2 could basically junk the hole if you get a bad joint of pipe
3 that has not been properly tested. At the very least it
4 might cost several days of fishing or drilling out, swedging
5 the casing. At the worst you lose the hole and plug it.

6 Q Now are these separate items that accumu-
7 late to increase the costs shown by the Lone Star Bulletin
8 reflected in your Exhibit Number Three?

9 A Yes, the total -- the total price, or the
10 total cost there shown reflects list price of casing plus
11 tax, any storage or handling fees, the testing portion of
12 it, and the freight.

13 Q So these separate items are all separate-
14 ly supported by invoices or other documentation in Exhibit
15 Three?

16 A The testing and the tax are not actually
17 supported. They are included in the price under the mater-
18 ial transfers that we submitted.

19 MR. DICKERSON: Mr. Examiner,
20 at this time I move admission of TXO's Exhibits Three and
21 Four.

22 MR. STOGNER: Are there any ob-
23 jections?

24 MS. AUBREY: No objections.

25 MR. STOGNER: Exhibits Three

1 and Four will be admitted into evidence at this time.

2 MR. DICKERSON: I have no fur-
3 ther questions of Mr. Cate.

4 MR. STOGNER: Thank you, Mr.
5 Dickerson.

6 Ms. Aubrey, your witness.

7 MS. AUBREY: Thank you.

8 MR. STOGNER: Before you start,
9 let me get these suggested and actual figures figured out
10 here based on the other information that you give me.

11 MS. AUBREY: Thank you, Mr.
12 Stogner.

13

14 CROSS EXAMINATION

15 BY MS. AUBREY:

16 Q Mr. Cate, you testified that you believed
17 that the actual well costs that you compiled in your Exhibit
18 Three are reasonable well costs?

19 A Yes.

20 Q And that's for a Morrow completion. I'm
21 sorry, for a well drilled to the Morrow, is that right?

22 A That's correct.

23 Q Have you allocated the costs of drilling
24 this well and completing it in the Bone Springs between the
25 Morrow and the Bone Springs?

1 A I have looked at it briefly and have a
2 good idea of what I think the cost should be, if allocated.

3 Q Do you have a document which reflects the
4 costs to the Bone Springs?

5 A I've got a scratch pad.

6 Q What is your opinion, then, on the
7 reasonable well costs in a Bone Springs completion in this
8 wellbore?

9 A Last night I went through every invoice,
10 just in case this came up, and in my opinion the allocated
11 cost to the Bone Springs in the Sprinkle No. 1 should be ap-
12 proximately, within a few thousand dollars, I was rounding
13 off the nickels and dimes, but I've come up with \$814,361.

14 And those numbers were arrived at direct-
15 ly off the invoices in this Exhibit Number Three.

16 Q In arriving at that number, did you use
17 the same footage rate for drilling to the Bone Springs as
18 the number that's in here --

19 A Yes.

20 Q -- for drilling to the Morrow?

21 A Yes.

22 Q So you did not reduce that by the amount
23 that you would expect a drilling contractor to actually
24 charge for the Bone Springs.

25 A No, I didn't.

1 Q I believe you agreed with me last time we
2 did this that there is a significant difference in the foot-
3 age rate between the Morrow and the Bone Springs?

4 A Yes, there is, but you cannot get to the
5 Morrow unless you drill the Bone Spring.

6 Q So you're using the Morrow footage rate
7 in calculating what you believe to be the actual costs of
8 drilling to the Bone Spring.

9 A Yeah, that's correct, and that's the way
10 it should be because --

11 Q Well, Mr. Cate, I believe that the Exam-
12 iner is going to make that decision.

13 Will you agree with me that approximately
14 \$14.00 is a reasonable footage rate for a Bone Spring well?

15 A Yes.

16 Q And that the footage rate which you have
17 included in your costs for the Morrow is approximately
18 \$24.50, \$24.00, something like that.

19 A 24.50.

20 Q So we're talking about \$10.00 a foot dif-
21 ference.

22 A Yes.

23 Q Would there be a difference, in your
24 opinion, in the type of casing design that you would use if
25 this had been intended to be a Bone Springs well as opposed

1 to being -- intended to be a Morrow well?

2 A No doubt. I'd use cheaper grades, less
3 weight pipe. That's pretty standard, but you're not talking
4 the same thing.

5 Q Would it have been less expensive?

6 A I think I've done AFEs that are exhibits
7 in previous hearings that show that.

8 Q You're aware of the AFEs introduced in
9 some of the other Sprinkle cases --

10 A Yes.

11 Q -- which show that TXO's estimated costs
12 for a Bone Springs completion is either \$495,000 or
13 \$615,000.

14 A That's correct.

15 Q And if I recall correctly the \$615,000
16 AFE was a re-entry, is that correct?

17 A As well as the two additional drilling
18 wells.

19 Q And I believe last time we talked about
20 the Burleson AFEs, which adjoin the Sprinkle No. 1, are for
21 locations adjoining the Sprinkle No. 1, at 495,000?

22 A That's correct, but they did not include
23 pumping units and all, and I believe the Commission realized
24 our -- well, they upheld those AFEs as reasonable in the
25 Sprinkle 3 and 4 orders.

1 Q Mr. Cate, is there a pumping unit on the
2 Sprinkle No. 1?

3 A No, ma'am.

4 Q So we shouldn't include pumping in this
5 estimate of well costs, either, is that right?

6 A No.

7 Q So that's not the difference between 495
8 and 814.

9 A That was the difference in the 615 and
10 the 496 you were referring to.

11 Q But we have no -- no pumping unit here.

12 A No, we don't.

13 Q Okay. In preparing the \$495,000 AFEs for
14 the Bone Springs completions you proposed, did you use the
15 Morrow footage rate or the Bone Springs footage rate?

16 A I obviously used the Bone Springs footage
17 rate.

18 Q I believe you testified a few minutes ago
19 that your front sheet in your Exhibit Three indicates that
20 prior to this hearing you had charged your overhead rates in
21 accordance with the joint operating agreement?

22 A Well, yes, that's what we're charging our
23 other working interest owners that sign the JOA.

24 Q And did Mr. Sprinkle sign the JOA?

25 A No, he did not.

1 Q He was force pooled, wasn't he?

2 A Yes, he was.

3 Q Are you aware that TXO is limited by the
4 terms of the order entered in this case as to how much it
5 can charge for overhead?

6 A Yes, I am, and that is reflected in these
7 deductions, the adjustments that we've made.

8 Q And that was not an adjustment that was
9 made prior to the January 22nd hearing, is that correct?

10 A No.

11 Q Let me ask you some questions about the
12 wellhead equipment. You show a total wellhead cost of
13 37,715?

14 A Well, an adjusted cost now of 39,433.

15 Q Let me get the right piece of paper here.
16 I don't know whether Mr. Stogner has this one or not.
17 Yesterday we were given a new front sheet which shows some
18 additional adjustments bringing the total cost to
19 1,106,052.35.

20 And off that we're supposed to take
21 another 190665?

22 A Yes, that's correct.

23 Q So we now have 39,433 in wellhead costs?

24 A In what costs were taken under the
25 wellhead category.

1 Q Would those be other than wellhead costs?

2 A Some of them are, yes.

3 Q What costs are not wellhead costs that
4 are under the wellhead category?

5 A Let's go to it.

6 Q Okay.

7 A The ARMCO --

8 Q Just a second, Mr. Cate, I'm not quite
9 with you yet. I'm still looking for the wellhead here.

10 Okay.

11 A Okay, I --

12 MR. STOGNER: What color tabs
13 are you under and what sides?

14 MS. AUBREY: Well, Mr. Stogner,
15 yellow.

16 MR. STOGNER: Yellow.

17 MS. AUBREY: On the right side.

18 MR. STOGNER: On the right side.

19 A No, it's under -- well, I don't know if
20 the tabs are all -- it will be the third category under the
21 completion side.

22 MR. STOGNER: Completion well-
23 head, and the first, or the second page is an ARMCO National
24 Supply Company voucher?

25 A Yes, yes. Yes, yes. Yes. Under Well-

1 head I've got a total of approximately \$22,400 which would
2 be correctly charged as wellhead equipment.

3 If you'd like to go down the whole list,
4 I'm willing to.

5 Q Well, I'm just -- I'm trying to under-
6 stand this. You say \$22,000 some odd was properly charged
7 to the wellhead category?

8 A Yes. If I -- if I was doing that, then I
9 would charge approximately 22,000 out of this category to
10 wellhead, which means there's approximately -- was approxi-
11 mately \$14,000, the majority which should have gone under
12 casinghead equipment, and then approximately -- approximate-
13 ly 3 -- \$3300 which I believe was really flow lines and
14 separation and treating equipment, so I would have taken it
15 under the production side under separation and treating.

16 Q Am I to understand that you did not pre-
17 pare this exhibit?

18 A That's correct. I didn't prepare the ex-
19 hibit (not understood) testimony last time.

20 Q Okay, this is a new exhibit we have to-
21 day.

22 A It was still generated by our Accounting
23 Department.

24 Q And did you review it for accuracy before
25 you gave it to -- to us and to the examiner?

1 A Yes, and it -- it reflects the Exhibit
2 Two that we submitted last time in which the examiner told
3 us to get all the invoices and back-up data which reflect
4 our numbers on Exhibit Two, which they do.

5 Q I believe you were also directed to place
6 the invoices and back-up data in certain categories. That
7 was the examiner's charge to you last time, that you separ-
8 ate them out so we could tell what was completion and what
9 was drilling.

10 A I don't remember it being that way. I
11 thought we were supposed to verify our exhibits that we pre-
12 sented.

13 Q So the order in which these invoices have
14 been placed in this blue folder is not necessarily the order
15 in which you personally would place them?

16 A That's correct.

17 Q For instance, the ARMCO invoice, the
18 first invoice under Wellhead --

19 A There's approximately ten sheets of ARMCO
20 that I would take to flow lines and separation and treating.

21 Q This first ARMCO invoice, the first set
22 of ARMCO invoices are all for the tank battery, are't they?

23 A And production equipment, surface,
24 separation and treating.

25 Q Not for the wellhead?

1 A No.

2 Q So your \$36,000 figure that you have on
3 your tape, let me make sure that we're all looking at the
4 same thing. I'm looking at a photocopy of the adding
5 machine tape that's the very first thing after the tab that
6 says Wellhead.

7 A Yes.

8 Q Okay, I want that 36,715.30 there, to
9 which you have added some material transfers in the amount
10 of 2718, is that right?

11 A That's correct.

12 Q For a total of 39,433.30.

13 A Yes, I think that's -- yes.

14 Q But you're telling us that only 22,000 of
15 the that original \$36,000 is properly attributable to the
16 wellhead?

17 A Yes.

18 Q Is there some reason that in preparing
19 the document which you handed out yesterday as a supplement
20 to this exhibit you didn't reflect the \$22,000 figure?

21 A Yes, because this was supposed to corres-
22 pond to our Exhibit Number Two that we presented last time.

23 Q I am correct, this does say Wellhead
24 Equipment, 39,433.

25 A That's correct.

1 Q We're supposed to take \$14,000, approxi-
2 mately, out of there to get the actual wellhead cost?

3 A Yeah.

4 Q What other categories have you performed
5 that kind of calculation for?

6 A Well, just about all of them. Again, I
7 believe it was your Exhibit Four, if I'm mistaken, that
8 caused all that. Bill had added up the invoices and came up
9 with different totals, using our categories, at this last
10 hearing, and the totals didn't jibe with what our exhibit
11 showed.

12 Q Because there were invoices missing from
13 your exhibit last time, weren't there?

14 A Yes, there were. I agreed it was not in
15 the best of shape.

16 Q And are there invoices missing from this
17 exhibit or are these all the invoices?

18 A These are all that's in. The totals all
19 add up to what our exhibit showed and we've got the back-up
20 on all itemized costs.

21 Q But from what you have given us we cannot
22 tell whether or not the costs are properly allocated between
23 categories.

24 A Oh, I think you can tell by what -- by
25 engineeringwise or whatever. No, they're not all in the

1 proper categories.

2 Accountingwise it really doesn't matter
3 from a total well cost point of view, and that is the way we
4 approached this whole thing, was from a total well cost.

5 Q All right, let's talk about the casing
6 prices. I think we agreed last time that it was TXO's prac-
7 tice to charge casing out of your warehouse at a price which
8 was in excess of the current market price, and that you
9 thought that was fair and reasonable.

10 A Yes, we agreed that it was also done un-
11 der COPAS guidelines which --

12 Q Do you have that COPAS guideline?

13 A No, I don't have the COPAS guideline.

14 Q Are you an expert in COPAS?

15 A No, I'm not.

16 Q You're not in the Accounting Department,
17 are you?

18 A No, I'm not.

19 Q You don't prepare joint operating agree-
20 ments, do you?

21 A No, I don't.

22 Q What do you know about the COPAS guide-
23 lines?

24 A I know the guidelines in which these
25 materials were transferred out at, and if you'd like, we can

1 get an accountant here which will tell you time and time
2 again that that is fair and reasonable.

3 Q Well, you're speculating on that, aren't
4 you, Mr. Cate? That's not your field of expertise.

5 A No, it's not my field of expertise.

6 Q Now I think we established last time that
7 you transferred your 13-3/8ths inch casing out of your ware-
8 house and charged it to the location at 24.71 a foot.

9 A That's correct.

10 Q And that you were carrying it on your in-
11 ventory at 19.48 a foot.

12 A Yes, that's correct.

13 Q Would you agree with me that that's a 23
14 percent mark-up to the joint account?

15 A If, yes, if the numbers are correct I'd
16 agree that's a mark-up, yes.

17 Q And is it still your testimony that
18 that's fair and reasonable?

19 A Yes. There also includes in that mark-up
20 tax, Texas tax of 4.125 percent. That's where it was pur-
21 chased. We've got storage and handling fees of approximate-
22 ly a quarter, 25 cents per foot on a per foot basis.

23 Q Okay, we've got tax. Let me ask you some
24 questions about tax.

25 Are you saying that you are, when you

1 take the material out of your warehouse and you transfer it
2 -- that you've already bought, I assume, because it's in
3 your warehouse, you've already paid for it.

4 A Yeah.

5 Q At whatever price.

6 A Correct.

7 Q Transfer it to your location for your
8 well.

9 A Correct.

10 Q Do you charge and report to the State of
11 Texas sales tax on that transaction?

12 A It is charged to the well. Now whether
13 it's reported to the State, I don't know.

14 Q Now what do you do when you transfer it
15 back, Mr. Cate? Do you dock the sales tax?

16 A No. It should go back at the same price
17 it came back -- came out at.

18 Q Well, do you charge tax on every time you
19 take something out of your warehouse on a material trans-
20 fer? Do you charge the joint account sales tax on that
21 transaction?

22 A It should be, yes.

23 Q Well, then, do you -- when you take that
24 back to the warehouse because you didn't need it, do you
25 credit sales tax back?

1 A It should be credited back. That's the
2 way I understand it.

3 Q And do you -- you don't know whether or
4 not the tax on these -- this moving around of this casing is
5 reported to the State of Texas?

6 A No, I don't.

7 Q Now you've got -- so we've got sales tax
8 on this transfer.

9 We've got storage and handling?

10 A Yes.

11 Q Okay, let's talk about storage. Who do
12 you pay storage to?

13 A Well, storage is covered under operating
14 expenses for the warehouse, for the yard, the maintenance
15 and all, and the accountants told me that approximately 25
16 cents a foot is a very good number.

17 Q My question was to whom do you pay it?

18 A I don't know that it's actually -- well,
19 I'm not sure. We've got several different warehouses which
20 I'm sure we're paying rentals, either a lease fee or that we
21 outright own. So either the payment is within the company
22 or it's to perhaps E. L. Farmer, but I'm not sure exactly
23 who the payments go to.

24 Q Is there an invoice in here for storage?

25 A No, there's not. That is included in

1 this mark-up reflected on these material transfers.

2 Q All right. You're telling me that we've
3 got 4 percent tax.

4 A 4.125.

5 Q And 25 cents a foot.

6 A Approximately.

7 Q Anything else in there?

8 A Well, if there -- oh, with -- particular-
9 ly on this 13-3/8ths?

10 Q Yeah, let's stay with that one for a
11 minute.

12 A No, there shouldn't be anything else in
13 there.

14 Q No handling charges?

15 A Well, that's included under storage and
16 handling.

17 If there was testing it would be included
18 in there. If there was additional freight or anything it
19 would be in there, but the freight are itemized as separate
20 invoices within this category.

21 Q Did you test the surface and intermediate
22 casing?

23 A We did not test the surface and interme-
24 diate casing third party-wise.

25 Q So there should be no invoice in here, or

1 charge to the joint account for doing that, is that correct?

2 A As far as I remember there shouldn't be.
3 There might be a hydrostatic test or something like that but
4 it should not be the full scan that we would do on
5 production equipment.

6 Q If I'm correct in this, Mr. Cate, I took
7 19.48 as your price out of your warehouse and the tax on
8 that, I believe, is approximately 80.35 cents, and I add 25
9 cents to that for our storage fee, that gives me approxi-
10 mately \$1.05 per foot. Do you follow me?

11 A \$1.05 per foot.

12 Q In addition to your 19.48 that you're
13 showing as TXO's cost for carrying cost on this casing.

14 A Yes.

15 Q So we've got 19.48 and we add \$1.05,
16 that's \$20.53 a foot.

17 A That's correct.

18 Q And you're charging Mr. Sprinkle 24.71.

19 A We're not charging him anything. We're
20 charging the well 24.71 a foot, yes.

21 Q What is the -- how do you account for the
22 difference between those prices?

23 A The difference is under COPAS guidelines
24 out of stock you're allowed to charge list price that you've
25 got right there, a list price of \$23.43. Then you add your

1 tax, your storage and handling. I came out with \$24.65. I
2 missed it by six cents.

3 Q Are we operating under a joint operating
4 agreement here? Am I missing something, Mr. Cate?

5 A No, you're not.

6 Q We're not operating under COPAS, are we?

7 A We, for this hearing, probably not, but
8 as the accounting was done, that's what I'm trying to explain
9 to you.

10 Q I'm trying to determine what the actual,
11 reasonable, just, and fair well costs are to Mr. Sprinkle in
12 this wellbore, and it appears from what your testimony is
13 that you want to base reasonable on a COPAS guideline, which
14 is not, as you know, inforcable, but something that's con-
15 tractually agreed between working interest owners under a
16 joint operating agreement.

17 A That's correct, and why should Mr. Sprin-
18 kle receive any more benefit than the partners that actually
19 put the money up in the first place?

20 Q Well, I'm not sure I want to enter into a
21 philosophical discussion with you, Mr. Cate, but I'll be
22 glad to tell you why.

23 The reason is that Mr. Sprinkle --

24 MR. DICKERSON: Mr. Examiner,
25 I'm going to object to Ms. Aubrey is either testifying her-

1 self or something, she's not asking a question, it doesn't
2 appear to me.

3 MR. STOGNER: I agree.

4 Q You will agree with me that we're
5 operating under a New Mexico Oil Conservation Division
6 forced pooling order.

7 A Yes.

8 Q And do you agree with me that the Oil
9 Conservation Division has the statutory duty to determine
10 what reasonable well costs are?

11 A Yes, if requested, that's correct.

12 Q So you're charging the well \$4.00 more a
13 foot for the 13-3/8ths than you are carrying it on your
14 books.

15 A No, on our books we are carrying the
16 24.71.

17 Q You're charging it out of the warehouse
18 to the location.

19 A That's correct.

20 Q At 19.48.

21 A That's correct.

22 Q You are collecting tax on that transac-
23 tion; you are charging 25 cents a foot storage on that tran-
24 saction; all of which add up to \$4.00 less than what you are
25 charging the well.

1 A That's correct.

2 Q And you have performed the same type of
3 accounting procedure with all the other casing in this
4 wellbore, isn't that correct?

5 A That's correct.

6 Q And every instance you are charging out
7 of your warehouse at one price and charging a higher price
8 to the well.

9 A There's one or two instances that we've
10 purchased some of the casing direct and those costs are
11 reflected in here.

12 Q I just want to talk about material
13 transfers for awhile.

14 A Okay.

15 Q In the case of all your material
16 transfers, whether it's for wellhead equipment or casing, or
17 any -- packers, for instance, in every instance you have
18 charged them to the well at a price in excess of what you
19 would charge them out of your warehouse.

20 A Packers? I don't -- I don't remember a
21 material transfer on packers right now but --

22 Q Well, what --

23 A -- if you're talking casing, the 13-
24 5/8ths, yes.

25 Q And all the other casing, not just the
13-5/8ths.

1 A On material transfers, yes, in general it
2 was charged out under COPAS guidelines.

3 Q At a price in excess of what you took it
4 out of your warehouse at.

5 A Correct.

6 Q And the Examiner can tell that by looking
7 at these material transfers in your exhibit and comparing
8 the difference between the "from" figure and the "to"
9 figure, is that right?

10 A Yes, with the addition of tax, handling,
11 any -- the 4-1/2 inch casing will also reflect anywhere from
12 \$1.23 to \$1.85 for inspection, testing, and drifting, which
13 is not reflected on the surface and intermediate pipe.

14 Q And to all of this we add freight, is
15 that correct?

16 A And the freight is covered separately un-
17 der these invoices within this exhibit.

18 Q Now, to get -- let me start that over.

19 Did you call Lone Star before you made
20 these material transfers to determine what the market price
21 of the casing was?

22 A No, I did not.

23 Q Have you inquired since we began this
24 reasonable well cost discussion from Lone Star as to what
25 their market prices were in the summer of 1985?

1 A As to what they were in the summer of
2 1985?

3 Q Yes, when the well was drilled.

4 A No, I haven't gone back and asked them.

5 Q Let me go quickly here through your in-
6 voices for the casing.

7 A Okay.

8 Q We have a material transfer, do you have
9 that as my third piece of paper?

10 A Yes, ma'am.

11 Q And that shows it transferred out of your
12 warehouse and back into your warehouse?

13 A No.

14 Q No?

15 A That shows a transfer from the well back
16 to our warehouse after we were done with the casing.

17 Q Do you charge freight on that?

18 A Yeah, I believe there's a freight charge
19 in here; a trucking charge to get it back to the warehouse.

20 Q If you bring out something you don't need
21 to the location, you charge the joint account for freight to
22 take it back, is that what you're saying?

23 A This is not casing that wasn't needed.
24 You always take a few extra joints of casing out there. You
25 don't -- you can never predict your exact TD, so it's better

1 to have a few extra joints. You might find some ones that
2 get damaged in the trucking or if you found yourself without
3 -- short on pipe, it could be a disaster.

4 Q Let me ask my question again.

5 If you bring something out to the loca-
6 tion from your warehouse that you don't need, do you charge
7 the joint account freight to take it back?

8 A I imagine that there would be a trucking
9 charge, yes.

10 Q Let me take you through your invoices to
11 a Matador Casing Service invoice.

12 A Approximately where is it?

13 Q Oh, it's about three -- two -- two more
14 pages past the material transfer we just talked about.

15 A Yes.

16 Q 3294, what, 30?

17 A Yes.

18 Q Is that a drilling cost?

19 A It's a completion cost.

20 Q Should not be in your drilling section of
21 your exhibit, is that correct?

22 A That's correct.

23 Q Should not be in your total drilling
24 cost, then.

25 A That's correct.

1 Q Do you know how much of your drilling
2 costs here, \$680,000, is attributable to freight?

3 A No, I haven't added that up.

4 Q The next to last invoice that I have for
5 your surface and intermediate casing is a Lone Star Steel
6 Company invoice.

7 A That's correct.

8 Q I cannot read my copy. Is your copy leg-
9 ible?

10 A It wasn't just terrific but I do have the
11 numbers.

12 MR. STOGNER: Where is that,
13 Ms. Aubrey?

14 MS. AUBREY: Mr. Stogner, it's
15 second from last in my set, the second page from the last in
16 that set of surface and intermediate casing.

17 A Under Pieces over there on the left, that
18 should reflect 8.

19 Q Okay.

20 A The quantity, 35860 -- 358.6.

21 Q Okay.

22 A The description of 13-3/8ths, 48 pound,
23 H-40 STC casing.

24 I had trouble with the weight also, but I
25 believe it's a 17213.

1 Q Okay.

2 A And FOB mill, which is from the mill, what
3 -- the price they're saying is 1869.67, I believe.

4 Q That's 1,869.67?

5 A No. Yeah, 1,869.

6 Under Amounts, a total of 6,704. Then
7 they add tax, the third line down, 251.42, and a total of --
8 they have a total of 6956.06, as the total cost. It re-
9 flects a note, handwritten note reflects that the Dallas
10 posted it as \$6,817, which corresponds to the -- in the mid-
11 dle of the page, it says, deduct \$139.42 cash discount if
12 paid by a certain date, which I believe is either 10 or 30
13 days, whatever.

14 Q If I divide 6187 by 358.6 feet, I get
15 19.01 a foot.

16 A Right.

17 Q Including tax.

18 A Okay.

19 Q That's for the same 13-3/8ths that you
20 were charging out at 24.71.

21 A That's not the identical pipe. The pipe
22 we charged out was six joints, if I'm remembering correct,
23 out of stock.

24 Yes, six joints that we transferred out
25 of stock, and this is a purchase of eight.

1 Q And is that what accounts for the differ-
2 ence between 19.01 and 24.71?

3 A Yes, and the other items that we discus-
4 sed earlier.

5 Q All right, we've got tax in the 19.01.
6 The only thing we don't have is 25 cent storage, because you
7 don't have to store it, I assume, when you buy it from Lone
8 Star.

9 A Correct.

10 Q So we're at 19.26, including tax and
11 storage, versus 24.71, including tax and storage.

12 A That's correct.

13 Q How do you account for the difference, Mr.
14 Cate?

15 A Like I explained before, it is accounted
16 out of stock under COPAS guidelines.

17 Q So you make a profit every time you
18 transfer something as a material transfer to a location.

19 A Not necessarily. I don't know that that
20 pipe hadn't been in our yard and was not bought at this
21 price. As pipe comes in, I don't know if we could find the
22 exact lot it came in; it's possible. But that's all I can
23 say, is that it's charged out under COPAS guidelines.

24 Q Well, Mr. Cate, last time we did this you
25 said that it is your practice --

1 A Well, it is.

2 Q Let me finish the question. It is your
3 practice to charge material transfers to the location at a
4 price in excess of what you carried them in your warehouse
5 at, and in excess of the price on the market.

6 Do you recall that discussion that we had
7 on January 22nd?

8 A Yes, I recall, and --

9 Q And I believe you testified that it was
10 an industry-wide practice to do that.

11 A I don't remember if I said that, but I --
12 it is accepted by industry, yes.

13 Q Would you use the same casing in a Bone
14 Springs completion?

15 A Yes, I believe so. You're talking sur-
16 face?

17 Q Surface and intermediate casing.

18 A Intermediate, it depends, if we set it at
19 the depth of 4800 foot again, no. If we set it at 2800
20 foot, which is normally what we've been doing out there, I
21 think we use a lesser grade of 8-5/8ths than was required
22 for this well.

23 Q The requirement was because you were
24 going to the Morrows, right?

25 A Yes, it was.

1 Q Have you made a calculation there on your
2 scratch pad about how much the surface and intermediate
3 casing would cost to the Bone Springs?

4 A No. I'm -- if I'm remembering, though, I
5 might have an old Bone Spring AFE if you --

6 Q Well, what I'm trying to get at, sir, is
7 that when we started this, you gave the Examiner a cost to
8 the Bone Springs of \$814,000 some odd?

9 A Oh, yes.

10 Q Is that correct?

11 A Uh-huh.

12 Q And in order to do that you must have al-
13 located some portion of the surface and intermediate casing
14 to the Bone Springs.

15 A I allocated 100 percent of it.

16 Q That's what I'm trying to get at. So
17 you're still saying 90,148.74 is fair and reasonable surface
18 and intermediate casing to the Bone Springs.

19 A Yes, uh-huh.

20 Q Notwithstanding that, you will agree with
21 me that you might have used a lesser quality if this were to
22 be a Bone Springs completion.

23 A But it was not.

24 Q Now we've already talked about the
25 drilling rate and you agree with me that 1425, and there-

1 abouts, is fair and reasonable for a Bone Springs well?

2 A Yes.

3 Q And that TXO is charging the joint ac-
4 count 24.50.

5 A That's correct.

6 Q And that your \$814,000 figure does not --
7 let me try that again, your \$814,000 figure includes 24.50.

8 A Yes, it's based 8700 foot times 24.50.

9 Q Even though that would not be the rate
10 that it would cost to drill a Bone Springs well.

11 A We didn't drill a Bone Springs well in
12 this case.

13 Q Well, the Commissioner's ruled that we
14 can talk about cost allocation. I'm trying to find out what
15 Bone Springs costs are. I just want it clear that that's
16 the number (not clearly understood).

17 A Well, we're talking about a Morrow well
18 as to what the actual costs were; not a Bone Spring well.

19 Q Let's move on down the list of invoices.
20 Let's go to Legal.

21 A To which one? I'm sorry.

22 Q Legal, under Drilling.

23 MS. AUBREY: Mr. Stogner, it is
24 the very last tab on the lefthand side in my set of docu-
25 ments.

1 MR. STOGNER: With the first
2 page showing the figure is 5,202.02?

3 MS. AUBREY: That is correct.

4 MR. STOGNER: Am I on the right
5 one, Mr. Cate?

6 A Yes.

7 MR. STOGNER: Okay.

8 A It would be the last item on the Drilling
9 side, left side.

10 Q Mr. Cate, you tape shows 5202.02?

11 A That's correct.

12 Q And what is this piece of paper that fol-
13 lows the copy of the adding machine tape?

14 A The piece of paper is the -- is off the
15 ledger for the well of what was charged to that category.
16 At the time it might take as much as a month or six weeks to
17 find all of this because it's input on a computer type thing
18 and we didn't have our access to it.

19 We could probably get it out of Dallas
20 but what it entails is permitting charges; title and ab-
21 stract work that was done; lawyers' fees and supports for
22 hearings on the Sprinkle No. 1.

23 Q You charged the joint account for the at-
24 torneys' fees for force pooling the -- this well?

25 A Certainly.

1 Q Is that in here?

2 A Certainly.

3 Q Which charge is that?

4 A Well, I'm not sure if it's -- which one
5 it is, or several of them. I'm not -- like I say, we didn't
6 have that exactly available, but --

7 Q Well, don't you get copies of bills from
8 your lawyer?

9 A Yes. I don't, but I'm sure we do, and
10 then on to Dallas, but I'm not sure which one was our law-
11 yer's fee.

12 Q You don't know what any of this 5000 is
13 for, do you?

14 A By item?

15 Q By item.

16 A No. I don't know by item but I know what
17 charges would have gone in there.

18 Q And you know, and you've testified that
19 you did not put this exhibit together, is that correct?

20 A That's correct.

21 Q You did not make the decision to code
22 whatever this \$5200 charge is to legal.

23 A That's correct.

24 Q So you don't know what any of this is,
25 whether it's properly under legal or not.

1 A Correct.

2 Q And you don't know of your own knowledge
3 whether it's even properly chargeable to the joint account.

4 A No, but I do know there are legal fees
5 associated with this well and I have not seen any other in-
6 voices in any other categories that should have come under
7 Legal, so we know the money was spent but I don't -- didn't
8 see anything else over here that was Legal.

9 Q And you --

10 A Certainly some of them are correct, if not
11 most all of them.

12 Q Well, that's a supposition on your part,
13 there, isn't it?

14 A Yes, it is.

15 Q Mr. Cate, you've talked about what your
16 impression of fair and reasonable is this morning. Is it
17 your impression and understanding that it's fair and reason-
18 able to force pool a man and then charge him legal fees to
19 do it?

20 A We didn't charge him any fees. We are
21 charging the well under which our partners will share these
22 costs and it is not only fair but it is required that we
23 charge our partners the cost associated with this well.

24 Q Is Mr. Sprinkle your partner?

25 A No, he is not.

1 Q Is he being charged for any legal fees to
2 force pool him?

3 A Not directly.

4 Q Therefore you're putting them in the well
5 costs, aren't you?

6 A They were associated costs with drilling
7 the well.

8 Q Just trying to find out what you're
9 doing, Mr. Cates. They're in here. Is that correct?

10 A That's correct.

11 Q And you intend to apply Mr. Sprinkle's
12 proportionate share of the well costs and include in that
13 the legal costs.

14 A I would imagine so.

15 Q Under your Drilling category, are there
16 any costs which you would take out completely if this were a
17 Bone Springs well?

18 A Yes.

19 Q Would you tell me what those are?

20 A You mean in general or invoice by in-
21 voice?

22 Q Why don't we start with in general and
23 then we'll go back to the invoices?

24 A On the drilling side for, as the exhibit
25 is, okay, is prepared, I would take out any cost, number

1 one, should have been categorized as completion or produc-
2 tion equipment, plus any cost directly related to the drill-
3 ing past 8700 foot would be taken out, and that would ac-
4 count for any Wolfcamp -- well, just below Bone Springs TD,
5 I would take out.

6 Q You'd take out drilling costs below 8700
7 feet, roughly.

8 A Uh-huh.

9 Q Anything else?

10 A No, just what should have been categor-
11 ized, perhap, in completion.

12 Q What about mud and chemicals?

13 A You're going ot have mud and chemical
14 cost, and the way I approached that was -- also water is un-
15 der that category -- any water that was delivered prior to
16 8700 foot I took to the Bone Spring; when it was delivered
17 after 8700 foot -- I believe that we cut -- we cut 8700 foot
18 on June 1st, if my memory serves me right, and so any char-
19 ges after June 1st I deleted from the Bone Spring costs.

20 Q And what is your drilling cost to the
21 Morrow? I'm sorry, to the Bone Springs?

22 A The total, based on the invoices in this
23 drilling side of the packet, which now I did not make cor-
24 rections for mis-categorized stuff because then in going
25 over to the completion side, if you find things over in

1 drilling that should be Bone Spring I (not clearly under-
2 stood).

3 So, on my drilling side as the invoices
4 in this exhibit, I had a total of \$455,331.

5 MR. STOGNER: Repeat that.

6 A \$455,331.

7 MR. STOGNER: Thank you.

8 Let's recess for about ten or
9 fifteen minutes.

10

11 (Thereupon a recess was taken.)

12

13 MR. STOGNER: Ms. Aubrey.

14 Q Mr. Cate, the next category I'd like to
15 talk about is the production casing.

16 A Okay.

17 Q Mr. Cate, on the production casing was
18 all the production casing out of your warehouse as a mater-
19 ial transfer?

20 A I believe all the casing that we used
21 was. I honestly can't remember if we bought a few joints or
22 not. I think it was all out of storage, though.

23 Q So your \$117,155.42 figure is for mater-
24 ial -- casing -- casing transferred out as a material trans-
25 fer.

1 A Well, and then the associated testing and
2 what other invoices -- from what I can tell here there were
3 not any invoices that should not have been in here, although
4 there should have been some additional costs; for example,
5 the 4-1/2 inch casing crew invoice that you referred to
6 earlier in the drilling category, it should have been over
7 here; a labor cost associated with running the pipe in the
8 hole.

9 Q My first invoice in my exhibit, your
10 Exhibit Three, is a material transfer order for 166 joints
11 of 4-1/2 inch N-80 casing. Do we have the same document?

12 A Yes, ma'am.

13 Q And this document shows it from your yard
14 at a book value of \$49,350?

15 A Yes.

16 Q And to the location at a book value of
17 \$70,032?

18 A That's correct.

19 Q Would you agree with me that you're taking
20 it out of your inventory at 6.74 a foot, charging it to the
21 location at 9.56 a foot?

22 A 9.50 --

23 Q 6 a foot.

24 A Yes, ma'am.

25 Q That does not include freight, does it?

1 A No, it does not.

2 Q Would you agree with me that that's ap-
3 proximately a 42 percent mark-up from your warehouse to the
4 location?

5 A Yes.

6 Q My next document, Mr. Cate, is the credit
7 memo, which I believe we saw earlier under surface and in-
8 termediate casing.

9 A May I expound, please, on this first mat-
10 erial transfer?

11 Q Well, if you want to expound you'll have
12 the opportunity when Mr. Dickerson asks the questions.

13 Is your next document the credit memo we
14 have discussed previously?

15 A Yes.

16 Q The next one I have is a freight charge.

17 A Yes, ma'am.

18 Q It appears to be hauling the 4-1/2 inch
19 production casing out to the location.

20 A Yes, ma'am.

21 Q A distance of 580 miles.

22 A That's correct.

23 Q Where is the yard or the warehouse which
24 this came from?

25 A It's in Lone Star, Texas.

1 Q Does TXO have any warehouses or yards in
2 the State of New Mexico?

3 A I believe that there may be an E. L. Far-
4 mer Yard. I'm not sure if it's Carlsbad or Hobbs. I think
5 we might have one. I know we've got an E. L. Farmer yard in
6 Odessa, Texas, but I'm not sure if we've got one here in New
7 Mexico.

8 Q Where is Lone Star, Texas?

9 A Well, it's East Texas.

10 Q Do you know whether or not TXO has a yard
11 or a warehouse from which you could have acquired this cas-
12 ing that was closer to the well loc^ation than Lone Star,
13 Texas?

14 A I don't know that for sure. I imagine
15 that if the required casing was not any closer, then that's
16 where we had to go. If it was closer I'm pretty sure we
17 would have sent it out of, perhaps, the yard in Dallas might
18 have been closer.

19 Q Can you buy this casing in the State of
20 New Mexico?

21 A Yes, you can buy this casing in the State
22 of New Mexico.

23 I believe there's a -- now, I've got
24 something that shows all the distributor -- authorized dis-
25 tributors. I can look and see if there is one in New Mex-

1 | ico.

2 Q I don't think you need to do that, Mr.
3 Cate.

4 The invoice that I have is hauling some
5 of it back to Lone Star, Texas.

6 A Yes, ma'am.

7 Q So between these two invoices we've got
8 \$5300 or so of freight charges.

9 A Yes, ma'am.

10 Q Next invoice I have appears to be another
11 Farmer invoice.

12 A That's just the lading -- the lading bill
13 corresponding to the previous invoice; just a back-up show-
14 ing that it was hauled. It's a lading, bill of lading.

15 Q Let me ask you where McCamey, Texas, is,
16 do you know?

17 A Yes. McCamey, Texas, is, oh, approxi-
18 mately 100 miles south of Odessa, I believe.

19 Q West Texas.

20 A Yes, West Texas, Southwest Texas.

21 Q The next invoice I have after that bill
22 of lading shows that TXO hauled miscellaneous casing from
23 Sprinkle No. 1 to the McCamey yard.

24 A That's correct.

25 Q Do you know whether or not that casing

1 was available in the first instance from the McCamey yard as
2 opposed to the Lone Star yard?

3 A Yes, I do know that. Our procedure is
4 that if we have the casing in the McCamey yard we'll trans-
5 fer it out from there. It was not there and so we had to
6 get it from our Dallas office.

7 Q You're assuming it was not there.

8 A I will -- I'm sure it was not there be-
9 cause that is the procedure.

10 Q But you don't know about this particular
11 casing. You weren't there.

12 A No, I wasn't.

13 Q Now, have you allocated the casing cost
14 between the Bone Springs and the Morrow?

15 A For the 4-1/2 inch.

16 Q For the 4-1/2.

17 A Yes, I have.

18 Q And what difference is there in this?

19 A I used 100 percent of the N-80 and added
20 1500 foot, should have been 1400 foot, of the S-95; used our
21 numbers off our material transfers and arrived at the casing
22 cost.

23 Q What is that?

24 A Well, including all the freight charges
25 that would have bene required, anyways, and the other in

1 voices associated with that, \$90,182.

2 Q Can you, for my own information, give me
3 a footage difference? Do you need less of it for a Bone
4 Springs well?

5 A Yes. Yes.

6 Q Can we talk about it, if we can, from
7 what you have in front of you, sir, in feet?

8 A Yes.

9 Q How many feet?

10 A Okay, it should be 7322.5 foot of the 4-
11 1/2 inch N-80 and -- let me find that material transfer --
12 the N-80 was at \$9.56 a foot.

13 Q Okay. Let me see if I'm with you here.
14 Yeah, that's the very first invoice under production casing.

15 A Yes.

16 Q Okay. Then you have some S-95.

17 A Yes, and then I used -- I used 1500 foot
18 of the S-95, which I believe is \$12.26 a foot that we char-
19 ged it out.

20 Q You charged it out at 12.26?

21 A I believe so. That's what's reflected on
22 the material transfer for the S-95.

23 Q And it was being carried in your inven-
24 tory at \$10.10.

25 A Yes, that's correct. It does not include

1 the testing services, handling, tax.

2 Q Is there an invoice in here for testing?

3 A No, there is not.

4 Q How much did you spend for testing?

5 A On which casing? On the S-95 or the N-
6 80?

7 Q Either one.

8 A Okay. On the -- on the S-95, approxi-
9 mately \$1.85 a foot and on the N-80, \$1.23 per foot.

10 Q Where do we get that number from our ex-
11 hibit, Mr. Cate?

12 A We didn't get that number from our exhi-
13 bit.

14 Q Where are you getting that number, then?

15 A I got it from our accountants in Dallas.

16 Q Is that simply, then, added into the pro-
17 duction -- production casing number of 17,155.42 without an
18 invoice to back it up?

19 A That is reflected in the difference on
20 our material transfer between -- from what it went out of
21 stock at to what it came to the well at.

22 Q A dollar something.

23 A \$1.23 or \$1.85, and I've got some prices,
24 lists on other casing and all. I can tell you what each of
25 the testing items cost. There are several things that are

1 done, hydrostatic testing, if you wish.

2 Q I'd rather have you explain to me what
3 the invoice means where it says TXO Roman Numeral III
4 inspected.

5 A Which one are we on?

6 Q I'm looking at the 4-1/2 inch S-95 casing
7 material transfer.

8 A The Roman Numeral III inspected is our
9 code which tells what was done. I mean it's just a code,
10 which it should have included the hydrostatic testing to at
11 least 80 percent of the minimum burst yield plus a magnet --
12 I'm trying to remember what that is, but it's an electromag-
13 netic flux machine that checks the wall thickness and finds
14 defects -- defects in the pipe, plus the joint end inspec-
15 tion, the threads inspection.

16 Q So that tells you that it's been tested
17 and inspected.

18 A Yes.

19 Q Okay, and it shows you tested and inspec-
20 ted coming out of the warehouse and tested and inspected
21 coming to the location, is that right?

22 A That's what it appears, but I can't -- I
23 don't think that it would have been inspected twice like
24 that.

25 Q That's what your exhibit shows, is that

1 right?

2 A Well, that's what it shows, yes.

3 Q And in fact from your exhibit it appears
4 that you have charged your testing charge twice on this cas-
5 ing.

6 A No, I don't think that that -- I don't
7 think that's necessarily the cases. I couldn't deduct -- I
8 mean I wouldn't necessarily deduct that. You're implying
9 the \$10.10 already includes, but I don't believe that's cor-
10 rect.

11 Q All I'm saying, Mr. Cate, is that your
12 exhibit shows the casing coming from your warehouse with the
13 legend TXO Roman Numeral III Inspected at \$10.10.

14 A Yes, but you've got to understand that at
15 the time this pipe is sent out of warehouse, it's already
16 been third party inspected, so now the description of that
17 pipe will reflect that.

18 Q So it gets inspected again at the loca-
19 tion?

20 A No. No, it's only inspected once, but
21 it's inspected between the time this book value of 62-what-
22 ever, \$62,638, it's inspected between the time it's bought
23 at that price and the time it's transferred out to the well.

24 Q Who's this third party to inspect?

25 A Oh, tuboscope (sic) plus -- let me get

1 that.

2 AMF Tuboscope is someone we commonly use.
3 Associated Oilfield Consulting Services, East Texas Pipe
4 Service, and that's another AMF Tuboscope.

5 Q Are those invoices from this well that
6 you're looking at?

7 A Some of them are and some of them aren't.

8 Q There are no inspection invoices, how-
9 ever, in the set which the Examiner has, is that correct?

10 A That's correct.

11 Q Is there -- what's the reason for that?

12 A Well, it was -- I'm not sure there's a
13 good reason. Some of these charges were in lots of 20,000
14 foot of pipe and don't actually reflect the 166 joints; some
15 do.

16 There's no reason for it not to be there
17 or for it to be there.

18 Q Well, wouldn't the reason for it to be
19 there so that we can verify the inspection costs?

20 A Yes.

21 Q Let me take you to your last piece of pa-
22 per under Production Casing.

23 A Uh-huh.

24 Q Or at least my last piece of paper under
25 Production Casing. It appears to be a sheet of paper with

1 one line of printing on it.

2 A It is.

3 Q And it appears to have the figure of
4 \$884.00.

5 A That's a credit; it's got a minus behind
6 it.

7 Q And what is that for?

8 A If you go to the sheet before that, it's
9 on the material transfer, the very bottom line says two
10 joints of N-80 from 90 foot at \$884.00 charged. Probably
11 didn't get shipped like that it was a mistake, so this is
12 just a -- that is a credit back for that -- those two
13 joints.

14 Q And that's for the N-80?

15 A Yes, ma'am.

16 Q Okay. Now let's go back to your first
17 material transfer on the N-80 4-1/2 inch, okay, you charged
18 to the location at 9.56 and carried your book value at 670
19 -- wait, I'm sorry, 6.74, and if I'm dividing correctly,
20 you're crediting it back at \$9.82 a foot?

21 A That's the way it looks, uh-huh, but that
22 really doesn't matter. The total price was identical; I
23 mean what was added was taken right off and perhaps that's
24 the reason. I don't know what the exact reason for the
25 charge and the credit was.

1 Q But they're different footage rates there
2 --
3 A Yes.
4 Q -- for the same pipe.
5 A Yes.
6 Q All right, let's go to the next set of
7 documents, and frankly, I believe at this point my exhibit
8 gets out of order with yours. It was certainly out of order
9 with Mr. McCoy's, so if I'm talking about a piece of paper
10 that you don't have in front of you, tell me, and we'll see
11 if we can find it.
12 A Okay.
13 Q My next invoice is for \$370.
14 A Which category are we in?
15 Q The next category, this is Tubing.
16 A Tubing, okay. The first one I show is a
17 material -- no, that isn't it, that's not the right one.
18 Q It's right behind the photocopy of the
19 adding machine tape in my exhibit.
20 A Yes, okay, \$340?
21 Q Right.
22 MR. STOGNER: I'm sorry, \$300
23 and what?
24 MS. AUBREY: \$340.70.
25 MR. STOGNER: And this is Trey

1 Trucks?

2 MS. AUBREY: That's right.

3 MR. STOGNER: Okay.

4 Q The invoice appears to be dated November
5 3rd of '85.

6 A Correct.

7 Q For work done 10-23 and 10-31 '85.

8 A Yeah.

9 Q Can you tell me what that's for?

10 A It's to haul the tubing that was not used
11 -- well, let's see -- maybe I'm not sure.

12 Well, it appears it's loading and fork-
13 lift charges on the -- taking some tubing to the TXO yard in
14 McCamey, but it does not say where it's from.

15 Q Do you know when this well was completed
16 in the Bone Springs and began Bone Springs production?

17 A Approximately August, about the first of
18 August, I believe.

19 I'll agree that's probably a mistake --
20 mistake in the invoice.

21 Q In the sense that it belongs to some
22 other well?

23 A Yeah, I think, if I remember right, I'm
24 thinking now it really belongs to the Sprinkle Federal No. 2
25 because we did swop out our tubing on that well.

1 Q It does say, though, here on the front of
2 it, Sprinkle Federal No. 1.

3 A Well, yes, it does.

4 Q Yes. Now I don't have in my set a tubing
5 invoice. Mr. McCoy has one in his but I don't have that in
6 front of me.

7 Can we -- do you have one in your set?

8 A Yes. It should be the last item, and you
9 didn't get a copy?

10 Q There is not one in the set that I have.
11 I believe Mr. McCoy found his under some other category and
12 I just want to make sure the examiner is able to find a tub-
13 ing invoice in this set of documents.

14 A It should be the last invoice in the cat-
15 egory.

16 MR. STOGNER: Okay, I have --
17 the last invoice I have under Tubing category is from Vin-
18 son, V-I-N-S- --

19 A Yes, that's correct.

20 MR. STOGNER: (Not understood)
21 Company?

22 A Uh-huh.

23 MR. STOGNER: And that's for a
24 charge of 39,795 and 12.

25 Are we all looking at the same

1 thing?

2 Q I think we are.

3 A Yes.

4 Q Does Nippon tubing mean Japanese tubing --

5 A Yes, it does.

6 Q -- Mr. Cate? Do you recall telling me on
7 the 22nd of January that there was something wrong with us-
8 ing Japanese tubing in this well?

9 A I said some Japanese casing is what we
10 were discussing at the time.

11 Q Okay. And you bought this new.

12 A Yes.

13 Q So we don't have to look at material
14 transfers on the tubing.

15 A Correct.

16 Q Would you make any adjustment in the tub-
17 ing dollar amount for footage between a Bone Springs well
18 and a Morrow?

19 A Footagewise, yes. It should only take
20 approximately 80 -- 8900 foot out, probably, about 200 foot
21 more than TD, to take care of any bad joints.

22 Q And have you -- do you have a number
23 there in terms of the cost allocation to the Bone Springs?

24 A From this whole tubing category, yes, I
25 gave \$34,928 to tubing.

1 Q In the Bone Springs?

2 A Just for the Bone Spring, yes.

3 Q But you've only got 34,927.99 for the
4 whole well.

5 A Well, all I did was take the cost of what
6 we bought it for and take, you know, 8900 foot out there,
7 but there's been some transferred back, which checking there
8 will be 200 foot or so transferred back.

9 Again I see the difference, I think. It
10 appears that on our material transfer from the well back to
11 the yard, we actually charged the tubing out at about 40
12 cents or 50 cents a foot higher than we paid for it, so
13 that's a credit in your favor this time.

14 Q On your compilation, all of the new ad-
15 justments that you gave all of us yesterday --

16 A Yes.

17 Q -- you showed 34,927.99 for tubing, is
18 that correct?

19 A Correct.

20 Q And your figure to me now attributable
21 only to the Bone Springs is 34,928. Did I hear you cor-
22 rectly?

23 A Sounds like it's exactly what it should
24 be.

25 Q So you are saying that there is no dif-

1 ference in the tubing price between the Morrow and the Bone
2 Spring.

3 A No. This tubing price reflects all the
4 transfers of the tubing back out of -- from the well, from
5 the time we took it out to test zones deeper than the Bone
6 Spring. Right now we've only got a Bone Spring equivalent
7 of tubing in the hole, so that price ought to be identical.
8 That's why it is.

9 Q Let me ask you this. Would you use N-80
10 tubing --

11 A Yes.

12 Q -- for a Bone Spring completion?

13 A That -- that depth is right about at the
14 point that we like to change over to N-80.

15 Q What is Bone -- what is the grade of tub-
16 ing that you would use at a shallower depth?

17 A Oh, it goes to a J-55 at a shallow depth.

18 Q That's a judgment call, isn't it?

19 A Yes, and there's design aspects and, you
20 know, experience, and all, but we like to get the higher
21 grade for our string of tubing in there in case also we have
22 to frac it, which we fraced several -- well, I believe two
23 of them down tubing, and J-55 will not withstand the pres-
24 sures of the fracs, frac -- propped frac jobs.

25 Q I don't want to take you through all of

1 these, Mr. Cate, but let me have you move on down to -- let
2 me find where I am first.

3 I'm in the Wellhead section, and in this
4 section I have counted invoices for 8 gate valves.

5 A That's -- are you transferring any of
6 them back? I think we've got a material transfer of at
7 least one of those gate valves back.

8 Q How many gate valves are required?

9 A For a Morrow gas well, high pressure.

10 Q Well, let's talk about that first, how
11 many.

12 A Okay, as many as seven or eight, it could
13 be. It depends on the pressure that you anticipate.

14 Q How about for a Bone Springs oil well?

15 A Probably a maximum of four is all that
16 would be required, and maybe just three. It depends, of
17 course, upon pressures.

18 Q Do you know whether or not you have
19 transferred five of the eight back to the warehouse?

20 A I believe that we have and, of course,
21 that will not be reflected here.

22 We completed another well where we did
23 need higher pressure equipment, and since it was not re-
24 quired for this Bone Spring oil producer, we did transfer
25 it, and I've discussed that with Bill, I believe.

1 Q But from what the examiner has, can he
2 tell whether or not the joint account has been credited for
3 five of the eight?

4 A No, it has not been credited.

5 Q Let me -- I must have misunderstood you.
6 A charge to the joint account for eight gate valves?

7 A Yes, they were actually used.

8 Q But they were taken off the well and
9 taken some place else?

10 A Subsequent to all this; subsequent to the
11 time that the Commission required us to put this cost allo-
12 cation -- well, whatever it is, the cost basis for our well
13 together, those valves were on the well.

14 Q They are no longer on the well, is that
15 correct?

16 A That's correct, and that will be reflec-
17 ted in a material transfer that will show the deduction to
18 the well, just like any other thing, after I believe it was
19 what, September, I mean October 31st is the date that this
20 was supposed to be prepared?

21 Q And this well was never, ever, completed
22 in the Morrow, is that right?

23 A That is true.

24 Q This well never produced gas.

25 A That's true.

1 Q You didn't need those eight gate valves
2 from the beginning.

3 A Not necessarily. We did test the Wolf-
4 camp, which in the area can be gas and it can be oil.

5 Q You tested the Wolfcamp, it was nonpro-
6 ductive, the well was not completed in the Wolfcamp, and you
7 came back up the hole to Bone Springs.

8 A That's true.

9 Q And by August 1st the well was producing
10 in the Bone Springs and it was producing oil.

11 A That's correct.

12 Q And you have not yet given the joint ac-
13 count for the Sprinkle No. 1 credit for those gate valves
14 you took off the well.

15 A They were not taken off the well probably
16 till, I'm going to say, a month ago, maybe less, three weeks
17 ago.

18 Q Is there anything else that you've got
19 out there that you don't need to produce an oil well?

20 A I don't believe so. I think that's going
21 to be everything else surface-wise, anyway, that's going to
22 be required.

23 Q Let me have you look now at what I have
24 as my last piece of paper under Wellhead. It is an invoice
25 from ERC Equipment Renewal Company.

1 A Uh-huh.

2 Q Do you have that, sir?

3 A Yes, I do.

4 Q Is it marked out with X's, my copy is.

5 A Yes.

6 Q And it's for some gate valves, a flange
7 adapter, and a casinghead.

8 A Well, yes.

9 Q That's what it shows on this piece of pa-
10 per.

11 A But those were transferred to different
12 wells.

13 MS. AUBREY: Do you have that,
14 Mr. Stogner?

15 MR. STOGNER: That is the -- I
16 show that as being the last exhibit under Wellhead?

17 MS. AUBREY: Yes, I think we're
18 all looking at the same paper.

19 Q Would you look up at the top and tell me
20 what the date of that is?

21 A It's 5-29-84.

22 Q A year before this well was spudded.

23 A Yes.

24 Q Why is it in your stack of invoices for
25 the Sprinkle No. 1?

1 A Probably because it was attached to some
2 other description and it probably shouldn't even be in
3 there. I don't think that a cost is reflected if it's
4 scratched out. It must just be an extra piece of paper that
5 shouldn't be there.

6 Q Let me have you go to the piece of paper
7 right before that, which is another invoice from ERC,
8 material and services per receiving report, R-6582, at-
9 tached, 519.65.

10 Do you have that piece of paper?

11 A Yes, I do.

12 Q If you will look at the paper behind it,
13 which we just discussed, it shows Order R-6582 at the top,
14 does it not?

15 A Yes, it does.

16 Q Do you have an opinion as to whether or
17 not this charge reflected on -- of 519.65 was included in
18 your well costs for the Sprinkle No. 1 Well?

19 A Yes, it was, if that's the \$417 -- yeah,
20 they might have just used the old receipt if accounting
21 couldn't find the new one; maybe they used the old one to
22 show as back up to what the charge was.

23 Q Well, but this could not possibly be for
24 the Sprinkle No. 1 Well.

25 A Well, maybe the date is not correct on

1 this. I don't know. There are -- there's always that pos-
2 sibility.

3 Q Let me have you look at the third line in
4 the line portion of the exhibit -- of the document. There's
5 -- let me read down for you -- valve gauge, and then SNIA
6 61457. And then the next line is handwritten to 7-2-84. Do
7 you see that on your copy?

8 A Yes.

9 Q Mr. Cate, I'm still in Wellhead and I'm
10 looking at two material transfers, one dated 7-15-85 and one
11 dated 5-20-85.

12 A The -- what's the item that's being re-
13 ferred to?

14 Q Gate valve, McEvoy.

15 A Okay, I guess --

16 Q What I think --

17 A I guess it's the first material transfer?

18 Q I believe so, sir, yes.

19 A Okay.

20 Q Now, does this piece of paper show that
21 it's being transferred -- let me strike that.

22 What does this -- what does this show? I
23 can't figure it out.

24 A It shows it being transferred from the
25 well to the ERC yard in Odessa.

1 Q Okay, and let me have you go down about
2 halfway through your documents to the 7-10-85 material
3 transfer.

4 A Okay.

5 Q And that's where I assume it came from
6 the warehouse to the location?

7 A Yes, ma'am.

8 Q And is that one the eight gate valves
9 we've been talking about?

10 A I believe it's the one that was transfer-
11 red back off the well. It's -- yeah, it's identical
12 description and the serial number is identical.

13 Q So that would lead you to conclude, would
14 it, that there -- after that transfer was made that there
15 were seven -- seven gate valves on the well.

16 A I believe that's correct.

17 Q Would you look at your tape at the begin-
18 ning of the Wellhead section and see if you can tell where
19 the credit for that piece of equipment going back to the
20 warehouse is?

21 Never mind, sir, I found it. I didn't
22 see that before.

23 Now, have you changed your supervision
24 numbers at all, Mr. Cate?

25 A For what, a Bone Spring test, or for

1 what?

2 Q Well, completion and supervision.

3 A Completion and supervision.

4 Q Okay, I'm looking at your compilation
5 here where you show 13182.33 for supervision.

6 A Correct. No, I haven't changed --
7 haven't changed that.

8 Q And is that -- how do you calculate that
9 dollar amount?

10 A Okay, that dollar amount is the summation
11 of our drilling foreman wages, I guess, plus his time, his
12 mileage, his -- any expenses he may incur related to that
13 well, plus first line supervision, which could be our drill-
14 ing superintendent, if he makes a trip to the well; any en-
15 gineers, any geologists that went out there.

16 I think that is what those supervision
17 charges are going to be.

18 Q Do you have an opinion, Mr. Cate, as to
19 whether or not under the forced pooling order you are per-
20 mitted to charge out your wages for your employees for
21 supervising and completion of a well in addition to your
22 completion overhead?

23 A No, I'm not sure on that one.

24 Q I see also from looking at this that you
25 have charged out supervision for drilling in addition to

1 your drilling overhead, is that correct?

2 A Correct.

3 Q And that you have -- have you charged out
4 any -- have you charged installation overhead? Have you
5 charged any supervision for that down under the Production
6 section?

7 A No, not there.

8 Q Just under completion and drilling?

9 A Uh-huh.

10 See, the overhead, as I understand it,
11 anyway, is to cover the levels above your first line super-
12 vision, which is engineers salaries and accounting, paper-
13 work, and general overhead like that.

14 Supervision is just additional costs that
15 we personally took and went out there. I mean that's just
16 direct charge for time, mileage, expenses.

17 Q Wages, you said.

18 A Well, I say wages, I mean for the time
19 they spent there's a formula they're going to calculate his
20 hourly basis and put it on there. I'm sure that's looking
21 at it as a wage, I guess.

22 Q Let me have you look at your supporting
23 document for that charge, that supervision, production --
24 completion supervision charge, the 13182.33. You've got
25 some names here, some men's names, are these folks regular

1 employees of TXO?

2 A Yes, they are.

3 Q Are they paid a regular wage by TXO?

4 A Yes, they are.

5 Q Are they paid only for the hours they
6 work on this well or are they paid on a monthly salary basis?
7 is?

8 A They are paid a monthly salary.

9 Q Are the costs that you have here a portion
10 of that monthly salary or is this additional compensation
11 from TXO to these men?

12 A No, it's not additional compensation.
13 Again, it is a counting procedure that is allowed on -- over
14 the guidelines of when you spend, any of your people spend
15 time solely on that well, then they are allowed to charge
16 their time and their mileage and any other services that
17 were particularly for that well.

18 Q Are we operating under COPAS?

19 A No.

20 Q Do you have anything in this Exhibit Number
21 Three to show what these charges are for or when they
22 were incurred?

23 A No, I don't.

24 Q Do these numbers, there's a whole series
25 of numbers to the lefthand sides of the gentlemen's names,

1 do those numbers mean anything to you?

2 A They're -- they really don't mean a lot
3 to me, no. All I believe is that for 85 that means 1985 is
4 when they were incurred.

5 Q I tried real hard to figure a date for
6 many of these numbers and I couldn't do it. If there's a
7 way to do that, I'd appreciate it if you'd tell me.

8 A No, I don't think there's a date and what
9 I did on this, I took the number of days that we were on the
10 completion and on our AFE there's an average of -- we esti-
11 mate an average of \$250 a day should take care of the com-
12 pletion supervision.

13 Q \$250 a day?

14 A Correct.

15 Q And how many days for completion?

16 A I believe it was 35 that we were on there.

17 Q And that comes out to 4,759. I'm sorry, I
18 just multiplied 250 times 35. I may have done it incor-
19 rectly.

20 A 8,750. But that's generally first --
21 first line, and that again was just an estimate.

22 Lane Griffing, as you'll see there, Grif-
23 fing/Lane, it's backwards, his name's really Lane Griffing,
24 he was the production engineer and he went out there for
25 production operations.

1 Q Did he get paid by you those days, any-
2 way?

3 A Get paid by --

4 Q By TXO anyway?

5 A Well, yes.

6 Q You didn't pay him any more money to go
7 out to the location.

8 A No, that's part of his job.

9 Q Now we didn't go through this for Dril-
10 ling but you did the same thing under your drilling supervi-
11 sion, I assume.

12 A That's correct.

13 Q Charged your employees' time off against
14 the joint account.

15 A That's correct.

16 Q Do you want to reduce this number at all
17 for a Bone Springs well?

18 A Yeah, just going on the basis of \$250 a
19 day, I came up with completion supervision approximately
20 \$6000 for this particular well because we did spend a lot of
21 time on the Bone Spring completion; not for a Bone Spring
22 well, for this particular Bone Spring well.

23 Q Do you want to reduce the drilling super-
24 vision at all for a Bone Spring well?

25 A For this particular cost allocation to

1 the Bone Spring, I would give it approximately 50 -- I mean
2 \$5,250; it's approximately 22 days for drilling operations
3 for a Bone Spring well and on day 21 we had cut 8700 foot,
4 which is the depth at which the Bone Spring is.

5 Q Do you know what the order you're oper-
6 ating under permits you to charge for supervision?

7 A No, I'm not sure.

8 Q Have you reviewed the forced pooling or-
9 der in this case to see what the Oil Conservation Division
10 has told you you may charge for supervision?

11 A I reviewed it but I -- just on the over-
12 head. I didn't check on the supervision.

13 Q Mr. Cates -- Cate, is it your intention
14 to prepare an exhibit for the examiner which shows TXO's es-
15 timate of reasonable well costs to the Bone Springs in this
16 wellbore?

17 A Yes, we -- we can do that if requested.
18 All I did last night was jot a few numbers down just in case
19 we did discuss the allocation. But right now I do not have
20 an exhibit.

21 Q Do you have all the invoices in for the
22 well, do you think?

23 A Again, as we stated before, the great ma-
24 jority should be here. There may be a few stragglers, some
25 that get lost in accounting, that happens. 99 percent

1 should be here.

2 Q So you should be in a position to give
3 the examiner some sort of estimate on behalf of TXO as to
4 what it would cost to drill and complete a Bone Springs
5 well.

6 A We're not talking that. We are talking
7 the cost attributable to the Bone Springs within this well.

8 Q Let me try my question again.

9 Are you in a position to give the exam-
10 iner an estimate of what TXO believes it would cost to drill
11 and complete a Bone Springs well?

12 A Yes.

13 Q Are you in a position to take the cost
14 that you have shown in this exhibit and allocate them be-
15 tween the Morrow and the Bone Springs?

16 A Yes.

17 Q In doing so is it your intent to use the
18 material transfer prices we have talked about today?

19 A Yes, that is what I based my \$814,000 on.
20 If the Commission decides a more appropriate number, then I
21 will base it on that.

22 Q Are you in a position to obtain for the
23 examiner current market prices for the surface and interme-
24 diate casing and the production casing from Lone Star or
25 from another supplier, but I use Lone Star because you have

1 used that book as an exhibit, as they were in May of 1985?

2 MR. DICKERSON: Mr. Examiner,
3 I'm going to interrupt at this time, only on the basis that
4 speculation or checking with different vendors toward what
5 an actual piece of pipe or a given service could have been
6 performed at in the entire West Texas/southeastern New Mex-
7 ico is not what we're here to decide.

8 What we're here to decide is
9 the reasonable well cost incurred by TXO as designated oper-
10 ator, with all the discretion that that involves, and with a
11 corporation the size of TXO Production Corporation, as those
12 figures actually occurred in this well and a comparison be-
13 tween the actual costs involved and whether or not those
14 costs are reasonable.

15 But it's not TXO's obligation
16 nor is it the practice of any operator to go out and shop
17 item by item, piece by piece, for every service performed,
18 every bit of material put into a well.

19 The designation by this Divi-
20 sion of an operator necessarily delegates to that operator,
21 in order to carry out its proper duties as operator under
22 the order, the discretion to charge for prices in accordance
23 with its usual practice, assuming that those are the prac-
24 tice of a prudent operator in the business.

25 MS. AUBREY: May I respond, Mr.

1 Stogner?

2 MR. STOGNER: Please.

3 MS. AUBREY: I challenge the
4 statement that a reasonable and prudent operator does not go
5 out and shop to get the joint account the best price for the
6 well equipment needed to equip the well, and by definition
7 that could not be true.

8 We're not (not understood) as
9 an operator -- as an operator not supposed to make a profit
10 charging material out of your warehouse, and Mr. Cate has
11 testified before you today that they have made a profit of
12 in the range of 27 to 42 percent on the casing in this well
13 by transferring it out of their warehouse and to the loca-
14 tion at different prices.

15 I believe that is is necessary
16 and required for your determination of what a reasoanble
17 well cost is to know what the current market value, which in
18 fact is what COPAS says you must charge, is the current
19 value, and that it is TXO's responsibility to provide you
20 with current market value as of May, 1985, for every piece
21 of equipment in this well that they took out of their ware-
22 house.

23 What --

24 MR. DICKERSON: Mr. Examiner --

25 MS. AUBREY: May I finish, Mr.

1 Dickerson?

2 MR. DICKERSON: Yes, excuse me.

3 MS. AUBREY: What they are ask-
4 ing you to do is to give them their 27 or 42 percent profit
5 because you have nothing to compare that to. You have no
6 way of knowing whether if a charge out of inventory at 1243
7 and charge the location 1573, you don't have anything to
8 tell you whether or not even 1243 is market value.

9 I mean they've admitted that
10 they bump the price up when they take it to the location, in
11 excess of their freight, of their taxes, and of their stor-
12 age charges. They've already told you that.

13 What you don't have, and you're
14 not going to have unless we can get the answer to this ques-
15 tion, is current market value in May, 1985, what it would
16 have cost them to buy this casing as opposed to moving it
17 around from their warehouse to their location.

18 MR. DICKERSON: Mr. Examiner, I
19 would like to point out, as a practical matter, let's put
20 ourselves in the position of an operator, such as TXO.

21 How many joints of tubing, how
22 many joints of casing, are purchased by this company or any
23 other operator in the oil and gas business over a period of
24 several years? Fluctuating prices and what not, it's a mat-
25 ter of common knowledge, and the examiner knows of his own

1 knowledge, these individual joints of tubing, each joint of
2 casing, they cannot be consecutively marked. They're not
3 consecutively numbered or any such what -- there is no feasible,
4 possible method of tracing to each joint of tubing or
5 casing or any other piece of equipment at a price out of inventory
6 the exact dollar amount for which a check was written in payment
7 of that. The entire industry practice as recognized and set forth
8 in the accounting -- COPAS accounting procedure, standards to which
9 Ms. Aubrey referred recognize this fact. It cannot be done. There
10 are procedures established to account for materials and inventory
11 and the witness has testified that TXO has followed these procedures
12 in accounting in the only manner possible to do so.

14 The third joint from the bottom
15 of this hole in this tubing string cannot be traced to an
16 invoice anywhere on earth that reflects what was paid for
17 that price, but the procedures that are set up to charge for
18 such items accommodate the need to reflect it on an individual
19 well basis.

20 MR. STOGNER: Ms. Aubrey, could
21 you please restate that question?

22 MS. AUBREY: Yes. My question,
23 I believe, was whether or not TXO was in a position to obtain
24 from Lone Star, who was one of your suppliers for casing
25 market value prices as of May, 1985, for the casing,

1 surface, intermediate, and production casing actually used
2 in this well.

3 Q Are you in a position to do that?

4 MR. STOGNER: And this is the
5 question you are objecting to, Mr. Dickerson?

6 MR. DICKERSON: I'm not neces-
7 sarily objecting. The answer is obviously yes, TXO could go
8 out, get on the telephone and find out what given suppliers,
9 unlimited number, could have sold X number of joints to tub-
10 ing, X number of joints of casing, for in May of 1985.

11 My objection goes further than
12 that, Mr. Examiner. It is not TXO's obligation as operator
13 to do that. It is not prohibited to charge materials out of
14 inventory. If it were, no operator in New Mexico or any-
15 where else could have a yard because the OCD, when called
16 before it on proceedings similar to this, would not allow
17 charges to be made from inventory. Pipe yards would be to-
18 tally obsolete. That's not the custom in the industry.
19 It's obviously, given the economics of scale, and what not,
20 cheaper and in the long run better for all the interest
21 owners in wells to allow the operator to purchase inventory
22 in large quantities to obtain these savings, store it in the
23 yard, and account for it under standard practices.

24 MR. STOGNER: I think what we
25 just did here was shorten the closing statements.

1 For purposes of obtaining in-
2 formation, as such, I'm going to allow this question to go,
3 to help me better understand the marketing system of drill-
4 ling a well and completing one.

5 So your objection is overruled,
6 Mr. Dickerson.

7 A Okay, the answer is yes, and I've brought
8 with me a Lone Star sales bulletin which shows an applicable
9 discount at the time this pipe was sent out.

10 Now it doesn't necessarily reflect when
11 it was purchased but at the time it was sent out the dis-
12 count from the list price was 7-1/2 percent --

13 Q About when -- excuse me, I need to inter-
14 rupt here, before you read from that, --

15 A Well, it's --

16 MS. AUBREY: Is there a ques-
17 tion -- is Mr. Cate responding to --

18 MR. DICKERSON: He's answering
19 your question.

20 MS. AUBREY: -- a question, Mr.
21 Examiner?

22 MR. STOGNER: I believe he is.

23 A Should we go ahead and enter this or do
24 you just want the numbers? I mean this is a copy of a Lone
25 Star sales bulletin which mentions the price list and then

1 it mentions for certain grades what the discount off list
2 will be as of the date listed right here.

3 Q And what date is that?

4 A November 16th, 1984, and this Bulletin
5 No. 235.

6 MR. STOGNER: Can that be made
7 a supplement to Exhibit Four?

8 A Sure.

9 Q My question to you, Mr. Cate, was May of
10 '85. Did you bring a piece of paper with you that shows
11 what the market --

12 A Yes.

13 Q -- price was in May of '85?

14 A Then the subsequent Bulletin No. 236,
15 price bulletin, effective June 14th, 1985, has a different
16 discount ranging from 20 to 25 percent, but our pipe was
17 taken out when Bulletin 235 was in effect, at 7-1/2 or 10
18 percent.

19 Q Taken out of where?

20 A Out of the inventory when the pipe was
21 used. Isn't that what you asked?

22 Q When did it go into inventory?

23 A I don't know.

24 Q Do you know whether it went into inven-
25 tory at a higher or lower price?

1 A I believe it probably went in at a higher
2 price than it actually got charged out because the way the
3 accounting system works, it's a weighted average that pipe
4 that was bought at this price a long time ago that's still
5 being carried on the list, as you buy newer pipe as the dis-
6 counts are getting larger, that weighted average will come
7 down and that's how it's transferred out. So chances are it
8 actually is coming out less than we did pay for it, but
9 again, that's another accounting procedure.

10 Q If it comes out at less than you paid for
11 it, that's -- it's not a problem for the working interest
12 owners of the well, is it?

13 A No.

14 Q I mean if TXO takes advantage of buying
15 pipe in quantity and storing it in its yard, that's a busi-
16 ness practice that you have chosen to engage in.

17 A Yes.

18 Q Isn't that correct? And do you -- you
19 bet that you are going to be able to charge it out to your
20 working interest owners for more than you pay for it.

21 A Not necessarily. It depends if it was
22 bought before any discounts were in effect.

23 Q In other words, it was not in effect when
24 this well was drilled, right?

25 A When it was drilled, but I don't know

1 when the pipe was bought.

2 Q And you're -- you are charging to the
3 joint account at a price higher than you're carrying it on
4 your own books, right.

5 A Yes. Would you like copies of these?

6 MR. STOGNER: I would. You
7 could submit those as a supplement to Exhibit Four to keep
8 the record straight.

9 MR. DICKERSON: I'll mark them
10 TXO Exhibit Four A and B.

11 MR. STOGNER: Let's take about
12 a five minute break at this time.

13

14 (Thereupon a recess was taken.)

15

16 MR. STOGNER: Ms. Aubrey?

17 Q I want to ask you about one last invoice,
18 Mr. Cate.

19 It is under your adjustment section on
20 the righthand page of your blue folder.

21 The one I want to talk about is the
22 material transfer of a -- I can't really read this but it's
23 a packer; there's only one in here.

24 A It's a Guiberson.

25 Q Guiberson packer.

1 MR. STOGNER: G-U-I-B-E-R-S-O-
2 N.

3 Is this the invoice dated Nov-
4 ember 21st, 1985?

5 MS. AUBREY: It is a material
6 transfer.

7 MR. STOGNER: Oh, I've got the
8 wrong one.

9 MR. AUBREY: Dated 12-13-85.
10 That's the one. I believe it's the only material transfer
11 in here.

12 MR. STOGNER: Okay.

13 A Well, there's other material transfers
14 but those are for the stack pack on the back that we're just
15 showing were corrected.

16 Q All right.

17 We're transferring this packer, a Class B
18 packer, from I assume your warehouse?

19 A Yes.

20 Q From Odessa to the Sprinkle No. 1.

21 A Yes.

22 Q And we show it coming out of the ware-
23 house at \$1,781 and going to the location at \$2,487.

24 My question to you is, is your explana-
25 tion of this (not understood) price the same as the explana-

1 tion you've given all along for the difference in casing
2 prices out of your warehouse?

3 A Would you show me where the -- where it's
4 coming out and going in at those prices?

5 Q You have the exhibit in front of you.
6 Sir?

7 A Yes. Okay, I was on a different sheet.
8 What I imagine the case is, is that when we transferred it
9 back the difference will be the rework that was required to
10 get it in working quality again. When a packer is pulled
11 from a well and transferred back, there is always charges
12 for what they call R & R rework, packer rubbers, whatever.

13 That's my best guess.

14 Q Well, now, I guess I didn't understand
15 that, Mr. Cate.

16 We're taking it out of Odessa at 1781,
17 \$1,781.

18 A That's correct.

19 Q And we're taking it to the well location
20 where it suddenly becomes worth 2487, for a Class B packer;
21 comes out of Odessa a Class B, it goes to location a Class
22 B, and we've got a \$700 increase in value.

23 A That's what I mean, and it could be that
24 the cost is taken at list minus 25 percent for used or
25 remanufactured or rebuilt is what Condition B is called.

1 It's -- it's either remanufactured or has been used pre-
2 viously, and that's what a Condition B is.

3 It's possible that the same explanation
4 would apply as to what the casing is.

5 Q So you don't really know whether this is
6 just a situation where TXO carries it in its warehouse at
7 one value and charges the joint account another price, or
8 you did something to the packer.

9 A No, I don't know for sure.

10 Q Do you have an invoice in here to reflect
11 any repair to the packer?

12 A No.

13 MS. AUBREY: Mr. Examiner, I
14 want to conclude my examination of Mr. Cate; however, I do
15 not want by omission to leave the impression that the char-
16 ges which we have discussed so far are the only charges to
17 which Mr. Sprinkle objects, and I don't want to spend the
18 rest of the day going through every piece of paper in this
19 large folder.

20 I believe we have brought out
21 the ones that we believe are the most outrageous over char-
22 ges; however, we do believe that there are additional in-
23 voices in here which -- or additional charges in here that
24 are not backed up by actual invoices, which are charged at
25 an excessive price and which should not, of course, be char-

1 ged at all to a Bone Springs well.

2 With that statement, I will
3 pass the witness.

4 MR. STOGNER: Okay, Mr.
5 Dickerson, redirect.

6 MR. DICKERSON: May I have a
7 few minutes?

8 MR. STOGNER: Surely.

9

10 (Thereupon a recess was taken.)

11

12 (Following the recess a lengthy discussion was had off the
13 record concerning allocation of costs between the two
14 zones. Thereafter closing statements were presented, as
15 follows:)

16 MR. DICKERSON: Mr. Examiner,
17 at the January 22nd hearing it became apparent that Mr.
18 Sprinkle in this Case 8807 sought to require the Division,
19 upon his objection to the actual well costs incurred in the
20 Sprinkle No. 1 Well, to allocate those costs not on a total
21 one well basis but instead to separately allocate the costs
22 incurred in the drilling of the well separate and apart to
23 the Bone Springs formation.

24 There are three cases, and we
25 have submitted a brief and Mr. Sprinkle has his well which

1 another examiner has read, and to the best of my ability and
2 knowledge, these are the only three cases directly bearing
3 on the very esoteric legal point that we're here to argue,
4 and that is whether or not the so-called splitting of risk
5 between zones would be appropriate and should be applied in
6 the case to be decided before us here.

7 There's no question and we do
8 not make any claim that given the developing case law in
9 this area, and it seems logical and well reasoned to me that
10 there is a place for performing this function for splitting
11 the cost between one or some but less than all zones in a
12 well.

13 The New Mexico Supreme Court
14 very strongly implied in the Viking Petroleum case cited in
15 our brief, even though in that case it upheld the denial by
16 this Division of Viking's attempt to participate in an Abo
17 formation test and yet not to participate in an Ordovician
18 test in zones below that. It nevertheless strongly implied
19 with reference to cases from other states that our statute
20 in New Mexico is sufficiently broad to under the proper
21 facts in evidence permit this Division to do so.

22 This Division, both before Vik-
23 ing was handed down, and after, has in fact done so in sev-
24 eral instances.

25 TXO submits that the proper

1 arena for making allocation of costs and election for allo-
2 cation of costs is not after a well is drilled, it is prior
3 to a well being drilled, and you will note from the facts in
4 all three of the cases cited in our brief, all three of
5 those cases, as far as it can be determined from the orders,
6 were, in fact, orders entered in preparation to drilling a
7 well, not in a situation such as this where a well has been
8 pooled, no appeal taken, a final pooling order, and then the
9 pooled party comes back in, then claiming for the first time
10 he is entitled to allocate the cost.

11 There are three circumstances
12 which I submit this cases recognize are entirely proper for
13 some splitting of the cost between various zones, and the
14 three cases that we argue here, each one of these three
15 cases, I think, is representative of these type three cir-
16 cumstances.

17 Ms. Aubrey, in her brief sub-
18 mitted to the examiner, attached a copy of a Lynx Petroleum
19 Consultants-Texaco recent order entered by the Oil Conserva-
20 tion Division.

21 That case sets forth one of
22 these situations in which an allocation of cost between less
23 than all total well costs might and probably is entirely
24 proper. In that Texaco-Lynx Petroleum Consultants case we
25 had a situation where Texaco, the party seeking the alloca-

1 tion of costs, does not share in the 40-acre tract in which
2 -- on which the well was physically located. Texaco's in-
3 terest was in the additional 120 acres in the 160-acre gas
4 unit discussed in that case. Perfectly proper if that well
5 is completed on 100 and -- on 40-acre spacing, Texaco has no
6 interest in a 40-acre spacing well. It should not have to
7 pay the costs attributable to that formation on 40-acre
8 spacing.

9 That's one situation. It's not
10 the situation in Sprinkle.

11 The second situation in which
12 it's entirely proper is the situation set out in the Mara-
13 thon case cites in our brief, also decided by the Supreme
14 Court of Oklahoma.

15 In that case the well was phy-
16 sically located in the northwest quarter of a section. Mar-
17 athon owned 310 net acres in various parts of the entire
18 section but in the northwest quarter Marathon owned no in-
19 terest in the Atoka zone and the Atoka zone on 160-acre
20 spacing was one of the zones sought to be tested in this
21 well.

22 The court strongly implied and
23 in fact went so far as to point out it would not be proper
24 and it would not be equitable and it would not have been
25 done under the terms of the Oklahoma Corporation Commission

1 order, to require Marathon, which had no interest in the
2 northwest quarter, to spend any share of the cost attribut-
3 able to a Bone -- or an Atoka completion, any of the comple-
4 tion costs attributable to the Atoka, because Marathon had
5 no interest in it. You can't charge someone for an interest
6 which they do not own.

7 That, however, is not the sit-
8 uation in Sprinkle again.

9 In the C. F. Braun case, the
10 third situation where allocation of costs is totally proper
11 was exhibited. In that cause -- or in that case, and this
12 is very similar to the Viking Petroleum case, but what the
13 party protesting the order in that case wanted to do was to
14 -- there are thirteen separate zoned common sources of sup-
15 ply, all with 640-acre spacing, were involved, so that we
16 had not the Lynx Petroleum Company problem, nor the Marathon
17 case problem, nor the Sprinkle problem, all thirteen common
18 sources of supply were stipulated to be on 640-acre spacing,
19 but what the party desired to do in that case was to pick
20 out a zone in the middle, the Morrow I believe it was in
21 that case, and participat in the Morrow zone. He did not
22 want to participate in any zones below the Morrow. He did
23 not want to participate nor share any costs of any zones
24 above the Morrow. The court, and we think correctly, held
25 that an election to participate in one zone carries with it

1 by implication and as it should, the election to participate
2 in all zones above that, because obviously, the drill bit
3 has to penetrate all those higher zones in order to test a
4 lower zone.

5 Those three cases are not the
6 Sprinkle case. You'll recall, and the record in this case
7 reflects, that the Sprinkle Federal No. 1 Well is located in
8 the northwest quarter of the section. Mr. Joseph Sprinkle
9 owns 31.25 percent interest in the northwest quarter. He
10 owns no interest in the northeast quarter of the section.

11 Exhibits Five and Seven submit-
12 ted by TXO at the original hearing in Case 8494 show that
13 the well was proposed, as is the common practice, on the
14 basis of the largest proration unit anticipated to be as-
15 signed to that well, which, as projected to be a Morrow
16 well, was the north half of the section.

17 Under that anticipated spacing
18 unit, and under the AFE submitted as Exhibit Number Seven
19 and the joint operating agreement submitted as Exhibit Num-
20 ber Five, the only election extended to Mr. Sprinkle was to
21 participate in one zone penetrating all horizons down to the
22 base of the Morrow. His interest was therefore 31.25 per-
23 cent of 160/320, recognizing the pooling over the 320.

24 However, the application in the
25 case also recognized that our rules, and they're not chan-

1 ged, these rules are not changed by a forced pooling order,
2 require that a Bone Spring oil well be on 40-acre spacing.
3 A Morrow gas well would have been on 320-acre spacing, but
4 regardless, Mr. Sprinkle still has the same interest in the
5 northwest quarter as he had without regard to the joint
6 operating agreement, because he's obviously not a party to
7 that. He has 31.25 percent interest in the Bone Spring for-
8 mation, and I think it becomes apparent from this that to
9 the extent any allocation is decided to be required by this
10 Division, it necessarily follows that his share of all Bone
11 Spring costs is 31.25 percent interest.

12 He is entitled to 31.25 percent
13 of the net income from that well, less his proportionate
14 part of royalty and overriding royalty burdens. He has to
15 bear, and would have had to bear had the parties drilled on-
16 ly a Bone Spring well, 31.25 percent of the cost.

17 And I'll close, Mr. Examiner,
18 by saying only that I think this Division needs to look very
19 closely at the ramifications of this if it is held that at
20 any time after a forced pooling order is entered, simply by
21 the procedure of objecting to the actual well cost incurred,
22 then a party with the benefit of 20/20 hindsight can come
23 back in, discount the well costs attributable to his inter-
24 est for the purpose of the forced pooling penalty by virtue
25 of what happened in the drilling of that well, which zones

1 were productive; which zones were not productive; and in
2 that way, in effect, rewrite the Division order.

3 We submit that's not proper.
4 There is a proper case for allocation. The Joesph Sprinkle
5 case before us now is not that case; we're after the fact;
6 it's too late. Had Mr. Sprinkle come in and made a request
7 to do it, presented substantial evidence as to the reason-
8 ableness of his desire to participate in a Bone Spring test
9 and not in a Morrow, the Division would most likely have al-
10 lowed him to do so.

11 He made no such request. He is
12 now seeking to remedy his oversight in not appearing at the
13 hearing and seeking to participate in the Bone Spring test,
14 and we submit it is not proper and it's not legal.

15 MR. STOGNER: Thank you, sir.

16 Ms. Aubrey?

17 MS. AUBREY: Thank you. TXO
18 complains that no allocation was made between the zones
19 prior to when this well was drilled. TXO was the applicant
20 in this case and they did not request or put on cost alloca-
21 tion as far as that forced pooling case.

22 TXO admits that the only elec-
23 tion they gave Mr. Sprinkle was to participate in all zones
24 and yet at the same time they tell you that you can't allo-
25 cate the costs now because he didn't get an allocation prior

1 to the drilling of the well. That doesn't make any sense,
2 Mr. Examiner.

3 What we have here is simple.
4 What we have here is a situation where Morrow costs are go-
5 ing to be reimbursed out of Bone Spring production, and
6 that's the real issue here. The real issue before you today
7 is whether or not this Division has the statutory authority
8 to require a shallow interest in pay for the costs of a
9 deeper well.

10 We submit to you that the an-
11 swer to that question is no, this Division does not have the
12 statutory authority to do that. We don't need to look out-
13 side the jurisdiction of New Mexico to find the answers to
14 the question. We have an answer to that question in our
15 forced pooling statute. I've cited that to you in my brief
16 and it's a very sort sentence, which I will read to you now.

17 "No part of production or pro-
18 ceeds accruing to any owner or owners of a separate interest
19 in such unit shall be applied toward the payment of any cost
20 properly chargeable to any other interest in said unit."

21 That's part of the forced
22 pooling statute, the statute that permits TXO to collect a
23 200 percent penalty in this case against Mr. Sprinkle's in-
24 terest.

25 In the C. F. Braun case cited

1 by TXO and also cited by us in our brief the Oklahoma court,
2 the Supreme Court of Oklahoma, recognized that cost allocation
3 tion was proper where the parties treat two separate sources
4 of supply as separate. That's what happened here. We have
5 a 40-acre Bone Spring unit pooled separately from a 320-acre
6 Morrow unit. The party here, TXO, although it didn't ask
7 for a cost allocation, pooled those two units separately.

8 The Supreme Court of Oklahoma
9 agreed that cost allocation is required in that instance.
10 We do not have an instance here where 320 acres was pooled
11 from the surface to the base of the Morrow. We have a sep-
12 arate 40-acre spacing unit dedicated to the Bone Spring pro-
13 duction, separately pooled in this Division's order, and all
14 we're asking you to decide is that it is unequitable, un-
15 just, and a violation of the pooling statute to permit TXO
16 to recover costs below the base of the Bone Springs to the
17 Morrow from Bone Springs production. That is the only place
18 it could come. We all agree if this well were dry in the
19 Morrow and there was no formation up hole in which to com-
20 plete it, TXO couldn't get any money at all from Mr. Sprin-
21 kle; not one dime for 13,500 feet, but TXO's figured out a
22 way to get reimbursement from a shallow zone for that extra
23 5000 dollar -- for 5000 feet of wellbore for a dry hole.

24 If you allow them to escape
25 cost allocation that is what you've given them. You will

1 have given them a free ride from the base of the Bone
2 Springs to the Morrow in direct contravention of our forced
3 pooling statute.

4 There are no cases directly on
5 point, but I don't believe that we need court decisions from
6 other jurisdictions to decide this. We have our forced
7 pooling statute and it tells you you can't use one interest
8 to pay for another interest in a well.

9 We have the Lynx case. I re-
10 presented the applicant in the Lynx case and it was the ap-
11 plicant in the Lynx case who asked for the cost allocation,
12 not Texaco. Texaco was not willing to pay one dime for that
13 wellbore. The Oil Conservation Commission held in the Lynx
14 case that from the base of the shallow zone to the base of
15 the deeper zone was the responsibility of the party with the
16 interest in the deeper zone.

17 If you translate that to our
18 situation here, what that says to you is it is the respons-
19 ibility of TXO to pay for the base of the Bone Spring to
20 the base of the Morrow because Mr. Sprinkle went nonconsent
21 and doesn't -- there isn't one Mcf of gas in the borehole
22 out of which to pay his costs. There isn't any Morrow pro-
23 duction and that is why it should be TXO's responsibility to
24 pay to get down there. They're the operator. They force
25 pooled Sprinkle. He went nonconsent as is his statutory

1 right to do and has the right to free of cost in the Morrow.

2 Being free of cost in the Mor-
3 row means being free of any cost attributable to the attempt
4 to complete that well in the Morrow.

5 This Division does not have and
6 never has had statutory authority to make a shallow -- pro-
7 duction from a shallow zone pay off the cost of a deeper
8 zone, and the cost of a penalty when theres no deep zone
9 production.

10 And that's the simple issue be-
11 fore you.

12 MR. STOGNER: Thank you, Ms.
13 Aubrey.

14 Is there anything further in
15 Case 88077?

16 If not, this case will be taken
17 under advisement and this hearing is hereby adjourned.

18

19 (Hearing adjourned.)

20

21

22

23

24

25

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO
HEREBY CERTIFY the foregoing Transcript of Hearing before
the Oil Conservation Division (Commission) was reported by
me; that the said transcript is a full, true, and correct
record of the hearing, prepared by me to the best of my
ability.

Sally W. Boyd CSR

I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. 8802
heard by me on 20 February 1986.

Michael E. Stogner, Examiner
Oil Conservation Division

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO

22 January 1986

EXAMINER HEARING

IN THE MATTER OF:

Application of Joseph S. Sprinkle
for a determination of reasonable
well costs, Lea County, New Mexico.

CASE
8807

BEFORE: Michael E. Stogner, Examiner

TRANSCRIPT OF HEARING

A P P E A R A N C E S

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I N D E X

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STATEMENT BY MR. DICKERSON

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STATEMENT BY MS. AUBREY

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JEFF BOURGEOIS

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Direct Examination by Mr. Dickerson

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Cross Examination by Ms. Aubrey

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Redirect Examination by Mr. Dickerson

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Recross Examination by Ms. Aubrey

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STATEMENT BY MR. DICKERSON

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STATEMENT BY MS. AUBREY

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STATEMENT BY MR. DICKERSON

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STATEMENT BY MS. AUBREY

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STATEMENT BY MR. DICKERSON

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STATEMENT BY MS. AUBREY

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STATEMENT BY MR. TAYLOR

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RANDALL CATE

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Direct Examination by Mr. Dickerson

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Cross Examination by Ms. Aubrey

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STATEMENT BY MS. AUBREY

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MR. STOGNER: This hearing will
come to order.

We will now call Case Number
8807.

MR. TAYLOR: the application of
Joseph S. Sprinkle for determination of reasonable well
costs, Lea County, New Mexico.

MR. STOGNER: Call for appear-
ances.

MR. DICKERSON: Mr. Examiner,
I'm Chad Dickerson of Artesia, New Mexico, appearing on be-
half of TXO Production Corporation.

I have two witnesses.

MR. STOGNER: Additional ap-
pearances?

MS. AUBREY: Mr. Examiner, my
name is Karen Aubrey of the law firm of Kellahin & Kellahin,
Santa Fe. I represent Joseph S. Sprinkle, and I have one
witness to be sworn.

MR. STOGNER: Are there any
other appearances in this matter?

If not, will all the witnesses
please stand at this time to be sworn?

1 (Witnesses sworn.)

2
3 MR. DICKERSON: Mr. Examiner,
4 if I may, I would like to refresh your recollection a little
5 bit. I have taken the liberty of producing for you here the
6 file Case 8494, which was the original proceeding out of
7 which this case arose.

8 You will recall that that, Mr.
9 Examiner, was the application filed by TXO for compulsory
10 pooling of its Sprinkle No. 1 Well.

11 The Sprinkle No. 1 Well was a
12 Morrow targetted test well, with the Bone Spring as its
13 secondary objective.

14 The Morrow was dry; the Bone
15 Spring was productive. Mr. Sprinkle was pooled in that pro-
16 ceeding. There was no appearance made by Mr. Sprinkle. The
17 maximum statutory 200 percent risk factor was imposed and
18 upon compliance with TXO of the terms of the order entered
19 in Case 8494, concernig the furnishing of actual well costs
20 to him, Mr. Sprinkle has filed this proceeding as his objec-
21 tion to the actual well cost, stating that based on the fact
22 that, allegedly, that the reasonable well costs were less
23 than the actual well costs incurred by TXO.

24 We thought that for clarity's
25 sake it would be proper for TXO to put on its case first

1 concerning our claims as to the actual well costs, and the
2 reasonable well costs incurred in the drilling of this well,
3 and then Mr. Sprinkle to have his opportunity to answer our
4 case.

5 MR. STOGNER: Ms. Aubrey.

6 MS. AUBREY: Mr. Examiner,
7 that's an acceptable way to Mr. Sprinkle to proceed.

8 I would ask at this time that
9 you take administrative notice of the file in Case 8494 and
10 the order that was entered.

11 Mr. Sprinkle's application for
12 determination of reasonable well costs is, as Mr. Dickerson
13 said, made under the terms of the forced pooling order. Mr.
14 Sprinkle was a nonconsenting working interest owner in two
15 separate zones, which were pooled by virtue of that order.

16 The Bone Spring and the Morrow
17 were separately pooled in Order Number 7850.

18 Mr. Sprinkle has a 30 percent interest,
19 roughly, in the Morrow formation -- I'm sorry, a 15 percent
20 interest in the Morrow and roughly a 30 percent interest in
21 the Bone Spring formation.

22 He has been furnished with a letter which
23 is marked as an exhibit and which you'll see later, showing
24 the total cost of the well to total depth of 13,500 feet.

25 As you will recall, this well was not

1 productive in the Morrow but only productive in the Bone
2 Spring. The Bone Spring formation which is producing in
3 this wellbore is roughly (inaudible.)

4 We hope today that TXO will provide Mr.
5 Sprinkle with an allocation of the well costs between the
6 two zones, which is something we have not had before, and we
7 are going to ask the Examiner to make a determination as to
8 whether or not those costs, once they're allocated, are
9 reasonable, and also ask the Examiner to allocate the risk
10 factor between the two separate pools.

11 MR. STOGNER: Thank you, Ms.
12 Aubrey.

13 Oh, before we go any further, I
14 will take administrative notice in the proceedings in Case
15 No. 8494, which lead up to Order No. R-7850 in this matter.

16 At this time, Mr. Dickerson, I
17 will allow you to proceed.

18 MR. DICKERSON: Okay. Mr. Exa-
19 miner, I might just say that we have a disagreement,
20 obviously, over what the proper function of this proceeding
21 is, and Ms. Aubrey has submitted a brief and I have some
22 legal argument that I would like to make at the time, but it
23 would probably more -- be more proper to do that either upon
24 our objection to the testimony that she intends to elicit or
25 upon closing, at your preference.

1 If you need a little elucidation,
2 hopefully, of legal questions that we're going to be,
3 obviously, discussing here, I'd be glad to address that at
4 this time or I'll wait, as you prefer.

5 MR. STOGNER: In talking to my
6 general counsel, we'll go ahead and allow the testimony
7 first.

8 MR. DICKERSON: Okay. Mr.
9 Examiner, we'll call Jeff Bourgeois at this time.

10
11 JEFF BOURGEOIS,
12 being called as a witness and being duly sworn upon his
13 oath, testified as follows, to-wit:

14
15 DIRECT EXAMINATION

16 BY MR. DICKERSON:

17 Q Mr. Bourgeois, would you state your name,
18 your occupation, and by whom you're employed, please?

19 A My name is Jeff Bourgeois. I'm a petro-
20 leum landman with TXO Production Corporation in Midland,
21 Texas.

22 Q And, Mr. Bourgeois, you have previously
23 testified as a landman not only in other cases but in the
24 original Case 8494, out of which this proceeding today
25 arose, did you not?

1 A That's correct.

2 MR. DICKERSON: Is this witness
3 acceptable, Mr. Examiner?

4 MR. STOGNER: Are there any ob-
5 jections?

6 MS. AUBREY: No objections.

7 MR. STOGNER: He is so quali-
8 fied.

9 Q For the purpose, Mr. Bourgeois, of brief-
10 ly expounded on some of the items that Ms. Aubrey and myself
11 reminded the Examiner of, will you briefly summarize for him
12 what occurred in Case 8494?

13 MS. AUBREY: Well, I'll object
14 to that.

15 Mr. Stogner can read the tran-
16 script. We've asked him to take administrative notice of
17 the file and the order.

18 MR. DICKERSON: Mr. Examiner,
19 I'm going to belabor this. I'm going to elicit a very few,
20 what I consider to be pertinent facts, that we submit are
21 contained in that file, and I think it's for clarity's sake
22 that we briefly and not laboriously talk about a few of
23 those facts and exhibits that were put in that file.

24 I don't intend to -- I don't
25 intend to go to seed on any of it. It's going to be fairly

1 short and for the purpose of refreshing your recollection as
2 much as ours. It's been several months since this case was
3 heard.

4 If it's not necessary, well, I
5 can eliminate some of it, but I feel that it is necessary.

6 MR. STOGNER: Ms. Aubrey, I'm
7 going to overrule and allow this question.

8 Please continue.

9 Q Mr. Bourgeois, just very briefly state
10 what occurred in Case 8494, as far as the ultimate result
11 was concerned.

12 A TXO had applied for a compulsory pooling
13 order form 4825 feet below the surface to the base of the
14 Morrow, at approximately 13,300 feet for a well we were
15 drilling at 660 feet from the north and west lines of Sec-
16 tion 26, Township 18 South, Range 32 East.

17 As a result of our application, the Com-
18 mission entered an order pooling all mineral interests in
19 the north half of Section 26 down through the base of the
20 Morrow formation, to be dedicated to a Morrow gas well, and
21 also pooled all mineral interests from 4825 feet beneath the
22 surface down through the base of the Bone Springs in the
23 northwest northwest of said Section 26, to be dedicated to a
24 Bone Spring well, should the Morrow prove unsuccessful.

25 Q Mr. Bourgeois, were there any interests

1 subjected to that compulsory pooling order other than that
2 of Mr. Sprinkle?

3 A Yes, sir. Mr. J. Cecil Rhodes, Mr. Lewis
4 Burleson, and Mr. O. H. Berry, all three of their interests
5 were also pooled, as well.

6 Q Mr. Bourgeois, what was the proposed
7 spacing unit for that original Sprinkle Federal No. 1 Well?

8 A As a Morrow test it was to be the north
9 half of section 26.

10 Q And the well, you stated, was physically
11 located in the northwest quarter of the northwest quarter of
12 Section 26.

13 A That's correct.

14 Q Directing your attention, Mr. Bourgeois,
15 to what was admitted into evidence as TXO Exhibit Five in
16 Case 8494, very briefly summarize the interest of Mr. Sprin-
17 kle, both in the northwest quarter and in the northeast
18 quarter of that north half proration unit.

19 A Okay. On the Exhibit A of this proposed
20 operating agreement the contract area was designated as
21 north half Section 26, and Mr. Sprinkle's interest, should
22 he or would he have participated would have been 15.625 per-
23 cent in the Morrow well.

24 Q Explain very briefly how that interest
25 was calculated.

1 A All right.

2 Q What is his gross interest in the
3 northwest quarter of the section where the well is physical-
4 ly located?

5 A Mr. Sprinkle's gross interest in that
6 northwest quarter is 31.25 percent. When -- when that is
7 diluted over the entire north half, it reduces to 15.625.

8 MR. STOGNER: Please continue.

9 Q Mr. Bourgeois, during your -- the record
10 in Case 8494 reflects certain correspondence, and so forth,
11 with Mr. Sprinkle and yourself on behalf of TXO, does it
12 not?

13 A Yes, it does.

14 Q At any time during those negotiations was
15 there any intention expressed by Mr. Sprinkle, or desire ex-
16 pressed by him. to participate in a Bone Spring test and not
17 participate in a Morrow test?

18 A No.

19 Q Was any such alternative offered to him
20 by TXO?

21 A No, at the time the well was proposed as
22 a Morrow test, and that was our primary objective, and that
23 is how the well was proposed to all parties.

24 Q Mr. Bourgeois, provision order number, or
25 the decretal paragraph numbered four in Order 7850, required

1 that after the effective date of the order and within 90
2 days prior to commencing the well TXO will furnish a copy of
3 the AFE to Mr. Sprinkle.

4 Let me hand you what is marked as Exhibit
5 Number One and ask you if that is what that document re-
6 flects?

7 A Yes. That was our compliance with that
8 requirement for the order.

9 Q Now, decretal numbered paragraph six of
10 that same order, then required TXO within 90 days following
11 completion of the well to -- or no, just within 90 days fol-
12 lowing completion of the well, to furnish an itemized sche-
13 dule of actual well costs.

14 Let me show you the objection filed by
15 Mr. Sprinkle in this proceeding and direct your attention to
16 Exhibit A to that, and ask you if that is your letter in
17 satisfaction of that part of Order 7850.

18 A Yes, this was a letter sent by Mr. Rob-
19 erts of our Accounting Department. Attached to his letter
20 was the breakdown of the gross estimate, which was the costs
21 reflected on our AFE that was used in this case.

22 And the second column is the gross cost,
23 which is the actual costs we incurred in the drilling of
24 this well.

25 Q Now you were required by the terms of the

1 order to furnish that statement within ninety days following
2 the completion of that well.

3 At the expiration of that ninety-day
4 period did TXO in fact have total final well costs in from
5 the subcontractors and processed?

6 A No.

7 Q And would you refer the Examiner, just
8 read that portion of your letter which referred to that
9 problem?

10 A The letter states that the report at-
11 tached only includes costs that have been processed through
12 September 30, 1985, and will not reflect subsequent costs
13 for invoices still being processed for October, '85.

14 Q And to your knowledge have certain addi-
15 tional invoices been processed since the date of your let-
16 ter?

17 A Yes.

18 Q So that you were, in an attempt to comply
19 with the deadline there, you had to go with the facts that
20 you had at that time and you simply did not have all the
21 well costs in at that point.

22 A Correct.

23 MR. DICKERSON: Mr. Examiner, I
24 would move admission of TXO Exhibit Number One at this time.

25 And I have no further questions

1 of this witness.

2 MR. STOGNER: Are there any
3 objections?

4 MS. AUBREY: No objection.

5 MR. STOGNER: Exhibit Number
6 One will be admitted into evidence.

7 Ms. Aubrey, your witness.

8 MS. AUBREY: Thank you.

9

10 CROSS EXAMINATION

11 BY MS. AUBREY:

12 Q Mr. Bourgeois, do you have a copy of
13 Order 7850 in front of you?

14 A Yes.

15 Q Am I correct in stating that the location
16 which was approved by Order 7850 was standard for oil?

17 A That's correct.

18 Q And nonstandard for gas?

19 A That's correct.

20 Q Is there anything in that order that
21 reflects that the primary objective of TXO was the Morrow
22 and the secondary objective was the Bone Spring?

23 A I do not know that it's set out that way,
24 that it says -- using the words "primary" and "secondary".

25 Q I believe those were the words you used

1 in your direct testimony.

2 A Just previously there, yes, uh-huh.

3 Q You testified at the initial hearing in
4 this matter, didn't you, Mr. Bourgeois?

5 A Yes.

6 Q And you referred to an exhibit at that
7 hearing which you have referred the Examiner to today, Exhi-
8 bit Number Five, which is the joint operating agreement?

9 A That's correct.

10 Q Did Mr. Sprinkle sign the joint operating
11 agreement?

12 A No.

13 Q And you testified at the initial hearing
14 back in March on the risk factor contained in that operating
15 agreement, didn't you?

16 A I believe the risk factor is usually left
17 up to the geology portion of it.

18 I may have made a recommendation as to
19 what TXO was seeking.

20 Q Do you recall what that was?

21 A The statutory maximum of 200 percent.

22 Q Do you recall telling the Examiner that
23 you were seeking the same penalty which was contained in the
24 joint operating agreement on page five?

25 MR. DICKERSON: Mr. Examiner,

1 I'm going to object at this point on the simple basis that
2 it's been many months since Mr. Bourgeois testified and we
3 made an attempt this morning to get the transcript and it
4 had been checked out, and if he is going to be cross exa-
5 mined over his testimony, I would like an opportunity for
6 him to review it.

7 I don't think it's worth belab-
8 boring. The Examiner has already taken administrative no-
9 tice of that, and you will, of course, have access to the
10 testimony as actually presented, for whatever that's worth.

11 MS. AUBREY: If I may respond,
12 Mr. Stogner, I offered Mr. Dickerson my copy of the tran-
13 script this morning and he photocopied some of it.

14 I'll be happy to hand the wit-
15 ness my copy.

16 MR. STOGNER: I'm going to
17 overrule your objection, Mr. Dickerson, and allow Mr. Bour-
18 geois to take a look at the testimony from the March hear-
19 ing.

20 MS. AUBREY: Mr. Examiner, I'm
21 showing Mr. Bourgeois page 9, line 17 of the transcript of
22 the March hearing in this matter.

23 A Is that what you're referring to?

24 Q I'm referring specifically, Mr. Bour-
25 geois, to your testimony following the question which is

1 contained at lines 21 through 23.

2 A Okay.

3 Q Do you recall that testimony, sir?

4 A Yes.

5 Q You have the operating agreement there in
6 front of you, don't you?

7 A Yes, ma'am.

8 Q Would you look at page 5?

9 A Okay.

10 Q And tell me whether or not, in fact, the
11 penalty that's contained there applies to subsequent wells
12 on the unit and not the initial test well?

13 A That is true. It's under subsequent
14 operations.

15 Q So it wouldn't apply to the initial test
16 well on the unit, would it?

17 A No, it wouldn't.

18 Q Do you want to tell me what relevance
19 that had, then, at the March hearing, to your testimony be-
20 fore this examiner on what the risk factor should be?

21 A The 300 percent that we used here is what
22 we use in our operating agreements.

23 There is always possibilities of subse-
24 quent development or even subsequent operations on the ini-
25 tial test well, prior to or subsequent to the completing

1 down to the first zone that it is successfully completed in,
2 and it's well known in the industry after the life of one
3 producing formation expires, many operators try to gain pro-
4 duction from other formations or restore production to the
5 original producing formation, and so the subsequent opera-
6 tions portion of the operating agreement, as well as the
7 penalties outlined in that portion, are needed to cover
8 those situations.

9 Q But that doesn't have anything to do with
10 the penalty that should be imposed on the initial test well
11 in the unit by the terms of your operating agreement.

12 A No. The -- the parties who -- well, it
13 could apply in such operations where on the initial test
14 well, once the operator agrees to set pipe to certain -- a
15 casing point, should a party, participating party at that
16 time not wish to set casing, he can then have his interest
17 put into a nonconsenting stature and be subject to penal-
18 ties.

19 Q I don't think I made myself clear to you,
20 Mr. Bourgeois.

21 A Okay.

22 Q That penalty that you referred the Exam-
23 iner to, which is contained in your Exhibit Five to the
24 March case, applies to subsequent wells which are drilled on
25 the unit, is that correct?

1 A Subsequent wells or subsequent operations
2 on an initial well.

3 Q It does not apply to the initial comple-
4 tion of the initial well on a unit.

5 A No.

6 Q How many other Bone Springs are there
7 currently producing in Section 26? And I'm -- I'm not
8 trying to pin you --

9 A Okay.

10 Q -- down, I know we did this two weeks ago
11 and I've forgotten.

12 A Two. As of today there's two additional
13 wells, for a total of three on the section.

14 Q And how many additional wells does TXO
15 propose?

16 A We have three producing and have proposed
17 the remaining five locations that we have an interest in.

18 Q You testified, Mr. Bourgeois, on direct
19 Examination about the breakout, you called it, of actual
20 costs that had been incurred by TXO in connection with the
21 Sprinkle No. 1.

22 Do you have that in front of you in your
23 set?

24 A Yes.

25 Q If you don't, it's my Exhibit Number Three

1 in my set, which I think you also have in front of you.

2 A I have a copy of that letter from Mr.
3 Roberts and the attachments to said letter.

4 Q If I can read this, Mr. Bourgeois, I have
5 a bad copy here, the total costs are shown as \$1,089,429.45.

6 A That's correct.

7 Q And that is the gross cost to TXO of
8 drilling and completing the Sprinkle Federal No. 1?

9 A Those are the costs that we had booked to
10 that well as of September 30.

11 Q Are those costs as of now greater?

12 A Yes.

13 Q Do you have that figure or do you have a
14 witness who will give us that figure?

15 A There's a figure on our Exhibit Number
16 Two.

17 Q I don't have a copy of --

18 MR. DICKERSON: I furnished you
19 with a copy of that two weeks ago, Ms. Aubrey. We have an-
20 other one, if you'd like it. I'm sorry, it's exactly the
21 same thing as I (not clearly understood).

22 Q So we're now at a \$1,107,521? Do you
23 agree, if I'm reading that correctly?

24 A That's correct.

25 Q Does your letter and its attachment which

1 is marked in my exhibits as Sprinkle Exhibit Number Three,
2 and which is attached to Mr. Sprinkle's application, break
3 out the costs between the Morrow zone and the Bone Springs?

4 A No, it doesn't.

5 Q Is TXO seeking to impose the penalty
6 which was granted in Case 8494 against the costs of complet-
7 ing the well in the Morrow?

8 A I didn't follow that, Ms. Aubrey. I
9 think the well was not completed. Are you asking me what --

10 Q Let me try one more time.

11 A Okay.

12 Q The costs which you have given Mr. Sprin-
13 kle include the costs of drilling the well to the Morrow, is
14 that correct?

15 A Uh-huh.

16 Q The well was dry in the Morrow.

17 A Right.

18 Q Do you seek from Mr. Sprinkle that por-
19 tion of the costs which are attributable to the cost of
20 drilling from the base of the Bone Springs to the Morrow?

21 A Yes.

22 Q So you want those costs from Mr. Sprin-
23 kle, is that correct?

24 A We -- yes, we do, in addition to --

25 Q Okay.

1 A -- the total well costs.

2 Q And do you seek to impose a penalty on
3 the cost of drilling the well from the base of the Bone
4 Springs to the Morrow?

5 A Yes.

6 Q And out of what do you think that penalty
7 should be paid?

8 A Out of production.

9 Q Out of production from what zone?

10 A The Bone Spring.

11 Q So you are seeking to recover a penalty
12 which is the cost of going from the base of the Bone Springs
13 to the Morrow out of Bone Springs reserves.

14 A Yes.

15 Q In presenting Case 8494, Mr. Bourgeois,
16 did you ask the Commission, or did TXO, I'm not talking
17 about you personally, did you ask the Examiner to allocate
18 the costs between the two separately pooled zones?

19 A No.

20 Q Did you ask the Examiner to allocate the
21 risk of drilling and completing a well between the two
22 zones?

23 A No.

24 Q Is it TXO's intention to give Mr. Sprin-
25 kle a breakdown of those costs attributable to the Morrow

1 dry hole and those costs attributable to the completed well
2 in the Bone Springs?

3 A No.

4 Q I don't know whether you're the right
5 person to ask, Mr. Bourgeois, but do you have any informa-
6 tion with regard to production or the payout status of the
7 well?

8 A I do not know what the payout status is.
9 I'm confident that it has not reached that status yet,
10 though.

11 Q Did you bring with you any production
12 data?

13 A No, the most recent production data we
14 have, a well was submitted or testified to at the January
15 9th Examiner Hearing, when the Sprinkle 3 and 4 compulsory
16 pooling cases were heard.

17 Q As a landman, Mr. Bourgeois, do you have
18 any knowledge or expertise in going through your cost esti-
19 mate with me item by item? I don't want to ask you if
20 you're not the person to ask.

21 MR. DICKERSON: Ms. Aubrey, I
22 might just state, we do have another witness who's an engin-
23 eer who's familiar with these figures. And I have no objec-
24 tion to your asking Mr. Bourgeois, I just think that he can
25 answer your questions and Mr. Bourgeois probably cannot.

1 MS. AUBREY: Fine, I will be
2 happy to ask the engineer.

3 Q Who else is in this well besides TXO and
4 Mr. Sprinkle?

5 A As interest owners right now?

6 Q As working interest owners right now.

7 A Okay, they are the three previously men-
8 tioned nonconsenting working interest owners, and TXO has
9 assigned part of their interest to APCOT-FINADEL Joint Ven-
10 ture, an agreement between American PetroFina and TXO as to
11 development prospects. It's just a company-wide agreement
12 where we normally assign them 25 percent, or they have an
13 option to take 25 percent of many of our projects.

14 Q When was that assignment made?

15 A I do not know if the assignment's been
16 formally processed, since we have to request the assignment
17 from the interest that we earn from the parties, but they
18 were allowed participation in the well from the beginning.

19 Q So they had a working interest in the be-
20 ginning?

21 A Yes.

22 Q Do they have any overriding royalty or
23 net revenue interest?

24 A Their working interest and net revenue
25 interest is taken directly out of TXO's. If we have 100

1 percent of a well, for instance, with an 80 percent net re-
2 venue, they can come and take 25 percent of that.

3 Q Have they paid their share of the costs
4 of drilling this well?

5 A I assume they have. I know that we've
6 billed them. I don't handle that end. I do not handle that
7 end of the drilling process.

8 Q And on what basis would they be billed?
9 On what total cost of the well would you bill your partners?

10 A On the total cost of the well.

11 Q Is their interest equal in the Morrow and
12 the Bone Springs?

13 A Yes, it is.

14 Q So whatever their interest in the Bone
15 Springs is, it's the same in the Morrow?

16 A Uh-huh. Yes.

17 Q Is it your testimony, Mr. Bourgeois, that
18 you've billed them based on the \$107,000 figure -- I'm sor-
19 ry, \$1,107,000 figure --

20 MR. DICKERSON: Objection, Mr.
21 Examiner. It's his testimony that he does not handle that
22 part of the procedures.

23 Again, our next witness is --
24 and our next exhibit when our next witness gets to it, will
25 cover these exact questions, you might want to wait until

1 then.

2 MS. AUBREY: I'd like to do
3 this quickly, too, Chad. If he doesn't know, he can tell me
4 he doesn't know what they were billed on.

5 Q Do you know, Mr. Bourgeois, what number
6 was used to apply times 25 percent to your partners?

7 A They are going to be billed on whatever
8 costs we incurred. If we incurred -- I do not know exactly
9 what the percentage is between TXO and FINA, but they will
10 be billed on actual well cost from surface to total depth,
11 and I don't know if that's a monthly billing. I know we
12 will not wait until -- until \$1.2-million of invoices stack
13 up before we bill them. I'm sure it's probably a monthly
14 accounting of some sort, but I -- just my assumption.

15 Q What department is that handled through?

16 A Accounting.

17 Q Do you know if TXO was carried for any
18 interest in the well?

19 A No, we were not.

20 MS. AUBREY: That's all I have,
21 Mr. Stogner.

22 MR. STOGNER: Thank you, Ms.
23 Aubrey.

24 Mr. Dickerson, any redirect?

25

REDIRECT EXAMINATION

1
2 BY MR. DICKERSON:

3 Q Mr. Stogner, in reply to Ms. Aubrey's
4 questions concerning allocation of the costs between the
5 Bone Spring and the Morrow portion of this test, this --
6 this well was drilled from the surface to total depth and
7 there is one cost for doing that, isn't there?

8 A That's correct.

9 Q Now, Mr. Sprinkle, you previously testi-
10 fied, never requested to -- the opportunity to participate
11 in a Bone Spring test and be force pooled or not have to
12 participate in a Morrow test, did he?

13 A No, he didn't.

14 Q And when you testified that it was not
15 TXO's intention to break down the cost between the Bone
16 Spring and the Morrow, you didn't intend to imply that it
17 was not TXO's intention to provide first full cost data re-
18 garding all costs incurred in this well, did you not?

19 A Right, we just intended to show all the
20 costs expended in drilling this well.

21 Q And it was your further testimony in res-
22 ponse to Ms. Aubrey's questions that it was TXO's position
23 that Mr. Sprinkle was pooled in this well, not in anyl sep-
24 arate zone in this well. Mr. Sprinkle was pooled in
25 the entire well.

1 A That's correct.

2 Q Now, given the fact that after the fact,
3 now, when all our crystal balls are much clearer than they
4 were before this well was drilled, and we now know that the
5 zones below the Bone Spring were nonproductive in this well
6 and that the Bone Spring was the productive zone in this
7 well, given that fact, the anticipated size of the spacing
8 unit has contracted, hasn't it?

9 A Yes, it has.

10 Q So it is longer 320 acres as it would
11 have been had a Morrow well been completed or had all par-
12 ties throughout the north half of Section 26 voluntarily
13 participated in the drilling of that Sprinkle No. 1 Well and
14 signed a joint operating agreement to that effect, as was
15 requested.

16 A That's correct, and subsequently, now the
17 spacing is the 40 acres being the northwest northwest of
18 Section 26.

19 Q And since Mr. Sprinkle was not a party to
20 a voluntary pooling agreement, which had the contractual ef-
21 fect of pooling the whole north half of Section 20, his in-
22 terest as to his gross and net interest in the Bone Spring
23 production, is different from that that it would have been
24 in the Morrow, is it not?

25 A That's correct.

1 Q You previously testified that his inter-
2 est, his gross interest, his paying interest in the Morrow
3 would have been 15.625 percent of the well, representing his
4 31.25 percent working interest in the northeast quarter, or
5 the northwest quarter, excuse me, pooled over the whole 320
6 acres.

7 A That's correct.

8 Q Now, what is TXO's position as far as the
9 gross income from the well to which Mr. Sprinkle is entit-
10 led, since it is now a Bone Spring well and is producing
11 Bone Spring oil?

12 A TXO's position is that he was pooled in
13 the order with a 15.625 percent interest and therefore it is
14 our contention that we should cover out of 31.25 percent of
15 production 15.1625 percent of the actual well costs, plus
16 the 200 percent penalty.

17 Q In other words, TXO acknowledges that Mr.
18 Sprinkle has twice the interest in production from this Bone
19 Spring well than he would have had in production from a Mor-
20 row well.

21 A Correct.

22 Q By reason of in a Morrow well his inter-
23 est would have been pooled over the entire spacing unit and
24 in a 40-acre spacing unit in which he's got an undivided in-
25 terest there is no pooling necessary.

1 A Right.

2 Q So all you're saying, is it not, is that
3 the entire cost attributable of drilling the well, which
4 was, Mr. Sprinkle's share was 15.625 percent, should be
5 borne out of his net revenue interest attributable to his
6 working interest in the northwest quarter.

7 A Correct.

8 Q Mr. Bourgeois, in response to Ms.
9 Aubrey's question regarding APCOT-FINADEL, to briefly sum-
10 marize would it be true to say that APCOT-FINADEL Joint Ven-
11 ture simply acquired an undivided one-fourth interest of
12 whatever TXO had?

13 A Yeah.

14 Q And Ms. Aubrey's questions regarding the
15 relevance of your earlier testimony regarding the nonconsent
16 provisions or nonconsent penalty provision of the joint
17 operating agreement for subsequent wells and subsequent
18 operations, isn't it true that that testimony was elicited
19 merely to show that as to subsequent wells the parties to
20 the joint operating agreement had agreed on a risk penalty
21 which would be roughly equivalent to that maximum under the
22 statutory compulsory pooling statute?

23 A That's right, that would be.

24 Q It was not designed to show that that --
25 mislead the examiner or cause him to think that that provi-

1 sion applied to the drilling of the initial test well, was
2 it?

3 A No.

4 Q Obviously when all the parties have exe-
5 cuted a joint operating agreement, they, by that fact and by
6 the execution of an AFE, have agreed to pay their share of
7 the costs in the initial well.

8 A Right.

9 Q So that provision applies to subsequent
10 operations.

11 A Uh-huh.

12 Q And that was the purpose the testimony
13 was elicited.

14 A Yes.

15 Q To very briefly summarize the point one
16 more time, Mr. Bourgeois, it is TXO's position in this case
17 that the cost attributable to Mr. Sprinkle's interest in the
18 Sprinkle Federal No. 1 Well is 15.625 of the actual well
19 cost, not to exceed the reasonable well costs of the entire
20 well.

21 A That's correct.

22 Q And that dollar figure, once it is deter-
23 mined in accordance with that when this Division has made
24 its finding as to the reasonable well cost, that dollar
25 figure is to be recovered out of Mr. Sprinkle's net interest

1 after payment of the royalties to which his lease is sub-
2 ject, of any other burdens on his lease, to be recovered out
3 of his 31 percent gross interest in the Sprinkle No. 1 Well.

4 A Correct.

5 MR. DICKERSON: I have no fur-
6 ther questions of this witness, Mr. Examiner.

7 MR. STOGNER: Thank you , Mr.
8 Dickerson. Ms. Aubrey?

9 MS. AUBREY: Thank you.

10

11 RECROSS EXAMINATION

12 BY MS. AUBREY:

13 Q Mr. Bourgeois, if the well were dry in
14 the Morrow, if it had been a dry hole in the Morrow, and
15 there was no other zone to recomplete the well in, do you
16 follow me so far?

17 A Yeah.

18 Q Okay, how much would Mr. Sprinkle have to
19 pay you?

20 A He would have to pay us nothing, because
21 we would not have any zone in which to recover a nonconsent-
22 ing interest out of with a dry hole from surface to total
23 depth.

24 Q And that's because there would be no pro-
25 duction against which the penalty could apply, isn't that

1 right?

2 A That's correct.

3 Q And that's because a nonconsenting work-
4 ing interest owner doesn't have to pay his share of dry hole
5 costs.

6 A Correct.

7 Q He doesn't have to pay for a dry hole if
8 he goes nonconsent.

9 A Correct.

10 Q Does it cost more to drill a well to the
11 Morrow than it does to drill a well to the Bone Spring?

12 A Yes.

13 MS. AUBREY: That's all I have.

14 MR. STOGNER: Thank you, Ms.

15 Aubrey.

16 Mr. Dickerson, any more redi-
17 rect?

18 MR. DICKERSON: No. Mr. Exa-
19 miner?

20 MR. STAMETS: Yes, sir.

21 MR. DICKERSON: If I could say
22 that I think it's apparent to us all where all this is
23 going, and I think we probably all agree that the questions
24 involved are, at this point are legal questions, and not --
25 we're not here on the typical well cost objection case,

1 where we're arguing that the costs of the well, actual costs
2 are the same as the reasonable well costs, nitpicking over
3 whether or not the operator properly carried out his duties
4 as operator, whether he got competitive prices for materials
5 and services rendered in the drilling of that well, and
6 things like that.

7 We're talking about something
8 entirely different. The allocation of the costs between the
9 two zones, and to the extent it would be helpful to the Exa-
10 miner, to get out of order a little bit and take a very
11 brief moment for a little legal argument on the legal issue,
12 we'd be happy to do it, or again, we'll wait until the end.
13 It's your pleasure.

14 MS. AUBREY: So the Examiner's
15 not mislead, we are going to talk about reasonable well
16 costs. That is our intent. It is our claim that the costs,
17 whatever zone they're attributable to, are unreasonable as
18 they have been given to Mr. Sprinkle.

19 That's our first contention.

20 MR. TAYLOR: And is it your
21 contention, Karen, that the actual money, the monies ex-
22 pended were unreasonable or that only the -- that there
23 should be an allocation of those monies and the fact that
24 there hasn't is unreasonable?

25 MS. AUBREY: Well, Jeff, I have

1 three contentions. The first is that the actual dollar fig-
2 ures which are shown by TXO and given to Mr. Sprinkle are
3 unreasonable and inaccurate. That is my first contention.

4 My second contention is that
5 they should be allocated, once we determine what's reason-
6 able here and what's right and fair, we should allocate
7 those costs between the two zones.

8 And my third contention is,
9 once that's done, this Commission, under its powers to re-
10 tain jurisdiction under the forced pooling order, needs to
11 allocate the penalty.

12 So there are three, three
13 claims that we're making.

14 MR. TAYLOR: I see, I didn't
15 understand.

16 MR. DICKERSON: May I state our
17 claims, Mr. Taylor?

18 MR. TAYLOR: Sure, just to
19 clarify what's going on.

20 MR. DICKERSON: In Viking Pet-
21 roleum, Inc., which I'm sure we're all aware, 100 New Mexico
22 451, the first case to reach the Supreme Court of New Mexico
23 involving some of the questions that we're arguing here, and
24 you will recall that in that case Viking wished to partici-
25 pate as to the zones from the surface to the base of the

1 Abo, which was 160-acre spacing, but did not wish to parti-
2 cipate in the remainder of the test objective in the well to
3 be drilled there, which was to the Ordovician
4 formation.

5 This Division denied Viking's
6 application to elect to participate in one zone and not the
7 other, and pooled his interest identically to the manner in
8 which Mr. Sprinkle's interest was pooled in the case for
9 which we're here today.

10 However, very significantly,
11 and I think that the practice of the OCD since that time has
12 recognized that the Supreme Court very clearly in that case
13 seemed to imply and recognize that this Division did have
14 statutory authority, I'm not -- it's not a square holding in
15 that case, because it was not at issue in that case, but I
16 think the case very clearly implies that the Supreme Court
17 was leading toward the construction of our compulsory pool-
18 ing statute, that such allocations can be made within the
19 language of our compulsory pooling statute.

20 That was significant because
21 we're all aware, again, in several cases which have arisen
22 since the Viking case, that was exactly what had happened.

23 Parties have appeared, expres-
24 sed the desire to participate in one zone, not to another
25 zone. The Division, when faced with what it felt was -- or

1 what it found was substantial evidence to support such a re-
2 quest, has on several occasions, to my knowledge, issued or-
3 ders allocating costs and applying the penalty in compulsory
4 pooling cases between zones under such a mechanism. It gets
5 fairly complicated and we know that and understand it, and
6 appreciate it; however, if our statute permits it, it's the
7 duty of this Division in a proper case to do it.

8 However, let me tell you what
9 is significant about the difference between the Viking case
10 and these other cases, and what we're doing here today.

11 This is not a de novo review of
12 the order in Case 8494. This is an objection to well costs;
13 however, Mr. Sprinkle was not here. He made no appearance,
14 personally or by counsel, or by any other representative.

15 First well, of course, and find
16 a good well, and makes everybody smarter, but I submit to
17 you that what is happening here is that this so-called argu-
18 ment over well costs and allocating the costs is a not so
19 subtle attempt to avoid our rules by which we all abide in
20 this Division, and one of those rules that only a party who
21 appears in the Examiner Hearing has standing to object to
22 anything that happened in that hearing.

23 If he wants to protect his in-
24 terest, if he wants to show up and participate in a Bone
25 Spring test and not participate in that portion of a deeper

1 test, and offers evidence on which the Division can do it,
2 we concede under Viking that this Division certainly has the
3 authority, although it's a difficult duty, to -- to do that
4 in a proper case.

5 What Mr. Sprinkle is attempting
6 to do, is to undo what he didn't do last March, or April,
7 February, whenever this hearing was heard. He didn't show
8 up. He didn't want to participate in the Bone Spring test.

9 The whole thing, as you'll re-
10 view the testimony in the earlier case, was that this was a
11 wildcat venture. The testimony was that it was -- the
12 principal objective was the Morrow formation. The Bone
13 Spring objective was a secondary, still hopeful.

14 Before that well was drilled,
15 nobody, including TXO, nor Mr. Sprinkle, knew what was going
16 to happen.

17 What happened was that the Bone
18 Spring and everything -- or everything below the Bone Spring
19 was not productive after being tested. The Bone Spring was,
20 however, productive, and Mr. Sprinkle, by this subterfuge of
21 coming in and now asking this Division to allocate the costs
22 and only charge him with his share of costs in the Bone
23 Springs, is attempting to avoid the problem that he found
24 himself in when he didn't show up and ask to allowed to par-
25 ticipate in the Bone Spring.

1 Of course, conceding that the
2 Division has the power to allow -- have allowed him to do
3 that, it would have required him to put his money up, pay
4 his share of the cost in the well, and there has been no
5 testimony at any point by Mr. Sprinkle that -- no desire ex-
6 pressed at the time of the original hearing that he wanted
7 to participate in drilling any part of this test anywhere
8 from the surface to almost 13,000 feet, he didn't desire to
9 have anything to do with it.

10 But now that it is a commercial
11 producer he wants to take a portion of the cost and we would
12 assume that Ms. Aubrey's probably conjured up some argument
13 here to cut the total well costs, or Bone Springs costs al-
14 located to Mr. Sprinkle to a fraction of what the total well
15 costs in fact were, and only apply his -- or only allow TXO
16 to recover his penalty out of that interest.

17 But we submit that's improper.
18 The order in Case 8494 did exactly what the order upheld by
19 the Supreme Court in Viking did, and that was to pool all
20 mineral interests, whatever they may be, and you'll agree,
21 in that -- or you'll remember in that case that there were
22 -- we were talking -- there were two separate zones invol-
23 ved, the Abo zone, and an Ordovician gas zone, and the sit-
24 uation was exactly the same.

25 What was different in that case

1 was that Viking showed up and desired to participate in the
2 Abo portion of the test, while in that case the OCD disal-
3 lowed his participation, evidently based on unsubstantial
4 evidence in support of it, or something, that situation is
5 entirely and diametrically different than the situation with
6 which we're posed here today.

7 The order in this Case 8494, we
8 submit, is directed to total well costs, so long as those
9 costs do not exceed what is reasonable.

10 We concede, and readily agree,
11 that it is this Division's duty under our statute to deter-
12 mine that an operator does not get away with charging non-
13 consenting and pooled interests with costs which are in ex-
14 cess of what are reasonable and actually necessary under
15 the circumstances.

16 However, it's a far different
17 and more extreme step to leap to the grand conclusion beyond
18 that that by disguising it under that charade and thereby
19 allocate the costs of the well between these two zones and
20 thereby accomplish indirectly, which Mr. Sprinkle cannot do
21 directly, because he's subject to the order. The order is
22 in effect as written. It's not subject to collateral attack
23 or appeal in the courthouse.

24 And we submit that inquiry
25 along these lines of so-called allocation of these costs to

1 any extent deviating from anything except the difference, if
2 any, between actual well costs incurred in all operations
3 on this well and those which are reasonable is not proper
4 and that this Division would save lots of time and simplify
5 the issues greatly by limiting the testimony to be heard in
6 this proceeding to the actual well costs as opposed to those
7 which are reasonable.

8 MR. STOGNER: Ms. Aubrey.

9 MS. AUBREY: Well, I'm not
10 quite sure where we are, Mr. Stogner. It appears to me that
11 Mr. Dickerson has just given his closing statement.

12 I don't care to sit here and
13 argue about the subterfuge perpetrated on anyone. What TXO
14 has done is they've given Mr. Sprinkle a list of costs and
15 they admit those costs are Morrow costs, the costs of the
16 well to the Morrow, and in contravention of our forced
17 pooling statute they want to recover that out of Bone
18 Springs production instead. It's not a complicated thing.
19 They don't have any Morrow production against which they can
20 impose a penalty. They can't collect any money from Mr.
21 Sprinkle in the Morrow because the Morrow was dry, but
22 they've got some production up the hole and they're trying
23 to come in and convince you that it is right and proper and
24 legal under the statute to require the costs of the shall-
25 lower zone to pay for the costs of drilling to the deeper

1 zone, and even their witness agrees would be TXO's risk and
2 cost and obligation if there were no other producing zone in
3 the well.

4 If this well had been dry in
5 the Morrow, as much as they would have liked to charge Mr.
6 Sprinkle for that well, if there were no other producing
7 formations, they couldn't have done it. But they have
8 figured out a way to take a risk-free ride from 8700 to
9 13,500, and that way is to charge the costs of the deeper
10 zone against production from the shallower zone.

11 I submit to you the statute
12 does not permit that to happen. We need to talk about allo-
13 cation of costs here and we need to determine what costs are
14 fair and reasonable.

15 Is it fair and reasonable to
16 charge the cost of getting from 8700 feet to 13,500 for Mor-
17 row gas against a Bone Springs oil well? Is that fair and
18 reasonable? Is that a necessary cost of Bone Springs pro-
19 duction? Of course, it's not.

20 I commend the Viking case to
21 you. It does not help us one bit, unfortunately, in this
22 case because what the Supreme Court actually held was that
23 the Commission can decide this on a case to case basis.
24 That's the whole (not clearly understood).

25 Since that case, however, a

1 number of orders have been issued, one recently and before
2 the Oil Conservation Commission in Case 8631, and two Divi-
3 sion cases, of which I have copies of the orders in Cases
4 7499 and 7992, which recognize that it is not fair, just, or
5 reasonable to make the shallower zone bear the cost of the
6 deeper zone and that costs should be allocated between the
7 two zones.

8 I have copies for the Examiner.
9 I'm sorry, I don't have copies for counsel. I've marked
10 these as Sprinkle Exhibits Number Ten, Eleven, and Twelve,
11 and would ask you to read them together with the copy of the
12 Viking case (not clearly understood).

13 MR. DICKERSON: One very brief
14 sentence, and I will stop, Mr. Stogner.

15 I want you to consider the ram-
16 ifications of what Ms. Aubrey is asking you to do.

17 In every single, compulsory
18 pooling order issued by this Division, assuming this argu-
19 ment is correct, all the force pooled party has to do after
20 that well was drilled at the risk, remember this, always at
21 the risk of the operator who obtained that pooling order,
22 all a party has to do is object to the well costs. Then he
23 goes in, and in southeastern New Mexico we're aware of the
24 fact that we may have ten zones from top to bottom, only one
25 of which may be productive. He says, the cost of this well

1 as to these other nine zones was a waste. It was of no
2 benefit to me. I can't be charged for it because they
3 weren't productive and we're going to allocate the cost in
4 every single case that this Division orders forevermore, if
5 it follows the line of reasoning that Ms. Aubrey is persuad-
6 ing here today, because there's no difference; there's al-
7 ways going to be nonproductive zones in a well.

8 Not every formation drilled
9 through produces oil and gas. Where do we stop?

10 I submit that we stop it if a
11 party desires to participate in a zone by paying his share
12 of the costs and does not desire to participate in the
13 deeper zone, which he considers more risky, we have the
14 mechanism as evidenced by the cases which Ms. Aubrey has
15 brought to your attention, to which I earlier referred, by
16 which this Division can permit that to be done; protect this
17 interest when the facts justify it.

18 The facts do not justify it in
19 this case. There's no way to stop this if we go down this
20 road. The only place to stop it is now and we'd submit that
21 it's improper to receive testimony upon the allocation of
22 costs between the Bone Springs, that it is total well costs
23 we're talking about and whether or not those total well
24 costs are reasonable.

25 MR. STOGNER: Ms. Aubrey.

1 MS. AUBREY: Well, Mr. Stogner,
2 I would like to remind you that that Order 7850 separately
3 pools two zones. This isn't a case where we're going down
4 eight or ten possibly productive formations in a wellbore
5 and picking and choosing among them.

6 TXO came in and asked for two
7 separate pooling paragraphs. They have two separate spacing
8 and proration units. They claim now that the Bone Springs
9 was their secondary objective. There's nothing in the re-
10 cord, I don't believe, before you for you to make that
11 determination, but I don't think that's terribly important.

12 We're not (not clearly under-
13 stood). They tested the Wolfcamp interval. We've got two
14 separately pooled formations. Mr. Sprinkle is not picking
15 and choosing. He was separately pooled in the Bone Springs
16 in the well. He's got the right to go nonconsent in this
17 wellbore. The statute gives him that right and the statute
18 also only gives TXO the right to collect his share of costs
19 out of production, and they want his share of the costs of
20 going out the Morrow out of the shallower zone.

21 MR. STOGNER: I'm going to take
22 a five minute recess at that time.

23

24 (Thereupon a recess was taken.)

25

1 MR. STOGNER: This hearing will
2 come to order again.

3 I've been in counsel with my
4 general counsel and I'm going to let him address the issues
5 here.

6 MR. TAYLOR: I'm somewhat --
7 we're both somewhat confused about who's making what mo-
8 tions, but here's what we've decided to do, in essence:

9 We're going to take under ad-
10 visement the question of -- and not rule now -- of whether
11 or not the really, I suppose, legal issue, although I'm not
12 sure totally, is whether or not the Bone Springs can pay for
13 the Morrow, but we are not going to take any evidence on the
14 allocation of costs between the two today.

15 We're going to wait until we
16 research that issue and can make a ruling one way or an-
17 other.

18 So today, the only other thing
19 in issue is going to be the total, the reasonableness of the
20 total well costs, and not the reasonableness of the alloca-
21 tion between the two zones, until we've made a ruling on
22 whether or not whoever's made that motion is correct.

23 MS. AUBREY: Can I have a clar-
24 ification, Mr. Taylor?

25 MR. TAYLOR: Maybe.

1 MS. AUBREY: As I understand
2 it, you are going to require TXO to justify the actual well
3 costs, contained on whatever exhibit it is they have them
4 on?

5 MR. TAYLOR: Assuming you did
6 say you are objecting not only to the allocation between
7 them but you are also objecting to the total well costs.

8 MS. AUBREY: (Not clearly un-
9 derstood) objecting to the reasonable well costs, but you
10 are not going to require TXO to tell us today which costs
11 are attributable to which zones.

12 MR. TAYLOR: Oh, I think that's
13 what we decided, right.

14 MS. AUBREY: In the event that
15 --

16 MR. TAYLOR: That will -- we're
17 not going to do that until we rule on the question of
18 whether or not the Bone Springs and the Morrow should be
19 separated as to cost of the well.

20 MS. AUBREY: In the event that
21 you rule that TXO is required to allocate those costs to the
22 two zones, are you going to require TXO to come back here
23 and give you that information?

24 MR. TAYLOR: Right, then we'll
25 have a hearing on that, because, obviously, if we ruled in

1 your favor and ruled that the Bone Springs does not have to
2 carry the Morrow, then we would have to take all those costs
3 out of (not clearly understood). Correct?

4 MS. AUBREY: So we'll come back
5 and do this again, then, if you rule that way.

6 MR. TAYLOR: Correct. Unless
7 there's a strong objection to that.

8 MR. DICKERSON: No, that's per-
9 fectly satisfactory with us.

10 MR. TAYLOR: We really didn't
11 want to get into all that until we determine how that ruling
12 is going to be made.

13 MR. DICKERSON: And, Mr. Tay-
14 lor, I might say along those lines, I have fairly diligently
15 searched myself for a case on this exact issue, which you
16 are discussing, and I have not found a case exactly on point,
17 but I'm not totally certain that I have exhausted the law
18 library yet, and I would appreciate an opportunity to, say
19 within ten days, if I can find any authority on the ques-
20 tion, have ten days following today's date in which to sub-
21 mit a short memorandum on the question.

22 MS. AUBREY: And we would as
23 well.

24 MR. TAYLOR: I think that would
25 be a good idea, if you'd like to do it, because we -- that's

1 one reason we're waiting, because we really -- I think it's
2 a novel question for us here as to whether -- what's going
3 on in this well.

4 MR. STOGNER: Would ten days be
5 sufficient for both parties?

6 MR. DICKERSON: To be -- to be
7 safe, Mr. Examiner, why don't you give us twenty days? I
8 can have it in twenty days.

9 MS. AUBREY: Or we could have
10 it that we would be able to perhaps argue the question
11 again, if the examiner wanted argument, at the next docket
12 Mr. Stogner will be the examiner for, which, if I under-
13 stand, will be the 19th of February, and if we could submit
14 memoranda in advance of that, say, five days before the
15 19th, and then perhaps the examiner would give us an oppor-
16 tunity to argue at that hearing.

17 MR. STOGNER: I could be here
18 on the 5th if that would be --

19 MR. DICKERSON: That might push
20 us a little bit, Mr. Examiner. I think it's not going to
21 hurt us to wait and I'd just as soon have the opportunity
22 for little extra time to make sure that I could exhaust --
23 find out whether or not there are any cases on the exact
24 point. The Law of Pooling and Unitization, which I don't
25 know if you have, but it's in the law school library in Al-

1 buquerque, which I looked at last night, and it is --

2 MR. TAYLOR: So you're the one
3 that had it out.

4 MR. DICKERSON: -- close but no
5 cigar.

6 MR. TAYLOR: I was there last
7 night and I saw it laying on the table.

8 MR. DICKERSON: Is that right?
9 Yeah.

10 MR. STOGNER: So the 19th is
11 satisfactory to both of you.

12 MS. AUBREY: If that is satis-
13 factory with the examiner.

14 Would you like the submissions
15 made in advance of that date, Mr. Stogner?

16 MR. TAYLOR: Sure if you could.
17 That way we'd get to read them, if you could do them by Mon-
18 day of that day so we could read them before -- Monday of
19 that week.

20 So we are going forward now on
21 the sole question of the reasonableness of the total well
22 costs.

23 MR. DICKERSON: Correct. I
24 call Mr. Randall Cate at this time.

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RANDALL CATE,

being called as a witness and being duly sworn upon his
oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Cate, what is your full name, your
occupation, and by whom are you employed?

A My name is Randall Cate. I am employed
by TXO Production Corp. in the West Texas District, Midland,
Texas.

My title is District Drilling Engineer.

Q Now, Mr. Cate, you have previously testi-
fied as a petroleum engineer before this Division and had
your credentials made a matter of record within the last
month, have you not?

A Yes, I have.

Q Specifically, with regard to the issues
before the Division today, as to the reasonableness versus
the actual well costs incurred in the Sprinkle Federal No. 1
Well, will you briefly summarize for the Examiner your
experience, your work with TXO, what your employment covers
in connection with the Sprinkle No. 1 Well, which would give
you an opportunity to become familiar with the costs, the

1 operations there were conducted on that well and the costs
2 incurred in the drilling and completing of that well and the
3 resonableness thereof?

4 A Okay. Through my four and a half years
5 at TXO I've been through each department, reservoir, produc-
6 tion, and drilling, and as also supervisor and management --
7 supervisor, I guess, what we'd say, in each of those depart-
8 ments, as the District Engineer in each of those levels.

9 And throughout the drilling of all of our
10 wells that is the District Engineer's responsiblity, is to
11 watch the wells costs, if not to the minutest details, on an
12 overview, and so I have reviewed the AFE that was prepared
13 by Mark Weideman and used in this hearing, and followed the
14 drilling of the well and on the completion, was very closely
15 involved in the completion with recommendations.

16 Q Now, was it Mr. Weideman --

17 A Mark Weideman.

18 Q -- Mark Weideman that testified in the
19 earlier case and who, I believe, testimony in one of the
20 earlier Sprinkle cases, shows did prepare this original AFE.

21 Specifically tell the examiner what has
22 occurred so that Mr. Weideman's duties no longer include
23 coming and testifying to the well costs that you're about to
24 testify to.

25 A I'm not sure if he ever testified.

1 Q No.

2 A Okay.

3 Q I didn't say that, but you said that he
4 prepared the AFE.

5 A Yes, he prepared the AFE --

6 Q Right.

7 A -- under -- under supervision.

8 Q Why is he not here, is what I'm asking?

9 A Well, because it's my responsibility.

10 Q You've changed jobs.

11 A Right. He has gone into a production en-
12 gineering capacity.

13 Q And, specifically, with regard to the
14 drilling and completion of the Sprinkle Federal No. 1 Well,
15 were you the engineer in charge of that completion of that
16 well?

17 A Yes, I am.

18 Q And in connection with your employment in
19 that capacity by TXO, have you -- did you, while the comple-
20 tion was in progress and in the months after that, and have
21 you since that time, are you familiar with all operations
22 incurred in the drilling of the well and the costs charged
23 and paid by TXO for those operations and services?

24 A Yes.

25 MR. DICKERSON: We tender this

1 witness as an expert, Mr. Examiner.

2 MR. STOGNER: Are there any ob-
3 jections?

4 MS. AUBREY: I have no objec-
5 tion.

6 MR. STOGNER: Mr Cate is so
7 qualified.

8 Q Mr. Cate, let us direct our attention to
9 what we have marked and submitted as TXO Exhibit Number Two,
10 and if you would turn to the top sheet of that exhibit,
11 which appears to be a summary of certain costs in connection
12 with this -- with the drilling of this well, and sort of
13 summarize or review the information shown on that summary
14 for the examiner.

15 A Okay. We've got several categories.
16 Gross Estimate is taken off, directly off the AFE, and the
17 Gross Cost category to date, which this should be -- says it
18 was processed in January, is the actual invoice dollars that
19 have been credited towards each of the categories that you
20 see here within the drilling of the well.

21 The Net Cost is for TXO's interest.
22 Gross Variance shows the difference between the actual ver-
23 sus the AFE estimates, and you can go down the line and see
24 that Gross Estimated for -- to complete the drilling of the
25 well was 643, and our totals have been 680, and the comple-

1 tion side of it alone was estimated to be 328 versus the ac-
2 tuals that were 379, 380,000.

3 And at the bottom line down there that
4 the AFE is \$1,023,250.00 in the AFE estimate versus the ac-
5 tual costs, \$1,107,521.

6 So it gives you an idea of the closeness
7 at hand of actuals versus what we anticipated spending and
8 the total cost has come out within 8 percent.

9 Q Your actual costs incurred then exceeded
10 your estimated costs by approximately 8 percent.

11 A That's correct.

12 Q Now, the balance of Exhibit Number Two,
13 Mr. Cate, is nothing more than copies of all the invoices
14 incurred and paid by TXO as operator in the drilling of this
15 well, is that correct?

16 A Yes, to the date that this report was
17 done and I imagine there may be some more straggling in.

18 Q But this report was current at the date
19 shown, January 4th of 1986?

20 A Yes, I believe so.

21 Q Is it customary that there is a lag time
22 between actual contracting for services and goods and the
23 drilling of a well and the time when the invoices are
24 actually received and paid by the operator?

25 A Yes, that's correct, and one more thing.

1 This is -- this report here is printed out in our Accounting
2 Department, and as all the invoices get totaled in, and --
3 but yes, there is a lag time. I would imagine that the
4 great majority of costs have been --have hit this report.

5 Q So that you heard Mr. Bourgeois'
6 testimony regarding the fact that at the point ninety days
7 after the completion of this Sprinkle Federal No. 1 Well,
8 when itemized well costs had to be furnished to Mr. Sprinkle
9 under terms of the order, that simply could not physically
10 be done because of this lag time to this small discrepancy
11 in these figures?

12 A That's correct. The way the system
13 works, we will receive the invoices from the people that do
14 the work for us, and then they are routed through a system
15 of checks from our field peopled, moving them all the way up
16 to -- depending on the cost of it -- even the District Mana-
17 ger may approve certain costs.

18 Then they are routed back down to
19 accounting and sent to Dallas to be taped, and all this
20 takes a lot of time.

21 Q Okay, I'll get into that a little bit
22 more in a few minutes, Mr. Cate.

23 Let me -- directing your attention still
24 to the summary of this Exhibit Number Two, --

25 A Uh-huh.

1 Q -- is a variance of -- or an AFE being
2 exceeded by 108.23 percent, in your opinion is that a
3 material variance as far as what one should expect from an
4 oil and gas operator?

5 A Yes. Of course it was only exceeded by 8
6 percent, and that's well within what we would feel is a very
7 good guess, that sometimes you'll have some come in less if
8 you have unexpected problems. 20 percent above the AFE is
9 not outrageous. Some companies on their AFE's will even add
10 a miscellaneous or a contingency line in there and add 10 or
11 15 percent just for that purpose.

12 Q Now, this Sprinkle Federal No. 1 Well was
13 the first well drilled in the immediate vicinity by TXO, was
14 it not?

15 A Yes, that's correct.

16 Q Now, since that time I believe TXO has
17 drilled two additional wells in the north half of Section
18 26.

19 A That's correct.

20 Q And you're familiar, are you not, with
21 the operations conducted on those wells and the cost incur-
22 red in drilling those wells, also?

23 A Yes.

24 Q Given TXO's experience now in the area,
25 which it did not have in the time they came up with an AFE

1 for the anticipated costs in drilling the Sprinkle Federal
2 No. 1 Well were to be incurred, would you say the -- anyl
3 material, assuming that the Sprinkle Federal No. 1 Well were
4 to be drilled today, given what TXO knows now, would there
5 be any material variation from the AFE, which was used for
6 the drilling of that well originally?

7 A No, I don't believe so, except that a
8 footage rate for drilling contractors, I believe, we might
9 today versue six to eight months ago when the well was spud-
10 ded, I believe it was eight months ago, may be down another
11 \$2.00 a foot, so there could be some \$20,000 difference
12 there with the competition among the rigs.

13 But generally, everything else should be
14 about the same.

15 Q I don't want to belabor this, Mr. Cate,
16 with having you refer to all the invoices which go into the
17 -- all the summaries of the various items of tangible and
18 intangible expense which were incurred in this well, but
19 would it be fair to say that some of your estimates on cer-
20 tain items were high and some were low, but overall the var-
21 iance was slightly in excess of 8 percent of your antici-
22 pated costs?

23 A That's correct.

24 Q Now, Mr. Cate, you made a brief reference
25 a few minutes ago to the procedure by which TXO has it per

1 sonnel review, approve, and process invoices received by
2 subcontractors for payment of costs incurred in drilling a
3 well.

4 For all of our benefit would you briefly,
5 but in a little more detail, describe the procedure TXO uses
6 to approve the costs and invoices such as you've submitted
7 here for final payment by TXO?

8 Q Okay. Virtually every field ticket has
9 to be signed by our foreman. Water-hauling, anything from
10 water-hauling to the trucking charges, tubulars, they are
11 required to sign those.

12 Then as the invoices come in, we have a
13 drilling superintendent, who is the immediate supervisor of
14 all the foremen, and he is required to sign every invoice.

15 If they are under \$1000, I don't see
16 them, but then they will, if they're over \$1000, then they
17 go through me, and then I will approve them and review them
18 and send them on.

19 If they're over \$5000 they go to the next
20 line of supervision, and if, I think it's \$20,000, they'll
21 go to the District Manager.

22 We have a minimum of three signatures re-
23 quired and as many as, I guess, six could be required, de-
24 pending on the cost.

25 Q What's the purpose for such an elaborate

1 procedure and so many parties involved in approval of in-
2 voices for payment by TXO?

3 A It's strictly a safeguard that we know
4 exactly which dollars are spent and if the money that is
5 spent was required and got charged to the correct well.

6 Q Is it common to find invoices about which
7 a question is raised so that some objection at some point in
8 the TXO chain of command is raised to an invoice for some
9 reason or another?

10 A Yes, there have been several instances
11 where the wrong arithmetic, overcharges, something like
12 that, miscoding, is another possibility.

13 Q Would it also be correct to say that that
14 procedure is designed to insure that TXO only pays as opera-
15 tor for goods and services which were actually rendered or
16 delivered --

17 A That's correct.

18 Q -- to its operation? And does a part of
19 that procedure involve making sure that the goods and ser-
20 vices reflected by such invoices were in fact delivered and
21 utilized?

22 A That's correct.

23 Q Mr. Cate, in your opinion, were the ac-
24 tual costs incurred in the drilling of the Sprinkle Federal
25 No. 1 Well of \$1,107,521.63 that amount of money which was

1 reasonably necessary in order to pay for the goods and ser-
2 vices that were rendered in the drilling and completion of
3 that well?

4 A Yes. As far as to date, I believe the
5 majority of the major costs are in and do accurately des-
6 cribe the actual and reasonable cost of the well. There may
7 be a few credits back to the well that haven't hit; maybe
8 some tubing transferred. There may be some invoices that
9 haven't hit that will need to be charged against the well,
10 but I believe this will be a very close, very close number
11 when it's -- when it's over with.

12 Q But is it your testimony that in this
13 case the reasonable costs of drilling and completing the
14 Sprinkle Federal No. 1 Well, which should be allocated by
15 this Division for purposes of the pooling order are the same
16 as the actual cost incurred by TXO for such purposes?

17 A Yes.

18 Q Mr. Cate, very briefly with regard to Ex-
19 hibit Number Two again, I notice a column entitle Net Cost
20 next to the one entitled Gross Cost. If you did not, and I
21 missed it if you did, tell us what those two columns repre-
22 sent.

23 A Yes. I believe I did mention it, but Net
24 Cost is -- is TXO's own working interest that that way we
25 can keep up with the amount of money we're spending. That's

1 --

2 Q And so of that gross cost actually incur-
3 red in the well, that \$845,817.79, was TXO's actual share of
4 the cost of drilling the well.

5 A I believe that's what the column is for.

6 Q And the difference would be cost borne by
7 APCOT-FINADEL or other parties carrying a share of the wor-
8 king interest which we've previously heard?

9 A By the other working interest owners, uh-
10 huh.

11 MR. DICKERSON: Mr. Examiner, I
12 have no further questions of this witness.

13 We move admission of TXO's Ex-
14 hibit Number Two.

15 MR. STOGNER: When you refer to
16 Exhibit Number Two, Mr. Dickerson, do you refer to the en-
17 tire pack?

18 MR. DICKERSON: I refer to the
19 entire thing, yes, sir.

20 MR. STOGNER: Are both of these
21 my copies?

22 MR. DICKERSON: You may have
23 both, yes.

24 MR. STOGNER: Are there any
25 objections, Ms. Aubrey?

1 MS. AUBREY: I have no objec-
2 tion to the admission of the exhibit, Mr. Stogner.

3 May we have a moment, please,
4 so I may discuss Mr. Cate's testimony with my engineering
5 witness?

6 MR. STOGNER: Yes. If there
7 are no objections to Exhibit Number Two, it will be admitted
8 into evidence at this time.

9 About how much time do you --

10 MS. AUBREY: Well, maybe ten
11 minutes.

12 MR. STOGNER: How does twenty
13 minutes sound to everybody?

14 MS. AUBREY: Sounds great.

15 MR. STOGNER: Okay, we'll take
16 a twenty minute little lunch break.

17

18 (Thereupon the noon recess was taken.)

19

20 MR. STOGNER: This hearing will
21 come to order.

22 Ms. Aubrey.

23 MS. AUBREY: Thank you.

24

25

CROSS EXAMINATION

BY MS. AUBREY:

Q Mr. Cate, I believe you testified that you personally approved every invoice over \$1000 that's in connection with the completion of the well, is that -- was that your testimony?

A Yes. I review and approve.

Q And do you sign those invoices?

A Sometimes yes, sometimes no. Now I do. My duties have been expanded in the last few months to sign every invoice over \$1000 regardless, but each engineer that's in charge of this well reviews those invoices.

Q Would there be an engineer's signature, then, on these invoices for this particular well, for the Sprinkle No. 1?

A There will be, and each one should have at least the Drilling and Production Manager's engineer, which is Howard Kemp, and those are the initials HAK, among others.

Q Would that be for all invoices or only those over \$1000?

A Well, just over \$1000, and then a lot of them over \$5000 now, because once I approve them over \$1000, he doesn't see them unless they're \$5000.

Q Did you put your -- you yourself put

1 these invoices together?

2 A No, I didn't. This came from our
3 Accounting Department.

4 Q So someone in your Accounting Department
5 put together a package which contained all the invoices
6 which you have on the Sprinkle No. 1 Well.

7 A That's correct.

8 Q Have you reviewed them to be sure that
9 they are accurate and that all of the invoices are in fact
10 included?

11 A Yeah. I can't promise all of the in-
12 voices are there, but I reviewed them to the best I could to
13 make sure that invoices that were there were charges that
14 had been expected.

15 Q Are you aware, Mr. Cate, that these are
16 not in any particular order?

17 A Yes. They're mainly by date, I believe,
18 as they came in.

19 Q So they're not separated from cost of
20 drilling, completing, and producing the well.

21 A No, they're not. It's as we received
22 them, I'm pretty sure.

23 Q And what department at TXO prepared the
24 first page of Exhibit Number Two, which is your, apparently
25 a computer printout?

1 A That, I believe I testified, is the Ac-
2 counting Department that prepares this page.

3 Q When do you see these invoices, before or
4 after they've gone to Accounting for payment?

5 A They go to Accounting first and there is
6 a voucher with some information recorded on it. The actual
7 invoice is stapled to it and then it's routed up to the en-
8 gineers and the Drilling Superintendent.

9 Q How many wells do you have that responsi-
10 bility for, Mr. Cate?

11 A 100 a year that we drill and 50 wells a
12 year that we participate in that I would see some invoices
13 on.

14 Q I believe you testified that there was
15 only an 8 percent variance between your AFE estimate and
16 your actual cost for the well?

17 A That's correct.

18 Q I believe you also testified that you do
19 not know whether or not all the costs for the well are in.

20 A That's correct.

21 Q Is it possible that the variance will be
22 greater than 8 percent when you get all the invoices in?

23 A It's possible.

24 Q You testified on direct that some com-
25 panies insert a miscellaneous category into their well costs

1 to take care of the additional -- the difference between the
2 AFE and the actual cost of the well, is that your testimony?

3 A Yes. As a risk factor, I guess, they'll
4 just add 10 percent or 15; some companies do.

5 Q Now how do they designate that on their
6 printouts or on their actual well costs?

7 A There will be a category that will say
8 miscellaneous or contingency, and that's all it's for.

9 Q You have some categories here, such as
10 Other IDC, Other Equipment, Other Completion IDC. Is that
11 the sort of category you're talking about on this document?

12 A No. It's any other intangible drilling
13 costs, is what that is, and trucking might go there or some
14 BOT testing, things like that, and the accountants did not
15 put any -- any charge to that, but we don't have a cost on
16 the AFE that's just a -- that you take a certain percentage
17 of what you've already got and add it on top and say, that
18 covers it.

19 Q Now, I -- these numbers next to your
20 written categories on Exhibit Number Two, are those account-
21 ing codes?

22 A Those are accounting codes.

23 Q Do you know why the accounting code for
24 Legal and the accounting code for Other Completion IDC is
25 the same?

1 A No, I don't.

2 Q Do you know what Other Completion IDC is?

3 A Well, Other Completion IDC could be
4 trucking, some contract labor, perhaps, that's an intangible
5 thing that may not necessarily be coded right under -- under
6 this other, but I don't know why, you know, there's no, I
7 mean, a cost applied up there but yet there is some in com-
8 pletion.

9 I'm not (not clearly understood.)

10 Q Let me have you stick with that classifi-
11 cation for a moment. Your AFE has \$10,000 worth of Other
12 Completion IDC. On your Exhibit Two you show \$10,000 Esti-
13 mated Other Completion IDC. Do you see that, Mr. Cate?

14 A Under Completion, yes.

15 Q That's correct, sir.

16 A Uh-huh.

17 Q Gross Cost of \$5,837.37.

18 A Correct.

19 Q Do you know what that is?

20 A Off the top of my head, I don't. I can't
21 remember which invoices went in there.

22 Q Do you know, sir, whether or not there
23 are in fact any invoices in here for that category?

24 A No, I can't say I do. It's my guess
25 there's been 100 or more invoices. I'm not sure.

1 Q Mr. Cate, you were here in Santa Fe on
2 the 9th of January when a copy of this package which you've
3 makred as Exhibit Two was given to Sprinkle, is that cor-
4 rect?

5 A Yes, ma'am.

6 Q Have you made an inquiry, Mr. Cate, into
7 whether or not in this package of documents, which is
8 Exhibit Number Two, there is an invoice which correctly, or
9 which reflects at all your Gross Cost, shown in your second
10 column on the left on Exhibit Number Two?

11 A If -- would you state that again, please?

12 Q Sure.

13 A If the invoices --

14 Q Do you know if you have given us an
15 invoice for each cost shown under your Gross Cost category?

16 A The invoices for each category, as they
17 are coded, should add up to this sum right here, but I
18 didn't go in and add every invoice, assuming that the
19 computer is correct in its total for what code it -- the
20 invoices got charged to.

21 Q You show here 90,148.74 for Surface &
22 Intermediate Casing, right?

23 A Correct.

24 Q That's code 102. Right?

25 A Yes, ma'am.

1 Q Down under Drilling, I'm sorry, down un-
2 der your completion portion, you also show another code 102
3 and that's in the amount of 117,155.42.

4 A That's correct.

5 Q Is it your testimony that the invoices in
6 this pile of documents, which reflect the total of adding
7 those two, 90,000 plus 117,000?

8 A There should be. If ot invoices, then
9 material transfers or something to that -- well, it would
10 have to be one or the other, a transfer or a work order
11 which shows the cost was there before it would get here,
12 yes.

13 Q Let me ask you about material transfers,
14 Mr. Cate. Can you explain what those are to the Examiner?

15 A Yes. A material transfer from an engin-
16 eering point of view, I'm not an accountant, but from what I
17 understand, if there is equipment that is either in stock,
18 inventory, or is on a well, another well, that is abandoned,
19 shut in for one reason or another, and that equipment is
20 needed on a new well, then we will use the old equipment,
21 grade it for its condition, and then transfer that equipment
22 out of stock, from another well, to the well that we're
23 going to use it on.

24 Then a little material transfer slip is
25 filled out in the field and it comes into the office where

1 we have material coordinators which will prepare these
2 material transfer sheets in Exhibit Two. They will find the
3 list cost of the item based on the graded condition from
4 what the field people say the grade is, deduct a certain
5 percentage due to the lesser value based on condition.

6 Q The production casing, for instance, on
7 this well, is reflected in your invoices by material trans-
8 fers, is that correct?

9 A Yes, I believe it is.

10 Q There is other equipment which you have
11 included in Exhibit Two that is reflected on material trans-
12 fers, is that correct?

13 A Yes, there is.

14 Q I believe you testified on direct about
15 the similarity between the cost estimate for drilling the
16 Sprinkle No. 1 and the other wells you've drilled in the
17 area? Do you recall that series of questions and answers
18 between you and your attorney?

19 A Yes, as far as being reasonable for the
20 area, yes.

21 Q The other wells in the area are not Mor-
22 row wells, are they?

23 A There are some other Morrow wells, not in
24 the immediate area.

25 Q The other wells that TXO has drilled and

1 proposes to drill in this area are not Morrow wells.

2 A They are not Morrow tests.

3 Q Have you broken out, in order to justify
4 that statement, have you compared the cost of the Bone
5 Springs in this wellbore to the cost of the Bone Springs --

6 MR. DICKERSON: Objection.

7 Q -- in that wellbore?

8 MR. DICKERSON: Objection, Mr.
9 Examiner. We, if I don't misunderstand the previous ruling,
10 are not going into that line of inquiry at this date.

11 MS. AUBREY: That is not my in-
12 tent, Mr. Examiner. My intent is to test his knowledge.

13 He told you these are reason-
14 able and he compared them to the other TXO Bone Springs
15 wells, and I think it's only fair that I'm allowed to in-
16 quire as to how he made -- how he makes that statement.

17 MR. STOGNER: Objection over-
18 ruled.

19 A Would you state the question again,
20 please?

21 Q Sure. You testified on direct that in
22 your opinion the costs of the Sprinkle No. 1 are reasonable
23 compared to the other wells that TXO has drilled in this
24 area. Do you recall that testimony?

25 A Yes. It doesn't sound like what I meant,

1 because you can't compare the No. 1 to the other wells, the
2 two --

3 Q Well, tell me what you meant, then, Mr.
4 Cates.

5 A Well, do you remember, can you read me
6 the question that I answered, and that will help?

7 Q No, I can't. Let me try asking you an-
8 other question.

9 Did you have an opinion, did you intend
10 to give the Examiner an opinion that in comparison with the
11 other wells which TXO has drilled, that your well costs are
12 reasonable for the Sprinkle No. 1?

13 A I would -- I would say yes, if I can
14 qualify it.

15 Q Please do.

16 A The Sprinkle No. 1 is a Morrow test and
17 the costs incurred for a Morrow test were reasonable; just
18 as the costs that we occurred on the other wells we've drill-
19 led, even though they are two totally separate wells by de-
20 sign, by conception, by products required, by costs, that in
21 itself is reasonable, also.

22 Q So to go back to my original question,
23 you have not compared the Bone Springs costs in the Sprinkle
24 No. 1 with the Bone Springs costs in the Sprinkle 2, 3, your
25 proposed 3, or 4.

1 A Yes, now I have a portion of it. I com-
2 pared what we had done on the completion side for the Sprin-
3 kle No. 2 as to what it cost on the completion for the
4 Sprinkle No. 1. I have compared that and subsequently,
5 that's reflected in the AFE's that were done on some other
6 wells.

7 Q Would that be the 3 and the 4, Sprinkle 3
8 and 4?

9 A Well, more so the Burlesons. The AFE's
10 for the Sprinkle 3 and 4 were prepared prior to the comple-
11 tion of the Sprinkle and Burleson wells.

12 Q Would you agree with me, Mr. Cates, that
13 the footage drilling rate is less for a shallower well than
14 for a deeper well?

15 A Yes.

16 Q Do you know what that difference happens
17 to be?

18 A Yes.

19 Q Can you tell me what it is?

20 A It is generally a direct function of the
21 number of days that the rig will be required to stay on the
22 location.

23 Q You have Footage/Turnkey Drilling here as
24 zero?

25 A Yes.

1 Q And then you have Daywork Drilling?

2 A Right.

3 Q Can you explain the difference between
4 those two?

5 A Yes. When the AFE was prepared, the
6 costs on the AFE were put under a daywork cost, as for the
7 AFE estimate, and it's easier to do because we know the num-
8 ber of days from wells in the area that it will take to com-
9 plete the well, and then you can back out what the footage
10 rate should be.

11 So on the AFE the code was under Daywork,
12 and so that's how it -- why it got coded, even though we
13 went on a footage contract, which people do that, and gener-
14 ally it's going footage now.

15 But the AFE categories that day were what
16 the costs came in as a footage, but the cost has to go under
17 what it was in the AFE accountingwise.

18 Q Let me see if I'm with you here.

19 It says Daywork Drilling, Gross Estimate
20 247; Gross Cost 353,956.

21 A Correct.

22 Q But that's really footage.

23 A The \$353,000 is a footage rate. It also
24 includes category 267, Rig Support. It also includes cate-
25 gory 231, Bits. So those 247,000, plus the 25,000, plus the

1 42,000, Gross Estimate dollars, would be covered under the
2 353 for the footage rate.

3 Q Plus the 911.45 and the 200, I assume.

4 A That's correct.

5 Q Right. Mr. Cates, I'm trying to figure
6 out what the fast way to do this is and I'm not sure that I
7 know.

8 Well, I'll just do it what I think the
9 fast way and if Mr. Dickerson doesn't like it, we can talk
10 about it.

11 Let me tell you, sir, --

12 MR. DICKERSON: Give up.

13 Q We have been through this pile of docu-
14 ments which you gave us. There are no invoices for the sur-
15 face and intermediate casing.

16 A And no material transfers?

17 Q And no material transfers. There are no
18 invoices for drilling overhead. There are no invoices --

19 A May I say something? There will not be
20 an invoice, I don't believe there will be an invoice under
21 overhead, because that's a calculated rate based on JOA num-
22 bers, and I believe that's correct, so there shouldn't be
23 any invoice there.

24 Q There is a \$13,000 difference between
25 your invoices for production casing, which is reflected in

1 the material transfers and the cost which you show of
2 \$117,000.

3 There are no invoices for meters or in-
4 stallation overhead.

5 There are no invoices for supervision un-
6 der the completion supervision.

7 And in a number of other instances there
8 are material differences between the total of your invoices
9 and your costs.

10 Now, I don't want to go through page by
11 page. What I would like to do is ask Mr. Dickerson if he
12 has any objection to having me show the witness Sprinkle
13 Number Four, which is a cost analysis prepared by Mr. Bill
14 McCoy, so that I can go through that with him.

15 MR. DICKERSON: No, I don't
16 have any objection.

17 Is that the -- one of your pro-
18 posed --

19 MS. AUBREY: That's one of our
20 proposed exhibits.

21 A You said the Sprinkle 4?

22 Q It's Sprinkle Exhibit Number Four.

23 A Oh.

24 Q I have an extra copy, Mr Dickerson, to
25 give the witness.

1 Mr. Cates, let me have you look at Sprin-
2 kle Exhibit Number Four, which is entitled Cost Analysis.

3 A Okay.

4 Q And let's start with something fairly
5 simple.

6 Let's start with category 213 under
7 Drilling, which is Legal.

8 Do you know what that \$5,202 figure is
9 for?

10 A Not of the top of my head. I can't
11 remember everyone of these invoices.

12 Q Your invoice in your invoice packet,
13 there is an invoice for \$723.91 for a Surface Use Plant.

14 A That was probably our filing fees and our
15 use of Arthur Brown for the permitting.

16 Q What, in your opinion, would account for
17 the remainder of the cost?

18 A Oh, there -- well, without really seeing
19 it, I can't be sure, but I'd imagine that there are other
20 legal fees that -- not legal fees, but fees for permitting,
21 possibly staking.

22 See, accounting, as many invoices as
23 there are in a million dollar well, which you see, at least
24 most of them, if not all of them, there are going to most
25 likely be some accounting mistakes.

1 So in coding, I found some myself in cod-
2 ing, and it's highly possible that some things got miscoded.

3 Q Is there any way we can tell from what
4 you've given us what is correctly coded and what is not?

5 A Not unless we go through each one and if
6 you'd like to do that, I can -- we can save time and I can
7 get with the accountants and see exactly which one and we'll
8 send you a corrected version.

9 Q Well, Mr. Cate, I assumed that's what we
10 had here in Exhibit Number Two, that this was a correct ver-
11 sion of the cost of this well.

12 Let's go on up the page, if you don't
13 know what the remainder of the legal costs are, let's move
14 on to your category, oh, number 233. It says there Cement-
15 ing Services and Supplies.

16 Your invoice, your cost as shown on your
17 exhibit is 66,231.92?

18 A Yes, ma'am.

19 Q And our total of the invoices you've
20 given us is 48,252.49.

21 Can you explain discrepancy?

22 A I believe if we go down to the Cementing
23 Services, number 233, the TXO cost is only 4000 versus
24 16,000 in invoices and I believe it's apparent that those
25 invoices were miscoded as Completion instead of -- and

1 should be up under the Drilling.

2 Q So if I add 66,231.92 and 4,089.13, I
3 should come up to the same number as if I add your invoices,
4 is that correct?

5 A It's -- I'm not sure that it should be
6 correct.

7 Q You're not sure that it should be cor-
8 rect?

9 A No. You all have added, may I assume
10 that you all have added your invoices under this invoice
11 side over here?

12 Q Let me tell you --

13 A I don't know that our accounting
14 procedure was the same as ours.

15 Q Let me tell me what we've done. We've
16 used your accounting codes; separated the invoices out
17 according to your accounting codes which are shown in part
18 on -- on your Exhibit Number Two, but in more detail on the
19 initial letter and attachment that you sent to Mr. Sprinkle,
20 and have added up the invoices according to your own
21 accounting codes, whatever those are.

22 A Okay.

23 Q Under number 104 for the Casinghead, your
24 invoices exceed your costs. Is that again, in your opinion,
25 a coding error?

1 A I believe so. If we go down to Wellhead
2 Equipment, invoices are less than the cost, so probably some
3 wellhead equipment got charged as casinghead equipment.

4 Q Is that correct from either an engineer-
5 ing or accounting point of view?

6 A I won't say it's correct but it's under-
7 standable and highly likely. I don't think -- for one
8 thing, that's why we have audits. Everybody has audits be-
9 cause every company makes mistakes in coding and invoice
10 procedures.

11 So, no, it's not correct but unfortunate-
12 ly, something that was going to happen.

13 Q Is it something that can be corrected
14 through an audit?

15 A Yes, and we do audits, internal audits.

16 Q How about external audits?

17 A I think those are done, also.

18 Q Are you aware that those are often pro-
19 vided for in the terms of a joint operating agreement?

20 A I'm not aware of that.

21 Q Would you agree with me that given what-
22 ever the coding confusion is here, it would require some
23 kind of an audit to straighten this out before we can talk
24 meaningfully about the differences between your invoices and
25 your costs?

1 A I don't think -- for instance, I found
2 the material transfer where the intermediate and surface
3 pipe was transferred out there, so, obviously, you all mis-
4 sed that one.

5 Q Is that the Farmer's invoice that you're
6 looking at? Is that an invoice from Farmer or is that a
7 material transfer?

8 A No. No. This is a material transfer.

9 Q Is that for the production string?

10 A This is for 8-5/8ths, 18-3/8ths foot,
11 this is a transfer back to the yard. This is what was left.

12 Q We didn't find anything transferring it
13 out to the location.

14 A No, that wasn't the one. I'd like to
15 keep looking.

16 Q Please do.

17 A It should be there. It is obvious, is it
18 not, that that casing is there, or are you questioning if
19 it's even there?

20 It's in the well and it cost money so it
21 --

22 Q Well, my question is how much, Mr. Cate.
23 it cost.

24 A Well, well --

25 MR. TAYLOR: Karen, how about

1 if TXO undertakes to match up and provide invoices for each
2 thing and show you which they are so that you can add -- or
3 what's your problem? We don't want to just sit here and
4 look through invoices all day.

5 MS. AUBREY: No, I don't want
6 to look through invoices, either. That's what they gave us.
7 It's not Sprinkle's fault if they are miscoded, if that's
8 true.

9 A Right.

10 MR. TAYLOR: Well, what would
11 you prefer? I mean, we're suggesting that maybe they --

12 MR. DICKERSON: We would be
13 glad to do that, Mr. Examiner. I think there were obviously
14 some things that are not explained and they need some
15 explanation, and since we're going to be back here on the
16 19th, we will undertake to do that.

17 MS. AUBREY: Let me then just
18 direct Mr. Cate to some very specific invoices which are in
19 here and ask him some questions about those.

20 Would that be an acceptable way
21 to proceed?

22 MR. STOGNER: Yes. Which in-
23 voices are those?

24 MS. AUBREY: Well, I have taken
25 the liberty of marking them as exhibits and they're in my

1 exhibit package.

2 MR. STOGNER: And those exhibit
3 packages are invoices that you pulled out of their Exhibit
4 Two --

5 MS. AUBREY: Yes, sir.

6 MR. STOGNER: -- is that cor-
7 rect?

8 MS. AUBREY: Yes, sir. They
9 came out of the copy of Exhibit Two which was given to us
10 on the 9th of January.

11 MR. TAYLOR: But before the
12 next hearing they will provide us with the number of in-
13 voices that add up to the total and they will match up in-
14 voices as against each line item so that you can figure it
15 out.

16 A Yes. I didn't realize it was going to be
17 so hard to follow.

18 MR. TAYLOR: Why don't you tell
19 them when you need it by? When is the next hearing?

20 MS. AUBREY: The next hearing
21 is on the 5th. I don't know whether you can do that by the
22 5th? We could do it on the 19th.

23 MR. DICKERSON: Their big prob-
24 lem, as I understand it, is that the accounting is handled
25 and we have to contact the Dallas Office and there's a ques-

1 tion of coordination. We will -- Karen, let me call you
2 next week. We -- let me just leave it like this.

3 We will try to have -- as I un-
4 derstand it, our next, in this case, is the 19th.

5 MS. AUBREY: I'm going to be
6 back on the 19th, anyway.

7 MR. DICKERSON: And so -- but
8 we will --

9 MR. TAYLOR: Prior to that
10 time.

11 MR. DICKERSON: We will get
12 with the accountants in Dallas, have Mr. Cate coordinate
13 with them, and if it just can be done by the 5th, which
14 would be two weeks, we will endeavor to expound a little bit
15 by that time.

16 MS. AUBREY: Let me say for the
17 record, Mr. McKay will not -- Mr. McCoy will not be avail-
18 able as a witness on the 5th, so maybe just planning on the
19 19th is going to be the safest way for everyone to go.

20 MR. DICKERSON: Yeah, I thought
21 that's what we'd done, anyway.

22 But we can still -- if we can
23 get them by the 5th so that you have some time, we'll --
24 we'll try to get them compared and picked apart by the 5th.

25 MR. TAYLOR: Why don't you pro-

1 vide us with a copy at the same time you provide them with
2 one.

3 We'll have our accountants re-
4 view it.

5 MR. DICKERSON: We'll have
6 ours, too.

7 Q Let me have you look at what I've marked
8 as Sprinkle Exhibit Number Six, Mr. Cate. It's a two-page
9 exhibit. I'm sorry, it's a four-page exhibit, the first two
10 pages of which are photocopies of your material transfer
11 tickets.

12 A Okay.

13 Q As I read this, this is a material trans-
14 fer of a certain number of joints of 4-1/2 inch N-80 casing.

15 Am I reading that correctly, the first
16 page?

17 A I believe that's correct, out of -- out
18 of Dallas, provided to us by Dallas, yes.

19 Q What price per square foot -- I'm -- per
20 foot have you charged for this casing?

21 A I haven't got a calculator or -- this
22 dollar figure that you've calculated, I assume is -- go
23 ahead and use that?

24 Q Well, I'm assuming it's correct. You're
25 willing to --

1 A It looks correct.

2 MS. AUBREY: So that the re-
3 cord's clear, Mr. Examiner, the notations in handwriting on
4 this exhibit were made by our witness.

5 MR. STOGNER: 6.74 per foot?

6 MS. AUBREY: Yes, and 9.56 per
7 foot.

8 A Yes, that's correct.

9 Q Now one of these appears to be a "To" and
10 one of them appears to be a "From".

11 A Uh-huh.

12 Q Can you explain that to me?

13 A Well, I believe that this upper one, the
14 top box shows that it was sent from Dallas and the lower box
15 is to the Sprinkle No. 1 Well.

16 Q And have you checked to see whether or
17 not \$6.74 a foot is correct?

18 A Yes, as far as what shows to be transfer-
19 red here.

20 Q Does that mean that you transferred out
21 of your warehouse at \$6.74 a square foot -- \$6.74 a foot?

22 A That, I'm not sure if that is what this
23 number is saying or not.

24 Q How do we figure that out, Mr. Cate.

25 A It's something I can get with the ac-

1 counting people and see if that's a book value that was
2 transferred out.

3 Q And that portion of that exhibit shows
4 apparently that it was charged to the Sprinkle No. 1 Well at
5 \$9.56.

6 A That's what it appears.

7 Q Does that appear to you to be fair and
8 reasonable?

9 A It appears to be reasonable if this is
10 the list price for casing and I've got my little book, let
11 me check if it is list price with maybe some added for the
12 inspecting and drifting, and trucking will be on there, al-
13 so, should be.

14 That is an industry-accepted thing when
15 you transfer items out of stock, they come out at list
16 price.

17 Q Okay, but when you -- when you transfer
18 them out of a warehouse, aren't they supposed to be trans-
19 ferred to the location at the same price per foot?

20 A Not necessarily. I don't know of any ac-
21 counting procedure that guarantees that, and I know of some
22 that allow the opposite.

23 Q And this is Class A equipment, is that
24 right?

25 A That's what it says.

1 Q There would be a difference if it were
2 Class B, is that right?

3 A That's correct.

4 Q And you don't know right now what the
5 list price for Class A 4-1/2 inch N-80 casing is?

6 A Yeah, I can find out what the price would
7 be.

8 MS. AUBREY: So the record is
9 clear, sir, whose price book is that?

10 A Okay, this is Lone Star Steel Company.
11 It's a Casing and Tubing, Technical Data, Dimensions and
12 Performance Properties, and --

13 Q What date is that, sir?

14 A It is the 1983 publication, and in it --
15 so this shows to be the list price of \$830 per 100 foot,
16 which would be \$8.30, and then if you add testing, drifting,
17 inspecting, and trucking, I can see that value being cor-
18 rect.

19 Q Are the prices less now than they were in
20 1983?

21 A Which prices?

22 Q Prices for 4-1/2 inch N-80 casing.

23 A We still use this publication. Lone Star
24 still uses this price.

25 Q So you don't know whether this reflects

1 the actual market value on the market when this well was
2 drilled of N-80 casing.

3 A It probably should have.

4 Q You don't know that, though, Mr. Cates,
5 do you?

6 A No, I don't know it for certain.

7 Q And if I were to tell you that as of the
8 date this well was drilling, one could purchase that casing
9 for 5.95 as opposed to 9.56, would you have an opinion about
10 that?

11 A From Lone Star?

12 Q From Lone Star.

13 A Delivered, that's delivered, tested,
14 drifted, including trucking.

15 Q Delivered to location; brand new casing;
16 not casing out of the warehouse.

17 A Well, I guess I would believe it.
18 Reasonable cost, you know, as outlined in the accounting
19 procedures, that would be reasonable if these procedures are
20 being used, which they are not only by TXO but other
21 companies. That is, it must be reasonable if it is being
22 accepted by many companies.

23 Q Do you have an opinion as to whether it's
24 fair and reasonable to charge equipment which TXO has stock-
25 piled and has on hand to its working interest parties at a

1 price which is in excess of the list price?

2 A I don't believe that's -- it's not in ex-
3 cess of our list price.

4 Q Well, you're not selling it; you're buy-
5 ing it, aren't you?

6 A That's correct.

7 Q And you're not buying it for this well
8 because you've already got it in your warehouse, isn't that
9 right?

10 A That's correct.

11 Q And if you could buy this from Lone Star
12 delivered to your location for 5.95, do you have an opinion
13 as to whether it's fair and reasonable to charge your work-
14 ing interest parties more than that?

15 A Well, I'll say that it's reasonable. I
16 can't say that it's totally fair, but I don't know that
17 that's the question.

18 Q Well, what's reasonable about it? Is it
19 TXO's intent to make a profit out of its working interest
20 parties by casing the well at a price out of the warehouse
21 which is higher than the market price?

22 A No, and as a matter of fact, any working
23 interest owner under JOA has the right to bring their own
24 casing out there if they wish to.

25 Q But not a nonconsenting working interest

1 owner, is that right?

2 A I suppose that's correct.

3 Q So if a man decides he doesn't want to
4 consent in the well are you telling me you think it's fair
5 and reasonable to charge twice as much for the casing as a
6 working interest owner that provides the casing to the loca-
7 tion?

8 A Again, it may be reasonable under -- un-
9 der accepted industry practices.

10 Q Are you testifying before this Examiner
11 that that is an accepted industry practice?

12 A I believe it is because we are partici-
13 pating in wells where the same thing happens. Items out of
14 stock come to us at list price, also.

15 Q At whose list, Mr Cate, a 1983 list that
16 TXO uses because it's higher than the market price now?

17 A That's not the reasons it is used. The
18 reason it is used is because that is what Lone Star Steel
19 has given us.

20 Q Well, do you ever call Lone Star Steel on
21 the telephone and ask them how much this stuff costs?

22 A No, we don't. It's handled out of Dal-
23 las.

24 Q So you charge your working interest par-
25 ties 9.56. You can buy it on the open market today for

1 5.22, and you were telling this examiner that that's a
2 reasonable well cost.

3 A Yes, it's reasonable and accepted.

4 Q Let me have you look at the last two
5 pages of Sprinkle Exhibit Number Six.

6 Do you know anything about Bearing Ser-
7 vice and Supply?

8 A No, ma'am.

9 Q Will you agree with me that this letter
10 dated January 17th, 1986, signed by Ray Owens to Bill McCoy
11 shows N-80 casing at 5.22 a feet "FOB your location 10 miles
12 southeast of Maljamar"?

13 A I'll agree that that is the unit price.
14 I don't -- can you show me where it is for the same quality
15 Lone Star casing?

16 Q Well, does it make a difference?

17 A You're darned right it makes a differ-
18 ence.

19 Q If it's designated --

20 A If it's Japanese pipe, it's low quality.
21 You get what you pay for.

22 Q And would you agree with me that the API
23 designation means something?

24 A Yes, API means it meets a minimum re-
25 quirement. It doesn't mean it exceeds it.

1 Q Would you compare that with the quality
2 of the casing you use?

3 A Well, ours is API 5A. Yours is API R-3,
4 and I can't say which is a better quality, but based on the
5 price I'd assume this is the lesser quality.

6 Q You're assuming based on which price?

7 A On the price differential between the
8 list, the book list price and this bid price.

9 Q Between your 1983 \$8-some odd cent price
10 or your \$9.56 price, or your \$6.74 price?

11 A Based on the \$9.00 price.

12 MR. DICKERSON: Mr. Examiner,
13 before we pursue this -- I don't know how much further we're
14 going to pursue it, but I would just point out that I'm not
15 desiring to limit Ms. Aubrey's cross examination; however,
16 many of her questions are based on assumed facts which are
17 not yet in evidence.

18 I'll just point that out for
19 all of our consideration.

20 MR. STOGNER: It will be so
21 noted.

22 MS. AUBREY: I would point out,
23 also, that these are for the most part exhibits that came
24 out of TXO's file.

25 We can do this the slow way or

1 we can do it the fast way.

2 MR. DICKERSON: Okay, I'm let-
3 ting you go.

4 Q Look at the second page of Exhibit Number
5 Six now.

6 A Okay.

7 Q This shows both S-95 casing and N-80
8 casing, is that correct?

9 A That's correct.

10 Q The material transfer out of your ware-
11 house, is that correct?

12 A No.

13 Q Well, where's it from?

14 A It appears to be from the Sprinkle Well
15 to -- to the warehouse.

16 Q Is this the same casing that we saw on
17 the previous page?

18 A It appears that at least the N-80 casing
19 is the same and based on your numbers, it appears the price
20 actually got transferred back to the warehouse at a higher
21 price than we sent it to the well.

22 Q Do you know whether or not there is any-
23 thing in your packet of documents showing the price transfer
24 to the location of the S-95 casing?

25 A Okay, well, let me look through our file.

1 I thought there was something showing that price.

2 I wanted to go through one more time and
3 see if that transfer was in here.

4 Q Okay.

5 A But I haven't seen it.

6 Q Well, I'm not going to hold you, Mr.
7 Cates, as to whether or not it's in there.

8 Why don't we move on to another question,
9 unless you feel like you want ot continue to look.

10 A No, that's all right.

11 Q Let me have you look at what we've marked
12 as our Exhibit Number Seven, which is a document out of
13 TXO's files.

14 Do you have that in front of you, sir?

15 A It's a --

16 Q Number Seven, Stack Pack, material trans-
17 fer.

18 A Okay, I just didn't see it marked on
19 here.

20 Q I'm sorry, sir, it's marked on the back.

21 A Ah, okay.

22 Q No wonder you didn't see it.

23 It's a two-page exhibit, Mr. Cate. Let
24 me begin by asking you to look at both pages.

25 First of all, can you tell me what a

1 stack pack is?

2 A A stack pack is a combination vertical
3 separator and heater-treater for gas wells, mainly. You
4 don't need a stack pack for oil wells.

5 Q This appears to me, and correct me if I'm
6 wrong, to have been transferred from the Pioneer Federal
7 Well No. 1 to the Sprinkle Federal No. 1 sometime in August
8 of 1985, Date Moved 8/05/85. Do you see that, sir?

9 A Yes.

10 Q And it was moved back from the Sprinkle
11 No. 1 to Pioneer Federal No. 1 on 8/12/85. Do you see that?

12 A Yes, I do.

13 Q And this is a piece of equipment that we
14 need for a gas well.

15 A That's correct.

16 Q And the Sprinkle No. 1 is producing oil.
17 Is that correct?

18 A Yes.

19 Q Was it completed as a gas well?

20 A No, but there was certainly a chance when
21 we were testing the Wolfcamp that it might have been a gas
22 well.

23 Q When did you test the Wolfcamp in this
24 well?

25 A Let me find the exact dates. It appears

1 that was in early July.

2 Q Does it appear from your records that you
3 perforated the Bone Springs in the wellbore about July 5th,
4 coming back up the hole?

5 A It's within a couple days, yes.

6 Q Middle of July sometime.

7 A Right.

8 Q And at that time you had abandoned any
9 hopes that this would ever be a gas well in the Morrow or
10 Wolfcamp?

11 A Yes, and that should not have been
12 transferred, I agree. I don't see any reason for it myself
13 and I'll look into it.

14 Q Now, we're not finished with Number
15 Seven, yet, Mr. Case.

16 It appears to me that it was transferred
17 to the Sprinkle Well on 8-5-85 at a cost of \$9,768. Am I
18 correct in reading that document that way?

19 A Yes, that's correct.

20 Q And that it was transferred back to the
21 Pioneer Federal Com seven days later at a cost of \$6,169.
22 Am I correct about that?

23 A That's correct.

24 Q Did it lose \$3000 in value in seven days
25 sitting on the location?

1 A No, it did not.

2 Q What is your explanation for the discre-
3 pancy in those numbers?

4 A I'm not sure because I would think it
5 was a typo because we've got a whole lot less interest in
6 Pioneer.

7 Q In what sense do you mean "a typo"?

8 A Well, or just missed. The conditions are
9 the same; it's in the same condition. It's not used.

10 The only thing I can see that might have
11 come out of that is some trucking back and forth and that
12 may be the difference, but --

13 Q \$3000 worth of trucking for a piece of
14 equipment you didn't need for an oil well?

15 A I agree that it shouldn't have been done.

16 Q Do you know whether or not there are any
17 invoices for tubing in this packet of documents?

18 A I thought there were some material trans-
19 fers for tubing. Let's make sure, if I can find them.

20 Well, I'm not sure if there are or not.

21 Q And do you know what price per foot TXO
22 is charging to the joint account for tubing?

23 A It should be the list price in this book-
24 let.

25 Q The 1983 Lone Star Price Book?

1 A It's not actually listed here. We've got
2 the piece of paper here that was from Lone Star but in this
3 booklet it's not here.

4 I believe it's the (not clearly under-
5 stood) tubular book but I didn't bring that one that's got
6 the tubing prices in it.

7 Q So you don't have the tubing prices with
8 you.

9 Do you have them on that piece of paper?
10 I just didn't understand you.

11 A Yes, I do have them on this piece of
12 paper and that's what we charged -- should have charged
13 would have been 3.83 a foot plus any testing and trucking
14 required.

15 Q Okay, would you agree with me that if you
16 add trucking and testing to 3.83 a fair price for the N-80
17 would be \$5.69 a foot?

18 A Yes, that's possible, yes.

19 Q Do you know how much N-80 is in the well-
20 bore?

21 A Should be roughly 80 -- I believe there
22 should be 8600, maybe, just above the TD of the well, above
23 the pay.

24 Q And your tubing price, so I'm clear, was
25 3.83 on your little piece of paper there in your book?

1 A Right.

2 Q Did you bid out the location on this
3 well?

4 A Yes.

5 Q To whom did you bid it; who bid it?

6 A I don't remember exactly right now but we
7 take bids on --

8 Q Did you get more than one bid?

9 A Yeah, I'm certain we did.

10 Q Do you know how many?

11 A At least two; probably three.

12 Q Do you know what the range of those bids
13 was?

14 A I don't remember exactly.

15 Q What about the drilling contract? Did
16 you bid that?

17 A Yes.

18 Q How many bids did you get?

19 A There will be two or three, that's just
20 standard.

21 Q And do you have -- do you have those with
22 you?

23 A No, but I can get that.

24 Q Would you mind making that available to
25 the Examiner when you provide the additional data that

1 you're going to provide?

2 MR. DICKERSON: Can we go off
3 the record just a minute, or we are.

4
5 (Thereupon a discussion was had off the record.)

6
7 MR. STOGNER: Let's go back on
8 the record, Sally.

9 MS. AUBREY: Mr. Examiner, we
10 appear to have to come to the point in the case where we
11 cannot proceed without the additional documentation which
12 TXO has agreed to furnish us.

13 I suggest that we continue this
14 matter to the 19th of February.

15 TXO has agreed to try to fur-
16 nish some additonal breakdown of the invoices to Mr. Sprin-
17 kle by the 5th, if possible, and possibly we'll be able to
18 proceed more quickly on the 19th.

19 MR. STOGNER: Mr. Dickerson?

20 MR. DICKERSON: I'll join in
21 that belief, Mr. Examiner, and I would go further and say
22 that if we had this controversy to a point that we were
23 arguing only on the reasonable well costs of the total
24 expenditures in connecti⁴n with this well as opposed to some
25 allocation of the Bone Springs, and what not, it appears to

1 me that there would be a good possibility of the people get-
2 ting together and agreeing on what is a correct charge and
3 what is not a correct charge.

4 MS. AUBREY: As I understand
5 it, Mr. Examiner, each side will be allowed to brief the is-
6 sue and will be required to send their briefs no later than
7 the Monday prior to the February 19th hearing.

8 MS. STOGNER: Ms. Aubrey,
9 you're correct on that.

10 And TXO is going to provide by
11 the 5th to Mr. Sprinkle a breakdown corresponding to your
12 Exhibit Two, the first page of that.

13 Is there anything further from
14 either of the parties in this?

15 This case will be continued to
16 the Examiner's Hearing tentatively scheduled on February
17 19th, 1986.

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(Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY
CERTIFY that the foregoing Transcript of Hearing before the
Oil Conservation Division (Commission) was reported by me;
that the said transcript is a full, true, and correct record
of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR

I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. _____
heard by me on _____ 19____

_____, Examiner
Oil Conservation Division