

NEW MEXICO OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
STATE OF NEW MEXICO
CASE NO. 10471

IN THE MATTER OF:

The Application of Southwest
Royalties, Inc., for compulsory
pooling, Eddy County, New Mexico.

BEFORE:

DAVID R. CATANACH
Hearing Examiner
State Land Office Building
April 30, 1992

REPORTED BY:

DEBBIE VESTAL
Certified Shorthand Reporter
for the State of New Mexico

ORIGINAL

A P P E A R A N C E S

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BY: PAUL A. COOTER, ESQ.

FOR YATES PETROLEUM:

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BY: ERNEST L. CARROLL, ESQ.

FOR CONOCO, INC.:

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Post Office Box 2265
Santa Fe, New Mexico 87504-2265
BY: W. THOMAS KELLAHIN, ESQ.

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1 EXAMINER CATANACH: At this time we'll
2 call Case 10471, Application of Southwest
3 Royalties, Inc., for compulsory pooling, Eddy
4 County, New Mexico.

5 Are there appearances in this case?

6 MR. COOTER: Paul Cooter with the Rodey
7 law firm appearing on behalf of the applicant,
8 Southwest Royalties. I have two witnesses, John
9 Tate and Richard Masterson.

10 MR. CARROLL: Mr. Examiner, I'm Ernest
11 Carroll with the law firm of Losee, Carson, Haas
12 & Carroll of Artesia, New Mexico. I'm appearing
13 on behalf of Yates Petroleum. We do not have any
14 witnesses. I would just request time to make a
15 short statement to explain the position of Yates
16 Petroleum with respect to this application.

17 EXAMINER CATANACH: Would it be helpful
18 to make that statement before the testimony, Mr.
19 Carroll?

20 MR. CARROLL: It wouldn't hurt, because
21 I'm not going in any way to try to contest what
22 Mr. Cooter is trying to do.

23 EXAMINER CATANACH: Why don't we go
24 ahead and do that then.

25 MR. KELLAHIN: May I enter my

1 appearance, Mr. Examiner?

2 EXAMINER CATANACH: I'm sorry. Yes,
3 Mr. Kellahin.

4 MR. KELLAHIN: Tom Kellahin of the
5 Santa Fe law firm of Kellahin, Kellahin & Aubrey
6 appearing today on behalf of Conoco, Inc.

7 EXAMINER CATANACH: You may proceed,
8 Mr. Carroll.

9 MR. CARROLL: Thank you. Mr. Catanach,
10 basically the position of Yates Petroleum or why
11 it is an interested party with respect to this
12 forced pooling application is that, and it
13 relates basically with Mr. Kellahin's client,
14 Conoco, Conoco and Yates Petroleum right now have
15 a dispute with respect to a farmout agreement
16 which contains a back-in after payout. There is
17 a dispute as to when or how you determine this
18 payout.

19 So at the present time Yates
20 Petroleum's interest is only a royalty interest
21 underlying the tract that Mr. Cooter seeks to
22 compulsory pool, though we contend that if we
23 prevail in a lawsuit, which is a pending lawsuit
24 now in the Eddy County District Court, State
25 District Court, wherein we have actually brought

1 suit against Conoco for an interpretation of the
2 contract between the two of us, the only thing
3 that we wish to make known is that we would want
4 to join in, if our interest is shown and the
5 Court gives it to us. But I don't know how you
6 can even deal with that procedurally. I'm not
7 sure.

8 But Yates Petroleum instructed me,
9 knowing that and being advised that I'm not sure
10 how their interest could be legally taken into
11 account, they did want to go on the record of
12 having appeared, advising the Commission that we
13 are seeking to establish an interest through this
14 lawsuit with Conoco, and that we would like to
15 participate in the drilling of a well out there
16 should we prevail and have an interest. And that
17 is basically Yates' position.

18 EXAMINER CATANACH: Mr. Carroll, one
19 question: Who owns the interest that you claim
20 you can back into at the present time?

21 MR. CARROLL: Well, at the present time
22 Conoco would be the working interest holder. We
23 have a royalty interest there, should we prevail
24 and get the determination of how you determine
25 payout. We don't, and I honestly cannot tell you

1 if payout has occurred according to our
2 definition on this, because we're also suing for
3 an accounting out there with respect to this
4 well.

5 So I can't make any representation
6 other than right now we just have a royalty
7 interest. And we are making claim to more than
8 that, but we have not proven that nor have we had
9 access to materials which would allow me to even
10 make a prediction. So we may or may not under
11 either scenario. I just don't know.

12 EXAMINER CATANACH: Okay. Mr.
13 Kellahin?

14 MR. KELLAHIN: Mr. Examiner, I
15 represent Conoco in the litigation which Mr.
16 Carroll has described to you. I don't tell
17 fortunes, and I don't predict the outcome of
18 litigation. I can't even represent to you an
19 objective statement of the facts because Mr.
20 Carroll and I are trying to still discover those
21 facts.

22 It arises out of some farmouts and
23 operating agreements that occurred back in the
24 early 70s. And 20 years later we're trying to
25 reconstruct the interest that Yates' entities may

1 have in the Conoco interest.

2 To answer your question, though, Conoco
3 at this point, unless the Court adopts the Yates'
4 position, Conoco controls the working interest.
5 Out of that working interest, Yates has an
6 overriding royalty which may be converted to a
7 working interest subject to payout and some
8 contract interpretations.

9 So that is the problem, and we can't
10 give you any direction on what to do in this
11 particular case because it's beyond our abilities
12 to predict what will be the outcome of that
13 litigation.

14 EXAMINER CATANACH: Thank you, Mr.
15 Kellahin, Mr. Carroll.

16 Mr. Cooter, you may proceed. I'm
17 sorry. Let's get your witnesses sworn in. Will
18 the witnesses stand and be sworn in, please.

19 MR. COOTER: John Tate and Richard
20 Masterson.

21 [The witnesses were duly sworn.]

22 JOHN TATE

23 Having been duly sworn upon his oath, was
24 examined and testified as follows:

25 EXAMINATION

1 BY MR. COOTER:

2 Q. Mr. Tate, would you state your name for
3 the record, sir?

4 A. My name is John Tate.

5 Q. By whom are you employed?

6 A. Currently employed by Southwest
7 Royalties, Inc., out of Midland, Texas.

8 Q. What is your position with Southwest
9 Royalties?

10 A. I'm land manager and vice president of
11 land recovery.

12 Q. Would you summarize briefly your
13 educational background and work experience for
14 the Hearing Examiner?

15 A. Yes, sir. I'm a graduate of
16 Hardin-Simmons University. Upon graduation from
17 school, I returned to Midland. Went to work for
18 a small independent land brokerage firm for a
19 year, worked for them a year, at which point I
20 went to work for another independent, C. F.
21 Lawrence & Associates in Midland.

22 I was with Mr. Lawrence for over seven
23 years, at which time I changed jobs and joined
24 the Southwest Royalties firm. I've been there a
25 little over three years.

1 Q. Are you familiar with the application
2 filed by Southwest Royalties in this case?

3 A. Yes, sir, I am.

4 Q. And the area in the southeastern New
5 Mexico and Eddy County which is the location of
6 the proposed forced pooling?

7 A. Yes, sir.

8 MR. COOTER: I tender Mr. Tate as an
9 expert witness.

10 EXAMINER CATANACH: Mr. Tate is so
11 qualified.

12 Q. (BY MR. COOTER) Let's first turn to
13 the application, if you would, Mr. Tate, and
14 state what Southwest Royalties seeks by this
15 application.

16 A. We are currently seeking a compulsory
17 pooling of the northeast quarter of Section 17,
18 Township 19 South, Range 25 East, Eddy County,
19 New Mexico, for the purposes of drilling an Upper
20 Pennsylvanian test.

21 Q. What interest is owned by Southwest
22 Royalties in that area?

23 A. We currently own a one-eighth, or 12.5
24 percent leasehold working interest in the entire
25 160-acre tract.

1 Q. And the balance is owned by Conoco?

2 A. It's my understanding the balance is
3 owned by Conoco.

4 Q. Why do you seek to force pool this
5 160-acre tract owning only one-eighth interest?

6 A. Well, we have taken a lease from
7 another independent oil and gas company who is
8 very active, very strong in Eddy County, New
9 Mexico. Our lease is due to expire on July 21 of
10 this year, and we have no real expectation that
11 we can re-acquire that oil and gas lease. We
12 believe they will probably develop that tract on
13 their own should it no longer be under lease.

14 Q. Have you contacted Conoco in an effort
15 to get their joinder?

16 A. Yes, I have on a number of occasions,
17 both by telephone and written correspondence.

18 Q. We'll get into the details later on
19 that. But let me direct your attention first to
20 what has been marked as Exhibit No. 1. Would you
21 identify that?

22 A. This is strictly a shot of a Midland
23 map, land map, indicating the area that we are
24 interested in. You'll notice the northeast
25 quarter of Section 17 is highlighted in yellow,

1 simply indicating the tract we wish to pool.

2 Q. All right. Then next turn to what
3 we've marked as Exhibit No. 2, identify that, and
4 explain it.

5 A. That is the leasehold takeoff that was
6 prepared by a landman at my direction. It's
7 dated March 9, 1992. That shows the current
8 leasehold working interest ownership in that
9 tract. Subsequent to acquiring this takeoff and
10 visiting with Conoco, I was informed that Conoco
11 had purchased the interest of Mr. Horton and Mr.
12 Nicklaus, but those instruments of conveyance had
13 not been placed of record in Eddy County, New
14 Mexico.

15 At the time they also informed me that
16 they had tried on a number of occasions to
17 contact Ms. Nunes and were unable to locate her.
18 We did the same and were unable to locate Ms.
19 Nunes as well.

20 That exhibit shows Conoco owning -- or
21 Southwest Royalties owning one-eighth and
22 basically Conoco owning the rest of the leasehold
23 working interest in that area.

24 Q. Next turn to Exhibit No. 3, Mr. Tate.
25 It appears to be an AFE. Identify that for us,

1 please.

2 A. That is our proposed cost of completed
3 well, authority for expenditure, for an 8200-foot
4 Upper Penn well that was prepared by folks in our
5 office.

6 Q. And what is the anticipated cost of a
7 completed producing well?

8 A. As indicated by the AFE, we expect we
9 will be right at \$526,760.

10 Q. What efforts have been made to obtain
11 approval or voluntary joinder of Conoco?

12 A. Well, we have contacted Conoco on a
13 number of occasions, as I stated, both in written
14 form or written correspondence as well as over
15 the telephone. In those conversations with
16 Conoco, they told me they believed that they
17 owned the remainder 87 percent.

18 We wrote them proposing the well. On a
19 couple of occasions in my visiting with Conoco
20 land staff in Midland, they advised me that they
21 do indeed like the location, but there are three
22 or four other prospects in that immediate area
23 that they like as much, and they would prefer not
24 to participate in the drilling of this well
25 because their budget was limited for 1992 and

1 they prefer to put what few -- or the allocated
2 drilling budget they had into other locations as
3 opposed to this location.

4 Q. Let's be specific on those contacts,
5 Mr. Tate. And let me hand you, to refresh your
6 memory, when did you first contact Conoco?

7 A. Our initial contact was by certified
8 mail on March 16, 1992. It was a letter
9 basically proposing the well, inviting Conoco's
10 joinder in the drilling of this well.

11 Q. What followed after that?

12 A. Upon receipt of that, I received a
13 phone call from one of the Conoco landmen.
14 Unfortunately, his name escapes me right now.
15 And we basically had the conversation that I just
16 related to you about they liked the prospect, but
17 it's not one of their favorites and they would
18 prefer to delay drilling at this time, at which
19 point I explained to him because of the terms of
20 our lease, we felt like it was necessary that we
21 had to drill the well prior to the first of July
22 and that we were not in a position to put off the
23 drilling of the well.

24 Q. What followed after that?

25 A. Well, at that time we went ahead and we

1 re-proposed a letter back to Conoco and again
2 asked for their joinder and participation by
3 certified mail, more in an effort to let those
4 folks know that we were truly serious; that we
5 intended to go forward in as rapid manner as
6 possible to get the well drilled.

7 We were again given pretty much the
8 same answer. It was just something they couldn't
9 do right now.

10 Q. Was a copy of the AFE furnished Conoco
11 before this application was filed?

12 A. Yes, it was. We went ahead about the
13 same time, on March 30, by certified mail and
14 furnished Conoco with an AFE stating our proposed
15 costs in drilling completion of this well.

16 Q. After this application was filed, were
17 the interest owners, as shown on Exhibit 2, all
18 furnished copies of the application and notified
19 of this hearing date?

20 A. Yes, sir, they were by certified mail.
21 Unfortunately, the notification sent to Ms. Nunes
22 returned to us, as I suppose the address is bad.
23 But Mr. Horton and Mr. Nicklaus and Conoco were
24 indeed informed of this hearing.

25 MR. COOTER: Mr. Examiner, I'd tender

1 Exhibit 4, which is an affidavit of Mr. Carr, who
2 was then representing Southwest Royalties, of the
3 mailing of the application and notification of
4 this hearing date.

5 Q. Are you prepared at this time to make a
6 recommendation to the Hearing Examiner as to the
7 risk penalty that should be assessed against the
8 nonconsenting interest owners if the application
9 is granted?

10 A. Yes, sir, I am.

11 Q. What is that recommendation?

12 A. We would request and recommend that a
13 penalty of 200 percent be assessed to the
14 property.

15 Q. And upon what do you base this 200
16 percent recommendation?

17 A. Well, there is a number of things
18 really. It's a fairly risky well to drill. I
19 guess most importantly we're basically banking
20 the deal. We're going to pay -- actually
21 seven-eighths of every dollar we spend is being
22 paid for somebody else in that we only have an
23 eighth interest. We're banking the deal out of
24 our own pocket, taking the risk of drilling the
25 well, bringing the well in.

1 I'm not a geologist, but I've been in
2 the oil business long enough to know that there
3 is some risk associated with this well inasmuch
4 as it is down-dip from the other production.

5 Also, we have had to put very strong
6 consideration into the amount of water a well
7 such as this could produce. It could be very
8 high volume, and that in itself could make the
9 well uneconomic. You could have a producing oil,
10 but if you don't have the proper disposal
11 facilities, your well could be very
12 uneconomical.

13 Q. Do you believe that there is a distinct
14 possibility that a well drilled at your proposed
15 location would not be a commercial success?

16 A. Absolutely.

17 Q. Do you have an estimate of overhead and
18 administrative costs while drilling and then
19 after drilling while the well is producing?

20 A. Yes, sir, I do. We believe for a well
21 of this depth that our company would be inclined
22 to charge approximately \$5,000 a month for
23 drilling well overhead and \$500 a month as a
24 producing well rate.

25 Q. Are those in line with similar charges

1 by other area operators?

2 A. I believe they are if not substantially
3 cheaper than what most other folks are charging
4 in that area.

5 Q. Southwest Royalties does ask to be
6 designated operator --

7 A. Yes, sir, we do.

8 Q. -- If the application is granted. In
9 your opinion would the granting of this
10 application be in the best interests of
11 conservation, prevention of waste, and protection
12 of correlative rights?

13 A. Yes, sir, very much.

14 MR. COOTER: That concludes my direct
15 examination.

16 EXAMINER CATANACH: Mr. Cooter, do you
17 want to enter your exhibits as evidence?

18 MR. COOTER: Yes. Thank you, sir. We
19 would tender -- well, let me ask you a question.

20 Q. Were Exhibits 1 through 3 either
21 prepared by you or under your direction and
22 supervision?

23 A. Yes, sir, they were.

24 MR. COOTER: Exhibit No. 4 is the
25 affidavit of Mr. Carr, and we would tender all

1 four exhibits.

2 EXAMINER CATANACH: Okay. Exhibits 1
3 through 4 will be admitted as evidence.

4 Any questions of the witness? Mr.
5 Kellahin.

6 MR. KELLAHIN: Thank you, Mr.
7 Examiner.

8 EXAMINATION

9 BY MR. KELLAHIN:

10 Q. Mr. Tate, when I look at Exhibit 1,
11 you've outlined for me the northeast quarter of
12 Section 17?

13 A. Yes, sir.

14 Q. Do you have an undivided one-eighth
15 working interest underlying the entire northeast
16 quarter of that section?

17 A. Yes, sir, we do.

18 Q. Does your company have any other
19 working interest in the immediate vicinity?

20 A. I don't know. I really can't answer
21 that question. We have a number of holdings in
22 Eddy County, New Mexico. And I really can't
23 answer that question, whether we do or not in
24 that immediate vicinity.

25 Q. Do you currently operate any of the

1 Dagger Draw wells?

2 A. If I could defer to our second witness,
3 I think he's more qualified to answer that than I
4 am because I really don't know.

5 Q. Do you know if you have any working
6 interest in the production attributed to wells
7 producing out of the Dagger Draw Pool?

8 A. No, sir, I don't.

9 Q. The preparation of the AFE that you
10 testified to, did you determine what the current
11 costs were that other operators in this vicinity
12 were experiencing for the costs of drilling this
13 type of well to this depth?

14 A. As best we could. What we do when we
15 prepare an AFE, it's pretty much out of company
16 policy that you take a minimum of three bids from
17 all of your various vendors and contractors. We
18 went ahead and we prepared this AFE in the same
19 manner. We took bids with those contractors that
20 operate, whether they drill, treat, provide pipe
21 services, or whatever in that area. And we think
22 they're very much in line.

23 Q. Do you recall the three contractors you
24 obtained bids from?

25 A. No, sir. I did not actually prepare

1 this AFE. It was prepared under my supervision
2 by Mr. Steve Garner.

3 Q. Garner's signature is the one at the
4 bottom?

5 A. Yes, sir, that's correct.

6 Q. Have you awarded a bid to a contractor
7 for this well?

8 A. No, sir, not until this compulsory
9 pooling, hopefully, is ruled in our favor.

10 Q. Are there contingencies in there to
11 handle the disposal of the produced water?

12 A. No, there's not in our AFE.

13 Q. Help me understand the chronology of
14 events with regards to your interest. What is
15 the beginning date of the primary term of the
16 lease in question that you hold?

17 A. May I defer to my file?

18 Q. Certainly.

19 A. We have an oil and gas lease dated July
20 20, 1990.

21 Q. July 20 of 1990?

22 A. Yes, sir.

23 Q. Was it a two-year lease then expiring
24 on July 20 of 92?

25 A. 92, yes, sir.

1 Q. Prior to your initial letter to Conoco,
2 which was the March 16, 1992, letter --

3 A. Yes, sir.

4 Q. -- did you make any efforts to initiate
5 the proposed drilling of this well in this
6 spacing unit prior to that date?

7 A. Not the type you're talking about. I
8 think, if you're talking about notifying Conoco
9 or stuff, we run a very lean shop where we work.
10 We have a very busy schedule, very lean shop, and
11 we pretty much have to concentrate on things as
12 they come. We don't have the luxury to have
13 enough people to start working on these things a
14 year or six months in advance.

15 We are very much aware of this
16 circumstance. We knew it was coming, time that
17 we needed to do something about it, and we take
18 basically each buyer as they come.

19 Q. Okay. So for the first 17 months or
20 so, the primary term, you didn't do anything to
21 develop your lease?

22 A. That's right. We're kind of of the
23 position that we had an eighth and Conoco had
24 87-1/2 percent, if something was to be done, it's
25 kind of standard operating procedure that Conoco

1 would have proposed the well.

2 When it became obvious that not only
3 were they not going to propose the well, but that
4 they had no interest in drilling the well, we had
5 no other alternative than to file for this
6 compulsory pooling.

7 Q. Did you make any inquiries prior to
8 March 16 of 92 about having Conoco initiate at
9 your request the drilling of this well?

10 A. No, sir.

11 Q. Who is the interest owner from whom you
12 obtained your lease?

13 A. Our lessor is Marshall & Winston, Inc.
14 It's an independent oil and gas company out of --

15 Q. Marshall --

16 A. Marshal & Winston, Inc.

17 Q. Yes. I know the company. The proposal
18 to Conoco on the 16th of March was one in which
19 you asked them to participate in the well?

20 A. That is correct.

21 Q. Did you give them any other options or
22 alternatives?

23 A. Yes, we did. We offered them the
24 option, at the time we said we would even be
25 willing to consider a farmout under the following

1 terms. It was at that point that Conoco brought
2 to our attention that this was subject to a
3 lawsuit, the issue of which was a reversionary
4 interest that somebody was entitled to after
5 payout of evidently a number of wells out there.

6 With that in mind, we became a little
7 less inclined to take a farmout from Conoco.
8 Inasmuch as we didn't know what the other court
9 might hold someday, we didn't feel like we could
10 roll the dice on a deal like that.

11 Q. Have you submitted to Conoco a proposed
12 joint operating agreement at this time?

13 A. No, sir, I have not. I did not see any
14 need to. They told me they had no interest for
15 doing that.

16 Q. I'm interested in your assessment of
17 the risk penalty.

18 A. Uh-huh.

19 Q. Tell me again the components by which
20 you support your conclusion that 200 percent is
21 reasonable.

22 A. By and large, if this well is -- if
23 this well is going to get drilled, we're the only
24 guys that are going to drill it. Nobody else is
25 going to drill it. In doing so, even that we

1 have 12-1/2 percent working interest, we're
2 basically banking another 87.5 percent of the
3 drilling costs, which is our well's AFE for half
4 a million dollars.

5 If we should drill an uneconomic well
6 or dry hole, that's it. We have put the money up
7 for a very expensive dry hole. Conoco gets their
8 acreage evaluated with no cost to them. If Yates
9 should ultimately prevail, they get their acreage
10 evaluated at no cost to them. I think we're
11 providing a service to those folks as well as the
12 state of New Mexico, hopefully to ourselves.

13 Q. Are there any other reasons that you
14 used to support that conclusion about the penalty
15 factor?

16 A. Again, I'm not a geologist. I do know
17 enough about the oil business to know that there
18 is a relative risk. We feel like we're certainly
19 down-dip on the well. It could be that we could
20 make a dry hole regardless of how much water we
21 make.

22 And also the water is another concern.
23 If you get a high-volume water well, it's going
24 to be difficult to dispose of that water in a
25 timely and cost-effective manner.

1 Q. In coming up to a conclusion about the
2 penalty factor --

3 A. Uh-huh.

4 Q. -- what portion of that risk do you
5 attribute to the risk you undertake in disposing
6 of produced water from the well?

7 A. Maybe a third.

8 Q. What percentage of the risk do you
9 attribute to the geologic portion of the project?

10 A. I don't know. Something -- probably a
11 third, I guess.

12 Q. Okay. Then the remaining third is the
13 risk you undertake in financing the deal when you
14 have such a small percentage?

15 A. Yes, sir.

16 Q. Would it make a difference to you if
17 Marshall & Winston would extend your lease for
18 you?

19 A. Not particularly. We have come in and
20 we set up these things. We look at an annual
21 budget. We have the dollars budgeted to drill
22 this well, and we have certain moneys committed
23 to drill this well. We have commitments to other
24 folks as well. And I think we would still be
25 inclined to go ahead and drill the well before

1 the first of July.

2 Q. Is this a financial arrangement where
3 Southwest Royalties fronts the entire cost of the
4 well, or do you have investors that help you bear
5 that risk?

6 A. We would front the entire cost of this
7 well.

8 MR. KELLAHIN: Thank you, Mr.
9 Examiner.

10 EXAMINER CATANACH: Any questions, Mr.
11 Carroll.

12 MR. CARROLL: No, Mr. Examiner.

13 EXAMINATION

14 BY EXAMINER CATANACH:

15 Q. Mr. Tate, the parties you're actually
16 pooling in this application are Conoco and the
17 Nunes' interest?

18 A. Yes, sir, that would be true.
19 Unfortunately, we cannot locate Ms. Nunes.

20 Q. Can you describe for me your efforts to
21 do so?

22 A. It's my understanding that Mr. Carr
23 originally represented us in this pooling hearing
24 and Mr. Carr sent to her a notification of
25 pooling by certified mail, return receipt

1 requested, which was returned to his office by
2 the Postal Service.

3 Q. Do you know where Mr. Carr obtained the
4 address?

5 A. He got -- I believe he got the address
6 off of our takeoff, I think, Exhibit 2, which is
7 my understanding that address for Ms. Nunes came
8 out of the Eddy County Tax Assessor's Office.

9 Q. So there's not been any additional
10 efforts to track her down?

11 A. No, sir. In visiting with Conoco when
12 we originally started talking about this deal,
13 they told me -- they obviously were interested in
14 buying other interests in there. They told me
15 that they had bought the two gentlemen's
16 interest, just not placed them of record, and
17 that they had tried very hard to find Ms. Nunes.

18 As a matter of fact, they told me,
19 "Good luck in trying to find her." They
20 indicated to me they had spent a lot of time and
21 effort trying to locate Ms. Nunes and were unable
22 to do so.

23 Q. Mr. Tate, has Southwest drilled any
24 Pennsylvanian wells in this area?

25 A. Not to my knowledge.

1 Q. Have you examined the drilling costs of
2 any other operators in the area?

3 A. Our company is structured, by and
4 large, we acquire a lot of properties. Most of
5 the properties we acquire, a large majority of
6 them come from major oil companies. We are very
7 familiar with those costs, both administration
8 and drilling well rates. We consistently have --
9 our AFEs for drilling the workovers consistently
10 cheaper, light-years cheaper.

11 We know what the costs are to operate
12 in there. We believe our administrative overhead
13 is substantially less than most folks. We feel
14 like we have a good handle on the costs for what
15 other folks would charge in that area; we know we
16 do.

17 EXAMINER CATANACH: I have nothing
18 further of the witness. He may be excused.

19 MR. COOTER: May I ask just another
20 question very briefly?

21 FURTHER EXAMINATION

22 BY MR. COOTER:

23 Q. In response to Mr. Kellahin's question
24 about the factors that went into your
25 recommendation for the risk penalty, I think you

1 named three of them. Has there been any really
2 division of -- you named three factors and then
3 indicated that maybe each one was a third to it.
4 Has that been done purposely to attach a third
5 factor to each one of those or just generalized
6 ballpark?

7 A. Just trying to answer Mr. Kellahin's
8 question.

9 MR. COOTER: Thank you.

10 EXAMINER CATANACH: The witness may be
11 excused.

12 MR. COOTER: Next we call Richard
13 Masterson.

14 RICHARD MASTERSON

15 Having been duly sworn upon his oath, was
16 examined and testified as follows:

17 EXAMINATION

18 BY MR. COOTER:

19 Q. State your name for the record, sir.

20 A. Richard Masterson.

21 Q. And by whom are you employed?

22 A. Southwest Royalties, Inc.

23 Q. And where do you work for the company?

24 A. Midland, Texas.

25 Q. What's your position with Southwest

1 Royalties?

2 A. Vice President of Exploration and
3 Acquisitions.

4 Q. Relate briefly your educational
5 background and work experience.

6 A. I graduated from Trinity University in
7 1974 with a BA in geology. I went to work for
8 Texaco, Monsanto, and Grand Banks Energy. In
9 1986 I went to work for Southwest Royalties and
10 have been there since.

11 Q. What was your degree in at Trinity?

12 A. Geology.

13 Q. Have you practiced that profession?

14 A. Since 1974.

15 Q. Are you familiar with the application
16 filed by your company in this case?

17 A. Yes.

18 Q. And familiar with the area concerned in
19 southeastern New Mexico?

20 A. Yes.

21 MR. COOTER: We would tender Mr.
22 Masterson as an expert witness.

23 EXAMINER CATANACH: He is so qualified.

24 Q. (BY MR. COOTER) Let me direct your
25 attention, please, to Exhibit No. 5. Would you

1 identify that and explain it to the Examiner.

2 A. This is a structural map based on --
3 mapped on the top of the Upper Penn Reef
4 carbonates mapping horizon. The yellow is our
5 subject acreage; green dots, proposed location
6 signified with the red arrow. The red dots are
7 mainly control points to construct the map. And
8 the green triangles are basically nearby water
9 disposal wells that were shown in the January,
10 Volume I, Conservation Committee's publication.

11 Q. Where is the location of your proposed
12 well on the structure?

13 A. It's on the -- appears to be on the
14 down-dip edge of the basically monoclinal dip
15 down to the east.

16 Q. Are you ready to go to the
17 cross-section?

18 A. The mapping horizon that this map is
19 constructed on is signified by this correlation
20 line.

21 Q. Now, we're looking at Exhibit 6?

22 A. Here. The cross-section basically runs
23 from northwest to southeast starting in the Yates
24 No. 2 Roy AET, going through the No. 1 well on
25 that lease through the Roger Hanks, Barbero

1 Federal No. 3, through the proposed location into
2 the Roger Hanks Julie Com. lease.

3 The red coloration or perforated
4 intervals in each well, scout card information is
5 below each well. It's a structural cross-section
6 hung on minus 4,000 feet below sea level. And
7 vertical scale is 1 inch equals 40 feet;
8 horizontal, 1 inch equals 200.

9 Basically this is used to just show the
10 structural dip, its relationship between the
11 other wells in the area. One of the things we
12 were looking at and some of the questions asked
13 Mr. Tate probably could be answered if they're
14 re-asked to me in a little more concise form on
15 the risk and the predictability of risk.

16 Q. I wanted to ask you that next. You
17 heard Mr. Tate's testimony. One factor for
18 seeking the 200 percent risk factor was the
19 location of this proposed well on the structure,
20 is it not?

21 A. That's correct. And the main
22 predictability problem we have is in the amount
23 of oil cut or water cut in each individual well.

24 Q. All right. Let's go to Exhibit No. 7.

25 A. 7.

1 Q. That's what you're referring to, are
2 you not?

3 A. Right. Variations in water production
4 are pretty hard to predict. A well that's
5 slightly up-dip and on this cross-section, Yates
6 No. 1 Roy, in January produced 2,000 barrels of
7 water a day.

8 And this helps to show the risk in
9 getting an economical well and predicting how
10 much water will be moved, predicting what type of
11 pumping mechanism will have to be used versus a
12 beam pump, submersible pump, and the expenditures
13 in each case. Water disposal was also a major
14 concern to us.

15 Q. Go a little further with what is shown
16 on Exhibit No. 7, if you would, Mr. Masterson.

17 A. Basically these are just numbers
18 derived from the latest production book, the
19 statistical information from the Conservation
20 Committee's most recent production.

21 Q. There are a couple of wells to the
22 north in the south half-south half of Section 8.
23 What are those figures?

24 A. The No. 1 Roy is an older well that
25 basically produces approximately 90 barrels of

1 oil per day and approximately 2,000 barrels of
2 water a day with Mcf, you know, Mcf of gas per
3 month.

4 Q. That well, too, is a little higher on
5 the structure than your proposed well, is it not?

6 A. That's correct. Also there's new
7 information on the 3 AJJ well just to the
8 northeast of there in the northwest quarter of
9 the southeast quarter of Section 8. It
10 originally came in with a rather large water cut.

11 Q. And that same finding is throughout the
12 area as far as the amount of water?

13 A. That's correct. Water varies
14 throughout the field depending on the perforated
15 interval and depending somewhat on structural
16 situation. It's a combination of these two
17 things.

18 Q. Considering the location of the
19 proposed well on the down-dip side of the
20 formation and also the problems with reference to
21 the water and water disposal, do you believe that
22 there is a distinct possibility that the well
23 which Southwest Royalties proposes drilled at the
24 location contemplated would not be a commercial
25 success?

1 A. There's definitely that risk involved.
2 That's one of the main reasons we're asking the
3 penalty.

4 Q. Did you participate with Mr. Tate in
5 the review of those problems and in formulating
6 the recommendation that was made to the Examiner
7 today?

8 A. Yes.

9 Q. Anything else?

10 A. One of the things -- AFE.

11 Q. Yes. Okay.

12 A. As far as water -- one of the questions
13 that was asked: Was water disposal input in the
14 initial AFE? No, it isn't. Probably a
15 supplemental AFE would have to be issued to know
16 how much flow line, how much work over an
17 existing dry hole in the area, what would be the
18 results, and then this would be based somewhat on
19 the results of the well test and what we found in
20 the wellbore. But research has been gathered in
21 the area for water disposal.

22 Cost on the well, we'll bid out. We
23 have not agreed to any bids at this point. And
24 we do operate wells in Eddy County. We do not
25 operate any in the North Dagger Draw. We do have

1 working interests. Our company buys many
2 nonoperated working interests. We have
3 nonoperated working interests in many wells in
4 Eddy and Lea Counties and many wells in this type
5 reservoir, and we do have a pretty good handle of
6 what normal operating expenditures are.

7 One problem in nailing this down
8 exactly is: What is the final result of water
9 disposal? What is the final result of type of
10 pumping mechanism? And where will the water go?
11 That's a very difficult number.

12 Q. That completes my -- oh, first, were
13 Exhibit Nos. 5, 6, and 7 either prepared by you
14 or under your direction and supervision?

15 A. Yes, sir.

16 MR. COOTER: We would tender Exhibits
17 5, 6, and 7 at this time.

18 EXAMINER CATANACH: Exhibits 5 through
19 7 will be admitted as evidence.

20 MR. COOTER: That concludes our direct
21 examination.

22 EXAMINER CATANACH: Mr. Kellahin.

23 MR. KELLAHIN: Thank you, Mr.
24 Examiner.

25 EXAMINATION

1 BY MR. KELLAHIN:

2 Q. Mr. Masterson, on your cross-section
3 can you use one of those wells to identify for me
4 what would be the top and the bottom of the North
5 Dagger Draw Pennsylvanian Pool?

6 A. Different wells have been perforated,
7 not on this cross-section unfortunately, to the
8 south in various different zones and intervals.
9 But for the most part, in the local area of this
10 wellbore, the upper section in between the first
11 two correlative lines here on the cross-section
12 in the upper part between the second and third is
13 mainly tight and it's in a nonproductive. And
14 there are localized instances where it develops.

15 We do not expect that to develop in
16 this wellbore. It would be very hard to predict
17 that it would, and it would be very risky.

18 Q. What I'm looking at, the datum, minus
19 4,000 feet on the cross-section, where is that in
20 relation to the top of the pool?

21 A. Where is that in relation to the top of
22 the pool? I'm not sure. It's within 100 feet
23 general.

24 Q. In which direction?

25 A. It's above 100 feet.

1 Q. This datum point, minus 4,000 is
2 approximately 100 feet?

3 A. Above the top of the Upper Penn Reef.
4 Above the main perforations it's several hundred
5 feet.

6 Q. Okay. When we look at the bottom
7 section of the cross-section, how deep can we go
8 in the Pennsylvanian Reef and still attain oil
9 production in this pool?

10 A. We're expecting in our wellbore to be
11 able to go approximately 7900. We will base this
12 on mud logging information, well log information,
13 and if there is not lost circulation, there are a
14 lot of other problems involved here. Basically
15 on logs and any type offset, further offset
16 production. Initially the well will be produced
17 basically in this interval much like the offset
18 wells where it's shaded red on the map.

19 Q. The drilling plan is to take the well
20 down to a total depth to penetrate at least the
21 lowest horizontal?

22 A. Yes.

23 Q. Until it basically shales out. You can
24 see it better on the first log here because they
25 went deep enough and had enough rat hole when

1 they logged the well that you can see the base of
2 the carbonate.

3 Q. Have the operators that have drilled
4 wells in the pool been able to affect the
5 oil-water ratio by perforating in certain
6 portions of the reef?

7 A. They have -- with my limited knowledge
8 of each individual wellbore and what they have
9 done, especially in recent times on workovers,
10 not all that information is available to me.
11 They have improved in cutting down on some water
12 production throughout the pool, yes. The answer
13 to that is yes.

14 In the local area I have not seen that
15 occur. In fact, all the recent wells on strike
16 or even slightly up-dip in this local area have
17 large water production. In fact, this field, as
18 you know, was about to be abandoned by Conoco
19 when it was revitalized because they did find
20 that oil and other zones would be found in oil
21 below existing water pays or wells that have gone
22 to water. I know I'm not wording that properly.
23 But basically they found new oil pays below
24 existing water production.

25 Q. On your structure map, when you mapped

1 the top of the Upper Penn Reef --

2 A. Yes.

3 Q. -- does that correspond on the
4 cross-section to the line that you've identified
5 as the top of the Upper Penn Reef?

6 A. Right.

7 Q. That's what you're mapping?

8 A. Right. It is mainly -- the map is to
9 show that it's mainly just slight dip, monoclinal
10 dip, down-dip to the east. It's to show that
11 there isn't -- it's not a structural closure, so
12 to speak, in this localized area.

13 Q. I believe I heard you to say under
14 direct examination that structure did affect your
15 decision in picking a location for the well.

16 A. It's not a tectonic, I should say, type
17 of trapping mechanism. In other words, there's
18 not major faulting occurring here. There's not
19 major folding occurring here. It's a build-up
20 type, or sort of, to use the correct vocabulary.

21 Q. Structure taking part in --

22 A. Structure --

23 Q. Let me ask you the question before you
24 answer it. Does structure play a part in picking
25 a location in the northeast quarter of the

1 section?

2 A. Structural position is of some
3 importance in picking the location. The wells to
4 the north on strike have big water already
5 up-dip, structurally up-dip. There's two things
6 that go into picking location, known porosity
7 development and structural position, okay.

8 Q. Did you prepare an isopach to show me
9 the porosity distribution?

10 A. No. Isopach was not prepared to show
11 porosity distribution. Isopach on the electric
12 log calculations is even suspect. You're dealing
13 with the type of porosity development that isn't
14 always a quantitative cutoff that you can use.
15 It's somewhat qualitative on electric log
16 calculations. This is one reason why so much has
17 been passed up in the area.

18 Q. I'm trying to understand the geologic
19 tools that you have selected upon which to base
20 your location. And you have told me now you have
21 not used an isopach methodology to help you
22 define the porosity of the reservoir.

23 A. This is one problem. Isopach
24 methodology is not always the correct way to find
25 the continuity of a reservoir. Sometimes direct

1 correlation between logs can -- it can be
2 discontinuous between wells.

3 Q. I didn't ask you why you didn't use
4 it. You just didn't use it?

5 A. I didn't use it, and that's why, or the
6 reason why.

7 Q. You've used a structure map, though?

8 A. Yes. I've used a structure map just to
9 show basically our position on the down-dip edge
10 of the field.

11 Q. When you look at the structure map, did
12 you pick a location based on the structural
13 relationship?

14 A. Not totally, no. Partially it is based
15 on structural position, partially because we have
16 two logs here, two known points where we would be
17 in between that do have porosity development
18 within the field and the formation, and this also
19 helps to reduce risk.

20 Q. Can you define a water well contact?

21 A. No.

22 Q. Why did you choose to take your
23 cross-section the way you did?

24 A. Log availability. The wells -- many of
25 the logs have not been released. I contacted the

1 Conservation Committee. Logs have not been
2 released or through PDI. That's one of the main
3 reasons, the newer wells. But these wells are
4 representative wells.

5 Q. What caused you not to pick a location
6 in the northeast -- I'm sorry, the northwest of
7 the northeast? That would be an up-structure
8 position.

9 A. We possibly might change that bearing
10 the outcome of any information we find in the
11 future. This is an ongoing area of development.
12 The main risk difference is that it is not
13 between two logs where I have control of
14 porosity.

15 Q. How are you going to change?

16 A. Structurally it will be slightly
17 up-dip. It will have higher risk for porosity
18 development. That's my answer.

19 Q. You running out of time on your base
20 lease, Mr. Masterson?

21 A. That's right.

22 Q. What more information are you going to
23 get on which to decide what to do?

24 A. Offset drilling to the north of us, if
25 the logs are released and are available, we will

1 be able to input even more information into the
2 drilling of this location.

3 Q. North of you then --

4 A. Yates.

5 Q. -- in Section 8?

6 A. Yes.

7 Q. There is what looks like a well
8 location that's identified with a No. 4?

9 A. That's correct.

10 Q. Is that a drilling well?

11 A. That's a stake location. It may be
12 drilling at this time, I don't know. They may
13 have moved the rig out since the last PI report.
14 The location to the north is a completion out of
15 that vicinity.

16 Q. Is there a change in the oil-water
17 ratio as you move structurally within the
18 reservoir?

19 A. Basically the higher water initial --
20 higher initial water-to-oil ratio or higher water
21 percentage is in the down-dip wells. There are
22 wells after time, especially depending on where
23 you're looking in the lives of these wells, that
24 make production structurally up-dip.

25 This is part of my point, and the

1 cross-section itself is the No. 1 well -- was
2 completed a little earlier on the Roy lease than
3 the No. 2. A lot of the wells come in making
4 lower water percentage and over anywhere from a
5 range of several months to several years go to
6 large water cut.

7 Q. Your proposed well location appears to
8 be offset on three sides by dry well symbols.

9 A. Plug producers.

10 Q. Those are plug producers?

11 A. Plug producers. They all complete. In
12 fact, two of them are on this cross-section, and
13 they show the producing intervals.

14 Q. Have you examined the ultimate recovery
15 of production from those wells to determine if
16 they were economic successes?

17 A. They vary. Of the three wells, the
18 wells that were drilling in between were, I would
19 think, economic successes at the time they were
20 drilled. I don't know. I didn't calculate. But
21 they would be economical successes to date. The
22 well to the south would not.

23 Q. If you move up again?

24 A. I can't remember the exact "cums," but
25 I can find that out.

1 Q. If you move up again into the northwest
2 of the northeast, there is a 40-acre tract within
3 that area that appears not to have been exposed
4 prior to depletion by produced wells.

5 A. To some extent it would be -- it may be
6 less depleted than this location.

7 Q. Wouldn't that reduce your risk?

8 A. It's arguable that it might. It does
9 increase the risk on the reservoir development.
10 It reduces risk on drainage. It reduces slightly
11 the risk on structural position.

12 Q. In response to a question of Mr. Cooter
13 you said that this represented a high-risk
14 location for you.

15 A. It's, okay, relatively high risk in
16 that the water disposal problem, the water
17 production problem, the unpredictability of
18 initial water production and further water
19 production down the line, yes. That's true for
20 us.

21 Q. On a scale of 1 to 100, what is the
22 percentage of risk that you will get on a
23 noncommercial well?

24 A. I don't know if I can -- a
25 noncommercial well?

1 Q. I'm trying to have you focus for me as
2 a layman to understand when you roll in all these
3 technical things --

4 A. I understand what you're --

5 Q. -- and reach a conclusion, if I'm the
6 guy writing the check so that you do this deal --

7 A. What would I tell my boss?

8 Q. Yes. What would you tell him?

9 A. All right. I'd tell him -- I would
10 explain this in more than zero to 100 percent.
11 Is that okay? Tell me if this is a good answer,
12 and you can ask it again if it's not. To get a
13 well that would pay out is -- depending on what
14 happens while drilling.

15 After drilling getting a well that will
16 pay out barring no mechanical problems, you would
17 probably have a fifty-fifty chance to get a well
18 that would be future revenues to cost of
19 two-to-one, your risk goes up quite a bit, and
20 you have probably a third of a chance to do this
21 at the situation it is now.

22 The risks increase as you predict rate
23 of return. As you approach different "cums," oil
24 cumulative production. Is that --

25 MR. KELLAHIN: Yes, sir. That helps me

1 understand.

2 Thank you, Mr. Examiner.

3 THE WITNESS: I can't do much better
4 than that.

5 EXAMINER CATANACH: Anything, Mr.
6 Carroll?

7 MR. CARROLL: No, Mr. Examiner.

8 EXAMINER CATANACH: Okay. I don't have
9 any questions of the witness. You may be excused
10 unless you have anything further.

11 MR. COOTER: No, sir. That concludes
12 our presentation.

13 EXAMINER CATANACH: Okay. Is there
14 anything further in this case?

15 MR. KELLAHIN: No, sir.

16 EXAMINER CATANACH: There being nothing
17 further, Case 10471 will be taken under
18 advisement.

19 [And the proceedings were concluded.]

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I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. 10471,
heard by me on April 30 1992.

David R. Catanch, Examiner
Oil Conservation Division

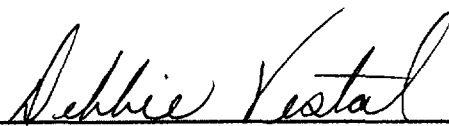
1 CERTIFICATE OF REPORTER

2
3 STATE OF NEW MEXICO)
4 COUNTY OF SANTA FE) ss.
5

6 I, Debbie Vestal, Certified Shorthand
7 Reporter and Notary Public, HEREBY CERTIFY that
8 the foregoing transcript of proceedings before
9 the Oil Conservation Division was reported by me;
10 that I caused my notes to be transcribed under my
11 personal supervision; and that the foregoing is a
12 true and accurate record of the proceedings.

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

18 WITNESS MY HAND AND SEAL May 6, 1992.
19
20

21 
22 _____
23 DEBBIE VESTAL, RPR
24 NEW MEXICO CSR NO. 3
25