

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:)
APPLICATION OF PRESTON EXPLORATION,)
L.L.C., FOR COMPULSORY POOLING, EDDY)
COUNTY, NEW MEXICO)

CASE NO. 13,236

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

May 27th, 2004

Santa Fe, New Mexico

2004 JUN 10 PM 3 25

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 27th, 2004, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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Examiner Hearing
CASE NO. 13,236

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* * *

Additional submission by Applicant, not offered or admitted:

	Identified
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* * *

A P P E A R A N C E S

FOR THE APPLICANT:

MILLER, STRATVERT P.A.
150 Washington
Suite 300
Santa Fe, New Mexico 87501
By: J. SCOTT HALL

FOR CHASE FARMS and CHASE OIL CORPORATION:

HOLLAND & HART, L.L.P., and CAMPBELL & CARR
110 N. Guadalupe, Suite 1
P.O. Box 2208
Santa Fe, New Mexico 87504-2208
By: WILLIAM F. CARR

FOR MURCHISON OIL AND GAS:

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

* * *

1 WHEREUPON, the following proceedings were had at
2 8:33 a.m.:

3 EXAMINER STOGNER: Hearing will come to order.

4 At the request of the Applicant and with the
5 understanding of the other parties in today's docket, at
6 this time I will call Case 13,236, which appears on page 3.
7 This is the Application of Preston Exploration, L.L.C., for
8 compulsory pooling, Eddy County, New Mexico.

9 At this time I'll call for appearances.

10 MR. HALL: Mr. Examiner, Scott Hall, Miller
11 Stratvert, P.A., Santa Fe, on behalf of the Applicant,
12 Preston Exploration, L.L.C.

13 I anticipate calling only one witness this
14 morning, but I ask that three be sworn in.

15 EXAMINER STOGNER: Any other appearances?

16 MR. CARR: May it please the Examiner, my name is
17 William F. Carr with the Santa Fe office of Holland and
18 Hart, L.L.P. We represent in this case Chase Farms, a New
19 Mexico general partnership, and Chase Oil Corporation. I
20 have one witness.

21 EXAMINER STOGNER: Any other appearances?

22 MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,
23 representing Murchison Oil and Gas, Incorporated. I have
24 no witnesses.

25 EXAMINER STOGNER: Any other appearances?

1 Can I please have all four witnesses or potential
2 witnesses please stand to be sworn at this time?

3 (Thereupon, the witnesses were sworn.)

4 EXAMINER STOGNER: Okay, as of note, I had five
5 people stand up to be sworn. Mr. Hall, you said one
6 witness, but three to be sworn?

7 MR. HALL: Correct.

8 EXAMINER STOGNER: And you had one witness, Mr.
9 Carr?

10 MR. CARR: Yes, sir. My witness stood and was
11 sworn.

12 EXAMINER STOGNER: Okay, who was the mystery
13 witness then?

14 MR. WHEELER: I think Bo stood. You're not
15 planning on calling him, right?

16 MR. HALL: He's welcome to testify.

17 EXAMINER STOGNER: Okay, please let the record
18 show that five witnesses were sworn, and let's make careful
19 whenever we do introduce them that they were indeed sworn.

20 Okay, Mr. -- Is there any need for opening
21 statements at this time?

22 MR. HALL: No, Mr. Examiner.

23 MR. CARR: No, sir.

24 EXAMINER STOGNER: Okay, Mr. Hall?

25 MR. HALL: Mr. Examiner, at this time we would

1 call Mark Wheeler to the stand.

2 MARK WHEELER,

3 the witness herein, after having been first duly sworn upon
4 his oath, was examined and testified as follows:

5 DIRECT EXAMINATION

6 BY MR. HALL:

7 Q. For the record, please state your name, sir.

8 A. Mark Wheeler.

9 Q. Mr. Wheeler, where do you live and by whom are
10 you employed?

11 A. Midland, Texas. I'm employed by Capstone Oil and
12 Gas Company, L.P.

13 Q. And what do you do for Capstone?

14 A. Landman.

15 Q. And what is your relationship and the
16 relationship of Capstone to the Applicant, Preston
17 Exploration?

18 A. Capstone is in the primary business of generating
19 prospects. We put together the land generally and turn
20 prospects to industry partners. We do not operate
21 ourselves, and so we get the prospects ready to drill and
22 then whatever the operator needs for us to do to continue
23 to get the participants together, to try to get wells
24 drilled, we take care of for them.

25 Q. All right, and are you authorized to speak on

1 behalf of the Applicant, Preston?

2 A. Yes, I am.

3 Q. You've previously testified before the Division
4 and had your credentials accepted as a matter of record; is
5 that correct?

6 A. Yes, in the old location.

7 Q. And you're familiar with the Application that's
8 been filed in this case and the subject area?

9 A. Yes, I am.

10 MR. HALL: Are the witness's credentials
11 acceptable, Mr. Examiner?

12 EXAMINER STOGNER: Any objection?

13 MR. CARR: No objection.

14 EXAMINER STOGNER: So qualified.

15 Q. (By Mr. Hall) Briefly, would you explain to the
16 Examiner what Preston is seeking by this Application?

17 A. Preston seeks the pooling of all unjoined
18 interests in the north half of Section 29, Township 17
19 South, Range 26 East, Eddy County, New Mexico, to be
20 dedicated to the drilling of our Roughneck Red 29 Number 1
21 well.

22 Q. All right. You've prepared certain exhibits in
23 connection with your testimony this morning?

24 A. Yes, I have.

25 Q. Let's look at that packet of exhibits. On top

1 you have a chronology of events I understand you
2 participated in the preparation of. Exhibit Number 1, your
3 land plat, let's look at that, if you could explain that to
4 the Examiner.

5 A. This is a land plat, a blown-up land plat of
6 Section 29 indicating the surface and bottomhole location
7 for the proposed well.

8 Q. And what's the primary objective for the well?

9 A. Morrow.

10 Q. Let's look at Exhibit 2, your ownership
11 breakdown, if you could explain that to the Hearing
12 Examiner.

13 A. This is a breakdown of the leasehold ownership in
14 the north half of Section 29. It shows all of the net
15 acres for each party, the working interest before payout,
16 after payout, and the working interest associated for each
17 party.

18 Q. And the working interest in your second column
19 before payout is what we should be focused on this morning?

20 A. Yes. Actually it's the third column.

21 Q. Third column?

22 A. Yes.

23 Q. How long has Preston owned its lease interest in
24 the north half of Section 29?

25 A. Since January 15th of this year.

1 Q. Okay. Now, what percentage of the acreage in the
2 320-acre unit is voluntarily committed to the well at
3 present?

4 A. Approximately 52.69 percent.

5 Q. Let's refer to Exhibit 2, if you could identify
6 the interests presently committed and the interests you're
7 seeking to pool today.

8 A. Presently committed are the interests, WJP
9 Exploration, which is one of Preston's entities, down
10 through CMW Interests, Inc., and also, then, Cactus Energy,
11 E3 Energy, and Saguaro Resources. Those parties are
12 committed.

13 I'm sorry, did you ask which ones we're asking to
14 pool?

15 Q. In addition.

16 A. We're asking to pool Chase Oil Corporation;
17 Murchison Oil and Gas, Inc.; and MEC Petroleum Corporation.

18 Q. Now, are you asking for the imposition of a 200-
19 percent risk penalty against the unjoined working interests
20 to the pool?

21 A. Yes, sir.

22 Q. And does Preston seek to be designated operator
23 of the well?

24 A. Yes, they do.

25 Q. In your opinion, Mr. Wheeler, has Preston and

1 Capstone made a good-faith effort to locate all the
2 interest owners, working interest owners, communicate with
3 them and obtain their voluntary participation in the well?

4 A. Yes, we have.

5 Q. What is the proposed surface and bottomhole
6 location for the well?

7 A. 1480 feet from the north line and 1980 feet from
8 the west line of Section 29, 17-26.

9 Q. And that's a standard gas well location?

10 A. Yes, it is.

11 Q. Would you explain to the Examiner your efforts
12 and the efforts of Preston to obtain the voluntary
13 participation of the interest owners you're seeking to pool
14 today?

15 A. We made a number of phone contacts over the
16 months, as well as visiting personally with the
17 representatives of Chase Oil out in the field and certainly
18 over the phone. We've also talked extensively with Mike
19 Daugherty of Murchison, who is also representing MEC
20 Petroleum Corporation.

21 Q. If you could refer to the chronology you helped
22 prepare, does that provide a fair narrative of the history
23 of events, your efforts to obtain everybody's participation
24 in the well?

25 A. Yes, sir, it does.

1 Q. When did you first -- When was the well first
2 proposed?

3 A. The well was first proposed January 13th of this
4 year. It was done so after telephone conversation between
5 myself and Mr. Lanning of Chase Oil.

6 We were made aware by Mr. Lanning that there was
7 a potential surface issue down the road. They had plans to
8 install a pecan orchard in this area, and we were made
9 aware by him that we had a potential problem in drilling in
10 this north half for surface. But at the time that he
11 contacted me, we asked him -- you know, in deference to
12 trying to work with him on the surface, I asked him where
13 would be an okay location for us to drill? And he
14 indicated that as long as we stayed no further south than
15 1480 feet off the north line, that we would stay out of the
16 proposed orchard.

17 So I went to our geologist Jerry Elger at that
18 time and said, you know, where in your geology could we
19 stake a location that would stay within your proposed -- or
20 your expected channel. And that's how we picked the
21 location of 1480 from the north, 1980 from the west.

22 Q. Now, by reference to your chronology, is this in
23 the January, 2004, time frame?

24 A. Yes, that's during January of 2004, prior to our
25 sending the AFE on January 13th.

1 Q. And that's Exhibit 3, that's your formal well-
2 proposal letter?

3 A. Yes.

4 Q. Let's look at that. The third page of that, it's
5 the third copy of the same letter, addressed to Caza
6 Energy, L.L.C., Robert C. Chase, Richard L. Chase, Gerene
7 Diane Chase Crouch.

8 When you -- your conversations with Mr. Lanning,
9 your dealings with him, did you understand that he was
10 representing Caza, Chase Farms, Chase Energy Corporation,
11 and the individuals shown on your notice letter?

12 A. That was my understanding, yes, sir.

13 Q. Let's look at Exhibit 4. What is that?

14 A. That would be their letter, Chase's letter to us,
15 dated February 19th.

16 Q. And that was their response to your formal well
17 proposal letter of January 13th?

18 A. Yes, sir.

19 Q. In essence, what does the letter say?

20 A. Well, basically they indicated that the interest
21 was leased to another party at that time, rather than the
22 people that we notified. Of course, at the time we sent
23 out the well proposal, the existing oil and gas lease was
24 to the parties that we notified. And they also indicated
25 that they had taken an additional interest in the area from

1 Dennis Riley, a mineral interest lease, that we thought had
2 previously been held by production, so we had not
3 approached him. And we were incorrect in that assumption.

4 But they also indicated they did not want further
5 activity on the surface in the south half of the north
6 half, which was where our proposed location was.

7 Q. So if I understand it, at the time of your
8 January telephone conversations with Mr. Lanning, and at
9 the time of your January 13th well-proposal letter, the
10 acreage was under lease to Caza; is that correct?

11 A. It was under lease to Caza and the other parties
12 that we notified.

13 Q. I see. And then by the time you received the
14 response on February 19th, you found out from Mr. Lanning
15 the acreage was then leased to Chase Oil Corporation; is
16 that accurate?

17 A. Yes, sir. The previous lease had expired at the
18 end of January and they gave themselves a new lease
19 effective February 1st, and it went into Chase Oil
20 Corporation.

21 Q. But at the time you were proposing the well, you
22 were dealing with the apparent interest owners of record at
23 that time?

24 A. Yes, sir.

25 Q. Look at Exhibit Number 5. Identify that, please

1 sir.

2 A. That is a copy of the new lease from Chase Farms
3 to Chase Oil Corporation, dated February 1st of this year.

4 Q. All right. If you look at the second page of
5 that, it shows county recordation information at the bottom
6 of the page. What date was that lease --

7 A. It was recorded --

8 Q. -- filed of record?

9 A. -- in Eddy County on February 5th of '04.

10 Q. All right. And who was the lessor?

11 A. Lessor was Chase Farms. Yeah, Chase Farms.

12 Q. And the lessee?

13 A. Chase Oil Corporation.

14 Q. And the lease is executed by --

15 A. Chase Farms.

16 Q. By Mack C. Chase?

17 A. Mack Chase, yes, general partner of Chase Farms.

18 Q. If you would focus your attention on page 2,
19 paragraph 14 --

20 A. Yes, sir.

21 Q. -- of that lease, what does that provide for?

22 A. That says that the "Lessee shall not enter upon,
23 occupy, traverse, or otherwise use the surface...for any
24 purpose."

25 Q. All right. Now again, during this time frame was

1 it your understanding that the principals of Caza Energy,
2 Chase Oil and Chase Farms were all the same?

3 A. Yes, sir.

4 Q. And if we look back to Exhibit 4, which is the
5 Chase Oil Corporation letter dated February 19th, 2004 --

6 A. Yes, sir.

7 Q. -- signed by Mr. Lanning, who was he signing on
8 behalf of?

9 A. It states he was signing it on behalf of Chase
10 Oil Corporation and Chase Farms.

11 Q. All right. Mr. Wheeler, based on your experience
12 as a professional landman, is it your view that the lease,
13 Exhibit 5, that was granted to Chase Oil by Chase Farms, is
14 something less than an arm's-length transaction?

15 MR. CARR: I object. This calls for a legal
16 conclusion, unless they can establish whether or not these
17 are -- these are separate legal entities, and I think Mr.
18 Wheeler is being asked to reach a legal conclusion as to
19 what their relationship is and whether or not this is arm's
20 length.

21 MR. HALL: Mr. Examiner, Mr. Wheeler is
22 established as a professional landman witness, qualified to
23 express an opinion. His area of expertise includes
24 conveyancing, negotiation of leases. This falls squarely
25 within his area of expertise, and he is qualified to

1 express an opinion.

2 EXAMINER STOGNER: Objection sustained.

3 Q. (By Mr. Hall) If you would, Mr. Wheeler, outline
4 for the Hearing Examiner what Chase's objections were to
5 the original surface location proposed.

6 A. Chase has plans to install a -- Chase Farms has
7 plans to install a pecan orchard across a majority of the
8 south half of the north half of Section 29. At this time
9 there are no trees in the south half, north half, I
10 believe. In our conversations with Mr. Lanning when we met
11 with him in the field, that was going to go in late this
12 fall or early this winter. There are pecan trees in the
13 south half of the section, but not any currently in the
14 north half of Section 29.

15 Their objection at a later point, again, we were
16 under the impression that anything south of 1480 feet from
17 the north line they would object to, but anything up to
18 that point from the north line, that would be okay with
19 them. That's how we picked our original location.

20 We -- I guess subsequent to that, they decided
21 they did not want to have any surface disturbance occur in
22 the south half, north half, that they controlled. And so
23 that is my opinion or my understanding of their objection.

24 Q. If you would refer back to your chronology again,
25 about the February or March, 2004, time frame, were there

1 meetings at the location, on site, with Chase Farms and
2 Chase Oil to discuss the location?

3 A. Three representatives from Capstone met with Mr.
4 Lanning in the field on location on March 8th. We went out
5 and saw the current pecan orchard in the south half, talked
6 about alternative locations for us to drill from in this
7 north half. We discussed a number of different locations,
8 and subsequent to that they got back to us and said they
9 did not want any surface disturbance in the south half,
10 north half, and wished that we would place the well off
11 site and drill directionally to our bottomhole location.

12 Q. Now, were you picking your bottomhole location
13 based on geology?

14 A. Yes.

15 Q. Let's refer to Exhibit 6, if you would identify
16 that, please, sir.

17 A. This is a letter from Mr. Blue of Preston
18 Exploration, back to Chase Farms after our March 8th
19 meeting. Additionally, Randy Ford who is an engineer that
20 represents Preston, also met out in the field to discuss
21 location with Chase Farms after our March 8th meeting, and
22 this is a letter back to Chase farms, to Mr. Lanning,
23 requesting that we reach some sort of agreement as far as
24 us drilling a potential well directionally, but to keep the
25 surface -- to try to work with them to keep the well off

1 the surface, but to -- We wanted a reasonable trade in
2 order to get that done.

3 Q. All right. Now, who is Mr. Blue?

4 A. Mr. Blue is the land manager for Preston
5 Exploration.

6 Q. All right. And so Exhibit 6 is basically a
7 proposal letter to address the surface concerns?

8 A. Yes.

9 Q. By the way, what is the current use of the
10 surface at the proposed location?

11 A. It's just a -- It's a plowed field, there's
12 nothing growing there. It's just a plowed, cultivated
13 field, but there's absolutely -- I don't believe there's
14 anything growing there. There didn't appear to be when we
15 were out there.

16 Q. When Capstone and Preston were discussing changes
17 to the surface location with Chase, did you take into
18 consideration any prior development in the immediate
19 proximity to this well?

20 A. An prior drilling development?

21 Q. Yes.

22 A. Yes, sir, we talked about -- we obviously looked
23 at the key well which is to the east of this section, in
24 Section 28, that's producing gas.

25 And then after that point Murchison had drilled a

1 well in this north half of Section 29, called the Tiz Now
2 Number 1 well, and we also discussed that location with Mr.
3 Lanning about possibly re-entering onto that well site and
4 drilling directionally from there.

5 Q. Now, were your other participants in the well
6 conditioning their participation based on the understanding
7 that your bottomhole location would be 1480 from the north
8 line and 1980 from the west line?

9 A. Yes, sir, they were.

10 Q. And if you'd refer to Exhibit 7, what is that,
11 please?

12 A. That's a letter from Cactus, Inc., also
13 representing Saguaro Resources and E3 Energy, wherein they
14 state their approval of our AFE is conditioned upon us
15 drilling at that bottomhole location.

16 Q. All right. Were the additional costs of drilling
17 a directional well a concern to Preston?

18 A. Absolutely.

19 Q. Briefly, would you tell the Hearing Examiner what
20 those cost differences would be between a straight-hole and
21 a directional drill?

22 A. For a completed well, we estimate the difference
23 in cost to be \$226,000 additional for the directional well.

24 Q. And if it becomes necessary today, does Preston
25 have a drilling engineer available to testify about the AFE

1 cost for the straight-hole and the directional drilling?

2 A. Yes, we do.

3 Q. Now, did the revised surface location and the
4 terms for participation demanded by Chase adversely affect
5 the economics of the drilling project here?

6 A. Yes, sir.

7 Q. And was there a concern that Chase's demands for
8 an alternate location posed an undue geologic and
9 mechanical risk to the well?

10 A. Yes, sir.

11 Q. Would you discuss the further efforts of Preston
12 to obtain the voluntary participation of the Chase
13 interests in drilling of the well? And if you would refer
14 to the exhibits, specifically Exhibits 8, 13 and 14,
15 briefly run through those and narrate those for the Hearing
16 Examiner.

17 A. Exhibit 8 is a listing of -- a compilation of
18 e-mails that went back and forth between Mr. Lanning and
19 Mr. Blue of Preston, discussing the trade terms that we
20 were desiring in order to consider an alternate location.

21 As you can see, Mr. Lanning had responded pretty
22 much in every instance that they needed basically the same
23 terms. I believe there was a little bit of relenting
24 toward the end, but they basically wanted the same terms,
25 would never take into account the additional costs that we

1 were expending or being asked to expend.

2 And then Exhibit 13 are some additional e-mails
3 that were a little later on and, in fact, right up until
4 right before this hearing.

5 Q. And Exhibit 14, those are additional e-mails --

6 A. Yes.

7 Q. -- further negotiations with Chase?

8 A. Right, Exhibit 14 goes right up until May 19th, I
9 believe.

10 Q. And basically what was Chase demanding for their
11 participation?

12 A. They demanded that they be carried, and they did
13 not want to participate in the well, which is basically
14 what they told us all along. They felt like we would
15 probably be drilling a dry hole, and they did not want to
16 participate. But they -- after promising us in the field a
17 sweetheart deal, then the terms they wanted was a third
18 back in after payout.

19 Q. And there was no consideration given to the
20 additional drilling cost for a directional drill?

21 A. None, they just wanted us to bear those costs.

22 Q. All right. Let's look at Exhibit 9, if you would
23 identify that, please, sir.

24 A. That is a revised AFE sent out by Preston on
25 April 6th for an alternate location. This is when we felt

1 like we were going to be able to hopefully make some sort
2 of a reasonable trade with Caza or Chase, and we -- at the
3 time, the estimated AFE was about \$100,000 more. Since
4 that time additional costs have been figured, and in light
5 of going rates on everything the costs are significantly
6 higher. That was sent out to all of the parties that had
7 indicated that they wanted to participate in the well, as
8 well as Chase and Murchison and MEC.

9 Q. All right, let's look at Exhibits 10 and 11.

10 A. Exhibit 10 is a letter back from Murchison
11 stating that they did not want to participate in the well,
12 they would give a six-month term assignment, 75-percent net
13 revenue and back in at 30 percent. Again, that is an
14 unworkable deal for us to drill this well.

15 Q. And when you were dealing with Murchison Oil and
16 Gas, Inc., is it your understanding they were also speaking
17 for the MEC --

18 A. Yes.

19 Q. -- interest?

20 A. Yes. In fact, they refer in this letter to
21 representing both companies.

22 Q. I see. And in your opinion, did you make a good
23 faith effort to obtain the voluntary participation of the
24 Murchison and the MEC?

25 A. Yes, sir, we've been in constant contact with Mr.

1 Daugherty of Murchison over time.

2 Q. And with respect to the Chase interests,
3 Murchison and MEC, you simply weren't able to cut a deal
4 with them; is that right?

5 A. That's correct.

6 Q. Let's look at Exhibit 12. Are the Saguaro,
7 Cactus Energy and the E3 interests now committed under a
8 JOA?

9 A. Yes, they are.

10 Q. And is that attached to -- or referenced in
11 Exhibit 12?

12 A. It's referenced in Exhibit 12, yes, sir.

13 Q. Okay. In view of you efforts to negotiate with
14 the Chase interests their issuance of a lease after the
15 fact, after the well was proposed, Chase Farms to Chase Oil
16 with the surface-restriction stipulations, how does the
17 Division propose -- or how do you propose the Division
18 handle the Chase interests in this pooling case?

19 A. We propose the Division pool their interest and
20 authorize Preston to drill the well at its original
21 location.

22 Q. I hand you what's been marked as Exhibit 15, Mr.
23 Wheeler. Could you identify that, please, sir?

24 A. This is Preston's AFE for both a straight-hole
25 and a directional well from the locations we've been

1 discussing.

2 Q. Now, the top page, Exhibit 15, that's the most
3 recent revised straight-hole drilling cost?

4 A. That's correct.

5 Q. For the record, what's the total for a completed
6 well?

7 A. \$1,031,000.

8 Q. And if you look at the next page, Exhibit 16, is
9 that the AFE for the directional drill?

10 A. The completed cost is \$1,261,800.

11 Q. Okay. Now for the straight-hole drill, are those
12 costs in line with what's being charged by other operators
13 in the area for similar wells?

14 A. Yes.

15 Q. And have you made an estimate of the overhead and
16 administrative costs while drilling and producing the well?

17 A. Yes, we have, \$4100 per month for the drilling
18 rate and \$410 per month for the producing rate.

19 Q. And are those costs in line with the Ernst and
20 Young rates?

21 A. Yes, they are.

22 Q. And you are recommending that those drilling and
23 producing overhead rates be incorporated in any order that
24 issues from this hearing?

25 A. Yes.

1 Q. And does Preston request that the order provide
2 for an adjustment of the drilling and producing overhead
3 rates in accordance with the current COPAS bulletin for the
4 area?

5 A. Yes, sir.

6 Q. In your opinion, would granting Preston's
7 Application be in the best interests of conservation, the
8 prevention of waste and the protection of correlative
9 rights?

10 A. Yes.

11 Q. Were Exhibits 1 through 16 and your chronology
12 prepared by you or at your direction --

13 A. Yes --

14 Q. -- with your participation?

15 A. -- they were.

16 MR. HALL: At this time, Mr. Examiner, we move
17 the admission of Exhibits 1 through 16. We also have our
18 hearing notice affidavit, which we'll mark as Exhibit 17.
19 We tender that as well.

20 EXAMINER STOGNER: Do I have that Exhibit Number
21 17?

22 MR. HALL: Yes, sir.

23 MR. CARR: Could I see a copy?

24 EXAMINER STOGNER: Let's see, I have an affidavit
25 that is -- Is that the one you're referring to, 17?

1 Any objections?

2 MR. CARR: I don't have the notice affidavit.

3 Other than that, I have no objection.

4 EXAMINER STOGNER: Exhibits 1 through 17 will be
5 admitted into evidence.

6 Before I -- Let me just ask one question. On
7 Exhibit Number 2, the parties, what is that Elger
8 Exploration, Inc.? I heard you say from WJP down to CMW
9 interests had volunteered?

10 THE WITNESS: I apologize, Mr. Examiner, I should
11 have included Elger. I saw CMW as the last one, but it
12 actually is Elger, so that group plus Cactus, E3 and
13 Saguaro are all voluntary --

14 EXAMINER STOGNER: With Chase, Murchison and MEC.
15 Okay, that was -- I just -- that was all I had.

16 THE WITNESS: I thought that CMW was below Elger.

17 EXAMINER STOGNER: Thank you.

18 Mr. Carr, your witness.

19 MR. CARR: Thank you, Mr. Stogner.

20 CROSS-EXAMINATION

21 BY MR. CARR:

22 Q. Mr. Wheeler, you're the landman for Capstone; is
23 that correct?

24 A. Yes.

25 Q. And how long have you been a landman with

1 Capstone?

2 A. Approximately three years.

3 Q. Does Capstone operate any wells in New Mexico?

4 A. No, we do not.

5 Q. Has Capstone drilled any wells in this state?

6 A. We do not operate anywhere. We have never
7 operated a single well.

8 Q. You're speaking today also for Preston?

9 A. Yes.

10 Q. Does Preston operate any wells in New Mexico at
11 this time?

12 A. Yes.

13 A. Have they drilled wells in New Mexico?

14 A. Yes, they have.

15 Q. Your job as a landman -- correct me if I'm wrong
16 -- is in regard to the formation of spacing units, is to
17 attempt to voluntarily combine the tracts in a proposed
18 spacing unit; is that correct?

19 A. That's our desire, yes.

20 Q. And in this case you're the land person who was
21 responsible for combining the interests in the north half
22 of the section; is that right?

23 A. Initially. At a later point both Mr. Blue and I
24 attempted to work on this.

25 Q. When you do this you're required to understand

1 oil and gas contracts and agreements, are you not?

2 A. Yes, sir.

3 Q. And to understand oil and gas leases?

4 A. Yes.

5 Q. And property rights?

6 A. Yes, sir.

7 Q. And when you go about this, you look in the
8 records and find those documents, and that helps guide you
9 as you go about your work to combine these tracts; is that
10 correct?

11 A. Generally we have workers check the records for
12 us in the counties and then make reports to us.

13 Q. But it's based on those documents?

14 A. Yes.

15 Q. And then you rely on those as you go forward and
16 do your work?

17 A. Yes, sir.

18 Q. When you were combining the interests in the
19 north half of this section, did you examine the leases for
20 the various properties in the north half of 29?

21 A. Yes, sir, the ones that were of record at that
22 time.

23 Q. And you looked at all of them, not just the Caza
24 or Mack Energy leases?

25 A. We actually leased most of the entire north half,

1 north half of the section.

2 Q. Have you leased the north half of the northeast
3 of the section?

4 A. Yes, we have.

5 Q. That was a lease originally from someone named
6 Joy?

7 A. Jack Joy, yes.

8 Q. And who was that initially leased to?

9 A. It was initially leased, I believe, to -- it was
10 either to Chase or to Murchison. Murchison drilled the
11 well, the Tiz Now well. I don't recall, without going back
12 in my records to see, who the lessee was on that lease, but
13 one of those two parties.

14 Q. But you have now acquired that interest?

15 A. Yes, we have.

16 Q. The lease that was drilled by Murchison in the
17 northeast quarter, if we look at Section 1, it was not
18 actually located on the Joy lease, the north half of the
19 northeast, was it?

20 A. No, sir.

21 Q. And do you know why that was?

22 A. I believe Mr. Joy had a no-surface restriction on
23 the north half, northeast.

24 Q. And so the well was not located on that property?

25 A. That's correct.

1 Q. Now, you now hold that lease?

2 A. Yes.

3 Q. And you're familiar with the terms of the Joy
4 lease?

5 A. Yes.

6 Q. And you know it has a no-surface-occupancy
7 provision?

8 A. Yes, sir.

9 Q. When you advise your management about whether or
10 not they can develop this property, do you have an opinion
11 as to whether or not they can drill on the north half of
12 the northeast?

13 A. My opinion would be, since we agreed to a lease
14 that has a no-surface occupancy on the north half,
15 northeast, that we could not drill there.

16 Q. And so you would honor that provision?

17 A. Yes, absolutely.

18 Q. When you looked at the leases that cover the
19 north half of this section back in 2003, you were aware,
20 were you not, that the Chase Farms lease to Caza was set to
21 -- scheduled to expire of its own terms the end of January?

22 A. We assumed that it would. I mean, leases can be
23 extended or amended, but at the time we knew it was under
24 lease, but we did not know what the status would be after
25 January 31st.

1 Q. And there would either be an extension of the
2 lease, or it could be re-leased at that --

3 A. That's correct.

4 Q. So a new lease was issued, you're not saying that
5 there was anything improper about Chase Farms issuing a new
6 lease on this property at the end of the lease term, are
7 you?

8 A. I don't think there's anything improper about
9 them about them issuing a new lease. I don't know whether
10 giving a lease internally is exactly within the letter of
11 the law, but that's, you know, my opinion.

12 Q. You don't know if this was a -- When you say
13 "internally", you're not making any judgment on the status
14 of the parties legally, are you?

15 A. No. I mean, I know Chase Farms and Chase Oil
16 Corporation are different.

17 Q. And we're not disputing that Caza, Chase Oil,
18 Chase Farms all have overlapping ownership.

19 Have you compared the -- The lease that was
20 issued by Chase Farms to Chase Oil in early February this
21 year, that contains a no-surface-occupancy --

22 A. Yes, sir.

23 Q. -- provision, does it not?

24 A. Yes, sir. That's the clause we went through
25 earlier.

1 Q. Ad that is identical to the no-surface-occupancy
2 provision in the Joy lease, the north half of the
3 northeast, is it not?

4 A. They both have the same intent. I'm not sure the
5 language is exactly identical without comparing it.

6 Q. You haven't done that?

7 A. I've not recently -- I mean, I negotiated the
8 Jack Joy lease, but I don't recall if the exact language
9 was used by Chase when they did their lease.

10 Q. But you'd agree they both contain a provision, a
11 no-surface-occupancy provision?

12 A. Yes.

13 Q. As you go about your work as a landman, you're
14 familiar with leases, federal leases, state leases, fee
15 leases, all of the above; isn't that correct?

16 A. Yes, sir.

17 Q. If there was a federal lease on this property
18 that contained a no-surface occupancy provision, would your
19 opinion be that that would preclude the drilling of a well
20 on that tract?

21 MR. HALL: Objection, it's -- on the basis of
22 relevance. Also calls for speculation.

23 MR. CARR: I'm going to restate the question.

24 EXAMINER STOGNER: Please do.

25 Q. (By Mr. Carr) If there was a federal lease on

1 the north half of Section -- and you're an expert, and
2 these are the facts I'm going to ask you to assume -- that
3 there was a federal lease on the north half of Section 29,
4 and there was a no-surface-occupancy provision in that
5 lease, would you disclose that to your management when you
6 were discussing with them whether or not they could develop
7 the acreage?

8 MR. HALL: Same objection, Mr. Examiner.

9 EXAMINER STOGNER: Overruled.

10 THE WITNESS: I would look at the stipulation,
11 and we would follow the letter of the law, assuming that we
12 took that lease subject to that.

13 Q. (By Mr. Carr) When you say if you took a lease
14 subject to that, what do you mean by that phrase, taking a
15 lease subject to a provision of a lease?

16 A. If we're aware of a stipulation, the no-surface-
17 occupancy, at the time we pay consideration and purchase a
18 lease then, you know, we're taking that lease, buying that
19 lease, subject to that stipulation.

20 Q. If the lease contains that stipulation and you
21 don't purchase it but acquire it, or acquire the rights to
22 -- or you combine those lands by a compulsory pooling
23 action, would that give you the right to go on the surface
24 of a lease that had a no-surface-occupancy provision?

25 MR. HALL: Mr. Examiner, let me state an

1 objection at this point in view of Mr. Carr's earlier
2 objection that questioning calls for a legal conclusion on
3 the witness, an objection which you sustained. I think
4 this question does as well, at this point. I make the same
5 objection.

6 MR. CARR: Mr. Stogner, I think the problem with
7 this case is that we have multiple leases in the north half
8 of this section. Some contain no surface occupancy
9 provision, some do not. And there is a question that
10 requires an interpretation of this lease. Obviously, if
11 you're going to honor some and perhaps not honor others,
12 there's an underlying question that requires a legal
13 interpretation of the effect of those provisions.

14 I would suggest to you that that is not a
15 question for the Oil Conservation Division, and I would
16 suggest to you that this case should be continued for 30
17 days to let the parties negotiate. If they're unable to
18 reach a negotiation within 30 days, Chase Oil Corporation
19 will file a petition with the District Court of Eddy County
20 asking that the status of their no-surface-occupancy
21 provision be determined to see if it is binding on people
22 who subsequently take that property either voluntarily or
23 through an exercise of the police power of the state.

24 EXAMINER STOGNER: Mr. Hall?

25 MR. HALL: Mr. Examiner, we would object to any

1 request for a continuance or delay in these proceedings at
2 this point. The hearing on this Application was continued
3 at least three times, I believe, at the request of Chase.
4 We agreed to all three continuances. We think there's been
5 adequate opportunity for negotiations here. I think we've
6 demonstrated that through Mr. Wheeler's testimony and the
7 exhibits.

8 I think Mr. Carr is correct in the sense that
9 there is a legal dispute about the effect of the surface
10 stipulation. I think Mr. Carr is trying to place the
11 Division in the position of having to litigate that and
12 make that determination, when prior existing precedent
13 orders have directed that the Division and Commission do
14 not have the jurisdiction to do so.

15 I would refer you to Order Number R-12,093-A, Mr.
16 Examiner. That's the order that issued from the Valles
17 Caldera Trust proceeding, and in that order the Commission
18 determined that the Division does not have the jurisdiction
19 to determine title or the rights of any party to occupy
20 property.

21 And that's exactly the case here. I think you do
22 have the jurisdiction to proceed with the Application and
23 then issue an order accordingly. If there is a dispute for
24 litigation, the parties may negotiate that outside of the
25 context of this hearing. Chase, if it wishes, may try to

1 get that question answered in the district courts, but it
2 should not be a basis for delaying this proceeding any
3 further.

4 MR. CARR: Mr. Stogner, Valles Caldera does say
5 what Mr. Scott Hall just said, that is, you don't have the
6 right to determine who has the right to occupy the
7 property.

8 Now, the question here is not whether or not
9 negotiations have taken place. They have. The question
10 here is not whether or not these interests can be combined.
11 They can. We don't oppose that. We don't oppose combining
12 all the mineral interests in the north half of this section
13 for an appropriate well.

14 But the question here is, do they have a right to
15 occupy the surface when the lease entered between separate
16 legal entities says you may not use the surface. It
17 doesn't prevent development. It means moving the red dot,
18 the surface location on their Exhibit 1, to the north, to
19 the line just above the word "OXY", and they access the
20 minerals from a point where we all agree they have a right
21 to occupy the property. If they don't have a right to
22 occupy the property, they can't meet a statutory
23 precondition to a pooling order, and that is, they must
24 tell you they have the right to drill. The right to drill
25 the well, they propose.

1 And we submit to you, because of this lease
2 provision, they do not have that right. And therefore they
3 cannot pool these lands for this well. We wouldn't oppose
4 pooling it for a well located in the north half of the
5 northwest.

6 They've also testified, Mr. Wheeler did, that
7 they had considered directionally drilling from the
8 Murchison location. If you look at that on Exhibit 1 and
9 you can see the distance they considered directionally
10 drilling to get their proposed location, to honor the lease
11 provisions, they only have to move to the north to get on
12 the property that bears the name Leonard L. Fellows.

13 We submit they do not have -- cannot establish
14 they have a right to pool with this well, that the
15 Commission and Division have correctly announced that you
16 don't have the right to determine if they can occupy the
17 property. That must be done by the courts.

18 Our last correspondence in Mr. Wheeler's
19 documents say we were willing to talk to our management
20 about reducing the burden we were requiring. And we submit
21 to you the way this should be handled is, we should have 30
22 days within which either to agree to some solution
23 voluntarily, or we will file a declaratory judgment action
24 in the District Court of Eddy County, New Mexico.

25 MR. HALL: Mr. Examiner, I think Chase is simply

1 trying to throw up dust and obscure the purpose of this
2 proceeding. Again, Chase is trying to place you in the
3 position of having to litigate and make a determination
4 about legal rights.

5 We've already established that the lease issued
6 by Chase to Chase is not owned by Capstone or Preston.
7 They're not bound to it, they're not parties to it, it was
8 not negotiated with them.

9 What Mr. Carr wants you to do is make a
10 determination whether or not that surface stipulation binds
11 parties who are not a party to the lease. I submit you
12 cannot do that.

13 There's an underlying question here, though, Mr.
14 Examiner, where it appears, as in this case, that the lease
15 is not the product of an arm's length negotiation and
16 transaction and it was issued for purposes of circumventing
17 the Division's jurisdiction to prevent you from issuing an
18 order at a location proposed by the Applicant. Then you
19 have a right to inquire about the terms of that lease and
20 the circumstances of its negotiation. There's precedent
21 for you doing so.

22 And I would refer you, Mr. Examiner, to two other
23 cases in addition to the Valles Caldera case.

24 If you would look at Order Number R-7335, it's
25 the Rio Pecos-Ralph Nix case. Circumstances similar to

1 this. After a well was proposed, after a pooling
2 proceeding was commenced, a party put a 50-percent
3 overriding burden on its lease interest. And the Division
4 went right through that, saw through that transaction and
5 said, That's an improper way, that's an improper means to
6 circumvent the Division's jurisdiction. It would not allow
7 it.

8 I would also refer you to Order Number
9 R-11,573-B. That's the last of the series of the Bettis,
10 Boyle and Stovall Sunwest cases, where again there were
11 negotiations after a well was proposed to an interest
12 owner, and that interest owner turned around and issued a
13 lease to an affiliate corporation. Neither the Division
14 nor the Commission allowed that. It viewed that as
15 improper and an improper means to circumvent the agency's
16 jurisdiction again, and it allowed the proceeding to go
17 forward and the interests were pooled.

18 I have copies of those cases for, Mr. Examiner,
19 if you'd like them.

20 MR. CARR: And Mr. Stogner, I have just one very
21 brief response.

22 EXAMINER STOGNER: Okay, keep it just for a sec
23 here.

24 Statement, Mr. Carr?

25 MR. CARR: Mr. Stogner, I just want to make clear

1 what we believe we're doing. We're not trying to
2 circumvent the jurisdiction of the OCD, we're trying to
3 honor it as announced in the Valles Caldera case. We're
4 not trying to put you in a position where you determine
5 property rights, we're trying to move that question where
6 it belongs, to the District Court, as it was in the
7 TMBR/Sharp-Arrington fight recently where the effect of an
8 APD was going to be determined based on some underlying
9 property rights, and the Division stood down while that
10 matter was pursued in the court. That's we think is the
11 appropriate way to go here.

12 EXAMINER STOGNER: I'm going to take a 10-minute
13 recess at this point.

14 (Thereupon, a recess was taken at 9:21 a.m.)

15 (The following proceedings had at 9:36 a.m.)

16 EXAMINER STOGNER: Hearing will come to order.

17 MR. HALL: Mr. Examiner, during the break we were
18 successful in negotiating a compromise with Chase Oil
19 Corporation.

20 Chase will consent to being pooled for its own
21 lease from Chase Farms, as well as for the Riley lease
22 acreage, provided that the well is drilled from a surface
23 location 1200 feet from the north line and 1280 feet from
24 the west line, give or take as necessary to accommodate
25 some certain surface considerations over there.

1 We will provide you with a stipulated pooling
2 order. We think there's sufficient evidence in the record
3 for you to make the findings of a basic pooling order. We
4 don't believe there's any further need for evidence in this
5 case.

6 And with that, that concludes our case on direct.

7 EXAMINER STOGNER: What was the -- from a surface
8 location to what?

9 MR. HALL: The same bottomhole location, 1480
10 from the north line, 1980 from the west line.

11 MR. CARR: And Mr. Stogner, Mr. Hall has
12 correctly stated our agreement.

13 EXAMINER STOGNER: Okay, is there any further
14 need for evidence today?

15 MR. CARR: No, sir.

16 MR. HALL: Not on behalf of the Applicant.

17 MR. CARR: And not on behalf of Chase Farms or
18 Chase Oil Corporation.

19 EXAMINER STOGNER: Okay. Anything further in
20 this matter?

21 MR. CARR: Nothing.

22 EXAMINER STOGNER: Okay, Case 13,236 will be
23 taken under advisement.

24 Thank you, gentlemen.

25 MR. CARR: Thank you very much. Thank you for

1 taking this out of order.

2 EXAMINER STOGNER: You're welcome. I appreciate
3 everybody's indulgence and patience in that.

4 And we will never find out who the fifth mystery
5 witness was.

6 (Thereupon, these proceedings were concluded at
7 9:38 a.m.)

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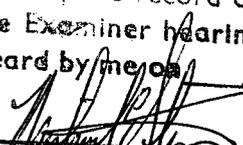
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I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. 13236,
heard by me on 27 May 2004.

_____, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL May 31st, 2004.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 16th, 2006