

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

IN THE MATTER OF THE HEARING CALLED
BY THE OIL CONSERVATION DIVISION FOR
THE PURPOSE OF CONSIDERING:

ORIGINAL

CASES 15404
and 15405

APPLICATION OF BURNETT OIL CO., INC.,
for a NON-STANDARD OIL SPACING AND
PRORATION UNIT AND COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

December 3, 2015

Santa Fe, New Mexico

BEFORE: MICHAEL McMILLAN, CHIEF EXAMINER
WILLIAM V. JONES, EXAMINER
GABRIEL WADE, LEGAL EXAMINER

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This matter came on for hearing before the
New Mexico Oil Conservation Division, Michael McMILLAN,
Chief Examiner, William V. Jones, Examiner, and Gabriel
Wade, Legal Examiner, on December 3, 2015, at the New
Mexico Energy, Minerals, and Natural Resources
Department, Wendell Chino Building, 1220 South St.
Francis Drive, Porter Hall, Room 102, Santa Fe, New
Mexico.

REPORTED BY: ELLEN H. ALLANIC
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I N D E X

CASE NUMBER 15404-15405 CALLED

BURNETT OIL CO., INC.

CASE-IN-CHIEF:

WITNESS COLEY MEANS

	Direct	Redirect	Further
By Mr. Bruce	5	20	23

	Cross	Recross	Further
By Mr. Padilla	12		

	EXAMINATION
Examiner Jones	22

1 ARD OIL, LTD., AND ARD ENERGY, LTD.
CASE-IN-CHIEF

2

3 WITNESS HOUSTON KAUFFMAN

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5 By Mr. Padilla	Direct 24	Redirect	Further
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6 By Mr. Bruce	Cross 31	Recross	Further
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11 Reporter's Certificate	PAGE 38
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14 E X H I B I T I N D E X

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16 Exhibits Offered and Admitted

16

17 BURNETT OIL CO., INC. EXHIBIT 15	PAGE 13
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1 (Time noted 11:22 a.m.)

2 EXAMINER McMILLAN: At this time I would
3 like to call case 15404, Application of Burnett Oil Co.,
4 Inc., for a nonstandard oil spacing and proration unit
5 and compulsory pooling, Eddy County, New Mexico.

6 This case is also combined with case
7 No. 15405, Application of Burnett Oil Co., Inc., for a
8 nonstandard oil spacing and proration unit and
9 compulsory pooling, Eddy County, New Mexico.

10 Call for appearances.

11 MR. BRUCE: Mr. Examiner, Jim Bruce of Santa
12 Fe representing the applicant. I have one witness.

13 EXAMINER McMILLAN: Any other appearances?

14 MR. PADILLA: Yes, Mr. Examiner. I appear
15 on behalf of Ard Oil, Ltd., and Ard Energy Group, Ltd.,
16 and I have one witness.

17 EXAMINER McMILLAN: Just for the record,
18 case 15410 will be starting at 1:30 for those of you who
19 are interested. That is the Energen case.

20 MR. BRUCE: My witness is Coley Means. He
21 was previously sworn in at the last hearing and was
22 qualified as an expert petroleum landman as was
23 Mr. Padilla's witness, Mr. Kauffman.

24 If we could just recognize that rather than
25 going through the questioning.

1 MR. PADILLA: That's fine.

2 EXAMINER JONES: That's fine.

3 EXAMINER McMILLAN: That sounds good.

4 Please proceed.

5 COLEY MEANS

6 having first been duly sworn, was examined and testified
7 as follows:

8 DIRECT EXAMINATION

9 BY MR. BRUCE:

10 Q. Mr. Means, what's your title? You work for
11 Burnett Oil Company, do you not?

12 A. Affirmative.

13 Q. And what is your title there?

14 A. I'm a land manager.

15 Q. And have you been involved in negotiations with
16 the -- we'll call them the Ards regarding these -- the
17 wells involved in these two cases?

18 A. I have.

19 Q. At the end of last hearing, the matter was
20 continued to allow continued negotiations between the
21 parties. Have you been involved in those
22 negotiations?

23 A. I have.

24 Q. I submitted to the Examiners and to the Court
25 Reporter Exhibit 15. Could you summarize what is

1 contained in Exhibit 15 and maybe just start with a
2 brief timeline.

3 A. Sure. So we had the hearing November 12th. It
4 was continued so that we could continue, slash, begin
5 negotiations. We sent an offer to Ard, a written offer,
6 on November 18th, which was two pronged.

7 It was a standard term assignment offer to term
8 assign the interest at \$750 an acre and 80 percent net
9 revenue and 180-day continuous development. Those are
10 the highlights, more or less.

11 The second prong of the offer was actually what
12 Ard originally requested we do, which was offer them to
13 enter into a JOA and in lieu of a nonconsent penalty,
14 they would go out on an override. So that was kind of
15 prong B of the offer. So that went out to them on
16 November 18th -- excuse me -- November 19th.

17 So through November 19th and, roughly, the end of
18 November, just various correspondence, us checking in,
19 Ard asking for certain information, the majority of
20 which we furnished and, you know, just, more or less,
21 conversations.

22 On November 30th, we received a counterproposal
23 from Ard. The counterproposal was at \$1,800 an acre, a
24 75 net revenue, but a minimum of 2 percent and a 45-day
25 continuous development provision.

1 We countered that counter the following day on
2 December 1st at \$1,000 an acre, a 75 net, but not the
3 minimum 2 percent and 180-day continuous development.

4 I have not heard any response back to date on our
5 counter-counter, if you will.

6 And that's kind of the highlight of the
7 negotiations that have gone on since November the 12th
8 hearing.

9 Q. And are you willing to continue negotiating with
10 the Ards?

11 A. Absolutely.

12 Q. Now, does Exhibit 15 contain the various letters
13 and e-mails, et cetera, between the parties, including
14 Mr. Kauffman who is assisting Mr. Ard in this matter?

15 A. That is correct. The bulk of the substance is
16 there.

17 Q. Okay.

18 MR. BRUCE: If you would go to -- maybe go
19 to the last six pages of Exhibit 15, Mr. McMillan,
20 Mr. Jones, and Mr. Wade, starting with the letter dated
21 November 18th from Burnett to the Ards.

22 Q. Just briefly, Mr. Means, that is the original
23 written proposal made to the Ards containing either a
24 term assignment offer or a JOA offer?

25 A. That is it.

1 Q. And then the next -- and that takes up three
2 pages. And the next letter is from Mr. Julian Ard to
3 Burnett requesting certain production. Was information
4 provided to the Ards under that request?

5 A. Yes. We did send him -- we never heard anything
6 different, but sent him a raft of information, more or
7 less, we thought answering what he was looking for.

8 Q. And then the next page is an e-mail from Mr. Ard
9 to Mr. Rhodes who works for Burnett, right?

10 A. Yes.

11 Q. And copying Mr. Kauffman.

12 That is the counterproposal you mentioned from
13 the Ards to Burnett?

14 A. Yes.

15 Q. And then the final, the last page of Exhibit 15
16 is what you just mentioned, the counter-counterproposal?

17 A. Correct.

18 Q. Now, let's just go through a couple of items.
19 That very last page of Exhibit 15, \$1,000 per net acre,
20 delivering a 75 percent net revenue interest and 180-day
21 continuous development requirement, are those the basic
22 terms of other term assignments obtained by Burnett in
23 this prospect?

24 A. Yes.

25 Q. And, approximately, what year were those term

1 assignments executed?

2 A. 2011.

3 Q. At the time those other term assignments were
4 taken by Burnett under essentially these same terms, was
5 the price of oil substantially higher?

6 A. I think if we looked at it, the answer would be
7 yes. Things were a little rosier back then and the
8 outlook a little better.

9 Q. Based on that, do you think this
10 counter-counterproposal, the last page of Exhibit 15 is
11 fair and reasonable?

12 A. Yes, particularly when you consider that what
13 we've offered here is for a two-month term assignment.
14 The term on this is very short, which is normally very
15 advantageous. We have to drill this well by
16 January 23rd, 2016, so we will spud the well. I mean,
17 in January we will drill a well, which should be for --
18 if he's going to get into an override position, it's
19 very advantageous -- and those other term assignments,
20 as you referenced, and we didn't base our offer on
21 those. That kind of came up. Subsequent, we ended up
22 being at more or less the same terms.

23 But those are standard deals. The \$1,000 bonus
24 was paid for a 30-month term assignment. And we've
25 offered that for a two-month term assignment.

1 We believe the counter 45 days continuous
2 development is just untenable in this environment. And
3 to be honest with you -- I mean, as in an override
4 position, you would like development, but that pace of
5 development is not in your best interest at \$40 oil in
6 my opinion -- in our interest, for sure, and, arguably,
7 in an overriding royalty owner's position.

8 So we think that is just too fast. We have some
9 other term assignments that are all termed at 180 days.
10 It's pretty standard. We think that is very reasonable.

11 And I would say delivering a 75 net revenue is --
12 you know, seems to be the standard and we are willing to
13 do that.

14 Q. In your opinion, has Burnett made a good faith
15 effort to obtain the voluntary joinder of the Ards in
16 this well?

17 A. Yes. You will see right here an initial
18 two-pronged offer which included, actually, their
19 request for what they would like to see done and then a
20 subsequent counter-counter moving in their direction.

21 I think some very reasonable terms and -- but,
22 again, we have not heard a response to our
23 counter-counter yet.

24 Q. And, again, you will continue discussing --

25 A. Yes. If they wanted to accept this offer, we

1 would happily do it today, tomorrow, or sometime in the
2 near future.

3 MR. BRUCE: And, Mr. Jones and Mr. Wade, you
4 will remember there was a provision in a JOA that
5 Burnett got waived which prevented any of the working
6 interest partners from negotiating with the Ards.

7 Q. And that has been waived by all parties?

8 A. Yes. And we received that right on November
9 the 11th from COG.

10 Q. So if they wanted to, the Ards, besides
11 negotiating with Burnett, they could negotiate with the
12 other working interest owners?

13 A. With anybody.

14 Q. One final question.

15 You mentioned January 23rd. Under the other term
16 assignments, does Burnett have to commence a well by
17 that date?

18 A. We do.

19 Q. And as a result, would you like an expedited
20 order in this case?

21 A. If at all possible.

22 Q. And was Exhibit 15 either prepared by you or
23 compiled from company business records?

24 A. Prepared by me.

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

1 admission of Exhibit 15.

2 MR. PADILLA: No objection.

3 EXAMINER McMILLAN: Exhibit 15 may now be
4 accepted as part of the record.

5 (BURNETT OIL CO., INC., EXHIBIT 15 WAS
6 OFFERED AND ADMITTED.)

7 MR. BRUCE: And I have no further questions
8 of the witness.

9 CROSS-EXAMINATION

10 BY MR. PADILLA:

11 Q. Mr. Means, we were here on November 12th, the
12 last time, and the day before is when you got the
13 waiver, late in the day, the waiver from Concho,
14 correct?

15 A. Correct.

16 Q. Why did you wait six days to make an offer at
17 that time?

18 A. Well, we got back and the weekend, one, and we
19 just took a few days to come up with -- you know, to run
20 our economics and, you know, try to value how the
21 override impacts our net revenue. And as a matter of
22 course, it just took a few days.

23 Q. And you testified that you believe that this is
24 a -- it's your opinion that your offer is a reasonable
25 offer under certain factors, including the \$1,000 per

1 acre factor, right?

2 A. Yes, on the whole. And, I think, on the whole
3 and in part, it is a very reasonable offer, absolutely,
4 and, arguably, a good offer.

5 Q. Did you seek any other -- let me ask you this.
6 Did you pay for any other participating interests in
7 formulating this drilling prospect?

8 A. Well, I referenced the term assignments we took
9 back in -- why am I drawing a blank? -- 2011-ish, I
10 believe. At 2011, we took term assignments from four
11 parties, I believe.

12 Q. You also extended the term assignments relating
13 to the Hudson Group?

14 A. That's correct.

15 Q. In early 2015, correct?

16 A. Correct.

17 Q. And what consideration did you give for that?

18 A. Well, the actual dollar consideration on that was
19 relatively nominal, I mean, like \$100 an acre.

20 At the time, those extensions were -- the whole
21 point of this was to line up the clock, if you will, on
22 the obligations. So we had all these term assignments
23 staggered out going all over. So we paid some
24 people nominal...

25 And if you'll notice, in effect, the

1 consideration for those was an amendment of the
2 provision -- of the continuous development provision to
3 back up when that clock starts from filing your C-102 to
4 rig release.

5 So right on top of that, if I recall, it was \$100
6 an acre.

7 Q. So you were formulating documentation such as
8 extension to the Hudson Group in early 2015. And my
9 question to you is why did you not contact the Ard
10 interest at that time?

11 A. We met with Mr. Ard in December of 2014 and
12 discussed this project.

13 Q. But you didn't disclose the JOA provision that
14 prevented you from dealing with Mr. Ard; is that right?

15 A. Well, that's correct. I testified to this
16 before. The issue with the provision and Mr. Ard was we
17 sat down with Mr. Ard himself and said we would like
18 to -- you know, we're about to have to do some
19 development in this Maljamar prospect and we would like
20 to get you on board.

21 At the time, there was some controversy about
22 what exactly had been earned under the Concho term
23 assignments and what was going to be released and what
24 was going to be subject to the operating agreement.

25 There was a lot of balls in the air. And we told

1 them, We need to get that stuff sorted out and then
2 we'll deal with you.

3 And then we inadvertently forgot the provision in
4 the operating agreement that precluded us from dealing
5 with them. So we didn't not intentionally disclose it.
6 We just looked past it until we got further down the
7 road and recalled that, Oh, yeah, we can't deal with
8 him.

9 Q. My point, Mr. Means, is that you were making
10 efforts to consolidate the ownership back in February --
11 as I read through the Hudson extensions -- well, one was
12 signed on February 11th, 2015. And are you telling me
13 that you sort of inadvertently forgot to deal with Ard
14 from February through sometime in September when you
15 started trying to contact Mr. Ard?

16 A. No. We didn't forget to deal with them. Like I
17 say, at the time there was the Concho term assignments.
18 We didn't receive the reassignment from Concho to Ard
19 until May. And so, you know, that whole time, as far as
20 we were concerned -- and if you looked at public record,
21 the interest was held by Concho.

22 Q. When did the Concho term assignment expire?

23 A. That's a good question. And I can't answer that.
24 You would have to ask Concho and Ard. It is my opinion
25 it expired in October of 2013. But that's my opinion.

1 Q. Was there something that you would do as far as
2 due diligence in preparation for drilling the well?

3 A. What exactly? Research Concho's terms on it.

4 Q. If you are telling me that you think it expired
5 in 2013, certainly in February of 2015, you would --
6 presumably you would have known that this interest had
7 expired and was no longer viable because they had not
8 been earned by Concho; is that a fair statement?

9 A. I think so. You know, to be honest with you,
10 Concho and Burnett have had a rocky history, and we try
11 to stay out of their way. If they had a term assignment
12 that they let expire, we're going to let them go back
13 and pursue it. We are not going to go and try to run
14 under them without talking to them first. And at the
15 time that just wasn't an option honestly.

16 So the Ard and the Concho term assignment is
17 really Concho and Ard's business. That was nothing that
18 Burnett had anything to do with. And we stayed out of
19 that. And that's -- for that reason.

20 Q. From February of 2015 through November 12th, this
21 year, you did not make a proposal to the Ard interests,
22 correct?

23 A. That's correct. I think that's correct, yes.

24 Q. And because of the contractual provision, I think
25 you've already testified -- and I don't want to put any

1 words in your mouth here -- but you've testified you
2 couldn't have made an offer to Ard before Concho waived
3 the contractual provision?

4 A. Yes. At the previous hearing, there was a lot of
5 discussion on that subject. But we were contractually
6 restricted from dealing with the Ard interest.

7 Q. Now, did you -- did Chase buy into this well
8 proposal?

9 A. Yes.

10 Q. When did Chase buy into this proposal?

11 A. In October of this year.

12 Q. And how much did they pay to get into this
13 proposal?

14 THE WITNESS: Do I have to answer that?

15 A. I mean that is a business dealing, and it's a
16 separate matter what a working interest partner got.

17 Q. It is certainly relevant as to what the
18 consideration for buying into the well is, and I want to
19 see how that compares to the offer.

20 A. Well, on the one hand, they didn't buy into the
21 well. They bought into an entire prospect in a
22 development program. You know, the consideration for
23 that is multifaceted. It's a much larger area than two
24 wells.

25 MR. BRUCE: We would object because it's

1 confidential data.

2 MR. WADE: Off the record for a second.

3 (Discussion off the record.)

4 MR. WADE: So we will sustain the objection
5 and you don't have to answer the question.

6 Q. Did you acquire any other term assignments from
7 other working interest owners for this two-well project?

8 A. For this two-well project?

9 Q. Yes.

10 A. The fore referenced. The four we acquired back
11 in 2010, 2011. We have not acquired any recent term
12 assignments -- I mean since the four.

13 Q. Let me ask you about your offer of November 18th;
14 you based it on 80 percent net revenue interest,
15 correct?

16 A. Correct.

17 Q. What were the lease burdens at that time?

18 A. To Ard's interest?

19 Q. Yes.

20 A. I believe he's just subject to the United States
21 Royalty, 12 and 1/2.

22 Q. Does the United States Royalty have a sliding
23 scale that would -- if the sliding scale was triggered
24 that would erase any kind of override to Ard?

25 A. Part of this acreage is subject to Schedule D

1 sliding scale royalty. And that's complicated math. I
2 mean it depends on a lot of factors.

3 But it wouldn't necessarily erase his override,
4 although our proposal -- our second proposal was, yes,
5 his override would be subject to the sliding scale, so
6 that if the royalty started sliding, that would
7 affect -- that would come out of his -- his difference
8 keep, if you will, would get smaller.

9 Q. In your latest offers or your counteroffer of two
10 days ago, did you change the 80 percent net revenue
11 interest?

12 A. We did. And requested deliver a 75 net, we
13 agreed to that. We will agree to him delivering a 75
14 net.

15 Q. And the continued-drilling clause was only
16 45 days, and where are you now with that?

17 A. We proposed 180; he countered with 45. And we
18 went back with 180. Because of the other term
19 assignments we have and because of our development
20 program of what we are trying to do in the environment,
21 we will not go shorter than 180 days.

22 MR. PADILLA: We don't have any further
23 questions.

24 MR. BRUCE: May I ask a few follow-up
25 questions?

1 EXAMINER McMILLAN: Yes. Go ahead.

2 REDIRECT EXAMINATION

3 BY MR. BRUCE:

4 Q. First of all with those 2011 term assignments,
5 for those Burnett did pay \$1,000 an acre?

6 A. That's correct. Paid \$1,000 an acre those.

7 Q. The same as what's being offered to the Ards?

8 A. Correct.

9 Q. And they have 180-day drilling obligations?

10 A. They have 180-day drilling obligations.

11 Q. And what kind of net were those under?

12 A. 75 percent net revenue term assignments. So they
13 would deliver a 75 net.

14 Q. So, again, you're offering the same to the Ards
15 that you got term assignments for four years ago or so?

16 A. Back in 2011, those were for 30-month terms.
17 This is for less than two months.

18 Q. Now, if I recall correctly -- and correct me if I
19 am wrong -- but the testimony last go around, you
20 already said that when it came to the termination of the
21 Ard/COG term assignment you stayed away from that. But
22 did you contact COG regarding the status of that term
23 assignment?

24 A. Multiple times.

25 Q. Was it hard getting them to respond?

1 A. Yes.

2 Q. And, finally, you got information about the
3 termination of the term assignment?

4 A. That's correct. And we received final
5 confirmation and termination of it on -- in May of this
6 year. And to the best of my knowledge, to date, those
7 reassignments of the interest have yet to be recorded
8 and become a public record. So if you were just
9 researching, you would still find that Concho owns the
10 interest.

11 Q. But let me ask you something. Until now under
12 your contractual obligations you couldn't offer a term
13 assignment to the Ards until mid-November?

14 A. That's correct.

15 Q. But you did make a well proposal to the Ards?

16 A. Yes. We asked them to join in this well or --
17 excuse me -- wells.

18 Q. That is a well proposal?

19 A. That is a well proposal. And we sent them an AFE
20 for both wells.

21 Q. For both wells?

22 A. Yes.

23 MR. BRUCE: That is all I have. Thank you.

24 EXAMINER McMILLAN: Go ahead.

25 ---oOo---

1 EXAMINATION BY EXAMINER JONES

2 EXAMINER JONES: Mr. Means, this letter you
3 wrote on December the 1st, this was this Tuesday --
4 right? -- just a couple of days ago?

5 THE WITNESS: Yes, sir.

6 EXAMINER JONES: That one is the latest in
7 the correspondence?

8 THE WITNESS: Is that is our
9 counter-counter, if you will. That offer is on the
10 table.

11 EXAMINER JONES: And you are saying here
12 that this -- the term -- this offer will expire January
13 the 23rd; is that what you're saying?

14 THE WITNESS: No. That's that the term on
15 the term assignment would expire January 23rd.

16 EXAMINER JONES: So the letter is open
17 there?

18 THE WITNESS: Yes. No expiration on our
19 offer. The offer is good.

20 EXAMINER JONES: Okay. Is there other
21 constraints on when you would drill and when you have to
22 drill or your economics? Is it going to be affected by
23 continuing this for a protracted length of time?

24 THE WITNESS: If at all possible -- we are
25 going to lose valuable term assignment rights if we

1 don't get this well drilled by January 23rd. And that's
2 spud. So, in reality, we need to back that up some
3 amount of time.

4 And we have to get this well drilled for all
5 the other four term assignments. So it would be -- yes,
6 we can't afford to continue this any longer, if
7 possible.

8 EXAMINER JONES: I don't have any more
9 questions.

10 EXAMINER McMILLAN: Go ahead.

11 MR. WADE: I don't have any questions.

12 MR. BRUCE: Can I clarify one thing?

13 FURTHER EXAMINATION

14 BY MR. BRUCE:

15 Q. The counter-counteroffer, as we've called it,
16 Mr. Means, really there's two terms there. There's
17 about a month and a half term followed by a 180-day
18 term?

19 A. Yes. It's just a -- the term on the term
20 assignment, I mean, normally you buy a year or two
21 years, whatever. It's kind of like the primary term, if
22 you will.

23 We are saying we will just take the primary term
24 to line it up with our others but pay you what we would
25 pay for a much longer period of time. But then the

1 continued development. We'll drill the well in January
2 and then every 180 days, which will be timed from rig
3 release to spud of the next well, very favorable to the
4 assigner, as it is for our other assigners.

5 That was our consideration for these amendments
6 and extensions to a vast degree. So they have a timely
7 clock. So from rig release of that January rig to,
8 let's say, February sometime, 180 days later we will
9 spud another one, and on we go.

10 And we intend to have that program at that pace
11 until, perhaps, you know, commodity price improves a
12 little better and then we'll quicken it. You know how
13 it goes. And, but, yes, that's...

14 EXAMINER JONES: Thanks.

15 EXAMINER McMILLAN: Thank you very much.

16 THE WITNESS: Thank you.

17 MR. PADILLA: I call Mr. Kauffman at this
18 time.

19 EXAMINER McMILLAN: Thank you.

20 HOUSTON KAUFFMAN
21 having first been duly sworn, was examined and testified
22 as follows:

23 DIRECT EXAMINATION

24 BY MR. PADILLA:

25 Q. Mr. Kauffman, you testified on November 12th in

1 the first part of this hearing?

2 A. Correct.

3 Q. Let me have you -- let me hand you Exhibit 15 and
4 have you turn to the last page of that exhibit. And
5 that is the December 1st counter-counterproposal as I
6 understand it.

7 A. (Witness complies.)

8 Q. What opinion do you have as to whether or not
9 this proposal is within reasonable parameters for term
10 assignment?

11 A. Well, I'll start with a statement that was made
12 in Mr. Ard's counterproposal on December 1st to Burnett
13 on their November 19th proposal, was that the prior
14 terms that the Ards were able to get were pretty much as
15 laid out in that counteroffer that Mr. Ard made.

16 At that time, it was 1,800 an acre, delivering a
17 75 percent net revenue interest lease, never to be less
18 than 2 percent in the event -- and that is designed --
19 that's a fairly common thing when there's something like
20 a sliding scale royalty or something that takes the
21 lease burdens beyond 25 percent. Had a provision for a
22 45-day continuous development program in lieu of the
23 180-day continuous development program.

24 So those were terms that were offered before and
25 that were accepted and I'm not sure exactly what the

1 arrangements were between Burnett and Concho, but both
2 Burnett and Concho have drilled a number of wells under
3 those -- under those same terms.

4 I believe that Concho, from talking to their land
5 department, still has plans. They have drilled a number
6 of wells on the portion of the acreage that they
7 retained from Ards' term assignment that they did not --
8 I don't know whether they had actually assigned it to
9 Burnett or what the exact terms were, but a portion of
10 the acreage in the Ards' term assignment stayed with
11 Concho. And Concho operates horizontal wells on those.
12 Concho advises they can plan on continuing to drill
13 wells on those which have these same overriding royalty
14 terms.

15 As to whether this is reasonable at this time, I
16 feel like a very good determination of what would be
17 reasonable at this time, regardless, as Mr. Means
18 pointed out, what you might have perceived it to be back
19 in 2011, 2012 when these deals were being put together,
20 is that Chase has bought into this prospect, in an
21 arm's-length transaction with Burnett, and I think that
22 in October, as Mr. Means testifies, and I think that
23 that would be a pretty good indication that they have
24 taken a nonoperated interest, which is the same as what
25 Mr. Ard would have, from Burnett, so I think that that

1 would be -- that would pretty well establish what a
2 knowledgeable party like Chase would be willing to pay
3 for that type of nonoperative working interest, not just
4 in these two wells but in this entire prospect area.

5 Q. Mr. Kauffman, have you had any contact with Chase
6 about selling your interest to Chase?

7 A. Yes.

8 Q. And what conclusions or what is the range of
9 discussions that you've had with regard to selling that
10 interest that would have -- that could be compared with
11 the offer of December 1st?

12 A. Chase had made -- Chase eventually made a written
13 offer to make an outright purchase of the Ards' interest
14 subject to an overriding royalty. But it was an
15 outright purchase, so there would be no time factors in
16 terms of drilling an initial well or drilling any
17 additional wells. Chase would own it in perpetuity.

18 Mr. Ard advised me to advise Chase that he was
19 not willing to sell it in perpetuity. And in that
20 regard, I did discuss terms with Chase that are similar
21 to the same terms -- this was on Monday -- they were
22 similar to the same terms -- or Tuesday rather, Tuesday
23 morning -- similar to the same terms that Mr. Ard had
24 countered to Burnett.

25 They had indicated verbally that 1,800 an acre

1 was something that they felt like they could do. By the
2 way, I had also asked them the terms of the
3 previously -- and, once again, on Tuesday, I asked them
4 for those terms of what they paid to get into this
5 prospect to Burnett. They declined to tell me --
6 politely.

7 But they indicated that 1,800 an acre and the 75
8 percent net revenue interest would probably be agreeable
9 to them. They said that they couldn't -- just right
10 there in that telephone conversation that they would
11 have a problem with the overriding royalty never to be
12 less than 2 percent in the event that the sliding scales
13 kicked in, and that they would have a problem with the
14 45-day continuous development program, which I would
15 expect of a nonoperator buying an interest, because they
16 do not have control of the pace of drilling, to have a
17 problem with a 45-day continuous development program
18 versus an operator has more control of the pace of the
19 drilling, of course.

20 Q. Mr. Kauffman, have you talked to anyone else
21 regarding the going rate for a term assignment?

22 A. No. Other than my experience with this
23 particular area, no. I do not have extensive knowledge
24 of how the economics of this area compare to other areas
25 and how this term assignment -- how these terms might

1 compare with, you know, other areas with other
2 economics.

3 Q. Have you talked with anyone regarding this
4 particular prospect without doing a term assignment with
5 anyone else other than Chase?

6 A. I talked to a couple of parties about whether or
7 not they would have interest in potentially taking a
8 term assignment from Mr. Ard or participating on some
9 promoted basis with his interest. I've thrown out the
10 opportunity to make the Ards an offer.

11 And I will -- I want to acknowledge -- which I
12 testified to before -- that it was Burnett that
13 suggested that Ard get in touch with Chase.

14 Q. In terms of timing, what kind of opinion do you
15 have in terms of whether you've had enough time to
16 negotiate this in good faith -- to where you have some
17 comfort level in terms of not having the specter of a
18 compulsory pooling case in front of you?

19 A. Yes. I think as you were asking Mr. Means
20 earlier, I think it's unfortunate that we didn't have
21 more opportunity to talk about this sooner. I realize
22 that they had placed themselves in a situation where
23 they could not visit with Mr. Ard prior to getting this
24 provision in that agreement waived.

25 And, I think, under normal circumstances -- I am

1 not sure that I am answering your question directly --
2 but I think I'm getting to the point that I think it
3 would have been more fruitful had those discussions been
4 going on prior to November 19th.

5 Q. What is your opinion as to the reasonableness of
6 the December 1st counter-counterproposal?

7 A. I think that in light of my conversation with
8 Chase -- again, I think the cash consideration is low I
9 think.

10 I think it is reasonable to add that 2 percent in
11 the event that the sliding scale royalties kick in.
12 When they kick in, they kick in at very high rates of
13 production. And when you have those very high rates of
14 production, your well is economic enough where it could
15 bear that additional burden.

16 When you have that type of provision and it stays
17 in in perpetuity for the life of the well and you get at
18 the tail end of the production, that not to be less than
19 2 percent, when your well's only marginally economic --
20 I have seen it to where that additional 2 percent can
21 indeed -- it can hasten the abandonment point because
22 you are just marginally holding it economically.

23 But the sliding scale royalties kick in at -- I
24 can't remember exactly on this particular lease. But
25 it's in the hundreds of barrels as I recall when those

1 sliding scales kick in. So you have a very economic
2 well at that point.

3 Q. Anything further you wish to add?

4 A. Nothing more.

5 MR. PADILLA: I pass the witness.

6 CROSS-EXAMINATION

7 BY MR. BRUCE:

8 Q. Just a few questions, Mr. Kauffman. I can't
9 remember, I think we both acknowledged, you and I, at
10 the last hearing that we have probably been in business
11 way too long.

12 A. I'll acknowledge that. You can put that on the
13 record.

14 Q. But just from a historical standpoint -- and I
15 know every situation is different -- but term
16 assignments often contain 180-day continuous drilling
17 obligation, historically?

18 A. And less, historically.

19 Q. And less. 45 days is a little low, don't you
20 think, historically?

21 A. Historically, before pad drilling of horizontal
22 wells, when you're going in and you're just getting over
23 and you're bam, bam, bam. You're doing things and you
24 are trying to create economies of scale by making
25 multi-well commitments with contractors. I --

1 Q. There's plenty of scenarios?

2 A. Yes, exactly.

3 Q. I don't want to -- go ahead.

4 A. Yeah. I'm not going to deny that that is shorter
5 than what you typically see. But, historically, that
6 was before as I was just pointing out -- the
7 circumstances will dictate.

8 Q. I understand. It's past lunch and I want to get
9 done.

10 A. Me too.

11 Q. Mr. Ard's counterproposal, as opposed to
12 Burnett's latest thing, did I understand you in saying
13 what his counterproposal was basically what COG gave him
14 in 2011?

15 A. Yes. It was 2012 for his --

16 Q. 2012, okay.

17 A. -- for his term assignment.

18 Q. Okay.

19 A. Executed April 1, 2012. And the other ones were,
20 I believe, I think they were executed towards the end of
21 2011 with the other parties.

22 Q. The acreage that COG earned and kept under the
23 Ard term assignment --

24 A. Yes.

25 Q. Once that acreage is earned, is there any

1 development obligation, further development obligation?

2 A. It's under that -- well, it's under that term
3 assignment that has a 45-day continuous development
4 provision, yes.

5 Q. But if a well is drilled, say, in one 40 -- just
6 assume one 40-acre tract, that 40 is earned until
7 production ceases?

8 A. Correct. No more continuous development on that
9 is required -- as to the earned acreage.

10 Q. As to the earned acreage. That is what I was
11 asking about. And when it comes to offers,
12 counteroffers, counter-counteroffers, each company has
13 different economics, rates of return, et cetera?

14 A. Yes.

15 Q. And are the Ards willing to continue discussion
16 with Burnett?

17 A. Yes.

18 Q. One final question. On federal leases with
19 sliding scale royalties, isn't that generally based on
20 average daily production during the course of a month
21 for all wells on a lease, rather than just looking at
22 individual wells?

23 A. Yes.

24 Q. So if Burnett drilled the first well and it had
25 pretty substantial production, that's not exactly what

1 you look at; you have to look at all the wells on that
2 lease, all oil wells on that lease?

3 A. I am not familiar enough with the leases in this
4 particular situation to say yes or no to that to
5 question.

6 But whatever that calculation would be, yes,
7 you'd have to do that calculation.

8 MR. BRUCE: The only thing I could offer --
9 if the Division wanted it -- is Mr. Means testified to
10 the Schedule D. We can certainly provide a Schedule D
11 royalty schedule to the Division. It is a federal form.

12 EXAMINER JONES: To further explain the
13 sliding scale --

14 MR. BRUCE: Really the provision is pretty
15 brief. I think what Mr. Kauffman said is true, the
16 schedule as to what the royalty rate is under 50 to 75
17 barrels a day or 75 to 100 barrels per day, but the
18 provision regarding how it's calculated is very short.

19 EXAMINER JONES: It is in the lease, though,
20 right?

21 MR. BRUCE: Yes, it is.

22 EXAMINER JONES: Mr. Head Examiner.

23 EXAMINER McMILLAN: I don't see a need
24 for it.

25 MR. WADE: Redirect?

1 MR. PADILLA: I don't have any questions.

2 MR. WADE: Is anybody going to be doing a
3 closing argument then at this point?

4 MR. BRUCE: I would just say -- both parties
5 have indulged in negotiations, both parties are willing
6 to continue negotiations. I know it will take a little
7 while for an order to come out. We would like an order
8 before mid-January, one way or another, so we can
9 determine what we need to do.

10 We think we made a good faith effort but we
11 are willing to continue negotiations.

12 MR. PADILLA: That in itself is an admission
13 that there hasn't been adequate time and this compulsory
14 pooling case should not have been brought before the
15 parties had a chance to negotiate something.

16 I know that we are here and the Division
17 does have jurisdiction over these kind of matters. But
18 I also think that Burnett pushed the limit in this
19 case -- is that for whatever reason, he waited until the
20 last minute and said, Oh, my God, we have this
21 contractual provision in this joint-operating agreement
22 and now our only option is to bring a compulsory pooling
23 case and, essentially, force Ard to accept any deal that
24 was out there if it did not want to participate.

25 I mean, there's a lot of consideration that

1 goes into whether or not you should participate. And
2 somebody who wants to participate generally studies the
3 area. There's been no time to really study this area
4 and determine whether or not it is feasible to
5 participate in the well.

6 The next best thing is to do a term
7 assignment, which is an option here. And that's what's
8 been under consideration. But to be forced -- now,
9 Mr. Bruce makes the point that at least one compulsory
10 pooling may be issued January 15th so that Burnett can
11 save its term assignments when it should have started
12 this whole process way back.

13 In cross-examination -- well, we brought out
14 they got those lease extensions from the Hudson Group in
15 February, and that is plenty of time. We didn't do
16 anything with Ard. Yes, they may have had talks, but
17 there were no proposals. And then they realized they
18 had this bad provision that prevented them from even
19 dealing with Ard.

20 So this is not Ards' fault at all here.
21 And, yeah, it's very compelling to say we want to save
22 our term assignments. But the Division should not be a
23 party to effectively saving those term assignments when
24 Burnett didn't timely take care of business.

25 MR. BRUCE: One thing I would point out in

1 response to what Mr. Padilla said is that --

2 MR. WADE: Is this going to be a short
3 response?

4 MR. BRUCE: Very short, yes.

5 Burnett requested an amendment to the JOA
6 and got responses from everyone within a few days in
7 late September. And it was COG that held it up until
8 November 11th; otherwise, the case probably would have
9 been taken under advisement three weeks ago.

10 EXAMINER McMILLAN: Cases No. 15404 and
11 15405 will be taken under advisement. Thank you.

12 We will be stopping for lunch and we will be
13 back at 1:30 p.m.

14

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18 (Time noted 12:17 p.m.)

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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. _____,
heard by me on December 3, 2015.

Paul Baca, Examiner
Oil Conservation Division

1 STATE OF NEW MEXICO)
2) ss.
3 COUNTY OF BERNALILLO)
4
5
6

7 REPORTER'S CERTIFICATE

8
9 I, ELLEN H. ALLANIC, New Mexico Reporter CCR
10 No. 100, DO HEREBY CERTIFY that on Thursday, December 3,
11 2015, the proceedings in the above-captioned matter were
12 taken before me, that I did report in stenographic
13 shorthand the proceedings set forth herein, and the
14 foregoing pages are a true and correct transcription to
15 the best of my ability and control.

16
17 I FURTHER CERTIFY that I am neither employed by
18 nor related to nor contracted with (unless excepted by
19 the rules) any of the parties or attorneys in this case,
20 and that I have no interest whatsoever in the final
21 disposition of this case in any court.

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