

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:)
) CASE NO. 13,788
APPLICATION OF CHI OPERATING, INC., FOR)
APPROVAL OF OFF-LEASE STORAGE AND)
MEASUREMENT, EDDY COUNTY, NEW MEXICO)
)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID R. CATANACH, Hearing Examiner

September 28th, 2006

Santa Fe, New Mexico

2006 OCT 12 AM 10 16

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, September 28th, 2006, 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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September 28th, 2006
 Examiner Hearing
 CASE NO. 13,788

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A P P E A R A N C E S

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By: ERNEST L. PADILLA

* * *

1 WHEREUPON, the following proceedings were had at
2 9:30 a.m.:

3 EXAMINER CATANACH: All right, let's call the
4 hearing back to order, and I will call Case 13,788, the
5 Application of Chi Operating, Inc., for approval of off-
6 lease storage and measurement, Eddy County, New Mexico.

7 Call for appearances.

8 MR. CARR: May it please the Examiner, my name is
9 William F. Carr with the Santa Fe office of Holland and
10 Hart, L.L.P. We represent Chi Operating, Inc., in this
11 matter, and I have one witness.

12 EXAMINER CATANACH: Additional appearances?

13 MR. PADILLA: Mr. Examiner, Ernest L. Padilla for
14 Charles Hagerman. And I don't have a witness, he's at St.
15 Vincent Hospital.

16 EXAMINER CATANACH: Okay. Will the witness
17 please stand to be sworn in?

18 (Thereupon, the witness was sworn.)

19 JOHN W. QUALLS,
20 the witness herein, after having been first duly sworn upon
21 his oath, was examined and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. PADILLA:

24 Q. Would you state your full name for the record,
25 please?

1 A. John Walter Qualls.

2 Q. Mr. Qualls, where do you reside?

3 A. 5316 Sherwood Drive, Midland, Texas.

4 Q. By whom are you employed?

5 A. Chi Operating, Inc.

6 Q. And what is your position with Chi Operating,
7 Inc.?

8 A. Vice president.

9 Q. Mr. Qualls, have you previously testified before
10 the New Mexico Oil Conservation Division?

11 A. Yes.

12 Q. And at the time of your testimony, were your
13 credentials as an expert accepted and made a matter of
14 record?

15 A. Yes.

16 Q. How were you qualified at that time?

17 A. As a landman and geologist.

18 Q. Are you familiar with the Application filed in
19 this case on behalf of Chi Operating, Inc.?

20 A. Yes.

21 Q. And are you familiar with the status of the lands
22 in the subject area and the wells that are involved in this
23 case? And I mean both the Hagerman Well Number 1 and the
24 Allen Well Number 3.

25 A. Yes.

1 MR. CARR: We tender Mr. Qualls as an expert in
2 petroleum land matters and geology.

3 EXAMINER CATANACH: Any objection? Mr. Padilla?

4 MR. PADILLA: No objection.

5 EXAMINER CATANACH: Mr. Qualls is so qualified.

6 Q. (By Mr. Carr) Mr. Qualls, would you refer to
7 what has been marked Chi Operating, Inc., Exhibit Number 1,
8 identify that and then review the information on this
9 exhibit for the Examiner.

10 A. Exhibit Number 1 is a land plat of 22 South, 27
11 East. The Hagerman Number 1 well is located 1650 from the
12 south, 2200 from the west of Section 30 in 22 South, 27
13 East. And the Allen Number 3 is 660 from the north, 1980
14 from the east, Section 31, 22 South, 27 East.

15 Q. Is the Hagerman well located within the city
16 limits of the City of Carlsbad, New Mexico?

17 A. Yes.

18 Q. And is the Allen well in the city limits?

19 A. No.

20 Q. It's outside the --

21 A. It's outside the city limits.

22 Q. And why is Chi proposing to locate these
23 facilities off-lease and outside the City of Carlsbad?

24 A. Well, we wanted to put the storage tanks on the
25 Allen Number 3, which is outside the City of Carlsbad.

1 Q. Will this enable you to go forward with these
2 facilities and be -- and not be subject to the rules and
3 regulations of the City of Carlsbad?

4 A. Yes.

5 Q. Will it enable you to more efficiently operate
6 the well?

7 A. Yes.

8 Q. And you're interested in having -- minimizing
9 your negotiations and dealings with the City of Carlsbad;
10 is that not true?

11 A. Yes.

12 Q. Let's give the Examiner a little bit of
13 background on what you're seeking. What is the status of
14 each of the wells?

15 A. The Hagerman well was re-entered and completed in
16 late 2005. It's a 40-acre oil well in the northeast
17 quarter of the southwest quarter of Section 30, 22 South,
18 27 East.

19 The Allen Number 3 was a well we drilled -- we
20 spudded in February of '05, and it's a 40-acre oil well in
21 the northwest of the northeast quarter of Section 31, 22
22 South, 27 East.

23 Q. Let's go to what is marked Chi Exhibit Number 2.
24 Would you identify that, please?

25 A. This is our first application for surface

1 commingling, dated January the 11th of 2006.

2 Q. And in this Exhibit you've indicated that all
3 production was from a common source of supply; is that
4 right?

5 A. Yes.

6 Q. And what pool are we producing from?

7 A. It would be the South Carlsbad-Delaware Pool.

8 Q. And you indicated that you had notified all
9 interest owners of this Application; is that correct?

10 A. Yes.

11 Q. What was the measurement type that you were
12 proposing to utilize at that time?

13 A. The bi-monthly meter.

14 Q. Is a copy of the notice -- of your notice letter,
15 attached as the last document in Exhibit Number 2?

16 A. Yes.

17 Q. What happened at this well site?

18 A. Well, prior to the approval we received from the
19 Oil Conservation Division, the pumper turn the well on to
20 test the well.

21 Q. And so before you had received approval the well
22 was actually being commingled; is that right?

23 A. Yes.

24 Q. This did create a noncompliance issue for Chi
25 with the Oil Conservation Division; is that true?

1 A. Yes.

2 Q. And what has Chi done to attempt to resolve that
3 issue with the OCD?

4 A. We signed an agreed compliance order with the Oil
5 Conservation Division and paid a fine.

6 Q. And that was the \$1000 fine you paid --

7 A. Yes, sir.

8 Q. -- during this year?

9 Do you know how much production came from the
10 Hagerman well during this period of time?

11 A. Yes.

12 Q. And how do you know that?

13 A. By bi-monthly tests.

14 Q. And so in terms of production from the Hagerman
15 and the Allen, you were running a bi-monthly test. What
16 kind of test was that?

17 A. The production foreman would shut the well down
18 and test the other well to see what it was doing.

19 Q. And you tested each of the wells?

20 A. Yes.

21 Q. And then you, based on that test data, were able
22 to allocate production to each of the wells?

23 A. Yes.

24 Q. For how long a period of time was that going on?

25 A. That went on for about -- I want to say --

1 probably two and a half months.

2 Q. What happened with the Hagerman well when this
3 problem was discovered?

4 A. We shut it in.

5 Q. And is it shut in today?

6 A. Yes.

7 Q. At the time you were negotiating with the OCD in
8 working out this noncompliance issue, did you at that time
9 determine that you would no longer seek authority for
10 surface commingling?

11 A. Yes.

12 Q. And so today all you're seeking is authority for
13 off-lease measurement and storage of production from the
14 Hagerman well?

15 A. Yes.

16 Q. At this point in time, what do you know about the
17 Hagerman well? Are you still testing the well, or have you
18 been able to determine what kind of a producing well it's
19 going to be?

20 A. Still need to test the well to make sure what it
21 will produce.

22 Q. And all production to date on that well can be
23 allocated based on this testing arrangement?

24 A. Yes.

25 Q. What is the interest of Mr. Hagerman in this

1 well?

2 A. He leased his interest -- he's a mineral owner,
3 he leased his interest in the spacing unit to Chi. He
4 holds a 9.375-percent royalty interest.

5 Q. And there are actually a number of leases in the
6 tract committed to the Hagerman well; is that right?

7 A. Yes, there's five leases, I believe.

8 Q. And Randy Richardson, who wrote a letter for Mr.
9 Hagerman, is also one of those interest owners --

10 A. Yes, sir.

11 Q. -- is he not?

12 Did Mr. Hagerman protest the original Application
13 for surface commingling?

14 A. Yes.

15 Q. And in fact, he contacted the OCD initially
16 concerning the problems at the well site; isn't that right?

17 A. Right.

18 Q. Have you had discussions with him since that date
19 concerning your plans for this well?

20 A. Yes, I've talked to him a couple times, and I've
21 provided him with a copy of our facilities plat showing how
22 we're proposing to meter and store production off the
23 lease.

24 Q. What is Chi Exhibit Number 3?

25 A. That's the application for the off-lease storage,

1 which is dated June the 29th of 2006.

2 Q. And did you actually file this Application at
3 that time?

4 A. Yes.

5 Q. And to whom did you send it?

6 A. I sent a copy of the Application to Ms.
7 MacQuesten. I thought I had sent one to Mr. Catanach, but
8 he didn't receive it so I sent him another one on August
9 the 17th.

10 Q. So we've got two copies of this Application for
11 off-lease storage in the exhibit packet, but they are the
12 same?

13 A. Yes. And I also filed one with the OCD, with Tim
14 Gum in Artesia.

15 Q. All right. What is Exhibit Number 4?

16 A. Exhibit Number 4 is a letter I sent to the
17 interest owners seeking authorization for off-lease storage
18 and measurement for the Hagerman well.

19 Q. And this letter provides that a heater treater
20 and tanks for the Hagerman well would be on the Allen 3
21 surface facility; is that right?

22 A. Yes.

23 Q. Attached to this are the green cards -- copies of
24 the green cards showing that, in fact, you did mail this by
25 certified mail to all affected interest owners; is that

1 correct?

2 A. Yes.

3 Q. What is Exhibit Number 5?

4 A. Exhibit Number 5 is a letter from Mr. Hagerman
5 protesting the Application of Chi requesting the off-lease
6 storage and measurement.

7 Q. And this letter is dated June the 19th; is that
8 correct?

9 A. Yes.

10 Q. And that actually pre-dates the time that you
11 filed the Application?

12 A. Right.

13 Q. Had you discussed your plans for off-lease
14 storage with Mr. Hagerman at that time?

15 A. Yes, I had, and I sent him a revised plat.

16 Q. If we look at the bottom of the letter, there is
17 a PS on the letter, post-script, and that indicates that
18 they received -- the date on that is July 22nd, which is
19 after the Application was filed. Is this the letter as you
20 originally received it?

21 A. Right.

22 Q. What is Exhibit Number 6?

23 A. Exhibit Number 6 is a letter from Mr. Hagerman
24 where he references protesting the off-lease treatment. He
25 says, "Thanks for your recent revised plat. I am enclosing

1 a copy of my protest to the O.C.D. in Santa Fe."

2 Q. And that is actually the protest letter that was
3 attached to the June 19th letter that was the prior
4 exhibit?

5 A. Yes.

6 Q. What is Exhibit Number 7?

7 A. Exhibit Number 7 is the Application for the off-
8 lease storage which was sent to Mr. Catanach on August
9 17th.

10 Q. And is this the Application that has been set for
11 hearing?

12 A. Yes.

13 Q. Mr. Catanach advised you that it will be set for
14 hearing because of the objection that has been filed; is
15 that right?

16 A. Yes.

17 Q. All right. Let's look at this Application for a
18 minute. What is the character of the lands involved in the
19 Application?

20 A. Well, we're asking to -- for off-lease storage of
21 the Hagerman well onto the Allen Number 3 location.

22 Q. And are all the lands fee lands?

23 A. All the lands are fee lands, yes.

24 Q. And the source of the production still is just,
25 you're going to be putting South Carlsbad-Delaware Pool

1 production in the tanks on the Allen, but there's no
2 commingling of this production?

3 A. Yes.

4 Q. What is Exhibit Number 8?

5 A. Exhibit Number 8 is an actual site facility
6 diagram showing the tanks on the Allen Number 3, the heater
7 treater which goes to the Allen Number 3, the Hagerman
8 heater treater, and the water lines going to the tank.

9 Q. Are these facilities in place at this time?

10 A. Yes.

11 Q. When we look at these diagrams and we come in at
12 the upper right-hand corner where the line comes from the
13 Hagerman Number 1, at any point is there any opportunity
14 for the commingling of any of the production from the
15 Hagerman well with the Allen well?

16 A. No.

17 Q. Have all interest owners been notified of this
18 Application and this hearing date?

19 A. Yes.

20 Q. Is a copy of that -- Is Exhibit 9, I'm sorry, a
21 copy of an affidavit confirming that notice has been
22 provided?

23 A. Yes.

24 Q. Mr. Qualls, have you seen a letter that was
25 submitted to the Division from Mr. Richardson concerning

1 this Application?

2 A. Yes.

3 Q. Mr. Richardson expressed concern that there was
4 no way to ensure that royalty in these wells were getting
5 their share of production. Is that correct?

6 A. Well, sir, we tested each well bi-monthly, and we
7 allocated production based on that.

8 Q. And are you convinced that the allocation is
9 correct?

10 A. Yes.

11 Q. And that's the basis for the calculation of the
12 royalty payments to the owners from each well?

13 A. Yes.

14 Q. In your opinion, would approval of this
15 Application enable you to conclude the testing of the
16 Hagerman well and then properly account for all production
17 from that property?

18 A. Yes.

19 Q. In your opinion will approval of the Application
20 otherwise be in the best interest of conservation and the
21 prevention of waste?

22 A. Yes.

23 Q. Were Exhibits 1 through 9 prepared by you, or
24 have they been compiled under your direction and
25 supervision?

1 A. Yes.

2 Q. And can you testify to their accuracy?

3 A. Yes.

4 MR. CARR: Mr. Examiner, at this time move the
5 admission into evidence of Chi Exhibits 1 through 9.

6 EXAMINER CATANACH: Any objection?

7 MR. PADILLA: No objection.

8 EXAMINER CATANACH: Exhibits 1 through 9 will be
9 admitted.

10 MR. CARR: And that concludes my direct
11 examination of Mr. Qualls.

12 EXAMINER CATANACH: Mr. Padilla?

13 CROSS-EXAMINATION

14 BY MR. PADILLA:

15 Q. Mr. Qualls, can you tell us how much production
16 you have allocated to the Hagerman Number 1 well, based
17 upon your bi-monthly production tests for any production
18 from the Hagerman Number 1 in the past?

19 A. It would be 1053 barrels.

20 EXAMINER CATANACH: I'm sorry?

21 THE WITNESS: 1053 barrels.

22 EXAMINER CATANACH: 1053?

23 THE WITNESS: Uh-huh.

24 Q. (By Mr. Padilla) And how much did you attribute
25 to the Allen Number 3 well?

1 A. 254 barrels, I believe.

2 Q. Now did you report to the Oil Conservation
3 Commission, or the Division, all of the production to the
4 Allen Number 3 well?

5 A. Yes. It should be set up on a monthly production
6 reporting basis, the Allen Number 3 should be.

7 Q. So the Allen Number 3 has had all of the
8 production, past production, is that fair to say?

9 A. I'm not sure exactly what you're asking me.

10 Q. Well --

11 A. There was a confusion -- there was a mixup with
12 Navajo as to what production was allocated to the Hagerman
13 and what was allocated to the Allen Number 3, but we got
14 that cleared up, and I think that's all been --

15 Q. What did you submit to Navajo, to correct the
16 allocation?

17 A. We showed them what each well had been reported
18 producing, and I think they've got that all fixed up at
19 this point. I haven't talked to them recently.

20 Q. Has there been any gas production from the --

21 A. No.

22 Q. -- Hager [sic] Number 3?

23 A. No as.

24 Q. Or Number 1, I'm sorry.

25 A. No.

1 Q. How about the Allen Number 3?

2 A. No.

3 Q. Why is it that you sent gas division orders to
4 Mr. Hagerman?

5 A. That's in case it does make gas in the future.
6 We send gas division order out to all the royalty owners
7 and working interest owners for our records.

8 Q. Now -- So I see you have three different
9 schematics. You have the schematic that was originally
10 submitted with your surface commingling, the Application.

11 A. Right.

12 Q. And that showed on its face that there was
13 commingling, right?

14 A. Right.

15 Q. Then you submitted with your Application for off-
16 storage -- for an off-storage location -- or off-lease
17 storage, you submitted one that did not have a heater
18 treater for the Hagerman Number 1, right?

19 A. Yeah, I think that was just a mistake. I
20 corrected that, and we sent the one where the actual
21 facilities are now set up with a heater treater for each
22 well.

23 Q. Okay, and so as I see your Exhibit Number 3, I
24 believe that is the -- that's the most current version of
25 the schematic; is that right?

1 A. Yes, sir.

2 Q. That shows a heater treater on the right-hand
3 side of the schematic.

4 A. Uh-huh.

5 Q. Is that where it's actually located?

6 A. I believe that's where it's located.

7 Q. Okay. So that heater treater is located on the
8 lease itself for the Hagerman 1?

9 A. No, it's actually located on the Allen Number 3.
10 The line comes from the Hagerman Number 1 to the Allen
11 Number 3 where the heater treater is.

12 Q. So somewhere in there -- it's actually on the
13 lease of the Allen Number 3 well?

14 A. (Nods)

15 Q. Just to be off the city limits, I take it?

16 A. (Nods)

17 Q. Now let me go back and ask you about this bi-
18 monthly test. How do you conduct that test?

19 A. That's where our production guy shuts in each
20 well and runs a test to see what wells are producing how
21 much that day, and then he's got a computer program that he
22 plugs these numbers into, and that's what -- he estimates
23 how much oil is coming out of each well.

24 Unfortunately, these wells -- we're still testing
25 them, and we wish they were a lot better wells. They're

1 just -- we're still in the process of testing it to see
2 what we've got coming out of it. We haven't completed that
3 yet.

4 Q. Why is it necessary to test the wells now in that
5 manner, since you've segregated the production?

6 A. Why is it necessary now?

7 Q. Yes.

8 A. It's not now, because we'll have off-lease
9 storage and there will be a meter setup for each well. We
10 won't run a test anymore once we get the production started
11 on the Hagerman.

12 Q. Okay. But you've stated, as I understood your
13 testimony, is that you only produced the Hagerman for two
14 and a half months?

15 A. I believe that's correct.

16 Q. You believe that's correct, or is that correct?

17 A. I think that's right. I don't have the figures
18 in front of me. I think it started production November the
19 8th, is when we started producing the well, and I think we
20 shut it in -- but it wasn't running that whole time -- I
21 think we shut it in April the 28th, I think.

22 Q. When did you complete the Allen Number 3 well?

23 A. When did we complete it?

24 Q. Yes.

25 A. Oh, it was back in -- last summer. I don't have

1 the exact date. I can get that for you if you need it.

2 Q. Has that been a poor well or --

3 A. It's not a very good well.

4 Q. Is the Hagerman Number 1 a better well?

5 A. We don't know that at this time. I think the
6 Hagerman was making around -- the Allen was making three to
7 four barrels of oil a day, and the Hagerman was making
8 about that the same time we shut it in.

9 Q. Are you -- You said you're not familiar with the
10 computer program that your --

11 A. No.

12 Q. -- pumper was using to allocate production; is
13 that --

14 A. No, I don't work with it, but no.

15 Q. Was that based on pressures or just straight
16 production?

17 A. I'm not sure exactly how he uses it, but I can
18 get that answer for you. He watched it pretty close. I
19 know he was watching -- he was watching each well to see
20 what they were doing over -- We were trying to find out if
21 we had a well in the Hagerman Number 1, to make sure that
22 we had a well, and that's the reason he started testing it.
23 I wasn't aware that the approved Application had not come
24 back in from the OCD. That was my fault. But he was
25 watching the Hagerman Number 1, testing it to see if we had

1 a well, to proceed with our completion procedure.

2 Q. So every two weeks, I take it, or twice a month,
3 you would run this test, is that --

4 A. Uh-huh.

5 Q. And based on that test, you allocated production?

6 A. Right.

7 Q. But you reported all of the production coming
8 from the Allen Number 3 well?

9 A. Yeah, that was just a clerical error. That was
10 an error that was put into the computer, and it wasn't
11 cleared up with Navajo. I think we've got that fixed now.

12 Q. Were you monitoring pressures on the well as part
13 of -- Well, let me ask, do you know whether you were
14 monitoring pressures in this bi-monthly test?

15 A. I'm not sure if there was much pressure to
16 monitor, but I could find that out for you if you need to
17 know.

18 Q. Do you have a pumpjack on the wells?

19 A. Yes.

20 Q. Do you still have the information concerning the
21 bi-monthly tests that you made?

22 A. Yes, I can get that from our pumper.

23 MR. PADILLA: Mr. Examiner, I don't have any
24 further questions, but we would like to see the bi-monthly
25 test data.

1 EXAMINER CATANACH: Okay, I was kind of hoping
2 you would have that today. But you don't have that with
3 you?

4 MR. CARR: No, I mean, we had these problems with
5 the well, and we signed an agreed compliance order and paid
6 the fine, and we view this as trying to sort out where we
7 go from here. We're happy to provide that information on
8 things that have happened in the past. The case is really
9 just to get authority to go ahead and conduct these
10 facilities where they are. Basically, we had felt we
11 resolved that other past issue, at least with you, with the
12 Division, when we signed the agreed compliance order and
13 paid the fine. But as to these other matters, we're
14 certainly happy to provide that information to you.

15 (Off the record)

16 EXAMINATION

17 BY MS. MacQUESTEN:

18 Q. Okay, Mr. Qualls, you're familiar with that
19 agreed compliance order that was entered into --

20 A. Uh-huh.

21 Q. -- to resolve the commingling issue? And you
22 testified that you thought that resolved that matter, with
23 the payment of the fine and the signing of the order?

24 A. Right.

25 Q. Are you aware that a provision in that order was

1 that Chi would work with the OCD to ensure that past
2 reporting for the Hagerman Number 1 and Allen Number 3 is
3 correct?

4 A. Yes.

5 Q. And that if the OCD deems it necessary, Chi shall
6 conduct production tests on the two wells to determine the
7 appropriate allocation measure --

8 A. Right.

9 Q. -- and shall notify the OCD 48 hours ahead of
10 time so that we could witness that test?

11 A. Right.

12 Q. When this order was negotiated, Chi presented
13 some information verbally to the effect that they had done
14 production tests and had allocated the production based on
15 these tests; is that right?

16 A. Right.

17 Q. Now after the order was entered, do you recall a
18 letter from the OCD in August of this year regarding the
19 tests that were done?

20 A. Yes.

21 Q. And in that letter, didn't the OCD request that
22 Chi provide the well-production test results?

23 A. Yes. I thought we had gotten that to you.

24 Q. Well --

25 A. I talked to Tim Gum -- It's been a couple weeks

1 ago, and I thought that our production foreman had sent you
2 that information. In talking to Tim I thought he was
3 satisfied with that, and since the well had been shut in
4 since April, he didn't to go out and look at the well and
5 see the production off the well, is what Tim told me.

6 Q. Well, the letter that sent from the OCD was sent
7 from the Santa Fe office, wasn't it?

8 A. Yes.

9 Q. From me, in fact?

10 A. Right, and we sent you -- I've got a copy of a
11 letter -- I don't know if I have it on me, but we sent you
12 the way we allocated the production off of the Hagerman
13 well. I thought we did.

14 Q. Is this the letter that you sent to me in
15 response to my request?

16 A. I can't see it. Yes, but there should have been
17 some -- should have been some numbers that came with that,
18 there should have been some production numbers on how much
19 we allocate to each well, that should have come with that.

20 Q. Was there any reference to any sort of attachment
21 in this letter?

22 A. No, ma'am.

23 Q. And in fact, the entire description of what was
24 done on production -- and if I could just read this: At
25 the time of the last production on the Hagerman Number 1,

1 we bi-monthly shut one well down to get a test on the other
2 well, then plugged this number into the formula in the
3 computer program that we use.

4 A. (Nods)

5 Q. And that's essentially what you told us when we
6 negotiated the order?

7 A. Uh-huh.

8 Q. So this didn't provide any additional information
9 to us?

10 A. Okay, well, I thought Sonny had sent you some
11 additional information. I'll check and find out why there
12 wasn't anything sent with that.

13 Q. Now after this was sent you say you had some
14 conversation with Tim Gum?

15 A. Yeah, he called me -- I guess it was two weeks
16 ago, roughly that time period, and said that he wanted --
17 he was thinking about coming out and looking at the way we
18 allocate production off the Hagerman, and then he asked me
19 how long the Hagerman had been shut in.

20 And I told him it had been shut in since April.

21 And then he said, Well, I don't see any need to
22 come out there and look at it right now, then.

23 I said, We're coming to the hearing for the off-
24 lease storage and management, and he seemed to be satisfied
25 with that.

1 Q. Did you receive any assurance from the Santa Fe
2 office that that was sufficient?

3 A. No. I mean, we're -- we'll do -- If they want to
4 come out and look at us producing the well and show you how
5 we test the well, see what it's making, we're willing to do
6 that. We'll work any way we can on that.

7 Q. Now you say that your pumper does still have the
8 test results that were done originally?

9 A. Uh-huh.

10 Q. Would those show the length of time that the well
11 was producing and how much it produced during that time
12 period?

13 A. It should, yes.

14 Q. With the raw data?

15 A. Uh-huh.

16 Q. And then you say this information was put into
17 the computer program that the pumper had to determine the
18 allocation?

19 A. Uh-huh.

20 Q. Is that a computer program that the pumper came
21 up with, or is it a canned program that is available for
22 other people to use for allocation?

23 A. I'm not sure exactly, I'll have to ask him about
24 that. I think it comes off of our -- we have a -- we have
25 a computerized system that our pumpers use for all our

1 wells in New Mexico, and they type in the information into
2 it and it prints it out. It's called direct -- direct
3 something, I can't remember the last name of it. And it's
4 just a computerized program that shows all our production
5 from all of our wells every day,

6 Q. Could you provide us with more information on how
7 that program --

8 A. Sure.

9 Q. -- calculates the allocation?

10 A. Sure.

11 MS. MacQUESTEN: I don't have any other questions
12 at this time. We do have Mr. Daniel Sanchez here, he's our
13 enforcement and compliance manager. If you wish additional
14 information on what the District is supposed to be doing on
15 this, he's available to tell you.

16 EXAMINER CATANACH: The circumstances in this
17 case are a little bit complicated. I think since there
18 appears to be an ongoing investigation into a part of the
19 case that deals with production, I think that we should
20 keep that separate from the issues that we're dealing here
21 with today, dealing with, and I don't know that we should
22 get involved in that. I think the issue that we should be
23 involved today with is just the approval of the surface
24 off-lease storage.

25 And I would be inclined to let the Division

1 finish their investigation with regards to the production
2 history, and if there's a problem with that, I think that
3 at that time the Division could either bring a case, or Mr.
4 Hagerman could bring a case, to deal with that issue. That
5 would be my inclination. Is that -- Would you concur with
6 that, Ms. MacQuesten?

7 MS. MacQUESTEN: Yes, I would. The only reason I
8 wanted to ask the questions is that representations were
9 made that the original compliance matter was essentially
10 closed, and my point is that we don't consider it closed.

11 MR. CARR: Okay, well I want you to know that we
12 did and that we felt we were here only for the off-lease
13 storage Application because that's really, technically, the
14 only thing that's before you.

15 As to these other issues, we can get the
16 production information and description of the computer
17 program -- get all of those to you and to Mr. Padilla, and
18 to press that, because really that is beyond what we were
19 anticipating we were coming in here for today.

20 I do also just want to make a general statement
21 that when we've been working out of our office on
22 compliance matters we've been consistently telling people,
23 maybe incorrectly so, not to work with the District but to
24 only work with you. But I'm not sure that operators really
25 understand that, and I think there is a -- continuing to be

1 a source of some confusion there. But I can assure you
2 that Mr. Qualls and I can get this information to you and
3 get it to you very quickly. Then you can let us know,
4 either Mr. Hagerman, or you, if you think some follow-up
5 action is appropriate. And I'll give copies of everything
6 to Ernie.

7 MR. PADILLA: For my part, we don't have an
8 objection to the current Application, because that needs to
9 go forward so that the well can be produced, but the
10 Application also is made on the basis of -- or under Rule
11 303.B, which is -- which addresses commingling.

12 MR. CARR: And that's an interesting thing too,
13 because Rule 303.B, if you read it, talks about
14 commingling, the whole Rule, except in 303.B there is only
15 -- I can find a one-sentence reference to off-lease storage
16 and measurement, and we didn't even find standards in that
17 Rule to follow. So we just brought this to you.

18 But let me ask Mr. Qualls one question.

19 FURTHER EXAMINATION

20 BY MR. CARR:

21 Q. What is the current producing rate from the
22 Hagerman?

23 A. The Hagerman is --

24 Q. Do you have an idea of the last -- has it shown a
25 decline, or what --

1 A. The Hagerman hasn't produced since the end of
2 April. We shut it in when all this came to a head.

3 Q. And between November and April, I mean --

4 A. It averaged -- It averaged probably four barrels
5 a day, maybe five.

6 Q. And the total --

7 A. It has an initial production that was 20 to 25
8 barrels a day, initially.

9 Q. And is the total volume that has been allocated
10 out of that total stream to the Allen well 240 or -50
11 barrels total?

12 A. Uh-huh.

13 MR. CARR: Okay. We'll get all that data to you
14 and get it to Mr. Padilla, and then would like to meet with
15 you and coordinate with Santa Fe office so we're sure we're
16 square everywhere.

17 MR. PADILLA: I don't have a problem with that.
18 I think that if we had some assurance that the production
19 was calculated and allocated on a reasonable basis then,
20 we'll go forward with that?

21 EXAMINER CATANACH: Okay. Well, as long as you
22 don't have an objection to this immediate Application for
23 the surface commingling from here forward -- or the off-
24 lease storage, I'm sorry, not the commingling, but we can
25 go forward with the case. And like I said, if you guys

1 have a problem --

2 MR. CARR: We will have that data to you within
3 10 days --

4 THE WITNESS: Yeah.

5 MR. CARR: -- and more quickly than that if we
6 can, and to you as well.

7 EXAMINER CATANACH: Okay.

8 MR. CARR: I've indicated to Mr. Richardson I
9 will respond to his letter too and address that, and so
10 we'll copy everything to everyone.

11 EXAMINER CATANACH: Okay, I do have some
12 questions, and a couple of them kind of touch a little bit
13 on the production, but I'll try not to get too involved in
14 that.

15 EXAMINATION

16 BY EXAMINER CATANACH:

17 Q. The Hagerman Well Number -- what is it, Well
18 Number 1? --

19 A. Uh-huh.

20 Q. -- that was the recent recompletion, or the
21 recent re-entry?

22 A. Re-entry, yes.

23 Q. And that was completed -- it was completed in the
24 Delaware?

25 A. Uh-huh.

1 Q. Okay. Have you looked at the tests that were run
2 on that well, Mr. Qualls?

3 A. As far as -- ?

4 Q. The production tests that you actually did run on
5 the well?

6 A. No, I really haven't looked at them, I just
7 looked at the production, the daily production that was
8 being reported on. I'm not an engineer. We've got two
9 engineers in our office, and they do the actual testing of
10 the wells.

11 Q. So if it was tested for -- you said about two and
12 a half months?

13 A. I believe that's correct.

14 Q. So you ought to have at least maybe five tests
15 for the well?

16 A. Probably.

17 Q. Okay, I was trying to get it -- I wonder how the
18 test -- how consistent the test results are from that
19 period of time --

20 A. Okay.

21 Q. -- because if that was an initial completion I
22 don't know how long it would take the well to stabilize --

23 A. Right.

24 Q. -- its producing rate, but it could fluctuate --

25 A. Oh, yeah, it --

1 Q. -- pretty good in that period of time.

2 A. -- it did fluctuate quite a bit, and there were
3 some days where there was no production. I mean, you get
4 nothing one day, and -- Yeah, there was a lot of times
5 where it went up and down.

6 Q. Did it ever occur to you guys you might want to
7 test it at a more frequent interval because of that?

8 A. Yeah. Yeah, I think that came up also.

9 Q. Okay. Were the wells tested for a 24-hour
10 period?

11 A. I think that's correct. I'll have to check with
12 Sonny on that to make sure, but I think that's the way he
13 did it.

14 Q. Okay. And on the Allen well, that well was also
15 -- it was a recent drill; is that right?

16 A. Yes.

17 Q. Okay, and was the production on that well -- did
18 it also fluctuate during that period of time?

19 A. Yes.

20 Q. Okay. So at this point, I mean, with -- the best
21 data that we're going to have is the test data, and that's
22 probably the only thing we're going to be able to use as
23 far as allocating production?

24 A. Right.

25 Q. And let's see, the Hagerman well is shut in

1 currently?

2 A. Yes.

3 Q. And the Allen is still producing?

4 A. Yes, it's still producing. It averaged, for the
5 month of August, four barrels a day.

6 Q. Okay. Are these wells producing any water?

7 A. The Allen, I think, averaged 18 barrels of water
8 a day for the month of August. The Hagerman, like I say, I
9 don't know what it would -- how much water it would make.

10 Q. What do you guys do with that water?

11 A. It's -- There's a tank set on the Allen Number 3
12 facility that we put the water into.

13 Q. Okay, what do you do with it after you put it in
14 the tank?

15 A. Haul it off.

16 Q. And where do you dispose of it?

17 A. I'm not sure what disposal it's going to right
18 now. There's one up by Loco Hills, and -- all the
19 disposals are pretty much full in that area right now, so
20 it's whoever can take it and wherever they can put it.

21 Q. There's a charge for that; is that correct?

22 A. Yeah.

23 Q. And you charge that back to the well?

24 A. Yeah.

25 Q. I don't see where you're -- you meter the water

1 from the wells.

2 A. We will, once this -- once we can get this
3 approved for an off-lease storage, we will have a meter for
4 the well, for water and the oil.

5 Q. Where is that going to be located?

6 A. I'm not sure where Sonny is going to have it set
7 up, but I can find out for sure, where the meter for the
8 water will be.

9 Q. Okay, you may want to submit a revised diagram
10 showing that that water is going to be metered also --

11 A. Okay.

12 Q. -- because it probably does need to be metered,
13 just -- If you're charging the wells for disposing them,
14 then it needs to be accurately accounted for.

15 A. Sure.

16 Q. The oil sales, is that -- is there a meter that
17 you guys are going to use, or -- is that oil hauled away in
18 tanks --

19 A. Yes.

20 Q. -- in transports?

21 A. It will be transported.

22 Q. And how is that going to be metered?

23 A. There will be a meter at the heater treater to
24 tell how much oil is going into the tank, and then when
25 Navajo comes and picks it up, or whoever picks it up, it

1 tells how much oil they take.

2 Q. Okay.

3 A. That's all carefully monitored.

4 Q. Again, if you would revise your diagram to show
5 the location of the meters that you're going to be using.

6 A. Okay.

7 Q. I had a question about the -- You say the wells
8 aren't producing any gas at this point. Do you anticipate
9 that they might at some point?

10 A. I haven't been told that. I don't know that for
11 a fact. I know they haven't produced any gas. The Allen
12 Number 3 makes no gas.

13 Q. So you haven't set up any gas sales point for the
14 wells?

15 A. We have gas lines that go down to another well we
16 have down there, but I'm not sure if they have those in
17 place at this point, if there is gas to be made.

18 Q. Okay, I was a little unclear about the setup of
19 the gas lines. On Exhibit Number 8 you have got a gas line
20 that comes out of the Allen 3 heater treater and a gas line
21 that comes out of the Hagerman heater treater --

22 A. Right.

23 Q. -- and I don't know where those gas lines go, I
24 don't know if they -- if they at some point merge --

25 A. Okay.

1 Q. It just -- it's kind of -- I realize that there's
2 no gas production at this point, but can you explain to me
3 how that's going to work if there is any gas production --

4 A. Okay.

5 Q. -- whether that's going to be commingled or how
6 that's going to work?

7 A. Okay.

8 Q. Because again, if one of these wells starts
9 producing gas, it's going to have to be accounted for --

10 A. Yes.

11 Q. -- and allocated back to the well which it was
12 produced from.

13 A. Right. Well, they have a separate meter set up
14 for that if they do start making gas. I'll get you a
15 diagram showing where the gas lines are going. I'm pretty
16 sure they go to another well we have over there that goes
17 into a Duke line, but it will have a meter on each gas
18 line. But I'll double-check that for you.

19 Q. Okay. Is there any oil in the Hagerman tank at
20 this point?

21 A. No.

22 Q. So that tank is empty?

23 A. Yeah.

24 Q. The Allen tank has oil in it at this time?

25 A. It has some oil in it.

1 Q. Okay. Are these going to be the only two wells
2 that we're going to be talking about in this -- at this
3 facility, or are you drilling any more wells here?

4 A. I'm pretty sure that these are the only two that
5 are going to be on this particular facility. We do have
6 some more wells that we're trying to get permitted through
7 the City of Carlsbad that are in this vicinity, but I'm not
8 sure -- we haven't determined yet where we want to -- how
9 we're going to set those up.

10 Q. Okay.

11 A. Our whole plan for this was, these shallow
12 Delawares that are close to the City of Carlsbad or in the
13 City of Carlsbad, just to get them out of the city, get
14 them away from the community, get them away from the houses
15 and keep everybody happy, and make sure it's a safe
16 environment for the deal. That was our whole game plan, it
17 just kind of backfired on us.

18 EXAMINER CATANACH: Which is a fine idea, if you
19 can protect the correlative rights of --

20 THE WITNESS: Exactly

21 EXAMINER CATANACH: -- the interest owners. I
22 mean, that's --

23 THE WITNESS: Exactly.

24 EXAMINER CATANACH: -- that's the whole thing.

25 I don't think I have anything else.

1 MR. CARR: We will get the data you've requested
2 to you, the new schematic, and then we'll get the computer
3 program description and test results to you and to -- and
4 we'll send everything to Mr. Hagerman through Mr. Padilla.

5 MR. PADILLA: I have one further question, if I
6 may ask.

7 FURTHER EXAMINATION

8 BY MR. PADILLA:

9 Q. Mr. Qualls, Chi operates these wells, right?

10 A. Uh-huh.

11 Q. Both wells?

12 A. Right.

13 Q. Have you sold those wells?

14 A. Have we sold them?

15 Q. Yes.

16 A. No.

17 Q. Thank you.

18 A. Why?

19 Q. Well, somewhere in the correspondence I had
20 something that Mr. Hagerman believed -- where Navajo
21 reported that some of the wells had been sold.

22 A. No, we sold some of our interest, but we haven't
23 sold any of the wells. There was a working interest
24 partner that participates with us a lot, that bought part
25 of our interest in some of our wells.

1 MR. PADILLA: Okay, that's all I have.

2 THE WITNESS: No, we haven't sold the well.

3 EXAMINER CATANACH: Okay. So you'll get that
4 stuff to --

5 MR. CARR: Yes, we will --

6 EXAMINER CATANACH: -- the Division?

7 MR. CARR: -- we'll get that to you quickly.

8 EXAMINER CATANACH: Okay. Anything further,
9 gentlemen?

10 MR. PADILLA: Nothing.

11 MR. CARR: Nothing further.

12 EXAMINER CATANACH: Okay. There being nothing
13 further, Case 13,788 will be taken under advisement.

14 And Mr. Padilla, if you'll give Mr. Hagerman our
15 best wishes for a speedy recovery.

16 (Thereupon, these proceedings were concluded at
17 10:15 a.m.)

18 * * *

19 I do hereby certify that the foregoing is
20 a complete record of the proceedings in
the Examiner hearing of Case No. 13788,
21 heard by me on September 21, 2006.
22 David R. Catanch, Examiner
Oil Conservation Division

23

24

25

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 September 29th, 2006.



STEVEN T. BRENNER
 CCR No. 7

My commission expires: October 16th, 2006