

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 CHI OPERATING, INC.,)
FOR COMPULSORY POOLING, EDDY COUNTY,)
NEW MEXICO)

CASE NO. 13,814

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID R. CATANACH, Hearing Examiner

November 9th, 2006

Santa Fe, New Mexico

2006 NOV 20 PM 12

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, November 9th, 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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November 9th, 2006
 Examiner Hearing
 CASE NO. 13,814

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<u>JOHN W. QUALLS</u> (Landman)	
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* * *

A P P E A R A N C E S

FOR THE DIVISION:

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FOR THE APPLICANT:

HOLLAND & HART, L.L.P., and CAMPBELL & CARR
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P.O. Box 2208
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By: WILLIAM F. CARR

* * *

1 WHEREUPON, the following proceedings were had at
2 8:55 a.m.:

3 EXAMINER CATANACH: Call Case 13,814, the
4 Application of Chi Operating, Inc., for compulsory pooling,
5 Eddy County, New Mexico.

6 Call for appearances.

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

11 EXAMINER CATANACH: Any additional appearances?
12 Okay, will the witness please stand to be sworn
13 in?

14 (Thereupon, the witness was sworn.)

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

18 DIRECT EXAMINATION

19 BY MR. CARR:

20 Q. Would you state your name for the record, please?

21 A. John Qualls.

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

23 A. Midland, Texas.

24 Q. By whom are you employed?

25 A. Chi Energy, Inc.

1 Q. And what is your position with Chi?

2 A. I'm a landman.

3 Q. Have you previously testified before this
4 Division?

5 A. Yes, sir.

6 Q. At the time of that testimony, were your
7 credentials as an expert witness in petroleum land matters
8 accepted and made a matter of record?

9 A. Yes.

10 Q. Are you familiar with the Application filed in
11 this case?

12 A. Yes.

13 Q. And are you familiar with the status of the lands
14 in the area that's the subject of this Application?

15 A. Yes, sir.

16 MR. CARR: We tender Mr. Qualls as an expert in
17 petroleum land matters.

18 EXAMINER CATANACH: Mr. Qualls is so qualified.

19 Q. (By Examiner Catanach) Would you briefly
20 summarize for Mr. Catanach what it is that Chi seeks with
21 this Application?

22 A. We want an order pooling all mineral interests
23 from the surface to the base of the Morrow in the east half
24 of Section 4, Township 22 South, Range 26 East, Eddy
25 County, New Mexico.

1 Q. Are we also seeking the order to pool the
2 northeast quarter for any pool or formation developed on
3 160 acres?

4 A. Yes.

5 Q. And the northeast northeast for anything
6 developed on 40?

7 A. Yes.

8 Q. What is the name of the well to be dedicated to
9 these pooled units?

10 A. The name of the well is the WC 4 Well Number 4.

11 Q. And where is it located?

12 A. To be drilled from a nonstandard surface location
13 1120 feet from the north, 990 from the east line, and a
14 bottomhole location 1060 from the north and 660 from the
15 east.

16 Q. Is the bottomhole location standard?

17 A. Yes.

18 Q. Could you refer to what has been marked for
19 identification as Chi Exhibit Number 1 and review this for
20 the Examiner?

21 A. Chi Exhibit Number 1 is a land plat showing the
22 east half of Section 4 in 22-26, Eddy County, New Mexico.

23 Q. Now Mr. Qualls, our Exhibit 2 is supposed to be
24 an ownership breakdown. I don't find it in the exhibit
25 pack. Can you review for the Examiner the status of the

1 ownership in this spacing unit?

2 A. The owners we're trying to compulsory pool are
3 Virginia and Holly -- Virginia Franks and Holly Lawson and
4 Jerry Cox.

5 Q. And what interest in the spacing unit do these
6 individuals own?

7 A. They would have an interest of approximately .6
8 percent of the well.

9 Q. Okay. The primary objective in this well will be
10 the Morrow?

11 A. Yes.

12 Q. What is Exhibit Number 2?

13 A. What we've got marked here?

14 Q. Yes.

15 A. That's the APD.

16 Q. For the well?

17 A. Yes.

18 Q. And then Exhibit Number 3?

19 A. Exhibit Number 3 is a letter sent to Virginia
20 Franks and Holly Lawson and Jerry Cox.

21 Q. And when was this letter sent to them?

22 A. July the 26th to Jerry Cox and July the 28th of
23 2006 to Virginia Franks and Holly Lawson.

24 Q. Can you review the status of your negotiations
25 with each of these individuals since you initially proposed

1 the well to them?

2 A. We've talked to these people quite a few times.
3 They have indicated they will sign a lease. We have not
4 received a lease as of this date.

5 Q. As to Jerry Cox, what's the status of that --

6 A. He -- I sent him the lease in the letter. He had
7 the cover letter notarized and sent back to me. I talked
8 to him last week, he said he would have the lease notarized
9 and sent back to me.

10 Q. So you do believe Mr. Cox is trying to commit to
11 the well?

12 A. Yes.

13 Q. And as to these other two interest owners,
14 Virginia Franks and Holly Lawson?

15 A. They have indicated they will sign the lease and
16 send it to me, but I haven't received it yet.

17 Q. On each of these letters you have made notations
18 as to follow-up contacts with each of these individuals?

19 A. Yes, sir.

20 Q. If you are able to reach a voluntary agreement
21 with all of the interest owners in this -- in the pool
22 spacing units, will you immediately advise the Division?

23 A. Yes.

24 Q. Do you believe you've made a good faith effort to
25 reach agreement with all interest owners, cost-bearing

1 interest owners, in the spacing unit?

2 A. Yes.

3 Q. What is Exhibit Number 4?

4 A. Exhibit Number 4 is a copy of the AFE for the
5 well.

6 Q. And what are the costs as reflected on that AFE?

7 A. The dryhole cost would be \$1,426,421, completed
8 well will be \$2,234,068.

9 Q. Are these costs in line with what is charged by
10 other operators in the area for similar wells?

11 A. Yes.

12 Q. What is Exhibit 5?

13 A. Exhibit 5 is a copy of the JOA, joint operating
14 agreement, that we use.

15 Q. Is attached to this JOA a copy of the COPAS
16 accounting procedures for joint operations?

17 A. Yes.

18 Q. Do these procedures provide for periodic
19 adjustment of the overhead and administrative costs while
20 the well is being drilled and operated?

21 A. Yes.

22 Q. Does Chi request that the order that results from
23 this hearing also provide that the costs assessed by this
24 order, or established by the order in this case, also be
25 adjusted in accordance with these accounting procedures?

1 A. Yes, sir.

2 Q. Have you made an estimate of the overhead and
3 administrative costs to be incurred while drilling and also
4 while producing the well if it is successful?

5 A. Yes, sir, the drilling rate will be \$6000 a
6 month, the producing rate will be \$600 a month.

7 Q. And what is the source of these numbers?

8 A. That's Ernst and Young average.

9 Q. Do you recommend that these figures be
10 incorporated into the order that results from this hearing?

11 A. Yes, sir.

12 Q. Does Chi request that a 200-percent risk penalty
13 be imposed on any cost-bearing interest owner that doesn't
14 voluntarily commit to the drilling of this well?

15 A. Yes.

16 Q. And does Chi seek to be designated operator of
17 the well?

18 A. Yes.

19 Q. How soon do you plan to commence drilling of the
20 well?

21 A. We're drilling the well now.

22 Q. In your opinion, will granting this Application
23 be in the best interest of conservation, the prevention of
24 waste and the protection of correlative rights?

25 A. Yes.

1 Q. Is Exhibit Number 6 an affidavit confirming that
2 notice of this hearing has been provided in accordance with
3 the Rules of the Oil Conservation Division?

4 A. Yes.

5 Q. And it shows that Virginia Franks and Holly
6 Lawson have received notification of the hearing; is that
7 right?

8 A. Yes.

9 Q. Were Exhibits 1 through 6 either prepared by you
10 or compiled under your direction?

11 A. Yes.

12 MR. CARR: At this time, Mr. Catanach, I would
13 move the admission into evidence of Chi Exhibits 1 through
14 6.

15 EXAMINER CATANACH: Exhibits 1 through 6 will be
16 admitted.

17 MR. CARR: And that concludes my direct
18 examination of Mr. Qualls.

19 EXAMINATION

20 BY EXAMINER CATANACH:

21 Q. Mr. Qualls, notice was also provided to Shirley
22 Washburn?

23 A. She signed the lease and sent it in. We didn't
24 -- we did send her a letter, but she actually signed the
25 lease and sent it to us.

1 EXAMINER CATANACH: All-righty. Can you provide
2 us with a breakdown of who -- what the interest ownership
3 is --

4 MR. CARR: Yes --

5 EXAMINER CATANACH: -- within that --

6 MR. CARR: -- we can. I have it at the office.

7 I don't know why it wasn't included.

8 EXAMINER CATANACH: Okay.

9 MR. CARR: We'll bring that this after- -- send
10 it over this afternoon.

11 Q. (By Examiner Catanach) Okay. The two interests
12 that you're pooling, they own how much?

13 A. It's very small, they own a total of 4.243 gross
14 acres between Virginia Franks and Holly Lawson, and Jerry
15 Cox has 1.04 acres.

16 Q. Okay, I'm having a little trouble with the
17 application to drill. The C-101 doesn't seem to coincide
18 with the footage -- The footage of the well doesn't seem to
19 coincide with what you've got advertised in this case.

20 A. Yeah, that's -- I didn't catch that. That's
21 the -- We've had to move this location three different
22 times to get it away from the city. The approved APD is
23 actually a surface location and a bottomhole location. I
24 can get you a copy of that.

25 Q. Okay, so there is a subsequent APD --

1 A. Yes.

2 Q. -- that has the correct footages on it?

3 A. Yes, sir.

4 Q. And I notice also, on the bottom of that C-101
5 there's a reference to NSL -- I believe it's 5225?

6 A. Right.

7 Q. So you do have approval for an unorthodox
8 location?

9 A. Right. Yes, on this approved APD we did have an
10 approval for an unorthodox location. When we ended up
11 moving the well we got another APD approved for a surface
12 location and a bottomhole location.

13 Q. But the bottomhole location -- the new bottomhole
14 location is standard, right?

15 A. Yes, sir.

16 Q. Okay. But it is still planned to be a horizontal
17 well?

18 A. Yes, sir.

19 MR. CARR: Is it horizontal or directional?

20 THE WITNESS: It's directional.

21 Q. (By Examiner Catanach) What is the reason for
22 the directional?

23 A. To get it away from houses in the vicinity.
24 There's quite a few homes right there in this east half of
25 Section 4, so we ended up moving it across the road to get

1 it away from everybody's house.

2 Q. Is this in the Carlsbad area?

3 A. Yes.

4 Q. Okay. Do you know how deep the well is
5 currently, Mr. Qualls?

6 A. We're close to TD, probably around 11,500.

7 EXAMINATION

8 BY MR. BROOKS:

9 Q. The notice -- the location provision in the
10 advertisement, then, is correct, it's 1100 -- surface
11 location is 1100 from the north and 990 from the east?

12 A. Yes.

13 Q. And the bottomhole is 1060 from the north and 660
14 from the east?

15 A. Yes.

16 MR. BROOKS: Okay, that's all.

17 EXAMINER CATANACH: Okay, there being nothing
18 further --

19 MR. CARR: That concludes our presentation in
20 this case.

21 EXAMINER CATANACH: Pending your submission of
22 the additional listed documents, Case 13,814 will be taken
23 under advisement.

24 MR. CARR: You're requesting what?

25 EXAMINER CATANACH: The correct APD that shows

1 the correct location --

2 MR. CARR: Right.

3 EXAMINER CATANACH: -- and the breakdown of the
4 interest ownership within the unit.

5 MR. CARR: You do have the full AFE.

6 THE WITNESS: I had that APD faxed to your office
7 yesterday, so...

8 MR. CARR: Yes, I have that. I have both of
9 them, and I'll bring them over.

10 (Thereupon, these proceedings were concluded at
11 9:08 a.m.)

12 * * *

13
14
15
16 I do hereby certify that the foregoing is
17 a complete record of the proceedings in
the Examiner hearing of Case No. 13814,
18 heard by me on November 9 2006.

19 David R. Catnach, Examiner
20 Oil Conservation Division
21
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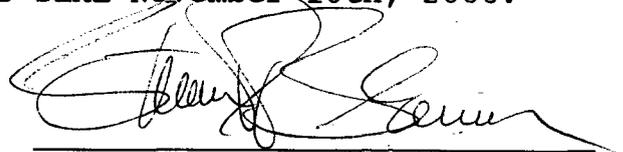
CERTIFICATE OF REPORTER

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 ~~November~~ 10th, 2006.



STEVEN T. BRENNER
 CCR No. 7

My commission expires: October 16th, 2010