STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

Application of Celero Energy II, LP to amend the Unit Agreement and the Unit Operating Agreement for the Rock Queen Unit and for Statutory Unitization.

Application of Celero II, LP to Expand the Water Flood Project and Institute a Tertiary Recovery Project for the Rock Queen Unit and to Qualify the Project for the Recovered Oil Tax Rate, Chaves and Lea Counties, New Mexico.

ORIGINAL

Case Nos. 14504 and 14505

AUGUST 19, 2010
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Santa Fe, New Mexico

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HEARING EXAMINER: DAVID BROOKS
TECHNICAL ADVISOR: TERRY WORNELL

For The Applicant:

JAMES GARRETT BRUCE, Esq.
P.O. Box 1056
Santa Fe, New Mexico 87504
505-982-2043

REPORTED BY: JAN GIBSON, CCR, RPR, CRR
Paul Baca Court Reporters
500 Fourth Street, NW - Suite 105
Albuquerque, New Mexico 87102

(Note: In Session at 9:45.)

HEARING EXAMINER BROOKS: We will go back on the record. At this time we will call Case No. 14504, Application of Celero Energy II, LP to amend the unit agreement and the unit operating agreement for the Rock Queen Unit and for statutory unitization and Case No. 14505, application of Celero II, LP to expand the water flood project and institute a tertiary recovery project for the Rock Queen Unit and to qualify the project for the recovered oil tax rate, Chaves and Lea Counties, New Mexico. Call for appearances.

MR. KELLAHIN: Jim Bruce of Santa Fe representing the applicant. I have three witnesses.

HEARING EXAMINER BROOKS: Are you going to be requesting to consolidate the two cases for the purposes of the hearing?

MR. KELLAHIN: Yes, sir.

HEARING EXAMINER BROOKS: I anticipated that. Cases No. 14504 and 14505 will be consolidated for the purposes of the hearing. Would the witnesses please stand and identify themselves?

(Note: Witnesses Jim Gresham, John Baker and Michael Metza sworn.)

HEARING EXAMINER BROOKS: You may proceed,

Mr. Bruce.

JIM GRESHAM

EXAMINATION

BY MR. BRUCE

Q. Would you please state your name and city of residence?

A. My name is Jim Gresham. I live in Fort Worth, Texas.

Q. And who do you work for and in what capacity?

A. I am a Certified Professional Landman. I work for Solero Energy II LP, and my position is Land Director.

Q. Have you previously testified before the Division?

A. No, I have not.

Q. Would you summarize your educational and employment background for the examiner.

A. Yes, sir. I graduated from the University of Texas with a petroleum land management degree in December of 1977. I spent three years with Getty Oil Company and I moved to Corpus Christi in 1980 and I worked for Cox Oil and Gas, an independent out of Dallas, Texas, for about 13 years. After that I worked for a number of different independent oil

companies, one of which was Pure Resources. I went to work for them in 2000, and some of the founders of Pure Resources ultimately were the founders of our company, Solero. I moved to Fort Worth about a year ago to go to work for Solero.

Q. Does your area of responsibility at Solero include this portion of southeast New Mexico?

A. Yes, it does.

Q. Are you familiar with the land matters involved in the application?

A. I am.

MR. BRUCE: Mr. Examiner, I tender Mr. Gresham as an expert petroleum landman.

HEARING EXAMINER BROOKS: So qualified.

Q. Mr. Gresham, could you summarize what Celero seeks in the two cases?

A. Yes, sir. Under Case 14504 Celero seeks to amend the unit agreement of the unit operating agreement and statutorily unitize all working interest owners and unitize Queen Formation underlying the 4939.77 acres of state, federal and fee lands of Chaves and Lee Counties, New Mexico. Also in Case 14505 Celero seeks approval to institute a tertiary recovery project.

Q. What is the unitized interval?

A. It's the Queen Sand as a member of the Queen Formation Guadalupe Series and part of the Permian system. The top of the interval is found at 3050 feet and the base is at 3066 feet. That's as seen on the gamma ray neutron log for the Gulf Oil Company, State of New Mexico BMC Well No. 1. That well is in the southeast quarter of the southeast quarter of Section 23, Township 13 south, Range 31 East. The unitized formation includes all subsurface points throughout the unit area correlative to these dips.

Q. What is the history of this unit? I refer you to Exhibit 1.

A. The unit was formed in 1959. It was approved by Case No. 1798 and by Commission Order No. R 1541. The water flood operations have been conducted in the unit ever since.

Q. And the Commission's order is marked as Exhibit 1?

A. Yes, it is.

Q. Was the unit agreement approved by the Bureau of Land Management and the State Land Office in 1959 or 1960?

A. Yes, they were.

Q. And what are Exhibits 2 and 3?

A. Exhibits 2 and 3 are the unit agreement and the unit operating agreement respectively.

Q. The existing ones?

A. The existing ones, correct.

Q. Was the unit formed before the Statutory Unitization Act was enacted?

A. Correct. As a result, joinder of the unit was voluntary.

Q. Now, please identify Exhibit 4 for the examiner.

A. Exhibit 4 is a land plat that outlines the unit area and identifies the separate tracts which comprise the unit area. There are 44 tracts within the unit.

Q. Now, the unit is already in existence and it's been around for some 50 years. Why are we here today?

A. Well, Celero purchased this property in June of 2007 with the intent to redevelop the water flood project and to institute a tertiary project. The redevelopment could potentially encompass 60 injection wells and 60 producing wells. Our expenditure could be over 65 million dollars. When the unit was formed, it was voluntary. About 3.015 percent of the working interest owners did not

ratify the unit. The existing unit operating agreement has certain conditions that allow small working interest owners to block expenditures for the unit operations. That is contained in Article 4.3.2 of the Unit Operating Agreement.

What that provision provides is should a party own 50 percent or more of the working interest, it requires the joinder of two additional parties with their cumulative interest being 10 percent. Celero, by itself, owns about 99.6 percent, so effectively it is impossible to accomplish that.

Because this project is expensive, Celero wants to ensure that all working interest parties are subject to an updated operating agreement. As a result we are amending the unit agreement and the unit operating agreement.

Q. What is Exhibit 5?

A. Exhibit 5 is the proposed amended unit agreement. It's a standard form used by the State Land Office and is similar to agreements approved previously by the Division. The unit agreement describes the unit area and the unitized formation. The unitized substances include all oil and gas produced from the unitized formation. This

agreement designates Celero Energy II LP as the operator.

Q. And does the copy submitted to the Division contain signature pages from the working interest owners who at this time have signed or agreed to the amended unit?

A. That's correct. Celero, as operator and working interest party is one of the parties. Circle Ridge Production, Inc., another nonoperating party, also executed the agreements as well as Manford Production Company.

Q. What is Exhibit 6?

A. Exhibit 6 is the proposed unit operating agreement. It sets forth the authorities and duties of the unit operator as well as the apportionment of expenses between the working interest owners.

Q. And again, has this been -- does it contain the signature pages for the various parties who at this time have signed on to the amended unit operating agreement?

A. That's correct. All three have executed the agreement as well.

Q. Does the amended unit operating agreement contain a provision for carrying working interest owners?

A. It does. That's in Article 11.4.

Q. Does it also provide for a penalty against nonconsenting working interest owners?

A. Yes, 11.8.

Q. Does the statutory unitization and amended unit operating agreement?

A. Yes, it does. In fact, submitted as Exhibit 7 are portions of the act which specifically allow the amendments to the plan of unitization. It also provides that tract participation factors previously approved shall remain the same after the amendment.

Q. And was tract participation agreed upon when the unit was originally formed?

A. It was. A listing of the participation factors is attached as Exhibit 8. These factors will be used in the amendment.

Q. And the participation factors in the -- I guess the Column 3, the participation factor column, have been used since the inception of the unit?

A. That's correct.

Q. Now, regarding ownership of the tracts within the unit, would you describe the tract ownership and how you determine the names of the interest owners?

A. Well, the unit tracts are formed according to common mineral ownership. If you go back to Exhibit No. 5, the amended unit agreement, and look at Exhibit B, you will find a tract-by-tract listing. This information is from current division order records.

Q. And how many interest owners are there in the unit area?

A. Currently there are ten working interest owners. There's 57 royalty owners and 42 overriding royalty interest owners.

Q. Who are the working interest owners? I refer you to Exhibit 9.

A. Exhibit 9 sets out all the interest of the parties. The ones highlighted in yellow are the parties that have not ratified the two agreements.

Q. So everyone in yellow has not signed on to the amended documents?

A. That's correct.

Q. And what is the total percentage of working interest owners who have voluntarily ratified the unit?

A. 99.638249 percent.

Q. Do you seek to unitize the royalty and overriding royalty owners?

A. No we do not. They will receive the same interest they currently have. Since they are unaffected, we do not seek statutory unitization from them.

Q. Have the Commissioner of Public Lands and the BLM preliminarily approved the amended unit agreement?

A. No, not yet. We have requested administrative approval. Of course, their percentage of interest will be unaffected by the applications.

Q. Let's discuss your effort to obtain voluntary unitization among the working interest owners. Let's start -- you said that Celero acquired this interest in mid 2007. What did it do with respect to the interest owners?

A. Well, when we acquired the property, we acquired something around 98 percent of the interest. And the previous operator, due to the issues that we are addressing today in this hearing, just began carrying all the parties and, frankly, I don't know how far back that procedure went.

So when we took on the operations of the property we began doing the same thing. We promptly began enhancing the property in terms of

environmental issues that had been in place for quite a long time. After eight months of owning the property, we had already spent almost 10 million dollars, and that was getting some of the wells back turned on, reequipping the wells, and the main issues were the environmental issues.

So in February of 2008, eight months after we acquired the property, we sent a letter to all of the parties informing them that we had already spent ten million dollars and explained to them that they had been in suspense for quite a long time and we offered to buy their interest for their outstanding JIBs. At that time there were 12 nonoperating parties. So in the ensuing months we were able to acquire three of those parties, and that brought us up to the 99.6 percent.

The other parties either never responded. I got a few phone calls from people wanting additional data but very little response at all.

We went about our business. In October of 2009 I sent a follow-up letter. In this letter, since I hadn't heard from anyone, I just made the presumption that they wanted to stay in. So we sent them an updated JIB billing asking them to please pay their share of the outstanding JIBs, and then we

put them at pay status. Otherwise, we would still like to acquire your interest. Again, we heard almost no response from any of the parties.

Q. Did you follow up the letters with phone calls?

A. I did. I did. A lot of people never called me back and we just never really got anywhere with it. The issue is a lot of the people are successors to the interest and it's a small -- I mean, cumulatively -- currently we have nine parties who own 4/10s of one percent. So it's a relatively small interest and it's hard to get anyone to focus on it.

So thereafter is when we went the letter out, Exhibit 10, which is in May of this year where we are informing them of our intentions and submitting to them the new amended agreements. And that's the status.

Q. And although there are approximately ten working interest owners now when the unit agreement was -- when the unit was originally formed I believe there were 40 working --

A. No, more like 56.

Q. 56 working interest owners. And at that time with the difference in working interest owners

and the fact that no one party controlled more than 50 percent, unit operations weren't constrained like they are now?

A. Correct. That certainly would have to be the case with the multiple number of parties involved.

Q. In your opinion, has Celero made a good faith effort to secure voluntary unitization?

A. Yes, sir, we sure have.

Q. And has notice of the unitization case been given to all working interest owners who did not voluntarily join in the unit?

A. Yes, sir.

Q. Is that reflected in my affidavit of notice marked Exhibit 11?

A. Yes, it is.

Q. They all received actual notice of this hearing?

A. Yes, sir, they have.

Q. In order for the Land Office and the Bureau of Land Management to approve unit agreements, record title owners also need to ratify the agreement. Were the record title owners also notified of this application?

A. Yes, sir, they were. That's Exhibit 12.

MR. BRUCE: Mr. Examiner, if you look at Exhibit 12, you will see that a couple of parties did not receive actual notice when the first mailing went out. I think everything was eventually -- everybody was eventually notified except -- I don't know how to pronounce it. G-E-R-O-R, Geror Oil Company.

Q. And Mr. Gresham, you had an independent landman check for parties on all the addresses, did you not?

A. Yes, we did.

MR. BRUCE: Mr. Examiner, since we could not locate that company, Exhibits 13 and 14 are affidavits of publication regarding the unitization of the record title owners. One is in the Roswell paper and one is from the Hobbs papers since we were dealing with two counties.

HEARING EXAMINER BROOKS: Thank you.

Q. Have any of the record title owners ratified the unit agreement?

A. Yes, sir. Those ratifications are contained in Exhibit 15.

Q. Now, with respect to the tertiary recovery application, was notice given to all of the proper offsets or surface interest owners?

A. Yes, sir. Exhibit 16 is a schedule showing the acreage within a have mile of the unit area, so notification was sent to all operators or lessees in the Queen Formation or with wells which penetrate the Queen Formation.

Q. And within the unit area, the only operator is Celero?

A. That's correct.

Q. And again, Exhibit 16 was prepared by an independent landman, I believe?

A. Yes, it was.

Q. And was notice of the injection application given to these parties?

A. Yes, it was.

Q. Is that reflected in the affidavit of notice submitted as Exhibit 17?

A. Yes, it is.

MR. BRUCE: Again, Mr. Examiner, there were, when all was said and done -- believe it or not, I believe almost everybody received actual notice, but since there were a few people we were uncertain of, we did publish notice as to certain of these interest owners and that's reflected in Exhibits 18 and 19, the affidavits of publication of Roswell and Hobbs interest owners.

Q. Mr. Gresham, in your opinion, will the granting of these two applications be in the interest of conservation and prevention of waste and protection of correlative rights?

A. Yes, sir. I believe that.

Q. Were Exhibits 1 through 19 prepared by you or under your supervision or compiled from business company records?

A. Yes, they were.

MR. BRUCE: I move the admission of Exhibits 1 through 19.

HEARING EXAMINER BROOKS: Exhibits 1 through 19 are admitted.

MR. BRUCE: No further questions of the witness.

HEARING EXAMINER BROOKS: Okay. I guess my question would be probably to counsel, but just to clarify the testimony as I understand it, you are proposing to statutory unitization of the working interest only?

THE WITNESS: Yes, sir.

HEARING EXAMINER BROOKS: I guess my question to you, Mr. Bruce, is did the statutes contemplate that? Is that something that we can actually do?

MR. BRUCE: I believe so, Mr. Examiner. Under 70-7-9 that says an order providing for unit operations may be amended by an order by the Division in the same -- subject to the same conditions as the original order provided if such an amendment affects only the rights and interests of the working interest owners. Approval by royalty owners shall not be required.

HEARING EXAMINER BROOKS: Are all the royalty interest owners committed to the unit? Is it only working interest owners not committed to the unit?

MR. BRUCE: I will doublecheck that. If there are a few royalty owners it's very small. I looked in the ratifications in the State Land Office file, and I believe most, if not all. But their interest will be unaffected regardless.

HEARING EXAMINER BROOKS: Okay. Very good. Thank you. You may step down and call your next witness, Mr. Bruce.

JONATHAN BAKER

EXAMINATION

BY MR. BRUCE

Q. Will you please such for the record?

A. Jonathan Buster Baker.

Q. Where do you reside?
A. Fort Worth, Texas.
Q. Who do you work for and in what capacity?
A. I work for Celero Energy in the capacity of a geologist.
Q. Have you previously testified before the Division?
A. Yes, I have.
Q. Were your credentials as an expert petroleum geologist accepted as a matter of record?
A. Yes.
Q. Does your area of responsibility at Celero include this portion of the Permian Basin?
A. Yes.
Q. Are you familiar with the geologic matters involved in these cases?
A. Yes.
MR. BRUCE: I tender Mr. Baker as an expert petroleum geologist.
HEARING EXAMINER BROOKS: So qualified.
Q. Mr. Baker, what is Exhibit 20?
A. Exhibit 20 shows three main points. It shows the geographical location of our project area, the age and nomenclature of the formations in question and also a type log of the formation that

is our objective.

First of all, I call your attention to the map of Texas and New Mexico up near the title of the presentation. You can see the general location of our project, which is in basically straddles the border of Chaves and Lea County, New Mexico.

The next thing I would point out is if you look directly below that map -- and I apologize for the small font. This is a stratigraphic column indicating the age and the formation nomenclature. The formation is termed the Queen, which is part of the Artesia group, which is Permian or, more specifically, Guadalupian in age.

Beyond that, there are three type logs. The type log furthest on the right shows the whole section from the surface down to just below into the San Andreas. As you go over to the left, it shows a close-up depiction of the Main Queen Sand interval, which is our interval in question.

You can see above it the Seven Rivers Formation in blue and below it the Grayburg Formation in gray. The Main Sand Interval that I indicated there is the interval of our object.

A few things I would point out about the Main Queen Sand is it occurs within our project area

or within the Rock Queen Unit from about 3,000 feet to 3100 feet measured depth, which corresponds to a subsea depth of about 1410 feet, which is on the west and 1310 feet which is on the east.

The sand is typically an average of 13 feet thick. The porosity ranges from 8 percent to 25 percent. It was deposited as both fluvial and deltaic sands and is a very fine to fine grade sandstone.

Q. One thing on this exhibit. The logs -- this is a fairly old field, is it not?

A. Yes.

Q. And a lot of wells were drilled and there were no logs on the wells?

A. That is true.

Q. So you have logs from the Drickey Queen 144. That is an unit immediately to the southwest?

A. It's directly to the south.

Q. Then you have one from the Trig federal well, which is a lease to the west of this unit, I believe?

A. That is true. I will show you the location of the Drickey Queen 144 well on a subsequent issue.

Q. Let's move to Exhibit 21. What does that

show?

A. One thing I would like to point out on this before we go to the next exhibit is that within our project area, none of these other intervals above or below are currently producing. It is only the Queen Formation that produces within the Rock Queen unit.

On to Exhibit 21? Exhibit 21 is a structure map constructed on the top of the Main Queen Sand interval. It was built by using most of the wells shown on this map. The yellow on this map is a representation of Celero's approximate acreage position. You can see the -- the center the purple outline is the outline of our injection area, our CO2 injection area, and the red outline is the outline of what we are speaking to today.

This generally shows that the structure in the area is the strike, which is -- which trends north northeast to south southwest. The dip is perpendicular to that and dips at a rate of about 25 feet for every mile.

One thing that you can see on here is that there are no -- we have not represented any faults, and I do not find any faults within this map area within the queen section.

Also shown on this map is the cross-section trace within the Unit A to A prime. It's rather small. Are you able to see that?

HEARING EXAMINER BROOKS: Yes.

Q. And just for reference, when we mention the Drickey Queen Unit, that starts in Section 35 to the south of the Rock Queen Unit and proceeds to the south southwest?

A. Yes. I'm sorry. If you look at the northeast quarter of Section 35 -- I will show you. Right here. That is the type well that I showed you on the previous exhibit.

Q. Let's move on to Exhibit 22. What does that show?

A. Exhibit 22 is a cross-section A to A prime that I showed you in Exhibit 21. It shows -- these are cased hole logs within our project area that show in yellow the Main Queen Sand Interval and is used to show the continuity of the reservoir over our project area.

Q. Is the -- was the original unit outlined from a geologic standpoint?

A. Yes, it was.

Q. And from a geologic standpoint has this reservoir been reasonably defined by development?

A. Yes.

Q. And is the Queen Reservoir continuous across the unit area?

A. Yes.

Q. Is there a fresh water zone in this area?

A. There are no fresh water wells inside the unit boundary. I do understand that the Ogallala aquifer exists. The very western limits of the Ogallala aquifer exist beneath our acreage at a depth of about 200 feet.

Q. Will the next witness have some data on fresh water in the area?

A. Yes.

Q. Were Exhibits 20 through 22 prepared by you or under your direction?

A. Yes.

Q. In your opinion, is the granting of these applications in the interest of conservation and the prevention of waste?

A. Yes.

MR. BRUCE: Mr. Examiner, I move the admission of Exhibits 20, 21 and 22.

HEARING EXAMINER BROOKS: 20, 21 and 22 are admitted.

MR. BRUCE: No further questions.

HEARING EXAMINER BROOKS: Okay. I don't believe I have any questions. Do you have any questions, Mr. Wornell?

MR. WORNELL: I don't think so. You did say that these are cased hole logs?

THE WITNESS: Yes.

MR. WORNELL: What kind of hole is it?

THE WITNESS: Gamma ray neutron.

MR. WORNELL: And that was logged fairly recently?

THE WITNESS: Those were logged recently by us.

MR. WORNELL: Thank you.

HEARING EXAMINER BROOKS: Okay. I guess the witness may stand down. Call your next witness, Mr. Bruce.

MR. BRUCE: We call Mr. Metza to the stand.

MICHAEL WAYNE METZA

DIRECT EXAMINATION

BY MR. BRUCE

Q. Would you please state your full name and city of residence.

A. My name is Michael Wayne Metza from Midland, Texas.

Q. Who do you work for and in what capacity?
A. I work for Celero Energy II LP as a senior production engineer.
Q. Have you previously testified before the Division?
A. Yes.
Q. Was it a while ago?
A. A long while ago. I believe it was in 1984 or '85.
Q. Why don't you, just for the Examiner, describe your educational and employment background.
A. I have a bachelor's degree in petroleum and natural gas engineering. For the first 16 years of my career I worked in various major oil companies. For the last 13 I worked in various engineering assignments for independent oil companies.
Q. How long have you worked for Celero Energy?
A. I worked for Celero Energy for approximately two years.
Q. Are you familiar with the engineering matters related to these applications?
A. Yes.
Q. And your area of responsibility at Celero

includes this portion of the Permian Basin?

A. Yes.

MR. BRUCE: Mr. Examiner, I tender Mr. Metza as an expert petroleum engineer.

HEARING EXAMINER BROOKS: So qualified.

Q (By Mr. Bruce) Mr. Metza, let's start out with your Exhibit 23. Could you give an overview of this project.

A. Exhibit 23 is Celero Energy's application for an EOR project involving admissible CO2 displacement. The project's name is Rock Queen CO2 Pilot. The exhibit gives the physical description of the acreage, the number of acres, its original unitization and the pool and formation name. It also lists 20 producing wells, 17 water alternating gas injection wells in the project area and 19 water injection wells that will be curtain wells surrounding the project. It shows also our replacement wells and one re-entry of a P and A well.

HEARING EXAMINER BROOKS: How many injection wells are there, 17 in total?

THE WITNESS: Seventeen. The application today involves 12 that exist and we are -- we have permitted five more to drill.

It shows that the capital cost of the facilities for the project going forward are is about 6.9 million dollars. That cost includes the cost of a pipeline to deliver CO2 to the field, roughly five million a day of compression capability, and miscellaneous CO2 injection and gathering facilities. Total project cost to date was roughly 42 million. Excuse me. Total project cost of approximately 42 million, roughly 28 million has been spent to date. The value of oil we expect to produce from the project is roughly 132 million dollars.

Q. Mr. Metza, on the exhibit -- excuse me, the unit agreement, it covers approximately 4900 acres but the initial project area for the CO2 flood is smaller than that; is that correct?

A. It's only roughly 1570 acres.

Q. And you mentioned the water injection wells, a curtain of water injection wells. You mentioned this again further on in your testimony, but what is the intent of the wells?

A. The purpose of those wells was to form a water curtain around the area where we inject CO2 and to keep the CO2 confined.

Q. Let's move on to your Exhibit 24. What

about does that show?

A. Exhibit 24 is a required plat of the production history of the pilot area. As you can see from the plot, cumulative oil production was 8.4 million barrels. Cumulative gas production was roughly .8 BCF. Cumulative water production was 60.5 million barrels and cumulative water injection was relatively 56.9 million barrels.

Behind Exhibit 24 is a table of the data that was used to develop Exhibit 24.

Q. A couple of matters. It shows a gas production that dropped off precipitously almost 48 years ago. Is there much in the way of gas production at this time from the unit area?

A. Very little. We have to augment our produced gas with propane in some of the facilities.

Q. And the other thing, although the application was -- I entitled the application as expansion of the water flood project, at this point Celero has already come in and redeveloped the water flood aspect of this project, has it not?

A. A great portion of it.

Q. So at this point, although there is more water injection to come, at this point the primary aspect of this hearing is for the tertiary recovery

project?

A. Yes.

Q. Let's move on to your outline marked Exhibit 25. What is set forth in that?

A. Exhibit 25 is a general discussion of the oil, gas and water production history and injection history of the CO2 pilot area. The original pilot area was developed as part of the Rock Queen Unit in the mid to late '50s when 124 wells were drilled in the unit's original 4940 acres. Wells were drilled on 40-acre space and primary production peaked in October of 1956 at roughly 1700 barrels of oil per day. Production was at a low gas/oil ratio and gas was eventually vented after August of 1962.

Production was water-free until water operations started in 1960. Our estimate of primary recovery is roughly 9 percent of the oil in place. Pilot areas put on a conventional five spot 80-acre pattern water flood by converting one-half of the wells in the area to injection. Injection in the area peaked in August of 1962 at roughly 6900 barrels of water per day until Celero purchased the property, after which injection again peaked in October of 2008 at slightly less than 7500 barrels of water per day.

Peak water flood response occurred in May of 1964 at a little more than 3300 barrels of oil per day with a little more than 3,000 barrels of water per day. Peak water production occurred in March of 1967 at a little more than 6900 barrels of water per day until Celero began returning wells to production when water again peaked in October of 2008 at a little more than 13,000 barrels of water per day.

Production continued to decline after the field was developed and the area became rather marginal by the mid 1970s. From that time to the mid 1980s 21 wells were plugged in the unit. Celero has since plugged five additional wells in the unit once we took over operations.

Secondary recovery is estimated at 28 percent of the oil in place. Total primary and secondary recovery is 37 percent of the oil in place.

The Rock Queen Unit has had numerous operators throughout its life. Celero purchased the property in June of 2007, specifically for the purpose of developing the unit using CO2 miscible displacement. Our estimated recovery from miscible CO2 is 2.1 million barrels of oil or approximately 9

percent of the oil in place. Purchased CO2 for the project is estimated at slightly more than 10 BCF and the produced CO2 will be reinjected. Our anticipated date of first injection is January 2011. Peak oil response for the project is estimated at 708 barrels per day.

Q. What does Exhibit 26 show?

A. Exhibit 26 is a required plot showing the anticipated performance of the pilot with respect to oil production, water production, water injection, CO2 injection and CO2 production.

Q. And Exhibits 27 is simply tabular data reflecting Exhibit 26?

A. Yes.

Q. What materials did you examine in your study of the reservoir?

A. We looked at, obviously, well logs, production history, available studies that have been done by prior operators or commissioned by prior operators and our company records.

Q. And although in your first exhibit you went over this somewhat, how does Celero plan to redevelop the unit for CO2 flood?

A. Initially, our plan is to start with the pilot area, inject CO2 via a WAG schedule, see how

it performs over the period of two years and then make a decision whether we can expand the pilot to include all of the Rock Queen Unit or probably what's been mentioned as the Drickey Queen Unit and other properties we own in the area.

Q. With respect to the CO2, is Celero in the process of obtaining a pipeline right-of-way for the CO2 line?

A. Pipeline has been staked right away we are securing right-of-ways for it. It's my understanding we have approximately 50 percent of those. Once we have secured right-of-ways and our pipeline has been -- our operations manual has been approved by the Pipeline Safety Bureau, we will start construction of 18 miles of six-inch pipeline.

Q. And Celero has secured a supply of CO2?

A. Yes.

Q. Was the tertiary recovery project and the water flood expansion or increase in water flooding that you have done over the last couple of years proposed as a method of extending the life of the reservoir?

A. Yes.

Q. What is the dried mechanism of the pool?

A. The primary dry mechanism was depletion.

Q. What is the current average production from wells within the Rock Queen Unit?

A. We average -- the majority of the wells producing roughly 4.5 barrels of oil per day with 440 barrels of water per day.

Q. Definitely you are at what used to be known as a stripper state at this point?

A. Yes.

Q. Is the unitized portion of this pool suitable for institution of a tertiary recovery project?

A. Yes.

Q. And is the area so depleted that it's prudent to apply an enhanced recovery program at this time?

A. Yes.

Q. Is the tertiary recovery project technically and economically feasible at this time?

A. Yes.

Q. Will the value of the oil and gas recovered by unit operations exceed the unit cost plus a reasonable profit?

A. Yes.

Q. Will the enhanced recovery operations result in the recovery of substantially more

hydrocarbons from the pool than would otherwise be recovered?

A. Yes.

Q. Will the enhanced recovery benefit the working interest and royalty owners in the area?

A. Yes.

Q. Is the unitized management and operation of this reservoir necessary to effectively carry on your proposed enhanced recovery operations?

A. Yes.

Q. And because of the estimated additional production which you will obtain, do the wells in the proposed unit qualify, or at least in the project area, qualify for the recovered oil tax rate?

A. Yes.

Q. Let's move on to your next exhibit, Mr. Metza, Exhibit 28. What does that reflect?

A. The exhibit is a plat which shows the CO2 pilot area, the active production in injection wells, the plugged and abandoned wells and the shut-in or temporarily abandoned wells in an area marked in red, which is one-half mile boundary we are calling our area of review for your injection well package.

Our area review is a little larger than the area that would normally occur if we used calculated half-mile radius around the 12 injection wells we will be requesting authority to inject with. And it was -- we made it a little larger for two reasons. The area includes the area review includes a half-mile radius around those wells to the north of the unit that we intend to redrill as injection wells. It also includes our replacement wells in the unit and one well that we intend to re-enter. Although we are not specifically requesting authority to inject in those replacement wells at this time.

The second reason was the area of review includes many of the wells that we are requesting as monitor wells for the project.

HEARING EXAMINER BROOKS: Now, you are only then requesting injection authority for the 12 wells?

A. Twelve wells in the CO2 pilot area.

Q. Mr. Metza, would you like for the order to provide for administrative approval of additional injection wells?

A. Subject to review under normal procedures.

Q. Yes. Is that what you are requesting?

A. Yes.

Q. Go ahead with this, Mr. Metza.

A. Lastly, where our area review boundary fell on a well or was close to a well, that well, for the purposes of review, was included in the review.

Q. And what is Exhibit 28A?

A. Exhibit 28A is a Midland Map Company plat on a one inch equals 4,000 foot scale which shows two miles around our pilot area, which is outlined in blue. It also shows current boundaries of the Rock Queen Unit outlined in yellow and all of the wells that have been drilled of record, according to the information that the map company has.

I have to apologize for American Inland Resources being designated as the operator of Rock Queen Unit. The people who published this resource have been advised that we have taken over operations and they have assured us it will be changed in the future.

Q. This exhibit was prepared as part of the C 108 package, was it not?

A. Yes. It's a required exhibit.

Q. What is Exhibit 29?

A. Exhibit 29 is N.M. OCD Form C 108,

authorization to inject, and signed by me. Attached to form C 108 are two pages which discuss Items 8, Data on the Proposed Operation -- excuse me, Item 7, Data on the Proposed Operation; Item 8, Geologic Data; Item 9, Data on the Proposed Stimulation Program; and Item 11, Data on Fresh Water Wells.

Q. Now, the rest of your exhibits, except for, I think, your final exhibit, all are part of the C 108 package, are they not?

A. Correct.

Q. And they have been broken out to make it easier for the examiner to look at them as you discussed them?

A. Correct.

Q. What do you want to begin with for your discussion of the C 108?

A. I would like to cover Item 7 in a little more detail at this time. It has to do with data on our proposed operation. Our project is an enhanced oil recovery pilot where we plan to inject carbon dioxide and water into the Queen Formation using a Walter alternating gas or WAG method.

The system will be closed. That is, all the produced water and all produced CO2 will be reinjected into the reservoir. Our proposed average

and maximum water injection pressure is 800 PSI. This pressure is slightly higher than the 610 PSI which would normally be allowed using the traditional calculation of 0.2 PSA per foot times depth to the top of the formation. We requested a little higher pressure based on some step rate data we have and we will go over that in Exhibit 33.

Consequently, we are proposing that we have a maximum and average wellhead injection pressure on water of 800 PSI for all of the current and future water injection wells and WAG wells in the entire Rock Queen unit. Our proposed maximum CO2 pressure is 1200 PSI. It's also based on the same step rate test data that we will go over in a minute.

Q. Next move to your Exhibit 30. What is contained in that?

A. Exhibit 30 are the required well data sheets and well sketches for the 12 WAG injection wells in our request. In the case of Rock Queen Unit 54, a copy of N.M. OCD Form C 133 at proposing to squeeze some well formations at 2934 and 2943 is included in that well's package.

Q. And what is Exhibit 31?

A. Exhibit 31 is a required list of all wells

within the area of review. There are 91 wells on the list. There are also nine replacement wells on the list, five which have recently been permitted. There are also four more plus one re-entry that are being staked and will be permitted.

The well list also shows a planned well type of injector for the Drickey Queen Sand Unit No. 1 and No. 4. These wells are currently active producing wells and an administrative application to convert them to water injection wells has been filed.

Q. Is that part of the water curtain that you were talking about?

A. Yes.

Q. And what is contained in Exhibit 32?

A. Exhibit 32 is the required well sketches of the 21 wells in the area of review which have been plugged and abandoned. One well in Section 23 Unit N has an issue in that there is not a plug immediately above the Queen Formation. A prior operator attempted to get to the bottom of the well but encountered junk at 1858. They spent two days, I believe, trying to get through it, then set plugs, cut and recovered the casing at 1025 feet and finished plugging it.

Celero proposes to re-enter the well in an attempt to make it an injection well. If we are unsuccessful, it's likely that the well will not be any appreciably different when we are finished.

Q. And again, this is no production above the Queen?

A. That is correct.

Q. What is contained in Exhibit 33?

A. Exhibit 33 is a summary of the data gathered from step rate tests that were run on ten wells in the Rock Queen Unit. The test on Rock Queen Unit No. 62 was used to calculate the recommended average and maximum wellhead injection pressures for produced water and CO2 for all of the wells in the Rock Queen Unit.

The test was run with fresh water and the surface pressure of 1050 PSI gauge was adjusted for the higher density of produced water and the lower density of CO2. The method to calculate 800 PSIG using produced water on injection and 1200 PSIG on CO2 injection are shown on the exhibit.

Attached to Exhibit 33 are the actual pump tests that were run on the wells in the field and a National Institute of Standards and Technology report which shows the physical properties of CO2 at

70 degrees.

Q. That's a standard table or standard data?

A. Yes.

Q. And these step rate tests were performed a couple year ago in connection with your water flood expansion, was it not?

A. Correct.

Q. And are these pressures that you have been using in use for water injection at this point? The recommended injection pressures?

A. No. In fact, throughout the history of the field injection pressures have been slightly higher than this on occasion.

Q. Okay. So you are not exceeding anything that has been used by previous operators?

A. We shouldn't be.

Q. And what is Exhibit 34?

A. Exhibit 34 is a comparison of the produced water from the Rock Queen Unit No. 84 and water from our fresh water system. Also attached are the analyses of both waters and an analysis of water from water well in Section 35 Township 13 South Range 31 East along with a map showing the well's location. This is a required submittal for the form C 108.

Q. And I believe the well that you obtained, the fresh water well is within about a half mile or less of the unit boundary?

A. The southern boundary of the Rock Queen Unit, yes.

Q. What type of water is injected into the unit?

A. Right now we inject produced water and fresh water from supply wells we have that take water from the Ogallala.

Q. And is there any compatibility problems between the formation water and the injection water?

A. No.

Q. Now, let's move on to your final exhibit, and maybe you should have Exhibit 28, the plat, out in front so you can show the examiner what you are talking about with respect to the monitoring wells and the water injection curtain. If you go through Exhibit 35 and inform the examiners of what you propose with respect to the monitor of the wells?

A. If you can refer to Exhibit 28, you will see a number of wells that have pastel yellow circles around them located on the west and north end of our CO2 pilot area. We are proposing these with monitor wells for roughly two years while we

evaluate the project.

Therefore there are eight shut in producers, six temporarily abandoned producers and three shut-in injection wells. We propose to limit production to the north in the hope that it offers the best opportunity to maximize CO2 utilization in the project and limit the possible CO2 migration. It's more cost-effective using these as monitor wells than expanding the water injection system to the north and west and the number of injection wells to support what would likely be marginal or uneconomic production at this time.

If necessary, a number of the wells could readily be converted to active water injection wells to maintain our water curtain to the north and the west of the project. Wells would be equipped with 2 3/8 plastic-coated tubing set on a packer with a single minimum 1500 PSI valve installed in each well. We would propose an initial mechanical integrity test be run after the installation of tubing and packer and then in intervals of one year thereafter.

Bottom hole pressures will be measured initially and each quarter thereafter in each well. The information would be made available to the

Division on request. The wells would remain as monitor wells for approximately two years while the performance of the pilot is evaluated.

Ultimate disposition of the wells at 16 of the 17 wells would be returned to production and one would be returned to injection in the event that the pilot is successful and the project is expanded. We have discussed this with compliance manager and attorney and they were not opposed to it as a means to meet our agreed compliance order for these wells.

Q. In other words, in normal circumstances these would be deemed out of compliance wells --

A. Because they have been shut in or temporarily abandoned for so long.

Q. But the Division staff has stated they will not count these as noncompliant wells for the purpose of the two years while you are evaluating the project?

A. Correct.

Q. In your opinion, will two years from the commencement of injection of CO2, will two years be sufficient to evaluate the project?

A. Yes.

Q. In your opinion, is the granting of the injection application in the interest of

conservation and the prevention of waste?

A. Yes.

Q. And were Exhibits 23 through 35 prepared by you or under your supervision?

A. Yes.

MR. BRUCE: Mr. Examiner, I move the admission of Exhibits 23 through 35.

HEARING EXAMINER BROOKS: Exhibits 23 through 35 are admitted.

MR. BRUCE: No further questions.

HEARING EXAMINER BROOKS: I don't believe I have any questions at this time either. Do you, Mr. Wornell?

MR. WORNELL: Just, I think, one or two here. On your WAG or your water alternating gas injection, your CO2, you say you have a contract for CO2.

THE WITNESS: That's correct.

MR. WORNELL: That's coming from?

THE WITNESS: Coming from Kinder Morgan roughly 18 miles almost due north of the Rock Queen Unit.

MR. WORNELL: Then the water that's associated with that injection, where is that coming from?

THE WITNESS: It will be produced water from the field. Where makeup water is required we will use fresh water.

MR. WORNELL: So the makeup water will be fresh Ogallala water?

THE WITNESS: Correct.

MR. WORNELL: No further questions.

MR. BRUCE: One question. You are currently using fresh water for injection?

THE WITNESS: Yes.

MR. BRUCE: That's all I have. Mr. Examiner.

HEARING EXAMINER BROOKS: Very good. If there's nothing further, then cases 14504 and 14505 will be taken under advisement. I believe you have one more case, Mr. Bruce?

MR. BRUCE: If I didn't send in a continuance, I should have.

HEARING EXAMINER BROOKS: You did on one, and maybe I didn't pick this up. The one I have is case No. 14528.

MR. BRUCE: If you could continue that for four weeks, please.

HEARING EXAMINER BROOKS: That would be to the 16th. Case 14528 is continued to November 16th.

I mean September 16th. Before we close the record, I believe this is case 14526. That was Mr. Kellahin's case. We want to substitute the original for a copy of the publication that was included in the exhibit package. With that, we will stand adjourned.

(Note: The hearing was concluded at 10:45).

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 14504 & 14505 heard by me on 9-19-2010

David K. Brooks, Examiner
Oil Conservation Division

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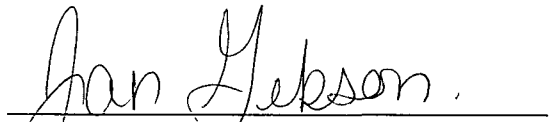
REPORTER'S CERTIFICATE

I, JAN GIBSON, Certified Court Reporter for the State of New Mexico, do hereby certify that I reported the foregoing proceedings in stenographic shorthand and that the foregoing pages are a true and correct transcript of those proceedings and was reduced to printed form under my direct supervision.

I FURTHER CERTIFY that I am neither employed by nor related to any of the parties or attorneys in this case and that I have no interest in the final disposition of this case.



JAN GIBSON, CCR-RPR-CRR
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