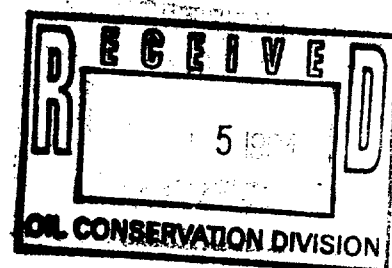


NEW MEXICO OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
STATE OF NEW MEXICO
CASE NO. 11077

IN THE MATTER OF:

The Application of Santa Fe Energy
Operating Partners, L.P. for Compulsory
Pooling, an Unorthodox Gas Well
Location, and Directional Drilling,
Lea County, New Mexico.

VOLUME I



BEFORE:

JIM MORROW

Hearing Examiner

State Land Office Building

September 1, 1994

REPORTED BY:

CARLA DIANE RODRIGUEZ, NMCCR No. 4
Certified Shorthand Reporter
for the State of New Mexico

ORIGINAL

A P P E A R A N C E S

FOR THE APPLICANT:

HINKLE, COX, EATON, COFFIELD & HENSLEY
Post Office Box 2068
Santa Fe, New Mexico 87504-2068
BY: **JAMES BRUCE, ESQ.**

FOR WALTER KRUG, d/b/a WALLEN PRODUCTION COMPANY:

KELLAHIN & KELLAHIN
Post Office Box 2265
Santa Fe, New Mexico 87504-2265
BY: **W. THOMAS KELLAHIN, ESQ.**

I N D E X

Page Number

Appearances

2

WITNESSES FOR THE APPLICANT:

1.

CURTIS D. SMITH

Examination by Mr. Bruce

4

Examination by Mr. Morrow

10

Examination by Mr. Kellahin

12

Certificate of Reporter

22

E X H I B I T S

Applicant's Exhibits

Page Marked

Exhibit No. 1

5

Exhibit No. 2

6

Exhibit No. 2A

7

Exhibit No. 3

7

Exhibit No. 4

9

Exhibit No. 5

9

Wallen Production Company Exhibits:

Exhibit No. 8

13

1 EXAMINER MORROW: We'll call Case
2 11077, which is the Application of Santa Fe
3 Energy Operating Partners for compulsory pooling
4 and an unorthodox gas well location and
5 directional drilling, in Lea County, New Mexico.

6 I'll call for appearances.

7 MR. BRUCE: Mr. Examiner, Jim Bruce
8 from the Hinkle Law Firm in Santa Fe,
9 representing the Applicant, and I have three
10 witnesses to be sworn.

11 MR. KELLAHIN: Mr. Examiner, I'm Tom
12 Kellahin of the Santa Fe law firm of Kellahin &
13 Kellahin. I'm appearing on behalf of Mr. Walter
14 Krug, who does business as Wallen Production
15 Company. Krug is spelled K-R-U-G. I have no
16 witnesses.

17 EXAMINER MORROW: Would the witnesses
18 please stand to be sworn.

19 [And the witnesses were duly sworn.]

20 MR. BRUCE: Mr. Examiner, I would call
21 Curtis Smith first to the stand. If we could
22 have the record reflect that he was previously
23 sworn and qualified as an expert petroleum
24 landman?

25 EXAMINER MORROW: All right.

CURTIS D. SMITH

Having been previously duly sworn upon his oath,
and qualified as an expert witness, was examined
and testified further as follows:

EXAMINATION

BY MR. BRUCE:

Q. Mr. Smith, are you familiar with the
land matters that are involved in this case?

A. Yes, sir, I am.

Q. Let's start out with, what exactly is
Santa Fe seeking in this case?

A. Santa Fe Energy seeks an order pooling
all mineral interests, from the surface to the
base of the Morrow formation, underlying the
south half of Section 18, Township 20 South,
Range 34 East, in Lea County, New Mexico.

We also seek approval for an unorthodox
surface and bottomhole location, and also
directional drilling.

Q. What is Exhibit 1?

A. Exhibit 1 is the land plat outlining
the well unit and identifying the well's surface
and bottomhole locations. Santa Fe Energy's
acreage is colored yellow.

Q. What is the exact well location?

1 A. The unit will be dedicated to the
2 Sinagua 18 Well No. 2, which will be drilled at
3 an unorthodox surface location of 2041 feet from
4 the south line and 2171 feet from the east line
5 of Section 18. The well will be drilled
6 directionally to a bottomhole location of
7 approximately 1300 feet from the south and east
8 lines of the section.

9 Q. Who does Santa Fe seek to pool in this
10 case?

11 A. Santa Fe Energy seeks to pool Doyle
12 Hartman, with a .8 percent working interest in
13 the unit; Larry Nermyr, with a .02 percent
14 working interest in the unit; Devisees of Dewey
15 E. Sparger, 1.25 percent working interest in the
16 proration unit; Anadarko, with 4.6 percent
17 interest; ORYX Energy Company, with .25 percent
18 working interest; Santa Fe Energy, along with
19 partners under an existing operating agreement,
20 owns over 93 percent of the working interest in
21 the south half of Section 18.

22 Q. Would you describe your efforts to get
23 these persons to join in the well? and I refer
24 you to Exhibit 2.

25 A. Exhibit 2 are my letters. First of

1 all, a letter to Mrs. Linda K. Armstrong, who is
2 the personal representative of the Devisees of
3 Dewey E. Sparger, offering to purchase her
4 interest. Also, letters to all of the parties
5 being compulsory pooled, offers for them to
6 participate in the well or farm out. I attached
7 to that letter Exhibit 2A, an operating
8 agreement, covering the south half of Section 18,
9 and also an AFE for the well.

10 And Exhibit 3 is my AFE and the
11 proposed well dry hole cost is \$902,000, and the
12 completed well cost is \$1.229 million for
13 completed cost.

14 Q. Have you made a reasonable effort to
15 obtain the voluntary joinder of these persons?

16 A. Yes, I have.

17 Q. Does Santa Fe ask that it be designated
18 operator of the well?

19 A. Yes, we do.

20 Q. Now, you mentioned the other well
21 costs. Is this in line with those normally
22 encountered in drilling wells to this depth in
23 this part of Lea County?

24 A. Yes, they are.

25 Q. Do you have a recommendation as to the

1 overhead rates that should be assessed against
2 the nonconsenting interests?

3 A. Yes. It is our recommendation that
4 \$5,200 per month be allowed for drilling well
5 rate, and \$520 per month be allowed for producing
6 well rate.

7 Q. And are those amounts in line with
8 other operating agreements in this area?

9 A. Yes. These rates fall in line with
10 what you normally see in the COPAS attached to
11 most operating agreements in this area.

12 Q. And this is a 13,700-foot test?

13 A. That is correct.

14 Q. What penalty do you recommend against
15 any nonconsenting interest owners?

16 A. Our cost plus 200 percent, so total 300
17 percent penalty. This is also a figure that's
18 most commonly used in operating agreements in
19 this area.

20 Q. And your geologist will further discuss
21 the penalty?

22 A. Yes.

23 Q. Were the parties being pooled notified
24 of this hearing?

25 A. Yes, they were.

1 Q. As to the unorthodox location aspect
2 and your directional drilling aspect of this
3 case, who are the offsets to this well?

4 A. Exhibit 4 lists the offset operators.
5 We're primarily offsetting ourselves; and Exhibit
6 4, along with the land plat, shows this.

7 Q. Now, on Exhibit 4, you list the offsets
8 not only of the Morrow rights but also of the
9 shallow rights?

10 A. That's correct.

11 Q. So it's all offsets?

12 A. Yes, sir.

13 Q. And, once again, the bottomhole
14 location, 1300 feet from the east line, you're
15 directly offsetting yourself?

16 A. That's correct.

17 Q. And these offsets were also notified of
18 the hearing?

19 A. Yes, they were.

20 Q. Is Exhibit 5 your affidavit of notice?

21 A. Yes, it is.

22 Q. And it contains all the letters and
23 copies of the certified return receipts to the
24 various parties?

25 A. Yes, that's correct.

1 Q. Were Exhibits 1 through 5 prepared by
2 you or compiled from company records?

3 A. That is correct.

4 Q. In your opinion, will the granting of
5 this application be in the interest of
6 conservation, the prevention of waste and the
7 protection of correlative rights?

8 A. Yes.

9 MR. BRUCE: Mr. Examiner, I move the
10 admission of Santa Fe Exhibits 1 through 5.

11 EXAMINER MORROW: 1 through 5 are
12 admitted.

13 EXAMINATION

14 BY EXAMINER MORROW:

15 Q. Mr. Smith, is there a list in here
16 somewhere showing the percentage of interest as
17 to those various--

18 A. Yes. Exhibit A to my operating
19 agreement lists the working interest partners.

20 Q. About halfway down through there, or
21 where is it?

22 A. About halfway through the contract,
23 just past the signature page, which is normally
24 page 15, but we have a lengthy Article 15
25 attached to the operating agreement.

1 Q. Okay. What was your statement in
2 response, that those people indicated they wanted
3 to be a part of it or not?

4 A. Two of the--well, the Devisees of Dewey
5 E. Sparger, they have responded to me with no
6 commitment as of this date. They indicated that
7 they would even like to see the exhibits from
8 this hearing before they make a decision, and I
9 told them that was fine with me.

10 ORYX Energy has indicated that they
11 will not participate but possibly make some sort
12 of a trade with Santa Fe Energy, but nothing
13 formal as of this date.

14 No response from Anadarko.

15 Doyle Hartman talked to their landman
16 and she stated that Hartman was not going to
17 participate or farm out.

18 And Larry Nermyr, no response
19 whatsoever.

20 Q. The rates you propose, I believe
21 they're in line with the Ernst & Young rates?

22 A. Yes, sir, that's primarily what I used
23 for those rates.

24 EXAMINER MORROW: Okay. Thank you.

25 MR. KELLAHIN: May I ask a couple of

1 questions?

2 EXAMINER MORROW: Oh, excuse me. Go
3 ahead, Tom.

4 EXAMINATION

5 BY MR. KELLAHIN:

6 Q. Mr. Smith, did you discuss with Mr.
7 Krug the location of your proposed well in
8 relation to his Yates oil wells that are in this
9 immediate vicinity?

10 A. No, but Mr. Darrell Roberts, our
11 drilling engineer did.

12 Q. You didn't have personal involvement in
13 that?

14 A. Not on this well. I did in our Sinagua
15 18 Fed Com No. 1, in the north half of Section
16 18, which does not relate to this, I know. Mr.
17 Roberts has spoken to Mr. Krug this time.

18 Q. The necessity for the directional
19 drilling of this well is based upon what, sir?

20 A. The potash enclave and the location
21 that the BLM gave us for our APD.

22 Q. Were you involved in that process?

23 A. Mr. Roberts and I were. Mr. Roberts
24 filed the APD, and we went over together to the
25 Carlsbad BLM office and sat down and talked to

1 the BLM people, and they gave us basically a
2 drilling island between the existing Yates wells,
3 which has, I guess, forced us to drill in this
4 location.

5 Q. Mr. Roberts has something to show us on
6 that topic, or is that a conversation you and I
7 need to have?

8 A. I have a plat from the BLM that shows
9 that drilling island. It's not listed as an
10 exhibit, but I can enter that.

11 Q. I would like to see that exhibit, if we
12 might.

13 [Discussion off the record.]

14 MR. KELLAHIN: With the Examiner's
15 permission, Mr. Smith, we'll mark this exhibit,
16 and I'll add it on to the end of my exhibit
17 package just to keep the sequence straight. I
18 propose to mark this Wallen Production Exhibit
19 No. 8.

20 A. Do you have a copy of your prehearing
21 statement that has those well locations?

22 Q. Yes.

23 A. That will help me.

24 EXAMINER MORROW: Exhibit 8, right?

25 MR. KELLAHIN: Yes, sir.

1 Q. Mr. Smith, when we look at Wallen
2 Exhibit 8, what are we looking at?

3 A. This is Exhibit 8?

4 Q. Yes, sir.

5 A. This is a plat that was given to us by
6 the BLM, and this portion of Section 8, and bear
7 with me, I need to identify these wells, where
8 they're drawn this drilling island.

9 Q. Show us how the drilling island is
10 identified on the display?

11 A. The drilling island, I took--drew lines
12 between these wells, these four wells, and told
13 us we could drill a location within that drilling
14 island.

15 Q. It is a square shape, if you will?

16 A. Almost.

17 Q. The corners of which is taken from four
18 of Mr. Krug's wells?

19 A. I think it's three of Mr. Krug's wells,
20 and this well to the southeast is Dewey E.
21 Sparger's well.

22 Q. We'll find a colored pen in a minute,
23 and perhaps you can shade in the drilling island
24 for us on one of the exhibits and that would
25 shortcut trying to define that drilling island.

1 So, it was in a rectangular or
2 square-shaped area?

3 A. Yes, this area identified on this plat.

4 Q. What was your understanding of the
5 basis for the BLM confining your surface location
6 to that area?

7 A. The 1986 Secretary's order, potash
8 order.

9 Q. What about that order did you
10 understand caused them to give you that as your
11 drilling island?

12 A. Well, if you're within a potash
13 enclave, the authorized officer can designate a
14 drilling island that will enable you to drill
15 your well within a potash enclave.

16 Q. Did he tell you what criteria he
17 identified for you that caused that to constitute
18 a suitable drilling island within the enclave?

19 A. No.

20 Q. Did he tell you if you were in an area
21 that's color coded, measured or inferred potash?

22 A. Oh, yeah. Yeah, that was part of our
23 discussion. And we knew, when we filed our
24 initial APD--actually, we filed it something like
25 1980 feet from the east line and, I guess, 1980

1 feet from the south line of Section 18 last year,
2 that was denied.

3 We filed another one here that's
4 identified on this plat, No. 2, which is
5 southeast of Dewey E. Sparger's well here, that
6 was denied.

7 Q. Those were vertical APDs?

8 A. Vertical APDs within the blue potash
9 enclave. Then they outlined this drilling island
10 between existing wells and told us we could drill
11 the directional well within that drilling island.

12 Q. What's the significance of the shape to
13 the north and west of the drilling island?

14 A. Oh, this? This is the barren area. If
15 you look on the potash map issued by the BLM,
16 this is the real barren area.

17 Q. As we move north of the barren area,
18 what is the significance of the next contour
19 line?

20 A. This is where the potash blue enclave
21 area pinches out, or ceases to exist. This area
22 is the KPLA, known potash leasing area, the
23 stair-step, bold, black line. Beyond that is the
24 secretary's boundary, which is not indicated on
25 this plat.

1 Q. Did you approach the BLM about any
2 alternative surface location, other than the two
3 you've described? You had a first APD for 1980?

4 A. Yeah, something like that.

5 Q. And then the second one, which is 660?

6 A. Don't know the exact location. I think
7 Darrell does, this second location here. I don't
8 know the footage location.

9 Q. Within that island area identified by
10 the BLM, what was the criteria, as you understand
11 it, that caused them to say that was a drilling
12 island?

13 A. My understanding was that this area
14 would not be mined for potash so we could drill
15 within the area that presumably will not be mined
16 for potash because of existing wells.

17 Q. Did he give you any kind of standard by
18 which you had to be--was there any standard
19 applied as to the distance to an existing oil
20 well?

21 A. Initially, they told us that we could
22 be within 200 feet of an existing well, or was it
23 150 feet? 150 feet. That's why we filed this
24 one.

25 The original--well, no, the second

1 location for the No. 2 well, which is 150 feet or
2 so from Dewey E. Sparger's well, they said, "No,
3 it can't be down here to the southeast," because
4 we're in the potash enclave, so they came up with
5 the drilling island.

6 Q. I'm trying to set the parameters of the
7 drilling island concept. How far out did you
8 understand you could go from an existing well and
9 still have it be part of the drilling island?

10 A. I guess 150 feet, as long as we were in
11 the drilling island, but we have surface
12 problems, which Mr. Roberts will testify, sand
13 dunes and so forth, electric lines. So, our
14 surface location was restricted within the
15 drilling island.

16 Q. Let me get a colored pen so we can
17 identify for the record what we're talking about,
18 in terms of that drilling island.

19 A. Okay.

20 Q. I think this yellow marker will work
21 all right. If you'll just shade in on your copy,
22 and then on the Examiner's copy of Exhibit 8,
23 we'll know what you've just described for us as
24 the drilling island.

25 Mr. Smith, did the BLM establish any

1 restrictions or limitations within the drilling
2 island area with regards to how close you could
3 be to an existing well?

4 A. No. It's been our understanding, in
5 dealing with the BLM, based on the Sinagua 18 Fed
6 Com No. 1, and other areas within the potash
7 enclave, that they will allow us to drill not
8 closer than 150 feet from an existing well.

9 So, in other words, we have to be 150
10 feet away or more from an existing well.

11 Q. So, within that drilling island, you
12 still have to be 150 feet away from an existing
13 well?

14 A. That's correct.

15 Q. Any other limitations, restrictions
16 within the drilling island?

17 A. No. And really the meeting was very
18 brief. They pulled the plat out--first of all,
19 they told us our APD for this well was going to
20 be denied. Then they said, "But you have an
21 alternate location within--you can come up with
22 an alternate location within the drilling
23 island."

24 With the depth of the well, Darrell and
25 I talked about that that might be workable, with

1 about a 10-percent deviation, we might can work
2 with this. So, we told the BLM, we'll take this
3 back to our office and talk to our people, and
4 make a decision on whether or not we can drill
5 within the drill island, and drill a deviated
6 well to get to our bottom-hole location that we
7 prefer geologically.

8 Darrell and I drove to the location,
9 all the way back to Midland, stood on about a
10 30-foot sand dune, surveyed the area, and decided
11 on where, within this drilling island, would be
12 the best location because of the surface
13 problems.

14 Q. Can you approximate for us where,
15 within the drilling island, then, you propose to
16 locate the well?

17 A. Yes. There's an X on this, and when we
18 were out on the sand dune or in the car, we put
19 an X on the plat, and that's what that X is.

20 Whether or not our exact location,
21 after staking the location and so forth, is
22 exactly where this X is, I don't know, but I
23 think Darrell can testify to that a little bit
24 better than I can.

25 MR. KELLAHIN: Thank you, Mr.

1 Examiner.

2 EXAMINER MORROW: All right.

3 MR. BRUCE: I have nothing further of
4 this witness.

5 [There was a change in court reporters
6 at this time. Please see Volume II for the
7 conclusion of the proceedings in Case 11077.]

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CERTIFICATE OF REPORTER

[illegible]

I, Carla Diane Rodriguez, Certified Shorthand Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I caused my notes to be transcribed under my personal supervision; 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 16,
1994.

CARLA DIANE RODRIGUEZ, RFR
CCR No. 4

I do hereby certify that the foregoing is
a complete and correct copy of the proceedings in
the Ex parte hearing of Case No. 11077,
heard by me on Sep 1, 1994.

Oil Conservation

CUMBRE COURT REPORTING
(505) 984-2244