

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 SOUTHLAND ROYALTY COMPANY )  
FOR COMPULSORY POOLING, RIO ARRIBA )  
COUNTY, NEW MEXICO )

CASE NO. 11,432

**ORIGINAL**

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER Hearing Examiner

December 7th, 1995

Santa Fe, New Mexico

**RECEIVED**

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Oil Conservation Division

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, December 7th, 1995, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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 Examiner Hearing  
 CASE NO. 11,432

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\* \* \*

## A P P E A R A N C E S

## FOR THE DIVISION:

RAND L. CARROLL  
Attorney at Law  
Legal Counsel to the Division  
2040 South Pacheco  
Santa Fe, New Mexico 87505

## FOR THE APPLICANT:

KELLAHIN & KELLAHIN  
117 N. Guadalupe  
P.O. Box 2265  
Santa Fe, New Mexico 87504-2265  
By: W. THOMAS KELLAHIN

FOR RAMONA B. SWEET, TRUSTEE OF THE RAMONA B. SWEET  
REVOCABLE TRUST; HOOPER, KIMBALL AND WILLIAMS, INC.; MABEL  
READ, AS TRUSTEE OF THE WARREN CLARK TRUST; WARREN CLARK;  
CAROLYN CLARK OATMAN, INDIVIDUALLY AND AS AGENT FOR WARREN  
CLARK; MABEL READ AND W.W. OATMAN, CO-TRUSTEES OF THE  
WARREN CLARK TESTAMENTARY TRUST; AND CHRISTOPHER C.  
PHILLIPS:

HINKLE, COX, EATON, COFFIELD & HENSLEY  
218 Montezuma  
P.O. Box 2068  
Santa Fe, New Mexico 87504-2068  
By: JAMES G. BRUCE

\* \* \*

1           WHEREUPON, the following proceedings were had at  
2   8:48 a.m.:

3           EXAMINER STOGNER: Call next case, Number 11,432.

4           MR. CARROLL: Application of Southland Royalty  
5   Company for compulsory pooling, Rio Arriba County, New  
6   Mexico.

7           EXAMINER STOGNER: Call for appearances.

8           MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of  
9   the Santa Fe law firm of Kellahin and Kellahin, appearing  
10   on behalf of the Applicant, and I have three witnesses to  
11   be sworn.

12          EXAMINER STOGNER: Any other appearances?

13          MR. BRUCE: Mr. Examiner, Jim Bruce from the  
14   Hinkle law firm. I have a bunch of people I'm  
15   representing. I don't have any witnesses.

16                 The people I am representing are Ramona B. Sweet,  
17   Trustee of the Ramona B. Sweet Revocable Trust; Hooper,  
18   Kimball and Williams, Inc.; Mabel Read, as Trustee of the  
19   Warren Clark Trust; Warren Clark; Carolyn Clark Oatman,  
20   individually and as agent for Warren Clark; Mabel Read and  
21   W.W. Oatman, co-trustees of the Warren Clark Testamentary  
22   Trust; and Christopher C. Phillips.

23          EXAMINER STOGNER: I assume that the parties  
24   which you're representing are parties to be force-pooled?

25          MR. BRUCE: They are, yes, sir. They're the --

1 most of the uncommitted working interest owners.

2 EXAMINER STOGNER: Roughly what percentage total?

3 MR. BRUCE: Just a second, Mr. Examiner, I can --

4 EXAMINER STOGNER: Just a rough estimate.

5 MR. BRUCE: Maybe Tom knows off the top of his  
6 head.

7 EXAMINER STOGNER: Mr. Kellahin, do you know?

8 MR. BRUCE: 25 to 30 percent, somewhere in that  
9 range, I think.

10 MR. KELLAHIN: Mr. Examiner, my landman will have  
11 to respond. I'm not certain of that percentage.

12 MR. BRUCE: I think I heard it. It's somewhere  
13 in the 20-percent, 25-percent range.

14 EXAMINER STOGNER: Okay, 20 to 30, okay. Just  
15 wanting to preliminarily see what is going on.

16 Any other appearances? There are none.

17 And you have no witnesses, Mr. Bruce?

18 MR. BRUCE: I may have one, but he'll be quite  
19 brief.

20 EXAMINER STOGNER: Okay, I'll tell you what:  
21 Until -- Let me go ahead and swear Mr. Kellahin's witnesses  
22 for Southland Royalty in. And should you need your  
23 witness, then we will swear them in at that time.

24 MR. BRUCE: Okay.

25 EXAMINER STOGNER: Will the Meridian witnesses

1 please stand? I'm sorry, Southland Royalty witnesses?

2 (Thereupon, the witnesses were sworn.)

3 EXAMINER STOGNER: Gentlemen, is there any need  
4 for opening remarks, or shall we just go ahead and proceed  
5 with the testimony?

6 MR. BRUCE: I don't have any opening remarks.

7 MR. KELLAHIN: I think I'll let Mr. Van Goebel  
8 lay out the fact situation as my client understands it.  
9 And so we're ready to proceed, Mr. Examiner.

10 EXAMINER STOGNER: Please.

11 MR. KELLAHIN: We call, then, as our first  
12 witness Mr. Van Goebel. Mr. Goebel is a petroleum landman  
13 with Southland Royalty Company. He resides in Farmington,  
14 New Mexico.

15 VAN L. GOEBEL,

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. KELLAHIN:

20 Q. Mr. Van Goebel, for the record, sir, would you  
21 please state your name and occupation?

22 A. My name is Van Goebel. I'm with Meridian  
23 Oil/Southland, located in Farmington. I'm a landman.

24 Q. For purposes of this case, Southland Royalty  
25 Company is operator of the existing spacing unit?

1 A. Yes.

2 Q. And you're operating as an employee for that  
3 company insofar as this pooling case is concerned?

4 A. Yes.

5 Q. As part of your land duties, have you made  
6 yourself knowledgeable about this existing wellbore, in  
7 terms of the land configuration and the ownership of those  
8 parties that participate or have participated in the Mancos  
9 production from this existing wellbore?

10 A. Yes.

11 Q. What does Southland Royalty propose to do?

12 A. The Hill Federal Number 2Y well was drilled  
13 originally as a Mancos-Dakota well producer in the Mancos.  
14 It's no longer productive.

15 We've received a letter from the Bureau of Land  
16 Management, wanting to know our procedures for plugging.  
17 Rather than plug, we would like to recomplete the well to  
18 the Mesaverde formation.

19 Q. As a Mancos well, what has been the acreage  
20 dedication to the well?

21 A. This well in the Mancos is located in the  
22 Gavilan-Mancos field. At the time it was drilled, the  
23 spacing was 320 acres. Later the spacing was changed to  
24 640s, but this well was grandfathered in under the original  
25 320 acres.

1 Q. So what portion of its Section 25 was dedicated  
2 to the Mancos production?

3 A. The north half.

4 Q. If the well is recompleted as a Mesaverde well,  
5 what is the proposed dedication?

6 A. The dedication is proposed as the north half of  
7 Section 25.

8 Q. So that orientation and size would be the same?

9 A. Yes.

10 Q. Was there an operating agreement that committed  
11 the parties on a contractual basis for production in this  
12 wellbore from the Mancos formation?

13 A. Yes, there is.

14 Q. Under that operating agreement, is Southland  
15 Royalty Company limited to the contract area being the  
16 Mancos formation?

17 A. The original operating agreement covered the  
18 Mancos-Dakota formations only.

19 Q. If the well is recompleted in the Mesaverde, will  
20 you have a contract that covers the interest owners?

21 A. No, not at this point.

22 Q. Have you proposed to all interest owners in the  
23 existing well the recompletion of the well?

24 A. Yes, in our joinder letter which was sent out in  
25 July, we proposed to plug the Mancos and recomplete the

1 Mesaverde and requested to amend the original operating  
2 agreement to cover the Mesaverde formation.

3 Q. All right. Is there a table or a summary by  
4 which the Examiner can see the various interest owners and  
5 their percentages in the proposed spacing unit?

6 A. Yes, there is, under Exhibit 3 --

7 Q. All right, sir, if we go to the first tab under  
8 Exhibit 3 --

9 A. -- is a breakout of the working interest owners  
10 with their percentages.

11 Q. Did you prepare that or have it prepared under  
12 your direction?

13 A. Yes.

14 Q. Have you satisfied yourself that it's correct and  
15 accurate, Mr. Van Goebel?

16 A. Yes.

17 Q. Based upon your work, do you have opinions with  
18 regards to the necessity at this time of a compulsory  
19 pooling application?

20 A. Yes, I feel we need one.

21 MR. KELLAHIN: At this time, Mr. Examiner, we  
22 tender Mr. Van Goebel as an expert petroleum landman.

23 EXAMINER STOGNER: Any objections?

24 MR. BRUCE: No.

25 EXAMINER STOGNER: Mr. Van Goebel is so

1 qualified.

2 Q. (By Mr. Kellahin) Let's talk in a summary  
3 fashion about the sequence of your efforts.

4 Approximately when did the Bureau of Land  
5 Management issue to Southland a notice that this well  
6 either had to be restored to production in some other  
7 formation or plugged and abandoned?

8 A. During 1994 we received a letter from the Bureau  
9 of Land Management, indicating they felt it was no longer  
10 economic and that they requested our procedure for plugging  
11 and abandonment.

12 Q. All right. Have you, with the aid of your  
13 technical employees for your company, made a determination  
14 as to whether this wellbore could be useful in any other  
15 formation?

16 A. Yes, our geologists and engineers examined the  
17 wellbore and geology and feel that the Mesaverde  
18 recompletion attempt could be made.

19 Q. All right. As a result of their recommendations,  
20 then, have you gone forward with your efforts to  
21 consolidate these interest owners for production on a  
22 voluntary basis out of the Mesaverde?

23 A. Yes.

24 Q. What is the ownership of the wellbore itself?

25 A. The ownership under the wellbore, the parties

1 that are in the Mancos Dakota are also the same working  
2 interest owners in the Mesaverde.

3 Q. In terms of your offer to those parties to  
4 participate in the recompletion of the well in the  
5 Mesaverde, is there to be any charge to those interest  
6 owners for the cost of the existing well?

7 A. No, we all paid for it when it was originally  
8 drilled.

9 Q. And so the proposal to them is to pay their  
10 proportionate share of plugging out of the Mancos and then  
11 the cost of the recompletion and attempt to obtain  
12 production out of the Mesaverde?

13 A. Yes.

14 Q. When we look at the summary sheet for Exhibit  
15 Number 3, go down the sheet and summarize for us what is  
16 the current status of all these parties.

17 A. Okay. Number one is Meridian/Southland.  
18 Southland Royalty Company has a 50-percent interest in the  
19 drill block, Meridian has a 12-1/2-percent interest.

20 Q. If we go over to the far right column, does that  
21 show the status as best you understand it to be of their  
22 approval or responses as of the date of the hearing today?

23 A. Yes, under the approval column I've indicated the  
24 responses I've received.

25 Q. At this point, can you approximate for the

1 Examiner the outstanding percentage as a total of those  
2 interest owners that are not committed to the recompletion?

3 A. Okay, at this point 74 percent have indicated  
4 they want to participate in the project, three percent have  
5 indicated they will elect to go nonconsent -- that would be  
6 number 11 and 12 -- and 23 percent have indicated no  
7 response as to their elections in the recompletion.

8 Q. All right. Let's go to the initial proposal in  
9 writing to these interest owners. If you'll turn back to  
10 Exhibit Tab Number 2, let's look at your letter of July  
11 17th, 1995.

12 Is this, in fact, your first written proposal to  
13 these parties with a specific proposal for the recompletion  
14 of the subject well?

15 A. Yes.

16 Q. What if any response did you have to your letter?

17 A. Shortly after the letter went out, many of the  
18 working interest owners responded in writing that prior to  
19 their evaluation of the recompletion they wanted to  
20 initiate gas balancing, cash out on the gas balancing for  
21 the Mancos formation.

22 Q. Describe for the Examiner the process that  
23 Southland Royalty utilizes for gas balancing with regards  
24 to the Mancos in this well or, in fact, any other well.  
25 How is that done?

1           A.    Okay, under the operating agreement, which is  
2 under Exhibit 4, there's a gas balancing agreement, which  
3 deals with parties that are overproduced or underproduced.  
4 And at the time a well is determined to be permanently no  
5 longer productive, those parties that are underproduced can  
6 request to be cash-settled for the gas that they did not  
7 sell.

8           Q.    At what point in time does that process -- is  
9 that initiated?

10          A.    At the time the well is going to be plugged.

11          Q.    Have you advised all these parties that have not  
12 committed their interests that Southland Royalty's practice  
13 under this agreement is to initiate gas balancing after the  
14 well has been plugged out of the Mancos?

15          A.    Yes, they're aware of that.

16          Q.    What then happened after the July 17th letter?  
17 Give us a general summary of the sequence of the efforts.

18          A.    Okay, after the July 17th letter, and then upon  
19 receipt of their request for gas balancing, I sent a memo  
20 to our department in Fort Worth, Texas, that handles gas  
21 balancing to initiate that procedure.

22                   In the mid part of October, they sent out a  
23 letter to all the working interest owners providing  
24 schedules of the volume sold, along with a schedule showing  
25 Southland's overproduced position, along with the volumes

1 and the pricing.

2 Q. Have you received any responses from the parties  
3 to be pooled at this point with regards to that issue?

4 A. On the gas balancing issue, I've been advised by  
5 our balancing department that they have received responses  
6 from some of the parties.

7 Q. What's the process, Mr. Van Goebel? Is that to  
8 take place independently, then, of your efforts to  
9 consolidate the interest owners for the recompletion and  
10 possible production out of the Mesaverde?

11 A. Yeah, that would be a side issue, not related to  
12 this proposal.

13 Q. At this point you do not, then, have a fully  
14 committed agreement by all interest owners for production  
15 out of the Mesaverde?

16 A. No.

17 Q. Have you offered to them amendments to the  
18 existing operating agreement by which that could take place  
19 on a contractual basis?

20 A. Under the July 17th letter, the initial proposal  
21 letter indicated that we would like to amend the existing  
22 operating agreements since all the parties were already  
23 joined under that agreement, and upon their approval, then,  
24 we would send to each owner a revised Exhibit A covering  
25 the Mesaverde formation.

1 Q. After the July 17th letter, did you follow up  
2 with additional letters to all these parties?

3 A. Yes, when they started the gas balancing, I sent  
4 a letter indicating that our gas balancing department had  
5 started that procedure, and again requested that they  
6 evaluate the proposal for the recompletion.

7 Q. Have you received any objection from these  
8 interest owners as to having Southwest -- Southland Royalty  
9 Company act as operator for the recompletion?

10 A. No, not at this point.

11 Q. Have you received any objection to the proposed  
12 AFE?

13 A. We received one comment from the Ramona B. Sweet  
14 Trust, indicating they had concerns about the cost.

15 Q. All right. And have you responded to them with  
16 regards to that concern?

17 A. They in their letter had a question on the cost  
18 and wanted a copy of the operating agreements, also the BLM  
19 demand letter, and wanted to know the salvage value and  
20 plugging costs, and we responded to that letter.

21 Q. Have you responded to all the requests that  
22 you've received from these interest owners?

23 A. Yes.

24 Q. Do you have a recommendation to the Examiner as  
25 to how to handle the overhead rates under a compulsory

1 pooling order to be issued to cover the Mesaverde portion  
2 of this process?

3 A. Since we would like to attempt to amend the  
4 existing operating agreement under the Application for  
5 compulsory pooling, we have indicated the overhead rates we  
6 request. We requested \$4950 per month drilling rate,  
7 \$494.98 per month for overhead operating.

8 Q. How did Southland Royalty arrive at that  
9 particular number?

10 A. Under the 1985 operating agreement under the  
11 COPAS attached to that agreement, operating agreement, the  
12 original overhead rate for drilling was \$3500 and was \$350  
13 for the producing.

14 Q. So you have escalated the original COPAS numbers,  
15 and if they're escalated pursuant to the schedule you'll  
16 get what you have just recommended to the Examiner as the  
17 rate to put in the pooling order?

18 A. Yes, under the COPAS agreement every April 1st  
19 there's an adjustment on the overhead rates, and this is  
20 the adjustment under those schedules.

21 Q. So that the rate is the same for those parties  
22 under the amended agreement as well as under a pooling  
23 order, do you recommend to the Examiner that there be a  
24 COPAS adjustment set forth in the pooling order whereby the  
25 numbers can track --

1 A. Yes.

2 Q. -- and be the same, for either nonconsenting  
3 pooling order parties --

4 A. Yes, and for the consenting.

5 Q. All right. In addition, you're dealing with  
6 federal oil and gas leases within this spacing unit.

7 A. Yes, the north half, if we look at -- Under  
8 Exhibit 3, there is a land plat, the last page, third page,  
9 showing the drill block north half of Section 25. It's  
10 comprised of three federal leases. In the northeast  
11 quarter, indicates the working interest owner percentage.  
12 Southland Royalty has 100 percent. In the northwest  
13 quarter you see there's two federal leases, and I've  
14 indicated the ownership under each federal lease.

15 Q. In order to comply with Bureau of Land Management  
16 practice, under a New Mexico Oil Conservation Division  
17 compulsory pooling order, are you requesting that the  
18 Division include in this pooling order an ordering  
19 paragraph that pools all mineral interest owners, whoever  
20 they may be, including record title ownership?

21 A. Yes.

22 Q. And what's the purpose of that?

23 A. Since we have a number of federal leases, we will  
24 have to enter into a communitization agreement, which will  
25 be executed by the record title owner, as well as by the

1 working interest owners.

2 Q. And if those record title interest owners fail to  
3 execute the communitization agreement, if their interest is  
4 specifically included in the pooling order, then the Bureau  
5 of Land Management will allow the pooling order to  
6 substitute for those signatures?

7 A. Yes.

8 Q. When we look at the information tabulated just in  
9 front of this land plat, does that show the record title  
10 ownership?

11 A. Yes, this schedule indicates the working interest  
12 owners and the record title owners found in the drill  
13 block.

14 Q. All right, sir. Attached to your July 17th,  
15 1995, letter, did you also submit to these various interest  
16 owners the itemized schedule for authority for expenditure?

17 A. Yes, as part of the letter also is enclosed the  
18 authority for expenditure, along with a wellbore diagram  
19 and a pertinent data sheet on the well.

20 Q. And then if we turn behind Exhibit Tab Number 4,  
21 what do we find at that point in the exhibit book?

22 A. Under Tab 4 is the operating agreement dated May  
23 10th, 1985, which covered the Dakota and Mancos formation.

24 Q. And Southland would propose to operate this well  
25 pursuant to this agreement as to those voluntary interest

1 owners?

2 A. Yes.

3 Q. And you would use it as a means of operating  
4 under a pooling order, would you not?

5 A. Yes.

6 Q. At this point, Mr. Van Goebel, do you have an  
7 opinion as to whether or not you've exhausted all  
8 reasonable good-faith efforts to obtain joinder by all  
9 these interest owners?

10 A. Yes.

11 Q. And what is your opinion?

12 A. I feel that we have made an attempt for the  
13 interest owners to make an evaluation of the recompletion,  
14 but up to this point I feel that there's other issues that  
15 they're concerned about, and they have not or will not make  
16 an election as to the Mesaverde.

17 Those parties that have evaluated, based on the  
18 recompletion, merits have either elected to participate or  
19 go nonconsent.

20 Q. With respect to those parties that are raising  
21 issues concerning gas balancing as to production from the  
22 Mancos formation, in your opinion do they appear to be  
23 knowledgeable about that process?

24 A. Yes.

25 Q. Are you dealing with knowledgeable people that

1 have interest in this well, as other wells?

2 A. Yes.

3 MR. KELLAHIN: That concludes my examination of  
4 Mr. Van Goebel.

5 We move the introduction of Exhibits 1 through 4.

6 EXAMINER STOGNER: Are there any objections?

7 MR. BRUCE: No, sir.

8 EXAMINER STOGNER: Exhibits 1 through 4 will be  
9 admitted into evidence at this time.

10 Thank you, Mr. Kellahin.

11 Mr. Bruce?

12 CROSS-EXAMINATION

13 BY MR. BRUCE:

14 Q. When did this well last produce from the Mancos  
15 and/or Dakota?

16 A. I believe it was back in the early 1990s.

17 Q. Like 1990 or 1991, something like that?

18 A. In that area, 1993.

19 Q. Okay. And it was not until -- what? Late 1995  
20 that you got into -- decided to go after gas balancing,  
21 cash balance the parties?

22 A. We had attempted to do various things with the  
23 well to get it to produce.

24 At one point we had tried to sell the well. We  
25 put it up for auction. It did not sell at the auction, so

1 it came back to us.

2 And then we had a new geologist come in and start  
3 working the area and he started looking at the Mesaverde  
4 and re-looked at this wellbore for a possible recompletion  
5 to the Mesaverde.

6 Q. Now, was gas balancing done at Meridian's  
7 instigation or at the instigation of my clients?

8 A. We would initiate the gas balancing when it was  
9 determined that the Mancos should be plugged. However, we  
10 did receive letters when we proposed the recompletion,  
11 which did act as a catalyst.

12 Q. One final question on that. Does the gas-  
13 balancing agreement provide for any interest on the cash in  
14 the --

15 A. No.

16 Q. Now, you mentioned the overhead rates. What were  
17 the operating rates? Four-hundred-and-some dollars?

18 A. Under -- You mean the one we want to amend to?

19 Q. Yes, the one you're requesting in the proposal,  
20 the Application.

21 A. Okay, under the first tab on the last page of the  
22 Application, under Number 4 is the overhead rates we're  
23 requesting.

24 Q. Are these the rates set out in *Ernst and Whinney*?

25 A. They're the rates that our accounting group would

1 go by under the COPAS agreements.

2 Q. How do they compare to the *Ernst and Whinney*  
3 rates?

4 A. I don't have those rates. They're in the  
5 ballpark for the San Juan Basin for what are being used by  
6 other operators.

7 Q. But you don't have any idea what the *Ernst and*  
8 *Whinney* rates are for a well of this depth in the San Juan  
9 Basin?

10 A. For the San Juan Basin, these would probably fall  
11 within those ranges.

12 Q. What ranges?

13 A. Between \$4000 -- around \$4000 for drilling, \$400  
14 for producing.

15 Q. Okay. So you're saying \$4000 and \$400 are  
16 probably what *Ernst and Whinney* --

17 A. No, I'm saying that that is the range, the  
18 ballpark, that I'm saying that these indicated here are  
19 within the fair range that they would show on their  
20 schedules.

21 Q. Getting back to the gas balancing, I just want to  
22 make sure of one point. Even if this well is recompleted,  
23 Meridian is going ahead with the cash balancing?

24 A. Yes, when we plug the Mancos, then that account  
25 will be closed and cash settlement will occur.

1 Q. Okay. Now, your Exhibit 2 you have your initial  
2 proposal letter regarding recompletion. Is this the only  
3 letter you sent out making an offer to parties to join in?

4 A. No, there are other letters that were sent out.  
5 In August a letter was sent out indicating that we would  
6 initiate the gas balancing.

7 Q. But that doesn't have to do with --

8 A. And then in November, again, letters were sent  
9 out indicating that the statements have been sent out with  
10 gas balancing, and we have requested again for them to re-  
11 evaluate the recompletion.

12 Q. Okay. But really those letters don't have  
13 strictly to do with an offer; they have more to do with gas  
14 balancing?

15 A. No, the letters that were sent out indicated that  
16 gas balancing had been initiated, and so it was a request,  
17 in essence, to say, let's set that to the side, please  
18 evaluate the recompletion and let us know your election.

19 Q. Did Meridian at any time make any offers to  
20 purchase or obtain farmouts from the nonconsenting parties?

21 A. We received a call from Christopher Phillips, who  
22 indicated he might be interested in selling his interest.  
23 I turned that over to our acquisitions group for  
24 evaluation.

25 Also, we received a letter from Ramona B. Sweet,

1 indicating that they would not contest the force pooling if  
2 we either gave them a per-acre bonus with an override, a  
3 150-acre, per-acre, dollar amount, plus a 6.25-percent  
4 override, or if we just gave them a flat 12.5 percent  
5 override.

6 We evaluated that and wrote back a letter to them  
7 indicating we declined, and requested again that they  
8 evaluate the recompletion.

9 Q. Did you ever make a counteroffer?

10 A. No.

11 Q. Did you ever respond in writing to Mr. Phillips'  
12 request?

13 A. No, we only had telephone conversations. And the  
14 acquisitions department, I believe -- I would have to  
15 confirm this -- I believe they did contact him by  
16 telephone.

17 Q. Looking at your Exhibit 3, the last page of it,  
18 sir, could an east-half unit be formed for this well?

19 A. Yes, we could have formed an east-half, but we  
20 had the existing north half with the parties already in  
21 place, so we --

22 Q. Who owns the southeast quarter as to the  
23 Mesaverde, the operating rights?

24 A. There's another -- we do not own anything in the  
25 south half. I would have to review my notes, get the

1 ownership for you for the south half.

2 Q. Who markets Southland Royalty's and Meridian's  
3 gas for this well?

4 A. Meridian does.

5 Q. Meridian does? If any of my clients join in the  
6 well, is Meridian prepared to commit to marketing their  
7 share of gas on the same terms and on the same basis that  
8 Meridian and Southland market their gas?

9 A. Meridian's marketing group recently sent out a  
10 letter to all working interest owners, indicating they  
11 would no longer market third-party gas.

12 Q. And why is that?

13 A. It seems like many times there are unhappy  
14 people, no matter what market conditions are, they're  
15 unhappy and they're bickering, and so it was decided that  
16 we would no longer market the gas.

17 Q. Does Meridian or Southland have any gas marketing  
18 subsidiaries?

19 A. No, I don't believe so.

20 Q. One final thing. If water is produced from that  
21 well, do you know how that will be disposed of?

22 A. You would have to address that question to my  
23 engineer or geologist.

24 MR. BRUCE: I have no further questions, Mr.  
25 Examiner.

1 EXAMINER STOGNER: Thank you, Mr. Bruce.

2 Mr. Kellahin, any redirect?

3 MR. KELLAHIN: No, sir.

4 EXAMINATION

5 BY EXAMINER STOGNER:

6 Q. In your Exhibit Number 2 -- That's the July 17th  
7 letter, but you said there were two other letters sent out  
8 subsequent to July 17th?

9 A. Yes, there was other letters that have not been  
10 put in the exhibit book.

11 Q. And why weren't they included in the exhibit  
12 book?

13 A. We just put the joinder letter in. I could bring  
14 you the other letters if you want. We have copies of  
15 those.

16 EXAMINER STOGNER: Mr. Kellahin, I think it would  
17 be pretty good to -- We did cover those substantially in  
18 the examination, cross-examination.

19 MR. KELLAHIN: Yes, sir, we have them available.  
20 If you would like to cover them now, we've got some.

21 EXAMINER STOGNER: Okay.

22 MR. KELLAHIN: Al, do you have the rest of these?

23 THE WITNESS: They're in the --

24 MR. KELLAHIN: Have you got the rest of these?

25 EXAMINER STOGNER: So you have handed me two

1 sheets of paper, one dated November 7th, and the other  
2 dated November 28th?

3 MR. KELLAHIN: Yes, Mr. Examiner. I'm also  
4 handing Mr. Bruce a copy of those same letters.

5 EXAMINER STOGNER: I propose we just supplement  
6 Exhibit Number 2, unless you have --

7 MR. KELLAHIN: We might just insert these in the  
8 exhibit book as a supplement to Exhibit 2. We appreciate  
9 that.

10 Q. (By Examiner Stogner) Okay. Now, was this all  
11 the written correspondence, Mr. Goebel?

12 A. There was additional correspondence where Ramona  
13 B. Sweet requested additional information wanting copies of  
14 the operating agreement, copies of the BLM letter, and the  
15 request for the salvage value, which we again responded to  
16 and sent her the information she requested.

17 Q. But that was just correspondence when Meridian  
18 and that end of the --

19 A. Yes.

20 Q. And now -- But these are the three  
21 correspondences that went out to all parties?

22 A. Yes, and then of course in the middle of October  
23 would have been the letters that went out from our gas  
24 balancing department on their request for balancing.

25 And I did send out a letter which -- back in

1 August 25th, just indicating that we had received their  
2 request for balancing and that it had been forwarded to our  
3 gas balancing department.

4 Q. Okay. Again, who requested the balancing?

5 A. The owners that are contesting us here would be  
6 the majority of the owners that are requesting balancing.

7 Q. Okay. So not all parties requested, but --

8 A. -- but it would be initiated, because the well --  
9 the Mancos formation was going to be plugged.

10 EXAMINER STOGNER: I have no other questions of  
11 Mr. Goebel at this time.

12 You may be excused -- Oh, I'm sorry, Mr. Bruce?

13 MR. BRUCE: Just one question.

14 FURTHER EXAMINATION

15 BY MR. BRUCE:

16 Q. Basically, it was the parties who were  
17 underproduced who requested balancing; is that correct?

18 A. I assume those were the -- Yeah, those would be  
19 the parties that were interested, yes.

20 Q. And no payments have been made yet?

21 A. No, the procedure they used, from what they told  
22 me, is that they send out the schedules to all the working  
23 interest owners and ask them to review the volumes and the  
24 money amounts shown, and that they request everybody come  
25 into a consensus and show that they're in agreement before

1 any checks are written or cash disbursed. This is to avoid  
2 any future problems, hopefully.

3 MR. BRUCE: Thank you, Mr. Examiner.

4 EXAMINER STOGNER: Mr. Kellahin?

5 MR. KELLAHIN: I only offer to comment on this  
6 issue if there's any confusion by the Division as to what I  
7 have recommended to Southland, and that is while these  
8 group of parties have other issues with Southland, the  
9 issue we're focusing here is the force-pooling case.

10 The practice under this operating agreement, and  
11 in fact most gas balancing arrangements, is to initiate gas  
12 balancing when you plug out of a formation. And when the  
13 well is plugged out of the Mancos, then that will trigger  
14 gas balancing, and it's a set of issues that these parties  
15 need to resolve outside of the Division's jurisdiction.

16 Because the operating agreement dealt only with  
17 the Mancos, and there is an inability to have an agreement  
18 on the Mesaverde, we would like your assistance in issuing  
19 a force-pooling order to cover the Mesaverde. I have  
20 recommended to Southland that they not include all the  
21 paperwork that dealt with these other issues.

22 If you would like to see all that information,  
23 I'm more than happy to supply it to you. We did not  
24 believe it would be relevant to your understanding and  
25 ability to issue a pooling case. If you would like to see

1 it, I'm more than happy to give it to you.

2 EXAMINER STOGNER: I don't think that will be  
3 necessary at this time.

4 Any other questions of this witness before we  
5 move on?

6 Mr. Kellahin?

7 MR. KELLAHIN: We would like to call Mr. Bill  
8 Hobbs at this point. Mr. Hobbs is a petroleum geologist.  
9 He resides in Farmington, New Mexico.

10 BILL HOBBS,  
11 the witness herein, after having been first duly sworn upon  
12 his oath, was examined and testified as follows:

13 DIRECT EXAMINATION

14 BY MR. KELLAHIN:

15 Q. Mr. Hobbs, for the record would you please state  
16 your name and occupation?

17 A. My name is Bill Hobbs. I'm a professional  
18 geologist, working for Meridian in Farmington, New Mexico.

19 Q. Mr. Hobbs, you have to speak up. There's a hum  
20 of the fan that makes it hard for at least me to hear you.

21 On prior occasions have you testified before the  
22 Division and qualified as an expert in matters of geology?

23 A. Yes, I have.

24 Q. Are you part of the technical team appearing on  
25 behalf of Southland Royalty Company and your involvement is

1 the geologic part of the team?

2 A. Yes, that's correct.

3 Q. Does your team have the responsibility for  
4 evaluating the Hill Federal Well 2Y to determine whether or  
5 not you have any further opportunities for production out  
6 of the Mancos formation?

7 A. Yes, I am.

8 Q. In addition, have you undertaken the personal  
9 responsibility to see if this wellbore can be utilized in  
10 any other formation?

11 A. Yes, I have.

12 Q. And based upon that technical study, do you now  
13 have certain conclusions?

14 A. Yes, I do.

15 MR. KELLAHIN: We tender Mr. Hobbs as an expert  
16 petroleum geologist.

17 EXAMINER STOGNER: Any objections?

18 MR. BRUCE: No, sir.

19 EXAMINER STOGNER: He is so qualified.

20 Q. (By Mr. Kellahin) Mr. Hobbs, give us a quick  
21 summary of where you stand with this wellbore in terms of  
22 any further potential production out of the Mancos  
23 formation.

24 A. The Mancos formation is a fractured shale  
25 producing zone. It's a pretty good producing zone; it is

1 part of the Basin.

2           Basically on open-hole logs the Mancos, at least  
3 in Meridian's shop, defies any real log analysis. But  
4 based on the production pressure data, what we can glean  
5 from the logs, we see no additional potential in this  
6 wellbore in the Mancos-Dakota formations.

7           Q. Do you see another use for this wellbore?

8           A. Yes, we do.

9           Q. And in what formation do you see that use?

10          A. We see some pretty good recompletion potential in  
11 the Mesaverde formation, which is above the existing  
12 perforations in the Mancos.

13          Q. All right, let's talk about the Mesaverde then.  
14 If you'll turn to the exhibit book and look behind Exhibit  
15 Tab Number 5, do all these geologic displays that we're  
16 about to discuss represent your work product?

17          A. Yes.

18          Q. Let's start with the orientation map, then, if  
19 you'll look at Exhibit Tab 5 and turn to the first display,  
20 identify and describe approximately where we are in the  
21 Basin when we look for the Hill Federal 2Y well.

22          A. The larger dark outline on this map is the  
23 outline of the Mesaverde outcrop, which basically helps  
24 define the outline of the San Juan Basin.

25                 The darker outline within the Mesaverde outcrop

1 shows the main areas of Mesaverde production within the San  
2 Juan Basin.

3           Down to the southeast, just northeast of a little  
4 box there, which is the Lindrith Unit, we showed a larger-  
5 than-scale-size dot indicating the indication of the Hill  
6 Federal Number 2Y well location and where that lies in  
7 respect to known commercial production from the Mesaverde  
8 formation.

9           Q.    The issue I would like you to address is the  
10 topic of the appropriate percentage risk factor penalty --

11           A.    Uh-huh.

12           Q.    -- to be applied in this pooling case.  Are you  
13 aware of the maximum penalty the Division awards in force-  
14 pooling cases?

15           A.    Yes, I am.

16           Q.    Cost plus 200 percent, is that familiar to you?

17           A.    Right.

18           Q.    In terms of that percentage, do you have an  
19 opinion as to the risk to assign to the recompletion of  
20 this well in the Mesaverde?

21           A.    Yes, I do.

22           Q.    And what is that opinion?

23           A.    Based on the geology of the surrounding area and  
24 the geology in this wellbore, I feel that the risk could  
25 even exceed the 200-percent allowable.  However, based on

1 the -- what the Commission does, we are requesting the  
2 maximum 200-percent allowable.

3 Q. When we look at the Mesaverde, where are we with  
4 this wellbore in relation to where we would find  
5 conventional Mesaverde production that would be profitable  
6 to Meridian, Southland Royalty or any other operator? Are  
7 we within that area?

8 A. No, we're outside of that area, referring back to  
9 this first exhibit that we looked at. We're on the order  
10 of -- It looks like the scale of this map is about one inch  
11 equals 18 miles. We're on the order of seven to eight  
12 miles southeast of what Meridian would deem to be  
13 commercial production from the Mesaverde formation.

14 Q. From a geologic point of view, could you as a  
15 geologist justify a well in the Mesaverde in this spacing  
16 unit if it was to be a new-drill stand-alone Mesaverde  
17 well?

18 A. Based on the risk and applying that risk to  
19 economics, Meridian could not, with the geology and reserve  
20 analysis that we've done on this well -- we could not  
21 justify to our management drilling a well at this location.

22 Q. What in your opinion is the only method by which  
23 you would have an opportunity to produce Mesaverde gas out  
24 of this wellbore, if it in fact is productive?

25 A. It would be a recompletion in this well, which

1 also we are proposing so that we don't waste the resource.  
2 We do have a wellbore we have something we need to do with,  
3 and we -- in spite of the risk that we've put on the well,  
4 that applies to geology, we think it warrants attempting a  
5 recompletion attempt in this wellbore.

6 Q. Let's see if we can establish for the Division  
7 the nearest Mesaverde production in this area.

8 If you'll turn to the next plat, let's look at  
9 that. It says the "Mesaverde Cumulative Production". Are  
10 you with me?

11 A. Yes.

12 Q. In the caption portion of that -- This is simply  
13 a map to show a line of cross-section and then give you  
14 some values. It is not a true isopach, is it, sir?

15 A. No, I gave this to my geological technician,  
16 whose name is also on this map down there, Sharon Nez. I  
17 gave her the information, we pulled the basic information  
18 out of *Petroleum Information* and put it into our computer  
19 with the idea that we would make an isopach map of  
20 Mesaverde cumulative production, and this map is going to  
21 be contoured on a 250 million contour interval, and the  
22 point of this map is within this four-section area.

23 The well in question, the Hill 2Y, by the way, is  
24 down here in the northeast of Section 25, is that the most  
25 Mesaverde production in this four-section area, is the well

1 in the southeast of 26, which has only made 50 million  
2 cubic feet of gas.

3 Q. All right, let's look at this, then. If we go  
4 from A', which is the subject well --

5 A. Yes.

6 Q. -- move through the line of cross-section on the  
7 plat, the well in 26 cum'd how much gas out of the  
8 Mesaverde?

9 A. Fifty million.

10 Q. All right. The next nearest well in this area  
11 that produced Mesaverde gas is found where, sir?

12 A. That would be up at the A end of the cross-  
13 section, northwest end in Section 23, in the northwest  
14 quarter.

15 That well, the Number 1 Gavilan-Howard, was  
16 perforated in the Point Lookout and Lower Menefee, and it's  
17 produced a half a million cubic feet of gas and has been  
18 active for at least two years.

19 Q. Is there any other wells within this four-section  
20 area that was -- for which Mesaverde gas production was  
21 attempted?

22 A. Yes, for some reason the computer map doesn't  
23 show the Mesaverde completion.

24 There is a well in the northeast of Section 23,  
25 very near that 23-1 Fee C well. This well was drilled

1 primarily to the Mesaverde, for Mesaverde production. That  
2 well was -- a completion attempt was made in the Point  
3 Lookout. This was in 1989. The well tested 300 MCF a day  
4 and 93 barrels of water a day and has never produced,  
5 according to our records.

6 Q. Is the risk diminished below the maximum penalty  
7 by proximity to established production in the Mesaverde?

8 A. No, quite the contrary, I think. Looking at the  
9 results of the surrounding wells, the risk is at least as  
10 high if not higher.

11 Q. Has the risk been diminished by the fact that you  
12 have a wellbore and a log available that would show you  
13 Mesaverde formation?

14 A. No.

15 Q. Let's turn to the next display. You've  
16 identified this as a gross clean Mesaverde isopach. You're  
17 looking at the tab behind Exhibit 5, and it's the third  
18 sheet. Mr. Hobbs, are you not, sir?

19 A. Yes.

20 Q. All right. You've put a value at the Hill  
21 Federal 2Y well of 116 feet. What does that mean?

22 A. That means using a gamma ray log, which I feel  
23 there's some very puzzling log character in all the wells  
24 that have penetrated the Mesaverde, particularly in this  
25 township, I did want to make one map that would represent

1 that there is at least clean reservoir rock available in  
2 Section 25. So this represents the amount of clean sand in  
3 the -- if you use just structurally the gamma-ray log -- in  
4 the Point Lookout, Menefee and Cliffhouse members of the  
5 Mesaverde formation.

6 Q. Does the fact that there's an estimated 116 feet  
7 of gross clean Mesaverde sand diminish the risk?

8 A. No, not at all.

9 Q. You've got to do something else as a geologist,  
10 do you not?

11 A. Right.

12 Q. You've got to determine true net effective pay  
13 out of the Mesaverde?

14 A. Correct.

15 Q. All right. Let's look to see how difficult that  
16 is. If you'll turn to the cross-section, Mr. Examiner,  
17 there's an envelope on the end of the exhibit book. If you  
18 pull that out, we'll look at Mr. Hobbs' cross-section.

19 A. This is the three-well cross-section which was  
20 shown on the locator map that was the second map, the  
21 Mesaverde cumulative production map.

22 The cross-section starts with the Gavilan-Howard  
23 Number 1 well in Section 23, to the northwest. Then it  
24 goes through the Alex Phillips Gavilan Number 2 in the  
25 southeast of Section 26. And the third well on the right

1 is the Southland Royalty Hill Federal Number 2Y well, with  
2 the proposed perforations in the Mesaverde shown on the  
3 left side of the depth track, where we would -- This is  
4 where we propose our Mesaverde recompletion attempt.

5 Q. All right. Let's look at the Hill Federal log.  
6 Describe the quality of this data.

7 A. As is typical of a number of wells in this part  
8 of the Basin, some of these wells, and in particular, the  
9 Hill 2Y, these wells were drilled -- oftentimes they just  
10 set surface casing, drilled all the way to the Mancos, and  
11 in the process created some pretty badly washed out hole  
12 conditions in the Mesaverde formation.

13 Subsequently, when open-hole logs were run, we  
14 feel that part of the difficulty in determining what is net  
15 effective pay has been affected by the borehole washout  
16 effects on open-hole logs.

17 So in some ways this -- the 2Y log is typical of  
18 wells in the area, and that it's not like up in the main  
19 producing trend where you can look at a log and you can see  
20 50 ohms resistivity and 10 percent porosity and you can  
21 look at a log from across the room and tell you you've got  
22 a fair amount of pay.

23 Q. What do you assess to be the opportunity, then,  
24 in the Mesaverde, and how do we illustrate that to the  
25 Examiner?

1           A.    The opportunity that we see, again, is  
2 demonstrated by where we have our proposed perforations.  
3 We do show perforations down through the Point Lookout  
4 formation, and some in the lowermost sand in the Cliffhouse  
5 formation.

6           Q.    These would be the new proposed perforations in  
7 the Mesaverde portion of this wellbore?

8           A.    Yes.

9           Q.    These, in fact, do not yet exist?

10          A.    No, no, they do not.

11          Q.    Is it reasonably probable that you as a geologic  
12 expert can take this log and come up with an accurate net  
13 pay isopach by which a reservoir engineer can make accurate  
14 calculations of recoverable -- I mean gas in place, and  
15 thereby determine recoverable gas?

16          A.    With the condition of these logs and some of the  
17 things that are going on geologically in this part of the  
18 Basin, I can give our engineer some risked net pay counts  
19 or estimates of pay with ranges of water saturations. But  
20 unlike in the main part of the Basin, we can pretty well  
21 pound our fist and say, This is how much net pay there is,  
22 this is what the volumetric reserves are going to be. It's  
23 very difficult to do down here.

24          Q.    How does that play a part in your conclusion  
25 about the 200 percent being the appropriate penalty factor

1 in terms of geologic risk?

2 A. Well, it plays a part in -- and I think this  
3 cross-section points it out -- in the other two wells in  
4 the cross-section on the right-hand side of the depth  
5 track, I've indicated where those wells have been  
6 perforated, and I've shown down at the bottom of the log  
7 portions of those wells both the Mancos-Dakota cumulative  
8 production history and how the Mesaverde was completed.

9 Our log doesn't look too different from the logs  
10 of those two wells, yet both of those wells, by our  
11 standards, and apparently by their operators' standards,  
12 are noneconomic wells.

13 Therefore, the -- We don't see that having the  
14 well data minimizes the risk, because part of -- The big  
15 problem is, how much gas is going to come out and where is  
16 all this water coming from? And that's where the logs  
17 aren't helping us, by telling us, avoid this zone,  
18 perforate this zone.

19 Q. When you look at the structural component in this  
20 area, does that play a part in your decision?

21 A. We don't believe so. We have -- The last map  
22 under Exhibit 5 is a structure contour map, and we have  
23 made a structure contour map through all these other wells  
24 that have had Mesaverde recompletion attempts made on them.

25 As in the other part -- the main part of the

1 Basin, the Mesaverde has stratigraphically trapped  
2 hydrocarbons in it, and we don't believe that structure  
3 plays a role in that.

4 What this map shows is, we are starting to get  
5 close to the east side of the east flank of the Basin, so  
6 we are seeing a component of west dip at this location,  
7 although it's not very much. But we don't think structure  
8 really plays a part in the hydrocarbon trapping here.

9 Q. You mentioned the possible risk of encountering  
10 water. Where would that water be encountered? In what  
11 portion of the Mesaverde?

12 A. Well, unfortunately that's the \$64,000 -- or  
13 whatever the cost is -- question. We were trying to look  
14 at this partly from a process-of-elimination standpoint.

15 Right now we're not sure whether the water that  
16 these other wells encountered is not coming from the  
17 Menefee or from the Menefee coals. We haven't been privy  
18 to any of the other analyses or any of the other data that  
19 those operators may have performed on the produced water.

20 But at this point we're not sure, and we're --  
21 When we originally proposed the well, we had a number of  
22 zones in the Menefee that we were going to perforate.

23 Our current position at the time of making this  
24 cross-section is, possibly that water is extraneous to the  
25 Cliffhouse and Point Lookout, and if we can stay out of the

1 Menefee, we might eliminate a lot of that water.

2 But we can't tell that from logs. We have to  
3 surmise that from some of the other operators' completion-  
4 attempt histories.

5 Q. And that's part of the risk involved in this  
6 process?

7 A. Absolutely.

8 MR. KELLAHIN: All right. That concludes my  
9 examination of Mr. Hobbs.

10 We move the introduction of his geologic displays  
11 behind Exhibit Tab Number 5.

12 EXAMINER STOGNER: Any objections?

13 MR. BRUCE: No.

14 EXAMINER STOGNER: Exhibit Number 5 will be  
15 admitted into evidence at this time.

16 Mr. Bruce, your witness.

17 CROSS-EXAMINATION

18 BY MR. BRUCE:

19 Q. Mr. Hobbs, looking at your Exhibit 5, the  
20 Gavilan-Howard Number 1, what does that well produce in the  
21 way of water?

22 A. Looking down at the bottom of that log --

23 MR. KELLAHIN: Let's make sure we're all looking  
24 at the right thing. You're looking at the cross-section,  
25 are you, Mr. Hobbs?

1 THE WITNESS: Yes, I'm looking at the cross-  
2 section. That should be the well on the left.

3 MR. KELLAHIN: That information --

4 THE WITNESS: Is that the well you're referring  
5 to?

6 MR. KELLAHIN: That information is shown at the  
7 bottom of the log section, is it not?

8 THE WITNESS: Yeah. That well's cumulative  
9 production -- Well, its initial production, it flowed 90  
10 MCF of gas a day, five barrels of oil per day, and that may  
11 have been condensate, and 133 barrels of water per day from  
12 the perforations as shown on the log.

13 From 1992 through 1993 that well has cum'd a half  
14 a million cubic feet of gas production, 200 barrels of oil  
15 and -- or 20 barrels of oil and 200 barrels of water -- and  
16 according to our records that well has been inactive since  
17 1994.

18 Q. (By Mr. Bruce) Did the high rates of water  
19 production affect its economics?

20 A. Yeah, the more water you produce, then you have  
21 the cost of disposing of the water.

22 And also that actually cuts down on the  
23 productivity of the gas. If the well -- Through the well's  
24 life, if the amount of water production remains constant,  
25 then as the gas portion of the reservoir starts depleting,

1 it is less able to lift that water. So then you have to  
2 start trying to pump the water, you know.

3 So it really has an overall negative effect on  
4 the gas productivity of the well.

5 Q. Now, what about the Gavilan Number 2? At what  
6 rate did that produce water? I notice that cumulative  
7 production figures show it produced quite a bit of water.

8 A. Yes, this well is a real puzzle, because they  
9 were even more limited in where they perforated. They just  
10 perforated the very upper part of the Point Lookout  
11 formation. They put a sand-water frac on the well.

12 The initial flow showed 600 MCF of gas a day, and  
13 they did not report any initial water production. But  
14 apparently through its life -- and it still is currently  
15 making approximately 5 MCF per day and zero oil, and I  
16 couldn't get a value on the water -- that well produced 50  
17 million cubic feet of gas, 400 barrels of oil, and 36,000  
18 barrels of water, which is probably 33,000 barrels over and  
19 above the amount of water they frac'd the well with.

20 So that water is coming out of the form- -- out  
21 of the wellbore somewhere. You know, whether it's coming  
22 out of the Point Lookout or the Menefee or -- That's part  
23 of the puzzle of trying to evaluate the potential in this  
24 area.

25 Q. One final thing, and maybe this is for the

1 engineer: Was any reserve study done for your proposed  
2 workover of the 2Y well?

3 A. I'm sorry, was a reserve study done?

4 Q. Yes.

5 A. Yes, we have to do that in-house whenever --

6 Q. Okay, is that the engineer's bailiwick?

7 A. Yes, yes. I'll pass the buck on to him.

8 MR. BRUCE: Then I have no further questions.

9 EXAMINER STOGNER: Mr. Bruce.

10 Mr. Kellahin, any redirect?

11 MR. KELLAHIN: No, sir.

12 EXAMINER STOGNER: I have no questions of this  
13 witness. He may be excused.

14 MR. KELLAHIN: Next witness, Mr. Examiner, is Mr.  
15 Curtis Newstrom. Mr. Newstrom is a petroleum engineer with  
16 Southland Royalty Company. He resides in Farmington.

17 CURTIS NEWSTROM,

18 the witness herein, after having been first duly sworn upon  
19 his oath, was examined and testified as follows:

20 DIRECT EXAMINATION

21 BY MR. KELLAHIN:

22 Q. Mr. Newstrom, for the record would you please  
23 state your name and occupation?

24 A. My name is Curtis Newstrom. I'm a petroleum  
25 engineer for Meridian Oil in Farmington, New Mexico.

1 Q. On prior occasions, Mr. Newstrom, have you  
2 testified before the Division and qualified as a petroleum  
3 engineering expert witness?

4 A. Yes, I have.

5 Q. Have you and Mr. Hobbs been part of the technical  
6 team that have analyzed the opportunity for Mesaverde  
7 production out of the Hill Federal 2Y well?

8 A. Yes, I have.

9 Q. As part of your duties, were you involved in  
10 analyzing and preparing recommendations for the plugging  
11 out of the Mancos and the recompletion attempt in the  
12 Mesaverde?

13 A. Yes.

14 Q. And as part of that process, are you aware of the  
15 anticipated costs that are proposed to be incurred for that  
16 activity?

17 A. Yes, I am.

18 MR. KELLAHIN: We tender Mr. Newstrom as an  
19 expert petroleum engineer.

20 EXAMINER STOGNER: Are there any objections? Mr.  
21 Newstrom is so qualified.

22 Q. (By Mr. Kellahin) Mr. Newstrom, let's turn to  
23 Exhibit Tab Number 6. Let's look specifically at -- Well,  
24 changed my mind.

25 Let's find the wellbore schematic. I think

1 that's a helpful place to start, and it was included behind  
2 Exhibit Tab Number 2, if you remember.

3 A. It's in Exhibit 7 by itself.

4 Q. Is it in 7 by itself?

5 A. Uh-huh.

6 Q. All right, let's turn to Exhibit 7, then, and  
7 let's look at the current status of the well and have you  
8 describe how it's currently configured.

9 A. On the left side of the schematic is the current  
10 situation. We have 2 3/8 tubing where we have produced the  
11 Mancos since 1985.

12 The proposed section on the right represents the  
13 wellbore after the recompletion with the cement retainer  
14 and cement effectively plugging off the Mancos formation  
15 and the proposed perforations in the Mesaverde formation.

16 Q. Do you concur with Mr. Hobbs that there is no  
17 further opportunity for production in this wellbore out of  
18 the Mancos formation?

19 A. Yes, I do.

20 Q. Do you also concur that its next best use is to  
21 attempt to test for production out of the Mesaverde, rather  
22 than simply plugging the well and abandoning the wellbore?

23 A. Yes, I do.

24 Q. What's the proposed activity, then, for the  
25 Mesaverde recompletion, starting first of all with how

1 you're going to plug out of the Mancos?

2 A. The plans to plug out of the Mancos are to  
3 squeeze off the existing perforations through a cement  
4 retainer and then recomplete uphole to the Mesaverde.

5 Q. As part of that activity, then, have you analyzed  
6 a proposed authority for expenditure for these estimated  
7 costs?

8 A. Yes, I have.

9 Q. And where will we find that tabulated in the  
10 exhibit book?

11 A. Under Exhibit Tab Number 6, we have a completion  
12 cost estimate as well as a facilities estimate for this  
13 proposed recompletion.

14 Q. All right, let's go through that and have you  
15 summarize for us. You don't have to look at each of the  
16 entries. Let's just talk about the totals.

17 A. The totals, \$250,000, in terms of total tangible  
18 and intangible costs for the recompletion, associated with  
19 the completion, all costs in there include the plugging out  
20 of the existing Mancos formation and recompleting to the --  
21 recompleting and testing the Mesaverde formation.

22 Q. In your opinion, are those fair and accurate and  
23 reasonable costs for this type of work?

24 A. Yes, they are.

25 Q. And do they represent reasonable estimates for

1 each of these particular activities?

2 A. Yes, they do.

3 Q. When you and the Southland personnel that  
4 actually undertake this activity -- You'll make some  
5 adjustments in the field or during the course of conducting  
6 this operation, and there may be some adjustments or  
7 changes; is that not true?

8 A. Yes, that is true.

9 Q. Based upon your current opinions, this is as  
10 accurate and reasonable as you can forecast for terms of  
11 asking owners to participate in these costs?

12 A. Yes, it is.

13 MR. KELLAHIN: That concludes my examination of  
14 Mr. Newstrom.

15 We move the introduction of Exhibits 6 and 7, Mr.  
16 Examiner.

17 EXAMINER STOGNER: Any objections?

18 MR. BRUCE: No, sir.

19 EXAMINER STOGNER: Exhibits 6 and 7 will be  
20 admitted into evidence.

21 Mr. Bruce, your witness.

22 CROSS-EXAMINATION

23 BY MR. BRUCE:

24 Q. What would the cost of drilling a new Mesaverde  
25 well be?

1           A.    We estimated -- Previously this year we estimated  
2 the cost to be around \$500,000, \$550,000, to drill a well  
3 to a similar depth.

4           Q.    Thanks.  What do you estimate the total  
5 production from the Mesaverde will be from this well?

6           A.    It's tough to say off the top of my head what our  
7 risked estimate for uplift would be.  I'd have to go back  
8 and look.  But just estimating, it would be on the order of  
9 250 to 500 MCF a day, initial production run.

10          Q.    And what about a cumulative production?

11          A.    In terms of overall reserves?

12          Q.    Yes.

13          A.    From the company's standpoint, we consider that  
14 to be proprietary information.  We've done our best to  
15 estimate reserves, but obviously there's some subjectivity  
16 involved.

17               MR. BRUCE:  I'd still ask that question, Mr.  
18 Examiner.  If necessary, clear the room and seal that.  But  
19 it's not attorney-client privilege, and I think my clients  
20 need that data in order to make an informed estimate as to  
21 whether or not to join in the well.

22               MR. KELLAHIN:  Mr. Examiner, I object.  That's  
23 proprietary to Meridian.  These interest owners have been  
24 provided all the technical data, they can make their own  
25 analysis of the risk involved in this process.

1 I'm sure Mr. Newstrom can describe for you the  
2 method and identify the issues of engineering concern. But  
3 to actually run or provide the internal economic  
4 calculations is of no benefit to the other interest owners  
5 and of no relevance to the Division.

6 And I'm happy to have Mr. --

7 MR. BRUCE: We're not asking for any economic  
8 data; I just want to know what Meridian or Southland  
9 Royalty thinks the well will cum.

10 EXAMINER STOGNER: I don't think such information  
11 is pertinent to this matter at this time on compulsory  
12 pooling matters. That very seldom ever comes up, of what a  
13 well -- what potential reserves are.

14 Obviously, there are some reserves that they're  
15 trying to go after, and that's the whole idea of compulsory  
16 pooling.

17 MR. BRUCE: Just for the record, Mr. Examiner, I  
18 would note that that would also apply to certain  
19 confidential geologic data that comes up in these hearings  
20 from time to time and that my clients have been required in  
21 the past to divulge.

22 Q. (By Mr. Bruce) Okay, Mr. Newstrom, will the well  
23 pay out?

24 A. Yes, by our estimations it will.

25 Q. Will it pay out cost plus 200 percent?

1 A. That's an uncertainty.

2 Q. Will it pay out cost plus 50 percent?

3 A. That's also an uncertainty. There's a tremendous  
4 amount of risk, both geologic and reservoir, associated  
5 with the project.

6 Q. So you think it will pay out, but beyond that you  
7 can't tell me?

8 A. Yeah, I mean, obviously we think there's enough  
9 potential to go after -- in this wellbore, to pursue  
10 testing the Mesaverde, but there is a considerable amount  
11 of risk.

12 Q. How much water do you think this well will  
13 produce per day?

14 A. We're hoping by -- through our analysis that  
15 we'll avoid water production completely.

16 Q. Okay. If it does produce water, how will that be  
17 disposed of?

18 A. We have a couple of different options. We have a  
19 saltwater disposal well in that area. More than likely,  
20 that would be the most prudent option, would be to dispose  
21 of the water in that well.

22 Q. Meridian has a saltwater disposal well?

23 A. Yes, sir.

24 Q. And would this well be charged for that disposal?

25 A. Would the cost to dispose of the water be

1 charged? Yes, sir, it would.

2 Q. Okay. What is the going rate for disposal  
3 charges?

4 A. I would have to check, and I wouldn't want to  
5 quote you a number. I would have to check on that.

6 MR. BRUCE: I would appreciate receiving that  
7 number.

8 Nothing further, Mr. Examiner.

9 EXAMINER STOGNER: Mr. Kellahin?

10 REDIRECT EXAMINATION

11 BY MR. KELLAHIN:

12 Q. From an engineer's perspective, identify for us  
13 the difficulties you have had and the conclusions you share  
14 with Mr. Hobbs about the risk involved.

15 A. Yeah, as Mr. Hobbs mentioned, the logs are  
16 suspect in this area, due to the condition of the hole  
17 during drilling. And so the information that's provided to  
18 me that I'm using to estimate my reserves, there is a lot  
19 of -- I have to build in a lot of assumptions and come up  
20 with my best estimate. But as he testified, there's a lot  
21 of uncertainty and a lot of risk associated with pursuing  
22 this.

23 MR. KELLAHIN: Okay, that concludes my  
24 examination of Mr. Newstrom.

25 EXAMINER STOGNER: Thank you.

1 MR. KELLAHIN: That concludes our presentation,  
2 Mr. Examiner, with the inclusion of what I will stamp as  
3 Meridian Exhibit Number 7. It's my certificate of  
4 notification.

5 EXAMINER STOGNER: I think you already have an  
6 Exhibit 7.

7 MR. KELLAHIN: I'm sorry, it should be Exhibit  
8 Number 9, Mr. Examiner.

9 EXAMINER STOGNER: For the record, Exhibit Number  
10 8 was a part of Exhibit 5. That was a geological cross-  
11 section, right?

12 MR. KELLAHIN: Yes, sir. And for clarity, I'm  
13 not sure we've admitted Exhibit 8.

14 EXAMINER STOGNER: If we haven't, I will go back  
15 and make it retroactive to the time that we admitted Number  
16 5, since it is a portion of that, so Exhibit Number 8 is  
17 admitted into evidence at this time.

18 And Exhibit Number 9, being the certificate of  
19 mailing compliance, will also be admitted into evidence at  
20 this time.

21 MR. KELLAHIN: That's all we have, Mr. Examiner.

22 EXAMINER STOGNER: I have no further questions of  
23 this witness. You may be excused.

24 MR. KELLAHIN: Unless there's questions from the  
25 Division, that's all I have to present, Mr. Examiner.

1 EXAMINER STOGNER: Mr. Bruce?

2 MR. BRUCE: I don't have any witnesses. I'd just  
3 like to make a very brief statement.

4 EXAMINER STOGNER: Okay, you may do that at this  
5 time.

6 MR. BRUCE: Mr. Examiner, my clients are in a  
7 dilemma. According to the testimony today, if they join  
8 they'll probably never recover their investment. If they  
9 don't join, they'll certainly never recover their  
10 investment, or receive anything from their interest.

11 I suppose there's two ways to look at this case.

12 If you listen to the geologist who says the risk  
13 is well in excess of 200 percent, frankly, the well isn't  
14 worth drilling, it's a waste of money. If you look at  
15 that, I think you have a reason to deny the Application;  
16 it's economic waste.

17 If it is worth drilling, I think you have to look  
18 at a couple of issues.

19 Mr. Goebel did start negotiations last July, but  
20 the only real offer letter was one in July, very few  
21 follow-up negotiations, never any offer for a farmout or  
22 purchase, which is standard in these cases. I just don't  
23 think there's been adequate negotiations between parties.

24 Assuming force-pooling is granted, the reason we  
25 are asking these gas-balancing questions, we think they

1 reflect on several issues.

2           According to my clients -- I've got a little  
3 letter to submit here -- It's been several years since this  
4 well has produced gas. It's taken Meridian/Southland  
5 Royalty that long to start cash balancing. We think this  
6 reflects on Southland Royalty Company's fitness as an  
7 operator. We also think it should be reflected in any  
8 penalty granted in a force-pooling order. And we would  
9 also suggest terms for the force-pooling order.

10           Because of gas-balancing issues, obviously, my  
11 clients might go quite some time without receiving their  
12 share of interest in the well. As a result, I would submit  
13 a letter signed by my clients which makes a few suggestions  
14 as to the overhead rates. We would suggest that you would  
15 choose the more economic of whatever Southland Royalty has  
16 proposed or the *Ernst and Whinney* rates.

17           And then you get down to the penalty.

18           Obviously, Southland Royalty refused to provide  
19 information where we could make a decision on what really  
20 is a fair penalty, based on engineering, based on well  
21 reserves. Penalties are based on equitable issues. We  
22 think that, all things considered in this case, if force  
23 pooling is granted, a substantially reduced penalty should  
24 be imposed, much lower than the normal 200 percent, just to  
25 provide all parties with a fair opportunity to recover some

1 and come off their interests.

2 Thank you.

3 And I would submit the Objectors' Exhibit A to  
4 this case. It's a letter signed by my clients, and I would  
5 just ask that it be made a part of the record.

6 EXAMINER STOGNER: Thank you, Mr. Bruce. Exhibit  
7 A, Objectors', Case 11,432, will be made part of the record  
8 in this case.

9 Mr. Kellahin, do you have anything at this time?

10 MR. KELLAHIN: I would like to comment on some of  
11 Mr. Bruce's observations.

12 It is Southland's opinion that Mr. Bruce's  
13 clients have been treated fairly. With regards to the  
14 overhead rates, you remember Mr. Van Goebel testified that  
15 they were taking the existing operating agreement, the  
16 existing rates, they were being escalated pursuant to the  
17 COPAS schedule, and the current rates he proposes to charge  
18 under the force-pooling order are equivalent to those rates  
19 that these interest owners are currently paying for a  
20 producing well when they're charged for the Mancos. We  
21 think that's fair and appropriate.

22 The fact that the schedule with *Ernst and Whinney*  
23 might be different is outside this issue, because we are  
24 dealing with an existing agreement for which we're simply  
25 trying to repeat the escalation.

1           The issue about gas balancing we have discussed  
2 this morning. We wanted to demonstrate to you that we are  
3 taking all appropriate action to respond to these parties'  
4 concern about gas balancing.

5           Mr. Bruce raises gas balancing apparently only  
6 recently through his clients. They criticize Southland for  
7 not initiating gas balancing earlier. But as we discussed  
8 earlier, Mr. Van Goebel says gas balancing does not occur  
9 until the wellbore has been plugged out of the Mancos.

10           Now, his clients could have asked that this  
11 wellbore be plugged out of this zone much earlier. They  
12 were participants under that agreement and could have  
13 initiated that process on their own. If there's been a  
14 delay, they've acquiesced in that delay.

15           We have proposed to them in writing, the July  
16 17th letter. Mr. Bruce is incorrect when he suggests that  
17 we are under some obligation to offer to purchase their  
18 interest, to provide them with additional compensation to  
19 farm out their interest. That is not required under New  
20 Mexico force pooling procedures. We have invited them the  
21 opportunity to pay their share.

22           This is a highly risky prospect. It is Meridian  
23 that is going to pay the \$250,000 worth of costs. If his  
24 clients consider it too risky, then they don't have to pay  
25 a thing. It's Meridian that's going to put their money up

1 front to do the prospect.

2 We think it's fair and reasonable, it's under the  
3 standard provisions of force pooling, and we would ask that  
4 you issue an order accordingly.

5 Thank you.

6 EXAMINER STOGNER: Does anybody else have  
7 anything further in Case Number 11,432 at this time?

8 This case will be taken under advisement.

9 (Thereupon, these proceedings were concluded at  
10 10:07 a.m.)

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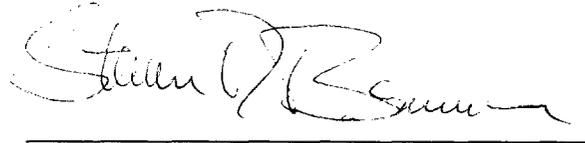
CERTIFICATE OF REPORTER

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 December 9th, 1995.



STEVEN T. BRENNER  
CCR No. 7

My commission expires: October 14, 1998

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 11432, heard by me on 7 December 1995.



, Examiner  
Oil Conservation Division