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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION
CASE 10112 and CASE 10113

EXAMINER HEARING

IN THE MATTER OF:

Application of Maralex Resources, Inc.,
for Compulsory Pooling, San Juan County,
New Mexico.

Application of Maralex Resources, Inc.,
for Compulsory Pooling, San Juan County,
New Mexico.

TRANSCRIPT OF PROCEEDINGS

BEFORE: JIM MORROW, EXAMINER

STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO
October 3, 1990

ORIGINAL

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FOR THE DIVISION:

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FOR THE APPLICANT:

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1 EXAMINER MORROW: Call Case 10112.

2 MR. STOVALL: Application of Maralex
3 Resources, Inc., for compulsory pooling, San Juan
4 County, New Mexico.

5 EXAMINER MORROW: Any appearances?

6 MR. O'HARE: My name is Mickey O'Hare. I'm
7 representing the Applicant.

8 EXAMINER MORROW: All right. Mr. O'Hare, I
9 would point out this was an administrative
10 application, and the operator had requested a
11 200-percent-risk penalty, which is higher than is
12 usually authorized in this field.

13 This case was advertised with the
14 Division-recommended 156 percent penalty.

15 So with that background, you may go ahead
16 and proceed, sir.

17 MR. O'HARE: Thank you. I've come to
18 provide a little more evidence and testimony to
19 support the 200 percent nonconsent penalty, for both
20 Case 10112 and Case 10113, and recommend that they be
21 combined.

22 EXAMINER MORROW: All right, we'll call
23 Case 10113.

24 MR. STOVALL: Application of Maralex
25 Resources, Inc., for compulsory pooling, San Juan

1 County, New Mexico.

2 EXAMINER MORROW: What was your name again,
3 sir?

4 MR. O'HARE: Mickey O'Hare.

5 EXAMINER MORROW: All right, go ahead, Mr.
6 O'Hare.

7 MR. O'HARE: I haven't previously testified
8 before the Division and would like to qualify myself
9 as an expert witness under the discipline of petroleum
10 engineering.

11 EXAMINER MORROW: Go ahead, sir.

12 THE WITNESS: I received a Bachelor of
13 Science degree from the New Mexico Institute of Mining
14 and Technology and went to work for Amoco Production
15 Company in their Four Corners District in Farmington,
16 New Mexico, in 1981, where I became involved in their
17 very early attempts at coal bed methane production,
18 exploration and development. I worked in Farmington
19 for four years, and drilled and completed some of the
20 early wells in the Cedar Hill Field, as well as the
21 first wells that Amoco drilled in the Piance Basin and
22 the Raton Basin. I also drilled the first
23 Amoco-operated coal bed methane wells in the Ignacio
24 area of Colorado.

25 In 1985 I was transferred to their Denver

1 office where I was assigned to the reservoir group,
2 and participated in their early attempts at reservoir
3 simulation of the Cedar Hill Field.

4 I joined the National Cooperative Refinery
5 Association in January of 1987, where I was a district
6 engineer over their Four Corners and Midland
7 Districts. Under my direction and supervision and
8 recommendations, NCRA developed their Ignacio
9 Fruitland Coal bed methane reserves under two separate
10 Indian leases, Southern Ute Indian tribal leases.

11 In January of this year I left NCRA and
12 co-founded Maralex Resources, Incorporated, and
13 currently serve as president of the company. I am a
14 Registered Professional Engineer in the state of
15 Colorado.

16 EXAMINER MORROW: We accept your
17 qualifications.

18 THE WITNESS: Thank you. Do I need to be
19 sworn in?

20 EXAMINER MORROW: Yes, you need to be sworn
21 in.

22 A. M. "MICKEY" O'HARE, P.E.

23 The witness herein, after having been first duly sworn
24 upon his oath, testified as follows:

25 THE WITNESS: As you stated, Mr. Examiner,

1 we did receive a letter from the Division stating that
2 the precedent had been set for 156 percent risk
3 penalty for the Fruitland Coal Bed Methane production
4 from the San Juan Basin. The primary thrust of our
5 argument today is going to be that that 156 percent,
6 or any set risk penalty applied across the basin, is
7 not equitable as it does not provide comparable
8 economics in terms of payouts, rate of returns, and
9 present worth at 15.

10 I have prepared Exhibit #10 to help clarify
11 that position and illustrate it. This exhibit shows
12 that the economics from one area of the San Juan Basin
13 varies very drastically to the next area of the San
14 Juan Basin. Our little project happens to be in an
15 area of the basin that is not as economically
16 attractive as certain other areas in the basin.

17 The Cedar Hill Field currently can be
18 developed at capital costs of about \$400,000. Initial
19 operating costs in that field currently run about
20 \$2,500 per month. On low end, initial rates from that
21 field will average about 500 Mcf a day, and we have
22 shown a peak rate of a million a day. There have been
23 some wells in the field that have produced up to two
24 million cubic feet of gas a day.

25 The payouts, using those numbers, is about

1 11.9 months. The present worth at 15, discounted 15
2 percent, is about \$310,000, and that is assuming a
3 risk penalty of 156 percent. After that--in other
4 words, after the operator obtains that return on
5 investment of 156 percent, he no longer has any
6 interest in the well. Those economics result in an
7 internal rate of return of 56.9 percent.

8 Going to Meridian's 30-6 Unit, capital
9 costs can run as high as \$800,000 including disposal
10 and compression costs. Initial operating costs are as
11 high, in fact sometimes higher than \$3,500 a month,
12 but their initial rates, again on the low end, average
13 somewhere around two million cubic feet of gas a day,
14 and we're showing a low-end peak rate of four million
15 a day. Again, there are wells in that unit that are
16 producing in excess of 20 million cubic feet of gas a
17 day.

18 The payout for what we've shown here is, a
19 low-case average well, is only 9.4 months; discounted
20 present worth at 15 percent is \$666,000. Again,
21 assuming a risk penalty of 156 percent and no interest
22 in the well after that return on investment has been
23 garnered by the operator. The internal rate of return
24 for that same project, individual well in that
25 project, is better than 66 percent.

1 In the Ignacio area of Colorado, we're
2 looking at again capital costs on the order of
3 \$800,000, including a deep disposal well and
4 compression costs. Operating costs initially are
5 about \$2,500 a month; initial rates are about 500 Mcf
6 a day and peak rates may be as good as a million cubic
7 feet of gas a day. The payoff for that project is
8 about 30.7 months. Discounted present worth at 15
9 percent is \$333,000, and the internal rate of return
10 is about 28 percent.

11 For our Aztec area project, we have
12 projected capital costs of \$236,000. This is assuming
13 that the wells produce essentially dry and that they
14 do not have to be compressed to get into the
15 low-pressure line systems in the area. Our operating
16 costs are lower than the other areas at \$1,200 a
17 month, but our initial rates are also significantly
18 lower than the other areas. We're looking at what we
19 consider an optimistic rate of 100 Mcf a day with a
20 peak rate of 200 a day. That generates a payout of 44
21 months, a discounted present worth at 15 percent of
22 \$50,000 and an internal rate of return of almost 21
23 percent.

24 Now, this table was prepared more for
25 comparison sake than to give an actual representation

1 of averages from these different areas. In other
2 words, we may have new wells that we haven't taken
3 into account here that could significantly alter the
4 rates and the economics that we've shown here. But
5 the point is that the 156-percent penalty assessed
6 across the basin does not generate an equitable
7 economic situation for our area of the basin.

8 The other point I want to make is that none
9 of these economics are risked, so what we're saying in
10 the Aztec area is even though we're showing a
11 20-percent internal rate of return, if you apply a
12 risk factor to that, we may be looking at as low as a
13 10 percent rate of return.

14 Exhibit 11 shows the projected economics we
15 have for the well in the southwest quarter of Section
16 17. There is a typo on this page calling it the Price
17 No. 1. It would actually be the Price No. 2 well.

18 These economics assume that the risk
19 penalty is what Maralex had requested, 200 percent.
20 Again, it uses the initial rate of 100 Mcf a day and
21 peak rate of 200 a day; a gas price of \$1.50 per Mcf,
22 and it also assumes that the interest that Maralex
23 owns in the area was tied up through a farmout
24 agreement, so it does include the terms of that
25 farmout agreement.

1 This results in a payout of 44 months,
2 discounted present worth at 15 percent of \$67,000; and
3 internal rate of return of 20.9 percent. Again, there
4 is another typo here. That should be 2.0 for that
5 return on investment rather the 2.9 shown, to come up
6 with the 200-percent risk penalty.

7 The additional assumptions made to generate
8 these economics include the \$1,200 per month operating
9 costs initially with those costs decreasing to \$700
10 per month after the third year and then escalating at
11 a rate of five percent per year thereafter. Again,
12 there has been no risk factor incorporated in these
13 economics.

14 What we're saying is that the immediate
15 offset to this well is called the Simmons No. 1 in the
16 northwest quarter of Section 17 operated by Meridian.
17 In our application for compulsory pooling we noted
18 that that well is currently producing about 65 Mcf a
19 day, and we are basing our projections on an
20 assumption that we can improve those rates to 100 Mcf
21 a day through proper treatment techniques in the
22 Fruitland Coal zone.

23 EXAMINATION

24 BY EXAMINER MORROW:

25 Q. What interest do you have in these two?

1 What is your working interest in these two?

2 A. We will have about 38 percent of these two
3 wellbores. Some of that was actually purchased
4 outright and the remainder was through farmout
5 agreements, but it was a small interest that was
6 purchased.

7 Q. In the 10112, you had an either/or
8 proposal. How would you plan to sort out the cost in
9 that operation?

10 A. The first thing we had planned on doing was
11 going into that Brimhall No. 1 well, pulling the
12 tubing and running a casing inspection log and a
13 cement bond log to determine the condition of the
14 wellbore. And those costs have not been included in
15 the \$235,750 that we had AFE'd to the partners. So
16 those would be additional costs.

17 If the wellbore is in a usable state, then
18 we would be able to include those costs in the AFE for
19 the recompletion attempt.

20 Q. The \$235,000 is for the recompletion?

21 A. \$235,000 is for the drilling of a new well.
22 The recompletion attempt, I believe, was \$140,000.

23 Q. You proposed all this at once? You plan to
24 propose it, first give them an opportunity to
25 participate in the recompletion, and then--

1 A. We gave them an and/or type of proposal,
2 all the partners in here, and essentially everybody
3 came back and said the risk is high enough to warrant
4 not doing anything, apparently.

5 Q. Are these two wells in the Aztec area?

6 A. That's right. They're right outside the
7 town of Aztec.

8 EXAMINER STOGNER: Mike, you reviewed
9 these. Do you have questions to ask?

10 MR. STOGNER: I do not have any questions
11 on Exhibits 10 or 11.

12 EXAMINER MORROW: Anything further, sir?
13 Or, Bob, you may have some questions?

14 MR. STOVALL: No, I don't have any
15 questions.

16 MR. O'HARE: That's the end of our
17 testimony.

18 EXAMINER MORROW: Cases 10112 and 10113
19 will be taken under advisement.

20 (Thereupon, the proceedings concluded.)

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CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

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.

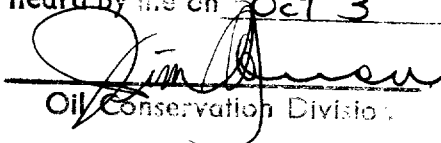
I FURTHER CERTIFY that I am not a relative
or employee of any of the parties or attorneys
involved in this matter and that I have no personal
interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL October 15, 1990.


CARLA DIANE RODRIGUEZ
CSR No. 91

My commission expires: May 25, 1991

I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. 10112 + 10113
heard by me on Oct 3 1990.


Examiner
Oil Conservation Division