STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BLDG.
SANTA FE, NEW MEXICO

9 January 1986

EXAMINER HEARING

IN THE MATTER OF:

Application of TXO Production Corp. for compulsory pooling, Lea County, New Mexico.	CASE 8783 8755

BEFORE: Michael E. Stogner, Examiner

TRANSCRIPT OF HEARING

A P P E A R A N C E S

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I N D E X

I N D E X CONT'D

E X H I B I T S

MR. STOGNER: This hearing will come to order.

I'm Michael E. Stogner. I'm the alternate examiner for today.

We will now call Cases Numbers 8783 and 8755. Before the hearing the applicant asked that these two cases be consolidated.

Are there any objections to these cases being consolidated at this time?

MR. KELLAHIN: No objection.

MR. STOGNER: We will now call Case Number 8783, which is the application of TXO Production Corporation for compulsory pooling, Lea County, New Mexico.

Case Number 8755 is the application of TXO Production Corporation for compulsory pooling, Lea County, New Mexico.

Case Number 8755 was heard on November 21st, 1985, and was continued to the Examiner's Hearing scheduled for December 16th. At that time it was continued to today.

We will call for appearances in both of these matters.

MR. DICKERSON: Mr. Stogner, I'm Chad Dickerson in Artesia, New Mexico, representing the

applicant, and I have three witnesses.

MR. STOGNER: Other appearances?

MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin, Santa Fe, New Mexico, appearing on behalf of Joseph S. Sprinkle.

I have one witness to be sworn.

MR. STOGNER: Are there any other appearances in this matter?

Will all witnesses please stand and be sworn at this time?

(Witnesses sworn.)

MR. STOGNER: Mr. Dickerson?

JEFF BOURGEOIS,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Bourgeois, will you state your name, your occupation, and by whom you're employed, please?

A My name is Jeff Bourgeois. I'm a petro-

leum landman with TXO Production Corp.

Q And you have previously and very recently testified and qualified as a landman before this Division?

A Yes, I have.

Q And are you familiar with the application in Case 8783?

A Yes.

MR. DICKERSON: Mr. Examiner, is this witness qualified?

MR. STOGNER: Are there any objections?

MR. KELLAHIN: No objection.

MR. STOGNER: Okay, Mr. Bourgeois is so qualified.

Q Mr. Bourgeois, will you refer to what we have marked as Exhibit Number One and describe what that plat shows for the Examiner, and summarize the purpose of TXO's application in Case 8783?

A Okay. The purpose of TXO's application in Case Number 8783 is that TXO is seeking an order pooling all mineral interests in all formations from a depth of 4825 feet beneath the surface down to the base of the Bone Spring formation, at approximately 8700 feet in the southeast quarter of the northwest quarter of Section 26, Township 18 South, Range 32 East, Lea County, New Mexico.

TXO also seeks in this order the cost of drilling and completing said well and allocation of the cost, and charges to be invoked for the operating costs and charges for supervision, as well as a risk penalty involved in this well.

Q Mr. Bourgeois, on your Exhibit Number One, what is the significance of the circle indicated on that map?

A The circle is the proposed location, located 2310 feet from the north line and 1650 feet from the west line.

The yellow outline indicates the proration unit to be dedicated to this well.

Q Now relate that to the Examiner, that is a direct east offset, is it not, to the Sprinkle No. 3 Well, with which case this Case Number 8783 is consolidated?

A Yes.

MR. DICKERSON: Mr. Examiner, for purposes of this hearing I don't really think it's necessary that you take administrative notice of what went on in the previous testimony, but to refresh your memory and mine, I think that TXO put on its entire case in Case 8755, involving the Sprinkle No. 3 Well.

Much of the testimony is common. All four of these wells which are concerned with the

problems which exist between Mr. Sprinkle and TXO are located, of course, in the same 160-acre quarter section and to the extent that the testimony is any different, we're going to offer a small amount of testimony today, but we would request that the testimony that is the same be utilized in this Case 8783 with the same effect as if we reintroduced it all.

MR. STOGNER: Thank you, Mr. Dickerson.

To make the record clear, I will take administrative notice of Case 8755, which is also made consolidated today with this case for purposes of testimony.

Thank you, Mr. Dickerson.

Q Mr. Bourgeois, refer, please, to what we've marked Exhibit Number Two and tell the examiner what that is.

A Exhibit Number Two is copies of correspondence proposing the drilling of the Sprinkle Federal No. 4 to the three parties at the time of the letter whose interests were uncommitted as to the 40-acre proration unit in question.

Q And that is the letter dated November 11th, 1985?

A Yes, it is, and also attached are the

certified mail receipts.

Q Now what are the -- or what is the status of those three parties' interest as far as this case is presently concerned?

A Mr. J. Cecil Rhodes has agreed to pool his interest and participate with TXO in the drilling of the Sprinkle No. 4.

Mr. Joseph Sprinkle and Mr. Lewis Burleson have not agreed to pool their interest and therefore, we're having this hearing.

Q The interest of all of those parties, in fact of all parties, is the same in both the Sprinkle No. 3 Well and the Sprinkle No. 4 Well, are they not?

A That's correct.

Q And for the record, once again, what is the interest of Mr. Sprinkle in this well?

A Mr. Sprinkle owns a 31.25 percent interest and Mr. Burleson owns a 1.30209 percent interest.

Q Will you refer to the AFE's under the names of each of these parties and compare that AFE to the AFE previously introduced in evidence in the Sprinkle No. 3 Well? Are those the same documents?

A Yes, with the appropriate changes in the heading as far as well name and location.

Q But the facts or the figures regarding

estimated well costs are the same in both instruments?

A Yes.

Q And the interests of the parties are all the same.

A Yes.

Q Mr. Bourgeois, what is TXO requesting regarding supervision and overhead rates in the No. 4 Well case?

A TXO is requesting that the following rates be used for the overhead charges: $5,374 per month for a drilling well rate and $538 per month as a producing well rate.

Q Now, have those requested rates been the subject of prior approval by this Division in any cases?

A Yes, they have.

Q And what well was that?

A It was the TXO Sprinkle Federal No. 2 Well.

Q And that was Case 8698, was it not?

A That's correct.

Q Mr. Bourgeois, refer to your Exhibit Number Three and describe what you've shown on that exhibit.

A This is just the AFE for the TXO Sprinkle Federal No. 4 Well, which shows dry hole cost at $286,050 and completed well cost at $615,550.

Q And that again, with the exception of the heading making it applicable to the No. 4 Well, is the same document that was previously introduced for the No. 3 Well?

A Yes.

MR. DICKERSON: Mr. Examiner, at this time move admission of TXO Exhibits One, Two, and Three.

MR. STOGNER: Exhibits One, Two, and Three will be admitted into evidence at this time.

MR. DICKERSON: And I have no further questions at this time of Mr. Bourgeois.

MR. STOGNER: Thank you, Mr. Dickerson.

Mr. Kellahin, your witness.

MR. KELLAHIN: Thank you, Mr. Examiner.

CROSS EXAMINATION

BY MR. KELLAHIN:

Q Let me direct your attention, Mr. Bourgeois, to the APE's first.

Let's see if I can refresh my memory and have you tell me if my recollection is correct about your prior testimony.

In the northwest quarter of the section

that we're dealing with, Section 26, Mr. Sprinkle has the same 31.25 percent interest for each of the 40-acre tracts that compose that quarter section?

A In the depths we're concerned with, yes.

Q All right. And we're confining ourselves here to the Bone Springs production that's spaced on 40-acre oil production, is it not?

A That, as well as any other producing formation encountered from 4825 on down through the base of the Bone Spring.

Q For purposes of the Bone Springs, the Sprinkle No. 1 Well in Unit letter D in the northwest of the northwest of 26, that was the first Sprinkle well, was it not?

A Right.

Q And that is the well that first established Bone Springs production in the immdiate area, as far as this quarter section goes?

A Yeah.

Q All right. At the -- that was a forced pooling case, also, was it not?

A Yes, it was.

Q All right, let's look and find the No. 2 Sprinkle Well. That's in Unit letter C of this section, is it not?

A That's correct.

Q And that also was a forced pooling case?

A That's correct.

Q In that forced pooling case for the No. 2 Well, do you recall, Mr. Bourgeois, what the estimated well costs were that you provided Mr. Sprinkle and the Commission for that well?

A I believe it was in the range of this same $615,000.

Q All right. When we look at this AFE, is this not the same total completed well cost number for the No. 4 Well that was used for the No. 3 Well? I'm sorry, the No. 2 Well?

I want to compare the No. 4 right now --

A To the No. 2?

Q -- to the No. 2. Your recollection is that the No. 2 was about the same number?

A Yes.

Q All right. Is there any document that you have available to you that will refresh your recollection?

A Yes, I have one here in front of me now.

Q That's for the No. 2?

A Yes. And there is a $300 difference and the Sprinkle Federal No. 2 AFE bottom line was $615,250.

Q All right, sir. Do you know what the actual completed well costs were for that well, including all the equipment necessary to produce oil into the tank?

A For the No. 2?

Q Yes, sir.

A To the best of my knowledge, all of our invoices have not been received from work we've had done on that well but I've been told that the completed well costs will be in the range of $480-to-500,000.

Q On the No. 3 Well, which is the subject of the hearing we started in November 21st, do you have a copy of the AFE for that well, Mr. Bourgeois, in which you could tell us what the estimated well costs for that well were?

A Yes. They are identical to the well costs shown on the AFE for the No. 4 Well.

Q Let's look at the ownership plat, Exhibit Number One which you have submitted today, and let me direct your attention to Section 26, to the well located in Unit letter B. I believe that's the Burleson Federal Well No. 3?

A Well No. 1.

Q All right, sir. Is there a Burleson Federal Well No. 3?

A It has been proposed but drilling operations have not been commenced.

Q All right. Let's look at the northeast quarter of the Section 26, and would you number for me, sir, the wells by name or as proposed to be named for that quarter section?

A Okay.

Q In Unit letter A?

A Unit letter A would be the Burleson Federal No. 2 --

Q All right.

A -- proposed location. The Unit letter F, Burleson Federal No. 3; Unit letter G, Burleson Federal No. 4.

Q Okay. And how about Unit letter B? That is already a Burleson No. 1?

A Yes.

Q Okay.

MR. STOGNER: Excuse me, before we go any further, let's back up to Unit letter A, being the No. 2 Well, is that correct?

A Yes.

MR. STOGNER: All right, now you mentioned a --

A Yes, A is No. 2.

MR. STOGNER: Okay.

A I may have them -- it's G and H.

Q The No. 3 is going to be G.

A And the 4 will be Unit letter H.

Q So when we look at the Burleson 3, that's the immediate 40-acre east offset to the Sprinkle 4.

A Yes.

Q All right. Is the Burleson No. 3 well, the offset to the Sprinkle 4 Well, is that also intended to be a Bone Springs test?

A Yes, it is.

Q Mr. Bourgeois, I have marked Sprinkle Exhibit Number One, a letter that purports to be over your signature to Mr. Burleson, dated October 29th, 1985.

In addition, I have attached to that exhibit another letter purportedly over your signature to Mr. Burleson dated December 9th, 1985.

Finally, I've attached an enclosure to that second letter which is purported to be an AFE for the Burleson Federal No. 3 Well.

I show you these Xeroxed copies of Exhibit Number One and those letters and ask you if you can identify those?

A Yes, I'm familiar with these letters.

Q Are those three pages true and correct copies of the originals that you prepared and executed?

A Yes.

Q All right, sir.

MR. KELLAHIN: Mr. Examiner, we'd move the introduction of Sprinkle Exhibit Number One.

MR. STOGNER: Mr. Kellahin, is Sprinkle Exhibit Number One consist of three pages here?

MR. KELLAHIN: Yes, sir, it does.

MR. STOGNER: Have there been copies issued to the -- TXO?

MR. KELLAHIN: That's my only copy. I'll be happy to make additional copies if the examiner wants me to at this time. That's the only copy I have.

MR. STOGNER: Mr. Dickerson, I will hand them to you and see if there's any objection.

MR. DICKERSON: We have no objection.

MR. STOGNER: At a later date when we take a recess why don't we get some copies made of it.

All right, at this time Sprinkle Exhibit One will be admitted into evidence.

Q Do you recall, Mr. Bourgeois, what the completed well costs were estimated to be for the Burleson Federal No. 3 Well?

A As on that exhibit, it's $496,000, rough-

ly.

Q Have you prepared or caused to be prepared other AFE's for other Bone Springs wells in this immediate area other than the ones that we have just talked about?

A Yes, there have been AFE's prepared on the three remaining Burleson Federal wells that we discussed earlier.

MR. DICKERSON: Mr. Kellahin, I might say that since we seem to be making an issue of this, I had neglected -- had not intended to call him, but it now appears that we will need to call Mr. Cate, who did prepared the AFE, and he might be able to testify more fully, if you'd like to ask him.

MR. KELLAHIN: Well, let me ask Mr. Bourgeois.

Q Mr. Bourgeois, you have represented in your direct testimony that the Commission should adopt as the estimated reasonable cost for the pooling order an AFE for the No. 1 -- for the No. 4 Well, $615,000+.

Can you explain to us why you've recommended that as the AFE cost when the direct 40-acre offset for a similar Bone Springs well is only $496,000?

A There are several explanations for that, and Mr. Cate will get into that later, but I would like to

state briefly, the ownership in the Sprinkle wells varies from well to well, therefore creating the necessity of the separate tank batteries per location.

On the Burleson tract there is common ownership in all four wells, therefore allowing the use of only one tank battery.

Therefore the storage facilities that's listed in the AFE provide for separate storage facilities on all four of the Sprinkle wells, and the inclusion of a pumping unit in the Sprinkle wells, also accounts for some of the price differentiation.

Q Let me direct your attention to the types of offers made to Mr. Sprinkle with regards to the Sprinkls wells, Mr. Bourgeois.

A Okay.

Q Let's go back and run through in sequence the offer.

Your Exhibit Number Two here represents the offer on the No. 4 Well in terms of a farmout agreement from Mr. Sprinkle to TXO, does it not?

A Yes.

Q And it sets forth terms that would establish that under the terms of the farmout TXO would receive out of the Sprinkle interest a net 75 percent revenue lease.

A That's correct.

Q All right. When we go back to the original well that was proposed, the No. 1 Well, before any of the Bone Springs wells were drilled, was that not the same offer in terms of a farmout that you gave Mr. Sprinkle then for the No. 1 Well?

A Yes, it was.

Q And for the No. 2 Well, the farmout offer remains the same?

A Yes.

Q And for the No. 3 Well it remains the same?

A Yes.

Q And for the No. 4 Well it remains the same.

A Yes.

Q In terms of a farmout proposal by your company, have you offered anyone else in this immediate area for this Bone Springs play any more -- any more favorable farmout terms than you are proposing to Mr. Sprinkle?

A No.

Q In terms of other opportunities or ways to reach a voluntary agreement, Mr. Bourgeois, have you tendered or proposed to Mr. Sprinkle any cash offer for his interest in the quarter section?

A Yes, we have.

Q Do you recall, sir, what the amount of money, approximately, was that you've offered for his interest?

A We made several offers. The largest offer from TXO, to the best of my recollection, was approximately $105,000, and at that point it was not agreeable with Mr. Sprinkle and we have not countered with a larger cash offer.

Q Have you offered anyone else in the immediate area with a leasehold interest any other cash offers that exceed the offer that you made to Mr. Sprinkle in relation to the interests involved?

A TXO purchased or is in the process of purchasing the interest of Mr. O. H. Berry, a leasehold interest in this quarter section of 1.30208 percent, on the basis of $7500 a working interest percentage.

Q Apart from Mr. Berry, Mr. Bourgeois, have you made anyone else in this immediate area any cash offers that exceed the offer that you made to Mr. Sprinkle?

A Not that would exceed that, no.

Q One other area, Mr. Bourgeois, to refresh the Examiner's recollection, the drilling commitments that TXO has obligated itself for the northwest quarter, in terms of its farmout of that acreage, if I recall your testimony,

provide for a ninety day continuous drilling provision after the completion of one well and the commencement of the next, is that correct?

A That's correct.

Q All right. In terms of the sequence of events, Mr. Bourgeois, what is the commencement date that is required of your company for the commencement of the No. 3 Well, which I believe is the next well in sequence?

A The No. 3 Well is the next well in sequence. We have calculated that date to be March 19th, which is greater than ninety days. The farm-in agreements that created this continuous development obligation provide that TXO shall be granted cumulative credit for faster drilling and with the spudding of the Sprinkle Federal No. 2 before the full ninety days was used, we can therefore credit that to our time clock for the spud date of the Sprinkle Federal No. 3 Well.

Q Can you tell us, Mr. Bourgeois, when you woudl anticipate having to commence the No. 4 Sprinkle Well in order to comply with your ninety day continuous development provisions in your farmout agreements?

A The No. 4 would be ninety days following the completion of the No. 3 Well.

Q Do you have an understanding of what the approximate length of reasonable time is between the com-

mencement and the completion of a Bone Springs well like this?

A Approximately 20, 25 days.

Q I'm not going to hold you to firm number; just an approximation in the sequence of events.

A Okay.

MR. KELLAHIN: Thank you, Mr. Examiner.

MR. STOGNER: Mr. Dickerson, any redirect?

MR. DICKERSON: Yes, Mr. Examiner.

REDIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Bourgeois, you briefly described the reason behind the substantial differences between the AFE's for the proposed Burleson wells and for these proposed Sprinkle wells.

Now, as I understand it, the underlying title to all of the northwest quarter is the same, is it not?

A That's correct.

Q But the difference -- will you explain for the Examiner a little bit what occurred to create a dif-

ference in actual ownership of the production which you testified necessitates a separate tank battery for each well?

A The forced pooling hearings that we've had on all the wells up to this point have created a case where different parties are force pooled in different wells and different parties have participated in different wells, and therefore, jumbling the interest up so that each well has different parties that own the working interest and the royalties.

Q Now let me tell you, Mr. Bourgeois, that I think that under our rules a forced pooling order in and of itself does not necessitate a separate tank battery. So I'm wondering can you describe a little bit more in each of those wells, and we may like to document this, Mr. Examiner, to the extent it would be useful to you, but in each of those wells, as I understand your testimony, some parties have participated in one well and farmed out in the next well, or something of that nature?

A On the farm-in agreements all the three parties who farmed out to TXO had the opportunity to take a back-in working interest at payout in the first well, and should be commence the drilling of a second well prior to payout from the first well, they would then have an election as to take their working interest in the remaining acreage of the farm-in area.

Of the three parties, one elected to keep their working interest; the other two elected to retain their overriding royalty interest, and a party who was force pooled in the No. 1 Well, namely Mr. Rhodes, joined in the No. 2 Well, and the situation is the same as Mr. Sprinkle's, pooled in the No. 1, and participated in the No. 2.

Q So that by itself made the title to the production from those two wells different --

A Right.

Q -- regardless of the pooling.

A That's correct.

Q So a pooling order in and of itself might require that the operator establish some means to separately measure the production from each well so as to be able to allocate the income to each well, but regardless of the pooling order, the title to the underlying production as the circumstances have developed, appear to going to be different in each of these four wells.

A Correct.

Q Mr. Kellahin asked you about a farmout offer and whether or not you had made any terms, made any offers more favorable to third parties than you had offered to Mr. Sprinkle in this and the preceding cases. I think you answered that you had not, is that correct?

A Correct.

Q Is it your experience as a landman negotiating trades and farmout agreements with other working interest owners that there is any advantage or disadvantage between the offering party, TXO in this instance, being consistent with all its operating co-tenants in making deals?

A I'm not sure I understood your question.

Q Well, you do not -- do you customarily make an arrangement with one party which is substantially more favorable or less favorable than you offered to somebody else?

A No.

Q And that would be just a matter of good business practice and makes it a little easier to get along with people if you treat everybody the same?

A Yes.

Q Now you did say, I think, that in one instance, at least, you had offered based on percentage, a relatively substantially higher cash offer to buy a small interest owner out than you had offered to purchase Mr. Sprinkle's interest, is that correct?

A That's correct.

Q What, if you know, would be the basis for TXO being willing to pay relatively more for a small interest and not for an interest that you testified was slightly in excess of one percent of the working interest and not for

one at the same relative price, such as Mr. Sprinkle's, which is 31.25 percent?

A It's relative to the overall cash exposure that TXO would face, you know, if they would have made that same offer to Mr. Sprinkle; quite a bit more money, and with the risk involved, our management did not want to make that kind of offer on that large an interest at this time.

Q So it's really comparable, would it not be, to the fact that square footage frontage for business purposes customarily brings a much higher per unit of area price than larger tracts of land.

A Right.

Q Did Mr. Sprinkle propose any counter offer to TXO at which price he would sell his interest in the northwest quarter of Section 26?

A Mr. Sprinkle did tender an offer to TXO which included his interest in the northwest as well as interest outside of that quarter section.

Q Do you know what that offer was?

A The offer was comprised of $1.2-million cash and a refund of his prepayment of $192,000 on the Sprinkle Federal No. 2, a 1.392-million.

Q Was TXO willing to accept that offer?

A No.

Q Do you have any knowledge yourself through any sources, Mr. Bourgeois, regarding any other activities by Mr. Sprinkle attempting to sell his interest in this acreage to third parties?

A I'm aware that he had made offers, or has contacted other parties concernign the sale of his interest in this area.

Q And do you know whether or not it's on the same terms as he offered to sell to TXO?

A I have no idea.

Q To your knowledge, have any of those third parties advised you, TXO, that they have accepted Mr. Sprinkle's offer?

A None that I know of have accepted the offer.

Q It would be reasonable for us to assume, wouldn't it, that none have, since Mr. Sprinkle is still involved in this proceeding?

A I would think that would be a fair assumption.

MR. DICKERSON: I have no further questions.

MR. STOGNER: Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Examiner.

RECROSS EXAMINATION

BY MR. KELLAHIN:

Q Mr. Bourgeois, is your practice or your company's policy to offer the same terms for acreage that has producing Bone Springs on it as opposed to acreage that is unexplored and undeveloped on the Bone Springs?

A Yes. That is an offer that we make on HBP acreage.

Q So you would make the same offer for rank wildcat Bone Springs as you would make if there was established production by two commerically producing oil wells in direct 40-acre offsets to the locations.

A No, we do not consider this area rank wildcat due to the great amount of production in the area from several different producing horizons.

MR. KELLAHIN: Nothing further.

MR. DICKERSON: I have nothing further, Mr. Examiner.

CROSS EXAMINATION

BY MR. STOGNER:

Q Mr. Bourgeois, what does HBP mean?

A Held by production. In other words, the lease is not in danger of expiring.

Q So I can make it clear in my mind, I have in front of me Sprinkle's Exhibit Number One, which Mr. Kellahin submitted into evidence after he started cross examining and your Exhibit Number Three, the AFE for the Sprinkle Federal Well No. 4.

You mentioned several times about the tank batteries having to be different tank batteries for a well, in other words, in the Federal -- I mean in the Sprinkle lease as opposed to having only one tank battery on the Burleson? Am I reading that correct?

A Yes. All the -- all the tanks on the Burleson lease will be located in one area and all production from all four wells can flow directly into that battery.

Q How many tank battery facilities does TXO propose that it will have if all four wells in the northwest quarter of the Sprinkle lease has production?

A We're working on the assumption that the interest will be different in all four wells; therefore there will be a different tank battery for each well, for a total of four.

Q So this tank battery equipment, whether it be four tank batteries or one tank battery for a well, or sharing tank batteries on a lease, is all reflected in an AFE, is that correct?

A Yes.

Q On the Burleson Federal Well No. 3 AFE is the production facilities, i.e. the tank battery, is that broken down essentially one-fourth cost for this well, one-fourth the cost of that tank battery facility for the -- all the other three wells? Is it broke out 25 percent per well?

A I'm not quite sure of that, Mr. Examiner. We have Mr. Cate to testify on these sorts of questions.

Q All right. You alluded to earlier during Mr. Kellahin's cross examination of a certain interest owner receiving a by-out option from TXO.

A Yes.

Q Who was that again?

A Mr. O. H. Berry.

Q B-E-R-R-Y.

A That's correct.

Q And what's his percentage again?

A 1.30208.

Q And what amount was he paid?

A It was $7500 a working interest percentage point. And I believe it calculated out --

Q In other words, if he had one percent he would have got $7500?

A Right, and on the --

Q So I can multiply 1.30208 times $7500.

A And that offer was rounded up to a more even number just $2-or-300 there, but the initial agreement was made on that basis, $7500 per point.

Q And what was Mr. Sprinkle offered?

A $105,000. I believe that's correct. These offers were made in telephone conversations and were never reduced to writing.

Q Okay, so Mr. Sprinkle was offered roughly $105,000 for this 36 -- roughly 36 percent?

MR. DICKERSON: 31.25 percent.

Q 31.25 percent.

MR. DICKERSON: Mr. --

A That's correct.

MR. STOGNER: Mr. Dickerson?

MR. DICKERSON: -- Stogner, I would just like to, you know, I'm afraid that we're getting off the beaten path here to the right of a co-interest owner as con-tenants in oil and gas property is to drill. It is not to force a sale. There is no legal obligation, moral obligation, or any other obligation on behalf of any party to do any more than participate in drilling of a well.

To the extent that this is relevant to a good faith effort to obtain voluntary pooling, we don't have any objection to going into it, but I would like to ask that this underlying fact be taken into account, that

the right of the co-interest owner is to drill and participate equally with his other co-tenants and the fact that a party is or is not willing under certain circumstances and for whatever reasons to pay various prices of the purchase of interest, is -- is not really extremely relevant to the proceeding, and I would just ask that it not be given any undue weight.

MR. KELLAHIN: I disagree vehemently with Mr. Dickerson's assessmetn of what is to be done here, and if you're ready for closing arguments, I can make mine now.

But I think your point of inquiry is very pertinent and it's facts that you need.

MR. STOGNER: Thank you, Mr. Kellahin. Thank you, Mr. Dickerson. I was just trying to clarify the figures and these things were brought out by Mr. Bourgeois during his -- during him being examined by you and cross examined by Mr. Kellahin. I'm trying to make it straight in my mind and my records here so I could get an order out quicker for all parties concerned.

Q Mr. Bourgeois, you mentioned something about a $1.2-million cash offer? Who was that to again?

A That was Mr. Sprinkle's offer to TXO to purchase his interest in the northwest quarter of this section, as well as some acreage that's not included in this

hearing, that is also in the same Federal lease.

Q All right, so that 1.2 was his offer to you to sell to you the whole northwest quarter plus some other interest.

A That's correct.

MR. STOGNER: I have no further questions of Mr. Bourgeois.

Is there any other questions of this witness?

MR. DICKERSON: No.

MR. STOGNER: If not, he may be excused.

MR. DICKERSON: Call Mr. Andy O'Hare at this time, Mr. Examiner.

ANDREW T. O'HARE,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. O''Hare, will you state your name, your occupation, and by whom you're employed?

A My name's Andrew T. O'Hare and I'm a geologist with TXO Production Corporation in Midland.

Q And within the last month and a half you have previously testified and qualified as a geologist before this Division, have you not?

A Yes, I have.

Q And you have in fact testified as a geologist in Case 8755 which is consolidated with Case 8783 today.

A Yes, I have.

Q And you are therefore, obviously familiar with the geological facts involving the Sprinkle No. 4 Well before us today?

A Yes, I am.

MR. DICKERSON: Are this witness' credentials satisfactory, Mr. Examiner?

MR. STOGNER: Any objections.

MR. KELLAHIN: No objections.

MR. STOGNER: Mr. O'Hare is considered qualified.

Q Mr. O'Hare, would it be fair to say that your testimony and your opinion regardng the geology or the geological factors which enter into the question of risk to be determined in the drilling of the No. 4 Well are not greatly different from the testimony that you've previously offered regardng the No. 3 Well and earlier Sprinkle wells that we've heard before this Division?

A Relatively similar, with the exception of structural location.

Q Okay, I will just ask you to, as we make our way through your exhibits here, you attempt to direct your testimony to differences between the Sprinkle No. 4 geology compared to the Sprinkle No. 3 geology, which we have previously had entered before the Division.

Turn to what we have marked and submitted as Exhibit Number Four, Mr. O'Hare, and describe what you have shown on that map.

A Exhibit Number Four is a production map very similar to the one that was presented for the Sprinkle 3, case, with the exception of the Burleson Federal No. 1 Well, which has been added with its IP, and updated production statistics on the Sprinkle No. 1 and the Sprinkle No. 2.

Q Just more current figures?

A Yes. That's the only difference.

Q Refer to our Exhibit Number Five, Mr. O'Hare and tell us what you have mapped on that document?

A Exhibit Five is the top of the Bone Spring pay sand, the same map that was presented at the Sprinkle 3 hearing, again with the exception of the additional data acquired from the drilling of the Burleson No. 1, and they all --

Q Can you --

A -- all structural configurations remain the same. As can be seen, the Sprinkle No. 4 location will be approximately 50 to 60 feet down dip structurally from the No. 3, the proposed No. 3 Well, as best can be estimated from current data available, and the same two structural noses appear as well as (not understood) that were discussed in the previous case.

Q What effect do the factors that you have mapped on this Exhibit Number Five have as far as the risk involved in drilling the Sprinkle No. 4 Well as compared to that you previously testified to regarding the Sprinkle No. 3 Well?

A The Sprinkle No. 4 will be, again, down dip structurally approximately 60 feet and would be the lowest completion on the Sprinkle tract to date.

Q And to me as a layman, that would mean that you're saying that in your opinion the Sprinkle No. 4 Well is relatively more risky than the Sprinkle No. 3 Well?

A Yes.

Q I wonder if you could very briefly relate the risk involved. You testified at the hearing on -- in Case 8698, in the Sprinkle No. 2 Well, did you not?

A Yes, I did.

Q Do you recall what risk penalty was im-

posed in that case?

A 180 percent.

Q I wonder if you could compare for the Examiner the differences shown by your Exhibit Number Five in risk, if any, between the Sprinkle No. 2 Well and the Sprinkle No. 3 Well?

A The Sprinkle No. 2 Well and the proposed Sprinkle No. 3 Well will be at the same, approximate, structural elevation, whereas, again as previously stated, the proposed Sprinkle No. 4 Well appears as if it will be approximately 60 feet down structure from both the No. 2 and hte proposed No. 3.

Q So would it be fair to say --

A Therefore making it possibly more risky due to possibly encountering an oil/water contact. The production from the William Hendon (sic) Junior Well in Section 35 has been very poor and is down dip structurally and there could be some type of reservoir (not understood).

Q Mr. O'Hare, refer to your Exhibit Number Six and tell us what it is.

A Exhibit Number Six is a porosity Isopach of the pay sands, which are the sands that produce in the No. 1, the No. 2, and the Burleson No. 1, which the proposed Sprinkle No. 4 is seen to be estimated at approximately 10 feet of sand porosity greater than 10 percent, which would

be about equivalent to the number of feet encountered in the William Hendon Junior Well and slightly less than the number of feet encountered in the Sprinkle No. 2 Well.

Q Now, direct our attention to that first well you compared it to, the W. Hendon Junior Well, that's the well in Section 35?

A Yes, which has produced, from all current records, just in excess of 5000 barrels of oil from a correlative Bone Spring Sand pay.

Q Roughly equivalent to that that you're interpreting as to be encountered in the Sprinkle No. 4 Well?

A Yes.

Q And do you know whether or not that roughly 5000 barrels of oil would be economic under today's conditions?

A No, not by any means.

Q Do you have anything further you'd like to add with regard to Exhibit Number Six?

A I think everything else was previously discussed on the Number --

Q Refer to your Exhibit Number Seven, Mr. O'Hare, and tell us what you've shown on that.

A Exhibit Number Seven is a stratigraphic cross section, the same one that was presented at the Sprinkle No. 3 Hearing.

Again, the pay sands, the porosity greater than 10 percent, is designated in green, and the sands that perfed and are pay are designated in yellow.

The same details remain as was previously discussed in the previous hearing.

Q There are no other or further comparisons that you make between what you've shown on this exhibit and the risk as between either the Sprinkle No. 2 and the 3 Wells, or the 3 and the 4 Wells?

A I think the risk that should be allocated should be the same as was asked for on the Sprinkle No. 3 Well.

Q So TXO is not, notwithstanding your opinion that the No. 4 Well is relatively riskier, seeking any greater risk penalty than that requested in the Sprinkle No. 3 Well?

A We've decided to -- to go with a -- the same number that we had on both the No. 2 and what we've asked for on the No. 3.

Q And based on your testimony, what is your recommendation, then, with respect to an appropriate penalty to be imposed for the risk involved in drilling the No. 4 Well?

A I would recommend a penalty no greater than 180 percent.

Q Mr. O'Hare, were Exhibits Four, Five, Six, and Seven prepared by you or under your direction and supervision?

A Yes, they were.

MR. DICKERSON: Mr. Examiner, move admission of TXO's Exhibits Four through Seven at this time.

MR. STOGNER: Any objections?

MR. KELLAHIN: No, sir.

MR. STOGNER: Exhibits Four through Seven will be admitted into evidence at this time.

MR. DICKERSON: And I have no further questions of this witness.

MR. STOGNER: Mr. Kellahin, your witness.

MR. KELLAHIN: Mr. Examiner, we've done this about an hour. Do you want to take a short break?

MR. STOGNER: Thank you, yes. Let's go ahead and take about a ten minute break.

(Thereupon a recess was taken.)

MR. STOGNER: This hearing will come to order.

Mr. Kellahin, I believe it was your turn for cross examination.

MR. KELLAHIN: Thank you, Mr. Stogner.

CROSS EXAMINATION

BY MR. KELLAHIN:

Q Mr. O'Hare, let me direct your attention, I guess, to the structure map, Exhibit Five, as well as Exhibit Four, which has your production information on it.

A Uh-huh.

Q And I want to look at the Burleson Federal No. 1 Well in 26 on the structure map. It would appear to have a better structural position than the Sprinkle No. 3 and not quite as good as the No. 4?

A Yes.

Q All right. In looking at the Burleson No. 1 Well, Mr. O'Hare, how would -- using the same method by which you've evaluated the risk for the Sprinkle wells, what would you have assessed the risk in the Burleson Federal No. 1 Well to have been?

A I haven't considered that.

Q Okay, could you do that for me now and make that consideration?

A I'd probably give it the same risk I'd

attach to the No. 2.

Q All right, about 180 percent, and when we look over at the production map, we see that the Burleson Federal No. 1 had an initial potential flow of 240 barrels a day, do you see that?

A Yes, I do.

Q Okay. Do you have an opinion as to whether the Burelson Federal No. 1 Well appears to be an economic well?

A That remains to be seen. It came on looking good.

Q Okay, it has all the appearances as a well that would be economic. It certainly wasn't a dry hole, was it?

A No, it wasn't a dry hole.

Q And when we look at the Sprinkle No. 2 Well, this is one you've also assessed the risk at 180 percent, and when we look at the production map, we see that that well has the ability to produce approximately 110 barrels of oil per day. Yes, sir? No, sir? Yes, all right.

Do you have an opinion as to whether that's an economic well?

A Again, it remains to be seen. It wasn't a dry hole, but not enough producition history to date to --

Q When you were studying risk, Mr. O'Hare,

and providing testimony on risk, how do you define risk? What is it you're talking about?

A Risk is a chance for a successful venture.

Q And what -- how do you define a successful venture in terms of a Bone Springs oil well in this particular area?

A Well, a well in a favorable structural position and one that penetrates a number of feet with porosity greater than 10 percent.

Q All right. Do you have a certain number of minimum feet of net porosity that would give you an opinion that that well would be successful?

A As I testified on the No. 3 hearing, that hasn't been established yet.

Q Okay. Can you look in Section 34 at the McKay Federal Well, drilled by Petroleum Development Corporation, the one with 9 feet of pay, do you find that?

A Uh-huh.

Q It's on Exhibit Number Six? Are you with me?

A Yes.

Q All right. Would 9 feet of pay in this area be a successful well?

A It's possible.

Q Okay. Do you know what the cumulative production has been on that well with 9 feet of pay?

A That well doesn't produce from the same interval; it produces from a carbonate interval in the Bone Spring. I think it's the second Bone Spring carbonate.

Q You've included it on the Isopach as part of the Bone Springs pay sand here. Isn't this the same correlative interval that's mapped?

A Yes, but it wasn't completed in that interval.

Q I see.

A Yeah, but it is a Bone Spring well.

Q How do you define, then, a successful well in terms of the net feet? Can you look at any of the wells in the north half of 26, one has got 20 feet; the other has got 12; Burleson's got 16. Does that give you a clue as to the net footage that would make a successful well?

A Again, it just hasn't been established --

Q Well, what does it take to establish --

A -- what amount of feet --

Q I'm sorry, I'm trying to understand.

A -- is required. There just hasn't been an extended production history on any of these wells to really tell whether they're going to produce at economic

limits, so I can't say at this point whether it's 10 feet or it's 15 feet or it's 2 feet. I just can't say.

Q How many locations has your company announced within this immediate area?

A We have proposed to develop the whole north half of Section 26.

Q That's eight wells.

A Uh-huh.

Q All right. You've proposed eight wells in this area. Are you going forward with all eight wells?

A At this point we plan to do that, unless we encounter a negative drillig venture or a dry hole.

Q Okay. You're going ahead with eight wells and you don't yet know if any of the three existing wells are successful wells?

A They appear to be successful.

Q All right, and --

A And we're drilling this on an optimistic outlook, but again, I can't say that they have proven to be economic ventures at this point.

Q But they have satisfied your company to the extent that you propose another five wells in this north half of this section.

A Yes, because if we had waited till they paid out we wouldn't have a chance at the acreage.

Q Let's look at the Isopach map for a moment and let me -- let me play geologist here with you, Mr. O'Hare.

I'd like to propose to you a possible range of redrawing the Isopach contours, and to show you what I've done and give me some flexibility on being a little wrong in the way I've contoured it, but tell me is -- if what I've done here is within the range of possible interpretations or reason in contouring the Isopach that would at least honor the data points that we have. Let me show this to you.

MR. KELLAHIN: So that the record is clear, Mr. Examiner, I've taken Mr. O'Hare's Exhibit Number Six and I have drawn in a yellow -- I'm sorry, in a red pen some contour lines on the south end of the proposed well, in which I've attempted to delete a nose or a thin section he's placed on the Isopach, and I want to show him what I've done and ask him if that is within the range of reason in terms of geologists.

A If you disconnect the points you can contour it that way, but that doesn't -- but based on my study in the area, that doesn't define the depositional history of this -- of these sandstones.

Q If we're honoring data points on the Isopach, have I generally attempted to do that with what's de-

picted on Exhibit Six, as modified?

A You can contour it this way, that's perfectly possible. You're not going against any geologic laws.

Q Let me show you your exhibit from September 11th hearing in Case 8698, Exhibit Number Eight, and ask you, sir, if in fact you yourself did not do something similar to what I've done?

A Yes. This was presented at the Sprinkle No. 3 Hearing, as well, and as I testified at that time, this was my initial work in the area and having re-examined the geology and looked at this pay sand on a regional basis, I've decided that the porosity thicknesses appear to be developed cohesively with the structural noses, which are demonstrated again on Exhibit Five.

So in the areas where you have a structural trough, as in the one running roughly northwest/southeast through Section 26, sand deposition is not of a sufficient quality, it doesn't appear to be of equal quality, as to the sand deposition on the structural noses themselves.

Q On Exhibit Number Eight from the earlier hearing, I believe, on the 9th of -- 11th of September, at the proposed location for the No. 3 and 4 Wells, what is the thickness that you have mapped on the Isopach?

A It appears to be greater than 25 percent, but again upon re-examination I would not agree with this map.

MR. KELLAHIN: Mr. Examiner, I show you a copy of Exhibit Number Eight, which is Mr. O'Hare's earlier Isopach, and I show you now what I will mark as Sprinkle Exhibit Number Two, to keep the record clear.

A If I may add something to clarify this fact.

Q I'll give you a chance in just a second.

A Oh.

MR. KELLAHIN: And Exhibit Number Two represents a re-drawing of the Isopach lines as Mr. O'Hare and I have discussed.

MR. STOGNER: Mr. Dickerson, have you had a chance to examine Sprinkle Exhibit Number Two?

MR. DICKERSON: I have no objection, Mr. Stogner.

MR. STOGNER: At this time Sprinkle Exhibit Number Two will be admitted into evidence.

Also I will take administrative notice on -- okay, I guess this is Exhibit Number Eight in Case Number 8698, and also that was admitted as Exhibit Num-

ber Five in Case Number 8755, is that correct, Mr. Kellahin?

MR. KELLAHIN: I believe it is not yet Exhibit Number Five in Case 8755.

MR. STOGNER: Okay.

MR. KELLAHIN: And that should be deleted from the exhibit.

MR. STOGNER: We'll just mark through on the righthand, lower righthand corner, where it alludes to Sprinkle Exhibit Number Five, and we'll take administrative notice of Exhibit Number Eight from Case Number 8698.

Q All right, now, Mr. O'Hare, you wanted to further explain your answer?

A Yes. These sands appear to be source from the north to northwest, and in the areas that I've mapped recently, porosity appears to develop in areas which are defined as structural noses, due to differential compaction of these sandstones.

In the structural troughs the sands appear to be much finer grained with a slightly higher shale percentage, whereas on these structural noses the sands are cleaner and of a slightly greater grain size, therefore making them of better pay quality.

Therefore my -- the reason for my re-interpretation of the porosity.

MR. KELLAHIN: Thank you, Mr. Examiner, I have nothing further of -- no further questions of Mr. O'Hare.

MR. DICKERSON: I have no further questions, Mr. Stogner.

CROSS EXAMINATION

BY MR. STOGNER:

Q Mr. O'Hare, I'm looking now at your Exhibit Number Six for today's case and in the northeast quarter of Section 27, the Mewbourne Federal Well No. 1-E, you showed the -- that to have 32 feet of the sand in that --

A Yes, and I originally showed it as having 5, I think.

Q I believe, if you're referring to Exhibit Number Eight on that Case 8698, you show 3 feet.

A I re-correlated that well.

Q I'm sorry, what?

A I re-correlated and therefore added more pay to that well, again having re-examined the area.

Q I'd like to refer over to Section Number 25, the Nortex G & O Uncle Sam Federal Com No. 1. Did you re-correlate that one, also?

A I did.

Q Are these the only two wells that you re-

correlated?

A We looked at the whole area and if you look at the cross section --

Q That's Exhibit Number Seven to which you refer?

A Yes.

Q Okay.

A The porosity Isopach is an Isopach of the sands that are shown in green on the cross section, and originally looking at those two wells I had correlated them differently and the sands that I had correlated them with did not have the same thicknesses of porosity and upon re-correlation, there is more feet of porosity to be included in what I call the pay sand.

Q What do you call the pay sands?

A It's, for example, in TXO Production Corporation's Sprinkle No. 1 Well it's the three sands designated in green.

Q Describe those sands, how they differ, those that you painted green as opposed to everything else on this cross -- I mean log.

A They -- they are more distinct on a resistivity log and unfortunately I didn't bring one of those with me, but they're -- they correlate very well when you use resistivity logs in the area, and upon my initial

examination of these Bone Spring sands when I constructed that first map, I did not consult the resistivity data in as great a detail as I did on my re-examination, and there appears to be, especially in the north half of Section 26, three distinct sands of which the three are colored green in the Sprinkle No. 1, which pay.

The two sands above have proven not to pay in that well.

Q Well, as I continue back to the east, do these three sands come together or do the --

A The configuration -- the configuration of the sands change once you move west, but the gross interval is correlative on a resistivity log.

Q So these three sands come together.

A They appear to merge and in the Newbourne Oil Company Federal E No. 10 in the 2 sands, with the lowermost being undeveloped.

As you can see on the cross section again, the Sprinkle No. 1 and the Sprinkle No. 2 both have the three sands, the same three sands, but you can see on the No. -- Sprinkle No. 2 that the third-most, or the deepest sand, the porosity is nowhere near as well developed as in the Sprinkle No. 1 Well.

Q What kind of porosity do you have painted green?

A Greater than 10 percent.

Q With respect to water resistivity, what -- what did you use for that?

A I have an ohm cutoff on that. The average resistivity, based on a .03 RW in the Sprinkle No. 2 Well, approximately 40 percent. Each distinct sand varies considerably from that; the lowermost being approximately 62 percent saturation, using a .03 RW.

MR. STOGNER: I have no further questions of Mr. O'Hare. Are there other questions of this witness?

MR. KELLAHIN: I might ask one further question, if I may.

MR. STOGNER: Mr. Kellahin.

RECROSS EXAMINATION

BY MR. KELLAHIN:

Q You used the word "successful" awhile ago, Mr. O'Hare in terms of defining an oil well. Could -- could you put some numbers to what you would mean by successful?

A We have another witness who's going to testify to that.

Q And you would use the same definition that he's going to use on success?

A Yes.

Q In terms of a total volume of oil produced, is that what you're saying?

A (Inaudible)

MR. STOGNER: Was that a "yes"?

A Yes.

MR. STOGNER: Are there any other questions of Mr. O'Hare?

If not, he may be excused.

Mr. Dickerson?

MR. DICKERSON: Call Mr. Randy Cate at this time.

Mr. Examiner, I stated that I had three witnesses. All four of my witnesses told me that they stood and were sworn, but Mr. Cate was the one who I had not anticipated using, if you're concerned with whether or not he's telling the truth.

MR. CATE: I think I had a premonition.

MR. KELLAHIN: Of the truth or of the --

MR. CATE: That I was going to be up here.

RANDALL CATE,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Cate, will you state your name, your occupation, and by whom you're employed, please?

A My name is Randall Cate. I'm District Drilling Engineer for TXO Production Corp. out of Midland, Texas.

Q And you testified as a petroleum engineer for TXO in Case 8755 at the original hearing, did you not?

A Yes, I did.

Q And the substance of your testimony in that was with regard to the authentication of the AFE's in the Sprinkle 2, 3, and 4 Wells?

A Yes, that's correct.

Q Your qualifications were accepted at that time?

A Yes.

MR. DICKERSON: I tender Mr. Cate as a petroleum engineer, Mr. Examiner.

MR. KELLAHIN: No objection.

MR. STOGNER: Mr. Cate is so

qualified. Also for the record, I did count more than the number of witnesses that were told to me and Mr. Cate has been sworn in.

MR. DICKERSON: Okay.

Q Mr. Cate, you previously testified that you had prepared the AFE on the Sprinkle No. 4 -- 3 Well, did you not?

A Yes.

Q And you have likewise prepared the AFE on the No. 4 Well.

A Yes.

Q Did you also prepare the AFE to which Mr. Kellahin alluded on the Burleson proposed wells?

A Yes.

Q You heard testimony elicited from Mr. Bourgeois regarding the difference between the Burleson Well AFE and the Sprinkle 3 and 4 Wells AFE's, and I would like for you to elaborate a little bit on that difference, the reasons behind it and how you allocated some of the differences.

A Okay. At the time that we proposed the -- or that I did the Sprinkle 3 and 4 AFE's, which were strictly just a drilling well, not a re-entry like the No. 2, that was a different case, we had just done our re-entry on the No. 2, and that was the only data we had.

It was a Morrow completion, which is a whole different animal than a -- or a Morrow attempt on the Sprinkle No. 1, which is a different animal than just a Bone Spring test and a re-entry for the Bone Spring, which is in itself a different animal.

That's the only data we really had and had not at that point attempted strictly drilling a well from top to bottom.

And I used a -- I had come up with the Burleson No. 1 AFE, approximately $615,000, and used the same basic numbers, the 615 for the Sprinkle 3 and 4 to propose those.

After that, when we proposed the Burleson 3, well, the 2 and the 3 and the 4, our numbers were reduced to 496,000, I believe, is the correct AFE.

At that time we had gone ahead and got a better handle on our completion costs for the Sprinkle No. 2 and we had already TD'ed and logged the Burleson No. 1, so there was more information available.

You'll notice the total drilling cost really has not changed much on any of the AFE's for a Bone Spring test. The difference between the, say, the Burleson No. 1 AFE versus any of the Sprinkles, they're, I believe, within $10,000, or 5,000.

The, I brought the completion costs down

as a reflection of -- that we would probably run 4-1/2 inch casing instead on the Burleson wells of 5-1/2, that was the possibility for the other wells, and I did not include pumping units because the Burleson No. 1 was gain moving up dip slightly from the Sprinkle No. 2 and the pay was thickening, which would tend ot indicate a better flowing capacity. And eventually they will need pumping units. We will AFE the approximately $60,000 to the other Burleson interests, so they will be paying those -- those costs.

And on the Sprinkle No. 2, now that we've had production data, production has fallen to roughly 60 barrels a day with a flowing pressure of only 30 pounds. It's not near as productive as the No. 1, which continues to flow pretty well.

So we're looking at a pumping unit. We're going to have to go ahead and pump that shortly. For those costs, there will be another 60,000, or so, for pumping units, rods, the engine, and the other bottom hole assembly which is required.

Q How did you treat the question that Mr. Bourgeois answered regarding the necessity to build separate tank batteries for each well on the Sprinkle wells and yet commingle all the production on the northeast quarter of Section 26 from the Burleson wells in one tank battery? How is that taken into account on your Burleson AFE's?

A Okay. On Burleson AFE's the storage that I've allotted is $10,000 for each well worth of tanks.

Now, that's approximately two Sprinkle l's. The required tank volumes that we neede on the Sprinkle 1 is -- is $22,500 worth approximately, and that was for four tanks instead of two oil tanks.

Q That was your actual cost on the Sprinkle No. 1?

A It's the actual cost on the Sprinkle No. 1, because it is a 200-barrel a day well, and, you know, we like to have three to five days and sometimes a week of extra storage capacity for cold weather problems, oil haulers not making it there on time, so that we don't have to shut the wells in, and it's just a safety precaution, also.

So if you can take the average of all those wells, if we have a couple of good ones and a couple not so good, that should be the sufficient tanking.

Q So basically you prorated the projected cost of one tank battery on the Burleson acreage in the northeast quarter among all those wells.

A Well, yes and -- yes and no. I just made my best guess as to what amount of tank room will be needed, but on a -- on an individual well basis, $10,000 could do it if it's a 100-barrel well.

Q But before the wells are drilled, there's

no reasonable way for you to project, is there, whether or not -- we don't know whether or not you're going to turn out to be correct on your assumptions of how much tank storage you need, or anything of that nature?

A That's right. AFE's are strictly estimates and best guess for -- for the costs.

Q And so based on what you now know, is it still your opinion that the Exhibit Number Three, which was admitted here today, being the AFE for the Sprinkle proposed No. 4 Well, is it still your opinion regarding the anticipated well costs for completing that well and equipping it with a separate tank battery?

A Yes, I believe that there's a good chance that we will spend that much money.

MR. DICKERSON: I have no further questions of Mr. Cate.

CROSS EXAMINATION

BY MR. KELLAHIN:

Q Mr. Cate, do you have before you the Burleson AFE and the Sprinkle AFE's so we can compare them directly?

A I'm not sure that I've got all of them. Which ones are you going --

Q I was simply picking out the No. 4 Sprin-

kle and the Burleson Federal 3.

A I don't have the Burleson 3 but I've got the Sprinkle 4.

Q On the Burleson wells, is the AFE approximately the same for each of the four Burleson wells?

A It's the same for the Burleson 2, 3, and 4.

Q The No. 1 Burleson has a difference.

A Yes. We had already proposed that prior to drilling a well, as I explained, from top to bottom, and so I have used that $615,000, what my estimate was.

Q For the Burleson 1 what was the actual completed well cost, now?

A The completed well cost right now, and it's just an estimate, but I believe it's going to be right at 500,000, and that does include the production facilities but will not include a pumping unit, rods, and a gas engine, if required.

Q Let's look at the Burleson Federal 3 AFE and the Sprinkle Federal 4 --

A Okay.

Q -- and see if we can draw some comparisons.

If you'll look on each AFE, on the Burleson one, when we look at simply the drilling cost

total, it's 281,000 versus the Sprinkle at 286. Are you with me?

A Yes, I am.

Q Those balance out, generally, all right?

A Uh-huh.

Q When we go down to the production equipment on each AFE, the Burleson is 35,000, the Sprinkle's up to 92. We have a difference of about 60,000.

A Correct.

Q All right. Let's focus on production equipment.

A Okay.

Q With regards to the Burleson wells, are each of those wells to be metered separately so that you'll know the production from each of those wells?

A We can do that through a system of headers which you just bring each well in and have a separator and a heater-treater for testing purposes only.

Now I'm not sure if our production people plan to do that or not.

Q What is the proposal for the Burleson wells, then, you would have a common tank battery for the four wells?

A Yes.

Q The tank battery is where on the AFE for

the Burleson No. 3?

A On the Burleson No. 3 what I did was put the storage -- well, the tank battery will be under --

Q The storage entry.

A Yeah, storage and additional separation and treating, if necessary.

Q All right, so we've got 10,000 under storage and 9,000 under separating and treating?

A Yes.

Q All right, 19,000, all right.

Now, on the Sprinkle acreage, do you propose to use a common tank battery for those four wells?

A No, we don't.

Q Okay, why not?

A As Mr. Bourgeois explained, with a different interests and different -- well, different interests within wells, TXO may only have 90 percent of the No. 1 and 50 percent of the No. 2, and making -- or to insure that each well, working interest owners and royalty owners get their exact share of production, it's generally not a good -- it's a good idea to keep those separate.

Q Okay. Can you also keep track of separate production from each of the four wells by simply metering that production?

A The -- the gas can be metered off a --

off a heater-treater into a separator, but as far as productionwise, you're basically going through about the ame expense if you want to continually measure each well all at the ame -- each one simultaneously. You're going to have to have heater-treater, separator, tanks for the No. 1 and the same thing for the number -- for each of them, so you're basically duplicating the same effort.

The only way you're going to get exact production data is to have separate batteries for each.

Q When I look at the APE for the Sprinkle Federal 4, and look at the storage entry and the separating and treating entry, I get $19,000, which is the same entry we had on the Burleson well.

A That's correct.

Q Well, I thought you told me we were going to have different tank batteries for each of the wells. Where is --

A We are.

Q Where is the number on the AFE?

A The APE, the number is 19,000, but again, we cannot -- we can all use our best guesses --

Q I didn't make myself clear. Why, when we have one tank battery in Burleson, the number is 19, and we're going to have four on the Sprinkle leases, I still have the same $19,000 number?

A The Burleson AFE's, each AFE has the storage, also, just as each Sprinkle AFE has the storage costs that may be needed.

The Burleson No. 3 does not have the total Burleson lease costs. I mean the only costs. Each -- each Sprinkle well and each Burleson well have costs allocated in there for the use of production equipment, I mean storage, or battery equipment, if needed.

Q Okay. When we get to the completion costs there's a difference in the completion costs of $50,000, approximately, $57,000 between the two with the Sprinkle being the more.

A That's correct.

Q You've explained that the principal difference is in the size of the casing; in the Sprinkle wells you're going to use 5-1/2 and in the Burleson use 4-1/2?

A Well, on this AFE, yes. Now, when we get the well TD'ed we may go with 4-1/2 inch casing on the Sprinkles, and that's also something that's common practice, is sizing your casing depending on what you think you're going to need.

If we're down dip and wet and we know we're going to have to pump, we're likely to run 5-1/2 inch casing because you get to put in 2-7/8ths tubing, which allows you to pump greater volumes than if you're restricted

to 4-1/2 inch casing, and 2-3/8ths inch tubing.

Q Why would you use a difference of 5-1/2 versus the 4-1/2 with wells this -- offsetting 40 acres from each other? What's the difference?

A Well, the No. 2 Well, as you know, came in lower, had less, less porosity, and less thickness, and it also had an IP that was -- initial potential which was less than the Sprinkle No. 1, so there was good chance that we may need to be pumping these wells.

If you add up the potential for water production where you have to pump greater volumes, then 5-1/2 inch casing is the way to go.

Q On the Sprinkle No. 2, which was the re-entry, --

A Yes, sir.

Q -- the estimated well costs for that well were 615,000, right?

A That's correct.

Q And the actual completed costs totaled what?

A It should be somewhere right at 500, 450 to 500, excluding the pumping unit that we're going to need.

Q All right.

MR. KELLAHIN: Thank you, Mr. Examiner.

MR. DICKERSON: Just one question, if I may.

REDIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Cate, the problem that bothered Mr. Kellahin, isn't that simply explained by the fact that if on the Burleson lease on the northeast quarter of Section 26 you have one giant tank battery to handle production from four wells, the size of that tank battery is going to be much larger than any tank battery devoted to only one of the Sprinkle wells, is it not?

A That's correct, and again, we did underestimate the required cost for the battery on the Sprinkle 1, or initially at the Sprinkle 1, because it was a better well so we didn't require more --

Q Assume the north half of Section 26 was totally developed so that we had eight wells producing exactly the same amount of oil, would it be fair to say, even though you would need the same storage capacity, presumably collectively for each of the Sprinkle wells and collectively for each of the Burleson wells, does it necessarily follow that the total cost of the tank battery four times the size of -- on the Burleson lease of the tank battery on each Sprinkle well, does the cost ratio follow in

direct proportion to the size of the storage facility?

A Yes, in direct proportion to the size of the tanks required and the number of tanks at that central battery that would be required, which should be less for four wells together than four wells separately. There should be more cost --

Q And so that's the reason that your AFE's on both the Sprinkle and the Burleson wells allocate the same amount to storage and treating facilities on each.

A That's right.

MR. DICKERSON: No further questions.

MR. STOGNER: Thank you, Mr. Dickerson.

Mr. Kellahin?

MR. KELLAHIN: Nothing more.

CROSS EXAMINATION

BY MR. STOGNER:

Q I did some quick figuring here. So the storage facilities on the Burleson lease would probably run at $76,000 total, is that correct?

A I'd say that's a good guess if all four wells come in and that, you know, 100 to 150 barrels a day, or so, I think that would handle the production.

MR. STOGNER: That's all I have at this time.

Are there any other questions of this witness?

MR. DICKERSON: No.

MR. STOGNER: He may be excused.

Mr. Dickerson?

MR. DICKERSON: Call Mr. Deen Wood.

DEEN WOOD,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Wood, would you state your name, your occupation, and by whom you are employed?

A My name is Deen Wood. I'm a petroleum engineer for TXO Production Corporation.

Q And have you previously testified before this Division as a petroleum engineer and had your credentials accepted?

A Yes, I have.

Q And has that been within the last six months?

A Yes, it has.

Q Have you, in preparation for your testimony in this case, Mr. Wood, made a study of the engineering data that TXO has developed from the wells in the vicinity of the Sprinkle 3 and 4 Wells for the purpose of forming an opinion as to the risk involved from TXO's standpoint as operator of these wells?

A Yes, I have.

Q And to your knowledge, are you familiar with all of the data developed from all of the existing wells on the Sprinkle acreage?

A Pretty much.

MR. DICKERSON: We tender Mr. Wood as an expert engineer.

MR. KELLAHIN: No objections.

MR. STOGNER: No objections? Mr. Wood is so qualified.

Q Mr. Wood, would you refer to what you have marked as your Exhibit Number Eight and tell the examiner what calculations you make and what conclusions you draw from those calculations?

A All right. Exhibit Number Eight is a volumetric calculation of recoverable oil for the Sprinkle

Federal No. 1 on 40 acres. Since the field is being developed on 40 acres, I made a calculation for what we would get oil-wise out of this 40-acre tract.

I did the same thing for the Sprinkle Federal No. 2 and that calculation is presented in Exhibit Number Nine.

My best estimation is that if left to themselves, these wells would do considerably better than this estimation, to the tune of maybe an additional 20-to-25,000 barrels; however, as I hope to indicate later on in my testimony, this will not be the case, and that there is considerable risk, economic risk, in our drilling of these wells.

Q Now refer to Exhibit Number Eight and tell us in a little more specific language, Mr. Wood, what it is you have calculated by the numbers you have depicted on that exhibit, and what the purpose of that was, and relate that to your -- as I understood it, you stated that left to itself, meaning, I guess, if we -- if you calculated the total recoverable reserves that could be produced from the Sprinkle Federal No. 1 Well, that that figure would be substantially in excess of the figure that you have shown on Exhibit A?

A That is correct. What I did is I went in and I looked at the log on the Sprinkle Federal No. 1 and

got what I consider to be hydrocarbon productive thickness of 30 feet of 11.6 percent porosity pay quality, and this is -- you all probably notice, this is greater than the number that Mr. O'Hare had presented in his geologic maps. For his purposes of finding where you might be able to make a good well, I assume that this parameters are good, since he's been successful, but as far as recoverable reserves, I feel like a greater pay thickness, namely 30 feet in the Sprinkle Federal No. 1, is more appropriate.

I also used an average water saturation of 37 percent, which is, I feel, extremely charitable. Mr. O'Hare disagrees with me, he thinks it should be higher, closer to 40-42 percent.

I used a 12 percent recovery factor, which in this type of reservoir is not at all unreasonable. It may be a little bit high.

My formation volume factor was calculated to be 1.559.

For 40 acres the calculation yields a total recoverable reserve number of 52,368 barrels of oil.

The well, as has already been introduced into testimony, is still making 200 barrels a day after coming in at closer to 260-275-280 barrels a day, so the decline so far has been pretty well flat; however, there's not enough history to tell conclusively what it will do; how-

ever, the indications are that it would be considerably better than my volumetric calculation would indicate, but in order to make the more than 100,000, 120-130,000 barrels, the well would have to drain considerably more than 40 acres, and as the field is being developed on 40-acre tracts, it can't do that. It will be in direct competition with other wells as we drill the acreage up on 40-acre tracts.

We have already been offset to the west with a well and we're about to be offset to the north. We will offset ourselves to the south, so it will be, the No. 1 will be completely ringed in and will effectively only be able to drain 40 acres.

52,000 barrels is not, in my best estimation , an economically viable prospect for the kind of expenditure that we would expect to incur on these type of deals.

My estimaton is that we require somewhere in the neighborhood of 70 acres minimum in order to meet our economic criteria.

I would like to point out that there is a Mewbourne well in the section due west of us. I think it's the Mewbourne G-1. It has a similar pay thickness and quality and has to date out of the correlative zone to my best knowledge produced about 52,000 barrels, and giving it the same attractive water saturation of 37 percent and the same

recovery factor, I find that it has already drained over 40 acres and at its present rate, which is about 60 barrels a day, and using the decline that it has exhibited so far of 37 percent, it will make ultimately 98,000 barrels; however, in doing so it must drain considerably more than 40 acres.

The last Mewbourne -- well, not the last Mewbourne well, but there is another Mewbourne well which I would like to refer back to one of Mr. O'Hare's exhibit, I think it is Exhibit Number Four, the Mewbourne No. 10-E, which is very close to the center of the section --

MR. STOGNER: Yes, I've got it.

A All right, it has comparable pay, actually higher porosity than that that was exhibited in the G-1, and it came in at a considerably smaller initial potential than we would expect from a well out there with that quality pay. That indicates that it has seen some effects of depletion and these wells do drain considerably more than 40 acres; therefore, the risk we incur on drilling these things on 40 acres is considerable, and that drainage is going to have a negative effect on our economics, and that is assuming that we get the same good quality pay that we have seen in our Sprinkle Federal No. 1.

Therefore, I think it's entirely appropriate that we get 180 percent penalty.

Q Now, Mr. Wood, again with -- directing

your attention to Exhibit Number Eight, do you have sufficient data now which enables you, or have you at this point formed an opinion that these wells do in fact, or will in fact, drain in excess of 40 acres?

A Yes, in my best estimate at this time, which, you know --

Q Now, Mr. Bourgeois previously testified also, did he not, that TXO's farmout requirements of ninety days between wells are contributing to TXO having the necessity to drill --

A That is correct, we --

Q -- these additional wells?

A -- would lose the acreage and reserves that we presently have leased would not be produced if we did not go ahead and drill it on these 40-acre tracts.

We will be offset, we understand there are plans to offset us to the west, the north, and to the south, and if we don't drill this thing up on 40 acres, and we get offset, then we're going to waste reserves to the competition and that is not fair to either us or the mineral owners that we're associated with.

Q And that competition, if you fail to comply with your drilling obligations in the south half of the northwest quarter of Section 26, include Mr. Joseph Sprinkle.

A Yes, sir, it could.

Q Let's turn now to what you have marked as your Exhibit Number Nine, Mr. Wood, and before we go into a little bit more detail about your opinion regarding the economics of these wells, tell the Examiner what you have shown on your calculations represented by Exhibit Number Nine?

A This is the same calculation that was done in Exhibit Number Eight, volumetric, doing this type calculation for the Sprinkle Federal No. 2. I used the same recovery factor and recalculated my formation volume factor, water saturation, and porosity, and arrived at the numbers that are indicated on the exhibit.

There is less pay in the No. 2 than there is in the No. 1 and the same calculation for 40 acres yields a recoverable oil volume of 30,635 barrels. That's nowhere near economic success for us.

Q Now when you say "economic success", Mr. Wood, you necessarily have to have reference to the worth of the price of oil.

A Yes, sir.

Q And I notice there are no dollar signs on either one of these exhibits.

A That is correct.

Q Now, what assumptions do you as a reservoir engineer have to make in order to evaluate the poten-

tial economics of a well?

A We do our best to forecast oil and gas prices and that is extremely uncertain under present conditions, but in calculating what I needed to meet economic parameters for these wells, I used an initial oil price of $26.00 a barrel, which is pretty terrible these days and --

Q What is the current price, do you know?

A Right now for West Texas crude, I don't know, I think it was like 25.50, it's been fluctuating between $25.50 and $26.50. I know that North Sea Brent went for $24.75 a barrel.

Q Mr. Wood, must briefly summarize whatever assumptions you've made for the price of oil and obviously your crystal ball is as cloudy as ours, but tell us the effect of those assumptions when this oil is turned into dollars.

A My assumption is that the oil price will start at $26.00 and escalate at 5 percent due to depletion of the well, and that in order for a new drill deal, a brand new Bone Springs well, to be economically successful under those conditions, we need approximately 90,000 barrels and 200-million cubic feet.

Q Now, Mr. Wood, is that assumption, a current price of $26.00 a barrel and annual escalation of 5 percent reasonable, even at current market conditions?

A No. It's going -- prices are going down. This is -- this is extremely optimistic.

Q And in your experience over the last few years, you have witnessed an already fairly steep decline in the price of oil, have you not?

A Definitely, definite decline.

Q And in your experience, do you forecast, cloudy though your forecast may be, that the price of oil is going to continue to decline?

A It looks like it will.

Q And have you made any calculations based on an assumed decline?

A Yes, I have. If we assumed that the price of oil were to drop to $20.00 a barrel, and then escalate at 5 percent through the depletion of a well, we would require 119,000 barrels and 275-million cubic feet of gas to meet our economic parameters, and in order for one of these wells to do this, we've got to drain considerably more than the 40-acre volume that we've calculated.

However, -- okay, excuse me.

Q Do you have anything further you'd like to add along that line?

A Okay. My opinion is that these wells should be developed on 60-acre spacing, of which there is no such thing, as far as I know, and that ultimately one would

want to waterflood this thing and that you're going to need it drilled on 40 acres and the most economical way of doing that is to drill it on 40 acres now and if you do drill it on 40 acres, you will recover some oil that would not be recovered if it was drilled on 80.

Q Okay, so it's therefore your opinion, then, based on your testimony, that the wells evidently will drain in excess of 40 acres but less than 80 acres but for various reasons, prudent, current development is on 40-acre spacing.

A Correct.

Q When you speak of TXO's economic parameters, Mr. Wood, tell us a little about how a corporation such as TXO Production Corporation establishes economics as far as being able to determine from an accounting standpoint whether a given well is or is not making money for the company and its shareholders.

A You're asking me for our economic criteria?

Q Well, when --

A What we --

Q With your economic criteria you are relating it and speaking in terms of --

A Okay.

Q -- in terms of the economics to TXO --

A Okay.

Q -- and so I just want you to explain a little bit about how the -- what are those parameters? What is economic? Obviously the productive wells have to pay for the dry holes, is that a fair statement?

A That's right. The productive wells have to pay for the dry holes, of which there are quite a few, unfortunately, so we generally seek to keep our rate of return at over 35 to 40 percent, and we also seek to get at least 2-1/2 or 3-to-1 type return on investment over the life of a well.

Q So it's not enough that a well merely repay all costs of drilling, completing, and operating the well.

A Oh, no.

Q Because it has not paid for any of the dry holes --

A If we just pay out and made 15 percent, we'd go broke.

Q And TXO and every other oil company in the country would go broke, as well.

A That's right. We have to pay for the failures as well as the successess.

Something else I might add, that I'd like to clarify about a question that Mr. Kellahin directed at

Mr. O'Hare was about the Sprinkle Federal No. 2. It is down to 60 barrels a day. It will not make 100 barrels a day. It's flowing tubing pressure has dropped to 30 pounds. We will have to put it on pump shortly.

It will be a poor well.

Q What do your studies and the exhibits that you have testified to, Mr. Wood, have to say about the risk that we're trying to anticipate here on the Sprinkle 3 and 4 Wells?

A It's considerable. While there's little doubt that we can drill down and will find some oil and gas, whether we find enough to make the deal attractive to us is entirely open at this point.

Q So in addition to mechanical risk, geological risk, what you're testifying to is economic risk, is that right?

A Yes, sir.

Q And is it your opinion based on these factors that a 180 percent risk penalty would be an appropriate penalty to be imposed on the Sprinkle 3 and 4 wells?

A Yes, sir.

MR. DICKERSON: Mr. Examiner, at this time move admission of TXO Exhibits Eight and Nine.

MR. STOGNER: Any objections?

MR. KELLAHIN: No objection.

MR. STOGNER: Exhibits Eight and Nine will be admitted into evidence.

Mr. Kellahin, your witness.

MR. KELLAHIN: I wonder if we might have a five minute break while I talk to the witnesses, please?

MR. STOGNER: We will take -- let's take a ten minute break.

(Thereupon a recess was taken.)

MR. STOGNER: This hearing will resume to order.

Mr. Kellahin, I believe it's your --

MR. KELLAHIN: Thank you, Mr. Examiner.

CROSS EXAMINATION

BY MR. KELLAHIN:

Q Mr. Wood, I think you've told us that in looking at Exhibit Number Eight and calculating the recoverable oil reserves on 40 acres, that you concluded that that's not an economically viable prospect.

What would be a recoverable oil number in

barrels that you would conclude would be economic?

A I gave you a number earlier that said approximately 90,000 barrels. I need to elaborate on that a little bit.

Our economic guidelines, like most people's, are flexible. We will trade off return on investment for rate of return. If we can get our money back fast enough, that makes up for not getting back -- not getting back quite as much.

The good wells, such as the Sprinkle Federal No. 1, are high initial potential wells that will have a high rate of return. If the rate of return is high enough, and the cum meets a certain minimum, we wouldn't have to have that much; however, I'd also like to point out that while the well is, the Sprinkle Federal No. 1 is still making 200 barrels a day, as the field is drilled up on 40 acres, and the wells are offset in different directions, it would be reasonably to expect that that rate would drop and, of course, it wouldn't cum as much as it would have had it not been offsetd.

Q Mr. O'Hare, in his testimony on November 21st, advised us in his presentation that the minimum rate of return that TXO would assign to this property was a 2-to-1 return on investment.

Now, is that within the range of flex-

ibility that you're talking about?

A It depends on the rate of return involved.

Q All right.

A We -- we wouldn't set out, particularly under current -- current market conditions are so uncertain, we wouldn't set out to drill a 2-to-1 deal. If we got one and the rate of return was high, we'd be happy with it.

Q Have you made a projection on the -- or have you constructed a decline curve on the production from the Sprinkle No. 1 to estimate the total recovery from that well?

A Not really. It's -- the decline at this point is essentially flat.

Q All right.

A I might add that that, at this point, doesn't mean a whole lot, either. You can look at the decline curve for the Mewbourne well, which was not offset, and while it started off very high, it dropped and we have no reason to assume that our well will be any different from theirs, with the similarity in the logs, and our wells shouldn't cum any more than theirs will ultimately.

Q Have you made any calculations of the total reserves in place for the field as it's defined now?

A No, not -- not per se. Being optimistic

you'd assume that it would have somewhere around 52,000 barrels per 40-acre tract, and that would average better pay with worse pay, and it wouldn't be an exact number. It would also -- also be assuming that the 12 percent recovery factor is correct, and that recovery factor, we hope, will be higher; however, since we do have to frac the wells to make them produce, it's reasonable to assume that it's tight and would not have an extremely high recovery factor, say, of 25 percent.

Only --

Q Do you -- I'm sorry, go ahead.

A Only time will tell. That's part of what we're hoping in drilling these things, is if the recovery factor will be higher; and to make good wells, we'll have some good ones, we'll have some bad ones, and that the recovery factor on the good wells will be higher and we will be able to make some good wells, especially with the rate of return consideration, but there's a risk there because it's an unknown at this point.

Q What is the basis for using a recovery factor of 12 percent?

A Well, there -- there are two basic things that I considered in arriving at that particular number.

We produce an extensive number of wells in Texas that are similar in that they must be fraced, they

are sandstones, and they have about an 8 percent recovery factor, which, due to the fact we have to frac them to make them produce, that's -- that's not entirely unexpected.

The other -- the other thing that I considered in looking at it was there is a paper in an SPE publication, and I don't remember which collection of papers it is, I'll be glad to supply it, that gives recovery factor ranges for sandstones, maximum, average, and minimum, adjusted for gas/oil ratio and oil gravity, and in the minimum range, which is where I think it is proper to look in this case, since the wells are so tight that they have to be fraced, it gives approximately a 12 percent recovery factor.

Q Let's look at that table and see what the maximum is.

A Well, an absolute maximum for this range would be up around 30 percent, 34 percent.

Q Is this a partial waterdrive reservoir?

A Not to our knowledge.

Q What is the drive mechanism in producing the reservoir?

A Solution gas drive, which, of course, causes you to assume a lower recovery factor.

Q All right. Were you the individual responsible for making the recommendations to management about the risk and the drilling of these wells?

A Yes, I am.

Q Were you involved in making the decision on the Sprinkle No. 2 Well in assessing its risk?

A Yes, to some degree. I might add at this time that management doesn't always follow my recommendations.

Q I appreciate that.

A And I have not been as enthusiastic about some of these as others have been, although I do think that they need to be drilled from both a competitive viewpoint and from recovering all the oil that is recoverable and the fact that I believe that they all will ultimately be economic prospects, in spite of the considerable risks that I've outlined.

Q How does your management, or how do you make recommendations to your management about a risk? Do you do the same kind of thing that you've done here and assign a certain risk to a prospect?

A Generally, yes. I evaluate it for -- for ultimate recovery, the effects of drainage, and how that would affect the ultimate recovery.

I then do an economic calculation and figure what our rate of return and return on investment would be under certain conditions, and of course, this is tempered by the risk for success or failure in drilling the

well, and based on that I make a recommendation.

Of course, the big uncertainty, one of the big uncertainties at this point is pricing.

We, of course, we don't know any more than anybody else; we're optimists.

Q What was the risk that you assigned to the No. 2 Sprinkle Well?

A I assigned it what we consider a normal development risk on these coming Sprinkle wells, the Sprinkle 3, a normal development risk, which I considered to be about a 75 percent chance of success.

Q That was Sprinkle No. 2?

A That was No. 3.

Q The No. 3, all right.

A It was decided we would do 2, well, I -- I was not involved in that particular decision until the decision has already been made.

Q Can you tell me what the chance of success in terms of a percentage was for the No. 2, although you didn't participate in that one?

A Well, it was a re-entry. The chance of success based on the fact that we had the No. 1 down already, this would probably be higher than (not clearly understood) 75 percent chance.

A I'd like to add that -- that the risk,

the amount of risk you assign to it, of course, tempers the return that you have to have; the amount of money that you have to make back in order to consider the deal as something that you'd want to put your money into before you drilled it.

I'd also add that my evaluation of the 3 and the 4 are not the same. None of those wells out there have the same risk.

Q All right, give us your evaluation of the chance of success on the No. 4. You say you have a different number.

A Well, I haven't got -- I haven't got a number prepared for that; however, that would be tempered by the results for the No. 3.

We've got a program outlined out there to drill that thing up. Being optimistic, we're going to say that every one of those deals are going to be good and we'll drill them until we hit a bad one, and as soon as we hit a bad one, we've got to re-evaluate subsequent wells, based on the information that that bad well gives us, and at this point I really -- it's hard to say anything definite about the 4 until we drill the 3, because it -- how it comes in will have a definite effect on the risk that I assign to the No. 4.

Q Will you have the benefit of the informa-

tion from drilling the Burleson No. 3 to re-assess the risk on the Sprinkle 3 and 4?

A I do not know. I'm not aware of -- of how we will --

Q The sequence.

A -- do the sequence.

Q Will the information that results from the Mewbourne Well in Unit letter A of Section 27, I believe that's a drilling a well at this point --

A That's the far northeast corner?

Q The northwest corner. It's the northeast of that section. It's the west offset to the Sprinkle 1.

A Okay, the west offset to the Sprinkle 1. Okay.

Q Mewbourne's got a well drilling in that unit, doesn't it?

A I think so. That's my understanding.

Q All right. Is there also a drilling well in Section 23 in the southwest of the southwest of that section?

A I know that one's intended there but I -- I don't know whether or not it's been spudded.

Q Does it eliminate TXO's economic risk, Mr. Wood, if Mr. Sprinkle's 30 percent interest in the northwest quarter is penalized at 180 percent forced pooling

penalty? Does that cover the economic risk to TXO of the prospect?

A Repeat that. Let me think about that for a second.

Q All right. You indicated that there's an economic risk involved.

A Uh-huh.

Q All right. Mr. Sprinkle has a 30 percent interest in the well.

A Uh-huh.

Q If we're assigning $615,000 to the estimate of the well costs, and if on top of recovering those costs we are also recovering an additional 180 percent penalty factor, as Mr. O'Hare has suggested because of this, will that result in a sufficient volume of dollars in order to cover the economic risk that you have projected for the wells?

A I don't know exactly. It would certainly reduce our exposure, as far as dollars went. While we would have to pay more, we would at the same time have a higher dollar amount coming back in to us.

Q You talked awhile ago about the development risk of the chance of success on the No. 3 Well in your opinion was a 75 percent chance of success. You gave me that number.

A That's more or less a rule of thumb success probability for a development well, and as best as I can tell, pending results from the Mewbourne well, that I don't have a better number to use at this point.

Q What is the lowest reasonable percentage or chance of success that your company would use before it wouldn't drill a well?

A I haven't calculated that. That all depends on how much -- we can -- we can drill a well at, say, figure one chance out of eight, if the possible return on it is high enough, either return on investment or rate of return. That all depends on how much you're going to make and how fast you're going to make it, and of course, the big question there, the two big questions here seem to be is the sand there and what will the recovery factor be.

The sands you don't know about unitl -- for sure until you drill a well and the recovery factor, you can't calculate until the field is depleted.

Q I didn't make myself clear, I'm sorry.

We've got three wells in the north half of 26.

A Uh-huh.

Q You tell me that you've gone to your management and you've told them that there's a 75 percent chance of success for the No. 3 Well, and I guess they've

told you go ahead and drill it, because that's what we're here for, all right?

What number do you have to give them before they tell you, Mr. Wood, this is a bad idea, we're not going to do it?

How do I know what your management does in terms of your recommendation? That's all I'm asking.

A I don't know. That's a function of our exposure, to really, you know, you would be willing to do a riskier deal if it was shallow and didn't cost much --

Q I understand that, but from these facts, from these facts, Mr. Wood.

A I don't know where the cutoff would be.

Q Okay, well, you just went to your management and said 75 chance of success and we're doing the well.

A Yes, based on this reserve number; the fact that we -- we haven't been offset yet; we will be offset sometime in the future, that will affect the amount of reserves that we get out ultimately, and, of course, whether or not the sands will be there in adequate amounts. We've seen from the Burleson 1 and the Sprinkle 1 are both good wells, but right in between the two we have the Sprinkle Federal No. 2, which is not going to be nearly as good as those others, those other two wells.

Q Have you given consideration to recom-

mending to your management that this area be spaced on 80-acre spacing for a temporary period in order to minimize the risk?

A That has been discussed; however, we decided not to try and do that, at least at this time, due to the fact that we were being offset rapidly, it appears on the all sides, and the fact that to the best of my ability, I would say that we would be leaving oil in the ground if we did drill it up on eighties, particularly the way the wells have been spaced, because you're going to get -- you're going to break a lot of gas out and in the extremes of 80-acre sections you're going to get some gas out and you're going to leave some dead oil in place that would have been recovered by wells on 40 acres.

That, combined with the fact that we're in a competitive situation with direct offsets, led us to the conclusion that we should go ahead and pursue developing on 40 acres, that the -- we would suffer less loss that way and that we still had the opportunity to make attractive deals.

MR. KELLAHIN: Nothing further.

MR. STOGNER: Thank you, Mr. Kellahin. Mr. Dickerson?

REDIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Wood, would it be roughly the converse of your 75 chance of success on the Sprinkle No. 3 Well to turn that around and say that you had a one in four chance of failure?

A Oh, absolutely. That's how we, you know, that's part of the process to arrive at that.

Q So it's the same -- it's the same difference as being -- having a 75 percent chance of crossing Cerrillos Road successfully or a one in four chance of getting hit by a Mack truck.

A That's right. One out of four wells will be dry, is what we're saying.

Q And so the maximum statutory penalty that can be assessed by this Division in a compulsory pooling case is obviously not tied to such simplistic 75 percent chance of success ratios, it recognizes, doesn't it appear to you as an engineer, that the purpose of the risk penalty is to compensate a party who has carried a nonconsenting party who had the right to consent to it, for all the cost of drilling that well at all the risk of the paying party?

MR. KELLAHIN: I'm going to object to that question. That's argumentative.

MR. DICKERSON: I think it's

obvious, Mr. Stogner.

I have no further questions.

MR. STOGNER: Thank you, Mr. Dickerson.

Any other questions of this witness?

If not, he may be excused.

Mr. Dickerson, do you wish to recall any of your witnesses?

MR. DICKERSON: No, Mr. Examiner, we will rest at this time.

MR. STOGNER: Thank you, Mr. Dickerson.

Mr. Kellahin, I believe it's your turn.

MR. KELLAHIN: Yes, sir, we'll call Mr. McCoy.

WILLIAM G. McCOY,

being called as a witness and being duly sworn upon his oath, testified as follows, to-wit:

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q Mr. McCoy, for the record would you

please state your name and occupation?

A My name is William G. McCoy. I'm a consulting engineer and geologist, living in Santa Fe, New Mexico.

Q Mr. McCoy, have you previously qualified before the Oil Conservation Division of New Mexico as a petroleum engineer and geologist?

A I have.

Q And have you been retained by Mr. Sprinkle to make an evaluation of the Bone Springs and of his interest in the production in Section 26 of the township and range that's under discussion here?

A I have.

MR. KELLAHIN: We tender Mr. McCoy as an expert petroleum geologist and engineer.

MR. STOGNER: Are there any objections?

MR. DICKERSON: No objection.

MR. STOGNER: Mr. McCoy is so qualified.

Q Mr. McCoy, I want to direct your attention to certain portions of the case and let's start, sir, with the overhead charges that TXO has requested be assessed in the two pooling applications that are under discussion.

I believe it was Mr. Bourgeois' testimony

that the overhead rate he was proposing for a producing well was $538 and for a drilling well rate of $5374.

I show you, sir, what is marked as Sprinkle Exhibit Number Three, and ask you to identify the source of this information for us.

A This is a copy of a page from a publication by Ernst and Whinney, accountants well known in the business, who make a yearly survey of various companies, what they charge for oil wells, gas wells, the drilling rate and the monthly producting rates, and in the absence of any unusual data, this type information is generally used in working out your operating agreement with nonoperators, and generally we use the average or a mean value in each case.

In this instance, in the 5000 to 10,000 feet, the drilling well rate would be 3753; monthly producing rate would be $392 per month.

Q Based upon your experience, Mr. McCoy, do you have a recommendation to this examiner as to what would be a reasonable overhead rate to assess in this pooling order?

A I would accept the average value presented in the Ernst and Whinney Report.

Q Let me direct your attention now, sir, tod the question of the AFE's that were the subject of the earlier discussion we had in this hearing, and I'm going to

show you for reference a copy of Mr. Bourgeois' exhibit that shows the AFE on the Sprinkle 4 and a copy of Sprinkle Exhibit One that shows the AFE on the Burleson Federal No. 3.

You've heard the discussions of both Mr. Bourgeois and of Mr. Cate concerning the preparation of the estimate of well expenditures.

Have you also made a review of those AFEs prior to the hearing?

A I have.

Q Do you have a recommendation to the Examiner as to what you would consider to be a reasonable estimate to be applied in the pooling order for a well of this type at this depth?

A I would accept the AFE on the No. 3 Burleson as beng reasonable for the area, recognizing that it is an estimate and only that.

The additional, say, $116,000 I don't feel could be justified by additional tank batteries.

Q Let me direct your attention, Mr. McCoy, to I believe it's Exhibit Number Four. Would you describe for us generally, Mr. McCoy, what has been your experience within this particular area concerning putting together prospects as a geologist and as an engineer, also?

A Within the area in Section 20, Unit G, I originated a drilling prospect for a Morrow test, did all

the AFE preparation, promoted the well, and ARCO drilled it. It's a three section unit; had to put together a working interest unit, and ARCO turned out to be the operator because of their interest in the well.

So I'm familiar with the area.

Also in the North Young Spring -- North Young Bone Springs Unit, Section 9, 4, I do work for a Mr. Anderso who has a small working interest in the unit.

Q Would you direct your attention to what is marked as Exhibit Number Four and identify that exhibit for us?

A Exhibit Four is my interpretation of the structure on top of the first Bone Springs Sand pay.

On it, I think, starting with Section 26, Unit A, we have a location for the No. 2 Burleson Federal; Unit B is the No. 1 Burleson Federal, which was completed as a producer from the pay. Unit C is the No. 2 Sprinkle completed from the same pay. Unit D is the No. 1 Sprinkle, and I have evidently, according to their exhibits mislocated the 3 and 4 Sprinkle Federal in Units E and F.

Unit G is the -- is the location for the No. 3 Burleson Federal. Unit H is the location for the No. 4 Sprinkle Federal -- I mean Burleson Federal.

In Section 23, Unit M is the Marshall and Winston Well which was spudded on December 31st and today's

report, the well was drilling at 4975 feet.

In Section 27, Unit A, the Newbourne Oil Company No. 11-E is at total depth and is in the process of being completed as of this date. And the other wells, the Black wells in Section 27 are Bone Springs producers from the same pay and in Section 34, Section 35 from the Bone Springs pay.

And in determining this pay, it is not one solid sand. It, in the No. 1 Burleson -- Sprinkle Federal I think there are three separate zones. So you can have from one to possibly four different zones within that pay interval.

Q At this time, Mr. McCoy, I'd like to show you Exhibit Number Five and have you identify Exhibit Number Five for us.

A Exhibit Number Five is my interpretation of the Isopach of this pay zone interval in the first Bone Springs Sand.

I did not have the interval in the No. 1 Burleson Federal to put on, but I believe at this time it's 26 feet, which means that you would bring the No. 2 Sprinkle in Unit C, the contour line at that point, to the north of the No. 1 Burleson Federal, opening up the structure to the east as far as thickness of sand.

Q I wanted to place before you at this

time, Mr. McCoy, copies of Mr. O'Hare's Exhibit Five, which is his structure map and a copy of his Exhibit Number Six, which is his Isopach map, and then we'll ask you some questions.

Looking at your Exhibit Number Five, your Isopach, have you honored all the data points that are available to you in drawing the contours for the Isopach?

A The only discrepancy is I used his value on Unit B in Section 27. I did not have the log; therefore I used his three feet on my Isopach.

You will notice on Exhibit Four I did not use the datum on top of the pay because I could not locate a log in Santa Fe.

Q Mr. O'Hare has re-adjusted his Ispach for the well in Section 27 and has now utilized, I believe, 31 feet, 32 feet. Will that have a material effect on how you would re-contour the Isopach that you've prepared?

A It would not affect the Sprinkle acreage. It would affect the acreage in the northeast quarter of Section 27 and the southeast quarter of Section 22.

Q What conclusions do you draw, Mr. McCoy, from an examination of your structure and your Isopach with regards to assessing the geologic risk involved in the Sprinkle 3 and 4 Wells?

A In my opinion, I think that the risk is

-- would be standard for a development well, which I believe nationwide is 80 percent. I think we heard 75 percent, so we're within the same ballpark.

The structure map that I have and the structure map that TXO has presented are essentially the same.

Q Are there any other geologic conclusions that you can draw at this time with regards to a comparison of your work from that of Mr. O'Hare in terms of the issues before the Examiner today?

A I don't -- I think that we could take the same data on their Exhibit Six and probably readjust it to account for the acreage opening up and being shown on my map as being 26+ feet.

Q Let me direct your attention now, sir, to assessing the engineering risk involved and the economics involved in this prospect, and for -- for that purpose I want to show you what is marked as Exhibit Number Six.

A Exhibit Number Six is my interpretation of the data that I utilized to calculate the reserves on the Sprinkle No. 1, and the data was acquired partially through TXO and partially through Mr. Sprinkle.

Since the, I think my thickness is 26 feet of pay as opposed to theirs of 30.

The water saturation I calculated was 25

-- 45 percent. I believe they used a minium of 37 and also 48.

Our porosity is essentially the same, 11.5 for my interpretation, 11.6 for theirs.

Gas/oil ratio, gravity, were furnished.

Initial bottom hole was calculated from the initial bottom hole pressure survey.

Bubble point pressure was calculated from an imperical calculation, as was the oil viscosity and the formation volume factor.

We used the Burleson Federal completion cost of 496,900. Using my calculations and my recovery factor of 25 percent, we calculate the recoverable reserves at 106,317 barrels.

The prices shown at the bottom were furnished me from production in November of 1985 by Atlantic Richfield, and I have taken their initial price, subracted out the transportation, state tax, and windfall profits tax, and calculated a net barrel -- price per barrel of $20.23.

The gas price was based on what I see in the market clearing price of 2.20 per MCF, with 15.7 state tax.

Q Mr. Wood has defined for us earlier what he thought was a successful well using a per barrel price for oil of $26.00. He estimated for us he would need appro-

ximately 90,000 barrels of oil to have a successful prospect using the economic return on investment and ratio he testified.

A Uh-huh.

Q Using his economic criteria and using your recoverable primary reserve number, would this well be economic?

A Using my recoverable --

Q Yes, sir.

A -- yes, it would.

Q You have used a recovery factor of 25 percent, Mr. McCoy. Would you describe for us your opinion as to why that number is more reliable than the one used by Mr. Wood?

A I don't -- well, let me state this. I'm going to express my opinion that 20 percent would be a standard, in the absence of any reservoir data, 20 percent would be a standard factor for a solution gas drive. It's my opinion there is a partial water drive and I have added 5 percent for that factor.

But 20 percent is a reasonable figure in the absence of conflicting data.

Q Are you familiar with the report that -- or study that Mr. Wood referred to in which he said that the range of maximum recovery was 30 percent versus a minimum 12

percent for reservoirs of the type that he characterized?

A Not immediately, but I've seen the actual article.

Q All right, sir.

Let's turn now, sir, to your evaluation of the economics, and I'm going to direct your attention to Exhibit Number Seven. Does this also represent your work product, Mr. McCoy?

A Yes, uh-huh.

Q Would you describe for us what you've done in this analysis?

A In this analysis the purpose of it was to try and determine what the ultimate penalty would cost Mr. Sprinkle in dollars due to the 180 percent risk factor.

And we start up at the top with the No. 1 Burleson Federal's AFE, and my calculation of reserves, I've assumed 160 barrels a day average production during payout period.

Using again my $20.00 per barrel oil price; $2.04 gas; $22.04 is the average income per barrel.

Taking the 160 times a day rate you come up with 4864 barrels per month, gross.

Gross income is 87 percent net revenue interest gives you the net revenue to the working interest; take off $1200 a month for operating costs; you have a net

income for the working interest.

Based on that net income and your well cost, the payout should be approximately 5.4 months.

Return on investment, using the well cost and the ultimate reserves is 3.7.

Then trying to work to Mr. Sprinkle's penalty, we take the gross barrels to payout and add onto that the penalty barrels to pay off the penalty, giving us the total of 73,000 barrels of oil to eliminate the penalty and for Mr. Sprinkle to regain his interest in the well.

At this time, taking that figure and subtracting it from the reserves, we find we have 32,773 left. Of that Mr. Sprinkle's 27 percent interest would be 8900.

His original reserves based on the 106,000 would be 28,000. His reserves lost due to the drilling and risk penalty of 19,000 barrels, the value of those, $440,700. Take off his drilling cost, actual drilling cost and we have a net loss of $285,419 as a direct result of the penalty assessed Mr. Sprinkle.

Q When we look to the middle of the exhibit and look at the return on investment of the 3.7, how do I understand that number in relation to Mr. O'Hare's testimony about a rate of return of 2-to-1 or Mr. Wood's testimony about a 3-to-1 rate of return?

What does 3.7 mean in terms of that?

A Well, I think this would be, probably, at your -- well, this depends. I'm looking at it from the independent's side and not a major company, but I would say a 3.7 for an independent is a minimum level; probably for a major company would be above average.

If we look at your gross barrels to payout of the 26,000 barrels, and if we use Mr. Wood's Exhibit A on his volumetric calculation where he shows just over 52,000 barrels of oil being recovered from the Sprinkle 1 Well, that would give you approximately a 2-to-1 return on investment, would it not?

A What, his 53,000?

Q Yes, sir.

A I think it would be less than that. I think it would be on the order of less than one, probably 9 -- I think I've calculated it, 9/10ths-to-1.

Q Can you conclude for us, Mr. McCoy, what percentage risk you would recommend that the examiner use in these forced pooling orders?

A Well, I think risk has to e related directly to this lease we're dealing with. We now have one, two, three producing wells. We have one, two offset wells, which have, one of them has pipe run, so probably we're going to have four producers.

I think the 80 percent success ratio is

being substantiated right now with those producing wells. I think the risk factor would be just the 20 percent remaining.

Q In terms of the statutory penalty applied by the Commission of allowing the operating party under the pooling order to recover out of the nonconsenting owner's share of production, that owner's share of the costs of the well, plus a maximum of 200 percent more, in terms of that relationship, what percentage assessment would you make in this case?

A Well, I would still take the 100 percent well cost plus 25 -- 20 percent markup as being adequate.

Q In terms of the sequence of events in order to give you as an expert or Mr. Sprinkle as a pooled party a fair opportunity in order to exercise his election, how would you recommend the examiner set forth the procedures for the drilling of the wells involved and the dissemination of the information resulting from that drilling?

A Well, number one, I think that Mr. Sprinkle directly should be furnished all information available from the No. 1 and the No. 2 Sprinkle, including invoices of actual well costs.

I think that the No. 3 and No. 4 Wells should be delayed until we have completion on the No. 11-E Mewbourne Well and the Marshall and Winston Well, in order

to generate more reliable data.

I think that it would be advisable, also, for TXO, if there is a question of the economics in a particular instance, to undertake more reservoir studies to acquire more information that would give us a better picture of what we're dealing in this type reservoir.

Q Do you have a recommendation to the Examiner concerning the information derived from the drilling of the No. 3 Well in relation to Mr. Sprinkle's election of participating in the fourth well?

A The same information and adequate time for evaluation of that data.

Q Why do you recommend that the wells be drilled consecutively versus concurrently and why do you recommend that the information be made available to Mr. Sprinkle in that order?

A That's standard operating procedure to drill one well, run your logs, make your evaluation, acquire additional data, then make your proposal to your joint interest partners to drill the next well based on, and furnishing them that information to justify the next location.

Q Would a procedure that follows that recommendation be one protected Mr. Sprinkle's correlative rights insofar as making his elections in this acreage be concerned?

A Yes, it would.

Q Is there anything else that you would like to add to your testimony at this time, Mr. McCoy?

A No, not at this time.

Q Were Exhibits Three through Seven prepared by you? I believe those represented geologic presentation and the economic and engineering parameters?

A Yes, I think Seven was the last, yeah.

Q All right, sir.

MR. KELLAHIN: At this time, Mr. Examiner, we move the introduction of Exhibits Three through Seven.

MR. STOGNER: Are there any objections?

MR. DICKERSON: Mr. Examiner, I have no objection to the admission of Exhibits Four through Seven.

I do have an objection to the admission of Exhibit Number Three. That is some purported survey result. There has been no testimony, no foundation, nor is there any supporting data submitted along with the raw conclusions expressed in this survey as to the underlying data that went into the study.

Obviously, and I think as Mr. McCoy conceded, independents and larger operators as opposed

to smaller operators, obviously have a higher overhead cost. Without a foundation, which has not been offered as to what companies, whether this included Mom and Pop operations, whether 75 percent of the survey answered, you'll see that the responses are set forth for two years, '85 and '84, whether 75 percent of those are one-horse operations or 75 percent of them are major oil companies, or whether they're equivalent to the size of TXO, none of that's explained and there's been no foundation. This is absolutely useless for your purposes in attempting to judge the proper supervision costs to be imposed in these requested forced pooling orders.

MR. KELLAHIN: If the Examiner please, this is a document that's typically inroduced before you in hearings. You are ofte presented with public information, source documents. We believe a proper foundation in fact has been used in this case. This document in fact has been used in similar cases before the Commission.

Mr. Dickerson's arguments may go to the weight to the information available for the purpose for which you may want to use it, and I believe Mr. McCoy has laid a proper foundation to show that it's reliable and ought to be properly introduced for consideration, and we so move.

MR. STOGNER: Mr. Dickerson,

I'm familiar with this publication that this comes from and we have in the past accepted copies of pages from other publications and will probably do so in the future.

I'm going to note your objection and let Number Three, Exhibit Number Three be admitted as evidence, along with Four through Seven.

MR. DICKERSON: Mr. Examiner, can I ask how long you would consent to sitting in an attempt to finish this today? Do you have a deadline by which you want us out of here or carry over to tomorrow, or whatever?

MR. STOGNER: Let's go off the record for a second.

(Thereupon a discussion was had off the record.)

MR. STOGNER: Here we go. The hearing will come to order.

Mr. Dickerson, I believe we're ready to cross examine Mr. McCoy.

CROSS EXAMINATION

BY MR. DICKERSON:

Q Mr. McCoy, I think in fairness you might concede with us that your Exhibits Four and Five, your in-

terpretations based on the geologic data and your maps drawn based on that, are a matter of opinion?

A It's not a matter of opinion. I've looked at some of the logs to verify the information in the hearing.

Q No, I understand that, but the -- even though your data points on which you draw your contour lines for exhibit on Section 5 are far different from those of Mr. O'Hare's interpretation based on the same raw data. There is an element, is there not, of your personal opinion and his personal opinion being involved when we're all trying to guess what is 9000 feet below the ground?

A Well, I think geologically, I don't think there's that much discrepancy, if you look at Exhibits -- my Exhibit Four and their Exhibit Five. I don't think you could say there's a radical difference.

Q Would you agree that yours is considerably simpler than his?

A Yes, it probably is.

Q Would you have an estimate of how much time you have devoted to this study?

A No, I don't keep a record book on it. I work on it and pull the logs and probably I can go through logs a little faster than some, but I do go through there and -- I don't know what your point is, but I don't think

they were that radically different, except that you have --

Q Well, you have -- well, my point is that the drill bit teaches us all what is --

A Yes, we have that.

Q -- 9000 feet below the ground --

A Right.

Q -- and we geologists and engineers get together and we all opine about what is there, but that drill bit is going to establish what is or isn't there, isn't it?

A Yeah, a dollar and a bit get you production.

Q With respect to your Exhibit Number Six, Mr. McCoy, your calculations of the recoverable reserves in this -- is that the Sprinkle No. 1 Well?

A Uh-huh.

Q What's the biggest factor that leads to the large discrepancy between the figures that Mr. Wood came up with and these that you come up with?

A Just the recovery factor.

Q Would you agree with the statement he made that until this field is depleted, none of us, in fact, know what the true recovery factor is?

A Right.

Q So that the more than double recovery

factor that you have used leads virtually to all the increase in reserves.

A Well, that's true, but I still think as a general industrywide acceptance of a 20 percent recovery factor on solution gas drive without conflicting data is acceptable.

Q Then you do think that this is -- you mentioned some opinion you had that this was a partial water drive?

A Very, very partial. We're getting water and a high water saturation.

Q Is that the factor that makes you think it's partly attributable to a water drive?

A Yeah, but that's insignificant. That's only 5 percent added to that and that's not significant.

Q Is that -- is that consistent with the testimony that we've heard regarding the rather tight nature of this porosity and the necessity of fracing these wells in order to obtain this production?

A Well, there's -- now if you want a little bit, I could expound on that.

I think the result of the fracing of the well is not absolutely directed towards the formation and its characteristic.

I think the fact that the well was dril-

led through for a period of 21, 21 days, having mud filtrate invasion and so forth, restricted the producing capacity of the well and could have required a frac job.

Q Could have what?

A Could have restricted the production and required a frac job to open up the formation again.

Now I'm not saying that's --

Q That's specualtion, isn't it?

A Yeah, but I mean it's very possible when you drill over a formation. There are instances where -- well, I won't comment on that, but there are instances where companies dealing with a particular formation will stop and complete the well at that point and then scoot over and drill a new well to the deeper formation because of the potential damage to the formation during drilling.

Q In connection with our consultation for Mr. Sprinkle in these cases, Mr. McCoy, is it part of your task to recommend to him whether or not he participates in these wells?

A I was not asked to do that.

Q If you were asked to do that, what would your recommendation be?

A My recommendation to Mr. Sprinkle based on the data we have available at this moment is that he recommend to TXO that until they have adequate information and the two

offset wells are completed, that we delay drilling until such time as those wells are drilled.

Q And until such time as TXO's drilling obligation under its farmout commitments have expired?

A You're talking to something I cannot answer.

Q You've heard the testimony regarding that, though, haven't you?

A Yeah, but I --

Q What you really recommend is that Mr. Sprinkle get another free ride on this No. 3 Well --

A No.

Q -- just like he got on the No. 2 Well, isn't it?

A That's not what I recommended. I said don't drill the well today. You don't have the information that would justify it.

Q How long do you want TXO to wait?

A Well, I would say if we drill -- Mewbourne ought to be completed within a week; Marshall and Winston probably within two weeks. That's not asking a lot.

Q This well, given the history of this dispute, is not going to be drilled in two weeks.

A No, but that's what I'm saying, we'll have that much more information and at that time with that

information, I think Mr. Sprinkle can make a decision to --

Q Well, you understand, do you not, Mr. McCoy, that when an order comes down force pooling his interest from this Divison, he's going to have a period of time after the issuance of that order in which to make his election.

A Yes.

Q So he's going to get -- still has the right and is extended the opportunity to participate in this well. Do you understand that?

A Yeah, I understand that, but I --

Q You would rather, I presume, as being a consultant employed by him, though, have the well drilled and him able to analyze it and then make his decision?

A I would never recommend that.

Q You wouldn't?

A No. I still say that Mr. Sprinkle's position today, if you were to ask him what did the No. 2 Well cost, what is this -- what does it look like, what is the completion interval, he has no information, no information. TXO has made no effort to furnish him with information to make a decision.

Q Well, that's your opinion.

A No, that's a fact. Mr. Sprinkle will say it.

Q Well, I know Mr. Sprinkle will say that --

A Well then --

Q -- and I know my people will say something different.

A Okay.

Q So that is not getting --

A Okay, all right, we're not --

Q -- us anywhere .

MR. KELLAHIN: Let's go on -- let's --

MR. STOGNER: One at a time; one at a time.

MR. KELLAHIN: Counsel is arguing with the witness.

A Okay.

MR. KELLAHIN: Let's get back on the subject.

MR. STOGNER: Mr. Dickerson.

Q Mr. McCoy, let me change a minute and direct your attention to your testiony regarding the reasonable well costs in your view of this Sprinkle 3 and 4 Well.

You testified, I think, that $496,000, roughly, representing the same cost as the Burleson Well --

A No, I --

Q -- AFE would be reasonable?

A I said the AFE on the Burleson No. 2 appeared to be a reasonable estimate of the costs.

Q Which was $496,000, roughly?

A That's right.

Q Now you heard the testimony, didn't you, Mr. McCoy, about the necessity by reason of differing ownership of production for separate tank batteries on the --

A Yes, I did.

Q Did you not believe that testimoy?

A Well, let's say I have a question in my mind, as I recall the testimony, that TXO might have a different interest in each of the wells.

Is that correct?

Q Well, if memory serves me, I think the testimony was if anyone, if any interest owner in a well has a different interest, the rules of the OCD require separate tank batteries, but regardless, was it your understanding of that testimony that the total difference was solely attributable to the cost of the tank batteries separately on the Sprinkle wells, whereas --

A That was my understanding.

Q Let me refresh your memory a little bit and see if we didn't also hear some testimony that part of that was due to a recommendation of 4-1/2 inch casing on the

-- on the Sprinkle -- or on the Burleson wells --

A Yes.

Q -- and 5-1/2 has been utilized on the --

A Uh-huh.

Q -- and further testimony that part of that cost differential was attributable to separation equipment, also, but also required in connection with a separate tank battery.

Now, it's -- and pumping units, as well?

A (Not clearly understood.)

Q The -- it's fairly obvious, though, isn't it Mr. McCoy, that four separate tank batteries to hold the same quantity of oil cost more than if you are fortunate enough to be able to hold all that oil in one tank battery?

A Well, I would say this. That I think that is true, but I think we have measurement techniques today where we could probably put a header in there and run the wells through it and separately meter each well. I believe I've seen advertisements of metering equipment today.

Q But your recommendation that the Burleson AFE figures be utilized on the Sprinkle wells did not calculate the cost of those alternatives, or anything like that?

A No.

Q Mr. Sprinkle, or excuse me, Mr. McCoy, directing your attention to your Exhibit Number Seven, I was

a little bit confused by that testimony as far as how it is punitive to Mr. Sprinkle at the rates of penalty that TXO has suggested in here?

A Uh-huh.

Q Couldn't all this penalty be avoided by him participating in this well?

A It could, and I think it's a matter of information to Mr. Sprinkle whether he does it or not.

Q If you were asked to make a recommendation, would it be your recommendation to him that he participate in this well?

A At this time, no, because I would rather see the offset wells (not clearly understood) and completed. That will give me that much more information to eliminate that much more of risk in drilling the well.

We could probably, with those two wells, and the information we'd have on them, maybe eliminate any of this.

Q In your opinion, Mr. McCoy, and based on your recommendation of a 20 percent risk penalty, you've testified before this Division many times, haven't you?

A Yes.

Q Can you cite me an example of a case where this Division has imposed a 20 percent risk penalty on the nonconsenting interest owners?

A No. But that doesn't make it right.

Q Can you describe to me or cite me an authority or explain your thinking a little bit, as I understood it, your recommendation of a 20 percent risk penalty was supposedly the equivalent of the 80 percent success factor that --

A Right.

Q -- that we had testimony from TXO regarding?

A 80 percent or eight out of ten wells would be productive.

Q But is it not the case that the risk penalty is designed to penalize --

A It's a penalty, yeah --

Q -- for the risk involved in the well.

A Uh-huh.

Q Let me ask you, if you were consulting with TXO or anyone else --

A Uh-huh.

Q -- in the position of being an operator, ready, willing, and able to drill a well, and on these same circumstances, would you recommend that any prudent operator drill a well to this depth at this cost on a 31-1/4 percent interest for the return of a 20 risk penalty if, as, and when the well ever produced that much?

A Well, I think we're speculating again, but I would say that: That let's turn it around and say that I'm the operator, TXO was 31 percent, based on the data we have today, I think, number one, I would have made a ore adequate offer that they join or farm out on the basis of a 50 percent back in, because the risk is (not understood). 25 percent back in is standard for a wildcate well but not for an offset development well such as this.

I would have made every effort to make a deal on that basis.

Q Are you aware that -- that when the first well was drilled, the Sprinkle Federal No. 1, when that well was drilled, that TXO's offer was on the basis of a 25 percent back in?

A Yeah, that was a wildcat well.

Q Uh-huh.

A But it should change once you get production. You cannot use that back in on a development well.

Q But it changed, did it not, because of TXO's initiative in drilling that well.

A Yeah, all right.

Q It was their money that paid that drill bit to get down there and find 220 barrels a day.

A Right.

Q It was not Mr. Sprinkle's.

A Right.

Q He chose not to participate.

A That takes care of No. 1.

Now we're into a position of drilling No. 2 and he still has the option.

Q And he participated in the No. 2, did he not?

A Right.

Q Now it's the No. 3 we're discussing and the No. 4.

A Uh-huh.

Q As far as your recommendations to the Division about all the information to be furnished by Mr. Sprinkle, that basically is the information that is customarily furnished among co-developing parties, such as when they're jointly interested in drilling, participating in a well, is it not?

In your experience in this business, Mr. McCoy, has it been your experience that -- that operators are ordered and in the custom of the industry make it a practice of revealing all their proprietary information to their competitors?

A Not to their competitors but to their joint interest owners.

Q Under a joint operating agreement.

A Yes. Yes.

Q But you recognize, don't you, that until Mr. Sprinkle signs the joint operating agreement and agrees to participate in these wells, we don't have an agreement with im to do that.

A Well, I think if you're -- if you are trying to do everything possible to solve the problem that may exist, I think you would make every effort to give all the information that you have available showing your willingness to help him make a decision to join or not.

I think you'd do that.

MR. DICKERSON: I have no further questions.

MR. STOGNER: Mr. Kellahin.

MR. KELLAHIN: Nothing further.

CROSS EXAMINATION

BY MR. STOGNER:

Q Mr. McCoy, we alluded a couple of times to a couple of wells as shown on your exhibits here.

A Uh-huh.

Q The Mewbourne well, which is the northeast quarter of the northeast quarter of 27, which one is that one?

A That's the No. 11-E, as in "eager",

that's at total depth.

Q I'm sorry?

A It's at total depth and I talked to the District Geologist there and he is supposed to send me a log on it, and let me know when they start their completion work, which should be this week, and here it is Thursday, and I haven't heard yet.

Q And when did they spud that well, do you know?

A I didn't get the spud date. I just got the fact that they're at total depth and running pipe and cementing, ready for completion.

Q About how long does it generally take to drill down (not clearly understood)?

A It should be about 20, 27 days.

Q Okay, let's go up to the southwest quarter southwest quarter of 23, that Marshall, a Marshall --

A Marshall and Winston. That was spudded 12-31-85 and today's drilling report, 4975.

Q Do you know if either one of these had a December 31st, 1985, lease deadline?

A No, but I can tell by looking at our map that we had -- that there, probably, I would assume that date was based on tax purposes.

Q Tax purposes alone?

A Yeah, I'm just speculating.

Q Okay. You don't know if they were waiting for TXO to drill their well or not?

A No, because their activity, Marshall and Winston are not that active, that they're actually drilling, because when I called them about this particular well, I said, the one here. She said, oh, the one in southeast New Mexico.

So it must be the only one they're drilling so they're not that active.

MR. STOGNER: Okay, I have no further questions of Mr. McCoy.

Are there any other questions of this witness?

If not, he may be excused.

Mr. Kellahin?

MR. KELLAHIN: I have nothing further, Mr. Examiner.

MR. STOGNER: Mr. Dickerson, do you wish ot recall any of your witnesses?

MR. DICKERSON: I am going to recall Mr. Bourgeois very briefly.

JEFF BOURGEOIS,

being recalled as a witness and remainng still under oath, testified as follows, to-wit:

REDIRECT EXAMINATION

BY MR. DICKERSON:

Q Mr. Bourgeois, you heard Mr. McCoy's testimony regarding the supervision costs and the factors recommended by him based on Sprinkle Exhibit Number Three, did you not?

A Yes, I did.

Q I wonder if we might go back to Exhibit Number Five that was introduced in the original hearing of 8755, and would you refresh us on what that is?

A TXO Exhibit Number Five in the Examiner Hearing on November 21st, '85, in Case Number 8755, was an operating agreement.

MR. STOGNER: Let me dig that out, first.

A Okay. This was submitted to show that the overhead rates that we are requesting had been agreed to by outside nonoperating parties. In particular in this case it is PetroAtlas Corporation. The operating agreement was the one used for this acreage. They had executed the operating agreement, and on the COPAS Exhibit 3, excuse me, Ex-

hibit C, page 3, the overhead rates of $5374 per month drilling and $538 per month producing were used in this particular agreement.

Also, another party, Mr. Cecil Rhodes, has agreed to these same rates we are requesting and has executed the operating agreement using these rates.

Q Now these are independent parties and no way related to TXO; these are arms-length transactions?

A Yes, they were.

Q Do you have any experience in your Burleson Well regarding supervision rates for wells in this area of this depth and cost?

A Mr. Burleson, Mr. Lewis B. Burleson and Mr. Jack Huff have both executed operating agreements with the joinder of their spouses, using identical overhead rates and have agreed to the drilling of all four of the proposed Burleson Federal wells.

Q Now your Exhibit Number Six introduced at the prior hearing in this case also bore on the question of overhead charges, did it not?

A Yes, it did.

Q And what was that?

A That was -- Exhibit Six was the interoffice memo prepared by our Dallas Accounting Department, setting forth the overhead rates which the various TXO dis-

tricts were to use.

Q And to your knowledge was that based on TXO's experience as to its overhead costs actually incurred?

A Yes.

MR. DICKERSON: I have no further questions of Mr. Bourgeois.

MR. STOGNER: Thank you, Mr. Dickerson.

Mr. Kellahin:

MR. KELLAHIN: No, sir.

CROSS EXAMINATION

BY MR. STOGNER:

Q Mr. Bourgeois, has TXO agreed to overhead charges of this amount or over?

A I don't recall any recent wells where we were a party to the well as a non-operator.

In a recent case before the hearing, the Pennzoil-TXO controversy, their proposed rates were, I believe, $5500 a month drilling and $550 a month producing, which are slightly higher than ours, and although they were different, they were not a point of contention in this case, and should that order be rendered in favor of Pennzoil to where they are the operator of the well and those overhead rates are proposed, TXO would accept those.

Q But the answer is no, that TXO has not agreed to these charges?

A Not in Lea County. We haven't been a non-operator recently.

Q Thank you, Mr. Bourgeois.

MR. STOGNER: Mr. Kellahin, would you wish to recall a witness at this time?

MR. KELLAHIN: No, sir.

MR. STOGNER: Mr. Dickerson?

MR. DICKERSON: No.

MR. STOGNER: I believe we're ready now for closing statements of both parties.

Mr. Kellahin, I'm going to ask you to go first.

Mr. Dickerson, you follow up.

Before we get going with closing statements, I would like to urge TXO and Mr. Sprinkle and Mr. Dickerson, any of your clients, and Mr. Kellahin, any of your clients, to participate in Mr. Whinney's Summary of Overhead Charges.

Mr. Kellahin, you may go first.

MR. KELLAHIN: We appreciate the fact, Mr. Examiner, that you have personally devoted a great deal of time to hearing this case.

We think this is an excellent

opportunity for the Commission to enter new guidelines and directions on forced pooling cases. There are issues raised in this case that need to be dealt with by the Commission to give us some new direction.

We also appreciate the fact that this is a complex matter. It is not the typical forced pooling case where you see a company coming in and trying to pool somebody they either can't find or who obviously doesn't want to have anything to do with the drilling of the wells.

We want to take the opportunity, if you'll allow us to submit an order we think will handle these two cases fairly and reasonably.

But this is not an issue of forced pooling. This case is about fair play.

We believe that TXO has demonstrated an attitude in this proceedings that the Commission ought not to tolerate. It's exemplified in certain ways and I'll try to articulate some of those for you.

One of the first examples, I think, is to show the true lack of interest that TXO has in order to form a voluntary unit, as the Commission asks parties to do.

Our forced pooling statute is not intended nor should it be allowed to be used as a club,

particularly over the little guys like Mr. Sprinkle, who doesn't have an operating company, is not out there to drill wells, and can't complete -- compete with someone as aggressive and as belligerent as TXO has been in this matter.

A typical example, and I can cite a number one -- a number of them, but a typical example is the fact that on October 24th TXO sends Mr. notice -- Mr. Sprinkle the notice to join in the No. 3 Well, and the very next day TXO's attorneys are filing the forced pooling application on the No. 3 Well.

That is fair play. Another example of fair play is the attitude they've taken about the four wells involved.

Mr. Bourgeois offers Mr. Sprinkle on the initial well back in February and January of this year the 25 percent back in after payout. TXO wants a 75 percetn net revenue interest. This is when this is nothing more than a wildcat Morrow venture, and you expect that kind of reaction, they send out the letter. Mr. Sprinkle gets pooled, goes nonconsent with regards to the Morrow well.

The Morrow is a dry hole and they recomplete in the Bone Springs.

Mr. Dickerson would have you believe that Mr. Sprinkle has not paid for the No. 1 Well. In fact he has. You can look at the production. He's sub-

ject to the 200 percent penalty as they argue in that well. He's going to pay for that one.

What do they do, though, the very next well, they now have Bone Springs production, the next 40-acre offset, do they offer him a better deal? Certainly not. They take out the same word processor and spit out the same form letter and send him the same notice, 75 percent net revenue interest to TXO, and what do they do? They sit back and they force pool him.

What does Mr. Sprinkle do this time? He sees that they have Bone Springs in the No. 1 Well and he sends them a check based upon their AFE, a $615,000 AFE, he sends them a $192,000. Mr. Sprinkle writes them a check. He participates.

What happens? He's overpaid. They keep wanting to use the highest possible estimate for the cost of the 3 and 4 Wells, while at the same time 40 acres away they're treating Mr. Burleson differently. We think that's another element of not being fair.

Let's have some fair play here. Mr. Dickerson makes the point that he contends that Mr. Sprinkle got a free ride in the No. 2 Well. Well, free ride is not what Mr. Dickerson is saying. He's saying that because TXO got locked into their ninety day developement drilling obligation that they were required to commence the

No. 2 Well before the statutory notice period has expired for Mr. Sprinkle. The contention is, and the correct phrasing, is he got a free look at the result of the well.

He didn't get a free ride. He sent them a check.

What are we doing now? The offers haven't changed any. The parties, despite the period of time that's gone by, are still in the same position. They sent Mr. Berry $7500 for a one percent interest, and what do they offer Mr. Sprinkle? Oh, $105,000. You want to balance that out? It's $226,000 is what would have been a reasonable offer to Mr. Sprinkle. Naw, they want to nickel and dime him. You can see it in terms of the overhead charges. They don't want to use the standard of the survey. They want to stick him a little bit more; hit him with a little higher number.

We think that's also an element of unfair play.

But I think the issue that demonstrates the greatest unfairness, and the issue that disturbs my client the greatest, is TXO hiding behind the pooling order, contending that they don't have to give him information because he was force pooled or elected not to participate. They continue to tight hole the man; they don't give him information, while they have the same infor

mation from which to make their judgments and decisions about drilling. We think that is an essential element of the lack of fair play.

Mr. Dickerson makes a great point of parading the joint operating agreement in here. We've had that same operating agreement in every forced pooling TXO's put on, and if you look at that operating agreement, I suggest that one way you can balance the equities and one we'll write into the order for you, is that under the forced pooling order TXO be required to treat us as they would treat anybody else under that joint operating agreement that they time and time again put in evidence here. If that's what they want to use, let's use it, and under that agrement we're entitled to the information. We want the information. Mr. Sprinkle wants the same information they have to put his money at risk as they are putting theirs at risk.

We think it's only fair and the timing of the sequence in terms of their drilling obligations can be conducted so that when the No. 3 Well is ordered, that the thirty day election period can still run. They can still meet their deadlines. They can commence their well, but before the fourth well is spudded, we want the Comission to require that TXO provide us with the drilling, completion, and testing information on the No. 3 Well

so that Mr. Sprinkle has an opportunity to re-assess his risk.

It disturbs me greatly that TXO wants to drill three wells and already plans for five more. I'm glad their pockets are so deep, but that's not your obligation. Your statutory obligation is to make sure that Mr. Sprinkle's rights are treated fairly, and we suggest that that's the way to do it; require that the notices and the orders and the drilling of the well be done consecutively so that he's treated fairly.

In terms of the risk factor penalty, there again lies, I think, a compelling reason to show the lack of fair play. Not only do they have three producing, economic wells forty acres away from us, they're going to drill some more.

They've got the Burleson 3 gettng ready to go, and what do they want to do? They want ot stick him with 180 percent penalty, and I think you can calculate from Mr. McCoy's exhibits the fact that they're making their profit on force pooling. Not only is it a club against Mr. Sprinkle, they make money on that little devil. You see what happens? The forced pooling statute with the 30 percent interest to Sprinkle with 180 percent penalty is going to put $200-and something thousand in their pocket.

The reserves are there. They

can be produced. They're not risking anything. I think the only way you stop this kind of attitude by a company to use forced pooling as a bludgeon against people is you could zero them out on that risk factor or set as Mr. McCoy says, put it a reasonable number, and he says 25 percent.

I know Mr. Stamets and the Commission has not set one that low in a long time, but I can recall one time they did, against Cities Service. Cities Service was force pooled and a little old lady, whose husband before he died says, don't sell the leased, and she says, I'm not signing your lease because grandpa, before he died, said don't sell it.

And what did Mr. Stamets do? He says, we're going to protect the equities. Cities Service, in this situation, deserves only 25 percent; that's all at risk. What's at risk? The cost of the money they're advancing for her share.

Mr. Sprinkle's no different than that lady. He's in the same position in terms of economics. Why not compensate TXO for what's at risk. It's the cost of the money. It's the $149,000 that they're going to put up for his share and how are they going ot get it back? Mr. McCoy says they'll recover it in four or five months. What's the cost of money? It can't be more than 25 percent. If your banker's charging you more than that,

let's talk about it. We ought to fix that for you. You ought to fix it for Mr. Sprinkle. Don't make it punitive against him; it's not fair.

MR. STOGNER: Thank you, Mr. Kellahin.

MR. DICKERSON: If I could just have a minute to recover my composure, I'm almost in tears.

MR. KELLAHIN: So am I, Mr. --

MR. DICKERSON: I would also like to talk about fair play, Mr. Stogner.

Our view of what has gone on here is substantially different than the view set forth by Mr. Kellahin.

TXO, on its own initiative generated a prospect in Mr. Kellahin's words, which was a wildcat Morrow prospect. Through luck, and because, not in -- not in spite of their aggressiveness that he also attributed to them, and they are proud to admit to, because of it, they discovered an attractive producing field.

Mr. Sprinkle has the right to participate. He does not have the right to blackmail anyone and we suggest that his actions and his words in this have been designed exactly to do that, to paint TXO as the bad boys, him as the poor innocent, comprable to Cities Service' little old lady, who cannot simply afford to do anything and

who yet, after the well was drilled, one pertinent fact which is interesting and some how omitted by Mr. Kellahin, later the Sprinkle No. 2 Well is drilled, then and only then, after he had access to the information that it was producing over 100 barrels a day, did he -- did he write his check.

Mr. Sprinkle, we would submit, is well able to afford to drill these wells. he has the absolute right to do it. TXO invites him to do it, has consistently invited him to do it, and would welcome the end of this dispute with his agreement to join in the drilling of these wells.

As far as the offer of $7500 per working interest percentage that TXO made, you need to recall a little bit further testimoy, and that was the testimony of Mr. Bourgeois concerning Mr. Sprinkle's offer, 1.2-million cash; not 226,000; 1.2-million cash.

If he really wants 226,000, he should offer to sell it for that. Mr. Sprinkle has by design and by utilizing every procedural rule in our OCD rules, intentionally has exhibited a pattern and has said as much that his intention is to delay this. He's well aware of TXO's drilling obligations which they agreed to and they have to live with, and they intend ot live with them, and he's going to ride it for all its worth. He is going, and

he has succeeded. This case came up, as you well remember, Mr. Examiner, many weeks ago for the first time. It was continued and now it's January 9th, 1986. TXO's must spud date is March 19th, 1986. TXO has been told by Mr. Sprinkle when the order comes out he's got thirty days to ask for a de novo, and he's going to do that, and we believe it. We believe it, and we think he will, and we think he's going to ride this for everything it's worth just exactly like he did the Sprinkle No. 2 Well.

The Sprinkle No. 2 Well was TXO's fault. If Mr. Sprinkle succeeds in doing this again, and we submit that what he's attempting to do is not honest, it's not fair, and it's not right, and to the extent that there is -- he's successful in doing this any more, it's not Mr. Sprinkle's fault, we would ask that the -- that this Division would have to share in some of the cost or some of the credit for allowing him to do that. He's entitled to go by the rules. We all have to go by the rules, but those rules are not or should not be used for purposes merely of delay, for purposes contrary to the spirit of cooperation, in attempting to get a well drilled for the mutual benefit of all the parties, and it's very abundantly clear that TXO is ready to drill these wells and they also concede that if they did not have the fond hope of making some money on these wells, they would not be ready to drill them. They

think they will make some money on the wells; however, they have a risk involved in drilling these wells when they have to carry risk, or at their sole cost and risk all the risk of a dry hole to a 31-1/4 percent interest; almost a 1/3 interest in a well costing in excess of $600,000.

The purpose of the penalty provisions of our statute are to balance that risk that they assumed because, as you're well aware, this risk can only be recovered out of production. If there's no production, TXO eats it, and they're ready to eat it. They are desirous of drilling this 3 and 4 Well. They're desirous of living with their farmout commitment and not losing by default acreage which they contracted with third parties to earn pursuant to a timely development program, nothing of which is unusual in the industry as I'm also sure this Division is well aware, and that it is, we submit, Mr. Sprinkle's design to thwart all this to his own benefit regardless of anybody else's rights. We heard a lot from Mr. Kellahin about Mr. Sprinkle's rights. I would submit to you that TXO has a few rights, too. These are correlative rights. They're not Mr. Sprinkle's rights and they're not TXO's rights in a vacuum, they are correlative right that both parties have the right to drill and the rights of both parties and the interests of both parties have to be balanced and only through the imposition of a forced pooling order by this Division, which

reasonably compensates TXO for the risk that it has been forced, not because it voluntarily assumed, it wanted to assume it, would, I would submit, Mr. Examiner, would far prefer to have Mr. Sprinkle participate in these wells.

It has been forced to resort, this is the court of last resort for TXO, and we think we're entitled to the risk penalty. We think that the evidence justifies a penalty of 180 percent, and we respectfully request that expedited consideration be given to this matter, and that in the event that Mr. Kellahin or we, to the extent it would be helpful to the Division could submit proposed orders, we'd be happy to do that. We would ask, however, that it be done very promptly. We would agree to have a proposed order in your office by Monday, and we'd ask that Mr. Kellahin do the same, and we urge expedited consideration of this a balanced consideration of not only Mr. Sprinkle's interest which we've heard so much about, but also of TXO's interest, whose goals are just as noble as any he may have.

MR. STOGNER: Thank you, Mr. Kellahin. Thank you, Mr. Dickerson.

(Not clearly understood,) but I also would like rough draft orders from each of you and to expedite this a little further, I'd like to have rough draft orders from both parties by Wednesday morning, before noon

on Wednesday, whatever next Wednesday is.

Is there anything further in either Case Number 8783 or 8755 at this time?

MR. DICKERSON: Nothing further.

MR. KELLAHIN: No, sir.

MR. STOGNER: If not, these cases will be taken under advisement.

(Hearing concluded.)

C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY CERTIFY that the foregoing Transcript of Hearing before the Oil Conservation Division (Commission) was reported by me; that the said transcript is a full, true, and correct record of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. _____ heard by me on _____ 19____

_____, Examiner
Oil Conservation Division