

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO

17 February 1988

EXAMINER HEARING

IN THE MATTER OF:

Application of Sun Exploration and CASE
Production Company for compulsory 9310
pooling, Lea County, New Mexico.

BEFORE: David R. Catanach, Examiner

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Division:

For the Applicant:

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MR. CATANACH: Call Case 9310, which is the application of Sun Exploration and Production Company for compulsory pooling, Lea County, New Mexico.

The applicant has requested that this case be continued to March 2nd.

Case 9310 is hereby continued to March 2nd.

(Hearing concluded.)

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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. 9310, heard by me on February 17, 1988:

David R. Cotant, Examiner
Oil Conservation Division

1 STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
2 OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
3 SANTA FE, NEW MEXICO

4 2 March 1988

5 EXAMINER HEARING

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7 IN THE MATTER OF:

8 Application of Sun Exploration and
9 Production Company for compulsory
pooling, Lea County, New Mexico.

CASE
9310

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11
12 BEFORE: Michael E. Stogner, Examiner
13
14

15 TRANSCRIPT OF HEARING
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18 A P P E A R A N C E S
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20 For the Division:
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23 For the Applicant:
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MR. STOGNER: Call next Case Number 9310, which is the application of Sun Exploration & Production Company for compulsory pooling, Lea County, New Mexico.

Upon the request of the applicant, this case will be continued to the Examiner's Hearing scheduled for March 16th, 1988, at which time there will be some advertisement corrections in that particular case.

(Hearing concluded.)

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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. 9310, heard by me on 2 March 1988.
Michael Stoyars, Examiner
Oil Conservation Division

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO

16 March 1988

EXAMINER HEARING

IN THE MATTER OF:

Application of Sun Exploration and CASE
Production Company for compulsory 9310
pooling, Lea County, New Mexico.

BEFORE: David R. Catanach, Examiner

TRANSCRIPT OF HEARING

A P P E A R A N C E S

For the Division: No attorney appearing.

For Sun E & P Co.: W. Thomas Kellahin
Attorney at Law
KELLAHIN, KELLAHIN & AUBREY
P. O. Box 2265
Santa Fe, New Mexico 87501-2265

For Santa Fe Exploration: Ernest L. Padilla
Attorney at Law
PADILLA & SNYDER
P. O. Box 2523
Santa Fe, New Mexico 87504-2523

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MR. CATANACH: Call Case 9310, the application of Sun Exploration and Production Company for compulsory pooling, Lea County, New Mexico.

Are there appearances in this case?

MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of Santa Fe, New Mexico, appearing on behalf of the applicant, Sun Exploration and Production Company.

I have two witnesses to be sworn.

MR. CATANACH: Any other appearances in this case?

MR. PADILLA: Mr. Examiner, Ernest L. Padilla, Santa Fe, New Mexico, with the law firm of Padilla and Snyder.

I have one witness. I may have another witness but I don't think that I will use that witness.

Appearing on behalf of Santa Fe Exploration Company.

MR. CATANACH: Will the witnesses please stand and be sworn in?

(Witnesses sworn.)

1
2 MR. KELLAHIN: Mr. Examiner, my
3 first witness is a landman with Sun. His name is Mike
4 Morgenthaler.

5
6 MIKE MORGANTHALER,
7 being called as a witness and being duly sworn upon his
8 oath, testified as follows, to-wit:

9
10 DIRECT EXAMINATION

11 BY MR. KELLAHIN:

12 Q Mr. Morgenthaler, have you testified on a
13 prior occasion before the Division as a petroleum landman?

14 A I have not.

15 Q Would you take a moment and describe to
16 the Examiner in what Sun office you work?

17 A I am a professional landman for Sun
18 Exploration and Production Company in their Southwest
19 District, which is located in Midland, Texas.

20 Q How long have you been employed as a
21 petroleum landman by Sun?

22 A Almost four years.

23 Q Prior to your employment by Sun have you
24 worked for anyone else in the field of petroleum land
25 management?

1 A Yes.
2 Q And what company or individual did you
3 work for?

4 A Gulf Oil Corporation.

5 Q And how many years did you work for Gulf?

6 A About four years.

7 Q Your total years of experience as a pet-
8 roleum landman are approximately eight years?

9 A That's right.

10 Q With regards to this specific application
11 of Sun with regards to the pooling of acreage in the north
12 half of Section 26, of Township 18 South, Range 33 East, in
13 Lea County, New Mexico, how long have you been personally
14 involved in that project?

15 A Since September of '87, so approximately
16 six, six months.

17 Q Have you been, since your commitment to
18 this project in September or whenever it was in '87, have
19 you been the principal landman for Sun that's negotiated
20 with the other working interest owners to form a spacing
21 unit for the drilling of this well?

22 A Yes.

23 MR. KELLAHIN: At this time,
24 Mr. Examiner, we tender Mr. Morgenthaler as an expert petro-
25 leum landman.

1 MR. CATANACH: He is so quali-
2 fied.

3 Q Mr. Morganthaler, let me direct your at-
4 tention to what is marked as Exhibit Number One. Let's take
5 a few minutes and describe to the Examiner what Sun is seek-
6 ing to accomplish with this application.

7 If you'll take a moment and identify for
8 us within Section 26 the various working interest owners as
9 you know them to be.

10 A Okay. In the plat before you, in Section
11 26, you'll see that Sun is noted as 100 percent. In those
12 tracts where it shows Sun to be 100 percent and identifying
13 each of those tracts in the west half of the northwest quar-
14 ter, as well as the west half of the southwest quarter, that
15 was previously Enron.

16 The remainder of the acreage that shows
17 in the south half to be Sun 100 percent was J. M. Huber.

18 In the hachured area, that is an undi-
19 vided ownership tract where Sun owns 45 percent, Tenneco
20 owned 35 percent and Santa Fe Exploration owns 20 percent.

21 We sought to put this prospect together,
22 attempting to get the voluntary participation from all these
23 parties in this section. We received farmouts from Enron
24 and Huber ad Tenneco.

25 Q As of today, Mr. Morganthaler, what, if

1 any, working interest participation is not yet committed to
2 the well?

3 A The working interest attributed to Santa
4 Fe Exploration.

5 Q And in dealing with Santa Fe Exploration,
6 what individual or individuals have you been dealing with?

7 A Primarily with Mr. McAlpine.

8 Q And Mr. McAlpine's in the hearing room
9 today and you recognize him?

10 A Correct.

11 Q What are -- what is your understanding of
12 the various possible combinations of spacing units that
13 might potentially be productive for a wellbore at this loca-
14 tion drilled to this depth?

15 A Well, there are approximately three dis-
16 tinct variations but those will be involved in different
17 formations; in other words, all of the spacing might be 80
18 acres. It could be a different objective that might be de-
19 noted for that spacing.

20 Q Let me direct your attention to Exhibit
21 Number Two and ask you, sir, whether or not you have pre-
22 pared a tabulation showing the anticipated horizons, the
23 spacing units, and then calculated Santa Fe Exploration's
24 anticipated working interest share based upon those spacing
25 units.

1 A Yes, I have.

2 Q Let's go through that list on Exhibit
3 Number Two and have you identify first of all Horizon anti-
4 cipated spacing and then what Santa Fe Exploration's inter-
5 est is as best you know it to be.

6 A In the first horizon we've noted the Bone
7 Spring formation, which we anticipate the spacing to be 80
8 acres. Now, depending upon how the proration unit ends up
9 being, either a laydown or a stand-up, in the event it were
10 to be a stand-up proration unit on 80-acre spacing, Santa Fe
11 Exploration's working interest would be 20 percent.

12 If it were a laydown proration unit, it
13 would be 10 percent.

14 In the event we make a Wolfcamp formation
15 well, it would be -- we anticipate the spacing would be 40
16 acres. It would -- on either McAlpine or Santa Fe Explora-
17 tion's interest would be 20 percent.

18 Strawn oil would be 40-acre spacing, we
19 anticipate, and Santa Fe Exploration's working interest
20 would be 20 percent.

21 The Atoka formation, we anticipate 320-
22 acre spacing. Mr. McAlpine's working interest would be 15
23 percent.

24 And the Morrow would be 320-acre spacing,
25 again 15 percent.

1 Q In the application as advertised and
2 docketed for hearing, the Bone Springs designation in the
3 docket shows a proposed dedication of the south half of the
4 northwest quarter to form a laydown spacing unit. Is that
5 consistent with your understanding?

6 A I think that is what we would propose to
7 do.

8 Q When we're dealing with the 40-acre tract
9 the application and the docket shows the dedication of the
10 southeast quarter of the northwest quarter. Is that consis-
11 tent with your understanding?

12 A It is.

13 Q And as far as the 320-acre spacing, that
14 would be the north half of the section?

15 A Correct.

16 Q Now with the exception of Santa Fe Ex-
17 ploration, you have reached voluntary agreement with all
18 other working interest owners regardless of the combinations
19 of spacing units?

20 A Correct.

21 Q Do you have any time constraints, Mr.
22 Morganthaler, on the commencement of this well?

23 A Yes, we do.

24 Q And what are they?

25 A The farm-in from Enron Oil and Gas has a

1 March 15th of '88 spud deadline.

2 Q In order to fulfill the terms of that
3 farm-in agreement with Enron, has Sun commenced the well?

4 A Yes.

5 Q When was the well commenced?

6 A I believe yesterday, the 15th, on the
7 15th.

8 Q Let's go to the negotiations with Mr.
9 McAlpine and Santa Fe Exploration as of now and ask you,
10 sir, whether or not you have submitted to Santa Fe Explora-
11 tion a current AFE for the drilling of this well.

12 A Yes, we have.

13 Q And has Mr. McAlpine executed and retur-
14 ned to you the latest revised AFE that you've submitted to
15 him?

16 A No.

17 Q Have you requested Mr. McAlpine to prepay
18 his share of the costs of the completed well?

19 A Yes.

20 Q And what percent -- and has Mr. McAlpine
21 or Santa Fe Exploration tendered to you funds or checks to
22 pay for their share of the well?

23 A No.

24 Q Have you submitted to Mr. McAlpine a pro-
25 posed operating agreement by which Sun would operate, drill,

1 complete and produce the well?

2 A Yes.

3 Q And have you received back from Mr. McAl-
4 pine an executed operating agreement that's fully acceptable
5 to Sun?

6 A No.

7 Q At this point, Mr. Morgenthaler, do you
8 have an opinion as to whether or not you have at this point
9 a voluntary agreement with Mr. McAlpine?

10 A I have no opinion.

11 Q And what is that opinion?

12 A I do not believe we have an agreement.

13 Q Prior to your involvement in formulating
14 spacing units for the drilling of this well, have you re-
15 viewed the existing files in the Land Department of Sun to
16 determine what activity was involved in this project that
17 predates your personal involvement?

18 A I have.

19 Q What does that file show you is the first
20 initial efforts made on behalf of Sun to obtain a voluntary
21 agreement from Mr. McAlpine and Santa Fe Exploration Com-
22 pany?

23 A We have correspondence as early as Janu-
24 ary of '87. There are notes to the file which suggest
25 that phone contacts had been (unclear) earlier.

1 Q Let me direct your attention to Exhibit
2 Number 3, Mr. Morganthaler, and ask you to identify this
3 letter marked as Exhibit Three. It's dated January 15th,
4 1987. Can you identify this letter as being a true and ac-
5 curate copy of a letter contained in the Sun land files with
6 regards to this project?

7 A It is.

8 Q The second letter is an exhibit marked
9 Exhibit Number Four, dated July 29th, 1987. Where did you
10 obtain this letter?

11 A In the same file as the prior letter.

12 Q Does that file contain any correspondence
13 or communications either from Sun or from Mr. McAlpine be-
14 tween January 15th of '87 and July 29th, 1987?

15 A It does not.

16 Q What is the purpose of the initial letter
17 as you understand it?

18 A To formally propose to the various work-
19 ing interest owners the formation of a working interest unit
20 to drill the proposed prospect.

21 Q And what is your understanding of the
22 purpose of the letter dated July 29th, '87, marked as Exhi-
23 bit Four?

24 A I think it's just to update the initial
25 inclinations of Enron and Huber and to further document our

1 intention to get this well drilled.

2 Q Let's talk about your own personal invol-
3 vement now.

4 Approximately when did you first become
5 involved in the project of obtaining voluntary agreement
6 with all the participants?

7 A I took over this area in September and I
8 met my -- met with my first contact with Santa Fe Explora-
9 tion in early November.

10 Q What was the purpose of that contact?

11 A The purpose was to ask Sun's opinion as
12 to whether we might negotiate a sale of Santa Fe Explora-
13 tion's interest under that hachured area I alluded to ear-
14 lier.

15 Q And with whom on behalf of Santa Fe EX-
16 ploration did you have those conversations?

17 A Mr. McAlpine and I talked.

18 Q In dealing with Santa Fe Exploration have
19 you ever dealt with any other individual than Mr. McAlpine?

20 A No.

21 Q What was the outcome of that initial con-
22 versation?

23 A We discussed the possibility of a sale.
24 We discussed the possible terms that might be presented by
25 Mr. McAlpine for Sun to consider, and as we left, I believe

1 Mr. McAlpine was going to sit down and think about whether
2 that was indeed a proposal he would like to make Sun.

3 Q Let me direct your attention to Exhibit
4 Number Five, Mr. Morgenthaler, and can you identify this ex-
5 hibit?

6 A Yes, I can.

7 Q And what is it?

8 A It's a transmittal letter where we sent
9 AFE's to Santa Fe Exploration to seek their voluntary parti-
10 cipation for drilling an initial test well.

11 Q In addition to forwarding the AFE, have
12 you indicated to Mr. McAlpine what you believe his partici-
13 pation interest was to be in the north half?

14 A I did.

15 Q And that's 15 percent and that's the same
16 15 percent shown on Exhibit Number Two?

17 A Correct.

18 Q What occurred following the sending of
19 this letter, Mr. Morgenthaler?

20 A We then received a response from Santa Fe
21 Exploration.

22 Q And is that response shown as Exhibit
23 Number Six, a letter dated December 3rd, '87?

24 A It is.

25 Q Okay, and what did Mr. McAlpine respond?

1 What did he tell you?

2 A He responded that it was his desire to
3 participate in the drilling of the captioned well.

4 Q Subject to what?

5 A Subject to an acceptable operating agree-
6 ment and a current AFE.

7 Q All right. The next Exhibit is an Exhi-
8 bit Number Seven, which is a letter under Santa Fe Explora-
9 tion's letterhead, dated January 14th.

10 A Correct.

11 Q What is your recollection of what tran-
12 spired, if anything, between December 3rd and the receipt of
13 Mr. McAlpine's letter of January 14th?

14 A I don't believe there was a lot of
15 discussion. This was in response to Sun preparing a joint
16 operating agreement, a memorandum of operating agreement,
17 and forwarding them on to Mr. McAlpine for his signature.

18 Q Those documents were forwarded by a let-
19 ter that is not here, is that true?

20 A That is correct.

21 Q In response to -- to the documents that
22 you sent Mr. McAlpine for his approval and signature, you
23 received back the January 14th letter.

24 A Correct.

25 Q There was no other communication from him

1 other than this letter?

2 A No.

3 Q What is your understanding of what Mr.
4 McAlpine has done in the letter of January 14th?

5 A He has set forth conditions under which
6 he feels a mutually acceptable agreement would have to be
7 enacted.

8 Q Had he executed or signed the operating
9 agreement that you submitted to him?

10 A He did.

11 Q And that signed operating agreement was
12 returned to you with this cover letter?

13 A With the conditional letter of accep-
14 tance, correct.

15 Q And the conditional letter of acceptance
16 set forth ten conditions that qualified his acceptance?

17 A Yes.

18 Q Did you take action on your own or through
19 consultation with Sun employees and management to determine
20 which, if any, of these ten conditions would be acceptable
21 to Sun?

22 A Yes.

23 Q And what action did you take?

24 A We circulated the pertinent points of the
25 conditional letter to each of our departments responsible

1 for overseeing those particular portions of a joint oper-
2 ating agreement.

3 Q And what direction did you ultimately
4 receive which you then communicated to Mr. McAlpine about
5 his ten conditions?

6 A We determined that four of the ten were
7 acceptable.

8 Q Would you identify for the Examiner which
9 are the four of these ten conditions Sun accepted?

10 A Yes. Items Number 1, 7, 8 and 10.

11 Q Did you communicate or someone on behalf
12 -- else on behalf of Sun communicate to Mr. McAlpine your
13 response to the other six items?

14 A Yes.

15 Q And how was that done?

16 A First there was a discussion between our
17 District Landman, Ken Gray, and Mr. McAlpine concerning
18 Sun's objections to the items in those conditional letters.

19 That was followed up by my sending a
20 formal response letter to Mr. McAlpine.

21 Q Do you have a copy of the formal response
22 letter as any of the proposed exhibits in the hearing today,
23 Mr. Morganthaler?

24 A I do.

25 Q And which number is it?

1 A Nine.

2 Q All right, let's skip Eight for a moment
3 and go to Exhibit Nine, and how did you communicate this in
4 writing to Mr. McAlpine, by letter dated January 22nd?

5 A That's correct.

6 Q And that was sent Federal Express?

7 A It was.

8 Q And what did you advise him?

9 A That we asked that he reconsider the six
10 provisions that we deemed were unacceptable.

11 Q In addition, what else did you tell him?

12 A We asked that if we did not receive
13 acknowledgment, that those six were acceptable to him, that
14 we did not feel we had an agreement under which we could
15 operate.

16 Q Did I understand "acceptable to him", in
17 other words the deletion of his remaining six items, if he
18 would delete those, you needed to know that by a particular
19 date.

20 A Correct.

21 Q And that date was January 27th.

22 A Correct.

23 Q Did you receive any written response from
24 Mr. McAlpine on or before the close of business on January
25 27th?

1 A We did not.

2 Q Let's go back to Exhibit Number Eight now
3 and have you identify that exhibit for us.

4 A This is a transmittal letter with a copy
5 of a revised AFE sent to Mr. McAlpine's approval.

6 Q What was the reason, as you understand
7 it, that another AFE was submitted to Mr. McAlpine for his
8 approval?

9 A We recently completed a well of our own
10 in this immediate area and had an up-to-date cost tabulation
11 for what the drilling of that well entailed.

12 Q And therefor you did what?

13 A So we studied what our costs were and re-
14 issued another AFE.

15 Q And you sent this to Mr. McAlpine by Fed-
16 eral Express?

17 A That's correct.

18 Q And attached to this letter is a copy of
19 the revised AFE?

20 A Correct.

21 Q And it's the one dated January 21st of
22 '88?

23 A It is.

24 Q What, if any, response did you get from
25 Mr. McAlpine with regards to this AFE?

1 A We received no response.

2 Q He hasn't sent you back an executed copy
3 of this revised AFE?

4 A No.

5 Q And have you received his check for 15
6 percent of the dry hole costs as set forth on this AFE?

7 A No.

8 Q I direct your attention now, Mr. Morgan-
9 thaler, to Exhibit Number Ten. Can you identify this one?

10 A Yes.

11 Q And what is it?

12 A It is a second letter to ask if indeed
13 Mr. McAlpine was going to execute his revised AFE.

14 Q And it provided an extension by which he
15 would return his check and the executed AFE?

16 A It did.

17 Q And what now was the new deadline that
18 you requested response by?

19 A February 12th, 1988.

20 Q And did, on or before that date, you re-
21 ceive back from Mr. McAlpine an executed revised AFE and his
22 check for his share of the cost of the dry hole?

23 A No.

24 Q Turn to Exhibit Number Eleven, Mr. Mor-
25 ganthaler, and can you identify this exhibit?

- 1 A Yes.
- 2 Q And what is it?
- 3 A It is an AFE cost breakdown for addi-
4 tional up-hole formations.
- 5 Q And to whom did you send this letter?
- 6 A To Santa Fe Exploration.
- 7 Q And what was the reason for doing this?
- 8 A To identify all of the potential horizons
9 that we anticipated force pooling.
- 10 Q Did you receive any response, either oral
11 or in writing, from Mr. McAlpine, responding to your Febru-
12 ary 8th, 1988 letter?
- 13 A No.
- 14 Q In setting forth his conditional accep-
15 tance of the operating agreement by letter dated January
16 14th, 1988, I think it's Exhibit Seven, did Mr. McAlpine
17 raise to you any objection about Sun being the operator of
18 the well?
- 19 A He did not.
- 20 Q Has he before or since raised any objec-
21 tion to you about Sun being the operator of the well?
- 22 A Not to me, no.
- 23 Q Has he raised any objection about the
24 orientation of any of the spacing units that you propose for
25 the drilling of the well?

1 A No.

2 Q Did Mr. McAlpine raise any objection to
3 the proposed overhead charges that were attached to the
4 COPAS agreement that's appended to the operating agreement?

5 A No.

6 Q And what were those overhead charges you
7 proposed?

8 A A drilling well rate of \$6128 and a pro-
9 ducing well rate of \$613.

10 Q In the event the Examiner issues a com-
11 pulsory pooling order, do you have a recommendation to him
12 as to what rates ought to apply?

13 A I do.

14 Q And what are those numbers?

15 A Those numbers stated in that joint oper-
16 ating agreement.

17 Q What's the basis for proposing those as
18 the charges for a drilling well rate and a producing well
19 rate on a monthly basis?

20 A The Land Department receives a monthly
21 tabulation from our Accounting Department of our actual
22 costs incurred through the prior month, so those figures are
23 then up-dated monthly and those are what we insert for a
24 joint operating agreement for that particular month.

25 Q Do you have an opinion as to whether

1 these charges represent a fair and reasonable charge for
2 operations?

3 A I do.

4 Q And what is that opinion?

5 A I believe they are fair and reasonable.

6 Q Have you received any objection from Mr.
7 McAlpine about the location of the well or the total depth
8 to be drilled?

9 A I have not.

10 Q Have you received any objection on his
11 part with regards to the drilling or completion program for
12 the well?

13 A No.

14 Q Mr. Morgenthaler, in your opinion are you
15 in a position on behalf of your company to extend any fur-
16 ther times in which to reach a voluntary agreement before
17 you must have a compulsory pooling order?

18 A We are in what we consider an emergency
19 situation and we do not feel an extension of time is palat-
20 able.

21 Q Were Exhibits One through Eleven repre-
22 sent documents that were compiled under the ordinary course
23 of the business conducted by Sun with regards to the land
24 matters involved in this transaction?

25 A I'm sorry, will you --

1 Q Yes, sir, the source of the documents is
2 your land file?

3 A Correct.

4 Q And they're compiled under the regular
5 course of your business?

6 A They are.

7 Q And the correspondence that's identified
8 as being sent by you was in fact sent by you?

9 A It was.

10 MR. KELLAHIN: We move the in-
11 troduction of Exhibits One through Eleven.

12 MR. PADILLA: No objection.

13 MR. CATANACH: Exhibits One
14 through Eleven will be admitted as evidence.

15 Mr. Padilla, your witness.

16

17 CROSS EXAMINATION

18 BY MR. PADILLA:

19 Q Mr. Morgenthaler, you submitted a form of
20 communitization agreement to Santa Fe Exploration to commu-
21 nitize the deep formations that would cover a 320-acre spac-
22 ing unit, did you not?

23 A I did.

24 Q Now, Santa Fe Exploration executed that
25 agreement, isn't that true?

1 A That's correct.

2 Q Now, did you conditionally accept that
3 communitization agreement as you did the joint operating
4 agreement?

5 A (Not clearly understood.)

6 Q You in fact submitted that to the Bureau
7 of Land Management for approval, did you not?

8 A Personally?

9 Q Well, personally or through your
10 agents.

11 A Yeah, yes.

12 Q And that communitization agreement has
13 been approved at this time.

14 A Yes.

15 Q What formations does that communitization
16 agreement cover?

17 A I do not recall the exact formations;
18 however, I believe it constituted all formations likely to
19 incur dry gas, but I cannot at this time recall the exact
20 formations in that communitization agreement.

21 Q Does that communitization agreement
22 perpetuate the farmout agreement that you have with Amerind?

23 A Yes, it could.

24 Q It could. When did you -- when did you
25 reach agreement with Huber and Enron?

1 A As far as an exact date?

2 Q Well, give me an approximate date. I'd
3 be satisfied with that.

4 A All right. We reached a formal agreement
5 with Huber approximately six weeks ago and a formal agree-
6 ment with Enron about ten days ago.

7 Q So, in other words, you communicated with
8 them -- well, let me ask this question.

9 Did you communicate with them in January
10 of 1987, as you did with Santa Fe Exploration?

11 A Yes. I did not; Sun did.

12 Q But your latest agreement with Enron is
13 ten days ago.

14 A Yes.

15 Q What's the spacing in the Bone Springs
16 formation?

17 A 80 acres.

18 Q What pool is -- what -- what pool are we
19 talking about that would cover 80 acres? Do you know?

20 A I'm not sure I understand you.

21 Q Well, why -- why -- you have -- why are
22 you on 80-acre spacing instead of 40-acre spacing?

23 A It's my understanding that that's what
24 the spacing would be decreed if we made a Bone Springs well.

25 Q You don't know whether there are special

1 spacing pool rules covering -- providing for 80-acre spac-
2 ing?

3 A I do not know if there are special rules,
4 no.

5 Q Now let me turn to the operating agree-
6 ment, Mr. Morganthaler, the one that you submitted to Santa
7 Fe Exploration, and in particular let's -- let's talk about
8 your Exhibit Number Seven, and let's talk about Item Number
9 Two on the Santa Fe letter.

10 Tell us, sir, why Item Number Two is not
11 acceptable to Sun Exploration.

12 A We feel that there is a casing point
13 election provided for under the terms of the joint operating
14 agreement and we feel that the term "mutually acceptable"
15 would be an addition that would confuse an already clear po-
16 sition in the joint operating agreement.

17 Q Can you show me on the operating agree-
18 ment where we have, or Santa Fe has a casing point election?

19 MR. KELLAHIN: Mr. Examiner,
20 I'll pose an objection at this point with regards to an item
21 by item discussion of each of these remaining six issues. I
22 believe it's irrelevant for your consideration.

23 The begining and ending of the
24 point is that there is no agreement and that's all you need
25 to know about this matter in order to issue a compulsory

1 pooling order.

2 Now we certainly can spend the
3 next hour talking about each one of these items and deter-
4 mining what Sun's understanding of them is, but I think it's
5 irrelevant. The point of the matter is that we don't have a
6 current AFE approved. We don't have Mr. McAlpine's share of
7 the money, and we have six conditions where he's put on the
8 operating agreement that are unacceptable to Sun and he's
9 not withdrawn them.

10 The point is there is no agree-
11 ment and we need to go forward.

12 MR. PADILLA: Mr. Examiner, let
13 me briefly go through the -- some of these exhibits that Sun
14 states that they do not consider that they have an agree-
15 ment.

16 Mr. Examiner, our testimony and
17 our point in being in this case is that we believe that we
18 do have an agreement. An AFE was executed by Santa Fe Ex-
19 ploration and it's not been, obviously, submitted by Santa
20 Fe Exploration here; at least I haven't seen it.

21 This is the same AFE which on
22 Exhibit Number Six Mr. McAlpine asked for a current AFE and
23 that is the one that he signed. Shortly after a forced
24 pooling application was filed Santa Fe Exploration received
25 another AFE and on the basis of that, basically, Santa Fe

1 Exploration would not submit 50 percent of the money under
2 the new AFE.

3 So we're here today trying to
4 find out what the point -- why -- why some of these points
5 are not acceptable to Santa Fe Exploration. I think it's
6 entirely relevant and that's the basis by -- why we're here.

7 We have filed a motion to dis-
8 miss that we hand delivered to your office in the last day,
9 and the basis of that motion is simply that we are not a
10 nonconsenting party under Section 70-2-17, and that we do
11 have --

12 MR. KELLAHIN: He's asked you,
13 if I might reply briefly, Mr. Examiner, he's asked you to
14 determine contract law and apply it to the Examiner environ-
15 ment. If they believe they have enough of the elements for
16 a contract, then the forum to decide that matter is the Dis-
17 trict Court and not the Commission.

18 We believe we've shown you that
19 there is sufficient information before you to establish that
20 there is no voluntary agreement and that we must go forward
21 with the compulsory pooling.

22 I will reserve and ask to com-
23 ment on Mr. Padilla's motion to dismiss the case later; how-
24 ever, at this point I think it's obvious that there is no
25 agreement and we ought to go forward with this.

1 MR. CATANACH: Mr. Padilla,
2 will clarification of some of these points help Santa Fe
3 make a decision whether to join the well or not?

4 MR. PADILLA: Well, I believe
5 to some extent, yes, Mr. Examiner. On the other hand, if I
6 may respond to this question of construction of contract
7 law, we're not asking you to construe this document at all.
8 We're just simply pointing out that based upon the exhibits
9 that have already been submitted here, and based upon this
10 model operating agreement, we have not refused to join in
11 the drilling of the well.

12 MR. CATANACH: Well, I would
13 say let's -- let's go on with your line of questioning and
14 try but keep it brief, Mr. Padilla.

15 MR. PADILLA: Okay.

16 MR. CATANACH: All right.

17 Q Go ahead, Mr. Morgenthaler, then if --

18 A In response to your question concerning
19 Item Number 2 and --

20 Q Right, yes.

21 A -- its acceptability to Sun, we feel it's
22 confusing to have the term "mutually acceptable" in there,
23 "mutually acceptable casing point election". There is an
24 election or there's not. The operator would normally
25 decide whether he deems it proper to set casing; then it is

1 up the non-operators to decide if they wish to participate
2 in that decision.

3 So "mutully acceptable casing point elec-
4 tion" is a -- is a nebulous concept that we don't under-
5 stand.

6 Q You question the word "mutually", is that
7 what you really question?

8 A Both words, actually, "mutually accep-
9 table".

10 Q Well, show me on this Exhibit Number --
11 on this joint operating agreement where Santa Fe Exploration
12 would have an election of some sort with respect to -- well,
13 with a casing point election.

14 A I'll have to study that. I don't know
15 off the top of my head.

16 Q Okay, let me go on, then.

17 Let's go on to Item Number 3, and you
18 might take that Item Number 3 and Number 4 together and have
19 you explain why you oppose -- why you insist on maintenance
20 of uniform interest and also the preferential right to pur-
21 chase.

22 A Well, they -- they are distinct cate-
23 gories.

24 Maintenance of uniform interest we prefer
25 to leave intact due to the accounting for the various poten-

1 tial players that a part could spin off to. In other words,
2 we're trying to limit the accounting and all the paper work
3 involved in a party just indiscriminately assigning off,
4 splintering off his interests.

5 As far as the preference right to pur-
6 chase we feel that that's an economic advantage that we
7 would like to keep.

8 Q Is it your -- is it your knowledge that
9 Santa Fe Exploration, as to its interest, was seeking inves-
10 tors or participants in order to come up with 15 percent of
11 their share?

12 A I've seen no such evidence.

13 Q And you have never -- this is absolutely
14 new, brand new to you that Santa Fe Exploration has inves-
15 tors for its interest?

16 A Yes, it is new that he had investors for
17 his interest.

18 Q Okay, let's go on to Item Number 6.

19 MR. PADILLA: I would explain
20 in the interest of time, Mr. Examiner, that Item Number 5 is
21 not at issue at this time.

22 Q But Item Number 6, if you would explain
23 that, Mr. Morganthaler.

24 A That's --

25 MR. KELLAHIN: I'm sorry, I

1 don't understand Mr. Padilla's statement. Are you withdraw-
2 ing 5 as a condition?

3 MR. PADILLA: Yes.

4 A Item Number 6 is a provision that if a
5 non-operator does not pay his bills in a timely fashion as
6 provided in an operating agreement, the operator would have
7 the right to withhold well information.

8 Q Is this printed language in this operat-
9 ing agreement, Mr. Morganthaler?

10 A It is printed in the operating agreement.

11 Q Is it printed or typewritten?

12 A It is typewritten.

13 Q So it's not part of the agreement itself,
14 as far as printing is concerned. It's not in the printed
15 document. It's added language by Sun Exploration.

16 A Correct.

17 Q Correct?

18 A Yes.

19 Q And it's your position that that's abso-
20 lutely necessary under the agreement.

21 A Opinion or Sun's position?

22 Q Well, your position, or Sun, give me
23 Sun's position.

24 A Sun's -- Sun's position is we feel like
25 taht if an operator pays his bills in a timely fashion that

1 will not be an undue hardship.

2 Q If an operator doesn't pay his bills does
3 Sun charge him interest?

4 A I believe that they do.

5 Q Let's go on to Item Number 7, Mr. Morgan-
6 thaler.

7 Let me, before I go on to Item Number 7,
8 under this operating agreement you have a lien for non-oper-
9 ators failure to pay, isn't that correct?

10 A Yes.

11 Q And you have a lien on the production at-
12 tributable to that interest, correct?

13 A Yes.

14 Q Matter of fact, you can foreclose in the
15 -- on that lien, isn't that right?

16 A You can stand in line for foreclosure,
17 correct.

18 Q Let's go to Item Number 9 now and tell us
19 what your concern is with that.

20 A Primarily that the accounting that's re-
21 quested in Item Number 9 would be too voluminous to prepare
22 every thirty days. I'm not sure we have the capability to
23 do that.

24 Q Okay. Let's go now to Exhibit Number
25 Four. I believe that's the one that you had an AFE attached

1 to that.

2 Can you tell me when that AFE was pre-
3 pared?

4 A I believe it was prepared in March of
5 '87.

6 Q And when did you submit that AFE to Santa
7 Fe Exploration?

8 A On July 29th of '87.

9 Q And did you request that AFE at some
10 point in conjunction with the joint operating agreement?

11 A Not in this correspondence.

12 Q You didn't? This was not part of the
13 joint operating agreement?

14 A This correspondence was not.

15 Q How about the AFE?

16 A The AFE was returned. This AFE that you
17 allude to was returned by Mr. McAlpine when he sent back his
18 joint operating agreement and conditional letter of accep-
19 tance.

20 Q And that was attached to the joint oper-
21 ating agreement as an exhibit?

22 A Yes.

23 Q And when did you submit the joint operat-
24 ing agreement to Santa Fe Exploration?

25 A I do not have a copy -- I mean I can re-

1 search that but I don't have that as an exhibit.

2 Q It was done sometime in 1988, wasn't it?

3 A Yes.

4 Q Now when did you submit the second AFE to
5 Santa Fe Exploration? I believe it's with your -- with one
6 of these other exhibits.

7 A I believe in January of '88.

8 Q How far apart was the time, to your know-
9 ledge, between the time you submitted a joint operating
10 agreement with the first AFE and the time you submitted the
11 second AFE to Santa Fe Exploration?

12 A I don't believe we sent a joint operating
13 agreement with the first AFE.

14 Q How would Santa Fe Exploration know
15 whether -- didn't they request by their correspondence here
16 a current AFE?

17 A Yes.

18 Q And it wasn't -- wasn't the first AFE
19 current at that time?

20 A It was.

21 Q That was the one you were working from,
22 was it not, the first AFE?

23 A Yes.

24 Q Isn't it true that you did not submit the
25 second AFE until after you filed for compulsory pooling in

1 this case?

2 A I believe it was almost simultaneous. I
3 don't believe it was after. I think it was the same day.

4 Q Now let me direct your attention to your
5 Exhibit Number Eleven. The interest that you state there as
6 to the different horizons, prospective horizons or forma-
7 tions that you would explore, is based purely on surface
8 ownership, isn't that correct? Surface acreage?

9 A As computed; a net acreage position based
10 on surface acreage.

11 Q Explain to me, Mr. Morganthaler, if you
12 -- if Santa Fe Exploration -- well, let me -- let me ask
13 the question this way.

14 Santa Fe Exploration owns 15 percent yet
15 as to Bone Springs they would only wind up with 10 percent,
16 and in fact, what I'm asking, wouldn't they be paying 15
17 percent for 10 percent in this case?

18 A It could be.

19 Q Does that seem equitable to you?

20 A Yes.

21 Q I'm sorry, let me go back now to the pre-
22 vious -- make a comparison of the two AFEs that you have
23 submitted and have you, Mr. Morganthaler, explain the dif-
24 ferences between the two AFEs.

25 A First of all, I have to give you my opin-

1 ion. I'm not sure I'm qualified to explain detail by detail
2 the differences between the two AFEs.

3 I can speak in broad strokes.

4 Q Give me your -- give me your broad
5 strokes, then.

6 MR. KELLAHIN: If it will help
7 you, the next witness will also discuss that.

8 MR. PADILLA: Okay.

9 A Do you want me to?

10 Q Go ahead.

11 A We, as I stated earlier, I believe,
12 drilled a well recently in this area so we had what we felt
13 was a very accurate up-to-date cost estimate for what a well
14 of this type would entail, so we felt it would be prudent to
15 send what we believed were the most accurate costs to the
16 working interest parties.

17 Q Have you made a comparison of the
18 increase from the first AFE to second AFE?

19 A In detail, no.

20 Q Would your next -- Mr. Morgenthaler, do
21 you know what (unclear) bids were taken in preparing the
22 second AFE or any of the AFEs that you have submitted to
23 Santa Fe Exploration as to any of the costs shown in those
24 AFEs?

25 A I'm not sure, but I will answer. I be-

1 lieve we do. In other words, I think we get a cursory bid
2 on people that we normally do business with that would drill
3 these type of wells; however, I believe that the second AFE
4 was more directly based on costs that we incurred as a re-
5 sult of drilling the well earlier.

6 Q In other words, to your knowledge no bids
7 were taken and it was based --

8 A No.

9 Q -- basically on the first --

10 A No, not to my -- I believe bids were
11 taken when they formulate an AFE. Now, what sort of detail
12 that involves, I do not know.

13 Q Would your next witness be able to dis-
14 cuss this to some extent?

15 MR. KELLAHIN: I don't know,
16 Mr. Padilla. You'll have to ask him about it.

17 Q Mr. Morganthaler, one -- one final ques-
18 tion.

19 Is it your position that the joint oper-
20 ating agreement as with the conditions you have accepted, is
21 now set in concrete and that there's no room for further ne-
22 gotiation at all with respect to those items that are still
23 in contention, in your opinion?

24 A I believe there's room for negotiation;
25 however, I have no authority to state how far or to what ex-

1 tent those negotiations would (unclear.)

2 Q From whom did you seek authority to make
3 any changes with regard to any of these items that are shown
4 in the Santa Fe --

5 A As I alluded to earlier, we have a circu-
6 lation process where we ask what we deem are experts within
7 our own company as to their areas of responsibility, the ac-
8 ceptability to Sun of those various provisions.

9 Those are then tabulated, forwarded to
10 the District Land Department, reviewed with our management.

11 Q And in fact, as I understand it, is that
12 there would be no further changes, although you still say
13 there is room for negotiation.

14 A I cannot say there would be no further
15 changes if negotiations produced acceptable results to Sun.

16 Q Only acceptable to Sun or --

17 MR. KELLAHIN: I'm going to ob-
18 ject at this time, Mr. Examiner. If we're going to talk
19 about settlement or negotiation on this matter, that's sep-
20 arate and apart from the hearing process.

21 MR. CATANACH: (Not clearly un-
22 derstood.)

23 MR. PADILLA: I think that's
24 all the questions I have, Mr. Examiner.

25 MR. CATANACH: Okay. I have no

1 -- no questions of the witness.

2 MR. KELLAHIN: Couple of points
3 I'd like to clarify with the witness, if I might.

4

5 REDIRECT EXAMINATION

6 BY MR. KELLAHIN:

7 Q In referring to Exhibit Number Eleven in
8 response to Mr. Padilla, Mr. Morgenthaler, he raised with
9 you the fact that Mr. McAlpine is being asked to pay 15 per-
10 cent of the cost of the well when under the laydown Bone
11 Spring he has a 10 percent interest, and your testimony was
12 that sounded fair.

13 A It did.

14 Q When we look at the letter, we also have
15 participation in the Wolfcamp and the Strawn where he has 20
16 percent and you're not asking him to pay 20 percent of those
17 zones, are you?

18 A We are not.

19 Q It's 15 percent.

20 A Correct.

21 Q Cuts both ways, doesn't it?

22 A True.

23 Q The business about the communitization
24 agreement, does the fact that you have a communitization
25 agreement signed constitute enough of the elements by which

1 you can have a total voluntary agreement by the parties?

2 A No.

3 Q In addition to a communitization
4 agreement you need a fully acceptable operating agreement.

5 A Correct.

6 Q You need a current AFE that's acceptable
7 and approved by all parties?

8 A Yes.

9 Q And you need the prepayment by the
10 working interest owners that are going to participate.

11 A Yes.

12 Q And of those four elements all you have
13 is a signed communitization agreement.

14 A Correct.

15 MR. KELLAHIN: Thank you.

16 Nothing further.

17 MR. CATANACH: The witness may
18 be excused.

19 MR. KELLAHIN: Mr. Dougherty is
20 a geologist.

21

22 PATRICK B. DOUGHERTY,

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

25

DIRECT EXAMINATION

1
2 BY MR. KELLAHIN:

3 Q Mr. Dougherty, for the record would you
4 please state your name and occupation?

5 A My name, full name is Patrick B. Dougher-
6 ty. I'm a professional geologist for Sun Exploration and
7 Production Company.

8 Q Mr. Dougherty, have you previously testi-
9 fied before the Division as a geologist?

10 A Yes, I have.

11 Q Did you present or prepare the geologic
12 evaluation of this particular well with regards to all
13 potential formations that might be productive?

14 A Yes, I did.

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

17 MR. CATANACH: He is so quali-
18 fied.

19 Q Mr. Dougherty let's begin, if you will,
20 sir, with the -- I'm sorry.

21 Would you summarize for us, Mr. Dougher-
22 ty, where we're going with your analysis of the potential
23 for this well in the various formations?

24 A We're going to try to determine the risk
25 factor involved in drilling and completing to the zones that

1 have already been outlined in previous testimony.

2 Q Your investigation had to do with the po-
3 tential for production in the Bone Springs, the Wolfcamp,
4 the Strawn, and Atoka, and the Morrow?

5 A Yes, it did.

6 Q And you have examined the potential in
7 each of those zones?

8 A Yes, I have.

9 Q Ultimately you have concluded what, Mr.
10 Dougherty, about your opinion and assessment of the risk
11 factor penalty that you will recommend and request the Exa-
12 miner to incorporate into this order?

13 A I feel that the maximum risk of 200 per-
14 cent is -- is going to be applicable in this case due to the
15 risk involved in drilling to and completing a well in the
16 Atoka-Morrow and also involved in the secondary horizons.

17 Q Will that same hundred -- same 200 per-
18 cent risk factor penalty apply to all the potential forma-
19 tions?

20 A Yes, they will, primarily because they're
21 all necessary, really, for an economic venture in this (un-
22 clear).

23 Q To what extent were you involved in the
24 picking of this well location and the determination of a
25 drilling program for the well?

1 A Approximately a year and a half ago I in-
2 herited this area from other geologists but the actual well
3 location was picked by myself earlier in 1987 and all the
4 work, geologic work and actual location picks were my --
5 were my work.

6 Q In addition to doing this work are you
7 familiar with the basis upon which Sun revised the AFE and
8 submitted that to Mr. McAlpine for his approval?

9 A In a limited sense. I'm not completely
10 up to date on the bid factor Mr. Padilla did mention, but I
11 can answer many questions about the differences they have.

12 Q Will one of your displays show us the
13 well that triggered the revised AFE?

14 A It happens to fall right off the display,
15 but it's -- it will be easily -- be able to tell you exactly
16 where that well location is.

17 Q Let's go through your geologic presenta-
18 tion and we'll come back to the cost of the well.

19 If you'll turn now to Exhibit Number
20 Twelve, would you identify and describe this exhibit?

21 A This is really just a land plat of the
22 general area around our Sun Exploration and Production Com-
23 pany Corbin Fed Com No. 1, which is our proposed well which
24 is spudded as of yesterday.

25 The well is located in a legal location

1 in the north half of Section 26, 1980 from the west line and
2 1650 from the north line.

3 I've indicated the wells that are -- it's
4 -- circled with a large circle on this plat are the wells
5 that have penetrated to at least the Bone Spring formation
6 or deeper, so it would be all the deep tests on the -- in
7 the immediate vicinity.

8 I've also outlined on this plat two cross
9 sections, cross section A-A' and B-B', which we'll address
10 as later exhibits in terms of making correlative stratigra-
11 phic interpretations of the area.

12 The general area that we're in for Atoka-
13 Morrow, we're in the northern end of the Delaware Basin
14 about 27 miles west of Hobbs, New Mexico.

15 Q Let's start, if you will now, with Exhibit
16 Number Thirteen and we're starting with the geology for the
17 deepest potential zone of production and then you're going
18 to come up the wellbore.

19 A Yes, I am.

20 Q All right, let's start with that first
21 deepest zone and identify and describe what that formation
22 is.

23 A This is a map, actually two maps, one
24 being a structure map on the top of the Lower Morrow marker.
25 That structure map is overlaid by a gross sand Isopach of

1 the Lower Morrow gross sand in the area and vicinity of our
2 -- of our well.

3 We feel the potential to prospect, real-
4 ly, we're trying to drill to a depth of 13,700 to penetrate
5 Morrow sands as they cross across a small structural feature
6 in -- which we've notified here in Section 26.

7 Q What is the closest producing well that
8 produces from this horizon?

9 A The closest producing well is approxi-
10 mately a mile and a half to the northwest, that being in the
11 southeast quarter of Section 21. It is highlighted in
12 green. All the Lower Morrow producers are highlighted with
13 a green colored pencil.

14 Q When we look in Section 27 there is a
15 Morrow producer in the southwest quarter?

16 A Yes, there is.

17 Q Is there any well between that producer
18 and the proposed location that penetrated this interval?

19 A Yes, the well in the northeast quarter of
20 Section 27 penetrated the lower Morrow interval but it tes-
21 ted tight initially and they did some well work on it and
22 ended up swabbing water out of the Lower Morrow zone.

23 I might correct -- at least clarify a
24 point. The nearest economic producer was the well in the
25 southeast quarter of Section 21.

1 The well in the southwest quarter of Sec-
2 tion 27 has produced from the Lower Morrow, also, but it's
3 an undetermined amount because it's an open hole completion
4 combined with Middle Morrow up hole.

5 Q Your assessment based upon this evalua-
6 tion is that the Lower Morrow justifies the 200 percent risk
7 factor?

8 A Yes, it does. Our interpretation is
9 based on scattered well control, first off, with the Morrow
10 penetrations indicated by the subsea datums next to the
11 points; the nearest well being 3/4ths of a mile to west.

12 The depositional environment of the
13 Morrow itself is a complex, fluvial, deltaic environment
14 with porosity and permeability determinations next to
15 impossible to make until you've actually drilled a well in
16 that location.

17 Also, the economic potential, our nearest
18 well, as I've already mentioned, that is of economic
19 potential in the Morrow is the well in the southeast quarter
20 of Section 21, so we're drilling a strict Lower Morrow
21 wildcat at this location and it does deem the 200 percent
22 penalty necessary.

23 Q Let's move up the formations and go to
24 the next one, which is the Middle Morrow?

25 A Yes, it is.

1 Q And that's displayed on Exhibit Fourteen?

2 A Yes, it is. Once again, it's the same
3 structure map underneath. That's the top of the Lower Mor-
4 row structure. Now I've overlain the Middle Morrow gross
5 sand Isopach on top of that, that structure map. We are in-
6 dicating that sand development to cross across the same
7 structure; once again we're anticipating penetrating that
8 sand in a position to obtain some sort of economic produc-
9 tion.

10 Q And your assessment of the risk factor
11 penalty for this formation?

12 A It should be the same, the 200 percent
13 penalty, based on really the same reasons, the complex depo-
14 sitional environment. The nearest economic production is
15 once again the well in the southeast quarter of Section 21,
16 that being the Aztec Federal "MA" No. 2.

17 The well in the direct offset 3/4ths of a
18 mile west of our location is the Aztec Federal "MA" No. 1,
19 and it does, as indicated here in orange, it has produced
20 from Middle Morrow, but it only produced 97-million cubic
21 feet and about 2300 barrels of condensate before its
22 abandonment, which is obviously uneconomic for this depth.

23 Q Let's go now, sir, to the next interval
24 up and that's the Atoka Strawn?

25 A Yes. The next Exhibit is Exhibit

1 Fifteen, being a structure map on the top of the Atoka car-
2 bonate. I've overlain on that a Strawn sand limit map and
3 also indicated the proration, the 40-acre proration unit
4 which we'd be talking about as a 40-acre oil reservoir in
5 this area of Lea County is -- it's boxed in around our well
6 site.

7 The, really, the risk factor here is
8 really the same ones I've mentioned in the Morrow. It's --
9 the Strawn sand is only productive in the three wells high-
10 lighted in red on this exhibit. The one well in Section 28
11 that is half highlighted is -- did flow oil out of the
12 Strawn but has never been produced.

13 The limited number of well completions is
14 part of the risk factor. We have no Strawn and development
15 north, east or west of our -- of our location in any imme-
16 diate Morrow penetrations.

17 Moving due west of our well location is
18 the Aztec Federal "MA" No. 1 in the northeast quarter of
19 Section 27. It's highlighted in red and it was productive
20 from the -- from the Strawn sand; produced about 70,893 bar-
21 rels of oil, I believe, and about 270-million cubic feet of
22 gas. It's a secondary target. That amount of production is
23 uneconomic at the depth we're talking about a completion,
24 which would be for the Strawn around twelve three to twelve
25 four in depth, so we feel it's really -- it's an up-hole

1 target which helps us to minimize our risk in drilling to
2 deeper horizons, but by itself it does not warrant, if we
3 did find a Strawn sand interval, we would not be able to de
4 velop it on strictly Strawn sand with 40-acre spacing.

5 Q Turn now to Exhibit Number Sixteen. What
6 formation are we dealing with here?

7 A This is the Wolfcamp formation. The ex-
8 hibit is a structure map on the top of the Wolfcamp lime
9 pick, showing general just south, gently southwest dip, gen-
10 erally.

11 I've highlighted once again in purple all
12 the Wolfcamp producers in the immediate vicinity of our
13 well. As you can see, the nearest producer is about a mile
14 and a half to the northwest, that being the Southland Royal-
15 ty Aztec 22 Federal Well in the northwest quarter of Section
16 22. It's produced a little over 10,000 barrels of oil be-
17 fore its abandonment.

18 The six wells all told have only averaged
19 46,000 barrels of oil per well from the Wolfcamp.

20 This once again would be a 40-acre oil
21 pool at this point where we are drilling. Now, the risk de-
22 termination is really, once again, our same that we've men-
23 tioned before, the complexity of the depositional environ-
24 ment. The Wolfcamp porosity development is very erratic in
25 this area of Lea County. There really are no operators

1 drilling in this immediate vicinity strictly for Wolfcamp as
2 a primary producing zone due to its limited economic poten-
3 tial and we feel like based on the limited economic poten-
4 tial and the limited subsurface well control and the erratic
5 nature of the Wolfcamp reservoir itself, feel like the maxi-
6 mum penalty is once again warranted in this case.

7 Q Let's go up to the Bone Springs forma-
8 tion, Mr. Dougherty, and have you identify and describe
9 that. I think it's on Exhibit Seventeen?

10 A Yes, it is. Exhibit Seventeen is a
11 structure map on the top of the Second Bone Spring sand.
12 The Second Bone Spring sand is what is productive in the EK
13 Bone Spring Field in due east of our prospect and partially
14 south. All the Bone Spring producers are highlighted here
15 in a light blue.

16 Q The EK Bone Springs is that acreage imme-
17 diately to the south that's displayed in the blue circles?

18 A Yes, all these -- all these wells are in-
19 cluded in what they call the EK -- at least the wells in
20 Section 25, 36, and the south half of 26, are in the EK Bone
21 Spring Field.

22 Q What's the spacing for that pool?

23 A It is an 80-acre spacing.

24 Q And you're within a mile of that pool.

25 A Right, and that's -- was really our de-

1 termination for anticipating an 80-acre determination in our
2 well site.

3 The Bone Spring production in this area
4 of Lea County, the reason it's really -- this production is
5 on 80-acre spacing in the EK Field is it's productive Bone
6 Spring sand. That field has produced cumulative about a
7 million barrels of oil out of 22 wells, which is around a
8 little over 45,000, 46,000 barrels of oil per well. A num-
9 ber of the wells, they're of varied economic potential. We
10 generally feel that the risk in our location for Bone Spring
11 is once again the complex depositional environment of the
12 Bone Spring. It's a huge stratigraphic interval of possible
13 Bone Spring production all the way from First Bone Spring
14 sand through a number of detrital carbonates, those being
15 limestone and dolomite detritals, into the Second Bone
16 Spring sand and Third Bone Spring sand.

17 So any number of porosity intervals could
18 develop within those horizons and by the subsurface control
19 we have we are not able to make a substantial determination
20 of what would be the most likely to produce.

21 The production in Section 25 in the EK
22 Bone Spring Field, due to its limited productive capabili-
23 ties, they have put on the 80-acre spacing to allow it to
24 drain a larger interval. We do feel, though, that that main
25 pay, which is the better pay, is really in Section 25 and

1 the accompanying Section 30 in the next township, is a large
2 -- about a 25-foot porosity interval in the Second Bone
3 Spring sand and in the northwest quarter of Section 25, the
4 Manzano Edith Federal No. 3, that porosity zone is not pre-
5 sent.

6 So we have a well between our location
7 and the main EK Bone Spring Field where that porosity zone
8 which would allow you to have the 45-46,000 barrel well
9 equivalent production is just not there.

10 So we feel like we're at high risk of
11 finding even a good secondary zone in the Bone Spring but
12 it's one that we have enough likelihood of finding produc-
13 tion we feel like it's warranted to be force pooled and 200
14 percent maximum penalty.

15 Q Have you constructed a cross section
16 through this area so that we can see what the structure
17 looks like as we go from one wellbore to another?

18 A Yes, I have. Exhibit Number Eighteen is
19 a -- and refer back to Exhibit Twelve, also, to give you the
20 outline of where the cross section does fall, they're both
21 east/west cross sections.

22 Exhibit Eighteen just shows our Strawn to
23 Mississippian correlations throughout the area, indicating
24 the well-to-well correlations from -- from this cross sec-
25 tion you can determine the complexity of the Morrow deposi-

1 tional environment. The sands are -- generally the produc-
2 tive sands are extremely thin and really well-to-well cor-
3 relations are extremely difficult and that's one of our pri-
4 mary reasons for the risk determination.

5 Our location is shown here on the fourth
6 location from the -- from the west on this cross section.
7 All the correlative markers are shown. We also are showing
8 our Strawn oil productive horizon around 12,300 feet. It
9 produces from the thin, shelf sands in that area and I do
10 want to mention that that zone is also over-pressured for
11 that depth. We're -- the completion depth there is around
12 12,300 feet. The wells there had -- had bottom hole shut-in
13 pressures on DSTs of in the high 6000's, 6800 pounds, 6900
14 pounds, which is approximately 1000 to 1500 pounds over-
15 balanced for the area and that adds additional risk to your
16 Morrow evaluation. That over-pressured zone that cuts your
17 mud and makes sample identification difficult and can cause
18 mechanical problems in drilling the well down to the deeper
19 horizons.

20 Q Was that additional potential risk taken
21 into consideration in the revised AFE?

22 A Yes, it is. These -- these zones which
23 we'll -- I'm sure we'll talk about in more depth, both the
24 Strawn and the Atoka, there is an Atoka sand in this area
25 also, which is -- it's really just one Atoka well. It's in

1 the northeast quarter of Section 24. I don't have it high-
2 lighted on any of our maps. It's the Sun Exploration and
3 Production New Mexico Fed Com, but that well was penetrated
4 in an Atoka sand which was over pressured also; had in ex-
5 cess of 7000 pounds bottom hole pressure. It caused consid-
6 erable problems in completing that well to a depth -- get-
7 ting that well down to a depth to evaluate the Morrow and
8 raised our costs significantly.

9 Q Let's take a look at your other cross
10 section. It's also a structural cross section?

11 A Yes, and it's -- once again, it's Exhibit
12 Nineteen. It's -- it goes through essentially the same
13 wells. It only differs, really, in, I believe, one well.

14 It's once again a structural cross sec-
15 tion indicating my stratigraphic picks for the area so you
16 can better get a determination of how I pursued my mapping.

17 The only real important point I do want
18 to make is the two wells in the far east side of the cross
19 section both show you that EK Bone Spring porosity develop-
20 ment in the Second Bone Spring sand. That sand is the one
21 that I was depicting that we do -- we feel is highly risky
22 it's going to be present at our location and it's one of the
23 main determinations for incurring the 200 percent penalty.
24 We just don't -- we don't have a very good handle on that
25 porosity interval and where it may develop.

1 Q Let me turn now with you, Mr. Dougherty,
2 to Exhibit Number Four that Mr. Morgenthaler discussed ear-
3 lier. Attached to that exhibit is the March 3rd, '87 AFE
4 and then if you'll also find a copy of Exhibit Eight, which
5 is the January 21st, 1988, AFE.

6 A Okay.

7 Q Is there a display that we can use where
8 you can generally describe the well that was drilled which
9 resulted in the re-evaluation of the costs for the subject
10 well?

11 A In referring to our Exhibit Twelve, which
12 was our initial plat, Sun drilled and is attempting a com-
13 pletion in the Bone Spring in our Sun Exploration and Pro-
14 duction Buffalo Federal No. 1, which is almost three miles
15 exactly due south of our proposed location. It would be in
16 Section 11 of Township 19 South, 33 East, 1980 from east and
17 660 from the north of that section, so it falls just barely
18 off our plat here, but it's almost exactly due south of our
19 location.

20 We drilled that well to a depth of 12,700
21 feet. We encountered shows in the Atoka and Bone Springs
22 and Morrow; ended up having to try a completion back in the
23 Bone Springs.

24 That well, just coincidentally, happened
25 to TD right at the end, really, right in the middle of Jam-

1 uary, about the time we were pursuing our negotiations on
2 the Corbin Well and our drilling engineers felt, since we
3 had not operated a well out here for about a year and a
4 half, they decided that they would -- wanted to up date our
5 AFE based on that well due to all the general well cost in-
6 creases that occurred in the drilling of that Buffalo Feder-
7 al Well.

8 Q When we look at Exhibit Number Four,
9 there are some increases and some differences between that
10 AFE and the revised AFE.

11 A Yes.

12 Q Can you take a moment and based upon in-
13 formation you have concerning this AFE, can you generally
14 describe what are the significant differences between the
15 two AFE's?

16 A Well, there generally was across the
17 board increased all the way down the AFE's as you compare
18 them, but I'll try to hit the major points and then if we
19 need clarification I'll address those.

20 First off, on the line number 42, being
21 the footage contract rates, the more recent AFE, that dated
22 January of '88, we're carrying an \$18.00 a foot footage
23 charge. The AFE of March, '87 was a \$20.00 a foot footage
24 charge.

25 The differences in the AFE's was the

1 March, '87 AFE was considering that we were going to drill
2 the well on a footage contract all the way to a depth of
3 13,700 feet.

4 Due to our high pressure zones in the
5 Atoka and Strawn, our Operations Group has determined that
6 it would be more prudent once we got down to a depth of
7 about 10,000 feet to have Sun in more direct control of the
8 operations due to the pressure problems. That's part of the
9 reason they revised the AFE. What they did was went ahead
10 and changed our footage contract rate, which I'm sure they
11 asked for an estimate on that, got \$18.00 a foot. I believe
12 that's what we had on our Buffalo Federal Well. \$18.00 a
13 foot charge times 10,000 feet equals \$180,000. So there's a
14 discrepancy between those two numbers, really, just based on
15 the depth that we are going to be on footage contract.

16 Subsequently, since we did reduce the
17 amount of the well that would be drilled on footage con-
18 tract, the day work increased. That's the 40 days indicated
19 here at \$4200 a day. Those are -- that's the amount of days
20 that our drilling group felt would be necessary to drill the
21 well from a depth of 10,000 feet down to 13,700. That's
22 what we experience in our Buffalo Federal Well and the
23 length of that time, it's -- it was -- it would be very hard
24 to shorten that amount of time. It is possible that that
25 could occur but due to our experience in the Buffalo Well,

1 that seemed like a very reasonable amount.

2 What it -- how it ended up was that we
3 increased the day work cost from the original March, '87 AFE
4 from \$32,000 up to \$168,000, and that was just due to the
5 additional day work charges.

6 So the overall drilling costs between the
7 two AFE's, the original March AFE was \$306,000 footage and
8 day work, our January, '88 was \$348,000 footage and day
9 work.

10 One more point, since we would be on day
11 work, our bit charges went up considerably and we exper-
12 ienced enumerable problems on the Buffalo Well in obtaining
13 bits. There was a shortage of the bits necessary to drill
14 the shale and carbamate sections in the lower portions of the
15 hole. Finding quality bits was a problem. We ended up using
16 more than we anticipated and that's the \$60,000 charge on
17 the bit line, which would be line 44 of the AFE.

18 So those three things right there account
19 for close to \$90-to-\$100,000 in the differences in the
20 AFE's.

21 Pipe charges, there's a shortage of tubu-
22 lar goods. Those have gone up kind of across the board in
23 our Tangible line and all the other subsequent charges have
24 also just kind of across the board gone up, from water to
25 mud, our mud-logging group has upped their charges somewhat,

1 so it's -- it's kind of an across the board increase.

2 Q Under the terms of the original AFE, how
3 do those work if the actual costs are more than the esti-
4 mated AFE? How does that mechanism work in terms of the
5 operating agreement?

6 A I think we file a supplemental AFE and
7 bill the partners for supplemental work. We have the con-
8 tingency factors in here, which we do -- I think we do have
9 a contingency clause in our operating agreement.

10 I'm not familiar with the details of how
11 exactly the charges are handled.

12 Q Based upon your understanding of the de-
13 velopment of this AFE, do you have an opinion as to whether
14 or not the revised AFE is more accurate, realistic and
15 reasonable in terms of the costs for drilling this well as
16 opposed to the original AFE?

17 A I feel it is. We -- just due to the fact
18 the fact of the Buffalo, it's hard to argue with actual bil-
19 led costs. I couldn't argue -- I'd like to see them lower;
20 it would make it easier to get wells drilled, but these are
21 the charges our drilling group feel comfortable with.

22 From our experience in the area, one
23 other point to mention, was the New Mexico Fed Com Well,
24 which was up in Section 24, the Atoka producer, we did have
25 problems with that well due to the high pressure zones but

1 hat well ended up costing approximately a million three to a
2 \$1,400,000, about 200,000 more than what we're estimating
3 here, so we've had really two pretty good indicators, two
4 wells within the last two years to base our cost estimates
5 on and I feel like at this point that they are legitimate
6 charges.

7 MR. KELLAHIN: I have nothing
8 further of Mr. Dougherty.

9 We move the introduction of his
10 Exhibits Twelve through Nineteen.

11 MR. CATANACH: Exhibits Twelve
12 through Nineteen will be admitted as evidence.

13 Mr. Padilla?

14

15

CROSS EXAMINATION

16 BY MR. PADILLA:

17 Q Mr. Dougherty, since I have these AFEs in
18 front of me here, on line 43 can you tell me why you jumped
19 from 8 days of day work to 40 days of day work?

20 A As I already explained, the reason is be-
21 cause we changed the amount of the well that we would be on
22 footage contract, so we anticipated that there would be an
23 increased number of days we'd be on day work where Sun would
24 be in charge of operations. That went from 8 to 40 days.

25 Q Well, you're still getting charges for

1 total footage down on the line 42 item, isn't that correct?

2 A That's for down to 10,000 feet, \$18.00
3 for a depth of 10,000 feet which would be \$180,000.

4 Q Now where exactly is this Buffalo Fed-
5 eral Well that you testified about?

6 A It's Section 11 of 19 South, 33 East. If
7 you would go three miles due south of our proposed location
8 on that plat, it would be -- if you could hand me your plat
9 I'd mark it on there for you, if that would help.

10 This would be an approximate location in
11 Section 11 of Township 19 South, 33 East.

12 Q Now, you indicated that you had exper-
13 ienced high pressures in this Buffalo Federal Well, isn't
14 that correct?

15 A I indicated we encountered pressure zones
16 and shows in the Atoka in that well. They were not over-
17 pressured.

18 Q What -- what information have you submit-
19 ted here today to show some correlation between the Atoka
20 formation in the Buffalo Federal 1 Well and the proposed
21 location?

22 A None, because there's -- the Atoka sand,
23 they're completely different and the Atoka comes and goes.
24 It's not a primary or secondary target in this region in New
25 Mexico. It's only been encountered, really, in our Section

1 24 Well, which Mr. McAlpine was involved in. He's aware of
2 where that Atoka zone developed in that well. Prediction of
3 where that Atoka is going to develop is beyond our capabili-
4 ties. It's not -- you can't discern it from seismic, well
5 control; it's only spottily in wells in the area, so it's --
6 it's something we have no, no control over prediction.

7 Q So you had -- so in effect there would --
8 you had no geologic communication there at all.

9 A No.

10 Q And you probably have no pressure
11 communication at all, either.

12 A No.

13 Q Now, do you know whether any bids were
14 taken on the second AFE?

15 A I am not aware of bids being taken. I
16 know when they did revise them. I'm not sure if they worked
17 off of just -- just cost alone on the Buffalo Well or they
18 took additional bids on all these other figures. I do not
19 know.

20 Q Who drilled the Buffalo Well?

21 A Sun Exploration and Production.

22 Q I understand that, but who was your
23 drilling contractor, I should ask?

24 A McVey. McVey Drilling Company, Rig No.
25 10, I believe.

1 Q Who was your drilling contractor that's
2 drilling the proposed well?

3 A I believe it's Wilbros.

4 Q Do you know whether you took a bid from
5 the Buffalo drilling contractor as well?

6 A I do not know who they took. I'm not
7 really involved in any of that.

8 Q Do you know whether -- is it Sun's policy
9 to take bids on the wells that you're --

10 A Sure. We try to bid from a number of
11 contractors in the area on each well. As of right now I
12 know there's a shortage of contractors, also, so you have to
13 take multiple bids, especially with the time frame we were
14 under on our Corbin Well it was very important we got a
15 number of multiple bids and estimates.

16 MR. PADILLA: Mr. Examiner,
17 that's all I have.

18 MR. CATANACH: Anything
19 further, Mr. Kellahin?

20 MR. KELLAHIN: No, sir.

21 MR. CATANACH: I have no
22 questions. The witness may be excused.

23 MR. KELLAHIN: That concludes
24 our direct presentation, Mr. Examiner.

25

1 (Thereupon a recess was taken.)

2

3 MR. CATANACH: Okay, Mr.
4 Padilla.

5 MR. PADILLA: Mr. Examiner, we
6 call William McAlpine, who has been sworn.

7

8 WILLIAM A. McALPINE,
9 being called as a witness and being previously sworn upon
10 his oath, testified as follows, to-wit:

11

12 DIRECT EXAMINATION

13 BY MR. PADILLA:

14 Q Mr. McAlpine, for the record would you
15 please state your name and where you reside?

16 A William A. McAlpine, Junior. 2200 West
17 Mescalero Road, Roswell, New Mexico.

18 Q Mr. McAlpine, what is your connection
19 with Santa Fe Exploration Company?

20 A I'm the president of the corporation.

21 Q And as president of the corporation have
22 you previously appeared before the Oil Conservation Division?

23 A I have.

24 Q Mr. McAlpine, you are the -- or Santa Fe
25 Exploration Company is opposed to the compulsory pooling

1 case before us here today, is that correct?

2 A I'm sorry, I missed the first of that
3 question.

4 Q Santa Fe Exploration is the opposed to
5 the compulsory pooling --

6 A Yes. Yes, sir.

7 Q -- application.

8 A Yes, sir.

9 Q Can you briefly tell us, sir, the -- from
10 a historical perspective your dealings with Sun Exploration
11 with regard to this case?

12 A Well, in this particular area we have had
13 several years of experience that began actually with the ac-
14 quisition of a larger tract, a deep tract, that was pur-
15 chased out of a bankruptcy that lies adjacent to Section 26
16 to the north and one well that has been drilled there that
17 was previously alluded to, the New Mexico Federal No. 1,
18 which produced in the Atoka.

19 We have currently, I believe, about six
20 Bone Springs wells producing in the Mescalero Ridge in that
21 tract that lies to the -- to the north. Sun is the operator
22 on all of these wells.

23 We, at Santa Fe Exploration, had owned
24 this particular tract in Section 26 100 percent, that is
25 partially the subject of this hearing and Sun had indicated

1 an interest in it even before we bought the Trigg tract the
2 larger tract out of the bankruptcy court to the north, and
3 so I sold, Santa Fe Exploration sold an interest in this
4 tract to both Sun and Tenneco that has previously been tes-
5 tified to.

6 We certainly have no objection to having
7 a well drilled in here. We would like to see one drilled as
8 the exploration also has progressed into the tract to the
9 north.

10 Q Now the differences that you have with
11 Sun appear to result out of a joint operating agreement that
12 was proposed to you, is that correct?

13 A Yes, principally.

14 Q Let me show you what -- hand you what we
15 have marked Exhibit Number One, which also has been submit-
16 ted by Sun Exploration, and in particular let me ask you the
17 same questions that I asked Mr. Morgenthaler concerning
18 those items which you did not agree to.

19 First of all, would you give us your ver-
20 sion of Item No. 2 on that exhibit?

21 A Well, it was pointed out to us by a local
22 attorney that we called to review the operating agreement
23 that we did not have as a nonoperator a casing point elec-
24 tion in the operating agreement. It -- and so, you know,
25 I'm certainly not an authority on that but that's what the

1 attorney said and all we wanted was to make sure that we had
2 a casing point election because we didn't want to run pipe
3 on something that we might not think would be productive. I
4 mean for our interest.

5 Q Why is that so important to you, Mr. Mc-
6 Alpine?

7 A Well, we certainly don't pretend to know
8 everything there is to know about the oil business but by
9 the same token, we don't want to pay for trying to complete
10 and running pipe to a zone that our consultants feel that
11 the risks are higher than the rewards.

12 Q Would you be willing to have some kind of
13 reasonable notice as to whether or not you should proceed
14 further in casing the well, for example?

15 A Just a standard casing point election is
16 all we request.

17 Q In your opinion is that unreasonable?

18 A Well, as the operator of wells, we cer-
19 tainly allow non-operators with us to have that election.

20 Q Okay, let's go to Items 3 and 4 and I'd
21 for you to discuss those, if you would, please.

22 A Well, 3 and 4, in my opinion, kind of go
23 together.

24 Number one, Mr. Morgenthaler indicated
25 that that was Sun's right to have an option or the first

1 right of refusal on our interest in the well. I just don't
2 believe that's true.

3 No, they don't have that right and nobody
4 else has that right. When I sold them the interest in this
5 lease it wasn't predicated on them having an option on the
6 rest of our interest or the first right to purchase it if we
7 were to sell it to someone else, and we're not asking to
8 have the first right on their interest if they decide to
9 sell to someone else.

10 Now, the Item No. 3 there, I talked to
11 Mr. Morganthaler several times on the telephone and one of
12 the discussions that I had was to make sure that I had a
13 current AFE because we're a little bitty company and we
14 could not afford to take this size risk on this hole, and so
15 I wanted to make sure that we had the most current AFE and
16 my last conversation, as I recall, and I'll have to confess
17 my memory is somewhat faulty at times, but occurred in
18 December, because I was going to go out and sell a portion
19 of this to investors which I told Mr. Morganthaler on the
20 phone that I was going to do, and that's why I needed a cur-
21 rent AFE, and which I did, and which the money was put in
22 the bank for that, you know, for the drilling of this well.

23 Q How does that relate to this uniform in-
24 terest on Item No. 3?

25 A Well, it has the ability to preclude you.

1 We dont' want to be a middleman, you know. The people that
2 are investing us are big boys and they have reasonably deep
3 pockets and they can paddle their own canoe, and we think
4 that the sale of oil and gas should be paid directly from
5 the buyer to those people and not using Santa Fe Exploration
6 as an intermediary.

7 By the same token, the purchasers of
8 those interests would prefer to have it handled that way,
9 also. This Item No. 3 can preclude that from happening in
10 an orderly manner.

11 Q From your knowledge in dealing with -- in
12 the oil and gas industry, can that type of provision be
13 changed in an operating agreement?

14 A Well, certainly, anything that the par-
15 ties agree to can be altered.

16 Q Okay, let's go on now to Item No. 6 and
17 have you discuss that, please.

18 A I'm, unfortunately, I have to confess to
19 you that we have had problems financially and we struggle
20 along and we're delighted to still be in business and Sun
21 has been very good to us, as have many other people, in
22 helping us to continue in the oil business, and we -- in
23 these six wells that I have previously alluded to in the
24 Bone Springs, as well as the New Mexico Federal, the Atoka
25 well. The -- our records reflect that we owe Sun some \$25-

1 to-\$30,000, consequently, and what happens is the oil runs
2 from those wells go directly to Sun. Sun's the operator.
3 They're the buyer of the product, and they receive our por-
4 tion of the runs on our account.

5 Consequently, we could find ourselves in
6 this particular situation with this added language in a sit-
7 uation where we had -- let's assume for the moment, that
8 Sun says, okay, we'll agree that you have a casing point
9 election, but from the Accounting Department and the field
10 operations sometimes there's a lag of communications, as
11 I'll demonstrate in a little bit, and we could be precluded
12 from seeing the logs, if -- if it was the desire of Sun, or
13 any other information to make a determination of whether we
14 should run pipe or not. And, consequently, we don't believe
15 -- we believe Sun's interest is adequately protected in the
16 operating agreement without this added language that they
17 have proposed.

18 Q Let's go on now to Exhibit -- or Item No.
19 9 and tell us why you propose that 30-day accounting period.

20 A In a New Mexico Federal well in Section
21 24 above, the well was completed sometime, let's say in -- I
22 want to say in April. It could have been in March, but last
23 spring of '87.

24 The 4-point test was something in the vi-
25 cinity of 50-million cubic feet a day and 600 barrels of oil

1 and no water; a fairly decent well.

2 The -- there was a pipeline connection
3 made in July and product was sold starting in July of 1987.
4 We have -- Santa Fe Exploration has never received any ac-
5 counting -- let me back up. We have never received a full
6 accounting of products sold, either gas or oil, from that
7 well since July, nor has our account ever been credited one
8 penny, but by the same token, Sun has charged our account
9 for interest that we owed Sun.

10 We, you know, we just -- all we are ask-
11 ing for is some type of timely accounting and I suggested
12 there thirty days after the end of the month in which the
13 product was sold. Well, if that crowds their computer, then
14 make it sixty days; some kind of reasonable accounting is
15 what we'd like to see.

16 Q How does that relate to this well? Why
17 -- why do you want that provision with respect to drilling
18 this well?

19 A Well, let's see, I thought I just made
20 that clear, but --

21 Q Okay.

22 A -- you see, the well that we -- the last
23 well we just drilled that started producing in July, we
24 still don't have an accounting for and we felt like that if
25 -- if some kind of language like this was put in this oper-

1 ating agreement, then perhaps we could find out what was
2 happening on this well, if it happens to produce, in a
3 reasonable time.

4 Q Let me hand you what we have marked as
5 Exhibit Number Two and have you identify that, please.

6 A Yes, it's the AFE that was submitted by
7 Sun to Santa Fe Exploration as a current AFE up until two
8 days after we were force pooled.

9 Q What communications did you have with Sun
10 concerning the currency of this AFE?

11 A Well, as I previously testified, Mr. Mor-
12 ganthaler and I had several conversations about it just to
13 ascertain that it was in fact current.

14 Q And did you execute that AFE?

15 A I did.

16 Q And did you make an investigation your-
17 self as to the reasonableness of the costs contained in that
18 AFE?

19 A Yes. I felt it was reasonable.

20 Q And have you made a comparison of that
21 AFE to the second AFE submitted to you by Sun?

22 A To some degree.

23 Q And generally can you tell us what are
24 the differences?

25 A Well, as Mr. Dougherty has already testi-

1 fied to, that the majority of that is in the actual drilling
2 costs and in the bits, and in that regard we contacted the
3 drilling contractor, Moranco Drilling Company, that drilled
4 the Morrow well. It was an Morrow test; it made in the Ato-
5 ka, but the New Mexico Federal No. 1 in Section 24 that was
6 drilled last spring, to see what type of bid they might sub-
7 mit if they had been contacted to submit a bid, and it was
8 roughly \$100,000 under the new AFE that was sent to us.

9 Q What items on that -- on the second AFE,
10 and let me hand that to you, in particular did you question?

11 A Well, the first one was the first item on
12 there. The road and dirt work went from 15,000 to 50, so we
13 sent our dirt man out to give us a bid based on the stakes
14 that Sun had -- had staked.

15 Q Let me hand you what we have marked as
16 Exhibit Number Eight and have you tell the Examiner what
17 that is.

18 A Well, our dirt contractor was willing to
19 build the road and do all the dirt work for \$18,400, in-
20 cluding tax.

21 Q What --

22 A That they're estimating at \$50,000.

23 Q What other items in general do you think
24 apply?

25 A Well, I don't believe that in general

1 costs have risen in a year. Pipe prices have risen. Costs
2 generally in the oil field, I think as demonstrated by the
3 dirt work, there is not that much drilling taking place.

4 Now, Sun has been very active. Why there
5 probably hasn't been anybody more active in southeast New
6 Mexico in drilling wells than Sun.

7 Q You now have to go back to your investors
8 on the basis of the second AFE should you decide to join in
9 drilling this well?

10 A Well, I -- I -- probably the paperwork
11 doesn't make it mandatory, but I will, yes. And we fully
12 realize that all of those are estimates, the AFE's, and
13 we're going to pay what the final costs are, but we would
14 hope that it's, you know, we get the feeling that the non-
15 operator with Sun at times has no communication whatsoever,
16 you know. We don't know what contractors bid, which ones
17 were invited to bid, what their bids were, you know, a copy
18 of the contract, you know. It's fully demonstrated by to-
19 day, it's all news to us that somebody was drilling yester-
20 day as of, you know, thirty minutes ago.

21 And I don't think that is untypical. I
22 think that is -- that's typical of our experience.

23 Q Okay, let's go on to what we have marked
24 as Exhibits Three and Four, Mr. McAlpine. Tell us what
25 those are.

1 A Well, it's a communitization agreement
2 that was prepared by Mr. Hunker, an attorney retained by Sun
3 to do this communitization agreement on this property, and
4 this, as I recall, was back in January and Mr. Hunker called
5 and said they were in a rush to get this thing signed and
6 sent in and I said, well, we haven't agreed on the oper-
7 ating agreement as yet. I don't want to hold up the process
8 of this well but do you feel that it would reduce our chan-
9 ces of negotiating a reasonable operating agreement?

10 He said, "Absolutely not, Bill. This
11 needs to be signed so we can get all the participants to ex-
12 ecute it and filed with the BLM."

13 And I said fine, and I went right down
14 and signed it.

15 Q And it's been approved, as indicated by
16 Exhibit Number Four, isn't that correct?

17 A Yes, sir.

18 Q Now, you executed this about the same
19 time that you executed the joint operating agreement, is
20 that correct?

21 A Yes, and as a matter of fact, I believe I
22 got it out to Mr. Morganthaler, the AFE and the operating
23 agreement, on the same day that George was getting this out,
24 this communitization agreement.

25 Q And to your knowledge the communitization

1 agreement was not conditionally accepted.

2 A No, it was not.

3 Q Let's go on to what we have marked as Ex-
4 hibit Number Five and have you tell us what that is.

5 A Well, this is a page from an operating
6 agreement provided to us by others as a standard casing
7 point election. I'll have to confess to you I don't know,
8 you know, what a standard casing point election should say,
9 other than, you know, you should have so many hours after
10 you get the log to decided whether you want to, you know,
11 pay your part to complete or not.

12 Q You're submitting that as an example of
13 something that could be inserted in the operating agreement.

14 A Yes, sir.

15 Q Okay, let's go on now to Exhibit Number
16 Six and have you identify that, please.

17 A Well --

18 MR. PADILLA: Mr. Examiner,
19 this is already in evidence, submitted by Sun.

20 A It's a -- it's a further breakdown of
21 what expenses might be incurred in these different zones as
22 far as completion or dry hole is concerned.

23 And it also relates to, specifically, to
24 Bone Springs, Wolfcamp and Strawn, which, you know, I don't
25 -- if we had been putting this together, we don't believe

1 it's done properly. We don't believe it's done fairly, if
2 we're going to pay -- whether it's us or somebody else, be-
3 cause they're probably going to have some partners, too, be-
4 sides us as working interest people, and I'm of the opinion
5 that if you pay for 15 percent of the well you ought to get
6 15 percent of it whether you make it in the Atoka or the
7 Strawn or in the Wolcamp or the Bone Springs or wherever you
8 make it, and now the way that Sun has structured it, it's
9 strictly on who owns what landwise, surface, and I don't
10 think the guy that comes in with the HNG farmout, or Enron,
11 should be penalized if -- if the best zone to -- that's made
12 there happens to be a Wolcamp, because that 40 acres isn't
13 on him. If he has paid for, well, hypothetically, 10 per-
14 cent of the well or whatever -- whatever it is, then I think
15 he ought to have 10 percent of the Wolcamp zone even though
16 that 40-acre spacing doesn't happen to be on his 80 acres.

17 So I object, and specifically for Santa
18 Fe Exploration to pay for 15 percent of the well and to --
19 when we don't want 20 percent, either, in the Wolcamp.
20 We'd like to pay for 15 percent and get 15 percent. Simple
21 as that.

22 Q Okay. let me show you what we have mar-
23 ked as Exhibit Number Seven and have you identify that and
24 tell us what it is.

25 A Well, this is, as I've previously testi-

1 fied to, we have endeavored to get an accounting on the New
2 Mexico Federal Well. This sheet arrived a couple of weeks
3 ago from the Accounting Department of Sun in Dallas and it
4 breaks down interest of these charged against our account to
5 Sun for what we owe Sun and we have absolutely no objection
6 to that whatsoever and, again, I want to thank Sun for --
7 for treating us fairly in -- in this bill paying area.

8 What we do object to is not having our
9 account credited for this big well since they started
10 selling the product last July and still charging us interest
11 on our balance before any credit has been given to our
12 account.

13 Q Have you communicated that --

14 A We have.

15 Q -- problem with --

16 A Yes, sir, on several occasions.

17 Q And what has been the result?

18 A Nothing as yet. It's been taken up with
19 the computer, I think.

20 Q And is that the reason that you proposed
21 certain changes to the operating agreement?

22 A Well, it would certainly be nice to, you
23 know, have some idea about, you know, what the well was
24 producing and, you know, what the prices were and even if we
25 didn't get credit immediately to our account.

1 Q Now, Mr. McAlpine, you -- is it your
2 testimony that you're willing to drill this well and you
3 have no objection to the location or any of the geology pre-
4 sented by Sun?

5 A Yes, sir.

6 Q Would you put up your 15 percent if Sun
7 accommodated you in some manner with respect to some of
8 these changes?

9 A We -- we would. We believe in reviewing
10 the history of what has happened, that it would be appro-
11 priate for us to put up 15 percent of the AFE that they sub-
12 mitted to us up until two days after the filing of the for-
13 ced pooling, and we fully understand that as money is spent,
14 if -- if the end result is that the well costs more, we're
15 going to have to -- to pay our proportionate share of that.

16 Q Why haven't you tendered that 15 percent
17 to date, Mr. McAlpine?

18 A Well, we -- we have not been able to re-
19 solve our differences on this operating agreement.

20 Q Are you going to tender that amount on
21 the -- on a letter that Sun may send you to tender that
22 amount or are you going to want to resolve some of these
23 contractual things?

24 A Well, we believe it's a businesslike man-
25 ner to try to get these things resolved and we would like to

1 think that what we have requested are reasonable requests,
2 you know, from any operator. If given the chance, we would
3 take the other side of the coin. We would operate the well.
4 Obviously it's a little late for that at the moment, appa-
5 rently, since it's already drilling, but we would have no --
6 and that was going to be my testimony, that we'd be happy to
7 operate this well and take the other side of what we're pro-
8 posing.

9 Q Mr. McAlpine, do you have anything fur-
10 ther to add to your testimony?

11 A No, sir, I don't believe so.

12 MR. PADILLA: Mr. Examiner, we
13 tender Exhibits One through Eight.

14 MR. CATANACH: Exhibits One
15 through Eight will be admitted as evidence.

16 MR. KELLAHIN: I'll see if I
17 can keep this short and simple, Mr. Examiner.

18 MR. CATANACH: Okay.

19

20 CROSS EXAMINATION

21 BY MR. KELLAHIN:

22 Q Mr. McAlpine, when Mr. Morganthaler sent
23 you the letter on January, I believe it's 26, but let me
24 find the specific exhibit, sorry, on January 22nd, 1988,
25 which we marked and introduced as Sun Exhibit Number Nine,

1 did you receive this letter?

2 A I imagine I received every one that they
3 sent me. Yes, I did.

4 Q And in that letter they've asked you to
5 reconsider your request for revisions of the operating
6 agreement as itemized in your letter of January 14th?

7 A Yes, sir.

8 Q Did you respond to Sun in writing with
9 regards to that letter?

10 A No, I did not.

11 Q When we look at the operating agreement,
12 they have advised you that of the ten conditions there were
13 four of those conditions that were acceptable to them and
14 there were six that they would not accept.

15 A Yes.

16 Q Am I correct in understanding as of today
17 that with the deletion of No. 5 about the gas-balancing
18 agreement, there still remains five items for which there is
19 no agreement?

20 A That's correct. May I, if I can, tell
21 you, though, that we did have, even though I didn't respond
22 by letter, since some attorney that had prepared the commun-
23 itization agreement, George Hunker, there in Roswell, was
24 involved in this, I went -- I had a meeting with Mr. Hunker
25 and we went through these steps together including the

1 financial area and I was told by Mr. Hunker that he had a
2 lengthy conversation with I think it was Mr. Morgenthaler
3 but I'm not sure about that, but with Sun in regard to these
4 particular items.

5 Q The communitization agreement that's in-
6 troduced as Exhibit Number Three, it is certainly not your
7 position or your testimony that this communitization agree-
8 ment fully executed constitutes a complete voluntary agree-
9 ment about the well.

10 A No, it does not.

11 Q As to the question of the casing point
12 election, I think you were advised that -- by some lawyer
13 who you did not identify, that the printed document that
14 was submitted to you, the operating agreement, the model
15 form operating agreement, Form 610, 1982, did not contain a
16 casing point election in it?

17 A That's correct.

18 Q Did that lawyer show you page 10, and if
19 you have a copy of it perhaps we could turn to page 10, and
20 if you'll look up here on -- commencing on the fourth line
21 on the printed form, is that in fact not a casing point
22 election document?

23 A It sure seems like it.

24 Q In each of the letters in which Mr. Mor-
25 ganthaler submitted to you, I believe it's the January let-

1 ter, and let me find it so I can be absolutely correct.
2 Here -- here's an example of it. There was a letter submit-
3 ted to you dated January 16th of '88 in which they first
4 submitted to you the revised AFE.

5 A Uh-huh.

6 Q Did you get that?

7 A The revised AFE?

8 Q Yes, sir.

9 A Yes, I did.

10 Q And that provided in that letter a re-
11 quest that you return the executed AFE along with your check
12 within a certain period of time, and am I correct in under-
13 standing that you have not executed the revised AFE or ten-
14 dered any check?

15 A No, I have not.

16 Q There was a follow-up letter sent after
17 that, February 2nd, by Federal Express, in which Mr. Morgan-
18 thaler again reminded you of the revised AFE and the request
19 for the check. You did not respond to that letter, did you,
20 sir?

21 A That's correct.

22 Q When we talk about your Exhibit Number
23 Seven on the accounting information for the New Mexico Fed-
24 eral Com No. 1 Well, that was a well in which you executed
25 an operating agreement?

- 1 A Yes.
- 2 Q And you executed an AFE?
- 3 A Yes.
- 4 Q And did you prepay any portion of that
5 well?
- 6 A No, I did not.
- 7 Q Did -- at any point did you pay any sums
8 for that well?
- 9 A Yes.
- 10 Q At what point did you first tender sums
11 for that well?
- 12 A All of our oil and gas runs with Sun have
13 been credited towards that account.
- 14 Q Other than crediting your share of pro-
15 duction and runs from the well to your account --
- 16 A Now, not this well. We've never had any
17 credit from the well you're speaking of, but the other wells
18 that I mentioned in my previous testimony.
- 19 Q All right, sir, other than applying your
20 share of runs from other wells in which you had interest --
- 21 A Uh-huh.
- 22 Q Did you pay any of the invoices for that
23 well?
- 24 A No.
- 25 Q Are you prepared to execute the revised

1 AFE as of now?

2 A Is Sun prepared to change the operating
3 agreement?

4 Q My question to you is if your signing on
5 the AFE is conditioned upon Sun's acceptance of the last
6 five terms, is that what you're saying?

7 A Yes, sir.

8 Q Assuming Sun is not, would you execute
9 the AFE?

10 A No.

11 Q Did you ever advise Sun of your concerns
12 about Item No. 3 and 4 set forth in your letter and they're
13 both found on the printed form on page 12. The first one is
14 the uniform interest under paragraph D on page 12.

15 A Yes, I'm familiar with it.

16 Q Did you advise them that you needed to
17 have this changed because of the potential of additional in-
18 vestors?

19 A No, but I had mentioned that previously
20 to Mr. Morgenthaler.

21 Q Did you follow that up in any other way
22 other than a previous mention to Mr. Morgenthaler --

23 A No, I did not.

24 Q -- about that point? (Not clearly under-
25 stood) exists in the printed form, does it not?

1 A Oh, it does.

2 Q And this is the printed form that's com-
3 monly used in the industry?

4 A Yes, and it's not unusual at all to have
5 those stricken --

6 Q But that is language --

7 A -- and any time that we have a nonopera-
8 tor that requests of us as an operator, we strike them.

9 Q But that language does exist in the prin-
10 ted form as --

11 A Yes, it does.

12 Q -- you buy it from the printer.

13 A Yes, it does.

14 Q Am I correct in understanding that at
15 this point we have an executed communitization agreement.

16 A Yes.

17 Q We do not have an operating agreement be-
18 tween you and Sun that each party fully agrees upon.

19 A Correct.

20 Q We do not have an AFE signed by you that
21 is fully acceptable to Sun.

22 A Correct.

23 Q And we do not have the prepayment of any
24 funds to be applied by you to the well.

25 A That's correct.

1 MR. KELLAHIN: Nothing further.

2 MR. CATANACH: I have no ques-
3 tions.

4 Do you gentlemen care to make
5 closing statements?

6 MR. KELLAHIN: I'd be happy to
7 waive closing statements. I've got clients that would like
8 to make an airplane.

9 MR. CATANACH: Mr. Padilla, do
10 you have anything you want to say?

11 MR. PADILLA: Well, I'll keep
12 it very brief, then, Mr. Examiner.

13 I think Mr. Kellahin has tried
14 to make an effort to say that the communitization agreement
15 means nothing. In fact, what you have by an approved com-
16 munitization is a pooling of the lands. The spacing or the
17 compulsory pooling statute is founded on spacing require-
18 ments. I mean the only reason, and it seems very unusual in
19 this case that the only thing that we have that Sun rejected
20 here, or did not reject is the communitization agreement be-
21 cause it simply benefits their interest.

22 At this point they're coming
23 ahead with the compulsory pooling order and if necessary I
24 suppose we, should the Division be predisposed to do so, is
25 that we would operate under the basis of the pooling order,

1 but we certainly don't want to do that, but on the other
2 hand, we haven't had the demonstration here that the pooling
3 order, or the joint operating agreement as proposed by Sun
4 should set in concrete. And I think you have a business de-
5 cision here by Mr. McAlpine, saying I'm not going to tender
6 my money until I get an agreement that both of us can live
7 with. It's simple. We haven't had anything from Sun saying
8 that -- that, no, we can't live with this thing, but what we
9 seem to have is that nobody, including Mr. Morgenthaler, has
10 authority and that is not unusual in a large corporation
11 such as Sun.

12 His testimony was that he real-
13 ly hadn't sought authority to change any of those condi-
14 tions.

15 They all -- they did take it
16 through the merry-go-round, there's no question about it,
17 but nothing was ever done, and I think as operator Sun cer-
18 tainly has an obligation to do this and not necessarily rely
19 on Mr. McAlpine to say, well, you know, you can take it or
20 leave it, and it has been their position in this case all
21 along.

22 So I really think in conjunc-
23 tion with our motion to dismiss, and especially since the
24 lands have already been pooled, that the application should
25 be denied and dismissed.

1 MR. KELLAHIN: Briefly, Mr.
2 Catanach.

3 The communitization agreement
4 as we discussed in our testimony is not the end-all/save-all
5 of the situation.

6 Communitization is only one of
7 the four parts of the puzzle. Communitization is simply an
8 agreement to take separate, individual tracts and put them
9 together on a -- under a spacing unit.

10 Mr. McAlpine admitted to me as
11 Mr. Morgenthaler testified, that the communitization agree-
12 ment by itself is not enough. We must also have an oper-
13 ating agreement that determines how the parties have volun-
14 tarily agreed to drill, complete, and produce the well.

15 Both sides admit that despite
16 the efforts, that agreement has not been completed. These
17 are conditions that Mr. McAlpine has placed upon his appro-
18 val and his signature on the operating agreement.

19 We've done all I think we can
20 do in terms of negotiating that. We've advised him of our
21 rejection of six of the ten elements that he has set forth
22 and he stopped corresponding with us. What else can we do?

23 We're under time constraints to
24 drill the well and we have to commit our funds to drilling
25 that well.

1 The issue about the division of
2 risk or the apportionment or the allocation among the var-
3 ious zones is an issue Mr. McAlpine raised with you. That
4 certainly was done simply because we are confined and con-
5 strained by the rules of pooling before the Commission. We
6 are unable under our pooling provisions to let him partici-
7 pate on a 15 percent basis in a 40-acre well. It would be
8 very nice if we could pool a working interest ownership and
9 have a working interest unit, but we are precluded from
10 pooling anything larger than the spacing unit that applies
11 to that formation.

12 What we have done is provided
13 Mr. McAlpine with the opportunity to make partial elections.
14 He could elect to participate and pay his share of the costs
15 of the well down through the Bone Springs, the Wolfcamp, or
16 whatever, and go nonconsent on the rest of the portion of
17 the well pursuant to the split risk orders that the Commis-
18 sion enters for pooling cases.

19 And that's the purpose by which
20 that document was prepared, is to give him an opportunity
21 see how we might apportion those costs.

22 There is a significant differ-
23 ence over the AFE. Mr. McAlpine says he will not approve
24 the revised AFE. That's a fundamental part of the four
25 parts by which he must decide; if there is no agreement

1 about the costs of the well, you must find what you think to
2 be reasonable.

3 We believe our proof justifies
4 the second AFE as being reasonable.

5 Mr. McAlpine is not without
6 protection under the pooling order. He is entitled to
7 subsequent hearings to determine the actual, reasonable
8 costs and if he has objection as to actual monies spent for
9 road construction or whatever, he's entitled to a hearing
10 before this agency to have you make such a determination for
11 him.

12 In addition, under the
13 operating agreement, he's got that contractual right,
14 anyway, for an accounting and a justification of those
15 costs, so he's certainly not without remedy regardless of
16 what he does.

17 We think it's important to have
18 this matter resolved. We've made our best effort to reach a
19 voluntary agreement. Both sides admit that it's not done
20 and we have no other choice but to ask you to enter a
21 compulsory pooling case -- order in this case, and we'd like
22 you to do so.

23 MR. CATANACH: Thank you.

24 There being nothing further in
25 Case 9310, it will be taken under advisement.

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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. 9310 heard by me on March 16, 1988.

David R. Catant, Examiner
Oil Conservation Division