

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING)
CALLED BY THE OIL CONSERVATION)
DIVISION FOR THE PURPOSE OF)
CONSIDERING:) CASE NO. 10305
APPLICATION OF LBO NEW MEXICO,)
INC., FOR COMPULSORY POOLING AND)
AN UNORTHODOX GAS WELL LOCATION,)
LEA COUNTY, NEW MEXICO)
)

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID R. CATANACH, Hearing Examiner
May 16, 1991
8:15 a.m.
Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Division on May 16, 1991, at 8:15 a.m. at Oil Conservation Division Conference Room, State Land Office Building, 310 Old Santa Fe Trail, Santa Fe, New Mexico, before Paula Wegeforth, Certified Court Reporter No. 264, for the State of New Mexico.

FOR: OIL CONSERVATION DIVISION BY: PAULA WEGEFORTH
Certified Court Reporter
CSR No. 264

I N D E X

1	May 16, 1991	
2	Examiner Hearing	
	CASE NO. 10305	
3		PAGE
4	APPEARANCES	3
	APPLICANT'S WITNESSES:	
5	RAYMOND A. DIAZ	
	Direct Examination by Mr. Kellahin	5
6	Cross- Examination by Mr. Starrak	30
	Examination by Mr. Stovall	40
7	Examination by Examiner Catanach	55
8	JEFFRY ALLEN SMITH	
	Direct Examination by Mr. Kellahin	60
9	Examination by Examiner Catanach	74
10	CLOSING STATEMENTS	
	By Mr. Starrak	78
11	By Mr. Kellahin	83
12	REPORTER'S CERTIFICATE	85
	* * *	
13	E X H I B I T S	
		ADMTD
14	APPLICANT'S EXHIBIT	
15	1 through 8	30
16	9	72
17		
18		
19		
20		
21		
22		
23		
24		
25		

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

A P P E A R A N C E S

FOR THE DIVISION: ROBERT G. STOVALL, ESQ.
 General Counsel
 Oil Conservation Commission
 State Land Office Building
 310 Old Santa Fe Trail
 Santa Fe, New Mexico 87501

FOR THE APPLICANT: KELLAHIN, KELLAHIN & AUBREY
 Attorneys at Law
 BY: W. THOMAS KELLAHIN, ESQ.
 117 North Guadalupe
 Santa Fe, New Mexico 87501

ALSO PRESENT: R.J. STARRAK

* * *

1 EXAMINER CATANACH: I'll call the first case for
2 today, 10305.

3 MR. STOVALL: Application of LBO New Mexico, Inc., for
4 compulsory pooling and an orthodox gas well location,
5 Lea County, New Mexico.

6 EXAMINER CATANACH: Are there appearances in this
7 case?

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

12 EXAMINER CATANACH: Are there other appearances?

13 MR. STARRAK: Yes. I'm Jim Starrak from Midland,
14 Texas. I have an interest in this well, and I would like
15 to appear also.

16 EXAMINER CATANACH: Okay. Will the two witnesses
17 please stand and be sworn in?

18 MR. STOVALL: Mr. Starrak, do you intend to give any
19 testimony? Perhaps you should go ahead and stand and be
20 sworn just in case you want to and then you're ready to go.

21 (Whereupon The witnesses were duly sworn.)

22 MR. KELLAHIN: All right. We're ready.

23 RAYMOND A. DIAZ,
24 the Witness herein, having been first duly sworn, was
25 examined and testified as follows:

1 DIRECT EXAMINATION

2 BY MR. KELLAHIN:

3 Q. Mr. Diaz, for the record would you please state
4 your name and occupation?5 A. Raymond A. Diaz, and I'm president of Strata
6 Energy Resources Corporation, which is a parent of LBO
7 New Mexico, Inc.8 Q. Mr. Diaz, on prior occasions have you testified
9 before the Oil Conservation Division of New Mexico?

10 A. No, I have not.

11 Q. Would you give us a summary of your educational
12 background, sir?13 A. I have a B.S. from University of Tampa, Florida,
14 and I have a J.D. from University of California at
15 Berkeley.16 Q. Summarize for us your experience in the oil and
17 gas industry, if you will, sir.18 A. I was -- from 1973 to 1976 I used to be regional
19 counsel for Atlantic Richfield Corporation in Denver,
20 Colorado, and my duties were to supervise the land
21 department, doing title opinions, reviewing the public
22 records, drafting oil and gas leases, agreements and just
23 basically all of the land functions of -- through Arco in
24 the Rocky Mountains.

25 Q. Have you performed those functions for your

1 company with regards to efforts to identify the interest
2 owners in Section 9 of Township 11 south, Range 33 east,
3 Lea County, New Mexico?

4 A. In cooperation with Rudy Whirdle, an attorney in
5 Midland -- used to be with Lynch, Chappel; now he's on his
6 own -- I have worked on the land acquiring the lease rights
7 to this property, yes.

8 Q. Based upon that information, do you have a
9 knowledge and an understanding about the interest owners
10 that are entitled to share in the production in Section 9,
11 particularly the south half of Section 9?

12 A. Yes, I do.

13 Q. Have you been the principal individual for your
14 company that's made an effort to obtain the voluntary
15 agreement of all the interest owners to participate in the
16 production that may be derived from the subject well?

17 A. Yes, I have.

18 MR. KELLAHIN: At this time, Mr. Examiner, we tender
19 Mr. Diaz as an expert oil and gas attorney with knowledge
20 in petroleum land matters.

21 EXAMINER CATANACH: He is so qualified.

22 Q. (By Mr. Kellahin) Mr. Diaz, let me take a
23 moment, sir, and, first of all, identify for the examiner
24 how we've organized the exhibit book.

25 MR. KELLAHIN: Mr. Catanach, the exhibit book is

1 identified in sections by tabs on the right-hand margin.
2 Each of the tab sections has been identified as an exhibit
3 number, starting first of all with the application as
4 Exhibit 1. Thereafter the tabs separating the various
5 parts of the presentation have been identified with a
6 number.

7 Q. (By Mr. Kellahin) I'd like to skip the
8 application for a moment and turn your attention to Tab 2,
9 which is identified as the plat map, and also direct your
10 attention, Mr. Diaz, to that schematic, if you will.

11 When we look at the representation of Section 9
12 on that display, identify for us the proposed location of
13 the subject well in terms of what 40-acre tract it would be
14 located in.

15 A. We would be proposing to drill a well to 11,000
16 feet in the northwest of the southwest quarter of
17 Section 9, right in the center of the north or southwest,
18 which would be in a -- depending on the formation that we
19 would complete in, in terms of Wolfcamp, it would be in the
20 north half of that southwest, which is an 80-acre, in terms
21 of other formations, varying from 160 to 320, depending if
22 they were gas, and we -- you know, the spacing would change
23 as set forth in the application.

24 Q. Let's start with the deepest potential gas zones
25 and work up vertically in the the well bore.

1 The location in the south half, if the well
2 produces from a gas zone that is spaced on 320 acres, it's
3 your proposal then to dedicate the south half of Section 9
4 to the well?

5 A. That's correct.

6 Q. And the well would be drilled to a total depth
7 sufficient enough to be subject to some of the
8 320-gas-spacing rules?

9 A. That's correct.

10 Q. As we progress up the well bore, is there a
11 spacing that would apply on 160 acres for the southwest
12 quarter of Section 9 if you get shallow gas production?

13 A. I believe the Atoka would call for 160. I'm not
14 a hundred percent sure.

15 Q. That's my recollection too, Mr. Diaz, but there
16 is at least some possibility that if there's shallow gas
17 production, then it will be your intent to dedicate the
18 southwest quarter of Section 9 to the well?

19 A. That's correct.

20 Q. As we move up into the oil spacing units and
21 focus in on the Wolfcamp --

22 A. Right.

23 Q. -- within the south half of Section 9, are there
24 any producing Wolfcamp oil wells currently?

25 A. Yes. There's one in the northeast of the

1 southwest called the O.G. State No. 1 well.

2 Q. And the spacing unit assigned to that well is
3 what acreage, sir?

4 A. It's the north half of Section 9 -- I mean,
5 north half of the southwest of Section 9.

6 Q. The subject well, then, is the in-filled
7 location, if you will, for a second well on the 80-acre
8 Wolfcamp spacing unit?

9 A. Right. That's correct.

10 Q. When we look at the south half, summarize for us
11 what are the leases involved so that the examiner will
12 recognize the groups of changing interest owners and
13 percentages.

14 A. Right. The ownership of the north half of the
15 southwest and the south half of the southeast is identical,
16 and it consists of two state leases, which are referred to
17 in the petition, which we acquired from -- from the group
18 that is listed on Exhibit -- well, it's -- let's see. What
19 exhibit --

20 Q. It should be 4. It's the working interest
21 owners?

22 A. Right. Then the ownership of the south half of
23 the southwest in the north half of the southeast is owned a
24 hundred percent by LBO New Mexico, Inc., which we acquired
25 from a state bid sale about a year or two -- I think

1 approximately a year or two ago.

2 Q. Okay. Let me direct your attention to the next
3 tab section. It says, "Special Pool Rules." It's Tab
4 No. 3.

5 What is the purpose of this information,
6 Mr. Diaz?

7 A. Are you referring to --

8 Q. This is the Evelyn Downs memo.

9 A. Right. Well, this is to comply with the
10 existing spacing and proration units for the state in terms
11 of completion in the Bagley and the Permo-Penn and in the
12 other deeper zones that we may encounter.

13 Q. You have confirmed, then, with the district
14 office of the Oil Conservation Division what their records
15 indicate in terms of special pool rules that may govern the
16 drilling of this well and the dedication of acreage to this
17 well?

18 A. That's correct.

19 Q. Let's turn now, sir, to the blue tab that says
20 "Working Interest Owners" -- it's Exhibit 4 -- and turn
21 behind that tab and have you identify for me what is
22 represented on this display.

23 A. These are the working interest owners that have
24 a contingent working interest; that is, they come into
25 effect at such time as we reach payout in the first well,

1 which we are probably about two years from reaching
2 payout.

3 Q. When you talk about the first well, how is that
4 well identified? What's it called?

5 A. It's called the O.G. State No. 1.

6 Q. The O.G. State No. 1 is currently producing from
7 the Wolfcamp, and it is the well in the northeast of the
8 southwest quarter?

9 A. That's correct.

10 Q. To which the north half of the southwest is
11 dedicated?

12 A. That's correct.

13 Q. The tabulation of interest owners -- do you have
14 any working interest owners that are not reflected on this
15 sheet that have not agreed to participate in some fashion?

16 A. No, we do not.

17 Q. This represents, then, all the interests that
18 are not yet committed to the O.G. State No. 2 well, the
19 subject well?

20 A. That's correct.

21 Q. Summarize for the examiner briefly how these
22 particular interest owners within this group obtained their
23 interest.

24 A. 1989 we acquired the right to drill -- the
25 leases, the lease rights, from Team Exploration, which is

1 owned by Don Turner, who's a geologist in Midland. And my
2 understanding of it was that Don and a gentleman by the
3 name of McAnnelly out of Midland had procured the leases
4 from Chevron in a sale, and they had proceeded to reenter
5 an old existing well, the original O.G. State No. 1, which
6 is located 90 feet to the southwest of the well that's now
7 producing in the northeast of the southwest.

8 And they had attempted to go back in and
9 recomplete in the Wolfcamp because Chevron, which was Gulf,
10 acquired from Gulf, had never completed in the Wolf Camp.
11 They had just produced a Permo-Penn.

12 And it was an unsuccessful attempt in that they
13 encountered collapsed casing in that well, so they couldn't
14 proceed any further. My understanding was they did spend a
15 considerable amount of money, and the investors that they
16 had participating in that recompletion attempt decided they
17 didn't want to put in any more money and they just wanted
18 out of the deal completely.

19 And so we were approached by Turner with the
20 idea of coming in, putting up the money to drill a new
21 well, because at that point that was the only way that we
22 could get to the Wolfcamp. And we entered into an
23 agreement. It was an assignment from Turner and McAnnelly,
24 which was -- who was operating in the Paloma, to us, to LBO
25 New Mexico, which assignment is of record, granting us a

1 hundred percent working interest. And actually, Turner
2 retained a right to participate for twelve and a half
3 percent, which he did put up his share of the money. And
4 we then drilled a new well.

5 These interest holders were given -- my
6 understanding was that they were given their interest for
7 services rendered or to be rendered in connection with the
8 initial reentry attempt, the recompletion attempt.

9 Q. Of that O.G. State No. 1 well?

10 A. Right, of the old well. Right.

11 Q. When we look at their potential participation in
12 this new well, the O.G. State No. 2 --

13 A. Right.

14 Q. -- are they characterized as working interest
15 owners where they will have an opportunity to pay their
16 share of the costs of this second well and participate in
17 the initial production of that well before payout?

18 A. That's correct.

19 Q. When we look at this list now, help us identify
20 those parties that you have now reached an agreement with
21 and may now be deleted from the list.

22 A. Right. CBAT Corporation, the first one, we have
23 bought their interest, and the assignment is being recorded
24 by Rudy -- our attorney in Midland, who -- he was, you
25 know, handled the transaction, so we now own that third.

1 Kent Cearley is a field supervisor. We use him
2 on all our wells to complete the wells, and he will be
3 providing services for his one percent, but because it's --
4 you know, service is to be performed in the future, we want
5 to maintain him in the forced pooling in the event that he
6 were to change his mind and not provide those services.

7 Q. At least for the purposes of the hearing on the
8 order at this point, we need to keep him on the list?

9 A. That's corret.

10 Q. All right. Let's go down to the next one.

11 A. The two Chisick brothers, Michael and Steven,
12 have written me a letter saying that they would agree to
13 farmout under the terms that we proposed in a prior
14 correspondence, which it was dated -- let's see here --
15 February 8th, 1991.

16 Actually, I take that back. It's -- we had
17 written a letter -- actually, we had written two letters,
18 one in January, and given all of these parties on the list
19 an opportunity to participate in the second well. We felt
20 that even though their working interest is not vested until
21 we get -- we reach payout on the first well, that it's --
22 traditionally you let them participate in the second well
23 if you're going to drill it before the payout is reached.

24 And Chisick elected to go -- we gave them three
25 choices: They could sell their interest -- and we gave

1 them a purchase price of \$1,000 per one percent -- they can
2 farmout, or they can put -- you know, participate in -- or
3 lease the interest to us.

4 Q. And that was offered to everybody on this list
5 in January?

6 A. That's correct.

7 Q. Okay. Now, you've got an agreement with
8 Chisick, but that agreement has not yet been finalized by
9 the appropriate assignments being placed of record?

10 A. That's correct.

11 Q. So we're going to leave them on the list? Is
12 that your recommendation?

13 A. Until we get in writing from them the farmout,
14 correct.

15 Q. Let's continue with the list, then.

16 A. Bob Harris we haven't heard from. He's one of
17 Turner's friends in Chicago.

18 Q. No response?

19 A. What's that?

20 Q. No response?

21 A. No response.

22 Kent Kirby is an engineer in Midland. He's a
23 friend of Turner. No response from him. He -- well, we
24 did exchange some correspondence indicating that -- he
25 indicated he wanted to do something, but his terms were not

1 acceptable to us.

2 Q. Okay.

3 A. So right now the ball is back in his court to
4 propose something different.

5 Annette Mills is Turner's secretary, and she's a
6 real nice lady, and she has done a lot for us without us
7 requesting -- answering the phone and things of that
8 nature -- so I voluntarily have agreed to put up her money
9 for her, because she's a divorced mother and doesn't, you
10 know, have a lot of money, and so she's really in bad
11 economic straits. So we're going to go ahead and carry
12 her.

13 James Starrak is a gentleman that is here, and
14 so I'll -- he has not -- we have not reached agreement with
15 him.

16 Q. Okay.

17 A. "Team" is Turner, and so there are three
18 interests in here: Team Exploration, Susan Turner, his
19 wife, and Donald Turner, the last interest. They are
20 all -- we have reached agreement with Don where he would
21 get a small override in lieu of all these interests, and
22 the agreement is in the process of being drafted.

23 Q. So we need to leave Team Exploration and the two
24 Turners on until those documents have been recorded?

25 A. That's correct. And then Bonnie Wilson we have

1 bought, so LBO New Mexico owns Bonnie Wilson's interest.

2 Q. Okay. Let's go back -- or let's continue, then,
3 Mr. Diaz, with the tabulation of correspondence, and I'm
4 not going to ask you to go through the details of that
5 correspondence. It's contained within the exhibit, and to
6 the best of your knowlege these are accurate and correct
7 copies of the correspondence involved with this
8 presentation?

9 A. Yes.

10 Q. Let's talk specifically about the --
11 Mr. Starrak's involvement. Have you at this point
12 exhausted your opportunities to reach a voluntary agreement
13 with Mr. Starrak, as you believe?

14 A. I believe we have.

15 Q. Do you desire to have his interest subject to
16 the force pooling order?

17 A. Right. Yes, we do.

18 Q. Let's turn to the overhead rates that you
19 recommend to the examiner that he apply in this case.

20 A. Right.

21 Q. Do you have a recommendation for him?

22 A. We generally guide ourselves by the Ernst and
23 Young survey of operating expenses and operating fees, and
24 for a depth of an 11,000-foot well I believe it's a little
25 over \$500 per month and over \$5,000 for drilling. We

1 have -- we just went ahead and applied \$5,000 during the
2 drilling and completion stage per month and \$500
3 thereafter and when it's operating to cover our overhead,
4 which is -- I believe it's in compliance with Ernst and
5 Young.

6 Q. Let's turn now, then, to the AFE that is shown
7 behind the green tab. Give us some background on this,
8 Mr. Diaz. How was this document prepared?

9 A. This was prepared by Matt Grusha, an engineer in
10 Midland, and also with the input of Donald Turner, who
11 is -- you know, the one who brought the prospect, who is
12 very knowledgeable about this area, and also with the
13 assistance of Jeff Smith, our geologist, who is here, and
14 my input and Kent Cearley, who is the field supervisor.

15 So this has been gone over and actually is based
16 upon our experience in the No. 1 well. Even though it only
17 went to 8,600 feet, we have a pretty good idea of what it's
18 going to cost, and we also have -- we procured three bids
19 from drillers from Sitton Drilling, Norton Drilling and
20 Jeff -- what was that No. 1 well? -- Peterson, right.

21 Q. Are you satisfied, Mr. Diaz, that in your
22 opinion this AFE is a fair and reasonable expectation of
23 the costs for drilling and completing the well?

24 A. Yes, I am.

25 Q. The plan of the well is to drill it to a total

1 depth of how many feet approximately?

2 A. 11,200.

3 Q. What's your principal objective at that depth?

4 A. Mississippian.

5 Q. What's the next shallowest objective?

6 A. In the area would be Atoka production, which I
7 believe it's about 10,800, something like that.

8 Q. Do you have some Pennsylvanian potential, then,
9 in this area?

10 A. Yes. Permo-Penn would be at about ten-two,
11 ten-three.

12 Q. The operating agreement that deals with the
13 O.G. State No. 1 well, the first well --

14 A. Right.

15 Q. -- that is now producing in the Wolfcamp --

16 A. Right.

17 Q. -- that operating agreement provides, does it
18 not, for subsequent operations?

19 A. Correct.

20 Q. Under the subsequent operations, anyone
21 considered bound by that agreement would have the
22 opportunity to pay their share of the costs of subsequent
23 operations?

24 A. That's correct.

25 Q. Would the O.G. State No. 2 well constitute

1 subsequent operations, in your opinion?

2 A. Yes, it it would.

3 Q. If that operating agreement is enforceable and
4 applies to the interest owners and they elect not to
5 participate, is there a nonconsent penalty?

6 A. Yes, there is.

7 Q. What is that nonconsent penalty?

8 A. Three hundred percent.

9 Q. Have you had correspondence or communications
10 from Mr. Starrak about his desire to participate in this
11 second well and whether or not he's bound by this operating
12 agreement, what election he would make?

13 A. Okay. There's an issue as to -- the operating
14 agreement is signed by LBO and Donald Turner, Team
15 Exploration. The relationship that exists -- the legal
16 relationship existing between Donald Turner, Team and all
17 these working interest owners is really not known to me
18 because some of them claim that Turner represents their
19 interest. Some of them claim that he does not.

20 There's sort of a -- they don't have any joint
21 venture partnership agreement in effect, and it's sort of a
22 loose group. And, as a matter of fact, they are sort of
23 antagonistic in that the McAnnelly camp, which represents
24 McAnnelly and Mr. Starrak, is, you know, not in -- you
25 know, to my knowledge, they don't get along real well with

1 the Turner group, which is most of these other people and
2 Turner.

3 And so I get different statements. Some of them
4 want to be bound by the operating agreement, and some of
5 them do not. In other words, some of them say that when
6 Turner signed the operating agreement he was doing it just
7 on his behalf and they are not bound. Others take the
8 position that he bound both of them, you know, themselves
9 and him, that he speaks for them. So --

10 Q. Let's explore both alternatives concerning
11 Mr. Starrak's interest, and let's explore the presumption
12 that Mr. Starrak's interest has been committed to the
13 second well by Mr. Turner executing the operating
14 agreement.

15 If that is the situation, then, what, if any,
16 communications or correspondence do you have from
17 Mr. Starrak about his intent?

18 A. Right. Well, just in the event that he would be
19 bound by the operating agreement, in the event that that
20 were to be the case, we mailed him a letter where we
21 referred to the operating agreement. And he responded by
22 stating that -- he says, "We are in receipt of your January
23 18th" -- this letter is dated February 6th, 1991, from
24 Mr. Starrak to us, and it says, "We are in receipt of your
25 January 18th, 1991, letter in which you propose the

1 drilling of a deep test to the Mississippian formation
2 11,300" -- which is 200, but -- "This letter is to advise
3 that we do not wish to join in the drilling of this
4 Mississippian test and agree to go under the agreement
5 Article 6." Now, I'm assuming that he's referring to the
6 operating agreement that was signed by Mr. Turner and LBO.

7 "We will expect, however, that if the
8 Mississippian is nonproductive" -- and I note that he just
9 refers to the Mississippian even though the Atoka and the
10 Permo-Penn are two zones that lie between the Wolf Camp and
11 the Mississippian, which could be productive. So I don't
12 know whether he just doesn't believe they exist, or he's
13 decided that they don't -- they are not important to him.

14 "...that we will be offered the opportunity to
15 participate in any completion attempt to be made in the
16 Wolf Camp formation or other correlative zones in the O.G.
17 State No. 1 well."

18 Now, the way I interpret that letter would be
19 that at such point in time as we're ready to complete in
20 the Wolfcamp, which is the zone that's producing in the
21 O.G. State No. 1, which he has a back-in working interest,
22 that he would then pay his share of the completion -- in
23 that Wolf Camp it's one percent -- and he would be entitled
24 to his one percent interest in the Wolfcamp, because -- "an
25 opportunity to participate in any completion."

1 However, the drilling costs and -- to get to the
2 Wolfcamp are simply ignored, and I'm assuming that he's not
3 expecting to pay his share of that.

4 Q. Is that an acceptable position for you to
5 accept?

6 A. No, that is not.

7 Q. Let's take the alternative procedure.

8 A. Right.

9 Q. And let's assume that you need the compulsory
10 pooling procedures to commit Mr. Starrak's interest to the
11 well --

12 A. Right.

13 Q. -- because for some reason it's determined that
14 his interest is not committed or bound by this operating
15 agreement.

16 A. That's correct.

17 Q. You're going to have a group of potential owners
18 that may be in that position; is that correct?

19 A. That's correct.

20 Q. Under the forced pooling procedures, you have
21 requested from the division that you have forced pooling of
22 these interests, including Mr. Starrak's, and that they be
23 afforded an opportunity to make an election --

24 A. Right.

25 Q. -- on their participation in this well to total

1 depth.

2 A. Right.

3 Q. What is your request of this examiner concerning
4 an opportunity for Mr. Starrak or any others to make a
5 post-drilling recompletion election into the Wolf Camp and
6 pay only their proportionate share of the recompletion
7 costs?

8 A. Right. To me it would be an unfair position to
9 allow someone to share in the production of the zone by
10 simply paying their share of the completion when we have
11 all the drilling costs, and the reason we had to go with
12 the forced pooling was when we initially had approached all
13 these working interest owners, on the basis of the
14 operating agreement, a lot of them, specifically Bob Whitt,
15 who's an attorney in Midland, said, "You know, I'm not
16 bound by that agreement, and, you know, it doesn't mean
17 anything to me, and Donald Turner has no authority to bind
18 me."

19 So the -- our attorneys in Midland and here,
20 your firm, advised us that just to be on the safe side and
21 cover all the angles we better go ahead and file for forced
22 pooling because we could be in litigation in terms of
23 trying to prove that the operating agreement in fact was
24 signed by Turner on their behalf and that kind of thing.
25 So we want to proceed both -- on the both so that we can

1 cover all the bases.

2 Q. Now, when we proceed under the forced pooling,
3 what is your recommendation to the examiner on the period
4 of time in which Mr. Starrak and others will have in which
5 to make their election?

6 Is it going to be a period prior to the
7 commencement of the well, or do you want to afford them the
8 chance to make a post-drilling election on any of the
9 shallower zones above the base of the Mississippian?

10 A. No. Our position is that they should decide
11 before we drill the well, which is the customary way of
12 doing it -- not after we drill the well -- whether they are
13 going to participate or not, and if they do elect to
14 participate, they should pay the full share of
15 participating in that well and not just the completion
16 costs.

17 Q. Let me direct your attention, sir, to the next
18 tabulation of information after the AFE. It's the pink
19 tab. It says, "Economics."

20 How were the economics generated?

21 A. Well, basically we took -- Turner, Donald
22 Turner, and myself, based on the production we had obtained
23 on the No. 1 well from the Wolfcamp and as well as the
24 production of the well surrounding us and what we feel is
25 still left in the Permo-Penn, did some basic analysis of

1 what kind of production we could be expecting to come up
2 with.

3 Q. Let's back up just a second. When we look at
4 the O.G. State No. 1 well, the currently producing well --

5 A. Right.

6 Q. -- what's its approximate current rate of oil
7 production out of the Wolfcamp?

8 A. 20 barrels per day.

9 Q. And that 80-acre spacing unit, based on this
10 depth bracket, is assigned a daily allowable of how many
11 barrels?

12 A. 420, to my best knowledge.

13 Q. So you have approximately 400 barrels a day
14 excess allowable that can be shared and applied to the
15 second well?

16 A. That's correct. And from our conversations with
17 Mr. Sexton in the Hobbs district, he informed me that you
18 can drill more than one well in the spacing unit so long as
19 you don't exceed the overall allowable, and right now at 20
20 barrels a day we're not anywhere near the 420 barrels
21 allowable, and we're just letting oil in the ground, which
22 is not going to do the State of New Mexico or us any good
23 by just letting it remain there.

24 Q. Where are you in relation to the production on
25 the O.G. State No. 1 well and the payout of the cost on

1 that well?

2 A. The payout on the well -- we have approximately
3 a million dollars in that well. The reason for that is it
4 cost us almost \$500,000 to drill and complete the well
5 initially, and then we had collapsed casing in the well.

6 And I may add that when we bought these leases
7 from the Turner group, which involved -- which included
8 Mr. Starrak, we were represented that the equipment that
9 they had purchased -- because they had all the equipment
10 purchased: the tank battery, the casing, the tubing,
11 everything -- was, you know, in very good, excellent
12 condition. And we went ahead and on that basis went
13 forward.

14 Q. So you accepted those representations by the
15 Turner group, including Mr. Starrak, about the quality of
16 the equipment in this well?

17 A. Well, Mr. Starrak himself didn't make any
18 representations to that effect, but he was part of the
19 group, and the spokesmen for the group, Mr. McAnnelly and
20 Mr. Turner and Kent Kirby, who is an engineer, represented
21 to me that the equipment that they had purchased and which
22 is being sold to us along with the leases was in excellent
23 condition.

24 As it turns out, the casing that they had
25 purchased was used casing, had not been scoped, was just

1 drift and tested, and that really doesn't tell you very
2 much -- the integrity of the casing.

3 And then also we now found out that some of the
4 casing was casing that they had pulled out of the old well,
5 and so -- a well that maybe is 40 years old. Who knows
6 what condition that was in?

7 And my own opinion and those who I've spoken to
8 is that -- because I saw the casing when we pulled it out
9 of the collapsed well. I'm talking about when it collapsed
10 in the second well -- was very poor quality casing, and it
11 was pretty much doomed to collapse. Now --

12 Q. How many additional dollars did you spend then
13 in getting the O.G. State No. 1 well in a production status
14 for the Wolfcamp well?

15 A. \$529,000.

16 Q. Your AFE for the second well, then, is based
17 upon the experience from the first well?

18 A. That's correct, because there have been a lot of
19 collapsed wells in the area, and with the fact that we had
20 one, we are going to use 24-pound casing, which is a little
21 heavier than what most people are using.

22 Also, we're cementing from top to bottom to take
23 no chances.

24 May I add that in Mr. Starrak's letter to the
25 commission he states that we have given no information on

1 the cementing program that we're going to undertake. We do
2 have in the AFE an amount allocated for casing, for
3 production casing, cementing and production casing.

4 And in addition we have -- in my answer to
5 Mr. Starrak I end the letter by stating that -- with saying
6 that his terms were not acceptable to us. I say, "If you
7 have any questions or desire further information, please
8 let us know." And even in the prior letter -- we always
9 conclude our letters -- we're always willing to share
10 information. All Mr. Starrak had to do was give me a call
11 or write me a letter and ask me what we propose to do as
12 far as cementing, the production casing, and I would have
13 told him that it was from top to bottom. And I would have
14 told him it was going to be B.J. Titon, and I could refer
15 him to B.J. Titon exactly as to what, and he could get all
16 the information he wanted. But he chose not to do so.

17 So this is kind of a surprise to us that he's,
18 you know, trying to find information from the commission
19 that could have been made readily available to him, and I
20 don't know what the purpose of that is.

21 Q. At this point you have not been able to reach an
22 agreement with Mr. Starrak, either upon his participation,
23 farming out his interest or assigning it to you for this
24 well?

25 A. That's correct.

1 MR. KELLAHIN: Mr. Examiner, that concludes my
2 examination of Mr. Diaz. We would move the introduction of
3 LBO's Exhibits, which, I believe, were 1 through 8, if you
4 will, sir.

5 EXAMINER CATANACH: Exhibits 1 through 8 will be
6 admitted as evidence.

7 (Whereupon Exhibits 1 through 8 were admitted into
8 evidence.)

9 MR. KELLAHIN: There will be questions, Mr. Diaz.
10 Please stay seated.

11 EXAMINER CATANACH: Go ahead and let Mr. Starrak
12 cross-examine the witness now if he so desires.

13 MR. STARRAK: Okay.

14 CROSS-EXAMINATION

15 BY MR. STARRAK:

16 Q. Mr. Diaz, you've indicated that the McAnnelly
17 and Starrak group -- and I didn't know there was one -- was
18 antagonistic to the Turner group.

19 How do you figure this?

20 A. Mr. Turner tells me that he is not exactly in
21 the best of terms with Mr. McAnnelly at this point in time.

22 Q. I'm not or he's not?

23 A. He's not.

24 Q. He's not. Well, I didn't know that I was in
25 trouble with Turner, but --

1 MR. KELLAHIN: Mr. Stovall, I wondered if you might
2 help Mr. Starrak with forming his questions so that he
3 keeps his comments in the form of a question, and if he has
4 statements he wants to make, he might make them under oath
5 when it's his time to testify.

6 MR. STARRAK: Okay. Okay.

7 Q. (By Mr. Starrak) Has Mr. Turner indicated to
8 you that I will not go by the operating agreement that he
9 signed with LBO?

10 A. I didn't make that statement.

11 Q. Pardon me?

12 A. I have not made that statement.

13 Q. There is a group, then, that will not adhere to
14 the -- or represents -- adhere to the operating agreement
15 that was first signed by Turner?

16 A. I am saying that when I first proposed the
17 operating agreement, that Mr. Whitt, the attorney in
18 Midland, who has since -- we bought his interest out --
19 took the position that Mr. Turner's execution of the
20 operating agreement was not binding because he was not --
21 he never authorized his attorney to sign any kind of an
22 operating agreement on his behalf. And I believe that
23 there has been one other party that's taken that position.

24 And what I stated was that since I haven't heard
25 from some of these parties, I don't want to be in a

1 position where we're faced with some wanting to be bound
2 and some not wanting to be bound. And that's the reason
3 we're here for the forced pooling.

4 Q. Okay. Then -- as far as you're concerned, then,
5 I am not one of the group who is not adhering to the
6 operating agreement?

7 A. I never stated that you were in the group that
8 was not adhering. As a matter of fact, your letter appears
9 to accept the operating agreement because you refer to
10 paragraph -- Article 6 of the operating agreement.
11 Although you don't state "this operating agreement," I'm
12 assuming that's the only agreement you are referring to.

13 Q. Okay. On the letter I wrote you regarding
14 coming back into the completion of the Wolfcamp well, you
15 assumed that this was just for the actual completion costs
16 of the well at the time?

17 A. That's the way I interpret it.

18 Q. Have you ever been in any deep-drilling well or
19 shallow pool where operators have come back into the well
20 after going on consenting on a deep test?

21 A. We have been in one in a Fosselman test in
22 Glascot County.

23 Q. Well, isn't it generally that there is a cost
24 worked out on a deep well as to the drilling of the shallow
25 zone where people back in and pay their share?

1 A. I would say that the normal rule is that if
2 you -- if you're going to participate just in the shallow
3 zone, that you would pay your share of the drilling and
4 completion of that shallow zone, yes. That's the normal
5 way, right.

6 Q. Yes, but when a deep well is drilled by less
7 than all parties, and there's a shallow pool, they go
8 through the shallow pool, they are nonproductive below; and
9 have you ever seen where they are back in -- people would
10 join in the completion of the shallow well at a calculated
11 cost based on the price to -- cost to drill a well to that
12 depth?

13 A. I have seen many versions of it. I guess it
14 depends on the operating agreement and the state law.
15 State laws vary.

16 I would think the more equitable approach would
17 be to have the participant in the shallow well on the
18 shallow pool participate not only in the completion costs
19 but in the drilling and completion to that zone, yes.

20 However, it could vary depending on what the
21 operating agreement states and what the state law states.
22 I don't think there's a general rule that applies to the
23 whole country.

24 Q. What you're asking the people that were
25 originally in the O.G. State well is that in order to

1 retain their Wolfcamp rights they have to drill or
2 participate in the drilling of an 11,200-foot Mississippian
3 well; is that correct?

4 A. What our position was that under the operating
5 agreement, which apparently you chose to be bound, that you
6 have to -- when a party proposes an operation, you either
7 consent to it as proposed or you don't. And we have
8 proposed a Mississippian test.

9 Now, the reason that it's going to be very
10 difficult to segregate the Wolfcamp from the lower zones is
11 that it is -- the common practice in this area that when
12 your Permo-Penn -- assuming we have Permo-Penn production,
13 which is a good likelihood -- gets to a certain level, you
14 complete in the Wolfcamp and you commingle the two zones.

15 And as a matter of fact, the wells around us -- some are
16 commingled in the two zones.

17 That if you participated only to the Wolfcamp
18 and we commingle the two zones, how do we account for the
19 oil coming out of one and the other one unless we do a dual
20 completion? If we do a dual completion by putting, you
21 know, double tubing in there, it's going to increase the
22 cost of the well. If we drill a second well just to the
23 Wolfcamp, you're going to have unnecessary drilling
24 expense. You -- maybe you have some solutions to that.

25 Q. Okay. I don't think that was my question. The

1 question is that you expect the people, and myself
2 included, in order to retain any rights in the Wolfcamp,
3 that I have to join in the drilling of a deep well.

4 Q. I believe I answered that. I stated that we
5 took the position that you have to either consent or not
6 consent to the proposed operation, which is drilling to the
7 Mississippian, yes. That's the letter -- our letter to
8 everyone states that, correct.

9 Q. Does LBO have any farmout or drilling options or
10 anything around the Section 9 well that -- for the
11 Mississippian test?

12 A. I believe we went through the plat. We showed
13 that LBO owns a hundred percent of the south half of the
14 southwest and the north half of the southeast.

15 Q. That's --

16 A. I did state that for the record.

17 Q. That's not the question, though. My question
18 is: Do you have any farmout or drilling options outside of
19 the south half?

20 MR. KELLAHIN: I'm going to object to the question. I
21 think it's irrelevant. You don't have any anyway, do you?

22 THE WITNESS: No, I don't have any.

23 MR. STARRAK: Why is it irrelevant?

24 THE WITNESS: I don't have any.

25 MR. KELLAHIN: It's not the subject of the spacing

1 unit question.

2 MR. STOVALL: Go ahead, Mr. Starrak. He's answered
3 the question.

4 Q. (By Mr. Starrak) Okay. You don't have any?

5 A. No, don't have any.

6 Q. When you took over as operator of the well, did
7 you hire Turner and any of the other people in the well to
8 work for you?

9 A. I didn't hire them. When we agreed to undertake
10 to take over the leases and to put up the money to drill a
11 new well, part of the consideration, the agreement with
12 Turner and McAnnelly and Kirby, was that they would
13 undertake to supervise the drilling and completion of the
14 well and then turn it over to us once it was ready to be
15 operated, and that's what they did.

16 And, you know, that was the only -- I wanted to
17 be sure that they were involved because they had the
18 knowledge of the area and of the well and what had
19 transpired, and I felt they would be best to do that, to do
20 it that way, right.

21 Q. So they were actually working for you at the
22 time when --

23 A. They weren't working for me. I wasn't paying
24 them any salaries. I wasn't paying them any consulting
25 fees. I'm saying that as part of the consideration for LBO

1 undertaking to put up the half a million that was needed to
2 drill and complete the well we requested that they would be
3 involved in the drilling and completion of the well.

4 Q. Okay. When the well collapsed -- the casing
5 collapsed in the well and everybody was informed of the
6 cost of fixing it up, I wrote you several -- I wrote you
7 twice and Turner once, requesting information on the
8 cementing details, the casing hanging and cementing. I
9 never did receive those.

10 A. That was turned over to Mr. Kirby, Kent Kirby,
11 and Donald Turner, who were the geologist and engineer on
12 the well.

13 Q. That was turned over to them?

14 A. That's correct.

15 Q. What do you mean?

16 A. To answer. To respond to your questions.

17 I'm going to repeat this. LBO was not -- we
18 were not the ones who drilled and completed -- we put up
19 the money to drill and complete the well, and we did get an
20 assignment of the leases. But the job of supervising the
21 drilling and completion and, you know, selecting who the
22 contractors and all was in the hands of -- it was placed in
23 the hands of Donald Turner, Kent Kirby and Kent Cearley,
24 those three gentlemen.

25 Q. And you had a contract with them?

1 MR. KELLAHIN: We've been patient, Mr. Examiner. I'm
2 not sure this is heading anywhere.

3 THE WITNESS: I've answered that question three times.

4 MR. STARRAK: Well, I think that part of the point is
5 that -- you know, we're talking about his testimony that
6 the people that owned the well originally gave him bad
7 equipment, and he -- my name was mentioned along in that,
8 and also they had used casing.

9 You know, this well was 20, 30 years old. The
10 tank had been sitting out there I don't know how many
11 years. I don't know what they expected on the thing, and I
12 don't know whether it's germane to this hearing or not, but
13 it seemed to be when it was brought up by Mr. Diaz.

14 MR. STOVALL: Mr. Starrak, I might make a suggestion,
15 just in terms of being able to get out the information that
16 you're concerned with. You will be able to have an
17 opportunity to testify as to facts about which you have
18 knowledge. I think it would be most productive for you
19 to -- if there are things that you would like to get in in
20 terms of information about which you have knowledge, do
21 that directly, testify on your own behalf.

22 MR. STARRAK: Okay.

23 MR. STOVALL: With respect to what Mr. Diaz has
24 testified to, you're certainly free to ask him the
25 questions, but I recommend that you make your own case

1 yourself and just question him on issues which he's raised.

2 MR. STARRAK: Okay.

3 Q. (By Mr. Starrak) I guess one other question,
4 Mr. Diaz.

5 On the AFE and the letter that you sent out, we
6 were charged one percent of the total well cost --

7 A. I'm assuming that's the way it's stated.

8 Q. -- to 11,200 feet, right?

9 A. That's -- your invoice probably would reflect
10 one percent of that, that's correct, of the total AFE cost.

11 Q. And on a Mississippian well, we would have --
12 actually, in there with the group we would have 160 acres;
13 you would have 160 acres?

14 A. You own a one percent interest in 160 acres, and
15 we own a hundred percent interest in 160, and depending on
16 the deep formation that would be productive, the spacing
17 unit would take that into consideration. I mean,
18 everything would be prorated to the interest that you own.

19 That's the only way it can be done.

20 Q. But you're asking us to pay up front as though
21 the Mississippian was not producing; is that right?

22 A. Well, I -- I'm saying that if you -- if we've
23 made -- if you believe that the amount that we've billed
24 you is incorrect, I'll be glad to -- you know, to make it
25 to you one percent portionately reduced.

1 In some zones, if it's an 80-acre spacing, then
 2 you would have -- your one percent would be of the total of
 3 that. If it goes beyond the acreage that you own, then
 4 your interest would be diluted, and you would -- and so is
 5 your cost to that.

6 Q. Oh.

7 A. Right.

8 Q. Okay. So you wouldn't have to pay up front.

9 MR. STARRAK: All right. That's all I have.

10 MR. STOVALL: I had a few questions. I'd just like to
 11 clarify some things just to make sure my understanding of
 12 the situation.

13 EXAMINATION

14 BY MR. STOVALL:

15 Q. Going back to -- let's see. You've got your
 16 plat map. I'm going to just use that as a reference point.

17 The 320-acre spacing unit you're proposing is
 18 the south half of Section 9; is that correct?

19 A. That's correct.

20 Q. And that applies to which formations?

21 A. I believe that applies to the Mississippian gas.

22 Q. And the spot shown on the exhibit behind that
 23 plat map is the proposed well?

24 A. That's correct.

25 Q. Where is the existing well?

1 A. It's the 40 acres right to the east of it, so it
2 would be in the northeast of the southwest, right in the
3 center.

4 Actually, it's not really in the center. It's
5 90 feet to the northeast of the center.

6 Q. And that's a Wolfcamp well?

7 A. Yes, it is.

8 Q. What's the proration unit for that well?

9 A. 80 acres.

10 Q. Which 80 acres?

11 A. The north half of Section 9. So, in other
12 words, we wouldd be drilling -- as far as the Wolfcamp,
13 there would be two wells in that proration unit, but the
14 current well is only doing 20 barrels a day, and we don't
15 anticipate that our new well would do more than, you know,
16 40, 50 barrels a day. So we would still be way under the
17 420 allowable for the Wolfcamp.

18 Q. Now, if I understand correctly, Mr. Starrak's
19 interest -- and since he's the party that's here that we're
20 concerned about, I'll only ask about his --

21 A. Right.

22 Q. -- is a back-in interest when the No. 1 well
23 achieves payout; is that correct?

24 A. That's correct.

25 Q. Do you interpret that that interest would be --

1 or how will that interest be affected by the drilling of
2 the No. 2?

3 A. My -- it shouldn't be affected because at the
4 time we reach payout, which we estimate would be probably
5 three or four years from now, depending on oil prices, he
6 will get his one percent, and then he will have one percent
7 of the Wolfcamp from production of that well.

8 As far as this well, the new well, draining any
9 reserves from that, you know, pulling away any reserves
10 from that well, we have evidence to show that that is not
11 the case; that, as a matter of fact, we think that the
12 existing well is only draining maybe 20 acres at best
13 because of the tightness of the zone. The permeability is
14 not very good, as indicative by the production we're
15 getting out of it.

16 If you -- you know, doing your volumetrics on
17 the zone, there is a lot more oil than -- we wouldn't even
18 drain a third of the spacing unit right now.

19 Q. And you would -- you propose to continue
20 operating that No. 1 well?

21 A. That's correct. That's correct.

22 Q. I assume the cost of -- this is the well in
23 which you had to replace casing or --

24 A. Yes, that's correct.

25 Q. And that cost is included in this payout number;

1 is that correct?

2 A. Yes, it is.

3 Q. Let's move on now to correspondence and the
4 operating agreement. I see behind the correspondence tab
5 an operating agreement --

6 A. That's correct.

7 Q. -- dated April 1st, 1989.

8 A. That's correct.

9 Q. And when I go back to the Exhibit A to that
10 operating agreement, the description of the lands subject
11 to that operating is the north half of the southwest
12 quarter and the south half of the southeast quarter of
13 Section 9; is that correct?

14 A. That's correct.

15 Q. And where is Mr. Starrak's interest?

16 A. It's in the north half of the southwest and the
17 south half of the southeast.

18 Q. So the south half of the southwest and the north
19 half of the southeast are not covered by this operating
20 agreement?

21 A. That's correct.

22 Q. So does that mean that you have -- then you
23 proposed a new operating agreement. I guess that's the one
24 behind the operating agreement tab; is that correct?

25 A. Well, what we -- we sent this out in terms of

1 the -- since the well is going to be located in the north
2 half of the southwest, and in terms of the Wolfcamp and the
3 Permo-Penn, we will be operating in an 80-acre spacing
4 unit, that the operating agreement would apply as to those.

5 When you then get into a 320 or 160 proration
6 unit, where you're going to have to pool the two -- the
7 four leases -- or actually, three leases, you know, to get
8 to that, then it would be -- the ownership would be
9 different. And so part of it would be subject to the
10 operating agreement, part of it would not. And that's
11 really another reason why we wanted to go through the
12 forced pooling, because the operating agreement would not
13 cover that new acreage that is owned a hundred percent by
14 LBO.

15 Q. You are an attorney, right?

16 A. Yes.

17 Q. And what state are you licensed in?

18 A. Colorado and California.

19 Q. And you are familiar with oil and gas law?

20 A. I believe I am.

21 Q. I'm a bit concerned here that you're coming in
22 and saying that you think you have an operating agreement
23 but you're not sure, so we're going to force pool -- you're
24 going to force pool Mr. Starrak's interest and the others.
25 But you think the operating agreement allows you to go

1 drill the well and bring his interest in under the
2 operating agreement, but just in case you want to force
3 pool it.

4 Which way do you want it? I guess that that's
5 the question.

6 A. Well, all right. The problem was created by the
7 fact that you have many parties who are -- it's a very
8 loosely structured group, and -- who we bought the interest
9 from. For instance, Mr. Starrak -- his involvement is
10 through McAnnelly, who was a partner of -- or a name of
11 Turner, and the background to that we have no knowledge of.

12 In other words, they have never produced any
13 kind of a joint venture agreement or partnership agreement,
14 so I really don't know what their agreement was. All I
15 know is that they are -- their interest was as part of the
16 assignment from Turner to us. He reserved them a back-in
17 working interest.

18 When Turner -- when we bought the leases from
19 Turner, he signed this operating agreement purporting to
20 bind all these parties, but as I've stated, that, you know,
21 some of them -- a couple of them have taken the position
22 that Turner did not have the power and authority to bind
23 them.

24 And so we're in a -- we have not -- you know,
25 the only alternative we have is to go to court and seek a

1 declaratory decree from the court stating what our rights
2 are in the operating agreement and how many parties are
3 affected and how much of the land is covered and that kind
4 of thing. In other words, it's quite extended. It's
5 binding on the other parties.

6 So since we have this -- we're in this
7 predicament between a rock and a hard place, in order to,
8 you know, not drill and complete the well and then have
9 parties come and say, "Gee, we weren't bound by the
10 operating agreement so, you know, you went ahead and
11 drilled the well without our permission, or you didn't give
12 us" -- so we went ahead and assumed that they were bound,
13 and we gave them notice. And then on the other hand we're
14 force pooling them to take into consideration those who
15 decide that they don't want to be bound by the operating
16 agreement.

17 To us it's just a -- we went with the advice of
18 counsel.

19 Q. Suppose we enter a forced pooling order -- now,
20 let's understand first -- make sure that you understand
21 that if we enter a forced pooling order, it does not
22 incorporate the terms of the operating agreement.

23 A. That's correct.

24 Q. It in fact assumes there is no operating
25 agreement.

1 A. That's correct. Right.

2 Q. By asking us to enter that order, and if we
3 enter an order, are you not in effect saying that the
4 operating agreement is not controlling in this situation?

5 A. Well, Tom, do you want to --

6 MR. KELLAHIN: We're saying we do not know,
7 Mr. Stovall, and so we want the comfort of having the
8 forced pooling order in place to protect us in the event
9 the dispute is resolved so -- in such a way that there
10 isn't an operating agreement.

11 In addition, it's hard to get a new operating
12 agreement with this one in place, so I think I concur in
13 what Mr. Diaz has said. We're caught in a dilemma that
14 needs your assistance, and it's not unusual to have this
15 occur on occasion.

16 THE WITNESS: We initially were going to go ahead
17 under the assumption that the operating agreement was
18 controlling, but Karen Aubrey of Tom's firm stated that --
19 and Rudy Whirdle with Lynch, Chappel in Midland -- that
20 that would be a risky way to proceed, to go ahead and spend
21 almost a million dollars drilling a well and not know who
22 is bound and who isn't by the operating agreement.

23 Because the only signature on the operating
24 agreement is Donald Turner, and Donald Turner has never
25 produced any agreement with these parties, you know,

1 showing that he has the authority to bind them, whether
2 it's a joint venture or a partnership agreement or anything
3 like that.

4 I mean, so legally they can object to saying,
5 "Well, you know, that operating agreement is not binding on
6 me," and so where are we at that point? We have to have
7 some protection, and we're hoping to get it from the
8 commission.

9 In addition, we have different ownership in the
10 two tracts, so that if we do go to 160 or 320 spacing, we
11 would be pooling the two leases, some of which these
12 parties have an interest in and some of it which they don't
13 have an interest in. And so definitely the operating
14 agreement would not be -- would not apply to that -- to the
15 new lease, which we own a hundred percent.

16 Q. (By Mr. Stovall) The new lease is the --

17 A. The south half of the southwest and the north
18 half of the southeast.

19 Q. So you don't have any parties in those tracts
20 which you need to pool?

21 A. That's correct.

22 Q. So LBO could -- or Strata, or whoever is
23 operating, whoever's name it is in, could in effect
24 voluntarily commit those interests to the operating -- to
25 the operating rules that apply to the spacing unit?

1 A. That's correct. That's correct.

2 Q. Now, am I correct -- did I understand you to say
3 that the operating agreement -- under the terms of the
4 operating agreement, as you interpret it, that a party
5 either joins the entire operation or a nonconsent on the
6 entire operation and can't select between depths?

7 A. All right.

8 Q. Without regard to the allocation of costs. I'm
9 just talking about prorations and horizons.

10 A. Right. No, no. Right. When we sent out the
11 notices, we ran this by Rudy Whirdle of Lynch, Chappel in
12 Midland, who's an oil and gas attorney, and he stated that
13 when a party proposes an operation, it has been his
14 experience in the years he's been in practice that the
15 other parties have to give consent to the operation as
16 proposed or not consent.

17 I mean, they can't just selectively say --
18 because then you have one party saying, "Well, I'll go to
19 the Wolfcamp." The other one says, "I'll go to the
20 Permo-Penn." The other one says, "Well, I'll go to the
21 Atoka," and before you know it you have a nightmare,
22 because you have different parties participating in
23 different zones.

24 And then how you allocate the production -- and
25 if you complete and commingle two zones, which is probably

1 going to be the case, you're going to commingle the
2 Permo-Penn and the Wolfcamp, then -- I mean, I just don't
3 know how you can keep track of how much oil is coming out
4 of each zone without doing a dual completion, and that's --
5 I would really prefer not to have to incur the additional
6 costs of a dual completion.

7 Q. If -- what I understand Mr. Starrak's position
8 is, is that he is willing to participate in what he
9 considers to be a safer Wolfcamp prospect, and -- but is
10 unwilling to participate in the riskier and more costly
11 Mississippian.

12 Do you understand that as being his position as
13 well?

14 A. I would say that would seem to me to be his
15 position, yes.

16 Q. Notwithstanding the question about whether he's
17 talking about paying for a completion or drilling or
18 whatever.

19 A. Right. Right. Right.

20 Q. What would be the position of your company if
21 the division were to enter an order which in effect allowed
22 him to prepay costs based on an appropriate allocation to,
23 say, the Wolfcamp?

24 And I understand the other questions. I just --

25 A. Right. Well, obviously we would be bound by any

1 position the commission -- any order from the commission.
2 If you ask me for what we would like to see, my problems
3 are going to be that if we have Mississippian or Atoka
4 production, it could be years, 20, 30 years, before we even
5 get to the Wolfcamp. In that case, then, what -- at what
6 point in time does he pay his money?

7 Number two, if at the point in time that we
8 commingle the Permo-Penn and the Wolfcamp, how do we -- how
9 do we account to Mr. Starrak for his one percent of the
10 Wolfcamp production?

11 Q. I understand those problems --

12 A. Right.

13 Q. -- and that may be evidentiary in support of not
14 entering that sort of order. My question is -- to you is:
15 As the company president and as an attorney --

16 A. Right.

17 Q. -- you're kind of picking and choosing your
18 remedies at the moment between the operating agreement,
19 which we have no authority to enforce and interpret --

20 A. Right.

21 Q. -- and asking the commission to force pool
22 Mr. Starrak's interest into whatever well, and you're
23 asking for the forced pooling into the entire well.

24 If you don't like the order, does that then
25 leave you with the option of going back and saying, "Well,

1 we're going to go after the operating agreement," and use
2 that rather than the commission order?

3 Where are you in that position? I mean, are you
4 leaving your options open? Is that what you're trying to
5 do here?

6 A. No. I'm not trying -- basically the forced
7 pooling would apply to everyone on this list, some of which
8 we haven't heard from, some of which -- the majority of
9 which we have some kind of an agreement, and our objective
10 is simply this: We want to protect ourselves in case some
11 of these people disavow being bound by the operating
12 agreement, in which case we don't want to go to court and
13 prove that at the time Mr. Turner executed the operating
14 agreement he was doing so with the express or implied
15 consent of these parties, you know, because then you get
16 into an agency-principal-proof relationship and --

17 Q. I understand all the legal questions you've got
18 there.

19 A. Right. Right. So we would -- all we're trying
20 to do really is saying that, you know, we want the
21 protection of the commission in terms of -- if you ask me
22 which we would prefer to follow, it doesn't really make any
23 difference to us, to be honest with you.

24 I'm not -- you know, I'm not -- in principle I'm
25 not opposed to what Mr. Starrak is suggesting. I'm just

1 trying to think of how we can -- you know, we can go and
2 meet his request and -- without imposing a significant
3 additional cost to us, because if I have to, you know, do a
4 dual completion to account for his production, then I will
5 not drill the well. That's as simple as that. I just
6 won't drill, and then he can just have the lease and make
7 no payment for it.

8 Q. If -- Mr. Starrak's correspondence does refer to
9 the operating agreement.

10 A. Yes, he does.

11 Q. As a lawyer --

12 A. Right.

13 Q. -- and I'm asking you for your opinion because
14 you are qualified to do so -- does that in fact indicate
15 his intent to be -- to have the operating agreement control
16 his interest?

17 A. I would say we -- you know, we don't -- I'm not
18 trying to be facetious, but we can ask Mr. Starrak what he
19 intended when he wrote the letter.

20 Q. No. I may take that opportunity, but I'm asking
21 you while I've got you here.

22 A. I would think that the operating agreement that
23 he was referring to was this operating agreement, and that
24 he thereby intends to be bound by it. That's the way I
25 would interpret it.

1 Q. In which case, then, the commission does not, I
2 guess, have the authority to force pool his interest
3 because it's controlled by the operating agreement.

4 MR. KELLAHIN: Let me interject a thought here.

5 I don't think the division needs to worry about
6 that because the forced pooling will apply only to those
7 parties that are not contractually bound, and if
8 Mr. Starrak takes the position, even if we disagree with
9 it, that he is committed under this operating agreement,
10 and if he has to seek a court solution of that and is
11 determined the contract controls, then it takes precedence
12 over the pooling order.

13 The predicate for the pooling is an absence of
14 an agreement, and so it really represents a safety net for
15 Mr. Diaz, and it does not need to concern you, I think,
16 that we are discussing this as a dual remedy for us.
17 Mr. Diaz doesn't have to choose either one. If he and
18 Mr. Starrak agree that Mr. Starrak's interest is committed
19 by the terms of that operating agreement, they can worry
20 about how to apply its terms and conditions.

21 What we're asking you for is for those parties
22 that may take another position, or for the district court
23 if they say that Mr. Starrak's not bound, we have the
24 comfort of at least knowing the interests are committed to
25 the 320 or the 160 or the 280.

1 So I don't think we're choosing remedies. We're
2 choosing a solution that gives us a committment of all
3 interests in the well, and if the contract controls his
4 interest, Mr. Starrak's interest, then it will take
5 precedence over the pooling order.

6 MR. STOVALL: I have no further questions.

7 EXAMINATION

8 BY EXAMINER CATANACH:

9 Q. Mr. Diaz, what is LBO's interest in the north
10 half of the southwest and the south half of the southeast?

11 A. 87 and a half percent.

12 MR. STOVALL: That's the -- of the working interest,
13 right?

14 THE WITNESS: That's correct.

15 MR. STOVALL: Not of the whole?

16 THE WITNESS: That's correct. I believe that when --
17 well, right now it's an 87 and a half working interest with
18 an 87 and a half net revenue interest.

19 At such time as these parties back in, it will
20 go -- it will drop down then to -- I believe it's an 81
21 percent working interest with an 80 percent or 81 percent
22 NRI. They pretty much follow each other.

23 MR. STOVALL: Not a lot of override is what you're
24 saying?

25 THE WITNESS: There's a small back-in override

1 interest. I think it's -- maybe it adds up to less than
2 three percent back-in overrides.

3 Q. (By Examiner Catanach) Just to make sure I
4 understand who you are pooling and who you are in effect --
5 well, I'm not sure if you're dismissing those parties from
6 the case, but you said you bought out CBAT's interest?

7 A. Right. We bought them out, and also Bonnie
8 Wilson, down on the bottom. So they can be deleted from
9 this.

10 Q. You are carrying Annette Mills' interest, so
11 that's --

12 A. Right.

13 Q. The interest of -- I can't -- was it Kent
14 Cearley who is the guy that works for you?

15 A. Kent Cearley, right. He should be left because
16 of the fact that he will be providing services on the well,
17 on the new well, in exchange for his -- for a share of
18 cost. But if -- you know, if you were to get -- something
19 were to happen to him and he couldn't provide the interest,
20 then we would be left with no protection, or if he changed
21 his mind.

22 We have nothing in writing to that. It's just
23 an oral agreement. So he would want to -- I would want to
24 keep him there, be subject to the pooling.

25 Q. Is he subject to any risk penalty if he --

1 A. Well, in the operating agreement he would have a
2 300 percent, and in the forced pooling it would be what it
3 states.

4 One other question I had was that, since the
5 operating agreement -- it would be relating to the question
6 you asked -- it only applies to the north half of the
7 southwest and the south half of the southeast, that when we
8 establish -- when we need 320 or 160 spacing units, we are
9 going to have to pool the interest, and so we're going to
10 have -- that's not covered by the operating agreement, and
11 so we need to resolve that issue as well. That's why the
12 pooling of -- order would come into play.

13 MR. STOVALL: But if I'm not mistaken, the acreage
14 that's not covered by the operating agreement is owned by
15 LBO a hundred percent.

16 THE WITNESS: Right. Right.

17 MR. STOVALL: And so they are not really concerned
18 about a penalty provision on those -- on those acres.
19 Presumably you're going to consent and pay your costs.

20 THE WITNESS: Right. Yeah. Right.

21 Simply, as we complete in other zones, then
22 there's additional costs of completing in these upper
23 zones, and each party is, you know, made to pay their
24 proportionate share. Taking into consideration the
25 diversity of interests, that if they chose not to, what

1 penalty would apply and -- you know, and that kind of
2 thing?

3 And again, I stress that I feel uncomfortable
4 with relying on Turner's signature alone as binding all
5 these parties. For instance, the Barick group, which they
6 are in an override position, but they told me that Turner
7 never had any authority to sign on behalf of anyone. They
8 are out of Alabama.

9 MR. STOVALL: I think, as Mr. Kellahin pointed out,
10 that's not really at issue, as to who is or who is not a
11 party to the operating agreement.

12 THE WITNESS: Okay.

13 Q. (By Examiner Catanach) Is it your understanding
14 that the Atoka -- or is there any Strawn in this area? Do
15 you know?

16 A. To my knowledge, it's not productive in this
17 area.

18 MR. HOOVER: Those are really questions for me, sir.

19 EXAMINER CATANACH: Oh, okay. I'll wait on that.

20 MR. KELLAHIN: We have a geologist, Mr. Hoover.

21 EXAMINER CATANACH: Okay. I'll defer that.

22 Q. (By Examiner Catanach) Mr. Diaz, do you know
23 what the difference in the well costs would be for drilling
24 a Wolfcamp well as compared to drilling a Mississippian
25 well?

1 A. Well, my guess would be -- and I guess you never
2 know exactly -- that the difference is going to be
3 approximately \$250,000. In other words, you're looking at
4 about a half a million or maybe somewhere between four and
5 five hundred thousand for a Wolfcamp completion and
6 somewhere between six and eight for a Mississippian-Atoka
7 type of completion.

8 And, you know, ours is going to be a little more
9 costly than the wells in the area because we're using new
10 casing. We're using 24-pound casing, and we're using
11 cementing all the way from bottom to top. A lot of the
12 operators nearby use 17-pound, use casing, and they didn't
13 cement all the way.

14 But, you know, after the experience we've had,
15 believe me, we don't want to take any chances.

16 Q. Well, I've done a little studying on that area,
17 and I don't know if new casing and cement is going to help
18 you, really.

19 MR. STOVALL: Don't tell him that.

20 EXAMINER CATANACH: It's a pretty bad area.

21 I believe that's all I have. Did you have
22 anything else?

23 Witness may be excused.

24 MR. STOVALL: Mr. Examiner, I'd like at this time to
25 call Mr. Jeff Smith.

1 JEFFRY ALLEN SMITH,
2 the Witness herein, having been first duly sworn, was
3 examined and testified as follows:

4 DIRECT EXAMINATION

5 BY MR. KELLAHIN:

6 Q. Mr. Smith, for the record, would you please
7 state your name and occupation?

8 A. My name is Jeffry Allen Smith. I'm a geologist.

9 Q. Mr. Smith, on prior occasions you've testified
10 before the division as a geologist, have you not?

11 A. Yes, I have.

12 Q. And in your experience as a geologist you have
13 on occasion worked as a practical petroleum engineer, have
14 you not?

15 A. In a qualitative sense primarily. Twenty-one
16 years of petroleum geology, you can't help but pick up a
17 little bit of shade-tree reservoir engineering.

18 Q. Within this particular area of the Wolfcamp, in
19 addition to geologic information, you have informed
20 yourself about the permeability of the reservoir or looked
21 at the production characteristics of the wells in the area
22 and tried to compare the production characteristics to the
23 geology?

24 A. Yes, I have.

25 Q. In addition, you have some sense based upon your

1 background and experience of the range of permeability you
2 might anticipate in the Wolfcamp in this area?

3 A. Yes. This -- looks like this particular area
4 where the O.G. State No. 1 is located and the O.G. State
5 No. 2 is proposed is very poor with respect to the average
6 Wolfcamp in the area.

7 Q. So in addition to the typical disciplines of
8 geology, you, based upon your experience, do have certain
9 understanding of some of the engineering aspects that go
10 into giving you a more informed position on drilling wells
11 and locating them in this particular section for all
12 potential producing horizons?

13 A. It may not seem so, but I hope so.

14 Q. All right. We'll find out.

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

17 EXAMINER CATANACH: He is so qualified.

18 MR. STOVALL: And practical oilman, Mr. Kellahin?

19 MR. KELLAHIN: I believe so. We're going to test his
20 experience here.

21 Q. (By Mr. Kellahin) Mr. Smith, for aiding us in
22 our discussion, let me have you turn to the last display in
23 the package. It's identified as the Wolfcamp structure
24 map.

25 Is this a document that you prepared, Mr. Smith?

1 A. No, it is not.

2 Q. Have you satisfied yourself that the
3 information, as well as the interpretation of structure, is
4 accurate and consistent with an interpretation that you
5 would make if you had constructed the map yourself?

6 A. Yes. I've reviewed it, and I didn't find any
7 busts in any of the data. And if you took ten geologists
8 and gave them points and said, "Count with this," you're
9 going to get ten different answers, but I think this is a
10 very reasonable answer.

11 Q. All right. Let's take a moment and orient the
12 examiner to some of the key components of the information
13 shown on the display.

14 First of all, let's start out with the O.G.
15 State No. 1 well, the producing Wolfcamp well in the south
16 half of Section 9. Where do we find that?

17 A. I'm sorry; what specific well?

18 Q. The producing Wolf Camp well.

19 A. Yes.

20 Q. How is that shown on this display?

21 A. Just shown by a solid dot.

22 Q. And it is the dot in the 40 acres east of the
23 black dot that has the arrow adjacent to it?

24 A. Yes, correct.

25 Q. The arrow shows the proposed location?

1 A. Yes, sir.

2 Q. All right. That location will be standard as to
3 all formations with the exceptions of the deep-gas zones;
4 is that not true?

5 A. That's correct.

6 Q. The location is 660 from the west boundary and
7 1980 from the south line?

8 A. Yes.

9 Q. Let's talk for a moment about the deep-gas
10 potential.

11 Why in your opinion is the proposed unorthodox
12 location -- insofar as gas production below the top of the
13 Wolfcamp is concerned, why is that the preferable location
14 to any standard location in the south half of 9 for that
15 potential production?

16 A. The reason to drill this well and the hope of
17 having an economic completion really rely on a combination
18 of the Wolfcamp carbonate and what are generally classified
19 here as the Pennsylvanian or Permo-Penn carbonates.

20 The chance of success from the Mississippian is
21 probably less than one percent, but there's been a
22 misconception here, I think -- or at least I've sensed
23 it -- that we're drilling a Mississippian test to test
24 Mississippian. We're not. It's just -- it's the
25 nomenclature.

1 If Exxon goes out and drills a 28,000-foot well
2 and stakes it as a basement test, they are not hoping to
3 make oil from the pre-Cambrian. They are going to
4 penetrate the pre-Cambrian, so it's called a basement test,
5 but they are most likely looking at Devonian Fosselman
6 elements.

7 We don't anticipate production from
8 Mississippian, but you know that you are through the Atoka
9 Morrow by tagging Mississippian lime. That says, "Okay,
10 we've gone through it."

11 We think there is a slight chance, a worthwhile
12 chance, of looking at the Atoka Morrow clastic zone. If I
13 can direct your attention to the map, in Section 16,
14 immediately south of Section 9, the McAlester and Texas
15 Crude State No. 1-HN in the very south end of the section,
16 TD-ed at 11,607 feet. That well did penetrate these
17 sections. It drill stem tested. It had tests -- I don't
18 recall exactly, but they are in the range -- the rates on
19 tests were in the range of 3.5 million gas per day, 100
20 barrels condensate per day, which I consider to be a very,
21 very good show. Hardly anyone in this area has ever gone
22 below the base of the Strawn, which is at approximately --
23 varies between ten-four and ten-six. For the sake of a
24 couple hundred more feet we can look at zones at a mile
25 away that had very significant show.

1 So I gathered the sense that people, you know,
2 are at least thinking, "Mississippian. Why are they going
3 Mississippian?" Well, it's not a Mississippian test.
4 That's the nomenclature. We know we're through Atoka
5 Morrow when we tag Mississippian.

6 I digressed, but --

7 Q. Well, it was helpful, Mr. Smith.

8 A. We would not --

9 Q. Let's look at the Permo-Penn a little bit.

10 A. I'm going to go ahead with it, Tom.

11 You're probably sitting here saying, "Why do
12 these guys wants to drill an \$800,000 well to offset a
13 20-barrel-a-day well?" Well, we don't. We couldn't go in
14 here and justify drilling a Wolfcamp well. It would be
15 stupid.

16 We do think that there's a reasonable chance
17 that considerable oil has been left behind in the normal
18 North Bagley-Permo-Penn pay, which is not one pay, but a
19 series of stacked, very small porosity stringers.

20 The original Gulf Lease State, which has now
21 been replaced by our 1 O.G., only made 130,000 barrels of
22 oil. The reason it only made 130,000 barrels of oil was
23 because their casing collapsed, so we had to abandon the
24 well prematurely.

25 We think that we have a little hole here in the

1 drainage from that normal North Bagley pay. If there
2 are -- if there are fifty or 60,000 barrels of oil left in
3 it because of the premature abandonment of that well, and
4 if there are thirty or 40,000 barrels left, hopefully, in
5 the Wolfcamp at that location, that would be incremental to
6 what the O.G. could recover. Then we could have a
7 100,000-barrel well and be economically viable.

8 To include the Wolfcamp and the Permo-Penn
9 horizons, we would have to go to approximately 10,600 feet.
10 To look at the Atoka Morrow, which had the very significant
11 show a mile away, we only have to go a couple hundred extra
12 feet. We said, "Why not?" A couple hundred feet extra
13 doesn't cost very much.

14 But there has been, I think, a sense that we've
15 been talking about instead of going to 8,750 at the Wolf
16 Camp, we're going to 11-something at some other horizon and
17 that we've added a huge incremental cost. In effect,
18 that's not really true.

19 The only justification for drilling this well is
20 to try to add reserves from an uneconomic Wolfcamp to an
21 uneconomic Permo-Penn, put the two together, two and two
22 equals four, and all of a sudden have something that is
23 economic. So the only justification of drilling a well is
24 to go to approximately ten-six to begin with. To look at
25 the wildcat of the Atoka Morrow is only a couple of hundred

1 extra feet. We're adding very little incremental cost to
2 look at a potentially very good zone.

3 Mississippian? We don't care about
4 Mississippian. We're just going to tag it so that we know
5 it's in the Atoka zone.

6 And I hope maybe I've shed a little light on
7 what I perceived as some misconceptions.

8 Q. Let me ask your opinion with regards to the risk
9 factor component you would recommend to the examiner to
10 include in the forced pooling order.

11 You are familiar with that concept, are you not,
12 Mr. Smith?

13 A. Yes, I certainly am.

14 Q. What is your recommendation to the examiner with
15 regards to a risk factor percentage to be applied in the
16 pooling case?

17 A. I would ask for the maximum pooling.

18 Q. The cost plus 200 percent?

19 A. Yes. The risk in here is very significant on
20 twofolds. Not a dry hole. Probably the Mississippian will
21 be dry. Probably the Atoka Morrow will be dry. The
22 Wolfcamp and Permo-Penn aren't going to be dry. They are
23 not going to be dry. They will make a well.

24 Q. Well, you mean they will produce oil?

25 A. They will produce oil.

1 Q. What's the risk?

2 A. The risk is that you have an economically
3 noncommercial or a subcommercial well on one hand. The
4 other risk is mechanical. As we've already had the
5 discussion from several quarters, we do have a little
6 problem with Aboe, Aboe heating out here and knocking some
7 casing in once in a while. That is a very substantial
8 mechanical risk.

9 Q. Help us have a better understanding of the
10 productivity of the wells in relation to their either
11 structural position or the thickness of the Wolfcamp pay
12 interval or the Permo-Penn pay intervals.

13 A. Structure has almost no relevance whatsoever
14 here. The entire Bagley, North Bagley field complex is on
15 a very large structure, and all we're seeing here are
16 little crinulations on top of this big structure.

17 Q. Is there a relationship --

18 A. It's porosity and permeability. That's the
19 question.

20 Q. When you map porosity, can you determine a
21 relationship between porosity thickness and the
22 productivity of the wells that can be explained
23 independently of permeability?

24 A. Yes. In fact, most of the North Bagley field,
25 when you map Wolfcamp porosity, you come up with zero and

1 you get zero production. There are only a few pods in here
2 where Wolfcamp does develop porosity. It's been my
3 experience that on those pods were developed porosity.

4 But the permeability is very, very good, and
5 usually a typical Wolfcamp well will come in with initial
6 rates very, very high. That's the reason the allowable has
7 been set so high. It's not uncommon for a Wolfcamp well to
8 come in 700 to 1,000 barrels a day. Generally there's a
9 fairly rapid decline, but they'd normally come in very big
10 because the permeability is very, very good as a rule.

11 We expected that at this location. That's why
12 we drilled the O.G. to begin with. We could see the
13 porosity was well developed in the abandoned Gulf well. We
14 assumed that the permeability -- particularly since the
15 gamma ray showed very clean carbonate, we would have
16 excellent permeability as a typical Wolfcamp well.

17 And we were -- the snakepit didn't have it. We
18 kept thinking we had a mechanical problem, that maybe we
19 should retreat the well and do this or do that, and finally
20 we ran a bottomhole pressure bomb and found out that we had
21 real low permeability.

22 Q. What is the estimated range of permeability in
23 the Wolfcamp?

24 A. Service companies that we've had look at it
25 evaluate productivity and bottomhole pressures of -- have

1 estimated the permeability at this location anywhere from
2 .2 millidarcies to 1.7 millidarcies, which is exceedingly
3 low.

4 Q. Based on those reservoir parameters and using a
5 volumetric calculation, what is the estimated drainage area
6 for the existing O.G. State No. 1 well?

7 A. Primarily because of the very low pressure --
8 we're not really sure why the pressure is so low here --
9 it's been concluded that we should have an effective
10 drainage of somewhere between 20 and 25 acres. You can
11 drain a pretty good-sized area through very low
12 permeability rock if you have pressure to move it, but we
13 don't have the pressure.

14 It's -- a normal pressure in the Wolfcamp here
15 would be a range of 2,900 to 3,000 pounds, and we have what
16 appears to be -- after a 72-hole -- 72-hour build-up, we
17 only had 625 pounds. And we estimated, extrapolating that,
18 we'd probably have a
19 bottomhole pressure of about 800 pounds.

20 And I don't know why we have lower pressure
21 here. I presume that we have had pressure depletion from
22 some other wells which probably have not ever reported
23 Wolfcamp completions.

24 Q. Are there Wolfcamp and Permo-Penn oil wells that
25 are down-hole commingled in this vicinity?

1 A. Yes. That is the normal procedure, yes, when
2 you have sort of equal pressure.

3 Now, you would not go into an old Permo-Penn
4 well that had pressure down to five or 600 pounds and then
5 open up a 3,000-pound Wolfcamp zone and try to commingle
6 them. You can commingle them all. You can commingle them
7 down hole, but when you have relatively static pressures,
8 equal pressures, that is the only way that makes any sense
9 to produce them.

10 At this location we would clearly expect that
11 the Permo-Penn zones would also be at low pressures, but
12 we're surrounded by wells that have made, you know, three
13 to four to 500,000 barrels of oil. Clearly the pressure at
14 this location should be low in those zones as well as in
15 the Wolfcamp, and the only way it makes sense to complete
16 is to try to take all those zones -- there are a myriad of
17 zones in the Permo-Penn, and they might -- we could have
18 two. We could have ten. We don't know. It varies from
19 well to well -- and add those to the Wolf Camp and try to
20 put them on one stream.

21 Q. Based upon your background and experience, is
22 this well a suitable well to afford the working interest
23 owners an opportunity to make elections for participation
24 on various zones?

25 A. No. I don't see any practical answer to that,

1 and we've really -- we have thought about that, talked
2 about it, and we don't see a practical solution to saying,
3 "Okay, you can participate in this zone, but then, what
4 about this other zone?"

5 The only way to -- probably to try to do it is
6 to commingle them. I just don't see a practical answer to
7 it. I think if -- you know, I would -- and I understand
8 Mr. Starrak's position, you know. And I would say that,
9 you know, if we were sitting here on a Yates field and then
10 we said to them, "Okay. Well, we're going to go down to
11 30,000 feet to look at some other zone," I could certainly
12 understand his problem.

13 I don't -- possibly Mr. Starrak didn't
14 understand that what we're trying to do is add
15 Pennsylvanian reserves. We're only looking at a couple of
16 hundred extra feet by going through the Atoka Morrow to the
17 top of the Mississippian. We could not drill a well here
18 just for the Wolfcamp, and we could not drill a well here
19 just for the Permo-Penn. We need the two zones here to
20 make it viable.

21 MR. KELLAHIN: That concludes my examination of
22 Mr. Smith. We would move the introduction of Exhibit 9.

23 EXAMINER CATANACH: Exhibit 9 will be admitted into
24 evidence.

25 (Whereupon Exhibit 9 was admitted into evidence.)

1 MR. KELLAHIN: In addition, at this time,
2 Mr. Examiner, we would tender Exhibit 10, which is the
3 affidavit of mailing of notice for the hearing to all the
4 parties for which we're seeking participation.

5 EXAMINER CATANACH: Mr. Kellahin, does that include
6 notice to offset operators for the orthodox location?

7 MR. KELLAHIN: Yes, it does.

8 EXAMINER CATANACH: Those being whom? Do you know who
9 those are?

10 MR. KELLAHIN: I wish you hadn't asked me that.

11 MR. STOVALL: I noticed there are some other names in
12 the return receipt cards that did not appear in the
13 exhibit.

14 MR. KELLAHIN: During the break, Mr. Examiner, I can
15 identify those for you. I'm not sure I can do it from
16 memory right now.

17 EXAMINER CATANACH: Okay.

18 MR. KELLAHIN: That was one of the reasons the case
19 was continued and readvertised, is that we were picking up
20 notice to the offsets concerning the unorthodox gas well,
21 and while they are here, I'll need to do it during the
22 break to tell you which ones they are.

23 MR. STOVALL: Mr. Kellahin, may I make a suggestion,
24 and perhaps what you might do is tomorrow or some time
25 submit an exhibit just listing the parties, the ones

1 noticed for forced pooling and unorthodox and for an
2 unorthodox only. That might be a better way to put it in
3 the record.

4 MR. KELLAHIN: I think that's a good suggestion,
5 Mr. Examiner, and with your permission we'll be happy to do
6 it that way.

7 EXAMINER CATANACH: Yes, we'll do it that way.

8 Mr. Starrak?

9 MR. STARRAK: I have no questions.

10 EXAMINER CATANACH: Okay.

11 THE WITNESS: I didn't really answer the one question
12 you had before: Is there any Strawn production around
13 here? Yes.

14 EXAMINER CATANACH: Go ahead.

15 THE WITNESS: Most of these wells around have Strawn,
16 but they don't call it Strawn, per say. It's called
17 "Permo-Penn."

18 There has not been really adequate breakdown, at
19 least stratigraphic, between, you know, boundaries of
20 Wolfcamp, Cisco, Canyon, Strawn, etc. The Wolfcamp has
21 been considered -- that one little stringer in the Wolfcamp
22 has been considered Wolfcamp zone. Anything below that has
23 been considered Permo-Penn, but in truth a lot of that is,
24 yes, Strawn.

25 * * * * *

EXAMINATION

1
2 BY EXAMINER CATANACH:

3 Q. What is your understanding -- how far down does
4 the Permo-Penn encompass? It encompasses the Cisco? The
5 Strawn?

6 A. If we separate the Atoka Morrow -- which of
7 course they are Pennsylvanian acreage too, but for ease of
8 nomenclature they have not been considered Permo-Penn in
9 this field -- then approximately ten-six is the base of
10 what is considered North Bagley-Permo-Penn pack.

11 Q. So in order to get the production that you
12 anticipate from the Permo-Penn, you have to drill it down
13 to ten-six anyway?

14 A. Well, that would be prudent. We might have it
15 all at ten, but how do you know?

16 Q. In order to test --

17 A. Because other wells have it at ten-four and
18 ten-five, and a well adjacent to a well that has pay at
19 ten-six may have its bottom pay at ninety-eight. They are
20 not really homogeneous.

21 It's also difficult to work porosity in this
22 field because the field was developed at a time when the
23 only reliable porosity tool was the sonic log, and
24 unfortunately a sonic log is not very reliable in this type
25 of zone. These are fractured, thug-developed porosity

1 zones, and the only two things that sonic doesn't read is
2 fractures and thugs, which is about all we have in here.

3 So usually you pick the porosity zones on older
4 logs, pick it by cycle-skipping on subjects, and you get
5 this nice log coming along, and pretty soon you see these
6 wild lines, and that's the cycle-skip. And that's the
7 porosity on sonic log, or at least you hope it is.

8 The more recent logging devices, density
9 neutrons, etc., are very good for quantitative work, but
10 most of the wells are logged with sonic logs, and the
11 quantitative work with those in this field is almost
12 impossible. They are good for correlation of trying to
13 follow a zone from well to well, but most of these zones
14 come and go fairly rapidly. They've had just tremendous
15 reserves in them.

16 But the prudent course would be to go to about
17 ten-six if you're looking to cover all your Permo-Penn pay.

18 Q. Is it my understanding that the reason that
19 you're drilling in the location you are and not, say, at a
20 standard Atoka Morrow gas well location is because that's
21 where you feel the reserves are in the Permo-Penn and the
22 Wolf Camp that you need to recover?

23 A. Yes. Yes.

24 Q. And the other two quarter sections that you're
25 not drilling in, those don't have the potential?

1 A. If we hit something in the Atoka Morrow,
2 everyone is going to be happy. We're going to make all the
3 offset operators happy because they'll be looking at it --
4 and we'll be happy, naturally.

5 But we think that the -- our chance here, 99
6 percent of our chance, is to make Wolfcamp Permo-Penn work
7 for us. And that's the optimal location for the Permo-Penn
8 because that is a little spot where I feel like we have a
9 little hole in the drainage.

10 Q. You said there was a well that tested the Atoka
11 and Morrow?

12 A. Yes, sir.

13 Q. Approximately a mile --

14 A. Yes. And I don't differentiate. We call --
15 we're just calling it Atoka Morrow. I didn't differentiate
16 the zones.

17 Q. Did that well produce from those zones?

18 A. Not to my knowledge, sir.

19 Q. It was just tested?

20 A. Yes.

21 Q. Do you know why it wasn't produced?

22 A. I would suspect two possibilities. One is it
23 was probably drilled at a time when you had to pay them to
24 come get your gas, and the other possibility is that they
25 production tested and that depleted on production test or

1 severely declined on production test. But I don't know
2 know for a fact.

3 Q. You've got no Atoka Morrow production in this
4 whole general area?

5 A. No, we don't, sir, not on the North Bagley or
6 Bagley field complex. We don't have to go too far off of
7 here. You know, we're not going to go from here to Burton
8 Flat to find it. It's much closer than that, but, you
9 know, in this vicinity -- I could take the map that you
10 look at and I could expand that, you know, fourfold and I
11 won't show you any Atoka Morrow production.

12 EXAMINER CATANACH: I believe that's all I have.

13 MR. STOVALL: I have nothing. You did fine.

14 EXAMINER CATANACH: Are there any other questions of
15 this witness?

16 MR. KELLAHIN: No, sir.

17 EXAMINER CATANACH: If not, you may be excused.

18 MR. KELLAHIN: That concludes our presentation,
19 Mr. Examiner.

20 MR. STOVALL: Mr. Starrak, did you wish to testify and
21 put -- make a record?

22 MR. STARRAK: Not particularly. I'd just like to
23 reiterate a statement, maybe --

24 MR. STOVALL: All right.

25 MR. STARRAK: -- that -- I want to say that Turner did

1 represent me on the --

2 MR. STOVALL: I'm sorry; say that again.

3 MR. STARRAK: Mr. Turner did represent me on the
4 operating agreement. I told him he could. And the
5 condition was that LBO did not want to try to gather around
6 to make a farmout with everybody, and so he wanted to be
7 the one to operate it. And I did give him my permission,
8 and I stand by that.

9 I'm certainly not trying to stand in the way of
10 an 11,200 -- 11,200-foot well in the State of New Mexico.
11 I'm merely trying to retain some of the rights that I
12 obtained in the Wolfcamp formation in Section 9.

13 There's some talk about how everybody came about
14 their interest in the thing, and I'll tell you how I came
15 about mine. I was hired to work over the well, and it was
16 reported when they bought it that they just dropped the
17 tubing, and after about 20 days of fishing we finally had
18 collapsed casing.

19 The group who was selling this well, Turner and
20 McAnnelly, didn't have enough money to pay me, so I took an
21 interest in the well. That's how I came about it.

22 I would like to retain the ability to get into
23 the Wolfcamp formation here, the operating agreement that I
24 now have in the case, that a well shall not be completed in
25 the same formation, whether it is a producing well, and

1 without all owners' consent. And this well would be in
2 deference to that, and any difference of pooling by the
3 commission would probably override that operating
4 agreement. I don't know the answer to that, but I'm afraid
5 it might.

6 I'm willing to negotiate. I'm willing to join a
7 Wolfcamp well on the location which they have suggested,
8 and I'm not trying to hold anything up.

9 That's all I have to say. Thank you.

10 MR. STOVALL: May I ask you a couple of questions,
11 Mr. Starrak, just to clarify things for my understanding?

12 MR. STARRAK: Yes.

13 MR. STOVALL: One, you've indicated that Mr. Turner
14 did act in your interest in executing this -- did represent
15 you.

16 Do you understand that if in fact the operating
17 agreement is controlling, that as the discussion has been
18 here, the forced pooling order will probably not apply to
19 you, and it will be an interpretation of the operating
20 agreement, which the commission is not in a position to do,
21 that will determine how your interest will be brought into
22 the proposed well?

23 MR. STARRAK: Well, I thought that if the pooling in
24 the Wolfcamp was awarded by the commission, then it would
25 override our operating agreement that we do have. But

1 you -- so I guess I don't understand.

2 MR. STOVALL: No. The pooling applies to parties
3 whose interest is not covered by an agreement, and if there
4 is an agreement, that agreement is controlling, and the
5 forced pooling would not apply to parties to that
6 agreement.

7 MR. STARRAK: Okay.

8 MR. STOVALL: So I think that's quite the opposite,
9 apparently, of what you understand.

10 MR. STARRAK: But if you change the spacing for the
11 Wolfcamp formation, does that not fly in the face of the
12 operating agreement?

13 MR. STOVALL: I don't think they are proposing to
14 change the spacing for the Wolfcamp formation. I don't
15 understand that to be the application.

16 Am I not correct, Mr. Kellahin?

17 MR. KELLAHIN: You're correct, Mr. Stovall. The
18 spacing for the Wolfcamp stays on 80 acres.

19 MR. STOVALL: I think you may have a question -- I
20 mean, you are admitting that you are a party to the
21 operating agreement.

22 MR. STARRAK: Yes.

23 MR. STOVALL: Now, there is, then, a question perhaps
24 of what the operating agreement provisions are, and this
25 division is not -- does not have the authority to interpret

1 or enforce the operating agreement.

2 But I will tell you that if in fact you are a
3 party to the operating agreement, and if that operating
4 agreement controls the participation of interests in this
5 well, then the forced pooling order will in effect have no
6 real impact on you. It will be the operating agreement
7 that determines how your interest is affected.

8 MR. STARRAK: Okay.

9 MR. STOVALL: You'd simply be a party not affected --
10 even though you are listed and noticed in on this forced
11 pooling, the operating agreement will be the controlling
12 document, not the forced pooling order.

13 MR. STARRAK: All right.

14 MR. STOVALL: And one other question I've got. Does
15 your interest -- is your interest surface to the center of
16 the earth, essentially, or is it limited to the Wolfcamp?

17 MR. STARRAK: Actually, it's surface to the center of
18 the earth.

19 MR. STOVALL: Okay.

20 MR. STARRAK: The percentage in the O.G. well that was
21 drilled by LBO -- there was a provision in the agreement --
22 not the operating agreement, but the farmout agreement that
23 Turner had with LBO -- that if the well didn't pay out in a
24 certain period of time, then we would lose a certain
25 percentage of our interest, which we did.

1 I still think that I have an interest even prior
2 to payout over the rest of the lands that were covered by
3 the agreement, the operating agreement, but that -- I don't
4 want to get into that here.

5 MR. STOVALL: Yes, this is not the right form for
6 that.

7 That's all the questions I have for Mr. Starrak.

8 EXAMINER CATANACH: Is there anything else in this
9 case?

10 MR. KELLAHIN: Briefly, Mr. Examiner, and I think
11 perhaps we're all saying the same thing here at the end,
12 that if Mr. Starrak's interest is controlled by the
13 operating agreement, then my client has told you here under
14 oath that he will afford Mr. Starrak the opportunity to
15 participate in the well using whatever contractual
16 provisions are set forth in that agreement.

17 In the event, however, there are other parties
18 not controlled by that operating agreement or claim that
19 they are not, or in addition if there are zones that are
20 productive on a different spacing pattern, then we will
21 need the benefit of the pooling order, and we will again
22 afford Mr. Starrak and all the parties the opportunity to
23 participate pursuant to the pooling order provisions.

24 That operating agreement, unfortunately, doesn't
25 control the whole south half of the section, and because of

1 the potential multiplicity of spacing units that may be
2 exposed, we do want the comfort of at least having the
3 pooling order to protect us in the event the contracts are
4 deemed not to control, or if there is an election made that
5 is determined to be not effective by the operating
6 agreement, we would like to have the ability to go forward
7 and drill and test the various formations for production.

8 And I think we have all perhaps said the same
9 thing in the last few minutes, but we do need the comfort
10 of having the pooling order as an ultimate remedy in the
11 event the joint operating agreement does not properly
12 commit the interests to the well.

13 EXAMINER CATANACH: Thank you.

14 Is there anything further in this case? If not,
15 Case 10305 will be taken under advisement.

16
17 (The foregoing hearing was concluded at the
18 approximate hour of 10:10 a.m.)

19 * * *

20
21 I do hereby certify that the foregoing is
22 a complete record of the proceedings in
23 the Examiner hearing of Case No. 10305,
24 heard by me on July 16 1991.
25 David L. Catanach, Examiner
Oil Conservation Division

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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

REPORTER'S CERTIFICATE

I, PAULA WEGEFORTH, a Certified Court Reporter and Notary Public, DO HEREBY CERTIFY that I stenographically reported these proceedings before the Oil Conservation Division; and that the foregoing is a true, complete and accurate transcript of the proceedings of said hearing as appears from my stenographic notes so taken and transcribed under my personal supervision.

I FURTHER CERTIFY that I am not related to nor employed by any of the parties hereto, and have no interest in the outcome hereof.

DATED at Santa Fe, New Mexico, this 3rd day of June, 1991.

My Commission Expires:
September 27, 1993

Paula Wegeforth
PAULA WEGEFORTH
Certified Court Reporter
CSR No. 264, Notary Public

NEW MEXICO OIL CONSERVATION COMMISSION

EXAMINER HEARING

SANTA FE, NEW MEXICO

Hearing Date MAY 16, 1991 Time: 8:15 A.M.

NAME	REPRESENTING	LOCATION
Maurice Trimmer	Byram + Co.	SF
William J. Day	Campbell + Slack	Santa Fe
Jack Allen	Stevens Op Corp	Roswell
Jerry Hoover	Conoco	Midland TX
JIM ALLEN	CONOCO	" "
DON EUBANK	CONOCO	" "
Mark McClelland	Conoco	" "
Jim STARRAK	SELF	MIDLAND TEXAS
Don Stevens	Stevens Op Corp.	Roswell, NM.
Greg Vujovich	" " "	" "
Brad Burks	Bird Creek Resources	Tulsa, OK

NEW MEXICO OIL CONSERVATION COMMISSION

EXAMINER HEARING

SANTA FE, NEW MEXICO

Hearing Date MAY 16, 1991 Time: 8:15 A.M.

NAME	REPRESENTING	LOCATION