

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

6 20 May 1986

7 COMMISSION HEARING

8 IN THE MATTER OF:

9 Application of Mallon Oil Company CASE
10 for compulsory pooling, Rio Arriba 8900
11 County, New Mexico.

12
13
14 BEFORE: Richard L. Stamets, Chairman
15 Ed Kelley, Commissioner

16 TRANSCRIPT OF HEARING

17
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MR. STAMETS: Call Case Number
8900.

MR. TAYLOR: Application of
Mallon Oil Company for compulsory pooling, Rio Arriba Coun-
ty, New Mexico.

MR. STAMETS: Call for appear-
ances in this case.

MR. ROBERTS: Mr. Chairman, my
name is Tommy Roberts. I'm an attorney from Farmington, New
Mexico, and I'm appearing today on behalf of Mallon Oil Com-
pany, the applicant in this case.

I have four witnesses to be
sworn.

MR. STAMETS: Other appear-
ances?

MR. HALL: Mr. Chairman, my
name is Scott Hall with the Santa Fe law firm of Campbell
and Black, appearing on behalf of Mesa Grande Resources and
we have one witness.

MR. STAMETS: I'd like to have
all those who will be witnesses in this case stand and be
sworn at this time.

(Witnesses sworn.)

1 MR. STAMETS: Mr. Roberts, you
2 may proceed.

3 MR. ROBERTS: Mr. Chairman, be-
4 fore we proceed any further, I want to submit an affidavit
5 that the notice requirements of the rules and regulations
6 have been complied with, and I would submit that to you for
7 the record.

8 MR. STAMETS: Very good, thank
9 you.

10 MR. ROBERTS: And if I could,
11 I'd like to just give a brief opening statement to give you
12 a little bit of background about the position of Mallon Oil
13 Company in this case.

14 MR. STAMETS: Fine.

15 MR. ROBERTS: Mallon Oil Com-
16 pany has drilled and completed its Johnson Federal 12-5 Well
17 on 40-acre spacing in accordance with statewide spacing
18 rules under the rules and regulations of the Oil Conserva-
19 tion Division.

20 Subsequent to the time that the
21 well was drilled and completed, and effective on January
22 1st, 1986, the Gavilan Mancos Oil Pool was extended by order
23 of the Oil Conservatioin Commission to include the acreage
24 on which the Johnson Federal 12-5 Well is located.

25 These pool rules, as you know,

1 require 320-acre spacing for wells completed in the Mancos
2 formation as it's defined in the pool rules.

3 As a result of the extension of
4 the Gavilan Mancos Oil Pool, Mallon Oil Company has dedi-
5 cated the west half of Section 12, Township 25 North, Range
6 2 West, to its well.

7 Mallon controls the operating
8 rights under 240 acres of that -- that 320-acre tract, and
9 Mesa Grande Resources, Inc., controls the balance of the ac-
10 reage, 80 acres.

11 Mallon and Mesa Grande Resour-
12 ces have attempted to reach an agreement as to the basis for
13 the participation of the parties in the Johnson Federal 12-5
14 Well but as of this date they've been unable to reach a com-
15 promise solution. As a result of that inability to agree,
16 Mallon has filed this application and seeks to force pool
17 the mineral interest from the top of the Mancos formation to
18 the base of the Dakota formation in the west half of Section
19 12, 25 North, 2 West.

20 This is not an ordinary compul-
21 sory pooling situation in that the Johnson Federal 12-5 Well
22 has already been drilled and completed under the circumstan-
23 ces that I've already described. Because this is not an or-
24 dinary situation the relief requested by Mallon in this case
25 is different from a request for relief you might expect to

1 receive in a predrilling force pooled situation.

2 In this case Mallon requests
3 the following relief:

4 It requests an order of the
5 Commission force pooling these mineral interests from the
6 top of the Mancos to the base of the Dakota under the west
7 half of Section 12.

8 Requests a determination by the
9 Commission that the actual costs incurred in the drilling
10 and completion and operation of the Johnson Federal 12-5
11 Well are reasonable costs and were necessarily incurred.

12 Requests a determination by the
13 Commission of a reasonable premium associated with the risk
14 assumed solely by Mallon Oil Company in drilling this well
15 to be included as an element of the actual costs incurred.

16 It seeks an order of the Com-
17 mission requiring Mesa Grande Resources to elect within a
18 reasonable period of time to either pay its 25 percent share
19 of the actual costs incurred, which would include the
20 reasonable premium for risk assumed solely by Mallon or to
21 have its share of these costs recovered by Mallon Oil Com-
22 pany from production.

23 And it seeks an order of the
24 Commission that Mallon Oil Company would continue as the
25 operator of the well and an order of the Commission setting

1 reasonable supervisory charges applicable to the drilling
2 and producing phases of the well to be recovered by Mallon
3 Oil Company.

4 I think that both parties to
5 this dispute would agree that the primary issue is whether
6 it is appropriate under the circumstances that Mese Grande
7 Resources reimburse Mallon Oil Company for its proportionate
8 part of the risk associated with the drilling of the well,
9 which was assumed solely by Mallon Oil Company.

10 The evidence that Mallon will
11 present will provide a reasonable basis for the Commission
12 to reasonably conclude that risk reimbursement is appro-
13 priate and that -- will provide a reasonable basis for the
14 (not clearly understood) of that risk.

15 That would close our opening
16 statement.

17 MR. HALL: If I may briefly re-
18 spond, Mr. Commissioner.

19 We agree with Mr. Roberts sum-
20 marization of the nature of the case. It does boil down to
21 whether or not the imposition of a risk penalty or a risk
22 premium is appropriate in this case.

23 In connection with that we
24 would assert that Mallon has failed to comply with the re-
25 quirements enumerated in Section 70-2-17 and 18, which must

1 be accomplished before the pooling can be sought at all.

2 In view of that, not only is
3 the risk imposition improper but we believe that the attempt
4 to obtain pooling is premature at this time.

5 The dispute comes down to
6 whether or not the pooled interest owned by Mesa Grande was
7 in fact allowed an adequate opportunity to contribute its
8 acreage and pay its proportionate share of costs volun-
9 tarily.

10 We will present evidence that
11 that opportunity was never afforded Mesa Grande. Accord-
12 ingly, to Mallon's failure to afford that opportunity, the
13 pooling should not issue and there should be absolutely no
14 consideration of reasonableness of costs for a risk penalty
15 in this proceeding.

16 MR. STAMETS: Thank you. Mr.
17 Roberts, you may proceed.

18 MR. ROBERTS: I'll call as my
19 first witness, Mr. George Mallon. Mr. Mallon is at the
20 witness chair at this point.

21
22 GEORGE MALLON,
23 being called as a witness and being duly sworn upon his
24 oath, testified as follows, to-wit:
25

1 DIRECT EXAMINATION

2 BY MR. ROBERTS:

3 Q Mr. Mallon, would you state your name and
4 your place of residence for the record?

5 A George Mallon, Denver, Colorado.

6 Q What is your occupation, Mr. Mallon?

7 A I act as president of Mallon Oil Company.

8 Q How long have you been employed in that
9 capacity?10 A The corporation was formed in 1978 and
11 I've been in that capacity since that time.

12 Q What is the nature of your business?

13 A We're a full blown operating oil company
14 with geologic and engineering and land staff.15 Q Would you explain the nature and extent
16 of your operations in the area of the Gavilan Mancos Oil
17 Pool?18 A In the particular subject area we bought
19 a land position there in 1984 and they were basically short
20 term leases and we began a drilling operation in there as
21 fast as we could do the permitting process and have con-
22 tinued to drill. I think we have six wells at this time and
23 I think we have two more locations to drill.24 Q Are you familiar with the application in
25 this case?

1 A Yes, I am.

2 Q Mr. Mallon, would you briefly describe
3 the purpose of this application?

4 A Yes, I would. I think what I would like
5 to do, Mr. Chairman, is go through and refer -- I'd like to
6 refer to Exhibit One just a second and go through a sequence
7 of events in chronological order.

8 The subject tract there, Section 12, if
9 we had read that map in June of 1985, Tract 1 would have
10 been held by Mallon. Tract 2 at that time would have been
11 held by Northwest Pipeline/Texaco, and Tract 3 would have
12 been held by A. G. Hill.

13 In June of '85, at that time the spacing
14 was 40 acres and we really had to drill the well; we were
15 coming into winter and the lease expired in March. We'd al-
16 ready had one winter experience drilling out there and we
17 didn't want to do it again.

18 So we requested a farmout, options for
19 farmouts, from A. G. Hill and Northwest Pipeline at that
20 time.

21 Several months passed in the process.
22 Northwest Pipeline denied the farmout because they told us
23 that they were putting an acreage package out for bid. A.
24 G. Hill basically took the position that we'll consider it,
25 along with about twenty other requests.

1 We felt we had no choice at that time so
2 we went ahead and permitted in July. On August 22nd the
3 well as spudded and it was TD'ed and pipe was run on Septem-
4 ber 11th.

5 Through this whole sequence of events to
6 that point in time, quite frankly we did not even know who
7 Mesa Grande was and there would have been no opportunity for
8 us to offer them the ability to join this well.

9 Subsequently we did support the 320 spac-
10 ing, which I believe was held on October the 9th, and I
11 think the Commission issued an order in early January and we
12 feel that was the proper position, you know, for spacing,
13 but at the time we drilled this well, I don't think that we
14 had any other choice.

15 So I think the way I would describe Mal-
16 lon's position for this application is that -- and Mr. Phil-
17 lips here, in several phone conversations, has indicated to
18 me that had he been offered the opportunity to join this
19 well he would have done so, and I believe that. I believe
20 he would have done so.

21 The point is, I was not in a position to
22 offer him to join in. I didn't know he existed, quite
23 frankly. We were negotiating with Northwest and at the time
24 the well was drilled they just -- they had no title to the
25 land to be offered.

1 So -- but I do believe he would have
2 joined in, so I guess what I'm trying to drive at here is
3 Mesa Grande, because of the subsequent event of the spacing
4 change, the subsequent event of their acquisition of the 80
5 acres, has been, you know, inadvertently or call it what you
6 will, they were placed in a position and we were placed in a
7 position where we, you know, came at odds, and I think both
8 parties were caught beyond their circumstances and beyond
9 their control; however, I would say that Mesa Grande's cir-
10 cumstances at the particular point in time when it occurred
11 that they acquired the acreage was infinitely better than
12 Mallon's. They now have a chance to join a well that was
13 drilled and the pipe is run and just a check of the state
14 records would indicate that there were no major problems
15 with this well.

16 So in getting to the reality of the sit-
17 uation that exists between us, I almost view this at this
18 point in time as though Mallon has turnkeyed this well to
19 Mesa Grande, and that's, I think, a realistic situation. We
20 turnkeyed it through not only the casing but into the tank
21 and in that particular area we did assume, I'd say we as-
22 sumed substantial risk and I can point to some of the costs
23 in our other wells to back that up, and I do not know of
24 anybody in our industry that will turnkey a well without
25 charging some kind of premium and I think it's a reasonable

1 expectation from the party that has been turnkeyed to -- to
2 pay that premium. And I think that's probably where we
3 stand. We feel like we've turnkeyed a well to them and we'd
4 love to have them join us. We don't think there should be
5 more dense drilling in the area but they have inherited a
6 very nice situation and I think they should pay for it.

7 Q Mr. Mallon, you made the statement that
8 you felt like you were not in a position to offer participa-
9 tion to Mesa Grande Resources. Now, I'm assuming that you
10 made that statement in regards to the period of time in
11 which the well was --

12 A Yeah.

13 Q -- being developed on 40-acre spacing?

14 A When I -- when I permitted and started
15 drilling this well back in June, July, and August time
16 frame, I didn't even know who Mesa Grande was. I'd just
17 never dealt with them.

18 Q And is that because you were drilling the
19 well under -- under state regulation on 40-acre spacing?

20 A It was because we were drilling on a 40-
21 acre spacing but not only that, we have checked the adjacent
22 acreage and Mesa Grande did not appear on the adjacent ac-
23 reage. It was Northwest Pipeline, and that's who we nego-
24 tiated with, Northwest Pipeline.

25 Q Subsequent to the date, the effective date

1 of the extension of the Gavilan Mancos Oil Pool to encompass
2 this acreage in the west half of Section 12, then did you
3 make efforts to negotiate participation terms with Mesa
4 Grande Resources?

5 A At the time the new order for 320 came
6 out?

7 Q Yes.

8 A Let me see if I have the date here.

9 Q Mr. Mallon, we've got another witness
10 here that can testify to that.

11 A Okay, yes. The thing that I was going to
12 say there is that at some point in time Northwest Pipeline
13 put out a large acreage package to bid and it was a very,
14 you know, very sought after bid. We bid it, Mesa Grande,
15 Dugan, you name it, everybody bidded on it, and that was the
16 process, I forget the time frame that went on but there was
17 a time frame way after we drilled the well, that -- where
18 people were bidding on the Mesa -- the Northwest Pipeline
19 acreage, and it was at that time that Mesa Grande, my under-
20 standing is Mesa Grande acquired the tract at that point in
21 time, and that's what Mesa Grande has told us, that they won
22 the bid.

23 But all of this occurred months after the
24 drilling of the well.

25 Q Now you've analogized the circumstances

1 that the parties find themselves in at this point in time to
2 a situation where an operator would turnkey the drilling of
3 a well for non-operating working interest partners. Have
4 you been in turnkey operations previously?

5 A Yes, but not a lot. That's not normally
6 our style of operation. What few times we've been involved,
7 if we had a -- a working interest partner, non-operator, who
8 wanted to participate in a well but maybe had a tight bud-
9 get, for whatever reason, he had to know his absolute cost
10 limits, we would not -- we being Mallon Oil Company, opera-
11 tor -- would not turnkey.

12 What we would do is we'd go to the drill-
13 ing contractor, take a turnkey contract from the drilling
14 contractor and then just pass that through at whatever the
15 cost was to our working interest partners. We've done that
16 on a couple of cases.

17 Q And would that be a standard method of
18 structuring a turnkey operation, at least from the prospec-
19 tive of your operation?

20 A From us, yes.

21 Q In that type of an arrangement what would
22 happen when actual costs exceeded estimated costs that have
23 formed the basis for the participation?

24 A Well, if you turnkey to somebody and you
25 have a cost overrun, you have to eat it. If you have a

1 turnkey and you've done a good operation, had no problems
2 with the well, usually you pocket some profits.

3 Q Okay. Now let me -- let me just reiter-
4 ate so that I can understand real clearly the circumstances.
5 You've testified that you would take a drilling bid and pass
6 those terms on to your working interest partners, is that
7 correct?

8 A That -- that's correct, but in fact what
9 I would call a true turnkey, which in my mind we've kind of
10 delivered a true turnkey to Mesa Grande, but a true turnkey
11 is extremely difficult to get. What you get from these
12 drilling contractors, they say, we'll turnkey the well but
13 there's limitations. If you lose circulation longer than 24
14 hours than the operator starts eating it. If we spend more
15 than \$6000 on water, then you've got to pay for it. If we
16 spend more than \$8000 on mud, you've got to pay for it. So
17 that is what we would pass through to the other working in-
18 terest partners, whatever we could secure for their benefit.

19 Q Would it be accurate to say that the
20 drilling contractor would build into that bid any compensa-
21 tion that he felt he needed to have to cover the risk invol-
22 ved in drilling in the area?

23 A You bet. It depends on the area but I
24 guess in our experience, we drill about 20 wells a year and
25 depending on the basin we're in, we may take a limited turn-

1 key, but it can vary anywhere from, I don't know, 20 or 30
2 percent markup to several hundred percent.

3 Q And therefore is it accurate to say that
4 the estimated costs that would be passed on to your working
5 interest partners at the point where you arrange to deal for
6 participation, would also include the -- the compensation
7 for the risk.

8 A Yeah, whatever they cranked into us, they
9 would have to pay their share of the freight, too.

10 MR. ROBERTS: I have no other
11 questions of this witness on direct.

12 MR. STAMETS: Are there ques-
13 tions of Mr. Mallon?

14 MR. HALL: Yes, Mr. Chairman.

15

16 CROSS EXAMINATION

17 BY MR. HALL:

18 Q Mr. Mallon, I'd like to ask you a few
19 questions about turnkey operations.

20 A Okay.

21 Q Isn't it true in most cases when you have
22 a turnkey deal, you already have an agreement or a contract
23 between the parties that discuss such matters as premiums
24 and risks?

25 A Yeah, I would think that's generally

1 true.

2 Q You didn't have that in this case, did
3 you?

4 A No.

5 Q What was your spud date again? Did you
6 tell me October?

7 A August 22nd.

8 Q Did you have a problem with your lease on
9 your 40 acres --

10 A Yeah. What happened is this -- we had
11 drilled our -- what we call our (not clearly understood)
12 well up here in the dead of winter and it had cost us a lot
13 of money to operate up here in winter.

14 This particular lease expired in March
15 and we wanted to get this well down and completed prior to
16 mid-November, and that, you know, that was the reason for
17 the (not clearly understood).

18 Q So the lease expiration was March of
19 1986, is that correct?

20 A Yeah, I forget the exact date but Karen
21 can give it to you later.

22 Q But there wasn't any problem with rig
23 availability in that part of the country that --

24 A No problem with rig availability.

25 Q So conceivably you could have drilled at

1 any time from August to March of '86, is that right?

2 A That's correct.

3 Q Did you personally ever talk with anyone
4 at Mesa Grande about participation in this well?

5 A After they had won the bid from North-
6 west.

7 Q And when did you become aware of that?

8 A Karen, do you have the first letter that
9 we wrote to Mesa Grande? When was the date of the first
10 letter?

11 I guess, subject to Greg's correction, I
12 guess they won the bid sometime in mid-October would be my
13 guess because as soon as we -- we -- we were called by War-
14 ren Curtis at Northwest Pipeline. He told us that Mesa
15 Grande had won the bid and we called immediately and tried
16 to get a farmout from them.

17 So I guess, in the latter, say, from, oh,
18 somewhere in October 21st through the end of October, I pro-
19 bably had at least one conversation with Alex Phillips and
20 maybe one with Greg. I know there were some after that time
21 but as soon as we found out they bid it, you know, had won
22 the bid, we tried to make contact with them.

23 Q Okay. But you were aware sometime in ad-
24 vance of the spud date that Northwest had assembled this
25 package and was putting it up for bid.

1 A No, as a matter of fact it was not. It
2 was only after we had the request by coming over in Septem-
3 ber that we found out.

4 Q Okay, but I believe you stated in your
5 direct testimony that you were in fact aware of the bid be-
6 fore the spud date.

7 A Well, in June, '85, when we were putting
8 this together, okay, we requested a farmout at that time and
9 somewhere in that process between June and August, I don't
10 know the exact date, I might could find it for you, but be-
11 tween June and August when we spudded, that was when we, I
12 think, when we found out they were putting the package out,
13 because they had -- I don't -- do you know the correct date,
14 Kevin? I don't know. I know that emphatically we were told
15 no, that they would not farm out because I personally con-
16 ducted that phone conversation.

17 Q Let me ask you a question before he helps
18 you out here.

19 Did you offer Northwest Pipeline any
20 other deal than a farmout?

21 A I don't think we did.

22 Q Okay, so --

23 A Did we? Did we offer o buy it?

24 THE REPORTER: I have to have
25 people identified if this is going to go into the record.

1 Q Okay.

2 MR. ROBERTS: You'll need to
3 respond to his questions and then we'll --

4 A Oh, okay.

5 MR. ROBERTS: -- have Karen on
6 the stand and --

7 Q Can you answer the question?

8 A Will you ask it again?

9 Q I'm not sure I remember. Something like
10 whether you offered --

11 A Oh, did I -- did I offer Northwest any
12 other deal?

13 Q Yes.

14 A I don't remember. I talked to Warren
15 Curtis at length about trying to get an option for a farm-
16 out. You've got to realize at the time the spacing was 40
17 acres, so all we could ask for was an option to farmout.

18 Q Well, let's talk about that a little bit.
19 You were involved with an application to change the pool
20 rules to 320-acre spacing, were you not?

21 A That's correct.

22 Q When did you first become involved in
23 that?

24 A I'm trying to think. Can I ask -- I'm
25 trying to remember the first time Al Greer came in Denver

1 because that's when we first got involved.

2 MR. ROBERTS: If you don't know
3 the --

4 A I don't know.

5 MR. ROBERTS: -- answer just
6 say you don't know.

7 A Okay.

8 Q Let me help you. Was it more than a year
9 before the spudding of this well?

10 A No.

11 Q More than six months?

12 A I tell you, I just don't remember. I'd
13 have to go back to the record on that.

14 Q It was, in fact, sometime in advance of
15 the spud date.

16 A Well, if you go back to our original be-
17 ginning of drilling in this area, okay, back to the very be-
18 ginning, there is paperwork on file with various Federal
19 agencies where when we first started drilling we, in fact,
20 tried to get the state to change the spacing back in those
21 days to 320. They wouldn't go with 320. We talked to them
22 about 160, and at that time this was a pretty -- this was
23 not developmental drilling. It was more removed from the
24 main field and the Aztec Office for the Commission at that
25 time felt like we needed to develop more data on statewide

1 spacing and then come back and they wanted us to go ahead
2 and drill on forties, and that's what we did.

3 Q Okay. Now, correct me if I'm wrong, but
4 I believe the application and hearing on the change to the
5 pool rules was made in September of 1985.

6 A I'm not sure when the application was;
7 the hearing was on October 9th.

8 Q All right. Well, if you'll assume that
9 the application was --

10 A Okay, fine. That's fine.

11 Q -- in September just for --

12 A Okay.

13 Q -- purposes of convenience here.
14 Wouldn't it be safe to also assume that you would have had
15 to have prepared for the application along with the other
16 applicants involved sometime in advance of the spud date?

17 A Yeah, I would think so.

18 Q Okay. So then you were on notice at that
19 time that there was a likelihood the rules would go to 320
20 and you would be required to seek joinder of the other
21 interests in the balance of the acreage comprising a 320-
22 acre proration unit.

23 A Well, if that's agreed in the mind of the
24 Commission, I'd have been on notice, yeah.

25 Q But that's what you sought to have the

1 Commission --

2 A That's what we -- that's what we -- if
3 you're trying to make the point that we supported 320's, we
4 did support 320's and that goes way back even before this
5 was applied for. I mean that's a matter of record.

6 Q Okay. But it goes hand in hand with that
7 that you would have been required to seek joinder.

8 A Well, I think I see the point you're
9 trying to make, but I'm not going to wait and let a lease
10 expire while the Commission decides what's the appropriate
11 rules for an area.

12 Q And in this case expiration was --

13 A March.

14 Q -- months away. What -- when was the
15 completion date of this well?

16 A Well, I'm not sure what you mean by com-
17 pletion. The pipe was run on September the 11th and then,
18 you know, I don't know the date the pumping units and every-
19 thing were set; probably within 30 - 45 days thereafter.

20 Q Okay, when was the well potentialled, if
21 you know?

22 A No, I don't.

23 Q Does someone with you here today know?
24 Will he be testifying?

25 A Yes.

1 Q Do you know when first production was
2 taken from this lease?

3 A No, sir, but he can answer that.

4 Q Let me ask you, did you ever personally
5 have any dealings with anybody at Mesa Grande?

6 A Well, I've had -- I don't know what you
7 mean personally, but I've had conversations with Greg's dad
8 and conversations with Greg.

9 Q And his father is E. Alex Phillips, is
10 that correct?

11 A That's who I was talking to on the phone,
12 I assume. I've never met him.

13 Q Do you know if Mesa Grande had operated
14 any wells in the immediate vicinity?

15 A No, I do not.

16 Q Okay. Had you never associated the name
17 Mesa Grande and Phillips before?

18 A No.

19 Q Well, when you spoke with Greg, were you
20 ever asked to provide any sort of tight hole information on
21 the well?

22 A I think he asked for it a couple of
23 times.

24 Q And how did you respond?

25 A I think we didn't give him any of the

1 data.

2 Q Were you told by Mr. Phillips that Mesa
3 Grande was willing to contribute its acreage and pay its
4 fair share of the costs?

5 A Well, if you mean by fair share of costs,
6 that's what he indicated on the phone, that they would pay
7 25 percent of the costs.

8 Q 25 percent, their share, the risk penalty
9 not withstanding?

10 A That's correct.

11 Q Okay. And you didn't accept that offer,
12 is that correct?

13 A Well, I tell you, I'm not in the habit of
14 drilling wells and then getting them down and on production
15 and have people join them later.

16 Q I understand that, but I guess the answer
17 to my question is no?

18 A No.

19 Q Am I correct that the only deal offered
20 to Mesa Grande was a farmout whereby Mesa Grande would --
21 was allowed a 6-1/4 override that would back into a 40
22 percent working interest?

23 A That was not the only deal offered, but I
24 thought that was a pretty generous one.

25 Q Mr. Mallon, there is presently production

1 from the well, is there not?

2 A That's correct.

3 Q What's happening to the proceeds attri-
4 butable to Mesa Grande's share?

5 A All proceeds are being held in escrow.

6 Q At whose direction?

7 A Mine.

8 Q What is the reason that you directed
9 those funds be suspended?

10 A We want to settle up who owns the 80 and
11 under what circumstances it's going to come into the unit;
12 matter of fact we subsequently, after all this went through,
13 we TD'ed the well, had it on production. I might add that
14 A. G. Hill went ahead and farmed out their 160 acres under
15 the same terms that we proposed for Mesa Grande, and their
16 funds are also in escrow waiting for this to be resolved.

17 Q Is there some sort of question in the
18 mind of your company on the title to the 80 acres?

19 A If there is I don't think I'm aware of
20 it.

21 Q Are you aware of any third party claim to
22 the proceeds being suspended attributable to this 80 acres?

23 A No.

24 Q Mr. Mallon, are you aware of the provi-
25 sions of Section 70-2-19(B) of the New Mexico Statutes and

1 has anyone apprised you of that?

2 Are you aware that you're obliged to pay
3 the interest his share of proceeds under that statute?

4 MR. ROBERTS: I would object,
5 Mr. Chairman. That calls for a legal conclusion and this is
6 not in a position to make that legal conclusion.

7 MR. HALL: Maybe he can answer
8 the question, Mr. Commissioner.

9 MR. STAMETS: Well, I think he
10 was only asked if he were aware of -- of the statute and he
11 can --

12 MR. ROBERTS: And then he was
13 asked if he was aware of an obligation --

14 MR. STAMETS: To pay.

15 MR. ROBERTS: -- to pay, and I
16 think that's where we might differ as to interpretation of
17 the statute.

18 MR. STAMETS: Mr. -- I will
19 allow the first half of the question --

20 A No, I'm not aware.

21 MR. STAMETS: -- and strike the
22 second.

23 Q Mr. Mallon, are you aware of the New
24 Mexico Oil and Gas Proceeds Payment Act?

25 A No.

1 Q Well, let me ask you, are the funds
2 suspended on behalf of Mesa Grande being held in escrow with
3 a New Mexico institution?

4 A No, it's just in a separate checking ac-
5 count at Mallon Oil Company.

6 Q Is that an interest bearing checking ac-
7 count?

8 A I don't think so.

9 Q Do you dispute Mesa Grande's entitlement
10 to its share of proceeds?

11 A I don't know whether they're entitled to
12 anything.

13 Q Well, what's the basis of the question in
14 your mind?

15 A Because we do have a controversy here and
16 I'm get it resolved.

17 Q So am I correct in saying that the basis
18 of the question in your mind is limited to this pooling pro-
19 ceeding?

20 A Is who owns the 80 acres and is it going
21 to be in this pool, yes.

22 Q All right. And I believe you told me
23 earlier that your company had no question as to the status
24 of title to that 80 acres. Isn't that what you said?

25 A I'm not aware of a problem. If there is,

1 maybe Karen might know of it, or, you know, I don't know.

2 Q Has your company obtained a title opinion
3 for this 80 acres?

4 A I don't know. You'll have to ask Karen.

5 MR. HALL: I have no further
6 questions.

7 MR. STAMETS: Are there other
8 questions of this witness? Mr. Chavez?

9

10 QUESTIONS BY MR. CHAVEZ:

11 Q Frank Chavez, District Supervisor, Oil
12 Conservation Division, Aztec District.

13 Mr. Mallon, did you negotiate with North-
14 west Pipeline and Mr. Gill in anticipation of having 320-
15 acre spacing in the west half of this section?

16 A I think we were anticipating that the
17 Commission would go to 320 and that's what we were support-
18 ing.

19 MR. CHAVEZ: That's all I have.

20 MR. STAMETS: Any other ques-
21 tions of Mr. Mallon?

22 He may be excused.

23 MR. ROBERTS: Mr. Chairman, I'd
24 call Tucker Bayless.

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

DIRECT EXAMINATION

BY MR. ROBERTS:

Q Mr. Bayless, would you state your name
and place of residence for the record?

A My legal name is Price Bayless and I live
in Farmington, New Mexico. My first name is Price; nobody
knows me by that.

Q P-R-I-C-E.

A I am generally known by the name Tucker
but that's not my legal name.

Q What is your occupation?

A I'm manager of Bayless Drilling Company in
Farmington.

Q How long have you been in that position?

A We formed the company in the spring of
1977 and I've been in that position since we formed it.

Q And what is the nature of that business?

A We have contract drilling and contract
well servicing rigs.

Q Have you previously testified before the

1 Oil Conservation Commission?

2 A No.

3 Q Would you summarize your post-high school
4 educational background?

5 A I graduated from high school. I attended
6 University of New Mexico where I received a Bachelor of
7 Science in mechanical engineering and I went to work for At-
8 lantic Richfield Company in 1975 for slightly under two
9 years as an operations engineer and then moved back to Far-
10 mington and formed Bayless Drilling.

11 Q Would you summarize your work experience
12 prior to assuming that present position?

13 A Yes. I think I just did.

14 Q You already did that? Are you familiar
15 in general with drilling operations in the area of the Gavi-
16 lan Mancos Oil Pool?

17 A Yes.

18 Q And are you familiar with the drilling
19 operations on the Mallon Oil Company Johnson Federal 12-5
20 Well?

21 A Yes.

22 Q Okay. And would you describe that famil-
23 iarity?

24 A We were the drilling contractor with our
25 rig on that particular Mallon well. We also drilled two

1 other Mallon wells in the area, one Southland Royalty well
2 and on -- a little bit removed, four wells recently for Al
3 Greer in the Canada Ojitos Unit.

4 Q Are you familiar with the purpose of this
5 application in this case?

6 A Yes, I am.

7 MR. ROBERTS: Mr. Chairman, I
8 tender Mr. Bayless as an expert in the field of contract
9 drilling.

10 MR. HALL: We have no objec-
11 tion.

12 MR. STAMETS: The witness is
13 considered qualified.

14 Q Mr. Bayless, you've heard Mr. Mallon tes-
15 tify and he's -- he's analogized the circumstances that the
16 parties find themselves in to a turnkey operation that might
17 have been negotiated by working interest parties in a piece
18 of acreage.

19 What does the term "turnkey" mean to you
20 from your perspective as a drilling contractor?

21 A Normally the term "turnkey contract" sig-
22 nifies that whoever the contractor is that accepts the turn-
23 key will assume all risk and liability to any given point on
24 whether to drill a well, whether it be to casing point, to
25 logging point, into the tanks, at a pre-specified point and

1 the contractor would assume the risk of all costs and prob-
2 lems up to that point.

3 Q Have you operated under a turnkey drill-
4 ing contract on any prior occasion?

5 A I've operated under turnkey and modified
6 turnkey.

7 Q And how would you distinguish those two
8 types of drilling contracts?

9 A Modified turnkey would be essentially a
10 turnkey contract with what we refer to as cutouts or limits,
11 which is sort of in conflict with turnkey, because I don't
12 assume the ultimate liability, and that can be in rig time
13 for guaranteeing a log. It can be in the actual total cost
14 of mud; total cost of water, whether it's a dollar amount or
15 circulation, lost circulation clause, something, some clause
16 that limits the contractor's liability and in turn passes
17 that liability on to the operator.

18 That would modified turnkey.

19 Q What kind of contract did you utilize in
20 drilling the Johnson Federal 12-5 Well for Mallon Oil Com-
21 pany?

22 A We operated under a standard IADC day
23 work drilling contract.

24 Q In the Gavilan Mancos Oil Pool area would
25 you drill a well on what you have characterized as a true

1 turnkey drilling contract?

2 A No, I wouldn't drill under a true turnkey
3 with no -- with no modifications, no cutouts.

4 Q And why would you not do that?

5 A At this point there -- I don't feel there
6 are enough wells and the drilling is consistent enough to
7 warrant us assuming a liability of the -- it's a high risk
8 area. We have lost circulation. We have some deviation
9 problems. We have sluffing tight hole problems. It's just
10 a high risk area for contract drilling and I don't feel that
11 we have enough information to say what the average well is
12 going to be.

13 Q How would you develop and structure a
14 turnkey drilling proposal just in general terms?

15 MR. HALL: Mr. Commissioner, I
16 think I'm going to interpose an objection at this point.
17 We're being faced questions about turnkey drilling contracts
18 between the operator and drilling contractor here and the
19 issue at hand is whether or not there's any sort of agree-
20 ment between the pooling party and the pooled party, which
21 the evidence shows to date there has not been.

22 We think these questions are
23 irrelevant.

24 MR. ROBERTS: Mr. Chairman,
25 we're developing our case and the (not clearly understood)

1 of our case through this testimony and we feel that we're
2 entitled to make that presentation and develop our -- our
3 case.

4 We're taking a position, as I
5 indicated in our opening statement, that what the parties
6 find themselves in is a turnkey situation where one operator
7 has assumed all of the risk that was inherent in the drill-
8 ing process for another operator, and at this point in time
9 we have that operator seeking to come into the participation
10 in the particular drilling venture without bearing any cost
11 that he would have been assessed in a turnkey operation.

12 We are trying to make that ana-
13 lysis and that analysis, we think, is a legitimate approach
14 to this problem. We're dealing with a unique situation that
15 the well was drilled and completed before spacing required
16 the joinder of additional parties in this well and so we
17 feel that it requires a unique resolution of this unique
18 problem.

19 We think we are entitled to
20 present the case and to develop our theory.

21 MR. HALL: May I respond to
22 that?

23 Again, Mr. Commissioner, this
24 witness is being asked to testify as to risk. We pointed
25 out that such a consideration would be premature until it's

1 been established that the operator-pooling party here has
2 met the requisites under the statute to allow the pooling.
3 Then there may be consideration of risk.

4 That the applicant has failed
5 to do thus far; they haven't met their prima facie burden.
6 Therefore we'd object to any sort of consideration of risk
7 at this point.

8 MR. ROBERTS: Mr. Commissioner,
9 we've got an argument that's basically a legal argument.
10 I've made the interpretation under New Mexico Statute 70-2-
11 17, which the compulsory pooling statute, that the Commis-
12 sion is empowered to determine on what basis parties will --
13 will participate in the drilling and completion of a well.

14 You have the -- one of your
15 functions is to -- to make sure that each party has the
16 right to his fair share of production without unreasonable
17 and unnecessary expense.

18 We are -- we are taking the
19 position in this case that what we have here is a turnkey
20 situation and in a turnkey situation risk is built-in as an
21 actual cost and passed on to -- to the various parties to
22 the deal, and we believe that Mallon Oil Company has the
23 right to produce its fair share of the reserves under this
24 320-acre tract without unnecessary expense.

25 We're taking the position that

1 for it to bear all of the burden of the risk is to assume
2 its disproportionate part of the risk, which should be an
3 actual cost in this situation.

4 We're not here to say that this
5 is a standard type forced pooling situation; obviously it is
6 not. Because it's not a standard forced pooling situation
7 it requires different treatment and this is -- this is the
8 argument we have. We have a basic, legal disagreement as to
9 the applicability and the scope of the statute that's
10 involved, and we want to be able to present our case and
11 develop our case.

12 MR. HALL: Well, I'll simply
13 renew my objection. We have everything but the agreement
14 that is required between the parties. If the Commission is
15 inclined to receive additional evidence on risk, then we
16 would request that the record be kept open so that Mesa
17 Grande be afforded an opportunity to put on its own evidence
18 as to lack of risk.

19 MR. ROBERTS: Mr. Chairman, the
20 parties were advised by virtue of the notice as to what the
21 scope of the hearing was. Risk was definitely an element of
22 the application and the parties should have been prepared to
23 -- to address the risk factor.

24 MR. STAMETS: The Commission
25 will allow the current line of testimony. As to the issue

1 of risk, I believe, and of course we have the opportunity to
2 stand corrected before the hearing is over, but the adver-
3 tisement is broad enough to cover all those issues which are
4 commonly included in any compulsory pooling, and we would
5 expect to hear evidence as to risk from all the parties here
6 today as opposed to granting additional time; however, we'll
7 reconsider that closer to the end of the hearing.

8 You may proceed, Mr. Roberts.

9 MR. ROBERTS: Okay.

10 Q My question, I think, was, Mr. Bayless,
11 how would you develop with respect to a turnkey proposal in
12 general terms, not giving any particular regard to the area
13 that you're dealing with?

14 A Obviously it would vary by area. Assum-
15 ing it was in an area that I felt I was comfortable with a
16 turnkey contract, either modified or complete and total
17 turnkey, I would review each item that I had to furnish un-
18 der the contract, as I stated earlier, a starting and an
19 ending point. I may have to furnish the surface dirt work;
20 various items of drilling the well; surface casing and ce-
21 ment conceivably could be considered; rig time to drill it;
22 cost of drilling mud; cost of drilling water; and a normal
23 contract in San Juan Basin, or Four Corners area, in a turn-
24 key contract would normally end at that point. We very sel-
25 dom furnish -- I've seen very few bid requests where they

1 actually ask us to furnish a log at TD or a long string of
2 casing.

3 So I would review it in the area I was
4 in, each item on a -- on a per item basis, and come up with
5 an estimated cost of that item based on the well I was drill-
6 ling.

7 Obviously, I couldn't -- it's very diffi-
8 cult to say, there are too many specifics involved, but each
9 item you'd bill to your cost and you would attach a risk
10 factor to each item. There is considerably less risk to
11 fixing a price to build a location than there is to furnish-
12 ing the drilling fluids for a well. The lost circulation
13 comes in -- comes into play, so what you would do is basic-
14 ally start off with each item, add a risk to that particular
15 item, come up with a total cost of the well and those fig-
16 ures then would be adjusted based on whether it's a one-well
17 contract or a ten-well contract, because in everything with
18 risk, the more we can spread the risk among several pro-
19 jects, the lower we have to attach to any one project.

20 Q Then would it be accurate to say that
21 from what you've said and taking it one step further, that
22 the -- that the total dollar value of such a proposal would
23 vary by area?

24 A Yes, sir, that would be correct, by area,
25 yes.

1 Q And depending on what factors in terms of
2 risk?

3 A Okay, I'm sorry, I don't understand.

4 Q Depending on what kind of risk factors?

5 A A number of risk factors, or --

6 Q No, no, just the types of risk that you
7 might expect in here.

8 A If it's an area known for lost circula-
9 tion we'd obviously put a higher risk factor on -- on the
10 drilling fluids, both mud and water.

11 If it's an area that is known for diffi-
12 culty in getting a log to bottom we have to include a risk
13 of more days of rig time and fuel.

14 If it's a directional, highly deviation
15 -- highly deviated area, we need to include cost for more
16 tools.

17 Q Now, Mr. Bayless, I want you at this
18 point to assume that you were preparing a turnkey drilling
19 proposal for a single well in the Gavilan Mancos Oil Pool
20 area.

21 How would you structure that proposal?

22 MR. HALL: Well, I'm going to
23 object to the question. It calls for speculation. It
24 doesn't seem to deal with this well. I think the question
25 in everybody's mind here is there -- has there been risk

1 assessment performed for the subject well.

2 MR. ROBERTS: And, Mr. Bayless,
3 Mr. Chairman, has testified previously that he would not in
4 this Gavilan Mancos Oil Pool area propose a drilling con-
5 tract on a turnkey basis because of the -- the high risk in-
6 volved in drilling in that area, but I think it's appro-
7 priate for an expert witness to be able to take a hypotheti-
8 cal situation and to indicate how he would handle that hypo-
9 thetical situation.

10 MR. STAMETS: I think this goes
11 along with the other testimony that we've already indicated
12 we will allow, so you may proceed.

13 Q Okay, Mr. Bayless, the question was as-
14 suming you were preparing a turnkey drilling proposal for a
15 single well in the Gavilan Mancos Oil Pool area, how would
16 you structure that proposal?

17 A I was asked to come up with prior to
18 drilling if I could do a turnkey, and the only way I could
19 justify it at that time was to go through any information,
20 and I am not privy to as much information of this type as I
21 need to do it, but before I'd ever go under contract to do
22 it, I would have the following information, and that is
23 worst case of each item that is questionable, and again, I'd
24 have to rule out -- I can look at the surface location, so I
25 don't have to have the worst case, because they're differ-

1 ent, but the downhole problems, the actual drilling prob-
2 lems, I would look at the worst case on an item by item pro-
3 gram and I would figure out how many the most days to drill
4 a well was and I would multiply -- I would multiply that by
5 my daily cost of my rig.

6 I would look at the highest mud bill, the
7 highest water bill, the highest bit bill, the highest of
8 each of these items and add them together because I would
9 know of no other way to estimate what you're going to run
10 into underground in an area that has as little -- as little
11 development, and still has as little development, and as in-
12 consistent development as this area has.

13 MR. ROBERTS: Mr. Chairman, I
14 have no other questions of this witness.

15 MR. STAMETS: Are there other
16 questions of the witness? Mr. Chavez.

17
18 QUESTIONS BY MR. CHAVEZ:

19 Q Mr. Bayless, have you drilled other wells
20 for Mr. Mallon in this area?

21 A Yes, sir, I have.

22 Q In what order did you drill the wells in-
23 sofar as concerns this well and the other wells you drilled?

24 A I have to look at my files to see. I
25 don't remember.

1 Q Did you drill a couple of wells, other
2 wells before you drilled this well?

3 A This is the middle well?

4 MR. MALLON: This is the first
5 well.

6 A This is the first and I drilled two
7 others, but after that I drilled -- I should know these
8 dates.

9 Q It doesn't matter. Did you look at the
10 records of other drillers in the area?

11 A Yes, sir, the only way a drilling con-
12 tractor, and it's rumored to be a highly competitive busi-
13 ness right now, the only records that are available to us
14 are from service companies. Operators don't get in the
15 habit of furnishing -- furnishing their well costs on pre-
16 vious wells. Other drilling contractors do not -- are not
17 in the habit of furnishing us their costs, so basically our
18 primary source of information are what we call bit records,
19 and bit records indicate total time on a well, total rotat-
20 ing time, total number of bits, and to some extent the prob-
21 lems incurred. Obviously, if they're on it thirty days but
22 they still only have the same 300 hours of drilling of some-
23 body's on it seventeen days, one can assume that that thir-
24 teen days were lost in another operation, lost circulation,
25 plugback as it got crooked, some feature like that, and then

1 you would go to a mud company. Other service companies is
2 where we get our information in an area we haven't drilled.

3 Q Thank you. In this particular well did
4 you drill this on a modified turnkey?

5 A No, sir, straight day work contract.

6 Q Why was that?

7 A I looked at the area. I was not comfor-
8 table with assuming all of the risk and I can't -- I can an-
9 swer my feeling. Kevin Fitzgerald with Mallon may have it
10 -- okay. I put so many cutouts in a well in an area like
11 this that the ultimate responsibility would lie with the
12 operator, anyway, which would mean even if I went in there
13 under a footage or turnkey, I would bid the fast hole or the
14 trouble-free hole at a higher footage and any time I had
15 problems I'd turn it over to the operator and he'd assume
16 the responsiblity on a day work basis, anyway.

17 So it makes more sense from an operator's
18 point of view, in my mind, to start off with his assuming
19 the risk and he can control the operation from the -- from
20 the beginning.

21 Q As a drilling contractor and familiar
22 with that area, have the other drilling contractors basical-
23 ly done about the same type of program up to the time that
24 you drilled this well?

25 A Probably half and half, I would say.

1 Q What was the other half?

2 A A footage or a modified turnkey, I would
3 assume. We -- again, I don't have -- I don't have copies of
4 -- I know what type of bid I received from other companies
5 and whether they actually got it or not, because I knew I
6 wouldn't.

7 Amoco, for instance, may ask for a turn-
8 key bid. I wouldn't turn a turnkey bid in, so I turned in a
9 day work. Another contractor may or may not have. I'm --
10 I'm not aware of it on a well by well basis.

11 Q So you don't really know, then, who's
12 taking the risk on a well by well basis, do you?

13 A I know -- no, sir, I don't know specific-
14 ally which risks are assumed by which person.

15 I do know that the standard IADC con-
16 tract, Amoco's standard contract, even on turnkey, has cut-
17 outs in it so they still assume the ultimate liability, or
18 an ultimate liability and risk.

19 Q Thank you.

20 MR. HALL: I have some ques-
21 tions, Mr. Commissioner.

22 MR. STAMETS: Mr. Hall.

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CROSS EXAMINATION

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BY MR. HALL:

Q Mr. Bayless, I believe you can answer this with a yes or no.

Did you testify on direct that in making your risk assessment that you sought to spread the risk among various projects?

A I guess you want a yes or no.

Yes, I said I could lower my risk on any one given project by spreading it among several.

MR. STAMETS: That's along yes.

A It's shorter than my last yes.

Q In this case was your hypothetical risk assessment you testified about here, was that for a single well or spread out amongst several projects?

A The worst case that I gave, where I'd add up the worst case, that's what I would do on a single well.

Q Is this the first Gavilan Mancos Dakota -- whatever -- Mancos well you've drilled in the area?

A In that area? I believe so.

Q All right. How many other wells like that --

A Excuse me, I may be wrong. They drilled a Southland well right in here the same and I can't remember which of them came first.

1 Q We have one first and another maybe.

2 MR. ROBERTS: The discussion is
3 which is first and which is second.

4 A Yeah, I drilled several wells in there
5 and I'm just not too sure whether the Mallon well -- this
6 well was the first or second.

7 Q Okay.

8 A Although -- nothing.

9 Q Do you have any idea how many other wells
10 like this there are in the area that are currently produc-
11 ing?

12 A Gobs is probably not the technical answer
13 you're looking for, but I know there are several.

14 Q We'll go with "gobs".

15 MR. HALL: I have nothing fur-
16 ther.

17 MR. ROBERTS: I have no other
18 questions for the witness.

19 MR. STAMETS: Any other ques-
20 tions for the witness?

21 He may be excused.

22 We'll take a five minute rest
23 break here.

24

25

(Thereupon a recess was taken.)

1
2 MR. STAMETS: The hearing will
3 please come to order.

4 MR. ROBERTS: We'll call Kevin
5 Fitzgerald to the witness chair.

6
7 KEVIN FITZGERALD,
8 being called as a witness and being duly sworn upon his
9 oath, testified as follows, to-wit:

10
11 DIRECT EXAMINATION

12 BY MR. ROBERTS:

13 Q Mr. Fitzgerald, would you state your name
14 and your place of residence for the record?

15 A Kevin Fitzgerald, Denver, Colorado.

16 Q And what is your occupation?

17 A Petroleum engineer for Mallon Oil Com-
18 pany.

19 Q How long have you been employed by Mallon
20 Oil Company?

21 A For three years.

22 Q What are your responsibilities for Mal-
23 lon?

24 A I oversee all the engineering operations
25 for the company.

1 Q Have you previously testified before the
2 Oil Conservation Commission?

3 A No, I have not.

4 Q Would you summarize, briefly summarize
5 your post-high school educational background?

6 A I attended the University of Oklahoma
7 where I obtained a Bachelor of Science degree in petroleum
8 engineering in 1978.

9 Q And would you briefly summarize your work
10 experience prior to employment with Mallon Oil Company?

11 A I worked for Amoco Production Company as
12 an engineer from 1979 to -- excuse me, from 1975 to 1981.

13 I was with Juniper Petroleum from 1981 to
14 '83, and then was with -- I have been with Mallon Oil Com-
15 pany since 1983.

16 Q What kind of job responsibilities did you
17 have with those two companies you were employed by prior to
18 Mallon Oil Company?

19 A I was a production engineer where I did
20 -- I was -- did a lot of field work, actually, wellsite work
21 on drilling and engineering and completion engineering.

22 Q And are you familiar with Mallon's opera-
23 tions in the area of the Gavilan Mancos Oil Pool?

24 A Yes, I am.

25 Q And would you describe the basis of that

1 familiarity?

2 A I monitor the day to day operations, both
3 drilling, production, and completion operations.

4 Q And are you familiar with the operations
5 of other operators in the area of the Gavilan Mancos Oil
6 Pool?

7 A Yes, I am.

8 Q And what is the basis for that familiar-
9 ity?

10 A In working with other operators through
11 the Gavilan Study Committee that we formed and in working
12 trying to find out information prior to any of our drilling
13 and completion work in the area.

14 Q And, Mr. Fitzgerald, are you familiar
15 with the contents of this application and its purpose?

16 A Yes, I am.

17 MR. ROBERTS: Mr. Chairman, I
18 would tender Mr. Fitzgerald as an expert in the field of
19 petroleum engineering.

20 MR. STAMETS: He is considered
21 qualified.

22 Q Mr. Fitzgerald, I would refer you to what
23 has been marked as Exhibit Number One. Would you please
24 identify that exhibit and very briefly explain its signifi-
25 cance to this application?

1 A This exhibit shows Section 12. It has a
2 well location of the Johnson Federal 12-5. It shows the
3 blue outline is the outline of the proration unit existing
4 at the time the well was drilled.

5 The orange highlighted area shows the
6 area Mallon proposes to commit to the 320 spacing unit that
7 now exists.

8 It also shows the tracts of acreage and
9 ownership as we believe it at present.

10 Q And, Mr. Fitzgerald, are these separate
11 tracts that have been identified as Tract No. 1, Tract No.
12 2, and Tract No. 3, do they represent separate lease lines?

13 A Yes, they do.

14 Q I want you to refer now to what's been
15 marked as Exhibit Number Two and identify that exhibit.

16 A This is the well completion report that's
17 been filed with the BLM, Bureau of Land Management.

18 Q Mr. Fitzgerald, when was the well spud-
19 ded?

20 A The well was spudded August 22nd, 1985.

21 Q What factors formed the basis for your
22 decision to spud the well at that time?

23 A We had our lease expiration date of 3-31,
24 1986.

25 We had intended to have this well drilled

1 and completed before the winter weather got -- had gotten
2 bad, which is generally in the November/December time frame
3 and it doesn't improve until about May/June.

4 Q When was the well tested and first pro-
5 duced?

6 A We started completion 10-14-85. The ini-
7 tial potential tests were taken on 10-24-85 as shown on the
8 completion report, and we actually put the well on produc-
9 tion December 12th, 1985, for oil sales and subsequently
10 connected for gas sale on 1-3 of '86.

11 Q What type of well is this?

12 A In comparing to the --

13 Q Basically I'm just referring to how is
14 this well classified for purposes of the completion report?

15 In what formation is it completed?

16 A In the Mancos formation.

17 Q At the time of the commencement of the
18 well and then at the times of the completion, testing, and
19 date of first production from the well, was this area, this
20 acreage on which the well is located subject to any pool
21 rules?

22 A No, it wasn't. It was subject to state-
23 wide unspaced -- undesignated.

24 Q And on what spacing pattern was the well
25 drilled?

1 A On 40-acre spacing.

2 Q Now, there has been testimony, I believe,
3 already in this case, and if not, I would assume the Commis-
4 sion would take notice of the effective date of the exten-
5 sion of the Gavilan Mancos Oil Pool as being effective Jan-
6 uary 1st, 1986.

7 How did that order affect your operations
8 on this well?

9 A It's required us to pool additional ac-
10 reage in the -- in the unit.

11 Q Briefly summarize the production history
12 of the well.

13 A The well was put on production in Decem-
14 ber and through March 31st it's produced 10,032 barrels of
15 oil, 17,337 MCF of gas.

16 Q Are you familiar with other production
17 rates from other wells in the Gavilan Mancos Oil Pool?

18 A Yes, I am.

19 Q How does this -- how do these rates of
20 production compare with other productive rates from other
21 wells in the area?

22 A I'd say this is about average.

23 Q What's the current status of this well?

24 A The well is shut in pending approval of
25 the communitization agreement.

1 Q Mr. Fitzgerald, I want to backtrack a
2 little bit and try to fill in some of the gaps, some of the
3 misinformation that may have been conveyed as a result of
4 prior testimony.

5 What was the date of the filing of the
6 application for permit to drill?

7 A The well was permitted to drill in 9 --
8 the application was filed in 9-25 of 1984.

9 Q And on what date did you receive approval
10 of this application?

11 A That would be in October, October 23rd,
12 1984.

13 Q And when did you start your activity to
14 build the location for this well?

15 A In August 13th of 1985.

16 Q And then it's been your testimony the
17 well was spudded on August 22nd of 1985?

18 A Right.

19 Q At what point in time did you begin to
20 deal with the potential problems involved in the effect that
21 an extension of the Gavilan Mancos Oil Pool would have on
22 your operations?

23 A From our previous drilling we had discus-
24 sed drilling in the area completions and were attempting to
25 determine on our own behalf what we ultimately thought spac-

1 ing should be of what spacing would be appropriate for the
2 area.

3 We had been given indications from the
4 Aztec Office of the Oil and Gas Commission that not enough
5 data existed to either extend the pool, the Gavilan Mancos
6 Pool from the south or create our own oil pool.

7 Q And at what point in time was that? Can
8 you identify a date, a general date?

9 A That would be in the summer of 1985.

10 Q Okay. Prior to the time that the well
11 was spudded?

12 A Right.

13 Q Okay, go ahead and continue.

14 A The application for the extension of the
15 Gavilan Pool was filed on behalf of Dugan Production, at
16 which time I think we participated in a meeting at Dugan
17 Production's office with Southland Royalty, Al Greer, and
18 Jerome P. McHugh on September 11th, 1985.

19 At that time we listened to what everyone
20 had to say. It was the drilling of the Johnson Well that
21 brought the spacing about because Al Greer became aware of
22 the fact that this was drilled on a 40-acre proration unit
23 and was very concerned because this section lies within the
24 boundary, adjacent to the boundary of the Canada Ojitos
25 Unit.

1 A I think that that was probably just due
2 to the fact that Mr. Mallon didn't have the dates in front
3 of him.

4 Q Mr. Fitzgerald, in your opinion have your
5 operations on the Johnson Federal 12-5 Well been conducted
6 at all times with due regard to the rules, existing rules of
7 the Oil Conservation Division?

8 A Yes.

9 Q At any time have you in any of your
10 operations on this well, have you attempted to beat the
11 rights of other working interest owners or leasehold
12 interest owners to participate in a proration unit assigned
13 to this well?

14 A No, we have not.

15 Q Mr. Fitzgerald, would you refer to what's
16 been marked as Exhibit Number Three?

17 A This Exhibit Number Three is a cost
18 tabulation prepared from our accounting system of actual
19 costs through March 31st, 1986, on the Johnson Federal 12-5.

20 Q Mr. Fitzgerald, would you identify the
21 drilling and completion costs incurred on this well through
22 that date? I'm referring to the total costs of drilling and
23 completing the well.

24 A A total cost to date of \$565,840, and
25 that's for drilling and completion costs.

1 Q What are the total intangible drilling
2 costs that have been incurred through that date?

3 A \$255,016.

4 Q Then is it reasonable to assume that the
5 balance, which is approximately \$310,000 are the total tan-
6 gible drilling costs and the total costs of completion of
7 the well?

8 A Yes, that's correct.

9 Q What operating costs have been incurred
10 in operating this well?

11 A Lease operating expenses that don't show
12 up here on this Exhibit Number Three have been \$24,700.

13 Q And describe briefly in what manner those
14 operating costs have been incurred. Are they just normal
15 operating maintenance costs associated with a well?

16 A Routine costs such as drilling or the
17 operating and supervision of the well.

18 Q And in your opinion are those costs
19 reasonable?

20 A Yes, they are.

21 Q Were they necessarily incurred?

22 A Yes.

23 Q Has a premium for risk been factored into
24 these actual costs that are tabulated on Exhibit Number
25 Three?

1 A No, Exhibit Three shows no premium or
2 risk adjustment.

3 Q How do these actual costs compare with
4 the estimated costs that you had anticipated prior to the
5 drilling and completing the well?

6 A These are within 3 percent, within 5 per-
7 cent.

8 Q Mr. Fitzgerald, are you familiar with
9 other drilling and completion operations in the Gavilan Man-
10 cos Oil Pool area?

11 A Yes, I am.

12 Q Which ones are you familiar with?

13 A We've -- Mallon Oil Company has operated
14 six wells in the immediate area to date.

15 Q And based on your experience and your
16 knowledge of the area, are these total costs reasonable?

17 A Yes, they are.

18 Q And were these costs necessarily incur-
19 red?

20 A Yes, they were.

21 Q Is there any item of these costs that are
22 tabulated on Exhibit Number Three that were unusually or un-
23 reasonably high for the area?

24 A No, there weren't.

25 Q I want you to refer at this time to Exhi-

1 bit Number Four, please, and identify that exhibit.

2 A Exhibit Number Four shows a map of the --
3 of the Gavilan area primarily centered on our acreage on
4 wells that Mallon Oil Company has operated.

5 It shows the original boundary of the
6 Gavilan Mancos Pool at the time it existed at the time the
7 well was drilled. The outer boundary shows the revised Man-
8 cos -- Gavilan Mancos Pool boundary as of January 1st, 1986.

9 The highlighted wells are Mancos penetra-
10 tions at the time the Johnson 12-5 was drilled and you can
11 see there are some other wells with the diamonds around them
12 that have been drilled subsequent to the drilling of the
13 Johnson 12-5.

14 One of the reasons for preparing this map
15 is to show the sparsity of wells drilled to the Mancos as it
16 existed at the time we drilled the Johnson 12-5.

17 MR. STAMETS: I'm not sure I
18 understood the testimony as to which wells had been drilled
19 at the Johnson Well was drilled.

20 A Okay, the shaded wells, the orange shad-
21 ing on the diamonds indicate wells that were drilled, that
22 had been drilled through the Mancos formation as of the time
23 the Johnson 12-5 was drilled.

24 MR. STAMETS: If we go into
25 Section 1 immediately north, in the northeast quarter

1 there's one well that's drilled that's shaded in orange.

2 A Right.

3 MR. STAMETS: In the southwest
4 quarter there's a second well which is, I presume, now a
5 Mancos well --

6 A Right.

7 MR. STAMETS: -- that had not
8 been drilled at that time.

9 A Right.

10 MR. STAMETS: Okay, thank you.

11 A In this well -- in this map we did not
12 remove the shallow -- or the circles of the shallow Pictured
13 Cliffs wells that are in the area. We did not remove those.

14 Q Mr. Fitzgerald, what conclusions, if any,
15 can you draw from the data reflected in this exhibit?

16 A That at the time -- at the time we drill-
17 led this well that a high amount of drilling risk existed in
18 the area. There was not a significant amount of drilling
19 activities totally surrounding it.

20 Q Mr. Fitzgerald, if you took into consid-
21 eration, well, if you assumed that you had not yet spudded
22 the Johnson Federal 12-5 and you were getting ready to spud
23 that well knowing what activity had been conducted in the
24 area, how would that affect your assessment of the risk in-
25 volved in drilling the well now; having available all of the

1 drilling and completion data to date?

2 A I would say there was a high amount of
3 risk.

4 Q Now, in addition to the indicators of
5 risk that you say are reflected on Exhibit Number Four, are
6 there risks associated with actual drilling operations in
7 the area?

8 A Yes, there are.

9 Q What kinds of risks are those?

10 A The Gavilan area in general has a high
11 amount of risk associated with it. There's drilling prob-
12 lems of severe lost circulation, sluffing shale, deviation
13 problems, that extend the period of time that it takes to
14 drill the well to the objective depth and significantly in-
15 creases the costs incurred in wells with problems.

16 Q Are there risks associated with actual
17 completion operations in the Gavilan Mancos Oil Pool area?

18 A There are, but they're not of the magni-
19 tude of -- that the drilling risks are. They're smaller,
20 quite a bit smaller amount.

21 Q Mr. Fitzgerald, in your opinion would it
22 be appropriate for the Commission in this case to incorpor-
23 ate a premium for risk into the actual costs incurred in
24 drilling the Johnson Federal 12-5 Well?

25 A Yes.

- 1 Q In what amount?
- 2 A 100 percent of the drilling costs.
- 3 Q And what, refresh our memory, I guess re-
- 4 fresh the record's memory, as to what total dollar figure
- 5 that is.
- 6 A Those drilling costs would be \$255,016.
- 7 Q And those are intangible drilling costs?
- 8 A Intangible drilling costs.
- 9 Q So it's your testimony that you would not
- 10 ask that that rate of risk premium be applied to the tan-
- 11 gible drilling costs or the completion costs. Is that ac-
- 12 curate?
- 13 A That's right.
- 14 Q Okay. But is it also accurate to say
- 15 that you would hope to recover as a reimbursement from Mesa
- 16 Grande Resources their proportionate share of the total in-
- 17 tangible drilling cost and the total completion costs?
- 18 A Yes.
- 19 Q Mr. Fitzgerald, what is the basis for
- 20 your opinion that a premium for risk is appropriate in this
- 21 case?
- 22 A I've reviewed the costs on the six wells
- 23 operated by Mallon Oil Company and other wells in the area.
- 24 Costs have been previously presented to the Commission in a
- 25 previous Case 8350, Exhibit Seven, which drilling (not

1 clearly understood) forming the Gavilan Mancos Pool, and
2 presented quite a bit of cost data at the time.

3 Mallon Oil Company assumed all the risk
4 on behalf of Mesa Grande basically and turnkey -- basically
5 turnkeyed the well.

6 In the case represented by Mr. Bayless,
7 he indicated the true turnkey, he would take items on a
8 worst case basis. The worst case I'm familiar with, costs,
9 total costs on the wells vary from \$445,000 to over \$1.2-
10 million. I've heard of other costs higher than that but I
11 haven't actually seen the data presented on those.

12 The worst, in this worst case scenario,
13 drilling costs of approximately \$900,000, had a case like
14 this been the basis for Mesa Grande's participation in the
15 Johnson Well, in a turnkey situation they would have had a
16 share of \$225,000.

17 Q And now that would be intangible drilling
18 costs.

19 A Intangible drilling costs.

20 Q And what would that compare to if they
21 pay only their 25 percent share of the intangible drilling
22 costs actually incurred in the drilling of the Johnson Fed-
23 eral?

24 A In the Johnson 12-5 a 25 percent share of
25 intangible drilling costs would be \$64,000, approximately

1 \$64,000.

2 On the basis of what Mallon is requesting
3 here from assuming the entire risk associated with the drill-
4 ling, we are requesting a 100 percent risk factor and in
5 that case Mesa Grande's share would be \$127,500; a signifi-
6 cant amount less than the amount previously.

7 More closely related, Mallon Oil Company
8 was the operator of a well in Section -- the northeast quar-
9 ter of Section 2, called the Fisher Federal 2-1. Mallon's
10 costs due to problems incurred in the drilling operation of
11 severe lost circulation, stuck pipe, extremely high mud
12 costs, required 45 days to drill. The costs associated to
13 just intangible drilling costs were \$570,000.

14 Had this well been the basis for partici-
15 pation, the 25 percent share would be \$142,500.

16 Q Now, Mr. Fitzgerald, when you say had it
17 been the basis for participation are you referring to the
18 basis for Mesa Grande's participation in the Johnson Federal
19 12-5 assuming a turnkey operation?

20 A Yes.

21 Q Okay, and what would have been their --
22 their share of those intangible drilling costs?

23 A \$142,500.

24 Q And how would that compare to the actual
25 costs incurred and Mesa Grande's 25 percent of those actual

1 costs incurred in the Johnson Federal 12-5 Well?

2 A It would be significantly higher. I
3 think in light of -- I think in light of these examples
4 here, we're not asking for the, you know, for the highest
5 amount, I know we're not asking for a significant amount. I
6 think that the 100 percent risk adjustment would be consid-
7 ered fair and is lower than any true turnkey actually that
8 we could obtain in the area.

9 Q Okay. Mr. Fitzgerald, do you propose
10 supervisory charges to be set by the Commission for the
11 drilling and producing phases of this well?

12 A Yes, we do.

13 Q And in what amount?

14 A \$4000 per month during the drilling and
15 completion phase and \$400 a month for the operating.

16 Q Okay, and at this point in time, since
17 the well's already been drilled, have those costs in any way
18 factored into the total costs of drilling and completing the
19 well that are reflected on Exhibit Number Three, I believe?

20 A Yes.

21 Q And so basically you're asking the Com-
22 mission to validate those costs --

23 A Yes, sir.

24 Q -- that you've charged to the well?

25 And do you propose that Mallon Oil Com-

1 pany continue to act as the designated operator of the John-
2 son Federal 12-5 Well?

3 A Yes, we do.

4 Q Mr. Fitzgerald, in your opinion will the
5 granting of your application on the conditions and terms set
6 forth in your testimony and the testimony of the other
7 parties who have testified before you, be in the best
8 interest of conservation and facilitate the protection of
9 correlative rights and the prevention of waste?

10 A Yes, I do.

11 Q Were Exhibits One through Four either
12 prepared by you or at your direction and under your
13 supervision?

14 A Yes, they were.

15 MR. ROBERTS: Mr. Chairman, I
16 would move the admission of Exhibits One through Four on
17 behalf of Mallon Oil Company.

18 MR. HALL: Might I have an
19 opportunity to voir dire the witness on the exhibits,
20 please?

21

22 VOIR DIRE EXAMINATION

23 BY MR. HALL:

24 Q Mr. Fitzgerald, looking at Exhibit Four,
25 did you compile all the data that's shown on this exhibit?

1 A It was prepared in our office, yes.

2 Q But you personally did not compile this
3 data, is that correct?

4 A No, I didn't.

5 Q Okay. Did you --

6 A I did verify it.

7 Q Did you have anything to do with the lo-
8 cation of the Isopach lines on here?

9 A No, I didn't.

10 Q Okay.

11 A I have verified the Isopachs. They're
12 similar to other maps I've seen of the area.

13 Q Did you obtain the production volume in-
14 formation on the other wells shown on the exhibit?

15 A Yes, I did. I might say something there,
16 too. The wells to the south in the original Gavilan Mancos
17 boundary, the numbers offsetting each one of those wells
18 where numbers are available, were taken -- were taken from
19 Petroleum Information Reports, which would be taken from the
20 actual completion reports filed on the wells.

21 On the wells to the north that Mallon has
22 in Section number 1 and number 2, those numbers were not
23 taken from IP Reports or initial production reports, but
24 were estimated from initial production after recovery of --
25 of test fluid.

1 MR. HALL: Mr. Commissioner,
2 I'm going to object to the tender of Exhibit Four. It con-
3 tains hearsay, as the witness has testified.

4 MR. ROBERTS: Mr. Chairman, --

5 MR. STAMETS: Mr. Roberts, let
6 me ask a couple of questions here and I'll certainly give
7 you an opportunity to respond.

8 It seems to me that the thrust
9 of Mr. Fitzgerald's testimony relative to this exhibit was
10 to show what wells had or had not been completed at the time
11 of the drilling of the Johnson 12-5 Well, is that correct,
12 plus to show what the pool boundaries were at that time and
13 what they are now.

14 MR. ROBERTS: Yes, and to make
15 some implications, I guess, from that data that you've just
16 highlighted about the risk involved. And there's data here
17 that is not relevant to Mr. Fitzgerald's testimony but for
18 those purposes that you've identified, yes, we'd agree they
19 cover the basics of his testimony.

20 MR. STAMETS: You didn't intend
21 to put him on as a geologist.

22 MR. ROBERTS: No.

23 MR. STAMETS: And, Mr. Fitz-
24 gerald, you -- did you color the little orange colors on
25 here?

1 A Yes, sir, I did.

2 Q And did you verify that the wells on here
3 which you've marked as Gallup producers indeed are Gallup
4 producers?

5 A Yes.

6 MR. STAMETS: We would accept
7 the -- all of the exhibits which have been presented by Mr.
8 Fitzgerald here with the provision that Exhibit Number Four
9 is accepted only for those issues which we have discussed at
10 this point.

11 MR. ROBERTS: Thank you, Mr.
12 Chairman.

13 I have no other questions.

14
15 CROSS EXAMINATION

16 BY MR. STAMETS:

17 Q I'd like to clarify a couple of things,
18 Mr. Fitzgerald.

19 If I understood your testimony correctly,
20 what you would like to have as a premium on this well would
21 be a figure which would represent 100 percent of the
22 intangible drilling costs attributable to Mesa Grande?

23 A Right, yes, sir.

24 Q All right, and if I did my math
25 correctly, Mesa Grande's share of intangible drilling costs

1 would be about 32,400 without any risk.

2 MR. ROBERTS: The testimony was
3 that their share of the total intangible drilling costs would
4 be about 64,000. His testimony was that total intangible
5 drilling costs were \$255,000.

6 MR. STAMETS: 255?

7 A Yes.

8 MR. ROBERTS: Yes.

9 MR. STAMETS: But Exhibit --
10 okay, I see, I'm sorry about that. I stopped at the -- up
11 at the top one.

12 So we're looking at 25 percent
13 of 255 times 2.

14 MR. ROBERTS: Would you say
15 that again?

16 MR. STAMETS: 25 percent of
17 \$255,016 times 2.

18 A That would be correct.

19 Q And, Mr. Fitzgerald, when Mr. Mallon, or
20 the company makes a decision on whether or not to drill a
21 well, what rate of return are you looking at? Let's say Mr.
22 Mallon is 100 percent owner of the acreage, what rate of re-
23 turn are you looking for before he'll invest that money?

24 A I don't think we have a set parameter,
25 set number of parameters. It probably depends upon the risk

1 involved for the drilling and the, you know, reserves attri-
2 buted to that.

3 I don't think we have set parameters like
4 a lot of major oil companies do.

5 Q Do you recall when this well was drilled
6 if you had that kind of a meeting or a discussion of calcu-
7 lating what you expected as a rate of return?

8 A I think we were looking for a return on
9 investment or something on the order of about 10 to 1.

10 Q Presumably 100 percent on tangibles would
11 represent less than that on that share of that part of the
12 investment that Mr. Mallon made.

13 A I'm sorry.

14 Q Okay, 100 percent of Mesa Grande's share
15 of the tangible costs would not represent a 10 to 1 return
16 to Mr. Mallon for his investment --

17 A No, they wouldn't.

18 Q -- as to their share.

19 A No, they would not.

20 Q You mentioned \$4000 and \$400 as the over-
21 head charges. Do you have any voluntary agreements where
22 anybody has agreed to allow you to charge that much for sim-
23 ilar wells?

24 A Yes, we do.

25 Q Do you have any of those with you?

1 A No, I don't. We can provide them.

2 Q Okay, I would like to see some of those
3 submitted at some time plus the -- the rates, the average
4 rates out of any industry publication that covers these same
5 issues.

6 A I believe these are less than the COPAS
7 amount, the published rates.

8 MR. STAMETS: Are there other
9 questions of the witness?

10 MR. HALL: Yes, Mr. Commis-
11 sioner.

12
13 CROSS EXAMINATION

14 BY MR. HALL:

15 Q Mr. Fitzgerald, do you have any idea of
16 the total number of Gavilan Mancos wells that are presently
17 producing?

18 A I believe there's around 45 that have
19 been completed but there's a number of the wells shut in and
20 I'm not aware of which wells are shut in currently and which
21 wells are on production.

22 Q Do you have any idea of the number of
23 wells that were drilled to that objective that were not com-
24 pleted as commercial wells?

25 A I know of wells that we would consider

1 noncommercial, that they probably would not return their in-
2 vestment.

3 Q Do you have any idea of the number of
4 those?

5 A I would think in the Gavilan Pool there's
6 only four or five.

7 Q Now if I understand you correctly, when
8 you sought to substantiate your cost potential and intan-
9 gible for drilling and completion of this well, you referred
10 to only one other well and that was the McHugh Well, is that
11 correct?

12 A Could you repeat that? I'm not sure --

13 Q Well, I believe in your direct testimony
14 you stated that you sought to compare your drilling and com-
15 pletion costs with costs for other like wells.

16 A Yes,

17 Q In order to confirm the reasonableness,
18 and you referred to only one other well and that was the
19 McHugh well, is that correct?

20 A No, I -- I reviewed costs on six wells
21 operated by Mallon Oil Company and nineteen wells that were
22 operated by outside parties, and this was all the data I had
23 available.

24 Q If I understand you correctly, you had
25 data available for nineteen wells?

1 A Yes.

2 Q And what was the source of all that data?

3 A A total of 25 wells. Six wells that Mal-
4 lon Oil Company operates we know the cost of. There were
5 nineteen wells that had been presented to the Commission in
6 a previous case, as an exhibit to a previous case, where
7 they analyzed completion, drilling and completion costs.

8 Q And that was presented by Jerome McHugh,
9 is that correct?

10 A It was. It had been prepared by John Roe
11 of Dugan Production.

12 Q Okay. Did you have any opportunity to
13 take those figures in this exhibit and confirm them with ac-
14 tual data?

15 A I don't think I follow.

16 Q Well, did you simply rely upon th infor-
17 mation shown in that exhibit as to costs or did you seek to
18 confirm the data shown on that exhibit with --

19 A Oh, I confirmed it with John Roe who pre-
20 pared -- who prepared the exhibit.

21 Q And do you have any idea how he compiled
22 all that data or did you simply confirm it with him?

23 A I just confirmed it with John Roe.

24 Q Okay. So that's what we call in the
25 legal business, hearsay. Do you understand that?

1 MR. ROBERTS: We'd object --

2 A Yes, sir.

3 MR. ROBERTS: -- to the ques-
4 tion.

5 MR. STAMETS: I'm not sure it
6 was a question.

7 MR. ROBERTS: To the statement.

8 MR. HALL: Seeing if he under
9 stood that.

10 Q To make sure I understand something else,
11 again, you were involved with the consideraton of uping the
12 spacing to 320 acres along with Dugan and Greer, is that
13 correct?

14 A Yes, we were.

15 Q And your first meeting with them was in
16 September, September 11th, 1985?

17 A Yes, it was.

18 Q Had you had an occasion to discuss that
19 in-house before that meeting?

20 A Yes, we had.

21 Q How far in advance of that meeting?

22 A Just a couple of days. That meeting had
23 been called at pretty sort notice.

24 Q And if I understand it, at that time you
25 were unsure of your support for that application, is that

1 correct?

2 A Right.

3 Q But you were, in fact, aware that the ap-
4 plication was under consideration.

5 A The application had not been formally put
6 together by anybody at that time. No one had formally --
7 this was a meeting to discuss whether people were for exten-
8 ding this. This was -- these were people who had acreage in
9 the area north of Gavilan.

10 Q But you were in fact aware that the ap-
11 plication was at least under consideration.

12 A At that time there was no application or
13 it wasn't -- this meeting was to determine whether people
14 were for it or against it.

15 Q Okay. Do you know who the purchaser for
16 the oil is off this well?

17 A We, since the well was drilled we've had
18 three different purchasers.

19 Q And do you know when first sales were
20 made?

21 A I don't have that with me. It would have
22 been in December of '85.

23 Q Would October of '85 be any more correct,
24 or can you recall?

25 A I don't know. I doubt it, but I don't
know.

1 Q And I believe you stated that were were
2 aware of at least 25 other Gavilan Mancos wells in the area
3 and perhaps as many as 47 Gavilan Mancos wells?

4 A Yes, I'm not sure of the exact amount but
5 it's in that area.

6 Q And those, as I understand it in connec-
7 tion with your testimony with Exhibit Four, those wells were
8 in existence at the time the subject well was spudded, is
9 that correct?

10 A At that time were (not clearly under-
11 stood).

12 Q (Not clearly understood) for those 47
13 wells. They would have all been on 40-acre spacing at some
14 point, is that correct?

15 A No, the majority of those wells, I be-
16 lieve, were drilled under the spacing, the Gavilan spacing
17 order.

18 Q Okay. Do you have any idea how many were
19 outside of the Gavilan Pool at that time that were on 40 ac-
20 res, if any?

21 A I don't know to the south but in our area
22 there would be six wells.

23 Q All right, so for each of those six wells
24 may we assume that the operators would have to have dedi-
25 cated 320 acres for each and every one of them?

1 A No.

2 Q Why not?

3 A Because no -- no spacing existed at that
4 time. It's undesignated. It was not a spaced area, it's
5 undesignated; therefore 40 under the rules is the statewide
6 spacing in undesignated areas.

7 Q And under the present rules with the ex-
8 tension?

9 A Under the present rules with the exten-
10 sion 320 acres would have to be dedicated.

11 Q Okay. Are you aware of any discussion
12 amongst members of the industry with regards to dedication
13 of 320 acres (not clearly understood)?

14 A Not at all prior to the drilling of this
15 well.

16 Q But you've heard so since?

17 A Yes.

18 Q Let me ask you, how long have you been
19 familiar with operations in the subject area?

20 A For about two years.

21 Q Right, and you've heard of the name E.
22 Alex Phillips before, haven't you?

23 A Yes, I have.

24 Q And you've heard of Mesa Grande Resources
25 before?

1 A Yes, I have.

2 Q So someone in Mallon was in fact familiar
3 with Mesa Grande's operations in the area.

4 A To the south and I know that they're --
5 -- they're operators of wells that were in the spaced area.

6 Q Okay.

7 MR. HALL: I have nothing fur-
8 ther.

9 MR. STAMETS: Other questions
10 of this witness?

11 MR. LYON: Could I ask a ques-
12 tion?

13 MR. STAMETS: Mr. Lyon.

14
15 QUESTIONS BY MR. LYON:

16 Q Referring to your Exhibit Three, you have
17 up in the top lefthand portion, AFE number in the Johnson
18 Gavilan No. 2. What's -- what's the significant of that?

19 A That's just an accounting description;
20 it's internal to our company.

21 Q This is the same --

22 A It's -- right, the well --

23 Q -- well here.

24 A Right, it is the well, Johnson 12-5 is
25 (not clearly understood) to the right.

1 Q And up there at the top righthand portion
2 it says AFE Comparison Report.

3 A Yes.

4 Q And the data that you have shown on here
5 is the actual --

6 A It is actual data.

7 Q Okay. Now, referring to Exhibit Number
8 Four, are these dual completions, these Gavilan wells? Are
9 the dual completions?

10 A No, they're not. These are single
11 completions.

12 Q Are they oil wells?

13 A They're oil wells.

14 Q I just was curious why they put the
15 sunburst around those wells when the legend says that a
16 sunburst means a gas well.

17 A I believe it's due to the fact that these
18 produce oil with casinghead gas.

19 Q It's been my experience that most wells,
20 most oil wells do produce casinghead gas, so I was just a
21 little bit confused.

22 And one further point, is this not a
23 structure map rather than an Isopach map?

24 A It is a structure map, yes.

25 MR. LYON: That's all I have.

1 MR. ROBERTS: Mr. Chairman,
2 could I ask one question?

3 MR. STAMETS: Yes, Mr. Roberts.
4

5 REDIRECT EXAMINATION

6 BY MR. ROBERTS:

7 Q On direct examination in response to one
8 of my questions concerning production history from the John-
9 son Federal 12-5 Well, you responded that first oil sales
10 occurred in December of 1985.

11 When Mr. Hall just asked you the question
12 when first oil sales occurred you said that you believed
13 December, 1985. He at that point said could it have been
14 October, 1985.

15 Do you know when first sales occurred?

16 A No, I don't.

17 Q Okay. Would it have been -- I want to
18 point out one thing, Mr. Fitzgerald. Look at your Exhibit
19 Number Two and refer to the item that's labeled Date First
20 Production, the entry of October 24th, 1985.

21 A Yes.

22 Q What is the significance of the Date
23 First Production? What -- what occurred at that point?

24 A That's the date, that's the first date
25 that oil was produced from the wellbore into tanks.

1 Q Does that necessarily imply that sales
2 occurred then?

3 A No, it does not.

4 Q Okay. In a logical sequence of completing
5 a well and running production to the tanks initially, how
6 long would it take before a sale could be consummated?

7 A In general we wait till we produce 200
8 barrels of oil and then sell the oil.

9 Q Is it likely, then, in this circumstance
10 that that first sale occurred in December of 1985?

11 A Yes, it is.

12 MR. ROBERTS: I don't have any
13 other questions.

14 MR. STAMETS: Any other ques-
15 tions of the witness?

16 He may be excused.

17 MR. ROBERTS: We'd call Karen
18 McClintock.

19

20

KAREN McCLINTOCK,

21 being called as a witness and being duly sworn upon ~~her~~

22 oath, testified as follows, to-wit:

23

24

25

DIRECT EXAMINATION

1
2 BY MR. ROBERTS:

3 Q Would you state your name and your place
4 of residence for the record?

5 A Karen McClintock. Denver, Colorado.

6 Q How long -- what is your occupation?

7 A My title is Landman for Mallon Oil Com-
8 pany.

9 Q How long have you been employed in that
10 capacity?

11 A Five years.

12 Q What are your responsibilities in that
13 capacity with Mallon Oil Company?

14 A I'm responsible for obtaining and main-
15 taining a leasehold in various areas of interest that we
16 have.

17 Q Are you familiar with Mallon's operations
18 in the Gavilan Mancos Oil Pool area?

19 A Yes.

20 Q And did you have some responsibility in
21 securing leasehold interest in that area?

22 A Yes.

23 Q Would you describe some of those activi-
24 ties?

25 A Yes. Pertaining to the Section 12, I

1 originally tried to negotiate farmouts.

2 Q Let me -- let me interrupt just a second.
3 Just in general terms what kind of --

4 A Oh, okay. I requested farmouts and I al-
5 so negotiated directly with Mesa Grande concerning Section
6 12.

7 Q Okay. Are you familiar with Mallon's ap-
8 plication in this case?

9 A Yes, I am.

10 Q Refer to what has been introduced into the
11 record as Mallon Oil Company's Exhibit Number One. Would
12 you just refer to that exhibit, please, and -- and briefly
13 describe it?

14 A Yes. I prepared this land plat and it
15 has three separate tracts.

16 Tract No. 1 is located in the west half
17 in the northwest quarter of Section 12, Township 25 North,
18 Range 2 West, and it's owned -- the recording -- I mean
19 operating rights and record title ownership is Mallon Oil
20 Company, et al.

21 Tract No. 2 is located in the east half
22 of the northwest quarter. This is kind of difficult. We're
23 not really sure who owns it because while I show that North-
24 west Pipeline/Texaco owns it (not clearly understood) to
25 Mesa Grande.

1 Tract No. 3 is owned by A. G. Hill and
2 it's located in the southwest quarter and Mallon Oil Company
3 has operating rights. We did obtain a farmout from A. G.
4 Hill dated October 29th, 1985.

5 Q You had indicated that there is some un-
6 certainty as to ownership of the operating rights or the re-
7 cord title as to what's been labeled as Tract Number 2,
8 which is the east half of the northwest quarter of Section
9 12. Why have you been dealing with Mesa Grande Resources in
10 trying to obtain a voluntary joinder of their interest to
11 that well?

12 A It's my understanding through conversa-
13 tions with Mesa Grande and Northwest Pipeline that consider-
14 ation has been paid by Mesa Grande but there's a problem
15 with the title and what they're actually to receive from
16 Northwest Pipeline and Texaco, and so under the direction of
17 Northwest Pipeline we have been dealing with Mesa Grande and
18 we felt consideration paid was sufficient evidence for us to
19 go forward with negotiations with Mesa Grande.

20 Q Has Mesa Grande Resources through their
21 representative indicated to you that they are the owners of
22 the operating rights in that tract?

23 A Yes.

24 Q Okay. You were here when Mr. Mallon tes-
25 tified. On cross examination Mr. Hall asked him what had

1 been done with the proceeds of production attributable to
2 the 80-acre tract which is labeled as Tract No. 2 on this
3 exhibit.

4 Mr. Mallon, I believe, responded that
5 those funds were being held pending a resolution of the man-
6 ner in which Mesa Grande Resources would participate in this
7 well.

8 Are you familiar with the reason for the
9 escrow of those funds?

10 A Yes, I am.

11 Q And what is that reason?

12 A The money for -- from the Johnson 12-5
13 Well is held in escrow due to the fact that we do not --
14 that we did not have a Division order title opinion
15 prepared.

16 The Division order title opinion which we
17 prepared only covered the 140 acres in which Mallon controls
18 and at the time that had the Division order title opinion
19 completed for that 240 acres, we did not have a communitiza-
20 tion agreement approved; therefore we cannot release any
21 funds.

22 Q And are you telling me that there's some
23 uncertainty as to the actual ownership of that 80-acre
24 tract?

25 A Yes. It would be very difficult at this
point for us to release any money even with an approved com-

1 unitization agreement due to the fact for all practical
2 purposes Mesa Grande really does not have title and I could
3 not effectively -- I could not allow the release of the rev-
4 enue until I found out exactly who had the money just be-
5 cause it's not on record.

6 Q Basically what you're asking for is a
7 little more formality in the -- in the identification of the
8 interest owners.

9 A Exactly.

10 Q You have already indicated that you've
11 been involved in Mallon's attempts to obtain the voluntary
12 pooling of the leasehold interest in the west half of Sec-
13 tion 12. Would you briefly describe the -- describe the
14 contacts, communications that you've had with Mesa Grande
15 Resources in an effort to obtain the voluntary joinder of
16 the interest in the 80-acre tract labeled as Tract Number 2?

17 A Okay. We have been in negotiations with
18 Northwest Pipeline but when we received the information that
19 Mesa Grande had indeed won the bid from Northwest Pipeline,
20 I contacted Greg Phillips on October 24th, 1985, and I re-
21 quested a farmout. At that time he wanted me to put my re-
22 quest in writing and also include all pertinent data in
23 terms of the drilling and completion.

24 Q Let me back -- let me interrupt you a
25 little bit.

1 A Sure.

2 Q I may interrrupt you and --

3 A No problem.

4 Q -- ask you questions periodically.

5 So at what point did you become aware
6 initially that Mesa Grande Resources had acquired an inter-
7 est in this well?

8 Are you able to identify that point in
9 time?

10 A It was somewhere between October 8th when
11 we sent in a bid for Northwest Pipeline acreage. We bid on
12 this particular tract that I've identified as Tract Number
13 2, and the day, October 24th, 1985, and it was pretty close
14 to October 24th, 1985, because I wanted to contact them im-
15 mediately when I found out they indeed had the ownership or
16 they had purchased the acreage.

17 Q Okay, go ahead and continue.

18 A All right. On October 24th, when I
19 talked with Greg Phillips, I went ahead and I prepared my
20 farmout request letter and I offered them a 6-1/4 overriding
21 royalty before payout with an option to convert to a 40 per-
22 cent working interest after payout and at that time the well
23 was tight hole and the only information I could offer them
24 was that casing was in the hole and we anticipated produc-
25 tion within 30 days, and that was the only information I

1 could give them.

2 Q And did you -- what was Mesa Grande's re-
3 sponse to that proposal?

4 A I got a phone call on October 28th, 1985,
5 from Mr. Alex Phillips. He was very upset about the letter
6 and he was concerned that -- by the contents of my letter
7 because I did state that we felt economically that we would
8 have to go to the 240-acre standard proration unit and he
9 was very upset about that.

10 The same date George Mallon called Mr.
11 Phillips, Alex Phillips, to explain that my letter was not
12 a threat and we were just stating a fact and were sorry that
13 we -- we did not intend to pose a threat at all.

14 On October 30th, 1985, I got the letter
15 from Mesa Grande and it stated that they wanted to partici-
16 pate. They were requesting an AFE, a communitization agree-
17 ment, an operating agreement, and all pertinent data.

18 Q How did you respond to the October 30th
19 letter from Mesa Grande Resources where they indicated their
20 willingness to participate in the costs of drilling and com-
21 pleting the well?

22 A I called Greg Phillips and I told them
23 that -- I explained to them again our full story, that
24 everyone who previously has testified in terms of that the
25 40-acre, we were to drill on 40 acres that we could not ap-

1 proach them because we were required to drill on the 40 ac-
2 res.

3 He told me at that time to go ahead and
4 submit the operating agreement and AFE.

5 I told him our idea concerning the prem-
6 ium or the risk factor at that point, and he said for me to
7 go ahead and send it, and that's what I did.

8 Q Okay. And what were the -- what was the
9 date of that next correspondence that you sent, where you
10 sent along an AFE and an operating agreement?

11 A Okay, that was on November 8th, 1985. I
12 went ahead and I mailed the operating agreement. As an at-
13 tached Exhibit F, I attached the AFE.

14 Q And did that AFE propose a recovery or a
15 reimbursement for risk that you had assumed solely?

16 A Yes.

17 Q And what were the -- what was the pro-
18 posal?

19 A We proposed that they pay a 50 percent
20 risk factor on both tangible and intangible costs.

21 Q Okay. What was the response of Mesa
22 Grande Resources to that proposal?

23 A On November 22nd I received a letter that
24 was dated November 20th, 1985, from Greg, stating he felt
25 the risk factor was unwarranted and he wanted me to re-sub-

1 mit a revised AFE eliminating the risk factor.

2 Q Okay, and how did you respond to that re-
3 quest?

4 A I felt that perhaps there was come con-
5 fusion up to this time because in the correspondence that
6 Greg had mailed to me he kept stating that we didn't offer
7 him a share and things like that and we had an opportunity,
8 we should have offered them their share, and I tried to ex-
9 plain to them that we -- we didn't even know that Mesa Gran-
10 de had an interest at the time prior to drilling the well;
11 therefore I felt the letter that I dated November 27th was
12 warranted and I just reiterated all the events that took
13 place up to that point, perhaps as a clarification of Mellon
14 Oil Company's position, and I asked him to re-review the
15 operating agreement and with attached AFE.

16 Q Did Mesa Grande Resources ultimately re-
17 ject your proposal to recover 50 percent premium for risk
18 assumed on all costs incurred?

19 A Yes.

20 Q And then did you submit another proposal
21 to Mesa Grande Resources?

22 A It was -- yes. There was a phone call
23 between George and Greg, George Mallon, Greg Phillips, and
24 Greg had indicated that he felt like a risk factor was not
25 warranted on both tangible and intangible but perhaps only

1 the -- he only wanted us to go ahead and put a 50 percent --
2 well, I should say I don't know. I wasn't involved in the
3 conversation. I can only tell you what Mr. Mallon told me,
4 was that --

5 Q Well, tell me what -- what you ultimately
6 sent as a proposal to Mesa Grande Resources.

7 A Okay. We ultimately sent a proposal and
8 it was dated January 14, 1986, and we put a 50 percent risk
9 factor on the intangible costs only with a zero risk factor
10 on the tangible. And I prepared this letter for Mr. Mal-
11 lon's signature and it was what was my understanding of the
12 phone conversation between Greg Phillips and George Mallon.

13 Q And in your opinion was that proposal
14 made in an effort to obtain the voluntary joinder of Mesa
15 Grande Resources in the participation in this well?

16 A Yes.

17 Q Okay. What was Mesa Grande Resources'
18 response to that proposal?

19 A The response to that proposal, I did not
20 get anything back in terms of anything in writing. All I
21 know is that when I contacted Greg Phillips and (not clearly
22 understood), they came to the office and at that point they
23 had not received this letter, our second proposal concerning
24 the risk factor.

25 And at that point they just told us to go

1 ahead with the -- a Commission hearing.

2 Q And you testified that your last proposal
3 was a 50 percent risk factor, or risk premium on intangible
4 drilling costs. Are those -- were those based on estimated
5 intangible drilling costs or were they based on actual intan-
6 gible drilling costs?

7 A We did not have actual costs at that
8 point. They were AFE.

9 Q Okay. And what's the current status of
10 your dealings -- well, that's not a good question. I know
11 what the current status of your dealings is. We're here.

12 MR. ROBERTS: I have no other
13 questions.

14 MR. STAMETS: Are there ques-
15 tions of this witness?

16 MR. HALL: Yes, Mr. Commis-
17 sioner.

18
19 CROSS EXAMINATION

20 BY MR. HALL:

21 Q Ms. McClintock, what is the basis of your
22 understanding that a 240-acre nonstandard proration unit
23 might be available to Mallon?

24 A I received that information from Kevin
25 Fitzgerald and George Mallon in our office.

1 Q Well, isn't it accurate that you either
2 have the choice of 320 or 40?

3 A That's true, but if you -- my letter
4 states that we would apply. That does not necessarily mean
5 that we would obtain.

6 Q Is there any other reason you sought 240
7 acres?

8 A We did have 240 acres within the west
9 half because we had obtained the A. G. Hill farmout.

10 Q Wasn't it simply because you spoke for
11 240 acres?

12 A I really don't know.

13 Q Who would know that?

14 A Pardon me?

15 Q Who would know that?

16 A I would -- it was Kevin Fitzgerald,
17 George Mallon, in our office that had discussed this and
18 proposed this to me.

19 Q Now, I understand on October 24th, 1985,
20 you wrote to Greg Phillips setting out the offer which was a
21 farmout or you would pose the threat of going to the Commis-
22 sion seeking a 240-acre nonstandard proration unit, isn't
23 that correct?

24 A No, that is not. It was not a threat, I
25 don't feel.

1 I wrote the letter but I did not mean our
2 intent for a threat at all.

3 Q But those were the only alternatives,
4 farmout or 240 acres.

5 A At that point those were the only two al-
6 ternatives we discussed.

7 Q Are -- is it your testimony to me here
8 today, then, that Mesa Grande did not offer to participate
9 in the well by paying its share of costs and contribute its
10 acreage?

11 A No. I said that --

12 Q That is not your testimony?

13 A (Not clearly understood) twice in writing
14 and they told us that they wanted to participate. That was
15 never a question.

16 Q But they did not want to participate vis-
17 a-vis a farmout, is that correct?

18 A That's correct.

19 Q Ms. McClintock, isn't it customary prac-
20 tice in the industry to provide an interest owner with an
21 AFE, an operating agreement, prior to asking him to tender
22 his costs, if you know?

23 A Well, I'm -- I'm -- could you repeat
24 that?

25 Q Do you know what the standard practice in

1 the industry is in that respect?

2 A In terms of --

3 Q Isn't it standard practice to provide an
4 interest owner you're seeking joinder of to give him an AFE
5 and an operating agreement before he's expected to tender
6 his well costs?

7 A Yes, which we did.

8 Q Okay.

9 A We had requested a farmout previously and
10 we do not normally send out an AFE or an operating agree-
11 ment, obviously, for a farmout.

12 Q The first time you provided an AFE or
13 operating agreement was November 8th, isn't that correct?

14 A No, that's not correct.

15 Q When was the first time?

16 A The first time we mailed an operating
17 agreement with attached Exhibit -- I mean F, which is our
18 AFE, was November 8th.

19 Q Yes, which I believe I said, unless I'm
20 mistaken.

21 A Oh, I'm sorry. I thought you said Octo-
22 ber 8th.

23 Q I'm sorry, I may have.

24 MR. STAMETS: I think you both
25 agreed on that date.

1 Q When were your first dealings with North-
2 west Pipeline?

3 A In about June 14th, 1985. I should say
4 it is June 14th, 1985.

5 Q And were you advised at that time that
6 Northwest was putting together a package of properties up
7 for bid?

8 A No, I wasn't. I was just informed that
9 they would not farmout the acreage or sell it.

10 Q When were you aware that they putting
11 that property up for bid?

12 A To be honest with you, I cannot truthful-
13 ly answer that because I don't remember.

14 Q You're an attorney, are you not?

15 A No, I'm not.

16 Q The proceeds from the subject well were
17 escrowed at your direction. Do I understand that correct-
18 ly?

19 A Not necessarily at my direction. I had
20 suggested that perhaps until we had gotten complete title,
21 which I don't know of any oil company that would make a dis-
22 tribution of revenue without a complete, full-blown title
23 opinion, and that was my recommendation.

24 Q Why hadn't been -- why hadn't one been
25 obtained at that time for this well?

1 A I wait till the date of first sales be-
2 fore I request any abstracts. In this case we had obtained
3 a farmout from A. G. Hill. They had absolutely no title re-
4 cords at all in their office so I had to obtain a base ab-
5 stract for the southwest quarter of Section 12, which was
6 very time consuming because it was very detailed.

7 Q I understand you do have a Division order
8 title opinion for the 240 acres, isn't that right?

9 A That's correct.

10 Q You don't have one for the balance of the
11 80 acres.

12 A That's correct.

13 Q Are you seeking one now?

14 A Abstracts for the 80 acres?

15 Q Division order title opinions.

16 A For the remaining 80 acres?

17 Q For the 80 acres, yes.

18 A No, I'm not. I talked with Kathy
19 Michaels in Mesa Grande's office and I again reiterated to
20 Greg that at that point when this is all settled, then I
21 would go forward.

22 Q All right. So you did not rely upon any
23 sort of title opinion in suspending the funds for the 80 ac-
24 res.

25 A No, because there was no need to. Like I

1 said, I didn't have a Division order title opinion and we
2 will not release funds without one.

3 Q Is that company policy?

4 A Yes, it is.

5 Q And as a landman I assume you're general-
6 ly familiar with the statutes governing oil and gas practice
7 in New Mexico, wouldn't that be correct?

8 A Yes.

9 Q Okay, so you're aware of the -- the New
10 Mexico Oil and Gas Proceeds Payment Act?

11 A No.

12 Q The funds are escrowed in a New Mexico
13 institution, are they not?

14 A No.

15 Q Are they in an interest-bearing account?

16 A I don't know. I don't work in accoun-
17 ting.

18 MR. ROBERTS: Mr. Chairman,
19 those questions were previously asked of a witness and were
20 answered.

21 MR. HALL: Of another witness
22 who stated that he did not direct the suspense and I believe
23 this witness has testified that she did in fact direct the
24 suspense.

25 MR. STAMETS: You may proceed.

1 Q To your knowledge is there any third
2 party claim to those proceeds in suspense?

3 A I can't answer that because I have not
4 talked with Texaco.

5 Q Has anyone communicated a claim to those
6 proceeds to anyone at Mallon?

7 A No.

8 Q When you spoke to Northwest and you were
9 advised that those properties would not be farmed out to
10 you, did you pursue that any further with Northwest?

11 A Yes, I did.

12 Q And what did you do?

13 A I contacted them in August. I don't have
14 a specific date for that, and I contacted Warren Curtis at
15 Northwest Pipeline and once again requested a farmout.

16 Q And was that rejected?

17 A Yes, it was.

18 Q For what reason?

19 A He didn't go into any details, just that
20 at this point they were re-reviewing all of their acreage in
21 the area and at this time he could not give me an answer.

22 Q Did -- but he did not expressly reject a
23 farmout, if I understand you correctly.

24 A No, I -- but he did not go on further to
25 say that at the time when they had completely reviewed their

1 acreage they would give us a farmout.

2 Q Did you afford Northwest an opportunity
3 to contribute their acreage to the well and participate in
4 their share of costs?

5 A No.

6 Q Did you threaten to pool their interest,
7 too if they didn't take the farmout?

8 A No.

9 Q So after your last contact with Northwest
10 in August as I understand it, you simply dropped the matter,
11 is that correct?

12 A No, that's not true.

13 Q What did you -- what did you do after
14 that?

15 A At that time we realized that Northwest
16 Pipeline was in the process of putting together -- or at
17 some time we got a copy of the bid package that Northwest
18 Pipeline had mailed out and on October 8th, 1985, Mallon Oil
19 Company bid on the Northwest Pipeline acreage, which in-
20 cluded the acreage in question here in Section 12.

21 Q Okay. And I take it you, too, were aware
22 that there was a pending or probably application to extend
23 the pool rules and provide for 320-acre spacing in the area.

24 A Not until a later date.

25 Q Okay, about when?

1 A I knew of the meeting on September 11th,
2 I knew what they were going down for but I don't have an
3 exact date, you know, of when I knew definitely, you know,
4 obviously until the order came out, then I knew definitely.

5 Q So you were proceeding under the presump-
6 tion that 40 acres was the correct spacing, is that correct?

7 A Yes.

8 Q And why did you contact Northwest in the
9 first place?

10 A Because I'm a landman and I try to obtain
11 additional leasehold interests in the area.

12 Q So your contact with Northwest was not
13 for contribution of their acreage to this well?

14 A At the time we were trying to obtain ad-
15 ditional interests within the area and that was my initial
16 contact with Northwest Pipeline.

17 Q So the answer to my question is no?

18 A Your question again?

19 MR. ROBERTS: Repeat your ques-
20 tion.

21 Q Well, the question is, you did not con-
22 tact Northwest with the idea of seeking their contribution
23 of their acreage to a 320-acre well.

24 A Initially, no.

25 Q Didn't you previously tell me that you

1 offered them a farmout for the well?

2 A Uh-huh, but that --

3 Q Okay, that's all I need.

4 MR. HALL: I have no further
5 questions.

6 MR. STAMETS: Mr. Chavez.

7
8 QUESTIONS BY MR. CHAVEZ:

9 Q Ms. McClintock, what penalty or premium
10 did A. G. Hill interest -- what premium or penalty did the
11 A. G. Hill interest pay?

12 A They did not pay any. It was a straight
13 farmout.

14 Q Are you aware that the revenue interest
15 to any acreage added to this well is effective only as of
16 the date the order is effective that extended the pool?

17 A Yes.

18 MR. CHAVEZ: That's all.

19 MR. STAMETS: Any other ques-
20 tions?

21 She may be excused.

22 I presume that that concludes
23 your direct testimony, Mr. Roberts?

24 MR. ROBERTS: Yes.

25 MR. STAMETS: Scott?

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GREGORY R. PHILLIPS,

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

DIRECT EXAMINATION

BY MR. HALL:

Q For the record please state your name.

A Gregory Phillips.

Q And where do you live?

A Tulsa, Oklahoma.

Q By whom are you employed and in what capacity?

A I am an officer of Mesa Grande Resources.

Q All right. Have you previously testified before this Commission?

A No, sir, I haven't.

Q If you would, please, why don't you give a brief summary of your educational and work experience?

A I graduated from Oklahoma State University in December of 1983. My Bachelor was in chemistry with an emphasis in geology and mathematics.

Q All right, and what has your work experience been since then?

A My work experience has been solely with

1 Mesa Grande Resources. I commenced employment with them as
2 a Regulatory Compliance Agent, Production Manager. At that
3 time I was reviewing operating agreements, unitization agree-
4 ments for errors, corrections and land additions.

5 We had a landman on the payroll who sub-
6 sequently departed for places unknown, and I took over land
7 duties.

8 Q You stated you were an officer of Mesa
9 Grande. What --

10 A I am a Vice President of Mesa Grande.

11 Q -- position is it?

12 MR. HALL: At this point, Mr.
13 Commissioner, we would tender Mr. Phillips as qualified by
14 virtue of education and work experience.

15 MR. STAMETS: I presume you're
16 -- exactly what role are you qualifying him for, basically
17 that of Mr. Mallon, operator?

18 MR. HALL: Yes.

19 MR. STAMETS: He's considered
20 qualified.

21 Q Mr. Phillips, are you familiar with the
22 subject lands and subject application here today?

23 A Yes, sir, I am.

24 Q Let me ask you, when did Mesa Grande ac-
25 quire its interest in the subject areage?

1 A As other people have stated, it's August
2 sometime; however, it's a rather complicated issue.

3 Mesa Grande made a proposal to Northwest
4 Pipeline February of 1984, effective March 1, 1984. We were
5 -- there was an agreement signed, a bill of sale for this
6 acreage, and several thousand other acres.

7 We went to closing. Originally we had a
8 closing for Northwest Exploration property at September
9 17th, 1984, and then we went to a second closing for North-
10 west Pipeline acreage August 14th, 1985.

11 Hours previous to the closing I dis-
12 covered through a very old, obscure document there was pre-
13 ferential right to purchase in this acreage and subsequently
14 the tract which we're discussing today had to be left out of
15 the closing in order to give all parties that had a prefer-
16 ential right of purchase the opportunity to acquire.

17 It was readvertised for bid and as it
18 turned out, we were again the successful bidder, August 8th,
19 I believe, August some -- excuse me, October sometime of
20 1985.

21 Q So Mesa Grande is in fact the owner of
22 the interest in the 80 acres?

23 A Well, the story gets deeper. Northwest
24 Pipeline acquired some interest from Texaco. Texaco made an
25 assignment of operating rights to Northwest Pipeline.

1 Northwest Pipeline sold to Mesa Grande Resources record tit-
2 le. Mesa Grande had not been able to inspect the assignment
3 made from Texaco to Northwest Pipeline and we were informed
4 by the personnel in the legal department of Northwest Pipe-
5 line that all prior assignments were in order and therefore
6 our title assignments would be acceptable to the BLM.

7 Subsequently after filing our record tit-
8 le assignments, the BLM rejected them because Northwest
9 Pipeline did not own record title to 100 percent of the
10 tract. They owned record title to 75 and 25 percent operat-
11 ing rights, and we are in the midst of correcting that right
12 now.

13 Q If you would, please, would you summarize
14 the efforts that Mallon Oil undertook to secure the volun-
15 tary joinder of Mesa Grande's interest in this property?

16 MR. STAMETS: Before you answer
17 that question, let me ask one.

18 Is -- is Mesa Grande, assuming
19 that right now, this afternoon, Mr. Mallon said okay, I'll
20 let you guys in if you'll pay your share and send me a check
21 tomorrow, is Mesa Grande in any -- are you -- I assume you
22 have the money in the bank, are you in the position to do
23 that today or are you --

24 A I have a check in my briefcase. I will
25 write it out if that is the --

1 MR. STAMETS: Okay, so you
2 don't have the kind of problem with BLM that would prevent
3 you from -- from joining in this well today --

4 A No, sir, we don't. It's a matter of mak-
5 ing an operating right assignment as opposed to record tit-
6 le. We have the choice right now of correcting Texaco's as-
7 signment to Northwest Pipeline, which will be done, but in
8 the interim Northwest Pipeline will make an assignment of
9 operating rights to Mesa Grande Resources. There has been
10 an exchange of funds between the two companies.

11 In essence Mesa Grande Resources would
12 have legal recourse should the transaction not transpire,
13 and given these facts, we would be more than willing to par-
14 ticipate today.

15 MR. STAMETS: Sorry.

16 Q One follow-up question in that regard.
17 Has a request for approval of the assignment been filed of
18 record with the BLM for this tract, if you know?

19 A We have discussed it with the BLM, told
20 them what the problem is, and they have suggested that we
21 file an operating right assignment from Northwest Pipeline,
22 which has not been done.

23 Q Okay, BLM is aware of the transaction?

24 A They are aware of what is going on; how-
25 ever, they don't want to change anything.

1 Q If you would, please, Mr. Phillips, I'd
2 like you to summarize for the Commission the efforts that
3 Mallon Oil has undertaken to secure Mesa Grande's participa-
4 tion in this well?

5 A In order to be brief for everyone's bene-
6 fit, Karen did cover it substantially.

7 They initially contacted us in October,
8 October 14th. Karen and I spoke of the situation. I asked
9 her to provide something in writing. I received a letter
10 late in October dated October 24th covering the terms of the
11 farmout which they wanted. They did propose a 6-1/4 over-
12 riding royalty and a 40 percent back-in at payout, and with-
13 in the same letter they suggested that if we were not will-
14 ing to accept that farmout that they would form a substan-
15 dard proration unit around us.

16 Q All right, now you have before you a
17 stack of exhibits that have been marked Opponents Exhibits A
18 through E. Are those the letters you've been referring to,
19 particularly Exhibit A?

20 A Yes, sir. The letter I just covered is
21 marked Exhibit A.

22 Q All right. Why don't you just summarize
23 the history utilizing each of those exhibits, if you would,
24 please?

25 A Okay, I just covered Exhibit A. This was

1 their initial written request for us to join them. The re-
2 quest by virtue of a farmout. They indicated within this
3 letter that the well is tight hole and that the only infor-
4 mation they can release is casing is in the hole. We were
5 able to find out through field sources, all the pumpers know
6 what's going on, that in fact the well had been completed at
7 that point.

8 I responded to her, to Karen McClintock's
9 letter of October 24th with a letter dated October 30th. I
10 suggested to her that we were not interested in granting a
11 farmout and that we would like to participate in the well.
12 I requested at that time an AFE, an approved drilling permit
13 including a C-102, a communitization agreement, and an oper-
14 ating agreement covering the well.

15 I also went on to say that when these had
16 been executed we would expect all pertinent data and sug-
17 gested that she perhaps review some files of their support
18 of Case Number 8713, which was the Gavilan Mancos Pool ex-
19 tension hearing.

20 Q All right. Up until that time you really
21 didn't request, or did you request any tight hole informa-
22 tion?

23 A I don't believe I did. I think a drill-
24 ing permit and the acreage dedication plat is not confiden-
25 tial but I could be mistaken.

1 Q What were you given, if anything?

2 A At this point we had received nothing. In
3 her next correspondence of November 8, which would be the
4 next exhibit marked Exhibit Number C, she did send an oper-
5 ating agreement and an AFE.

6 Q Did that AFE contain a penalty?

7 A Yes. The AFE that we received provided
8 for a penalty throughout all costs of the well including
9 completion and drilling, intangible and tangible.

10 I rejected that offer. Well, I -- what I
11 told her, we had a phone conversation between November 8th
12 and my letter of November 20th, and I told her that I would
13 not be willing to sign the operating agreement or the AFE
14 because of the risk factor that they were requesting.

15 My letter of November 20th again reiter-
16 ated this amount; suggested that we have each time in all
17 contacts indicated our willingness to participate and pay
18 our percentage interest in the well.

19 I requested that she submit a revised AFE
20 eliminating the 50 percent markup and suggested also that we
21 would be in a position to execute all agreements after we
22 had this new AFE.

23 That letter of November 20th is marked
24 Exhibit Number D.

25 On November 27th, or sometime thereafter,

1 we received a letter dated November 27th and Karen within
2 this letter provided me information which she felt was rele-
3 vant to the issues we were discussing.

4 She responded to my inference of the Da-
5 kota-Gallup, Gavilan-Gallup-Dakota Pool extension case, and
6 she also suggested within this letter that Mallon Oil had
7 originally tried to obtain 320-acre spacing.

8 Prior to the discovery of the designated
9 40-acre spacing, she suggests that Mallon had every inten-
10 tion of drilling on 320-acre spacing, even going as far as
11 to contact, excuse me, A. G. Hill and Northwest Pipeline for
12 a farmout.

13 She further suggests that Mallon did not
14 have an option to include the acreage that we were debating
15 because at the time it was owned by Northwest Pipeline and
16 we did not hold record title, or any rights in there at all,
17 which I do not contest.

18 She further suggests in the letter that
19 there were risks involved in drilling the well and closes
20 with that.

21 Subsequent to that, Karen and I had a
22 phone conversation, I don't remember the exact date, and it
23 was more discussion of the letter of November 20th and the
24 pertinent facts of the Commission of what she and the super-
25 visor in Aztec may or may not have discussed. Generally a

1 conversation of the letter but not making any agreements or
2 commitment to one way or the other.

3 After that Mr. Mallon called me on Janu-
4 ary 2nd. He was very polite. He -- it never has been an ar-
5 gumentative issue particularly; it's just that they've con-
6 tended that we should pay a risk and we've contended that we
7 haven't.

8 He suggested that if we could not reach
9 some agreement, that we would let it go to the Commission
10 and let the Commission make the decision. I agreed. I went
11 on to further ask him about how he could assess a risk fac-
12 tor on the completion costs when in a previous conversation
13 between Karen and myself she had indicated to me that the
14 well had not been completed and he responded with, "That's
15 what I told her to tell you."

16 And this is where their supposition that
17 I made a reference to the intangible drilling being only
18 subject to the risk penalty was derived. I don't believe,
19 as I remember the conversation and reference to my notes of
20 it, that I did suggest we would be in a position to accept a
21 risk factor of those costs. I was only questioning why they
22 would be assessing a risk factor on costs that had not yet
23 been incurred.

24 January 14th Karen, as she says, prepared
25 a letter which Mr. Mallon signed and included within it an

1 AFE with some actual cost data and suggested that since the
2 well was virtually free of cost overruns that we ought to
3 accept the risk and go on, the risk penalty.

4 A phone conversation took place thereaf-
5 ter on January 21st and I told her no, that this would not
6 be acceptable and we should refer it to the Commission and
7 here we are today.

8 Q Let me ask you, is it uncommon in the
9 business to receive an AFE and an operating agreement before
10 you're asked to participate in the deal?

11 A No, it's not uncommon to receive those
12 documents. Most likely it is common and for our own company
13 policy whenever we request participation in any form,
14 whether it be farmouts or a direct participation, we would
15 send those documents along.

16 Q Was Mesa Grande really afforded an oppor-
17 tunity to participate by contributing your acreage and pay-
18 ing your proportionate share of the well costs without pen-
19 alty at any time?

20 A Only through virtue of the farmout pro-
21 posal.

22 Q Which is something completely different.

23 A Which is something completely different,
24 which was not acceptable to us. We are a major operator,
25 perhaps I'll relinquish to number two, but we try harder,

1 the largest operator in the area. I think at that point in
2 time that we were dealing with the issue Mr. Mallon insin-
3 uated he'd never heard of us, but we had drilled five wells
4 of our own and then taken over operatorship of two more of
5 Northwest Exploration's, the Gavilan 1 and Gavilan 1-A,
6 which was subsequently changed to Gavilan 3.

7 Our Gavilan Howard Well would have been
8 the sixth well drilled in the field and I find it somewhat
9 difficult for anyone that has a knowledge of the area
10 they're drilling to say they have no awareness of us.

11 Q In your opinion will Mesa Grande's abil-
12 ity to recover, receive its just and fair share of produc-
13 tion from the lands without unnecessary expense be impaired
14 should Mallon's application be granted?

15 A Yes.

16 Q Were Exhibits A through E prepared by you
17 or at your direction or are these kept in your company's
18 files as a normal practice?

19 A These are letters written by myself or by
20 Karen McClintock and are all taken and copied from our
21 files.

22 MR. HALL: At this point we'd
23 offer Exhibits A through E into evidence.

24 MR. STAMETS: The exhibits will
25 be admitted.

1 Are there questions of the wit-
2 ness?

3 MR. ROBERTS: I have some.

4 MR. STAMETS: Mr. Roberts.
5

6 CROSS EXAMINATION

7 BY MR. ROBERTS:

8 Q Mr. Phillips, I interpret your testimony
9 basically to be that you do not believe it's appropriate
10 that you be assessed a risk premium under the circumstances
11 presented in this case, is that accurate?

12 A That is correct.

13 Q What is your judgment as to the risk
14 involved in drilling a well in this area?

15 A I am not an engineer but my judgment is
16 that there is some risk involved. I have followed the
17 drilling of the wells. We are a company that has drilled
18 eight wells in the area now. I have followed them as
19 closely, perhaps, as Mr. Fitzgerald has in the drilling. I
20 try to keep track of cost problems; try to make analyses of
21 ways of avoiding problems; therefore, there are in initial
22 drilling -- let me rephrase, please.

23 If a person were uncommon to the area,
24 new to the area, having never drilled before, there would
25 be some formations that would be difficult to encounter;

1 however, given any amount of drilling experience in the
2 area, I don't believe there is a substantial amount of risk
3 involved.

4 Q And you've -- you all have had some
5 experience in the area, haven't you?

6 A Yes, sir, we have.

7 Q Would you -- could you name some of the
8 wells that you've drilling in the area?

9 A We --

10 Q To the Mancos formation, or -- Mancos or
11 Dakota.

12 A We've drilled the Gavilan Howard No. 1;
13 the Gavilan No. 2, which was drilled and operated by E. Alex
14 Phillips; the Brown No. 1; the Marauder No. 1; the Hellcat
15 No. 1; the Bearcat No. 1; the Invader No. 1.

16 Q Did you experience any lost circulation
17 problems on the Gavilan Howard No. 1 Well?

18 A We experienced in the Gallup formation a
19 loss of, as I remember, in the range of 100 to 150 barrels
20 of drilling fluids.

21 Q What kind of experience did you have with
22 your Gavilan No. 2 Well?

23 A In the drilling process there is -- there
24 is some lost circulation in the wells but to us it's not a
25 detriment as long as it's controlled because this is a good

1 indication of productive intervals.

2 As a comparison study, I've been involved
3 with a well in Oklahoma that has lost thousands and thous-
4 ands and thousands of barrels of fluid and I don't believe
5 anything less than a couple hundred barrels of fluid is a
6 quote/unquote lost circulation problem/

7 Q Isn't it -- wouldn't it be accurate to
8 say that your total costs incurred on the Gavilan No. 2 Well
9 to date exceeded \$900,000?

10 A Yes. The Gavilan 2 Well has been a sig-
11 nificant problem; has been quite costly, that had nothing to
12 do with the drilling of the well.

13 Q And isn't it true that the well is not
14 even -- has not produced at this point?

15 A It has produced. It has not produced as
16 well as we would have liked. It's to date marginal but we
17 have sunk money into it and with oil increases I think we
18 can make a living with it.

19 Q What kind of costs did you incur on the
20 Gavilan Howard No. 1 Well?

21 A Final cost on that well was approximately
22 \$750,000.

23 Q I want to place you in a hypothetical
24 situation based on your -- your expertise as an operator.

25 If you were involved in a pre-drilling

1 forced pool situation in this area and you were -- you were
2 the proposed operator of a well which was proposed to be
3 drilled to the Mancos formation, would you seek a risk pen-
4 alty?

5 A If we had contacted the party of which we
6 were force pooling and they had refused to participate, yes.

7 Q What amount would you seek? Would you
8 seek the maximum permissible in the statutes?

9 A Yes, sir, we would. We'd probably seek
10 something which would initiate their cooperation.

11 Q And wouldn't it be your judgment that if
12 you were going to obtain that risk that you requested it
13 would have to be some way related to the true risk involved
14 in the area?

15 MR. HALL: I'll object to the
16 question. It's vague as to form --

17 MR. ROBERTS: I'll rephrase it.

18 MR. HALL: -- and we haven't --

19 MR. ROBERTS: You're not ob-
20 jecting to his ability to answer the question, are you?

21 MR. HALL: Well, the question
22 has been propounded within the context of being a hypotheti-
23 cal.

24 MR. ROBERTS: Yes.

25 MR. HALL: We object in that

1 the question is directed towards this specific area at this
2 time.

3 MR. STAMETS: Well, I didn't
4 understand the question, so if you'll --

5 MR. ROBERTS: Okay.

6 MR. STAMETS: -- rephrase it
7 then we can all see it together.

8 MR. ROBERTS: Okay.

9 Q If you were seeking a risk penalty in
10 that situation, would you accept the -- my statement that
11 you would have to come before the examiner or the commission
12 and show that a risk truly existed before you'd be able to
13 have a risk penalty awarded?

14 A In a pre-drilling situation?

15 Q Yes.

16 A Yes.

17 Q Okay. What would you do if you were in
18 Mallon's position in a case like this?

19 A We have been in Mallon's position.

20 Q What have you done?

21 A And it was very early in the Gavilan Man-
22 cos Pool formation. We drilled the Gavilan Howard Well. It
23 was approved by Mr. Chavez' office on 160 acres.

24 Subsequent to the drilling of the well we
25 were required to respace for 320, which took in acreage

1 owned by Northwest Pipeline, Dugan Production Corporation,
2 and A. G. Hill.

3 We proposed farmouts to all parties. Mr.
4 Hill farmed out. Northwest Pipeline, Mr. Dugan chose to
5 participate. We sent them an AFE, an operating agreement,
6 and we allowed them to participate on a heads up cost.

7 Q Are you saying that you wouldn't seek a
8 premium in that situation?

9 A We -- it has already transpired and we
10 did not seek any premium.

11 Q If you were confronted with that situa-
12 tion again would you seek a premium?

13 A I don't believe that we've got the capa-
14 city to dictate to the state how they spaced an area, al-
15 though we've tried. We communicated with parties. We felt
16 like it was our bad luck for drilling. Northwest Pipeline
17 at that point had drilled three wells, at least two that I
18 know of that had to be respaced.

19 I believe Mr. McHugh, Jerome P. McHugh
20 had drilled the Native Son No. 2 at that point that had to
21 be respaced.

22 Of all the wells at that point that had
23 been drilled that required respacing, not only Mesa Grande
24 but none of the other operators requested a risk factor from
25 any of the parties spaced into their wells.

1 Q Mr. Phillips, are you familiar with the
2 application of Mesa Grande Resources in Case 8897 before the
3 Examiner that was heard on May 14th, I believe, of this
4 year, where you sought to force pool interests, I believe,
5 in the Pictured Cliffs formation in Section 5, Township 25
6 North, Range 2 West?

7 A I am.

8 Q And was that a pre-drilling situation
9 there?

10 No, it was not; however I don't feel like
11 it's relevant.

12 Q Well, in that case --

13 A Am I allowed to express an opinion?

14 Q Sure. In that case what kind of a risk
15 penalty did you seek?

16 MR. HALL: If you know the an-
17 swer.

18 A I do not know the answer. I could make a
19 guess.

20 Q Well, did you seek a 200 percent risk
21 factor?

22 A I believe it was a 200 percent.

23 Q And the well was drilled and completed --

24 A Yes.

25 Q -- at the time?

1 A Yes, sir.

2 Q How do you justify that position in con-
3 junction with the position you've taken here today?

4 A I justify it in the fact that we had pro-
5 posed the well to Chevron and we had given them the alterna-
6 tive, number one, to farm out under given terms. We had
7 given them the alternative to participate on a heads up cost
8 and we have given them the alternative to go nonconsent un-
9 der pre-prescribed terms within the operating agreement.

10 They sent us a letter back and said, we
11 don't want any of your alternatives. We're going to sit and
12 wait and see what happens.

13 Their response to us was antagonistic;
14 therefore we chose to approach it from a less than congenial
15 --

16 Q But in that case you believed that you
17 incurred the complete risk for the --

18 A Let me say this, Mr. Roberts. Are we not
19 crossing two cases? I mean what relevance does this have
20 with --

21 Q I think it has a lot of relevance to --
22 to your position in terms of whether a risk premium is ap-
23 propriate in this case, and --

24 MR. HALL: Well, I'm going to
25 object to counsel's testifying.

1 MR. STAMETS: Yes, it's --

2 A I think that it -- since there has not
3 been an order --

4 MR. STAMETS: Excuse me, gen-
5 tlemen, if each of you, all of us, would allow us to go one
6 at a time it will make for a better record and attorneys
7 don't need to be testifying.

8 A I might suggest that since there has not
9 been an order passed on that case that it would not be ap-
10 propriate for me to sit and discuss it.

11 Q So are you saying you're not going to an-
12 swer any more questions --

13 A I will --

14 MR. HALL: I object to that
15 question.

16 A I will object to that question. If you
17 care to ask --

18 Q You're going to object to the question?

19 A If you care to ask more questions I will
20 object to them one by one.

21 Q Well, that's pretty nice when you can ob-
22 ject to the questions. Mr. Phillips.

23 A Well, go ahead, and I'm just -- you're
24 putting me in a position to testify or make a statement upon
25 a case which has no relevance to you.

1 Q Isn't your position in that case, which
2 has similar, some similar characteristics to this one, where
3 you incurred all of the risk associated with the drilling
4 and completion of that particular well --

5 A Yes.

6 Q At this point would you concede that you
7 are seeking to be compensated for that risk that you as-
8 sumed?

9 MR. HALL: I'm going to object
10 to the question. It's been asked and answered and it's also
11 --

12 MR. ROBERTS: I don't think it
13 has been answered --

14 MR. HALL: -- irrelevant.

15 MR. ROBERTS: -- and it is rele-
16 vant.

17 MR. STAMETS: I understood that
18 the answer to the question was that it was a different sit-
19 uation in that Mesa Grande had given Chevron three different
20 options to join in the well, one of which was to pay their
21 share --

22 MR. ROBERTS: The question
23 doesn't --

24 A Prior to the drilling of the well.

25 MR. STAMETS: -- which is one

1 of the options that Mesa Grande would like here.

2 MR. ROBERTS: Yes. The question
3 doesn't go to the options that were provided. It goes to an
4 indication of what Mesa Grande Resources feels it is entit-
5 led to --

6 A I will answer the question.

7 MR. ROBERTS: -- after having
8 assumed that risk.

9 MR. HALL: I'm going to restate
10 my objection. It's irrelevant and I'm going to object to
11 this whole line of testimony and questioning.

12 MR. TAYLOR: Quit arguing --

13 MR. STAMETS: That's good ad-
14 vice. Let me say that since the case has come up that I'll
15 review that case subsequent to today's hearing and determine
16 whether or not there's any relevance.

17 A May I respond further?

18 MR. HALL: Let me ask if
19 there's been a ruling to my objection.

20 MR. STAMETS: Yes, your objec-
21 tion is sustained with the provision that I do plan to look
22 at the case and see if there's relevance.

23 Q Mr. Phillips, I have one -- one last
24 question.

25 Let's assume again, and I want to put you

1 in your role as an expert operator --

2 A I don't profess to be an expert operator.
3 I profess to be an operator.

4 Q Well, you're qualified for an expert --

5 A Thank you.

6 Q -- and if you were confronted with a
7 situation here where the actual costs incurred by Mallon Oil
8 Company on this Johnson Federal 12-5 Well were in the range
9 of \$1.5-million instead of \$565,000 as actual costs have
10 come out, would you want to join in that well?

11 MR. HALL: I'm going to object.
12 It calls for speculation.

13 MR. STAMETS: I'm sorry, I was
14 discussing something our departing attorney and you're going
15 to have to tell me what it is that you're objecting to.

16 MR. ROBERTS: I can repeat the
17 question, if that would be the best way to handle it.

18 I asked Mr. Phillips if he were
19 confronted with a situation, hypothetical situation, where
20 the actual costs incurred in drilling and completing the
21 Johnson Federal 12-5 Well were on the order of \$1,500,000 as
22 opposed to the actual costs of \$565,000, whether he would
23 elect to participate in that well at this point in time
24 given these circumstances.

25 MR. HALL: And I'm going to re-

1 state my objection as calling for speculation and we have
2 previously objected to any line of questioning with respect
3 to participation vis-a-vis, the risk involved and the costs
4 involved in the confines of this hearing today.

5 A May I make a comment on an answer to the
6 question that may be relevant.

7 MR. STAMETS: Just hold that a
8 second.

9 MR. HALL: Mr. Examiner, Mr.
10 Commissioner, I think it will expedite matters, we'll with-
11 draw our objection to this particular question only.

12 MR. STAMETS: Okay, good. That
13 will expedite matters.

14 A I will answer it. We agreed to partici-
15 pate on first communication and we had no idea what costs
16 were or production levels were at that point. Until today I
17 had no idea what production levels were. We have never,
18 never, prior to today in this hearing known what actual
19 costs were and we have, each time we've been contacted,
20 agreed to participate for cost.

21 Q Let me ask the question again because I
22 don't believe that that was responsive to the question.

23 MR. STAMETS: I understood him
24 to say, yes, he would.

25 MR. ROBERTS: Okay, if that's

1 what you understood.

2 MR. STAMETS: Was that your an-
3 swer? Yes, if it was \$1-million you'd pay your share today?

4 A Yes, sir.

5 MR. STAMETS: Yes, sir.

6 MR. ROBERTS: I hope you get
7 that chance sometime.

8 I have no other questions.

9 A Hope it's offered sometime.

10 MR. STAMETS: Are there other
11 questions of the witness?

12 Mr. Chavez.

13

14 QUESTIONS BY MR. CHAVEZ:

15 Q I want to clear up a point. Mr. Phil-
16 lips, the original wells that are being offered by Mesa
17 Grande in the area, were they drilled and operated under the
18 name Mesa Grande originally?

19 A Mesa Grande Resources.

20 Q Or Mesa Grande Resources?

21 A Yes, sir.

22 Q Okay.

23 A If you're referring to Gallup wells. We
24 have two wells drilled within the area to the Pictured Cliff
25 horizon, which are operated by NANCO, which is an affiliated

1 entity.

2 Q And I'll ask you to recollect again, if
3 you recall that any wells were drilled and operated under
4 the recorded name of E. Alex Phillips?

5 A Yes, sir. I'd thought I said that the
6 Gavilan 2 Well was operated and drilled under E. Alex Phil-
7 lips.

8 MR. CHAVEZ: That's all I have.

9 MR. STAMETS: Other questions.

10 A I was including that in the number of
11 wells with Mesa Grande. E. Alex Phillips is the president
12 of Mesa Grande.

13 MR. HALL: Mr. Commissioner,
14 that concludes the opponent's case.

15 We have a few brief closing
16 comments but in view of the time we'll be pleased to submit
17 those via letter.

18 MR. STAMETS; That sounds like
19 an outstanding idea.

20 It seems to me that much of
21 what we are discussing here today hinges around the legali-
22 ties, or legal interpretation, or the meanings of the stat-
23 utes, particular 70-2-17 (C), especially the second para-
24 graph.

25 That paragraph talks about or-

1 ders which we might issue. It talks about those orders
2 being under terms and conditions that are just and reason-
3 able, and also providing the opportunity for the interest
4 owners to recovery their share without unnecessary expense.

5 In the latter part of that par-
6 agraph it goes on talking about pooling orders making provi-
7 sions as to owner or owners who elect not to pay their pro-
8 portionate share in advance and what does that language mean
9 in a situation like this.

10 Okay, and then also the sen-
11 tence which includes the line "may include a charge for risk
12 involved in the drilling of such well". This is, to my
13 knowledge, the first case of this type which the Commission
14 has faced. Perhaps there is one other in Case 8897, I'm not
15 clear on that, and so we may set some precedents in this
16 case and I certainly would like to do it right.

17 In addition to any briefings
18 you would like and which you would make on that, a proposed
19 form of order could be very helpful.

20 MR. ROBERTS: Do you have a
21 time frame for when you'd want those? I've got a problem in
22 that I'm not going to be back in my office for about ten
23 days, so if you could give us some kind of a time guideline
24 that would accommodate that situation, I would appreciate
25 it.

1 MR. STAMETS: Normally after a
2 hearing like this we would be signing orders at the next
3 Commission Hearing, which in this case will be June 19th.

4 If we could have that informa-
5 tion, let's see, two weeks, this is the -- what is today --
6 I don't have my calendar here, what's -- well, if we have it
7 by the 9th of June, that should be sufficient time to look
8 that over and get an order by the time of the hearing.

9 Let's see, June 9th is a Monday
10 and that ought to be fine.

11 Is there anything further in
12 this case?

13 MR. ROBERTS: Thank you.

14 MR. STAMETS: We appreciate
15 everybody and the hearing is taken under advisement and the
16 hearing is adjourned.

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18 (Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY
CERTIFY that the foregoing Transcript of Hearing before the
Oil Conservation Division (Commission) was reported by me;
that the said transcript is a full, true, and correct record
of the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR