

## STATE OF NEW MEXICO

## ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

## OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY )  
 THE OIL CONSERVATION DIVISION FOR THE )  
 PURPOSE OF CONSIDERING: )

CASE NO. 12,171

APPLICATION OF GILLESPIE OIL, INC., FOR )  
 UNIT EXPANSION, STATUTORY UNITIZATION )  
 AND QUALIFICATION OF THE EXPANDED UNIT )  
 AREA FOR THE RECOVERED OIL TAX RATE AND )  
 CERTIFICATION OF A POSITIVE PRODUCTION )  
 RESPONSE PURSUANT TO THE "NEW MEXICO )  
 ENHANCED OIL RECOVERY ACT", LEA COUNTY, )  
 NEW MEXICO )

ORIGINAL

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 OIL CONSERVATION DIV

REPORTER'S TRANSCRIPT OF PROCEEDINGSEXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

May 27th, 1999

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 27th, 1999, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

\* \* \*

STEVEN T. BRENNER, CCR  
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 Examiner Hearing  
 CASE NO. 12,171

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(Continued...)

## A P P E A R A N C E S (Continued)

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By: PAUL A. COOTER

ALSO PRESENT:

PHILLIP GLENN ADAMS and DONNA ADAMS  
Lovington land owners

\* \* \*

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1           WHEREUPON, the following proceedings were had at  
2   8:22 a.m.:

3           EXAMINER STOGNER: At this time I believe we're  
4 ready to call Case Number 12,171

5           MR. CARROLL: Application of Gillespie Oil, Inc.,  
6 for unit expansion, statutory unitization and qualification  
7 of the expanded unit area for the recovered oil tax rate  
8 and certification of a positive production response  
9 pursuant to the "New Mexico Enhanced Oil Recovery Act", Lea  
10 County, New Mexico.

11          EXAMINER STOGNER: Call for appearances.

12          MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,  
13 representing the Applicant and Charles B. Gillespie, Jr.

14          MR. HALL: Mr. Examiner, Scott Hall from the  
15 Miller Stratvert Torgerson law firm, Santa Fe, on behalf of  
16 Energen Resources Corporation, with two witnesses this  
17 morning.

18          MR. CARR: May it please the Examiner, my name is  
19 William F. Carr with the Santa Fe law firm Campbell, Carr,  
20 Berge and Sheridan. I'd like to enter our appearance on  
21 behalf of Hanley Petroleum, Inc., and Yates Petroleum  
22 Corporation.

23                 I will have one witness for Yates Petroleum  
24 Corporation and would like to make a statement at the  
25 conclusion of the hearing on behalf of Hanley.



1 MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of  
2 the Santa Fe law firm of Kellahin and Kellahin, appearing  
3 on behalf of Snyder Ranches, Inc., and Mr. Larry Squires.

4 EXAMINER STOGNER: Do you have any witnesses?

5 MR. KELLAHIN: No, Mr. Examiner.

6 MR. COOTER: Paul Cooter, appearing on behalf of  
7 David H. Arrington and David H. Arrington Oil and Gas, Inc.  
8 I have no witnesses.

9 EXAMINER STOGNER: Any other appearances?

10 Mr. Bruce, how many witnesses do you have?

11 MR. BRUCE: I have two, possibly three witnesses.

12 EXAMINER STOGNER: Okay.

13 At this time let's swear the witnesses in. Let's  
14 have all six of them, is my count, go ahead and stand to be  
15 sworn.

16 (Thereupon, the witnesses were sworn.)

17 EXAMINER STOGNER: I believe we probably would  
18 require some opening statements at this time, also to  
19 perhaps summarize what we're doing here.

20 MR. BRUCE: Yes, Mr. Examiner. My opening  
21 statement is essentially a history of the pool and the  
22 unit.

23 EXAMINER STOGNER: Good.

24 MR. BRUCE: May it please the Examiner, I would  
25 like to give a history of the West Lovington-Strawn Pool

1 and the West Lovington-Strawn Unit before we begin  
2 presenting witnesses.

3 Mr. Examiner, Charles Gillespie began putting  
4 together a leasehold block in this immediate area in the  
5 mid-1980s. The key property was Unit Tract Number 1, which  
6 is the Hamilton Federal lease. Mr. Gillespie spent years  
7 and years obtaining a farmout from Phillips Petroleum in  
8 that tract. Once that farmout was obtained in the early  
9 1990s, drilling began.

10 The West Lovington-Strawn Pool was discovered in  
11 June, 1992, by the Hamilton Federal Well Number 1, which is  
12 now the Unit Well Number 1, located in the southwest of the  
13 southeast of Section 33, Township 15 South, Range 35 East.

14 After that well was drilled in late 1992, special  
15 pool rules were sought for the pool. Order Number R-9722  
16 increased spacing from 40 to 80 acres with a depth bracket  
17 allowable of 445 barrels of oil per day. That allowable  
18 was later reduced to 250 barrels of oil per day under Order  
19 Number R-9722-C. The gas-oil ratio remains at statewide  
20 2000 to 1.

21 Mr. Examiner, I know you were involved in some of  
22 these hearings. If you'll recall, Mr. Gillespie wanted to  
23 call the pool the Patience-Strawn, due to his patience in  
24 putting together this prospect. The Division originally  
25 called the pool the East Big Dog-Strawn, which Mr.

1 Gillespie objected to because he thought it was a  
2 derogatory name. The Division compromised by renaming the  
3 pool the West Lovington-Strawn.

4 Now, ten additional wells were drilled in the  
5 pool by 1995. However, as early as April, 1993, Mr.  
6 Gillespie and Enserch Exploration, the largest working  
7 interest owners in the pool, began considering a pressure-  
8 maintenance project due to the rapid pressure depletion in  
9 this solution gas drive reservoir.

10 Wells in the pool were produced at top allowable  
11 very early in the life of the pool. However, due to the  
12 pressure decline, Mr. Gillespie, who is the only operator  
13 in the pool, voluntarily curtailed production to 100  
14 barrels of oil per day per well, in May, 1994, which is  
15 about a year and a half before the pressure-maintenance  
16 project began.

17 At that time, the reservoir was approaching  
18 critical gas saturation, and the depletion of the  
19 reservoir's bottomhole pressure had to be slowed down. If  
20 wells had continued to produce at top allowable, critical  
21 gas saturation would have been reached before the pool was  
22 unitized. Had that occurred, free gas within the reservoir  
23 would have become mobile, and the producing GOR would have  
24 increased rapidly, depleting the reservoir of its main  
25 energy drive.

1           If that had occurred, oil production would have  
2 rapidly declined, and a significant volume of the original  
3 oil in place would not have been recovered. In fact, we  
4 probably wouldn't be here today if production had not been  
5 restricted in 1994. There would be nothing to argue about,  
6 because the reservoir would have been depleted.

7           A unit was proposed, and in June, 1995, a hearing  
8 was held before the Division, resulting in Order Numbers  
9 R-10,448 and R-10,449, approving statutory unitization and  
10 a gas-injection pressure-maintenance project for the unit.

11           Unitization took about a year and a half to  
12 accomplish.

13           I see you have Exhibit 1 in front of you. This  
14 is the hydrocarbon pore volume or HPV map, adopted by the  
15 Division in the original unitization hearing. The reason  
16 this map is important is because tract participations were  
17 based on HPV under each tract.

18           Now, the unit operator and Enserch had proposed a  
19 different map, but a royalty owner appeared and objected,  
20 and the Division adopted this map, this Platt-Sparks map,  
21 as the basis for allocating hydrocarbons.

22           After the Division's order, the unit operator  
23 sought ratifications, and the unit became effective October  
24 1, 1995.

25           If you can refer to Exhibit 2, Mr. Examiner,

1 after the unitization hearing there was additional  
2 development. The Chandler well Number 1, which is in the  
3 south half, southeast of Section 28, Unit Tract 14, was  
4 drilled, and the State "S" Well Number 1 in Unit Tract 13  
5 was drilled. These wells at the time were outside the  
6 unit's boundaries. They extended the reservoir's  
7 boundaries as then known, and the two new wells were later  
8 determined to be in pressure communication with the unit's  
9 reservoir.

10 The unit operator applied for a unit expansion,  
11 and these two wells were brought into the unit effective  
12 November 1, 1997.

13 Mr. Carroll, could I answer -- ?

14 MR. CARROLL: Where's Tract 13?

15 MR. BRUCE: Over on the east side of the unit.

16 MR. CARROLL: Oh, I see.

17 MR. BRUCE: The unit expansion order was Order  
18 Number R-10,864, and this expansion took about a year, a  
19 year and a half, to accomplish.

20 Now, Exhibit 2 is the HPV map adopted by the  
21 Division in that hearing. Again, unitization was hotly  
22 contested, and unitization did not become effective until  
23 months after the expansion hearing, because ratifications  
24 had to be obtained from additional interest owners.

25 Injection of gas into the unitized formation

1 began in October, 1995. By that time, the bottomhole  
2 pressure in the reservoir was about 3300 p.s.i. As of May  
3 1, 1999, a total of 6.4 BCF of gas has been injected into  
4 the reservoir.

5 As a result of the gas injection, bottomhole  
6 pressure, as of the latest measurements just a few weeks  
7 ago, is now about 3220 p.s.i. Therefore, there has been a  
8 drop of only 70 or 80 p.s.i. over the last three and a half  
9 years, even though 2.38 million barrels of oil have been  
10 produced from the reservoir since injection began. We  
11 believe that, in short, pressure maintenance was approved  
12 in time to prevent harm to the reservoir.

13 In March, 1998, Charles Gillespie drilled the  
14 Snyder "C" Well Number 4. Mr. Examiner, maybe you'd like  
15 to look at Exhibit 3 at this time. This is another HPV  
16 map. The "C" Number 4 is in proposed Tract 17 on the  
17 southeast side of the reservoir. It is located in Lot 1 of  
18 Section 6, 16 South -- I believe that's 36 East.

19 At a working interest owners' meeting last fall,  
20 Dave Boneau of Yates Petroleum proposed the formation of a  
21 technical committee to consider unit expansion and related  
22 matters. Pressure testing was also approved at that  
23 meeting, which showed that the "C" 4 well was in the West  
24 Lovington-Strawn Pool.

25 Also, the technical committee reconsidered and

1 proposed inclusion in the unit of the Snyder "EC" Com Well  
2 Number 1, and that well is in Tract 16, just to the  
3 southwest of the "C" 4 well. Now, this well was completed  
4 in March of 1996. It has never been a prolific producer  
5 but it does produce about 40 barrels of oil a day on pump.

6 As a result of the technical committee meetings,  
7 we're now before the Division seeking a second expansion of  
8 the unit. Based on the meetings of the technical agreement  
9 [sic], I believe there's general agreement on a number of  
10 issues.

11 First, although there is some dispute, we believe  
12 that substantial additional acreage should be added to the  
13 unit.

14 Furthermore, the parties agree -- or at least the  
15 technical committee agreed that the Snyder "C" 4 well and  
16 the Snyder "EC" Com well should be included in the unit.

17 There is also general agreement on changing the  
18 tract participation formula. Previously, it was based on  
19 essentially 100 percent HPV. The proposal today will be  
20 based on 80 percent HPV plus 20 percent well factor, which  
21 will be explained to you later.

22 Another area of agreement is specifically  
23 providing in the unit agreement that gas purchased for  
24 injection be recovered by the working interest owners who  
25 paid for it. In other words, there would be a split

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1 because there are different interest owners now than there  
2 were before the unit expansion.

3 Another item of agreement is trying to resolve  
4 how Tract 15, owned by Hanley Petroleum, may best be  
5 brought into the unit. And Mr. Carr will address that  
6 later.

7 There are areas of disagreement. These are  
8 primarily the exact extent of the acreage to be brought  
9 into the unit, at what percentage of payout wells should be  
10 brought into the expanded unit, and how to treat a new well  
11 now being drilled by Energen Resources Corporation in the  
12 second expansion area. And Mr. Examiner, if you'll look at  
13 Exhibit 3, proposed Tract 21, Energen has a well located in  
14 that tract on the east side of the unit, to the northeast  
15 of the Snyder "C" 4 well.

16 Mr. Hall, in one of his pleadings, stated that  
17 the history of this unit has been difficult, and I think  
18 Dave Boneau's comments at the beginning of this will only  
19 serve to confirm that.

20 However, I believe that the best course of action  
21 at this point is for the Division to review the evidence,  
22 make a decision, and for the unit operator to seek  
23 ratifications from the interest owners of that decision. I  
24 believe this has worked in the past, and I believe it will  
25 work again.



1           My first witness will discuss unit production and  
2     introduce the technical committee proposal, and I think the  
3     best course of action is to let all parties discuss the  
4     technical committee proposal. I do have a witness at the  
5     end to discuss two issues which Mr. Gillespie individually  
6     wishes to present.

7           At that, I'd turn it over to anyone else for  
8     their opening comments.

9           EXAMINER STOGNER: Thank you, Mr. Bruce.

10          MR. HALL: Mr. Stogner, on behalf of Energen, let  
11     me make precisely clear, it's Energen's position that we  
12     wish to see this expansion issue resolved just as soon as  
13     it can be.

14          At the same time, Mr. Examiner, it's our view  
15     that this hearing today is premature, and that's why we had  
16     filed our Motion for continuance earlier. The reason we  
17     had done that, Mr. Examiner, there are issues out there of  
18     sufficient disagreement that we think will prevent  
19     ratification of this unit under the expansion proposed by  
20     the unit operator.

21          When you as the Examiner, with your Counsel,  
22     examine issues brought before you, you need to be cognizant  
23     of two operative statutes under the Statutory Unitization  
24     Act. They are Sections 70-7-9 and 70-7-10. Those two  
25     sections in particular address the procedures for approving

1 the expansions of previously existing units. Those the  
2 sections at play here today in which, because of the  
3 disagreement on the few remaining issues, I believe will  
4 prevent ratification of this proposal, which again makes  
5 this hearing today premature.

6 I think we're all in agreement that this unit  
7 expansion process has been long, it has been difficult, and  
8 I'd be the first to say that all the parties have worked  
9 diligently to try to resolve all of these issues. They've  
10 worked very hard at it.

11 When the technical committee was formed last  
12 November, it had six or seven meetings through March of  
13 this year, and they came upon an agreement for unit  
14 boundaries, allocation of pore volume and what we thought  
15 was tract participation.

16 Once the technicians took their work to the  
17 lawyers, it was a very difficult task incumbent upon the  
18 lawyers to try to present the owners with a formula that  
19 could be ratified by everyone.

20 I certainly do not mean to slight to draftsmen of  
21 the proposed amendment to the unit agreement addressing the  
22 tract participation formula, but I must say that I don't  
23 think the proposed formula accurately reflects what the  
24 technical committee agreed to. For that reason, primarily  
25 that reason, I think ratification will be precluded until

1 those issues are addressed, until they are resolved.

2 Briefly, Mr. Examiner, through the course of  
3 testimony today you will hear how to reach an accommodation  
4 on the inclusion of all these tracts. One tract is  
5 particularly problematic. It had an expiring lease for  
6 which an extension was obtained. The parties agreed to  
7 reallocate pore volume in a certain way. It's very  
8 difficult how they got there, but I think they have general  
9 agreement on that.

10 However, to do that, under the formula proposed  
11 by the unit operator, it will require a reallocation of  
12 participation among a previously existing tract. And  
13 that's why I say you as the Examiner need to be cognizant  
14 of the operation of Section 70-7-9 and 70-7-10 of the unit  
15 agreement. That is the primary issue you're going to have  
16 to deal with today.

17 There are other collateral issues. There is the  
18 issue of the propriety of bringing in previously drilled  
19 wells in the expansion area in excess of 100 percent  
20 payout. That particular issue is beyond the ambit of the  
21 Application that's filed here today, but I think it still  
22 has a bearing on this case. It may affect ratification, it  
23 may not. We may answer that question today. But that is  
24 just one more reason why we think this proceeding today is  
25 premature. And again, we would request that this matter be

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1 continued until these issues are resolved by participation  
2 of the technical committee and their principals and their  
3 counsel.

4 EXAMINER STOGNER: Is that all, Mr. Hall?

5 MR. HALL: Yes, sir.

6 EXAMINER STOGNER: Anybody else?

7 MR. KELLAHIN: Yes, sir.

8 EXAMINER STOGNER: Mr. Kellahin.

9 MR. KELLAHIN: Mr. Examiner, I'm here today on  
10 behalf of Snyder Ranches, Inc., and Larry Squires.

11 If you'll refer back to Exhibit 3, which is the  
12 proposed exhibit from Gillespie, it shows the tract  
13 configurations as the Applicant seeks to have the unit  
14 extended. Let me identify for you the tracts for which  
15 Snyder Ranches is the royalty owner. They are Tract 6,  
16 which is currently in the unit. They include in the  
17 proposed expansion area Tract 16, 17, 22, 23 and Tract 27.

18 We concur and support Mr. Bruce's opening  
19 statement on behalf of Gillespie, and my purpose is to  
20 supplement his comments.

21 Mr. Bruce referred to his first map that  
22 Gillespie will introduce, and he referred to it as the  
23 royalty owners' pore volume map. That was Snyder Ranches'  
24 pore volume map.

25 I respectfully disagree with Mr. Hall about the

1 fact that this case is premature, Mr. Examiner; it is not.  
2 The history of this statutory unitization is one where the  
3 Division has made some ultimate decisions for which the  
4 interest owners at the time could not reach voluntary  
5 agreement.

6 And if you go back to Case 11,195, the original  
7 unitization case back in June of 1995, that order is a  
8 detailed summary of what occurred at that point in time.  
9 It's Order Number R-10,449.

10 And when you read that order and look at the  
11 transcripts and the exhibits, you'll see very clearly and  
12 quickly that there was a fundamental difference between  
13 Snyder Ranches and with Gillespie-Crow about the  
14 hydrocarbon pore volume distribution. And you will see  
15 that that issue was resolved by the Division adopting the  
16 Snyder Ranches' pore volume map. They rejected the  
17 Gillespie-Crow pore volume map.

18 And as a part of that decision, then, the  
19 participation formula and the tract parameters were  
20 adjusted using the Snyder Ranch map. That matter was in  
21 dispute. It was no guarantee that it would be ratified  
22 with that significant change. And despite that dilemma,  
23 the parties ratified and approved the original unit.

24 Again, the hydrocarbon pore volume map became an  
25 issue. And it became an issue in August of 1996 in Case

1 11,599. That's Order Number R-10,448-A, and that is the  
2 order that resulted in the separation of the West  
3 Lovington-Strawn Pool from the Big Dog. And when you look  
4 at the maps and look at the order, you can see what's  
5 happening in terms of changing the size and the shape of  
6 the pore volume map. You'll see that the pore volume maps  
7 are in disagreement.

8 The Division entered that order, and then we  
9 proceed to the next significant case. It's the first  
10 expansion case, Case 11,724. It's Order Number R-10,864,  
11 again a comprehensive, detailed outline, the chronology and  
12 a history of the disputed facts. It should be the  
13 benchmark of where you make your decision, based upon  
14 today's case.

15 Again you'll see that you have the unusual  
16 situation where the unit operator and a substantial portion  
17 of the interest owners were in disagreement. It's not the  
18 conventional unit case where there's a substantial  
19 agreement as to what that -- needs to happen. When you  
20 look at those pore volume maps, you'll see that there is a  
21 substantial difference.

22 What happened is that the Hanley-Yates pore  
23 volume map and their strategy was rejected. The pore  
24 volume map that Mr. Bruce showed you -- it's Exhibit Number  
25 2 in his case today -- shows you what happened.

1           The end result is Tract 14 for the Hanley  
2   Petroleum Chandler well was brought in. Again, pore volume  
3   was used to distribute equity to that tract.

4           Tract 12 and 13 were brought in. Tract 12 has  
5   got the Gillespie State "S" well in it; that's the one  
6   Yates has an interest in. And those two tracts were  
7   brought in.

8           The rest of Yates' request was rejected. That  
9   matter is on a de novo appeal before the Commission and has  
10  been continued for many, many months.

11          We are now back before you on the issues that Mr.  
12  Bruce has described for you. We need the Division's  
13  authority and jurisdiction to make decisions upon the pore  
14  volume map, the inclusion of these tracts. You need to  
15  make decisions on what happens with wells that exist in the  
16  expansion area and how they're to be brought in under an  
17  equitable manner.

18          The Energen well that's drilling in the southwest  
19  southwest of 35 -- it's part of Tract 21 -- is a big issue.  
20  What do you do with that well? Is that drilling well going  
21  to be used to change the hydrocarbon pore volume map for  
22  distribution? Is that well going to give a payout factor  
23  before it comes in?

24          In addition, you're going to look at the formula.  
25  The formula is dramatically different than the original

1 unit formula. The original unit formula was based upon  
2 hydrocarbon pore volume, and here's what happened.

3 Based upon that map, if there was a tract with a  
4 producing well in that tract, there was a debit. That  
5 tract was charged with the cumulative production of oil  
6 from that well, and so when that tract came into the unit  
7 it did not get a bonus; it was charged with that  
8 production.

9 Thereafter, as this pool has -- the unit has been  
10 expanded. For example, the State S well was not subject to  
11 the same rules. It was allowed to achieve payout of almost  
12 six times, and the tract owners kept that production before  
13 that tract came in.

14 You need to decide if what happens with the  
15 second expansion is equitable in light of the history of  
16 the changing formula, the changing equities and what occurs  
17 for today's purposes.

18 The end result is, this is not premature, Mr.  
19 Stogner. It requires your attention, it requires your aid  
20 and experience to help us resolve some of the technical  
21 differences for which the technical people cannot agree.

22 Snyder Ranches has a significant royalty interest  
23 in this activity. We're in the existing unit, we're in the  
24 expansion area, and we're here to participate, Mr.  
25 Examiner.



1 Thank you.

2 EXAMINER STOGNER: Mr. Kellahin.

3 Mr. Carr, Mr. Cooter, any statements?

4 MR. CARR: May it please the Examiner, very  
5 briefly.

6 I'm here for Hanley to address the status of  
7 Tract 15, which is the south half of the southwest quarter  
8 of Section 28. This is acreage which, when we were looking  
9 at the proposed second expansion, we proposed be included  
10 in the unit and it was not. We've gone *de novo* on that  
11 matter. That matter is still pending before the  
12 Commission.

13 It is, however, part of the overall unit  
14 expansion, and for that reason I'm going to at the end of  
15 the hearing request permission to make a statement  
16 concerning that tract and tender into the record a copy of  
17 a certified letter from the Commissioner of Public Lands.

18 I have also asked that the case, the *de novo*  
19 case, be reopened. And when that occurs, to avoid an  
20 additional hearing and to help wrap this matter up and  
21 address the issues concerning Tract 15, I will dismiss all  
22 parts of the *de novo* application except Tract 15 and ask  
23 that an order be entered on the record made here today.

24 As to Yates' participation in the case, Dr.  
25 Boneau has been actively involved with the working interest

1 owner committee's efforts to resolve all the issues that  
2 are before you, and I will call him to comment on Yates'  
3 position on the issues as they stand as they unfold during  
4 the course of this hearing.

5 EXAMINER STOGNER: Mr. Cooter?

6 MR. COOTER: Mr. Stogner, I have no opening  
7 statement. As I mentioned in my letter yesterday, we  
8 represent Mr. Arrington, who has an interest in the  
9 southwest quarter of Section 35. I'm observing.

10 EXAMINER STOGNER: Mr. Bruce?

11 MR. BRUCE: Could I just add one thing, Mr.  
12 Examiner, in response to Mr. Hall's comments?

13 I do not think the case is premature. I think  
14 you should let the parties make their presentations. The  
15 Division, after it hears the evidence, may grant Mr. Hall's  
16 request, but I think that shouldn't be done at this point.

17 After it hears the evidence, it may also rule  
18 down the line in favor of one party or it may pick and  
19 choose among the options. However, I firmly believe that  
20 once a decision is made, the expansion will be approved.

21 One final matter. Expansion does need to be  
22 approved as soon as possible to maximize benefits to the  
23 interest owners. This reservoir has now produced a total  
24 of 3.85 million barrels of oil and is relatively late in  
25 its life. I think the best course to follow is to hear

1 this matter now.

2 It may be that if this goes forward, Energen may  
3 suggest a supplemental hearing. That may be acceptable to  
4 my clients, but I think you need to hear the evidence.  
5 We've got a -- quote, unquote -- free day in front of us,  
6 and I suggest we proceed.

7 EXAMINER STOGNER: Mr. Bruce, Mr. Hall mentioned  
8 the two statutes, 70-7-9, 70-7-10. Do you have some  
9 comment?

10 MR. BRUCE: Well, he mentioned them but he didn't  
11 say why they were so important.

12 I do recognize that, you know, 70-7-10 has to do  
13 with previously established units. Basically, we're going  
14 to have to go out after this hearing and get ratifications  
15 from 75 percent of the working interest owners and 75  
16 percent of the royalty owners.

17 We are treating the original order as one tract.  
18 Tracts 1 through 11 will be treated as one tract, pursuant  
19 to the terms of that statute.

20 Other than that, if Mr. Hall would explain, maybe  
21 I could comment further.

22 EXAMINER STOGNER: Mr. Hall?

23 MR. HALL: Mr. Examiner, I'm glad to have this  
24 opportunity to discuss this issue. I think it's very  
25 important, if we can clear this up. I doubt it.

1           The way those two sections operate when there is  
2 an expansion of a previously approved unit, the tracts  
3 comprising the original unit are treated as one and  
4 additional tracts brought into the unit are treated as  
5 separate tracts.

6           Now, for purposes of the first expansion, the  
7 unit Tracts 1 through 11 were treated as one tract, and  
8 Tracts 12, 13 and 14 treated as separate tracts. That  
9 expansion was approved.

10           The unit now, in its present iteration, consists  
11 of Tracts 1 through 14. The expansion proposes to bring in  
12 Tracts 15 through 27, to form the second expansion. Tracts  
13 15 through 27 are treated as separate tracts, and Tracts 1  
14 through 14 are treated as a single tract under the  
15 operation of the statute.

16           Where you have a reallocation within the original  
17 tract -- I'm speaking of Tracts 1 through 14 now -- in  
18 order to effect another expansion, that requires the  
19 approval of 100 percent of the working interests and 100  
20 percent of the non-cost-bearing interests.

21           If you'll look to Section 70-7-9.B, I believe  
22 that's the operative section we have to deal with as it  
23 stands now, because there's disagreement on the allocation.  
24 Ratification will not be possible until there is agreement  
25 on allocation. That's why I think this hearing is

1 premature.

2 Under the formula proposed by the unit operator,  
3 in order to bring Tract 14 up to the proposed percentage,  
4 it required a reallocation from all tracts in the original  
5 unit, and that's what I think triggers the operation of  
6 Section 70-7-9.B.

7 EXAMINER STOGNER: Mr. Bruce?

8 MR. BRUCE: Mr. Examiner, this is the first time  
9 Energen has ever raised this issue. In Mr. Hall's last  
10 pleading he said that Energen was one of the primary movers  
11 in the technical committee. They're responsible for  
12 Exhibit 3, in large part, and now they're complaining about  
13 it? I don't understand.

14 A couple other matters. I think the fact that  
15 this matter is still on *de novo*, as Mr. Carr mentioned,  
16 gives the Division the leeway to alter any percentages in  
17 Tracts 12, 13 and 14, because in essence, it's still on  
18 appeal.

19 The final matter is, I could see Mr. Hall's point  
20 if, for instance, Tract 14, the Hanley tract, was being  
21 reduced in its percentage. But it's not, it's going up.  
22 It is being given a substantial -- No matter how you look  
23 at it, it will gain a substantial increase in  
24 participation.

25 And furthermore, unless Energen is stating that

1 it will never ratify unit expansion in any fashion, we do  
2 not know that we cannot get ratifications from interest  
3 owners in the unit.

4 MR. HALL: Mr. Stogner, let me clarify one thing.

5 Energen endorses the HPV map, Exhibit 3. We  
6 agree to these unit boundaries and these contours.

7 Our disagreement is over the operation of the  
8 formula and the allocation of participation under the  
9 proposed Exhibit C, which is attached to Mr. Bruce's  
10 Application. It provides for a three-percent allocation to  
11 Tract 14 and a 1.36-percent allocation to Tract 15. That's  
12 the disagreement right there. We think that proposal is at  
13 odds with what the technical committee agreed to.

14 And in any event, even if those numbers can be  
15 overcome, there is still the issue of -- the operation of  
16 the proposed formula requires reallocation of participation  
17 in the original unit tract. Till there's agreement on  
18 Exhibit C, there can't be ratification of the formula.

19 MR. CARROLL: And Mr. Hall, what are the odds of  
20 getting an agreement? You've been working on it for  
21 months.

22 MR. HALL: We're very close, we're very close. I  
23 think the parties need to talk further and work out this  
24 particular issue.

25 I think a lot of other issues will go away. This

1 is the final issue, as I see it, that's going to prevent  
2 this unit expansion from going forward.

3 The Examiner can issue an order pursuant to the  
4 unit operator's proposal, but it's subject to ratification.  
5 And without 100-percent ratification -- I can only speak  
6 for Energen; I don't know what the other parties out there  
7 will do, but you need 100-percent ratification of the  
8 working interests and the royalty interests, as I  
9 understand it, in the operation of -- the unit operation  
10 proposed formula.

11 EXAMINER STOGNER: Mr. Carr?

12 MR. CARR: Yes, sir?

13 EXAMINER STOGNER: In the *de novo* case, I  
14 understand Tract 15 is the tract in question; is that  
15 correct?

16 MR. CARR: Yes, sir, that's correct.

17 EXAMINER STOGNER: As far as the formulas for 12,  
18 13 and 14, that was agreeable to Hanley in the -- I believe  
19 that's Order Number R-10,864?

20 MR. CARR: The order that expanded the unit to  
21 pick up those tracts, we challenge all of that expansion,  
22 thinking additional acreage should be included.

23 Now, to deal with the timing of the lease  
24 expiration, we are prepared to support the current  
25 expansion and then request that Tract 15, that one

1 remaining tract, be brought in with an effective date that  
2 predates the expiration of the underlying lease, to keep  
3 the lease from just -- because of the delays.

4 MR. CARROLL: Mr. Hall, Energen doesn't agree  
5 with the percentages for Tracts 14 and 15; is that what you  
6 said?

7 MR. HALL: That's correct.

8 MR. CARROLL: What do they believe should be the  
9 proper percentages?

10 MR. HALL: We'll present testimony which will  
11 show what the technical committee agreed to and show how  
12 the unit operator's proposal and Application is at odds  
13 with that.

14 EXAMINER STOGNER: Okay. With that, if that, if  
15 there's nothing further -- Mr. Bruce?

16 MR. BRUCE: I have nothing further, Mr. Examiner.

17 EXAMINER STOGNER: Then I think we should  
18 commence with the testimony today.

19 Are you going to need some time to prepare for  
20 the first witness?

21 MR. BRUCE: No, I'm ready to go.

22 EXAMINER STOGNER: Okay.

23 MR. BRUCE: Call Mr. Mladenka to the stand.

24 For the record, his last name is spelled  
25 M-l-a-d-e-n-k-a.



1                                    MARK MLADENKA,  
2     the witness herein, after having been first duly sworn upon  
3     his oath, was examined and testified as follows:

4                                    DIRECT EXAMINATION

5     BY MR. BRUCE:

6                Q.     Would you please state your name and city of  
7     residence?

8                A.     My name is Mark Mladenka. I live in Midland,  
9     Texas.

10              Q.     Who do you work for, and in what capacity?

11              A.     I'm employed by Mr. Charles Gillespie as his  
12     production manager.

13              Q.     Are you also employed by Gillespie Oil,  
14     Incorporated?

15              A.     Yes, I am.

16              Q.     Have you previously testified before the  
17     Division?

18              A.     I have.

19              Q.     Were your credentials at that time accepted as an  
20     expert petroleum engineer?

21              A.     Yes, they were.

22              Q.     And are you familiar with engineering matters  
23     pertaining to the West Lovington-Strawn Unit and the West  
24     Lovington-Strawn Pool?

25              A.     Yes, I am.

1 MR. BRUCE: Mr. Examiner, I tender Mr. Mladenka  
2 as an expert petroleum engineer.

3 EXAMINER STOGNER: Any objections? He is so  
4 qualified.

5 Q. (By Mr. Bruce) Now, Mr. Mladenka, I've given a  
6 history of the pool and the unit. Could you please  
7 reiterate the recent developments that have led to this  
8 hearing?

9 A. The -- As you mentioned, the Snyder "C" Well 4  
10 was drilled last spring, completed March, 1998.

11 Within a very short period of time, in April of  
12 1998, we called a working interest owners' meeting to  
13 disseminate some data on that well. We passed out log data  
14 and pressure data from a drill stem test, indicated to the  
15 owners there was -- this well could possibly be  
16 communicated to the unit. However, those tests -- that one  
17 single pressure test was inconclusive.

18 There was other data that indicated that well may  
19 or may not be in the pool due to the fact that the specific  
20 gravity of the well was considerably higher than the unit,  
21 the produced gas was higher than the unit was, and also the  
22 liquid content of the produced gas. So...

23 And also at that meeting we told the owners that  
24 we would -- it would require another set of pressure tests  
25 after a certain amount of production was produced to

1 determine if there was any drawdown, separate pool or not.

2 In the meantime, we called another working  
3 interest owners' meeting in November of 1998. At that  
4 meeting we proposed the technical committee -- Yates  
5 Petroleum proposed us forming a technical committee to  
6 resolve issues surrounding the first expansion.

7 Also, there's always been a contention from the  
8 previous -- to the hydrocarbon pore volume map, the oil in  
9 place by the material balance was considerably more than  
10 what the HPV maps calculated. The technical committee was  
11 charged to find this additional oil, propose some way of  
12 satisfying the issue of the first expansion.

13 And therefore, within a week after the meeting we  
14 initiated our shut-in pressure buildup on the "C" 4 and the  
15 entire unit also. When that data was processed, we called  
16 our first technical committee meeting, and it was held on  
17 December the 7th.

18 Q. Who were the members of the technical committee?

19 A. The members were Yates, Hanley and Energen and  
20 Charles Gillespie, Jr. Each had a representative there,  
21 one or two or more.

22 Q. What were the results of the buildup test on the  
23 "C" 4 and on the unit?

24 A. The test without a doubt showed the Snyder "C" 4  
25 was connected to the reservoir.

1           And we had five meetings between the time of  
2       December the 7th through March the 5th of 1999. I believe  
3       that was the fifth meeting of the technical committee. We  
4       looked at the expansion boundaries, bringing additional  
5       wells into the unit, and suggested a revised tract  
6       participation formula.

7           Q.    Were other matters brought up at the technical  
8       committee meetings or at working interest owners' meetings?

9           A.    Yes, there were. There are issues regarding when  
10      a well should be brought into the unit and recovery of  
11      make-up gas by the working interest owners. I'll discuss  
12      some of those issues later.

13          Q.    Okay. Now, I've already identified Exhibit 3,  
14      but could you briefly identify that for the Examiner?

15          A.    Exhibit 3 is the HPV map the members drafted in  
16      the technical committee over -- That was relatively the  
17      easiest thing to do. Three meetings into the technical  
18      committee we had this map, I believe.

19                I'd like to point out, Well Number 12 in the west  
20      half of the southeast quarter of Section 32 -- 34, and Well  
21      Number 13 in the south half of the southeast quarter of  
22      Section 28. These wells were brought into the unit by the  
23      first expansion.

24                And the second expansion is proposed to bring in  
25      the Snyder "EC" Com in Tract 16, located in Lot 2 of

1 Section 6, and the Snyder "C" Well Number 4 in Lot 1 of  
2 Section 6, be brought into the unit.

3 Q. Okay. Now, before we discuss the expansion,  
4 let's discuss the injection of gas into the unit and  
5 production from the unit.

6 Looking at Exhibit 3, what well are you injecting  
7 into?

8 A. We're injecting into the injection well, the WLSU  
9 Well Number 7. It's located in Tract 5, Section 1. We're  
10 injecting -- That well is structurally the highest well in  
11 the reservoir, and it was chosen as the gas injection well.

12 The exposed perforations in each of the producing  
13 wells in the unit are at or near the bottom of the Strawn  
14 porosity.

15 Q. Now, referring to Exhibit 4, what has been the  
16 effect of gas injection on pressures in the Strawn  
17 formation in this pool?

18 A. Exhibit 4 is the plot of the reservoir pressure  
19 versus the cum oil production. We've also put on the curve  
20 our calculated model of our pressure depletion curve, how  
21 it would have responded without gas injection.

22 As you can see -- I'll just point out the time  
23 periods here. At 1.47 million barrels, we had a bottom  
24 pressure of around 3300. That's when the gas injection  
25 began.

1           The first expansion, held in May of 1997, we were  
2   at 2.75. That was the first -- That was the hearing in May  
3   of 1997.

4           The unit became effective May 1st of 1998, and we  
5   were at 3.1 million barrels. Last November, the pressure  
6   information that we -- I'm sorry, last February, the next  
7   point, that was 3.78 million barrels.

8           The next-to-the-last point is -- Let me back up.  
9   the second-to-the-last point is November, 1998, pressure,  
10  where we had 3.78 million barrels.

11          The last point is the result of a pressure test  
12  we just concluded Monday, May the 23rd or 24th. The  
13  bottomhole pressure there is 3223. I'd like to point out  
14  the slight accelerated drop in reservoir pressure there.  
15  Three months ago we made the decision to reduce our gas  
16  injection or gas -- buying of make-up gas. This  
17  precipitated the decline in reservoir pressure that you see  
18  there.

19          Q.   What are the following pages, Mr. Mladenka?

20          A.   The second page is a material balance showing  
21  from the day the gas injection began, showing oil  
22  production, gas, water. Water is not included in any form  
23  of the material balance. We neglected it. And also you  
24  can see by -- We started gas injection in October of 1995.  
25  By May of 1996 we encountered some free gas production, and

1 free gas production is determined from exceeding an 1800  
2 gas-oil ratio. That's essentially the gas-oil -- the  
3 solution gas of oil at 3300 pounds in this particular  
4 reservoir.

5           You can -- I'll point -- Since we started the  
6 injection process, we've recovered nearly 2.4 million  
7 barrels, we've injected 6.4 BCF of gas. We're currently  
8 showing a 326,000 reservoir imbalance of reservoir  
9 withdrawal versus injection.

10           The next column is our current GOR of 3800, and  
11 the -- Then once again, the last column is the reservoir  
12 pressure since injection began.

13           Q. How do the actual bottomhole pressure figures  
14 compare with calculated and extrapolated bottomhole  
15 figures?

16           A. They compare extremely well. The model was based  
17 on the Turner method, and our reservoir engineer is here to  
18 answer any specific questions on that.

19           This is the exact same model we presented at each  
20 one of these hearings, and as far as I remember, I don't  
21 recall any conflict of discussions on this model.

22           Q. Did the injection program successfully prevent  
23 additional gas from breaking out of solution?

24           A. Yes, any additional free gas due to the  
25 maintenance of the reservoir pressure stopped at that

1 point.

2 Q. Now, are the rates at which the unit wells have  
3 been producing greater than the rates you could have  
4 produced the wells without the pressure-maintenance  
5 project?

6 A. Yes.

7 Q. And was the pressure-maintenance project approved  
8 in time to prevent harm to the reservoir?

9 A. Yes, it was.

10 Q. Now, if you could refer to Exhibit 5, could you  
11 briefly set forth how much the pool has produced to date?

12 A. Exhibit 5 starts off with a graphical  
13 representation of the West Lovington-Strawn Pool. It  
14 includes the 13 unit wells, Wells 1 through 13, the Snyder  
15 "EC" Com and the recently drilled Snyder "C" 4.

16 Jim pointed out where we reduced our production  
17 in 1994 based on the study, feasibility study, for the gas  
18 pressure-maintenance project. And then it reached a peak  
19 production of nearly 90,000 barrels a month in March of  
20 1997.

21 Gas-oil ratio started out at about 2000 GOR,  
22 dipped down to around 1500, and it's currently at 3800 GOR  
23 for the pool.

24 Oil production is about 1300 barrels a day.  
25 We're showing April production of 39,000 barrels for the



1 month, gas production of 151,000 MCF. Once again, our cum  
2 oil is at 3.87 million barrels, cum gas 8.3 million, and  
3 our gas injection at the 6.4 BCF.

4 EXAMINER STOGNER: Do you want to give me that  
5 volume, monthly volume of oil production again?

6 THE WITNESS: Okay, it's actually on page 2 of  
7 the tabular data, April of 1999.

8 EXAMINER STOGNER: And what is the monthly  
9 average?

10 THE WITNESS: About 1300 a day, currently, for  
11 April. Since November of 1998, it's ranged between 39,000  
12 barrels to 44,000 barrels a month, the last six months.

13 EXAMINER STOGNER: You keep saying 1300, but  
14 according to your chart it looks like 13,000. I'm a little  
15 confused.

16 Q. (By Mr. Bruce) You said 1300 a day, as  
17 opposed --

18 A. Right, this is barrels per month.

19 EXAMINER STOGNER: Okay.

20 THE WITNESS: Okay?

21 EXAMINER STOGNER: All right.

22 THE WITNESS: My chart is in barrels per month.

23 EXAMINER STOGNER: Okay, good. Keep me honest,  
24 keep me clean.

25 THE WITNESS: Sure. I think in barrels per day

1 more than I do a month, so...

2 EXAMINER STOGNER: Sam here, that's the reason --  
3 Thank you, sir. I appreciate that. Sorry about that.

4 Q. (By Mr. Bruce) Now, Mr. Mladenka, looking at  
5 Exhibit 5 it appears that the GOR has been increasing over  
6 the last year or so.

7 A. Yes, it has. It started with the -- I guess --  
8 It's all based on the structural position of these wells.  
9 If a set of perforations were exposed, the highest  
10 perforation which seems to indicate where the gas-oil  
11 contact is, therefore the gas-oil ratio increased due to  
12 the, I guess, relatively permeability of the gas to the  
13 oil, and/or coning of the gas to the particular producing  
14 wells.

15 Q. Could you identify Exhibit 5A for the Examiner  
16 and maybe show him a little more graphically why the GOR  
17 may be increasing?

18 A. Exhibit 5A, we're calling it a 2-D structural  
19 display of the West Lovington-Strawn Pool. The vertical  
20 scale is correct, the horizontal is not, or the position of  
21 the wells in relation -- These are every well in the pool.  
22 No north-south direction is -- It's just a map of the --  
23 It's a depiction of the top of the porosity, the base of  
24 the porosity, where we think the current gas-oil contact  
25 is, and where we know the oil-water contact is.

1           And these wells all, almost without exception,  
2           had an increase in GOR when the gas cap went past the top  
3           perforation, exposed. There was an attempt to isolate the  
4           bottom of the injection -- or the producing interval. Like  
5           Jim said, this reservoir -- We didn't believe it was this  
6           big, and the entire pay section, or most of the pay section  
7           was perforated. Hindsight will kill you every time. But  
8           we're trying to isolate that with a dual packer system in  
9           our producing wells, isolating the bottom ten feet of the  
10          longer sections of perforated interval.

11                 But Well Number 5 is shut in due to plus 10,000  
12          GOR.

13                 Number 7 is our gas injection well.

14                 Number 6 is -- Essentially we produce it every  
15          other day, 20 barrels of oil --

16                 Q.    Because of its high GOR?

17                 A.    Yeah, extremely high.

18                 Well Number 1 is shut in. We can't produce it  
19          without the gas -- GOR above 8000.

20                 Well Number 4 is the same way.

21                 Well Number 2 is shut in.

22                 Well Number 3, that is where we're picking our  
23          current gas-oil ratio at. It's at the top perforation.  
24          It's exhibited a gas-oil ratio above 1800 for quite some  
25          time, but we're just calling at that point right now.

1 Well Number 9 was shut in a while back. It  
2 exhibited a high gas-oil ratio.

3 Well Number 8, current GOR is 3968. The top set  
4 of perfs are exposed to the gas cap.

5 Well Number 10, the same way.

6 The Snyder "EC" Com, it's our pumping well. It's  
7 below the gas-oil contact, therefore the GOR of 1468.

8 Well Number 12, the former State "S" well, 3216  
9 GOR. The top perf is exposed to -- And there's no packer  
10 in that well. When that well was drilled, we just couldn't  
11 imagine it would be communicated with the gas injection  
12 well that far away.

13 Number 11, 1000 GOR on that well. It's below the  
14 gas-oil contact.

15 And the "C" 4, it's -- Just within the last two  
16 months, the gas-oil ratio has increased above the initial  
17 GOR from 1500 to 1900. We're actually showing some free  
18 gas production out of the "C" 4. Current producing rates  
19 on the "C" 4 are restricted by a field allowable of 250 a  
20 day. Due to the acreage, it is allowed to produce 285 a  
21 day with a GOR limit of 200, but we're not able to produce  
22 the 285 a day due to the fact that we're limited by the GOR  
23 at this time.

24 Q. The final well is the Hanley Chandler well; is  
25 that correct?

1           A.    Oh, that's correct. Well Number 13, the well on  
2   the extreme north end of the unit, it is perforated well  
3   below the gas-oil contact. The current gas-oil ratio is  
4   1635.

5           Q.    Is that still the only well that produces  
6   significant amounts of water?

7           A.    That's correct.

8                   The Well Number 10 makes about 22 barrels of  
9   water a day currently.

10                  Well Number 11, about four barrels -- two to four  
11   barrels of water a day.

12                  We've been watching for it to show up in Well  
13   Number 3, but it hasn't produced any water yet. We might  
14   haul a truck load of water every four months off that tank  
15   battery.

16           Q.    Okay. Now, let's get into the unit documents a  
17   little bit.

18                  Were the unit agreement and unit operating  
19   agreement previously approved by the Division?

20           A.    Yes, they were.

21           Q.    Have these documents been revised for the second  
22   expansion?

23           A.    Yes, they are revisions to Exhibits A, B, C and D  
24   to be attached to the unit agreement and unit operating  
25   agreement, as well as proposed revisions to certain

1 provisions in the bodies of the two agreements.

2 Q. Okay. What is Exhibit 6?

3 A. Exhibit 6 is the proposed expansion, the federal  
4 acreage involved, the state land involved, and the fee  
5 acreage involved, with each tract numbered with the acreage  
6 associated with each tract and the percentages thereof in  
7 the proposed expansion.

8 Q. This is the technical committee proposal?

9 A. That is correct.

10 Q. Okay. And they're proposing adding in -- I don't  
11 have an exact number here, but about 1125 acres roughly,  
12 1120 acres?

13 A. From the first expansion.

14 Q. Yes, from the first expansion.

15 A. Right.

16 Q. Okay. And this just simply would be a revision  
17 to Exhibit "A" to the unit agreement?

18 A. That is correct.

19 Q. Now, let me just go down these. Exhibit 7A is  
20 Exhibit "B", the ownership listing for the original unit  
21 area, Tracts 1 through 11; is that correct?

22 A. That is correct.

23 Q. Updated to reflect any interest changes since the  
24 last go-around?

25 A. Yes.

1 Q. Okay. Exhibit 7B is simply the same Exhibit "B",  
2 but it's for the first expansion area, Tracts 12, 13 and  
3 14, updated as necessary?

4 A. That is correct.

5 Q. And Exhibit 7C is -- would be the Exhibit "B" for  
6 the additional tracts under the technical committee  
7 proposal?

8 A. That is correct.

9 Q. Okay. Now, you know, I don't want to confuse  
10 people too much here, Mr. Mladenka, but this Exhibit "B"  
11 shows -- If you'll compare Exhibit 6 to the Exhibit "A" to  
12 the unit agreement.

13 EXAMINER STOGNER: Okay, back up here --

14 MR. BRUCE: Okay.

15 EXAMINER STOGNER: -- I'm getting confused.

16 MR. BRUCE: Sure. Mr. Examiner, if you could  
17 look at Exhibit 6, just the colored map -- Maybe I could  
18 just point this out myself, Mr. Examiner.

19 If you'll look at Tract 16 where the Snyder "EC"  
20 Com well is located

21 THE WITNESS: Yes.

22 MR. BRUCE: This map would have to be -- Mr.  
23 Examiner, would have be revised somewhat. This was based  
24 on what the technical committee put together. Tract 16 is  
25 actually two tracts. And on Exhibit 7C it correctly lists

1 it as two tracts. Okay? Kind of split down the middle.  
2 This was discovered just recently, in the last few weeks.

3 And then also, if you'll look at the land plat,  
4 Tract 21 is actually three tracts, which in the Exhibit "B"  
5 are listed as Tracts 21A, 21B and 21C. This has resulted  
6 from additional title work since this land plat was put  
7 together.

8 EXAMINER STOGNER: How about Tract 18?

9 MR. BRUCE: Tract 18, yes. Now -- And I'll have  
10 another map later for you, Mr. Examiner. The way Tract 21  
11 is split up is kind of odd. But yes, Tract 18 is actually  
12 Tracts 18A and -B.

13 And then going down the list, Tract 22 is  
14 actually 22A and -B.

15 23 is actually 23A and -B.

16 And then 25 -- Where the heck is Tract 25?

17 THE WITNESS: Northeast 34.

18 MR. BRUCE: Yeah, is actually 25A and -B.

19 EXAMINER STOGNER: Okay. Now, on your Exhibit  
20 Number 6, it looks like you have Tract 25 that has fee and  
21 state lands?

22 MR. BRUCE: Yeah, and so we are -- That is  
23 correct, Mr. Examiner. Like I said, this was recently  
24 devised or determined, and you are correct, Tract -- what  
25 would be 25A is the State of New Mexico tract in the



1 northeast of the northeast of 34, and Tract 25B would be  
2 the fee tract in the northwest of the northeast of 34.

3 We can get a corrected Exhibit "A" together, but  
4 due to its recent discovery we ran out of time.

5 Q. (By Mr. Bruce) Mr. Mladenka these exhibits were  
6 prepared on just some recent title data that was procured  
7 by the unit operator; is that correct?

8 A. That is correct.

9 Q. What is Exhibit 8?

10 A. Exhibit 8 is the Exhibit "C" on the second  
11 expansion. It contains the proposed tract participations  
12 for the expanded area, based on the technical committee  
13 proposal.

14 Q. And next -- And these participation formulas were  
15 -- they were based on the proposed tract participation  
16 formula, which is the new Section 13 to the unit Agreement;  
17 is that correct?

18 A. That is correct.

19 Q. And that's marked Exhibit 9?

20 A. Exhibit 9.

21 Q. Now, this is what Mr. Hall referred to -- and --

22 A. Yes --

23 Q. -- as a result -- Yeah, let me interrupt, Mr.  
24 Mladenka. I mean -- And I think Yates will have something  
25 to say on this, Energen will have something to say on this.

1 But this was prepared based on our understanding of what  
2 the technical committee proposed?

3 A. That was correct.

4 Q. Okay. And there may be some differences of  
5 opinion, but we can let Energen talk about that.

6 As to the second expansion of the unit, maybe  
7 that's just the thing to focus on at this point, which is  
8 paragraph 3 of Section 13. Could you discuss that briefly  
9 -- it is kind of complicated -- and maybe tell what factors  
10 have changed from the prior participation formula used in  
11 the unit agreement.

12 A. The original tract participation formula was  
13 entirely based on hydrocarbon pore volume, 100-percent  
14 factor.

15 The charge of the technical committee was to try  
16 to satisfy interest owners' concerns on the first  
17 expansion, and the technical committee came up with the 80-  
18 percent hydrocarbon pore volume plus the 20-percent well  
19 factor formula. The hydrocarbon pore volume is strictly  
20 the tract pore volume divided by the pore volume under the  
21 entire expanded unit.

22 We did change the -- In order to come closer to  
23 the material balance equation, we had to -- We looked at  
24 several things. We compared the porosity that was  
25 originally used. I think the Gillespie-Crow application

1 used 85 percent of the density, and Snyder Ranches used the  
2 crossplot porosity for the porosity in the calculation, the  
3 HPV. We compared the core data to the density porosity.  
4 The members agreed that we should go to a 100-percent  
5 factor of the density porosity reading.

6 We also re-examined the  $R_w$ . The first two were  
7 strictly taken off DSTs off the -- I believe it was the  
8 Number 10 and the 11. We caught samples, had them redone,  
9 and dropped the  $R_w$  from .052 to .48 to come up with our  
10 hydrocarbon pore volume.

11 The wellbore factor tried to take into the  
12 account of a poor well drilled into the unit, i.e., the  
13 Snyder "EC" Com, the well has never produced more than -- I  
14 think the highest production is 40 barrels a day or  
15 something like that.

16 And also the Well Number 13, it produced water at  
17 the very start, prior to the unit being expanded. In  
18 November of 1997 it was put on pump, making 200 barrels of  
19 water.

20 To be fair to the original unit owners in Tracts  
21 1 through 11, the Committee gave the existing Tracts 1  
22 through 11, 11 full wells. And then they were de-rated.  
23 The Snyder "EC" Com, if you just took 40 divided by the top  
24 allowable that the pool well could do is 16 percent.  
25 Therefore, the "EC" Com was given a 16-percent well factor.

1 And the Hanley well -- And this production is the maximum  
2 average daily production during a consecutive six-month  
3 period.

4 Take, for example, the Hanley well, about 200  
5 barrels a day for a six-month period. Divided by 250,  
6 that's about 80 percent. So that Hanley tract has an 80-  
7 percent well factor assigned to Tract 14.

8 Q. And then the new formula is 80 percent based on  
9 HPV and 20 percent based on the well factor?

10 A. And 20 percent on the well factor.

11 Q. Okay. And then, without getting into detail --  
12 and maybe we should let other people discuss this -- are  
13 the issues regarding Tract 14 and 15, which is down in  
14 subparagraph (c), (c) and (d); is that correct?

15 A. That's correct.

16 Q. Rather than going into this in any more detail,  
17 maybe that would best be left to cross-examination --

18 A. Okay.

19 Q. -- or some explanation by the other witnesses.

20 Now, in accordance with the Act, Tracts 1 through  
21 11 were treated as one tract; is that right?

22 A. They were.

23 Q. The original unit.

24 Now, the next exhibit, Exhibit 10, what is the  
25 reason for this proposal, Mr. Mladenka?

1           A.   Exhibit 10 is a revision of Section 16 with an  
2 additional paragraph to it, which in the unit operating  
3 agreement, or unit agreement, which allows for the owners  
4 essentially to pay for the make-up gas, to recoup that  
5 portion of gas in their proportionate share of expense.  
6 That substance or this item was never addressed by the unit  
7 operating agreement previously.

8           Q.   So before November 1, 1997, for the injected  
9 volumes or for the make-up volumes injected before that  
10 date, the working interest owners at that time would be  
11 entitled to recover that gas?

12          A.   Yes, in their proportion of expenses they paid  
13 for that gas.

14          Q.   Okay. And this was initially proposed by Mr.  
15 Hall on behalf of Energen; is that correct?

16          A.   That is correct. It needs to be in there.

17          Q.   Now, Exhibits 11A and 11B, if I may, Mr.  
18 Mladenka, these are simply working interest and royalty  
19 interest ownership totals under the technical committee  
20 proposal; is that correct?

21          A.   That's correct, it's the allocation of the 80-20  
22 formula applied to each tract, and that particular working  
23 interest ownership in those tracts is then summed to  
24 working interest total --

25          Q.   Okay, so --

1 A. -- on the last page.

2 Q. So Exhibit 11A is the working interest, and it  
3 would be 100 percent of the working interest, as totaled up  
4 here?

5 A. Correct.

6 Q. And then Exhibit 11B would be 100 percent of the  
7 royalty interest in the expanded unit, totaled up?

8 A. That is correct.

9 Q. Okay. Now, just a couple of final exhibits. Is  
10 the unit operator also requesting that the expansion area  
11 be certified for the recovered oil tax rate and that the  
12 additional two wells being brought into it be certified for  
13 a positive production response?

14 A. Yes, we are.

15 Q. In your opinion, is the expanded unit qualified  
16 for the recovered oil tax rate?

17 A. Yes, it is.

18 Q. Will the unit recover substantially more oil than  
19 if the pressure-maintenance project had not been  
20 instituted?

21 A. It has, and it will continue.

22 Q. Have the Snyder "C" Well Number 4 and the Snyder  
23 "EC" Com Well Number 1 shown a positive production response  
24 attributable to the pressure-maintenance project?

25 A. I would have to say so. The Exhibit 12 is the

1 production curve for the Snyder "C" Well Number 4. As you  
2 can see, we -- our first production is shown in April of  
3 1998, gas-oil ratio, 1200, 1300, 1400, I guess.

4 Q. But the production rate of oil wouldn't have been  
5 that flat without the pressure-maintenance project?

6 A. That is correct. After our pressure buildup in  
7 1998, that's when we went to our actual allowable 285 a  
8 day. We held it at 250 a day prior to the buildup.

9 Q. And Exhibit 13 is a similar chart for the Snyder  
10 "EC" Com?

11 A. Yes, the Snyder "EC" Com well was potentialed in  
12 March, 1996, made about 1200 barrels a month, and it's  
13 still at about 1200 barrels, 1100 to 1200 barrels a month.

14 Q. And it's --

15 A. The gas-oil ratio is essentially the same also.

16 Q. So again, it's essentially the same -- you  
17 wouldn't --

18 A. Correct.

19 Q. You wouldn't have seen this without some --

20 A. You wouldn't expect that without some sort of  
21 pressure response or communication.

22 Q. Do you request a project allowable for the  
23 expanded unit similar to the prior unit and unit expansion?

24 A. Yes, this will let the allowables be transferred  
25 among unit wells and prevent the drilling of unnecessary

1 wells.

2 Q. And the project allowable would be simply the top  
3 allowable 250 barrels per day, multiplied by the number of  
4 wells in the unit?

5 A. Correct.

6 Q. Producing wells in the unit?

7 A. Correct.

8 Q. In your opinion, has the reservoir within the  
9 unit expansion area been reasonably defined by development?

10 A. We believe so.

11 Q. And is the expansion of the unit reasonably  
12 necessary for the purposes of the unit and the pressure-  
13 maintenance project?

14 A. Yes.

15 Q. Has the institution of the pressure-maintenance  
16 project resulted in the recovery of substantially more oil  
17 from the pool than would otherwise have been recovered?

18 A. Yes.

19 Q. Will the additional costs, if any, of conducting  
20 pressure-maintenance operations for the expanded unit  
21 exceed the cost of additional oil recovered, plus a  
22 reasonable profit?

23 A. No.

24 Q. In your opinion, will the expansion of the unit  
25 benefit the interest owners in the expanded unit?



1 A. Yes.

2 Q. Now, has Gillespie sought to obtain the  
3 ratifications of the interest owners in the unit at this  
4 point?

5 A. Not yet. Due to various disagreements between  
6 interest owners, we believe that it will save some time to  
7 obtain ratifications after the Division issues its order.

8 Q. Were all of the interest owners in the expanded  
9 unit area, including royalty owners, notified of this  
10 hearing?

11 A. Yes.

12 Q. And is the affidavit of notice submitted as  
13 Exhibit 14?

14 A. Yes.

15 Q. And does that contain copies of the notice letter  
16 and the --

17 A. Certified return receipts.

18 Q. In your opinion, is unit expansion in the  
19 interest of conservation and the prevention of waste?

20 A. Yes, it is.

21 Q. And were Exhibits 1 through 14 prepared by you or  
22 under your direction or compiled from company business  
23 records?

24 A. Yes, they were.

25 MR. BRUCE: Mr. Examiner, I'd move the admission

1 of Exhibits 1 through 14 at this time.

2 EXAMINER STOGNER: Exhibits 1 through 14 will be  
3 admitted into evidence at this time.

4 Thank you, Mr. Bruce.

5 Mr. Hall, your witness.

6 MR. HALL: Thank you, Mr. Examiner.

7 CROSS-EXAMINATION

8 BY MR. HALL:

9 Q. Mr. Mladenka, are you the best witness for  
10 Gillespie situated to testify about the operation of the  
11 formula, the amendment to the formula, or will Mr. Conner  
12 be handling that issue?

13 A. The formula?

14 Q. Yes, the amendment to the unit agreement,  
15 participation formula?

16 A. Jim and I worked on that.

17 Q. You participated in the deliberations of the  
18 technical committee?

19 A. Yes, I did.

20 Q. Can you explain to the Hearing Examiner the  
21 problem the technical committee had with bringing Tract 15  
22 into the unit?

23 A. Long story. Tract 15 was originally leased by  
24 Hanley Petroleum. It was not brought into the unit on the  
25 first expansion due to a very small amount of HPV we had

1 drawn through it.

2 In the meantime, Hanley and Yates filed a *de novo*  
3 on it. Hanley drilled a well to the north, a dry hole.  
4 The new HPV map, the tech committee had to honor that dry  
5 hole, which pulled hydrocarbon pore volume zero line out.  
6 In the meantime that lease expired, or technically expired,  
7 without exception to --

8 MR. BRUCE: Mr. Examiner, if I may, it has not  
9 expired. It is past its primary term. But it is still a  
10 valid lease under the records of the State Land  
11 Commissioner.

12 EXAMINER STOGNER: Okay, to make sure that we're  
13 talking about that, that's Tract 15, that's that south --

14 THE WITNESS: South half --

15 EXAMINER STOGNER: -- half --

16 THE WITNESS: -- of the southwest.

17 And it was kind of beyond the ability of the  
18 technical committee to figure out how we were going to  
19 bring in Tract 15 and honor Hanley interests.

20 First off, let me back up. It kind of leads into  
21 several things.

22 When we proposed the formula, everybody was going  
23 to propose a parameter, let's say, oil in place, wellbore,  
24 and Hanley's concern was a minimum amount of interest in --  
25 well, it looked like Tract 14 and 15 would get them to that

1 interest level.

2 Due to the expiration concerns that we have with  
3 Tract 15, we allowed the -- since there was no well there,  
4 the hydrocarbon pore volume drawn under Tract 15 would be  
5 given to Tract 14, and we tried to word that in this  
6 exhibit -- What was it, Jim? 13 or -- Exhibit 9, which was  
7 the change of Section 13 of the unit operating agreement,  
8 and just allow Tract 14 to have three-percent interest.

9 Did I do very well at that? With -- Go ahead.

10 Q. (By Mr. Hall) Go ahead, were you finished?

11 A. No, that's it.

12 Q. What was the basis of your understanding that the  
13 Committee agreed to provide for a three-percent  
14 participation factor for Tract 14? I'm sorry -- No,  
15 correct, 14.

16 A. Well, Tract 15, the hydrocarbon pore volume  
17 participation drawn from Tract 15 was like -- It had a  
18 percentage of 1.6 percent, 1.4 percent. Tract 14, in  
19 combination, the wellbore factor and the hydrocarbon pore  
20 1.6, the combination of the two was three percent.

21 Due to the fact that Tract 15 was unknown, the  
22 situation of it, to ensure Hanley would get their three  
23 percent, not knowing the status of what the State would do,  
24 allow them to keep their lease or not, we just assigned the  
25 interest that Tract 15 had to Tract 14, or that portion of

1 it, and distributed it among all the other owners of all  
2 the other tracts, would give up a portion of their interest  
3 and give it to Tract 14, to bring it up to the three  
4 percent Hanley required.

5 Q. The formula that tries to provide for this, your  
6 Exhibit 9 -- Do you have that in front of you?

7 A. Yeah, I've got it here somewhere. Okay.

8 Q. Looking at Exhibit 9 and paragraph 3 of Exhibit  
9 9, doesn't the formula necessarily presume that Hanley will  
10 be able to contribute a valid lease for Tract 15 and bring  
11 that lease to the unit?

12 A. Where are we talking about?

13 Q. Well, doesn't the formula make that presumption?  
14 Isn't that the premise of the formula?

15 A. I don't recall that portion of it, that they were  
16 responsible with Tract 15. We -- They had it at one time,  
17 they requested three-percent ownership, the percentages --  
18 hydrocarbon pore volumes were presented ranging from 10-  
19 percent well factor to 70 -- 30 percent. We pointed it out  
20 to Hanley at the meeting that, Hey, there's your three  
21 percent. You've got 20-percent well factor, 80-percent  
22 hydrocarbon. There's your three percent that you are  
23 requesting ownership in.

24 That is essentially how we came up with 80-20.  
25 It could have been 10-90, 90-10, 70-30. But Hanley's

1 request was three-percent ownership of the unit.

2 And the Tract 15 under the technical committee  
3 had -- I forget exactly. I've got some information. It  
4 had like 1.4 percent with the wellbore in Tract 14,  
5 hydrocarbon plus the 20-percent well factor. Those two in  
6 combination were three percent. The status of that lease  
7 was in question. In order to give Hanley its three  
8 percent, get them to three percent and make the committee  
9 move forward, we  
10 -- all the owners in the tract would contribute that 1.4  
11 percent in Tract 15 to Tract 14. And that's what I thought  
12 I wrote in this revised Section 13.

13 Q. Now, you were just referring, I believe, to your  
14 Exhibit 3, which is the technical committee --

15 A. That is correct.

16 Q. -- HPV map?

17 A. That is correct.

18 Q. And the boundaries proposed for the unit  
19 expansion there include Tract 15, correct?

20 A. That is correct.

21 Q. And Tract 15 and 14 are both presently owned by  
22 Hanley, as far as we know, correct?

23 A. As far as we know.

24 Q. If I understand you correctly from your earlier  
25 testimony, you said it was the intent of the technical

1 committee to attribute a three-percent participation to  
2 Hanley?

3 A. We would get Hanley to three percent, whatever it  
4 took, essentially. That was my understanding. And we had  
5 to write this up, and this was essentially a first draft of  
6 this Section 13 revised. It was something that at our  
7 working interest owners' meeting we had agreement -- and I  
8 believe this is correct -- from Yates and Hanley, saying,  
9 This is correct.

10 Q. So to be clear, as I understand your testimony,  
11 the three-percent participation for Hanley is inclusive of  
12 both Tracts 14 and 15; is that accurate?

13 A. Let me look at my Exhibit "C", I guess it is.

14 Q. Exhibit 8.

15 A. Or Exhibit -- Tract 15 still has a 1.3 -- This is  
16 Exhibit "C", our Exhibit 8. Tract 15 still has 1.36  
17 percent interest in it. So whoever's got the lease, the  
18 State, Hanley -- I guess we should have addressed, if  
19 Hanley retained Tract 15, they would only accept the three  
20 percent or whatever combination Tract 14 and 15 would  
21 amount to.

22 Q. But again referring to Exhibit 8, the Tract  
23 Participation Exhibit "C", the aggregate interest  
24 attributed to Hanley for its ownership of Tracts 14 and 15  
25 exceeds three percent, does it not?

1 A. That is correct.

2 Q. So it's approximately together 4.4 percent?

3 A. That is correct. But it -- I believe this  
4 Section 13 that I wrote, with Jim's help, assumed no  
5 ownership by Hanley in Tract 15.

6 Q. So what is being proposed to the Examiner here  
7 today? Are we asking him to issue an order presuming that  
8 Tract 15 is or is not part of the unit?

9 A. If you look at our ownership, I believe, of the  
10 Exhibit "D", our Exhibit 11A, the State shows there is no  
11 ownership by Hanley Petroleum in Tract 15. I guess I  
12 should have said that at the very first.

13 Q. What's the exhibit number again? I'm sorry.

14 A. It's Exhibit 11A.

15 Q. Do we have any reason to believe that the State  
16 lease covering Tract 15 is not currently in effect?

17 A. It's on hold, as far as I know, pending the *de*  
18 *nov*o, the outcome of the *de novo* that's been filed.

19 Q. What happens if, in fact, Tract 15 is still a  
20 valid lease? It's contributed to the unit, correct?

21 A. We will probably -- we will -- if Hanley -- Well,  
22 Hanley understands they get three percent from the  
23 technical committee. I'm sure they would not claim  
24 ownership of the other three percent. They would retain  
25 the actual ownership. If you just take the difference



1 between 3 and 1.36, they would get 1.4 for Tract -- or 1.6  
2 for Tract 14, 1.4 for Tract 15. The combination would then  
3 be three percent.

4 Or what -- let it -- the tract -- In fact, it  
5 doesn't come up exactly three percent; it's like 2.98  
6 percent. If you let the leases stand on their own. And I  
7 think Hanley would accept the less than three percent, the  
8 2.98, if they retained ownership in Tract 15. And Exhibit  
9 "C" would be changed.

10 There's a lot of "if's".

11 Q. In earlier testimony, I believe I heard you say  
12 that to bring Hanley's ownership to the three percent or  
13 the 4.4 percent, or whatever scenario --

14 A. It was never anyone's intent to give them more  
15 than three percent.

16 Q. To bring them up to three percent?

17 A. Correct.

18 Q. Whatever happens, with or without the lease --

19 A. Right.

20 Q. -- Tract 15 --

21 A. That is correct. That was Hanley's request of  
22 the technical committee.

23 And the way this thing worked, we were given the  
24 charge to come up with some way of making everybody happy.  
25 So everyone was allowed to pick a parameter and show it.

1 And -- or give a list out to everyone and let them review  
2 it, and then we would meet and hammer out a proposal.

3 Energen's position was one of only two factors to  
4 be considered, and only those two: oil in place and well  
5 factor. There were other ideas among the group of acreage  
6 and of several other things.

7 Immediately after that discussion, Energen -- I  
8 mean Hanley, said, We want three percent. And Energen had  
9 a spread sheet with the -- a 90-10 hydrocarbon well factor,  
10 80-20, 70-30. And we went over there, and lo and behold,  
11 Tracts 14 and 15 came up with 2.98 percent, based on the  
12 80-20 proposal from Energen. Ah, great, we've got a  
13 formula now.

14 Then we started discussing this -- the land  
15 issues and whether or not Hanley actually retained  
16 ownership in that. And that's where the three-percent  
17 number comes from, and that's how we arrived at the 80-20.

18 Q. I'm not sure I follow, which is not necessarily  
19 your fault. It's a difficult problem.

20 Let me refer you to something, if I might, Mr.  
21 Mladenka.

22 You were present at the working interest owners'  
23 meeting on April 13th, 1999, in Midland?

24 A. Correct.

25 Q. Look at -- I've handed you what's been marked as

1 Exhibit M-1. This is an excerpt from the transcript taken  
2 by a court reporter at that meeting.

3 Let me clarify one thing with respect to  
4 Gillespie's understanding of what Hanley's expectation was  
5 with respect its participation in the unit.

6 If you would look at the last page of Exhibit M-1  
7 -- the excerpt is from page 37 -- let me simply read that  
8 into the record, the statement by Mr. Rogers, beginning on  
9 line 15 there:

10

11 MR. ROGERS: Jim Rogers, Hanley Petroleum. As I  
12 understand, what you're saying is -- or what we're  
13 talking about is we will consider the bringing in of  
14 Tracts 14 and 15 with a tract participation factor of  
15 twenty-nine-hundredths of one percent effective  
16 11-1-97. And then, with this new configuration as of  
17 4-1-99, then the interest would increase to where  
18 Tracts 14 and 15 would have three percent. Now, is  
19 that right what we're talking about?

20

21 Do you see that language there?

22 A. Yes, I do.

23 Q. Would that tend to suggest to you that Hanley  
24 expected a three-percent aggregate interest for both Tracts  
25 14 and 15?

1 A. That's my belief.

2 Q. And is that understanding reflected on Gillespie  
3 Exhibit 8, the revision to unit agreement Exhibit "C" for  
4 Tracts 14 and 15?

5 A. This was after we wrote the Section that you're  
6 looking at, or we're talking about, the proposal. So no,  
7 the Exhibit "C", as we -- in our Exhibit 8, correct, that  
8 shows three percent, 14, 1.3, no, it does not follow this.

9 Q. All right. Let me get back to a question I  
10 started earlier. If you'd refer back to your Exhibit 9,  
11 please, sir. It's the proposed formula.

12 A. Okay.

13 Q. If you'd refer specifically to paragraph 3 (c),  
14 page 2 of that exhibit, now, I understand you to say  
15 earlier that to get Hanley up to its participation  
16 interest, whatever it might be, or whatever scenario, that  
17 would require a reallocation of interest from the other  
18 tracts; is that correct?

19 A. Correct.

20 Q. And is paragraph 3 (c) the language that purports  
21 to accomplish that?

22 A. That was what it was intended to do.

23 Q. All right. And the reallocation would come from  
24 not only Tracts 1 through 11 but would also include Tracts  
25 13 and 14 -- 12, 13 and 14, correct?

1           A.    I believe that's right, 12, 13 and 14.

2                   But, as I said, on our Exhibit "D", showing the  
3 ownership, it shows Hanley has no interest in Tract 15.  
4 Now, whether or not they retain the ownership, these  
5 exhibits will be wrong.

6           Q.    How do we address that, if there is indeed a  
7 change required?

8           A.    I'm not exactly sure. That was beyond the scope  
9 of the technical committee. Several things hung in it. I  
10 don't know if this is appropriate to say. I think, you  
11 know, we're going to have to be extremely open on how this  
12 is done.

13          Q.    Well, again let's refer back to paragraph 3 (c)  
14 of Exhibit 9. Look at that language. It says, "After the  
15 calculations in subparagraph (a) are made, Tract 14's Tract  
16 Participation shall be increased to 3% by means of the  
17 other Tracts proportionately contributing a portion of  
18 their participation percentages..." And it goes on.

19                   When that language says "other Tracts", what  
20 other tracts is it referring to? Tracts 1 through 27?

21          A.    All other tracts, 1 through 11 as a whole and all  
22 the other tracts are reduced by the proportionate  
23 difference and added to Tract 14 in --

24          Q.    And we understand --

25          A.    -- their relative proportion of the original. If

1 every tract -- Even Tract 15 contributes a little of its  
2 interest to Tract 14, is what I'm saying.

3 Q. Right, and we understand that Tract 14 is part of  
4 the existing unit?

5 A. Yes.

6 Q. And its participation changes as well?

7 A. Yes. But that -- the reason to keep 1 through 11  
8 together was the *de novo*. Yates and Hanley would not --  
9 We'd face a *de novo* if we didn't change the formula, so you  
10 can't -- If you can't bring Hanley up to speed on our  
11 formula, if it was brought in under the original oil in  
12 place, 100 percent, three-tenths of 1 percent, you cannot  
13 do it unless you keep Tracts 1 through 11 as a whole, and  
14 not 1 through 14.

15 That was an issue Jim and I talked about, how  
16 will we do this? So we just decided, and I believe it  
17 satisfied Yates on the new formula, and Hanley. However,  
18 Tract 15 was the cog -- the stick in the wheel. And that  
19 was the reason to bring 14 up. The ownership -- Exhibit  
20 "D" shows Hanley has no ownership in Tract 15.

21 If we can -- I don't know exactly how it will all  
22 pan out. That is you all's concern. The unit needs to go  
23 forward. But I believe we got to an agreement on the Yates  
24 and Hanley issue, the *de novo*. That was one of the things  
25 we had to clear up at the technical committee. And this

1     seemed to do it.

2             Q.     Let me move on to another issue, Mr. Mladenka.

3                     You'll agree that there's an issue between  
4     Gillespie and Energen, potentially others, with respect to  
5     bringing in previously drilled wells on expansion acreage  
6     at more than 100-percent payout? Do you agree with that?

7             A.     Correct, and I believe there's others also.

8             Q.     Who are the others?

9             A.     Royalty owners.

10            Q.     Can you identify those?

11            A.     I believe it's Snyder Ranches.

12            Q.     What is Snyder Ranches' position, as you  
13     understand it?

14            A.     As -- I believe I heard Tom say, the issue of the  
15     payout, or the concern of -- our concern -- I'll say this:  
16     our concern that Mr. Gillespie -- and I was trying to get  
17     the technical committee to adopt an increase in the percent  
18     of payout for a well to join in.

19                     My proposal was not adopted. Hanley's proposal  
20     was adopted, Energen's proposal was adopted. I could not  
21     get a percentage of payout increase from the 100 percent  
22     included in the technical committee's proposal.

23            Q.     Is it correct to say that Mr. Gillespie wants to  
24     receive 200-percent payout for bringing in the "C" 4 well?

25            A.     That was what was initially presented to the

1 working interest owners at the meeting in April, correct.

2 Q. If you can speak to this, I'd appreciate it, but  
3 will Mr. Gillespie ratify the expansion as it's being  
4 proposed today if he does not have agreement on 200-percent  
5 payment for the "C" 4 well?

6 A. He has proposed another proposal. This proposal  
7 was the charge of the technical committee, as operator of  
8 the unit. We took the technical committee's  
9 recommendation, and this is the proposal. Mr. Gillespie,  
10 as a single, individual owner in the unit and the Snyder  
11 "C" 4 has some differences. We could not get the payout in  
12 the technical committee recommendation. He will be  
13 proposing later today another unit expansion proposal.

14 Q. In addition -- An expansion different from what's  
15 being proposed here?

16 A. Correct.

17 Q. Has this proposal been shown to anyone before  
18 today, other than Gillespie?

19 A. No, it has not. Due to results of the working  
20 interest owners' meeting in April, we presented this  
21 proposal. We presented three ballots for voting. One of  
22 them was an AFE for 200-percent payout. That was defeated  
23 by Energen's vote. I believe we only had four working  
24 interest owners -- three other -- two other working  
25 interest owners respond. Phillips agreed, as I understand,



1 to all three proposals.

2 The first proposal was to bring in the Snyder  
3 "EC" Com and the "C" 4.

4 The second proposal was to expand the unit to  
5 include Tracts 15 through 27.

6 The third proposal was the 200-percent payout.

7 Energen voted for proposal 1 and 2. The 200  
8 percent was voted against by Energen. Phillips Petroleum  
9 voted for all three proposals. And ADIA has voted for the  
10 expansion to include the "EC" and the "C" 4, voted against  
11 15 through 27, and voted for the 200 percent. Charles  
12 Gillespie did not vote and essentially withdrew his AFE, or  
13 the ballot --

14 Q. Well --

15 A. -- and proposed this, or will propose this  
16 different view of the expansion.

17 Q. You've got me off track from the payout issue  
18 with this bombshell.

19 Let me ask the question. If I understand  
20 correctly, because Mr. Gillespie is now proposing a new  
21 expansion, new participation, I assume that no one's  
22 seeing, is it safe to assume that he will not vote to  
23 approve the expansion and formula participation that's  
24 being proposed under the Application we're all here for  
25 today?

1           A.    I would like for the Commission to see both of  
2 these proposals, and I think Jim alluded to there may be  
3 pieces of both to use, let us have something go out to be  
4 ratified, and I can't say if he'll ratify even that. But I  
5 would like to think that there would be a proposal that  
6 comes up that will be ratified.

7           Q.    I would too. Let me ask you, getting back to the  
8 AFE or the approval of the 200-percent payout for bringing  
9 in the Snyder "C" 4 well, is that issue a component of the  
10 new proposal?

11          A.    In a form, yes.

12          Q.    What form is it?

13          A.    It is a multiple payout.

14          Q.    In other words, ratification of this new proposal  
15 will be contingent on all the interest owners approving  
16 multiple payout for the Snyder "C" 4 as part of the overall  
17 package; is that accurate?

18          A.    I don't know. I don't -- I haven't seen what the  
19 Commission is going to do. They may go back to the 100-  
20 percent oil-in-place number that we've always been dealing  
21 with. I don't know.

22          Q.    Well, I'm speaking on the payout issue  
23 specifically, though.

24          A.    The -- it -- I can't say how he'll vote without  
25 looking at what actually -- He'll vote for this -- his

1 proposal.

2 Q. I'm sorry, say that again?

3 A. When we present our proposal, he will ratify that  
4 one.

5 Q. All right. So -- But he will not ratify the  
6 Application proposal? Yes or no?

7 A. I would say no --

8 Q. All right.

9 A. -- as I understand his position. That's why we  
10 are going to present our own proposal.

11 You've got to realize, Scott, I tried to get the  
12 technical committee to include a multiple payout. We  
13 wouldn't even consider it. And we gave on Hanley, we gave  
14 with Energen, and wouldn't even be considered for any  
15 consideration on the "C" 4.

16 EXAMINER STOGNER: Mr. Bruce, this is somewhat  
17 unusual. Do you want to make a statement at this point?  
18 What are we doing here?

19 MR. BRUCE: Well, Mr. Examiner, just like the  
20 last couple of go-arounds, people had different things to  
21 propose, period.

22 EXAMINER STOGNER: Well, if you're proposing  
23 something that won't be ratified, then --

24 MR. BRUCE: No, I do not know that, Mr. Examiner.  
25 I can't say that.

1           The technical committee -- Let me take a step  
2 back. The technical committee was formed, it made this  
3 proposal. The majority of the technical committee asked  
4 the unit operator to submit this proposal, and that's what  
5 the unit operator is doing.

6           MR. CARROLL: But Mr. Bruce, the unit operator --  
7 Mr. Mladenka just testified the unit operator wouldn't  
8 ratify the proposal that's being --

9           MR. BRUCE: Oh, I don't -- I think Mr. Mladenka  
10 misspoke. I do not know that. He said he doesn't know,  
11 and I think that is the answer. Mr. Gillespie will make a  
12 proposal on well payout. If it's not adopted, he'll have  
13 to look at it. He's never said that he will not ratify it.  
14 He's never told me that.

15           He does want -- It goes back to this, Mr.  
16 Examiner: The Hanley Petroleum Chandler Well Number 1 paid  
17 out 250 percent before it was brought into the unit. The  
18 State "S" Well Number 1 paid out 550 percent before it was  
19 brought into the unit. Mr. Gillespie individually would  
20 like to be treated somewhat similar to the Chandler well,  
21 at least as to the Snyder "C" 4 well. He's going to make  
22 that proposal today.

23           The Commission -- The Division may not adopt it.  
24 Like I said, there are several issues here today. The  
25 Division may look at it, issue its order, it will be sent

1 out for ratification.

2 I do not know what Mr. Gillespie will or will not  
3 vote for. He wants -- The only thing he's told me is, he  
4 wants this over with. He's tired of fighting it. I  
5 believe once the Division makes a decision, ratifications  
6 will be forthcoming. I said that in my opening, I firmly  
7 believe that now.

8 EXAMINER STOGNER: Do you have any other  
9 questions or any cross-examination?

10 MR. HALL: I'm a little unclear on where we stand  
11 with Mr. Mladenka's direct testimony. I thought the direct  
12 case through Mr. Mladenka was concluded and we were on  
13 cross. It sounds like he will be called back again to  
14 present the new proposal; is that correct?

15 MR. BRUCE: I don't plan on it. I have another  
16 witness.

17 MR. HALL: To present the new proposal?

18 MR. BRUCE: Yes.

19 MR. HALL: I think that concludes my cross-  
20 examination.

21 EXAMINER STOGNER: Do you have any redirect?

22 MR. BRUCE: Just a couple of things, Mr.  
23 Examiner, just --

24 EXAMINER STOGNER: Mr. Bruce, hang on. Okay, I  
25 believe we have another question here.

1 MR. CARR: I have just a few questions.

2 CROSS-EXAMINATION

3 BY MR. CARR:

4 Q. Mr. Mladenka, did you represent Mr. Gillespie on  
5 the working or the technical committee?

6 A. Yes.

7 Q. And I understood your Exhibit Number 3, the  
8 hydrocarbon pore volume map that you presented, to be the  
9 result of that committee effort; is that correct?

10 A. That is correct.

11 Q. And the attempt in what was being proposed by the  
12 technical committee, am I fair to understand it was to  
13 include tracts in which there was now believed to be  
14 hydrocarbon pore volume?

15 A. Correct.

16 Q. Now, that map shows hydrocarbon pore volume under  
17 Tract 15, the Hanley tract which is at issue; is that  
18 correct?

19 A. That is correct.

20 Q. Have you seen the proposal that may be made by  
21 Mr. Gillespie on his behalf later today?

22 A. Yes, I have.

23 Q. Did that also show hydrocarbon pore volume under  
24 Tract 15?

25 A. Yes, it does.

1           Q.   And you understand that while this process has  
2   been going on, the lease on Tract 15 reached the end of its  
3   primary term?

4           A.   Right.

5           Q.   And you understand that the Commissioner of  
6   Public Lands has agreed that if, in fact, the unit is  
7   expanded to include that tract under which there are  
8   hydrocarbon pore volumes, during the primary term of that  
9   lease, he will consider that lease to be in full force and  
10   effect?

11          A.   If the unit -- the Tract 15 is included before  
12   the lease expires.

13          Q.   Before the end of its term?

14          A.   Yes, I think I understand that.

15          Q.   And do you understand that Hanley, through its *de*  
16   *nov*o, is going to ask the Commission to expand the unit  
17   effective during the primary term of that lease, to bring  
18   that in so the lease wouldn't expire?

19          A.   Yes, but --

20          Q.   And if that happened, then Hanley would be in a  
21   position to contribute Tract 15 to the unit?

22          A.   Correct.

23          Q.   And Hanley has sought to be treated as if that  
24   lease were in effect -- I mean, it would be then entitled  
25   to approximately three percent, correct?

1 A. Correct.

2 Q. And if in that *de novo* process that lease is  
3 contributed, then each lease would get what it's entitled  
4 to, based on the technical committee report, hydrocarb- --

5 A. On its own merit, correct.

6 Q. Right. And in that circumstance there would be  
7 no need for any reallocation between tracts; is that not  
8 correct?

9 A. I think that's correct.

10 Q. And then Exhibit Number 8 would need to be  
11 reflected to show that; isn't that correct?

12 A. Yes.

13 Q. And there would be no reallocation of interest?

14 A. Correct.

15 Q. And everyone would get what they're entitled to  
16 under the formula?

17 A. That would be very nice.

18 MR. CARR: Thank you, that's all I have.

19 EXAMINER STOGNER: Mr. Kellahin?

20 MR. KELLAHIN: Thank you, Mr. Examiner.

21 CROSS-EXAMINATION

22 BY MR. KELLAHIN:

23 Q. Mr. Mladenka, let me see if I can understand what  
24 I think the technical committee agreed to do and did not  
25 agree to do.



1           If we go back to Gillespie Exhibit 3, this is the  
2 distribution of hydrocarbon pore volume that the technical  
3 committee agreed would most closely match the material  
4 balance calculation of original oil in place?

5           A.   It's a much better improvement over the previous  
6 two.

7           Q.   All right. So when we're talking about  
8 correlative rights and giving each tract equity, then  
9 distribution of hydrocarbon pore volume was generally  
10 agreed upon to be a significant parameter, true?

11          A.   Correct, correct.

12          Q.   Hydrocarbon pore volume has historically been  
13 used to divide equity among tracts in the unit, has it not?

14          A.   Yes, it has.

15          Q.   The original unit formula was, in essence, 100-  
16 percent pore volume distribution, was it not?

17          A.   That was correct.

18          Q.   For the wells in the original unit that existed  
19 at the time that the original unit was effective, those  
20 tracts with wells were debited for any cumulative oil  
21 production up to the effective date of unitization; is that  
22 not true?

23          A.   I believe that's correct.

24          Q.   All right. So at that point, tracts with wells  
25 got a debit, and then their remaining share of the oil in

1 place based upon pore volume distribution?

2 A. Yes.

3 Q. All right. We get to the first expansion. At  
4 that point, now, we've got the Hanley Chandler well in  
5 Tract 14, you've got the Gillespie State "S" well in Tract  
6 12 where Yates has got the interest. At the time of that  
7 expansion, then pore volume was used to distribute equity  
8 to Tracts 14 and 12, were they not?

9 A. They were.

10 Q. However, there was a change in practice.  
11 Existing production from those two wells was not debited  
12 against the tracts' original oil in place, was it?

13 A. I believe that's correct. If I'm not mistaken, I  
14 think the production before a certain period of time was  
15 what was deducted, and these two wells were actually  
16 produced after that particular time.

17 Q. One of the arguments that Gillespie was advancing  
18 at the latest rounds of working interest owner meetings is  
19 how to handle the Snyder "C" 4 well as to when it comes  
20 into the unit and what happens with its cumulative oil  
21 production, right?

22 A. Essentially, the -- when it comes into the unit.  
23 I don't recall us discussing the cum oil or anything.

24 Q. When we look at the State "S" 1 well, by the time  
25 that is into the unit, the owners in Tract 12 have received

1 5 1/2 times payout of the cost of that well?

2 A. That is correct.

3 Q. And they got to keep that production?

4 A. Every penny.

5 Q. On the Hanley Chandler 1 well in Tract 14, they  
6 got 2 1/2 times payout, and they got to keep all that?

7 A. That is correct.

8 Q. There was no deduction, credit or --

9 A. No.

10 Q. -- other compensation for the unit?

11 A. They were compensated for the inventory also.

12 Q. All right.

13 A. Both of them, Tract 12, 13 and 14.

14 Q. When we get down to the Snyder "C" 4 well, now,  
15 Energen is taking the position that the Snyder "C" 4 well  
16 should get only one times payout, and then it comes into  
17 the unit?

18 A. That is correct.

19 Q. And Gillespie differs with that point, doesn't  
20 it?

21 A. The technical committee came up with that, and  
22 that's what we presented, correct.

23 Q. All right. So there is a point of difference,  
24 when the Examiner is deciding the differences, as to what  
25 is going to be fair and reasonable for a tract that has an

1 existing well and is being contributed to the unit?

2 A. Yes, there are disagreements between parties.

3 Q. Okay. What is your position in Tract 21 where  
4 Energen has a drilling well in the southwest southwest of  
5 35? How are we going to treat that one?

6 A. The committee proposed what I have shown. At the  
7 working interest owners' meeting, we were told that Tract  
8 21 should be reconsidered based on the actual well -- what  
9 the wellbore encounters in 21. There's a few scenarios  
10 here about to unfold.

11 If it's a dry hole, Tracts 24 and 23 will  
12 probably be brought in unnecessarily.

13 Tract 21 could be increased or decreased based on  
14 the hydrocarbon pore volume.

15 And the well factor could also influence it. If  
16 it's a dry hole when we bring it in, it will be based on  
17 HPV only. But we'll be bringing in Tract 24, which is  
18 probably goat pasture.

19 I'd like to say something about the well factor,  
20 which --

21 Q. Well, let me get to that in a minute.

22 A. Okay, go ahead.

23 Q. Let's talk about the drilling wells. Within the  
24 expansion area or the original unit, is the Energen well in  
25 Tract 21 the only well now being drilled or planned in the

1 near future?

2 A. Not as far as I know.

3 Q. So in the absence of that wellbore we could  
4 maintain the status quo long enough to get a pore volume  
5 that everybody is comfortable with, satisfies existing  
6 data, get a formula, have a ballot, and see if we can move  
7 ahead with life?

8 A. As soon as the well penetrates the Strawn and a  
9 pressure test is taken, you can determine whether or not --  
10 Pressure is the key here, if it's communicated with the  
11 unit or not.

12 Q. Isn't the presumption that the pore volume is  
13 going to exist under Tract 21 that at this time it ought to  
14 contribute, it ought to be included in the unit?

15 A. Yes, the way we've drawn it.

16 Q. All right. So how do we stop redrawing the pore-  
17 volume map every time an additional well is added to the  
18 unit? Are you going to redraw it every time?

19 A. I commented before that we don't like to bring in  
20 unnecessary acreage. We'd like to have the drill bit find  
21 it, bring it into the unit, based on what the actual pore  
22 volume is calculated by the wellbore.

23 Q. Well, here's the problem with that, Mr. Mladenka.  
24 If you wait till you develop the pool entirely with all the  
25 necessary wellbores, we're going to unitize this after the

1 reservoir has been fully depleted. Then you'll have an  
2 accurate number.

3 A. It's just a dynamic thing. Each time a well is  
4 drilled, it changes the picture.

5 Q. All right. So at this point in time, what  
6 happens with this drilling well? Are we going to forget  
7 about it, are we going to freeze it in terms of this pore  
8 volume map, or are we going to come back next month and re-  
9 do the map?

10 A. It's hard to think that far ahead.

11 Q. All right. Let's talk about the wellbore factor.  
12 Now, the proposed change is an 80-20 split, 80 percent  
13 hydrocarbon pore volume, 20 percent this wellbore factor?

14 A. That's correct.

15 Q. And the wellbore factor, as I understand it, is  
16 to make Hanley happy. Is that where you got that?

17 A. There were -- Everyone was to contribute an idea  
18 on the formula. We didn't even get far to discussing,  
19 other than what was faxed between the members, faxed.

20 At the meeting a new member showed up to the  
21 technical committee, voiced Energen's position of only oil  
22 in place and well factor, and then Hanley jumped up --  
23 Well, we want three percent then.

24 Q. Well, let's talk about that. Where does the  
25 three percent come from that makes that fair and equitable

1 to anybody?

2 A. Well, it happened to come from an 80-20 split  
3 that Energen had been working on. That came the closest to  
4 get Hanley to their fair portion, or of what they wanted.

5 Q. All right, that's my question. The three percent  
6 is what they wanted?

7 A. Correct.

8 Q. Does the three percent represent anything within  
9 the tracts that they controlled at that time in terms of  
10 their share of oil in place?

11 A. Yes.

12 Q. All right, so that's the link?

13 A. Right.

14 Q. All right. So there is some science behind the  
15 three percent?

16 A. Exactly.

17 Q. That is their equitable share for those two  
18 tracts?

19 A. That is correct.

20 Q. And how you back into giving them is part of the  
21 commotion about this three-percent figure?

22 A. Exactly.

23 Q. All right. When we look at the wellbore factor,  
24 now, there's a way to calculate that factor. It is a  
25 certain rate over a certain period?

1 A. That is correct.

2 Q. All right. Let's compare the Hanley Chandler  
3 well with the Snyder "C" 4 well --

4 A. Okay.

5 Q. -- in terms of its true value to the unit as to  
6 each well in the position in the pressure maintenance  
7 project. Which of those two wells is more important for  
8 the remaining life of the unit?

9 A. At nine-dollar oil, the Hanley well is hurting.  
10 The operating costs were compared on a dollar-barrel basis.  
11 I think the Snyder "EC" Com was -- on a per-barrel basis,  
12 the operating cost was a third of what -- the operating  
13 cost for the Hanley well. And that's almost 80 percent of  
14 it due to hauling water off.

15 Q. So when you look at the future forecast for  
16 operations, the Hanley Chandler 1 well is likely to be  
17 abandoned in the not-too-distant future?

18 A. The water-oil ratio is going up, and it's a  
19 possibility. As soon as the reservoir pressure starts to  
20 drop and you're going to have -- We're pumping it from 7500  
21 feet. It's going to be more and more difficult to keep  
22 your oil rate up with the existing equipment.

23 I don't foresee that well being -- contributing  
24 that much value. It will either be a washback because  
25 we're going to have to spend more money on bigger units,



1 and also handling the water.

2 Q. Let's look at the Chandler well in relation to  
3 the other Snyder well, the EC 1 in Tract 16. Now, this is  
4 the well that has a -- what? A 16-percent well factor? I  
5 think you told that?

6 A. That is correct.

7 Q. The Hanley well gets an 80-percent well factor?

8 A. That's correct.

9 Q. When you look at the position of the Snyder "EC"  
10 1 well for the remaining future oil recovery in the  
11 pressure-maintenance project, as a practical matter the  
12 Snyder well is more valuable to the unit, is it not?

13 A. I feel like it probably depends on the oil price.  
14 The operating cost right now on the Snyder "EC" Com is a  
15 lot less, I think. I haven't really put a number to it,  
16 but I think currently the "EC" Com is probably generating  
17 more income than the -- at 40 barrels a day. The Hanley  
18 well, the 13 well, is down to 60 barrels a day at current  
19 rates.

20 So yes, I'd say that right now the "EC" Com is  
21 more valuable than the well in Tract 14.

22 Q. Well, in looking at Tract 16 and 17, the capture  
23 point for each of those wells in the unit as they capture  
24 oil for the unit are better positioned and of greater value  
25 than the Chandler well, are they not?

1           A.    If you consider water, yes.  If you consider  
2 structural position and the relative position of those two  
3 wells, in this map here you'll see that the Snyder "C" 4 is  
4 communicated in the gas cap.  The "EC" Com has got a little  
5 ways to go.  That well will probably make 40 barrels a day  
6 until reservoir pressure no longer contributes any push to  
7 it.  I don't think you'll ever see the gas cap on that  
8 well.

9           Q.    All right, let's look at the wellbore factor,  
10 then.  The wellbore factor, the 80-20 split, was a way to  
11 back into the three-percent equity for Hanley, right?

12          A.    Assuming no ownership in Tract 15.

13          Q.    All right.  Did you examine any other percentage  
14 for a wellbore factor to see if it was equitable for all  
15 the tracts?

16          A.    Say that again?

17          Q.    Yeah, did you use any other wellbore factor,  
18 other than 20 percent, to see how it affected any of the  
19 rest of these tracts?

20          A.    I'm sure each member ran their own numbers out.

21          Q.    Well, what's your assessment about the fairness  
22 of the 20-percent allocation to a wellbore factor, as to  
23 all tracts in the unit?

24          A.    We -- even though -- We're trying to be as fair  
25 as we could.  Tracts 1 through 11, even though some of the

1 wells never produced at 250 a day, they were capable of it.  
2 And we assigned one to those particular wells. I felt like  
3 it was a compromise.

4 Q. But within the range of fairness?

5 A. Yes.

6 Q. Give me an understanding about the pore volume  
7 map on Exhibit 3. When you look at the north edge of the  
8 zero line, it's contiguous with the oil-water contact,  
9 right? You see it across --

10 A. Yes, I believe that's based on the top of the  
11 Strawn.

12 Q. As you move around clockwise and you get to  
13 Section 35, you're using the zero line for the pore volume  
14 calculations, as opposed to what is the oil-water contact,  
15 right?

16 A. Yes, it appears that way.

17 Q. All right. Why not include all the reservoir  
18 down to the oil-water contact?

19 A. I don't know. That is where we felt like the  
20 porosity boundary was. That's the zero. There's no  
21 porosity between the zero line and the oil-water contact  
22 where we're mapping, no hydrocarbon pore volume between the  
23 zero line and the water-oil contact, no porosity, no  
24 hydrocarbon-bearing porosity.

25 Q. All right. So there's a reasonable technical

1 basis for using the zero line as opposed to the additional  
2 part of the Strawn that would take you down to the oil-  
3 water contact?

4 A. Right.

5 Q. So summarize for me where are the points of  
6 difference...

7 Well, let me ask you this: If Energen and  
8 Gillespie agree, do you control enough of the working  
9 interest to have the 75 percent?

10 A. Yes.

11 Q. What's the split between the two of you?

12 A. Currently it's about 50-50, like 45 percent, 45  
13 percent, or -- We control like 92 percent of it.

14 Q. Then why are you trying to make Hanley happy?

15 A. A *de novo*, threat of shut-in, I've had this gun  
16 pointed at my head for seven, eight months. We thought we  
17 made Hanley happy, now Energen's filed it. We're -- It's  
18 time to get a proposal out.

19 Q. So with 90 percent of the working interest owner  
20 controlled by Energen and Gillespie, there were still  
21 substantial issues of concern to you that, in your opinion,  
22 required combinations with Yates and Hanley?

23 A. Yes.

24 Q. All right, summarize for me the differences, now.  
25 You have, at least at the working interest owner committee,

1 the technical group level of this process, you've got  
2 agreement on a hydrocarbon pore volume map and how to  
3 allocate all that back to the tracts, right?

4 A. Correct.

5 Q. We have a method to provide an additional  
6 compensation for tracts that have wells on the 80-20 split.  
7 There was a way for everybody to agree to that formula?

8 A. That's correct.

9 Q. All right. So the difference is whether or not  
10 the Snyder "C" 4 well gets more than one times payout.  
11 That's the difference, right?

12 A. That's the difference.

13 Q. All right. Is there any other difference?

14 A. No. Well, I think our proposals show a different  
15 map, expansion area.

16 Q. No, I meant within the technical committee.

17 A. Oh, no, that was it --

18 Q. All right.

19 A. -- just within the technical committee.

20 Q. And the way to compensate Hanley for this three  
21 percent is tied back to the pore volume distribution, and  
22 at least in the technical committee everybody says, That's  
23 a way to make it work, let the lawyers figure out how to  
24 write the words?

25 A. Exactly.

1 Q. All right. So the only reason we're here today  
2 is because somebody can't make up their mind on the  
3 wellbore payout percentage for the Snyder "C" 4 well?

4 A. Yes.

5 Q. At the technical committee, Gillespie was willing  
6 to accept two times?

7 A. Yes.

8 Q. What's the difference in dollars between one and  
9 two times payout?

10 A. On the "C" 4?

11 Q. Yes, sir.

12 A. About \$700,000.

13 Q. So we're here fighting over \$700,000?

14 A. Correct.

15 MR. KELLAHIN: No further questions.

16 EXAMINER STOGNER: Mr. Cooter?

17 MR. COOTER: I have no questions.

18 EXAMINER STOGNER: Mr. Bruce?

19 MR. BRUCE: Just a couple of follow-ups. I think  
20 Mr. Boneau will testify about the formula, so we'll leave  
21 that go.

22 REDIRECT EXAMINATION

23 BY MR. BRUCE:

24 Q. On the well-payout issue, Mr. Mladenka, that  
25 proposal made at the working interest owners' meeting was

1 retracted by Mr. Gillespie, was it not?

2 A. Correct.

3 Q. Now, Mr. Gillespie is what? Seventy-three years  
4 old?

5 A. That's correct.

6 Q. Extremely poor health?

7 A. Correct.

8 Q. This pool is almost like a child to him, isn't  
9 it? It might sound funny, but isn't it?

10 A. Yes, he should get rid of some of his stuff, but  
11 he doesn't.

12 Q. He would like to see final resolution to the  
13 unitization matters?

14 A. Extremely, he would be pleased.

15 Q. Mr. Gillespie's personal witness will make a  
16 proposal regarding well payout, won't he?

17 A. Yes, he will.

18 Q. And it's already come up but, you know, Mr.  
19 Gillespie would like some payout factor involved?

20 A. Yes, that's correct.

21 Q. At this point he's willing to let the Division  
22 make a decision, isn't he?

23 A. That is correct.

24 MR. BRUCE: That's all I have.

25 EXAMINER STOGNER: Mr. Carroll?

## EXAMINATION

BY MR. CARROLL:

Q. Mr. Mladenka, we've discussed the payout for the Snyder "C". Is there any issue as to payout for the Snyder "EC" Com?

A. We had proposed, based on the well factor, if you gave the 200 percent, the -- you'd get 100 percent for the wellbore, the "EC" Com. You can't have less than -- if a tract -- Okay, let me back up.

You have 16-percent well factor. What I proposed was 116-percent payout for the "EC" Com. So you get 100 percent plus whatever well factor percent between the next -- between 100 and 200 percent. So it would be 116 percent. The well factor for the tract, the "EC" Com, is 16 percent, it gets 116-percent payout.

Q. So the well factor for the Snyder "C", then, is one?

A. One. So --

Q. Okay.

A. -- 100 percent of the next hundred is 200 percent.

Q. And then going back to Tracts 14 and 15 -- and I guess assigning three percent to Hanley is based on the fact that if they're right and Tract 15 should have been included all along, they would get three percent for both



1 tracts?

2 A. Correct.

3 Q. But if it's later included and through no fault  
4 of their own they've lost the lease on 15, they'd still get  
5 the three percent --

6 A. Right.

7 Q. -- for 14. And if they do lose the lease, there  
8 will actually be 4.4 assigned to 14 and 15, and the Land  
9 Office will get the extra 1.4?

10 A. Correct.

11 MR. CARROLL: Okay, that's all I have.

12 EXAMINER STOGNER: I believe it's time we take  
13 about a 20-minute recess at this time.

14 (Thereupon, a recess was taken at 10:45 a.m.)

15 (The following proceedings had at 11:15 a.m.)

16 EXAMINER STOGNER: This hearing will come to  
17 order.

18 I believe there's another entry of appearance at  
19 this time, and I will let this gentleman do so at this  
20 time. Please stand and state your name.

21 MR. ADAMS: Thank you, sir, I'm Phillip Glenn  
22 Adams. My wife and I -- Donna -- were residents of  
23 Lovington. I've been there all my life and have land in  
24 Lovington. I used to be a Commissioner there, but she got  
25 a job, moved up with her state job and we had to move to

1 Albuquerque -- to Santa Fe, ten years ago.

2           So we'd just like to say that on the surface, we  
3 feel like -- we object -- this new well that's being --  
4 started being drilled yesterday -- our interest, being a  
5 part of this big thing. We always felt that for 30 or 40  
6 years the people in the Snyder Ranches were getting stuff  
7 out from under our stuff. But it looks like they admit  
8 they have, and sure enough, it might be a dry hole now.  
9 But you know, at one time it might have had a lot of fluid  
10 and pressure.

11           I just wanted to tell you that -- keep the new  
12 folks in mind, that some of the other people have really  
13 done well for 40 years.

14           EXAMINER STOGNER: Thank you, sir. The record  
15 will so show Mr. Adams' appearance in this matter.

16           MR. HALL: Mr. Examiner, briefly, some additional  
17 matters came up on cross-examination of Mr. Mladenka, and  
18 I'd like to reserve the right to call him later if  
19 necessary, pending what's presented with the new proposal.  
20 But in the interests of time, I'll forego further cross-  
21 examination of him on those new issues, if that's agreeable  
22 with the Examiner.

23           I'd also move the admission of Exhibit M-1.

24           EXAMINER STOGNER: That was -- Okay, we'll admit  
25 Exhibit Number M-1 -- and that is Energen's Exhibit -- into

1 evidence at this time.

2 MR. BRUCE: Mr. Examiner, I don't know if I moved  
3 the admission of Gillespie Oil Exhibits 1 through 14,  
4 but --

5 EXAMINER STOGNER: I believe you did, but I'll do  
6 that again, and just make sure that the record is clear on  
7 that. Exhibits 1 through -- that's 14, right? -- are  
8 admitted into evidence at this time if we haven't already  
9 done so.

10 Okay, Mr. Bruce?

11 MR. BRUCE: Mr. Examiner, that's all I had on the  
12 technical committee report. At this time I thought it  
13 best, since we're on the technical committee stuff, if  
14 there is any testimony by Dr. Boneau or by Energen about  
15 that to perhaps clarify what should be in the technical  
16 committee, if Scott or Bill or Tom would like to present  
17 their witnesses, I'd be more than glad to let them do so.

18 MR. CARROLL: Mr. Bruce, I have one more question  
19 of Mr. Mladenka.

20 EXAMINATION (Continued)

21 BY MR. CARROLL:

22 Q. How would the Energen well be treated that's  
23 currently being drilled for payout purposes?

24 A. Under the technical committee proposal, it's only  
25 the hydrocarbon pore volume as you see drawn and no

1 wellbore factor. The technical committee also proposed an  
2 effective date of April 1st -- so there's no well -- of  
3 1999.

4 Q. What do you mean there's no well?

5 A. Well, there's no well -- We picked an effective  
6 date of April 1st. There's no well there, so it gets no  
7 well factor, and we just give it the drawn in HPV volume  
8 right now as shown.

9 MR. CARROLL: Okay. Mr. Bruce?

10 MR. BRUCE: I was going to point out that there  
11 has been correspondence between Mr. Hall and myself, and I  
12 believe Energen will have a different proposal.

13 And all Mark was talking about was that under the  
14 technical committee map and formula as now drawn, the  
15 effective date would be April 1, 1999 for unit expansion.  
16 And since there was no well at that time, there would be no  
17 well factor. So, you know, that 80-20 formula would be --  
18 the 20-percent well factor would be 20 percent of zero. So  
19 that tract's participation would be based solely on HPV.

20 Q. (By Mr. Carroll) So if it was a dry hole, what  
21 would they be credited with?

22 A. The current HPV allocated to it, as we drew.

23 MR. CARROLL: Okay.

24 EXAMINER STOGNER: And the same if the well is a  
25 big success, it still gets the same percentage; is that

1 correct?

2 THE WITNESS: (Nods)

3 EXAMINER STOGNER: Okay. So Mr. Bruce, are you  
4 resting your case at this time?

5 MR. BRUCE: I'm resting the case on the technical  
6 committee presentation. And, you know, it's up to your  
7 pleasure and the pleasure of the other attorneys. If there  
8 are any points of clarification -- and there may well be  
9 with Scott, on how Energen sees the tract participation  
10 formula, maybe that would help clear -- at least as to that  
11 portion, would help us clear up the matter.

12 EXAMINER STOGNER: Okay, why don't you proceed,  
13 Mr. Bruce, and see what they've got to say today?

14 MR. CARROLL: Mr. Hall, do you have a witness as  
15 to the technical committee?

16 MR. HALL: Yes, I'll proceed however you wish.

17 MR. CARR: Mr. Examiner, Dr. Boneau was here to  
18 -- really for two purposes: to just summarize the situation  
19 as to Tract 14 and 15, and also give an overview on the  
20 formula. If you would like that at this time, I could call  
21 him and we could do that. A lot of it has been covered.  
22 We could make a fairly brief presentation.

23 EXAMINER STOGNER: If it's brief, then I'd like  
24 to have it on the record at this time, while we're all  
25 here.

1 MR. CARR: All right. At this time, with your  
2 permission, Mr. Examiner, I'd call David Boneau.

3 EXAMINER STOGNER: Dr. Boneau has been briefed  
4 that this will be brief?

5 MR. CARR: He has been briefed, this will be  
6 brief.

7 DAVID F. BONEAU,  
8 the witness herein, after having been first duly sworn upon  
9 his oath, was examined and testified as follows:

10 DIRECT EXAMINATION

11 BY MR. CARR:

12 Q. Could you briefly state your name for the record?

13 A. David Francis Boneau.

14 Q. Where do you reside?

15 A. I live in Artesia, New Mexico, and I work --

16 Q. By whom are you employed?

17 A. I'm employed as a reservoir engineer by Yates  
18 Petroleum Corporation.

19 Q. Dr. Boneau, have you previously testified before  
20 this Division and had your credentials as an expert in  
21 petroleum engineering accepted and made a matter of record?

22 A. Yes, sir, I have.

23 Q. Are you familiar with the Application filed in  
24 this case on behalf of Gillespie?

25 A. Yes, sir.

1 Q. Have you been involved in the prior hearings and  
2 negotiations concerning the development of the Strawn  
3 reservoir in the area of the West Lovington-Strawn Unit?

4 A. Yes, we've been involved since the time the unit  
5 was formed. We were not part of the original unit.

6 Q. Are you prepared today to present testimony  
7 concerning the proposal before the Division concerning the  
8 inclusion of certain tracts in the reservoir and the  
9 allocation formula?

10 A. Yes, sir, we're just -- try to clear up a few  
11 things.

12 MR. CARR: Are Dr. Boneau's qualifications  
13 acceptable?

14 EXAMINER STOGNER: Any objection?

15 Dr. Boneau is so qualified.

16 Q. (By Mr. Carr) Dr. Boneau, first I'd like to  
17 direct your attention to the recommendation of the  
18 technical committee concerning the inclusion of Tracts 14  
19 and 15 and the allocation of the unit production between  
20 those two tracts. Could you just summarize the position of  
21 the technical committee in that regard?

22 A. If we can keep this brief, it will be a miracle.

23 The technical committee drew the map in Exhibit  
24 3, and it includes hydrocarbon pore volume in Tract 14 and  
25 Tract 15. And it sounded like, towards the end, that you

1 guys were getting the fog cleared away and starting to  
2 understand what's going on.

3 But Tract 15 contains significant hydrocarbon  
4 pore volume and needs to be in the unit. It has this fact  
5 that its perm went away in June or something of 1998, I  
6 believe, was about the time that its -- the action, the  
7 drilling on it, ended and it would expire except for the  
8 extraordinary circumstances.

9 We discussed -- So we want Tract 15 to be in the  
10 unit, and we discussed three ways -- I think we discussed  
11 three ways to try to approach that.

12 And the first was that we called Mr. Carr who  
13 worked out the deal with us, with the State Land Office.  
14 Somehow we get the State Land Office just to say that it's  
15 effective, that the lease is held until April 1, 1999. I  
16 don't know why they would do that; but if they would do  
17 that, that would solve the problem. Does that make sense?  
18 Okay.

19 The second thing we talked about was, re-open the  
20 *de novo* and get Tract 15 included as of 11-1-97, along with  
21 Tracts 12, 13 and 14. And that would, then, have it in the  
22 unit before the expiration date, it would be okay. And  
23 there's some issues related to back payment of royalties  
24 and fairness of treatment, et cetera, that, in my memory,  
25 mostly it was the Energen people said would be bigger



1 problems. But anyway, there were some problems with that  
2 approach.

3 Q. And those are issues, Dr. Boneau, that would be  
4 resolved with the Land Office; is that right?

5 A. That would be with the Land Office. But the  
6 technical committee moved away from that approach because  
7 of those kind of problems.

8 And the third approach, which is what you've  
9 heard from Gillespie, was, I would call, just-give-Hanley-  
10 three-percent approach. Okay. And that's what we tried --  
11 what was tried to be presented to you.

12 Okay, let's get the numbers right.

13 The technical committee hydrocarbon pore map and  
14 the 80-20 formula result in Tract 14 having 1.6 percent, in  
15 round numbers, and Tract 15 having 1.4 percent, in round  
16 numbers. Okay.

17 So the just-give-Hanley-three-percent approach  
18 would say, Let's put the total of those, three percent,  
19 into Tract 14, because Hanley clearly owns Tract 14.

20 And you can't make Tract 15 disappear, so you've  
21 got 1.4 percent sitting in Tract 15, under the presumption  
22 that that lease has expired and it's back to the Land  
23 Office.

24 To make all that add up to 100, you've got to  
25 subtract 1.4 percent from something. And so what Mark

1     tried to explain was that you deduct 1.4 percent from all  
2     the other tracts proportionately, proportionate to how much  
3     each tract has.

4             So now you have three percent in Tract 14, 1.4  
5     percent in Tract 15, with Land Office ownership, and you've  
6     reduced the other tracts so that it all adds up to a  
7     hundred.

8             Now, then presumably Tract 15 could go back up  
9     for lease again sometime. The State Land Office might put  
10    that back up for lease. And the unit would try to bid on  
11    it. If the unit bid on it and bought it, you could  
12    redistribute that, go back to all the people that gave it  
13    up and end up just back where you were.

14            I could explain that in more detail, but I think  
15    it's obvious.

16            If some, what I call tenth party, you know,  
17    somebody else, buys that, they would own 1.4 percent of the  
18    unit. And the people who gave up something would not get  
19    it back, basically.

20            Okay, is that enough of an explanation or am I  
21    just --

22            Q.    Dr. Boneau --

23            A.    -- repeating what -- I'm just repeating what  
24    maybe is already in your head. I think it's --

25            Q.    And Dr. Boneau, if, in fact, the --

1 A. -- it does make sense eventually.

2 Q. -- the unit is expanded to include Tract 15 as  
3 part of the *de novo* process, then that tract would just  
4 come into the unit, and the numbers set forth on Exhibit 8  
5 that show three percent in Tract 14 and an additional sum  
6 for Tract 15, those numbers would have to be readjusted; is  
7 that not correct?

8 A. I think every number on that Exhibit 8 would have  
9 to be readjusted. But if you can get Tract 15 into the  
10 unit through the *de novo* process, you simply use the  
11 unadjusted numbers from the technical committee.

12 Q. And you worked with the -- as a representative of  
13 Yates Petroleum Corporation on the technical committee, did  
14 you not?

15 A. Yes, sir.

16 Q. You were involved in the discussions that  
17 resulted in the formula that was presented as the work  
18 product of the technical committee; is that fair?

19 A. Yes.

20 Q. And can you just summarize how the formula is  
21 designed to work?

22 A. I'd like to go a little bit before that. I  
23 think, as everybody knows, when that first expansion took  
24 place Gillespie proposed something that was adopted, and  
25 Yates and Hanley proposed, really, in opposition, another

1 set of ideas. And those ideas were mostly a different  
2 boundary and a different formula. Our boundary was based  
3 on 3-D seismic, which turned out to be partly wrong anyway.

4 Our boundary was rejected, and I think our  
5 formula was rejected along with the baby and the bathwater.

6 But some facts are that, the Hanley well, the  
7 Chandler well, was producing 194 barrels of oil a day  
8 before it went into the unit, and the formula that resulted  
9 from that expansion hearing gave them 8 barrels a day.  
10 Now, I'm just saying, the formula on the first expansion  
11 did not treat Hanley fairly, in my opinion. And I've done  
12 predictions that the Hanley will produce 12 percent of the  
13 remaining oil, and they got .28 percent.

14 Anyway, the whole idea of the *de novo* is not that  
15 Yates was really mad about the expansion, the first  
16 expansion, but the treatment of Hanley was not fair, in my  
17 judgment. And so Yates' approach since that time has been  
18 to try to get a fair shake for Hanley. It's that simple.

19 Okay. And part of the idea -- The main part of  
20 the idea of Hanley getting a fair shake was that a formula  
21 based on hydrocarbon pore volumes where you keep adding  
22 little pimples of hydrocarbon pore volume was not going to  
23 give these edge wells that they're due, and you needed a  
24 formula that included something related to production and  
25 wellbores.

1           And so I went into this technical committee  
2           action with the main goal of getting a formula that had  
3           wellbore factor, what we call wellbore factor, which is  
4           really a production kind of -- a worth-of-the-well idea.

5           And in the committee all of us brought up 20  
6           different parameters and, you know, a hundred to the nth  
7           kind of formula ideas. But Energen put them down on paper  
8           in a coherent way that covered the range that people were  
9           talking about, and -- yeah, like was described to you.

10           When the 80-20 formula came up, actually myself  
11           and the Hanley people said, Oh, we'd like 75-25 better.  
12           But it gave Hanley ten times what they were getting, and  
13           they -- You know, maybe they deserved 20 times or five  
14           times, but it was the first thing that was in the realm of  
15           sense. And we were happy to take it, and it's a fair --  
16           you know, it turns out to be a fair formula for everybody  
17           and wonderful.

18           And we talked about a lot of things, but they had  
19           these things on paper. The one in the middle was a 20-80,  
20           and it got Hanley ten times what they wanted and it kept  
21           Yates about where it was, and in the interest of not  
22           fighting and going ahead, boy, let's go with that. And  
23           everybody says, Yippee, and we go on to these harder  
24           things.

25           I don't know, does that answer your question in

1 any sense, in any helpful way?

2 Q. In your opinion, does the former Hanley Chandler  
3 well contribute real value to the unit?

4 A. Very definitely, very definitely so. The best  
5 exhibit of it is that picture that Mark showed with his  
6 one-dimensional picture. The Hanley well is in an ideal  
7 position for this process where the gas is pushing the oil  
8 down. It's better than the "EC" 1 in that it has a good  
9 permeability. It's in the ideal position.

10 The kicker is that, somehow things water. It  
11 shouldn't make water, but it makes water. Something in  
12 drilling and completing it resulted in it making water, and  
13 that's a knock on it, that's a bad thing. Other than that,  
14 it would be the best well in the whole pool for producing  
15 under this gas-injection project. Without the gas-  
16 injection project, its value would go down.

17 And so it's not worth millions and millions of  
18 dollars, but it's a very valuable well, especially for this  
19 gas-injection project, and it deserves more than .28  
20 percent of the unit.

21 Q. Dr. Boneau, do you have anything further to add  
22 to your testimony?

23 A. No, I think that you guys have indulged us long  
24 enough.

25 MR. CARR: That concludes my direct examination

1 of Dr. Boneau.

2 EXAMINER STOGNER: Mr. Hall?

3 MR. HALL: I have no questions?

4 EXAMINER STOGNER: Mr. Bruce?

5 MR. BRUCE: No questions.

6 EXAMINER STOGNER: Mr. Kellahin?

7 MR. KELLAHIN: Thank you, Mr. Examiner.

8 CROSS-EXAMINATION

9 BY MR. KELLAHIN:

10 Q. Dr. Boneau, when you studied the technical data  
11 for the Hanley Chandler well, there is no doubt that that  
12 is in pressure communication with the pressure-maintenance  
13 project, is it?

14 A. It's in pressure communication.

15 Q. And by the time the Chandler well is brought into  
16 the unit, you agree, do you not, sir, that the owners of  
17 that tract receive two and a half times the cost of that  
18 wellbore? Is that not true?

19 A. As far as I know, that's true. Hanley told me  
20 something like that is true.

21 Q. When we look at Tract 12 for the Gillespie State  
22 "S" 1 well, that well also is directly pressure-connected  
23 to the pressure-maintenance project, is it not?

24 A. That's what the data shows, yes, sir.

25 Q. And by the time that well is brought into the

1 unit, the owners of that spacing unit realized six times  
2 payout, did they not?

3 A. You say that. I don't think it's six times, but  
4 five and a half times or whatever --

5 Q. All right, let's use five and half. Are you  
6 comfortable with five and a half?

7 A. Five and a half is wonderful. From the Yates --  
8 Obviously, from the Yates point of view, I'm a little bit  
9 unhappy with the inference that we're getting rich off of  
10 this, but we own a half a percent of the unit, and we have  
11 spent way more dollars on Mr. Carr than we have gotten rich  
12 on this well, I'll tell you.

13 Q. Well, I'm looking for the fair shake now, Dr.  
14 Boneau. When we look at the Snyder "C" 4 well, that well,  
15 the data shows, is in pressure connection with the  
16 pressure-maintenance project, is it not?

17 A. That's the conclusion from the data, yes.

18 Q. So how are we going to do equity to the tract  
19 owners in 17 for the Snyder "C" 4 well if they're limited  
20 by this proceeding to only receiving their money back one  
21 time before the well is contributed to the unit? Where is  
22 the fair shake for Tract 17?

23 A. I'm tempted to talk about blame, and I don't want  
24 to get into that a whole lot. But Mr. Gillespie has put  
25 himself in positions he doesn't want to be in. In the



1 first case, in the State "S" and the Chandler well, he  
2 really wanted them in fast, and his action brought them in  
3 slow. On the Snyder "C" 4 well, he really wants it in slow  
4 because he owns it, and his actions are going to bring it  
5 in fast.

6 Q. Let's set aside who owns what in which wellbore,  
7 but let's just look at the facts of when the wellbores --

8 A. Okay?

9 Q. -- contributed in terms of payout. How many  
10 times --

11 A. Through various -- You know, through various  
12 things that happened, the Chandler well and the State "S"  
13 well were brought in slow, and they got all this money that  
14 you're talking about. And I mean that's a fact, it's  
15 indisputable.

16 Q. Part of that delay was a result of the contested  
17 hearings and going to a *de novo* process, was it not, sir?

18 A. Probably some part. But the fact -- That  
19 happened, and I'm trying to actually answer your question  
20 now.

21 Q. I'm waiting for it.

22 A. The fact that that happened gives Mr. Gillespie  
23 an argument that he needs more than a 100-percent payout on  
24 the "C" 4. And I can appreciate his position on that, and  
25 I can agree that because of the special circumstances he

1 needs more than 100-percent payout on the "C" 4.

2 Q. Where do you vote?

3 A. Where do I vote?

4 Q. Yes, sir.

5 A. I mean, I will vote anywhere that Energen and  
6 Gillespie agree. As a matter of fact, I think I voted for  
7 Gillespie's 200-percent-payout AFE. I put it in the mail  
8 to him, and if he didn't get it -- But that doesn't mean  
9 that I'm jumping up and down for 200 percent and hate 150.

10 Q. It was not Yates' negative vote that had anything  
11 to do with the difference of opinion between Energen and --

12 A. No, and Yates -- I voted for the 200 percent. If  
13 you guys gave me something with 150 percent, I would vote  
14 for it. If you gave me -- You know, I will vote for any of  
15 those.

16 Q. You've answered my question, Dr. Boneau.

17 A. It's the two -- It's you two guys that have got  
18 to agree.

19 Q. Let me ask you this. We've got an Energen well  
20 that's just about ready to spud in the southwest southwest  
21 of 35 in Tract 21. You can read Exhibit 9, which is the  
22 new paragraph 13 that was worked on. You can read that if  
23 the effective date is April 1st of 1999, then any wells  
24 after that date are unit wells, are they not?

25 A. That's the way I would see it, yes.

1 Q. So my question is, what should we do with the  
2 Energen well in the southwest southwest of 35? How do we  
3 handle the fact that there are additional wells to be  
4 drilled in the unit?

5 A. Well, once the unit is formed and there are  
6 additional wells drilled by the unit, they're clearly unit  
7 wells. So let's just talk about this one.

8 Q. All right.

9 A. And I can only see two things to do. I would  
10 prefer that the unit drilled that well. And I stated that  
11 at the working interest owners' meeting and that Yates  
12 would sign up for its portion of that well this minute if  
13 somebody would give me the piece of paper. I detect that  
14 not -- that the big owners don't agree on that and that's  
15 not happening, but that's what ought to happen.

16 The other thing that could happen, that other  
17 thing that makes some sense to me, is that we come out of  
18 this deal with a boundary and a formula and some good  
19 things, but we don't -- we come out of this with the  
20 framework of an agreement.

21 The well is drilled, you find out the data on it,  
22  $\phi$ h and et cetera, feet of pay and all that good stuff. And  
23 you give that data to the technical committee and Platt-  
24 Sparks or whoever else wants to come, and give us six weeks  
25 or something to come up with a new, agreed-upon hydrocarbon

1 pore volume map, and you insert that hydrocarbon pore  
2 volume map into the formula instead of ABC, or all the  
3 zillion other ones that we have.

4 Those are the only two things that make sense to  
5 me that I can think, for handling that well.

6 And the other alternative is, you know, postpone  
7 the whole talk until six months from now or a year from  
8 now.

9 Anyway, those are the only two things that make  
10 sense to me right now.

11 MR. KELLAHIN: Thank you, Dr. Boneau.

12 EXAMINER STOGNER: Mr. Cooter?

13 MR. COOTER: I have no questions.

14 EXAMINER STOGNER: Mr. Carr, do you have any  
15 redirect?

16 MR. CARR: No, I do not.

17 EXAMINATION

18 BY EXAMINER STOGNER:

19 Q. Let's take one little scenario on that Tract  
20 Number 15.

21 If the lease is indeed expired and Hanley goes  
22 out and bids on it and gets it, that is the only way they  
23 could get 4.5 percent under this proposal?

24 A. I see what you're saying. I think I see what  
25 you're saying. And personally, I think that should not be

1 allowed to happen, that any -- in my idea, what's  
2 reasonable, any member of the unit that buys it should be  
3 forced to share it with the unit, and then it goes back to  
4 everybody else.

5 I mean, that's -- to me, that's just a variation  
6 of the unit buys it. And I wouldn't, you know, make a side  
7 agreement, or whatever, that individual members of the unit  
8 can't compete with the unit in bidding on it. That would  
9 be my approach, but --

10 Q. But that wasn't put into the agreement under the  
11 present terms?

12 A. I don't see that written in the --

13 Q. Under the present terms, anybody that comes in on  
14 a successful bid with the Land Office would be entitled to  
15 what, 1.4 percent; is that correct?

16 A. That's correct.

17 EXAMINER STOGNER: Okay. Any other questions of  
18 Dr. Boneau?

19 You may be excused.

20 MR. CARR: Thank you, Mr. Stogner.

21 EXAMINER STOGNER: Anything further, Mr. Bruce?

22 MR. HALL: Mr. Stogner, we'll be pleased to call  
23 our single witness now.

24 EXAMINER STOGNER: Okay.

25 MR. HALL: Call Barney Kahn to the stand.

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BARNEY KAHN,

the witness herein, after having been first duly sworn upon  
his oath, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. HALL:

Q. For the record, please state -- sir, state your  
name.

A. Barney Kahn.

Q. And where do you live and by whom are you  
employed?

A. I live in Birmingham, Alabama. I've been  
employed by Energen Resources for the past two and a  
quarter years.

Q. And what do you do for Energen?

A. I'm a reservoir engineer.

Q. You have not previously testified before the New  
Mexico Oil Conservation Division; is that correct?

A. No, I have not.

Q. Have you testified before other states'  
regulatory agencies or courts and had your credentials  
accepted as a matter of record?

A. Yes, I've testified in the State of Texas and  
various bankruptcy hearings in various cases.

Q. Would you please give the Hearing Examiner a  
brief summary of your educational background and work

1 experience?

2 A. Okay, I've been a registered engineer in Texas  
3 since 1968. I graduated from Texas A&M with a degree in  
4 engineering in 1960. Thirty years of my employment has  
5 been with petroleum consulting companies. Seventeen of  
6 those years were with Gruy and Associates. Half of that  
7 time was as the Senior VP in the Houston Office.

8 Another 13 years -- I formed a consulting company  
9 -- I was with that consulting company, Kahn and Associates.

10 Q. Are you familiar with the Application before the  
11 Division today?

12 A. Yes.

13 Q. And you're familiar with the West Lovington-  
14 Strawn Unit?

15 A. Yes.

16 MR. HALL: Mr. Examiner, are the witness's  
17 credentials acceptable?

18 EXAMINER STOGNER: Any objections? So qualified.

19 Q. (By Mr. Hall) Mr. Kahn, did you participate in  
20 the West Lovington-Strawn Unit technical committee  
21 deliberations?

22 A. Yes, I first became involved in the technical  
23 committee meeting February 11th of this year.

24 Q. All right. Could you explain to the Hearing  
25 Examiner your understanding of the circumstances leading up

1 to the agreement on the HPV well-factor based formula  
2 proposed by the technical committee?

3 A. Well, it was Energen's position that 100 percent  
4 of the HPV volume would be the most acceptable factor to  
5 use in the participation formula, but that we were willing  
6 to go along with an additional parameter, which was a well  
7 factor parameter, that took into account wells that were  
8 not able to produce the full allowable for a six-month  
9 period of time.

10 Q. What was the technical basis for the 80-20  
11 formula?

12 A. Well, the technical basis for the well factor was  
13 the fact that any of the wells that could have produced  
14 over 250 barrels a day consecutively for six months would  
15 be assigned a factor of one. Any of the wells that were  
16 unable to produce 250 barrels a day were proportionately  
17 reduced.

18 Q. From your --

19 A. There was no technical basis for saying that  
20 80-20 was any better than 90-10 or 70-30.

21 Q. Was that formula adopted partly in order to bring  
22 the Hanley interest up to three percent?

23 A. Right, the combination of Tract 14 and Tract 15  
24 came up to approximately three percent, which was one of  
25 the goals of the Hanley and Yates group.



1 Q. What was your understanding of what the technical  
2 committee agreed for the allocations to Tract 14 and Tract  
3 15?

4 A. Well, Hanley's interest would be approximately  
5 three percent, based on the total of Tract 14 and 15, but  
6 it was never Energen's intention or our understanding that  
7 Hanley would ever get Tract 15 if it came into the unit  
8 later, at 1.4 percent added to the three percent. That was  
9 never an understanding.

10 The understanding was always that Hanley would  
11 have a maximum of three percent based on the combined Tract  
12 14 and Tract 15.

13 Q. Because of the circumstances surrounding the  
14 lease on Tract 15, was the technical committee really  
15 obliged to make the presumption that Tract 15 had a valid  
16 lease on it and would be contributed to the unit on that  
17 basis?

18 A. In order to come up with the combined interest,  
19 yes, we had to make that assumption.

20 Q. All right. You understood that Hanley was in  
21 agreement with that approach?

22 A. Yes.

23 Q. Let's refer to Exhibit 1 before you there,  
24 please, sir.

25 Is Exhibit 1 a copy of the Application the unit

1 operator, Gillespie Oil, has filed with the Division in  
2 this proceeding?

3 A. Yes.

4 Q. If you will look at the last page of that exhibit  
5 -- it's marked Exhibit 3, but it is the "Exhibit 'C'  
6 (Second Revision)" -- do you have that in front of you?

7 A. Yes.

8 Q. Does that Exhibit "C" purport to attribute three-  
9 percent participation to Tract 14?

10 A. Yes.

11 Q. And does it also purport to attribute an  
12 additional 1.3604 percent to Tract 15?

13 A. Yes.

14 Q. And is that in accord with what the technical  
15 committee agreed to?

16 A. The last meeting of the technical committee did  
17 not get this far. We did not get as far as saying what the  
18 tract participations would be. This was never discussed in  
19 this detail.

20 Q. All right. When was the first time Energen  
21 became aware of these proposed allocations, as shown on  
22 Exhibit 1, the last page of Exhibit "C"?

23 A. I don't remember the date that we received this  
24 from the operator.

25 Q. Would it be accurate to say it was close in time

- 1 to the last working interest owners' meeting on April 13th?
- 2 A. Probably, yes.
- 3 Q. If we accept the operator's proposed allocation
- 4 of approximately 4.4 percent to both Tracts 14 and 15, is
- 5 that allocation supported by the hydrocarbon pore volume
- 6 mapping, the oil-in-place calculations that have been done
- 7 for the unit?
- 8 A. No, it's not.
- 9 Q. Let's look at Exhibit 2, please, sir. Can you
- 10 identify that?
- 11 A. Yes, I see Exhibit 2.
- 12 Q. What is that?
- 13 A. That's showing how the well factor and the
- 14 hydrocarbon pore volume factor were used in determining
- 15 what the participation percentages would be.
- 16 Q. Now, who created this document?
- 17 A. I believe the operator did.
- 18 Q. Let's look at each of the columns in Exhibit 2.
- 19 Which of those columns more accurately reflect what the
- 20 technical committee agreed with respect to allocations to
- 21 Tract 14 and 15?
- 22 A. Okay, are we talking about Exhibit 2 that's a
- 23 part of Exhibit 1?
- 24 Q. No, sir.
- 25 A. Oh, I'm sorry, I was looking at Exhibit 2 as a

1 part of Exhibit 1.

2 Could you repeat the question, please?

3 Q. I'd better back up. Who created this document,  
4 Exhibit 2?

5 A. The operator, I believe.

6 Q. And again, explain what this document is.

7 A. This document shows the original tract  
8 participation, it shows what the new expansion allocation  
9 would be, and it shows what the decimal fraction of the  
10 expanded unit would be for all of the tracts.

11 Then it has an adjustment of -- In order to  
12 allocate three percent to Tract 14, then it shows what the  
13 adjustment would have to be to all the other tracts in  
14 order to make up for that three percent.

15 Q. Let's look at the column with the heading "1999  
16 Expansion, 3% to Tract 14". Do you see that column there?

17 A. Yes.

18 Q. Does that column accurately reflect what the  
19 technical committee agreed to with respect to allocations  
20 to Tract 14 and 15?

21 A. The last technical committee meeting didn't get  
22 that far.

23 Q. All right, let's look at the column just to the  
24 left of that, fifth column from the right. It's headed  
25 "1999 Expansion New Tract Allocation (Decimal)".

1 A. Yes.

2 Q. Does that column more accurately reflect what the  
3 technical committee agreed to with respect to allocations  
4 to Tract 14 and 15?

5 A. Yes.

6 Q. And what are those allocations reflected on  
7 there?

8 A. For Tract 14 it would be approximately 1.6  
9 percent. For Tract 15 it would be approximately 1.4  
10 percent.

11 Q. All right. Let's turn to Exhibit 3 now, please,  
12 sir.

13 A. Okay.

14 Q. Would you identify that, please?

15 A. Exhibit 3 is a spreadsheet that I prepared.

16 Q. And what does it show?

17 A. What it shows is the participation for the  
18 various tracts, for the Tracts 1 through 11, and it shows  
19 what -- under that participation, what Energen's  
20 participation would be, Phillips, Gillespie, Tract 14,  
21 Tract 15, and then all others.

22 The first line is the current participation,  
23 which shows Tract 11 -- 1 through 11, as being 95 percent  
24 of the total. Energen's participation is 46 percent, et  
25 cetera.

1 Q. All right.

2 A. The next line on the spreadsheet shows what the  
3 new participations in the expanded unit would be under 100  
4 percent of HPV, and in that case it shows that Energen's  
5 participation would be reduced to 42.3 percent.

6 Gillespie's percentage would be 45.16 percent.

7 Then we go down to the line that's highlighted,  
8 which shows the HPV at 80 percent and the well factor at 20  
9 percent, which is what the technical committee approved,  
10 and that shows that Energen's percentage under that would  
11 drop to 41.7 percent, which is a reduction from going with  
12 the straight HPV of 100 percent.

13 In the case of Gillespie, their interest goes up  
14 from 45.1 percent to 45.6 percent.

15 So everybody -- all of the different participants  
16 benefit from an HPV 80 and a well of 20 percent, except  
17 Energen.

18 Q. So Energen has given up substantial participation  
19 in order to --

20 A. Yes.

21 Q. -- finalize expansion?

22 A. Right, we did this to expedite the expansion of  
23 the unit.

24 Q. In your opinion, has Energen in any way  
25 obstructed or delayed the unit expansion process?

1 A. Not that I'm aware of.

2 Q. Referring back to Exhibit 2, the participation  
3 allocations, particularly with respect to the fifth column  
4 from the right, it shows the technical committee's  
5 allocations to Tract 14 and 15; is that correct?

6 A. Yes.

7 Q. Does Energen reflect that the allocations  
8 reflected on Exhibit 2, that particular column, be  
9 incorporated into any order that issues from this hearing?

10 A. Yes.

11 Q. Would you briefly give the Hearing Examiner a  
12 status of the operations on the Beadle Number 1 well in  
13 Tract 21?

14 A. The operations on the Beadle Number 1 well began  
15 -- Let's see, the date is May 19th. And it's currently  
16 drilling.

17 Q. All right. If you would refer to Exhibit 3, the  
18 Gillespie Exhibit 3, the pore volume map, Tract 21 is  
19 identified on there, is it not?

20 A. Yes, it is.

21 Q. And there is no location for the well on that --

22 A. That's true.

23 Q. -- is that correct?

24 Is it correct that the well is located 330 feet  
25 from the south and west lines of that section?

1 A. That's correct.

2 Q. Under the proposed participation formula, adopted  
3 by the technical committee, is Tract 21 being credited for  
4 a wellbore on that tract?

5 A. No, it is not.

6 Q. Is that agreeable to Energen?

7 A. Yes.

8 Q. Does Energen support the unit expansion with an  
9 April 1 effective date?

10 A. Yes.

11 Q. With respect to Exhibit 2, did you participate in  
12 the construction of this exhibit by virtue of your  
13 participation in the technical committee?

14 A. Exhibit 2? Yes, I did.

15 Q. And Exhibit 3, was that created by you?

16 A. Yes.

17 MR. HALL: And, Mr. Examiner, Exhibit 1 is the  
18 application already filed of record in this case.

19 We'd move the admission of Exhibits 1, 2 and 3.

20 That concludes our direct of this witness.

21 EXAMINER STOGNER: Any objections?

22 MR. CARR: No objection.

23 EXAMINER STOGNER: Exhibits 1, 2 and 3 will be  
24 admitted into evidence.

25 Thank you, Mr. Hall.



1 Mr. Bruce, your witness.

2 CROSS-EXAMINATION

3 BY MR. BRUCE:

4 Q. Just a couple of questions, Mr. Kahn.

5 One of Mr. Hall's final questions is if -- for  
6 Exhibit "C", what are you proposing goes in there. I just  
7 want to -- you know, I just want to know so, if necessary,  
8 we can incorporate it.

9 A. Okay, this is Exhibit --

10 Q. No, no, no. You were testifying off your  
11 Exhibits 2 and 3, and you said you -- I believe in answer  
12 to a question, you wanted the Exhibit "C" tract  
13 participation amended to reflect different numbers. Is  
14 that what you stated?

15 A. Well, I --

16 Q. And if so, what numbers do you want in there?  
17 That's all I'm asking.

18 A. Well, I would like to see Tract 14 be at  
19 approximately 1.6 percent and Tract 15 be at approximately  
20 1.4 percent.

21 Q. Okay.

22 A. Without the reallocation of the interest in the  
23 remaining of the tracts.

24 Q. Okay, but still under the agreement that Hanley  
25 would still end up with a total of three percent; is that

1 correct?

2 A. Yes.

3 Q. One way or another?

4 A. Right, but they would never end up with more than  
5 three percent.

6 Q. One final thing. Does the well on Tract 21, the  
7 Beadle -- the Beadle well, is that it?

8 A. Yes.

9 Q. That has been commenced?

10 A. Yes.

11 Q. Now, if Tract 21 was already in the unit, would  
12 Energen have proposed that well as a unit well?

13 In other words, would they want to see that well  
14 drilled?

15 MR. HALL: I'm going to object. That's for  
16 conjecture. That's not the circumstances before us today.

17 MR. BRUCE: Mr. Examiner, at the last working  
18 interest owners meeting, one of Energen's personnel said  
19 there was additional development necessary in the pool, and  
20 I would just simply like to know if this is a well Energen  
21 would propose as necessary development in the pool.

22 MR. HALL: Calls for a hypothetical response.

23 EXAMINER STOGNER: I'm going to allow the witness  
24 to answer that question.

25 THE WITNESS: Yes, I believe the timing would

1 have been different. I think the timing was necessitated  
2 by the expiration of the lease.

3 Q. (By Mr. Bruce) Would any further development be  
4 necessary, then, in the pool?

5 A. We haven't really initiated any studies along  
6 that line that would give us any conclusive ideas on that  
7 yet.

8 MR. BRUCE: That's all I have, Mr. Examiner.

9 EXAMINER STOGNER: Okay. Thank you, Mr. Bruce.  
10 Mr. Carr?

11 MR. CARR: I have no questions.

12 EXAMINER STOGNER: Mr. Kellahin?

13 MR. KELLAHIN: No questions.

14 EXAMINER STOGNER: Mr. Cooter?

15 MR. COOTER: No questions.

16 EXAMINER STOGNER: Mr. Hall?

17 MR. HALL: Brief redirect in view of the last  
18 question.

19 REDIRECT EXAMINATION

20 BY MR. HALL:

21 Q. Mr. Kahn, isn't it true that it was necessary to  
22 drill the Beadle Number 1 because the lease was expiring  
23 and the unit expansion had not gone forward to preserve  
24 those leases?

25 A. That's it.

## EXAMINATION

BY EXAMINER STOGNER:

Q. When is that tract expiring?

A. It expires -- would have expired on the 21st, I believe.

Q. May 21st?

A. Yes, sir.

## EXAMINATION

BY MR. CARROLL:

Q. Mr. Kahn, what's the AFE on that well?

A. I don't --

MR. HALL: Do you know?

THE WITNESS: I don't know.

MR. BRUCE: Mr. Carroll, that well was the subject of a force-pooling application a month ago, four weeks ago, and it would be in that well file.

MR. HALL: I'll provide that to you.

MR. CARROLL: Just curious.

## FURTHER EXAMINATION

BY EXAMINER STOGNER:

Q. Okay, let me make sure I get this straight. Energen wishes Hanley no more than three percent; is that correct?

A. Yes, sir.

Q. And the only way to get more than three percent

1 of Hanley was as a successful bidder on the expired lease  
2 in Tract 15?

3 A. Well, the presumption would have to be that if  
4 the unit was a successful bidder on that, then that  
5 interest would be basically assigned to Hanley. But that  
6 would not necessitate reducing any of the tract  
7 participations.

8 Q. In other words, you don't wish to see Tract 15  
9 included in the unit whatsoever?

10 A. Oh, yes, we do.

11 Q. Oh, you do, okay.

12 A. We wish to see it in the unit, but we wish to see  
13 that the unit is the ones that are the -- would bid on that  
14 lease and acquire that lease, or Hanley.

15 FURTHER EXAMINATION

16 BY MR. CARROLL:

17 Q. So it's your understanding that everybody in this  
18 room agrees that Hanley is not going to get more than three  
19 percent?

20 A. That was always our understanding from the  
21 technical committee. I think what the confusion was is the  
22 way the wording was in paragraph (c), was that it didn't  
23 specifically state that.

24 MR. CARR: Mr. Examiner, if I might interrupt, as  
25 the attorney for Hanley, Hanley is not seeking three

1 percent either.

2 EXAMINER STOGNER: I can see where the wording in  
3 that subparagraph (c) was perhaps confusing.

4 MR. BRUCE: It was confusing to me, Mr. Examiner.

5 EXAMINER STOGNER: Well, there's several good  
6 legal minds in here. Do you think it would be possible for  
7 all four or five to get together and come up with  
8 something.

9 MR. HALL: The two of us will.

10 (Laughter)

11 EXAMINER STOGNER: I'm not going to ask which two  
12 you're referring to, Mr. Hall.

13 MR. CARR: I hope that's not the two that helped  
14 get this to this point.

15 EXAMINER STOGNER: Mr. Bruce?

16 MR. BRUCE: Mr. Examiner, if I could, I just  
17 noticed one thing on Mr. Kahn's Exhibit 3.

18 FURTHER EXAMINATION

19 BY MR. BRUCE:

20 Q. The top columns, Mr. Kahn, the bottom lines,  
21 where it says "HPV 80% Well 20% Tract 21", et cetera, is  
22 that Energen's proposal?

23 A. No, it is not. It is only there to exhibit the  
24 fact that we would be better off --

25 Q. There would be changes?

1           A.     Right, we would -- Energen would benefit by  
2     having Tract 21 included, but that is not our proposal.

3           EXAMINER STOGNER:   Are there any other questions  
4     of this witness?

5           You may be excused at this time.

6           Mr. Hall, do you have any additional testimony?

7           MR. HALL:   Not at this time.

8           Let me offer -- I had Mr. Cromwell, the geologist  
9     to present the geology supporting the technical committee  
10    agreements and HPV map. I think you've heard some of that  
11    already today. If you're satisfied with what's presented  
12    on that already, I'll forego presenting Mr. Cromwell. But  
13    he is available.

14          EXAMINER STOGNER:   I believe as far as the  
15    technical end of it, with the agreement that I understand  
16    from everybody in this room, I'm satisfied with it, unless  
17    both of you feel there's something that you need to present  
18    at this time.

19          MR. HALL:   Well, I understand we're going to have  
20    a new proposal here in a second, and I would certainly be  
21    interested to see what's coming.

22          EXAMINER STOGNER:   And then we can always -- if  
23    that leads to a disagreement in the geological format, then  
24    we could bring them back up.

25          Okay, Mr. Bruce?

1 MR. BRUCE: What's your pleasure, Mr. Examiner?  
2 It's noon.

3 EXAMINER STOGNER: Yep, I guess we'd better go to  
4 lunch.

5 Let's reconvene at 1:15. I was just having so  
6 much fun I just forgot what time it is. Let's make it  
7 1:15.

8 (Thereupon, a recess was taken at 12:08 p.m.)

9 (The following proceedings had at 1:33 p.m.)

10 EXAMINER STOGNER: I apologize, I got tied up on  
11 the telephone.

12 Mr. Bruce?

13 MR. BRUCE: Call Mr. Charuk to the stand. His  
14 name is spelled C-h-a-r-u-k.

15 EXAMINER STOGNER: Okay, now you've handed a set  
16 of exhibits here, and they look like they're marked 1 --

17 MR. BRUCE: Yeah, I could, Mr. Examiner -- The  
18 first set would be Gillespie Oil Exhibits 1 through 14, and  
19 these will be Charles Gillespie Exhibits.

20 EXAMINER STOGNER: Okay. Then maybe you want to  
21 explain to me the difference at this point for the record?

22 MR. BRUCE: Well, we just got numbering them and  
23 thought it was easier to do that way.

24 EXAMINER STOGNER: All right, so it's more  
25 numbering. Okay.



1 MR. BRUCE: Now, this proposal is specifically by  
2 Mr. Gillespie as an individual interest owner in the unit.

3 LYNN S. CHARUK,  
4 the witness herein, after having been first duly sworn upon  
5 his oath, was examined and testified as follows:

6 DIRECT EXAMINATION

7 BY MR. BRUCE:

8 Q. Would you please state your name for the record?

9 A. Lynn S. Charuk.

10 Q. And where do you reside?

11 A. Midland, Texas.

12 Q. What's your profession?

13 A. Certified petroleum geologist.

14 Q. What is your relationship to Mr. Gillespie?

15 A. I've been employed by Mr. Gillespie to evaluate  
16 the West Lovington-Strawn Unit as a -- as him as a working  
17 interest owner.

18 Q. Before we get going, just to make the point  
19 clear, on behalf of Mr. Gillespie, you're going to make a  
20 couple of proposals; is that correct?

21 A. Yes, sir.

22 Q. Now, first of all, so we can narrow it down, the  
23 80-20 formula that the technical committee proposed, Mr.  
24 Gillespie accepts that?

25 A. Yes.

- 1 Q. He accepts bringing in the two wells to the unit?
- 2 A. Yes.
- 3 Q. He's proposing a slightly smaller unit; is that
- 4 correct?
- 5 A. That's true.
- 6 Q. It's not any additional land outside what the
- 7 technical committee proposed?
- 8 A. That's correct.
- 9 Q. He also supports doing anything reasonably
- 10 necessary to maintain the lease on Tract 15?
- 11 A. Yes.
- 12 Q. But he will also make a proposal on well payout;
- 13 is that correct?
- 14 A. Yes.
- 15 Q. Have you previously testified before the Division
- 16 as a geologist?
- 17 A. Yes, I have.
- 18 Q. And were your credentials as an expert petroleum
- 19 geologist accepted as a matter of record?
- 20 A. Yes, they were.
- 21 Q. Have you studied the geology in this area, and
- 22 have you prepared some geologic and other exhibits with
- 23 respect to geological matters involved in the unit?
- 24 A. Yes.
- 25 MR. BRUCE: Mr. Examiner, I'd tender Mr. Charuk

1 as an expert petroleum geologist.

2 EXAMINER STOGNER: Any objection?

3 MR. HALL: No.

4 EXAMINER STOGNER: Mr. Charuk is so qualified.

5 Q. (By Mr. Bruce) Mr. Charuk, very briefly, what is  
6 Exhibit -- Gillespie Exhibit 1?

7 A. That is Mr. Gillespie's unit tract map for  
8 existing acreage in the unit, and also proposed acreage to  
9 bring into the unit.

10 Q. Okay.

11 A. The small dashed line shows the original unit,  
12 the large dashed line shows the unit after the first  
13 expansion. And everything outside the large dashed line is  
14 the proposed acreage to bring into the unit.

15 Q. Okay, a couple of things, maybe, to point out.  
16 Tract 21 is split into three tracts, as previously noted;  
17 is that correct?

18 A. Yes, sir.

19 Q. And then Tract 16 is actually 16A and 16B; is  
20 that correct?

21 A. That's correct, A on top, B on the bottom.

22 Q. And this map would simply be Exhibit A to the  
23 unit agreement?

24 A. That's right.

25 Q. Could you identify Exhibit 2 for the Examiner,

1 discuss it, and the reason why Mr. Gillespie's boundary is  
2 as he has proposed?

3 A. Well, Exhibit 2 is a cross-section, a north-south  
4 and an east-west cross-section. And if I may put this on  
5 the wall?

6 Q. And while you're at it, explain the color-coding  
7 on the map, Mr. Charuk?

8 A. Okay, it shows several things. The north-south  
9 cross-section on top goes from the Chandler well on the  
10 north end to the Number 7 injection well on the south end  
11 of the unit. And that's basically going downdip to updip.

12 The cross-section on the bottom is a strike  
13 section, and it goes east-west through the unit.

14 And what it shows is the three phases of the  
15 reservoir, the oil -- I mean, the water on the bottom, the  
16 oil in the middle, gas on the top.

17 It also shows the top of the Strawn, which is  
18 this marker up here, which sometimes coincides with the top  
19 of the porosity and sometimes doesn't coincide with the top  
20 of the porosity.

21 And it also shows the top of the porosity and the  
22 base of the porosity. And basically what these two cross-  
23 sections do is outline the bioherm or the container, if you  
24 will, of this West Lovington-Strawn unit that holds the oil  
25 and the gas. It's a very well contained bioherm, it's

1     bounded all around, and it's basically -- It's a beautiful  
2     feature.

3             Q.     Before we go any further, was your study based  
4     solely on well control and regional trends?

5             A.     Yes, Mr. Gillespie felt that after we had 15  
6     wells drilled in the unit, that it was a good time to  
7     evaluate the geology based on subsurface, and that's all  
8     I've done.

9             Q.     No seismic was involved?

10            A.     No seismic.

11            Q.     Let's move on to your next exhibit, Exhibit 3.  
12     Very briefly, what does this exhibit show?

13            A.     Exhibit 3 is an isopach map of the West  
14     Lovington-Strawn and other fields around. It's based on  
15     the same parameters as the technical committee have  
16     adopted, the three-percent porosity cutoff.

17                   And basically it shows the West Lovington-Strawn,  
18     the unit outline, and the -- my interpretation of where the  
19     porosity in the West Lovington-Strawn is present.

20                   The zero line is the key to this isopach. It  
21     shows basically the edge of the bioherm. Anything -- If  
22     there's a Strawn well that doesn't have anything above a  
23     zero porosity cutoff, it will not produce oil or gas.

24            Q.     Now, you've also included on here the other  
25     Strawn porosity pods in this area, have you not?

1           A.    Uh-huh, several.

2           Q.    And really, this whole development area was  
3 kicked off initially by development in the West Lovington-  
4 Strawn Pool; is that correct?

5           A.    With the discovery of the Hamilton Number 1,  
6 Section 33.

7           Q.    Let's move on to your Exhibit 4, and please  
8 identify that for the Examiner.

9           A.    Exhibit 4 is a structure map on top of the  
10 porosity. I believe it is a much more relevant horizon to  
11 mark or to map than the top of the Strawn itself. This top  
12 of the Strawn marker does not really indicate the oil-water  
13 and gas-oil contacts as closely and as accurately as the  
14 top of the Strawn porosity does, because sometimes the  
15 porosity is 20 or 30 feet below the top of the Strawn.

16                So what I've done is, I've reviewed all the wells  
17 in the unit, found the top of the porosity, based upon a  
18 three-percent porosity cutoff and generated a structure map  
19 on the top of the porosity.

20                And at the same time, I took my zero line from  
21 the isopach map and superimposed it around the unit to show  
22 the edge of where the porosity occurs, to indicate anything  
23 outside of that dark black line, that really is very, you  
24 know, either edgy or a low chance of commercial Strawn  
25 porosity occurring.

1           And the three colors, of course, represent the  
2 original oil-water contact, as defined by the technical  
3 committee, of minus 7617, and our latest gas-oil contact in  
4 the boundary between the green and the pink, which is  
5 basically based on all the well data that we have in the  
6 field that I was able to obtain as far as GOR information.

7           And the most recent occurrence would be the  
8 Snyder 4 "C", which in the last month or so has gone from  
9 an 1800 GOR to approximately a 2500 GOR. So based on that  
10 contact there, I've adjusted the GOR -- or the gas-oil  
11 contact slightly downdip to the Snyder 4 "C".

12          Q.   Now, I think you alluded to it, but your oil-  
13 water contact would be different than the technical  
14 committee's because you're using the top of the Strawn  
15 porosity rather than top of the Strawn formation?

16          A.   Yes. The first thing when I noticed the  
17 technical committee maps, I felt that that top of the  
18 Strawn is not relevant to where the oil and the gas is in  
19 the container. You've got to map the structure on the  
20 porosity, if you really want to get a true, accurate  
21 picture of the oil and gas contained in the West Lovington-  
22 Strawn Unit.

23          Q.   Why don't you move on to your Exhibit 5 and  
24 identify that and discuss its contents?

25          A.   Well, that's a similar exhibit. It's just the

1 base of the porosity map. And as you can see, some of the  
2 wells, like particularly, this is the base of the porosity,  
3 the same zero outline generated from my original isopach  
4 map.

5 As you can see, some of the wells, particularly  
6 in Tracts 8 and 10 and 3 have some porosity below water,  
7 original oil-water contact. So we have some porosity  
8 that's wet in these wells.

9 Whereas when, if you say we look at the Hamilton  
10 Federal Number 1, it has a 100-percent oil column when it  
11 was drilled. That's what it encountered. Some of these  
12 wells were wet in the bottom, based on the original  
13 technical committee oil-water cutoff.

14 Q. Okay. Now, looking at this, would it be fair to  
15 say that you really wouldn't want to drill a well in the  
16 pink area on this map?

17 A. Yeah, I feel like the pink area has been  
18 completely filled with the gas, the 30 BCF or so that we've  
19 injected over the last several years to maintain reservoir  
20 pressure, and I feel like that it's structurally updip to  
21 the rest of the unit, and consequently if we drilled a well  
22 in there, we would probably make a small amount of oil, but  
23 in a very short time we'd have a GOR in the range of 4000,  
24 maybe 5000, to 1, which would really just be flowing back  
25 injected dry gas that we've already paid to put into the



1 unit.

2 Q. And looking at the map -- what? The Unit wells 1  
3 and 3 and 4 have already been shut in, have they?

4 A. There are several of those wells that are shut in  
5 because their GORs were so high, they restricted production  
6 to the point where it wasn't economical.

7 Also, I might add that the permeability in the  
8 cores that I've looked at in several of these wells is  
9 phenomenal. It's like Mideastern-quality rock. It's 500  
10 to 800 millidarcies of perm. And some of the streaks in  
11 there were so permeable that you could take a piece of the  
12 core and hold it up to your face and blow through it, and  
13 your air would come out on the other side of the core. So  
14 it's very well communicated reservoir.

15 Q. Okay. Next, let's move on to your Exhibit 6.  
16 What does that map show?

17 A. Okay, Exhibit 6 is basically an HPV map. And I  
18 used to generate this map all the data that I've obtained  
19 from these first three maps as far as oil-water contacts on  
20 the top of the porosity.

21 The shape of the HPV on feature is exactly  
22 modeled after my porosity isopach, which shows, you know,  
23 zero porosity as a dark line, and then you see the HPV  
24 starts right inside there. You've got to have porosity or  
25 you're not going to have any HPV.

1           And it shows the water contacts on the north end  
2 of the downdip side of the field, as interpreted from my  
3 structural map. And I used all the same values that the  
4 technical committee used on their map as far as the numbers  
5 that are assigned to each well, so I didn't change any of  
6 the values of the wells.

7           What I did was just reinterpret the HPV to obtain  
8 a oil-in-place, original-oil-in-place number of -- I think  
9 it's within one percent of the -- or less than one percent  
10 of the material balance of the entire field.

11           I think this map represents 15.6 HPV -- or 15.6  
12 million, and the original oil in place, as calculated by  
13 material balance, is 15.7. So I'm very close. This map  
14 comes much closer than the technical committee HPV map, by  
15 over a million barrels.

16           Q. Now, looking at this blue indicates wells that  
17 would be water-producing?

18           A. The blue in this indicates wells that would be  
19 100-percent water from top to bottom of the Strawn  
20 porosity.

21           Q. Okay. Now, you know, comparing this to the  
22 technical committee map, let's start so the Examiner has an  
23 idea of what was excluded on your map. Looking at the east  
24 half, northeast quarter of Section 32 --

25           A. Yes.

1 Q. That was in the -- That 80 acres is in the  
2 technical committee proposal?

3 A. Right, and it's excluded on this proposal because  
4 it's downdip and, I feel, wet.

5 Q. Okay. Now, Mr. Gillespie does have a working  
6 interest in that tract?

7 A. I believe he owns 25 percent of that.

8 Q. Now, moving to the southwest corner of the unit,  
9 you left in Tract 20 but you excluded 10 acres around the  
10 Gillespie State "D" Number 8 well. What was the purpose of  
11 that?

12 A. The State "D" 8 is not in communication with this  
13 reservoir. It's in -- It appears to be more in  
14 communication with the Big Dog reservoir. We know for  
15 certain, though, it's not in communication with the West  
16 Lovington-Strawn unit because the pressures weren't  
17 anywhere near the same.

18 Q. And that's Mr. Gillespie's well?

19 A. That's his well.

20 Q. But it shouldn't be part of the unit?

21 A. No, it's not necessary to be part of the unit.

22 Q. And then in Section 34 you omitted the northeast  
23 quarter?

24 A. Yes. Section 34, you have three wells up in that  
25 area. You have one in Section 26 and 27, and then you've

1 got the Julia Culp Number 2 well.

2 All three of those wells have zero porosity. If  
3 you have zero porosity, you have zero potential in the  
4 Strawn to produce.

5 Besides that, you're going downdip towards the  
6 Tatum Basin, and so in my opinion that's all going to be  
7 wet or no porosity whatsoever over there. Mr. Gillespie  
8 didn't feel we needed to bring in extra acreage like that  
9 to dilute the unit.

10 Q. Okay. Mr. Gillespie also owns acreage in the  
11 northeast quarter of 34, doesn't he?

12 A. I'm not sure what he owns. I just did the  
13 geology. I didn't have any biases as far as where is Mr.  
14 Gillespie's acreage and where is not his acreage.

15 Q. And then the other items you left out are, say,  
16 the east half of the southwest quarter of Section 35 and  
17 the acreage to the south, which would be the south half of  
18 the northwest quarter of Section 5, or it may be lots 5 and  
19 6 --

20 A. That's correct.

21 Q. -- probably more correct.

22 But you show some HPV in Section 5. Why wasn't  
23 that included?

24 A. We just felt that it was not thick enough to  
25 drill a well over there.

1           It just wasn't -- You've got a dry hole to the  
2 south in that Rouse 5, and we just feel like there's not  
3 going to be any porosity over there.

4           Q.   Do you feel this map represents a reasonable  
5 interpretation of the West Lovington-Strawn reservoir?

6           A.   Yes, because it matches so closely to the  
7 original-oil-in-place numbers that the engineering have  
8 come up with. I feel it's very close.

9           Q.   Okay. So then these numbers were used to  
10 calculate HPV, and then the same similar formula was used,  
11 the 80-20 formula was used to calculate tract allocations  
12 or --

13          A.   Yes.

14          Q.   -- net percentages?

15          Q.   Okay. Now, let's briefly go over a few of the  
16 exhibits. Exhibit 7, Mr. Charuk, would that simply be  
17 Exhibit B for the expansion area under Mr. Gillespie's  
18 proposal?

19          A.   Yes, I assume so. I did not prepare these.

20          Q.   Okay. And this came from -- This was prepared by  
21 Mr. Gillespie's office --

22          A.   Uh-huh.

23          Q.   -- or on his behalf? It's simply an ownership  
24 listing; is that correct?

25          A.   Okay, yes.

1 Q. Exhibits 8 and 9 are simply working interest and  
2 royalty interest ownership under Mr. Gillespie's proposal?

3 A. Uh-huh.

4 EXAMINER STOGNER: I'm sorry, was that a yes or a  
5 no?

6 THE WITNESS: Yes. Yes, sorry.

7 Q. (By Mr. Bruce) And Exhibit 10 would be Exhibit  
8 "C" to the unit agreement under Mr. Gillespie's proposal?

9 A. Yes.

10 Q. Now, let's move on just to the final item, Mr.  
11 Charuk. It's been -- You were here earlier this morning  
12 listening to testimony?

13 A. Yes, sir.

14 Q. And the issue of the well payout came up.  
15 Submitted as Exhibit 11 is a portion of the unit operating  
16 agreement, in particular Article 10.4 of the unit operating  
17 agreement. What does the second paragraph of that section,  
18 in essence, provide?

19 A. Are you asking me to read it?

20 Q. Well, what does it provide regarding payout of  
21 wells?

22 A. The paragraph that starts with "All wells  
23 completed in -- "

24 Q. Yes.

25 A. " -- the Strawn formation"?

1 Q. Yes, sir.

2 A. "If a Unit well has not reached payout status as  
3 of the effective date of unitization, the Working Interest  
4 Owners in the Unit, in proration [sic] to their working  
5 interest in their Unit, shall pay to the workers [sic]  
6 owners of each such well the amount necessary to reach  
7 payout."

8 Q. In other words, it provides for 100-percent  
9 payout?

10 A. Yes.

11 Q. Is Exhibit 12 Mr. Gillespie's proposal to amend  
12 that paragraph?

13 A. Yes.

14 Q. In a few words, what would it provide as to well  
15 payout?

16 A. "250 percent payout of reasonable well costs as  
17 of the effective date of the unit expansion".

18 Q. Okay. And that would apply, really, to any well  
19 that's --

20 A. Including the Energen well that's drilling right  
21 now.

22 Q. In your opinion, would that be -- is this a fair  
23 proposal?

24 A. Well, if we look back at the -- In my opinion, if  
25 we look back at the original isopach map, Mr. Gillespie

1 first drilled the "EC" Com Number 1, which had four feet of  
2 pay.

3 At that time there was no other wells over there  
4 on the east side of the unit. To me, that was -- to  
5 drill -- to gut up and drill Tract 17, to drill the 4 "C"  
6 was a very risky location to drill at the time this well  
7 was drilled.

8 Mr. Gillespie paid 100 percent of the risk money  
9 in this well, and Mr. Gillespie's been in business for 50  
10 years. I don't really feel like he's been in that business  
11 to go around getting 100-percent payout on wells that he  
12 takes 100-percent risk on.

13 Q. Were Mr. Gillespie's Exhibits 1 through 12  
14 prepared by you, under your direction, or compiled from Mr.  
15 Gillespie's business records?

16 A. Yes.

17 Q. And in your opinion, is the granting of Mr.  
18 Gillespie's proposal in the interests of conservation and  
19 the prevention of waste?

20 A. Yes, sir.

21 MR. BRUCE: Mr. Examiner, at this point I'd move  
22 the admission of Gillespie Exhibits 1 through 12.

23 EXAMINER STOGNER: Any objection?

24 MR. CARR: No objection.

25 MR. HALL: No objection.



1 EXAMINER STOGNER: Charles B. Gillespie Exhibits  
2 1 through 12 will be admitted into evidence at this time.

3 Is that all, Mr. Bruce?

4 MR. BRUCE: That's all I have, Mr. Examiner.

5 EXAMINER STOGNER: Mr. Hall?

6 CROSS-EXAMINATION

7 BY MR. HALL:

8 Q. Mr. Charuk, is Charles B. Gillespie, Jr., the  
9 operator of the West Lovington-Strawn Unit?

10 A. Charles B. Gillespie, Jr., Inc., is the operator  
11 of the Lovington-Strawn Unit.

12 Q. And who's the principal of that corporation? Is  
13 it Charles B. Gillespie, Jr.?

14 A. I wouldn't know that. I would assume so, but I  
15 don't know that.

16 Q. Is, in fact, this new proposal being promoted by  
17 the operator of the West Lovington-Strawn Unit? There's no  
18 debate about that, is there?

19 A. It's being proposed as Charles B. Gillespie, the  
20 working interest owner, who will also pay his fair share of  
21 anything that is proposed on this proposal.

22 Q. My question is, there is no question that this  
23 new proposal is being proposed by the unit operator?

24 A. Well, I don't think it is. I think it's being  
25 proposed -- He's also a working interest owner, and he has

1 rights like anyone else as a working interest owner, and if  
2 he wants to hire a geologist to propose a new proposal, I  
3 think that is separate from the unit operator who operates  
4 the unit. I don't feel like -- I think those are two  
5 separate entities.

6 Q. Do you know if either Charles B. Gillespie, Jr.,  
7 or Gillespie Oil, Inc., has made a good-faith effort to  
8 secure voluntary agreement to the new proposal?

9 A. I think he has tried. I think me being here is a  
10 testament to that, because he hired me personally to try to  
11 work this out with you guys so we can get on and get this  
12 unit unitized.

13 Q. Well, the fact is, it's never been revealed to  
14 anyone else out of Gillespie Oil, Inc., before this  
15 afternoon; isn't that right?

16 A. That's correct.

17 Q. Let me ask you about your Exhibit 8, please, sir.  
18 Do you have that in front of you?

19 A. Yes.

20 Q. The last page of that shows working interest  
21 totals for the proposed unit.

22 A. Yes.

23 Q. Can you say whether the Energen interest, as  
24 Gillespie proposes, is smaller than what the technical  
25 committee proposed? Do you know?

1           A.    I'm not sure. I'm a geologist. I didn't compile  
2 the -- you know, the technical committee or these numbers,  
3 as far as adding them up. I just did geology.

4           Q.    Who is Geraldine Anderson Hill?

5           A.    I do not know.

6           Q.    Do you know if Geraldine Anderson Hill is  
7 presently an interest owner under the current unit?

8           A.    No.

9           Q.    Let me ask you about your Exhibit 11. Since you  
10 testified about this, can you tell me what your  
11 understanding is with respect to the operation of payout  
12 provision under the current operating agreement?

13          A.    I've never read the operating agreement.

14          Q.    You've never read Exhibit 11 before?

15          A.    Just a few minutes ago I looked at part of it.  
16 It says 100 percent, if that's what you're trying to get  
17 to.

18          Q.    It's your understanding that wells brought into  
19 the unit shall be brought in at 100-percent payout; is that  
20 what you're saying?

21          A.    Necessary to reach payout.

22          Q.    And that, to you, means 100 percent?

23          A.    Well, I would say payout is payout, yeah.

24          Q.    So the answer is yes?

25          A.    Yes.

1 Q. And Charles B. Gillespie, Jr., Gillespie Oil and  
2 whoever it is, is proposing that the unit operating  
3 agreement be amended according to the terms reflected in  
4 Exhibit 12; is that correct?

5 A. Yes.

6 Q. Do you know if the proposal to amend the  
7 operating agreement was included within the Application  
8 before the Hearing Examiner here today?

9 A. (Shakes head)

10 Q. Answer verbally.

11 A. No, sir.

12 Q. Can you explain the operation of your proposed  
13 language in Exhibit 12?

14 A. Well, it's very similar to the technical  
15 committee's. It's an 80-20 -- 80-percent HPV, 20-percent  
16 wellbore factor.

17 The only difference I feel that it has, it allows  
18 for a 250-percent payout of any well that's brought into  
19 the unit.

20 Q. Well, let's look at the last sentence on Exhibit  
21 12.

22 A. Okay.

23 Q. Why don't you just read that into the record?

24 A. "Any such well which has a Wellbore Factor of  
25 less than 1 shall receive 100% of payout plus an amount

1 equal to (Well Factor x 150%)."

2 Q. So if a well is located on a tract which has a  
3 well factor of zero --

4 A. Uh-huh.

5 Q. -- it shall be brought in, according to this  
6 formula, 150 percent -- Let me back up.

7 It shall be brought in at 100 percent of cost  
8 plus an amount equal to well factor times 150 percent. And  
9 if the well factor is zero, zero times 150 percent is zero,  
10 correct?

11 A. Yes.

12 Q. Okay. Would you take Exhibit 6 before you, your  
13 HPV map?

14 A. Yes, sir.

15 Q. Tell us what the red numerals mean on the  
16 exhibit.

17 A. The red numerals are the HPV value assigned to  
18 all those wells by the technical committee.

19 Q. And what are you showing for the "EC" Com Number  
20 1?

21 A. That's a 1.0.

22 Q. Right. Let me show you the committee's HPV map.  
23 It's Gillespie Exhibit 3. What does it show for the Snyder  
24 "EC" Com?

25 A. Point one.

1 Q. Which one is correct?

2 A. Point one, I believe, because it's similar --  
3 It's just even more similar to the Hanley wells.

4 Q. Will that mistake affect the way you've drawn  
5 your contours on Exhibit 6?

6 A. It would tighten up that Tract 16B a little bit.  
7 It would just raise it up a little closer to the well.

8 Q. Would it have any bearing on your tract  
9 participations as shown on Exhibit 10?

10 A. I'm not sure if Mr. Gillespie owns Tract 16, how  
11 much interest he has in Tract 16B. I don't know if -- I'm  
12 sure it will have a bearing somewhere.

13 Q. Do you know the status of the payout of the  
14 Snyder "C" 4 well?

15 A. I believe it's paid out. I'm --

16 Q. Do you know -- I'm sorry?

17 A. I believe it's paid out.

18 Q. Do you know when it paid out?

19 A. I'm not sure. A month ago, maybe.

20 MR. HALL: Nothing further of this witness.

21 EXAMINER STOGNER: Thank you, Mr. Hall.

22 Mr. Carr?

23 MR. CARR: I have no questions.

24 EXAMINER STOGNER: Mr. Kellahin?

25 MR. KELLAHIN: Thank you, Mr. Examiner.

## CROSS-EXAMINATION

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BY MR. KELLAHIN:

Q. Mr. Charuk, would you give me some of your volumes again? You were using from material balance calculations 15.7 million barrels in place?

A. That's according to Mr. McDermott, who's done the material balance calculations for the unit. He felt that 15.7 million barrels was the figure to use for original oil in place.

Q. When we volumetrically calculate on your Exhibit Number 6 the original oil in place, what number is that?

A. It comes within a half a percent of 15.7 million barrels. I'm not quite sure what --

Q. You don't have the volume; it's within half a percent, you said?

A. So I would guess that would probably be within 100,000 barrels.

Q. For the pore volume map that was introduced earlier this morning, this Exhibit 3, that had -- the technical committee's pore volume map, what's the volume for that?

A. I don't know exactly, but I believe it's somewhere in the ballpark of a million barrels shy of the original oil in place number. I think it's 14.8, but -- That's close.

1 Q. What accounts for the difference between the  
2 technical committee pore volume map and your map?

3 A. Well, I believe there's not enough pore volume on  
4 the technical committee map.

5 Q. You've used the same values, except --

6 A. Except for this --

7 Q. -- for the way you've contoured --

8 A. Except for this "EC" Com Number 1. I believe  
9 they were -- the contour number was wrong.

10 MR. KELLAHIN: All right, I don't have any other  
11 questions. Thank you, Mr. Examiner.

12 EXAMINER STOGNER: Thank you, Mr. Kellahin.

13 Mr. Cooter?

14 MR. COOTER: I have no questions.

15 EXAMINER STOGNER: Mr. Bruce, any redirect?

16 MR. BRUCE: No, sir.

17 EXAMINATION

18 BY EXAMINER STOGNER:

19 Q. What was your function with the technical  
20 committee?

21 A. I had no function with the technical committee.  
22 I never met with the technical committee. I met with Mr.  
23 Gillespie in his home.

24 EXAMINER STOGNER: Any other questions of this  
25 witness?



1 MR. BRUCE: No, sir.

2 EXAMINER STOGNER: You may be excused.

3 THE WITNESS: Thank you.

4 EXAMINER STOGNER: Mr. Bruce --

5 MR. BRUCE: That's all I have.

6 EXAMINER STOGNER: -- do you have anything  
7 further either for the Applicant in this matter or anybody  
8 else that you may be representing?

9 MR. BRUCE: Nothing.

10 EXAMINER STOGNER: Mr. Hall?

11 MR. HALL: I'd like to recall Mark Mladenka.

12 EXAMINER STOGNER: Mr. Hall? Okay, hold it.

13 Just for the record, restate your name.

14 MR. MLADENKA: My name is Mark Mladenka.

15 EXAMINER STOGNER: And your qualifications were  
16 as an engineer or geologist?

17 MR. MLADENKA: Engineer.

18 EXAMINER STOGNER: As an engineer. Okay.

19 Mr. Hall?

20 MARK MLADENKA (Recalled),  
21 the witness herein, having been previously duly sworn upon  
22 his oath, was examined and testified as follows:

23 DIRECT EXAMINATION

24 BY MR. HALL:

25 Q. You're employed by Gillespie Oil, Inc., correct?

1           A.    Mr. Gillespie signs my check as Charles B.  
2 Gillespie, Jr. I, working for -- I operate wells for him  
3 personally, and I also operate the wells as the production  
4 manager for Gillespie Oil, Inc.

5           Q.    Okay, who are the principals in Gillespie Oil,  
6 Inc.?

7           A.    I'm not sure. I know Mr. Gillespie is, and I  
8 believe one of his other long-time employees.

9           EXAMINER STOGNER: Along that same line, let me  
10 ask you a question. Who is the operator of the West  
11 Lovington Unit?

12           THE WITNESS: Gillespie Oil, Inc.

13           EXAMINER STOGNER: Okay. Mr. Hall?

14           Q.    (By Mr. Hall) Mr. Mladenka, the new proposal by  
15 Charles B. Gillespie, Jr., are you -- is Mr. Gillespie  
16 proposing any particular effective date for this proposal?

17           A.    I believe we'll leave it up to the Commission.  
18 I'm not aware of any proposed date. Whenever it's  
19 ratified, I would expect that's the effective date.

20           Q.    Now, the effective date proposed by the technical  
21 committee was April 1, 1999; do you agree with that?

22           A.    That's correct.

23           Q.    If I understand what you've just said, you're  
24 proposing that this proposal become effective with  
25 ratification sometime in the future?

1           A.    I believe that's the way the proposal was  
2 submitted.

3           Q.    Can you enlighten us about the specific date the  
4 Snyder "C" 4 paid out?

5           A.    Not the specific date, but it paid out during, I  
6 believe, the month of February, and we -- the technical  
7 committee agreed on April 1st, being brought into the unit.

8           Q.    All right.

9           A.    Of 1999, both dates.

10          Q.    So if that well is brought into the unit, the  
11 April 1 effective date, post-payout, it will, in fact,  
12 receive some percentage in excess of 100-percent payout,  
13 correct?

14          A.    That is correct, under Charles Gillespie's  
15 proposal.

16          Q.    And indeed under the technical committee's  
17 proposal?

18          A.    The way it stands, yes.

19          Q.    Earlier, isn't it true that Mr. Gillespie had  
20 demanded a 200-percent payout for the "C" 4 well?

21          A.    In the negotiating process, in order to  
22 compromise, to get something through the technical  
23 committee, we agreed that we weren't trying to max out  
24 anything. We would have accepted the 200 percent. We  
25 wanted it in the proposal; it did not get in the proposal.

1 And at that time I believe Mr. Gillespie wanted to address  
2 the payout issue another way. We couldn't do it.

3 Q. All right. And the issue of the payout was not  
4 included within the Application that Gillespie Oil, Inc.,  
5 brought before the Division today; is that right?

6 A. The technical committee would not allow it, other  
7 than what the operating agreement currently provided. It's  
8 already provided for.

9 Q. And the current operating agreement says 100-  
10 percent payout?

11 A. Correct.

12 Q. Would you explain a little bit about the basis of  
13 the payout? Is a payment to the royalty interest owner a  
14 component of payout costs?

15 A. I believe it says all interest owners, which  
16 would include the royalty and overriding royalty interests.

17 Q. So, let me make sure I understand this.  
18 Gillespie has some arrangement with the royalty interest  
19 owners to pay him a share of payout revenues?

20 A. The interest owners -- all interest owners, under  
21 the State "S" and the Hanley, had 250 percent in the Hanley  
22 well. The fee owners of the State had 550 percent in the  
23 State "S", all interest owners under any well brought into  
24 the unit.

25 Q. Why would a royalty interest owner care about

1 reimbursement of well costs? It's a non-cost-bearing  
2 interest.

3 A. An issue of fairness. The Hanley well -- This is  
4 all about fairness. The Hanley well got 250, the State "S"  
5 550, all interest owners in the Hanley well benefit, all  
6 interest owners, and all interest owners in the State "S".

7 Q. You're not telling me that the State of New  
8 Mexico recouped a share of payout costs?

9 A. That is our proposal.

10 Q. If your payout cost includes as a component a  
11 payment to the royalty interest owner does that, in fact,  
12 inflate the payout cost over actual cost?

13 In other words, the cost in addition to the  
14 actual drilling and completion operation, what --

15 A. That's correct.

16 Q. What is the legal obligation of any of the other  
17 unit interest owners for paying such a cost, if you know?

18 A. I'm not following you.

19 Q. Maybe this will help us understand this issue.  
20 I'm having a problem with it myself, Mr. Mladenka.

21 Let's look at what's been marked as Exhibit M-2.  
22 Do you recognize that as the agenda and other materials  
23 handed out at the unit working interest owners' meeting on  
24 April 13th, 1999?

25 A. Yes, I prepared all of this.

1 Q. If you will refer to -- Let's see, the sixth page  
2 of that exhibit, at the top of it, it's labeled "SNY C#4  
3 Payout".

4 A. Okay.

5 Q. That was handed out at the interest owners'  
6 meeting, correct?

7 A. That was.

8 Q. Let's go through some of the entries on here.  
9 There's an summary line-item entry at the top, Snyder "C"  
10 Well Number 4, Actual Costs equals \$786,099. Do you see  
11 that?

12 A. That's correct.

13 Q. What is included in that?

14 A. The drilling overhead, all the intangible,  
15 drilling, up to the -- all equipment costs, completion  
16 costs, no -- and overhead while drilling. After the well  
17 started producing, the normal operating costs would take  
18 over, but this is the actual cost to drill and complete the  
19 well.

20 Q. All right.

21 A. I don't believe it includes any acreage cost.

22 Q. All right. Further on down, there's a line item.  
23 It says, Estimated -- "Est. Payout Period (Months), 6.5".  
24 Do you see that there?

25 A. Yes.

1 Q. So explain that. 6.5 months from when?

2 A. If you look, I show a production history from  
3 April of 1998 to February of 1999. Total oil barrels was  
4 77,000 barrels, average of 7042, with a, quote, unquote,  
5 net revenue interest.

6 This was just for illustrative purposes. 75-  
7 percent net revenue. This could apply to any interest  
8 owner in the unit, outside the unit, Mr. Gillespie's  
9 interests, whoever. It was just a generalization.

10 The net per month of that was \$5300 a month based  
11 on our net barrels, based on an oil price of \$14 a barrel.  
12 That generated an oil income of \$74,000 a month, and that's  
13 an average during that period of time on the oil side of  
14 it.

15 The gas also again, it made 117,000 MCF during  
16 that period of time. 11,000 is the average. I gave it a  
17 net factor of zero, assuming that it would go into the  
18 unit, the unit owners would buy this well, all the residue  
19 gas would then be attributed to the unit, so there would be  
20 no interest in the gas production, no net revenue from gas  
21 production, no price for the gas, therefore no revenue on  
22 the gas.

23 And this is taken forward from the -- after  
24 payout, okay? And it comes into the unit.

25 The residue gas, this is what is -- the liquids

1 removed from the gas stream itself. In a sense, you have  
2 -- What is that? 40 MMCF as liquids. You know, 117,000  
3 minus 74,000, that number I just said. And that's the  
4 residue gas that's available -- See, all the residue gas  
5 that is produced in the unit is returned to the unit, and  
6 therefore you don't have to buy additional make-up gas.

7           So this residue gas would be -- If it was brought  
8 into the unit, this residue gas would be available to  
9 reinject. Therefore, the -- that's like an additional --  
10 As soon as the Snyder "C" 4 comes in the unit, that residue  
11 gas will come into the unit. It will back out the  
12 additional make-up gas to be bought. Therefore it's a net  
13 gain in gas, or revenue, that can be applied toward the  
14 payout of the "C" 4.

15           And item -- The next one is April 20 -- you know,  
16 the -- whatever period that is. Liquid revenue, \$154,000.  
17 Once again, the average was 14,000. The 75-85, the unit is  
18 under contract of 75 percent of liquids; the "C" 4 is  
19 currently under the contract of 85 percent. And I'm just  
20 trying to get back to the liquid revenue the unit would  
21 receive per month. It shows -- from the "C" 4, based on a  
22 75-percent net-revenue interest of 9300. You add all those  
23 up, \$96,000 a month.

24           So therefore, at \$14 a barrel, and \$1.90, based  
25 on previous production history, the "C" 4 would benefit the



1 unit \$96,000 a month. Therefore, any payout of the  
2 \$786,000 -- Okay, and then I estimated March of 1999. I  
3 think the payout status of March 1st of 1999, that shows a  
4 \$68,000-plus, March 1st, the well paid out, plus \$68,000.  
5 And the effective date was April 1st, so I'm saying that --  
6 I'm estimating the revenue for March, \$96,000.

7 So April 1st would be \$164,000 above payout. And  
8 if it comes in the unit, you'll realize a net gain to the  
9 unit owners -- based on a 75-percent net revenue, \$14 oil,  
10 \$1.90 -- it would pay out that investment at 6.5 months.  
11 And that's strictly on a payout basis.

12 If you consider the royalty owner -- and this, to  
13 -- this is not truly what Mr. Gillespie is -- You need to  
14 put the overriding royalty in here also, and I'm not sure  
15 what that interest is. Four or five percent. So if you  
16 include the royalty owner in there -- Let me see how I got  
17 that. Oh, his interest is -- the royalty owner's, Snyder  
18 Ranches', was 15.6 percent, times the 622.

19 The remaining amount to reach 200 percent was  
20 \$97,000, which would then be added to the \$622,000.  
21 Therefore you come up with this \$719,000 divided by the  
22 \$96,000 revenue the well would contribute to the unit, it  
23 would pay out in seven and a half months.

24 Q. All right. So you would expect to reach payout  
25 to make up that 200 percent in six and a half months?

1           A.   Without the royalty owner or the overriding  
2 interest consideration.

3           Q.   And so when you add in the royalty owner  
4 consideration, it extends the payout --

5           A.   You asked me that already, yes.

6           Q.   -- a month or two?

7                   Well, again, let me ask the question. This line  
8 item, "Royalty Owner Consideration", consideration for  
9 what?

10          A.   Fairness.

11          Q.   Is there some agreement between Gillespie and a  
12 royalty owner we don't know about?

13          A.   No, it's -- the royalty owner, our position is,  
14 we wanted to be treated similarly as the Hanley well was  
15 and the State "S". The State "S" paid out five and a half  
16 times, everyone was paid five and a half, the State was  
17 paid their share five and a half times, the royalty owner  
18 under the Chandler well was paid five and a half times.

19               MR. BRUCE: Two and half.

20               THE WITNESS: Two and a half.

21          Q.   (By Mr. Hall) But as I understand it, under your  
22 new proposal, for instance, the Beadle well would come into  
23 the unit, zero well factor, would recoup only 100-percent  
24 payout cost?

25          A.   If it's a dry hole, why would we want it in the

1 unit, number one?

2 Q. Assume it's not --

3 A. If it's a gas-cap well, 100-percent gas,  
4 therefore no oil production, it would have zero. But in  
5 order not to allow another person draw down this energy we  
6 put in, it would come in at 100 percent. Therefore no  
7 additional above 100 percent.

8 Q. Mr. Mladenka, if Mr. Gillespie doesn't receive  
9 approval of the 250-percent payout provision now, will he  
10 withhold ratification of any proposal?

11 A. I don't know.

12 Q. Who knows the answer to that question?

13 A. Mr. Gillespie.

14 Q. Is anybody else here today who can answer that  
15 question?

16 A. I don't believe they can.

17 MR. HALL: No further questions.

18 EXAMINER STOGNER: Mr. Kellahin?

19 MR. KELLAHIN: Thank you, Mr. Stogner.

20 CROSS-EXAMINATION

21 BY MR. KELLAHIN:

22 Q. Mr. Mladenka, I don't care about the math. Let  
23 me see if I understand the point.

24 When the "S" 1 well is drilled, it's drilled not  
25 in the unit? it's drilled on an 80-acre spacing unit,

1 right?

2 A. Correct.

3 Q. It's drilled, it commences producing. That total  
4 production, then, has value, it's distributed to all the  
5 interest owners?

6 A. That was correct.

7 Q. The interest owners will include the working  
8 interest, the royalty and the overrides?

9 A. Yes.

10 Q. A sufficient number of months went by before that  
11 well was effectively put into the unit, correct?

12 A. That is correct.

13 Q. That period of time was long enough to produce  
14 enough hydrocarbons that if you did the math, it would  
15 equal five and a half times the cost of that well?

16 A. That is correct.

17 Q. All right. So when we look at the "C" 4 well,  
18 you're trying to establish fairness for the owners in that  
19 80-acre spacing unit for a producing well that currently is  
20 not in the unit?

21 A. That's correct.

22 Q. So this formula is one to derive an equity so  
23 that the interest owners, royalty, override and working,  
24 receive a certain total volume of production, reduced to  
25 dollars, that compensates them --

1 A. Correct.

2 Q. -- so that we have the equivalent of two or two  
3 and a half times payout?

4 A. Correct.

5 EXAMINER STOGNER: Mr. Kellahin.

6 Mr. Carr?

7 MR. CARR: I have no questions.

8 EXAMINER STOGNER: Mr. Cooter?

9 MR. COOTER: I have no questions.

10 EXAMINER STOGNER: Any redirect, Mr. Bruce?

11 MR. BRUCE: No, sir.

12 MR. HALL: Need to move the admission of Exhibit  
13 M-2, created by Mr. Mladenka.

14 EXAMINER STOGNER: Any objection?

15 MR. BRUCE: No, sir.

16 EXAMINER STOGNER: Exhibit M-2 will be admitted  
17 into evidence at this time.

18 EXAMINATION

19 BY MR. CARROLL:

20 Q. Mr. Mladenka, Gillespie Oil, Inc., is not a  
21 working interest owner in this unit; is that correct?

22 A. Of the unit? Or the "C" 4, no, they are not.

23 MR. BRUCE: Of the unit?

24 MR. CARROLL: Right.

25 MR. BRUCE: Gillespie Oil, Inc., owns no working

1 interest whatsoever.

2 MR. CARROLL: Right.

3 Q. (By Mr. Carroll) Now, when we're talking about  
4 payout here of both the Chandler well and the -- What is  
5 it, the "S" --

6 A. Yeah, the Number 12, on the east side. The  
7 southeast quarter of 34 is your Number 12.

8 Q. Right -- Oh, the Number 12. Number 12 well had  
9 five and a half times payout?

10 A. That is correct.

11 Q. Now, that wasn't grossed up to include the  
12 royalty interests, right? I mean, that five and a half was  
13 based upon the cost of the well?

14 A. However, royalty owners were being paid out of  
15 those revenue streams at the same time.

16 Q. Right, but the total amount of dollars was based  
17 upon the cost of the well, right? Five and a half times  
18 the cost?

19 A. Of the revenue, I believe, that Mr. Gillespie  
20 received -- No, I take that back. I think it was based  
21 on -- I need to go back and refigure the five and a half,  
22 but it's -- exactly how it was done, I'm not real sure  
23 how -- the royalty owner would be --

24 MR. BRUCE: Mr. Carroll, if I could answer that.  
25 Partly, the working interest owner receives a certain

1 percentage of production. The rest goes to the royalty and  
2 to the overriding royalty.

3 MR. CARROLL: Right.

4 MR. BRUCE: So he's not getting 100 percent of  
5 revenue to pay his well costs; he's only getting, say, 80  
6 percent.

7 MR. CARROLL: Right, but we're talking about a  
8 total amount here. Five and a half times of what? The  
9 well costs, right? Even though the working interest owners  
10 don't get that whole 550 percent.

11 MR. BRUCE: Now what you're talking about there  
12 is five and a half to the working interest owners. But in  
13 the interim, the royalty and overriding royalties have also  
14 been paid.

15 MR. CARROLL: Okay. All right, that answers my  
16 question.

17 EXAMINER STOGNER: Any other questions?

18 REDIRECT EXAMINATION

19 BY MR. HALL:

20 Q. Briefly, Mr. Mladenka. The -- What determined  
21 the payout on the Chandler, the State "S" 1 well?

22 A. We were giving a copy of the spreadsheet by  
23 Hanley, from Hanley's represented, showing their revenue  
24 and cost, up to -- from the time it was drilled to the time  
25 it was brought in the unit November 1st. During that time

1 period it generated a profit-to-investment of 1.4 -- or 2.4  
2 times payout, 2.5.

3 Q. Okay. So up until the time the unit expansion  
4 was effective --

5 A. Effective.

6 Q. -- the wells received 100-percent production  
7 revenues?

8 A. Correct. That was Hanley's benefit while they  
9 owned it before the unit did.

10 Q. So it's the effective date of the expansion, the  
11 administrative process, that determines when those two  
12 wells stopped receiving 100 percent of production revenues  
13 to offset well costs. That's why you can say one received  
14 400 percent payout, the other 200, what have you?

15 A. That's correct. We didn't put a date on there,  
16 we're letting the ratification process, the Commission, to  
17 set an effective date.

18 Q. So under your new proposal you're proposing, as I  
19 understand it, an effective date in the future, whenever  
20 ratification comes?

21 A. That's correct.

22 Q. Indeterminate date at this point, correct?

23 A. I think that's --

24 Q. Presuming ratification does not occur for another  
25 six months, how many times will the "C" 4 have paid out?



1           A.    It will come in -- if -- I don't know. I would  
2 say that I want this -- Mr. Gillespie wants this in the  
3 unit, he knows it needs to go in the unit. He wanted to be  
4 fair. The quicker we get this thing done, we won't have to  
5 worry about this.

6                   We're not -- Once again, the technical committee  
7 would not allow the discoverer of this field to have his  
8 wishes known, or that knew it but would not respond to it.  
9 And we're asking to be treated fairly.

10           MR. HALL: Nothing further.

11           EXAMINER STOGNER: Any other questions of this  
12 witness?

13           MR. BRUCE: No, sir.

14           EXAMINER STOGNER: You may be excused.

15                   I believe we've heard from five witnesses. Is  
16 there any others at this time?

17           MR. BRUCE: I have no further witnesses.

18           EXAMINER STOGNER: Okay. Where do we go from  
19 here?

20           MR. CARR: Mr. Stogner, I would like permission  
21 to make a brief statement and tender a letter into the  
22 record. By doing that, I think I can avoid ever having to  
23 have another hearing on this. That's my intent.

24                   But could I have just a minute to make a brief  
25 statement and present a certified copy of the letter from

1 the Commissioner of Public Lands? I think putting it in  
2 the record will result in the record being complete,  
3 because it is really the underlying reason for this Tract  
4 15/Tract 14 issue.

5 EXAMINER STOGNER: Okay, Mr. Carr?

6 MR. CARR: May it please the Examiner, what I've  
7 just handed you is a certified copy of the letter from the  
8 Commissioner of Public Lands in which the Commissioner  
9 advised Hanley that he would treat the lease as an  
10 effective -- and treat it as if it were in full force and  
11 effect if it is ultimately included in the unit as a part  
12 of the decision in Case Number 11,724, which is the case we  
13 now have filed a hearing *de novo* application in that matter  
14 and are requesting that that case be re-opened either  
15 before and Examiner or before the Commission.

16 I think it would be important at this time to  
17 note that both Hanley and Yates have been involved in and  
18 support the work of the technical committee, both in spirit  
19 and the letter of it.

20 When the case is called for *de novo* hearing, if  
21 this letter is admitted, we will present no new testimony.  
22 We will tender a proposed order. It will request that  
23 Tract 15 be included during the primary term of the lease  
24 on that acreage, and it will set forth an allocation to  
25 Tracts 14 and 15 in line with what Energen presented and

1 requested in its Exhibit 2, because Hanley is not seeking  
2 in excess of three percent; they're seeking that those two  
3 tracts be treated based on the representations and the  
4 geology presented and made part of the technical committee  
5 recommendation.

6 We think that by doing that and by bringing that  
7 tract in at that time, we won't be in the situation of  
8 later having to figure out what to do once it expires and  
9 is re-leased and in trying to rediscover how we're going to  
10 allocate that among the unit owners, and we believe this  
11 will be the most efficient way to achieve what we  
12 understand to have been the agreement between those who  
13 participated in the technical committee.

14 We then believe that, plus an order from this  
15 case, which we hope will be ratified, will once and for all  
16 bring this matter to a close.

17 And with that, I would request that this letter  
18 be admitted as Hanley Exhibit Number 1 and included in the  
19 record so that when the case, the *de novo* case, is  
20 reopened, we can simply ask that the record here be  
21 incorporated by reference and that an order enter.

22 EXAMINER STOGNER: The Hanley Exhibit Number 1  
23 will be admitted into evidence at this time.

24 MR. BRUCE: Mr. Examiner, I know the Applicant  
25 usually goes last, but maybe I can outline a few issues and

1 maybe help things.

2 I stated in my opening that there are areas of  
3 agreement, and there's a couple areas of disagreement. Let  
4 me go down some of these, and maybe it will narrow the  
5 issues.

6 Number one, I think the parties all agree on the  
7 formula, so nobody has to fight over that.

8 Everybody agrees on -- and I think Mr. Carr would  
9 agree, it's legally proper to have retroactive approval of  
10 bringing Tract 15 into the unit, number one, because it's  
11 still on a *de novo* appeal and, number two, because there is  
12 HPV under that tract that justified bringing that tract in.  
13 To me, that's really a non-issue. I think everybody's in  
14 favor of saving Hanley's lease.

15 Nobody objects to bringing in two more wells.  
16 And of course, if the Energen well is a good well, I don't  
17 think anybody would object to that.

18 Now, the effective date, there was some issue  
19 here, but in the end I think that matter is irrelevant.  
20 There are some legal issues involved in that. When should  
21 be the effective date? April 1? If the Division approves  
22 that, if the State Land Office, which has to approve this  
23 yet, if the Bureau of Land Management is in favor, so be  
24 it.

25 Everybody's in favor of expanding the unit. Mr.

1 Gillespie wants slightly less acreage in it. You've got  
2 two distinct proposals. We'd like you to look at it and  
3 choose. That's really issue number one.

4 And then issue two is the payout issue. This was  
5 proposed at the last working interest owners' meeting. It  
6 was put in the form of an AFE. That letter is in my file  
7 from Mr. Hall, that, you know, Energen didn't like that  
8 method. And that's why Mr. Gillespie proposed a revision  
9 to Article 10.4 of the unit operating agreement today.

10 As the witness has said, Mr. Gillespie's witness  
11 has said, it was just based on what's happened in the past.  
12 From my point of view, we wouldn't be here today, we  
13 wouldn't have been here in 1997 or in 1995, if it hadn't  
14 been for Mr. Gillespie.

15 We think some form of payout is fair on the "C" 4  
16 well. We'd ask you to look at that issue and decide.

17 There are a couple of other issues that came up  
18 right at the beginning regarding how you treat -- Mr. Hall  
19 may address this, but how you treat Tracts 12, 13 and 14,  
20 or for that matter Tracts 12, 13, 14 and 15.

21 There is language -- I looked at that language  
22 while we were on lunch break -- in the Statutory  
23 Unitization Act. I don't think that language is extremely  
24 clear.

25 And once again, the fact that the issue of Tracts

1 12 through 15 were on *de novo* appeal, I believe, gives the  
2 Division authority to change the tract participation  
3 formula, without having to worry about 100-percent approval  
4 by working and royalty interest owners. Certainly we will  
5 try to get that.

6 I'm sure if Hanley can get an increased  
7 percentage, they'll vote for it, all of their interest  
8 owners will, their royalty interest owners will, because I  
9 believe any of the proposals result in increases in those  
10 tract participations for those three or four tracts. So I  
11 don't think obtaining approval from the interest owners is  
12 an issue.

13 Simply put, I'd ask you to look at it and decide  
14 those two issues, let us know, and we'll gear up and obtain  
15 ratifications.

16 The first go-around, we had obtained  
17 ratifications before the unit hearing. As a matter of  
18 fact, there was approval by -- I forget exactly, but there  
19 was 98-percent working interest approval, 99-percent  
20 working interest approval, and the bulk of the royalty  
21 interests, and we had to go back the second time after the  
22 Division decided in favor of Snyder Ranches.

23 Once again, at the May, 1997, hearing -- May  
24 seems to be a popular month in this pool -- we didn't have  
25 all the ratifications, and we had to seek them afterwards.

1 I think the one final area is, Energen did point  
2 out its concerns with Section 13, the proposed tract  
3 participation factor. I don't think anybody really  
4 disagrees; we just need to get language together that would  
5 satisfy everyone. I think Mr. Hall and Mr. Carr and Mr.  
6 Kellahin and I can work on that and get you the revised  
7 thing. The intent is the same; it would just be different  
8 language.

9 And with that, I'd turn it over to whoever else  
10 would like to make a comment.

11 EXAMINER STOGNER: Mr. Hall?

12 MR. HALL: Briefly, Mr. Stogner.

13 I think -- little difficult to assess where we  
14 are. There are some legal impediments to a couple of  
15 issues here. Let me address the first one I see, and that  
16 is the new proposal by the unit operator, Mr. Gillespie,  
17 whoever it is, according to Charles B. Gillespie, Jr.,  
18 Exhibits 1 through 12.

19 I think you can give those proposals no  
20 consideration in the context of this hearing, particularly  
21 with respect to the fact that Section 70-7-6 of the  
22 Statutory Unitization Act requires you to make a finding  
23 under subpart 5 of that statute that the operators made a  
24 good-faith effort to try to get voluntary participation in  
25 such a proposal.

1           Just an hour ago is the first time any of us  
2 other than the Gillespies have ever seen this, so I don't  
3 think you can make that finding with respect to this  
4 proposal at all. I don't know why you should even consider  
5 it.

6           In addition to that, it includes matters that are  
7 beyond the scope of the Gillespie Application to you. It  
8 involves a dispute over a well-payout issue. There's a  
9 proposal to amend the operating agreement. That was not  
10 included in the Application, it was not included in the  
11 notice, not included in the advertisement. I don't know  
12 how you can consider that, frankly.

13           Aside from those legal technicalities, I think  
14 that payout issue is an issue you should not have to decide  
15 in any event. It seems to me that that issue is a matter  
16 of a contractual dispute between two parties that they  
17 ought to try to sort out outside the context of an Oil  
18 Conservation Division hearing, and that's where it ought to  
19 be sorted out.

20           With respect to the possibility of an order  
21 issuing on what the technical committee has proposed, I  
22 think there's more unanimity of agreement on that proposal  
23 than anything else. But some testimony made clear here  
24 today, I think there is sufficient disagreement on outside  
25 issues that will prevent ratification.

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1 Bottom-line question, posed it to Mr. Gillespie's  
2 representative, Mr. Mladenka: If Mr. Gillespie doesn't  
3 receive what he wants in this well-payout issue, will he  
4 withhold ratification of the technical committee proposal?  
5 Mr. Mladenka's answer was no.

6 Given that set of facts and circumstances, if I  
7 were you, I don't know if I'd want to waste the time and  
8 energy to write an order on anything that's before you  
9 today. I think what you ought to do with this case, Mr.  
10 Examiner, is continue it, not dismiss it. Continue it.  
11 It's been noticed and advertised already. Let the parties  
12 get together, iron out these final bugs. Let us come back  
13 before you and present you with revised language to account  
14 for the difficulties of Tract 15 participation formula, all  
15 these other issues. And it is hoped the parties can reach  
16 resolution on this well-payout issue, or eliminate that  
17 somehow. Till all that's done, I don't know that you want  
18 to waste your time writing an order.

19 That's all I have.

20 EXAMINER STOGNER: Thank you, Mr. Hall.

21 Mr. Kellahin?

22 MR. KELLAHIN: Thank you, Mr. Examiner.

23 Mr. Stogner, you have huge, broad powers to  
24 decide this problem. I can't imagine that these parties  
25 can go away and get this matter settled. They've tried for

1 months, they've met at my office, they can't get it solved.

2 The one issue for you to decide is the payout  
3 issue. You have the authority and the responsibility to  
4 decide that problem.

5 If you believe Mr. Hall that we must go back to  
6 square one, then everything we did in this case back in  
7 1995 was wrong. Because if you look at that order you'll  
8 remember that at the last moment Snyder Ranches came before  
9 Examiner Catanach and presented a pore volume map. And  
10 when you read the order, you'll find out that he ordered  
11 the Snyder Ranches' pore volume map to be substituted for  
12 that proposed by the technical committee.

13 Gillespie has presented that possibility to you  
14 today. One decision for you to make is whether or not you  
15 take the Gillespie revised map from this afternoon and  
16 require that it be substituted. You have that power and  
17 authority. If you do that, then the technical committee  
18 can do the math and do the calculations.

19 Once you make that decision, the only remaining  
20 decision to decide is the payout issue, because Energen has  
21 conceded all the other issues. Their witness got on the  
22 stand and said they conceded the April 1st, 1999, effective  
23 date. They didn't want the wellbore factor for the  
24 drilling Energen well. All the issues are resolved, with  
25 the exception of the payout.

1           We think the payout is an important equity  
2 decision for you to resolve. When you look at the "S" 1  
3 well that gets five and a half times, the Hanley Chandler  
4 well gets two and a half times, we think it is equitable,  
5 and certainly within your authority, to provide fairness to  
6 the owners of the interest in the "C" 4 well and give us  
7 more than one-time payout. We think that's the answer.

8           Sending us away doesn't solve the problem. We're  
9 here before you to ask your help. Decide that one issue  
10 for us, decide the pore-volume issue, and everything else  
11 falls into place. And we will go ahead with this unit, as  
12 we did back in 1995, where the Division had to decide an  
13 important issue. And once that decision was made,  
14 ratification followed thereafter.

15           So we reject the arguments of Energen and  
16 counsel. We support those of Gillespie and his  
17 representatives. We would like to see this accomplished  
18 and done. And it's not going to be done unless you take  
19 action and do something about the payout factor that's the  
20 one remaining issue for you to decide.

21           Thank you.

22           EXAMINER STOGNER: Mr. Kellahin.

23           Mr. Carr?

24           MR. CARR: I believe I gave my closing --

25           EXAMINER STOGNER: Oh, that's right.

1 MR. CARR: -- several times today.

2 EXAMINER STOGNER: Mr. Cooter, do you wish to say  
3 anything at this time?

4 MR. COOTER: One item which I mentioned in my  
5 letter that I sent yesterday afternoon to the Division as  
6 well as to all counsel here. Mr. Arrington, individually  
7 and for his company, would support the revised parameters  
8 of Mr. Gillespie, which excludes the east half of the  
9 southwest quarter of Section 35.

10 EXAMINER STOGNER: That would be Tract 24; is  
11 that what you're referring to?

12 MR. COOTER: I believe so. Yes, sir.

13 EXAMINER STOGNER: Let the record show that Mr.  
14 Cooter's reference to that east half of the southwest  
15 quarter of 34 is Tract 24 of the exhibits issued today, or  
16 admitted today.

17 MR. BRUCE: Mr. Examiner, if I could have just  
18 one minute --

19 EXAMINER STOGNER: Oh, sure, Mr. Bruce. You can  
20 have more than that.

21 MR. BRUCE: Really, all I need, in addition to  
22 Mr. Kellahin's comments, at the May, 1997, hearing -- not  
23 only at the May, 1995, hearing but at the May, 1997,  
24 hearing, Yates and Hanley, I believe, came in at the last  
25 minute with a proposal no one had seen.

1           Furthermore, I think the parties pretty much  
2       agreed that other than some technical committee meetings,  
3       we were not going to seek any ratifications until after a  
4       Division hearing, because there were matters of contention.

5           As far as notice of the hearing, you don't need  
6       to turn to it now, but if you would look at Gillespie Oil  
7       Exhibit 14 and the notice letter that went out, it  
8       specifically mentions Article 10.4 of the West Lovington-  
9       Strawn Unit operating agreement being at issue. And even  
10      the advertisement in the case states that one of the  
11      matters is the determination of credits and charges to be  
12      made among the various owners in the expanded unit area for  
13      their investment in wells and equipment. We think that's  
14      sufficient to bring these matters to issue.

15           Thank you, Mr. Examiner.

16           EXAMINER STOGNER: Mr. Bruce, would it help  
17      matters any if I considered redesignation of this pool to  
18      the Patience-Strawn?

19           MR. BRUCE: Could be, Mr. Examiner.

20           EXAMINER STOGNER: I'll keep that in mind.

21           MR. BRUCE: And we thank you for your patience  
22      today.

23           EXAMINER STOGNER: I feel at this time to take  
24      this case under advisement, and I'm going to request rough  
25      drafts. So you see, Mr. Scott Hall, that you'll be wasting

1 your time too, providing me a rough draft.

2 And if you would all like to get together and  
3 issue one or more than one, or, Mr. Bruce, you can even  
4 issue two, that would be fine.

5 (Laughter)

6 MR. BRUCE: I hope that's not an order, Mr.  
7 Examiner.

8 MR. HALL: Let me make sure I understand your  
9 comments. You do not want an order from me?

10 EXAMINER STOGNER: I would take one from you,  
11 yes, and I would even strongly recommend that you provide  
12 me a rough draft order, as anybody in here, as far as the  
13 legal counsels go. I would like to see everybody get  
14 together and issue me one draft order, but if that can't  
15 be, then maybe perhaps you can all get together and issue  
16 one draft order and then issue some differences that you  
17 may have. That would help tremendously.

18 I'd like to see this done in a timely manner.  
19 Let it be known that I'm going to be gone for two weeks,  
20 commencing June the 7th, so we're looking at a real quick  
21 deadline. If you can all get together by Monday, maybe we  
22 can get something out by Friday -- I'm sorry, Tuesday,  
23 since Monday is a holiday. Or is that asking too much?

24 MR. BRUCE: Perhaps since all the attorneys are  
25 here we could get together this afternoon.


1 EXAMINER STOGNER: The earlier, the better. I  
2 won't put any deadline. But just be aware of my schedule.

3 And at this time I will take Case Number 12,171  
4 under advisement.

5 And if there's nothing further in this matter,  
6 then this hearing is adjourned.

7 (Thereupon, these proceedings were concluded at  
8 3:00 p.m.)

9 \* \* \*

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11  
12  
13 I do hereby certify that the foregoing is  
14 a complete record of the proceedings in  
the Examiner hearing of Case No. 12171  
15 heard by me on 27 May 1999.  
16 , Examiner  
Oil Conservation Division  
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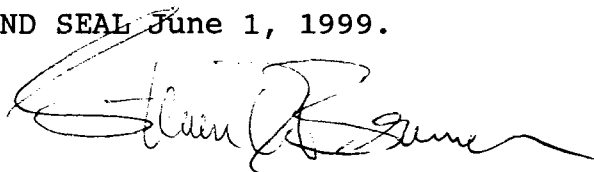
## CERTIFICATE OF REPORTER

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

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

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

WITNESS MY HAND AND SEAL June 1, 1999.



STEVEN T. BRENNER  
 CCR No. 7

My commission expires: October 14, 2002

STEVEN T. BRENNER, CCR  
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