

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: )

APPLICATION OF CHI ENERGY, INC., FOR )  
COMPULSORY POOLING, EDDY COUNTY, )  
NEW MEXICO )

CASE NO. 13,248

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

April 15th, 2004

Santa Fe, New Mexico

RECEIVED

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Oil Conservation Division  
1220 S. St. Francis Drive  
Santa Fe, NM 87505

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, April 15th, 2004, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

\* \* \*

## I N D E X

April 15th, 2004  
 Examiner Hearing  
 CASE NO. 13,248

## PAGE

## APPLICANT'S WITNESS:

JOHN QUALLS (Landman)

Direct Examination by Mr. Bruce 3

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\* \* \*

## E X H I B I T S

Applicant's	Identified	Admitted
Exhibit 1	4	12
Exhibit 2	5	12
Exhibit 3	5	12
Exhibit 4	8	-
Exhibit 5	10	12
Exhibit 6	10	12
Exhibit 7	11	12

\* \* \*

## A P P E A R A N C E S

## FOR THE APPLICANT:

JAMES G. BRUCE  
 Attorney at Law  
 P.O. Box 1056  
 Santa Fe, New Mexico 87504

\* \* \*

1 WHEREUPON, the following proceedings were had at  
2 8:55 a.m.:

3 EXAMINER STOGNER: At this time I'll call Case  
4 Number 13,248. This is the Application of Chi Energy,  
5 Inc., for compulsory pooling, Eddy County, New Mexico.  
6 Call for appearances.

7 MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,  
8 representing the Applicant. I have one witness.

9 EXAMINER STOGNER: Any other appearances?  
10 Will the witness please stand to be sworn?  
11 (Thereupon, the witness was sworn.)

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

15 DIRECT EXAMINATION

16 BY MR. BRUCE:

17 Q. Would you please state your name and city of  
18 residence for the record?

19 A. John Qualls, Midland, Texas.

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

21 A. Chi Energy, Inc., landman.

22 Q. Have you previously testified before the  
23 Division?

24 A. Yes, sir.

25 Q. And were your credentials as an expert landman

1 accepted as a matter of record?

2 A. Yes, sir.

3 Q. And are you familiar with the land matters  
4 involved in this case?

5 A. Yes, sir.

6 MR. BRUCE: Mr. Examiner, I tender Mr. Qualls as  
7 an expert petroleum landman.

8 EXAMINER STOGNER: Mr. Qualls is so qualified.

9 Q. (By Mr. Bruce) Mr. Qualls, briefly, what does  
10 Chi seek in this case?

11 A. We seek an order pooling the south half of  
12 Section 3, 22 South, 26 East, from the surface to the base  
13 of the Morrow formation for all pools or oil formations  
14 spaced on 320 acres. We also seek to pool the southeast  
15 quarter for 160-acre unit spacing.

16 Q. What is Exhibit 1?

17 A. Exhibit 1 is a land plat outlining the proposed  
18 well unit. The well is located at an orthodox location 660  
19 from the south and 660 from the east line.

20 Q. And what type of people do you seek to pool in  
21 this well unit?

22 A. We seek to pool a number of unleased mineral  
23 owners.

24 Q. Okay. Referring to Exhibit 2, could you briefly  
25 describe the problem in getting the joinder of everyone in

1 the south half of Section 3?

2 A. Exhibit 2 is a subdivision plat of the south half  
3 of Section 3. Most of the acreage is residential  
4 subdivisions. There are approximately 105 tracts of land,  
5 most of which are a few tenths of an acre in size. Many of  
6 these interest owners disappeared decades ago and could not  
7 be located.

8 Q. What percentage of the south half of Section 3  
9 has Chi leased?

10 A. We obtained approximately 75 leases from the  
11 mineral owners, covering about 94 percent of the mineral  
12 interest. The remainder is unleased.

13 Q. Is Exhibit 3 a list of the currently unleased  
14 mineral owners?

15 A. Yes.

16 Q. And page 1 contains those for whom you had a  
17 current address?

18 A. Yes.

19 Q. And pages 2 and 3 are the ones who we have no  
20 address for or there is no current valid address?

21 A. Yes.

22 Q. Okay --

23 EXAMINER STOGNER: Mr. --

24 MR. BRUCE: Yes, sir.

25 EXAMINER STOGNER: -- Bruce, give me a chance

1 to --

2 MR. BRUCE: Yeah.

3 EXAMINER STOGNER: -- look over these notes --

4 MR. BRUCE: Sure.

5 EXAMINER STOGNER: -- here, right quick.

6 Okay, Mr. Bruce, continue. I just wanted to --

7 MR. BRUCE: Sure. And Mr. Examiner, in going  
8 through this list, there are a couple of duplications. For  
9 instance, if you'll notice on the first page of Exhibit 3,  
10 four people down, there's Robert L. Graves and wife. And I  
11 also have them listed as no valid address on page 2, about  
12 halfway down. The reason for that is, we did have trouble  
13 getting in touch with him, and so I actually had him down  
14 as unlocatable, as well as locatable. As a matter of fact,  
15 he has received the Application, and I spoke to him about a  
16 week ago.

17 But there are some duplicates like that, just  
18 because we did not -- we had addresses that we thought were  
19 good and addresses that we thought were bad, so...

20 EXAMINER STOGNER: So when I do see it duplicated  
21 in here, they're not two different parties or two different  
22 people; they are the same --

23 MR. BRUCE: They are the same.

24 EXAMINER STOGNER: And if there's an address such  
25 as this one, they were located?

1 MR. BRUCE: Yes.

2 EXAMINER STOGNER: Thank you.

3 Q. (By Mr. Bruce) And approximately how many  
4 unleased interests are there, Mr. Qualls?

5 A. Approximately 40 unleased mineral interests, I  
6 believe.

7 Q. Now, if leases are obtained from any of these  
8 people, will you notify the Division?

9 A. Yes, sir.

10 MR. BRUCE: Mr. Examiner, I had -- and you had  
11 requested this -- Let me take a step back. There is a  
12 force pooling order on the south half of 3 for the first  
13 well in the well unit, which is in the southwest quarter --  
14 in the southwest of the southwest of Section 3, and that is  
15 Order Number R-12,098.

16 As part of that, I have promised to get you, and  
17 I have been working on, a list of interest ownership so you  
18 could see quarter section by quarter section, or quarter  
19 quarter section, or half section, what the percentage  
20 interests are. And I meant to have that ready for today,  
21 and it's almost done. With your permission, if I could  
22 submit that after the hearing today?

23 EXAMINER STOGNER: Okay, this an existing force  
24 pooling case in the south half of this Section 3 in which  
25 you're here for today?

1           A.    Yes, sir. Yes, sir. But that order did not  
2 provide for an infill well. And so what I plan to do is to  
3 submit a list to you, somewhat like Exhibit 3 -- and I will  
4 mark it as Exhibit 4 -- listing the percentage interests of  
5 all these people.

6           EXAMINER STOGNER: Thank you, sir.

7           Q.    (By Mr. Bruce) Now, Mr. Qualls, insofar as  
8 control of the well unit, you mentioned that you had about  
9 94 percent of the mineral interest leased in the south half  
10 of Section 3. But as far as working interest control, is  
11 there a different number than that?

12          A.    Yes, it's approximately 96 percent. There was  
13 two mineral owners, Roy Barton and E.L. Latham, have now  
14 joined in the well as unleased owners, and they have signed  
15 an AFE and a JOA.

16          Q.    And they have approximately a combined 2-percent  
17 interest?

18          A.    Yes.

19          Q.    Okay. Now, let's discuss the efforts of Chi to  
20 obtain the voluntary joinder of the mineral interest owners  
21 in this well. What steps did Chi take to lease the south  
22 half of Section 3?

23          A.    Starting about two or three years ago, Tierra Oil  
24 Company started leasing the south half of Section 3. We  
25 checked the county records and the other available records

1 and leased those interest owners they could. It also  
2 bought some of the minerals. Tierra has assigned the  
3 leases to us or leased its interest to us.

4 Q. Now, was another round of leasing attempted more  
5 recently?

6 A. Yes.

7 Q. And when did that start?

8 A. Starting in November, 2003, we had Tierra contact  
9 the interest owners for whom we had obtained new addresses.  
10 Most people indicated they wanted to lease their interest  
11 rather than join in the well as working interest owners.

12 Q. And I believe since then about what, 15 or 20  
13 leases were obtained from people?

14 A. Yes, sir, I believe that's right.

15 Q. Okay. Overall, what types of records were  
16 searched in trying to locate the interest owners?

17 A. Records of the county clerk, county assessor,  
18 phone records and Internet searches.

19 Q. I believe that Tierra Oil Company also called  
20 neighbors and asked what happened to certain of these  
21 people we could not locate?

22 A. Yes, sir.

23 Q. Did Chi then, as a last resort, send out proposal  
24 letters to the people for whom you had addresses?

25 A. Yes.

1 Q. And are those proposal letters marked as Exhibit  
2 5?

3 A. Yes, sir.

4 Q. In your opinion, has Chi made a good faith effort  
5 to obtain the voluntary joinder of the interest owners of  
6 the well who you could locate, or to lease those interest  
7 owners?

8 A. Yes.

9 Q. What is the cost of the well? And I refer you to  
10 Exhibit 6?

11 A. Exhibit 6 is a copy of the AFE for the well.  
12 It's an 11,900-foot test with an estimated dryhole cost of  
13 \$939,495 and a completed well cost of \$1,442,655.

14 Q. And are these costs in line with the costs for  
15 other wells drilled to this depth in this area of New  
16 Mexico?

17 A. Yes.

18 Q. Do you request that Chi Operating, Inc., be  
19 designated operator of the well?

20 A. Yes.

21 Q. And what recommendations do you have for overhead  
22 rates?

23 A. We request \$6000 a month be allowed for a  
24 drilling well and \$600 a month be allowed for a producing  
25 well.

1 Q. And are these amounts equal to those normally  
2 charged by Chi and other operators in this area for wells  
3 of this depth?

4 A. Yes.

5 Q. Do you request that this rate be adjusted  
6 periodically as provided by the COPAS accounting procedure?

7 A. Yes, sir.

8 Q. And do you request the maximum cost-plus-200-  
9 percent risk charge on any nonconsenting interest owners?

10 A. Yes, sir.

11 Q. And finally, were the interest owners for whom we  
12 had addresses notified of the hearing?

13 A. Yes, sir.

14 Q. Is that marked Exhibit 7?

15 A. Yes.

16 Q. Were Exhibits 1 through 7 prepared by you or  
17 under your supervision or compiled from company business  
18 records?

19 A. Yes, sir.

20 Q. And is the granting of Chi's Application in the  
21 interests of conservation and the prevention of waste?

22 A. Yes.

23 MR. BRUCE: Mr. Examiner, I'd move the admission  
24 of Chi Exhibits 1 through 3 and 5 through 7, with Exhibit 4  
25 to be submitted later today.

1 EXAMINER STOGNER: Exhibits 1 through 3 and 5  
2 through 7 will be admitted into evidence, and we'll hold  
3 the record open pending the submittal of Exhibit Number 4.

4 MR. BRUCE: And I have nothing further of this  
5 witness.

6 EXAMINATION

7 BY EXAMINER STOGNER:

8 Q. Mr. Qualls, on Exhibit Number 5 --

9 A. Yes, sir.

10 Q. -- okay, I have some April 15th letters. That  
11 looks like the first five pages, four pages; is that  
12 correct?

13 A. April 15th?

14 Q. I'm sorry, February 15th.

15 A. Yes, sir.

16 Q. Okay, and these letters were to and for which  
17 well?

18 MR. BRUCE: Mr. Examiner --

19 THE WITNESS: I may have those in there.

20 MR. BRUCE: -- I -- those were -- I'm sorry, Mr.  
21 Examiner, I didn't even notice that. Those were for the  
22 first well, but I believe some of those parties have been  
23 leased --

24 THE WITNESS: Yes, sir.

25 MR. BRUCE: -- and therefore they should not have

1     been included in this packet.

2                 THE WITNESS:   Right.

3                 EXAMINER STOGNER:   Okay.   Then why don't you  
4     examine him, and then we can just mark them out?   Leave  
5     them in here, but --

6                 MR. BRUCE:   Okay.

7                 EXAMINER STOGNER:   -- delete them or put a  
8     notation.   So why don't you --

9                 Q.    (By Mr. Bruce)   Mr. Qualls, the first four pages  
10    of Exhibit 5 are for the actual -- the WC 3 Well Number 2,  
11    which was the first well over in the southwest of the  
12    southwest; is it not?

13                A.    Yes, yes.

14                Q.    And those are inapplicable to this well; is that  
15    correct?

16                A.    Yes, sir.

17                EXAMINER STOGNER:   All-righty.   So let me again  
18    refer to Exhibit Number 5, and then flip over to March 1st.  
19    This was the first written communication with the unleased  
20    parties or the parties to be force pooled; is that correct?

21                A.    I believe Tierra had contacted them.   I'm not  
22    sure if Tierra had written them a letter.   I don't have a  
23    copy of that.   That's the first letter I think I wrote to  
24    them concerning this well.

25                Q.    So Tierra had approached them two years ago; is

1 that correct?

2 A. Yes, sir.

3 Q. And what's your understanding? Could you be a  
4 little bit more specific about what was done between March  
5 1st and two years ago on Tierra? Did they -- Was it a  
6 diligent search, or did they back off of it for a little  
7 bit? You had mentioned that there was a flurry of activity  
8 two years ago and then another flurry of activity.

9 A. Right, we've been -- there's been an ongoing --  
10 This has been a very tough thing to put together. There's  
11 been an ongoing conversation with all these people, and  
12 they're trying to find addresses, trying to find the people  
13 that actually own the minerals for the last two years.

14 Tierra went back, I believe, starting in  
15 November, and tried to release some of the people that we  
16 found more addresses on, that didn't join in the first  
17 well, and I think they've made a diligent effort to try to  
18 get everybody that we could find. It's been very  
19 difficult.

20 MR. BRUCE: And Mr. Examiner, at least as to the  
21 most recent batch of letters regarding leasing in the case  
22 file for the other case, there is an exhibit in there with  
23 letters from Tierra Oil Company seeking to lease these  
24 people.

25 EXAMINER STOGNER: Do you have that case number?

1 MR. BRUCE: 13,193. It was submitted as an  
2 exhibit at the hearing.

3 EXAMINER STOGNER: I'll take administrative  
4 notice on the file in Case 13,193, into this matter also.

5 Q. (By Examiner Stogner) Did Chi buy out Tierra?  
6 Was it a merger? What's the relationship?

7 A. They assigned their interest in the leases to us.

8 Q. Is there a Tierra Resources still around? Is  
9 there --

10 A. Yes, they're in San Antonio, based out of San  
11 Antonio. And they also participate in the well. They took  
12 a working interest in the first well, a small percentage.

13 Q. And what's the status of the first well? Has it  
14 been drilled? Is it completed? Is it producing?

15 A. It has been drilled, pipe has been set. We are  
16 in the process of getting the pipeline right-of-way put in  
17 -- or the pipeline right-of-way has been approved, we're in  
18 the process of laying the pipeline right now.

19 Q. Do you know the status of the APD on this well,  
20 your proposed well today?

21 A. I don't have a copy of that with me. I believe  
22 it has been approved. I can get a copy of that if you need  
23 that, sir.

24 EXAMINER STOGNER: Again, Mr. Bruce, you heard me  
25 ask Mr. Kellahin earlier --

1 MR. BRUCE: Yes, sir.

2 EXAMINER STOGNER: -- if you can provide me  
3 through an e-mail the APD number, and if you have a copy of  
4 the C-101, C-102.

5 MR. BRUCE: Yes, sir.

6 Q. (By Examiner Stogner) The \$6000/\$600, that was  
7 what was on the last compulsory pooling order in the south  
8 half, that Order R-12,098; is that right, Mr. Qualls?

9 A. Yes, sir.

10 Q. Were you the landman in that case?

11 A. Yes, sir.

12 EXAMINER STOGNER: I have no other questions of  
13 Mr. Qualls. You may be excused.

14 Do you have anything further, Mr. Bruce?

15 MR. BRUCE: No, sir.

16 EXAMINER STOGNER: One more time, anybody else  
17 have anything further in Case 13,248?

18 There being none, then this matter will be taken  
19 under advisement. I'll hold the record open, pending the  
20 issuance of Exhibit 4, Mr. Bruce. Thank you, sir.

21 Let's take a five-minute recess.

22 (Thereupon, these proceedings were concluded at  
23 9:15 a.m.)

24 I do hereby certify that the foregoing is  
25 \* \* \* a complete record of the proceedings in  
the Examiner hearing of Case No. 13248  
heard by me on 15 April 2004

STEVEN T. BRENNER  
(505) 989-9317

Examiner

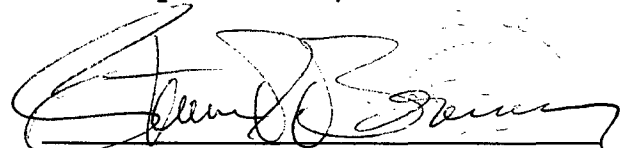
## CERTIFICATE OF REPORTER

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 April 16th, 2004.

  
STEVEN T. BRENNER  
CCR No. 7

My commission expires: October 16th, 2006