

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. 13,236

APPLICATION OF PRESTON EXPLORATION, )  
 L.L.C., FOR COMPULSORY POOLING, EDDY )  
 COUNTY, NEW MEXICO )

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

May 27th, 2004

Santa Fe, New Mexico

2004 JUN 10 PM 3 25

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 27th, 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.

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Examiner Hearing  
CASE NO. 13,236

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<u>MARK WHEELER</u> (Landman)	
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Additional submission by Applicant, not offered or  
admitted:

	Identified
Chronology	9, 11

\* \* \*

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

## FOR THE APPLICANT:

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Santa Fe, New Mexico 87501  
By: J. SCOTT HALL

## FOR CHASE FARMS and CHASE OIL CORPORATION:

HOLLAND & HART, L.L.P., and CAMPBELL & CARR  
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P.O. Box 2208  
Santa Fe, New Mexico 87504-2208  
By: WILLIAM F. CARR

## FOR MURCHISON OIL AND GAS:

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

\* \* \*

1           WHEREUPON, the following proceedings were had at  
2   8:33 a.m.:

3           EXAMINER STOGNER: Hearing will come to order.

4           At the request of the Applicant and with the  
5   understanding of the other parties in today's docket, at  
6   this time I will call Case 13,236, which appears on page 3.  
7   This is the Application of Preston Exploration, L.L.C., for  
8   compulsory pooling, Eddy County, New Mexico.

9           At this time I'll call for appearances.

10          MR. HALL: Mr. Examiner, Scott Hall, Miller  
11   Stratvert, P.A., Santa Fe, on behalf of the Applicant,  
12   Preston Exploration, L.L.C.

13          I anticipate calling only one witness this  
14   morning, but I ask that three be sworn in.

15          EXAMINER STOGNER: Any other appearances?

16          MR. CARR: May it please the Examiner, my name is  
17   William F. Carr with the Santa Fe office of Holland and  
18   Hart, L.L.P. We represent in this case Chase Farms, a New  
19   Mexico general partnership, and Chase Oil Corporation. I  
20   have one witness.

21          EXAMINER STOGNER: Any other appearances?

22          MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,  
23   representing Murchison Oil and Gas, Incorporated. I have  
24   no witnesses.

25          EXAMINER STOGNER: Any other appearances?

1 Can I please have all four witnesses or potential  
2 witnesses please stand to be sworn at this time?

3 (Thereupon, the witnesses were sworn.)

4 EXAMINER STOGNER: Okay, as of note, I had five  
5 people stand up to be sworn. Mr. Hall, you said one  
6 witness, but three to be sworn?

7 MR. HALL: Correct.

8 EXAMINER STOGNER: And you had one witness, Mr.  
9 Carr?

10 MR. CARR: Yes, sir. My witness stood and was  
11 sworn.

12 EXAMINER STOGNER: Okay, who was the mystery  
13 witness then?

14 MR. WHEELER: I think Bo stood. You're not  
15 planning on calling him, right?

16 MR. HALL: He's welcome to testify.

17 EXAMINER STOGNER: Okay, please let the record  
18 show that five witnesses were sworn, and let's make careful  
19 whenever we do introduce them that they were indeed sworn.

20 Okay, Mr. -- Is there any need for opening  
21 statements at this time?

22 MR. HALL: No, Mr. Examiner.

23 MR. CARR: No, sir.

24 EXAMINER STOGNER: Okay, Mr. Hall?

25 MR. HALL: Mr. Examiner, at this time we would

1 call Mark Wheeler to the stand.

2 MARK WHEELER,

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

5 DIRECT EXAMINATION

6 BY MR. HALL:

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

8 A. Mark Wheeler.

9 Q. Mr. Wheeler, where do you live and by whom are  
10 you employed?

11 A. Midland, Texas. I'm employed by Capstone Oil and  
12 Gas Company, L.P.

13 Q. And what do you do for Capstone?

14 A. Landman.

15 Q. And what is your relationship and the  
16 relationship of Capstone to the Applicant, Preston  
17 Exploration?

18 A. Capstone is in the primary business of generating  
19 prospects. We put together the land generally and turn  
20 prospects to industry partners. We do not operate  
21 ourselves, and so we get the prospects ready to drill and  
22 then whatever the operator needs for us to do to continue  
23 to get the participants together, to try to get wells  
24 drilled, we take care of for them.

25 Q. All right, and are you authorized to speak on

1     behalf of the Applicant, Preston?

2             A.     Yes, I am.

3             Q.     You've previously testified before the Division  
4     and had your credentials accepted as a matter of record; is  
5     that correct?

6             A.     Yes, in the old location.

7             Q.     And you're familiar with the Application that's  
8     been filed in this case and the subject area?

9             A.     Yes, I am.

10            MR. HALL:  Are the witness's credentials  
11     acceptable, Mr. Examiner?

12            EXAMINER STOGNER:  Any objection?

13            MR. CARR:  No objection.

14            EXAMINER STOGNER:  So qualified.

15            Q.     (By Mr. Hall)  Briefly, would you explain to the  
16     Examiner what Preston is seeking by this Application?

17            A.     Preston seeks the pooling of all unjoined  
18     interests in the north half of Section 29, Township 17  
19     South, Range 26 East, Eddy County, New Mexico, to be  
20     dedicated to the drilling of our Roughneck Red 29 Number 1  
21     well.

22            Q.     All right.  You've prepared certain exhibits in  
23     connection with your testimony this morning?

24            A.     Yes, I have.

25            Q.     Let's look at that packet of exhibits.  On top

1 you have a chronology of events I understand you  
2 participated in the preparation of. Exhibit Number 1, your  
3 land plat, let's look at that, if you could explain that to  
4 the Examiner.

5 A. This is a land plat, a blown-up land plat of  
6 Section 29 indicating the surface and bottomhole location  
7 for the proposed well.

8 Q. And what's the primary objective for the well?

9 A. Morrow.

10 Q. Let's look at Exhibit 2, your ownership  
11 breakdown, if you could explain that to the Hearing  
12 Examiner.

13 A. This is a breakdown of the leasehold ownership in  
14 the north half of Section 29. It shows all of the net  
15 acres for each party, the working interest before payout,  
16 after payout, and the working interest associated for each  
17 party.

18 Q. And the working interest in your second column  
19 before payout is what we should be focused on this morning?

20 A. Yes. Actually it's the third column.

21 Q. Third column?

22 A. Yes.

23 Q. How long has Preston owned its lease interest in  
24 the north half of Section 29?

25 A. Since January 15th of this year.

1 Q. Okay. Now, what percentage of the acreage in the  
2 320-acre unit is voluntarily committed to the well at  
3 present?

4 A. Approximately 52.69 percent.

5 Q. Let's refer to Exhibit 2, if you could identify  
6 the interests presently committed and the interests you're  
7 seeking to pool today.

8 A. Presently committed are the interests, WJP  
9 Exploration, which is one of Preston's entities, down  
10 through CMW Interests, Inc., and also, then, Cactus Energy,  
11 E3 Energy, and Saguaro Resources. Those parties are  
12 committed.

13 I'm sorry, did you ask which ones we're asking to  
14 pool?

15 Q. In addition.

16 A. We're asking to pool Chase Oil Corporation;  
17 Murchison Oil and Gas, Inc.; and MEC Petroleum Corporation.

18 Q. Now, are you asking for the imposition of a 200-  
19 percent risk penalty against the unjoined working interests  
20 to the pool?

21 A. Yes, sir.

22 Q. And does Preston seek to be designated operator  
23 of the well?

24 A. Yes, they do.

25 Q. In your opinion, Mr. Wheeler, has Preston and

1 Capstone made a good-faith effort to locate all the  
2 interest owners, working interest owners, communicate with  
3 them and obtain their voluntary participation in the well?

4 A. Yes, we have.

5 Q. What is the proposed surface and bottomhole  
6 location for the well?

7 A. 1480 feet from the north line and 1980 feet from  
8 the west line of Section 29, 17-26.

9 Q. And that's a standard gas well location?

10 A. Yes, it is.

11 Q. Would you explain to the Examiner your efforts  
12 and the efforts of Preston to obtain the voluntary  
13 participation of the interest owners you're seeking to pool  
14 today?

15 A. We made a number of phone contacts over the  
16 months, as well as visiting personally with the  
17 representatives of Chase Oil out in the field and certainly  
18 over the phone. We've also talked extensively with Mike  
19 Daugherty of Murchison, who is also representing MEC  
20 Petroleum Corporation.

21 Q. If you could refer to the chronology you helped  
22 prepare, does that provide a fair narrative of the history  
23 of events, your efforts to obtain everybody's participation  
24 in the well?

25 A. Yes, sir, it does.

1 Q. When did you first -- When was the well first  
2 proposed?

3 A. The well was first proposed January 13th of this  
4 year. It was done so after telephone conversation between  
5 myself and Mr. Lanning of Chase Oil.

6 We were made aware by Mr. Lanning that there was  
7 a potential surface issue down the road. They had plans to  
8 install a pecan orchard in this area, and we were made  
9 aware by him that we had a potential problem in drilling in  
10 this north half for surface. But at the time that he  
11 contacted me, we asked him -- you know, in deference to  
12 trying to work with him on the surface, I asked him where  
13 would be an okay location for us to drill? And he  
14 indicated that as long as we stayed no further south than  
15 1480 feet off the north line, that we would stay out of the  
16 proposed orchard.

17 So I went to our geologist Jerry Elger at that  
18 time and said, you know, where in your geology could we  
19 stake a location that would stay within your proposed -- or  
20 your expected channel. And that's how we picked the  
21 location of 1480 from the north, 1980 from the west.

22 Q. Now, by reference to your chronology, is this in  
23 the January, 2004, time frame?

24 A. Yes, that's during January of 2004, prior to our  
25 sending the AFE on January 13th.

1 Q. And that's Exhibit 3, that's your formal well-  
2 proposal letter?

3 A. Yes.

4 Q. Let's look at that. The third page of that, it's  
5 the third copy of the same letter, addressed to Caza  
6 Energy, L.L.C., Robert C. Chase, Richard L. Chase, Gerene  
7 Diane Chase Crouch.

8 When you -- your conversations with Mr. Lanning,  
9 your dealings with him, did you understand that he was  
10 representing Caza, Chase Farms, Chase Energy Corporation,  
11 and the individuals shown on your notice letter?

12 A. That was my understanding, yes, sir.

13 Q. Let's look at Exhibit 4. What is that?

14 A. That would be their letter, Chase's letter to us,  
15 dated February 19th.

16 Q. And that was their response to your formal well  
17 proposal letter of January 13th?

18 A. Yes, sir.

19 Q. In essence, what does the letter say?

20 A. Well, basically they indicated that the interest  
21 was leased to another party at that time, rather than the  
22 people that we notified. Of course, at the time we sent  
23 out the well proposal, the existing oil and gas lease was  
24 to the parties that we notified. And they also indicated  
25 that they had taken an additional interest in the area from

1 Dennis Riley, a mineral interest lease, that we thought had  
2 previously been held by production, so we had not  
3 approached him. And we were incorrect in that assumption.

4 But they also indicated they did not want further  
5 activity on the surface in the south half of the north  
6 half, which was where our proposed location was.

7 Q. So if I understand it, at the time of your  
8 January telephone conversations with Mr. Lanning, and at  
9 the time of your January 13th well-proposal letter, the  
10 acreage was under lease to Caza; is that correct?

11 A. It was under lease to Caza and the other parties  
12 that we notified.

13 Q. I see. And then by the time you received the  
14 response on February 19th, you found out from Mr. Lanning  
15 the acreage was then leased to Chase Oil Corporation; is  
16 that accurate?

17 A. Yes, sir. The previous lease had expired at the  
18 end of January and they gave themselves a new lease  
19 effective February 1st, and it went into Chase Oil  
20 Corporation.

21 Q. But at the time you were proposing the well, you  
22 were dealing with the apparent interest owners of record at  
23 that time?

24 A. Yes, sir.

25 Q. Look at Exhibit Number 5. Identify that, please

1 sir.

2 A. That is a copy of the new lease from Chase Farms  
3 to Chase Oil Corporation, dated February 1st of this year.

4 Q. All right. If you look at the second page of  
5 that, it shows county recordation information at the bottom  
6 of the page. What date was that lease --

7 A. It was recorded --

8 Q. -- filed of record?

9 A. -- in Eddy County on February 5th of '04.

10 Q. All right. And who was the lessor?

11 A. Lessor was Chase Farms. Yeah, Chase Farms.

12 Q. And the lessee?

13 A. Chase Oil Corporation.

14 Q. And the lease is executed by --

15 A. Chase Farms.

16 Q. By Mack C. Chase?

17 A. Mack Chase, yes, general partner of Chase Farms.

18 Q. If you would focus your attention on page 2,  
19 paragraph 14 --

20 A. Yes, sir.

21 Q. -- of that lease, what does that provide for?

22 A. That says that the "Lessee shall not enter upon,  
23 occupy, traverse, or otherwise use the surface...for any  
24 purpose."

25 Q. All right. Now again, during this time frame was

1 it your understanding that the principals of Caza Energy,  
2 Chase Oil and Chase Farms were all the same?

3 A. Yes, sir.

4 Q. And if we look back to Exhibit 4, which is the  
5 Chase Oil Corporation letter dated February 19th, 2004 --

6 A. Yes, sir.

7 Q. -- signed by Mr. Lanning, who was he signing on  
8 behalf of?

9 A. It states he was signing it on behalf of Chase  
10 Oil Corporation and Chase Farms.

11 Q. All right. Mr. Wheeler, based on your experience  
12 as a professional landman, is it your view that the lease,  
13 Exhibit 5, that was granted to Chase Oil by Chase Farms, is  
14 something less than an arm's-length transaction?

15 MR. CARR: I object. This calls for a legal  
16 conclusion, unless they can establish whether or not these  
17 are -- these are separate legal entities, and I think Mr.  
18 Wheeler is being asked to reach a legal conclusion as to  
19 what their relationship is and whether or not this is arm's  
20 length.

21 MR. HALL: Mr. Examiner, Mr. Wheeler is  
22 established as a professional landman witness, qualified to  
23 express an opinion. His area of expertise includes  
24 conveyancing, negotiation of leases. This falls squarely  
25 within his area of expertise, and he is qualified to

1 express an opinion.

2 EXAMINER STOGNER: Objection sustained.

3 Q. (By Mr. Hall) If you would, Mr. Wheeler, outline  
4 for the Hearing Examiner what Chase's objections were to  
5 the original surface location proposed.

6 A. Chase has plans to install a -- Chase Farms has  
7 plans to install a pecan orchard across a majority of the  
8 south half of the north half of Section 29. At this time  
9 there are no trees in the south half, north half, I  
10 believe. In our conversations with Mr. Lanning when we met  
11 with him in the field, that was going to go in late this  
12 fall or early this winter. There are pecan trees in the  
13 south half of the section, but not any currently in the  
14 north half of Section 29.

15 Their objection at a later point, again, we were  
16 under the impression that anything south of 1480 feet from  
17 the north line they would object to, but anything up to  
18 that point from the north line, that would be okay with  
19 them. That's how we picked our original location.

20 We -- I guess subsequent to that, they decided  
21 they did not want to have any surface disturbance occur in  
22 the south half, north half, that they controlled. And so  
23 that is my opinion or my understanding of their objection.

24 Q. If you would refer back to your chronology again,  
25 about the February or March, 2004, time frame, were there

1 meetings at the location, on site, with Chase Farms and  
2 Chase Oil to discuss the location?

3 A. Three representatives from Capstone met with Mr.  
4 Lanning in the field on location on March 8th. We went out  
5 and saw the current pecan orchard in the south half, talked  
6 about alternative locations for us to drill from in this  
7 north half. We discussed a number of different locations,  
8 and subsequent to that they got back to us and said they  
9 did not want any surface disturbance in the south half,  
10 north half, and wished that we would place the well off  
11 site and drill directionally to our bottomhole location.

12 Q. Now, were you picking your bottomhole location  
13 based on geology?

14 A. Yes.

15 Q. Let's refer to Exhibit 6, if you would identify  
16 that, please, sir.

17 A. This is a letter from Mr. Blue of Preston  
18 Exploration, back to Chase Farms after our March 8th  
19 meeting. Additionally, Randy Ford who is an engineer that  
20 represents Preston, also met out in the field to discuss  
21 location with Chase Farms after our March 8th meeting, and  
22 this is a letter back to Chase farms, to Mr. Lanning,  
23 requesting that we reach some sort of agreement as far as  
24 us drilling a potential well directionally, but to keep the  
25 surface -- to try to work with them to keep the well off

1 the surface, but to -- We wanted a reasonable trade in  
2 order to get that done.

3 Q. All right. Now, who is Mr. Blue?

4 A. Mr. Blue is the land manager for Preston  
5 Exploration.

6 Q. All right. And so Exhibit 6 is basically a  
7 proposal letter to address the surface concerns?

8 A. Yes.

9 Q. By the way, what is the current use of the  
10 surface at the proposed location?

11 A. It's just a -- It's a plowed field, there's  
12 nothing growing there. It's just a plowed, cultivated  
13 field, but there's absolutely -- I don't believe there's  
14 anything growing there. There didn't appear to be when we  
15 were out there.

16 Q. When Capstone and Preston were discussing changes  
17 to the surface location with Chase, did you take into  
18 consideration any prior development in the immediate  
19 proximity to this well?

20 A. An prior drilling development?

21 Q. Yes.

22 A. Yes, sir, we talked about -- we obviously looked  
23 at the key well which is to the east of this section, in  
24 Section 28, that's producing gas.

25 And then after that point Murchison had drilled a

1 well in this north half of Section 29, called the Tiz Now  
2 Number 1 well, and we also discussed that location with Mr.  
3 Lanning about possibly re-entering onto that well site and  
4 drilling directionally from there.

5 Q. Now, were your other participants in the well  
6 conditioning their participation based on the understanding  
7 that your bottomhole location would be 1480 from the north  
8 line and 1980 from the west line?

9 A. Yes, sir, they were.

10 Q. And if you'd refer to Exhibit 7, what is that,  
11 please?

12 A. That's a letter from Cactus, Inc., also  
13 representing Saguaro Resources and E3 Energy, wherein they  
14 state their approval of our AFE is conditioned upon us  
15 drilling at that bottomhole location.

16 Q. All right. Were the additional costs of drilling  
17 a directional well a concern to Preston?

18 A. Absolutely.

19 Q. Briefly, would you tell the Hearing Examiner what  
20 those cost differences would be between a straight-hole and  
21 a directional drill?

22 A. For a completed well, we estimate the difference  
23 in cost to be \$226,000 additional for the directional well.

24 Q. And if it becomes necessary today, does Preston  
25 have a drilling engineer available to testify about the AFE

1 cost for the straight-hole and the directional drilling?

2 A. Yes, we do.

3 Q. Now, did the revised surface location and the  
4 terms for participation demanded by Chase adversely affect  
5 the economics of the drilling project here?

6 A. Yes, sir.

7 Q. And was there a concern that Chase's demands for  
8 an alternate location posed an undue geologic and  
9 mechanical risk to the well?

10 A. Yes, sir.

11 Q. Would you discuss the further efforts of Preston  
12 to obtain the voluntary participation of the Chase  
13 interests in drilling of the well? And if you would refer  
14 to the exhibits, specifically Exhibits 8, 13 and 14,  
15 briefly run through those and narrate those for the Hearing  
16 Examiner.

17 A. Exhibit 8 is a listing of -- a compilation of  
18 e-mails that went back and forth between Mr. Lanning and  
19 Mr. Blue of Preston, discussing the trade terms that we  
20 were desiring in order to consider an alternate location.

21 As you can see, Mr. Lanning had responded pretty  
22 much in every instance that they needed basically the same  
23 terms. I believe there was a little bit of relenting  
24 toward the end, but they basically wanted the same terms,  
25 would never take into account the additional costs that we

1 were expending or being asked to expend.

2 And then Exhibit 13 are some additional e-mails  
3 that were a little later on and, in fact, right up until  
4 right before this hearing.

5 Q. And Exhibit 14, those are additional e-mails --

6 A. Yes.

7 Q. -- further negotiations with Chase?

8 A. Right, Exhibit 14 goes right up until May 19th, I  
9 believe.

10 Q. And basically what was Chase demanding for their  
11 participation?

12 A. They demanded that they be carried, and they did  
13 not want to participate in the well, which is basically  
14 what they told us all along. They felt like we would  
15 probably be drilling a dry hole, and they did not want to  
16 participate. But they -- after promising us in the field a  
17 sweetheart deal, then the terms they wanted was a third  
18 back in after payout.

19 Q. And there was no consideration given to the  
20 additional drilling cost for a directional drill?

21 A. None, they just wanted us to bear those costs.

22 Q. All right. Let's look at Exhibit 9, if you would  
23 identify that, please, sir.

24 A. That is a revised AFE sent out by Preston on  
25 April 6th for an alternate location. This is when we felt

1 like we were going to be able to hopefully make some sort  
2 of a reasonable trade with Caza or Chase, and we -- at the  
3 time, the estimated AFE was about \$100,000 more. Since  
4 that time additional costs have been figured, and in light  
5 of going rates on everything the costs are significantly  
6 higher. That was sent out to all of the parties that had  
7 indicated that they wanted to participate in the well, as  
8 well as Chase and Murchison and MEC.

9 Q. All right, let's look at Exhibits 10 and 11.

10 A. Exhibit 10 is a letter back from Murchison  
11 stating that they did not want to participate in the well,  
12 they would give a six-month term assignment, 75-percent net  
13 revenue and back in at 30 percent. Again, that is an  
14 unworkable deal for us to drill this well.

15 Q. And when you were dealing with Murchison Oil and  
16 Gas, Inc., is it your understanding they were also speaking  
17 for the MEC --

18 A. Yes.

19 Q. -- interest?

20 A. Yes. In fact, they refer in this letter to  
21 representing both companies.

22 Q. I see. And in your opinion, did you make a good  
23 faith effort to obtain the voluntary participation of the  
24 Murchison and the MEC?

25 A. Yes, sir, we've been in constant contact with Mr.

1 Daugherty of Murchison over time.

2 Q. And with respect to the Chase interests,  
3 Murchison and MEC, you simply weren't able to cut a deal  
4 with them; is that right?

5 A. That's correct.

6 Q. Let's look at Exhibit 12. Are the Saguaro,  
7 Cactus Energy and the E3 interests now committed under a  
8 JOA?

9 A. Yes, they are.

10 Q. And is that attached to -- or referenced in  
11 Exhibit 12?

12 A. It's referenced in Exhibit 12, yes, sir.

13 Q. Okay. In view of you efforts to negotiate with  
14 the Chase interests their issuance of a lease after the  
15 fact, after the well was proposed, Chase Farms to Chase Oil  
16 with the surface-restriction stipulations, how does the  
17 Division propose -- or how do you propose the Division  
18 handle the Chase interests in this pooling case?

19 A. We propose the Division pool their interest and  
20 authorize Preston to drill the well at its original  
21 location.

22 Q. I hand you what's been marked as Exhibit 15, Mr.  
23 Wheeler. Could you identify that, please, sir?

24 A. This is Preston's AFE for both a straight-hole  
25 and a directional well from the locations we've been

1 discussing.

2 Q. Now, the top page, Exhibit 15, that's the most  
3 recent revised straight-hole drilling cost?

4 A. That's correct.

5 Q. For the record, what's the total for a completed  
6 well?

7 A. \$1,031,000.

8 Q. And if you look at the next page, Exhibit 16, is  
9 that the AFE for the directional drill?

10 A. The completed cost is \$1,261,800.

11 Q. Okay. Now for the straight-hole drill, are those  
12 costs in line with what's being charged by other operators  
13 in the area for similar wells?

14 A. Yes.

15 Q. And have you made an estimate of the overhead and  
16 administrative costs while drilling and producing the well?

17 A. Yes, we have, \$4100 per month for the drilling  
18 rate and \$410 per month for the producing rate.

19 Q. And are those costs in line with the Ernst and  
20 Young rates?

21 A. Yes, they are.

22 Q. And you are recommending that those drilling and  
23 producing overhead rates be incorporated in any order that  
24 issues from this hearing?

25 A. Yes.

1 Q. And does Preston request that the order provide  
2 for an adjustment of the drilling and producing overhead  
3 rates in accordance with the current COPAS bulletin for the  
4 area?

5 A. Yes, sir.

6 Q. In your opinion, would granting Preston's  
7 Application be in the best interests of conservation, the  
8 prevention of waste and the protection of correlative  
9 rights?

10 A. Yes.

11 Q. Were Exhibits 1 through 16 and your chronology  
12 prepared by you or at your direction --

13 A. Yes --

14 Q. -- with your participation?

15 A. -- they were.

16 MR. HALL: At this time, Mr. Examiner, we move  
17 the admission of Exhibits 1 through 16. We also have our  
18 hearing notice affidavit, which we'll mark as Exhibit 17.  
19 We tender that as well.

20 EXAMINER STOGNER: Do I have that Exhibit Number  
21 17?

22 MR. HALL: Yes, sir.

23 MR. CARR: Could I see a copy?

24 EXAMINER STOGNER: Let's see, I have an affidavit  
25 that is -- Is that the one you're referring to, 17?

1 Any objections?

2 MR. CARR: I don't have the notice affidavit.

3 Other than that, I have no objection.

4 EXAMINER STOGNER: Exhibits 1 through 17 will be  
5 admitted into evidence.

6 Before I -- Let me just ask one question. On  
7 Exhibit Number 2, the parties, what is that Elger  
8 Exploration, Inc.? I heard you say from WJP down to CMW  
9 interests had volunteered?

10 THE WITNESS: I apologize, Mr. Examiner, I should  
11 have included Elger. I saw CMW as the last one, but it  
12 actually is Elger, so that group plus Cactus, E3 and  
13 Saguaro are all voluntary --

14 EXAMINER STOGNER: With Chase, Murchison and MEC.  
15 Okay, that was -- I just -- that was all I had.

16 THE WITNESS: I thought that CMW was below Elger.

17 EXAMINER STOGNER: Thank you.

18 Mr. Carr, your witness.

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

20 CROSS-EXAMINATION

21 BY MR. CARR:

22 Q. Mr. Wheeler, you're the landman for Capstone; is  
23 that correct?

24 A. Yes.

25 Q. And how long have you been a landman with

1 Capstone?

2 A. Approximately three years.

3 Q. Does Capstone operate any wells in New Mexico?

4 A. No, we do not.

5 Q. Has Capstone drilled any wells in this state?

6 A. We do not operate anywhere. We have never  
7 operated a single well.

8 Q. You're speaking today also for Preston?

9 A. Yes.

10 Q. Does Preston operate any wells in New Mexico at  
11 this time?

12 A. Yes.

13 A. Have they drilled wells in New Mexico?

14 A. Yes, they have.

15 Q. Your job as a landman -- correct me if I'm wrong  
16 -- is in regard to the formation of spacing units, is to  
17 attempt to voluntarily combine the tracts in a proposed  
18 spacing unit; is that correct?

19 A. That's our desire, yes.

20 Q. And in this case you're the land person who was  
21 responsible for combining the interests in the north half  
22 of the section; is that right?

23 A. Initially. At a later point both Mr. Blue and I  
24 attempted to work on this.

25 Q. When you do this you're required to understand

1 oil and gas contracts and agreements, are you not?

2 A. Yes, sir.

3 Q. And to understand oil and gas leases?

4 A. Yes.

5 Q. And property rights?

6 A. Yes, sir.

7 Q. And when you go about this, you look in the  
8 records and find those documents, and that helps guide you  
9 as you go about your work to combine these tracts; is that  
10 correct?

11 A. Generally we have workers check the records for  
12 us in the counties and then make reports to us.

13 Q. But it's based on those documents?

14 A. Yes.

15 Q. And then you rely on those as you go forward and  
16 do your work?

17 A. Yes, sir.

18 Q. When you were combining the interests in the  
19 north half of this section, did you examine the leases for  
20 the various properties in the north half of 29?

21 A. Yes, sir, the ones that were of record at that  
22 time.

23 Q. And you looked at all of them, not just the Caza  
24 or Mack Energy leases?

25 A. We actually leased most of the entire north half,

1 north half of the section.

2 Q. Have you leased the north half of the northeast  
3 of the section?

4 A. Yes, we have.

5 Q. That was a lease originally from someone named  
6 Joy?

7 A. Jack Joy, yes.

8 Q. And who was that initially leased to?

9 A. It was initially leased, I believe, to -- it was  
10 either to Chase or to Murchison. Murchison drilled the  
11 well, the Tiz Now well. I don't recall, without going back  
12 in my records to see, who the lessee was on that lease, but  
13 one of those two parties.

14 Q. But you have now acquired that interest?

15 A. Yes, we have.

16 Q. The lease that was drilled by Murchison in the  
17 northeast quarter, if we look at Section 1, it was not  
18 actually located on the Joy lease, the north half of the  
19 northeast, was it?

20 A. No, sir.

21 Q. And do you know why that was?

22 A. I believe Mr. Joy had a no-surface restriction on  
23 the north half, northeast.

24 Q. And so the well was not located on that property?

25 A. That's correct.

1 Q. Now, you now hold that lease?

2 A. Yes.

3 Q. And you're familiar with the terms of the Joy  
4 lease?

5 A. Yes.

6 Q. And you know it has a no-surface-occupancy  
7 provision?

8 A. Yes, sir.

9 Q. When you advise your management about whether or  
10 not they can develop this property, do you have an opinion  
11 as to whether or not they can drill on the north half of  
12 the northeast?

13 A. My opinion would be, since we agreed to a lease  
14 that has a no-surface occupancy on the north half,  
15 northeast, that we could not drill there.

16 Q. And so you would honor that provision?

17 A. Yes, absolutely.

18 Q. When you looked at the leases that cover the  
19 north half of this section back in 2003, you were aware,  
20 were you not, that the Chase Farms lease to Caza was set to  
21 -- scheduled to expire of its own terms the end of January?

22 A. We assumed that it would. I mean, leases can be  
23 extended or amended, but at the time we knew it was under  
24 lease, but we did not know what the status would be after  
25 January 31st.

1 Q. And there would either be an extension of the  
2 lease, or it could be re-leased at that --

3 A. That's correct.

4 Q. So a new lease was issued, you're not saying that  
5 there was anything improper about Chase Farms issuing a new  
6 lease on this property at the end of the lease term, are  
7 you?

8 A. I don't think there's anything improper about  
9 them about them issuing a new lease. I don't know whether  
10 giving a lease internally is exactly within the letter of  
11 the law, but that's, you know, my opinion.

12 Q. You don't know if this was a -- When you say  
13 "internally", you're not making any judgment on the status  
14 of the parties legally, are you?

15 A. No. I mean, I know Chase Farms and Chase Oil  
16 Corporation are different.

17 Q. And we're not disputing that Caza, Chase Oil,  
18 Chase Farms all have overlapping ownership.

19 Have you compared the -- The lease that was  
20 issued by Chase Farms to Chase Oil in early February this  
21 year, that contains a no-surface-occupancy --

22 A. Yes, sir.

23 Q. -- provision, does it not?

24 A. Yes, sir. That's the clause we went through  
25 earlier.

1 Q. Ad that is identical to the no-surface-occupancy  
2 provision in the Joy lease, the north half of the  
3 northeast, is it not?

4 A. They both have the same intent. I'm not sure the  
5 language is exactly identical without comparing it.

6 Q. You haven't done that?

7 A. I've not recently -- I mean, I negotiated the  
8 Jack Joy lease, but I don't recall if the exact language  
9 was used by Chase when they did their lease.

10 Q. But you'd agree they both contain a provision, a  
11 no-surface-occupancy provision?

12 A. Yes.

13 Q. As you go about your work as a landman, you're  
14 familiar with leases, federal leases, state leases, fee  
15 leases, all of the above; isn't that correct?

16 A. Yes, sir.

17 Q. If there was a federal lease on this property  
18 that contained a no-surface occupancy provision, would your  
19 opinion be that that would preclude the drilling of a well  
20 on that tract?

21 MR. HALL: Objection, it's -- on the basis of  
22 relevance. Also calls for speculation.

23 MR. CARR: I'm going to restate the question.

24 EXAMINER STOGNER: Please do.

25 Q. (By Mr. Carr) If there was a federal lease on

1 the north half of Section -- and you're an expert, and  
2 these are the facts I'm going to ask you to assume -- that  
3 there was a federal lease on the north half of Section 29,  
4 and there was a no-surface-occupancy provision in that  
5 lease, would you disclose that to your management when you  
6 were discussing with them whether or not they could develop  
7 the acreage?

8 MR. HALL: Same objection, Mr. Examiner.

9 EXAMINER STOGNER: Overruled.

10 THE WITNESS: I would look at the stipulation,  
11 and we would follow the letter of the law, assuming that we  
12 took that lease subject to that.

13 Q. (By Mr. Carr) When you say if you took a lease  
14 subject to that, what do you mean by that phrase, taking a  
15 lease subject to a provision of a lease?

16 A. If we're aware of a stipulation, the no-surface-  
17 occupancy, at the time we pay consideration and purchase a  
18 lease then, you know, we're taking that lease, buying that  
19 lease, subject to that stipulation.

20 Q. If the lease contains that stipulation and you  
21 don't purchase it but acquire it, or acquire the rights to  
22 -- or you combine those lands by a compulsory pooling  
23 action, would that give you the right to go on the surface  
24 of a lease that had a no-surface-occupancy provision?

25 MR. HALL: Mr. Examiner, let me state an

1 objection at this point in view of Mr. Carr's earlier  
2 objection that questioning calls for a legal conclusion on  
3 the witness, an objection which you sustained. I think  
4 this question does as well, at this point. I make the same  
5 objection.

6 MR. CARR: Mr. Stogner, I think the problem with  
7 this case is that we have multiple leases in the north half  
8 of this section. Some contain no surface occupancy  
9 provision, some do not. And there is a question that  
10 requires an interpretation of this lease. Obviously, if  
11 you're going to honor some and perhaps not honor others,  
12 there's an underlying question that requires a legal  
13 interpretation of the effect of those provisions.

14 I would suggest to you that that is not a  
15 question for the Oil Conservation Division, and I would  
16 suggest to you that this case should be continued for 30  
17 days to let the parties negotiate. If they're unable to  
18 reach a negotiation within 30 days, Chase Oil Corporation  
19 will file a petition with the District Court of Eddy County  
20 asking that the status of their no-surface-occupancy  
21 provision be determined to see if it is binding on people  
22 who subsequently take that property either voluntarily or  
23 through an exercise of the police power of the state.

24 EXAMINER STOGNER: Mr. Hall?

25 MR. HALL: Mr. Examiner, we would object to any

1 request for a continuance or delay in these proceedings at  
2 this point. The hearing on this Application was continued  
3 at least three times, I believe, at the request of Chase.  
4 We agreed to all three continuances. We think there's been  
5 adequate opportunity for negotiations here. I think we've  
6 demonstrated that through Mr. Wheeler's testimony and the  
7 exhibits.

8 I think Mr. Carr is correct in the sense that  
9 there is a legal dispute about the effect of the surface  
10 stipulation. I think Mr. Carr is trying to place the  
11 Division in the position of having to litigate that and  
12 make that determination, when prior existing precedent  
13 orders have directed that the Division and Commission do  
14 not have the jurisdiction to do so.

15 I would refer you to Order Number R-12,093-A, Mr.  
16 Examiner. That's the order that issued from the Valles  
17 Caldera Trust proceeding, and in that order the Commission  
18 determined that the Division does not have the jurisdiction  
19 to determine title or the rights of any party to occupy  
20 property.

21 And that's exactly the case here. I think you do  
22 have the jurisdiction to proceed with the Application and  
23 then issue an order accordingly. If there is a dispute for  
24 litigation, the parties may negotiate that outside of the  
25 context of this hearing. Chase, if it wishes, may try to

1 get that question answered in the district courts, but it  
2 should not be a basis for delaying this proceeding any  
3 further.

4 MR. CARR: Mr. Stogner, Valles Caldera does say  
5 what Mr. Scott Hall just said, that is, you don't have the  
6 right to determine who has the right to occupy the  
7 property.

8 Now, the question here is not whether or not  
9 negotiations have taken place. They have. The question  
10 here is not whether or not these interests can be combined.  
11 They can. We don't oppose that. We don't oppose combining  
12 all the mineral interests in the north half of this section  
13 for an appropriate well.

14 But the question here is, do they have a right to  
15 occupy the surface when the lease entered between separate  
16 legal entities says you may not use the surface. It  
17 doesn't prevent development. It means moving the red dot,  
18 the surface location on their Exhibit 1, to the north, to  
19 the line just above the word "OXY", and they access the  
20 minerals from a point where we all agree they have a right  
21 to occupy the property. If they don't have a right to  
22 occupy the property, they can't meet a statutory  
23 precondition to a pooling order, and that is, they must  
24 tell you they have the right to drill. The right to drill  
25 the well, they propose.

1           And we submit to you, because of this lease  
2 provision, they do not have that right. And therefore they  
3 cannot pool these lands for this well. We wouldn't oppose  
4 pooling it for a well located in the north half of the  
5 northwest.

6           They've also testified, Mr. Wheeler did, that  
7 they had considered directionally drilling from the  
8 Murchison location. If you look at that on Exhibit 1 and  
9 you can see the distance they considered directionally  
10 drilling to get their proposed location, to honor the lease  
11 provisions, they only have to move to the north to get on  
12 the property that bears the name Leonard L. Fellows.

13           We submit they do not have -- cannot establish  
14 they have a right to pool with this well, that the  
15 Commission and Division have correctly announced that you  
16 don't have the right to determine if they can occupy the  
17 property. That must be done by the courts.

18           Our last correspondence in Mr. Wheeler's  
19 documents say we were willing to talk to our management  
20 about reducing the burden we were requiring. And we submit  
21 to you the way this should be handled is, we should have 30  
22 days within which either to agree to some solution  
23 voluntarily, or we will file a declaratory judgment action  
24 in the District Court of Eddy County, New Mexico.

25           MR. HALL: Mr. Examiner, I think Chase is simply

1 trying to throw up dust and obscure the purpose of this  
2 proceeding. Again, Chase is trying to place you in the  
3 position of having to litigate and make a determination  
4 about legal rights.

5 We've already established that the lease issued  
6 by Chase to Chase is not owned by Capstone or Preston.  
7 They're not bound to it, they're not parties to it, it was  
8 not negotiated with them.

9 What Mr. Carr wants you to do is make a  
10 determination whether or not that surface stipulation binds  
11 parties who are not a party to the lease. I submit you  
12 cannot do that.

13 There's an underlying question here, though, Mr.  
14 Examiner, where it appears, as in this case, that the lease  
15 is not the product of an arm's length negotiation and  
16 transaction and it was issued for purposes of circumventing  
17 the Division's jurisdiction to prevent you from issuing an  
18 order at a location proposed by the Applicant. Then you  
19 have a right to inquire about the terms of that lease and  
20 the circumstances of its negotiation. There's precedent  
21 for you doing so.

22 And I would refer you, Mr. Examiner, to two other  
23 cases in addition to the Valles Caldera case.

24 If you would look at Order Number R-7335, it's  
25 the Rio Pecos-Ralph Nix case. Circumstances similar to

1 this. After a well was proposed, after a pooling  
2 proceeding was commenced, a party put a 50-percent  
3 overriding burden on its lease interest. And the Division  
4 went right through that, saw through that transaction and  
5 said, That's an improper way, that's an improper means to  
6 circumvent the Division's jurisdiction. It would not allow  
7 it.

8 I would also refer you to Order Number  
9 R-11,573-B. That's the last of the series of the Bettis,  
10 Boyle and Stovall Sunwest cases, where again there were  
11 negotiations after a well was proposed to an interest  
12 owner, and that interest owner turned around and issued a  
13 lease to an affiliate corporation. Neither the Division  
14 nor the Commission allowed that. It viewed that as  
15 improper and an improper means to circumvent the agency's  
16 jurisdiction again, and it allowed the proceeding to go  
17 forward and the interests were pooled.

18 I have copies of those cases for, Mr. Examiner,  
19 if you'd like them.

20 MR. CARR: And Mr. Stogner, I have just one very  
21 brief response.

22 EXAMINER STOGNER: Okay, keep it just for a sec  
23 here.

24 Statement, Mr. Carr?

25 MR. CARR: Mr. Stogner, I just want to make clear

1    what we believe we're doing.  We're not trying to  
2    circumvent the jurisdiction of the OCD, we're trying to  
3    honor it as announced in the Valles Caldera case.  We're  
4    not trying to put you in a position where you determine  
5    property rights, we're trying to move that question where  
6    it belongs, to the District Court, as it was in the  
7    TMBR/Sharp-Arrington fight recently where the effect of an  
8    APD was going to be determined based on some underlying  
9    property rights, and the Division stood down while that  
10   matter was pursued in the court.  That's we think is the  
11   appropriate way to go here.

12               EXAMINER STOGNER:  I'm going to take a 10-minute  
13   recess at this point.

14               (Thereupon, a recess was taken at 9:21 a.m.)

15               (The following proceedings had at 9:36 a.m.)

16               EXAMINER STOGNER:  Hearing will come to order.

17               MR. HALL:  Mr. Examiner, during the break we were  
18   successful in negotiating a compromise with Chase Oil  
19   Corporation.

20               Chase will consent to being pooled for its own  
21   lease from Chase Farms, as well as for the Riley lease  
22   acreage, provided that the well is drilled from a surface  
23   location 1200 feet from the north line and 1280 feet from  
24   the west line, give or take as necessary to accommodate  
25   some certain surface considerations over there.

1           We will provide you with a stipulated pooling  
2 order. We think there's sufficient evidence in the record  
3 for you to make the findings of a basic pooling order. We  
4 don't believe there's any further need for evidence in this  
5 case.

6           And with that, that concludes our case on direct.

7           EXAMINER STOGNER: What was the -- from a surface  
8 location to what?

9           MR. HALL: The same bottomhole location, 1480  
10 from the north line, 1980 from the west line.

11          MR. CARR: And Mr. Stogner, Mr. Hall has  
12 correctly stated our agreement.

13          EXAMINER STOGNER: Okay, is there any further  
14 need for evidence today?

15          MR. CARR: No, sir.

16          MR. HALL: Not on behalf of the Applicant.

17          MR. CARR: And not on behalf of Chase Farms or  
18 Chase Oil Corporation.

19          EXAMINER STOGNER: Okay. Anything further in  
20 this matter?

21          MR. CARR: Nothing.

22          EXAMINER STOGNER: Okay, Case 13,236 will be  
23 taken under advisement.

24          Thank you, gentlemen.

25          MR. CARR: Thank you very much. Thank you for

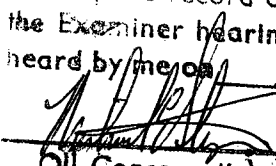
1 taking this out of order.

2 EXAMINER STOGNER: You're welcome. I appreciate  
3 everybody's indulgence and patience in that.

4 And we will never find out who the fifth mystery  
5 witness was.

6 (Thereupon, these proceedings were concluded at  
7 9:38 a.m.)

8 \* \* \*

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11  
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13  
14 I do hereby certify that the foregoing is  
15 a complete record of the proceedings in  
16 the Examiner hearing of Case No. 13236,  
17 heard by me on 27 May 2004.  
18  Examiner  
19 Oil Conservation Division  
20  
21  
22  
23  
24  
25


## 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 May 31st, 2004.

  
STEVEN T. BRENNER  
CCR No. 7

My commission expires: October 16th, 2006