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

ORIGINAL

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

FIRST AMENDED APPLICATION OF XTO ENERGY, INC., FOR COMPULSORY POOLING AND DOWNHOLE COMMINGLING, SAN JUAN COUNTY, NEW MEXICO

CASE NO. 14331

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID K. BROOKS, Presiding Examiner
TERRY G. WARNELL, Technical Examiner
WILLIAM V. JONES, Technical Examiner

August 20, 2009

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID K. BROOKS, Presiding Examiner, WILLIAM V. JONES, Technical Examiner, and TERRY G. WARNELL, Technical Examiner, on Thursday, August 20, 2009, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South St. Francis Drive, Room 102, Santa Fe, New Mexico.

REPORTED BY: Jacqueline R. Lujan, CCR #91
Paul Baca Professional Court Reporters
500 Fourth Street, N.W., Suite 105
Albuquerque, NM 87103 505-843-9241

A P P E A R A N C E S

FOR THE APPLICANT:

THOMAS W.. KELLAHIN, ESQ.
KELLAHIN & KELLAHIN
706 Gonzalez Rd.
Santa Fe, New Mexico 87501-8744

FOR SG METHANE COMPANY:

J. SCOTT HALL, ESQ.
MONTGOMERY & ANDREWS
325 Paseo de Peralta
Santa Fe, New Mexico 87501

E X H I B I T S

MR. BROOKS: Is everyone ready? At this time we call Case Number 14331. This is the amended application of XTO Energy, Inc., for compulsory pooling and downhole commingling, San Juan County, New Mexico. Call for appearances.

MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of the Santa Fe law firm of Kellahin & Kellahin appearing this morning on behalf of the applicant, and I have three witness to be sworn.

MR. HALL: Mr. Examiner, Scott Hall, Montgomery & Andrews law firm, Santa Fe, appearing on behalf of SG Methane Company. No witnesses.

MR. BROOKS: I want to take a lunch recess at 11:45. For three witnesses, it may be necessary to come back this afternoon.

You may proceed.

MR. KELLAHIN: Mr. Examiner, we'll call our first witness.

MR. BROOKS: Let's swear all the witnesses.

(The witnesses were sworn.)

MR. KELLAHIN: Mr. Jameson, if you'll have a seat at the witness table.

Mr. Examiner, you have before you a three-ring binder. I've given the court reporter the originals of

the documents, and they're in a sequence where the first part of these are the land documents. Then we have the engineer that prepared the cost allocations. Then the last witness is the engineer that did the production allocations.

We're dealing with a forced pooling case in the San Juan Basin on 160-acre spacing unit, It's a downhole commingled wellbore with the Pictured Cliff as the upper zone, and just below that is the Chacra.

We filed for a compulsory pooling, and during that process, Mr. Hall's client objected to some of the components that led us into amending application and adding, for the purposes of this hearing, the downhole commingling approval process. We have notified all of the parties entitled to notification under an administrative downhole commingling case and rolled that all into one package this morning.

MR. BROOKS: Okay.

BRADLEY JAMESON

Having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. KELLAHIN:

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

A. Bradley Jameson, and I'm associate landman for

XTO Energy.

Q. You've never testified before the Division, have you?

A. No.

Q. Mr. Jameson, describe for us your education.

A. I've got a Bachelor's in business marketing from Texas Tech University.

Q. How did that lead you into petroleum land?

A. My stepdad is an oil and gas attorney in New Mexico, or my step father-in-law is an oil and gas attorney, and that kind of led me into it.

Q. How long have you been a practicing oil and gas man?

A. This will be my fourth year.

Q. What are your duties with XTO?

A. I handle all the land matters in drilling the wells, from proposing wells to partners, title work.

Q. What area of responsibility in New Mexico are you associated?

A. San Juan County, Township 29 North.

Q. If we're looking at the spacing units and the interest owners involved in this particular well, the Martinez --

A. Yes, sir.

Q. -- that is something within your area of

responsibility?

A. Yes, it is.

Q. Have you made yourself knowledgeable about the interest owners in that spacing unit?

A. Yes, sir.

Q. Are you assigned the responsibility as a landman to contact and propose participation of all the working interest owners in the Martinez Well?

A. Yes, I was.

MR. KELLAHIN: We tender Mr. Jameson as an expert petroleum landman.

MR. HALL: No objection.

MR. BROOKS: So qualified.

Q. (By Mr. Kellahin) Mr. Jameson, if you open the exhibit book and turn to the first document, there's an index page. If you turn to Tab 1 and look at the first display. Identify for us what we're looking at.

A. It's a map.

Q. It has centered on the map a nine-section map with Section 24 in the center?

A. Yes, sir.

Q. Identify for us the subject well that's involved this morning. Where do we find that?

A. It's the Martinez Gas Com D 1R. It's in Section 24, which is in the center of the map, in the

northeast quarter.

Q. It's the one with the arrow pointed at it?

A. Yes, sir, it is.

Q. The formations associated with this Martinez Well are what, sir?

A. The Pictured Cliff and the Chacra.

Q. In the terms of those two formations, what is the appropriate size spacing unit assigned to that production?

A. 160.

Q. Within the 160-acre tract, that would be the Northeast quarter of Section 24?

A. Yes, it is.

Q. Do you have knowledge as to whoever the working interest owners are?

A. Yes, sir, I do.

Q. Is that ownership divided vertically?

A. It is.

Q. In what way?

A. We have owners in the Pictured Cliffs that are different than the Chacra.

Q. So let's turn to -- I moved the APD. It's not behind Tab 1 anymore. We moved it later in the discussion. But if you turn to Tab 2 now, there's the first display. Do you see that, Mr. Jameson?

A. Yes, sir, I do.

Q. Where was this -- what's marked as Exhibit A, where was this taken from?

A. It's from the proposed JOA to the working interest owners in the well.

Q. Have you satisfied yourself that this tabulation is correct and accurate?

A. Yes, I have.

Q. Describe for us how it is arranged and how the parties are identified.

A. We show the Unit Area A as the Pictured Cliffs formation, and we show the Unit Area B as the Chacra formation. We've got it split up as an operator, which is XTO Energy, and we show their working interest in Unit A and Unit B. And we've got the nonoperators listed and their interest in Unit A and B.

Q. When you look at the subdivision of the interest in the Pictured Cliff, then, you have a package of working interest owners. Which of the people in the Pictured Cliff entities are not yet participating?

A. Neither SG Methane or Frederick Lilly.

Q. And neither of those interest owners have interest down in the Chacra?

A. No, sir.

Q. Let's move over to the Chacra, which would be

Area B, and read down -- and you pick up two more individuals whose interest is only in the Chacra?

A. Yes, sir.

Q. Who are those?

A. Candace L. Kelton Cox and Georgia Lee Kelton.

Q. Based upon this ownership information --

MR. BROOKS: Excuse me. Are these -- Cox and Kelton, are they joining or are they to be pooled?

MR. KELLAHIN: They are to be pooled.

MR. BROOKS: So there are no joining interest owners, other than XTO?

MR. KELLAHIN: Unless XTO had partners or something.

MR. BROOKS: None that are of record?

MR. KELLAHIN: Right.

Q. (By Mr. Kellahin) Let's turn over to Tab 3, Mr. Jameson. Did you cause a well proposal to be sent to the parties for whom you're now seeking to compulsory pool?

A. Yes, sir, I did.

Q. When we look at the letter that's under Exhibit Tab 3, is this your letter?

A. Yes, sir, it is.

Q. Describe what you're doing.

A. I was just simply stating that I was with XTO

Energy. I'm proposing this well, the Martinez Gas Com D 1R. I show where the location of well is going to be. I enclosed in the proposal our AFEs for both the Pictured Cliffs and the Chacra.

Q. As part of that process, did you include an operating agreement at that point?

A. Yes, sir.

Q. And the operating agreement is contained in the Exhibit A that we just talked about?

A. Yes, sir.

Q. The first letter here is the one to Methane?

A. Yes, sir, it is.

Q. Just after the letter, there's some additional attachments that are delivery information. Describe for us what happened.

A. I sent the original letter to SG Methane. In our system this is the address we had for them. I guess it was a bad address. It came back. When I received the letter back, I resubmitted a letter to the address on 909 Fannin Street, Suite 2600.

Q. And your delivery information indicates that SG Methane received your well proposal when?

A. On November 3rd is the delivery date.

Q. As to the other interest owners in the well, either in the Pictured Cliff or the Chacra, did you also

send them well proposal letters?

A. Yes, sir, I did.

Q. Let's go to the next letter. Which one do you have?

A. Frederick Lilly, Jr. I sent him the letter, and his letter -- he accepted his letter. I have delivery confirmation for it, as well.

Q. At this point do you have any agreements with Mr. Lilly that allows him to participate?

A. No, sir, we don't.

Q. He's still an outstanding, uncommitted interest?

A. Yes.

Q. Is that also true of Methane?

A. Yes.

Q. Then we go on. The next letter is to Cox.

A. Yes, sir.

Q. What's the status of your attempts to get Candace Cox to commit to participating?

A. I sent the same letter at the same time as the other ones, and they received it. I've been -- haven't had any cantact with Candace Cox.

Q. And then the last letter in package?

A. Georgia Lee Kelton. I sent it to her. She never responded with a signed election letter. She did

give me a phone call saying she had some issues with the JOA.

Q. If you turn to Tab 4, there's a series of four pages. Before we talk about the four pages, are these the AFEs that you submitted with your well proposal letter?

A. Yes.

Q. How are these AFEs organized?

A. The first AFE you're looking at is the AFE for the Pictured Cliff.

Q. That's two pages?

A. Two pages.

Q. After that, what do you have?

A. I have the AFE from the Chacra.

Q. Is this method of sending a separate AFE for PC and one for Chacra the method that XTO utilizes?

A. Yes, sir.

Q. Is it your understanding that these costs have been apportioned between the two formations?

A. Yes, sir.

Q. And we have a cost engineer to describe that process to us later?

A. Yes, sir.

Q. So these were given to you to send out and you, in fact, sent them out?

A. Yes, sir, I did.

Q. If you turn to Tab 5, let's go back and summarize your dealings with Methane.

A. The first document I have under Tab 5 is a letter dated December 4th of '06.

Q. Was this in your file?

A. It is in my file.

Q. What does this represent?

A. This was a well proposal letter that was sent out by a landman at XTO to SG Methane.

Q. What is your understanding of the purpose of this letter?

A. To see if they want to elect to participate or not.

Q. And what is the type of wellbore configuration for the Martinez Well?

A. It was a stand-alone PC well at the time.

Q. So originally this wellbore was proposed to Methane as a stand-alone PC?

A. Yes, sir.

Q. When you sent your letter, what happened?

A. I didn't send this letter.

Q. When you sent your letter.

A. When I sent my letter, it was a Chacra PC well.

Q. Did Methane make an election, based upon the '06 letter, to participate with their interest in the Pictured Cliff if it was a stand-alone PC?

A. Yes, they did.

Q. Did they sign the appropriate documents?

A. Yes, they did.

Q. Did they give you some suggested changes to your operating agreement?

A. Yes.

Q. Were all those changes acceptable?

A. Yes, they were.

Q. Did they complain to you about the cost?

A. No, they did not.

Q. Turn to Tab 6, sir. Behind Tab 6 is part of an operating agreement. Can you identify what it is that we're looking at?

A. This is a copy of the operating agreement that -- the proposed operating agreement I sent out to the working interest owners for the Chacra and the PC.

Q. This is the one that was attached to the letter in October?

A. This was the operating agreement that was attached in 2008.

Q. To the 2008 proposal?

A. Yes.

Q. In this package for the Hearing Examiner -- we've got the first page and the index -- have you included the portion of the JOA that includes overhead rates? I think if you turn to what is marked page 4 of the JOA, you get a table or a section that deals with overhead rates.

A. Yes, I do.

Q. What were the overhead rates originally proposed by XTO for this well?

A. Proposed drilling well rate of 8,500 and producing well rate at 850.

Q. Have you subsequently done further research and have modified your request for overhead rates?

A. Yes, I have.

Q. What do you recommend to the Examiner as rates for including in this compulsory pooling?

A. $6,000 for drilling well rate, and the producing well rate at $600.

Q. What's the basis for doing that?

A. That's just become the standard that I've seen in San Juan County.

Q. The standard in terms of what you're charging others and others are charging you?

A. Yes, sir.

Q. Do others charge you in that range?

A. Yes, sir. We've accepted that.

Q. When we turn past page 4, then, we start a series of pages that are numbered 14B on through 14H, and then finally the signature page. What function of the operating agreement is associated with that portion of the documents I just describeed to you?

A. This looks like the cost allocation procedure between the two zones.

Q. The cost allocation procedure set out in your proposed joint operating agreement? That's what this is?

A. Yes, sir.

Q. Have you utilized these cost allocation procedures with other interest owners?

A. Yes.

Q. And they're the same ones that you're proposing to SG Methane?

A. Yes.

Q. Is the cost engineer able to describe those things?

A. I believe he will be.

Q. But this is the methodology that you have submitted to other parties for their participation on a voluntary basis?

A. Yes, it is.

Q. Let's turn to Tab Number 5. It's simply my

notification of hearing for this hearing in this case.

A. Tab 7?

Q. I'm sorry. Tab 7. This notice for hearing here. Let's turn to Tab 8. Were you asked to be responsible for the notification of the interest owners affected by the downhole commingling portion of this application?

A. Yes, I was.

Q. In order to accomplish that, did you send out a letter that I executed on July 30th?

A. Yes.

Q. In addition to that letter, did you enclose a copy of the Division Form C-107A?

A. Yes, I did.

Q. And the spreadsheets associated with that filing?

A. Yes.

Q. Were you able to assimilate a mailing list that included all parties with whom XTO had knowledge that might share in commingled production in the spacing unit?

A. Yes.

Q. When I look past the commingling application, there's a series of green cards, and there's -- and the final part is some white cards. What do the white cards

represent?

A. They're letters that we sent out. We just haven't received notification that the letter has been delivered to them.

Q. For the green cards, then, you have what?

A. We have confirmation that they have received the letter.

Q. Do you believe that you exhausted reasonable opportunities to these parties to participate?

A. Yes, I believe so.

MR. BROOKS: Do you have green cards from all of the relevant parties?

MR. KELLAHIN: Yes, sir, we do.

KELLAHIN: Mr. Examiner, that concludes my examination of Mr. Jameson. We would move the introduction of the documents starting with Exhibit Tab 1 through Exhibit Tab Number 8.

MR. HALL: No objection

MR. BROOKS: Exhibits 1 through 8 will be admitted.

Mr. Hall.

(Exhibits 1 through 8 were admitted.)

CROSS-EXAMINATION

BY MR. HALL:

Q. Mr. Jameson, can you walk us through the

history of first proposing and then drilling and then re-proposing this well. This well is drilled, is it not?

A. Yes, it is.

Q. But it's not completed?

A. No.

Q. When was the well actually drilled?

A. I'm not sure of the exact date, but I -- the engineers will be able to answer the exact date, but I know it was in November, maybe the middle part of November.

Q. Do you know, was the well drilled to its present TD in one operation, or was it deepened at any point to include the Chacra?

A. I'm not sure. I'm sure the engineers will be able to answer that.

Q. The well was initially proposed as a Pictured Cliffs well?

A. Yes.

Q. And drilling down to the Chacra, is that what motivated XTO to re-propose the well to the interest owners as a Chacra/Pictured Cliffs dual?

A. The well was proposeed in 2006. It wasn't drilled, so we felt like it was our responsibility to re-propose it. When we did re-propose, we felt the best interest of the well was Pictured Cliffs/Chacra.

Q. In your exhibits, I understood there were two well proposals. The original proposals that went out to SG --

A. In 2008? Is that what you're talking about? I sent an original proposal to SG in 2008. It was returned to me because of the bad address. When I got that letter back, I re-submitted it to SG Methane. In 2006, there was one proposal letter sent out, and it was -- SG Methane sent it back with their election to participate in the well at that time.

Q. That's your Exhibit 5?

A. The 2006 proposal, yes.

Q. So the exhibit following the first exhibit, the December 4th letter is SG's December 28th election letter; correct?

A. I believe it was -- yeah -- a previous. It was exhibit --

Q. In my notebook --

A. Exhibit 3 was the 2008 election letter?

Q. No. I'm looking at Exhibit 5. The first well proposal, the December 4th, 2006 well proposal.

A. Yes, sir.

Q. Then following that exhibit under that same tab is SG's December 28th, 2006 election letter?

A. Yes, sir.

Q. So we're correct, then, that the well was originally proposed as a Pictured Cliff stand-alone?

A. Yes, it was.

Q. What motivated XTO to re-propose the well as a dual?

A. I'm not going to speculate on why I think they did. I'm sure the engineers will be able to tell you the geologic reasons why.

Q. It's an engineering question?

A. (Witness nods head.)

Q. But you did not receive any election letter from SG to participate in the dual completion?

A. No, sir, we did not.

Q. Were you involved in the negotiations with SG for their participation?

A. Yes.

Q. Okay. Is it correct to say that as a condition to SG's participation in the well, you demanded from them that they deliver an 80 percent NRI lease -- NRI interest for their lease?

A. As far as their participation in the well?

Q. Yes.

A. No, sir, we didn't demand that.

Q. What did you demand? What were you asking them to deliver?

A. I guess I -- could you repeat the question?

Q. What interest were you asking SG to deliver to you for their participation in the well? Do you remember the terms?

A. They have a -- as far as their interest in the well?

Q. Yes.

A. I believe it was 13 something percent interest. I'm not --

Q. How would you pick up that interest? By way of farm out? Is that what you were requesting?

A. I guess I'm not getting what you're asking me. I sent the letter to SG Methane. They didn't respond. I called Robby Glenn, I believe is his name. He proposed to us that we farm out -- or that we farm in their interest. He set terms at the difference in burdens, the 75 percent, which the burdens in the lease is 83 percent, so we deliver an 8 percent override. We denied that, said that was not acceptable to us. We offered a difference in burdens of 80 percent, which would deliver a 3 percent override.

Q. Can you tell us what's the standard industry practice for participating in wells in the San Juan Basin? What are the typical terms? Are they 80 percent or 75 percent?

A. I've dealt with different -- I guess it depends on what the burdens are, but the standard override royalty that I've seen is around 3 percent.

Q. Why did XTO assume the risk in drilling this well before obtaining the participation of the interest owners?

MR. KELLAHIN: Objection to the form of the question, his use of the word, "assume the risk." We've already had a ruling on this.

MR. BROOKS: I don't remember ruling on it.

MR. KELLAHIN: When you quashed their subpoena, there's discussion in that order about the risk associated with drilling. And by rule, when you drill a well and pool later, you're entitled to the maximum 200 percent.

MR. BROOKS: Well, entitled is -- not necessarily, but, generally, that does apply. And I think my ruling -- my previous -- the order I previously drafted speaks for itself in those terms. But I'm going to overrule the objection to the question. The question can be asked. However, it's time for us to take a lunch recess, so we'll proceed at this time with a lunch recess. We'll stand in recess until 1:15.

(A lunch recess was taken.)

MR. BROOKS: Let us proceed with Case Number 14331. I believe you were cross-examining, Mr. Hall.

Q. (By Mr. Hall) I believe where we left off, you had just overruled Mr. Kellahin's objection, and I was asking you why XTO assumed the risk in drilling this well before joining all the enjoined interests.

A. We didn't assume any risk. We just drilled the well.

Q. There was no risk involved in drilling this well?

A. There's risk involved in drilling any well. We didn't assume any additional risks.

Q. What risk did you assume?

A. The risk that comes with drilling a well.

Q. Which would be? You can't identify the risks for us?

A. No.

Q. Why did XTO drill the well before consolidating all the interests? Was there a lease expiration, something like that?

A. No. It was simply rig scheduling. It's just how it worked. You know, no special reason.

Q. The well has not been completed?

A. No, sir, it hasn't.

Q. Does XTO plan on -- when is the completion scheduled for?

A. The completion is being held up by this matter, simply. We're pretty much waiting to complete the well until we get all the partiess in line pooled or not.

Q. Okay. Is there any -- tell me if you're not the correct witness to answer this question. But is there any geologic or engineering risk in the completion of operations?

A. I wouldn't be able to answer that.

Q. You've not been told of any?

A. No, sir.

MR. HALL: Will you have another witness that will discuss the proposed allocation of costs for the drilling operations?

MR. KELLAHIN: We do.

MR. HALL: That's all I have of this witness.

MR. WARNELL: No questions.

MR. BROOKS: Mr. Jones?

MR. JONES: No questions.

MR. BROOKS: I don't believe I have any questions, either. The witness may stand down.

MR. KELLAHIN: Justin Niederhofer is the

drilling engineer that we're calling as our next witness.

JUSTIN NIEDERHOFER

Having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q. For the record, please state your name and occupation.

A. Justin Niederhofer, drilling engineer, XTO Energy.

Q. Mr. Niederhofer, on prior occasions have you testified before the Division Examiner as a drilling engineer?

A. No, I have not.

Q. Summarize for us your education.

A. I have a Bachelor's in engineering, in petroleum engineering, from Texas Tech unit.

Q. What year, sir?

A. I graduated in 2007.

Q. How long have you worked for XTO?

A. For two years.

Q. Among your current responsibilities, what is it that you do in association with wells like the Martinez Well?

A. I write the drilling procedures and AFEs for wells that we propose to drill, and oversee the operation

of those procedures.

Q. Were you involved with the preparation of the AFEs for the Martinez Well?

A. No, I was not.

Q. That was done by another drilling engineer?

A. Yes, sir.

Q. Have you reviewed his work, then?

A. Yes, sir, I have.

Q. As a result of that review, have you also looked at the actual costs of drilling the well itself?

A. Yes, sir, I have.

Q. Have you looked at the cost allocation procedure set forth in XTO's proposed joint operating agreement?

A. Yes, sir, I have.

Q. Is that the methodology you employ when you allocate costs?

A. Yes, it is.

MR. KELLAHIN: We tender Mr. Niederhofer as an expert drilling engineer.

MR. HALL: Just one question. Do you have anybody -- are you related to anybody that works at Energen?

THE WITNESS: Yes, I am.

MR. HALL: No objection.

MR. BROOKS: He's so qualified.

Q. (By Mr. Kellahin) Mr. Niederhofer, let's turn to Exhibit Tab Number 9. I'm going to have you identify some documents here in a minute, but let's get a general overview of what your examination and what your conclusions now show you.

Approximately when was this well commenced?

A. This well was spud on November 14th of 2008.

Q. Its target objective when it was spud was what?

A. The PC and the Chacra.

Q. It was intended to be drilled as a downhole commingled wellbore?

A. Yes, sir.

Q. If you'll turn to Exhibit Tab 9, there's a series of documents. And before we get to the cost allocation discussions, let me have you lead us through the pages of the attachments starting with first page of the application for a permit to drill. What is it that we see here?

A. The first page is original APD from the Martinez Gas Com D 1R.

Q. This was when it was permitted as a stand-alone PC well?

A. Yes, sir, it is.

Q. Attached to that is there a following document indicating the addition of the Chacra?

A. Yes, sir. Attached is the sundry that was filed to add the Chacra to the existing APD.

Q. Is that the procedure that you followed?

A. Yes, sir.

Q. If you turn past that, what's the next display?

A. The plats for the well.

Q. The first plat is the C-102 for the Aztec PC?

A. Yes, sir.

Q. Following that plat, there will be another plat. What is that?

A. For the Otero Chacra that was added.

Q. When you have multiple zones like this, you file a separate C-102 for each?

A. Yes, sir.

Q. Following that, what do we find in the book?

A. We have the drilling program for the well being drilled as a Pictured Cliffs/Chacra well.

Q. As part of your work, did you look at and examine the AFEs that were sent by Mr. Jameson to the other working interest owners?

A. Yes, sir.

Q. Did you look at same AFEs that he introduced

earlier today, which were the pair? There was the PC and the Chacra documents for each of those zones.

A. Yes.

Q. Without going into the specifics, tell us generally the methodology that XTO applies in allocating costs in a wellbore that's to be drilled in this fashion.

A. Rephrase that a little bit.

Q. What's the methodology when you're looking for two zones? How do you go about the allocation for each zone?

A. That is set forth using the JOA that we typically use with other operators. It's been used in the past, and it defines how costs should be allocated to certain zones or multiple zones in a single wellbore based upon depth or a predetermined allocation.

Q. In this instance did you make your cost allocation based upon depth?

A. Yes, sir.

Q. To keep it is simple for me, if you start at the surface and go down to the base of the PC, and you have those total costs, how much of those total costs are directly applied to the PC?

A. I look at it typically by total well and by the JOA. That's how I determine how that total cost is. In comparing a stand-alone PC to a well with multiple

zones, it's very, very difficult to try and do a correct correlation across.

Q. Let me ask you just to understand the methodology. If I know the footage from the surface to the base of the Chacra and that's going to be my total wellbore link, how do I apportion the cost between the PC owners and the Chacra owners?

A. I'm not --

Q. Let me ask you this: If I'm at the base of the PC, the balance of that wellbore and its costs are associated with the Chacra; right?

A. If you're at the base of the PC?

Q. The base of the PC to the base of the Chacra, those are all Chacra costs?

A. Yes, sir.

Q. What do I do with that portion of the Chacra production, Chacra costs, that are associated with having gone from the surface to the base of the PC?

A. It's split between the two wells.

Q. How do you come up with the ratio for splitting it?

A. Using the formula given in our JOA that we typically use. It's an Excel calculation, basically.

Q. Assuming the total depth of the well is X number of feet, do you work out a ratio between how much

of that is PC and how much of that is Chacra?

A. Yes, sir.

Q. There's a ratio involved?

A. Yes.

Q. Running the calculation there, there's a portion of the cost from the surface to the base of the PC that gets apportioned to the Chacra?

A. Yes, sir.

Q. Do you have the actual comparison of how you did this?

A. Yes, sir. We do have -- part of the JOA describes that.

Q. Let's turn now to the exhibit book, and we're looking at Exhibit Tab 9. We've gone by the drilling program, and I have a page that is captioned, "Martinez Gas Com D 1R." Do you see that page?

A. Yes, sir.

Q. Is this a document that you prepared?

A. Yes, sir.

Q. This is the one that you worked on?

A. Yes.

Q. In the -- there's a column of information designated, "intangibles." Do you see that?

A. Yes, sir.

Q. As you follow those rows across from left to

right, you've got an AFE total for a certain component of those costs?

A. Yes, sir.

Q. Then you have another number that says, "actual invoice."

A. Yes.

Q. And after that you either have a plus or minus number.

A. Yes.

Q. Describe for us what you're doing.

A. Basically, what we do is we took the AFE for the total well and looked at each line item of that AFE and went back through the invoices from that well, totaled them up for each line item, and took the difference between the two.

Q. So when we look at the total AFE costs, we're looking at the total gross dollars without having been apportioned between the PC and the Chacra?

A. Yes, sir.

Q. In that comparison of the gross total AFE dollars, how do they compare totally to the actual costs?

A. For the drilling side, we are a little over budget due to costs that were not -- that we were not aware of at the time in trying to go forth with the well.

Q. So when I look at the very bottom, and I look

at intangibles, and I see a minus $3,600 --

A. Yes, sir.

Q. -- that means I've exceeded the AFE?

A. No. What we're showing is we have spent $3,600 less than what we invoiced but not -- what we're seeing on the intangibles covers both drilling and completion work. The next page showss the tangibles.

Q. If you look at the tangible portion of the comparison, what's the bottom line result of comparing the tangibles and the intangibles to actual cost?

A. Total tangibles, we are $190,000 under budget, and that is due to not having completed the well yet.

Q. Have you gone back and looked at the estimated well costs for the stand-alone PC for this well, the AFEs from '06?

A. Yes, sir.

Q. And how would those compare with the costs associated to drilling to the Pictured Cliff owners?

A. The original AFE for the stand-alone PC is more expensive than the cost of the PC in the commingled well.

Q. Why is that, sir?

A. Because you're able to split your costs between multiple zones and spread them out.

Q. If you'll turn past the analysis of actual

costs in the AFE, there is a half sheet of paper that has been highlighted with various shades of gray. What are you showing here?

A. I'm not seeing it.

MR. WARNELL: Is that the one that says, "Cost overruns"?

MR. KELLAHIN: Yes, sir.

A. What we're showing here are the major areas on the drilling side where we spent more than what we had anticipated in our AFE and giving justifications as to why.

Q. After that page, then, again we put back in the exhibit book the two AFEs, one for the Chacra and one for the PC that Mr. Jameson had talked about?

A. Yes, sir.

Q. Have you concluded as a drilling engineer that these costs are fair and reasonable?

A. Yes, sir, they are.

Q. When we turn past the AFEs, then, we come to a stick diagram. Did you find that in the book?

A. Yes.

Q. What are you intending to project for us with this display?

MR. BROOKS: Can you tell us where we are in the exhibit book?

MR. KELLAHIN: Yes. I'm sorry. The pages aren't numbered, Mr. Examiner. We're looking past --

MR. BROOKS: Behind which tab?

MR. KELLAHIN: Behind Tab 9, and Mr. Warnell has got the page.

MR. BROOKS: Okay.

Q. (By Mr. Kellahin) Mr. Niederhofer, let's turn your attention to the stick diagram.

A. Yes, sir.

Q. Explain to us what you're trying to illustrate.

A. This is illustrating the cost allocation of the two zones as written out by our JOA that we typically use.

Q. So applying that methodology in the cost allocation procedures and using this as a diagram, what percentage of the costs are apportioned to the PC?

A. To the PC? That would be 34 percent.

Q. What portion of the total costs, then, are apportioned to the Chacra?

A. 66.

Q. Are you satisfied that this is a fair and reasonable way to allocate the costs between the two zones?

A. Yes, sir, I am.

Q. Is this consistent with the methodology that XTO applies to other wells that are commingled like this?

A. Yes, sir, it is.

Q. Do you use this same formula if there are other zones involved, other than the PC and Chacra?

A. Yes, we do.

Q. This is widely used by your company as a standard method of that cost allocation?

A. Yes, sir.

Q. Following the diagram, we, again, put in the exhibit book the information for the cost allocation procedure out of the JOA?

A. Yes, sir.

Q. And you have reviewed this document in detail?

A. Yes.

Q. You work with this every day, do you not?

A. Yes, I do.

Q. What, then, is your ultimate conclusion, Mr. Niederhofer, about the allocation of costs between the owners in the PC versus the Chacra?

A. Owners in the PC would pay considerably less than those of the Chacra and have a lowered total cost for them, as well.

MR. KELLAHIN: That concludes my examination of Mr. Niederhofer. We move the introduction

of the documents behind Exhibit Tab Number 9.

MR. HALL: No objection.

MR. BROOKS: Exhibit 9 is admitted. Mr. Hall?

(Exhibit 9 was admitted.)

CROSS-EXAMINATION

BY MR. HALL:

Q. Mr. Niederhofer, are you familiar with the procedures for cost allocation that are set forth in COPAS Bulletin Number 2?

MR. KELLAHIN: It's not in that. He's asking you something else.

A. Without looking at it in front of me, I'm not sure which part you're talking about.

Q. There is some -- in your Exhibit 9 you have the graph depiction of the wellbore schematic, and right after that it looks like an excerpt from the JOA starting at page 14C. Is this the procedure that you utilized?

A. Yes, sir. In Part 6 on 14D.

Q. So I would turn to page 14D, and starting at paragraph 6, that's your formula?

A. Yes, sir, unless otherwise stated in 7, which are pre-designated splits which are not applicable to this well.

Q. This is not an exhibit to the JOA, is it? Is

this part of the main body of the JOA?

A. Yes, sir.

Q. It's the latter? It's part of the main body of the JOA?

A. Yes.

Q. As I understood you to explain, this is really -- the allocation is based on a pure footage ratio basis? Is that the simplest explanation?

A. Yes, sir.

Q. And if you're looking back at your well column under Exhibit 9, the TD for the well is approximately 3,189; is that right?

A. We TD'd this well at 3,200 feet. Proposed was 3,150, so --

Q. So the base of the Pictured Cliffs formation is -- let's see. I think you complete it from a 1,942 to 2,096. Does that sound about right? The Pictured Cliffs.

A. I'm not 100 percent certain on that.

Q. Would that be shown in your APD anywhere? Let me ask it this way: Is your lowest PC completed interval, is that 34 percent of the trip downhole to the TD?

A. It's roughly, yes, sir.

Q. Okay. Did taking this well down to 3,200 feet

result in any incremental cost in the drilling? What I'm driving at is, were you required to use a larger rig, heavier casing, different cement?

A. No, sir.

Q. The answer is no?

A. No, sir.

Q. Additional days on location, was that significant?

A. Maybe a day.

Q. Why did XTO view it necessary to try to pick up the Chacra with this well?

A. It's my understanding that we didn't have another Chacra well in that area, so -- that would be better answered by a geologist, which I'm not.

Q. Do you have one coming up?

A. Yes, sir.

Q. Okay. Did you look at any economic evaluations for the well?

A. No, sir, I did not.

Q. Do you know whether the well would be viable as a stand-alone Pictured Cliffs completion?

A. I could not answer that, no, sir.

Q. So you can't tell us whether the addition of the Chacra was necessary to make the well economic?

A. No, sir, I couldn't.

Q. Did you also have involvement in the commingling aspect of this application?

A. No, sir.

Q. Do you have a witness upcoming who can address that for us?

A. Yes.

Q. Let me ask you as an engineer, though, is there any reason that these zones can't be metered separately?

A. Um, I cannot -- I don't know.

Q. You know of no prohibition to that?

A. I don't know why they would or wouldn't. I'm a drilling engineer, and that would be on the side of completion.

MR. HALL: Okay. No further questions.

MR. BROOKS: Mr. Warnell?

EXAMINATION

BY MR. WARNELL:

Q. Can we put some depths to the tops and the bottoms of the PC and the Chacra? Like, I think I've gone through your exhibit --

A. In the drilling program, the last page of the drilling program shows the tops. And for the purpose of the JOA in calculating out the cost allocation, we used the top of the next zone to determine the bottom of the

zone above it.

Q. So what's the top of the PC?

A. The top of the PC is at 1,970, and the bottom would be the top of the Lewis Shale at 2,135.

Q. That's the Lewis Shale?

A. Yes, sir, which we would use as the bottom of the PC.

Q. Then we go down about another 800 or so feet?

A. Yes, sir.

Q. We get to the top of the Chacra, which is at --

A. 2,927.

Q. And the base of the Chacra --

A. -- would be at TD of 3,150.

Q. I think you said that TD was 32.

A. TD was actually 3,200. The tops that are given to me from our geologist are an estimate to the best of his ability, based upon previous knowledge of the area and surrounding wells that we have.

Q. So you drilled, you set surface pipe, and then you drilled the complete well; right? There was no intermediate string or anything?

A. No, sir.

MR. WARNELL: No more.

EXAMINATION

BY MR. JONES

Q. You had to set a conductor, but you didn't plan on it?

A. We didn't plan on it. That was dictated somewhat by the process of building the location. The area was very wet, and to try and reduce the -- any chance of contamination to the groundwater and the fact of us using a closed-loop mud system, because the area was so moist, we decided to go ahead and set a conductor pipe.

Q. You used a closed loop because it was --

A. -- because the ground was too wet to dig a pit and for -- just the use of the rig.

Q. Did you use a different rig for your service pipe?

A. No, sir, we did not. It was all set by the same rig.

Q. So you set a surface below the Ojo Alamo?

A. Yes.

Q. And you set -- did you set a pipe -- is that the -- is this accurate as far as the casing strings go? Did you set an intermediate --

A. The drilling program is accurate as far as the casings go, other than the fact that we did use the

conductor, which, like I said, was unanticipated.

Q. So it was just one string of production pipe?

A. Yes, sir.

Q. And you used the stage tool to cover the PC, or you didn't need to do that?

A. No, sir, we did not.

Q. The JOA, is that just for this particular 160 acres; is that correct?

A. The JOA --

Q. That you were just talking about here.

A. Um-hum.

Q. As far as the drilling goes, the drilling allocation formula goes, is that -- are you familiar with other JOAs? Is this one almost the same as all the others?

A. We used the same JOA in building our AFE cost estimates between all operators that we operate with.

Q. Do you maintain your own drill time clocks of your different -- of your wells in the San Juan Basin?

A. Yes.

Q. Do you have a database that has that drill time?

A. Yes.

MR. JONES: I don't have any more questions.

EXAMINATION

BY MR. BROOKS:

Q. Okay. I'm going to look at this wellbore diagram. Is this cost allocation that you compute on here, does that apply to all costs of drilling and completion?

A. Yes, sir. The only costs that do not get this split in our AFE are the frac cost, the cost of actually fracturing the well.

Q. Those would be specifically allocated to the two --

A. Yes, sir.

Q. Okay. The first formula that you have for the top formations, it's very easy to see what you're doing. The second one is much more complicated. But if I'm not missing something -- correct me if I'm wrong -- in this well, where you only have two formations, you don't have to -- we don't have to solve this second equation because we know that the costs are going to total 100 percent.

A. Yes, sir.

Q. So actually the cost allocation is completely solved by this first equation, which is, basically -- well, which is -- not just basically -- it is -- you take the depth from the surface to the estimated base of the higher formation.

A. Yes.

Q. And you take the depth from the surface to the estimated base in the lower formation. You take the proportion of the costs -- you apportion the cost of drilling between the upper formation and the lower formation based on the proportion between the base depth --

A. Between the two zones.

Q. And then you allocate half of the costs of drilling to the base of the upper formation to the upper formation, the other half to the lower formation, and then you allocate all of the costs of drilling from the base of the upper formation to the bottom hole, to the lower formation; is that correct?

A. Yes, sir. Pretty much.

Q. As apply to the two. I realize it gets more complicated if you have more formations, but we don't have that in this case; right?

A. Yes, sir.

Q. So this is something even a lawyer could understand.

A. Yes, sir.

Q. Now, this joint operating agreement -- and Mr. Jones touched on this, but I want to ask a little more about it. The land witness identified all of the working

interests except the interest of the pool parties -- to-be-pooled parties -- as being owned by XTO. Are there actually other participants that XTO has a joint operating agreement for this well?

A. For this well? No, sir.

Q. This joint operating agreement that you're relying on doesn't have anything to do with this well specifically; right?

A. No, sir.

Q. This is a prototype that you use in other wells?

A. Yes, sir.

Q. Now, you said that you used this formula with all operators that you -- all non-operators?

A. Yes, sir.

Q. I suppose -- have other -- have you used it where you were a non-operator and there were other operators operating?

A. Yes, sir.

Q. Do you know who drafted this?

A. No, sir, I do not.

Q. Have you ever had anybody object to it and want some other kind of allocation formula?

A. No, sir, not that I'm aware of.

Q. Do you have an estimate of how many wells

you've drilled under this -- multiple zone wells you've drilled under these provisions?

A. Roughly 200.

Q. Could you name some of the companies with whom participated with this type of agreement?

A. ConocoPhillipss, Burlington. I think we had some with Chevron.

MR. BROOKS: I think that's all my questions. Well, I guess, one other question.

Q. (By Mr. Brooks) 2,135 was the estimated base of the Pictured Cliffed; right?

A. Yes, sir.

Q. And did you identify -- did your geologist identify what the actual was when you drilled the well?

A. I'm sure we do have that somewhere.

Q. When you got down to 3,200, were you still in the Chacra, or did you break out at the base of the Chacra?

A. I would have to look at those tops to see.

MR. BROOKS: I think that's all the questions I have.

MR. HALL: I have a brief follow-up.

RECROSS-EXAMINATION

BY MR. HALL:

Q. Mr. Niederhofer, I had my finger on this a

minute ago, and I lost it. But you have the Pictured Cliffs bracketed from 1,970 feet to 2,135?

A. Yes, sir.

Q. As I understand it, your lowest completion in the Pictured Cliffs will be at 2,096. Does that sound right?

A. Where are you coming up with 2,096?

Q. Like I say, I had my finger on it. I think it was in your APD. My question is, is your 34 percent cutoff, is that measured from your lowest completion in the PC, or is that from the base of the PC?

A. From the base of the PC.

Q. And how are you allocating the cost of doing two completions?

A. The cost of the actual frac for that zone goes directly to the AFE of that zone.

Q. That cost is not shared?

A. No, sir, it is not.

MR. HALL: Nothing further.

MR. BROOKS: Mr. Kellahin?

MR. KELLAHIN: Nothing further.

MR. BROOKS: Very good. The witness may stand down. You may call your next witness.

MR. KELLAHIN: We will call the production engineer, Mr. Ryan Lavergne.

RYAN LAVERGNE

Having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q. For the record, sir, would you please state your name and occupation.

A. Ryan Lavergne, production engineer for XTO.

Q. Have you, on prior occasions, testified before the Division?

A. I have not.

Q. Please summarize your education.

A. I graduated May 11th from Colorado School of Mines, 2007.

Q. Subsequent to graduation, describe your employment history as an engineer.

A. I've been with XTO since June 1st, 2007.

Q. What are your duties as a production engineer?

A. I write completions. I perform production work, well maintenance, re-completions, submit downhole commingling allocations for wells that we're going to commingle, especially ones that we re-complete, and various other --

Q. When we look at the downhole commingling portion of this application, is this an allocation method that you have applied to this well? Have you done this

work?

A. I work interchangeably with our reservoir engineer, but this method I have done multiple times, yes, and I will rely on her -- it's work that I can do, and sometimes the reservoir engineer, especially with wells that are non-operated, they'll come up with EURs and just supply me with that information; but it's a simple --

Q. Are you familiar with the Division rules with regard to the various means by which you can measure and allocate production in commingled wellbores?

A. Yes.

MR. KELLAHIN: We tender Mr. Lavergne as an expert production engineer.

MR. HALL: No objection.

MR. BROOKS: So qualified.

Q. (By Mr. Kellahin) Mr. Lavergne, if you'll turn to Tab 10. Let's look at the locator map.

A. Okay.

Q. If we look at the nine-section locator map, describe what it is that you're trying to illustrate for us.

A. This shows the wells that were used in determining our allocations for production. The ones that have circles around them are Chacra wells that were

drilled or completed after 2000. The triangles are Pictured Cliffs wells completed after the year 2000.

Q. Of the various methods approved by the Division for production allocation, what methodology did you apply?

A. In this particular case, since the well at this time had not -- well, it wouldn't matter. It hadn't been completed, so there's no production data to use, so we will typically use a nine-section average. So we combine all these wells and take an average of their production.

Q. Is that a methodology that's approved by the district office in Aztec?

A. Yes.

Q. And you've utilized it in other wellbores like this?

A. Yes.

Q. Having looked at this display, identify for us how you go about utilizing this information to result in a production allocation.

A. Okay. I would probably like to refer to the production plots.

Q. Let's do that. I'm sorry these pages aren't numbered. I usually take time to do that. But if you'll turn towards the tail end, there's copies of the Division

rule, and then there will be a series of production plots. What's the first production plot that you find?

A. The Reid A SRC.

Q. And when we go back to our locator map, where is that well in relation to our locator map?

A. That well is Section 13.

Q. The one with the first circle in the south half of 13?

A. Yes.

Q. The production plots associated with your allocation method were selected by you using what criteria?

A. Production plots?

Q. Yes, sir. How do you select the wells from which to take your plots so you can do your allocation?

A. In this case we chose to use newer wells because they're more virgin. Older wells that were completed back in the '50s, the reservoir conditions are obviously different from then. So we use newer wells and come up with a better average, a better estimate, of what the well will do.

Q. When you do that, you developed a population of decline curves and -- how many do we have here?

A. I think there's seven.

Q. Do you think this is a fair and reasonable

selection of decline curves from wells for this purpose?

A. Yes.

Q. What, then, did you do with each of the decline curves?

A. We will take a best fit curve and start from the last production date. So in this case it would have been, like, March. And you'll see a lot of up and down, so we take a best fit, what production should be off that best fit curve. We'll decline it at 7 percent because, on average, it seems to be a good fit for most clients.

Q. Is that decline applicable to PC, as well as Chacra?

A. Yes.

Q. So both of them use the same percentage decline?

A. Yes. Then we take area under that curve and come up with the EUR.

Q. Then what do you do?

A. We take each well's EUR and a simple average, so add them all up and divide by three and divide by four.

Q. When we turn back to the first document behind Exhibit Tab 10, I'm looking at what is the first page of the Division downhole commingling form, C-107A. This form.

A. Yes.

Q. There's a regulatory analysis person who filled out this form?

A. Yes.

Q. Does she come to you for these numbers?

A. Yeah. You'll see top and bottom of pay. That comes from our estimated formation, top and bottom. Then she'll get the allocation percentages. That's what I give her. That's what initiated this document.

Q. Are you satisfied that these numbers are true and accurate?

A. Yes.

Q. When we turn past the first page of the commingling application, you have a spreadsheet of a single page, and then it spills over into a second page. Before we talk about what it says, what kind of information is located on this spreadsheet?

A. Information that's most important is the well name and your EUR for your oil and gas.

Q. How do you utilize this spreadsheet in order to come up with the allocation information on the Division form?

A. You'll see a lot of extra names. There's wells that -- they're split up between pre 2000 and post 2000 wells. So once all the information is plotted on

here, it just becomes a matter of taking an average. But this will show, just for our information, what these wells had performed in the past, compared to newer wells.

Q. Would this sheet represent, then, the population of wells from which you select the wells to do the calculation?

A. Yes. Those wells are on this.

Q. There are more wells on here than you selected?

A. Yes.

Q. And when we get down to the selected wells, we can come back to the locator map and find out which ones you actually selected?

A. Yes.

Q. We can take that and go to the individual decline curves for each of the population of seven wells?

A. Yes.

Q. If you'll turn over to last page of the Division filing of the commingling application, there is a very small summary sheet. You've gone too far.

MR. BROOKS: This is immediately behind the spreadsheet?

MR. KELLAHIN: Yes, sir.

Q. (By Mr. Kellahin) If you take this summary sheet, is this the end result of your analysis on how to

apportion production between these two zones?

A. Yes.

Q. Describe your conclusion.

A. The top chart would be the EUR averages from those select wells that were completed after 2000. And you'll see there's a total, and then it just splits up percentage based on those totals, the two zones.

Q. When I look at the top set, it's got, "Pictured Cliff Chacra total." Those are my volumes in mcf for barrels?

A. These are your EURs, yes.

Q. Then below that, I have the allocation on the percentage basis.

A. Yes.

Q. And the end result of your calculation is you're going to allocate 69 percent of the gas to the PC and the 31 percent to the Chacra?

A. (Witness nods head.)

Q. In your opinion, is that a fair and reasonable way to allocate production among the owners that are entitled to receive that production?

A. Yes. I think it's a very fair method.

MR. KELLAHIN: That concludes my examination of Mr. Lavergne. We move the introduction of the exhibits behind Exhibit Tab 10.

MR. HALL: No objection.

MR. BROOKS: Exhibit 10 is admitted. Cross-examination?

(Exhibit 10 was admitted.)

CROSS-EXAMINATION

BY MR. HALL:

Q. Mr. Lavergne, when XTO drilled this well, you obtained a pason total gas curve; is that right?

A. Excuse me?

Q. A pason total gas curve.

A. What is a pason gas curve?

Q. This is according to your counsel that -- we had requested information about the well, DST data, et cetera, and we were told that the only data XTO has are pason total gas curve and rate of penetration. Do you know what I'm --

A. I'm not --

Q. -- the gas curve that I'm talking about?

A. No.

Q. Would a gas curve have been relevant at all in your calculation of EURs for this well?

A. I am not familiar with what you're talking about, so I'd have to say no.

Q. Can you tell us what data you obtained during the course of drilling the well?

A. Until I get approval of downhole commingling, I don't do a whole lot of work, other than to make sure -- I showed you the information for getting a downhole commingle approved. Then I proceed with more research on the well and write a completion.

Q. Tell me, if you know, what data did XTO obtain while drilling the well?

MR. KELLAHIN: Objection, Mr. Examiner. As part of the prehearing process, there was a subpoena issued, a Motion to Quash, and we discussed -- and I disclosed to Mr. Hall all of the available data. The representation to you then and now is none of these witnesses have utilized that data in reaching their conclusions about commingling.

MR. BROOKS: Well, I will overrule the objection. You can ask for purposes of information.

MR. HALL: I have asked, and I believe you answered.

Q. (By Mr. Hall) Tell me what data that you know of was obtained by XTO during the course of drilling. Logs, DST tests. Anything else?

A. No DST, but we run open hole logs every time we drill a well, any daily rig reports. All that common information would be obtained during drilling.

Q. No gas tests, no pressure data, anything that

would help you --

A. No. We don't run bottom hole pressure tests. We drill all this based on offset wells, so that's how we go about determining where we want to drill.

Q. So when Mr. Kellahin says you all have pason total gas curve, we don't know what that is?

A. I've never heard that term.

Q. Looking at the way you determine EURs for your allocation formula, it's a pure engineering calculation; right? Geology didn't enter into this at all?

A. No. It's based on offset production.

Q. It presumes consistent homogeneous geology for both the PC and the Chacra throughout your nine-section area?

A. Um-hum. Yes.

Q. Would it have been meaningful for you to look at localized geology, like actual well logs, do a net pay calculation? Would that have had any bearing on your EUR calculation at all?

A. No.

Q. Is there any reason to believe that the geology is not continuous homogeneous for the Pictured Cliffs through your nine-section area of review?

A. No.

Q. There is none or you don't know?

A. I'm going to have to say no.

Q. Okay. I understand. Wouldn't you agree that the preferred and most reliable method to determine a proper allocation of production among zones is to have them metered separately?

A. It's probably -- now, are you talking one zone at a time? Are you talking a dual completion? Because the issue that comes up when you try to do that, you can produce one zone -- and this is another method that we use on some occasions, especially with dual completions. We'll prove the production from one zone. We re-complete another. You'll produce it for a month until production stabilizes.

When you downhole commingle a well down hole, conditions change. You're going to have cross flow between zones. You have water mixing. So conditions are going to change. Also, you've increased your cost just because you spent more time doing this work.

So to get -- without any production data on a well, this is the best way I believe -- anybody I've ever talked to about allocations -- about how to get those allocations done.

Q. Wouldn't you agree that since you're trying to recover well costs from different owners, different pools, it would be best to produce those zones

separately, meter them separately, and then you'd have the most accurate production data available to you that would allow you to allocate and recoup costs with 100 percent confidence?

A. I honestly feel that these allocations are going to be pretty accurate. I think most people that have an interest in these wells are going to be concerned about minimizing costs and, at the same time, being comfortable with these allocations. Again, you're doing one zone at a time. When you commingle them, everything changes. There's no guarantee that you're going to have that same production.

Q. Referring back to your spreadsheet that has your well list for your EUR calculations, how many of those are dual completions? Are any of them?

A. Commingled or dual completions?

Q. First, dual. Tell us of any dual completions first.

A. Without having pulled well histories of each of these wells, I couldn't tell you for sure. I'm assuming none of them. It's not a very common practice, especially in the last probably 20 or 30 years.

Q. So we're not reflecting any commingled Chacra/PC wells on here?

A. One of the wells we use is the

Chacra/Mesaverde PC well. None of them are strictly only Chacra and PC, no.

Q. So XTO doesn't have any experience in this nine-section area, any way of commingling Chacra and Pictured Cliffs production and allocating that production?

A. No, but the pooling is common. That's per the state agency. It's one of the pre-approved pools, downhole commingling pre-approved.

MR. HALL: That's all I have.

MR. BROOKS: Mr. Warnell?

MR. WARNELL: I'll pass.

MR. BROOKS: Mr. Jones?

EXAMINATION

BY MR. JONES:

Q. Chacra is nice for -- getting to be real popular for adding two wells for downhole commingling. And I don't know much about it. Since you're here, maybe -- I remember the Lewis, how people were chasing the Lewis a little bit. Is the Chacra anything like the Lewis, or is it like the PC, sort of?

A. Not having much experience with the Lewis, I couldn't tell you one way or the other. That's one nice thing about downhole commingling with the PC, is that since it doesn't typically produce much oil, we don't

have to hold back pressure on the zone, so we can pull them down to three or four pounds -- it's a compressor -- to lower that and get a higher DP, differential pressure, and produce more gas. It's probably more similar to a PC formation, yes.

Q. You're allocating all of your -- any liquids to the Chacra; right?

A. Water, I believe so. Oil, yes. The Chacra does make on occasion some small trace amounts of oil. The PC typically never makes much fluid at all.

Q. Do you have to have a little separator on the surface, like a --

A. PCs, we typically will never have one. A Chacra, common practice is usually not. It will all -- I think it's on a well-by-well basis, probably.

Q. The completion, how are you going to complete the well? How many days? Are you going to do it all in one day with different stages?

A. If we have pre-approved downhole commingle, two stages is not difficult to frac on one day. So we'll do our prep work. In this case we don't have a DV tool to drill out, but we'll prep the well, pressure test casing, rig up whatever service company we use, frac the lower zone, set a plug, frac the upper zone, flow it back for well control so we can get a rig back on. At that

time, once we've got all of our approvals, drill the plug out and turn the well on to production.

Q. The little -- you use a little -- the plug you set between the zones, how much differential pressure will it hold?

A. The ones we run are like 8,000-pound plugs, I believe.

Q. You run a well head protection --

A. Yeah. We put a frac valve on, a well head and a frac down casing. Granted we haven't had to do any cement remediation.

Q. What size well heads do you use? Is that a 3,000-pound well head?

A. I think we're trying to install 5,000-pound well heads.

Q. So you can frac them?

A. Yes.

Q. It looks like -- so you don't any log calculations? You like to use the reserve splitouts of those surrounding nine sections, but you're doing this beforehand, and you do have an open hole log on this?

A. Yes.

Q. Are your reservoir engineers giving you any kind of feedback about how the reserves calculate in this compared to the nine sections around it?

A. I think it would just boil down to that this is real data. You have a log. It's all calculations and estimations, anyways. This is real data. This is what has actually happened. It's a better indication of what your well is going to do.

Q. Do your reservoir engineers keep a database of all logs on all the wells they drill?

A. Yes.

Q. So they have these calculations?

A. Yeah. We do cross sections. When I go to do my completion report, I pull the logs, and I say, "This is where I want to pick my perfs." I'll take offset wells and correlate it to that. This has done well on other wells. I want to make sure I get the same correlation. I'm going to complete that same stringer, whatever -- however it correlates. If your offsets show it's good, you're going to want to complete it in that well, also.

Q. Do you report your -- you probably don't have to do it, but your reservoir engineers have to report production -- I mean reserves for different leases, different wells --

A. Right.

Q. -- properties that XTO owns. So they probably use these open hole log calculations, don't they?

A. For water saturations, probably on occasion. I don't know that -- probably in the San Juan here, where there's so many offsets and all that data is available that they rely on the open hole log calculations. In areas where you don't have those offsets, they're going to rely heavily upon those, yes.

Q. So it might be depleted?

A. Yes.

Q. So if there's no log calculations, that would be a big missing element of your pressure data?

A. Right.

Q. Speaking of that, it looks like that you may have -- now, when you frac these wells, you do it in two stages. You do an ISIP on each stage?

A. Yes.

Q. You're going to have -- do you do a breakdown and a shutdown before you do each stage?

A. We do an acid ball-off to make sure our perfs are open. Yeah, we try to get a nice pre-determined frac ingredient.

Q. So you can adjust things a little bit on the fly?

A. Yes.

Q. So from that, could you -- does that give you any indication on reservoir pressure?

A. Your frac reading? Yeah. Sure.

Q. It looks like on your perf depths, that you're going to have tp turn in some bottom hole pressures. Correct me if I'm wrong, but it looks like it's not within the 150 percent of your --

A. Yeah. And the way we've gone about doing that -- it was my indication that we would -- it was on completions that were more than two zones, that we would need those bottom hole pressures. But in that indication, the way I've done it in the past, it was just from offset wells.

Q. If you have the data --

A. Yeah. Well, you can back calculate, I guess, if you assume no fluid level in your well, and you can calculate your gas ingredient. It's pretty minimal. But your surface pressure, assuming no fluid in the well, it's going to be close to your bottom hole.

Q. If you have any offset wells that are only producing from the PC or only from the Chacra, otherwise, you have to do a -- kind of look at your total pressure and see maybe what -- but it looks like you're going to have to turn that in for us to approve this. This portion of this, it's been included in this application.

A. If that's needed, we can do that.

MR. JONES: No more questions.

MR. BROOKS: Okay.

EXAMINATION

BY MR. BROOKS:

Q. Do you know if this allocation formula for production has been used by agreement for allocating to respective formations where you have different ownership?

A. Yeah. I brought an example of another well. I don't know the ownership on that particular well.

Q. But you do not know if it's been used where there's a difference in ownership?

A. I can't tell you positively that that's been done, but I'm pretty sure.

MR. BROOKS: Okay.

EXAMINATION

BY MR. WARNELL:

Q. Mr. Lavergne, did you run a mud log?

A. I'm sure we have a mud log. Do we?

MR. KELLAHIN: No.

Q. I tried to transpose all your data onto the well schematic, so let me know if I've made a mistake or not. You're allocating zero percent of the oil to the PC, 100 percent to the Chacra, 69 percent of the gas to the PC. And do you remember the water? I've got 78 percent of the produced water to the PC versus 22 percent to the Chacra. Does that sound right? I took that

pretty much off of your EUR, your chart right before the --

A. Yes. And that's based off of -- those numbers come from the cumulative water from those seven wells that we used to determine allocations.

MR. WARNELL: Thank you.

MR. BROOKS: Mr. Kellahin?

MR. KELLAHIN: No, sir.

MR. BROOKS: Mr. Hall?

MR. HALL: Nothing more.

MR. BROOKS: The witness may stand down. Does that conclude --

MR. KELLAHIN: That concludes our presentation.

MR. BROOKS: I understood that you had no witnesses, Mr. Hall.

MR. HALL: No witnesses. I'd like to make a brief closing statement.

MR. BROOKS: Do you want to make a closing statement?

MR. KELLAHIN: I'll respond.

MR. BROOKS: You may proceed.

MR. HALL: Mr. Examiner, I think you have to satisfy yourself based on the evidence presented to you that the proposed cost allocation method results in a

fair allocation and is a fair means for the operator to recover costed in accordance with the statute.

From what we hear from the engineering witness, there is -- let me back up. As I read the various cases that have come out of the Division on cost allocations and production allocations, the preferred method seems to be a separate metering. And if you will look at one example case, in Case Number 17499, it's the Amoco Production Company case.

MR. BROOKS: I don't believe we've gotten to 17 yet.

MR. HALL: I'm sorry. 7499. I may be mixed up about that. The order number is R-7032. It's the Amoco case. It suggests to us that the preferred method is to -- where you have diverse ownership, the preferred method is to meter the zones separately. That way you know for sure how production is to be allocated and how to recover those costs.

The other issue I wish the Examiner to consider is the issue of risk. Under the pooling application, XTO has made application for a standard 200 percent risk penalty. I would argue that, in this circumstance, it's not justified. The landman witness testified that, in essence, there was no risk in drilling this well. Then as we heard more testimony from the two

engineering witnesses, they relied solely on engineering data to do their EURs and establish their decline rates, and using that data as a basis for the allocation.

One witness was asked whether XTO was confident that the geology was homogeneous and consistent throughout the nine-section area of review, and the answer to that, I believe, was yes. So there was no need for XTO to account for localized geologic conditions. There was no need to calculate net pays for purposes of establishing the EURs, no need to look at the well logs.

That tells me there was no geologic risks, and I think that is probably born out by the results you see in their exhibit, the spreadsheet of all the wells they analyzed within the area of review. That's what they're relying on for an allocation. I think we may rely on it to establish the absence of geologic risks.

We didn't hear anything about mechanical risk from the witness, but what we did hear was that there was consistent success in XTO's development program throughout this nine-section area, consistently gotten good results from all of these wells. They know how to do this. They had a program going. What motivated them to drill this well before joining all the participating interests was simply rig scheduling. So as the landman

witness testified again, that's why they did it. They didn't have an expiring lease or anything like that. It was the rig schedule.

Under those circumstances I don't think 200 percent risk is justified. They assumed the risk, and they weren't going to share knowledge about the existence or non-existence of the risk with any of the other interest owners. I'm sure we're going to hear from Mr. Kellahin that the rule is now -- it's a mandatory rule under Rule 35 is that you must afford 200 percent risk penalty. I don't think that's accurate.

If you look at Order Number R-11992, that is the order that led to the promulgation and adoption for the risk penalty rule.

MR. BROOKS: 11992?

MR. HALL: 11992, Case Number 13069. I think there is a preference for 200 percent risk of administrative convenience, but the findings make clear in that case that the Commission did not want to preclude a possibility that another risk penalty may apply, given the individual circumstances of a particular case. It wanted to be able to consider those situations, and that's what we have here.

I think you get guidance on the practices, the past practice of the Division, in these cases where there

is drilling before pooling and consolidation. And I would refer you to another -- several more cases where there has been zero percent risk penalty or 100 percent risk penalty. I would suggest that 100 percent risk penalty may be appropriate in this case.

But I would refer you to Order R-11327. That's the Chesapeake Operating Case, Case Number 12325. I refer you again to Order Number R-11700D, the TMBR/Sharp Arrington case.

MR. BROOKS: All these cases were decided before the adoption of the present rule; correct?

MR. HALL: The Arrington case was decided about one week before. Yes, they all were. I would also refer you to -- sorry. I've already referred you to Order Number R-11327, but I do have an extra copy of that one. Also, Order Number R-11327A. All of these cases have to do with drilling before pooling and -- or an indication of how the risk penalty was handled in those cases. Again, look at what the Commission contemplated in adopting the 200 percent rule, and I think you'll see that you're allowed to consider alternate circumstances. If I may approach?

MR. BROOKS: You may. Is that all?

MR. HALL: Yes, sir.

MR. BROOKS: Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Examiner. Every day I learn more and more about the things that Mr. Hall and I can't agree on. I've learned yet again there's more things we can't agree on.

The metering method set forth in the rules -- it's the last exhibit behind Exhibit 10 -- shows the various choices that the operator can make for allocating production. This engineer has testified that he's chosen a method that's accurate and reliable and utilized by the Division. It's only one of a number.

To require the operator in this circumstance to individually meter the zone is not what the rule says. You can shop among these various options and, as an expert, choose the one that's most applicable, and he's done that.

When you look at the risk factor, the rule is written in such a way that in the pre-hearing statement, the opponent of the standard 200 percent risk factor penalty assumes the burden of proof. Mr. Hall had that burden of proof this afternoon. He chose not to present any geology, any engineering or any witnesses to support his position.

But, be that as it may, in the order that you wrote in the pre-hearing motions in this case, the one where we had the hearing on July 15th, you got it

absolutely right, and I suggest that you still have it right. When you look at paragraph 7 of Order R-13156, it simply says, "The fact that XTO chose, as it was legally entitled to do, to defer applying for compulsory pooling until after drilling the well, reduces neither the risk XTO incurred in drilling the well, nor the benefit thereby conferred by SG or other nonworking interest owners." That's exactly where we are today.

And if you read the findings of fact in the Commission order that resulted in Rule 35 -- and I have an extra copy if you care to have yet another copy -- you've got plenty -- you'll see the debate that was resolved back in '03, when the Commission considered Mr. -- Mike Stogner was a big proponent for years as an examiner, that if you drilled the well first and then pooled later, it knocked you down to cost plus 100 percent. He came to that hearing before the Commission, advocated that as his position.

The industry was opposed to that. And Randy Patterson for Yates testified extensively -- reflected in the findings -- about why the risks associated should never be lower than cost plus 200 percent, even if you drill the well. He was persuasive in telling the Commission, as well as realizing what the industry already knows, that these numbers in the statute for risk

recovery are substantially lower than the actual real time risk in the field.

You have agreed with me then. I suggest you continue to agree. You got it right last month, and we suggest that the cases that Mr. Hall has cited to you have all been replaced by the Commission's directive on applying the risk factor penalty. There may be some extremely unusual, highly irregular cases for which you might choose to reduce the penalty. This is not one of them. We ask that you take the case under advisement and issue the order as requested by XTO.

MR. BROOKS: Very good. If there's nothing further, then Case 14331 will be taken under advisement. We are going to take a 10-minute recess.

* * *

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 14331, heard by me on Aug 20 2009.

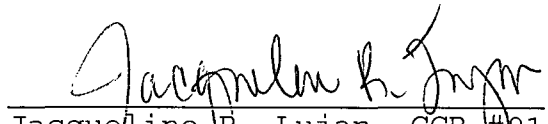
David K. Brooks, Examiner
Oil Conservation Division

REPORTER'S CERTIFICATE

I, JACQUELINE R. LUJAN, New Mexico CCR #91, DO HEREBY CERTIFY that on August 20, 2009, proceedings in the above captioned case were taken before me and that I did report in stenographic shorthand the proceedings set forth herein, and the foregoing pages are a true and correct transcription to the best of my ability.

I FURTHER CERTIFY that I am neither employed by nor related to nor contracted with any of the parties or attorneys in this case and that I have no interest whatsoever in the final disposition of this case in any court.

WITNESS MY HAND this 4th day of September, 2009.



Jacqueline R. Lujan, CCR #91
Expires: 12/31/2009