STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:	
APPLICATION OF BURLINGTON RESOURCES OIL AND GAS COMPANY FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	CASE NOS. 11,613
APPLICATION OF PENWELL ENERGY, INC., FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	and 11,622 (Consolidated)

REPORTER'S TRANSCRIPT OF PROCEEDINGS
COMMISSION HEARING

BEFORE: WILLIAM J. LEMAY, CHAIRMAN
WILLIAM WEISS, COMMISSIONER
JAMI BAILEY, COMMISSIONER

January 16th, 1997
Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, WILLIAM J. LEMAY, Chairman, on Thursday, January 16th, 1997, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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I N D E X

January 16th, 1997
Commission Hearing
CASE NOS. 11,613 and 11,622 (Consolidated)

(Continued...)

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(Continued...)

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* * *

WHEREUPON, the following proceedings were had at 9:12 a.m.:

CHAIRMAN LEMAY: Call Case Number 11,613 and 11,622, which are the Application of Burlington Resources for compulsory pooling and the Application of Penwell Energy for compulsory pooling.

These conflicting Applications, of course, will be consolidated for the purposes of the record and for purposes of issuing orders.

Appearances in these cases?

MR. KELLAHIN: Mr. Chairman, I'm Tom Kellahin of the Santa Fe law firm of Kellahin and Kellahin, appearing on behalf of the Applicant in Case 11,613, which is Burlington Resources Oil and Gas Company.

I have three witnesses to be sworn.

CHAIRMAN LEMAY: Thank you.

MR. CARR: May it please the Commission, my name is William F. Carr with the Santa Fe law firm Campbell, Carr, Berge and Sheridan. We represent Penwell Energy, Inc., and I have four witnesses.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

Will those witnesses that will be giving testimony please stand and raise your right hand?

(Thereupon, the witnesses were sworn.)

CHAIRMAN LEMAY: We shall begin.

Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Chairman.

Members of the Commission, this case was consolidated with -- these two cases were consolidated for hearing before Examiner Stogner, who heard this matter on October 3rd, 1996.

After the presentation of that case, on November 26th of 1996 he entered Order R-10,709, which approved Burlington's application and denied Penwell's application.

I'm going to give you a copy of his decision in that matter, because there are some basic statements of fact for which he's reached some conclusions that give us an outline of what we're about to show you today.

In early 1995, the ownership in this 40-acre oil spacing unit -- we're looking at Delaware oil wells; they are on occasion drilled to Bone Springs, but the production in here is Delaware oil wells -- in the spring of 1995, the ownership in the 40-acre tract is arranged such that a gentleman by the name of Prince owns about 50 percent, a gentleman by the name of C.W. Trainer has about 31 percent, Burlington -- at that time, I think, they were called Meridian -- had 13.5 percent, and Mr. Jerry Losee's two daughters, Ann and Elizabeth, split 5 percent, so each of them had 2.5.

This is in an area where Burlington and Pogo were developing Delaware oil wells in what is called the Red Tank area. Burlington referred to them as their Checkmate wells.

At that time, Burlington was interested in having a well drilled in this spacing unit, and this was a federal oil and gas lease area, and so in February of 1995 they filed an APD with the BLM.

In April, then, they proposed to these other interest owners, Mr. Trainer, Prince and the Losee sisters, the drilling of this Delaware well.

A month or two goes by, and Mr. Trainer counters with an AFE that's slightly lower than the AFE proposed by Burlington. Burlington, with 13 percent, provides Mr. Trainer the opportunity to drill the well first. He has obtained the agreement on his AFE of Mr. Losee on behalf of his daughters, Mr. Prince on behalf of his interests, and Mr. Trainer, then, has been authorized by Burlington to proceed to drill the well. This occurs in about May of 1995.

And then from May of 1995 to August 14th of 1996, despite repeated efforts by Burlington, Trainer does not commence the well.

By August of 1996, Burlington is now convinced that Mr. Trainer has no probable intentions of commencing this well in the near, foreseeable future, and so they repropose the well.

The well is reproposed, we're talking about an AFE of about $652,000. And they propose it to the same interest owners who are holding the interests at that time. It's Mr. Trainer, Mr. Prince and the Losee sisters.

A few days later, Mr. Trainer meets with Burlington and he says he doesn't have any trouble with having the well drilled. There apparently is no substantial disagreement on the costs of the well, there's no dispute about the location of the well, it's a well that needs to be drilled. But he's not prepared to do it, and yet he doesn't want Burlington to drill it.

Burlington recognizes that that obstacle cannot be overcome, and so a few days later, on August 26th of 1996, in their behalf, I file a compulsory pooling application.

Mr. Trainer is served on -- four days later, on August 30th, and after he is served then he begins to find a way to escape the consequences of force-pooling, and he contacts Penwell. He says, I'm about to be pooled; will you take my interest? And for a hundred dollars an acre and a small override, he assigns his interest to Penwell.

Penwell consolidates the Prince interest, the Trainer interest, and I think he has had the approval of Mr. Losee on behalf of his two daughters, that Penwell now wants to drill the well.

That is the basic fact situation with regards to the ownership dispute.

It is Burlington's position that it is now their turn to drill the well. They have provided for more than 17 months the opportunity to those interest owners with a majority to drill the well, and they failed to do so. And so we re-propose the well, and in order to avoid the force-pooling, they go out and find someone else.

The issue for you to decide is, does it really matter if Burlington drills it or if Penwell now drills it?

Our reservoir engineer will tell you it matters significantly. This is an area where these Delaware wells are not very prolific, the costs are sensitive, and it's very important to have experienced operators develop this resource. And if this was a dispute with Burlington and Pogo, it would go away and you would never hear it, because those are the two experienced operators in this pool.

The evidence will demonstrate to you that Penwell has no operations within miles of this pool, and yet they want to come in at the last minute and be designated the operator. We think that is inappropriate in the circumstances involved in this case, and that you ought to award the opportunity to Burlington to use their expertise that they have developed in the last few years in this area, and to go ahead and drill this well for the benefit of all the interest owners.

You'll find that it becomes very interesting when you look at the percentages. The testimony from the witnesses will talk about the percentages involved in this well.

Penwell asserts that they have the overwhelming majority of the gross working interest and that for that fact, and perhaps that fact alone, you ought to let them drill.

I invite you to pay close attention, though, to who is going to pay actually how much of this well. The testimony before Examiner Stogner was that Penwell is going to pay 12.236 percent of this well and that Burlington is going to pay 13.4 percent. When it gets down to cutting the check, Burlington, in fact, is going to pay more.

We believe that at the conclusion of the hearing, after you hear our geologic presentation, our engineering expertise with regards to how we have operated in this area, and when you hear our land presentation, you will conclude, as Mr. Stogner concluded, that Burlington ought to be awarded the right to drill and operate this well.

Thank you very much.

CHAIRMAN LEMAY: Thank you, Mr. Kellahin.

Mr. Carr?

MR. CARR: May it please the Commission, the owners of 86.6 percent of the working interest in this spacing unit, in compliance with the provisions of the compulsory pooling statutes, have reached a voluntary agreement for the development of this acreage, and they have agreed that Penwell should operate the well.

Penwell came and entered the scene in August of last year, 1995 [*sic*]. And yet, the evidence will show that for 18 months prior to that time, Burlington was anxious to drill a well. And they will whine and complain about what happened, but the bottom line is, they stand before you today screaming, It's our turn. And for 18 months it was their turn, and they did not drill the well.

They'll contrive all sorts of arguments about how, well, somebody else said they might. But the bottom line is, they have the right to drill, they could have, and they did not.

So when they talk about it being their turn, they're trumping up a false issue, they're misleading you.

Penwell entered the scene in August of this last year, and within one month, 86.6 percent of the working interest was committed to a well, if it would be drilled by them, and they were ready to go forward.

Burlington will play games with the numbers and they'll say, Well, Penwell pays 12 percent. But if you even look at Mr. Stogner's order, you can see that Penwell, and its partner in every single venture in which it's involved in New Mexico, CoEnergy Central, together -- together they pay 80-percent-plus of the costs of the well. And no matter what you do with the numbers for Burlington, they pay 13 percent.

But the fact of the matter is, we stand before you with the vast majority of the working interest owners, those who will pay the cost of the well, we've complied with the statute, we have a voluntary agreement, and we are now prepared to go forward to drill the well that for a year and a half Burlington could not get off the drawing board.

And what we have, yes, are competing pooling applications. And we came before an Examiner, and the Examiner order set aside the agreement of those of us who will pay the vast majority of the costs associated with developing the property, and they gave operations to Burlington. And I will tell you, there is one issue here, and that is who will operate the well. And in so doing, in giving operations to Burlington, they designated someone that 86.6 percent of the ownership did not want; they designated an operator unacceptable to the other owners.

The order that we are asking you to overturn, the Examiner order, we will show you, is factually incorrect.

It is legally wrong. And we're here today to ask you to correct that order, to honor the agreement that was voluntarily reached by 86.6 percent of the owners, and to let them develop this acreage and pay the costs to the operator they believe can best develop the property.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

You may proceed, Mr. Kellahin.

MR. KELLAHIN: I'd like to call Leslyn Swierc to the stand. Ms. Swierc is a petroleum landman with Burlington Petroleum. She resides in Midland, Texas. She spells her last name S-w-i-e-r-c.

CHAIRMAN LEMAY: S-w-i-e-r- --

MR. KELLAHIN: -- -c.

CHAIRMAN LEMAY: -- -c.

LESLYN M. SWIERC,

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

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q. Ms. Swierc, for the record, ma'am, would you please state your name and occupation?

A. My name is Leslyn Swierc. I'm a senior staff landman for Burlington Resources.

Q. And where do you reside?

A. I reside in Midland, Texas.

Q. On prior occasions have you qualified before the Division Examiner as an expert in matters of petroleum land management?

A. Yes, I have.

Q. Give us a short history of your experience with petroleum landman's work.

A. I began doing independent work in 1983. I worked as a broker, checking records, curing title, buying leases, for approximately five years.

I worked for two years for Gruss Petroleum, and Gruss Petroleum sold out completely, at which time I began working for Meridian Oil in 1989, which became Burlington resources.

During that time, I was involved in examining title, curing title, buying leases, negotiating contracts, preparation for drilling of wells, basically everything that involved normal petroleum land management.

Q. And for, I think, the -- at least the last year, you've been involved in this particular area, and specifically involved in this effort to get a well drilled in the spacing unit that's the subject of the hearing?

A. Yes, sir, that's correct.

MR. KELLAHIN: Mr. Chairman, we tender Ms. Swierc as an expert landman.

CHAIRMAN LEMAY: Her qualifications are

acceptable.

Q. (By Mr. Kellahin) Let me have you turn to what we've marked as Exhibit 1. Let's take a moment to show the Commission the color today of what you're trying to illustrate here.

A. What this plat is attempting to illustrate to you today is an area where we are active in drilling.

If you'll note Section 24, where it's got the yellow color coding, the blue and the green together, the yellow represents acreage which Burlington owns 100 percent. The blue acreage is the acreage which is the subject of this hearing today; it's owned by Burlington, Penwell and Mr. Losee's daughters. The green acreage represents acreage which is owned by Pogo Producing Company.

And then the pink, when you look further south in Section 25, is acreage that's owned jointly by Pogo and Burlington in this area.

Q. When we look at the 40-acre tract in Section 24, we're dealing with the northwest quarter of the southeast quarter of that section?

A. That is correct.

Q. To your knowledge, what type of oil and gas lease covers that 40-acre tract?

A. It's a federal oil and gas lease.

Q. Have you had title work done to determine at various points in time who were the interest owners of that federal oil and gas lease?

A. Yes, sir, I have.

Q. Let's turn to Exhibit 2 and look at the various points in time in which you have concluded what the interests were with regards to that spacing unit. Let's start with Exhibit 2, the first page, August 12th of 1996. What were you able to conclude?

A. On August 12th of 1996, I had David Logan, who's an independent broker working out of Midland, Texas, check the county and the BLM records, and his compilation of the ownership is as follows: Frederick Prince owned 50 percent of the working interest. Mr. Trainer owned 31 percent. Meridian, now Burlington, owned 13.4. Ann Losee owned 2.5 percent, and Elizabeth Losee owned 2.5 percent.

Q. Are those percentages consistent with data at Burlington's office to show what the interests were in January of 1995?

A. Yes, sir, they are.

Q. So from January of 1995 through August 12th of 1996, those interests remained unchanged?

A. That's correct.

Q. Okay. Have you subsequently had those interests checked to see what the status is?

A. Yes, sir, I did. As of January the 14th, I had Federal Abstract run another check of those records for the same oil and gas lease. They checked the federal records, and the federal records are showing that the operating rights, as of January 14th, were owned by: C.W. Trainer, 81 percent; Meridian, 13.4 percent; Elizabeth Losee, 2.5 percent; and Ann Losee, 2.5 percent.

Q. All right. So as of yesterday, the federal records show those interest still to be held in the same percentages?

A. Yes, sir, they do.

Q. All right. Let's start chronologically with Meridian, now Burlington's, efforts to get the well drilled in the 40-acre tract, and let's go back to early 1995 and start at that point.

If you'll turn with me to Exhibit Number 3, let's take a moment and talk about the application for permit to drill.

A. Okay.

Q. What are we seeing here?

A. In February of 1995, as you stated, Meridian did file an application for permit to drill the Checkmate 24 Federal Number 1.

It was approved, and we subsequently filed for a sundry notice, and that sundry notice was -- granted

Meridian, or Burlington, an extension until May 4th of 1997, in which to get this well drilled.

Q. To the best of your knowledge is this application for a permit to drill still in full force and effect, having been approved by the BLM for operations by Meridian, now Burlington?

A. Yes, sir, it is.

Q. Having satisfied yourself that you could, in fact, get the BLM to permit a well in this 40-acre tract, did Burlington attempt to consolidate, then, the interest owners so that they would have an opportunity to participate in that well?

A. Yes, sir, they did.

Q. And how did that happen?

A. Well, prior to -- You'll see my next exhibit, Number 4, is a letter dated April 21st, 1995, where Trey Shepherd, the landman that was working this area prior to my taking over, proposed the drilling of a 9000-foot Bone Spring test, to be drilled in the northeast -- excuse me, the northwest quarter of the southeast quarter of Section 24.

Prior to that time -- I want to take you back to 1992 -- Burlington was also in the process of trying to purchase additional interests in that area and had made offers to all the individuals at that time and was able to acquire that 13.4 percent that we currently owned.

So prior to the time of proposing the well, Burlington had tried to purchase the interests out there, and 13.4 percent was the amount that they were successful at purchasing.

Then in April of 1995, Burlington then proposed the drilling of the Bone Spring test, to the parties whom it could not purchase.

Q. A search of Burlington's records reflects what, as the next significant event, Ms. Swierc?

A. The next significant event, if you'll turn with me to Exhibit Number 5, is a letter that was received by Mr. Trey Shepherd from C.W. Trainer.

In this letter, Mr. Trainer is stating that he is returning Meridian's original AFE, and he is submitting a subsequent AFE. The location is the same, and the objective depth is the same; but he's returning Burlington's AFE, stating that he would prefer that he would operate, therefore he's resubmitting his AFE to take the place of Meridian's AFE.

Q. The two proposal AFEs at this point are about, oh, $24,000 apart, I assume?

A. That's correct.

Q. What happened then, after receiving Mr. Trainer's counter-proposed AFE, that he now be authorized to go ahead and drill the well that you originally proposed?

A. We were excited about the results of a test well that had been drilled in the area, and we were anxious to get the well drilled.

So in June, then, of 1995, which is Exhibit Number 6, if you'll turn with me, in June of 1995, Meridian executed Mr. Trainer's AFE, returned it to him, and asked that we be notified as soon as he was prepared to drill the well.

Q. What had you thought Meridian had achieved at this point, then?

A. We thought that we had achieved a voluntary agreement by the majority of the parties and that we were going to get a well drilled.

Q. And who was going to do that well?

A. And Mr. Trainer was going to drill that well.

Q. What happened next?

A. Nothing really occurred with the drilling of the well, so in September of 1995, if you'll turn with me, please, to Exhibit Number 7 --

Q. All right.

A. -- on September 7th of 1995, Trey Shepherd wrote a letter to the working interest partners, and he basically went through the chronology again, that we had proposed the well to the partners on April 21st of 1995.

On May 4th, Mr. Trainer returned our AFE and submitted his own.

On June 15th, we returned his AFE, stating that we were ready to drill, but as of this date, in September, no drilling operations had begun.

So he made a proposal in this letter to purchase the interest of all the parties for $500 per acre, if the well were not going to be drilled.

Q. Did that effort result in Mr. Trainer commencing the well at that time?

A. No, sir, it did not.

Q. What does a search of Meridian's records show with regards to the next significant event?

A. If you'll please turn with me to Exhibit Number 8, it's a memo, an internal memo that was generated by Mr. Trey Shepherd, again, stating that -- this is in, now, December of 1995 -- that he had had a telephone conversation with Mr. C.W. Trainer concerning the drilling of this well, and also the purchase of the interest.

Mr. Trainer made it clear to Mr. Shepherd that he would sell his interest in this acreage and that he also spoke for Mr. Prince in the selling of this acreage, but he wanted $4000 per acre to sell his interest to Burlington.

Mr. Shepherd told Mr. Trainer that the price was outrageous and that we couldn't purchase the interest for

$4000 per acre; it simply would not meet our economic parameters.

And Mr. Trainer then stated that he would proceed with the drilling of this well sometime in 1996, after he had lined up certain financial obligations and concluded other obligations that he had on his plate.

Q. From December, 1995, to August of 1996, did Mr. Trainer act to get the well drilled?

A. No, sir, he did not.

Q. In August of 1996, did you take action to repropose the well to the parties?

A. Yes, sir, I did.

Q. Let's turn to Exhibit 9 and have you describe what you did.

A. Exhibit 9 is a letter dated August 14th, 1996. I had taken over this area in January of 1996, and in August, then, reproposed the same well at the same location to the same objective depth, to the working interest owners at that time, being Frederick Prince, C.W. Trainer, Ann Losee and Elizabeth Losee.

And we also submitted our AFE for $651,000, which was less than our previous AFE for $699,000.

Q. What's your perception, as a landman, as to what's happening to these estimated costs? What's driving them down?

A. The experience that we have in the area has shown that there are significant operational pieces to the business that can control costs, and as a landman what I see is that, as we continue to drill more wells, we find ways that we can further reduce costs, simply by experience and correcting mistakes as we go along.

Q. Who are the primary technical people on your team that are analyzing those details for you and looking at operations, engineering aspects and the geology?

A. The reservoir engineer that's working this area is Doug Seams, the geologist that's working the area is Markus Thomerson. We also have a geophysicist that's working the area; his name is Mr. Hugh Hayes. We have a facilities engineer, Mr. Ralph Castille, that works the area, and a production engineer, Jack Gevecker, that works the area as well.

And all of these individuals are involved on a daily basis. Part of our job at Burlington Resources is working to reduce costs, and --

Q. As you get these revised AFEs and as the costs are re-analyzed, you're distributing those cost AFEs to the interest owners that would participate in the well?

A. That is correct.

Q. What happened following the August 14th, 1996, submittal to these parties? You said you sent this letter

to Prince, Mr. Trainer and Mr. Losee's daughters.
A. Yes, sir.
Q. What happened then?
A. On August 23rd, Mr. Trainer -- Actually, it was the day before, Mr. Trainer called and suggested that we have a meeting to discuss this well.
And on the next day, on August 23rd, Mr. Trainer came to Meridian's office and sat down with us and he had another proposal that he wanted to show us. We discussed the previous -- or his proposal, and then we discussed the drilling of this well.
Mr. Trainer told us that at that point that he agreed with the location, he agreed with the objective depth, he agreed that the well needed to be drilled, that he was in the process of trying to line up additional financing so that he could get the well drilled, but that he would prefer that he operated, and that he would not sign Burlington's AFE because simply he preferred to operate.
Q. The next exhibit is Exhibit 10?
A. Exhibit 10.
Q. Yes, ma'am. What's the point of this letter?
A. The point of this letter is to -- after the letter -- or the meeting on August 23rd, it was evident that Mr. Trainer and Mr. Prince were not going to sign

Burlington's AFE, and at that time I instructed you to go ahead and file for compulsory pooling.

On August 27th, it's a letter to the partner stating that we had applied for compulsory pooling, however we were still going to allow the partners their full 30 days to make an election.

Q. Following that letter, did you have subsequent conversations with Mr. Trainer with regards to his intentions concerning the compulsory pooling matter?

A. No, sir, I did not.

Q. Mr. Trainer was served with a copy of the compulsory pooling application on August 30th, 1996; I believe the record reflects that?

A. Yes, sir.

Q. Did you have any conversations with Mr. Trainer after that time?

A. No, sir, I did not.

Q. Let's turn to Exhibit 11. Would you identify and describe what this is?

A. This is an application by Penwell Energy for compulsory pooling, and I think that application is dated September 10th.

Q. Yes, ma'am, it's hard to read, but the records confirm here that it was filed on September 10th.

At the time Penwell filed its compulsory pooling application on September 10th, had Penwell given you a letter and an AFE inviting you to participate in the well if they should drill it?

A. No, sir.

Q. You got that after they had filed for force-pooling?

A. Yes, sir, I got it the next day.

Q. All right. Let's look at that. It's what? Exhibit 12?

A. Exhibit Number 12.

Q. All right. What is Penwell now proposing back to Burlington?

A. Penwell is now proposing that they drill the same well at the same location to the same objective depth, but rather they're submitting their AFE and proposing that they operate, and they're also telling us that they have filed for compulsory pooling.

Q. Did you talk to Mr. Mark Wheeler of Penwell with regards to the competing efforts of Burlington and Penwell to operate the well?

A. Yes, sir, we did.

Q. Did you receive any communication from Mr. Wheeler with regards to how he happened to obtain the interest from Trainer and Prince that he was contending gave him the right now to be a party that could propose the well?

A. Yes, sir, Mr. Wheeler was very cooperative in telling me that he was, in fact, dealing with Mr. Trainer and Mr. Prince, and he provided me a copy of a letter, also dated September 10th, which is Exhibit Number 13, where he had an agreement in principle with Mr. Trainer and Mr. Prince to purchase their interests.

The thing that's interesting to note, in paragraph number 7 of this letter, Penwell stated that it had -- in the case that it was unsuccessful in gaining operations of this well, that it had the right to withdraw from this obligation to purchase the interest from Mr. Trainer and Mr. Prince.

Q. What concern did you have on behalf of your company as to whether Penwell was going to go forward and drill the well, based upon this type of agreement?

A. The concern that I had with the experience in dealing with Mr. Trainer in the past, and the concern was whether or not this deal was actually going to close or not.

So if it didn't, would Burlington find itself in the same situation it had been in 17 months prior, where Trainer-Prince still owned the interest, and we're no closer to getting the well drilled now than we were at that previous time.

Q. Paragraph number 2 of that letter, on the first page, references the verbal agreement which apparently commits Penwell to commence the well on or before November 15th. Do you see that?

A. Yes, sir.

Q. Did you have any conversations with Mr. Wheeler as -- about when Penwell intended to commence the well?

A. Yes, sir, we talked to Penwell and asked them if they could guarantee a well would be drilled by October 15th. They said they would use their best efforts but that they could not guarantee that a well would be drilled by that time.

Q. Okay. Let's turn now to the next item of correspondence you're submitting. It's Exhibit 14. Identify and describe that for us, please.

A. Exhibit 14 is a letter dated September 13th, from Penwell Energy, and they're sending us a revised AFE. The AFE that they submitted on September 10th contained a mathematical error, and their price for the AFE had increased to $649,000.

Q. Prior to Burlington's filing its compulsory pooling case on August 26th, 1996, do you have an opinion as to whether or not you had exhausted all efforts to get Trainer, Prince and the Losee daughters to voluntarily join in this effort?

A. Yes, sir, I think we had. We had had numerous conversations, and when I say "we", I'm referring to the reservoir engineer and myself that were working the area. At the time it was Mr. Billy Juroska.

Mr. Juroska had numerous conversations with Mr. Trainer on unrelated issues but would always ask Mr. Trainer, When are you going to get our well drilled, when are you going to get our well drilled?

And Mr. Trainer would always respond, As soon as I can get the financing, as soon as I can get a rig lined up. I mean, he was always very cordial, but had a reason -- but had never started the well.

In one of those conversations, I was in Mr. Juroska's office and asked him again if he would be interested in selling his interest, and he said yes, for the going rate of $4000 per acre.

And we kind of laughed, and --

Q. That was outside of your budget, wasn't it?

A. That was outside our budget.

Q. Yeah. By August 26th of 1996, then, in your opinion, there was no opportunity to get these parties to agree with you?

A. No, sir.

Q. And they, in fact -- Mr. Trainer had the full right to commence drilling a well?

A. That is correct.

Q. After he was served with the force-pooling application, then, Penwell surfaced on the scene?

A. Yes, sir.

Q. Let's turn to the next item of correspondence. It's the Exhibit 15. Would you identify and describe for us what you're showing here?

A. Yes, sir, on November 27th, I sent a ballot to all the parties.

Q. This is after the compulsory pooling order has been issued by the Division?

A. Yes, sir, it is.

Q. And you're providing them their elections under the order?

A. That is correct.

Q. All right. Exhibit 16, Ms. Swierc, what's this?

A. Exhibit 16 is a letter dated December 20th.

As we stated in the previous hearing before Examiner Stogner, Burlington had an internal committee where we were working to reduce costs in this area because of the cost-sensitivity and the very nature of trying to reduce costs in this area. We promised that we would do what we could to reduce our costs even further.

So based on the findings of that committee, a new AFE was able to be generated, and we reduced our costs from

$651,000 to $618,000 and provided that revised AFE to all of the parties.

Q. Do you have a recommendation to the Commission concerning proposed overhead rates, should the Commission affirm Examiner Stogner's order?

A. Yes, sir, we do. We're proposing $5000 per well-month for a drilling well rate, and we're proposing $500 per well month for a producing well rate. That rate is commensurate with rates that we're currently charging in the area, and it's also commensurate with rates that Pogo was charging in the area where we are a nonoperator and paying those rates.

Q. To the best of your knowledge, Ms. Swierc, does Burlington have a rig available to commence the timely drilling of this well, should the Commission allow us to proceed?

A. Yes, sir, we do. We've got a rig available that has just completed drilling one well. It's moving to another well that's just offsetting this, and we'll be prepared to move that rig down to this well.

MR. KELLAHIN: Mr. Chairman, that concludes my examination of Ms. Swierc.

We move the introduction of her Exhibits 1 through 16.

CHAIRMAN LEMAY: Without objection, Exhibits 1 through 16 will be admitted into the record.

Mr. Carr?

MR. CARR: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. CARR:

Q. Ms. Swierc, let's go to Exhibit Number 1. If I understand your testimony, what we're talking about here today is the development of the blue acreage in the southeast quarter of Section 24; is that right?

A. That's correct.

Q. And in that tract, Burlington owns slightly over 13 percent of the working interest ownership; is that right?

A. That's correct.

Q. And after two years of trying to reach voluntary agreement for the development of that tract with the other 86.6 percent, you have not been able to get one other interest owner to join with you; is that a fair statement?

A. Yes, sir.

Q. Now, if a well is drilled as you propose on that tract, and you're operator, Burlington will only pay slightly over 13 percent of those costs; is that not right?

A. That's correct, if all the other parties participate.

Q. And if they don't, then you would still be able to collect their share out of production later on, you assume?

A. Yes, sir.

Q. Plus a penalty?

A. Yes, sir.

Q. What future plans does Burlington have for the development of the blue acreage in Section 24?

A. We have plans to develop it the same that we have developed the other acreage in the area. We drill a well, we evaluate it, operate it prudently, and depending on the success of that well, then we drill development wells based upon that.

Q. And you take them one at a time?

A. Yes, sir, we do.

Q. You don't come forward with a number of them and force people to make elections on a group of wells at a time?

A. No, sir, I don't think that would be a wise decision.

Q. Have you staked any locations in the acreage in Section 24?

A. We've staked the first location.

Q. Other than the one we're talking about?

A. No, sir, we have not.

Q. Have you made formal proposals of any additional wells in that acreage?

A. No, sir, we have not.

Q. If I understood your testimony, you looked in the public records back in August, on August the 12th, and, based on your search of the federal records, ascertained that Mr. Trainer and Mr. Pierce -- or Mr. Prince --

A. Prince, yes, sir.

Q. -- actually had the operating rights; is that correct?

A. That's correct.

Q. And again, you checked yesterday, and the federal records indicated that those individuals still owned the operating rights?

A. That's correct.

Q. Have you filed assignments of operating rights with the federal government, the BLM?

A. Yes, sir.

Q. It's fair to say that there is a period of time that it takes before those things actually are approved and find their way into the record?

A. That is correct.

Q. And so just because there has not in the BLM records been a transfer of these rights to Trainer and Prince, it isn't your testimony -- or intent of your testimony here today to suggest that Penwell doesn't own an interest in the property?

A. No, sir, that's not my testimony at all.

Q. Did you check the records of Lea County, New Mexico, to determine whether or not they had an interest recorded in this property?

A. Yes, I had a broker check that, and unfortunately I was not able to speak to him before I came today.

Q. So we don't know yet what that is?

A. That's correct.

Q. Burlington became interested in developing this particular property because of an offsetting well drilled in 1994; isn't that right?

A. Yes, sir.

Q. And because of that, in April of 1995 Burlington/Meridian proposed -- made the initial proposal to the other interest owners for a well to test the Delaware in this area?

A. That's correct. Actually, to test the Bone Spring.

Q. At the time you proposed that well in April, Meridian/Burlington owned operating rights in the tract; is that not correct?

A. Yes, sir.

Q. And you could have filed a force-pooling application back in 1995, could you not?

A. Yes, sir.

Q. And you did not do that because of negotiations with Mr. Trainer and Mr. Prince; is that the reason for not going forward with the well under Burlington's name?

A. That's correct. And Mr. Carr, I believe you even stated that the statute requires us to try to reach a voluntary agreement, and I think that's what we were trying to do during that time period.

Q. Do you normally allow 15 to 18 months to reach voluntary agreement?

A. Sometimes it takes over a year to reach voluntary agreement, yes, sir.

Q. And is that, in your opinion, a prudent thing to do when you're anxious to drill a well because of offsetting production?

A. I think the prudent thing to do is to make a wise decision with respect to the production from the well and how it affects your economics.

Obviously, I said that we were very excited about drilling the well when the test well was drilled, because the production was so high.

But significant changes occurred. The production fell off, and we began to see that cost savings was going to be very significant in this area, because the wells were not as prolific as we had initially thought.

Q. And one of the reasons you've testified that Burlington would like to be designated operator of the well is because of your experience in the area; isn't that right?

A. Yes, sir.

Q. And yet for 15 months you were willing to have Mr. Trainer drill the well; is that correct?

A. Yes, sir.

Q. Do you have any idea how many wells to the Bone Spring or Delaware in the area Mr. Trainer has recently drilled?

A. No, sir, I don't.

Q. That decision, I guess, had nothing to do, or do you know if it had anything to do with the expertise of Mr. Trainer?

A. That had nothing to do with the expertise of Mr. Trainer. We were trying to cooperate with Mr. Trainer.

Q. And that started by -- in May of 1995, with an AFE and an agreement for Mr. Trainer to drill the well?

A. Yes, sir.

Q. And then you took no activity other than contacting him and encouraging him for 15 months; is that right?

A. Yes, sir.

Q. Now, on August 15 of 1995, if I understood your testimony, you again proposed the well; is that right?

A. I beg your pardon?

Q. August 15th of 1995, was that when you again proposed the well? I'm sorry --

A. No, it --

Q. -- 1996.

A. August 14th of 1996, yes, sir.

Q. And it was, then, on the 26th of August that a compulsory pooling application was filed by Burlington; is that right?

A. Yes, sir.

Q. Did not Penwell contact you and request a continuance of the original hearing date on the compulsory pooling application?

A. Yes, sir.

Q. And you declined to grant that continuance or agree to it; is that not right?

A. That's right.

Q. And wasn't it at that time that you were advised by Penwell that if you couldn't give them a continuance, they would have to file a companion pooling cases?

A. I suppose, yes, sir.

Q. And that was filed on September the 10th, correct?

A. Yes.

Q. And that's why we're here today, right?
A. That's correct.
Q. When did you learn Penwell was actually involved in the effort to develop this acreage?
A. I think it was -- I don't recall the exact date, but I think it was around the end of August.
Q. At that time you knew Penwell was trying to negotiate with Mr. Trainer, did you not?
A. Yes, sir.
Q. And you basically agreed not to get in the way of those negotiations?
A. That is correct, I told Mr. Wheeler that we would not do anything to try to query his deal [*sic*] with Mr. Trainer.
Q. You were hoping it would be easier for them, perhaps, to reach an agreement with Mr. Trainer?
A. Certainly.
Q. And you knew that it was really -- what Penwell was proposing was really the same proposal that you were proposing?
A. The same well?
Q. Yes.
A. Yes.
Q. Same location?
A. The same objective depth.

Q. And isn't it fair to say here, the one question presented to the Commission today is simply who is going to be entitled to operate this well?

A. Yes, sir, I would say so.

Q. Now, you talked about negotiations with Penwell and stated that you asked if they could guarantee that a well would be drilled in October of 1995?

A. Yes, sir.

Q. Is that right?

A. Yes, sir.

Q. And they agreed to do the best they could; isn't that right?

A. Right.

Q. If another operator comes to Burlington and says, Will you guarantee a well on a certain date, is that the kind of guarantee you normally make?

A. We will do the best we can.

Q. And that's just what Penwell agreed to do, the best they could, right?

A. Right.

Q. Back in October of last year, you were aware that Penwell was going forward with a drilling title opinion, did you not?

A. Yes, sir.

Q. Did you have one at that time?

A. A drilling title opinion?

Q. Yes.

A. I had one on offsetting acreage. The lease was common, and I did not have one on this tract of land.

Q. Have you prepared a drilling title opinion on this tract as of this date?

A. No, sir, I have not.

Q. Back in October, there was concern on your part, or expressed, that Burlington might lose its funding if this well was not drilled by the end of 1996. I assume from your presence today that's no longer an issue?

A. Actually, that did occur. We -- The reason that it was so imperative that we get the well drilled by October 15th of 1996 is that internally, Burlington's vice president -- or our division's vice president, wants all of our capital spending either done or commenced by October of any given year, and that's why we were very anxious to get it done. The fact that the well was going to be drilled within that year, we were able to say that we were committed and we were able to keep that funding.

At the end of that year, of 1996, we did lose that funding. But because we had received a favorable order from the Commission, we were able to go ahead and capture funding for next year.

Q. Now, that favorable order was entered by the

Division on November 26th, was it not?

A. That's correct.

Q. And on November 27, did not Burlington send an additional AFE to the parties involved in this case?

A. Yes, sir.

Q. And was not that the identical AFE that had been presented at the time of the Examiner hearing?

A. Yes, sir, it was.

Q. And then it was about two weeks later that the new AFE that we're looking at today was then sent to the parties?

A. That's correct.

Q. Was that AFE prepared because of this hearing?

A. No, sir, we were in the process of working our cost reduction methods at that time, but it was my intent to get the clock started as quickly as I could on the 30-day election period, because we knew that the end of the year was coming up, we knew we had to get a rig, we knew that time was of the essence. Therefore, I wanted to get the ball rolling.

Concurrently with that, our engineers were in house working up a new AFE, getting bids so that we could get our cost reductions.

Q. And when you sent that initial AFE out right after the hearing, did you know that the case was going to be taken to a Commission *de novo* hearing?

A. No, sir, I did not.

Q. And it was after you learned that, that the lower AFE was then --

A. Perhaps.

Q. It was mailed, in fact, on December the 20th, was it not?

A. Yes, sir.

Q. What negotiations did you have with Mr. Losee or his daughters?

A. I spoke with Mr. Losee on one occasion, and in that conversation Mr. Losee stated that he would like to see the well drilled, but that he was concerned about some accounting issues that he had with Burlington and he did not want to support Burlington as operator due to those accounting issues.

Q. Did this occur back in April of 1995?

A. No, sir, the conversation I had with Mr. Losee, I believe, was the end of August of 1996.

Q. And had you talked with Mr. Losee or his daughters back in April of 1995 when you initially proposed the well?

A. No, sir, I did not. Trey Shepherd worked the area at that time.

Q. Are you aware of any of the background on the problems that Mr. Losee had had with accounting issues with Burlington?

A. I'm not fully aware of the facts. I think that he was concerned about not being paid.

Q. Did he tell you he had been paid for oil at the wrong price?

A. No, sir.

Q. Did he tell you that there had been substantial delays in getting payment?

A. Yes, sir, he did.

Q. Did he tell you that he had been unable to figure out the statements that came with his checks?

A. No, sir, he didn't state that.

Q. Did he talk to you about efforts that he had to undertake to get these matters corrected?

A. No, sir, we didn't go into those details.

Q. Did he talk with you to determine whether or not payments, including royalty, had been made in accordance with the -- based on the proper pricing?

A. No, sir.

MR. CARR: That's all I have. Thank you.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

REDIRECT EXAMINATION

BY MR. KELLAHIN:

Q. Ms. Swierc, with regards to Mr. Losee, have you made inquiry to determine whether the appropriate accounting people are attempting to address Mr. Losee's concern with regards to these issues which involve other properties?

A. Yes, sir, I have. I've contacted our accounting group, and they say that they are making every effort to correct any problems that Mr. Losee has with our accounting.

Q. In fact, Mr. Losee is due a refund check, I believe, that's being processed as we speak?

A. That is correct.

MR. KELLAHIN: All right, no further questions.

CHAIRMAN LEMAY: Commissioner Weiss?

COMMISSIONER WEISS: I have no questions.

CHAIRMAN LEMAY: Commissioner Bailey?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. The $500-per-acre offer --

A. Yes, ma'am.

Q. -- that you made to Mr. Trainer, and then his $4000 counteroffer --

A. Yes, ma'am.

Q. -- how do those compare with the comparable prices in the field at that time?

A. At that time, the $500 per acre was a very fair price. I think the $4000 per acre in the area is very outrageous.

Q. Meridian had bought their interest in 1992. Do you recall what that price was when you bought it?

A. I don't recall the exact price, no, ma'am. But I know it was nowhere close to $4000 per acre.

Q. Was it close to $500 per acre?

A. Yes. I can get that exact number.

COMMISSIONER BAILEY: That's all I have.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. Going into this lease, Ms. -- Swierc, is it?

A. Swierc.

Q. Swierc.

A. Yes, sir.

Q. -- you picked it up in 1989. I'm just curious how Mr. Prince acquired the lease. Was this a KGS tract, or was it a federal filing tract way back, or do you know anything about the origin of the lease?

A. I'm uncertain. I just -- I know that we purchased our interest in 1992, and I think it's just a competitive lease that he purchased. I don't even have the exact date of the lease now. Let me see. A competitive lease, 1989.

Q. You have it 7-1-89. So --

A. Right.

Q. -- was it your idea that Mr. Prince was the purchaser of that lease?

A. Actually, I think Mr. Trainer purchased the lease, and then it was standard practice that he assigned a portion of it to Mr. Prince.

Q. Mr. Prince has the largest percentage of the lease.

A. Yes, sir.

Q. And in your negotiations with Mr. Trainer, did you ever negotiate with Mr. Prince separately, or was Mr. Trainer always the spokesman for Mr. Prince?

A. Mr. Trainer just was always the spokesman for Mr. Prince. I have spoken with Mr. Prince. He's in Washington, D.C., and very difficult to reach, and Mr. Trainer primarily spoke for Mr. Prince.

Q. So in you offer, you offered the $500 an acre to all parties, but Mr. Trainer was the respondent and spoke for all parties concerning the $4000-per-acre counteroffer?

A. He spoke for Mr. Trainer and for Mr. Prince. He did not speak for the Losees.

Q. Was there anything in between -- discussed between $500 an acre and $4000 an acre?

A. No, sir, actually there was not. Mr. Trainer was adamant about what he wanted for his acreage.

Q. Did you offer anything above $500 an acre?
A. I asked him what he would take, and he said $5000 [*sic*] per acre.
Q. You talk back in excess override, anything besides cost per acres?
A. Oh, yes, sir, we discussed numerous -- numerous terms.
Q. Were there any other offers on the table, that you know of, that didn't have to do just cost per acre but had to do with equity interest in the farmout?
A. No, sir. Equity interest in the farmout --
Q. Well, in terms of -- Many deals or constructed not only on cost per acre --
A. Right.
Q. -- but there could be a back-in involved --
A. Right.
Q. -- after payout, there could be additional override --
A. Right.
Q. -- convertible after payout or before payout. There's lots of deals. Cost per acre isn't necessarily the only way to make a trade.
A. You're exactly right, and in those negotiations there was a net revenue associated with those costs per acre. We have certain economic parameters that we have to

meet internally in order to be able to justify paying a certain thing per acre.

And I don't -- Not only is it a cost per acre, but it's a certain net revenue level that we have to have. And also back-ins after payout affect our economics in a way that we have to look at each one of those individually.

Q. Was the 85-percent net revenue -- is that what you offered --

A. Yes, sir --

Q. -- what you wanted, obviously?

A. -- that's what we wanted, but we were willing to accept a lower net revenue interest, and I told him that.

Q. But that was never negotiated any further?

A. In conversations, just the fact that we would accept a lower net revenue interest. I asked him if he would sell the interest at an 80-percent net and keep that override.

But he was pretty adamant about the $4000 per acre.

CHAIRMAN LEMAY: There will be additional testimony concerning the prospect and the area. There's some geology --

MR. KELLAHIN: Yes, sir.

CHAIRMAN LEMAY: -- and engineering --

MR. KELLAHIN: Yes, sir.

CHAIRMAN LEMAY: -- from that point of view?

That's all I had.

Mr. Weiss?

COMMISSIONER WEISS: No additional questions.

CHAIRMAN LEMAY: Okay. Thank you, you may be excused.

THE WITNESS: Thank you.

<u>MARKUS D. THOMERSON</u>,

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

DIRECT EXAMINATION

BY MR. KELLAHIN:

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

A. Yes, my name is Markus Thomerson. I am the petroleum geologist for Burlington Resources. My primary area of responsibility right now is southeast New Mexico.

Q. Does that area include this Checkmate area in the Delaware oil wells that are being developed in this Red Tank Pool?

A. Yes, sir, it does.

Q. Where do you reside, sir?

A. Midland, Texas.

Q. Give us a short summary of your involvement with regard to this particular activity.

A. Okay. My tenure with Burlington Resources -- or at that time it was Meridian Oil -- started in 1993, specifically in the Delaware Basin. My particular time frame with this lease started in May of 1995. I've had total responsibility for all geological interpretation in this area since then.

MR. KELLAHIN: We tender Mr. Thomerson as an expert petroleum geologist.

CHAIRMAN LEMAY: Mr. Thomerson's qualifications are acceptable.

Q. (By Mr. Kellahin) Mr. Thomerson, if you'll turn to what's marked as Burlington Exhibit 17, before we talk about the interpretation, give us a way to understand the color codes and --

A. All right, sir.

Q. -- that type of detail in the legend.

A. Okay, this is a structure map that is based on a marker, a regional marker that we use It's the top of the basal Brushy Canyon. That particular marker is marked in red on the type log, which you see on the right-hand side of the map.

The map itself, again, as I said, is a structure map. I'm using a color fill, which indicates -- the hotter colors, the reds and the yellows, are indicating higher structural positions. The cooler colors, the blues, purples and so forth, are lower structural positions.

Q. Does structure matter in this pool?

A. Structure matters with regard to the basal Brushy Canyon, which are all of the dots you see in red.

Excuse me, let me rephrase that. With the Delaware. Not all of the red dots are specifically Brushy Canyon. There are some dots in there that are Cherry Canyon as well as Bell Canyon.

But with regard to this structure map in the basal Brushy Canyon, yes, the structure has great importance. With regard to the Bone Springs or the upper Bone Springs, it doesn't have any significance.

Q. In terms of structural position, give us a perspective on the Checkmate 24 Federal 1, the subject well, its location and what's occurring around it.

A. Okay, the Checkmate 24 Federal Number 1, as you can see, which is the highlighted well that we're talking about today, the pool that is directly to the west of you is the Red Tank Delaware field. Okay, this field is producing primarily from the basal Brushy Canyon. That is overlying a deeper Paleozoic structure.

And in this particular map, Exhibit 17 is a structure map based on that. The well in question is in a flank position with regard to that structure.

Q. What about the blue-dotted wells in the upper

Bone Springs? How does that fit together?

A. Okay, all of the blue-dotted wells are currently producing wells from the upper Bone Spring. And as you can see, these are all occurring on a flank position, on the eastern flank of this structure. Again, this structure is present-day structure with regard to the basal Brushy Canyon.

Q. The well has been targeted for a total depth sufficient to test the upper Bone Springs for production?

A. That is correct.

Q. Between that Bone Springs and the Delaware, which is your better prospect?

A. The better horizon, in my opinion, is the upper Bone Spring sand. The Delaware at the basal Brushy Canyon will be a secondary objective.

Q. All right. Let's turn to Exhibit 18 and have you identify and describe that display.

A. Okay, Exhibit 18 --

Q. Give us a chance to unfold it here.

A. Oh, I'm sorry.

Q. All right, sir, I have it in front of me. Same kind of color coding as on the prior display?

A. Yes, sir, that is correct. The numbers are different, however the color scheme remains the same, where the hotter colors, the reds and yellows, are indicating thicker sands.

Q. You've moved into an isopach presentation at this point?

A. That is correct, sir. This is a net sand map.

Q. All right.

A. It is based on a porosity cutoff of 12 percent. This comes from the density log.

Q. Let's look at the type log, so you can show us the interval that's being mapped on the isopach.

A. Okay, the interval we're looking at, again, the type log on the right-hand side, you see a red line that's marked on the "K2" sand. This is an informal designation. It does not have any stratigraphic significance beyond us.

And this is the main pay that we find in the Red Tank field, which is the Delaware field, again, that I'm talking about. It's due west of where we are right here.

And what we're looking at, the porosity cutoff is based on the density log, which is the green curve in track 3 of that type log.

Q. All right. Let's put Section 24 and the proposed location in perspective with regards to the net pay sand.

A. Yes, sir. What you're seeing, again, is with regard to that structural position from Exhibit 17, you see that the thicker sands in the basal Brushy Canyon are occurring in the middle of the Red Tank field.

Our Checkmate 24 location is not only in a structurally flank position or downdip position, but the sands in that area are going to -- in the basal Brushy Canyon, are going to be quite thin. In this instance here, I'm expecting sands anywhere from 15 to 20 feet thick. That's net sand.

Q. When we look at the area where, back in early 1995, there was the well that had the nice initial potential of about 400 barrels a day --

A. Yes, sir.

Q. -- where is that well?

A. That -- If you look at the Checkmate 24 Federal Number 1 location, the well that is due southwest -- it would be one location to the southwest of that -- is the Pogo Red Tank 24 Number 1. That is the well that we've been referring to that had a very high IP out of the upper Bone Spring sand.

Q. Since then, have subsequent wells been able to achieve that level of initial potential?

A. Not with -- Not to my knowledge, sir. Most of them have been less, as far as reported. You're always going to have hearsay.

Q. Let's move to the next display, then. If you give us a minute to unfold Exhibit 19, we're now going to turn to look at the structure, when you map the top of the upper Bone Spring sand?

A. Yes, sir.

Q. Again, find on the type log the point in the structure that you're mapping, and then we'll go to the left side of the display.

A. All right, sir. The type log, again, on the right-hand side of the map, we're looking at the structural -- present-day structural top of the upper Bone Spring sand. That's in the lowermost part of the type log. It's highlighted in red, in the same color-fill scheme, with the hotter colors being the higher structure, cooler colors being down on the flank.

You'll notice that there is a strong structural nose now occurring over Section 25, which is pretty well the heart of this play at this point in time, and of course that is the acreage that's currently owned by Pogo, which we have a small interest in.

And structurally, the Checkmate 24 Federal Number 1 is in a downdip position. However, in working this area, the structural component of the upper Bone Spring does not, to the best of my knowledge, have anything to do with your ability to make a commercial reservoir. It is entirely dependent upon the amount of reservoir-quality sand that you're going to obtain.

Q. And your geologic method to interpret the amount of reservoir-quality sand is to construct a net-pay isopach?

A. Yes, sir, that is correct. That would be the next exhibit.

Q. Let's look at that. All right, sir, would you identify and describe Exhibit 20?

A. Yes, sir. This is a net sand map. Again, it is based on a 12-percent porosity cutoff. This cutoff is from the density log.

If you look at the type log, we're looking at the same density curve, which would be in track 3. What I have here is, anything less than 12 net feet of sand is not colored in, reason being, in the wells that we have been involved with, with Pogo, as well as the wells that we operate in Section 36, which are also producing from this horizon, we have determined that 12 feet is pretty well an economic limit. Anything below that, you're not going to have what we would term to be a commercial well.

Q. When you look at this particular upper Bone Spring sands, is there a component of risk that you have to accept concerning the fact that a well can be commercial and have sufficient sand thickness and yet be a 40-acre location away from a well that is not commercial?

A. Yes, sir, there is significant risk involved here. This map is probably the best map you can look at with regard to this reservoir.

As you can see, there are numerous wells that have substantially thick sections of this upper Bone Spring sand, some in excess of 20 feet, 25 feet. And you can move one 40-acre location away, and you're down to less than 12 feet.

So you're looking at a very rapid change within your reservoir quality. So there's a substantial risk, geologic risk, based on that.

Q. When we focus specifically on Section 24, your immediate control is to the west, and you have an absence of control north and south, and then to the east?

A. Yes, sir, that is correct. There is one well up in Section 13 -- Excuse me, there are three wells in Section 13 that establish the northern limit.

That one particular well, which is in the northeast quarter, is a Morrow test. It has, I think, 13 feet of sand in it. The other two wells that are located in 13 do not have less than the 12 feet of sand, so they're not mapped.

But that is the extent of my control to the north.

Q. The well density in this area is one well per 40 acres; and these are oil wells, right?

A. Yes, sir.

Q. When we look at how to go about developing the southeast quarter of Section 24, where in your opinion is the best place to put the first well?

A. At this point in time, the way I've got it contoured, I think the Checkmate 24 Federal Number 1 location, as well as our Jackalope location, which is a well to the north that we're currently in the process of moving to.

Q. As an exploration geologist, is this a reservoir that's suitable for development by drilling multiple wells concurrently in the southeast quarter of Section 24?

A. No, sir. I think you need to evaluate these one at a time. We found that out in working with Pogo down in Section 25, and that is called the Covington lease. And again, we moved that very quickly, because you're looking at a reservoir that can change so radically from one location to the next. You drill your well, put your data in, and see where you -- and make sure that your next location is actually going to fit with your model.

Q. Give us a general summary, Mr. Thomerson, of how you and Pogo have developed expertise and experience as you continue to drill and produce wells in this pool.

A. Well, from the geologic standpoint, we have cooperated, not only because we own an interest, but it's in everybody's best interest, you know, from a geologic standpoint, to cooperate with one another, to get the best and most efficient use of this reservoir. And that comes back to sharing of data and so forth.

Q. Despite that cooperation, do you have a recommendation to the Commission as to the risk factor penalty to assess in this pooling case?

A. Yes, sir, I believe 200 percent.

Q. And that was your opinion and recommendation to Examiner Stogner?

A. Yes, sir, it was.

Q. And you have not changed that opinion?

A. No, sir, I have not.

Q. Are we looking at the same displays that Mr. Stogner looked at?

A. These have been slightly modified. There have been several wells that have been drilled in the area, none in Section 24, obviously.

But in Section 25, obviously, there have been three other wells drilled there. Two of those wells were not deep enough to penetrate the upper Bone Spring sand. And if you go to the extreme south edge of the map, there below Section 35, Yates has done quite a bit of drilling down there also.

Q. Does the new information developed since the last presentation cause you to change your opinion about the risk factor penalty?

A. No, sir, it does not. It actually enhances it.

MR. KELLAHIN: That concludes my examination of Mr. Thomerson.

We move the introduction of his Exhibits 17 through 20.

CHAIRMAN LEMAY: Without objection, Exhibits 17 through 20 will be admitted into the record.

Mr. Carr?

MR. CARR: I have no questions of this witness.

CHAIRMAN LEMAY: Commissioner Weiss?

EXAMINATION

BY COMMISSIONER WEISS:

Q. Yes, sir, Mr. Thomerson, on your isopach, Bone Springs isopach --

A. Yes, sir.

Q. -- are these computer-generated contours?

A. Yes, sir, they are. They are -- Actually what I do, to make this very short, is, they're hand-contoured at first. Some of the contours are digitized in, other contours that are outside of that, I allow the computer to take the -- I manipulate the gridding algorithm.

In a case where you've got such dense well control, the computer does a very good job.

Q. What algorithm is that?

A. In this particular method here, I'm using -- the program we're using is called Geographics, and I'm using an adaptive fitting algorithm. And essentially what that does, that is a -- it generates a variogram through the data. And since I'm dealing with porosity data, I know that this data can change radically very quickly. This variogram fits that best curve to that, and that's how you get a -- It does a very good job with this type of data. I've used other algorithms, and I wasn't very happy with the output that I got from them.

And that is a proprietary algorithm, Geographics. I mean, that's about the extent of my knowledge of it, or that they'll tell me about.

Q. That was my only question. I just didn't see the control there.

A. Well, the reason the control is not there, sir, is, I -- in using a color fill -- and this is probably, I guess, a limitation of the program -- the control points tend to get washed out when you put the overlay of the colored dots to indicate the wells, as well as the color-fill in the contours. You get a very busy map.

COMMISSIONER WEISS: That's my only question. Thank you.

CHAIRMAN LEMAY: Commissioner Bailey?

COMMISSIONER BAILEY: No, I don't have any questions.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. I have one. Just -- Mr. Thomerson, on your Exhibit Number 18, which I think is the upper Brushy Canyon isopach -- basal Brushy Canyon, actually. You call it the "K2" sand?

A. Yes, sir.

Q. Do you know if that sand also has designation "L" sand by other geologists? Have you ever looked at the terminology?

A. If the "L" -- If you're referring to the "L" sand, say, that's referred to by Strata --

Q. Yes.

A. -- or some of the others, okay, yes, sir, that is a lower sand.

Q. That's lower than the "K2" you show there?

A. Yes, sir, that is correct.

Q. Okay. Do you happen to know if those offset wells, that you show -- I guess there's a -- Again on your Exhibit 18, they're Bone Spring producers. One's a -- looks like a slightly west, northwest offset; the other is a southwest offset --

A. Number 1, I believe, has a commingling order present on it now, and it is commingling the Bone Spring with the Delaware.

Q. There was a Delaware completion on that?

A. Yes, sir, it's commingled. I don't know when that administrative order came down, but it was several months ago.

Q. Your exhibit shows it only producing from the Brushy Canyon.

A. Yes, sir, you're right, and that is a limitation -- how I was able to make this map up, if we go forward in Exhibit 21, that is the current production at this point --

Q. The Red Tank 24 Number 1 is a good well?

A. We've got -- The problem we've had out here -- I'm stretching my expertise here, but a lot of these wells we haven't had on line that long because of a lot of problems getting production. So there has been some problems with establishing what the EURs are going to be out of these wells because of the short time that we've had production data on them.

However, that well -- we've had it on quite a while, but -- and I could not tell you off the top of my head.

CHAIRMAN LEMAY: That's all I have.

Any other questions? If not, thank you, Mr. Thomerson. You may be excused.

Let's take about a 15-minute break.

(Thereupon, a recess was taken at 10:26 a.m.)

(The following proceedings had at 10:45 a.m.)

CHAIRMAN LEMAY: Mr. Kellahin, you may continue.

MR. KELLAHIN: Thank you, Mr. Chairman.

My next witness is Doug Seams. He spells his last name S-e-a-m-s. Mr. Seams is a petroleum engineer.

DOUG SEAMS,

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

DIRECT EXAMINATION

BY MR. KELLAHIN:

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

A. Good morning. My name is Doug Seams. I'm a senior petroleum engineer, employed by Burlington Resources.

Q. And where do you reside, sir?

A. I live in Midland, Texas.

Q. Were you Burlington's engineering witness before Examiner Stogner when this case was heard at the Division level?

A. Yes, I was.

Q. Give us a short summary of your experience with regards to this particular project in the Red Tank area.

A. I became active in this area as the engineering -- When I say I became active, I moved into this area of southeastern Lea and Eddy County, including this Red Tank area, in June of 1996. I then have been involved very actively in this project through this date.

Q. Was it your effort to get Ms. Swierc and other members of the team to re-examine what was specifically happening concerning this well that Burlington had authorized Mr. Trainer to proceed to drill?

A. Yes, it was.

Q. And what caused you to have this item come to your attention?

A. What caused this item to come to our attention is, we actively track our capital spending throughout the year. And as Leslyn mentioned earlier, our vice president, who is the head of our divisional office, very much likes all the capital to be spent by mid-October, which is a fairly early deadline for us.

So in the midsummer portion of the year, we were very much reviewing our capital projects, those of which we had on the queue to be done, and those which -- projects that we needed to do in order to capture that total pot of capital.

Well, the Checkmate 24 Federal Number 1 was very much in the queue but did not have a firm timeline on it.

Q. Now, you separate out your activities in terms of those wells that Burlington is going to operate and drill, versus the nonoperated Burlington interests, do you not?

A. Yes, we do.

Q. And this was in the schedule of the nonoperated Burlington wells, because Mr. Trainer had been authorized to drill the well?

A. Yes, it was.

Q. Okay. Let's talk about what's happened in the pool. If you'll start with Exhibit 21, let's look at the way to code how these wells are being carried in terms of where they're producing. What's the color code?

A. Yes, Exhibit 21 represents the Checkmate 24 Number 1 area, and as you can see, that well is noted there near the top. Now, the wells with a red dot represent the existing Delaware sand production, and the wells with the blue dots represent the existing upper Bone Spring sand production.

And back to a question that was led to Markus, is, there are some wells out here that are commingled. We didn't have the opportunity, using our computer system, to show both the Delaware and the Tresnor. What we showed was to be the last completed interval.

Q. You have participated, then, with Mr. Thomerson as the technical team that analyzes the reservoir and looks at further opportunities to drill wells?

A. Yes.

Q. And we're about to look at your work product and your recommendations and opinions to the Commission?

A. Yes, we are.

MR. KELLAHIN: Mr. Chairman, at this time I would tender Mr. Seams as an expert petroleum engineer.

CHAIRMAN LEMAY: His qualifications are acceptable.

Q. (By Mr. Kellahin) Is there a way that you as an engineer can illustrate the relative initial potential of those wells, so that the Commission can see the comparison?

A. Yes, there is, and I'd like to point out to Exhibit Number 22 in order to show that.

Q. What are we looking at here?

A. Exhibit Number 22 is an initial potential map, and it's a qualitative -- or quantitative map, in that the larger the green dot, the larger the initial daily oil potential of these wells.

As you can see, the well that was southwest offset of the Checkmate 24 Federal Number 1, which is called the Red Tank 24 Federal Number 1, has the largest green dot and hence the highest IP of 449 barrels today. But you can also see noted there in the red numbers just to the left, and you can see the potential of the wells as they fall down there to the south.

Q. Let me have you look at Mr. Thomerson's Exhibit 19, which is his -- I'm sorry, that's the wrong one. I need the isopach on the upper Bone Springs. Which one is it?

Let's look at Exhibit 20, and I want to compare it to your IP bubble map.

A. Okay, we're looking at the same general area between the IP bubble map and using the exhibit that Markus Thomerson had shown on the net sand isopach.

Q. My question for you, sir, is, when Mr. Thomerson uses his best geologic judgment in how to give you an opportunity to pick the next best location, he's using a thickness map, and unfortunately it appears that the initial potential of the wells in that sand don't directly correlate to thickness?

A. This is true.

Q. Explain to us why this is such a complicated challenge for you and Mr. Thomerson and others in terms of where you locate and drill wells.

A. This is a very complex reservoir in the upper Bone Spring sand. In fact, through our continuous development of this sand, in partnership with Pogo, we've developed some methods in order to -- not mitigate, not get rid of risk, but in order to minimize the risk.

And as you can see, even with that there's still variations of quality of wells within the sandbodies.

You would expect your Red Tank 24 Federal Number 1, which has the largest IP dot of 450 barrels of oil per day to also be located in the very best spot on the reservoir. But if you look at the Exhibit Number 20 that was shown by Markus, this well has only slightly greater than 14 feet of pay.

So even within a constant pay thickness, you can have differences in pay quality that can give you better or worse wells.

Q. Would you propose to attempt to drill or propose multiple wells in the southeast quarter of 24, or would you simply drill them one at a time?

A. I would very much drill them one at a time, due to the complexities of this reservoir.

Q. Do you concur with Mr. Thomerson's assessment of the geologic risk that, from an engineering perspective, the 200-percent maximum risk factor penalty is appropriate in this case for this well?

A. Yes.

Q. Let's turn to Exhibit 23, Mr. Seams, and have you identify and describe that display.

A. Exhibit Number 23 shows the extent of Burlington Resources' operations in this immediate area. The green dots, of which there's 27 total, show the current Burlington Resource-operated producing wells. The red dots show the current Burlington Resources wells that are operated by Pogo but that we have a significant working interest in.

So once again, we have 27 direct-operated wells in the area, and we also have a significant working interest in 14 additional wells that are operated by Pogo.

Q. Are there any other operators in the pool?

A. There are two other operators in the pool. There are two minor wells operated to the south by Strata, and one lone well operated by Maralo, and -- Let me correct that. Between the difference between the October 3rd hearing and now, there's also three wells at the very bottom that do not have green dots on them. It would be the 3, going from left to right, the 1 and the 1. Those are all Yates wells.

Q. Mr. Seams, if this dispute about operations would be between you and Pogo, between Burlington and Pogo, would we be here today?

A. No, we would probably -- In fact, we would allow Pogo to go ahead and drill, complete and equip the well.

Q. Well, why are you so concerned, then, about having Penwell be the operator of the well?

A. Well, the comparison between Pogo and Penwell here is not a fair comparison. Pogo has extensive operations in this area, and we have worked jointly with Pogo to both reduce costs and also high-grade our geologic assessment of this area in order to minimize risk.

Q. Are there additional components that distinguish the Burlington operations in this immediate vicinity from any that Penwell might undertake?

A. Yes, there are.

Q. To the best of your knowledge, does Penwell have any operations in this immediate area?

A. The nearest operations that Penwell has to this are approximately four miles to the north in what's called their Diamondtail area. They have two wells there that are recently drilled.

Q. Let's talk about the operational aspects. If you'll turn to Exhibit 24 with me, help us understand the diagram that you're illustrating.

A. Exhibit 24 shows, number one, in the dotted red line, shows the current active Burlington Resources-operated leases.

There to the far south at the bottom of the page is our Mule Deer State lease, where we currently have six operated wells and one currently completing, which would be the Mule Deer State Number 7.

And then as we move to the northwest or up to the top of the page, the largest lease there is called our Checkerboard federal lease. And then on top of that would be the Red Tank federal lease and the Red Checker federal lease.

And to bring you back to a common point of reference as you move east of those leases is the Checkmate 24 Federal Number 1, denoted by the red, or maybe a purple, arrow.

Also shown on here are the active producing wells with the black spots and the well number. And then those lines noted by them are the active roads that we use in order to service those wells.

Q. What's the plan for taking production and produced water from the Checkmate 24 Federal 1 well if you're allowed to operate the well?

A. As you look at the Checkmate 24 Federal Number 1 well, with Burlington Resources as operator, we would then take this fluid down through a flow line and take it to our Checkerboard federal tank battery.

There's a couple things I'd like to bring up about having an existing tank battery here to process the fluid. Both -- Not only having a tank battery, we also have a LACT unit, and if you look to the north, up in our Red Tank federal lease, we also have our own proprietary saltwater disposal well.

Now, there's two key issues here of having our own tank battery when it comes to cost. The first key issue is that water trucking in the area costs on average about $1.40 to both truck and dispose of that water. With our saltwater disposal, we can dispose of this water for approximately 35 cents a barrel. Now, if we encounter a well that averages 50 barrels of water per day for the entire year, that's a savings of nearly $20,000 a year on a gross basis.

Now, the advantage of having a LACT unit is both from safety, environmental and cost. We receive a 25-cent-a-barrel premium on the price of crude here, due to having a LACT unit, because it alleviates the expense of trucking.

So with a, once again, a 100-barrel-a-day well for a year, we would then increase the revenue from that well by nearly $10,000 gross.

On the safety/environmental, once again we're able to keep the tank levels much lower by having a LACT unit continuously drain the tanks and not having to fill these tanks to full volume and then call out for a transport load to haul the oil off.

Q. If the Commission decides that Penwell should operate the well, then you will still have an interest in that production. Would you not, then, allow a nonoperated well to have access to your disposal system and other facilities?

A. No, we would not allow the disposal of nonoperated water into our saltwater disposal system.

Q. Well, are you just being ornery, or is there a good reason?

A. We have a significant amount of operations directly in the area and a very significant amount of water that goes into that saltwater disposal. Without having the direct control or operations over that produced water, we can't control the quantity or quality of that water that's going into our saltwater disposal. And we don't want to expose ourselves to the liability of losing that saltwater disposal, which really is able to maintain such low LOE base and able to continue production down to lower levels.

Q. What happens to produced water for wells that are not operated by Burlington? What is the alternative source for disposal?

A. Pogo also has their own saltwater disposal. The smaller operators in the area must truck their water.

Q. Okay, let's turn to the photographs, if you will. Let's take a few minutes and look at the illustrations that are displayed on the photographs, starting with 25. What are we looking at, and what does this mean?

A. The next four exhibits will all be photographs of the Red Tank federal area. And if I can, just looking back quickly at Exhibit Number 24, we showed the roads. These will be located up in the northern part, in the Red Tank federal lease.

In fact, all of these exhibits will be located around that blue triangle, that saltwater disposal. The pumping unit will be the Number 1 well there, and the tank battery listed right there will also be some pictures that we'll look at.

This is an example of some of Burlington Resources' operations directly in the area.

Q. All right. Exhibit 25 then?

A. Back to Exhibit 25, this is the Red Tank Federal Number 1 pumping unit. This is a Mark 456 pumping unit. As you can see, we've got a chemical containment vessel and then the safety measures, such as belt guards.

Q. Exhibit 26?

A. Exhibit 26 is a picture of the row of oil tanks. These are three 500-barrel, all-welded steel chrome-bottom oil tanks. And you can see, once again, for some of the environmental and safety aspects, we have some spill containment vessels out in front.

Q. Exhibit 27?

A. Exhibit 27 is the separation facilities at our Red Tank federal battery. And going from left to right, you see that we've got a 4-foot-by-20-foot and a 6-foot-by-

20-foot heater treater for the separation of oil and water.

And then as we move over to the right, in the background is a 30-inch-by-10-inch gas separator. And then in front of that is a horizontal free water knockout.

Q. And Exhibit 28?

A. The final picture is a good example of our proactiveness on managing this lease. The white box on the right is an electronic flow measurement device, which basically calculates the amount of gas sales that flows from this battery.

More importantly to me, when it comes to operations, is the box on the left. The box on the left is our facility alarm monitor. This monitors the entire tank battery for abnormally high or low levels and also power outages. And when it senses those, it uses the telemetry there at the top, and automatically calls the field supervisors or field foreman to come out and look at this battery for any potential problems.

Q. Let me have you help us put in perspective the time line, if you will, starting in 1993, so -- and going through 1997, so the Commission can see what's occurring in this area in terms of when the wells were drilled and what kind of initial potential they achieve.

If you'll do so by turning to Exhibit 29, help us illustrate that with your description.

A. Exhibit 29 is a bar graph of initial daily potentials based on the earliest wells drilled, being on the left, to the latest wells drilled, on the right.

The scale of this initial potential goes from zero to 500 barrels per day, with the highest of the bar graphs being, once again, that Red Tank Federal 24 Number 1 well, with an IP of nearly 450 barrels a day.

At the time that we initially submitted this AFE to C.W. Trainer, you can see that we had climbing IPs up to the 450 barrels a day, and we were very excited about this prospect.

Over the period of negotiations with C.W. Trainer, signified by the blue line at the top, you can see that we reached a period of 100-to-200 barrel-a-day-type IPs, with some variation within that.

And then over in the most recent time you can see that we've become very concerned about the economic sensitivity of this play with the declining well productivity.

Q. What, if any, concerns do you have as a petroleum engineer that if Penwell is allowed to operate the well, that these sensitivities of cost would be compromised?

A. We are concerned that with a higher well cost that, would Burlington not have an economic, viable project, we may lose what value that we feel is inherently there with the higher well costs. We feel that these are very much -- very cost-sensitive projects. And with the higher costs, both within the LOE and the capital side, we could lose that benefit of return.

Q. Let's turn to Exhibit 30 and look at some of the items of cost savings that you are examining, some of which I believe you've already initiated.

A. This is an exhibit that we also presented in front of Mr. Stogner, and this is an active program that we started in the summer of 1996, in order to further reduce our costs in the upper Bone Springs sand.

Now, we did this because we saw that we had to become very cost-sensitive in this area in order to maintain the economic viability of these.

At the time, our AFE costs that we also had sent to Penwell, was approximately $650,000. We then did detailed research in partnership with Pogo to find that we felt that we could reduce that AFE by another $74,000, thus extending the limits of the field and helping continue development.

Q. Does the AFE exchange between Burlington and Mr. Trainer back in 1995 come at a point in time before you and Pogo were examining and attempting to initiate cost savings in the pool?

A. Yes, it did.

Q. Let's -- We as lawyers talk with you as engineers about AFEs and their estimates, and things change, and whatever the actual costs, in fact, are going to be what's paid. Let's turn to that relationship, if you will. Let's look at Exhibit --

A. -- Number 31.

Q. -- 31, yeah, and let's talk about costs and how they're relating to this AFE discussion we're having.

A. Exhibit Number 31 shows with the red bar graphs -- These are the AFEs that we have submitted over time on the Checkmate 24 Number 1. At the far left is the original AFE that we had sent to C.W. Trainer for $699,000. As we go through time, going to the right, the next red bar chart in August of 1996 is the AFE that we had sent to Penwell for $652,000.

Now, in that period of time, we've since captured some of our cost savings plan, and I will tell you, we did not capture all $74,000. But we are on a plan to get to that target. We've since reduced that cost by an additional $32,000, to where our most recent AFE for this well is $618,000.

Now, can we do that in practice? The blue bar charts represent that in practice. To the south is our Mule Deer lease, and we have six existing wells there that are very similar to the Checkmate 24 Number 1 in both target, depth, and pumping and stimulation. Our initial Mule Deer well cost $762,000. Now, as we went from the Mule Deer 1, down through the 2, 3, 4 and all the way over to the right, to the final well, the Mule Deer Number 6, you can see that our final completed well cost is $565,000.

Q. In your opinion, is Penwell going to be able to achieve this success of cost reduction if they're allowed to operate?

A. My opinion is, they will not. This success is garnered from the history of being able to drill multiple wells in a common area and learn.

Q. Let's turn to Exhibit 32. What are you illustrating here, Mr. Seams?

A. Exhibit 32 is a detailed examination of any variation between Penwell's $649,000 AFE and Burlington Resources' most recent $618,000 AFE.

Now, all of the items on the AFE are not listed here. If the variance between identical items was less than $1000, I did not include those. I just wanted to show the items that did vary.

Now, these items are sorted from the highest variance -- From Penwell to Burlington, for instance, the highest variance is, Penwell has AFE'd nearly $31,000 in contingency, where Burlington has zero. Where, if you go to the bottom, it shows the highest positive variance for

Burlington, where we have approximately $19,000 charged out for our man-hours, to drill, complete and equip this well, but Penwell has approximately $2400.

Now, I won't bring out any specific point on this as being important, other than the sum total of all those variations is about $32,000, which boils out to be about the difference between those two AFEs.

I did take a very detailed look in this to see where those costs would vary and potentially why.

Q. The biggest accountable difference is the use of the contingency by Penwell of $30,000 and Burlington's practice of not using a contingency in the AFEs; is that right?

A. Yes, it is.

Q. Why have you chosen -- or why does Burlington choose not to use a contingency in its AFEs?

A. Originally, on some of our first wells, we would use some contingency. As we went through and we learned about these wells, of what exactly it would take to spend for these wells, we now have alleviated the contingency and feel very confident that the items we put down on the AFE are the actual items that will be spent, with very little over and above that.

Q. Is rig availability in the current market an issue of concern for engineers that are seeking to have their wells drilled?

A. It's very much an item of concern these days.

Q. And why is that so?

A. Rig availability has become a very difficult item to manage. The rigs are very much tied up, due to the effect of having significant higher oil and gas prices here recently.

Q. Do you have the good fortune at Burlington to have a rig available that can drill this well?

A. We do.

Q. And why is that so?

A. We have just completed drilling of our Mule Deer Number 7, and we are now drilling the well northeast of the Checkmate 24, and we would very much like to take that rig and drill the Checkmate 24 after it finishes drilling the northeast offset.

Q. Let me afford you an opportunity now, Mr. Seams, to summarize your conclusions from your engineering perspective and discuss with the Commission why you desire to have Burlington awarded operations, as opposed to Penwell.

A. I'd very much like to see Burlington awarded operations on the basis of two items, and those items would be minimizing risk, number one, and then lowering costs, number two.

We've proven throughout the history of our cooperation with Pogo that we can minimize the geological risk and high-grade these projects for all of the working interest owners.

On the object of costs, not only can we lower the capital cost of the AFE, but we can lower the cost of the daily operating expense on the LOE. We can get a little bit of revenue increase from having the ability to have our own LACT unit.

MR. KELLAHIN: That concludes my examination of Mr. Seams.

We move the introduction of his Exhibits 21 through 32.

CHAIRMAN LEMAY: Exhibits 21 through --

MR. KELLAHIN: 21 through 32.

CHAIRMAN LEMAY: -- 21 through 32 will be admitted without objection.

Mr. Carr?

CROSS-EXAMINATION

BY MR. CARR:

Q. Mr. Seams, could you tell me approximately how many Delaware/Bone Spring wells Burlington operates in this area?

A. In this immediate area?

Q. Yeah.

A. Twenty-seven.

Q. Twenty-seven. And those are the wells from which you've acquired this experience --

A. Uh-huh.

Q. -- is that right?

A. In this immediate area, yes.

Q. Prior to June of 1966 [*sic*] when you started working this area, what area did you work?

A. I worked -- I was the engineering liaison between Coastal Management, who operates the Waddell Ranch in central Crane County, and Meridian Oil.

And if I can just take a second to explain why that would be, we are the operator of record for the Waddell Ranch, yet we contracted out the daily operations to Coastal Management, and I was the engineering liaison to make sure that those ties were strong.

Q. And what formations were being developed out in that Waddell Ranch area?

A. There was multiple formations. There was 46 individual oil and gas pools within the Waddell Ranch, and I've watched individual formation, I would say 13-plus. We found two new ones while I was there.

Q. And how long were you on that project?

A. I was on that project for just a little over three years.

Q. If we look at Exhibit Number 21, how many of the wells actually on this exhibit -- on how many of those wells were you the engineer?

A. Approximately three.

Q. And who was the engineer responsible for this project before you?

A. The engineer prior to me for this project was Billy Juroska, and that would be the reservoir engineer.

Q. So -- And your experience has been on three wells drilled out here since June of 1996; is that right?

A. Could you repeat your question?

Q. Your experience on these three wells are wells that have been drilled since June of 1996?

A. My experience on these wells is both the records that we have, Mr. Carr. Now, as far as the wells that have been drilled during my tenure, yes, three wells.

Q. All right. Now, in drilling those -- If I look at your new AFE, you have reduced the size of tubular goods being used?

A. Yes, we have.

Q. How many of those three wells did you use the program that you're proposing with the new AFE, the slimholes?

A. The Mule Deer Number 6, which if it would please the Examiners, would be the foremost southern well in

Section 36, we have reduced ID tubulars.

If I might expound a bit --

Q. Let me ask you --

A. Go ahead.

Q. I mean, Mr. Kellahin can have you expound.

My question is really, have you used the identical casing program in that well that you're proposing now?

A. Yes, we have.

Q. Did you use 13 3/8 surface casing?

A. Yes, we did.

Q. Did you use -- I'm sorry, 9 5/8 surface casing?

A. Well, we have a very short string of 13 3/8, going to 9 5/8, yes.

Q. And did you use 8 3/4 intermediate casing --

A. I'm not sure --

Q. -- for an intermediate hole?

A. I'm not sure about that particular point.

Q. Did you use a 7 5/8 intermediate casing?

A. Once again, you're asking the same question. I'm not sure about that particular question.

Q. And do you know, was that a well on a federal tract?

A. Yes, it is.

Q. Okay --

A. Actually, no, that's a state tract, on the Mule Deer state.

Q. All right. If we go to Exhibit Number 22, I believe, referring to this exhibit, you stated that what you prefer to do is drill one well at a time; is that right?

A. Let me get Exhibit 22, please. Okay, go ahead, please.

Q. I think you testified while looking at this exhibit that what you do is drill one well at a time; is that right?

A. Yes.

Q. Then you evaluate that well?

A. Uh-huh.

Q. You get reserve information and decline information on the well; is that right?

A. No, it's not. Very much what we're looking for there is the geological interpretation. The time to gain the reserve and the production information is significant enough that if it's on the borderline, we'll wait for that data.

But very much if we get the geological data that we look for and we get a positive completion, we go with that.

Q. And so you would go forward without being able to estimate reserves or decline?

A. We feel pretty confident about estimating reserves from the open-hole logs, so we would have that number.

Q. And when -- You say you drill them one at a time. What are you talking about in terms of timing, drilling these individual wells? Do you drill them one right after another, just move the rig from one location to the next?

A. We have done that at times, yes.

Q. And is that how you typically go about developing the properties in this area?

A. What we typically do is, when we get a very positive response to a well, if we find a very good zone, we will immediately go to the next offset well. If we do find something is borderline or less than, then we will try to re-evaluate our direction.

Q. Ms. Swierc was talking about what you consider prudent, drilling one well at a time.

A. Uh-huh.

Q. That means that you drill one well and you might move the rig immediately to the next location; isn't that right?

A. Pending the results of the well that we just drilled, Mr. Carr.

Q. And it's not to suggest that you always sit back and take a look at the well. You just keep moving; isn't that fair?

A. Yes.

Q. If we look at Exhibit 23, you made reference to certain wells that were drilled by Yates. Could you identify those for me again?

A. I sure could. In fact, if we can look at Exhibit 22, it may be a bit clearer on there --

Q. Okay.

A. -- for the Examiners, please.

The three small green dots located there at the bottom, these are the Yates wells that has an IP of 108, going from left to right, 9 and 111, that would be the Thyme Number 3, the Thyme Number 1 and the Coriander AOC Number 1.

Q. The initial potentials, as shown on this bubble map, are what again? I'm sorry, Mr. Seams, I didn't hear.

A. The initial potentials shown on this bubble map are in barrels of oil per day.

Q. Okay, and they are what numbers?

A. For the Thyme Number 3, Mr. Carr, would be 108 barrels of oil per day.

Q. Okay, and then 9 on the next one and 111 on the next one --

A. Yes.

Q. -- is that what you're -- Is 111 a fairly good well?

A. That is something that's getting into the, what I would call borderline, for our economic evaluation. We get concerned at that level.

Q. Let's go to Exhibit 24. If I understand your testimony, what you're proposing to do is take production from the proposed well off lease and meter it over at your LACT unit; is that correct?

A. We wouldn't meter it at the LACT unit; we would meter it prior to entering the main tank battery facilities.

Q. Would it be on the lease?

A. It would be metered at the tank battery.

Q. And where is the tank battery? Is it on the lease?

A. The tank battery is located right there on the Number 2 location, which is on that lease, yes.

Q. Okay. Now, if under the joint operating agreement -- and I can tell you that the interest owners who haven't joined are intending to take their production in kind --

A. Uh-huh.

Q. -- will this facility work to permit them to take their production in kind?

A. It would depend on the type of contract that they signed for the LACT unit. If they intended on taking their production in kind through transport, we would need to add some additional costs for tankage.

Q. And that tankage isn't reflected in this proposal?

A. No. Now, if they did sign a contract that allowed them to take their production in kind to the LACT unit, it would be covered in there, yes.

Q. But if they were not willing to do that -- and I can tell you they are not -- then it would require additional tanks; isn't that right?

A. Yes, it would.

Q. Now, 86.6 percent of the saltwater produced from this well is saltwater attributable to other interest owners in the property; isn't that right?

A. Yes, it is.

Q. And it's not going to be taken and disposed of in your facility free of cost, is it?

A. We are going to charge 35 cents a barrel for a saltwater disposal fee, yes.

Q. And how will that cost be charged? Just as a separate billing back to these operators?

A. Yes.

Q. And does that fee include revenue to offset the costs of setting up the facility?

A. No.

Q. The facility will be made available free of cost, just a standard fee for use of that facility?

A. Yes.

Q. And how do you set that per-barrel figure? Do you know?

A. We set that per-barrel figure on the estimated cost that it takes for us to dispose of a barrel of water in this area, plus the annual maintenance that's involved with maintaining that system and well.

Q. And when you talk about cost for disposing a barrel, does that include any cost for the actual disposal well itself?

A. For the actual drilling and completion of it, Mr. Carr?

Q. Yes.

A. No.

Q. And those are billed outside and in addition to the overhead and administrative costs that are assessed by the operator?

A. Yes.

Q. Now, by using this facility, you testified that there would be, because of these facilities that you have, a savings; isn't that right?

A. Yes, I did.

Q. To whom do you sell the oil in the area?

A. I do not know the actual oil purchaser.

Q. You don't know whether or not it's sold to EOTT?

A. No, I do not.

Q. Do you know the prices received?

A. No, I do not.

Q. If the prices were substantially below what other operators could get for the product, wouldn't that be something you'd factor in before you decide that it's more economically desirable to sell through than to have you produce --

A. Very much so. It's not my capacity, though, as a reservoir engineer.

Q. Did you testify that if you were not the operator, that you would not make the disposal facilities available to Penwell; is that right?

A. Yes, I did.

Q. And so if you were not the operator you would bear your 13 percent of the trucking costs to dispose of the water; is that correct?

A. Yes, I did.

Q. And it's not because there would be any damage to your facility by making it available; isn't that right? I mean, you're not concerned about that?

A. We're very much concerned about that.

Q. And why are you concerned about it?

A. We're concerned about that -- Without direct control in the operations of the quality of the water that goes into that disposal well, we could potentially put that disposal well in inoperable use, which would provide a great amount of damage for other operations that are directly in the area that have very large volumes of water produced along with this.

Q. What do you do to the water that you produce before you inject it in your well?

A. We send it through our separation facilities for treatment.

Q. Again, if we look at all the paragraphs of the kind of equipment you have out there, if the operator -- if the owners have got 86 percent of the production from this well, require separate tankage, these facilities wouldn't work for that, would they?

A. Within the AFE, Mr. Carr, is an additional separation component that would augment this, so I want to tell you that, yes, they will work. I'll tell you that within the AFE we have additional separation facilities that has metering on the back side of it, that would then meter both the oil, the gas and the water volumes, that would then send it to the tankage --

Q. And so --
A. -- the sales.
Q. -- you would use this facility, and then you would add additional tankage?
A. If those owners wanted to sell through tankage.
Q. And I'm telling you that they do.
A. Okay.
Q. And you would add additional tankage, and then you would use these facilities; is that what you're telling me?
A. Plus additional separation facilities.
Q. So we would have additional separation facilities, as well as the tankage?
A. Okay.
Q. Is that what you're telling me?
A. Yes.
Q. If we go to your Exhibit Number 30 --
A. Uh-huh.
Q. -- and we look at this exhibit, these are potential savings, correct?
A. Potential savings --
Q. That's what they're styled. They're potential, they're not actual savings.
A. Please repeat your question.
Q. The savings that you indicate on this exhibit --

A. Uh-huh.

Q. -- the caption says they are potential; isn't that right?

A. Yes, it does.

Q. You may or may not be able to achieve them; isn't that right?

A. Yes, it is.

Q. And if we look at the casing and the $25,000 savings you're attributing to that, to get that savings you would have to be able to use the slimhole completion as reflected in your AFE; is that not right?

A. That's correct.

Q. Have you reviewed the federal requirements for drilling wells with the completion that you have proposed as a slimhole in this AFE?

A. I want to tell you that I personally have not. A member of our team in the drilling engineering group has.

Q. Do you realize that the intermediate casing would have an outside diameter of 8 1/2 inches?

A. I have not drawn that conclusion, no.

Q. Do you know that an intermediate hole of 3 1/4 inches with intermediate casing with an outside diameter of 8 1/2 inches only allows a quarter-inch clearance between the casing and the hole?

A. Once again, Mr. Carr, I haven't drawn that conclusion.

Q. Do you know that that's not allowed by federal regulations?

A. I haven't drawn that conclusion, Mr. Carr.

Q. If we go down to tubing, it talks about utilizing 2 3/8 production tubing on Delaware wells. We're talking about Delaware and Bone Spring?

A. Yes, we are.

Q. And it says IV Pronghorn. What does Pronghorn mean?

A. Pronghorn is a recent wildcat test that we had approximately three or four miles south of here that also utilized that slimhole-type design.

Q. If we go to, now, Exhibit 32 --

A. Uh-huh.

Q. -- that's the comparison.

A. Yeah, thank you.

Q. Do you know if that Pronghorn well is on a state or a federal lease?

A. I do not.

Q. I think you testified as a lead-in to this exhibit, the cost comparison, that you felt that your experience had caused you to bring the AFE costs down?

A. Yes, we very much did.

Q. If we go back to 31, the exhibit immediately

before, it's your original AFE, was for $699,200, correct?
A. Yes.
Q. And then if we go back to last August and we look at the AFEs that were being proposed at that time, your AFE was $651,700; is that right?
A. Yes.
Q. At that time, in fact, Penwell's AFE was even lower than the Burlington AFE; isn't that right?
A. By about $2000, yes.
Q. And your AFE figures have continued to come down?
A. Yes, they have.
Q. But as of August last year, in fact, even Penwell was coming in with an AFE that was comparable to what you were proposing for the well?
A. Yeah, and that's very interesting. That's why we built that detailed AFE variance sheet.
Q. Okay. And so if we go to the comparison of the AFEs --
A. Uh-huh.
Q. -- and we look at the first line, there's a zero contingency in your AFE, and $30,000 in the Penwell AFE, right?
A. That's correct.
Q. And as Mr. Kellahin indicated, here again, we're just talking about estimates?

A. Uh-huh.

Q. And that if a contingency fee is in an AFE and nothing happens that would require using those funds, then, in fact, the operator would not ultimately pay anything, right? It's just a cushion?

A. It is a cushion.

Q. And there is none in yours?

A. There is none in mine, that's correct.

Q. Now, have you ever had a situation where you've had to bill back an owner for, say, an escalation in water costs?

A. Yes, we have.

Q. And that's not covered in the AFE, is it?

A. No, it's not.

Q. That would be over and above it, correct?

A. Yes, it is.

Q. And if you had a contingency, that's where it would fall, correct?

A. Yes, it is.

Q. And without a contingency, it would just be an extra charge after the fact, right?

A. It would be an extra charge after the fact, but with our basis in the history of the wells that we've had, and seeing that we haven't encountered this extra charge, we have since concluded that we don't need to add that type of contingency for the extra charges you're alluding to.

Q. Okay, but if that occurred, you would have to bill it? It wouldn't be within a contingency?

A. Yes.

Q. And actually, what we're ultimately going to do is, whether Burlington is the operator or Penwell is the operator, we're going to pay on actual well costs, correct?

A. Yes.

Q. Fracture treatments. Have you had to, while completing a well, add additional money for a fracture treatment?

A. Yes, we have.

Q. And that would be something that's not reflected in your AFE, right?

A. In fact, sometimes gladly we have, where we encounter much more zone than we anticipated.

Q. And you're happy, but it isn't in the AFE, is it?

A. No, it's not.

Q. And you have to then charge that?

A. Uh-huh.

Q. Okay. If you -- I mean, we all know that an AFE is really your best guess, isn't it?

A. No. An AFE is your best guess, but it should be more than that; it should be an engineering estimate. And that's what we're trying to show here, is that the detail in the work that we've gone to has gone long -- far from a best guess. It's gone to a detailed engineering estimate of what it's going to take to drill, complete and produce the Checkmate 24 Number 1.

Q. But whether or not one operator thinks they should put a contingency and then another operator does not and would have to bill those things, that really doesn't determine whether that operator is prudent or imprudent, does it?

A. I think that, in its own right, does not determine prudency.

Q. You've got a number of zeros here. You've got a zero in your AFE for geological engineering. Are you going to have geological engineering on this well if you drill it?

A. We very much do.

Q. And that will be an in-house charge, will it not?

A. That would come out on what would be the G-and-A charge, yes.

Q. And what is the G-and-A charge?

A. It would be the administration and overhead that was alluded to with Ms. Swierc.

Q. It would be these overhead and administrative charges?

So just because it is zero on your comparison doesn't mean it's not going to be billed to Penwell and the other -- and the owners of the other 86 percent of the interest in the well?

A. That's true.

Q. If we look at title curative, again we have a zero. Will that be done in-house?

A. Yes.

Q. Okay. And so again, that would be an overhead and administrative cost?

A. Yes, it is.

Q. What are your overhead and administrative costs that you are proposing for this well?

A. If I could give that question back to Leslyn.

MR. CARR: Was that testified to earlier?

MR. KELLAHIN: Yeah, it was $5000 and $500.

Q. (By Mr. Carr) $5000/$500? Do you know what is being proposed by Penwell?

A. We're somewhere in the $400 range and somewhere in the $4000 range.

Q. Somewhat less?

A. Uh-huh.

Q. And so if we're going to try and determine what you're billing to the nonoperators, as opposed to what Penwell might bill to the nonoperators, we have to look at more than the AFE; we have to compare those other costs too do we not?

A. Uh-huh.

MR. CARR: That's all I have. Thank you.

CHAIRMAN LEMAY: Okay, thank you.

Commissioner Weiss?

EXAMINATION

BY COMMISSIONER WEISS:

Q. Yes, sir, Mr. Seams. Let's see, I have a question on the amount of water produced from the -- not the Delaware but this current zone in the Bone Springs, the sand, the upper sandbed.

A. The average production -- I thought this would be a good point to discuss. The average production for the Delaware wells in this area -- and I took the entire sampling of Delaware wells in this area, which was 68 of them -- is about 27 barrels of oil per day -- and this is today -- and 51 barrels of water.

Now, the average production for the existing upper Bone Spring sand wells is right at 27 barrels a day, also, out of a sampling of 20 wells, but only has about 5 barrels a day of water production.

Q. And then on your Exhibit 22, the bubble map, are the bubbles there proportional to the expense of the frac job?

A. I would like to say yes, but they're not. It really is -- The bubbles are in direct proportion to the size of the IP.

If the question is alluding to, does a bigger frac give you a larger IP, it's really much more related to the quality of the sand. We've had significant frac jobs. It's not part of this hearing, but in our Pronghorn well we had a much less IP.

Q. Okay. So are the frac jobs generally the same out here or --

A. The frac -- I'm sorry, go ahead.

Q. Go ahead, yes.

A. The average frac job out here has evolved from about 20,000 to 25,000 gallons to about 25,000 to 30,000 gallons.

Part of that is, we're learning better where to find the sweet spots of the field or the higher thick pay. And so those are going to garner a little bit higher volume frac job than the thinner spots.

And a little bit is, too, is, we get a little bit better well with a little more fracture fluid.

Q. And then you haven't addressed correlative rights. If we look at Exhibit 1, I guess that's the lease ownership, right?

A. Yes, sir.

Q. Is the green lease -- or -- Go ahead and find it.

A. Thank you.

Q. In Section 24, the green lease to the west of your proposed location there --

A. Yes, sir.

Q. -- is that draining the proposed location?

A. We don't estimate that these wells completely drain. They're 40-acre proration units, so we very much try to put these wells on -- within standard location parameters.

Q. So what's -- Answer my question, please. Is --

A. No, we don't feel that it's drained. In fact, that's very much why we'd like to drill it. We feel if we do, we'll find unique reserves and original reservoir pressure.

Q. So correlative rights is not an issue in this case?

A. No, I don't feel that it is.

COMMISSIONER WEISS: It's a business case, that's what I was trying to say.

Thank you, that's the only question that I had.

THE WITNESS: Thank you.

CHAIRMAN LEMAY: Commissioner Bailey?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. With the offset well production, do you see any

-- what is your estimated life expectancy of these wells?

A. Which one in particular?

Q. You said that the one to the west --

A. Uh-huh. Okay. The two wells to the west of the Checkmate 24 Number 1 would be the Red Tank Federal 24 Number 2, which is due west, and then the Red Tank Federal 24 Number 1, which is to the southwest.

The Red Tank Federal 24 Number 1 is actually a very good well. It had the highest IP in the upper Bone Spring sand, and it was later commingled with the Delaware. And to my last knowledge, it's been producing pretty well flat for about three years between the 40- and 50-, 60-barrel-a-day range, but I can't recall the exact number. But I would estimate its life to be greater than ten years.

The 2 is a little bit lesser quality of a well, and I would estimate its life to be somewhat less than ten years.

Q. Which is the one that Ms. Swierc was referring to when she said that production was decreasing to -- on those offset wells?

A. The ones, I think, that Ms. Swierc was alluding to has to do with the IP bar chart, if I can find that. It would be Exhibit Number 29. And if I'm recalling her testimony right, you can see that we had initial high IPs during the initial development of this field, and over the period of time you can see how the initial potentials declined, especially here in the later period of the field, we became very concerned about the economic viability.

Does that answer your question?

Q. I'll have to go back to transcript to see exactly what --

A. Okay, my apology if I didn't catch it right.

Q. So as I understand it, the expertise that's required is in the field operations, that there is no question about proprietary drilling or completion techniques that may or may not cause damage to the reservoir?

A. Yes.

Q. Referring to Exhibit 31, the comparable Mule Deer actual costs --

A. Yes, ma'am.

Q. -- why would the AFE for the Red Tank actually be $90,000 more in your AFE for August than what the actual costs were from the Mule Deer?

A. Okay, is that comparing our initial AFE estimate to the highest Mule Deer cost well?

Q. I'm looking at the February Mule Deer costs at $584,000 --

A. Yes.

Q. -- and the August, 1996, AFE at $651,000. So why is there such a discrepancy in what the actual costs are that you have in comparison to your AFEs?

A. On our Mule Deer Number 5, which would have been the $584,000 well, that well actually did take a little bit smaller stimulation, and these wells also did not require the facilities that the Checkmate 24 would require, due to the differences in ownership.

The Checkmate 24 would require an extensive flow line and additional separation facilities that would add to that cost.

COMMISSIONER BAILEY: That's all I have.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. Mr. Seams, I'm trying to get a fix on the Bone Spring production, upper Bone Spring sand. You say the ultimate primary recovery correlates pretty well with the initial potential?

A. I would probably say more loosely. There are some very high-IP wells that decline very rapidly, and then there are some very high-IP wells that do very well. But there is a loose correlation. It takes a high IP to make a good well eventually.

Q. What would you estimate recovery on that west offset to the high-IP well?

A. The direct west offset -- I'm sorry, the southwest offset would be the 450-barrel well. I'd estimate that to be over 100,000 barrels out of the Tresnor, which we call the upper Bone Spring sand.

Q. And how about the west offset?

A. The west offset, with a 141-barrel-a-day IP, declined very rapidly. I don't have the exact numbers on that, but I would estimate that to be somewhere around 50,000 barrels or less.

Q. How much does the Delaware contribute in terms of reserves to those wells if you commingle them, would you say?

A. The Delaware varies, but if you look at the average to the trend, the average in the trend is about 80,000 barrels from the upper Bone Spring sand and about 40,000 barrels in the Delaware.

But as you move east or west that can flip, because you get more Delaware as you move west, more upper Bone Spring sand as you move east.

Q. So here you're not anticipating much from the Delaware, more in the low range of Delaware contribution, and at the proposed location you're estimating low ranges of Delaware contribution?

A. Yeah, we're not estimating a very high chance of finding a prolific Delaware well.

Q. You're looking at how much of this proposed location? 100,000 barrels or -- You'd be happy with 100,000?

A. Yes, with our reduced costs, we would be happy with 100,000 barrels.

Q. You say -- When could you get a rig on location? You're drilling a north offset now?

A. Uh-huh. Yes, we are.

Q. You're move --

A. We're moving the rig currently, sir.

Q. How long does it take to drill a well?

A. It's going to take about 18 to 19 days.

Q. You could skid that rig south?

A. Yes.

Q. You would skid that rig south if you got operations?

A. Well, if we got operations, we would try to hold that rig in some shape, form or fashion to drill the Checkmate 24 Federal Number 1. If we had a significant delay in there, we are having requests from Pogo, the northern operator, if they can take that rig for a well while we waited on the time for the 24 Number --

Q. I guess the reason why I asked the question, I've heard -- We were just out in the oil patch, and they said you can't even get a rig until after April. I don't know -- the tightness out there, the infrastructure because of the high prices, I guess.

A. We've had this rig tied up since calendar year 1996, and we haven't wanted to let it go very much, due to that reason.

Q. Let me pose a couple hypothetical questions to you.

You indicated that you have no problem with Pogo drilling the well, had they been the -- say, the opposing force-pooling application. What would happen if -- hypothetically, if Pogo was given -- hypothetically, was given operations, but after 12 months they still didn't get the well drilled? Would you still feel the same way about Pogo?

A. We would begin to feel some frustration with the teamwork that we had established with them. We'd have to re-evaluate that. You have a good question.

Q. So you wouldn't necessarily support Pogo if there was a 12-month delay?

A. With a 12-month or longer delay, we would try to work to a solution.

Q. Which would involve what? Compulsory -- Would you want operations then, or would you --

A. It depends a lot, Mr. LeMay, on the conditions that go into it. If there's significant geological evidence that supports not drilling that well, then we'd like to evaluate it in teamwork fashion with them.

If there's evidence that Pogo just doesn't want to drill the well, yeah, we would go to force-pooling.

Q. But as far as the attractiveness of the location, has it varied through time, or has it always been an attractive location for the past -- whatever, 18, 12, 15 months?

A. It's been a very attractive location for the past year-plus. There hasn't been a lot of activity up in this area due to that leasing situation.

Q. But in your estimation, has it been drillable as a prospect all this period of time?

A. Yes.

CHAIRMAN LEMAY: That's the only questions I have.

Any additional questions?

If not, you may be excused. Thank you very much.

Let's break for lunch.

MR. KELLAHIN: What time would you like to come back?

CHAIRMAN LEMAY: One o'clock.

COMMISSIONER WEISS: Bill?

CHAIRMAN LEMAY: Yeah?

MR. CARR: My first witness will be Jerry Losee, and --

CHAIRMAN LEMAY: Yeah.

MR. CARR: -- Mr. Losee has a conflict. He's trying to leave.

CHAIRMAN LEMAY: Well, let's take Jerry then. If you don't mind. Are you through, Mr. Kellahin?

MR. KELLAHIN: Yes, sir.

CHAIRMAN LEMAY: Okay, let's -- You can start your case and Mr. Losee can present his testimony, and then we'll break for lunch.

MR. LOSEE: Appreciate it.

CHAIRMAN LEMAY: You bet.

<u>JERRY LOSEE</u>,

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

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your name for the record, please?

A. Jerry Losee.

Q. And where do you reside?

A. Artesia, New Mexico.

Q. Mr. Losee, are you a working interest owner in the acreage that is the subject of the captioned cases?

A. My daughters are actually the working interest owners.

Q. And what is your role in regard to these properties?

A. Well, as I explained to Penwell, the girls through me will actually participate in drilling the well if Penwell is operator. If not, they will farm it out to Penwell on the same basis that Mr. Trainer and Mr. Prince did.

Q. Have you been present for the testimony here today?

A. Yes.

Q. Initially, could you provide --

A. I've been -- That's not true, not all of it, but I've been present when Ms. Swierc testified about the --

Q. Could you provide the Commission with a brief history of your involvement with this lease?

A. Yes. C.W. Trainer contacted and asked some of us to participate with him in trying to buy this lease. It was competitive sale, and I believe 1989, you mentioned. I think the price was about $125 an acre, and a bunch of his friends or people he had promoted, including Prince, who incidentally lives in New York City, I understand, he used part of the money himself, and I bought an interest of 5.024, which is what it ended up.

A year or two later, or three, when it looked like it might be developed, I conveyed it to my two daughters, all of whom are at this point in their forties, or both of whom are. And when -- Well, Trainer then, the first thing about the acreage, I can't remember -- I'm going to guess it was 1992 or 1993. It got much hotter. There were some wells out of it that had been producing. They had got Delaware wells and also some Bone Springs.

And so he came up with a proposal to checkerboard 80s. The lease originally was in 23 and 24, and my recollection, it was nearly 1000 acres. He put the checkerboards out at $1250 an acre with a net 80-percent lease.

I told him that I was not interested, or the girls were not interested, in securing the money. My plan at that time was that they obtain an interest in production, which I hoped would last far longer than the money would.

And he sold the checkerboard 80s in Section 23 to Meridian, and I believe at the $1250 price, with the reservation of -- or an 80-percent net lease. He sold one 80. He had only one bid over in Section 24, is my recollection, and that was Pogo, and that's the price they paid for the lease, as I understand it.

Q. $1250?

A. $1250 an acre, yes, sir.

Q. Yes.

A. Eighty percent net.

Q. Was there a subsequent sale of the interests in this area?

A. Well, one outside of the girls' interest, and my interest later on, somewhere in 1984 -- if I said 1984, that's wrong. 1994. If I've been using "eighty", that's the wrong period. It's ninety.

Somewhere earlier, I think Meridian had offered Trainer $4000 an acre, and probably an 80-percent, although I don't have a recollection of that. Trainer decided he didn't want to sell. When he would get an offer, he would convey it to me.

By then, I think Meridian had purchased its 13-percent interest in all of the acreage, who were Trainer's original partner, and Trainer had purchased some, to bring his interest up to the 30-some-odd percent.

I told him I wasn't interested in selling, and I don't think he was, at the $4000 price. And maybe it was in 1993.

In 1994, as Meridian started drilling the wells and I guess Trainer either looked at his financial condition or looked at the wells, he took him up on the offer, with the rest of his acreage in Section 23. And it's my recollection that the price he got was the $4000 an acre, plus the 7.5 percent.

In the summer of 1994, after -- well, in 1993 --

Let me back up, I'll relate the -- In 1993, when Meridian proposed to drill the initial well, which actually turned out to be the Checkerboard Number 2, and it was, I believe, in the southeast quarter, southwest quarter, the girls farmed out their interest to Meridian for the best deal we could get, which was 1/8th override, gave them a 75-percent lease.

After that well was drilled -- and it was drilled to the Bone Springs, and I think they initially produced out of it. I think somewhere along the line they've plugged back, or maybe they've commingled. I do not know.

They proposed the Number 1, and the girls farmed out their interests to me, with a 75-percent interest, plus a back-in for 50 percent. The 1 -- 3 -- 1 well, Number 1, was drilled in 1993. It was completed sometime in May or June of 1993. Towards the end of 1993, they started the 3. They drilled successively, one right after the other, I believe, pretty close to it at any rate, the 3, 4, 5 and 6, in Section 23, Checkerboard wells.

Q. Did you participate in those wells?

A. I participated in those wells by signing the AFEs. And based on my conversation with Don Davis, and actually based on the correspondence, I would pay the actual cost of drilling. I did not -- I refused to sign a JOA without some material changes, and we never got one signed.

And the last of those wells, I think, the Number 6, say, was completed, I want to say, in May or June of 1994. And, you know, my relations with Don went extremely well. He would say, We're moving the rig and I'll get you an AFE. Do you want to join? And I said yes.

When he got around to the 6 I said, You know, I may farm that out to you. And then I disappeared on vacation. And then the next thing I know, I get back and the AFE is there and the well is actually down. And I had seen the logs on it; they sent me the logs. And I said, I'll do what you want. I told you I'd farm it out to you at 75 percent. I believe after payout their interest reduced to 70, or the girls' would. And it ended up, we decided to go ahead and participate.

Then along in July I had about $200,000 in the operation at that point, which is more than I would want to get in it, and I talked to Trey Shepherd, who -- I think that's probably the first time I visited with him. We talked about a farmout.

And then a few days later I got a letter, which I looked at the other day, going through my file. It was about August 1. He said, Here's the AFEs on the 7, 8, 9, 10 and 11, which we proposed to drill in this year, 1994.

I really wanted to wait and see what -- Some of these wells had already indicated they were falling off pretty good, and I kind of wanted to see if they were going to stabilize and get some estimate as to the reserves that might be under them. I thought if I went to the banker, he would kind of want to know that.

And when I became convinced that was their program, there wasn't anybody else in any of these wells, working interest owner, just Meridian and the Losees, and so I talked to him about selling it.

I reached an agreement with Trey -- maybe Don, I don't remember -- whereby I sold all of the working interest in the wells, my girls sold all of the back-in rights in the wells and reduced their override to 7.5 percent, and then they sold all of the rest of their acreage, undrilled acreage, in Section 23.

Q. And Mr. Losee, at this time do you own anything in the Checkerboard 23, 1, 3, 4, 5 and 6?

A. I own nothing. My girls own an override throughout that section of 7.5 percent, or their reduced portion of 7.5 percent.

Q. When were you asked to participate by Burlington in the proposed well?

A. I have no disagreement with Ms. Swierc's -- Do I pronounce it right, Swierc?

MS. SWIERC: Yes.

THE WITNESS: -- testimony as to, you know, you going back a year or so, and that's close enough to the dates.

Q. (By Mr. Carr) You also were asked to participate with Penwell, were you not?

A. Yes.

Q. And you have elected to go with Penwell?

A. Yes.

Q. Had you had problems with Burlington concerning well expenses?

A. Yes.

Q. What were those?

A. Well, I guess the first problem in realizing it was only the second well they had actually drilled, at least on the Checkerboard acreage.

The Number 1, which was the second one, the first well I participated, the AFE was about $845,000, and I knew it had exceeded the AFE tremendously. I refreshed my memory by looking at the file, and through December of 1993, the tangible and intangible costs of that well were $1.2 million.

I cannot tell you about how close the expenditures came on the 3, 4, 5 and 6, because by the time I got out, I was still getting invoices on those wells.

Q. Mr. Losee, I believe you testified you did not have a joint operating agreement for these wells with Meridian. Were there any conditions on your willingness to participate in the wells?

A. Well, my willingness was, I would pay the actual cost, plus a reasonable supervision charge.

Q. Were you actually billed the actual cost?

A. Well, I did not ever see the invoices. The only thing that I as a lay person in the area could determine is that the pipe charges were considerably higher, and if you go by a COPAS rate, they're going to be higher, simply because the COPAS rate for pipe is based on the east mill prices plus transportation. And I don't know anybody in our area, at least that I'm familiar with -- They buy their pipe off the west coast, Korea.

And the pipe charges on the Number 1 had exceeded -- oh, the surface pipe, by 15 or 20 percent. We got down to the production string, and it was, I think, 8 1/4 they had. And I looked at a couple of AFEs, as a matter of fact, the cost of some clients of mine at that time drilling Bone Springs wells, and same size pipe was $4.75. So I was nearly paying double the price.

I complained about it, called Don Davis, talked to him, and eventually I got a credit through on it several months later, probably latter 1993, early 1994.

I can't tell you about the other pipe -- the pipe charges on the 3, 4, 5 and 6, because I didn't have those analyzed by then.

Q. Did you have trouble receiving payment for production on the well?

A. Well, neither the girls, who still had an override under the first well, or myself got paid for -- They didn't get paid for the Number 2 on gas till the first part of 1994, some nine or ten months.

Q. Do you remember when the Number 1 well was completed?

A. May of 1993. I didn't get paid until May of 1994 for gas.

Q. In December of 1993, were your oil payments reduced?

A. Well, yes, they ran a charge through for gas and deducted off my oil payments for gas that I guess was produced from the Number 1 -- or Number 2 well, for which I had not been paid.

I need, Mr. Carr, to explain, and Commissioners, that Meridian maintains an owners' inquiry office in Fort Worth, and I got to know Mr. Tom Smith, who at least was one of the representatives, and he was very cordial and very helpful to the extent he could be. I had several conversations over many months trying to get the gas paid, and I'm sure he worked to try to figure out why I wasn't getting paid, or the girls either.

Q. Have you received balancing statements on casinghead gas from these wells?

A. I did, yes.

Q. Is that normal?

A. No, there wasn't a balancing agreement, and originally Mr. Smith explained to me that they weren't taking my gas.

And I said, I have a little difficulty understanding if -- you're lifting my oil, and you have to do that to get my gas.

But eventually we got -- We didn't ever get liquid payments, but we did get paid for the gas price.

Q. How did the price that Meridian was using for the oil production compare to other prices in the area, particularly Navajo's?

A. Well, through 1993 and 1994 they were selling the oil at one time, I believe, to Koch, and then eventually to EOTT, who I think was paying, as I understood it -- and this probably is my conversations with Mr. Smith -- based on the Koch postings. And Navajo's prices were running 25 to 35 cents a barrel higher for intermediate. By -- And I only got interested in this after Trainer started complaining that he wanted to take his oil in kind.

And he -- By the summer of 1994, Navajo's price differential between intermediate and Koch's had risen to 75 cents to a dollar a barrel higher. It was higher than what Meridian -- Meridian was using their posting, as I understood.

Q. You received statements with your payment vouchers from Meridian, did you not?

A. Yes.

Q. Did you have difficulty reconciling them?

A. Yes.

Q. What did you finally consider having to do to reconcile the information you were getting from Meridian?

A. Well, Meridian had a -- I say it's unusual, I have not seen it on any of the wells I have participated in.

But they had a theory that they actually estimated production towards the 20th of the month and made a payment, and then sometimes it wasn't -- they didn't correct it until next month, sometimes later on that month, and that was met by a bunch of negative numbers in their statement. And then they would positively pay what I assumed to be the accurate number.

But you could not balance -- I couldn't, at any rate, or my accountant really couldn't -- those numbers with the actual production figures on the wells.

Q. Did you look into a joint interest auditor to sort this out?

A. Yes, by the summer of 1994 I was convinced that I needed to do something to verify the cost in the wells, and the production, and I made some inquiry about could I find one and what would it cost to do so, to -- It's pretty hard to run a joint-interest audit with a 5-percent interest in the well, but I felt like that's the only way I was going to be satisfied.

Q. How many wells do you own working interest in, or have you owned working interest in?

A. Well, Mr. Carr, I cannot tell you, but somewhere, 60 to 80 or somewhere in there, I've participated and drilled.

Q. Is it unusual, in your experience, to have to look for an auditor to understand the payment information you're getting on your production?

A. Well, I haven't done it before. I haven't had to, I guess.

Q. In the summer of 1994, when you were looking into perhaps having to get an auditor, is that when Meridian proposed drilling the additional well?

A. Well, sometime in that time period, yes.

Q. Earlier today Ms. Swierc talked about it being prudent to drill one well -- it was prudent to drill one well at a time. What does that mean to you?

A. Well, I thought it meant that you drilled a well down and completed it and produced it for a while to determine what its flow rate would be, you could count on, and what the reserves might be. And I didn't have that information on the first six wells in the field in that Checkerboard lease. And I frankly wanted to wait a period of time.

Q. So at the time they proposed those wells, that's when you were looking for an auditor, and that's when they were proposing multiple wells at one time --

A. Yes.

Q. -- is that right?

A. And also, the other reason -- I mean, both of those are things that concerned me. And another reason that I sold out, obviously I didn't want to end up with -- in one year with about $400,000 in the wells.

Q. So you sold out?

A. Yes.

Q. Burlington then proposed an additional well?

A. I'm sorry, I didn't --

Q. And then Burlington proposed the drilling of this additional well, correct?

A. This one -- Yes.

Q. Yes.

A. That's right.

Q. And if the Oil Conservation Commission rules that they operate the well, will you retain any interest in the well?

A. I will not.

Q. Do you want to be in a well that is operated by Burlington, based on your past experience?

A. Well, I do not want to be a working interest owner if they do.

I have explained that -- or actually written a letter to Mr. Wheeler of Penwell that if they operate it we will participate, at least in the first two wells, and then I'll look at it. And if not, if Meridian's the operator, we'll farm out to Penwell on the same basis that Trainer did.

Q. You're willing to participate as a working interest owner in a well if Penwell is, in fact, the operator?

A. Yes.

Q. Was the purpose of any conveyance of your interest between your daughters and yourself ever to avoid a pooling statute?

A. Oh, no.

MR. CARR: That's all I have. Thank you, Mr. Losee.

CHAIRMAN LEMAY: Mr. Kellahin?

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Losee, I'd like a time reference. I think it was the second well you were involved in, was the one that was AFE'd for $845,000?

A. Something like that, yes.

Q. Do you remember the well? Which one are we talking about?

A. It's called the Checkerboard 1.

Q. Checkerboard 1.

A. Which was actually the second well drilled. That would have been in the northwest of the southeast quarter.

Q. All right, I was trying to put this in sequence by looking at Burlington Exhibit 29, but I've got the Bone Springs wells, and you were in a Delaware well, so that's not going to help me. What's our time frame?

A. Well, they drilled all of these wells, my recollection is, at least the first two or three or four was drilled into the Bone Springs --

Q. What's our time frame, Mr. Losee?

A. They drilled the 2 and the 1 in 1993.

Q. Okay. Those were the early wells, then, drilled in the area?

A. That's right. Well, the early wells on the Checkerboard.

Q. Yeah.

A. There's -- Yates has got wells to the east -- or to the west -- and --

Q. I'm looking at the Section 23 --

A. Yes.

Q. -- the properties to the west --

A. Yes.

Q. -- where you had an interest.

A. Yes.

Q. Did you ever have an interest in any of the Pogo-operated wells?

A. Only in these -- The girls have an override. I have no working interest in these two wells that are in 24.

Q. For Pogo, down in -- I think they were in another section to the south.

A. Well, no, Pogo --

Q. Pogo's got the wells in the --

A. -- the offset --

Q. -- southwest quarter.

A. -- to the proposed well.

Q. All right.

A. Yes. Yes, west half.

Q. After the initial wells in 1993 --

A. Yes.

Q. -- the costs have dropped appreciably for all the wells, have they not? The actual costs have been dropping, haven't they?

A. Mr. Kellahin, there's no sense in saying I can tell you, because at the time I sold out to Meridian, I was still getting tangible and intangible expenses charged to those -- for what are the 3, 4, 5 and 6, and I did not balance those out.

Q. Were you involved with Mr. Trainer in any discussions concerning the -- his counterproposal in May of 1995 for the well that's the subject of this hearing? Did you hear that earlier discussion?

A. Well, I talked to him, sure. I talked to him several times about all these.

Q. I assume you received Burlington's AFE in April of 1995 for this well?

A. Yes.

Q. And if my memory serves me right, you approved Mr. Trainer's AFE for --

A. That's correct.

Q. -- for the well in May of 1995?

A. I think that's right.

Q. You had elected Mr. Trainer to drill the well that we're still talking about today?

A. That's right.

Q. All right. This was at a time when you were concerned or had experienced the higher costs of the earlier wells that Burlington had drilled?

A. Well, I -- The only one that I could verify the costs, that I had verified it completely at that point, was the Number 1 well. The girls were in the Number 2 solely as override owners, so I didn't keep up with those costs.

Q. Okay.

A. And I had not run a running total on the 3, 4, 5 and 6, because I was still getting invoices on them.

Q. Is that the well that went down to more than 10,000 feet? That first well we're talking about? That was a deeper well, wasn't it?

A. I think most of those first two wells went to 10,000.

Q. Okay.

A. A little bit below them, I think.

Q. And that would explain some of the cost difference that we're seeing now, compared to then?

A. I think that's right. But I think the well was projected to 10,000 or more than 10,000, to the upper Bone Springs. I may be wrong on that too.

Q. All right. If your intent was not to be involved with Burlington as the operator of these wells, you had that opportunity when you signed Mr. Trainer's AFE to have him drill the well; is that not true?

A. That's correct.

Q. Did you pursue with Mr. Trainer having him commence drilling that well so you could avoid having Burlington operate the well?

A. I talked to him several times to encourage him to drill it himself, or get somebody to drill it for him.

Q. And he never got around to it, did he?

A. He never got around to it. I can't tell you whether it was financial or if he was too busy doing other things or -- but I did encourage him to -- Of course, as hindsight tells me, the price of oil has gone up, and it may have been worthwhile for everybody to have delayed a year, looking at crude oil.

Q. The interest involved, I believe -- I've forgotten the exact details, but my recollection is that Penwell acquired Mr. Trainer's interest in -- after being served with a force-pooling order in this case, Penwell acquired Mr. Trainer's interest by paying him $100 an acre and receiving a 75-percent net interest. Were you made that same proposal by Penwell?

A. Yes, but I think it was -- I had forgotten the hundred bucks an acre, but it was a 75-percent on the first well, and payout increased to 72 percent net revenue, and it was 72 on the rest of the wells.

Q. And am I correct in understanding that about in

September of 1996, you afforded Mr. Wheeler of Penwell the option to either allow you to participate in the well or to sell your interest, your daughter's interest?

A. I think the option was up to me, depending on who operated it, Mr. Kellahin.

Q. Okay. Mr. Losee, let me show you the letter you wrote Mr. Wheeler. I've read it as carefully as I can, sir, and I find nothing in here that describes the contingency that you have just stated. It appears not to have a contingency about whether or not Penwell is elected the operator. Let me let you look at that.

A. Mr. Kellahin, I think that's -- the letter correctly recites exactly what I sent to him. The basis of this letter and the fact that it was facsimile-transmitted is that Mr. Wheeler said before they went in to commit themselves on it, they wanted to know that the girls would go along with a proposal.

And my explanation to him, although not in this letter, on the telephone, was, if you all drill it, I will participate at least in the first two wells. As a matter of fact, the JOA which he sent included all of the lands in Section 24, and I said, all I'll sign one well on the east half of the southwest, in that 80-acre tract.

Q. Have you recently received multiple proposals from Penwell for other wells in the section?

A. I've got a whole bunch of permits to drill on the rest -- I imagine on the rest of the acreage, yes.

Q. Permits to drill filed by Penwell --

A. Yes.

Q. -- on the rest of the acreage --

A. Yes.

Q. -- in Section 23?

A. Yes.

Q. I'm sorry, Section 24?

A. Yes.

Q. All right.

A. And I have no commitment to do anything one way or the other on those.

Q. All right. You've seen copies of Penwell's applications for -- APD for the additional wells in Section 24. Have they submitted to you yet well proposals or AFEs?

A. I don't think I've seen any AFEs at all on any of those wells.

Q. How are you going to handle the subsequent proposals from Penwell for the section? Are you going to deal with these one at a time or --

A. That's my intention, yes.

Q. That's your methodology?

A. Yes, I'd like to look and see what happens when we drill the first one, and...

Q. Disputes between an operator and a nonoperator in a well sometimes are resolved simply by taking -- the nonoperator taking their share of production in kind; is that not true?

A. Yes.

Q. All right. And am I correct in understanding that if the Commission allows Burlington to drill this well, that that is the option that you will choose in this circumstance, would be to take your share in kind? Is that not true?

A. If Burlington operates?

Q. Yes, sir.

A. Well, I won't be participating. My girls would simply participate on an overriding royalty basis, and if Burlington is going to keep on selling it at Koch's prices, then yes, I'll explore the right for the girls to take it in kind.

Q. All right. Describe for me what it is that you have by terms of your farmout from your daughters. Do you retain any interest?

A. Well, as far as -- I have a farmout from them --

Q. Yes, sir.

A. -- which, if Meridian operates it, I'm going to cancel the farmout.

If Penwell operates it, then I'll take the farmout, which is -- Penwell would get a 75-percent net revenue lease, or I would get a 75-percent, excuse me, not Penwell. And the girls would have their share of a 12.5-percent royalty. They would back in for a 50-percent interest.

Q. Am I fair in characterizing that your difficulty with Burlington is with regards to marketing and accounting issues, as opposed to drilling, completing and the operation of the facility?

A. Well, the answer is yes. I am really not myself qualified to complain about the operations, and I think in fairness to Meridian I will explain that my relationship with Don Davis, who was doing the land work, originally was very good and he tried to be very helpful. I felt the same thing about their owner-inquiry man, Tom Smith, and as a matter of fact, the engineer at the time was Kevin --

Q. -- Metcalf, I think.

A. -- Metcalf, and Kevin couldn't have been more helpful.

But they really didn't have a lot of control, I felt like out of -- You know, they could listen to my complaint and try to get it straightened out. Sometimes it was accomplished very quickly, but sometimes it wasn't.

But I haven't -- I can't tell you about the operations. I'm not qualified to, Mr. Kellahin.

Q. All right. That concern about the accounting and the marketing issues were directed to the wells in Section 23 at a point in time in which the early wells were drilled; is that not true?

A. Yes, I haven't had any accounting since then --

Q. All right, sir.

A. -- problem.

MR. KELLAHIN: No further questions, Mr. Chairman. Thank you.

CHAIRMAN LEMAY: Thank you, Mr. Kellahin.

Commissioner Weiss?

COMMISSIONER WEISS: I have no questions.

CHAIRMAN LEMAY: Commissioner Bailey?

COMMISSIONER BAILEY: No questions.

CHAIRMAN LEMAY: Gosh, that got a bunch of them, Mr. Losee, but let me just -- I'm trying to get to the bottom of this.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. Is it really -- You got a better deal from Penwell than you got from Meridian, and that's -- the farmout sounds better than the force-pooling or --

A. Well --

Q. Meridian wouldn't deal with you on your interest in this section to your liking? I mean, $500 an acre isn't acceptable?

A. Meridian didn't offer -- Well, back up.

My recollection is, in my conversation that Ms. Swierc talked about in August or September, I asked them, would they consider a farmout for a 75-percent net lease and back-in? I said, You all probably won't give the girls the same back-in I will, but I'd like to know what back-in you would get.

I think she said, I'm not sure we'll give any, but I'll see.

And I think that's our last conversation. Maybe she turned me down. I'm not sure; I don't want to say she did. I didn't feel like I was, but I -- The next thing I got was the force-pooling application.

Q. But your deal from Penwell is definitely a better deal for you all than any deal you could make with Meridian, as far as retained interest and money?

A. Well, I did not offer -- Penwell's deal is a 75-percent, the first well, back-in, increase your override from 12.5 to 15.5, and on the other subsequent wells in the section 15.5 and $100 an acre.

I don't know whether that's better or worse than Meridian, but at least I felt like they would have a better control over the income, and hopefully we would be able to get away to get the price of the oil at something commensurate with Navajo's prices, rather than Koch's, which -- and I really haven't looked at the girls' last invoices, so I don't know where they're selling to those people.

But that's the reason I preferred, and still do, that Penwell operate the well.

Q. Yeah, that's what -- I thought because of those economic factors the -- You said Trainer got $4000 an acre from Meridian. That was, I guess, in Section 23, where the offsetting Delaware well is not -- I mean, the quality was better in Section 23 or something?

A. Well, I think -- I can't -- My recollection at the time he sold the 20 for $4000 -- and I can't tell you the time certain -- I think they had drilled through the 6. I think the northwest quarter, I don't believe, had a well in it, but that may be wrong too, Mr. LeMay. It was in 1994.

Q. But there were those prices floating around, but it wasn't in an area where the production looked like it would be better than maybe --

A. Oh, yes, yes, sure.

Q. You mentioned $1250 an acre, 80 percent net revenue. That's what Pogo paid, so -- In 23?

A. Yeah -- well, no, in 24, but that's what Meridian --

Q. In 24.

A. Meridian paid -- Trainer had two sales to Meridian in 23.

Q. Uh-huh.

A. The first one was that -- He offered to a lot of companies, Meridian, Pogo, and I'm sure he solicited Yates and a bunch of others.

Q. Yeah.

A. He made an offer that he'd sell it for $1250 with an 80-percent net revenue.

Meridian took him up on the Checkerboards in 23 --

Q. Uh-huh.

A. -- Pogo took this 180 in 24 --

Q. Uh-huh.

A. -- and that, I think, was probably in 1993, early 1993.

In 1994, Meridian bought the rest of his 80s, in Section 23, at $4000 an acre and with an 80-percent net revenue lease.

Q. Okay. Yeah, I think --

A. But there was some development at that time --

Q. Yeah.

A. -- Mr. LeMay, to answer your question.

Q. Yeah, okay. The last question I've got is trying to gauge your frustration with Trainer, the fact that he didn't drill the well between the period we issued the force-pooling order giving him the rights to drill the well, May, 1995, to August, 1996.

How would you characterize your posture? Were you anxious to get the well drilled? Was it kind of, Okay, C.W. is my friend, I'll see -- You know, he may not have the ability to drill, so he might have to find someone who can handle that kind of bucks for him.

Were you all kind of together, looking for an operator? Or was this -- Was your impression that C.W. was going to drill that well with his money, and you would participate?

A. Realizing that C.W. had gotten the deal together from the beginning, realizing that I'm not in the business of promoting oil and gas wells -- although I've participated for a great number of years I've never promoted any -- and I wanted the well drilled. At least at the point -- Well, I guess Pogo had finished their second well out there, and it seemed logical that it would be drilled. I got some numbers from Pogo, as to the -- what the wells look like. And I wanted to drill.

I probably talked to C.W. sometime in that year period, between 1995 and 1996, one or two times, but it's something -- You get busy and you don't talk to him. I was slowing down in my practice and wondering a little bit more. But I thought that he would either get the financing or find something to drill it. That's what I wanted him to do, one or the other.

Q. Were you frustrated with him that he couldn't do it during that period of time?

A. Yeah, that's probably a reasonable description of it, Mr. LeMay.

CHAIRMAN LEMAY: That's the only questions I have.

Anything else?

COMMISSIONER WEISS: No.

CHAIRMAN LEMAY: Thank you, Mr. Losee. You may be --

THE WITNESS: I take it I can be excused?

CHAIRMAN LEMAY: You can be excused.

Let's pick up again at 1:30.

(Thereupon, a recess was taken at 12:20 p.m.)

(The following proceedings had at 1:45 p.m.)

CHAIRMAN LEMAY: Are we ready to proceed? I think, Mr. Carr, you were finished with your first witness, were you, and were about to call your second at the last break?

MR. CARR: Yes, Mr. Chairman, and my second witness is Mr. Mark Wheeler.

MR. KELLAHIN: Mr. Chairman, before Mr. Carr starts with his next witness there's a matter of housekeeping.

I had Mr. Losee authenticate a letter to Mr. Wheeler. It's Exhibit 33 by Burlington. We would move the introduction of Burlington's Exhibit 33 at this time.

CHAIRMAN LEMAY: Without objection, Exhibit 33 will be entered into the record. Thank you, Mr. Kellahin.

You may proceed, Mr. Carr.

MARK WHEELER,

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

DIRECT EXAMINATION

BY MR. CARR:

Q. Will you state your name for the record, please?

A. Mark Wheeler.

Q. Where do you reside?

A. Midland, Texas.

Q. By whom are you employed?

A. Penwell Energy, Incorporated.

Q. What is your current position with Penwell?

A. Land manager for the Permian Basin.

Q. Have you previously testified before this Division?

A. Yes, I have.

Q. At the time of that testimony, were your credentials as a petroleum landman accepted and made a matter of record?

A. Yes, they were.

Q. Are you familiar with the Application filed in this case?

A. Yes.

Q. Are you familiar with the status of the lands in the subject area?

A. Yes, I am.

MR. CARR: Are the witness's qualifications acceptable?

CHAIRMAN LEMAY: His qualifications are acceptable.

Q. (By Mr. Carr) Mr. Wheeler, could you briefly review for the Commission what it is Penwell seeks with this Application?

A. Penwell seeks to be named operator and pool all minerals from the surface to the base of the Bone Springs formation under the northwest southeast quarter of Section 24, 22 South, 32 East, Lea County, New Mexico.

Q. And this unit will be dedicated to what well if you are successful?

A. Our Checkers 24 Federal Number 1 well, which is located at a standard 1980 feet from the east and south lines of that section.

Q. Is this the same location proposed by Burlington?

A. Yes, it is.

Q. Could you refer to what has been marked for identification as Penwell Exhibit Number 1, identify it and review it for the Commission?

A. This is a land plat that shows the acreage in yellow, which Penwell owns an interest in. It also shows our proposed Checkers 24 Federal Number 1 location and shows development in the area.

Q. And what is the primary objective in the proposed well?

A. Bone Springs formation at approximately 9000 feet.

Q. Can you identify what has been marked as Penwell Exhibit Number 2?

A. Exhibit Number 2 is our proposed operating agreement dated September the 10th of 1996, covering, in addition to this location, the remaining -- the remainder of the acreage shown in yellow on the previous exhibit.

Q. Does this exhibit contain an ownership breakdown showing the ownership of the northwest of the southeast of 24?

A. Yes, it does. Exhibit A to this agreement shows the interest broken down between Penwell, Burlington

Resources and Mr. Losee.

Q. What is the relationship between Penwell and CoEnergy?

A. CoEnergy Central Exploration is our financial partner who finances all of our drilling in New Mexico and other parts of the country. There's not been a single prospect that we've been involved with in New Mexico that CoEnergy is not also involved with.

Q. And what percentage at this time of the working interest has been voluntarily committed to Penwell's proposal for this well?

A. 86.599 percent.

Q. Can you identify what has been marked Penwell Exhibit Number 3?

A. This is a copy of Penwell's proposed AFE for the Checkers 24 Federal Number 1 well.

Q. Would you review the totals set forth on that exhibit?

A. The dryhole cost is $330,000, and the completed well cost is $649,320.

Q. Is this the same AFE and the same figures that were presented to the Examiner in the hearing last fall?

A. Yes, sir, it is.

Q. Are these costs in line with what has been charged by other operators for similar wells in the area?

A. Yes, as well as wells that we have drilled to similar depths.

Q. And these are higher than the AFE figures that were presented here today by Burlington, $618,400?

A. This is higher than the last AFE that we received from Burlington.

Q. Approximately how does it compare with the AFE that was presented last fall by Burlington?

A. The new Burlington AFE is approximately $30,000 to $35,000 cheaper.

Q. And how did your AFE compare to Burlington's last fall?

A. This AFE to their previous one, we were slightly cheaper, by $2000 or $3000.

Q. Could you summarize the efforts that have been made by Penwell to obtain the voluntary joinder of all working interest owners in your proposal for this well?

A. Since our entry into this prospect in early September of 1996, we immediately contacted both Burlington and Mr. Losee, and we obtained the joinder of all parties except Burlington. We have attempted to continue to obtain joinder of all parties, but thus far we've been unable to. We've visited Burlington's office, we've talked to them on the phone several times, and of course we had our hearing.

Q. When were you first contacted by Mr. Trainer about this development or this particular piece of property?

A. Mr. Trainer approached us in early September and came to our offices, I believe on September the 4th.

Q. And what happened at that time?

A. Well, he told us that he had been in this acreage -- in this area, not just this particular acreage, but in this area, for quite some time and bought the original lease and had turned property previously to Meridian and also to Pogo and had had some wells drilled.

He commented on the Checkerboard that he sold. And in fact, when I used to work at Maralo, Incorporated, Maralo looked at the Checkerboard that Meridian ended up buying.

He said that he had sold that and ended up selling the alternate Checkerboard also to Meridian for quite some sum of money, and he -- but that he had been served with a force-pooling notice and that he did not desire to participate if Burlington was going to operate, and therefore would like to sell his interest in the wells and just retain an override.

Q. And when did you reach an agreement with Mr. Trainer for the acquisition of this property?

A. Shortly thereafter. I think we actually closed that in the latter part of September.

Q. And then how soon thereafter were you able to get the Losee interests committed?

A. Actually, we started visiting with Mr. Losee -- It took a while to get the purchase closed, but we in essence had a deal made to purchase the Trainer and Prince interests, so we began to -- we visited with Mr. Losee, as well as having a visit with Burlington in their offices to discuss drilling this well, and --

Q. What did you get from Trainer and Prince? An assignment?

A. We got an assignment of operating rights, yes, sir.

Q. And has that been filed with the Bureau of Land Management?

A. Yes, it has.

Q. Has that also been recorded in the records of Lea County, New Mexico?

A. Yes, it has.

Q. Has Penwell drilled other Bone Spring wells in this immediate area?

A. Our closest production is approximately four to five miles to the south of this area. We have a large Bone Springs field that we're developing just across the line in Eddy County, and we're currently drilling our sixth well in that field, and we've also participated in several other ones.

Q. When did Penwell first become involved in New Mexico, approximately?

A. Well, Penwell -- Probably the latter part of 1995 was the first time they had participated in any wells or any acreage in New Mexico.

Q. And at this time, how many drilling rigs does Penwell have going in this state?

A. In New Mexico?

Q. Yes.

A. The last time I checked, we had either seven or eight, depending on whether they had actually completed one of the wells.

Q. And if you are designated as operator will you have any opportunity going forward with the drilling of this well in the immediate future?

A. Yes, we would plan on drilling this well immediately. We have rigs committed to us and available.

Q. Can you identify what has been marked as Penwell Exhibit Number 4?

A. This is just a compilation of letters to Mr. Losee, and letters to and from Meridian or Burlington to Mr. Trainer, and then also to us.

Q. This morning you were present for the testimony of Ms. Swierc, were you not?

A. Yes, I was.

Q. Do you have any real disagreement with the time frame that she set out in her presentation?

A. No, I do not.

Q. Have you made an estimate of the overhead and administrative costs to be incurred while drilling this well and also while producing it if you are successful?

A. Yes, sir, we have. $4178 a month during the drilling and $440 a month when it's producing.

Q. And what is the source of those figures?

A. We used the Ernst and Young figures from the 1995 estimate. I believe that at the time this operating agreement was proposed, the percentage of increase that's allowed under COPAS had not been -- had not come forward at that time, but the numbers that we used were the 1995 numbers.

Q. Does Penwell recommend that these figures be incorporated into any order which results from this hearing?

A. Yes, we do.

Q. Were Exhibits 1 through 5 prepared by you or compiled at your direction?

A. Yes, they were.

MR. CARR: At this time, may it please the Commission, we would offer -- or move the admission into evidence of Penwell Exhibits 1 through 5.

CHAIRMAN LEMAY: Without objection, Penwell Exhibits 1 through 5 will be admitted into the record.

MR. CARR: And that concludes my direct examination of Mr. Wheeler.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Wheeler, I have a copy of the Ernst and Young 1995 book. Are you aware of what the 1996 schedule is going to provide for the average of well costs?

A. We have been told that the increase is 4.1 percent for 1995, so these figures plus 4.1 percent would probably -- I have not seen the 1996 book, but I will assume that's what will be in there.

Q. I'm going to show you a copy of the book here. It's the only copy I have. Apparently Ernst and Young, on the basis of tabulating 98 wells in the category between 5000 feet to 10,000 feet for 1995 has a mean average for drilling monthly rates of $4178. That's what you used?

A. Yes, sir.

Q. You did not use the median, which was the $4500 number?

A. Our agreement with CoEnergy Central provides that we use the mean and not the median.

Q. All right. And the monthly producing well rate, the median is $450 and the mean is $440?

A. Yes. And we used the mean also. I have the same book.

Q. Okay, you have the same book? All right.

Do you participate -- not you, your company. Does your company participate with Pogo in any of the wells in the area?

A. No, sir.

Q. I have your Exhibit 1 here, which is your locator map.

A. Yes, sir.

Q. The area shaded in yellow on Section 24 is the area where you have acquired interests from Mr. Trainer and Mr. Prince?

A. Yes, it is.

Q. Have you also taken it upon yourself to file applications for permits to drill on those tracts, other than the subject well we're dealing with?

A. Yes, sir, we have.

Q. And has your company filed applications for permits to drill on all six of the remaining 40-acre tracts in Section 24?

A. Yes, sir, we have.

Q. You've done that, haven't you?

A. Yes.

Q. You've staked those locations, have you not?

A. Yes.

Q. You staked those locations before you proposed those additional six wells to Burlington, who will be one of the interest owners in those spacing units? You chose to do that, didn't you?

A. That's typically what you do, is stake them, in order to get a permit.

Q. Have you yet sent Burlington well proposals and AFEs for any of those six wells?

A. Yes, we have all six.

Q. And all those six APDs -- AFEs and well proposals were submitted to Burlington after you filed for permitting the well?

A. Yes.

Q. Did you send all those to Mr. Losee as well?

A. Yes, we did.

Q. Okay. Are you familiar with the Division's order that was entered on November 26th of this year in this case?

A. Yes, I am.

Q. Let me show you a copy of it, Mr. Wheeler, and ask you to turn to page number 5. Now, you filed the applications for a permit to drill and submitted the AFEs and well proposals after the entry of this order; is that not true?

A. I believe that our correspondence -- I don't have the correspondence that went out. I believe that the AFEs went out prior to this order. There was quite some lag period between the hearing and the order, and I believe that the AFEs went out during the interim before November 26th.

Q. Were you undertaking that activity for these additional six wells with regard to the fact that the Division was finding it significant in Burlington's behalf that they were the first interest owner to propose a well in a spacing unit?

A. I had no way of knowing until the order came out what the Commission was finding.

Q. Were you operating under knowledge of the Division's guidelines for settling and resolving compulsory pooling cases? Did Mr. Carr give you that guideline?

A. I'm aware of the guideline. I don't know if I understand the question.

Q. All right, you're aware of the guideline. Are you aware the guideline contains a provision giving advantage to the working interest owner which first proposes a well?

A. I am aware of that provision, yes.

Q. Do you have a copy of what Ms. Swierc sponsored as her Exhibit 13, which is the confirmation of the verbal agreement that you made with Mr. Trainer by a letter dated September 10th, 1996? Do you have a copy of that, Mr. Williams?

A. I don't know if I have one handy. I know I've got one.

Q. All right, sir, let me give you my copy. Now, the assignments that you received from Trainer and Prince, what's the date that you recorded those two assignments in Lea County?

A. I don't have the exact date in front of me. We closed that particular deal the latter part of September and recorded them -- In fact, I believe, when we had our hearing on October the 3rd, those assignments had been sent for recording, so it must have been the latter part of September.

Q. Okay. Am I correct in understanding that all your transactions with Mr. Trainer occurred after August 30th of 1996 and after he had received notification that he was being subject to a force-pooling application filed by Burlington?

A. He came to us after he received that --

Q. All right.

A. -- order, after he received that notice, yes.

Q. This letter agreement of September 10th is the document by which the assignments are made? Let me say that a different way.

If you satisfy the terms and conditions of this letter agreement, did that earn you the assignments?

A. Well, that -- Yes, that and paying him the sum that we owed him, we would earn an assignment, yes.

Q. Okay. Did you have to satisfy all the terms and conditions of this letter agreement in order to get Mr. Trainer and Mr. Prince to sign those assignments?

A. No.

Q. Are those assignments contingent upon any of the conditions of this letter agreement?

A. No, they're not.

Q. So you've undertaken some other solution to achieving the assignments, other than for filling the terms of this letter agreement?

A. The assignments were prepared and paid for and recorded while we continued to see who would be designated operator.

Q. Okay. Is Penwell obligated to reassign these interests to Mr. Trainer or to Mr. Prince in the event the Commission does not award operations to Penwell?

A. No, that is at our option.

Q. Okay. So Mr. Trainer and Mr. Prince can't trigger that?

A. No, sir.

Q. Can Mr. Prince or Mr. Trainer require you to reassign the interests to them in the event you fail to spud the well by a particular date?

A. Yes, sir, if we do not drill a well, then we would have to reassign to them.

Q. All right. What is --

A. But if the well is not drilled, it doesn't have to be drilled by us, but if a well is not drilled.

Q. All right. Is there a new time deadline? November 15 is long gone. What's the new deadline?

A. We have not formally extended it. I've been in continuous contact with Mr. Trainer since our first hearing on October the 3rd. He was aware that we were waiting on the order after the order was issued. In late November I made him aware of the order and told him that we were planning on filing for *de novo*. He suggested that that was an excellent idea and that we continue along that basis.

Q. Okay. On page 2 of the letter agreement, Mr. Wheeler, in paragraph number 7 --

A. Yes.

Q. -- the letter agreement says, In the event that

Penwell is unsuccessful in obtaining operations -- it says for all wells drilled in the acreage described in A, and that is for the area shaded in yellow? Yes, it is, isn't it?

A. Yes.

Q. So that it covers more than just the subject well; it's the rest of the wells drilled on the yellow acreage?

A. That is correct.

Q. If you're unsuccessful in operating those wells, then you, Penwell, has the option to withdraw from this agreement, and you have no obligation to Trainer?

A. Yes, sir, we --

Q. What's the status of that?

A. We did not want to have an 81.575-percent interest in this acreage and not be able to operate.

Q. Okay. So you still have available to you the contingency under this agreement where Penwell could reassign the interests back to Trainer and Prince at your election if you don't get operations?

A. That is correct.

Q. All right. Has Penwell made a decision about what to do with regards to re-assignment of the interests for the tract that's the subject of this well?

A. Not until this matter is resolved, no.

Q. All right. So you still have the option to return to Trainer and Prince the interest acquired at least for this tract?

A. Yeah.

Q. Let's talk about the relationship with CoEnergy. What is CoEnergy?

A. CoEnergy is a subsidiary of Michigan Consolidated Natural Gas out of Detroit. They are a large -- the largest gas distributor and utility in Michigan, and they maintain an investment vehicle through CoEnergy in oil and gas properties, exploration throughout the United States.

Q. In the State of New Mexico, CoEnergy is not operating interests for their own account?

A. CoEnergy does not operate anywhere, to my knowledge.

Q. In New Mexico, their arrangement between Penwell and CoEnergy is that you are going to be the operating entity or the operating partner, if you will?

A. Yes, that's correct.

Q. Under that arrangement, is CoEnergy's funding of your participation in this well conditioned upon Penwell being the operator of the well?

A. Not necessarily. The priority in our arrangement with CoEnergy is that Penwell operate, but there have been other circumstances where we have not been the operator, and CoEnergy has participated along with us.

Q. By my count, in Lea County I think you have about 11 wells that you operate.

A. That's probably pretty accurate.

Q. And of those 11 wells, is CoEnergy a funding partner in all 11 of those wells?

A. Yes, they are.

Q. And in each instance they've funded, and you have been the operator?

A. In Lea County, I believe there's a well that Santa Fe Energy operated on our Drover prospect. I believe that the other wells -- I'd have to look at a list, but I believe that the other wells are all Penwell-operated.

Q. So they have made at least one exception you're aware of?

A. They've made several exceptions.

Q. Have they made an exception on this well at this time?

A. No, not until this matter is resolved.

Q. Okay. If CoEnergy elects not to fund their interests, then they acquire no interest in the well?

A. That's correct.

Q. And that entire percentage interest now is up to Penwell to fund?

A. That's correct.

Q. Do you intend to fund your share of the well?

A. Yes, we do.

Q. Even if CoEnergy doesn't participate?

A. Well, CoEnergy has signed our AFE and has signed the prospect summary which triggers their participation in the prospect.

Q. All right, let me turn it around the other way then.

A. I assume that if we are not named operator, they will still participate.

Q. All right, that's an assumption at this point?

A. Yes.

Q. So you know they've committed to your AFE, and so if you're the operator, you know that you only have to pay the cost-bearing share of the well?

A. If we're the operator, we will pay the -- yeah, the cost-bearing share that we discussed, 12.3, whatever, 12.23 or something.

Q. But there is no commitment yet about what happens if the Commission confirms the Examiner order unless Burlington operate?

A. There's no final determination, although again I believe since they've signed the prospect summary, that they will participate.

Q. Even though Burlington might be designated as the operator?

A. That's correct.

Q. All right. Let me make sure I understand. Is Penwell prepared to fund the entire percentage that would otherwise be shared with CoEnergy if Burlington is named operator?

A. I believe so, yes.

Q. Mr. Wheeler, let me show you what I propose to introduce as Exhibit 34. You recognize this billing statement?

A. Yes, I do. I prepared it.

Q. All right. It's dated September 30th, 1996, is it not?

A. Yes, it is.

Q. And in fact, you sent this to the interest owners that would pay for the Checkers well, which is the subject well we're debating?

A. Yes, I did.

Q. And you submitted that to Burlington prior to the hearing we had before Examiner Stogner?

A. Yes, I did.

Q. Under this calculation, when I compare the interest percentages on Exhibit 34 to Exhibit A attached to your proposed operating agreement, which is part of Exhibit 2, there's some differences in the percentages, and I want to make sure the Commission understands those.

A. Okay, if you add Penwell and CoEnergy Central's interest together, that would be 81.575 percent, which is shown in Exhibit A.

Q. Okay.

A. The reason the operating agreement lists Penwell instead of Penwell and CoEnergy is, at the time the operating agreement was prepared, CoEnergy had not signed our prospect summary agreeing to participate in the well, so at that point it was all Penwell's interest.

Q. All right.

A. And, record-titlewise, remains all Penwell's interest. We still have not assigned to CoEnergy.

Q. Okay. When we look at Exhibit 34, it shows that Penwell's going to pay for 12.24 percent, if you will, of the actual costs of the well; is that not true?

A. That's correct.

Q. Part of that calculation is the result of the fact that CoEnergy is going to carry a certain portion of Penwell's interest down to the casingpoint election; is that the way I understand it?

A. It actually is through the tanks of the well.

Q. Oh, through the tanks of the well, they're going to pay your share?

A. Yes.

Q. Okay. And when we look at the paying share that Burlington is going to have, they're going to be paying 13.4 percent?

A. That's correct.

Q. And then Mr. Losee and his daughters have the other 5 percent?

A. That's correct.

MR. KELLAHIN: Mr. Chairman, we would move the introduction of Exhibit 34.

MR. CARR: No objection.

CHAIRMAN LEMAY: Exhibit 34 into the record.

Q. (By Mr. Kellahin) Have we covered all the items on Exhibit 13, the letter agreement of September 10th, 1996, in terms of any contingencies that are not yet discussed here this afternoon?

A. Well, there's a continuous development program which Penwell will have to prosecute in order to maintain their interests that they purchased from Mr. Prince and Mr. Trainer, so that is a contingency.

Q. You've got 180 days between wells; is that what this is?

A. That's correct.

Q. All right. Mr. Wheeler, I believe you told me at the last hearing that you found it significant that Penwell's gross interest was substantially larger than

Burlington, and urged the Examiner to decide the case based upon that difference; is that not true?

A. That's correct. Our funding from CoEnergy is no different than the funding Burlington receives from internally. Everything we do in New Mexico, CoEnergy is involved with us on, if they choose to be, as they have here. So in my mind, CoEnergy and Penwell are one entity. They certainly have an election to do something different, but to date they have not. They use our expertise.

Q. What has been your practice or Penwell's practice in the reverse situation, where Penwell and CoEnergy have a minority interest? What do they do in terms of operating the well or participating with a majority owner in those operations?

A. To my knowledge, thus far, we have -- the operations where we have a minority interest have been the ones that we have not ended up being operator generally. I don't know that's the case in every situation, but -- I'd have to look at those individually. But the majority of our prospects, we are the largest owner, at least 50 percent or larger.

Q. On behalf of Penwell, have you advanced the proposition that Penwell, having proposed the well, should be the operator, even though you have a minority interest in the spacing unit?

A. Not to my knowledge, not when you take Penwell and CoEnergy together.

Q. All right. Let me see if I can refresh your recollection.

Let me show you what I have as a December 19th, 1996, well proposal to Ms. Swierc, over your signature, in which Penwell is proposing a Morrow gas well in Section 33, 19 South, 33 East, Lea County, New Mexico, and you attach a proposed operating agreement. And if you'll turn to Exhibit A you'll find that Penwell's interest before the tanks is only 3.75 percent, compared to the Burlington interest which is 50 percent.

A. Penwell and CoEnergy together have 25 percent. Our partner in the lease, Santa Fe Energy, has 25 percent. So Santa Fe has backed Penwell as operator of this particular prospect. So in this particular prospect we're at 50 percent and Burlington is at 50 percent.

Q. Do you have a commitment in writing from Santa Fe to participate with you in this well?

A. No, we do not at this point have a commitment in writing for them to participate. However, at the time Santa Fe entered into this acreage we had an understanding that Penwell would operate.

Q. Is that understanding to such a specific extent that contractually you can commit Santa Fe's interest over their objection in this particular prospect?

A. No, I submitted this AFE and this operating agreement to Santa Fe Energy at the same time I submitted it to Burlington. But because of our previous verbal agreement, I anticipate Santa Fe signing our AFE and operating agreement.

Q. Have you had any conversations with Santa Fe about their willingness to participate with you in this?

A. Not since I sent this letter, no.

Q. You told me your nearest operations were what? Four or five miles away?

A. To the south, yes, sir.

Q. Tell me again in what pool that's located?

A. We call the wells Diamondtail. I don't know that that's the official pool name, but they're in Section 23 of 23-32.

MR. KELLAHIN: Okay. Thank you, Mr. Chairman.

CHAIRMAN LEMAY: Were you going to submit that as an exhibit, what you were talking about, that --

MR. KELLAHIN: If you please, I have it marked, and I need to mark some copies. It would be Burlington Exhibit 35, if you please, Mr. Chairman.

CHAIRMAN LEMAY: Commissioner Weiss?

COMMISSIONER WEISS: I have no questions.

CHAIRMAN LEMAY: Commissioner Bailey?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. There was some discussion earlier that Meridian would be using EOTT and Koch for purchase of the oil. Who would Penwell sell to?

A. I don't know that that decision has been made at this point. We have sold production to various purchasers. I believe that -- I know that in the property to the south, that's four or five miles to the south that I was discussing, we sell to Navajo, but I -- for the oil. I do not know that they would necessarily be the purchaser here. But since they purchase in that same area, probably so.

COMMISSIONER BAILEY: That's all.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. Mr. Wheeler, J prospect, did you originate it?

A. Yes, I did.

Q. Okay. What do you call this prospect, the Trainer prospect?

A. Checkers.

Q. Checkers. Did you originate this?

A. I didn't orig- -- I mean, Mr. Trainer originated it --

Q. Okay.

A. -- by bringing it.

Q. Okay. So there's a difference. You came there with this one, your geology, your idea. Do you want to join us, Burlington? We've got 50 percent, you've got 50 percent.

Here -- I'm trying to get this thing in perspective -- Trainer comes to you. Was this deal on the street before it hit you, or did you -- I mean, here -- C.W. has got 14 months, doesn't get the well drilled, gets a request from Burlington, Hey, I'm going to drill unless you do.

He's pretty desperate. He comes -- I mean, I would assume he is. What's -- How did you get involved in this? I know C.W. came to you, but did he come to you and others in Midland, trying to get the thing sold?

A. I don't know whether we were the first ones to look at it or not. I think your categorizing him as desperate is probably a pretty good --

Q. Okay, thank you.

A. -- categorization because --

Q. Okay.

A. -- he suggested at that meeting some of the same concerns that Mr. Losee had --

Q. Okay.

A. -- about his previous dealings with Meridian.

Q. So you're kind of there for C.W., to get the job -- to preserve his rights under our initial force-pooling order, or trying to resurrect that force-pooling order because he --

A. There was no force-pooling order at the time Mr. Trainer brought this to us, Mr. LeMay. The first order that's been issued on this particular location is the one that we're discussing today, that was done in November of 1996.

MR. KELLAHIN: May I take a moment and clarify something?

CHAIRMAN LEMAY: Yes.

MR. KELLAHIN: I think you've misunderstood something.

CHAIRMAN LEMAY: Yes.

MR. KELLAHIN: In April of 1995, Burlington sent a well proposal and an AFE to Trainer and Prince.

Mr. Trainer countered in May of 1995 and said, Here's my AFE on your proposal; sign it and let me operate.

CHAIRMAN LEMAY: I'm sorry, I said force-pooling, but I mean, by agreement, Trainer had operations --

MR. KELLAHIN: That's right.

CHAIRMAN LEMAY: -- on the prospect between May, 1995, and August, 1996.

MR. KELLAHIN: Exactly right.

CHAIRMAN LEMAY: There wasn't a force-pool -- I said force- -- but I meant --

MR. KELLAHIN: It's not a force-pooling.

CHAIRMAN LEMAY: Not a force-pooling.

MR. KELLAHIN: It was a voluntary agreement --

CHAIRMAN LEMAY: A voluntary agreement. He had the majority of interest; it was agreed that he would operate the prospect.

Everyone is shaking their head, so that was --

MR. KELLAHIN: Yes.

CHAIRMAN LEMAY: -- at that period of time.

MR. KELLAHIN: Yes, sir.

Q. (By Chairman LeMay) And then time ran out or -- so to speak? And that's why you -- kind of desperate to get the job done?

A. Well, with all due respect to Mr. Trainer, what he did was really none of our concern. When he approached us and said, My interest is available, we would like for you to purchase it, we would like for you to see what you can do in working in Meridian, because I do not want to -- or Burlington at the time.

We looked at it and we said, Yes, we're interested in it. We contacted Mr. Losee. He immediately agreed to sign our AFE and participate with us. So we were prepared to move forward and drill the well.

So I don't think Penwell should be judged by what

Mr. Trainer did. We entered into this prospect as a good-faith purchaser, and immediately upon our entry into the prospect, we prosecuted getting this well drilled with the 86 percent that we had committed, as soon as we possibly could.

Q. Yeah, I wasn't questioning anything as far as the integrity of -- I mean, please don't misinterpret the question.

I was trying to get the chronology of events and also the agreements as they existed then. And I understand from your response that if you don't get operations you can reassign, or at least --

A. We have that option.

Q. -- get out of the deal, I guess --

A. We have that option.

Q. -- if you don't get operations? Okay.

You have rigs in the area, you're qualified to operate, you're willing to pursue the prospect. And you view this as -- How important are operations to you? Pretty important?

A. Well, they're important in our relationship with CoEnergy. But more importantly here, we represent, even without Mr. Losee, nearly 82 percent, 81.5 percent of the cost of this well. CoEnergy is counting on us. And with that kind of percentage in a $600,000 or $700,000 well, we feel like it's incumbent to try to operate that and do the best job we can at controlling our costs and also accounting for production properly and everything that we normally do.

Q. Do you think with a 180-day continuous development clause -- it's kind of a -- two clauses, as I understand; it goes back -- proration units go back if they're not developed -- that you'll have enough time to evaluate the previous well before you're obligated to drill the next one?

A. Yes, sir, in this area -- I'm not a geologist, but in this -- We do have a geologic witness. But in this area there's enough well experience, enough wells that have been drilled, that we feel like we can evaluate fairly quickly whether or not we want to drill under the continuous-development obligation.

Q. Does your operating agreement -- or have you seen it and compared it to the operating agreement of Burlington? Do they both have -- I just looked, like a hundred/three hundred on the nonconsent provision to the operating agreement?

A. I believe that's correct, they both have the same --

Q. And that's agreeable to you and also to Burlington, I assume?

A. Yes.

Q. So that part -- If you've got to hurry up and drill the wells because of the continuous-development clause, the other parties in the deal can go nonconsent on a 300-percent basis?

A. That's correct, under our proposal, yes.

Q. Yeah, okay.

A. And theirs.

CHAIRMAN LEMAY: And theirs, yeah. Thank you, that's it.

Any other questions of the witness?

That's all I have, thank you. The witness may be excused.

Mr. Carr?

MR. CARR: At this time we call Mr. Thoma.

<u>JOHN THOMA</u>,

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

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your name for the record, please?

A. John Thoma.

Q. Where do you reside?

A. Midland, Texas.

Q. By whom are you employed?

A. Penwell Energy.

Q. What is your current position with Penwell?

A. Geologist.

Q. Mr. Thoma, have you previously testified before this Division?

A. Yes, I have.

Q. At the time of that testimony, were your credentials accepted and made a matter of record?

A. Yes, they were.

Q. You've also testified before the Commission?

A. Yes, I have.

Q. Are you familiar with the Application filed in this case?

A. Yes.

Q. Have you made a geological study of the area surrounding the proposed well?

A. Yes, I have.

Q. Are you prepared to share the results of that study with the Commission?

A. Yes.

MR. CARR: Are the witness's qualifications acceptable?

CHAIRMAN LEMAY: His qualifications are acceptable.

Q. (By Mr. Carr) Mr. Thoma, let's refer to what has been marked as Penwell Exhibit Number 6. Do you have that in front of you?

A. Yes.

Q. Would you identify that and review it for the Commission?

A. Exhibit Number 6 is an isoporosity map of the upper Bone Springs Avalon sand, which is the sand, upper Bone Springs reservoir, that was shown on Mr. Thomerson's exhibit and was referred to as the Tresnor sand. It's the same reservoir, different name, local name.

The color coding is as follows: The red markers are proposed and/or drilling possibly industry locations. The green dots are producing or wells that have production-tested the Avalon sand. The yellow shown in Section 24 is the Penwell leasehold. And the proposed location, the Checkers 24 Federal Number 1, is shown with the blue diamond, heavy blue dot, in the northwest of the southeast of Section 24.

The balance of the triangles, numbered Number 2 through 6 -- or rather 7 -- are proposed permitted -- approved, as far as permitting is concerned, locations that have been staked by Penwell.

Q. Basically, what does your geological study tell you about the risk associated with the development of this prospect?

A. The risk associated with the prospect is fairly high. This map is -- it is a 10-percent isopach, using a 10-percent porosity cutoff, and so it shows a little bit greater continuity than does Burlington's map of the overall sand trend.

The better part of the risk in exploring for this sand is not necessarily penetrating the sand but in establishing commercial production from the sand.

There are critical net thickness cutoffs. There's great divergence on how much -- between geologists on how much net pay you need to establish commercial production. When I say "commercial production", I mean a well in the range of 80,000 to 120,000 barrels.

Q. In your opinion, is there a chance at this location you could drill a well that would not be capable of commercial production?

A. Yes, there is.

Q. Are you prepared to make a recommendation to the Commission as to the risk that should be assessed against any nonconsenting interest owner in the Penwell well?

A. Yes.

Q. And what is that?

A. 200 percent, plus cost.

Q. Does Penwell seek to be designated operator of the well?

A. Yes.

Q. In your opinion, will the granting of this Application and the drilling of this well be in the best interest of conservation, the prevention of waste and the protection of correlative rights?

A. Yes.

Q. Was Exhibit 6 prepared by you?

A. Yes, it was.

MR. CARR: At this time we wold move the admission into evidence of Penwell Exhibit 6.

CHAIRMAN LEMAY: Without objection, Exhibit 6 will enter the record.

MR. CARR: And that concludes my direct examination of Mr. Thoma.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

Mr. Kellahin?

MR. KELLAHIN: No questions. Thank you, Mr. Chairman.

CHAIRMAN LEMAY: Commissioner Weiss?

EXAMINATION

BY COMMISSIONER WEISS:

Q. How were the contours generated on Exhibit 6, or whatever it was? Six.

A. By hand.

COMMISSIONER WEISS: By hand. Quite a

difference.

That's the only question I had.

CHAIRMAN LEMAY: Commissioner Bailey?

COMMISSIONER BAILEY: I have no questions.

CHAIRMAN LEMAY: Are you going to have an engineer --

MR. CARR: Yes, I am.

CHAIRMAN LEMAY: -- following this? I have no questions. Thank you very much.

MR. CARR: At this time we would call Mr. Bill Pierce.

BILL PIERCE,

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

DIRECT EXAMINATION

BY MR. CARR:

Q. Would you state your name for the record, please?

A. Bill Pierce.

Q. Where do you reside?

A. Midland, Texas.

Q. Mr. Pierce, by whom are you employed?

A. Penwell Energy, Incorporated.

Q. And what is your position with Penwell?

A. Senior operations engineer.

Q. How long have you been employed by Penwell?

A. One year.

Q. Prior to your tenure with Penwell, for whom have you worked?

A. I worked for a major, Mobil Oil Corporation, and then two independents.

Q. And who are they?

A. Mewbourne Oil Company, and then for a while I did consulting work for the Forest Oil Corporation group.

Q. Has the geographic area of your responsibility for these companies, as well as Penwell, included southeastern New Mexico?

A. Yes, sir, they have.

Q. Have you been personally involved with the drilling of Delaware and Bone Springs wells in southeast New Mexico?

A. Yes, sir, I have.

Q. How many of these wells have you personally been involved with?

A. Over 100.

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

A. Yes, sir, I am.

Q. Are you familiar with the Burlington Application and the documents that relate to that Application?

A. Yes, sir.

Q. And have you reviewed those documents and are you prepared to make certain recommendations and observations to the Oil Conservation Commission?

A. Yes, I am.

MR. CARR: Are the qualifications of Mr. Pierce acceptable?

CHAIRMAN LEMAY: His qualifications are acceptable.

Q. (By Mr. Carr) Initially, Mr. Pierce, how many rigs do you have drilling in New Mexico at this time?

A. As of this morning, we have six.

Q. And would you have any problem of having a rig immediately available to drill this well, if authorized by the Oil Conservation Division?

A. No, sir, we would not.

Q. Let's go to what has been marked as Penwell Exhibit Number 7, which is a copy of the AFE of Burlington, dated early December, 1996. Do you have that in front of you?

A. Yes, sir.

Q. How does this AFE actually differ from the previous AFEs you've received from Burlington on this well?

A. The main difference I could determine, Mr. Carr, was in the tubulars that they intend to run, versus what they originally had proposed in their first AFE to us.

Q. And what are those changes? Can you be more specific?

A. Yes, sir, in the original AFE they had proposed surface casing of 13 3/8 diameter, followed by intermediate casing of 8 5/8, with a long string or production casing of 5 1/2 inches in diameter.

The new AFE submitted to us, they report to us that they would like to set 9-5/8-inch surface casing, 7-5/8-inch intermediate and 4-1/2-inch production casing.

Q. Okay. How large will the intermediate hole be under their current proposal?

A. It will have to be -- Based on what they've submitted, it can't be any larger than 8 3/4.

Q. Now what is the OD, outer diameter, of the 7 5/8 inch casing?

A. The OD of a 7 5/8 casing coupling is 8 1/2 inches.

Q. And that would be run, according to their proposal, in an 8-3/4-inch hole?

A. That is correct.

Q. Does this give you any concern as a drilling engineer?

A. Well, to begin with, Mr. Carr, the federal government, according to Mr. Joe Lara of the Carlsbad BLM office, they will not approve such a configuration on federal land.

Q. And why is that? Did he tell --

A. Because it does not give enough clearance for cement between the OD of the casing coupling and the borehole.

Q. In your opinion, is this a prudent way to complete a well in this area?

A. No, sir, it absolutely it is not.

Q. And when did you check with them on this matter?

A. Tuesday, I checked with Mr. Lara.

Q. Do you have any other concerns about the new AFE?

A. Well, one thing I noticed is -- It's not unusual for someone to drop a pumping unit size one size, but in this instance they have gone from a 912-size pumping unit down to a 456, and I'm not sure I really understand why they could drop a unit two sizes. That's a significant difference in production capabilities between a 912 and a 456, and I'm not sure I understand how they can do that. So...

Q. Is there anything in the current AFE that would provide -- from Burlington, that would provide for any separation equipment?

A. In the original AFE they did not provide for any separation equipment. In the new one they did provide for a heater treater, but they still have not provided for additional tanks to hold the oil from this particular well.

Q. If Burlington is the operator of this well, will Penwell and CoEnergy desire to take their share of production in kind?

A. Yes, sir, we will take our production in kind.

Q. Will you require that it be placed in a tank battery on the lease?

A. Yes, sir, we will.

Q. Is there anything in the AFE, as presented by Burlington, that would provide for the tanks that are necessary for this kind of an arrangement?

A. I couldn't find one, Mr. Carr.

Q. When was this AFE provided to Penwell?

A. I think we actually received ours in our office -- The week of the 21st, thereabouts, is when we actually received this AFE.

Q. And your Exhibit Number 7 is from the files of Penwell?

A. That is correct, yes, sir.

MR. CARR: Mr. Chairman, at this time I would offer into evidence Penwell's Exhibit Number 7.

And that concludes my direct examination of Mr. Pierce.

CHAIRMAN LEMAY: Okay, Mr. Carr. Without objection, Exhibit Number 7 of Penwell will be admitted into the record.

Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Are you familiar with the pumping capacity of the 456 unit?

A. Yes, sir.

Q. And what is that, sir?

A. Well, it depends on what kind of tubing you have in the hole, Mr. Kellahin.

Q. All right. And have you figured out what its capacity is with this wellbore configuration?

A. With this one of their latest AFE --

Q. Yes, sir.

A. -- or their original AFE?

Q. With the latest.

A. The latest AFE would allow them to move approximately 250 to 300 barrels a day.

Q. Under the prior configuration, how much fluid can you move?

A. They could move probably in excess of 600 barrels a day.

Q. Are you aware that the average fluid rate for the upper Bone Springs wells in this area is only 32 barrels?

A. Of total fluid?
Q. Yes, sir, a day?
A. Yes, sir, and that's why we wondered why they gave us such a large pumping unit size to begin with.
Q. But then you've just criticized them for dropping the pumping size.
A. Exactly, they can't seem to figure out what size they really need out there.
Q. But did you figure out with Mr. Joe Lara at the BLM why he approved this same slimhole configuration for Burlington in the Pronghorn well, and now he tells you he won't do it for this well?
A. Is the Pronghorn federal or state?
Q. Federal, sir.
A. Mr. Joe Lara said he would not approve this configuration.
Q. So he didn't explain to you the fact that they had already approved and Burlington was using this type of configuration on a federal lease?
A. No, sir, he did not.
Q. He didn't explain to you why they are now inconsistently telling you something that they now let us do?
A. No, sir, he did not.
MR. KELLAHIN: All right, no further questions.

CHAIRMAN LEMAY: Thank you. Commissioner Weiss?

EXAMINATION

BY COMMISSIONER WEISS:

A. Yes, sir, Mr. Pierce, what's your opinion on the aspects of drainage out here in this area by these two wells that are producing on the Pogo well?

A. Well, it has been our experience, or my personal experience over the years that some Bone Spring and some Delaware do have difficulty draining 40-acre oil spacing units.

COMMISSIONER WEISS: Thank you.

CHAIRMAN LEMAY: Commissioner Bailey?

EXAMINATION

BY COMMISSIONER BAILEY:

Q. The question of saltwater disposal came up earlier.

A. Yes, ma'am.

Q. What would be the plans for saltwater disposal?

A. Well, originally we had planned to approach Burlington to see if we could dispose of the water from this lease into their disposal system, but of course quite obviously that has changed, which now leaves us with no resource but to truck the water.

Q. And are you looking at $1.40 a barrel?

A. Mostly, the water hauled in that area goes from

$1.00 to $1.40 a barrel, yes, ma'am.

COMMISSIONER BAILEY: That's all.

EXAMINATION

BY CHAIRMAN LEMAY:

Q. Mr. Pierce, you've been around a while.

A. Yes, sir.

Q. You've been involved in lots of wells, I'll bet.

A. Yes, sir.

Q. What's been your experience with joint operation? What's a prudent time frame for an operator to get a well drilled if you're in partnership with them because of communitization?

A. From the time a well is first proposed, the industry, over the years, Mr. LeMay, has been anywhere from 60 to 90 days, from the time a well is actually proposed until it's actually spudded.

Q. And something that goes longer than that, how would you characterize it?

A. Obviously, the parties involved have problems, either financial or operational differences. You know, there can be various things to delay the drilling of a prospect.

CHAIRMAN LEMAY: Thank you, no further questions.

MR. CARR: Nothing further.

CHAIRMAN LEMAY: You may be excused. Thank you very much, Mr. Pierce.

MR. CARR: Ready for closing?

CHAIRMAN LEMAY: Ready to close?

MR. CARR: Yes, sir.

CHAIRMAN LEMAY: Let's do it.

MR. CARR: May it please the Commission, what we're talking here about today, as you're aware, are two competing compulsory pooling applications.

I think it's instructive to go back to the statute and start there, for the Oil and Gas Act provides that where there are separately owned tracts embraced within a single spacing or proration unit and the owners have not agreed to pool their interests, then they may come to the Division and you will pool them.

But before it says that, it also provides that they may validly pool their interests and go forward and develop the land as a unit.

When Penwell entered the picture in September, that's what they tried to do. They contacted the other owners, and within a month everyone except Burlington had agreed to join in a well they would drill and operate. And 86.6 percent said, yes, they would pay voluntarily their share.

They're here today, Burlington, now asking you to say that that agreement is of no value and that that 86 percent will have to pay for a well operated and drilled by someone they have elected not to go with.

As was clarified a few minutes ago, prior to last August in the context of this particular case, there was no pooling order. No one designated anyone operator of the well. You did not, until the order coming after the August hearing.

And what we really had was almost two years when Burlington was out there, anxious to get a well drilled, talking to Trainer, waiting, but not doing what it had a right to do: Come to you, pool the land and drill the well. That's what happened. Negotiations, but no one willing to step forward and say, We're going to go forward, we're going to develop the property. It really didn't happen until Penwell entered the scene, and in a month they were virtually ready to go.

So I think it's wrong to dwell, and I think it's a -- tactically may be useful to dwell a lot on what Mr. Trainer may or may not have done. But the fact is, Penwell is here with a right to drill, they stand before you with 86 percent of the working interest committed to them. They have a rig ready to go. They have lower overhead and administrative costs, based on Ernst and Young, not higher costs, because some of the things that might be in the AFE are actually in the overhead charges of Burlington, so they have a lower overhead and administrative proposal.

They have a valid AFE, an AFE which we'd like to cast aside on Burlington's side today, but was even lower than theirs in August and has been, if you look at the general trend, pretty much consistent with how the AFEs were coming down over a long period of time.

But I submit to you, it's also the valid AFE, for whether Mr. Lara didn't notice that the hole was too thin on the Pronghorn well or not -- yesterday he said, what they're proposing, the hole is too thin. And so they've got a well that's cheap, but we submit to you it's wrong, and we submit our AFE is the valid AFE.

And we stand before you with 86 percent of the working interest behind us, and no complaints. We don't have anyone coming in here and raising questions about what price of oil we use or how we account or are we balancing on casinghead gas or -- You know, we don't even have to have somebody in our company to deal with customer complaints. He may be a nice guy, but we don't have to have any.

What you've got is a situation where Mr. Losee says, If they operate, I'm out. I was in a mess, I got out of it. Don't put me back.

We're here, we think, with those things that count: quick action to get the well up and going, and a proposal to everyone, and most everyone in agreement, the best AFE, the lowest cost.

And all we need is for you not to throw out the agreement of almost everyone to give operations to someone the rest of them don't want. That's what this case is about.

And we ask you to honor the voluntary negotiations that resulted in an 86-percent joinder in our prospect, our proposal. And to do that, we ask you to grant our Application and deny the Application of Burlington.

CHAIRMAN LEMAY: Thank you, Mr. Carr.

Mr. Kellahin?

MR. KELLAHIN: Mr. Chairman, I have no idea what Mr. Carr just said. It makes absolutely no sense to me.

Has he forgotten 17 months of cooperation? Has he forgotten 17 months of a voluntary agreement? Has he forgotten that Trainer had all this time to spud the well? Where was he when we talked about the fact that Trainer was agreed upon voluntarily by all these interest owners to drill the well? That was the agreement.

Look at the statute. It talks about a voluntary agreement. Everybody signed off on his AFE. Yes, Burlington first proposed the well. Yes, they had a minority interest. Yes, they had operations in the area.

And yes, they deferred to the majority interest owner. And that's what happened.

And you can see and share in their frustration. You ask Mr. Pierce how long it takes to get a well drilled that you propose. Sixty to 90 days. Burlington was incredibly patient with Mr. Trainer. They gave him 17 months. They talked to him, they asked him, they gave him time for funding. He was a little guy. They waited for him to find all his marbles so he could go do this thing, and it doesn't happen.

Mr. Carr wants to assess Mr. Trainer's delay against Burlington? The whole point of the exercise is to avoid compulsory pooling.

And we had a solution. We would have preferred to drill the well then. We were the minority interest owner; we deferred to him. He said he was going to do it. We patiently waited; it didn't happen.

Commissioner Weiss was astute this morning when he recognized that this wasn't a waste case, this wasn't a correlative-rights case. He says it's a business case. It's the business of this Commission that's the case here today.

Look at Examiner Stogner's order. If you'll turn to page 5 with me and look at paragraph numbered 9, Mr. Stogner says, It would only serve to circumvent the purpose of the New Mexico Oil and Gas Act to allow a record owner of a working interest, Trainer and Prince, in the spacing unit at the time said party was served with a compulsory pooling application to avoid or delay having that entire percentage interest pooled by assigning, conveying, selling or otherwise burdening or reducing that interest.

That's exactly what he did. We proposed the well to him, he tells Leslyn, I don't want to be in a well with you. We file and serve him with a compulsory pooling application, and then after that he goes out and finds Penwell.

And look at Penwell. Penwell came in there with specific knowledge that Trainer and Prince had already been served with a pooling order. They didn't come in there as innocent bystanders. They saw what was happening, they assumed the risk of acquiring his interest late in the game.

And Mr. Wheeler is a very clever man. He figured out a way to protect his company, rightfully so. He's got a bailout on this deal. And if they don't get operations, he has got the unilateral right to turn this deal back to Trainer. And so if you have sympathy for Penwell, they are not at risk, they are not a party at harm. And they came in there with their eyes wide open as to the deal they were getting.

They can still make other deals with Mr. Trainer and Prince. They've already got six other proposals in this very area. The point is, we're disputing this one. And the one at hand is the one we've asked to operate for months now. It is our turn.

And what we have here is a case more than just the parties here. You need to begin to deal with the business of the Division. And the business is to make sure that once we engage upon compulsory pooling, that the party served does not have a way to delay, substitute, scatter their interest or manipulate their way out of the problem. We've gotten to the point where we need to institute compulsory pooling.

You need to decide if you want to ignore the fact that Mr. Prince is served and Mr. Trainer is served and the case is waiting for hearing. And if you want to substitute people in after the fact, then you need to tell us, because that's what you're being asked to do.

The business here is not waste, it's not correlative rights. It's more fundamental than that. It is what this Commission and what this agency and Division are going to do with regards to compulsory pooling cases under the Oil and Gas Act.

Mr. Stogner goes on and he makes specific findings. He says Burlington was the first to propose the well, he finds that of significance.

They went through the BLM process -- as we all know, it can be very lengthy and time-consuming -- and they got their APD approved.

And what's more, and what's very important, as the minority interest owner they gave the majority 15 months to get the deal done, and they couldn't do it.

The time is too late for Mr. Trainer to bring in somebody else. The time is too late to now let Penwell have a turn. The turn here belongs to Burlington. It is appropriate, it is fair. This is their back yard, if you will. They have the expertise, the technology and the operation experience in the area to effectively drill and produce the well.

I am sorry for Mr. Losee. He's a good friend of mine. He was a great friend of my dad's. He's got a marketing dispute with Burlington, he has got an accounting problem with Burlington. We will do our best effort to solve that. But that really is beyond, I think, the jurisdiction of the Commission.

We don't enter into force-pooling cases based upon marketing conditions, and we have accounting solutions for those examples, unfortunate as it may be, where Mr. Losee and others have a dispute over payment of proceeds.

Mr. Losee has another solution. He talked to you very candidly about the fact that he can sell his interest to Penwell, he can go nonconsent. He can take his production in kind. It is now not our effort to make people like Mr. Losee or anyone else in his position unhappy, and we apologize to him and to you if that's occurred.

But don't let that cloud the fact that we've got a fundamental issue of the business of the Division to decide in this case, and we think the only fair decision is to let us go forward and operate this well.

Thank you.

CHAIRMAN LEMAY: Thank you, Mr. Kellahin.

Is there anything additional in these cases, 11,613 and 11,622?

If not, the Commission shall take it under advisement.

Thank you very much.

(Thereupon, these proceedings were concluded at 2:50 p.m.)

* * *

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 Commission 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 January 21st, 1997.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 1998