STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:	
APPLICATION OF DUGAN PRODUCTION CORPORATION FOR COMPULSORY POOLING AND DOWNHOLE COMMINGLING, RIO ARRIBA COUNTY, NEW MEXICO	CASE NOS. 11,897
APPLICATION OF DUGAN PRODUCTION CORPORATION FOR TWO NONSTANDARD GAS SPACING AND PRORATION UNITS, RIO ARRIBA COUNTY, NEW MEXICO	and 11,899
	(Consolidated)

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

ORIGINAL

BEFORE: DAVID R. CATANACH, Hearing Examiner

January 8th, 1998

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, January 8th, 1998, 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 8th, 1998
Examiner Hearing
CASE NOS. 11,897 and 11,899 (Consolidated)

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E X H I B I T S

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A P P E A R A N C E S

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By: WILLIAM F. CARR

* * *

WHEREUPON, the following proceedings were had at 10:12 a.m.:

EXAMINER CATANACH: At this time we'll call Case 11,897.

MR. CARROLL: Application of Dugan Production Corporation for compulsory pooling and downhole commingling, Rio Arriba County, New Mexico.

EXAMINER CATANACH: At the request of the attorney for Dugan, we will at this time call Case Number 11,899 and consolidate it for the purpose of testimony.

MR. CARROLL: Application of Dugan Production Corporation for two nonstandard gas spacing and proration units, Rio Arriba County, New Mexico.

EXAMINER CATANACH: I will call for appearances in these cases.

MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of the Santa Fe law firm of Kellahin and Kellahin, appearing on behalf of Dugan Production Corporation, and I have two witnesses to be sworn.

MR. CARR: May it please the Examiner, my name is William F. Carr with the Santa Fe law firm Campbell, Carr, Berge and Sheridan. I represent Caulkins Oil Company in this matter, and I have one witness.

EXAMINER CATANACH: Additional appearances?

Okay, will the witnesses in these cases please stand to be sworn in?

(Thereupon, the witnesses were sworn.)

MR. KELLAHIN: Mr. Examiner, if you'll turn to Exhibit Number 1 I'll describe for you what Mr. Dugan proposes to accomplish. You can see that Section 14 is the subject of the discussion.

In the south half of Section 14, in July of 1997, Mr. Dugan acquired the southeast quarter. That was at a federal lease sale. The southwest quarter is controlled by Caulkins. They have 55 percent. Marathon and Louis Dreyfus each share the remaining interest. They're credited with 22.5 percent. Those are gross working interest numbers. You have to subtract override and royalty burdens.

In October, Mr. Dugan proposed to Caulkins the drilling of a Mesaverde Dakota well in the southeast quarter and to be drilled as a downhole commingled well. It has been his preference to have the southeast quarter set aside as a nonstandard proration unit and to allow Caulkins and the interest owners in the southwest quarter to drill their spacing unit.

You can see from the map that the only wells in the south half are Pictured Cliff wells. You'll see in the northwest of the southeast it says "M.D.", and there's a dot. That's Dugan's proposed well. In fact, there is no

Mesaverda-Dakota well in that quarter section.

Over in the southwest quarter you're going to see a gas well symbol. That's a Pictured Cliff well. Also in the northwest southwest, that dot represents the Caulkins proposed location.

In October, Mr. Dugan proposed to Caulkins the formation of the spacing unit, pursued the notion of a separate 160 for each. They were not able to make an agreement because Caulkins wants to operate, Mr. Dugan wants to operate, and there's a difference.

Mr. Dugan filed a compulsory pooling application. It was set on the docket for, I think, late November or early December. And after the case was filed for hearing, Caulkins has proposed their well; they proposed their well in December.

We have Caulkins' support, as I understand it, Mr. Examiner, to have you approve each of these as two nonstandard proration units, and that is our primary preference. If you choose not to do that, then we would like to be awarded operatorship because we have the largest single interest, we proposed the well first, and we would like to go forward under the pooling application.

In addition, I think we have the support of all parties that the well ought to be drilled as a commingled wellbore. There is sufficient data available to demonstrate the necessity to save money, to make this an economic venture by consolidating resources and drilling this as a commingled well. In addition, we believe Caulkins supports that concept.

There are minor differences in the AFE, there are minor differences in other issues. But predominantly, we believe the south half of Section 14 represents a unique opportunity to let the parties divide a standard spacing unit and to proceed accordingly.

It has not necessarily been the practice of the Division to do that, and I'll explain why. Typically, you'll have a 320 Dakota or Mesaverde spacing unit as a parent well, and only later do you have an infill well. In that circumstance, it is virtually impossible to separate the spacing unit without disrupting equity.

In this circumstance, we have the unique opportunity to divide this spacing unit because there, in fact, has never, ever been Mesaverde or Dakota production. And in doing so, we let each operator go about his business of operating his well in the manner and in the means they choose appropriate.

Therefore, we will ask you to approve the separation of the standard spacing unit and to allow each of these companies to proceed. Should you choose not to do so, we would ask that you approve our Application for compulsory pooling.

EXAMINER CATANACH: Mr. Carr, we don't have an application for Caulkins.

MR. CARR: Yes, we do. It was filed the first of this week and it is scheduled for the 5th of February. We prefer to do the whole thing at this time at an Examiner level, and on the 5th, when that case is called, we will reference the hearing on this day.

I do have a brief opening statement.

EXAMINER CATANACH: Go ahead.

MR. CARR: May it please the Examiner, one of the fundamental preconditions to obtaining a compulsory pooling order from this Division is that the affected owners have attempted in good faith to negotiate and agree on how the acreage can be developed.

In fact, in this case that has happened, and the parties have negotiated, and we also have a primary preference, and that is for the development of the south half of this section with two 160-acre nonstandard units. Dugan owns all of the southeast quarter; we own or represent all of the southwest quarter. And we're in agreement as to how that should be done.

The problem is that the Oil Conservation Division has expressed a reluctance to do that. But you need to know we stand before you having negotiated in good faith and having, we believe, resolved the issue.

Caulkins operates 189 wells in this area. And for many years they have owned -- since the 1950s -- the southwest quarter of this section, and have been unable to put together a laydown unit in the south half because the prior, Mead, would refuse to do it. That lease expired. Caulkins nominated the southeast quarter, and Dugan was successful in acquiring the lease.

Since that time we've had discussions with Dugan representatives in the field about developing the acreage, about who should operate it. Those occurred before the October 8th first formal proposal of the well. And on the very day the well was proposed, there were discussions going on about building a surface location.

So I think it's not clear exactly who's first in time on this one and who proposed the well first. If it requires a formal letter while verbal negotiations are going on, it is Dugan, and we're not fighting over those facts.

We do believe that you've got a 50-50 ownership split. Dugan owns all of the southeast because they acquired the lease. But we, in an arrangement with Marathon and Louis Dreyfus, own or represent all of the southwest, and we have arrangements with Marathon and Louis Dreyfus by which we operate other properties under the same kind of agreement.

I agree with Mr. Kellahin, there are minor differences in the AFE and overhead costs, and those aren't the issue here. And we also agree that downhole commingling is appropriate.

So there really is only one issue, and that's operations. And I don't think we're even here, really, to fight, but we've got to get some sort of a resolution on that question from you if, in fact, this Division rejects what the operators are proposing for the development of the south half of this section.

EXAMINER CATANACH: Okay, let's proceed.

MR. KELLAHIN: Mr. Examiner, my first witness is David Poage. He spells his last name P-o-a-g-e.

DAVID M. POAGE,

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. Poage, sir, for the record, would you please state your name and occupation?

A. My name is David Poage. I'm land manager for Dugan Production Corporation.

Q. On prior occasions have you testified before the Division in your capacity as an expert in land matters?

A. Yes, I have.

Q. Pursuant to your employment was it your primary responsibility on behalf of Mr. Dugan to contact the other potential working interest owners in the spacing unit and to discuss with them how the south half of Section 14 might be developed for production out of the Dakota and Mesaverde formations?

A. That's correct.

Q. Are you knowledgeable about the ownership in the south half of Section 14?

A. Yes, I am.

Q. Has it been your primary responsibility to provide correspondence and reply to correspondence from other interest owners?

A. Yes.

Q. And the primary telephone contact has been you with these other companies?

A. That's correct.

MR. KELLAHIN: We tender Mr. Poage as an expert landman.

EXAMINER CATANACH: He is so qualified.

Q. (By Mr. Kellahin) Mr. Poage, let me have you turn, sir, to Exhibit 1, and let's take a moment and identify first of all the color-coding. You've identified what appears to be spacing units that are outlined in half-section patterns oriented in different configurations, to which you have scribed a yellow outline and the name "Caulkins". What does that represent?

A. That's the existing established Mesaverde and/or Dakota spacing units within the area surrounding the south half of Section 14.

Q. When we look at those spacing units, there is a well symbol coding. Describe for us what you mean by the coding.

A. In an instance where you're looking at a well symbol that has a P and a C next to it, as it was located in the southeast southeast of Section 14, that's a Pictured Cliff and a Chacra well.

If you go to the east, you'll see a C.M.D. with a different symbol. That is a Chacra, Mesaverde and Dakota well. And that's pretty much what they stand for.

Q. In the south half of 14, you've outlined that in an orange outline. What does that represent?

A. That represents the south-half spacing unit that would be considered for the proposed compulsory pooling.

Q. When we look at the southeast quarter -- it's identified "Dugan 100 %" -- what type of lease are we dealing with here?

A. It's a federal oil and gas lease covering 160 acres.

Q. And when did Mr. Dugan acquire that lease?

A. The lease was effective September 1st, 1997.

Q. And to what extent is that lease burdened with royalties, overrides or production payments?

A. It is a standard 12-1/2-percent royalty with no overrides.

Q. So as to the southeast quarter, then, Mr. Dugan holds an 87-1/2-percent net revenue interest?

A. That's correct.

Q. When we look at the southwest quarter, when you first proposed the drilling of Mr. Dugan's Mona Lisa Number 2 well, what was your belief as to the ownership of the southwest quarter?

A. It was our understanding that Caulkins controlled the southwest quarter, and as a result we offered the opportunity to them to join with us in drilling that well on that basis.

Q. Let's set aside the locator map for a moment, and let's look at Exhibit Number 2. What have you compiled here?

A. Exhibit Number 2 is just a listing of the phone calls that I made a record of, and a brief of each of the descriptions that -- the different phone calls I've made in relation to the Mona Lisa Number 2.

Q. Prior to the first phone call on October 16th to

Marathon, in fact, you had other phone calls concerning the property in the spacing unit?
A. Right, there were other phone calls.
Q. At this point, though, you started making notations about your contacts?
A. That's correct.
Q. Okay. Let's start with that point. Mr. Dugan has acquired the lease in January of 1997. What, then, does he do?
A. We acquired our lease in September of 1997 --
Q. Yes, sir.
A. -- and proceeded to permit, drill and complete and tie in the Mona Lisa Number 1 well, which is the --
Q. And that's a --
A. -- Pictured Cliff --
Q. -- Pictured Cliff well?
A. It's a Pictured Cliff-Chacra commingle, located in the southeast southeast of 14.
Q. Okay, then what did you do?
A. During that same time we had also proposed to Caulkins the drilling of a Mesaverde-Dakota well.
Q. On what basis?
A. On the south-half basis.
Q. Okay. How did the discussions proceed?
A. Caulkins advised us that they wanted to operate

themselves and advised us of a couple other minor things that they had with -- problems with our AFE and that kind of thing.

Q. Who was the company to propose the drilling of the south half for Dakota-Mesaverde? Who was the first company to make that proposal?

A. Dugan.

Q. And in what manner was that made?

A. By our letter on October 6th, I believe it was.

Q. The formal letter. Prior to that, you had telephone conversations and expressed the desire to drill and operate the Mona Lisa Number 2?

A. That's correct.

Q. If you'll turn to Exhibit Number 3, what does this represent, Mr. Poage?

A. This is a copy of the letter, dated October 6th, to Caulkins Oil Company proposing the drilling of the Mesaverde-Dakota well that we signify as our Mona Lisa Number 2 well.

Q. Mr. Verquer's name is misspelled, but you address this to Bobby Verquer of Caulkins, in Bloomfield?

A. That's correct, I had talked to Bobby previously and he advised that I should send it directly to him.

Q. And so you did so?

A. Yes.

Q. All right. Included with that cover letter, did you submit to Caulkins a proposed AFE?

A. Yes, we did. It's here as Exhibit Number 4.

Q. Okay. What then transpired, Mr. Poage?

A. Well, shortly thereafter I received a phone call from Marathon and about the same time frame a letter from Louis Dreyfus, both of them advising me that they had received the copy of the letter, operating agreement, AFE, through Caulkins, and to indicate to us that they definitely had an ownership in the southwest quarter.

And as a result of that, we furnished to all three parties a subsequent letter, fully knowing already that they had received the AFE, as well as the operating agreement, we supplied to them a new Exhibit A to the operating agreement outlining the parties' interests in the south half of Section 14.

Q. What's your current understanding of Marathon's position concerning the issue of who operates and what spacing unit is formed and dedicated to the well?

A. I don't believe that Marathon -- and they've indicated to me that they don't wish to join and have offered to farm out their interest in a wellbore, southeast quarter only, to us.

Q. Do you know what position they have taken with regards to Caulkins' proposal for their well that they proposed in December?

A. No, I do not.

Q. As to your well proposal, their preference is to farm out?

A. That's correct.

Q. All right. Has that been acceptable to you?

A. No, we have not come to an acceptable conclusion because of the lease burdens that they have on there.

Q. Let's talk about the lease burdens. Let's go back to your map on the southeast quarter. You've got some percentages here, and these are gross numbers, are they not?

A. That's correct.

Q. Your research has caused you to reach a conclusion about the total burdens on the southwest quarter, has it not?

A. Yes.

Q. And what is that percentage?

A. Through discussions with Marathon as well as Caulkins, we have found that their lease is burdened with a 12-1/2-percent royalty, a 3-percent override and, in addition to the 3-percent override, another override equal to a one-third interest.

Q. That one-third characterizes, I think, a production payment; is that --

A. I think the assignment I saw characterizes it as an overriding royalty equal to a one-third net profits --
Q. Okay.
A. -- which effectively would give to the owners of the southwest quarter about a 51-percent net revenue interest.
Q. So when we compare net revenue interests, Mr. Dugan has the good fortune of having an 87-1/2-percent net revenue interest, and the southwest quarter has 51-percent net revenue interest?
A. That's my understanding, yes, correct.
Q. What significance does that have?
A. Well, from the standpoint of payout, risk, economic analysis, the high burdens in the southwest quarter would make it extremely more difficult to drill a productive and economic well.
Q. Does that form one of the bases by which Mr. Dugan wants to separate out the two quarter sections into separate spacing units?
A. That is correct.
Q. What is the current status, to the best of your knowledge, of the Louis Dreyfus position concerning your proposal?
A. The last discussion I had with Louis Dreyfus, I asked them as to their position as to whether they would

want to join in a south-half well, if that would be the case, or to farm out.

And the response I got was, they wanted to see the results of this hearing before they made that decision.

Q. Summarize for us what your understanding is of Caulkins' position concerning your proposal as we appear here today.

A. My understanding is that they have no problem and desire, as well as we do, to drill a well in the south half of Section 14.

Disallowing the small difference we have with an AFE and those items, they're -- have always taken the position that they wish to operate, and we have not come to a joinder conclusion as of this date as a result of that.

Q. Let's turn to Exhibit 5 and have you identify and describe Exhibit 5.

A. Exhibit 5 is a copy of the operating agreement that was furnished to all parties. It includes in it the new Exhibit A outlining the ownership of the south half, showing Dugan Production Corporation with 50 percent, Caulkins Oil Company with 27 1/2 percent, and Louis Dreyfus and Marathon each respectively with 11.25 percent. Those would be gross working interest percentages.

Q. When you turn your attention to the COPAS attachment to the operating agreement, what have you proposed for those parties that agree to the operating agreement for a drilling well rate and a producing well rate overhead on a monthly basis?

A. Our proposed producing overhead is -- let's see -- I believe it's $4000 per month for a drilling well rate and $400 per month for a producing well rate.

Q. Are those your recommendations for the Examiner, should he choose to enter a force pooling order in this case?

A. Yes, that's correct.

Q. How do those rates compare to what Mr. Dugan is being charged by others and what he charges others for Mesaverde-Dakota wells?

A. These are very similar for new wells being drilled today.

Q. Okay. Let me have you identify and describe Exhibit Number 6, Mr. Poage.

A. Exhibit Number 6 is a copy of a letter dated October 28th, to Caulkins, Marathon and Louis Dreyfus, and this is the letter I've referred to previously where we've furnished them an Exhibit -- a new, revised Exhibit A to the operating agreement.

Q. All right, sir. Let me have you direct your attention, then, to Exhibit 7. Identify and describe what you're doing here.

A. It's a copy of the letter that Dugan Production received on December the 5th from Caulkins Oil Company, well proposal for their Breech B 781, also to be located in the south half of Section 14.

Q. All right. And this is the proposal for their well?

A. That's correct.

Q. All right. At this point, Mr. Poage, do you have an opinion as to whether Dugan and Caulkins are going to be able to agree as to who operates the spacing unit in the event the Division chooses to keep this consolidated as a 320 spacing unit?

A. As of the present time, I can not see either party changing their present position as to operations.

Q. So we'll have to defer to the Examiner to make that choice?

A. That's correct.

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

We move the introduction of his Exhibits 1 through 7.

MR. CARR: No objection.

EXAMINER CATANACH: Exhibits 1 through 7 will be admitted as evidence.

Mr. Carr?

CROSS-EXAMINATION

BY MR. CARR:

Q. Mr. Poage, could you return to Exhibit 2 for just a second, please? I may not have heard you correctly. It starts with the date October the 16th. That's not your first conversation concerning the prospect, is it?

A. That's correct. This just happened to be the first day that -- When I went back to compile this, to bring myself up to date, I just went back and found the notes I could. I did not attempt to add anything additional, even though I know that Bobby and I and certain other parties have had discussions relating to this well prior to those dates.

Q. You proposed the well, actually, on October the 6th? That was the date of your formal proposal; isn't that right?

A. That is correct.

Q. And there had even been discussions prior to that time?

A. I had discussed with Bobby. That is prior to that, yes.

Q. How many wells, do you know, does Dugan operate in the, say, nine-section area surrounding this prospect? Do you know?

A. I believe it's just the Mona Lisa Number 1.

Q. And that's the current well in the southeast quarter?

A. That is correct.

Q. That's a Pictured Cliffs-Chacra completion?

A. Yes, sir.

Q. And what is dedicated to that? The 160 acres, being that one lease?

A. Southeast quarter is dedicated to that.

Q. When you got the letter from Caulkins on December the 4th, there was an AFE and a JOA attached; isn't that correct?

A. That is correct.

Q. In the JOA from Caulkins, their overhead rates were $760 while drilling and $237 while producing. Is it your understanding that if, in fact, Dugan was named operator of the south half, they would agree to those operating figures?

A. To those particular figures?

Q. To those figures.

A. We haven't taken that under consideration.

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

EXAMINATION

BY EXAMINER CATANACH:

Q. Mr. Poage, if Dugan is named the operator of the south half, is it willing to drill that well, even though the southwest quarter has those lease obligations?

A. That presents to us a large problem from an economic standpoint. I think we would -- The answer to that would be, yes, we would go ahead and drill the well because of our 50-percent ownership in the south half.

It would take a -- in my opinion, and this will be shown. I believe Mr. Roe has some more data to show you. It would take quite a bit of time for payout and economics to come into line, depending upon how the arrangements can be made for either joinder or nonconsents from the other parties.

Q. Is it your understanding that the well Caulkins is proposing, is that proposed to be a downhole commingled well as well? Is that your --

A. Well, off the top of my head I just don't remember.

Q. Okay. Now, Dugan is the only working interest owner in the southeast quarter?

A. That is correct.

Q. There are no other royalty interest owners and no other overrides?

A. No, it's just a straight federal lease with a federal royalty, and that's it.

Q. Do you know, with regards to the southwest

quarter, who owns the override on that?
A. I've seen the listing of who owns those. It's approximately 24, 25 different people.
Q. Okay. And Marathon has expressed their desire to farm out in the southwest quarter?
A. Yes, they did. They offered to Dugan to farm out a wellbore position in our Mona Lisa Number 2 well, and we haven't come to any acceptable agreement at this time.
Q. Is Marathon aware of the other proposal to form a nonstandard proration unit?
A. To form a nonstandard? Yes, they are.
Q. Do you know what their position is on that?
A. I believe they support their position.
Q. And how about Dreyfus?
A. Same there. I believe Dreyfus would also support the nonstandard proration unit.
Q. If Dugan is named operator of this south half, are they, in fact, prepared to drill two wells?
A. We're prepared to operate the south half as a standard operator and to drill the Mona Lisa Number 2 first and then consider infills at a -- further on down the line.
Q. Mr. Poage, does the -- These are two separate federal leases, right?
A. That is correct.
Q. Have you spoken with the BLM, or do you know if

they have a position with regards to this situation?

A. No, I have not spoken to them.

Q. Is there any reason, do you think, they would have a problem with it or they would not accept it?

A. I don't have any reason to believe that they would object.

Q. They're still going to get their royalty on each of the leases?

A. They will receive the same amount of royalty either way. And I believe it's the position of Dugan as well as Caulkins to drill two wells in that south half.

EXAMINER CATANACH: That's all I have at this point, Mr. Kellahin.

EXAMINATION

BY MR. CARROLL:

Q. Mr. Poage, do you know who owns the net profits override?

A. That's split up amongst 24 -- I think it's either 24 or 25 people, and Caulkins, Marathon and Louis Dreyfus are part of the 24 or 25. They have a small interest in that as well.

EXAMINER CATANACH: Okay. Are we done with this witness?

MR. KELLAHIN: Yes, sir.

Mr. Examiner, my next witness is John Roe. He's the engineering manager for Mr. Dugan. Mr. Roe is a professional registered engineer.

JOHN D. ROE, JR.,

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. Roe, for the record, sir, would you please state your name and occupation?

A. My name is John Dale Roe, Jr., and you spell that R-o-e, and I'm the engineering manager for Dugan Production Corp.

Q. On prior occasions, have you testified before the Division as a petroleum engineer?

A. Yes, I have.

Q. And pursuant to your employment by Mr. Dugan, have you made an engineering study of the Mona Lisa Number 2 well?

A. Yes, I have.

Q. Is it your primary responsibility to make recommendations to Mr. Dugan concerning the economics of these various well proposals?

A. Yes, it is.

Q. While you did not prepare the AFE, are you knowledgeable about the well costs involved concerning your well proposal?

A. Yes, I am.

MR. KELLAHIN: We tender Mr. Roe as an expert witness.

EXAMINER CATANACH: Mr. Roe is so qualified.

Q. (By Mr. Kellahin) Let's start with Exhibit Number 1 here, Mr. Roe, and look at the locator map.

As part of your study and preparation, you have examined data on the Caulkins wells in this immediate vicinity, have you not?

A. Yes, I have.

Q. What is the general vintage of their Mesaverde and Dakota wells?

A. Within the spacing units directly offsetting the south half of Section 14, there's 12 wells that have been drilled or are in the process of being drilled, and the earliest was completed in 1959, and the most recent is as late as -- It's either being completed or waiting on completion tools.

Q. Where is the newest well that Caulkins is attempting to complete in this area in the Dakota-Mesaverde?

A. The well that we show in the southwest southwest of 23 is a well that Caulkins commenced drilling in September of 1997, and the last information we have on it is that it's either waiting on completion or maybe completion is in process. I'm not sure of the current status of that well.

Q. Excluding that well, what's the vintage of the last Mesaverde-Dakota well Caulkins drilled in this area?

A. The next most recent well would be completed in 1985. That would be their Breech B 220M.

Q. And then prior to that?

A. And, of course, they date from there back to as early as January 20th, 1959, which would be their Breech 224.

Q. Are there spacing units in this immediate vicinity that Caulkins operates for which there is not an infill Mesaverde and Dakota well?

A. Yes, there's -- Well, basically, the spacing units that Caulkins operates that have been developed for any period of time have two wells for each spacing unit. The one spacing unit that Caulkins operates that only has one well would be the west half of Section 23, and that would be the well that they are currently in the process of completing.

Q. To your knowledge, to the lease burdens that apply to the southwest quarter of 14 on the Caulkins lease also apply to the other Caulkins-operated spacing units in this area?

A. I would anticipate that that burden carries to other wells on that same lease, but I don't know that for sure.

Q. When we look at the southwest quarter of 14, does it matter to you as an engineer doing economics that the net revenue interest for the southwest quarter is 51 percent?

A. As -- From an economics standpoint, that is a very heavy royalty burden and it would create a large disparity, and that's the basis of the problem we see. For Dugan Production it's not a problem. Our interest is going to based on a lease that we have 87-1/2-percent net beneficial interest. But for the owners in the southwest quarter, they're going to have a substantially different set of operating economics than we have.

Q. If any of those interest owners decide to not participate in the well, then you'll have to pay their share of the costs of the well, will you not?

A. That is correct.

Q. And then if the interest is burdened as you've described, you can recover your costs only out of their net revenue interest?

A. That's true.

Q. So what's going to happen?

A. Well, under those conditions, the southwest quarter would be a negative economic impact to Dugan Production.

Q. Let's turn to Exhibit 8 and have you identify this.

A. Exhibit 8 is nothing more than a copy of the C-102s. It consists of two pages. The top page is the dedicated spacing unit for the Mesaverde formation, and the second page would be that same information for the Basin Dakota.

These are the C-102s that were initially submitted with our APD to the BLM to drill this well, which was submitted on September 3rd and approved by the BLM on September 30th.

Q. All right. At this point, Mr. Dugan's application for a permit to drill his well has been approved, and he's ready to drill?

A. Actually, he's had a rig scheduled to be on location twice. I've had to tell him we need to -- a few other matters to resolve.

Q. So at this point we're ready to go, depending on the decision of the Examiner at the hearing?

A. That is correct.

Q. All right, let's turn to Exhibit 9. In doing your economics, you have to take into consideration the various interests and the burdens on the half section and then on each of the quarter sections; is that not true?

A. Yes, sir.

Q. And that's all this represents, is the tabulation of those interests and those burdens?

A. That's correct. We're just trying to show, if we have two nonstandard 160 spacing units, you would see the net ownership of the parties listed and also the net ownership of those same parties if we developed this with a 320-acre spacing unit.

Q. Okay. Let's go to the next exhibit, which I want to spend some time on, Mr. Roe. This is your economic analysis, and it's obviously your spreadsheet. Let's take a moment to make sure that everybody recognizes how to read this and how you have prepared it.

When we look at the first page, you have coded some information to direct our attention to that information?

A. Yes, sir.

Q. We are looking at the economics of what on the first page?

A. Okay, the first page would be the economics that would exist to the owners that are in the southeast quarter, and that's assuming that this well would be drilled on a 320-acre spacing unit. The owners in the southeast quarter would have a 50-percent working interest, and they would also have a net revenue interest of 43.75 --

Q. All right. And we find that information on the left margin where it says "Cost Oil Gas"?

A. Yes.

Q. The cost is not a dollar number, it's a percentage?

A. Yes.

Q. It's Mr. Dugan's gross percentage in the southeast quarter --

A. That's correct.

Q. -- divided into the spacing unit, which gives him the 50 percent?

A. Yes, sir.

Q. Then we look at the next column; it says "oil". In fact, that is his net revenue interest, less the federal royalty, proportionately reduced to the 320?

A. That is correct.

Q. All right. You're using those numbers, then, to see what the economic analysis shows for Mr. Dugan and his share?

A. That's true.

Q. As we go through the analysis for the southwest quarter, the assumptions you've made are consistent with both analyses, with the exception that you've changed the net revenue interest?

A. That's correct.

Q. All right. When we look at what happens with Mr. Dugan's share, you get down to the bottom where you've highlighted in blue on the last row --

A. Yes, sir.

Q. -- some information. What does the 210 mean?

A. The 210 would be, at the end of the productive life of this well the owners in the southeast quarter will have spent a total of $210,500, and that's -- in this instance, was in the form of the initial investment in the well. The 210 is 50 percent of our AFE.

Q. That would be his share of the costs?

A. That would be our share of the development and completion costs.

Q. On these spreadsheets, do you calculate and forecast what will be his total profit?

A. Yes, sir.

Q. And how do I find that?

A. Okay, that would be the next column over. That would be the third column from the right side, would be the cumulative cash flow. And I believe I've highlighted that in blue also. At the end of the productive life we will have recovered our investment plus an additional $683,000.

Q. I know it's common for engineers doing economic analysis to reduce that to a present-value number; is that not true?

A. Yes, that's true.

Q. And that's the number that you really work with, isn't it?

A. That's the number, considering that -- Yes, yeah, basically we discount our cash flow to account for such things as other investment opportunities, primarily, putting your money in the bank and comparing it to what you could get with no risk at all.

Q. All right, when you discount it what is going to be the present value?

A. Okay. We, for this economic analysis, have used a discount value of 10 percent. And using 10 percent, the value of that $683,000 equates to a present-worth value of $295,000, rounded off.

Q. So this deal is worth $84,000 after you pay your costs? Or is this after costs are recovered?

A. No, these would be after cost recovery.

Q. All right.

A. In other words, we would realize $684,000 profit after recovery, and that's worth a present value of $295,000.

Q. And that's a net after we take the cost out, right?

A. That's net, that's what we would have in the savings account if all of this money went to a savings account.

Q. A lot of times people analyze these in terms of the ratio of profit to investment, that kind of thing.

A. Yes, sir.

Q. Is that shown on this spreadsheet?

A. Our profit to investment is indicated. I didn't highlight it but it's in the upper right corner, and it would be right underneath the highlighted information that I did show as the payout date.

Q. It's a little four to one?

A. Yes, sir.

Q. When Mr. Dugan makes investments on wells such as this, what is his threshold of profit to investment? What's the standard here?

A. We like to see at least a 2-to-1 profit-to-investment.

Q. When we look at the payout period, how long is it going to take Mr. Dugan to get his money back?

A. With this cash flow it would indicate we have a 1.9-year payout, which would occur in December of 1999, before-tax basis.

Q. To make this forecast, you have made the same assumptions now in terms of price, rate of production, and you have simply adjusted their net revenue interest?

A. Yes, sir, the input data is exactly the same, with the exception of the net interest.

Q. All right, let's see what happens to the working interest owners in the southwest quarter. The Caulkins, Dreyfus and Marathon interest would be 50 percent, gross?

A. That is correct.

Q. The three companies will net just over 25 percent?

A. That's true.

Q. All right. What happens under this analysis?

A. Basically, the payout would be extended from 1.9 years to 4.6 years on a before-tax basis. The profit-to-investment would be reduced to basically a level that you would still do this, that it's not a very -- Like I say, it's close to what we would consider a minimum.

The $210,000 investment that you see necessitated because of the 50-percent working interest results in a net cash undiscounted value of $244,000, which, discounted at 10 percent, reduces to about $64,000.

Q. Under this economic analysis is it possible for Mr. Dugan to accept a farmout from Marathon and take on the obligation of their burdens?

A. It's very difficult for us to view that as an economic issue. It's -- And that's going to be one of the hurdles we have to deal with if that's Marathon's election to participate.

Q. If the companies, or some combination of them, go nonconsent and you have to pay the costs of the well out of your pocket, what happens to your ability to recover those costs plus being compensated for the risk factor penalty for assuming the risk?

A. Well, this economics on this second page would demonstrate that we likely would not ever recover much more than -- well, the risk -- We would ask for a risk factor of 200 percent, and that would not be provided --

Q. You'd never get it out of the well?

A. Right, thank you.

Q. Your recommendation to the Examiner, then, concerning the ultimate solution is what, sir?

A. Well, it is real clear to us, because of the substantial difference in the net beneficial interest that exists -- One thing that I failed to point out going through this is, if we use just, when do these wells get to an economic limit, the interest owners in the southeast quarter, because of the more -- less of a royalty burden, will have a productive life of nearly 34 years.

That same set of economics, the interest owners of the southwest quarter are going to have an economic production life of 27 years.

So basically the last six years of this economic analysis -- There's going to be a problem. Dugan is -- If we're operator of a well, we're going to continually get letters from Caulkins and from Marathon and from Louis Dreyfus wanting to know what we're going to do, because they're operating in a negative cash-flow position, and we're not going to be interested in shutting the well in because our economics are still positive.

So basically, the last six years of this operation, Caulkins is either going to be in a position to operate at a loss, they're going to want to make some sort of deal with Dugan, or we're going to have to shut the well in before we reach our economic limit.

And so the solution to this is, don't create that problem. If we go nonstandard spacing units, Dugan's operating economic limit can be identified when we get there, and the Caulkins parties will not have to worry about whether their month-to-month expenses are going to exceed the revenue from the well. And like I say, they'll be in control of their own economics.

Q. Let's talk about the operating rates. We've got $4000 and $400 proposed. Caulkins is subject to an old operating agreement that have kept their operating rates substantially less than current price for those rates; is that not true?

A. That's true.

Q. And they're proposing to apply those rates in the south half of 14 simply because that's what they're stuck with in their contract?

A. Well yes, I suspect that it's difficult for them to increase those values to the current terms because that's the operating agreement that's been in place, and if I was one of their partners, I would object to that being increased.

Q. Let's talk about comparing the AFEs. Mr. Dugan's AFE is about what? $420,000?

A. Yes, sir.

Q. And their AFE is what, $490,000?

A. Yes.

Q. And the difference is attributed to what, Mr. Roe?

A. The primary difference -- There's two significant differences. Caulkins prepared their AFE anticipating the use of 5-1/2-inch casing. In addition, they included automation equipment in their AFE.

Q. Let's talk about the automation equipment. You could put automation equipment on the well too for another $10,000 and do what they're proposing, could you not?

A. Actually, we could probably do it a little cheaper than they've got on their AFE, but that's true. The installation of automation equipment is -- You can do it on a single-well installation, and we could do it with no trouble.

Very few of Dugan's wells are automated, simply because we have our people in the field, and we don't see that there's a benefit to us, but that's something that could certainly be done.

Q. Mr. Carr made the point that Caulkins has all these operations in the immediate vicinity. In your opinion as an expert, does that attribute to them any advantage in terms of operating this spacing unit, that you cannot duplicate?

A. Whether or not we -- No, it doesn't. We have people that drive right by this location every day. Even though Dugan Production doesn't have the good fortune to have additional acreage other than the 160-acre lease we're talking about, we operate around 700 wells in the San Juan Basin. We have over 20 pumpers that go to the field, and at least two of them drive by this location every day.

Q. Is there any unusual field operation that creates an advantage such that Caulkins should be the operator?

A. None that I'm aware of.

Q. Any special -- Anything produce water?

A. Not that I'm aware of.

Q. What is your plan to give pipeline connections and that kind of thing? What is available in the area for you as well as for Caulkins?

A. Well, I do believe that's one issue that Caulkins has -- It's my understanding they are connected to Williams Field Services, although I don't know that.

Our plans would be to tie into El Paso system. We're probably within a mile and a half of the El Paso plant.

And our Mona Lisa 1, like I say, we've -- we only had the lease in September -- effective September 1st. We actually acquired it in July. But we've already drilled a well and got it hooked up to El Paso, and it's producing gas into the pipeline, and our plans would go back to El Paso with a second well and any future wells.

Q. Can you figure out anything, Mr. Roe, that gives Caulkins an advantage over your operating this well, simply because they have other Mesaverde and Dakota wells that they operate in this vicinity?

A. Well, for Caulkins it would be an additional well that would help share any overall expenses that they would have. So I can see that there would be a benefit to them.

But for Dugan production, I don't see -- Like I say, for us it's just another well in the San Juan Basin and, like I say, we already operate close to 700 wells. I don't see that it's a big problem for us.

Q. There's a difference in cost attributable to the fact that Caulkins has proposed 5-1/2-inch casing and Dugan has proposed 4-1/2-inch casing; is that not true?

A. Yeah, there's -- Their casing costs for 5 1/2 would be right at $43,000, compared to our casing costs for 4 1/2 of $28,000.

We would -- We desire to run 4-1/2-inch casing, and we've written our AFE to do so, but that would be contingent upon us having some confidence that we could downhole commingle the Mesaverde and Dakota and produce both zones with one string of tubing.

If for any reason it looks like we can't downhole commingle and we may have to install dual sets of tubing, we also probably would look to running 5-1/2-inch casing. That would increase our AFE cost from about $18,000 and make it fairly close to what Caulkins -- They AFE at $43,000. If we ran 5-1/2-inch casing, it would increase our overall AFE costs by about $22,000.

We -- As with any well we drill, we try to keep our completion costs to minimum, and we can do that with 4-1/2-inch casing.

Q. The only reason to run 5 1/2 is if the Examiner denies your ability to drill this as a commingled wellbore?

A. That's true.

Q. So the issue is here to discuss and resolve now?

A. It would be very important to us to know the

Commission's position regarding downhole commingling because, yes, if there's any question we also would look to 5-1/2-inch casing.

Q. All right, let's turn to that topic then. Let's start with Exhibit 11. Let's talk about where we're going, and then we'll talk about how you get there.

When you look at the commingling issues that the Division deals with, one of the first is to have you reach an opinion as to which of these zones or both zones are anticipated to be marginal. Do you have such an opinion, Mr. Roe?

A. Yes, I do.

Q. And what is that opinion?

A. Well, in our view, both zones, both the Mesaverde and the Dakota, fall within economic criteria that would be used to establish marginal nature. Within the near vicinity there's been a substantial amount of information that has demonstrated that the Dakota beyond any doubt is marginal, meets the definition of marginal.

And I just might point out that basically a standard procedure for wells in this immediate vicinity to produce the Mesaverde and Dakota is through downhole commingling.

Q. The Caulkins wells in here that have Mesaverde and Dakota in them are currently commingled, are they not?

A. That's correct.
Q. You used as a reference case, if you will, the Conoco order that approved their unitwide commingling of various formations including the Dakota and Mesaverde for the San Juan 28 and 7 unit?
A. Yes, I --
Q. How far away is that unit from you?
A. Okay, the San Juan 28-7 unit is approximately -- The boundary of that unit is approximately four miles to the northwest from this acreage.
Q. We've included a copy of the order, and we'll talk about your analogies and how you tie together in just a minute.
A. Yes.
Q. When we talk of the other commingling issues, to the best of our knowledge there's no split, vertical split, in ownership between the Dakota and Mesaverde in this section?
A. That is correct.
Q. So your allocation formula is intended to be what? How do you propose to allocate?
A. Well, we would propose using a fixed allocation from date of first production. And as was shown on the C-107-A form that we're offering as Exhibit Number 11, we're proposing a split of gas and condensate between the

zones of 40 percent to the Mesaverde and 60 percent to the Dakota.

Q. And what's your basis for getting the fixed percentage split?

A. Well, when we discuss the reference case and the resulting order from Conoco in their 28-7 unit, they demonstrated, at least to the satisfaction of the Commission and certainly to my satisfaction, that a fixed allocation percentage is workable for Mesaverde and Dakota production in this area.

And when you look at the offset wells, the cumulative production -- which we'll also show that in a subsequent exhibit, and I'll go over that in a lot more detail -- the 40-60 split would be pretty close to what you see in offset wells regarding -- with respect to current production and cumulative production.

Q. One of the issues to address is the possibility that you'll have a Dakota pressure higher than the original pressure of the Mesaverde. You've made that assumption, have you not?

A. Yes, sir.

Q. And you're asking this Division Examiner to grant you an exception from that pressure limitation in the event you should get pressures in the Dakota that exceed the original pressure in the Mesaverde?

A. That's correct.

Q. In your opinion, is that good engineering practice and sound judgment?

A. Yes.

Q. And you have reasons to support that?

A. Yes, I do.

Q. Okay. In looking at your projections on the well and forecasting the economics, you have made the assumption that both the Mesaverde and the Dakota will not be pressure-depleted in the half section?

A. Yes, I have.

Q. That represents a substantial risk, does it not?

A. Yes, it does.

Q. Do you have a recommendation to the Examiner, should he choose to enter a pooling order, as to what the risk factor penalty ought to be?

A. We would recommend that the maximum allowable penalty be established in this case, and we would ask that that penalty be 200 percent.

Q. Based upon what reasons, sir?

A. Well, we are drilling on a lease that has 12 -- or 10 wells immediately offsetting us that have produced for some time, some as far back as 1959.

I presented the economics and the pressure analysis, assuming that our acreage has not been affected by any prior production.

But as an engineer, I have to consider the fact that there has been a substantial amount of production occur from the offset wells. In fact, in the Mesaverde the 10 wells have produced 3.9 billion cubic feet of gas, and the 10 wells in the Dakota have produced 8.6 billion cubic feet of gas.

So it's certainly possible that there could be some pressure depletion that we encounter in the south half of Section 14.

Q. Let's turn to Exhibit 12. As part of your offset well data information submitted for commingling, you have tabulated what here, sir?

A. This presents -- What I've attempted to do here is walk around our spacing unit, starting to the north, and if you look back to our Exhibit 1, those would be the spacing units that we're looking at here.

For instance, to the north we have two wells, Caulkins' Breech B 220R and 220M. I've given you the locations, API numbers, pertinent data for those wells. If you look across the tabulation, I even show the downhole commingling order that was issued in each instance that allows those wells to be downhole commingled, and I've also indicated the allocation factors that were authorized in those orders for both gas and condensate.

And kind of the last thing in that tabulation, in the far right side, would be just a listing of what is the average production from the Mesaverde and Dakota for both gas and condensate.

And so I've indicated we have fully developed 320-acre sections -- or spacing units, to the north, northeast, east, southwest and west. And we have two spacing units that have only a parent well in them, so there would be room for an infill well. And then we have one spacing unit to the northwest -- or a spot for a spacing unit to the northwest that has no Mesaverde or Dakota development.

Q. Let me have you turn to Exhibit 13. Summarize for us the information you're submitting on Exhibit 13. What's the purpose here?

A. Okay, Exhibit 13 again looks at the spacing units that are adjacent to the south half of Section 14. It looks at the individual wells, and the upper portion of the first page on Exhibit 17 presents the information that's pertinent to the Blanco-Mesaverde Pool. And the lower portion of the page on Exhibit 13 presents that same information for the Dakota completions.

As I mentioned a little bit earlier, you can see by individual well the cumulative production, and my data is as of April 1st of 1997. The total of those 10 wells is

3.9 billion cubic feet of gas and nearly 40,000 barrels of condensate.

From the Mesaverde those same spacing units have produced 8.6 billion feet of gas plus nearly 93,000 barrels of condensate from the Dakota.

An additional piece of information that is shown on Exhibit -- the first page of Exhibit 13, would be what I'm showing as the initial production rate that existed for these wells back basically the first month of production.

And the primary reason that I wanted to show that is to be able to draw a comparison between these wells and wells that would exist in the San Juan 28-8 unit, approximately four miles to the northwest. And I would ask you to keep in mind -- And we'll have additional information on that in a little bit, but typically a Mesaverde well in the San Juan 28-7 unit would start out with initial production around 20 million a month.

You can see looking down through our 10 Mesaverde wells, with the exception of one well, all of our wells would be smaller, start with a lower rate, and therefore not quite as good of a Mesaverde section as exists in the San Juan 28-7 unit.

That same type of analysis with the Dakota, the initial rate that Conoco presented for their wells in the San Juan 28-7 unit for the Dakota completion was 13.3

million a day, and with the exception of four wells in the Dakota, all wells in offset production spacing units were lower than that.

Q. So when we compare rates of both formations to those that were in the Conoco unit, you anticipate lesser rates?

A. That is correct.

Q. And we're dealing with the Conoco order that approved their commingling of their wells?

A. Yes, sir. I'm depending upon that order pretty heavily, because Conoco presented a tremendous amount of information to support the marginal nature of the Dakota and the fact that downhole commingling of Mesaverde and Dakota is an acceptable completion procedure and will not be harmful to either zone.

Q. In terms of looking at economics, your spacing unit appears to be less favorable than the economics presented by Conoco in their case?

A. That is correct.

Q. If the Examiner wants to look at the production decline curves on each of the Mesaverde wells in your area plus the Dakota wells in your area, you have coded these so that he can see where that rate would be had he applied the Conoco criteria to your wellbore?

A. Yes, I have.

Q. Let's do that so we can see how you've illustrated it. Let's turn to the first one. It's the Breech 1 220R well?

A. Yes, sir.

Q. The initial rate on that well is what, in the Mesaverde?

A. Okay, what I've done there in pencil, if you just inscribe a production trend through the actual production data, which I've done with the straight line there, that would have an initial starting rate of 7500 MCF per month.

And the dot that would be above the scale there -- in fact, it's a little circled dot that's right below the well label -- that would be a point on that production graph that would equate to Conoco's 20.5 million a month that they consider to be typical of an average Mesaverde well in the San Juan 28-7 unit.

Q. And so by analogy you have taken each of these production plots, made those forecasts, compared it to what the Conoco criteria was for economics, and determined as to initial rate you're substantially less than what they demonstrated the rate to be?

A. That is correct.

Q. All right. When you've finished the analysis and the comparison to the Conoco 28 and 7 well, are you able to ultimately conclude that your economics in the Mesaverde and Dakota are less favorable?

A. That is true.

Q. Let's turn to the other issue on the -- or the next issue on commingling. If you'll direct your attention to Exhibit 14, identify and describe for us what we see here.

A. Okay, Exhibit 14 is a presentation of what I would anticipate the initial pressure to be for the Mesaverde completion, the Dakota completion, and then taking that data and putting it at a common pressure base, I have estimated what the Dakota pressure at a datum for the Mesaverde would be.

The information that allowed me to do this was -- or the source of my information was the initial shut-in tubing pressures that each well, each of the offset wells, reported at the time of their completion.

That information, as far as the data that was used to arrive at what I anticipate Mesaverde and Dakota pressures to be, that base information is presented on Exhibit Number 12 under the columns, "initial shut-in tubing or shut-in casing pressures".

I've taken that data, averaged it to arrive at what I would expect Mesaverde and Dakota pressures to be, and then using standard procedures I've calculated what those pressures would be at bottomhole conditions.

And that's basically what you see on the front page of Exhibit 14. The second and third pages of Exhibit 14 would be simply what we would anticipate the gas composition to be from a Mesaverde well that Dugan operates and from a Dakota well that Dugan operates in the general areas of what we're talking about.

And the primary purpose of showing those analyses is, through these calculations some of the compositions of the gas is important to arrive at an accurate calculation of bottomhole pressure, and that's the primary purpose of that.

Q. Conoco presented pressure data and obtained Division approval to commingle, despite the fact that they had the potential for pressure variations that exceeded the standard and the rule?

A. Yes, they did.

Q. All right. How does your pressure forecast in your area compare to what Conoco forecasted and obtained approval to do?

A. Our pressures that we anticipate and that are presented on Exhibit 14 are very, very similar to the pressures that Conoco presented. In fact, Conoco's pressures are just a little bit higher, but the data that was presented for San Juan 28-7 unit, our pressures are, I believe, very comparable.

Q. And again, the pressures you're anticipating have been used under the assumption that your spacing unit has not been pressure depleted?

A. That is correct.

Q. All right. Let's show the Examiner the relationship so he can see where this spacing unit is in relation to the 28 and 7. If you'll turn to Exhibit 15 --

A. Okay.

Q. -- show us the comparison.

A. Okay. Exhibit 15 is nothing more than just a well-location map for this general area, and I've delineated the southeastern boundary -- actually the boundary for the southern part of the San Juan 28-7 unit, although the western boundary looks like it got cut off. The western boundary of the San Juan 28-7 unit is right along the western edge of the paper, and you can see portions of the boundary indicated there.

From -- And I've also outlined the south half of Section 14, so you can see we're -- not a stone's throw away, but we're certainly within a distance of the San Juan 28-7 unit that -- What information exists for it, I believe, is -- it's reasonable to consider at our location four miles to the southeast.

Q. And then identify for us Exhibit 16.

A. Exhibit 16 is a copy of the order that was issued in Conoco's reference case. Again, that case was Number 11,815. It was heard in July and August of 1997. It's a very recent case. And the order that was issued in that was R-10,476-B, and that is -- And Conoco, in their case, was considering other intervals in addition to the Mesaverde and Dakota, although I am principally for this hearing using the information from that case that applies to the Mesaverde and Dakota intervals.

Q. They were dealing with a data set that gave them information on -- what? 133 Dakota wells and 118 Mesaverde wells?

A. Yeah, they basically have a substantial well count, both in the Mesaverde and Dakota. And I believe the numbers you mentioned are accurate, which provides them with a substantial amount of information for both intervals.

Q. And you've examined the data from that case and satisfied yourself that the application to your area is reasonable and appropriate for commingling purposes?

A. Yes, I have. I've reviewed -- I obtained a copy of the transcripts in this case, I've reviewed the transcripts, and it's my opinion that this is some awful good information, and it is applicable to our area.

Q. Let's turn finally now to Exhibit 17, which is taken from the Conoco case file -- it was their Case --

Exhibit 36 -- and have you describe what you're showing this for.

A. Well, what I wanted to show this -- and again, there was lots of information in the transcripts that I thought was good, but what Conoco is presenting here -- and as I indicated, there's more than just the Dakota and the Mesaverde that Conoco was dealing with, although for our purposes the upper two curves on this production curve would represent -- the very top curve is -- I should have color-coded this -- is their Mesaverde average performance. And the second curve down would be what they are presenting as an average production performance for the Dakota completions in the San Juan 28-7 unit.

Now, to generate this data, they only used 44 Dakota wells and 42 Mesaverde wells, but what they've done is, they've normalized all production. No matter what year it started to produce, they started at year one and come up with an average production for year one, an average production for year two, year three and so forth, and plot it here.

And so they give us not only where the initial production started -- For instance, the Dakota had an initial rate, Conoco presented, of 437 MCF a day. I've converted that to millions per month. And it's that information that I had compared the offset wells to on an earlier exhibit.

Same thing for the Mesaverde, Conoco starting out with an initial rate of 20.5 million a month, and you can see what they are presenting as a typical production decline trend.

In other words, a Dakota well would start at 13.3 million a month, decline for the first year at 52 percent, the second year at 19 percent, and then it would stabilize to the economic limit at 8 percent.

It's basically that production decline information that you'll see presented --

Q. It's on your Exhibit 13, I think.

A. Right, it's that information that I've traced over the offset well data on Exhibit 13. And the reason for me doing that was to show you that the offset wells in this general area, with respect to Mesaverde and Dakota production in the San Juan 28 and 7 unit, we're typically dealing with smaller wells.

Q. Because of the marginal nature of the production you anticipate in both the Dakota and Mesaverde for this spacing unit, in your opinion is it necessary to minimize the amount of money spent on this type of well?

A. Yes, that's standard Dugan operating procedure, to always keep that at an optimum, if at all possible. And the kind of wells we're looking at, and considering the risk involved, the initial drilling and completion costs would be very important.

Q. At this point, then, in your opinion, your AFE for $420,000 is fair and reasonable?

A. Yes.

Q. And you would recommend using the 4-1/2-inch casing, as opposed to 5-1/2?

A. If there is no question about the issue of downhole commingling, yes.

Q. And if that issue has to be deferred, then you'll have to spend the additional money and put the 5-1/2-inch in?

A. Yes, sir.

MR. KELLAHIN: All right. That concludes my examination of Mr. Roe.

We move the introduction of his Exhibits 8 through 17.

MR. CARR: No objection.

EXAMINER CATANACH: Exhibits 8 through 17 will be admitted as evidence.

Mr. Carr?

CROSS-EXAMINATION

BY MR. CARR:

Q. Mr. Roe, if I understood your testimony, because of pressure depletion -- and there's a potential for that in the south half of this section -- and the marginal production that you anticipate from the two principal zones, it was your testimony the 200-percent risk penalty would be appropriate; is that right?

A. Yes.

Q. And that would apply regardless of who prevailed and was operating this tract if, in fact, they were carrying something?

A. Yes, sir.

Q. When we look at the AFE, there's a disparity in the AFE costs. Your decision to go with 4-1/2 casing, as opposed to 5-1/2, really is dependent upon the determination as to the request to downhole commingle; isn't that right?

A. Yes, sir.

Q. In the southeast quarter of the section, Mr. Dugan has a Pictured Cliff-Chacra well; isn't that correct?

A. Yes.

Q. If a well was drilled in the southwest quarter of this section, if you were drilling one in the southwest quarter and considering a dual completion of commingled production, say, with the Pictured Cliffs, wouldn't it be prudent in that circumstance to have 5-1/2 casing?

A. I understood you to say that we would possibly in that new well in the southwest quarter be commingling

Pictured Cliff-Chacra with the Mesaverde-Dakota? I --

Q. If you commingled Mesaverde-Dakota, you could still -- we'd have the option with larger casing to, say, dually complete with one of those other zones, wouldn't we?

A. Yes, if you chose to dually complete. But I might point out that there is a Pictured Cliff well already there, and so you would just be looking at adding the Chacra. And if we were to choose that type of a completion -- which, I might add, Dugan Production wouldn't look forward to operating that kind of a well setup, two zones commingled through one string and a separate zone through a dual string of tubing, that would be a little more complicated than we --

Q. If you were doing that, 5-1/2 casing would be what you would need, though, don't you agree? You wouldn't try it with 4-1/2?

A. I for sure wouldn't try it with 4-1/2, and I'd probably run 7-inch.

Q. Your overhead and administrative costs are $4000 while drilling and $400 while producing; is that correct?

A. That's correct.

MR. CARR: That's all I have.

EXAMINATION

BY EXAMINER CATANACH:

Q. Mr. Roe, you don't see the pressure differential in the Mesaverde and Dakota to be a problem in a commingling situation?

A. I don't, Mr. Catanach. I think there's no question the Dakota is substantially higher pressured than the Mesaverde, but as Conoco spent quite a bit of time demonstrating, because of the low-permeability nature of Mesaverde and Dakota, just a small amount of producing time, the operating bottomhole pressure between each zone would be very comparable.

And because of the tight nature of the reservoir, if you were to shut either zone in or, in the instance of commingled, shut both zones in, the buildup time to come back to original pressure or near original pressure would be, very likely, much longer than the anticipated shut-in times.

So if there is any crossflow between -- from the Dakota to the Mesaverde, it will be just a very brief period during the early productive life of the well.

Q. Okay. Your proposed allocation is based mainly on offset production. Does Dugan intend to actually conduct a test on the well?

A. If the Commission would approve the fixed allocation between zones, we wouldn't anticipate individually testing again.

If individual tests are required, that would add about $25,000 to our completion costs. And as with any well, any time you produce and then kill the well and move things around, you always run the risk of getting some trash or jeopardizing the completion that you've just effected.

So our anticipated completion would be to not test individually, perforate both Mesaverde and Dakota, probably the same day, stimulate the same day or sequential days, and put the well on production.

Q. You've got pretty good faith in your numbers?

A. I've looked at all offset wells, and I've spent a substantial amount of time looking at other Mesaverde-Dakota information, even in addition to the San Juan 28-7 unit.

And so yes, I think we've been producing the Mesaverde and Dakota in the San Juan Basin long enough that there is a tremendous amount of information available with -- not too far away from this. I mean, there's some operators now looking at going to 80-acre spacing in Mesaverde -- or 80-acre drainage, not spacing.

So Mesaverde and Dakota both are mature pools. A lot of information has been developed. All -- I shouldn't say all. There is one well operated by Chateau that's not downhole commingled, but I don't understand why. With that one exception, all the offset wells are downhole commingled.

There's a reference order in the San Juan 28-7 unit that initially allowed them to downhole commingle 17 wells upon completion, and the reference order that we offered as Exhibit Number 16 allows any subsequent well in the San Juan 28-7 to be downhole commingled initially. And it was Conoco's conclusion that a fixed allocation factor is fine and will protect correlative rights.

And we have, in our south half of Section 14, the ownership in the Mesaverde and Dakota is the same. So even if there is a small difference, it shouldn't affect anybody's interests within the south half of Section 14.

Q. Okay. Let me ask you about -- Have you looked at any of the geology in this area, Mr. Roe?

A. Well, yes, I have. Dugan's geologist has worked the geology pretty well, and I've reviewed that geology with him.

Q. Okay. Let me ask you about what your opinion is as to -- If there are two separate units established here and there are two separate wells drilled, are these wells going to be comparable in terms of producing rates?

A. Well, what we can -- we see -- There is no information that I'm aware of that would tell us there should be a significant difference between southeast and southwest.

Our geologist, the way he plots the -- isopachs the Mesaverde thickness, the thickness in the southeast quarter is identical to the thickness in the southwest quarter. And the same thing exists in the Dakota.

Now, I will qualify that. The only information to the south we have is Caulkins' recently completed well. We did obtain those logs and have included that information in our analysis, and with that reservoir information geologically the Mesaverde and Dakota are very similar in the southeast and southwest.

Now, with regards to production information, you don't know until you drill. But reservoir-thicknesswise, we're looking at very similar pools in both quarters.

Q. So it is your opinion that the wells will be comparable --

A. Yes.

Q. -- in terms of producing rates?

A. Yes, sir.

EXAMINER CATANACH: I think that's all I have.

MR. KELLAHIN: Mr. Examiner, our last Exhibit is 18. It's our certificate of notification. We would move the introduction of Exhibit 18.

EXAMINER CATANACH: Exhibit Number 18 will be admitted as evidence.

Is there anything further, Mr. Kellahin?

MR. KELLAHIN: No, sir.

EXAMINER CATANACH: Five minutes? Let's take five minutes.

(Thereupon, a recess was taken at 11:40 a.m.)

(The following proceedings had at 11:55 a.m.)

EXAMINER CATANACH: Call the hearing back to order and turn it over to Mr. Carr at this time.

MR. CARR: Mr. Catanach, at this time we call Robert L. Verquer.

ROBERT L. VERQUER,

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 full name for the record?

A. Robert L. Verquer.

Q. And where do you reside?

A. Aztec, New Mexico.

Q. By whom are you employed?

A. Caulkins Oil Company.

Q. And what is your current position with Caulkins?

A. Superintendent.

Q. You're the field superintendent for Caulkins?

A. Yes, I am, sir.

Q. Have you previously testified before this

Division?

A. No, I have not.

Q. Could you briefly summarize for Mr. Catanach your educational background and your work experience?

A. High school graduate from Bloomfield High School. I went to work for Caulkins Oil Company in 1980 as a fuel pumper and since then have been promoted --

Q. Mr. Verquer, you're going to have to speak up just a little. That microphone doesn't amplify your voice.

A. I was employed by Caulkins Oil Company in August of 1980. From that point I've worked my way up through the company until my father retired in December of 1992, and I took over the superintendent position.

Q. While with Caulkins, have you participated in various courses and special programs on oil and gas production?

A. Multiple seminars on frac stimulation, cementing, well drilling, frac -- whatever.

Q. Are you familiar with the Applications filed in each of these cases by Dugan Production Corporation?

A. Yes, I am.

Q. And are you familiar with the subject area?

A. Yes, I am.

Q. How many wells does Caulkins actually operate in this area?

A. 189 wells, 210 meter stations, 314 producing zones.

MR. CARR: Mr. Catanach, at this time we tender Mr. Verquer as an expert -- as a practical oilman.

EXAMINER CATANACH: Any objection?

MR. KELLAHIN: No objection.

EXAMINER CATANACH: Mr. Verquer is so qualified.

Q. (By Mr. Carr) Mr. Verquer, are you familiar with the Application filed in this case by Caulkins for compulsory pooling of the same acreage which is the subject of this hearing?

A. Yes, I am.

Q. And that case is scheduled for hearing on February the 5th; is that right?

A. Right, correct.

Q. When we compare that application to the Application filed by Dugan, both of you are seeking to pool the same 320-acre tract; isn't that right?

A. That's correct.

Q. Both of you are seeking to downhole commingle production from the Blanco-Mesaverde and the Basin-Dakota Gas Pools; is that correct?

A. That's correct.

Q. Dugan seeks to be the operator, if there's a south-half unit, with his case, and we seek to be operator of the south-half unit with our Application; is that right?

A. That's right.

Q. Dugan also has an Application whereby Dugan is proposing two nonstandard units, one comprised of the southeast quarter of the section, the other of the southwest quarter of the section?

A. That's correct.

Q. Dugan would operate the southeast quarter under his proposal, and Caulkins would operate the southwest. Is that how you understand it?

A. Yes, it is.

Q. Does Caulkins support the development of the south half of the section with two 160-acre spacing or proration units?

A. Yes, we do.

Q. With two units, and if Caulkins was the operator of a 160-acre unit comprised of the southwest quarter, how would you propose to complete the well?

A. If we get the nonstandard proration units, Caulkins will drill a Dakota-Mesaverde-Chacra well. This would be a dual -- dually completed. We'd downhole commingle Dakota-Mesaverde and then produce the Chacra through a separate string.

Q. And for that reason it's essential that you have 5-1/2-inch casing in the well; is that right?

A. Yes, sir, it is.

Q. Could you identify for Mr. Catanach what's been marked as our Exhibit Number 1?

A. The map, the land map.

Q. And it shows the south half of 14, which is the subject proration unit?

A. Yes, it does.

Q. It's got an indication over the southeast quarter that says "Mead". Who is Mead?

A. Mead was the previous owners. They had originally drilled a Pictured Cliff well on this and produced at the final plug and abandonment. After abandoning the well, they left -- there had been no other production drilled or anything done on the sections for a period of three to four years.

I went down and nominated this 160-acre block so that we could go ahead and drill our Dakota well on this south half of this section. Dugan was successful in outbidding us for this southeast quarter.

Q. And that brings us here today, right?

A. Right.

Q. Can you review the ownership in the south half, as you understand it?

A. The ownership in the south half, we've had for approximately years. My father had attempted to drill a

Dakota well on this southwest quarter, 15, 20 years ago. He contacted the Mead owners. They were not interested, and we had some other infill wells that we were drilling at the time through 26-6, so we didn't push the issue. And we haven't for that period of time.

We're getting to a point where we've pretty well drilled all the infill wells, so the southwest quarter is what I started looking at back in the spring of -- it would be the spring of 1997 when I nominated this southeast quarter, because we decided we'd drill this if we wanted to drill the Dakota.

Q. Dugan acquired the lease and therefore has the working interest -- all the working interest in the southeast quarter; is that correct?

A. That's correct.

Q. Does Caulkins represent the working interest ownership at this hearing today in the southwest quarter?

A. Yes, we do.

Q. All of that will be voluntarily committed; no pooling would be needed in the southwest quarter?

A. No.

Q. And the other partners are Marathon and Dreyfus in that acreage?

A. Yes, they are.

Q. Do you operate other properties in which the

Marathon and Dreyfus interests are also involved?

A. Approximately 150 wells operated by Caulkins Oil. Any of our Breech wells are all standard 55 percent, 22.5, 22.5, and the 22.5-percent owners being Dreyfus and Marathon.

Q. Mr. Verquer, would you go to what's been marked as Exhibit Number 2, the AFE? You were present here today for the testimony of Mr. Roe, were you not?

A. Yes, I was.

Q. And do you agree with the comparison between the Caulkins AFE and the Dugan AFE made by Mr. Roe?

A. Yes, I do.

Q. Basically, the two differences in the AFEs relate to casing size and the adding of automation to the well, which Caulkins is proposing; is that correct?

A. Yes, it is.

Q. Why are you proposing to automate the well?

A. Automation -- Caulkins over the last three years has automated approximately 80 wells out in our field, wells that are producing more than 200 MCF per day or have a smaller producer on the same location that we could tie in simply.

What we've been able to do with automation out in the field is decrease waste by blowing wells to the atmosphere by over 90 percent, by using the automation.

We have software in the office that we can communicate with the wells in the field, turn the wells on and off and control the wells by a daily nomination, which allows us to meet our spot market obligations very easily.

Q. In your opinion, has automation of these wells resulted in more efficient operations?

A. In my opinion, yes.

Q. Does your AFE reflect actual costs that have been incurred by Caulkins during your 1997 drilling program?

A. Yes, it does.

Q. Do you concur with the testimony that's previously been presented concerning the efforts made to reach voluntary agreement for the development of this acreage?

A. Yes, I do.

Q. In your opinion, has a good-faith effort been made all the way around to come up with a proposal?

A. I think it has, yes.

Q. In this immediate area, how many wells does Caulkins actually operate?

A. 189 wells.

Q. And what percentage of the wells in this portion of these fields would you estimate that Caulkins operates?

A. Excuse me?

Q. Can you estimate the percentage of wells operated in, say, this immediate area by Caulkins?

A. Ninety to 95 percent right there in the immediate area.

Q. In the nine-section area surrounding the well, how many wells are you aware that Mr. Dugan actually operates?

A. The only well I'm aware of right there in the immediate area is the one -- the Mona Lisa Number 1.

Q. The Caulkins Exhibit Number 3, is that the letter that was sent by Caulkins to Dugan proposing the pooling of this acreage in December of this year?

A. Yes, it is.

Q. I think it would helpful for you to review the contacts, the first contact that you had with Dugan concerning the development of the south half of this acreage.

A. First contact I made with Sherman Dugan, we were drilling the 377 well, had Four Corners drilling up on our 377 well in Section 23, and I had seen Sherman down in the canyon, and he was staking the Mona Lisa Number 2 and the Mona Lisa Number 1, the PC-Chacra well.

Sherman and I spoke, and I had mentioned that we had planned on, now that we had an owner that we could deal with in the southeast quarter, that we would plan on drilling a Dakota well in 1997.

I also offered at that time to operate the Pictured Cliff-Chacra that they were planning on drilling, and we just joked about it. He offered to operate all of my wells also, and we went on about business. But we talked about drilling a well down here.

And the next -- I believe the next time I was talked to about a Dakota well was when Dave Poage called me -- and I'm not sure on what the date was. We were frac'ing our 8M well. He'd called, and they had a caterpillar down in the canyon and wanted to move on to the Mona Lisa Number 2 and build a location.

I had not seen a formal proposal on who would be the operator or an operating agreement at that time. I said, This sounds like we should go ahead, and told him to go ahead and build a location.

When I got to town that evening, the formal proposal was on my desk. After reading it, I called him back and told him, Let's hold off, because we needed to talk about who's going to be the operator, and it's come to here.

Q. The only written proposal from Caulkins was the December 4th letter; is that right?

A. That's correct.

Q. And with that letter was the AFE and a joint operating agreement; is that right?

A. Yes, it was.

Q. What were the overhead and administrative costs set forth in the joint operating agreement? Let me show you here.

A. Oh, overhead drilling and administrative was $760 during drilling and $237 per month to operate the well.

Q. Are these the standard costs that Caulkins sets forth in the operating agreements that it has with its partners in the area?

A. Yes, these are standard charges that Caulkins normally charges to other wells that we operate in partnership.

Q. And are these the figures that Caulkins would recommend be incorporated in the order that results from this hearing if this Application for compulsory pooling is granted?

A. Yes, it is.

Q. Do you agree with Mr. Roe that the acreage has suffered pressure depletion?

A. Yes, I do.

Q. And do you agree that each of these zones is capable, potentially, of only marginally production?

A. Yes, I do.

Q. In your opinion, is there a chance you could drill a well at the proposed location that would not be a commercial success?

A. There's always a chance, yes.

Q. Do you recommend that a 200-percent risk penalty also be imposed on anyone who doesn't participate in the well if you're designated operator?

A. Yes.

Q. And Caulkins is seeking to be designated operator of the south half of this section if, in fact, that acreage is pooled; is that right?

A. Yes.

Q. As to the downhole commingling portion of this case, do you concur with the Dugan testimony that the efficient way to produce the Basin-Dakota and Blanco-Mesaverde is to downhole commingle those zones?

A. Yes, I do.

Q. In fact, you're downhole commingling those zones in virtually every well that you operate in this immediate area; is that not right?

A. That's true.

Q. And will you file an administrative application seeking authorization to downhole commingle production in the wells which you operate on this property?

A. Yes.

Q. Do you have anything further to add to your testimony?

A. Not that I can think of, no.

Q. In your opinion, will approval of the Caulkins Application, pooling the south half of the section and designating Caulkins operator be in the best interests of conservation, the prevention of waste and the protection of correlative rights?

A. Yes, I do.

Q. If, in fact, you are designated the operator, will Caulkins proceed with the drilling of both wells, the one in the southwest quarter and the one in the southeast quarter?

A. Yes.

Q. Were Exhibits 1 through 3 prepared by you or under your direction?

A. Yes, they were.

MR. CARR: At this time, Mr. Catanach, we'd move the admission of Caulkins Exhibits 1 through 3.

EXAMINER CATANACH: Exhibits 1 through 3 will be admitted as evidence.

MR. CARR: And that concludes my direct examination of Mr. Verquer.

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Verquer, Dugan's formal well-proposal letter was dated October 6th, and it was sent to you and you received that letter?

A. Yes, I did.

Q. In relation to the date of the letter, October 6th, when did you get the letter?

A. However long the mail takes to get there. I'm not sure of the date, the exact date I received that.

Q. Upon receiving the letter, did you come to the conclusion that you wanted Caulkins to operate the well, as opposed to Dugan?

A. Yes, we do.

Q. And so -- Do you report to somebody else in Caulkins?

A. My boss is in Denver, Harley Higbie and Pat Robinson.

Q. Who makes decisions on proposing wells on behalf of your company to other interest owners?

A. I initially will propose the wells, and then the money is gathered in Denver to go ahead and -- Pat Robinson would be the one that would gather the money from the partners to drill the wells.

Q. So when you reached the conclusion that you wanted Caulkins to operate the well if it was a south-half spacing unit, you made that pretty quickly after the October 6th letter?

A. We made the decision that we wanted to drill a

Dakota well that -- when I nominated that property down there.

Q. So even before it was up to lease, you wanted to drill and operate the well?

A. We -- Yes, we had planned on drilling and operating a Dakota well in that south half of that section.

Q. And you knew in July, then, of 1997, that Dugan got the lease and not you?

A. Yes, I did.

Q. And you knew in September that the lease was issued to Dugan and not to Caulkins?

A. Yes, I did.

Q. Then why did you wait till December 4th to formally propose your well?

A. We had no plans of drilling that well in the 1997 program. We were going to drill a Dakota well in the 1998 program.

Q. You waited two months after you got Mr. Dugan's proposal before you got around to proposing a competing well?

A. Caulkins has actually waited 40 years to drill --

Q. Caulkins has waited 40 years? Is that true with your other acreage in the area, when we exclude Section 23? Well, let's look at Section 23 to the south.

You're drilling the 377?

A. I have drilled and completed the 377 well.

Q. And that's a recent well?

A. Yes, it is.

Q. And Caulkins controls Section 23?

A. Yes, it does.

Q. And so for what, 40 years you didn't drill Section 23?

A. Geologically, Section 23 and -- in that area. That Dakota well is the furthest Dakota well to the south in our field, or the furthest Dakota well in the south of anybody's leases around there. It is supposed to be poor Dakota country, and we've just gotten around to drilling that.

Q. Why did you drill in the north half of 23, as opposed to going to the south?

A. We wanted to go to the furthest well to the south, because we do have all the acreage in between there to come back toward the north.

Q. Do you know what the lease burdens are on the southwest quarter of 14?

A. No, I don't, other than we own -- Caulkins has 55 percent and Marathon/Dreyfus both 22.5. Dreyfus took over Marathon's.

Marathon did not -- What am I trying to say? Marathon -- I've lost my wording.

Q. Well, let me ask you a different question. Do you know what Caulkins' net revenue interest is in the southwest quarter of 14?

A. No, I don't.

Q. Do you know what Marathon's net revenue interest is in the southwest quarter of 14?

A. No, I don't.

Q. Louis Dreyfus?

A. No, I don't.

Q. Do you know if those burdens apply to Section 23 as well as the southwest of 14?

A. I would say the burdens would be the same, but I am not positive.

Q. Do you know if those burdens apply to any of the other spacing units surrounding the south half of 14?

A. No, I don't.

Q. Would that be an explanation of why Caulkins has waited so long to drill further wells in the Dakota and Mesaverde, because of those burdens?

A. I would not say so because of -- from talks I've had with my dad, which was the superintendent of this company for 40 years, they attempted to drill a Dakota well here back 15, 20 years ago and could not get a line through -- or an agreement between the Mead ownership and them to go ahead and drill it, so they just dropped it.

Q. Let me talk about your proposal in the southwest. You're proposing to drill a downhole commingled Mesaverde and Dakota, and you want the opportunity to dual that with the Chacra?

A. Yes, if we could get the nonstandard proration unit.

Q. Okay. In the absence of a nonstandard proration unit, it would be pretty difficult to utilize this wellbore for the Chacra, because Mr. Dugan would have no interest in the Chacra?

A. That's right.

Q. And so we would have the complexities of allocating costs to Mr. Dugan for the Dakota and Mesaverde and yet somehow not charge him for the incremental share of the Chacra?

A. If we do not get the nonstandard proration unit and Caulkins is ordered the operator of that 320 acres, there will be a Dakota-Mesaverde well drilled, and Caulkins at some later date will drill the Chacra well on another location.

Q. That introduces a further problem, then. We ought to split these things in half, don't you think? You operate the southwest quarter and do what you want with the Chacra, and let Mr. Dugan operate the southeast quarter?

A. I agree with that.

Q. That seems to make sense, doesn't it?

A. Yes, it does.

Q. Are the overhead rates that you're proposing, are they dictated to you because you're stuck with some old operating agreements that provide those low rates?

A. Pat Robinson handles this out of Denver. He sent me these figures down. Apparently these are overhead rates that they use, standard with Caulkins Oil Company. Why they use these figures I have no idea.

Q. So you can't answer my question?

A. I can't answer your question, no.

Q. You can forecast that both these zones are likely to be marginal, so you and Mr. Roe agree on that issue, do you not?

A. Yes, we do.

Q. And you don't see a problem with pressure differentials? That is not a concern for you?

A. No.

Q. We've got common ownership, to the best of your knowledge, in the zones, so that's not an issue?

A. Yes, sir.

Q. When we look around the southwest quarter of 14, it appears that if it's not Caulkins controlling the offsets it's Chateau or Louis Dreyfus; am I correct in understanding?

A. That's correct.

Q. All right. So if Dugan has notified all the offsetting interest owners on that map, then there's been no objection from any of those people. Are you aware of any objection?

A. I'm not, no.

Q. All right. The timing for drilling your well, either for the southwest quarter or if the Division approves your case, is what, sir?

A. April of 1998.

Q. It would be scheduled for April of 1998, all right.

A. Upon rig availability.

Q. And your preference for the 5-1/2-inch casing is to give you the flexibility to utilize that wellbore in the event you have to dual it with some other formation?

A. Right. I originally proposed that, planning on nonstandard proration units. I would agree with Mr. Roe also on the 4-1/2 casing if we're going to drill a Dakota-Mesaverde well, and just commingle it there, and we were awarded operator on the 320, we would run the 4-1/2 casing also.

Q. All right, so the difference in casing size really is not going to help us decide a dispute about pooling --

A. No.
Q. -- for the south half?
A. No.
Q. Okay. Is Caulkins an interest owner in any wells that Dugan operates?
A. Not that I'm aware of.
Q. How about the other way around?
A. Not that I'm aware of.
Q. Okay, so neither company is involved with each other currently?
A. No.
Q. The notion of automization in the office is simply spending $10,000, and if you didn't do it, Mr. Dugan could do it too?
A. I have no idea what they've got in their office as far as the software capabilities and things, to bring it in. But I assume they do have it.
MR. KELLAHIN: All right. No further questions, Mr. Examiner.

EXAMINATION

BY EXAMINER CATANACH:

Q. Okay, Mr. Verquer, with regards to the interests of Marathon and Dreyfus in the southwest quarter, is that subject to an existing operating agreement?
A. Yes, I would --

Q. So you're not -- You don't have to pool these interest owners for the south half. You feel like these interests are already tied up somehow?

A. I feel like we do. The best I'm aware of, the interest owner situation -- and I'm not the one qualified to be telling you -- going over the interest owners. Pat Robinson handles this out of the Denver office. But there's five owners up there, co-owners up there, which is Harley Higbie, George Caulkins, Art Holland, Jane Rathear and Keith Brown. They control the brunt of this working interest owners.

If one of the working interest owners decides not to participate in the well, the five partners will take over that percentage, just get the money and take care of it and assess a penalty to them. That's the way I understand it works, anyway, and I hate to get into that because I can't explain it well enough.

Q. I believe that Dugan testified that Marathon and Louis Dreyfus were aware of the proposal to form two nonstandard units; is that your understanding?

A. Yes.

Q. And what is your understanding of their position on that?

A. My understanding is, they were willing to go along with whatever Caulkins wanted to do, and Caulkins is willing to go with the nonstandard proration units.

If we do not go with the two nonstandard proration units and we decide to -- for one operator on the 320, Marathon and Dreyfus, my understanding was, would back us.

Q. Mr. Verquer, are you fairly confident, knowing this area, that two successful wells can be drilled on each of these 160 proration units?

A. Yes, I am.

Q. What happens if there isn't? What happens if one well is good and one well is bad? Is that going to be a problem for your interest owners?

A. If we break into nonstandard proration units, if we drill a dry hole out there. That's the risk we take every time we drill a well.

Q. You're saying that if Dugan for some reason gets a good well and you drill a dry hole that --

A. I may not be there any longer, but...

(Laughter)

Q. (By Examiner Catanach) Well, my concern is with some of the interest owners in your proration unit. I mean, are you acting in a manner to protect their interests by forming this unit and taking that risk?

A. We have discussed this with my boss, which is one of the five co-owners in Denver, and this was the decision we made before we come down here, that we would agree to two nonstandard proration units.

Q. Are any of the -- Besides the working interest owners, are any of the other interest owners aware of what's going on?

A. I'm sure they are, but I could not testify to that, no.

Q. Did you guys propose a 200-percent risk penalty on your proposed well?

A. Yes, we did.

Q. And it's my understanding, if you're awarded operatorship of the south half, your well in the southwest quarter will only be a Mesaverde-Dakota?

A. That's correct.

EXAMINER CATANACH: Mr. Carr, what application has Caulkins filed?

MR. CARR: Caulkins filed an Application for compulsory pooling of the south half, designating them operator for a well in the southwest quarter and for downhole commingling --

EXAMINER CATANACH: They, in fact --

MR. CARR: -- a parallel Application to the Dugan Application.

EXAMINER CATANACH: Okay, but they have not, in fact, filed an application for a nonstandard proration unit?

MR. CARR: No, we have not. We support the Application of Dugan in that regard.

MR. KELLAHIN: We corrected our advertisement to include in the ad specific reference to Caulkins operating the southwest quarter.

MR. CARR: That's correct.

MR. CARROLL: And Caulkins supports that?

MR. KELLAHIN: Yes. And then we sent corrected notices to Marathon and Dreyfus and to the offsets about that request.

EXAMINER CATANACH: Okay, that was a concern of ours.

You don't propose to put on any additional testimony on the 5th?

MR. CARR: No, we do not. We intend to file an administrative application as to the downhole commingling portion of the case.

EXAMINER CATANACH: So is it your understanding that the only party that needs to be pooled by Caulkins is Dugan in this case, Mr. Carr?

MR. CARR: Yes.

EXAMINER CATANACH: Okay. What else?

I believe that's all I have. Is there anything further?

MR. KELLAHIN: No, sir.

MR. CARR: Nothing further.

EXAMINER CATANACH: Okay, there being nothing further in these cases, Case 11,897 and 11,899 will be taken under advisement.

(Thereupon, these proceedings were concluded at 12:30 p.m.)

* * *

I do hereby certify that the foregoing is a complete [illegible] proceedings in the Examiner [illegible] No. 11897/11899, heard by me on 6/8/ 1998.

[illegible], Examiner
Oil Conservation [illegible]ion

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

I FURTHER CERTIFY that I am not a relative or employee of any of the parties or attorneys involved in this matter and that I have no personal interest in the final disposition of this matter.

WITNESS MY HAND AND SEAL January 11th, 1998.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 1998