

NEW MEXICO OIL CONSERVATION DIVISION

EXAMINER HEARINGSANTA FE, NEW MEXICOHearing Date NOVEMBER 19, 1998 Time 8:15 A.M.

NAME	REPRESENTING	LOCATION
W. Kellachin	Kellachin & Kellachin	Santa Fe
Brian Williams	MARATHON Oil Co	HOBBS
Paul Owen	Campbell, Carr Boels & Sorensen	Santa Fe
Duke Roush	Nearburg	Midland
Ted Gawloski	Nearburg	Midland
Jim Swine	BLM	SF
Allen F. Buckingham	BLM	Albq.
Mona Ables	Matacor	Dallas
Michael Muhlstein	Leakey Energy Services	Midland
Michael D. Hayes	Santa Fe Energy	Midland
William F. Jan	Langheer, Jan, & T. J. Jenden	Santa Fe
RICHARD ALVAREZ	PNM Keller McLeod	Alb. nm
Ned Kendrick	Montgomery & Andrews	SF
Valda Terrells	PNM / Mission Resources Corp.	Albuquerque
Rodney Hest	PNM	Albuquerque
Toni Estac	PNM	Albuquerque

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NAME	REPRESENTING	LOCATION
John Ferraiuolo	PNM	Alb
Ron Johnson	PNM	Albug.
Denny Foust	NMOC D	Aztec
Maureen	PNM	ABQ
Mark Sikelianos	PNM	ABQ
SBorral	Indy	SF
Rick Alvarez	Kelcher McLeod (PNM)	ABQ
Bruce Garber	Garber & Hallmark	SF
Ned Kendrick	Montgomery & Andrews	SF
Toni Bistara	PNM	Albq
John Ferraiuolo	PNM	Albq.
Denny Foust	NMOC D	Aztec
Maureen Gamm	PNM	ABQ.
Ron Johnson	PNM	ABQ
Mark Sikelianos	PNM	ABQ
Valda Truitt	MRCC (PNM)	ABQ
Barney - Heath	PNM	ABQ
J. E. Ellis	Burlington	Farmington

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:) CASE NO. 12,087
)
APPLICATION OF NEARBURG EXPLORATION)
COMPANY, L.L.C., FOR COMPULSORY POOLING,)
LEA COUNTY, NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MARK ASHLEY, Hearing Examiner

November 19th, 1998

Santa Fe, New Mexico

OIL CONSERVATION DIV
98 DEC -4 AM 8:46

This matter came on for hearing before the New Mexico Oil Conservation Division, MARK ASHLEY, Hearing Examiner, on Thursday, November 19th, 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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November 19th, 1998
Examiner Hearing
CASE NO. 12,087

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A P P E A R A N C E S

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 Santa Fe, New Mexico 87505

FOR THE APPLICANT:

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 Santa Fe, New Mexico 87504-2265
 By: W. THOMAS KELLAHIN

* * *

1 WHEREUPON, the following proceedings were had at
2 8:20.m.:
3

4 EXAMINER ASHLEY: This hearing will come to order
5 for Docket 32-98. Please note today's date, November 19th,
6 1998. I'm Mark Ashley, appointed Hearing Examiner for
7 today's cases.

8 Before we call the first case, I would like to go
9 over the docket and take care of the dismissals and
10 continuances.

11 (Off the record)

12 EXAMINER ASHLEY: At this time the Division calls
13 Case 12,087.

14 MR. CARROLL: Application of Nearburg Exploration
15 Company, L.L.C., for compulsory pooling, Lea County, New
16 Mexico.

17 EXAMINER ASHLEY: Call for appearances.

18 MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of
19 the Santa Fe law firm of Kellahin and Kellahin, appearing
20 on behalf of the Applicant, and I have two witnesses to be
21 sworn.

22 EXAMINER ASHLEY: Any additional appearances?

23 (Thereupon, the witnesses were sworn.)

24 MR. KELLAHIN: Mr. Examiner, the presentation is
25 for a compulsory pooling case this morning for a well that

1 will be drilled down through the base of the Morrow
2 formation. The proposed spacing unit is the north half of
3 Section 3.

4 You can see that on Exhibit Number 1 there are
5 two colored dots. Section 3, both the north and the south
6 half, are federal acreage.

7 And this well is in the R-111-P potash area. And
8 because the Bureau of Land Management's potash personnel
9 have required us to do so, the well is intended to be
10 drilled directionally.

11 The directional application, under Rule 111, has
12 been filed with the District Office, Mr. Chris Williams,
13 and he's holding that application pending matters that I'm
14 attending to, which include the final approvals of the APD
15 from the Bureau of Land Management and the running of the
16 notice period to the potash lessee within a mile of the
17 well location.

18 So when you see this case today, you need to
19 recognize that there are other parts to it, including a
20 directional drilling, an R-111-P potash approval, but the
21 topic today for you, sir, is compulsory pooling.

22 With that introduction, I'd like to call my first
23 witness, Mr. Duke Roush. Mr. Roush is a landman with
24 Nearburg Petroleum Producing Company in Midland, and he's
25 testified on prior occasions.

1 DUKE W. ROUSH,

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

4 DIRECT EXAMINATION

5 BY MR. KELLAHIN:

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

8 A. My name is Duke Roush, I'm a senior landman for
9 Nearburg Exploration Company.

10 Q. Has it been one of your duties, Mr. Roush, to
11 identify the ownership within the proposed spacing unit?

12 A. Yes, it has.

13 Q. And once making that identification, have you
14 been involved with and responsible for contacting those
15 other interest owners in an effort to reach a voluntary
16 agreement?

17 A. Yes, I have.

18 MR. KELLAHIN: We tender Mr. Roush as an expert
19 landman.

20 EXAMINER ASHLEY: Mr. Roush is so qualified.

21 Q. (By Mr. Kellahin) Would you turn to what is
22 marked as Exhibit 1 and identify that display for us?

23 A. Yes, it's a locator map showing both the surface
24 and bottomhole location and designating the north half of
25 the proration unit for this well, the Viper "3" Federal

1 Number 1.

2 Q. What is Nearburg's proposed plan for this well?

3 A. It will be drilled directionally from the south
4 half of -- a location 1650 -- 1600 from the east, 2200 from
5 the south, to a bottomhole location of 1650 from the north
6 and 1650 from the east.

7 Q. The current plan, then, is to have a well that
8 will be at a standard subsurface location within a drilling
9 window to be approved by the Division that would honor the
10 standard setbacks for deep gas spacing; is that not true?

11 A. That's correct.

12 Q. All right. When we look at the north half of
13 Section 2, Mr. Roush, let's turn to Exhibit Number 2 and
14 have you tell the Examiner whether or not the north half of
15 2 consists of a single lease.

16 A. That's correct. It covers all of Section 3, in
17 fact, and the ownership under this lease is undivided.

18 Q. All right. The entire Section 3 is a single
19 lease issued by what individual or entity?

20 A. It's a federal lease.

21 Q. When we look at the north half and propose a
22 spacing unit of 320 acres, can you tell me the division of
23 percentages among the working interest owners, as you found
24 them to be?

25 A. Nearburg Exploration company owns 18.611 percent

1 by virtue of a farmout from Burlington Resources. Samson
2 Resources Company owns 75 percent, and Merit Energy Company
3 owns 6.389 percent.

4 Q. Let's set that display aside for a moment and
5 look at Exhibit Number 3. Would you identify and describe
6 this display for us?

7 A. This is a map provided by the BLM showing the no-
8 drilling window or area of potash reserves. It's in the
9 measured portion. If you'll look, you'll see the surface
10 location is just barely outside of this line. This was the
11 location that was given to us by the BLM.

12 Q. That boundary -- Let's look at Section 3. You
13 find the surface location with an open circle --

14 A. Correct.

15 Q. -- and it's immediately adjacent to an area
16 described by a line. Inside that line are a series of
17 black hatchmarks?

18 A. Correct.

19 Q. That is intended to represent what?

20 A. That is a no-drilling area. It's an area of
21 known measured potash reserves.

22 Q. And this is supplied to you by the Bureau of Land
23 Management. You did not draft this document; is that true?

24 A. That's correct.

25 Q. What have you been told by the Bureau of Land

1 Management concerning the use of the surface in the north
2 half of Section 3?

3 A. We cannot use the surface in the north half of 3.

4 Q. So the proposed plan is to do what?

5 A. To drill a directional well where the -- the
6 location just outside of the measured area and to a
7 bottomhole -- a standard bottomhole location.

8 Q. All right. Let's turn now to the topic, Mr.
9 Roush, of your efforts to consolidate the interests in the
10 spacing unit for this well, and to do that would you turn
11 to what we've marked as Exhibit Number 4, and let's go
12 through in chronological order your first efforts to
13 consolidate in any fashion the working interest ownership
14 for this spacing unit.

15 A. Starting in June, we sent letters to both Samson
16 and Merit requesting either a term assignment or a farmout.
17 One was prepared by a broker we used by the name of Maynard
18 Shaw.

19 We continued our efforts, and September 17th we
20 actually sent a formal proposal, certified mail, proposing
21 the well, with an AFE and a JOA attached to both Samson and
22 Merit.

23 Q. Let's stop at that point, Mr. Roush, and set
24 aside Exhibit 4 and direct your attention to Exhibits 5 and
25 6. Would you identify those two documents?

1 A. Yes, these are the well proposals which were
2 mailed to both Samson and Merit.

3 Q. Exhibit 5 went to Merit, Exhibit 6 went to
4 Samson?

5 A. That's correct.

6 Q. Does the formal well proposal include
7 notification to these other working interest owners that
8 this well is intended to be drilled directionally?

9 A. Yes, it does.

10 Q. And you told them the proposed spacing unit for
11 the well?

12 A. Yes, we have.

13 Q. And you've attached a copy of the proposed costs
14 of the well?

15 A. That's correct.

16 Q. As of today, sir, have you received any objection
17 from either Merit or Samson concerning the well costs?

18 A. No, we have not.

19 Q. Have either one of those companies objected to
20 Nearburg Producing Company being designated the operator?

21 A. No, they have not.

22 Q. Have any of them objected to the directional
23 drilling of the well?

24 A. No.

25 Q. Have they objected to the utilization of the

1 north half of Section 3 as the spacing unit?

2 A. No, they have not.

3 Q. Has there been any objection that Nearburg is a
4 minority working interest owner and should not therefore
5 drill the well?

6 A. No.

7 Q. Let's turn, then, to what happened after
8 September 17th, going back through the chronology, what
9 then is the next thing that occurs between you and these
10 other two companies?

11 A. We had continuing negotiations with Samson, not
12 only on these properties but other properties. I had
13 verbal conversations with Gordon Jenner of Merit Energy.
14 We arrived at a verbal agreement to take their interest
15 under a farmout on a 75-25 basis, being 75 percent net
16 revenue delivered with a 25-percent back-in and payout of
17 the well.

18 Q. All right, let's do that, then. Let's look at
19 Exhibit 7 and look at the documentation that supports your
20 effort to obtain a farmout of Merit's interest in the
21 spacing unit. It's marked as Exhibit 7?

22 A. That's correct.

23 Q. And what is this letter?

24 A. This is a farmout agreement that I prepared for
25 their execution, at their request, and it was mailed on

1 October 21st.

2 Q. Okay. Mr. Gordon Jenner with Merit does what for
3 that company?

4 A. My understanding is, he is a geologist.

5 Q. And who is Fred Diem?

6 A. My understanding is that Fred is their executive
7 counsel.

8 Q. And you were directed by Mr. Jenner to prepare a
9 farmout agreement and supply it to Merit, and that's what
10 you did?

11 A. That's correct.

12 Q. What's the next thing that happened?

13 A. On October 27th I received a phone call from Mr.
14 Diem. He had some suggested changes to the farmout; he
15 informed me that these changes were absolutely
16 unnegotiable. I listened to the changes, asked that he fax
17 me the changes so that I could incorporate them into the
18 agreement.

19 Later on in the day, Mr. Jenner called me
20 requesting that they wanted to alter the agreement so that
21 it would only cover depth below the base of the Wolfcamp
22 formation.

23 Q. Let's go back to the first discussion of the day
24 where Mr. Diem is sending you back modifications to the
25 farmout.

1 Let me direct your attention to Exhibit Number 8.
2 Can you identify that exhibit?

3 A. Yes, that's a fax we received. If you'll look on
4 page 1 after the cover sheet, he's advising us that Merit
5 Energy Partners, L.P.; Merit Energy Partners III, L.P.;
6 Merit Energy Partners VII, L.P.; and Merit Partners, L.P.,
7 formerly MeritNet Partners, would be the actual parties who
8 would execute this agreement.

9 Q. Did Mr. Diem make any representations to you
10 concerning his ability to negotiate and reach agreements
11 with you on behalf of all of these companies?

12 A. Yes, he did.

13 Q. In what way was he the representative of the
14 Merit groups?

15 A. He's a vice president for Merit Energy Company
16 and a vice president for Merit Energy Company which is a
17 general partner of all three of these limited partnerships,
18 or four of them.

19 Q. After receiving back, then, on the 27th, his fax
20 of these changes to the proposed farmout agreement, what
21 then did you do?

22 A. I attempted -- Well, we looked at the revisions.
23 At that point in time, after Mr. Jenner called wanting the
24 restrictions on the surface, we advised him that we needed
25 all depths. Mr. Jenner advised me then, essentially we had

1 no deal and we were at an impasse.

2 Q. His proposed modification, was that a significant
3 change to you?

4 A. Yes, it is.

5 Q. And he was proposing to exclude Merit's interest
6 in any formations from the surface to the base of the
7 Wolfcamp?

8 A. That's correct.

9 Q. And that caused the voluntary efforts to then
10 fail?

11 A. That's correct.

12 Q. Let's turn to the topic of Samson. Have you made
13 contact with Samson?

14 A. Yes, we have, and we, as of yesterday, received a
15 letter agreement agreeing to the terms of their voluntary
16 farmout to us.

17 Q. Have you negotiated or attempted to negotiate
18 having Samson's interest committed to other spacing units
19 for other wells?

20 A. Yes, we have.

21 Q. What is your concern about the timeliness of
22 being able to complete a voluntary agreement with Samson?

23 A. We've recently attempted to acquire a farmout
24 from Samson in our Minis 2 well currently drilling. It
25 took us in excess of six months to get a formal agreement

1 from them. I hope that doesn't happen this time, but it
2 may.

3 Q. So your intent is to continue to try to reach an
4 ultimate written conclusion with Samson, but you would like
5 to leave them subject to a pooling order until we can
6 accomplish that, or until the time is expired in which you
7 can do it?

8 A. Correct.

9 Q. All right. Let me ask you this concerning the
10 Merit interest: Have you recently discovered that there
11 are burdens on the Merit Energy Company interest?

12 A. Yes.

13 Q. Describe for the Examiner in a summary way what
14 it is that causes you concern about the Merit interest.

15 A. We had a title opinion rendered that we received
16 at the first part of this week. One of the requirements
17 under the title opinion revolves around a net-profits
18 interest that has been granted from Merit Energy to these
19 partnerships. It's a 95-percent net profits, it's an
20 internal type of conveyance.

21 The conveyance documents, although they put us on
22 notice that there is a net-profits interest, they refer
23 back to a master net-profits agreement that's located in
24 the offices of Merit. So we have, at this point in time,
25 no way of record, of being able to determine what this net

1 profits is, how it's generated, what's deducted, what's not
2 deducted.

3 Q. What is your concern?

4 A. My concern is that we're taking an interest
5 that's so badly burdened that it's totally uneconomic.

6 Q. What do you intend to do about the potential net-
7 profits burden, insofar as it affects our presentation to
8 this Examiner?

9 A. Well, I would like to see the net profits go
10 away.

11 Q. And if it doesn't?

12 A. If it doesn't, then I would like to have the net
13 profits be included in any penalty that is granted under
14 the force pooling, so that we might recoup the net profits
15 as we would our drilling cost.

16 Q. All right. You will continue to discuss with
17 Merit whether they will voluntarily release this spacing
18 unit from the net-profit interest?

19 A. Yes, we will.

20 Q. All right. And if it becomes an issue, then
21 we'll simply come back to the Division and ask for
22 assistance with regards to the net-profit interest?

23 A. That's correct.

24 Q. All right. Let me direct your attention now to
25 the joint operating agreement, Mr. Roush. Would you

1 identify this document?

2 A. Yes, this is a joint operating agreement covering
3 the north half of 3. This was provided at the same time we
4 provided the AFE and the well proposal.

5 Q. What do you propose under the operating agreement
6 for monthly overhead drilling and producing well rates?

7 A. If you look on page 4 of the COPAS, it's \$6000
8 for a drilling well rate and \$600 for a producing well
9 rate.

10 Q. Do you have a recommendation to this Examiner as
11 to an overhead rate on a monthly basis for a drilling well
12 and a producing well to be included in a pooling order?

13 A. Yes, I do.

14 Q. And what is that recommendation?

15 A. \$6000 for a drilling well rate and \$600 for a
16 producing well rate.

17 Q. How does that compare to what Nearburg is
18 charging for similar wells to this depth in your current
19 practice?

20 A. It's the same as we have in the wells located
21 within the area.

22 Q. This is within the general range, then, of the
23 pricing, the voluntary agreements are reached?

24 A. Yes.

25 MR. KELLAHIN: Mr. Examiner, that concludes my

1 examination of Mr. Roush.

2 We move the introduction of his Exhibits 1
3 through 9.

4 EXAMINER ASHLEY: Exhibits 1 through 9 will be
5 admitted as evidence.

6 EXAMINATION

7 BY EXAMINER ASHLEY:

8 Q. Mr. Roush, you said that all of Section 3 -- the
9 ownership is common through all of Section 3?

10 A. Yes, it is.

11 Q. And the north half of Section 3 cannot be used
12 because of the potash stipulation from the --

13 A. From the BLM.

14 Q. -- BLM? Okay.

15 Looking at Exhibit 3, I noticed on the map
16 there's another little circle within that no-drilling area.
17 What is that?

18 A. I believe that is our bottomhole location. Are
19 you talking about the circle that has the "BHL" on it?

20 Q. No, the other circle that has the "U-132".

21 A. That is either a well that has gone down and
22 measured the potash reserves or an actual core hole that
23 someone has gone in and actually cored the potash to
24 determine the extent of this outline.

25 Q. Okay. And one more question about this net-

1 profits agreement that you were talking about earlier, and
2 you said you would like that to be included as part of the
3 penalty?

4 A. Yes, sir.

5 Q. Did you state, or did I miss, a risk penalty that
6 you recommended?

7 MR. KELLAHIN: Our next witness will address that
8 Mr. Examiner --

9 EXAMINER ASHLEY: Okay.

10 MR. KELLAHIN: -- if that's appropriate.

11 EXAMINER ASHLEY: That's fine.

12 Mr. Carroll?

13 EXAMINATION

14 BY MR. CARROLL:

15 Q. Mr. Roush, did you say you have a written
16 agreement with Samson that was executed yesterday?

17 A. A letter agreement, yes, just sets out the basic
18 terms of an understanding of a trade which will be followed
19 up with a formal farmout agreement.

20 Q. Okay, so you want to pool Samson until such time
21 as you reach definite agreement?

22 A. Yeah, our history with the last well we drilled
23 with them, we delayed the hearing, and we delayed the
24 hearing, we delayed the hearing, we delayed the hearing,
25 and literally it went six months before we actually

1 received the formal agreement.

2 Q. Getting to this net-profits interest, you're on
3 notice of a net-profits interest, but this net-profits
4 interest then refers to a master net-profits interest
5 agreement --

6 A. Yeah.

7 Q. -- among these --

8 A. Here's a copy of record. This is common in all
9 of the transactions. If you'll look up, I've underlined at
10 the top --

11 Q. The net-profits agreement dated February 3rd --

12 A. Yeah.

13 Q. -- 1992?

14 A. And if you'll look at the bottom it says, Such
15 agreement being on file at the offices of the Assignor, so
16 it's not of record. So we can't determine, you know,
17 through a standard record check what the net profits
18 consist of. I don't know if it allows the deduction of
19 operating cost or it allows the -- We have no way of
20 knowing how it's calculated.

21 MR. CARROLL: And did I understand Mr. Kellahin
22 right, that Nearburg might come back before the Division
23 once it determines what exactly this net-profits interest
24 is?

25 MR. KELLAHIN: Yes, Mr. Carroll. Mr. Roush just

1 discovered this through the title opinion received this
2 week. And so he will, under my direction, contact Merit,
3 attempt to get from them either access to the base
4 agreement or a commitment in writing that they will manage
5 the net-profit interest the way he's just described it.
6 They will avoid triggering the net-profit interest until
7 Nearburg's recouped the working interest share. In other
8 words, that's not a deduction.

9 If that fails and it's determined to be
10 materially adverse to the prospects for this well, we'll
11 simply have to come back and let you decide whether our
12 pooling order is subject to the net profits interest or
13 whether you want to set it aside until we recoup the cost
14 and the penalty. We're just advising you that we've
15 discovered that issue; we're not asking you to decide it
16 today.

17 MR. CARROLL: You're asking us to address it in
18 the order?

19 MR. KELLAHIN: I think I will submit to Mr.
20 Ashley a draft so that it's reflected in the order that it
21 exists, and we may have to come back and reopen the case
22 later if we can't resolve it.

23 MR. CARROLL: Okay, so you'll submit us a draft
24 order dealing with these net profits.

25 EXAMINER ASHLEY: That sounds good.

1 MR. CARROLL: That's all I have.

2 EXAMINER ASHLEY: No further questions.

3 MR. KELLAHIN: Mr. Examiner, our next witness is
4 Mr. Ted Gawloski. Mr. Gawloski is a petroleum geologist.

5 TED GAWLOSKI,

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

8 DIRECT EXAMINATION

9 BY MR. KELLAHIN:

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

12 A. My name is Ted Gawloski. I'm a geologist for
13 Nearburg Producing Company in Midland, Texas.

14 Q. Mr. Gawloski, there's an overhead air-
15 conditioning fan. You'll have to speak up. It's sometimes
16 a little hard to hear when you're sitting in that position
17 in the room.

18 A. My name is Ted Gawloski. I'm a geologist with
19 Nearburg Producing Company.

20 Q. And where do you reside, sir?

21 A. Midland, Texas.

22 Q. On prior occasions have you qualified as an
23 expert petroleum geologist before the Division?

24 A. Yes, I have.

25 Q. As part of your work as a geologist for Nearburg,

1 have you made a study of this particular well?

2 A. Yes, I have.

3 Q. At this point do you have opinions concerning a
4 proposed risk-factor penalty to recommend to the Examiner
5 for inclusion in this pooling order?

6 A. Yes, I do.

7 MR. KELLAHIN: We tender Mr. Gawloski as an
8 expert witness.

9 EXAMINER ASHLEY: Mr. Gawloski is so qualified.

10 Q. (By Mr. Kellahin) Mr. Gawloski, what is your
11 opinion as to that percentage?

12 A. In my opinion, that percentage should be the
13 maximum allowed under the Division's Rules.

14 Q. The Division Rules are interpreted to allow you
15 to recover out of future production the pooled parties'
16 interest in the cost plus as much as two more times --

17 A. That's correct.

18 Q. -- a 200-percent penalty?

19 A. That's correct.

20 Q. All right. Let's look at the reasons that cause
21 you to reach that opinion. If you'll turn to Exhibit
22 Number 11, identify that so that we'll know what we're
23 looking at.

24 A. Okay, Exhibit Number 11 is a production plat. It
25 covers about a 15-square-mile area around the proposed

1 location, which is located in Section 3 of 20 South, 33
2 East.

3 And within this 15-square-mile area there have
4 been 17 wells drilled to the Morrow, and 13 of these wells
5 have been completed as Morrow producers. Four of them have
6 been Morrow dry holes. They may have been completed in
7 other zones.

8 Two of the wells are recently drilled wells, and
9 if you just take the 11 completed wells within this area,
10 they average -- they've produced a little over 11 BCF and
11 451,000 barrels of oil, for an average of a little over a
12 BCF a well, and 41,000 barrels of oil.

13 Q. What does that mean? In terms of assigning a
14 risk, what does that estimate of future productivity per
15 well mean to you?

16 A. Well, it means there is quite a risk as far as
17 the reserves out here. And if you include the dry holes,
18 the reserves per well go down to less than three-quarters
19 of a BCF per well. So there is inherent risk in drilling
20 in this area out here as far as the reserves that are
21 needed for an economic well.

22 Q. Can you generally characterize the major
23 formation or pools that you're seeking to access?

24 A. Yes.

25 Q. Which ones are they?

1 A. Well, the red on this map are the Morrow
2 producing wells, and the purple wells that are mainly
3 located in Section 2 and 11 are Bone Spring wells, and
4 there are one or two Wolfcamp wells, the one up in 27 that
5 has produced out of the Wolfcamp.

6 Q. The major objective, then, is to penetrate and
7 test the Morrow?

8 A. That's correct.

9 Q. Characterize that reservoir pool for the
10 Examiner.

11 A. Well, why don't we refer to the --

12 Q. Yeah, perhaps that's helpful. Let's look at the
13 cross-section and have you illustrate the complexity of the
14 reservoir in this area.

15 A. Exhibit Number 12 is a cross-section. It covers
16 the Morrow formation. And if you refer to any one of
17 the -- Exhibit 11, you'll see a line of cross-section. It
18 goes through a well in Section 34, through the proposed
19 location, across to a well in Section 35 and over into two
20 wells in Section 2.

21 And if you come down to where the sands are in
22 the Morrow, we break out the Morrow into a Morrow "B" and a
23 Morrow "C" sand sections, and if you just look across there
24 you'll see the variability of these sands. They come and
25 go, they're not stratigraphically equivalent.

1 And one thing you'll note is, there's some wells
2 that have good production out of really thin sands, and the
3 well off to the southeast there has perf'd several wells
4 there and has only cum'd about 600 million cubic feet of
5 gas.

6 And one of the things of note, even in our well
7 in Section 34, the zone that we're perforated in, in the
8 lower part, we have ran pressure tests on it, and that zone
9 has been determined to be of limited size, about a quarter
10 of a BCF.

11 So there is a lot of inherent risk in the size of
12 some of these reservoirs, and that's what this cross-
13 section is pointing out.

14 Q. Let's set the cross-section aside and use it as a
15 reference map, and let's start with the lower package in
16 the Morrow, which you have identified as the Morrow "C"
17 sands?

18 A. That's correct.

19 Q. If you'll turn to Exhibit 13, this is your
20 isopach of the Morrow "C" sand interval?

21 A. That's correct.

22 Q. Now, that sand package consists of multiple sand
23 members, does it not?

24 A. That's correct, two or three sand members within
25 that package.

1 Q. Describe for us, when we look at the Morrow "C",
2 what your opportunity is, and how do you associate the risk
3 with that opportunity?

4 A. What we're hoping to encounter in our location is
5 a trend that we see coming down from the northwest, but it
6 hasn't been that established as far as producing zone. The
7 big wells in Section 35 that do produce out of this horizon
8 are on a separate trend.

9 The wells in Section 2, in the south half of
10 Section 2, one of them which is on the cross-section, the
11 one well on the cross-section is a very limited size, even
12 though it appears to be quite a thick sand.

13 The well in the southeast quarter of Section 2,
14 which has the 48 feet there, was a nice thick sand, but
15 that well only produced 8 million cubic feet of gas and
16 then went to water.

17 So the zone essentially tested wet. So there's
18 inherent risk of this -- the lower Morrow here being wet.

19 And the closest well to us, which is our well in
20 Section 34, we didn't even encounter any kind of decent
21 sand in there. You can see that's on the cross-section.

22 So we're hoping to get into the sand package,
23 knowing, in fact, that it could be wet or it may be tight
24 or limited in here.

25 Q. Let's turn to the structure map, and show the

1 Examiner your conclusions concerning the possibility that
2 the lower "C" sands may be too wet to be productive of gas.
3 Identify and describe 14 for us.

4 A. Okay. Exhibit 14 is a structure map on the top
5 of the Morrow. And you can see that the two wells in 35,
6 in Exhibit 11 -- those are the two best wells out here --
7 they are on a structural ridge that extends essentially
8 north-south through here.

9 Now, as you move into Section 2, the two wells in
10 the south part, one of the had about 600 million. The
11 other one was -- tested 8 million and was wet, and it's at
12 a minus 9169. The proposed bottomhole location is going to
13 be somewhere about minus 9140, so we're close to where we
14 know that there's a possible problem with the zone being
15 wet.

16 And you can see as you go to the western part of
17 Section 3 that there's a strong re-entrant in there, and
18 we're trying to stay as -- on the edge of that major
19 structural ridge that extends down through there.

20 Q. One of your reasons, then, for the maximum
21 penalty is the substantial risk associated with water in
22 the lower Morrow?

23 A. That's correct.

24 Q. Let's look at your reasons to support the risk
25 when we look at the lower Morrow "B" sand. If you'll to

1 Exhibit 15, identify and describe that display.

2 A. This is an isopach of the lower Morrow "B".
3 There's anywhere from two to four sands within this
4 package. They do come and go. Some of them are tight,
5 some of them do have porosity.

6 One thing we do know about this particular
7 interval is that it does have zones that are limited.
8 Again, I can refer to the well in Section 34, the Nearburg
9 producing Jade "34" Federal Number 1, and onto the cross-
10 section. The zone that was perforated in there, it did
11 come on for about a million a day, but after a couple of
12 months, after some pressure-test information, we found that
13 the zone was limited and was only about a quarter of a BCF.

14 Also along those lines, there's really not that
15 strong a producer out of this horizon. The best wells that
16 are close to this in Section 11 are essentially a marginal
17 Morrow producer, about .15 BCF. The other well in Section
18 2 is about -- the one that's on the cross-section made
19 about .6 BCF, and it was out of several zones. So there is
20 some inherent risk in here, as far as some of these zones
21 being limited in their extent.

22 Q. Your geologic strategy is to try to try to access
23 as many of these Morrow stringers or sand intervals as
24 possible?

25 A. That's correct, that's -- Nearburg's strategy out

1 here is to maximize our sand package in here, because we
2 know that there is inherent risk with some of these
3 reservoirs being wet and some of them being limited.

4 Q. You attempted to do that with the Jade "34" well
5 up in Section 34, did you not?

6 A. That's correct, that's -- You know, this well has
7 about five or six sands in here, and we hope at least one
8 or two of these would be productive and have extent to
9 them.

10 Q. And when you summed the lower Morrow B for that
11 Jade "34" well, you approximated about 30 feet --

12 A. That's correct.

13 Q. -- at that location?

14 A. That's correct.

15 Q. And current information indicates that there is
16 still substantial risk associated with that well?

17 A. That's correct.

18 Q. And you're looking at a well in Section 3 now
19 that still has significant risk associated with it under
20 any interpretation?

21 A. That's correct.

22 Q. Summarize, then, for us the major reasons that
23 you have requested the maximum penalty for inclusion in the
24 compulsory pooling order.

25 A. Well, there are three or four main reasons. One

1 is the discontinuity of the sands within this area. In our
2 experience, several of these zones are limited.

3 Another factor is that the lower Morrow has not
4 been that productive out here and has some inherent risk of
5 being wet, producing water out here.

6 Those are the main reasons why we are looking for
7 the maximum penalty.

8 Q. Is it also a reason for you that despite the fact
9 that you're looking for the maximum total thickness,
10 thickness does not generally directly equate to
11 productivity?

12 A. That is correct.

13 Q. You can have a very small sand interval that's
14 prolific, and you could have a huge interval that is not?

15 A. That is correct.

16 MR. KELLAHIN: That concludes my examination of
17 Mr. Gawloski.

18 We move the introduction of his Exhibits 11
19 through 15.

20 EXAMINER ASHLEY: 11 through 15 will be admitted
21 as evidence.

22 EXAMINATION

23 BY EXAMINER ASHLEY:

24 Q. Mr. Gawloski, is the Jade "34" Federal Com Number
25 1 located within the no-drilling area that was given to you

1 by the BLM?

2 A. By the BLM, the potash?

3 Q. Yeah.

4 A. I don't believe so, no, we were able to drill
5 that as a straight hole.

6 Q. Okay. And when you talk about lower Morrow, you
7 mean the Morrow "B" and the "C"?

8 A. No, when I say lower Morrow I'm referring to the
9 Morrow "C".

10 EXAMINER ASHLEY: Okay, I have no further
11 questions.

12 MR. KELLAHIN: Mr. Examiner, the last Exhibit is
13 my Affidavit of Notice of Hearing, it's Exhibit 10. It
14 shows that Samson and Merit received notice of hearing,
15 including a copy of the Application, and they have chosen
16 not to participate. We would ask that you admit Exhibit
17 10.

18 And with that, that concludes our presentation.

19 EXAMINER ASHLEY: Okay, Exhibit 10 will be
20 admitted as evidence, and Case 12,087 will be taken under
21 advisement.

22 (Thereupon, these proceedings were concluded at
23 9:04 a.m.)

24

25

I do hereby certify that the foregoing is a true and correct copy of the proceedings of the hearing held on 11-19-98.
* * *
Mark Kellahin

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