

NEW MEXICO OIL CONSERVATION DIVISION

COMMISSION HEARINGSANTA FE, NEW MEXICOHearing Date JUNE 23, 2000 Time 9:00 A.M.

NAME	REPRESENTING	LOCATION
William J. Ray Dora L. Delveaux	Kingston Energy Services Woodward Clyde	Santa Fe Flagstaff, AZ
Michael O'Hara	Woodalex	Ignacio, NM
Jim Bue	-	Santa Fe

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

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

CASE NO. 12,299

APPLICATION OF REDWOLF PRODUCTION, INC.,)
 FOR COMPULSORY POOLING, SAN JUAN COUNTY,)
 NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

COMMISSION HEARING

BEFORE: LORI WROTENBERY, CHAIRMAN
 JAMI BAILEY, COMMISSIONER
 ROBERT LEE, COMMISSIONER

00 JUL -5 AM 8:36

OIL CONSERVATION DIV

June 23rd, 2000

Santa Fe, New Mexico

This matter came on for hearing before the Oil Conservation Commission, LORI WROTENBERY, Chairman, on Friday, June 23rd, 2000, 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.

* * *

STEVEN T. BRENNER, CCR
 (505) 989-9317

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 Commission Hearing
 CASE NO. 12,299

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A P P E A R A N C E S

FOR THE APPLICANT:

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* * *

1 WHEREUPON, the following proceedings were had at
2 9:04 a.m.:

3 CHAIRMAN WROTENBERY: I believe we're ready to
4 call Case 12,299. This is the Application of Redwolf
5 Production, Inc., for compulsory pooling in San Juan
6 County, New Mexico. This case is being heard upon the
7 application of Maralex Resources, Inc., for a *de novo*
8 hearing, pursuant to the provisions of Rule 1220.

9 I'll call for appearances at this time.

10 MR. CARR: May it please the Examiner, my name is
11 William F. Carr with the Santa Fe law firm Campbell, Carr,
12 Berge and Sheridan. We represent Redwolf Production, Inc.,
13 and I have one witness.

14 MR. BRUCE: Madame Chair, Jim Bruce of Santa Fe.
15 I represent Maralex Resources, Incorporated. I have one
16 witness.

17 CHAIRMAN WROTENBERY: Thank you. Do you have any
18 opening statements you'd like to make, or should we proceed
19 with the testimony?

20 MR. BRUCE: Just very briefly, Madame Chair.

21 Redwolf filed an Application to force pool
22 Maralex into the subject well unit, and that order was
23 granted. Maralex is not objecting to that portion of the
24 order.

25 What we are here for today is strictly limited to

1 the penalty provision in the order. The order awarded a
2 penalty of 156 percent, which for some time has been the
3 standard penalty the Division has awarded in Fruitland Coal
4 compulsory poolings. We, Maralex, simply think that is too
5 high and are asking for a reduction in that penalty.

6 MR. CARR: May it please the Commission, since
7 this is a case that is brought *de novo* to you, we will
8 focus on the issue of the risk penalty, but we will make a
9 full compulsory pooling presentation.

10 CHAIRMAN WROTENBERY: Thank you, Mr. Carr and Mr.
11 Bruce.

12 Let's see, procedurally, Maralex is the --

13 MR. BRUCE: Maralex is the Applicant --

14 CHAIRMAN WROTENBERY: -- *de novo* Applicant --

15 MR. BRUCE: -- but I think it may go easier if
16 Redwolf goes first and presents their pooling portion of
17 the case.

18 CHAIRMAN WROTENBERY: That sounds good, thank
19 you.

20 MR. CARR: May it please the Commission, at this
21 time I would like to request that the portions of the
22 Application which relate to compulsory pooling of 160-acre
23 units and 40-acre units in the north half of Section 36 be
24 dismissed. We requested that below. The original order
25 did not include that acreage. We're not seeking the

1 pooling of those spacing units.

2 CHAIRMAN WROTENBERY: Okay, thank you.

3 MR. CARR: And we're prepared to call Dana
4 Delventhal, and I don't know if she's been sworn.

5 CHAIRMAN WROTENBERY: No, she hasn't yet.

6 (Thereupon, the witnesses were sworn.)

7 DANA L. DELVENTHAL,

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

10 DIRECT EXAMINATION

11 BY MR. CARR:

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

13 A. My name is Dana Delventhal.

14 Q. Where do you reside?

15 A. In Farmington, New Mexico.

16 Q. By whom are you employed?

17 A. Redwolf Production, Incorporated.

18 Q. And who is Redwolf Production, Incorporated?

19 A. It's a small family-owned oil and gas operating
20 company, owned by myself and my husband.

21 Q. And what is your position with Redwolf?

22 A. Vice president.

23 Q. Have you previously testified before the New
24 Mexico Oil Conservation Commission?

25 A. Yes, I have.

1 Q. Perhaps, because there are new Commissioners,
2 would you review your educational background?

3 A. Yes, I graduated from the New Mexico Institute of
4 Mining and Technology in 1984 with a BS in petroleum
5 engineering. I started to work for Amoco out of college
6 and worked for them until 1990, whereas at that time my
7 husband and I formed our corporation and began purchasing
8 and drilling oil and gas wells.

9 Q. At all times since graduation from college have
10 you been employed as a petroleum engineer?

11 A. Yes, sir.

12 Q. Are you familiar with the Application filed in
13 this case?

14 A. I am.

15 Q. Are you familiar with the status of the lands
16 that are involved in this matter?

17 A. I am.

18 Q. Have you made an engineering study of the area
19 which is the subject of this Application?

20 A. I have.

21 Q. And are you prepared to share the results of your
22 work with the Oil Conservation Commission?

23 A. Yes, I am.

24 MR. CARR: We tender Ms. Delventhal as an expert
25 witness and petroleum engineer.

1 CHAIRMAN WROTENBERY: And we accept her
2 qualifications.

3 Q. (By Mr. Carr) Ms. Delventhal, initially would
4 you summarize for the Commission what it is that Redwolf
5 seeks in this case?

6 A. We are seeking an order to pool all of the
7 minerals from the surface to the base of the Pictured
8 Cliffs formation in the north half of Section 36 of 26
9 North, 13 West, San Juan County, for the development of
10 320-acre spacing.

11 Q. And to what well is this acreage dedicated?

12 A. This well will be dedicated to the Bear Number 1
13 well, which has been drilled in a legal location in the
14 northeast quarter of Section 13.

15 Q. The original pooling case, or application, was
16 heard in December of 1999; is that correct?

17 A. That's correct.

18 Q. And what was the result of that hearing?

19 A. As a result of that hearing, an order was issued,
20 Order Number R-11,301, which in effect pooled the north
21 half of 36. It designated Redwolf as operator of the tract
22 and the well and imposed a 156-percent penalty on working
23 interests that chose to not participate.

24 Q. Is a copy of that order what has been marked as
25 Redwolf Exhibit Number 1?

1 A. Yes, sir.

2 Q. Would you refer to order paragraph 9 of that
3 order and summarize the provisions set forth in that
4 paragraph.

5 A. The order requires for Redwolf to notify all
6 noncommitted working interest owners of the pooling order,
7 to issue a copy of the AFE and notify them that they have
8 30 days to elect to either participate in the well and pay
9 their proportionate share or to go nonconsent in that
10 completion.

11 Q. And did Redwolf provide Maralex with a copy of
12 the estimated well costs and advise them --

13 A. Yes, we did.

14 Q. -- and advise them they had an opportunity to
15 join?

16 A. That's correct. Exhibit Number 2 shows the
17 letter that was sent certified to Maralex, indicating that
18 the order had been issued, specifying what the costs that
19 they would have to pay, 30-day time period, and that an
20 election not to participate would be deemed to go
21 nonconsent.

22 Q. Did Maralex pay its share of the costs within 30
23 days?

24 A. No, sir.

25 Q. Did Maralex seek a stay of that Division order?

1 A. Not to my knowledge.

2 Q. What is your understanding of the status of that
3 order at this time?

4 A. As far as I know, it would be a final order and
5 that Maralex is deemed nonconsent in the participation in
6 the well.

7 Q. What is the status of the Bear Number 1 well?

8 A. The Bear was spud November 30th of 1999, because
9 of a lease deadline.

10 We've been in the process of waiting for Indian
11 right of way for pipeline, and we've recently received
12 those right of ways and are in the process of tying it in
13 for first delivery.

14 Q. Has the well been completed at this time?

15 A. Not entirely. We still have some completion work
16 to do, to set surface equipment, to lay the pipeline and to
17 test the well.

18 Q. Now, you proceeded with the drilling of this well
19 because of a lease expiration?

20 A. That's correct.

21 Q. When was that lease expired?

22 A. It was to expire December 1st of 1999.

23 Q. And when did you actually spud the well?

24 A. November 30th.

25 Q. Let's go to what has been marked as Redwolf

1 Exhibit Number 3. Will you identify that, please?

2 A. This is a C-102 for the Bear Number 1 well, and
3 outlines -- There are five tracts of ownership involved.
4 All the tracts are state leases, and the surface is state
5 owned, although it has been through a swap deemed over to
6 NAPI, for NAPI jurisdiction and tribal authority.

7 Q. And that approval from the tribe has now been
8 received?

9 A. Yes.

10 Q. The primary objective in the well is what pool?

11 A. The Basin Fruitland Coal.

12 Q. And that is spaced on 320 acres?

13 A. Yes, sir.

14 Q. Let's go to Exhibit Number 4. Will you identify
15 and review that, please?

16 A. Yes, Exhibit Number 4 is an ownership breakdown
17 of each tract. Redwolf is the lease owner in Tract Number
18 1, on which the well is drilled, and that's where we
19 derived our ownership. The other tracts are listed out,
20 and then on the very back a combination of Tract Numbers
21 shows the final ownership breakdown of the Basin Fruitland
22 Coal formation in that 320-acre spacing.

23 Q. At the Examiner Hearing, Energen appeared and
24 indicated it had not joined in the well. What is the
25 status of Energen at this time?

1 A. Energen has participated and has signed a JOA.

2 Q. And what percentage of the working interest is
3 now voluntarily committed to this well?

4 A. There are 22 owners in the tracts. And of those,
5 we've had 19 commit to the well, two we have been unable to
6 find -- 18. Yeah, two we have been unable to find, and
7 then one who has chosen not to participate.

8 Q. At this time you have in excess of what
9 percentage?

10 A. Just over 40 percent.

11 Q. Who are the owners you've been unable to locate?

12 A. The owners we've been unable to locate are T.J.
13 Foster, with a .07-percent interest, and Quasar Sciences
14 with a .07-percent interest.

15 Q. And what efforts have you made to locate these
16 individuals?

17 A. We searched court records and also did an
18 Internet search, and have been unable to find them.

19 Q. Other than these two interest owners and Maralex,
20 is every other interest committed to the well?

21 A. Yes, sir.

22 Q. Could you summarize for the Commission the
23 efforts you have made to obtain the voluntary participation
24 in the well of Maralex?

25 A. There's rather a long history. When we first

1 received our lease back in 1994, we proposed the drilling
2 of the well. But obviously, we only had a 25-percent
3 working interest.

4 At that time Maralex requested that they drill
5 and operate the well, and we agreed and said we would
6 participate. Unfortunately, the well never materialized.
7 As we neared our lease-expiration date, we began pursuing
8 the drilling and operating of it ourselves, with the land
9 work being done in 1998. It takes quite a long time to get
10 permit through the tribe, and then we drilled the well in
11 November of 1999.

12 Q. In your opinion, have you made a good-faith
13 effort to locate --

14 A. Yes, we've offered to buy their interest, we've
15 offered to farm it out, we've offered to have them
16 participate or to have them elect to go nonconsent and we
17 would carry their interest. We've just not had any luck.

18 Q. No agreement has been reached?

19 A. No, sir.

20 Q. Would you identify what has been marked as
21 Redwolf Exhibit Number 5?

22 A. This is a history starting in April of 1999, the
23 correspondence between us and the people we were unable to
24 find, in order to try to bring the pooled interest
25 together.

1 Since then, Energen, the Umbachs and Roger
2 Nielsen are all -- have elected to participate in the well,
3 and other than the two we've been unable to find, everyone
4 else is signed up, with the exception of Maralex.

5 Q. Let's go to Exhibit Number 6, the AFE. Would you
6 review the AFE and also revise the Division as to the
7 current status of the costs incurred in the drilling of the
8 Bear Number 1 well?

9 A. The AFE for the Bear Number 1 is a total well
10 cost of just over \$174,000. This is a pretty average well
11 cost for Basin Fruitland Coal in that area. There are some
12 -- It's a little higher than some Fruitland Coal wells
13 because of the pipeline situation, needing to lay about a
14 half a mile of pipeline.

15 Two, with the tribal surface, there are damages
16 and right-of-way fees that are higher. But \$174,000 for
17 that area would be normal.

18 To date, we've spent about \$77,000, and we
19 anticipate spending between \$90,000 and \$100,000 to finish
20 out the completion of the well, so we feel we'll be right
21 at AFE.

22 Q. These costs are in line with what other operators
23 have incurred for wells offsetting this prospect?

24 A. Yes, sir.

25 Q. Could you identify what has been marked as

1 Exhibit Number 7?

2 A. Exhibit Number 7 is, I believe the compulsory
3 pooling.

4 Q. Is this the affidavit that was provided by the
5 Campbell firm confirming that notice of this hearing was
6 provided in accordance with OCD rules?

7 A. Yes, sir.

8 Q. Have you made an estimate of the overhead and
9 administrative costs to be incurred while drilling the well
10 and while producing it, if it is successful?

11 A. Yes, we have proposed a \$4000 drilling overhead
12 rate and a \$400-per-month producing well rate. These rates
13 are below the Ernst and Young guidelines, and also they're
14 at or below what other operators are charging for that
15 area.

16 Q. In fact, they're lower than what Maralex has
17 proposed for a well in this area; is that not right?

18 A. Correct.

19 Q. Were they adopted by the Division in the order
20 entered in the first hearing on this application?

21 A. Yes, they were.

22 Q. Do you recommend that these figures be
23 incorporated into any order which results from this
24 hearing?

25 A. Yes, I do.

1 Q. Does Redwolf Production, Inc., seek to be
2 designated operator of the well?

3 A. Yes, sir.

4 Q. You've drilled other wells in this area?

5 A. Yes, sir.

6 Q. Let's go to what has been marked as Redwolf
7 Exhibit 8. Would you identify and review that, please?

8 A. This is a map I put together of the nine-section
9 area surrounding the Bear Number 1 well. If you look in
10 the middle, in Section 36, the Bear is noted in red ink and
11 is the well in question.

12 As you can see, there's quite a bit of Fruitland
13 Coal development in that nine-section area plat, with
14 pretty much each section developed, with the exception of
15 36.

16 If you'll note, the cumulative production and
17 these numbers are as of December, for the initial hearing.
18 Wells to the north and to the east tend to be stronger, and
19 then wells to the south and to the west tend to be weaker
20 producers.

21 Q. When we look at the wells to the south and the
22 west, the weaker producers, in your opinion will those
23 wells all be economic successes?

24 A. In all likelihood, no.

25 Q. Even at current gas prices, will they be

1 uneconomic?

2 A. No, they wouldn't.

3 Q. They would not --

4 A. They would not be --

5 Q. -- be at current gas prices.

6 Let's go to Exhibit Number 9. Would you review
7 that?

8 A. Exhibit Number 9 is a base-case economics that I
9 ran to see what the break-even point would be for the
10 development of the coal in that north half. And basically
11 what this says is that the cost of \$174,000 and a gas price
12 of \$1.75, it would require 373 MMBTU just to break even.

13 Now, certainly there are some issues now as far
14 as gas prices. The \$1.75 that I used for this evaluation
15 in December was a five-year average of San Juan Basin
16 index. Even if gas prices were doubled, you would still
17 need 190 MMCF in order simply to break even. And as you
18 can see on the map that was the previous exhibit, the ones
19 to the south and west won't reach those levels.

20 Q. When you drilled the well, there was no doubt you
21 would find coal; isn't that correct?

22 A. That's correct. This whole area -- and there are
23 certainly lots of -- it's near the old West Bisti Unit
24 Gallup -- there's a lot of log information, a lot of
25 information in that regard, and the coal is fairly well

1 blanketed throughout the entire area, the question being
2 whether the quality of the coal is enough to allow a
3 commercial completion.

4 Q. In your experience, is the situation you have
5 here, as it relates to the risk of making a commercial
6 well, typical of a Fruitland Coal Gas well?

7 A. Yes, sir.

8 Q. Are you prepared to make a recommendation to the
9 Commission as to the risk penalty that should be assessed
10 against any nonparticipating interest owner?

11 A. We feel this is a typical Basin Fruitland Coal
12 well and are satisfied with the 156-percent penalty that
13 was provided in the earlier ruling.

14 Q. And summarize the reasons for that
15 recommendation.

16 A. Although the 156 has entered as a normal for
17 Basin Fruitland Coal, an industry normal would be a 200
18 percent, and my personal opinion is that the Fruitland Coal
19 should be no different. But we realize that there are
20 precedents, and as long as we receive and also grant those
21 same percentages, we have no problem with that.

22 With the coal well, the drilling is fairly
23 simple, usually. Your risks are lost circulation or some
24 sort of drilling problem, but the largest part of the risk
25 in a coal well is the completion, because you have to spend

1 all the money to perforate and to frac and to test it and
2 bring it on line. And oftentimes it will be a year before
3 you know even what the established rate is going to be.

4 We have not had an opportunity at this point to
5 test or to put this well down the sales line, so at this
6 point I know no more information as far as its
7 commerciability than I did in December.

8 Q. In your opinion, will the approval of this
9 Application and the drilling of the Bear Number 1 be in the
10 best interests of conservation, the prevention of waste and
11 the protection of correlative rights?

12 A. I do.

13 Q. Does Redwolf request that the Examiner Order in
14 this case be affirmed?

15 A. Yes, we do.

16 Q. Were Exhibits 1 through 9 prepared by you or
17 compiled under your direction?

18 A. Yes, sir.

19 MR. CARR: At this time, we would move the
20 admission into evidence of Redwolf Exhibits 1 through 9.

21 CHAIRMAN WROTENBERY: Any objection?

22 MR. BRUCE: No, ma'am.

23 CHAIRMAN WROTENBERY: Okay, Redwolf Exhibits 1
24 through 9 will be admitted into the record.

25 MR. CARR: And that concludes my direct

1 examination of this witness.

2 CHAIRMAN WROTENBERY: Thank you. Any questions
3 for Ms. Delventhal?

4 COMMISSIONER BAILEY: Yes.

5 EXAMINATION

6 BY COMMISSIONER BAILEY:

7 Q. How long did it take you to get approval for the
8 right of way?

9 A. We applied for the right of way starting in June
10 of 1999, and we received it in May of 2000. So just under
11 a year.

12 Q. Just under a year. Did you have to pay a
13 significant amount?

14 A. Yes, I believe about \$35,000 --

15 Q. For --

16 A. -- for a half a mile.

17 Q. A half mile?

18 Your Exhibit 8 --

19 A. Yes, ma'am.

20 Q. -- the well in the southwest quarter of 31, would
21 you say that was an economic well?

22 A. It should be, yes.

23 Q. The well in the southwest quarter of Section 6,
24 would you say that was economic?

25 A. Yes.

1 Q. The well in the north half of 1, would you say
2 that was economic?

3 A. No, ma'am.

4 Q. And the well in the east half of 2, would you say
5 that was economic?

6 A. No, ma'am.

7 Q. Would you speculate about the economic payout on
8 a well in the south half of 36?

9 A. There has been a well drilled in the south half
10 of 36 several years ago that had been waiting pipeline
11 approval and tie-in. It may have first delivered by now.
12 So I have no information on it. It has not produced.

13 COMMISSIONER BAILEY: That's all I have, thank
14 you.

15 CHAIRMAN WROTENBERY: Commissioner Lee?

16 COMMISSIONER LEE: No.

17 EXAMINATION

18 BY CHAIRMAN WROTENBERY:

19 Q. On the issue of gas prices, you said the \$1.75
20 was a five-year average?

21 A. Of San Juan Basin index, yes, ma'am.

22 Q. What five-year period was that?

23 A. It would have been through November of 1999.

24 Q. What's the current --

25 A. Last month, I think, was \$3.78. The prior month

1 was \$2.78. But I have seen it well below a dollar as well.

2 Q. And do you -- Are you able to talk to the
3 Commission at all about the derivation of the 156-percent
4 penalty?

5 A. I don't know that I'm qualified to how it was
6 derived to begin with. I know that it's been an accepted
7 risk, because some issue was given to the Basin-Fruitland
8 Coal being strongly top-heavy in costs as far as equipment.
9 If you take a well that's 1200 or 1400 feet deep, to drill
10 it might be \$14,000. But to equipment, you might well
11 spend \$80,000. So that is a little bit different with the
12 shallower gas wells.

13 In all honesty, it's not really any different
14 than the Pictured Cliffs. You're within 20 feet of it.
15 Oftentimes the surface equipment is identical. So I
16 don't -- That's why I say in my mind that the industry
17 standard of 200 should apply to all, but we're certainly
18 willing to live with the 156 as long as we receive it on
19 our end as well.

20 CHAIRMAN WROTENBERY: Mr. Ross, did you have any
21 questions you wanted to ask?

22 MR. ROSS: Yeah, a couple, I think.

23 EXAMINATION

24 BY MR. ROSS:

25 Q. The \$35,000 cost for the right of way that you

1 referred to earlier, is that included in the --

2 A. It's included in the AFEs, yes. And that
3 includes the damages for the surface location and the half
4 mile.

5 Q. This right of way came from NAPI?

6 A. It's from the Navajo Tribe, uh-huh.

7 Q. So the surface has been deeded to the Navajo
8 Tribe?

9 A. Correct --

10 Q. It's not --

11 A. -- as part of NAPI. NAPI is an arm of the tribe,
12 but the tribe has ultimate authority.

13 Q. You testified a little bit earlier that there's
14 really -- that you're unable to determine how well this
15 well is going to produce at this time?

16 A. That's true.

17 Q. Do you have any indication whatsoever --

18 A. We did after we perforated it, we were able to
19 get a small gas test on it. And so it will make something;
20 the question is, how much? We haven't stimulated it, we
21 haven't tested it against surface pressure or against back
22 pressure to see what it should produce against line
23 pressure.

24 Q. Okay. Are you saying the well -- it appears at
25 this point it's going to be an economic well?

1 A. I have no -- I wish I had that guarantee, but no.
2 It could very easily be identical to the wells just to the
3 south, the Dugan wells, that will maybe make 30,000 in
4 their life. So in that case, no.

5 Q. So you understand there's gas present, you just
6 don't know how much?

7 A. It's always a question of the commerciability.
8 You can have a coal well that will produce 10 MCF a day,
9 you know, for the life of the well. You'll have one that
10 will start at 10 MCF a day, and it may increase to 50, 60,
11 100. Or you can have wells that -- 250. Even within a
12 nine-section area, there's a lot of variability in the coal
13 qualities, and you cannot tell off of a log to any
14 certainty what type of completion you'll have. Basically,
15 you just have to put it down the line and see what happens.

16 CHAIRMAN WROTENBERY: Mr. Bruce, I'm sorry, we
17 went out of order.

18 MR. BRUCE: That's fine.

19 CHAIRMAN WROTENBERY: Apologize for that.

20 MR. BRUCE: That's fine. The Commissioners
21 are -- Okay.

22 CHAIRMAN WROTENBERY: Yes.

23 CROSS-EXAMINATION

24 BY MR. BRUCE:

25 Q. Just a few quick questions. Ms. Delventhal,

1 could you look at your Exhibit 6, which is the AFE?

2 A. Okay.

3 Q. The third line item, "location damages", you have
4 \$9650. Is that exclusive of the money you spent purchasing
5 a right of way from the Navajo tribe?

6 A. That's correct. The right of way for the tribe I
7 included as a pipeline cost.

8 Q. Is that on this AFE?

9 A. In pieces and parts, yes, it is.

10 Q. Okay. So the \$175,000, roughly, would include
11 the Navajo right of way?

12 A. That's correct. As I've said, we've spent to
13 date \$77,000. That includes those costs, and I still feel
14 we'll be within one or two percent of AFE.

15 Q. What would that be included in, as far as the
16 pipeline cost? You said there were several line items.

17 A. Part of it is in materials, part is in
18 fabrication and installation, contract labor, miscellaneous
19 services. It's spread out by category throughout.

20 Q. Okay. And to reiterate, you have no test results
21 from the well?

22 A. Like I said, after perforation we had a small
23 test of gas, and that is it. And it's unstimulated.

24 Q. So it's unstimulated, and you have no pressure
25 data or anything?

1 A. No.

2 MR. BRUCE: That's all I have, Madame Chair.

3 CHAIRMAN WROTENBERY: Thank you.

4 Anything else?

5 MR. CARR: No, that concludes our direct
6 presentation in this case.

7 CHAIRMAN WROTENBERY: Thank you, Ms. Delventhal.

8 ALEXIS MICHAEL "MICKEY" O'HARE,

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

11 direct EXAMINATION

12 BY MR. BRUCE:

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

14 A. My full name is Alexis Michael O'Hare. I go by
15 Mickey.

16 Q. Who do you work for?

17 A. Maralex Resources.

18 Q. What is your position with Maralex?

19 A. I'm the president of the company.

20 Q. By training, what is your profession?

21 A. I'm a petroleum engineer by training.

22 Q. Have you previously testified before the
23 Commission?

24 A. Yes, I have, very extensively.

25 MR. BRUCE: The Commission may be painfully aware

1 of that, so...

2 CHAIRMAN WROTENBERY: It's good to see you again,
3 Mr. O'Hare, in a shorter proceeding.

4 Q. (By Mr. Bruce) And you have been previously
5 qualified before the Commission as an expert engineer?

6 A. Yes, I have.

7 Q. And are you familiar with the engineering matters
8 involved in this Application?

9 A. Yes, I am.

10 MR. BRUCE: Madame Chair, I tender Mr. O'Hare as
11 an expert petroleum engineer.

12 CHAIRMAN WROTENBERY: He is so qualified.

13 THE WITNESS: Thank you.

14 Q. (By Mr. Bruce) Mr. O'Hare, briefly, could you
15 identify Exhibit 1 and describe for the Commission what it
16 contains?

17 A. Exhibit 1 is a simple land plat showing the
18 ownership in the north half of Section 36, the drill site
19 spacing unit for the proposed well.

20 Q. And it shows the various working interest owners
21 in the tracts, or at least Maralex's interest?

22 A. That is correct, it shows Maralex's and Redwolf's
23 interests, and also SG Interests.

24 Q. Okay. And you recognize that Redwolf did have to
25 drill this well to save an expiring lease, did you?

1 A. That is correct, and we fully understand their
2 position and didn't have any objections to them doing that
3 drilling.

4 Q. Could then move on to Exhibit 2 and identify that
5 for the Examiner -- excuse me, the Commission?

6 A. Exhibit 2 is a cumulative production map of the
7 12 sections surrounding Section 36, and that production is
8 generally through October or December of 1999, whatever was
9 available at the time of the first hearing.

10 Q. Okay. Now, on these wells, you heard Ms.
11 Delventhal testify about wells to the south and west being
12 not as good, did you not?

13 A. Yes, I did.

14 Q. In drilling a well out here, is there any risk in
15 locating the formation itself?

16 A. No, as she stated, the coals are fairly blanketed
17 across this area. They generally range in thickness from
18 just under 20 feet to a maximum of about 35 feet.

19 Q. Okay. There are good wells, and there are some
20 poor wells on here, which we'll get into with your next
21 couple of exhibits also, but at this point, do you
22 attribute the poorer wells to the southwest to variations
23 in the formation or to other reasons?

24 A. We believe that the variations in the cumulative
25 production are due to two factors. Number one is that

1 there are different time frames under which the wells were
2 drilled. And number two are the completion techniques that
3 were employed in the completion of the wells. It just so
4 happens that all of the wells to the north and east of the
5 proposed well were drilled and completed by Maralex, and we
6 feel that our superior completion techniques have a much
7 greater impact on the cumulative production from the wells
8 than the formation characteristics.

9 Q. So it's a matter of completion technique versus
10 reservoir variation?

11 A. In our opinion, yes.

12 Q. Okay. One thing let's address before we get off
13 this plat. You have in the south half of Section 36 a well
14 that has "WOPL" under it. Could you describe the status of
15 that well?

16 A. That is a well that was drilled by Maralex back
17 in 1994, I believe. We immediately applied for a pipeline
18 right of way through the Navajo Indian Tribe. It has been
19 six years, and to my knowledge that Application still has
20 not been approved. My understanding was, the tribe came
21 back and asked for a damage assessment, along with what
22 they call Navajo tribal assessment of \$85 per rod, and we
23 refused to pay that initially.

24 Maralex since relinquished operations of the well
25 to SG Interests, who owns the majority interest in that

1 well, and they are still in negotiations with the tribe,
2 trying to secure a right of way for that pipeline.

3 The pipeline was intended to run northeast and
4 tie into the southwest quarter of Section 30, and our
5 intent was to -- once that pipeline was approved, was to
6 drill the well in the northeast quarter of Section 36.

7 Q. Is the south half of Section of 36 State of New
8 Mexico minerals?

9 A. Yes, it is.

10 Q. Let's move on to your Exhibit 3, and could you
11 discuss the production, ultimate production, from wells in
12 this immediate area?

13 A. Yes, Exhibit 3 shows in the first column the
14 cumulative recoveries that are shown on Exhibit 2.

15 Q. These are all the wells in this nine-section
16 area?

17 A. In the 12-section area --

18 Q. Or --

19 A. -- correct, yes, surrounding Section 36.

20 The remaining reserves were calculated off of
21 decline curves, and in one case there was an assumed
22 incline in production that would mimic an offset well to
23 get to the ultimate recovery, and I believe that is the
24 Jeter Number 1 well in Section 1, 25 North, 13 West. That
25 well has a fairly short production history, and so we tried

1 to mimic the incline on offsetting wells to get to that
2 ultimate recovery shown there of 174 million cubic feet.

3 As shown on this exhibit, the average ultimate
4 recovery for all of the wells in this 12-section area is
5 just under 700 million cubic feet of gas.

6 Q. And jumping ahead a little bit, that would be
7 economic, would it not?

8 A. Very much so. We will present some economics
9 here in our Number 5 exhibit.

10 Q. Okay. Now, before we move off of this exhibit,
11 looking at column 1, those figures are the same as those on
12 Maralex Exhibit 2?

13 A. That is correct.

14 Q. And then if you'll refer to your Exhibit 4 also,
15 the -- Is it the last column?

16 A. The ultimate recovery.

17 Q. Ultimate recovery is what is on Exhibit 4?

18 A. That is correct.

19 Q. Why don't you move on to your Exhibit 4, then,
20 and discuss the wells in the immediate area of the proposed
21 well, or I should say the well that has been drilled?

22 A. Well, again, as Exhibit 3 shows, the average
23 ultimate recovery for all of the wells in this 12-section
24 area is just under 700 million cubic feet of gas, but if
25 you look at the wells immediately surrounding the proposed

1 well in the northeast quarter of Section 36, the average
2 recovery, expected ultimate recovery, increases to just
3 under 800 million cubic feet of gas, and that includes a
4 well in the northeast quarter of Section 1, both wells in
5 Section 31, both wells in Section 30 and both -- I'm
6 sorry -- yes, both wells in Section 25 as well.

7 Q. Okay.

8 A. Even if you look at the wells to the south and
9 the west of the proposed well, there are only two wells
10 that will be less than the average estimated ultimate
11 recovery of 694 million cubic feet, and those are
12 relatively far away from the proposed well.

13 Q. There are better intervening wells closer to the
14 proposed location?

15 A. That is correct.

16 Q. Okay. On this plat, how many of these wells are
17 uneconomic, or will be uneconomic?

18 A. We believe there's only one that will be
19 uneconomic for the life of the well, and we think that's
20 due to a very poor completion procedure, and that is in the
21 Serendipity Number 3 in Section 26, the southwest quarter
22 of Section 26. We believe the rest of those wells will
23 ultimately, especially under current gas prices, generate
24 some very attractive economics.

25 Q. Okay. Now, when you're looking at this, these

1 wells do produce some water, do they not?

2 A. Most of them produce some water. Some of the
3 reports filed with the State do not show any water
4 production, but we think that is because they are going
5 into earthen pits, and that water has not been measured.
6 The average water production in the area appears to be
7 somewhere between five and ten barrels of water a day
8 initially.

9 The wells that we drilled and completed in here
10 had a maximum water producing rate to the very northeast of
11 about 22 barrels of water a day, and the one in Section 31,
12 the one in the northeast quarter of Section 31, had a
13 maximum rate of five barrels of water per day.

14 Q. Could the Redwolf well benefit from the
15 dewatering that has already occurred from the surrounding
16 wells?

17 A. They should see some benefit. And indeed, Dana's
18 comment about seeing gas upon perforation is an indication
19 that there was some dewatering done in this area that they
20 are benefitting from. Generally, these wells would not
21 show gas upon perforation. You would actually have to
22 break them down, fracture-stimulate them and recover your
23 load before you would gas on them.

24 Q. Of the surrounding wells in which Maralex owns an
25 interest or operates or once operated, are any of those

1 economic?

2 A. No, sir.

3 Q. Let's then move on to your Exhibits 5A, 5B and 5C
4 together, and could you explain what that shows to the
5 Commission?

6 A. Yes, Exhibit 5A is an economic run showing
7 projected economics and ultimate recoveries for a well that
8 is modeled off of the Bisti State Number 90, which is
9 located, I believe, in Section 2 of 25 North, 13 West. And
10 the reason that well was chosen is because it had a fairly
11 low initial rate that inclined over about a year and a half
12 to a peak rate of somewhere around 180 MCF per day and has
13 been declining at about between 12 1/2 and 15 percent per
14 year.

15 We basically took those numbers, assumed a net
16 revenue interest of 77 1/2 percent, used a \$175,000
17 drilling and completion cost and what we believe is a
18 conservative gas price based on June's San Juan Basin index
19 price of \$3.50 per MCF. We held that price flat or
20 constant for the life of the well, and you can see that the
21 economics generate an internal rate of return of 96
22 percent.

23 Q. That's pretty good?

24 A. That's a very attractive, economical well.

25 Q. What do the next two exhibits show?

1 A. The next two exhibits basically take the same
2 assumptions and simply reduce the gas price to see what
3 kind of effect the gas price would have on the economics of
4 the well.

5 Exhibit 5B shows a three-dollar gas price, and
6 there the internal rate of return is reduced to 76 percent.
7 You'll notice also that the gross gas production has been
8 kept below the 694 million cubic feet average ultimate
9 recovery shown on Exhibit 3.

10 And as the gas price is lowered, that gross
11 production number, the ultimate recovery, is reduced simply
12 due to the economics. But it starts at no higher than 679
13 million cubic feet of gas.

14 So in essence, we're saying an average well,
15 under current gas prices, will be very economically
16 attractive.

17 And the final exhibit, 5C, assumed a two-dollar
18 gas price held constant for the life of the well, and again
19 the internal rate of return is about 38 percent.

20 Q. That is still economic?

21 A. That's still very economic.

22 Q. Now, looking at this, Mr. O'Hare, one question
23 you might get from the Commission is, Why didn't you join
24 in the well?

25 A. We have always thought that this was a good

1 location, and we intended to drill it ourselves as soon as
2 we could secure a pipeline right of way from the tribe.
3 And Ms. Delventhal approached us in 1998, or -- even back
4 as early as 1994, it was our intention to move forward with
5 the well, provided that the pipeline right of way was
6 secured.

7 When we were having trouble with the tribe, we
8 felt it was in our interest to put our limited resources
9 into wells that would generate an immediate return on our
10 investment, and we felt that there was going to be a very
11 sizeable time delay in being able to get the well tied in
12 and on production. We have to commend Redwolf on their
13 ability to get a right of way from the tribe in a year's
14 time. That, to my knowledge, is a record. We've never
15 been able to do it under two years, so we congratulate
16 Redwolf on their accomplishment there.

17 We do feel very strongly that since the well is
18 surrounded by what appear to be very economic wells -- and
19 in fact, if you look at the projected economic -- or, I'm
20 sorry, ultimate recovery, there are only three wells in the
21 entire 12-section area that will come in at below the
22 average ultimate recovery shown on Exhibit 2, and those
23 three wells -- two of those three wells will still be
24 economic under current gas prices.

25 So basically what we're saying is, there is an

1 81-percent chance that this Bear Number 1 is going to be a
2 very economic well, or at least average in this area, and
3 the only risk we see is that Redwolf may have problems with
4 the completion. Our understanding of their operations is,
5 they've got some fairly good completion techniques, so we
6 feel fairly confident that they're going to have a very
7 good chance of making a good economic well in the Bear
8 Number 1 location.

9 We therefore ask that the penalty be reduced
10 substantially from that which was first employed in the
11 Basin for Fruitland Coal wells that were stepouts. 156
12 percent, in our view, came long before there was anywhere
13 close to the kind of development that we're seeing in this
14 area, and there was still substantial risk, both on the
15 drilling and completion and ultimate recovery side. And we
16 think that risk has basically been eliminated, and we think
17 that the penalty should reflect that.

18 Q. And again, you are not contesting the fact that
19 Maralex has gone nonconsent under the original pooling
20 order?

21 A. That is correct.

22 Q. And that no further letter from Redwolf or
23 anything is necessary to confirm that nonconsent status?

24 A. Correct.

25 Q. Were Exhibits 1 through 5C prepared by you or

1 under your direction?

2 A. Yes, they were.

3 Q. And in your opinion, is the granting of the
4 Application with a reduced penalty in the interests of
5 conservation and the prevention of waste?

6 A. Yes, it is.

7 MR. BRUCE: Madame Chair, I submit Maralex
8 Exhibits 1 through 5C.

9 CHAIRMAN WROTENBERY: Any objection?

10 MR. CARR: No objection.

11 CHAIRMAN WROTENBERY: Maralex Exhibits Number 1
12 through 5C are admitted as evidence into the record.

13 Any questions, Mr. Carr?

14 MR. CARR: Yes.

15 CROSS-EXAMINATION

16 BY MR. CARR:

17 Q. Mr. O'Hare, just to be sure I understand your
18 testimony, is it your testimony that Maralex understands or
19 does not dispute that it is a nonconsent party in this
20 well?

21 A. That is correct.

22 Q. And you're not seeking a new order and a new
23 election period?

24 A. A new election period?

25 Q. Yeah, a new period. You're not looking for,

1 after this hearing, a new 30-day period within which to
2 decide whether or not you're going to participate?

3 A. No, we are not.

4 Q. You testified that based on your work it looked
5 like there was an 81-percent chance that this would be an
6 economic well? Was that your testimony?

7 A. A better than average economic well, yes.

8 Q. So there's a 19-percent chance that it won't be a
9 better-than-average economic well?

10 A. Again, I think I testified that there is only one
11 well in this area that would not be economic to do a poor
12 completion technique, so I would say it would be one out of
13 16 wells, which is 16 percent, roughly.

14 Q. That's not how you would evaluate the success in
15 this well, just the number of wells that have been drilled,
16 would it?

17 A. No, again, I think that you have to take into
18 account the abilities of the operator. And as far as I
19 know, Redwolf is very capable and shouldn't have any
20 problems generating a good completion on this well.

21 Q. You would agree with me that whenever you go out
22 and drill a well even in this area, there is some chance
23 that you would not have a well that was a commercial
24 success, would you not?

25 A. There is always a chance, maybe a tenth of a

1 percent out of a hundred in an area like this, that you
2 would not have a good economic well, especially under
3 today's gas prices.

4 Q. And when you go in this industry and one person
5 goes out and takes the risk for someone else, whatever it
6 may be, it is common that a risk penalty is imposed to
7 compensate the person who takes the risk for the others;
8 isn't that right?

9 A. That is correct, and we're not trying to get out
10 of a penalty at all. What we're saying is that the risk is
11 so low that the penalty should reflect that low risk, and
12 what we would feel would be more appropriate would be
13 something in the 20- to 30-percent range, versus 156
14 percent.

15 Q. And what are you basing that 20 to 30 percent on?

16 A. There are two examples that were presented. In
17 fact, I think our attorney was involved in one of them,
18 where a force-pooling situation occurred about a year ago,
19 where the well had already been spudded, and I believe the
20 Division granted a 10-percent penalty for that situation.
21 It was a Dakota well, relatively low risk, as is this one,
22 and a very low penalty was assigned to that well.

23 We're saying we understand that there may be a
24 little bit more risk here than what there was in a
25 conventional well, just because of the completion on it.

1 And so we feel comfortable that a 20- to 30-percent penalty
2 is fair to everybody, and we're willing to accept something
3 in that range.

4 Q. At the Examiner level, there was testimony about
5 earlier orders where a 10-percent penalty was imposed on
6 Fruitland Coal Gas wells in compulsory pooling cases. Do
7 you recall that testimony?

8 A. I recall testimony about a 10-percent penalty. I
9 cannot swear that it was to a Fruitland --

10 Q. Are you today discussing a case that was
11 different from that case?

12 A. I don't believe so, but I would have to review
13 that testimony to find out. I think there were actually
14 two case numbers that were submitted during that testimony
15 in front of the Examiner. I don't recall --

16 MR. BRUCE: They were actually Fruitland Coal.

17 MR. CARR: They were Fruitland Coal wells, and is
18 -- I'm just trying to find out what your recommendation as
19 to a penalty is and what you're basing that on.

20 MR. BRUCE: Go ahead, Mickey.

21 They were Fruitland Coal wells --

22 THE WITNESS: Thank you.

23 MR. BRUCE: -- and I will provide the Commission
24 with those numbers.

25 CHAIRMAN WROTENBERY: Thank you.

1 Q. (By Mr. Carr) Are you talking about Order
2 Numbers R-9581 and 9585 that were referenced in the
3 earlier --

4 MR. BRUCE: 9584.

5 Q. (By Mr. Carr) Are you familiar with those
6 orders? I'm not going to try and push you into something
7 you aren't familiar with.

8 A. I'm only familiar with them to the extent that
9 I've discussed them with our counsel. I have not read
10 those orders, I don't have any of the hard data in front of
11 me on those.

12 Q. So I should not pursue those questions with you?

13 A. You might ask our attorney.

14 Q. You do know that 156-percent has become a
15 standard penalty in Fruitland Coal gas wells?

16 A. Again, my impression was always that penalty was
17 imposed on stepout wells, primarily, especially during the
18 early history of the development of the Fruitland Coals in
19 the San Juan Basin.

20 Q. Mr. O'Hare, when Maralex goes out and drills a
21 well in this area and you're carrying other interest
22 owners, you expect to be compensated for that in terms of a
23 risk penalty, do you not?

24 A. Yes, we do.

25 Q. Have you ever sought a penalty in the range of 20

1 to 30 percent?

2 A. On any wells that we've force-pooled?

3 Q. Yes.

4 A. I believe we've only force-pooled one well, and
5 it was during the early development of the field, in the
6 early 1990s -- 1991, if I remember correctly -- and it was
7 a stepout; no other wells had been drilled in that area.
8 And it was a 156-percent penalty.

9 Q. In fact, in the early 1990s, you filed
10 administrative applications, did you not to force pool the
11 Keyes wells and the Price wells in the Basin Fruitland
12 Coal? Do you recall that?

13 A. We don't have any wells named Keyes or Price, to
14 my knowledge, unless you're referring to an owner.

15 Q. What's that?

16 A. Are you referring to an owner?

17 Q. I was able to find in the records of the OCD
18 Cases 10,112 and 10,113, which were applications of Maralex
19 for compulsory pooling. They were cases that originally
20 had been filed administratively and then came to hearing,
21 and the question was the risk penalty. I believe you
22 testified at that hearing. Do you recall that?

23 A. Yes, I do.

24 Q. And those wells were pooling orders that were
25 obtained by Maralex through an administrative procedure,

1 were they not?

2 A. I thought it was through a hearing, but I'm not
3 sure I'm understanding the question.

4 Q. And then after -- Do you recall what the hearing
5 was about?

6 A. It was a force pooling.

7 Q. And do you recall the issue concerning the
8 penalty in those cases?

9 A. I believe that we had applied for a 200-percent
10 penalty in -- It may have been both of those cases. There
11 were two wells in the southwest Aztec area, immediately
12 offsetting each other, and there had been no other drilling
13 in the area, no other Fruitland Coal in the area. Those
14 were the first two wells. One was actually a recompletion
15 of a Dakota wellbore, and the other was the drilling of a
16 new well. We were unable to locate some of the owners, and
17 I believe there was one owner who had refused to join in
18 the well, refused to farm out or sell, and they were force
19 pooled.

20 Q. Do you recall that at that time you challenged
21 156-percent as being too low?

22 A. Yes, sir, I do.

23 Q. And that the Division, after the hearing, stayed
24 with 156 percent?

25 A. That is correct.

1 Q. And then in 1991 there were three cases by
2 Maralex in which, again, the issue was whether or not 156
3 percent was too low?

4 A. Are you referring to the same two cases, or three
5 additional --

6 Q. No, there were three additional cases in 1991 in
7 which you testified again. Do you recall those?

8 A. No, sir, I don't remember separate --

9 Q. Do you recall compulsory pooling cases in 1994,
10 when you appeared and testified and saw the 156-percent
11 penalty in a compulsory pooling case?

12 A. There was one case in 1994. I believe it was
13 called the Cecil Cast Number 1 well. Maralex was the
14 contract operator for SG Interests under that well. And
15 again, that was in the southwest Aztec area. Is that the
16 case you're referring to?

17 Q. Yes.

18 A. And at that time we still did not have an
19 economic well producing in the southwest Aztec area.

20 MR. CARR: I would request that the Commission
21 take administrative notice of the following cases. These
22 are pooling cases in which Maralex has appeared and sought
23 pooling orders. They're Cases 10,112, 10,113, 10,274,
24 10,275, 10,276, 11,006 and 11,007.

25 THE WITNESS: I believe at least two of those

1 were duplicates of the 1991 cases where we were unable to
2 get the wells drilled and came back again in 1994 after we
3 had secured all of the leases but one or two, and force-
4 pooled some of the same wells.

5 MR. CARR: That may be.

6 CHAIRMAN WROTENBERY: Any objection, Mr. Bruce?

7 MR. BRUCE: I have no objection.

8 CHAIRMAN WROTENBERY: Okay, the Commission will
9 take official notice of those cases.

10 Q. (By Mr. Carr) Mr. O'Hare, if I understood your
11 testimony, there really is no risk that you're going to
12 miss the coal out here. You're going to, when you drill in
13 Section 36, find the coal; isn't that fair to say?

14 A. And I believe Ms. Delventhal testified to that,
15 and since the well has already been drilled and logged, I'm
16 sure --

17 Q. There's no doubt on that today.

18 The risk really is, to the extent you find risk,
19 whether or not it's going to be an economic well; isn't
20 that fair to say?

21 A. That is correct.

22 Q. Now, you own 57 percent of the spacing unit which
23 is at interest here; isn't that correct?

24 A. Correct.

25 Q. You could have drilled a well?

1 A. Yes.

2 Q. And you did not?

3 A. Correct.

4 Q. And why did you not?

5 A. I think I explained that, it had to do with the
6 pipeline right-of-way issue. And again, when we were
7 taking six years on the offset well and still had not
8 secured a right of way, an acceptable right of way, if we
9 had paid the tribe's ransom we probably could have had it
10 in a much shorter time frame. But we felt that it was much
11 wiser for us to spend our money in other places where we
12 knew we could get our wells on production and get a return
13 on that money.

14 Q. When I look at your exhibits, you did some
15 economics on certain wells. You didn't do an economic
16 projection on the well in the southwest of 36, did you?
17 That would be a disastrous economic situation, wouldn't it?
18 You drilled the well and you can't produce it?

19 A. Your payout would be very long.

20 Q. A very long time.

21 A. And that would greatly reduce your rate of
22 return.

23 Q. And so when you go out and look at trying to
24 develop a property here, whether or not you're going to be
25 able to produce the well, in fact, is a valid

1 consideration, is it not?

2 A. And again, we understand that there was no choice
3 on the part of Redwolf to save their lease. However, we
4 contend that we should not be penalized for their
5 responsibility of saving their lease, and basically we feel
6 that's what is being asked here. Redwolf had to have a
7 well drilled in order to save their lease or risk losing
8 the lease when it came back in front of the State Land
9 Board and they reissued it for new leases. There would
10 have been more competition, because there are some good,
11 economic, very attractive wells in the area.

12 And basically what we're saying is, we understand
13 their position, we don't have a problem with them force-
14 pooling us into the well. We fully believed that it would
15 be at least a couple of years before the well could be
16 completed and tied in, and we felt our resources were
17 better spent elsewhere. And therefore, we elected to go
18 nonconsent. And we believe that a much more reasonable
19 penalty would be in the 20- to 30-percent range.

20 Q. When Redwolf actually went out, started and
21 drilled this well, would it be fair to say that there was
22 some risk they weren't going to be able to produce it for a
23 very long time?

24 A. Yes, we do believe there was some risk there.

25 Q. And the inability to produce the well would have

1 a very negative impact on the return on that investment;
2 isn't that right?

3 A. Part of that impact has obviously been offset by
4 the tremendous increase in gas prices since they drilled
5 their well. And in fact, we believe that a 20- to 30-
6 percent penalty is basically saying, You have invested your
7 money; if you had put it in the bank for that period of
8 time, you would not get anywhere close to a 20- to 30-
9 percent return on that money.

10 And so again, we feel a 20- to 30-percent penalty
11 is more than fair to Redwolf.

12 Q. Mr. O'Hare, my question was whether or not, if
13 you were -- if you drilled a well and were not able to
14 produce it for a long period of time, that would have a
15 negative impact on the economics; isn't that right?
16 Regardless of what the price is? If you can't sell it at
17 all, if you can't sell it, you've got an economic problem;
18 isn't that right?

19 A. It would have an economic problem. And again, it
20 is their decision to undertake that risk. Basically what
21 we're saying is, the risk should not be transferred to
22 Maralex, because we weren't willing to help them secure
23 their lease over whatever time it took for them to get
24 their right of way.

25 We feel that the penalty of 156 percent should

1 address those economic conditions that are beyond their
2 control. And certainly the pipeline right of way may have
3 been beyond their control, but not at 156 percent interest,
4 basically, is what they're asking you to assess against us
5 for helping them to save their lease, or allowing them to
6 save their lease.

7 Q. In saving their lease, in drilling a well,
8 Redwolf took that risk, as you said, correct?

9 A. Correct.

10 Q. And you did not?

11 A. Correct.

12 Q. And that is a risk they took?

13 A. Correct.

14 Q. And if they put their well on and produce it,
15 you're going to derive the benefit from having a producing
16 well in 36, correct?

17 A. Not until after they get all of their money back
18 plus whatever the Commission determines is a fair return on
19 that money.

20 Q. But when that day comes, because they drilled a
21 well, we'll be sharing when the penalty is then paid out?

22 A. We will also be sharing in the cost of operating
23 that well.

24 Q. Now, if I look at your Exhibit Number 2, you
25 indicated that there were some very good wells in 25, 30,

1 31, wells which you had drilled?

2 A. That is correct.

3 Q. And when were those wells drilled? Were they
4 drilled before 1996, or are they relatively new wells?

5 A. They were drilled before the exploration of the
6 tax credit at the end of 1992. Most of them were not put
7 on production until late 1993.

8 Q. And so is it fair to say that in 1996 you would
9 have known there was good production or potential
10 production in the north half of Section 36?

11 A. Yes, by 1996 we believed there was very good,
12 attractive production in the northeast quarter of Section
13 36.

14 Q. Now, in 1996 Maralex, in fact, proposed the
15 drilling of a well in the north half of 36, did you not?

16 A. Yes, we did.

17 Q. Let me hand you a JOA that I'd like you to look
18 at. This is a joint operating agreement dated June 20,
19 1996. It indicates Maralex Resources, Inc., is the
20 operator, and on page 15 is signed by Jennifer Ritcher,
21 attorney-in-fact for Maralex. Are you familiar with this?

22 A. With the operating agreement?

23 Q. Yes.

24 A. I have not reviewed it word for word, no.

25 Q. Do you have any reason to think this isn't an

1 operating agreement that was tendered to Redwolf when you
2 proposed the well in 1996?

3 A. No.

4 Q. If we go in this operating agreement to page 6,
5 we're in the middle of the provisions that are, I believe,
6 standard provisions concerning subsequent operations; is
7 that correct?

8 A. Yes, sir.

9 Q. If under subsequent operations there were costs
10 for drilling or re-working, deepening or plugging back or
11 testing or completing a well on this property, this
12 provides that you would be able, as Maralex, to charge
13 Redwolf 300 percent for those activities; isn't that right?

14 A. This is only after the well that this pertains to
15 has been drilled, completed and put on production.

16 Q. And we now have a well that has been drilled in
17 this acreage?

18 A. But not completed or put on production.

19 Q. But in this circumstance, even if it is
20 already -- You're farther ahead, were you not, if the well
21 is completed and on production? Wouldn't you be farther
22 ahead --

23 A. I think --

24 Q. -- than you are today?

25 A. I think the counsel for Redwolf is confusing this

1 with the nonconsent penalty in two ways.

2 Number one is, once a well has been drilled,
3 completed and put on production and has been proven to be
4 economic, there is a much greater reason to keep all of the
5 partners active in that well than there is prior to the
6 drilling of that well.

7 In other words, if Redwolf had come in, or
8 Maralex, for that matter, had come in and drilled this
9 well, it was productive and generating some good economic
10 return, and then say a nonoperator came in and proposed
11 some work that could jeopardize that production, under this
12 article that work could not be done unless the well was
13 uneconomic. And then there is more incentive for all the
14 partners to join in the well, because if they don't, 300
15 percent of the cost of that work would have to be recovered
16 before they come back into the well.

17 Q. If Redwolf had signed this agreement, if a well
18 had been drilled, and if someone had proposed on this
19 acreage to drill another well or recomplete, and Redwolf
20 elected not to participate, what percentage of their share
21 of the cost would be withheld out of production?

22 A. Another well could not be drilled under this
23 agreement on the same drill site spacing --

24 Q. What if you are --

25 A. -- unit, because there is 320-acre spacing for

1 the Fruitland Coals here in the state. So the only way
2 another well could be drilled under this agreement is if
3 the State first downspaced or allowed an infill drilling to
4 160 acres --

5 Q. Mr. O'Hare, what --

6 A. -- and since that's not addressed in here, this
7 agreement would have to be modified before that work could
8 be done --

9 Q. What if you --

10 A. -- or even proposed.

11 Q. What if you were re-working a well? That would
12 fall under this agreement, would it not?

13 A. Yes, it would.

14 Q. And what if Redwolf decided they weren't going or
15 weren't able to pay their share? What percent of their
16 share of production would be withheld because they were
17 nonconsenting parties?

18 A. If you look at the provisions on page 6, only 100
19 percent of that share of newly acquired surface equipment
20 beyond the wellhead, including separators, tanks, stock
21 tanks, pumping equipment and piping, would be allowed to be
22 recovered for that work. And then 300 percent of that
23 nonequipment portion of the costs and expenses would be
24 allowed to be recovered on a workover for the intangible
25 portion of that work.

1 And again, that provision is more incentive for
2 the nonoperators to join in the work than it is to allow
3 people to get out of the work. Basically it's saying, If
4 you have a good, economic well, you're not going to want to
5 step out and allow people to recover 300 percent of the
6 intangible costs of the work required to return that to a
7 good producing well status.

8 Q. Mr. O'Hare, wouldn't you think that a 156-percent
9 risk penalty in a compulsory pooling case involving the
10 Fruitland Coal would be incentive to some operators to
11 decide to participate in the well?

12 A. Yes, to some operators it would be.

13 MR. CARR: That's all I have.

14 EXAMINATION

15 BY COMMISSIONER BAILEY:

16 Q. You stated that you would expect that the Bear
17 well would benefit from dewatering from production of wells
18 in the surrounding sections --

19 A. Yes, ma'am.

20 Q. -- because of the fracture system that's involved
21 with Fruitland Coal production?

22 A. Yes, ma'am.

23 Q. On the other hand, if that well benefits from the
24 dewatering, is there also a possibility of drainage of
25 reserves from that section?

1 A. That is a possibility. But again, the State has
2 designated the 320-acre spacing, and we assume that that is
3 due to the fact that the wells are indeed draining close to
4 320 acres.

5 If you look at the position of the wells
6 offsetting, always the diagonal wells on a 320-acre spacing
7 have some chance of draining acreage, especially in the
8 diagonal offset acreage on offsetting sections.

9 Q. So the longer that a well is not put into
10 production, the greater the possibility that there is
11 drainage, possibly, into other sections?

12 A. Yes, ma'am.

13 Q. If the State owns the mineral estate in 36 and
14 does not own the mineral estate in another section
15 adjacent, is there a possibility of the State losing
16 certain reserves?

17 A. Yes, ma'am.

18 Q. You said that you would not -- and you say, "pay
19 ransom" to the tribe for the right of way for the well in
20 the south half of Section 36?

21 A. I believe that's my word, yes, ma'am.

22 Q. In your opinion, is it cheaper to pay
23 compensatory royalty than it is to pay right-of-way fees to
24 the tribes?

25 A. I have not run any economics to be able to say

1 that it would be cheaper one way or the other.

2 Q. Is Maralex the lessee of record for 240 acres in
3 the north half and 320 acres in the south half of Section
4 36?

5 A. I don't know the exact acreage amount in the
6 north half. I know it is significantly greater than what
7 we own in the south half.

8 I believe the lessee of record in the south half
9 is SG Interests for the Fruitland Coal.

10 COMMISSIONER BAILEY: And as less of record, the
11 less of record for any oil and gas lease is held
12 accountable to the Commission for all activities.

13 That's really all I have right now.

14 CHAIRMAN WROTENBERY: Commissioner Lee?

15 EXAMINATION

16 BY COMMISSIONER LEE:

17 Q. Do you have any interest in an adjacent well?

18 A. Yes, we do.

19 Q. Do you know that Redwolf had interest in the
20 adjacent well?

21 MS. DELVENTHAL: No, sir.

22 THE WITNESS: I'm not familiar with their --

23 Q. (By Commissioner Lee) No, I'm asking you.

24 A. I'm not familiar with their position in this
25 area.

1 Q. So apparently the drainage happened? Drainage.

2 A. Drainage has happened? Again, I think there
3 would need to be some reservoir --

4 Q. So is that beneficial to Maralex, if you have a
5 working interest in the adjacent well?

6 A. Yeah, and it could be beneficial to Maralex if
7 there is drainage.

8 Q. And it's not beneficial to Redwolf?

9 A. There is some benefit to Redwolf through the
10 dewatering. That gas has been desorbing, presumably, if
11 that reservoir pressure is lowered below the desorption
12 point.

13 Q. Yes, but apparently the gas is moving, right?
14 The gas is moving?

15 A. It could be, yes.

16 Q. Moving to where?

17 A. To the pressure sink caused by the offset wells.

18 Q. Where is the pressure sink?

19 A. It would be in the offsetting wellbores, most
20 likely, in the southwest quarter of Section 30.

21 Q. So do you have any interest in those wells?

22 A. In Section 30? Yes, Maralex does, a very small
23 interest compared to our interest in the north half of
24 Section 36.

25 COMMISSIONER LEE: Okay, no more questions.

EXAMINATION

BY CHAIRMAN WROTENBERY:

Q. Mr. O'Hare, could you explain in a little bit more detail the differences in the completion practices that you say account for some of the difference in recoveries from the wells in the area?

A. I'll be happy to. Some of the wells were completed -- at least the wells that we operated, were completed with nondamaging fluids. Most of the wells that we completed to the north and east, the stimulations were performed using non-gel-based fluids with nitrogen foams, and we took extra care to make sure that the additives that we needed to generate those foams were nondamaging to the coals, especially using non-ionic surfactants and making sure that our bactericides and any other additives would not have any kind of impact on the coals.

In contrast to that, there were a number of stimulations that were performed by other operators that used heavy gel loadings with additives that are very damaging to the coal, and very little care was taken to avoid imparting that damage to the coals.

On top of that, some of those stimulations didn't come close to completion. They were pumped, maybe a third of the job on some of them. In fact, I think one of them got like 10 percent of the designed fracture stimulation

1 into the coals.

2 So they damage the coals, then they didn't have
3 anywhere close to the fracture extension that we were able
4 to achieve in our wells.

5 CHAIRMAN WROTENBERY: You had another question, I
6 believe, Commissioner Bailey.

7 FURTHER EXAMINATION

8 BY COMMISSIONER BAILEY:

9 Q. Oh, yes. It struck me, does Maralex operate any
10 other wells on Indian surface?

11 A. Yes, we do.

12 Q. And you have paid their right-of-way fees for
13 the --

14 A. We have one recently acquired right of way where
15 we paid a little bit less than what they were trying to get
16 in here. It was a much shorter right of way, and the
17 overall cost came out to about \$25,000 for that right of
18 way.

19 If I might, I'd like to clarify our interest in
20 the offsetting wells so that you can see it is not a
21 benefit to Maralex not to participate in this well and try
22 to drain gas from it, from the offsetting wells.

23 In the southwest quarter of Section 30 --

24 CHAIRMAN WROTENBERY: Which exhibit are you
25 looking at?

1 THE WITNESS: I'm sorry, this is Exhibit --
2 either 2 or 4 works.

3 CHAIRMAN WROTENBERY: Okay.

4 THE WITNESS: In the southwest quarter of Section
5 30 Maralex owns a working interest, 10 percent in that
6 well. And our net revenue interest is 7.4 percent.

7 In the northeast quarter of Section 31 we own
8 7.5-percent working interest, and our net revenue interest
9 is .06 percent.

10 And in the northeast quarter of Section 25 we own
11 a 7.5-percent working interest, and our net revenue
12 interest is under 6 percent.

13 So if we were looking to recover reserves from
14 the offsetting wells, or through the offsetting wells from
15 the north half of Section 36, we would be shooting
16 ourselves in the foot, since we own a 57-percent interest
17 in the north half of Section 36.

18 Our sole reason for not joining in the well was,
19 we did not think that we could get the pipeline tie-in
20 within a reasonable period of time, and we had other
21 commitments for our resources at the time that we were
22 AFE'd for this work.

23 CHAIRMAN WROTENBERY: Mr. Ross, did you have any
24 questions?

25 MR. ROSS: Yeah, thank you, just a couple.

EXAMINATION

1
2 BY MR. ROSS:

3 Q. I gather from what you testified earlier that the
4 Navajo nation had made an offer on this pipeline right of
5 way to you at some time in 1994? Is that what you
6 testified?

7 A. No, we applied for it in 1994, I believe. I'm
8 not absolutely sure that they -- But it was at least two
9 and a half years after that before we actually got anything
10 back from the tribe.

11 And again, in addition to the offer, or to the --
12 when the tribe sets forth a resolution, it's not an offer;
13 it's basically, Here's what you will pay, or you won't put
14 your pipeline in.

15 And in addition to that high amount, they had
16 other stipulations in there that we did not feel
17 comfortable trying to adhere to, we could not agree to.
18 Some of them had to do with our legal rights under the
19 right-of-way agreement.

20 Q. What I'm interested in is whether the amount that
21 they had stipulated that you would pay for the right of way
22 was greater or less than what Redwolf ultimately did pay.

23 A. I honestly don't know what their per-rod charge
24 was or their per-foot charge was. When we were applying
25 for our right of way, it was from the well in the southwest

1 quarter of the section, and it ran the entire distance, a
2 little more than a mile, to the tie-in point in the
3 southwest quarter of Section 30. The total amount was very
4 significant. It was much more than what we were going to
5 pay to actually put the pipeline in place, buying the pipe
6 and trenching it in.

7 Q. There was testimony earlier, I think, that it was
8 about \$35,000 paid for the right of way, was the amount
9 they proposed you pay. Do you remember, was it greater or
10 less than that?

11 A. Again, I don't remember the exact number. I
12 would guess that it was greater than that, but again it's
13 for more -- greater distance also.

14 Q. Are you familiar with the completion techniques
15 that Redwolf proposes to use on their well?

16 A. The only thing I know is that they intend to
17 fracture-stimulate the well. I do not know what kind of
18 fracture techniques they intend to use.

19 Q. Now, I guess there are two assumptions that you
20 made when you were assessing the economics of this well and
21 the wells surrounding the well, to make your recommendation
22 as far as the risk penalty factor. One of them was the
23 life of the well. And I didn't hear you say, and I
24 couldn't quickly glean it from these materials what you
25 were assuming the life of the well was.

1 A. If you look on Exhibit 5A, -B or -C, down at
2 the -- on the left-hand side of the page under "year",
3 midway through the page, it will show the well life, total
4 year or total 17.8-year on 5C. 5B is 21.6-year, and 5A
5 shows 23.1 years.

6 Q. Why the difference?

7 A. Again, it's due to the economics generated by the
8 difference in gas prices. The higher the gas price -- and
9 again, we held those constant -- the higher the gas price,
10 the lower the economic limit of the well.

11 Q. Do you disagree with the testimony of Redwolf
12 that at \$1.75 an MCF, that some wells in this section would
13 be uneconomic?

14 A. Yes, I do disagree with that. Well, let me
15 rephrase my answer. There will be one or two wells at
16 \$1.75 MCF that will be uneconomic. I ran economics at
17 \$2.00 an MCF for an average well in this 12-section area,
18 and it is very strongly economic. A 38-percent rate of
19 return is a very good, healthy rate of return.

20 Q. Are you assuming when you make the recommendation
21 of a 20- to 30-percent risk penalty that current gas prices
22 are more reflective of what's going to occur during these
23 wells than the ones in the past?

24 A. I think what I'm saying is, even if they are not
25 reflective of what they -- I'm sorry, even if they are not

1 reflective of the prices we currently have, the rate of
2 return is still going to be acceptable for this well at a
3 \$2.00 gas price, assuming they have an average well in this
4 area.

5 MR. ROSS: Thank you.

6 CHAIRMAN WROTENBERY: Anything else,
7 Commissioners?

8 Mr. Bruce, did you have anything?

9 MR. BRUCE: I have a couple follow-up questions
10 for Mr. O'Hare.

11 REDIRECT EXAMINATION

12 BY MR. BRUCE:

13 Q. Regarding the risk involved in making a well
14 here, what -- referring back to some of Mr. Carr's
15 questions, basically what you're saying is, there is maybe
16 a 10-percent chance that the well will not produce at that
17 700-million-cubic-feet level; is that correct?

18 A. That's correct.

19 Q. And certainly you -- I think you agreed with Mr.
20 Carr that not producing a well has a negative effect on
21 economics?

22 A. Correct.

23 Q. But in your view, is lack of a pipeline -- That's
24 not a risk factor involved in drilling and completing a
25 well, is it?

1 A. No, sir.

2 Q. Finally, on the operating agreement Mr. Carr
3 showed you regarding the penalty provision, as you pointed
4 out, that's for additional drilling or reworking of a well,
5 is it not?

6 A. Correct.

7 Q. Now, if that's going to happen, that means that
8 something has gone wrong with the well, or it has ceased
9 producing, wouldn't you agree?

10 A. That is correct.

11 Q. And at that point there is risk involved because
12 you have a nonproducing well. Perhaps the zone has played
13 out or something?

14 A. Or if there are mechanical problems with the well
15 that -- so there's a risk of losing the wellbore, yes.

16 MR. BRUCE: That's all I have, Madame Chair.

17 CHAIRMAN WROTENBERY: Thank you. Mr. Carr,
18 anything else?

19 MR. CARR: Nothing further.

20 I have a closing statement.

21 CHAIRMAN WROTENBERY: Commissioners, anything
22 else for Mr. O'Hare?

23 Thank you for your testimony, Mr. O'Hare.

24 MR. CARR: May it please the Commission, I would
25 move the admission of Redwolf Exhibit 10.

1 MR. BRUCE: No objection.

2 CHAIRMAN WROTENBERY: It is admitted into the
3 record.

4 (Off the record)

5 CHAIRMAN WROTENBERY: Mr. Carr?

6 MR. CARR: May it please the Commission, this is
7 a *de novo* proceeding, but Redwolf remains the Applicant.
8 And I have a closing statement. I'm willing to go first or
9 last. But if in the closing statement some cases are
10 cited, I do want to have the opportunity to respond to
11 those. I think as the Applicant it's appropriate for me to
12 go last. I will go first if you prefer, but if cases are
13 cited as a precedent, I would like the opportunity to
14 respond to those, so that the record isn't closed without
15 that.

16 CHAIRMAN WROTENBERY: Are we all in agreement
17 with that?

18 MR. BRUCE: That's fine, and I'll let Mr. Carr go
19 first.

20 MR. CARR: May it please the Commission, this
21 case is a compulsory pooling case. And we really have no
22 issue in the case as to whether or not Redwolf is entitled
23 to a pooling order. They've met all the statutory
24 requirements.

25 And having done that, you do not have discretion,

1 you cannot deny their Application. The statute says when
2 you have more than one owner in a spacing unit and they
3 propose a well and they've been unable to reach voluntary
4 agreement, that after notice and hearing, and the Oil and
5 Gas Act says, you shall enter an order pooling the lands.
6 So we have that, we're entitled to the pooling of the land.

7 And the reason for that is that everyone has an
8 opportunity to go out and develop their acreage. Maralex
9 has testified that when they look at this property, it's a
10 good place to put a Fruitland Coal gas well. But because
11 they've been unable to produce it, a well in the southwest
12 quarter of the section, they simply didn't have an economic
13 picture that would justify their going forward with the
14 prospect.

15 I submit to you, it was too risky for them from
16 an economic point of view. Nobody here is arguing that you
17 wouldn't find the coal. The question is, can you pay it
18 out? And yet this is a risk Redwolf was willing to take.

19 And then the statute goes on and says, when
20 someone does this and is carrying someone else -- here, 57
21 percent of the well -- you may impose a penalty for the
22 risk they assume. And that's what this case is about.

23 As you know, we had to go forward to drill the
24 well, and we did. We had a lease expiration. We've been
25 in negotiation, active negotiation, for months, and

1 discussing the well for years, with Maralex, the largest
2 owner, who could have drilled but, because of the unique
3 facts of this particular situation, did not. So to avoid
4 the loss of our property we drilled the well.

5 We didn't only have to drill, we had to carry
6 Maralex. And we should be compensated for taking that
7 risk.

8 One thing in this case which is, I think,
9 inappropriate is to start now trying to look back to the
10 day the decision was made to drill this well and try and
11 start playing games with what prices are today or may be in
12 the future. The decision to go forward, the decision to
13 take the risk and the risk that was taken is properly based
14 on what the gas prices were on the day that decision was
15 made, and it was \$1.75, based on a five-year average.

16 Now, we can today sit here and say, Oh, well,
17 it's maybe \$2.78, \$3.78, \$10.78 ten years from now. One
18 thing I've learned in 25 years of this is, no one's ever
19 been right when they start projecting prices. We used a
20 five-year average, and we showed you what we used on the
21 day we decided we would take this risk.

22 We submit that 156 percent is an appropriate
23 penalty, that this is a typical well, and that there are
24 wells offsetting this property to the south and the west
25 that will not be commercial wells.

1 Maralex, if you'll look at the cases I asked you
2 to review, you'll see they've been here before. They've
3 been complaining about the 156-percent penalty in the past,
4 not as they are today when they're being pooled, that it's
5 too high, but when they were coming in to pool someone else
6 they were complaining that it is too low.

7 You can look at the cases. There are some that
8 repeat. But in seven cases in the last ten years, five of
9 them, they sought a 200-percent penalty after 156 had
10 become the norm for wells in this are. We submit the
11 penalty, the situation, is normal for a Fruitland Coal gas
12 well, 156 percent is appropriate.

13 When the well was drilled, we knew there would be
14 coal there. It has been drilled, and we know that. So
15 nothing there has really changed.

16 But what has changed is that we have not lost our
17 lease, not to Maralex, not to anyone else. We have gone
18 forward, taken the risk and developed our property. We
19 feel a little bit like games are being played: You go
20 ahead, you have to drill the well, you drill it, you take
21 the risk. We'll let you do that, but then we'll try to
22 after the fact avoid the penalty. This hasn't been allowed
23 in the past. We submit it should not be allowed here.

24 But I would submit to you that, you know, you can
25 try and work around the JOA any way you want, but it says

1 that if after you have a well, after you have a producing
2 well, if you want to go rework it, if you want to do
3 additional drilling, if under that agreement which was
4 proposed to Redwolf by Maralex, they're carrying us, the
5 penalty is 300 percent.

6 However, if we come before you and it's the other
7 way around and, in fact, we're carrying them, we get one-
8 tenth of that. I submit to you that's on its face wrong.

9 I believe Mr. Bruce will in a moment cite to you
10 some cases that date back to 1990 when Louise Lock was
11 force pooled by BHP. And in that case, because the well
12 had been drilled, a 10-percent penalty was imposed. And
13 when you hear Mr. Bruce, I want you to remember that that
14 fact situation differs dramatically from this in two very
15 important ways.

16 First of all, in that case, unlike what we have
17 here, BHP testified that only 10 percent of the risk
18 remained.

19 Also in that case, we had a situation where BHP
20 had never given Mrs. Lock an AFE and had not given her an
21 opportunity to participate in the well. It's a very
22 different situation than what we have here.

23 And the Division finds -- and it's in an
24 unnumbered finding, right ahead of Finding 13 in Order
25 Number R-9581-A -- 9581-A, right ahead of Finding 13, it

1 talks about the risk penalty. And it says, "In this
2 particular situation" -- that's a quote from the order.

3 In this particular situation we have an interest
4 owner who went out and drilled a well, carried an owner who
5 had 57 percent of the well but wouldn't drill it, took the
6 risk, came here, got a pooling order that imposed the
7 standard penalty. And we believe we have a situation which
8 is typical for Fruitland Coal, that the order entered below
9 should be affirmed and the penalty should be maintained.

10 CHAIRMAN WROTENBERY: Mr. Bruce?

11 MR. BRUCE: Members of the Commission, first of
12 all, no games are being played here. We're not coming in
13 after the fact, after the well has been drilled and there's
14 a lot of well data saying, Look, this is low risk because
15 it's making 500 MCF a day or it's making 200 barrels a day.
16 The fact is, there is no well data. Redwolf testified
17 about that.

18 Our request is, regardless of any data from the
19 well -- and in fact, there is none -- what we are looking
20 at is just like we were in -- I think the hearing was in
21 early December of 1999, December 2nd. The facts are
22 virtually the same now as they were back then.

23 Mr. Carr cites some cases against Maralex, but
24 the fact is, times change. If you go back to the 156-
25 percent penalty, that was established about a decade ago

1 when Fruitland Coal drilling was just beginning in the
2 Basin.

3 I think if you went back and looked at the data
4 from that hearing where that was established -- and I tried
5 to dig that up out of my files -- one of the factors, one
6 of the risk factors involved, was well completion. And
7 well completion was deemed to be about 10 percent of the
8 risk factor involved in drilling the well. And that's
9 where that 10-percent risk penalty comes in, in the cases
10 that Mr. Carr just mentioned and in the ones that I will
11 just cite.

12 Also, looking at the prior Maralex cases, as Mr.
13 O'Hare testified, you're not dealing with an area in those
14 cases that had surrounding wells, wells all around a
15 proposed location. As Mr. O'Hare stated, they were stepout
16 wells.

17 And as a matter of fact, as of the date of the
18 last hearing Maralex had force-pooling these wells in 1984,
19 he stated there was still no economic well in the area in
20 which he was drilling, and therefore 156-percent penalty
21 was assessed, and that was reasonable in that situation.
22 But as I said, times change.

23 Now, we understand that Redwolf had to drill the
24 well. Maralex did not seek to prevent them from drilling.
25 And in fact, the parties have been negotiating since it

1 looks like 1996, trying to get a well drilled in this area.
2 The problem was the surface owner. Maralex didn't seek to
3 oppose Redwolf and are glad they drilled the well. Our
4 position is simply that a penalty of 156 percent -- which
5 as I said is the maximum the Division has awarded in force-
6 pooling cases on Fruitland Coal wells -- is unreasonably
7 high in this situation.

8 As our witness testified, the anticipated
9 production from this well is about 800,000 MCF of gas,
10 eight-tenths of a BCF. Surely, based on the drilling cost
11 of \$175,000, this well will pay out many times over. This
12 militates against a high penalty.

13 The simple facts are this: It's a shallow well,
14 the coal is there, the drilling process is simple, it's low
15 cost, there's no risk involved in finding the formation,
16 and this location is surrounded by numerous excellent
17 wells.

18 We recognize that the lack of a pipeline has an
19 effect, but that's not a risk factor involved in drilling
20 and completing a well. And traditionally, the Division
21 Hearing Examiners have looked only at geological or
22 engineering risk in assessing a penalty, not at surface
23 equipment.

24 And as a matter of fact, no penalty is awarded
25 against surface equipment in a force-pooling order. It is

1 only based on geological and engineering risk.

2 That's what we get to with this model form
3 operating agreement. Of course, the parties can contract
4 for whatever they want, but if all you needed was a JOA to
5 support the penalty, then landmen alone would be coming up
6 here doing the force-pooling hearings. But because the
7 Division looks at geologic and mechanical risk, every
8 hearing for force-pooling in this state has to have a
9 geologist and/or an engineer testify about the geologic and
10 mechanical risk involved in drilling a well, drilling and
11 completing a well. When you look at that, I think 156
12 percent is too high.

13 I was involved in these prior cases. The order
14 numbers are R-9581-A and R-9584-A. Those went to the
15 Commission, and the Commission awarded the operator only a
16 10-percent penalty where a well had been drilled but not
17 yet completed. And the testimony was, based on the
18 original Division case, awarding 156-percent penalty in a
19 Fruitland Coal well, that 10 percent was attributable to
20 the completion of the well. And the facts were different
21 in that case, they are in almost every case. But the fact
22 remains that the completion risk is deemed to be 10 percent
23 by the Commission.

24 Also, just last year -- and I would ask
25 permission to submit these order numbers later; I forgot

1 them on my desk when I left the office this morning -- a
2 year ago, Cross Timbers drilled two Dakota wells. I
3 believe the Township was probably 28 North, 10 West. A
4 situation like this where the Division looked at the fact
5 that there were wells surrounding the proposed well
6 virtually on every proration unit, and even in that
7 situation where you're looking at a Dakota well, much
8 deeper, they reduced the penalty there by 50 percent, so
9 that the operator only got 150-percent penalty.

10 Again, we're just looking for a little fairness
11 here. If the Division can reduce a penalty even on a
12 deeper, riskier well, in this shallow well we think the
13 penalty should be substantially reduced.

14 We think and we believe this will be an excellent
15 well, and we hope it is, for all the interest owners
16 involved. Now, the 10-percent penalty I stated in these
17 prior orders may be too low, but 156 percent is too high.

18 We would urge the Commission to reaffirm the
19 pooling. Maralex is a nonconsent party in that pooling,
20 but we would ask that the penalty be substantially reduced
21 along the lines that Mr. O'Hare stated.

22 Thank you.

23 CHAIRMAN WROTENBERY: Thank you, Mr. Bruce.

24 Mr. Carr, anything further?

25 MR. CARR: I would just simply note that when you

1 look at these orders, Mr. Bruce is right, they all have
2 unique, particular fact situations. And we believe when
3 you start looking for a little fairness, that it is
4 appropriate to remember that one party took the risk, that
5 there are offsetting wells that will not be commercial, and
6 they took the risk for someone who was a majority owner but
7 who would not drill.

8 In that circumstance we believe we have the
9 typical situation that comes before you in the context of
10 pooling, and the 156-percent penalty is appropriate.

11 CHAIRMAN WROTENBERY: Thank you.

12 MR. CARR: That's all.

13 CHAIRMAN WROTENBERY: Mr. Bruce, would you
14 provide the cites to those --

15 MR. BRUCE: I will --

16 CHAIRMAN WROTENBERY: -- Cross Timbers cases last
17 year?

18 MR. BRUCE: Cross Timbers, I will do that this
19 afternoon when I get back home.

20 CHAIRMAN WROTENBERY: Thank you.

21 MR. BRUCE: I will also give those to Mr. Carr.

22 CHAIRMAN WROTENBERY: Thank you. Anything
23 further in this case? Well, we'll take this matter under
24 advisement.

25 And I would, I think, entertain a motion at this

1 point from one of the Commissioners to close this meeting
2 so that we can deliberate on this case.

3 COMMISSIONER BAILEY: I so move.

4 COMMISSIONER LEE: Second.

5 CHAIRMAN WROTENBERY: All in favor say "aye".

6 COMMISSIONER BAILEY: Aye.

7 COMMISSIONER LEE: Aye.

8 CHAIRMAN WROTENBERY: Aye.

9 (Off the record at 10:45 a.m.)

10 (The following proceedings held at 10:55 a.m.):

11 CHAIRMAN WROTENBERY: I'll entertain a motion to
12 open the meeting again.

13 COMMISSIONER BAILEY: I so move.

14 COMMISSIONER LEE: Second.

15 CHAIRMAN WROTENBERY: All in favor say "aye".

16 COMMISSIONER BAILEY: Aye.

17 COMMISSIONER LEE: Aye.

18 CHAIRMAN WROTENBERY: Aye.

19 For the record, the Commission closed the meeting
20 to deliberate on the Redwolf case we just heard, Case
21 12,299. The only item we discussed while the meeting was
22 closed was this particular case.

23 We are now back in open session and ready, I
24 think, to adjourn.

25 Are there any other items of business for the

1 Commission today?

2 No?

3 Then I think by acclamation we'll adjourn, how
4 about that?

5 Thank you very much.

6 (Thereupon, these proceedings were concluded at
7 10:56 a.m.)

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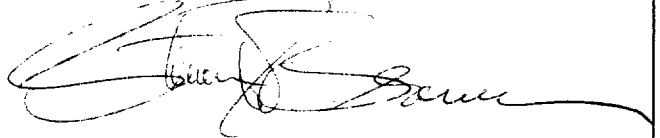
CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL June 28th, 2000.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002