STATE OF NEW MEXICO

ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

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

APPLICATION OF CHESAPEAKE OPERATING, INC., FOR COMPULSORY POOLING AND AN UNORTHODOX SUBSURFACE LOCATION, LEA COUNTY, NEW MEXICO

CASE NO. 12,325

ORIGINAL

00 FEB -7 PM 4:44

OIL CONSERVATION DIV.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MARK ASHLEY, Hearing Examiner

January 20th, 2000

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MARK ASHLEY, Hearing Examiner, on Thursday, January 20th, 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.

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* * *

WHEREUPON, the following proceedings were had at 1:07 p.m.:

EXAMINER ASHLEY: This hearing will now come to order, and the Division calls Case 12,325.

MR. CARROLL: Application of Chesapeake Operating, Inc., for compulsory pooling and an unorthodox subsurface location, Lea County, New Mexico.

EXAMINER ASHLEY: Call for appearances.

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

EXAMINER ASHLEY: Additional appearances?

MR. CARR: May it please the Examiner, my name is William F. Carr. I'm with the Santa Fe law firm Campbell, Carr, Berge and Sheridan. We represent Altura Energy, Ltd., and Southeast Royalties, Inc., in opposition to the Application, and I have two witnesses.

EXAMINER ASHLEY: Any more appearances?

Will the witnesses please rise to be sworn in?

(Thereupon, the witnesses were sworn.)

MR. KELLAHIN: Mr. Examiner, our first witness is Lynda Townsend. Mrs. Townsend is a petroleum landman with Chesapeake Operating, Inc.

LYNDA F. TOWNSEND,

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

DIRECT EXAMINATION

BY MR. KELLAHIN:

Q. Ms. Townsend, for the record would you please state your name and occupation?

A. My name is Lynda Townsend. I'm a landman with Chesapeake Operating in Oklahoma City. I handle the Permian Basin for Chesapeake, and have for the last two, two and a half years.

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

A. Yes, I have.

Q. And you have done so in previous compulsory pooling cases?

A. Yes, I have.

Q. As part of your employment with Chesapeake, are you familiar with the land ownership within the south half of Section 17 that is the subject of this hearing?

A. Yes, sir.

Q. In addition, were you involved in some of the permitting processes for the well?

A. Yes, I was.

Q. In addition to the ownership knowledge and the permitting for the well, were you also the individual for your company responsible for contacting the various working interest owners and attempting to reach voluntary agreements with them?

A. Yes, sir.

MR. KELLAHIN: We tender Mrs. Townsend as an expert petroleum landman.

EXAMINER ASHLEY: Ms. Townsend is so qualified.

Q. (By Mr. Kellahin) Let me have you turn to the exhibit book, Mrs. Townsend. If you go to the very back of the book, there is going to be a locator plat. It's marked as Chesapeake Exhibit 1.

A. Yes.

Q. If you'll unfold that plat for me, let's give the Examiner some of the basic factual information before we get into the specific details.

A. All right.

Q. When I look at this map, it is color-coded with a light yellow background?

A. Yes.

Q. What is that intended to represent?

A. That indicates Chesapeake leasehold.

Q. Leasehold insofar as that you have some percentage interest in that particular tract?

A. Yes.

Q. It would not be an indication of the percentage of interest that you would have?

A. No.

Q. Within the south half of 17, you have identified three separate tracts, have you not?

A. Yes.

Q. Describe for us how you've numbered the tracts.

A. All right. The tracts have been numbered. Tract 1 is the north half of the southwest, Tract 2 is the south half of the southwest, and Tract 3 is the entire southeast quarter.

Q. When you had the title examined for the south half of Section 17, did you learn that not only was the proposed spacing unit horizontally divided into three separate tracts, it is also vertically subdivided, is it not?

A. Yes, sir.

Q. So as you go down from the surface to various depths, you're going to have different combinations of owners and percentages?

A. Exactly.

Q. There is a dryhole symbol down in the southwest southwest of 17. Do you see that?

A. Yes.

Q. And then there is a line connecting the dryhole symbol to an open circle; do you see that?

A. Yes.

Q. What is that intended to represent?

A. The dryhole well is the original Barbara Fasken Barry Hobbs 1-17. We've re-entered that well. Now, the circle --

Q. What was the purpose of the re-entry?

A. The re-entry was to test the Strawn formation.

Q. Okay. As part of the permitting process for the Strawn in this area, can you identify for us what is the Strawn oil pool for which that well would be subject to?

A. Yes, the Strawn oil pool is in the Northeast Shoe Bar-Strawn. It is -- You have to be 330 from the quarter-quarter lines for the field rules.

Q. What is the spacing per well in that pool?

A. Eighty acres.

Q. You have in your table of information, do you not, behind Exhibit Tab Number 3, you've provided for the Examiner a copy of the rules for the Northeast Shoe Bar-Strawn Pool, have you not?

A. Yes, uh-huh.

Q. Okay. Let's talk about the permitting for the re-entry as a Strawn oil well on 80-acre spacing. What was the proposed dedication of acreage for the well?

A. South half, southwest.

Q. All right. It would have been all of Tract Number 2?

A. Right.

Q. To the best of your knowledge, at the time that well was permitted had you had, Chesapeake, consolidated all of the working interest ownership under some various types of voluntary agreements?

A. Yes.

Q. All right. That was your belief, was it not?

A. Yes.

Q. Would that have included obtaining leases from Altura?

A. Yes, in that south half, southwest.

Q. All right. Let's look at the permitting, then, for the re-entry as a Strawn attempt. If you'll turn behind Exhibit Tab Number 4 -- let's look at this portion of the book -- the first display here is a map and a vertical view of the deviation of the wellbore, is it not?

A. Yes.

Q. Have you had your technical people review this for you?

A. Yes.

Q. And when we look at the wellbore proposal, it is the black line, is it not?

A. Yes.

Q. That was the presumed or the planned profile for the well, and then the red line data shows the actual results of what happened?

A. Yes.

Q. Okay. Let's talk, then, about the next page. On September 24th of 1999, the Division issued an approval. What is this approval for?

A. This was the application to re-enter the well and take it horizontally.

Q. Okay. The purpose of doing this was for what? To obtain approval for an unorthodox location?

A. Well, it was to obtain approval to re-enter the well at what we thought was an unorthodox location. However, come to find out, in the Northeast Shoe Bar-Strawn we were not unorthodox.

Q. All right. So this was filed in September, anticipating that it might be unorthodox --

A. Right.

Q. -- Mr. Stogner's approved it as a directional wellbore?

A. Right.

Q. All right, let's turn to the next display. What does the C-101 show?

A. This is the actual permit for the re-entry of the College of the Southwest.

Q. All right. Beyond that, what's the next page?

A. The next page is the Application for the -- I'm sorry, it's the plat for the directional, showing the surface location and the bottomhole location.

Q. All right, this is the target in the Strawn?

A. Right.

Q. At this point in time, then, operations are commenced on the wellbore, a re-entry takes place, and the well is kicked off, and you're trying to hit this bottomhole target in the Strawn, correct?

A. Right.

Q. What happens in terms of field operations for the well once the field personnel penetrate the Strawn formation? What do they decide to do?

A. They decide at that point to either try to complete it as a Strawn well or, if not, what they want to do from that point on.

Q. And what did they decide to do then?

A. They decided to drill deeper, since the Strawn was nonproductive, and to go to the Atoka.

Q. All right, that was a decision made in the field about deepening the well --

A. Yes.

Q. -- to see if there was any potential Atoka production?

A. Right.

Q. All right. In terms of checking as to whether or not the spacing and the ownership were consolidated for purposes of an Atoka attempt, what is your understanding for an appropriate spacing for a well at that depth?

A. The appropriate spacing for a well at that depth would be 320 acres.

Q. All right. What was the understanding of Chesapeake's field personnel with regards to consolidation of all the working interest owners in the 320, then?

A. At the point that the original Altura lease was taken, it was exploration's understanding that all of Altura's lease had been taken in the south half, which was not a correct assumption.

Q. Once you became involved, then, in recognizing operational personnel had taken the choice to deepen the well to the Atoka and had become informed that the information that certain of your employees were utilizing in terms of ownership was not correct, then did you contact those interest owners who had not yet voluntarily committed to the wellbore?

A. I did not contact them, I had our broker contact them.

Q. All right. We'll come back to the sequence of getting the additional parties proposed at the wellbore.

So now you've got the well approved in the Strawn.

A. Uh-huh.

Q. Do you go back and do anything about amending your reports with the Division concerning deepening the well to the Atoka?

A. Yes, we sent in an amended report as far as the Atoka. We were told at the time -- We were going to have it walked through. The gentleman took the application there. We were told at that time it was unorthodox in the Atoka.

Q. All right. So when I look at this next C-102, there has been handwritten in an amended bottomhole location; do you see that?

A. Right.

Q. It says 580 feet from the south line?

A. Uh-huh.

Q. That would have been at what vertical distance in the wellbore? Is that at total depth or somewhere else?

A. That's at total depth.

Q. Okay. At total depth, then, the closest the wellbore is to the southern boundary is 580 feet?

A. Right.

Q. In terms of contacting the offsetting operators or working interest owners, did you contact those individuals and obtain waivers of objection for the location?

A. Yes, we did.

Q. Let's take a moment and go back to Exhibit 1 in Section 20.

A. Uh-huh.

Q. The wellbore is moving towards the south boundary. What are the working interest owners or operators that you contacted and obtained waivers from in Section 20?

A. We obtained waivers from Texaco and from Yates Petroleum. Texaco owns in the west half of the southeast and in the southeast of the southwest. Yates owns in the west half -- I mean east half of the east half.

Q. To the best of your knowledge, you believe you've gotten waivers from all of the interest owners affected by the unorthodox location?

A. Exactly.

Q. All right, let's move back to Exhibit 4 and look at the next plat after this amended C-102. What do you have next in the book? Yeah, you're --

A. Vicinity map?

Q. -- with me.

A. Vicinity map?

Q. Right.

A. Okay.

Q. You have simply two vicinity locator maps, right?

A. Right, uh-huh.

Q. All right. At this point in time, then, you've got a potential wellbore in the Strawn, it's on 80-acre oil spacing --

A. Right.

Q. -- and it would be the south half, southwest quarter?

A. Yes.

Q. You potentially have an Atoka well which would be dedicated to the south half?

A. Right.

Q. Are there any other formations that are potentially involved within this wellbore?

A. Yes, there's the Wolfcamp, which is a 160-acre unit, which takes in the whole southwest quarter, which would be the north half, southwest and the south half, southwest.

Q. All right, and that is the North Shoe Bar-Wolfcamp?

A. Yes.

Q. And it's a 160-acre oil pool?

A. Yes.

Q. Behind Exhibit Tab Number 3 have you provided the

Examiner with a copy of the special pool rules for the North Shoe Bar-Wolfcamp Pool?

A. Yes, and that's right behind the Strawn pool.

Q. And the Atoka pool, then, would be on statewide spacing?

A. Yes.

Q. Okay. Let's turn, now, to Exhibit Number 2, and let's identify for the Examiner the details of the ownership as they affect each of those three spacing units for those formations, all right?

A. All right.

Q. Let's start with the tabulation of formation information for the Wolfcamp pool if that is eventually determined to produce oil. If I look at your table and look at the final column in here where you summarize working interest in the Wolfcamp unit --

A. Right.

Q. -- what are you representing here?

A. These are all the working interest owners in the 160-acre Wolfcamp unit.

Q. Of those four entities or individuals, do you have leases or agreements with any of them?

A. With Fasken and Bonneville.

Q. All right. The Altura interest?

A. It's unleased --

Q. The Altura interest was --
A. -- in half of the unit --
Q. All right.
A. -- in the north half, southwest.
Q. The Altura interest is subject to a lease from Altura to Chesapeake for Tract 2?
A. Right.
Q. But there was no lease for Tract 1?
A. I'm sorry, it's the other way around.
Q. The other way --
A. We have the lease in Tract 1 and we do not have them leased in Tract 2.
Q. All right, as to the Wolfcamp?
A. Right.
Q. In Tract 2, you had them leased as to the Strawn?
A. No, the Strawn is the south half, southwest.
Q. That's what I'm saying. In Tract 2, the south half, southwest --
A. In Tract 1 is the south half, southwest. Oh, on the map?
Q. On my map.
A. Where are you looking?
Q. I'm looking at the map.
A. I'm looking at the -- I'm sorry -- I'm looking at the --

Q. Well then, I've thoroughly confused you.

EXAMINER ASHLEY: Exhibit 2, there's something wrong with Exhibit 2.

THE WITNESS: It's backwards on the tracts.

Q. (By Mr. Kellahin) All right. When we look at the map --

A. Uh-huh.

Q. -- then Tract 2 on the map, the Altura interest in Tract 2, is subject to a lease?

A. Right.

Q. And the lease is broad enough to include not only the Strawn but the Wolfcamp as to that 80 acres?

A. Right.

Q. To consolidate the 160-acre spacing unit for the Wolfcamp, though, Altura's interest in Tract 1 was not subject to a lease?

A. Right.

Q. Okay, so you made the calculation, and they have 13 percent, give or take, if this is a Wolfcamp spacing unit?

A. Uh-huh.

Q. All right. In the Strawn, when we look at the next portion of this display, you had all interests committed to the Strawn?

A. Yes.

Q. Let's go to the second page and have you describe the status of the Atoka, which would be a south-half spacing unit?

A. Uh-huh.

Q. Let's go to the bottom tabulation and have you tell me what the status is.

A. All right. Fasken is a participating entity, Bonneville, Southeast Royalties is unleased, Altura is unleased.

Q. Okay. As part of your negotiations, then, with Altura --

A. Uh-huh.

Q. -- in order to get a commitment as to the interests that were not committed for the Wolfcamp and the Atoka, did you make proposals to them?

A. Yes.

Q. Let's turn to the correspondence that is an effort to accomplish that. If we look behind Exhibit Tab 8, are we looking in the right part of the book?

A. Yes.

Q. Describe for us what you're doing, when you're doing, and what's occurring.

A. All right, I had written a letter to Altura, to Donnie Champlin, on October the 13th, basically offering to lease the remainder of their acreage in the south half of the Atoka unit at the same terms that we had taken the original lease at.

Q. Okay. What if any response did you receive from Altura to your proposal?

A. Well, I had gotten a letter from them, and I notice that it has not been included. It was a letter of October the 15th when Donnie explained to me that they were in the middle of a sale and they weren't granting any leases or term assignments at that point, that they basically were not conducting any business.

Q. At the time Chesapeake obtained from Altura the lease for the interests in Tract 2 --

A. Uh-huh.

Q. -- what's the approximate time period that that occurred? Do you remember?

A. Probably about 18 months to two years before.

Q. But as of this time in October of 1999, then, they are unwilling to execute a lease as to any other interest?

A. Right.

Q. Did you discuss with Altura's representatives any other possible way for a voluntary agreement, other than a lease?

A. Participation --

Q. All right.

A. -- in the well.

Q. And did you do that?

A. Yes.

Q. Let's turn to the correspondence that deals with that. There's an October 21st, 1999, letter.

A. Right.

Q. Are you still talking about lease terms?

A. We are talking about lease terms, but also we talked about the possibility of their participating. And an AFE was sent to them at that time, with this letter.

Q. Did you advise Altura or is Altura well aware that this is a drilled well?

A. Yes.

Q. What does Altura propose back to you?

A. I believe that on October the 27th I was sent back a letter where they proposed that -- basically that they would like to participate and they'd like to fairly resolve this issue and proposed to pay their 20-percent working interest share of the completion costs on specific AFE numbers.

Q. All right. They're dealing with an Atoka working interest, 20 percent, that agrees with what you believe their interest to be in that zone, right?

A. Yes.

Q. In order to participate with their 20-percent working interest in the well, how much money do they propose to pay Chesapeake to do that?

A. By taking the line item numbers and taking it back to their interest, I think it came to about $27,800.

Q. So for $27,800, they want to have a 20-percent interest in the Atoka if the Atoka produces?

A. Yes.

Q. As part of your proposals to Altura, did you include an AFE?

A. Yes.

Q. And what is the total AFE cost for this well?

A. Total dryhole costs are $503,000, I believe. Dryhole costs were $503,000, completed well costs were $856,000.

Q. Okay. Was their proposal acceptable to Chesapeake?

A. No.

Q. Why not?

A. Well, it wasn't quite enough money.

Q. What then did you do?

A. Went to management and talked with them, and then talked with Altura again, that we would certainly entertain, you know, actual cost basis, if we could bill them just on actual costs, we'd certainly entertain that idea.

Q. Okay. This fan is blowing right over my head, so it's hard for me to hear you. Would you --

A. I'm sorry.

Q. -- speak up for me?

So on November 23rd, there's a letter from you to Altura?

A. Yes.

Q. All right. What are your proposing on November 23rd in your correspondence to Altura?

A. That we go by the formula that's set out in the COPAS Bulletin Number 2, which is the determination of values for well-cost adjustments on joint operations.

Q. In accordance with the formula proposed by the COPAS bulletin, and based upon the AFE estimates, what had you calculated to be Altura's share of the dryhole cost?

A. It would have been 12.796 percent on -- Well, that's on the intangibles.

Q. Right. Reduced to a dollar amount, what would that number be?

A. Dollar amount would have been around $64,000.

Q. All right. And the letter shows that number --

A. Uh-huh.

Q. -- for Altura?

A. Yes.

Q. In addition, what would be their share of a completed well, using the COPAS bulletin method of apportioning costs?

A. Okay, it would have been $110,300, about 11.349 percent.

Q. So Altura's proposal to pay $27,800 is substantially less than what you calculate would be required under the COPAS bulletin?

A. Yes, sir.

Q. Let's talk about the COPAS bulletin. Is a copy of that bulletin included in the exhibit book?

A. Yes, it is.

Q. And where would we find that?

A. It is in Exhibit 6, right behind Exhibit 6.

Q. Is this a complete copy of the bulletin?

A. Yes.

Q. Based upon the methods of allocation in the bulletin, have you prepared a tabulation of how this is to be calculated?

A. Yes.

Q. And did you provide that tabulation to Altura?

A. I did.

Q. Let's go to your November 23rd letter.

A. Uh-huh.

Q. Look just past that one-page letter.

A. Uh-huh.

Q. Is this the tabulation?

A. Yes, it is.

Q. Let's take a moment and show the Examiner -- we're in Exhibit Tab 8, we're in the correspondence pages, and we're looking at the tabulation just behind the November 23rd letter.

The COPAS bulletin divides costs between intangibles and tangibles, right?

A. Yes.

Q. Okay. When you're dealing with the intangible portion of well costs, they have a method by which you can allocate those costs, do they not?

A. Yes.

Q. The method is described as what?

A. Using the drilling day ratio.

Q. All right. How many total days were involved in drilling this well to total depth from the surface to TD at the base or below the Atoka?

A. Nineteen.

Q. Did you determine how many days were involved from the surface to the base of the Wolfcamp?

A. Yes.

Q. And what was that number?

A. That was 12 days.

Q. So 12 divided by 19 gives you the 63 percent?

A. Yes.

Q. How did you calculate the days attributable to the Strawn?

A. Three days --

Q. Okay, and --

A. -- out of the 19, which gave me the 15.79 percent.

Q. All right, and how did you determine the days attributable to the Atoka?

A. It was four days of the 19, which gave us 21.05 percent.

Q. So from the base of the Strawn to total depth is four days, right?

A. Yes.

Q. Using those percentages, what does COPAS tell you then to do?

A. Since it's a three-formation wellbore, you take the three formations, and each formation is allocated a third. You take the percentages for those formations. The Wolfcamp was at 63.16 percent, so a third of that is 21.05.

Q. So each of the three get a third?

A. Right, they get a third of what their percentage allocation was.

Then we come down, and the allocation to Altura, they have 13.333 percent of the Wolfcamp. So you take the

13.333 percent of the Wolfcamp, which is the 21.05, and come out with the 2.806 percent for Altura.

Q. Okay. How do you handle sharing of costs from the base of the Wolfcamp down to the base of the Strawn?

A. Well, that's where you take the one-half, because there are only two formations -- The Strawn only has the two owners.

Q. All right, so you divide that in half, and --

A. Right.

Q. -- each has a percentage?

A. Uh-huh.

Q. All right. So how do you allocate, then, the intangibles to the Atoka ownership?

A. They have a third of the 63.16, which was their percentage allo- -- their 21.05, which is their percentage allocation; one-half of the 15.79, which was the Strawn, because there were two owners; and then 100 percent of 21.05, because everyone was there.

Q. All right. So when you sum those up for the Atoka, it's about 50 percent?

A. Right.

Q. And then you take Altura's percentage in the Atoka?

A. Their 20 percent --

Q. -- times the 50 percent?

A. -- of 49 percent, or the 50 percent.

Q. And it gets the 9.99?

A. Yes.

Q. All right. How do you handle under the COPAS bulletin the tangibles?

A. You do that on a footage ratio.

Q. All right, go through the calculation and show us what to do.

A. All right, the total footage for the well was 12,050 feet. So from 11,050 feet, 12,050 feet -- 11,050 feet was to the base of the Wolfcamp.

Q. Right.

A. The formula is the 11,050 feet over the 12,050 feet, which gives you 91.7 percent of the footage rate goes to the Wolfcamp formation.

It was 600 feet to base of the Strawn, which gives you a 4.97-percent ratio. And another 400 feet to TD or the base of the Atoka, which was the 3.32-percent ratio.

And then the allocation to the owners in each zone was the same. One-third of the 91.75 was 30.566 percent.

The Strawn had one-third of 91.7, plus one-half, because there were only two owners, and their percentage there was the 33.051.

The Atoka working interest was one-third of the

91.7 plus a half of the Strawn, plus 100 percent of the Atoka, for the 36.37. And there again, Altura had 13.333 percent of the Wolfcamp and 20 percent of the Atoka. So you take their 13.333 percent of the 30.566, which is the Wolfcamp, and you get a 4.075 percent.

Q. Okay.

A. And the same with the Atoka.

Q. Did Altura agree to accept the allocation participation as calculated by you using the COPAS Bulletin Number 2?

A. No.

Q. Did they give you any counterproposal?

A. Their counterproposal was that they would pay -- they would like to pay out of production, their share out of production if it were a producing well.

Q. They would accept this allocation formula, but they wanted to have you recover it out of future production?

A. Yes, but not the dryhole cost, only the producing cost.

Q. Oh, they didn't want to pay dryhole cost?

A. No.

Q. Okay. Was that acceptable to Chesapeake?

A. No.

Q. Let's leave this section and have you identify another section for me. If you go to Exhibit 7, you have the documentation here that supports what you have just described, right?

A. Yes.

Q. Including the calculation as to day in depths and then another copy of the tabulation of allocation costs?

A. Right.

Q. All right. Now, let's go and see what you have done with the Southeast Royalty interest that your trying to get committed to the well. Have you made similar proposals to Southeast Royalties?

A. Basically the offer to partici- -- or to take a term assignment from them or to have them participate in the well.

Q. Is there correspondence in the book that confirms --

A. Yes.

Q. -- that activity? And where do we find it?

A. It would be in Exhibit 8, behind the Altura letters.

Q. All right, let's look at that.

A. Okay, the first letter was written by Chalfant Properties, who's our broker, to Mr. --

Q. All right, now let me remind you, I think some of these are not in chronological order.

A. Right. These are in -- from back to front.

Q. All right, so let's go --

A. So this is the very last letter.

Q. Let's go to Exhibit Tab 9 and start looking at the last pages of Exhibit 8, and we'll go backwards in the book, all right?

A. Right.

Q. You had a broker attempt to --

A. Yes.

Q. -- resolve participation for Southeast Royalties?

A. Yes.

Q. And who was that individual?

A. Well, it was Bill Chalfant with Chalfant properties.

Q. Okay.

A. And I believe he had talked with him by phone before, and he did send a letter on October the 21st.

Q. And that's in your book here?

A. Yes. He wanted to purchase a term assignment. They have the 1.666 percent below 11,870 feet.

Q. Within the various spacing units, they only have an interest in the Atoka?

A. Yes.

Q. And that interest is this 1.6-percent interest?

A. Yes.

Q. It is -- They hold a lease?
A. Yes.
Q. What kind of lease do they have?
A. I believe it's a 60-acre lease with a 75-percent net.
Q. All right, so there's 25-percent royalty. Are there any overrides in that 25 percent, do you know?
A. No, the overrides go into shallower depths.
Q. All right, so --
A. They don't go to the deeper depths, below the eleven thousand --
Q. So at the Atoka, then, Southeast Royalties' lease carries a 25-percent royalty?
A. Yes.
Q. So all they have left is a 75-percent net revenue interest?
A. Exactly.
Q. All right. Did you talk to them about -- either through your broker or through you, about purchasing a lease?
A. Not --
Q. That's what Bill's doing here, right?
A. Yeah.
Q. He's proposing that?
A. Yeah.

Q. And did they accept these terms?
A. A term assignment, no, they did not.
Q. All right. Did you offer them an opportunity to participate in the well?
A. Yes, on November the 29th I wrote them a letter, offering them either to participate or take the term assignment with a little better terms. I think it was two years, rather than a three-year lease.
Q. Okay. Were you able to reach an agreement with Southeast Royalties as to committing their interest, either by way of lease or participation in the well?
A. No.
Q. When we turn to the last letter, then, the November 30th letter --
A. Uh-huh.
Q. -- from Southeast Royalties back to you --
A. Yes.
Q. -- what is Southeast Royalties proposing?
A. They had faxed this letter to me on November the 30th, they were proposing either a bonus and 10 percent of 8/8 overriding royalty interest or a carried working interest based upon the 1.667 working interest, less the carried portion of the expense.
Q. All right, let's look at the first option. It's a bonus plus they want a 10-percent override?

A. Uh-huh.
Q. Why is that not acceptable?
A. Chesapeake neither delivers nor do they recover anything less than a 75 percent. It's just company policy.
Q. All right, so 75 percent is the bottom line on a net-revenue interest --
A. Yes.
Q. -- either to sell or acquire --
A. Yes.
Q. -- an interest, and by a 10-percent override, it now reduces Southeastern Royalties to 65 percent?
A. Exactly.
Q. All right, and that's below the threshold that you're able to do business?
A. Right.
Q. Let's look at the second option. Why is that not acceptable?
A. We don't -- We have never given a carried revenue interest --
Q. Okay.
A. -- and don't want to start that.
Q. All right. But you did give them an opportunity to participate in the well?
A. Yes.
Q. All right. And Southeast Royalties, to the best

of your knowledge, knew that this was a drilled well?

A. Yes.

Q. You provided both Altura and Southeast Royalties copies of the AFE?

A. Yes.

Q. Let's turn to Exhibit 9. Describe for me what you're showing in Exhibit 9.

A. I have taken this sheet that shows the overhead rates directly out of one of the JOAs that we have presently in place with Fasken and with Bonneville. It shows drilling well rate of $6000 and a producing well rate of $600.

Q. What is your recommendation to the Examiner for inclusion in the pooling order for an overhead rate?

A. That we would be consistent with our JOAs and follow the same pattern that we have done up till now.

Q. All right, and this is the JOA that's been executed by Bonneville and Fasken --

A. Yes.

Q. -- for this very well?

A. Yes.

Q. And so you would like to have all the working interest owners being subject to the same monthly cost charge?

A. Yes.

Q. All right. Exhibit 10 is the package of waivers with regards to the unorthodox well location?

A. Yes.

Q. All right. And that completes your portion of the book, doesn't it?

A. Uh-huh.

MR. KELLAHIN: Mr. Examiner, we propose the introduction of Chesapeake's Exhibits 1 through 10.

EXAMINER ASHLEY: Exhibits 1 through 10 will be admitted as evidence.

Mr. Carr?

CROSS-EXAMINATION

BY MR. CARR:

Q. Ms. Townsend, initially I want to talk about the spacing unit for the Strawn well, the south half of the southwest quarter of 17.

A. Uh-huh.

Q. If I understand your testimony, you proposed some time ago to lease from Altura additional acreage, other than just that spacing unit in Section 17; is that correct?

A. I was not handling New Mexico at the time, but that is my understanding.

Q. And is it your understanding that Altura was only willing to lease to Chesapeake the acreage that would be encompassed within the spacing unit dedicated to the well?

A. That I cannot answer,

Q. The 80 acres that was leased was, in fact, the spacing unit --

A. Yes.

Q. -- correct, for the Strawn?

A. Yes.

Q. So you had acquired by lease the Altura interest. Did Southwest -- or Southeast Royalties, Inc., have an interest in the south half of the southwest quarter?

A. At below 11,870 feet, yes.

Q. And what depth was the Strawn?

A. The Strawn was eleven thousand, five -- eight hundred --

MR. KELLAHIN: It's in the book here somewhere.

Q. (By Mr. Carr) The point is, did you have to acquire some interest from Southeast Royalty for this Strawn proposed well?

A. No.

Q. Their interest was always below that depth?

A. Yes.

Q. When you proposed and drilled the well to test the Strawn, did Chesapeake actually own 100 percent of that 80 acres over their other working interest ownership?

A. There were other working interest owners.

Q. And who were they? Bonneville?

A. Bonneville Fuels and --

Q. -- Fasken?

A. -- Fasken.

Q. Now, were you involved in the decision to originally drill the well to the Strawn?

A. Yes.

Q. At that time, Chesapeake had information on the Barbara Fasken well that they were going to re-enter, did they not?

A. Uh-huh.

Q. Were you present when there were discussions as to whether or not you should drill the well to, say, the Atoka-Morrow? Was that discussed?

A. No.

Q. You only viewed this as a Strawn prospect at that time?

A. At that time.

Q. Was there any discussion about there being shows in the Wolfcamp?

A. No.

Q. Do you know if there's Wolfcamp production in the immediate area?

A. I don't know. I think there's only a couple wells, and I really can't testify as to the production. I don't know what it is.

Q. So when you started putting the acreage together, you're really viewing it as a Strawn test; isn't that correct?

A. Uh-huh.

Q. And the OCD approval that you got was for this well on an 80-acre Strawn unit?

A. Yes.

Q. Your land efforts were to put together an 80-acre Strawn unit?

A. Uh-huh.

Q. And originally the well was drilled based on an AFE for an 80-acre Strawn well, okay? Is that correct?

A. Yes.

Q. At the time that this was going forward -- and if I'm asking you questions that are out of your area, just cut me off -- there was a log available on the Fasken well, was there not?

A. I do not know.

Q. Okay. And will there be a witness who will know that?

A. I hope so.

Q. I do too. Okay.

You then proceeded to drill the well?

A. Uh-huh.

Q. And it was a dry hole or noncommercial in the

Strawn?

A. Right.

Q. If you had stopped at that point in time and not drilled on, that well -- There would have been no interest in that well owned by Altura; isn't that right?

A. If we had stopped.

Q. At the Strawn, the zone --

A. There would be no working interest owned by Altura.

Q. Would there be any working interest owned by Southwest [*sic*]?

A. No.

Q. If you had stopped at that point in time, Altura would have been responsible for none of the well costs; isn't that right?

A. Right.

Q. Southwest was not responsible for well costs to the Strawn?

A. Right.

Q. And so you got to the Strawn and a decision was made in the field to take the well deeper?

A. Yes.

Q. When that decision was made, there was no contact made with the OCD prior to just going forward down to the Atoka-Morrow --

A. No.

Q. -- is that right?

At what depth was the Strawn formation that you were targeting, do you know?

A. I believe it was 11,800, and the cutoff in the lease problem would have been 11,870.

Q. So you were at 11,800, subject to check?

A. Uh-huh.

Q. And how deep was the Atoka?

A. Oh, what did we say the Atoka came in at? I'm not really sure it was below 11,870.

Q. Would you agree with me that it was just several hundred feet below that?

A. Probably.

Q. So we had 11,800 feet of wellbore that Altura had no interest in and no obligation to pay for if you had stopped at the Strawn?

A. If we had stopped at the Strawn.

Q. And so by drilling an additional 300 or 400 feet, you then were in a position where you could look to Altura to pay for a portion of that wellbore; isn't that right?

A. Uh-huh.

Q. How much would it cost to drill 300 or 400 feet? Do you know?

A. I have no idea.

Q. Would it cost a lot less than, say, the $100,000, or do you know, that you're looking to Altura to pay?

A. Well, I'm sure it would have cost less, hypothetically, yes.

Q. Hypothetically less?

A. Well, I mean, are we talking about a hypothetical wellbore, or what are we --

Q. In this particular wellbore, to drill from 11,800 to the Atoka-Morrow --

A. Uh-huh.

Q. -- do you know whether that would cost more or less than the $100,000?

A. That would cost -- Or, it would have cost less than to the Strawn.

Q. So by deciding to go down the extra 300 or 400 feet, you were actually going to be in a better position financially on the well, because you could look to somebody else to pay $100,000, right?

A. Well, we had already paid it, though.

Q. But you were going to then look to somebody else to contribute $100,000 --

A. Yes --

Q. -- for the wellbore?

A. -- but we would have lost production also.

Q. You don't know how much production you could lose, do you?

A. No.

Q. You do know that you have had gas shows in the Morrow, correct? Or do you know that?

A. I don't know that.

Q. Do you know if you've cased in the Morrow?

A. I think we have run casing.

Q. Okay. In any event, when you went 300 or 400 feet deeper, you had other people that you were going to -- that you could look to, to pay part of the cost of the well, correct?

A. Yes.

Q. Now, were you responsible for putting together the AFE?

A. No.

Q. If I get into an area that's not yours, just --

A. All right.

Q. -- say "foul", okay?

In terms of the AFE, do you know if any costs were included for the wellbore that you utilized, the old Barbara Fasken wellbore?

A. I don't know.

Q. Okay, I should ask somebody else that?

A. Please.

Q. You talked about the negotiations between

Chesapeake and Altura --

A. Uh-huh.

Q. -- and you talked about the October 27 letter where Altura proposed to pay completion costs, and that was unacceptable?

A. Uh-huh.

Q. And you also talked about a proposal by Altura that they also participate and that you take their share just out of production --

A. Uh-huh.

Q. -- and that was unacceptable?

Wasn't there also an offer in mid-December whereby Mr. Champlin suggested that based on your November 23rd letter, they would split the difference and they might be willing to pay, oh, 8.76 percent of the actual cost?

A. Yes, that was all a verbal telephone conversation, yes.

Q. And that was unacceptable to you as well, correct?

A. Right.

Q. Now, when we go to the COPAS bulletin that you discussed --

A. Uh-huh.

Q. -- on the numbers that you've run, that's based on the assumption that Altura should pay a share of the cost of the wellbore through the Strawn; isn't that right?

A. I'm sorry, repeat that please.

Q. I mean, before we get to the COPAS bulletin --

A. Okay.

Q. -- we're allocating costs between people who are required to pay?

A. Uh-huh.

Q. And if Altura was not required to pay between, say, where you kicked out of the Fasken well to the Strawn formation, then we don't get any of this COPAS stuff; we would be looking at the portion of wellbore they should be required to pay for?

A. No.

Q. Not?

A. No, because we have now gone deeper and it's a completely different deal. It's no longer a Strawn.

Q. And it's a completely different deal because you decided to drill deeper 300 feet, right?

A. Yes.

Q. Doesn't that change the deal? It's a completely different deal because you drilled without first getting OCD approval, right?

A. Right.

Q. It's a completely different deal because you didn't do your land work for a 320-acre unit before you

drilled to a 320-acre pool, right?
A. Well --
Q. If you had done it before, we wouldn't be here now; isn't that right?
A. Right.
Q. You didn't do your land work for a 160-acre Wolfcamp until you had already drilled the well, right?
A. Right.
Q. And we're now being asked to pay for a well where the Strawn has been condemned, right?
A. Uh-huh.
Q. That's the primary objective. We're being asked to pay for a well based on what you now see in the section you now have in the Morrow, right?
A. (Nods)
Q. Do you know if that's anywhere near as good as what you can see in the old Barbara Fasken well that they didn't complete in?
A. I have no idea.
Q. All right, I'll go with somebody else.
A. Okay.
Q. I talked about the depths, you may have answered this. Do you know the total depth of the well?
A. I think the total depth is 12,050 feet.
Q. Okay, 12,050 feet?

A. Uh-huh.

MR. CARR: That's all I have, thank you.

MR. KELLAHIN: Mr. Examiner?

EXAMINER ASHLEY: Mr. Kellahin?

REDIRECT EXAMINATION

BY MR. KELLAHIN:

Q. Let's go back and clarify a couple of points, Ms. Townsend. If you turn to Exhibit 7 --

A. Uh-huh.

Q. -- there is a tabulation of spud date and rig release --

A. Yes.

Q. -- and then there's formations by footage?

A. Yes.

Q. If you turn back to Exhibit 2 now, we have a tabulation of ownership by formations, do we not?

A. Uh-huh.

Q. In response to Mr. Carr's question about Altura having no interest in this wellbore down through the Strawn, you indicated they would not. But look at the table here. It says Altura's got 13 percent in the Wolfcamp.

A. Right.

Q. Which is correct?

A. They do have 13 percent of the Wolfcamp.

Q. All right. Let's assume that the Atoka fails and doesn't produce. Then you come back uphole in the Wolfcamp, and if that is successful, they're going to have 13 percent of the production out of the Wolfcamp?

A. Right.

Q. And the COPAS bulletin deals with how to allocate those costs to a party that is going to share in that production?

A. Right.

Q. If Altura doesn't want to share in the costs of this well, they could have given you a lease, couldn't they?

A. Right.

Q. And that would have freed you up of all these expenses, true?

A. Yes, and that was one of my last conversations.

Q. And they've chosen not to do that?

A. Right.

MR. KELLAHIN: No further questions.

EXAMINER ASHLEY: Mr. Carr?

MR. CARR: Just a couple of questions.

RECROSS-EXAMINATION

BY MR. CARR:

Q. Can you tell me whether or not you intend to attempt a completion in the Wolfcamp?

A. I don't know.
Q. You don't know if that is actually a bona fide plan down the road?
A. I think it may be down the road. It depends. That's a different department from mine.
Q. You do know that Altura was in a position they were not able to give you a lease; that's their company position?
A. Right.
Q. And so they weren't in a position to do that, and you knew that when you made the last offer to them, right?
A. Well, the last offer I made to them, I think the reply was, no, they don't want a lease, they would rather participate.
Q. As to Southeast Royalty --
A. Uh-huh.
Q. -- it was your company policy, I think you stated, that you couldn't go below a 75-percent interest?
A. No.
Q. Now, this isn't a typical situation, this whole matter we're dealing with today for Chesapeake, is it?
A. No.
Q. I mean, it's not company policy to be in this kind of a situation?
A. It is not.

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

EXAMINATION

BY EXAMINER ASHLEY:

Q. Ms. Townsend, looking at Exhibit 2, first of all, before I ask any other questions, are the acreage dedications to Tract 1 and Tract 2 correctly stated in these?

A. Tract 2 should be the south half of the southwest, should correspond with the map, the locator map.

Q. Okay, so Tract 1 is the north half of the south- --

A. -- is the north half, southwest, yes.

Q. Is that the same for the Atoka on page 2 of Exhibit 2?

A. Yes, uh-huh. And it will also be -- The Strawn formation should be Tract 2 rather than Tract 1, down at the bottom of the first page.

Q. Should be -- Say that again?

A. It should be Tract 2 rather than -- It's labeled as Tract 1, and it should be Tract 2.

Q. Now, what was this well originally TD'd in when it was a Fasken well?

A. I believe it was the Strawn.

Q. It was already in the Strawn?

A. I think so.

Q. So you re-entered the well to test the Strawn?

A. Yes.

Q. Did you deepen the well at that time, or was the plan to deepen the well or just to re-enter it and test the Strawn?

A. I'm not for sure. I think probably what they did was go use that pole and then kick off to maybe a different spot. You probably need to ask Mr. Hefner.

Q. Okay.

A. He can probably give you a real clear answer.

Q. Now, regarding the Wolfcamp formation, Altura was the only one that had not agreed to participate --

A. Right.

Q. -- is that correct?

A. In half of the unit.

Q. In Tract 2?

A. Right. We had them leased in Tract 2 in the Wolfcamp, and they were unleased in Tract 1.

Q. Wait just a second.

A. Okay, Tract 2 is the south half of the southwest. We had them leased in that tract.

Q. You have them leased in that tract?

A. Yes, uh-huh. That's the Strawn unit also. That's the 80-acre Strawn unit. And it becomes a half of the 160-acre Wolfcamp unit.

Q. Okay, and the Wolfcamp unit, they show up in Tract 2, but they don't have any interest in Tract 1?

A. Okay, Tract 2 would be that first south half, southwest.

Q. Right.

A. They're leased in that tract --

Q. Okay.

A. -- to Chesapeake. And then Tract 1 is the north half, southwest. They are unleased in that tract, which leaves them unleased in half of the Wolfcamp unit.

Q. They don't show up on Tract 1.

A. Under the Wolfcamp?

Q. Yeah.

A. See the north half, southwest?

Q. Right.

A. See underneath where it goes Fasken, Bonneville, Altura Energy, 21.333 acres?

Q. Are you looking at the exhibit --

A. Uh-huh, the ownership detail by formation.

Q. Is Tract 1 the north half of the southwest quarter?

A. Yes.

Q. Okay, if I look at Tract 1, it's showing Fasken, Bonneville and Chesapeake.

A. Which Tract 1 are you --

MR. KELLAHIN: Let me see if I can straighten this out. The typo here is confusing everybody.

THE WITNESS: Uh-huh.

MR. KELLAHIN: When you look at this Wolfcamp table --

EXAMINER ASHLEY: Uh-huh.

MR. KELLAHIN: -- forget the tract number.

EXAMINER ASHLEY: Okay.

MR. KELLAHIN: The south half, southwest, has got Fasken, Bonneville and Chesapeake.

EXAMINER ASHLEY: Uh-huh.

MR. KELLAHIN: Altura's interest in the south half, southwest quarter doesn't show up as Altura's interest because they leased it to Chesapeake, which accounts for part of Chesapeake's 50-some interest. Are you with me?

EXAMINER ASHLEY: I kind of am with you.

MR. KELLAHIN: All right, let me try it again. I'll try it again.

Chesapeake's interest, they've got 72 percent. See that?

EXAMINER ASHLEY: Uh-huh.

MR. KELLAHIN: The reason that gets to be that number is, it includes a leasehold interest they got from Altura. All right?

THE WITNESS: Reverse the tract numbers.

EXAMINER ASHLEY: So that's going to be Tract 2 you're talking about?

MR. KELLAHIN: I'm talking about Tract 2.

EXAMINER ASHLEY: Okay.

MR. KELLAHIN: So Tract 2, now, Altura has leased to Chesapeake, and Chesapeake controls the working interest.

EXAMINER ASHLEY: Okay.

MR. KELLAHIN: So in the 80-acre spacing unit, everybody is committed. But when you move back uphole to the Wolfcamp and pick up another 80-acre tract, you'll see the next tabulation down shows Altura, because it is unleased.

So if you follow the description and ignore the tract number, I think it will straighten out the discussion.

EXAMINER ASHLEY: Okay, thank you.

Q. (By Examiner Ashley) Everything is committed in the Strawn?

A. Yes.

Q. Well, prior to deepening the well to the Atoka, had you proposed using this COPAS Bulletin Number 2?

A. Prior to completing it?

Q. Yes.

A. No. No.
Q. Okay. It wasn't until you were deep into the Atoka that that was decided?
A. Right.
Q. Prior to drilling to the Atoka, did you ever consider using this COPAS Bulletin 2 to allocate costs?
A. As far as to the Strawn, it wouldn't have been needed, because everyone was leased in the Strawn unit.
Q. But not in the Wolfcamp?
A. Well, but we just had a show in the Wolfcamp drilling to the Strawn. At that point, the Wolfcamp, they hadn't really decided what to do as far as the Wolfcamp was concerned. We were looking at a Strawn well at that point.
Q. Well, it seems to me that if you're willing to use the COPAS bulletin to allocate costs now that you've decided to go to the Atoka, it seems like that would have been the position you would have taken from the start, since there's a potential for Wolfcamp production?
A. Well, I'm not too sure they expected to find the Wolfcamp. I think that was a surprise.

EXAMINATION

BY MR. CARROLL:

Q. You could do this calculation again using the COPAS and just limit it to the Wolfcamp and the Strawn, couldn't you?

A. Uh-huh
Q. And what was the additional amount of cost to go from the Strawn to the Atoka?
A. I'm not sure.
MR. KELLAHIN: We have a witness that can answer that.
MR. CARROLL: Okay.

FURTHER EXAMINATION

BY EXAMINER ASHLEY:

Q. Can you tell me how deep the well originally was?
A. Before we re-entered it?
Q. Uh-huh.
A. I don't know what the old well was. I don't know the exact footage on the old well.
MR. CARROLL: You have a witness that can tell us, though, right?
THE WITNESS: Yes.
EXAMINER ASHLEY: I don't have anything further. Thank you.
THE WITNESS: Thank you.
MR. KELLAHIN: May I follow up with a question, Mr. Examiner?
EXAMINER ASHLEY: Sure.
MR. KELLAHIN: I'm not sure the sequence is straight.

FURTHER EXAMINATION

BY MR. KELLAHIN:

Q. You have a desire from your technical people to re-enter the old wellbore --

A. Yes.

Q. -- all right? They want to get to a bottomhole target in the Strawn that's at a different bottomhole target than the original wellbore?

A. Right.

Q. They want to get farther south, right?

A. Right.

Q. When you last touched this, this was to be a Strawn oil well, true?

A. Exactly.

Q. You then get back into the picture and they have drilled it to the Atoka?

A. Yes.

Q. You are told that the Strawn will not produce oil?

A. Right.

Q. They say there's potential in the Atoka, and there may be potential uphole in the Wolfcamp, true?

A. Yes.

Q. The well has been drilled, but it has never been tested?

A. Right.
Q. Okay? They ask you, What do we do? Right?
A. Right.
Q. You find out that you have to have a Wolfcamp 160-acre spacing unit, right?
A. Yes.
Q. You need a 320-acre spacing unit for the Atoka, right?
A. Yes.
Q. You called me and asked me what to do?
A. Yes.
Q. I sent you the bulletin?
A. Yes.
Q. And you proposed the bulletin solution to all the interest owners?
A. Yes.
Q. And that's how we got where we got?
A. (Nods)
EXAMINER ASHLEY: Mr. Carr?

FURTHER EXAMINATION

BY MR. CARR:
Q. And we can ask your technical people if there's Wolfcamp production in the area, correct?
A. I'm sure they'll know, yes.
MR. KELLAHIN: Yes, sir, we'll put those on.

Q. (By Mr. Carr) Okay. And is it the policy of Chesapeake to try and put together the acreage for all potentially prospective zones in a wellbore?

A. Normally.

MR. CARR: That's all.

THE WITNESS: Is that it?

EXAMINER ASHLEY: Just a minute.

Okay, I have nothing further. Thank you.

THE WITNESS: Thank you.

MR. KELLAHIN: Mr. Examiner, our next witness is Robert Hefner. Mr. Hefner is a petroleum geologist.

Mr. Hefner and I are going to be discussing the exhibits behind Exhibit Tab 11. They will consist of the locator plat, the cross-section, and then there's a seismic display on the Strawn, and we'll talk about all three of those.

ROBERT A. HEFNER, IV,

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

DIRECT EXAMINATION

BY MR. KELLAHIN:

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

A. Yes, I'm Robert Hefner and I'm a geologist for Chesapeake. I've been working the Permian Basin for them for the last five years.

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

A. I have.

Q. In addition, you have testified before the Examiners utilizing 3-D seismic data --

A. Yes, sir, I have.

Q. -- as part of your exploration tools for the Strawn formation?

A. That's correct.

Q. On prior occasions you've also testified as a geologic expert concerning the risk factor penalty in other compulsory pooling cases?

A. I have.

Q. So you're familiar with the concept as utilized by the Division?

A. I am.

Q. And you were involved in the re-entry and the directional drilling of the College of the Southwest 17 well?

A. Yes, sir.

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

EXAMINER ASHLEY: Mr. Hefner is so qualified.

Q. (By Mr. Kellahin) Mr. Hefner, let's go to

Exhibit 1, the locator map. Was there a sole formation target objective for the re-entry of this old well which we now call the College of the Southwest?

A. Yes, there was, and --

Q. What is that? What was that objective?

A. That was the Strawn. We had been actively drilling for Strawn in this township, and that had been our primary objective.

Q. Did it occur to you at the time that you were planning this re-entry that there was any possibility that you might encounter Wolfcamp oil production?

A. Nothing that would have been economic. There was a well on the northeast northeast quarter of that same section that made some marginal reserves, and then there was an attempt at a completion in the Wolfcamp by Yates in the Robert AGX well. Those were our two closest attempts in the Wolfcamp, which --

Q. All right. We've got a glitch in the color code here, don't we? If you'll look on the map in Section 20, in Unit Letter A, that is shaded blue as if it were Strawn. It should be green as a Wolfcamp, right?

A. Right.

Q. All right. So you had two -- The closest controls on the Wolfcamp is in Unit Letter A of 17, right?

A. Right.

Q. And Unit Letter A of 20?

A. Right.

Q. Okay.

A. And we had also attempted a DST on a Wolfcamp interval in our Ruth well that we had operated to the south in Section 20.

Q. All right. The re-entry well was originally called the what? I forgot the name.

A. It was called the Barry Hobbs, and it was drilled in 1986.

Q. The Hobbs well?

A. Yes, sir.

Q. Why were you proposing to use that wellbore for re-entry to deviate to a different bottomhole location in the Strawn?

A. To save us some costs, since the surface casing had already been set, and our 3-D seismic indicated that some Strawn reservoir potential existed nearby.

Q. Let's turn to the map plan and the vertical profile for the deviation, just to give us a visual reference. If you'll turn to Exhibit 4, let's look at the vertical profile.

A. In that vertical profile you'll see represented in black the plan that was developed by our vendor that was helping us directionally drill this when we did our re-entry. And the red line shows the actual path of that wellbore. And then I think we also have a day curve under one of the exhibits that kind of showed you -- behind Exhibit 7 -- the different activities that were conducted during those operations.

Q. All right, I think that's helpful. Let's do that, let's turn to Exhibit 7, go past the first summary sheet and fold out what it says, "Depth versus Days". Okay? The wellbore is re-entered. At what vertical depth, then, do you commence kicking off in the southerly direction and start building that angle?

A. At about 8500 feet.

Q. So at 8500 feet you're going to stop utilizing the old wellbore?

A. Yes.

Q. And the plan, then, is to control this and move it in the southerly direction?

A. That's correct, to directionally drill in a south and east direction from that original wellbore.

Q. All right. Let's look at the 3-D seismic display behind Exhibit Tab 11 and look at this illustration.

A. Yeah, that illustration represents the interpretation at the time that we made this attempt to drill the Strawn. The borehole plan shows you the actual results of the wellbore after the fact, and it has not been reinterpreted based on what we found in the wellbore. This was the interpretation prior to the operations in this sidetrack.

Q. The plan, then, was to utilize this wellbore which originally was too far north of this pod, this little porosity pod in the Strawn, and it had not penetrated that pod, if you will?

A. Right.

Q. And you were going to deviate that wellbore and try to get into this pod?

A. That's correct.

Q. All right, what happened?

A. Our interpretation was wrong, and the Strawn was tight.

Q. Let's save the locator map, Exhibit 1, so we can keep track of where we're going, but let's unfold the cross-section and talk about it.

A. What you also have in your booklet is a stratigraphic cross-section that, if you look on your Exhibit 1, goes from the Inexco Hobbs well that's in the northeast northeast of Section 17, down to the original Fasken Barry Hobbs well. It also has our sidetracked well in that cross-section, and then we go over to the Yates Robert AGX.

And to run through the nomenclature on this cross-section, that first line going across is the datum for Wolfcamp, and then we come down to a shaded area that's slightly pink, that's highlighting a particular Wolfcamp interval. You come down a little further, you'll see a kind of a light orange interval in the Wolfcamp that's highlighted.

Then you come down to this gray area which is often referred to as the Penn shale or Cisco/Canyon. Then in blue is the Strawn. The orange right underneath that blue is the Strawn clastics. Then you go into the Atoka shale by that green line and then the Atoka members that are present in that part of the column.

And this cross-section is datumized to the top of the Cisco/Canyon or Penn shales.

Q. Let's start the discussion with the Strawn information. When you look at the Strawn correlations, we're looking at the area that's shaded blue horizontally on the logs?

A. That's correct.

Q. All right. And you know what about the Strawn with the deviated wellbore?

A. That we did not get into reservoir quality rock with that deviated wellbore.

Q. And how do you know that?

A. You can use the logs that are represented in this cross-section, that if you see some deviation -- This log happens to be a sonic log. If you see that deviation to the left, it would indicate porosity, and we have none. It's really a straight line all the way through.

Q. Does Altura have this log?

A. Yeah, they were given all the data on the well to help them in making a decision.

Q. All right, let's talk about the status of the wellbore. You drilled it, and that's it. You haven't completed it, you haven't tested these intervals?

A. Right.

Q. It is just a standstill wellbore until we get this issue resolved?

A. Exactly.

Q. You have given Altura a copy of the log?

A. Yes, we have.

Q. Based upon your analysis of the log, there is no potential for doing any kind of testing or attempted completion in the Strawn?

A. That's correct.

Q. You missed it?

A. That's right.

Q. All right. Does the fact that you have a drilled well and log data for the Atoka diminish the risk that you recommend be imposed against those interest owners to less than the 200-percent maximum?

A. No, it doesn't lessen the risk at all. I guess first of all, most of the risk penalties that we usually get with other operators are much higher than what's ever allocated in New Mexico. And two, our immediate offsets were -- one, we had one that was considered to be a dry hole, and then an offset where attempts were made in these intervals proved to be uneconomic, so there's still a great deal of risk.

Q. All right. So let's look at the log data, then, on the Atoka and have you make the comparisons to the log data for the College of Southwest, as compared to log quality of the data.

A. The dry hole that Barbara Fasken originally drilled has the two Atoka members highlighted in yellow. They are substantially thicker than what we found in the deviated wellbore. The petrophysics from the logs are really, in essence, equivalent. And when Barbara Fasken drilled this well, they considered that to be not economic and then plugged the well.

And then if you look at the other offset, the Yates well, to the right of this wellbore, you can see some similar intervals that are also highlighted in yellow where Yates made a DST attempt in both of those intervals and only recovered mud, indicating that they were not economic reservoir.

Q. Altura's got the log, they can analyze the log in the Atoka. If they choose not to participate, then, what is your recommendation as to a penalty?

A. That it would be a full penalty.

Q. The maximum --

A. The maximum, the maximum penalty.

Q. Let's move up the wellbore and look at the Wolfcamp interval. That Wolfcamp interval is -- Help me out. Is it the pink or the yellow?

A. Yeah, actually the Wolfcamp is fairly thick here. It's from that top brown line down to where that gray starts, would really kind of represent most of the Wolfcamp. And there's lots of different members, but I've highlighted for the benefit of our discussion here today two intervals that would be an interval to attempt and also where offset operators have made attempts for completion as well.

Q. Okay. If you're analyzing the Wolfcamp interval, then, you as a geologist have picked what you think are the two best potential opportunities in the Wolfcamp?

A. Yes.

Q. And neither one of these has been tested, yet, right?

A. Not in the wellbore in question, now.

Q. Yeah, that was my question.

Let's look at the yellow interval of the Wolfcamp.

A. Uh-huh.

Q. As to that interval, what is your assessment or recommendation of a risk factor penalty to be applied in this case?

A. It would be the maximum. We have no production from this interval in the immediate area.

Q. All right. Let's look at the Wolfcamp data that is shown on Exhibit 1.

A. Yes.

Q. You've got a Wolfcamp producer in the northeast northeast of 17, and then the well in the northeast northeast of 20 was an Atoka well that failed in the Strawn and then was completed in the Wolfcamp?

A. That's correct.

Q. Okay. Why does not either one of those control points reduce the risk so it's less than the maximum penalty?

A. The well that's producing in the northeast northeast is in this cross-section also. It shows you the interval that was perforated. It has not been a very good well, probably wouldn't even pay for the costs of the well to begin with.

Our closest offset, really, is the Yates well, and that interval was perforated, that same interval that produces from that wellbore, and --

Q. The Yates well is in the northeast northeast of 20?

A. That's correct.

Q. Okay.

A. And that only has a 10-percent oil cut and since 1996 has only made 1400 barrels of oil.

Q. Okay. Do you have enough control in the Wolfcamp here that you could prepare an isopach map that would give you any confidence as to trying to figure out how much oil might be produced from your wellbore?

A. No, there's not --

Q. Why not?

A. There's not enough control points, one, and there's no direct correlation between logs and producible area.

Q. Let's move uphole to the pink area of the Wolfcamp that's shaded. Again, that's not been tested yet?

A. Not in the subject wellbore.

Q. All right. What's your recommendation to the Examiner concerning the risk factor penalty associated with any attempt to produce oil out of that interval?

A. For the same reasons, the maximum penalty.

Q. And anything else in the Wolfcamp would even be more speculative?

A. Absolutely.

MR. KELLAHIN: That concludes my examination of Mr. Hefner. We move the introduction of his exhibits behind Exhibit Tab Number 11.

EXAMINER ASHLEY: The exhibits behind -- Is there just that one exhibit, Exhibit 11?

MR. KELLAHIN: Yes, sir, he had the 3-D seismic display on the Strawn, is in the book, and then his cross-section.

EXAMINER ASHLEY: Okay, Exhibit 11 and the cross-section behind Exhibit 11 will be admitted as evidence.

Mr. Carr?

MR. CARR: Mr. Ashley.

CROSS-EXAMINATION

BY MR. CARR:

Q. Mr. Hefner --

A. Yes, sir.

Q. -- were you involved in the decision to drill this well?

A. Yes.

Q. Were you involved in the initial decisions to confine the original proposal to the Strawn interval?

A. That's correct.

Q. At the time that decision was made, you had reviewed the log on the Barbara Fasken well you were going to re-enter, had you not?

A. Right.

Q. And at that time you had determined, based on the information from that well, that the Atoka-Morrow was not worth a test of that zone; isn't that fair to say?

A. Yeah.

Q. It wasn't worth drilling an extra 300 or 400 feet below the Strawn to test it?

A. Yeah, because our objective was the Strawn.

Q. Wasn't your objective really any producing zone in that well, the Strawn being the principal objective?

A. Well, you always welcome serendipity, but the objective and the purpose of that well was for the Strawn.

Q. And the Atoka-Morrow looked like serendipity?

A. Yes.

Q. So did the Wolfcamp, to you?

A. Right.

Q. And the nearest Wolfcamp producers included a well in Unit A of Section 17; isn't that right?

A. That's right.

Q. Did you look at the production information on that well?

A. Yes.

Q. Would you agree with me that it produced over 76,000 barrels of oil?

Q. And you did not think that a well in the same section with that kind of producing rate would suggest to you that maybe the Wolfcamp would be prospective at this location?

A. We have drilled several wellbores in that area that have not offered anything in the Wolfcamp, and even attempted a DST, so no.

Q. Would 76,000 barrels pay for the Wolfcamp test?

A. I don't think so.

Q. If you were drilling all the way to the Strawn, do you think that the 76,000 barrels would be worth coming back up the hole at some time and trying to complete?

A. Well, if you know you can get 76,000 barrels of oil, yes, that would be worthwhile.

Q. And you have a well in the section that had produced that much?

A. Yes.

Q. Now, in putting this prospect together, it seems to me that what I understood you to say was, even looking at the logs and the data you available now, the Atoka-Morrow looks like a high-risk venture?

A. Right.

Q. Would you have drilled or recommended drilling a well stand-alone to the Atoka-Morrow? You would not, would you, based on this information?

A. That's correct.

Q. But when you get to a point where you're only 300 or 400 feet above it, does it make some sense to go ahead and take a look?

A. Yes.

Q. And so for Chesapeake, by drilling 300 or 400 feet you could look at the Morrow; isn't that right?

A. Look at the Atoka, yes.

Q. You already had your costs in the ground to the Strawn?

A. That's correct.

Q. So for 300 or 400 more feet you could look at the Atoka. How much did that cost you to go down?

A. I don't have what those costs are.

Q. Is someone going to testify about that?

A. I assume we can give estimates.

Q. Do you know if it would cost $100,000 to go down 400 feet?

A. I'd just be guessing.

Q. In any event, the cost to Chesapeake to go from where you were to the Atoka-Morrow was whatever the costs would be for drilling about 300 or 400 feet, whatever it is; isn't that right?

A. What was your question?

Q. I mean, if I understand the testimony, you're at the Strawn and you've decided to go to the Atoka-Morrow. The only additional costs are what you're going to incur to get to that depth, right?

A. That's correct.

Q. And yet the proposal and the options available for Altura or for Southeast Royalty is to look at that, the cost, from where you started drilling in the Barbara Fasken well all the way to the Atoka; isn't that right?

A. If they're wanting to participate in the completion attempt of any of that stratigraphic column, yes.

Q. That's right, so they're paying a lot more point forward from when you were at the base of the Strawn than you had to?

A. I think the decision is in whether they want to participate in the Atoka or the Wolfcamp.

Q. And pay the $100,000 to take the well?

A. If they're wanting to participate in it, yes.

Q. Do you --

A. They have all the information to make a decision. That's all we're asking them to do.

Q. Based on the information you have available to you now, do you believe Chesapeake will, in fact, attempt a completion in the Wolfcamp?

A. Yes.

Q. You would never have drilled a Wolfcamp stand-alone based on those kind of figures, would you?

A. No.

Q. It's just because the hole was there?

A. Correct.

Q. And that is something that you didn't anticipate when you drilled this well to the Strawn?

A. No, I mean -- No.

Q. Were you involved in the preparation of the AFE in any way?

A. No.

Q. Would you be making -- involved in any decision to include or not include costs in an AFE?

A. No, I'm not.

Q. Who does that?

A. That's done by management.

Q. You would have no say whether or not, say, seismic costs were included in this AFE?

A. I don't, no.

Q. Do you work with AFEs?

A. No.

Q. You don't know if that's normal to include it or not?

A. I believe Chesapeake normally does.
Q. Is it normal to include in a gas well the cost for, say, a pumping unit?
A. For a gas well?
Q. This was going to be a gas well, was it not?
A. The Strawn, no, it was going to be an oil well.
Q. So we have a pumping unit there, and that's still in there. Now we're looking at a gas well --
A. Right.
Q. -- in the Morrow?
A. We hope.
Q. You have cased the hole through the Atoka-Morrow, have you not?
A. Correct.
Q. You've got a mud log on that interval?
A. Correct.
Q. There are gas shows in it?
A. Correct.
Q. So with the information you have now from the well you've recently drilled in that interval, plus the Barbara Fasken information, isn't it fair to say you do have a reservoir?
A. There is potential. But as you can see, the Barbara Fasken was plugged, and the Yates well made a DST attempt that showed it was not productive and has the same

shows and the same log characteristics, so --

Q. But you are in the reservoir -- the reservoir --

A. There's some sandstone there. There's a question on whether we've got reservoir or not.

Q. And you have had gas shows?

A. Right.

Q. Now, when you initially started drilling the well, there's a certain amount of risk of being able to make a successful well in the Atoka-Morrow; you would agree with me?

A. Yeah, there's a risk in drilling any well, that's correct.

Q. Now, when you already have a wellbore to total depth -- which you do, correct? -- some of the risk has already been assumed; isn't that fair to say?

A. Looking at those offsets doesn't help me much.

Q. So having a well doesn't help you much in terms of risk?

A. You know you have some intervals that you can attempt some perforations at, but I -- You have both those sets of information there that didn't help you either in those cases. So I would say no. Plus the penalties that New Mexico offers are not high enough to begin with, so --

Q. Okay, but we know those are the penalties we're working with, right?

A. Right, so I think --
Q. Is it your testimony --
A. -- the maximum penalty would be fair.
Q. Is it your testimony that there's as much risk today of making a completion in the Atoka-Morrow as when you started this well?
A. In essence, yes.
Q. That having a hole available to you does not reduce the risk of a well?
A. I mean, no one re-entered that Barbara Fasken well to go complete that, so I guess Altura could have done that if they saw no risk in that.
Q. So it is your testimony that you haven't reduced the risk by having the wellbore --
A. In essence, no.
Q. It doesn't reduce the risk that you now have a log on it --
A. Perception --
Q. -- that you can take a look at the formation on the log, right?
A. What was your question? I'm sorry.
Q. Having the log to take a look at in this interval, that doesn't have any bearing on the risk associated with making a well?
A. In essence, no.

Q. Having gas shows on the mud log doesn't make any -- have any bearing on the --

A. It doesn't remove the risk in the two offset wells at all, so that's my response, I've said three times.

Q. Well, I was talking once about the gas shows --

A. Right.

Q. -- talking another time about having a favorable wellbore, another time about having an opportunity to look at the formation.

A. And we have --

Q. You have testified that --

A. And Altura had that same information with the Barbara Fasken well, and they chose to not make an attempt with that well.

Q. You understand, we're talking about the risks associated with the well you have drilled?

A. I know, there's nothing different between the two.

Q. Nothing different between the two at all?

A. Right.

Q. Are they comparable sections in the Morrow?

A. Even less so, actually.

Q. So there --

A. Even more risk than if you're trying to change that perception around.

Q. You've said no indication as to how you view the risk that you're going to have to case the hole?

A. What was your question?

Q. I mean, Chesapeake still says it's a 200-percent risk, it's a full-risk situation, right?

A. Absolutely.

Q. You've gone ahead and cased the hole. That still doesn't have any -- doesn't reflect any way on how you value your chances of making a --

A. Maybe in your perception, someone's perceptions. But in reality, no. Not until those perforations are made and attempt is --

Q. And you're not going ahead with the completions; isn't that right?

A. We are.

Q. But you've delayed it pending the outcome of this hearing, have you not?

A. That's correct.

Q. How much is it going to cost you to complete the well?

A. I did not prepare those estimates, so I don't have an answer for that.

Q. More than $100,000?

A. I'd only be guessing.

Q. Is it fair to say that as a geologist, you are really not a person to ask about costs associated with any portion of this well?

A. That's correct.

Q. When you make a recommendation -- Making a recommendation to your management concerning your efforts to attempt a completion in this well by drilling to the Strawn and going off to the -- I guess to the south?

A. Right.

Q. -- was a factor in your decision, the fact that you had an existing wellbore that would reduce your costs of getting to that depth?

A. Right.

Q. That was a factor?

A. Yeah, that was a factor.

Q. And if we go to the day you have a dry hole in the Strawn, isn't it fair to say that at that moment you also have a situation where you have a wellbore that would make it possible to, for much less cost, take a look at the Atoka-Morrow?

A. Sure.

Q. That's much less cost for you, Chesapeake, correct?

A. No, I mean, it didn't change how much it was going to cost us to get there, but --

Q. The incremental cost for you was just the cost of that extra drilling; isn't that right?

A. There is an incremental cost to go from one depth to another, yes.

Q. And if you got somebody else to pay that amount, it wouldn't cost you anything?

A. We're just asking whether they want to participate or not.

Q. And if they do, they're going to pay that cost, right? More than that cost?

A. There's a COPAS way to get to those costs that we've offered.

Q. That's a nice, easy solution, right?

A. It is.

Q. For a complicated problem?

A. Absolutely. I think that's why the COPAS bulletin exists.

Q. Does that COPAS bulletin exist -- Do you know the purposes it was designed for? Was it designed for a situation where -- Do you know whether or not it was when someone had put together a spacing --

A. I did not author it, so I do not know.

Q. For -- The day you decided to go deeper, test the Atoka, you were looking at drilling so many feet and your cost to do that, right?

A. Was I looking at that?

Q. Your company.

A. The company was, yes.

Q. And today, if Altura wants to take a look at this zone, they pay not only that additional amount but a share of the wellbore all the way up?

A. I think all we're proposing through the COPAS formulas is to move their cost of the Strawn -- And actually, we allocated three days to that where in essence we only drilled one day. And so part of that burden has been removed, even more so than what the COPAS suggests. And with the COPAS, we're dividing between three parties where one party is only one percent. And so that ratio is skewed to begin with.

So I think the COPAS is very fair.

Q. Why is it that if when you decide to re-enter the Fasken well and go to the Strawn, if you have the benefit of the wellbore as an owner in the Strawn interval --

A. What was your -- Start again?

Q. I mean, why is it that -- The question I have is, you've said that when you are able to test the Strawn -- where you've tested the Strawn in this well you've had an economic benefit by virtue of having that Fasken well, right?

A. By not having to set surface and --

Q. Right.

A. Right.

Q. And all the owners in the Strawn interval derive that benefit; isn't that right?

A. Any working interest partner in that well would benefit, yes.

Q. When you go and have a well that is dry in the Strawn, why shouldn't everyone below that interval have the benefit of having a wellbore that goes to the Strawn?

A. Because there's also some Wolfcamp potential.

Q. Wolfcamp potential that you did not see?

A. Right, but they have the information --

Q. Wolfcamp --

A. -- it's right there, it's --

Q. And so by --

A. We're asking them to make a decision to participate in that or not.

Q. By now taking the Wolfcamp and saying, Oh, yes, we find something now we didn't see before, you're now changing the game so that to see what the Morrow looks like, we have to pay the cost of the entire wellbore, right? Our share?

A. If you want to participate in it, yes.

Q. Why wouldn't it be appropriate to let you make an election -- You think this is funny? We don't. Why don't you --

A. I've answered the question several times. I don't know how to answer it any different.

MR. KELLAHIN: Mr. Carr is being argumentative and he's arguing with the witness.

MR. CARR: I'd like to have --

MR. KELLAHIN: I object.

MR. CARR: -- the witness answer the question that I asked him. My question is, if I can be allowed to ask it --

EXAMINER ASHLEY: Go ahead, Mr. Carr.

MR. KELLAHIN: And please don't talk over his answer, Mr. Carr.

MR. CARR: If we could finish an answer sometime, Mr. Kellahin, and not go into an endless narrative, maybe I could.

MR. KELLAHIN: Can you get to the point? Let's go.

MR. CARR: I'd like to ask a question if you'd shut up.

MR. KELLAHIN: I'm waiting for you.

Q. (By Mr. Carr) The question is this: If you someday actually do decide to make a completion in the Wolfcamp, wouldn't that be the time to let these other people make an election?

A. That would be -- Sure, that sounds reasonable.

MR. CARR: That's all I have.

EXAMINER ASHLEY: Mr. Kellahin?

MR. KELLAHIN: No, sir, that's it.

EXAMINATION

BY EXAMINER ASHLEY:

Q. Mr. Hefner, has a JOA been signed between any of the parties to this well regarding the 320-acre --

A. I wouldn't know the answer to that. I --

EXAMINER ASHLEY: Mr. Kellahin?

MR. KELLAHIN: Let me see if I can find out. I'm not sure I know.

My understanding, Mr. Examiner, is that the -- Bonneville and Fasken, either they have agreed to modify the operating agreement to cover the 320, or they've committed to do that. They've either signed the revisions or are in the process of doing so.

EXAMINER ASHLEY: And that revision would include COPAS Bulletin Number 2?

MR. KELLAHIN: I don't know.

Mr. Examiner, that has not yet been included in the joint operating agreement.

Q. (By Examiner Ashley) Okay, Mr. Hefner, I need you to help me summarize the events that led us to this point. Okay, first of all, you re-entered this well to drill horizontally or laterally in the Strawn well, complete it as a Strawn well?

A. Yeah, we wanted to penetrate the Strawn well at a different location than the existing wellbore, so we came up at a certain depth and then kicked off to directionally drill to a target in the Strawn that was south and east of that original wellbore.

Q. Okay. And then when you got to that point, that was tested and it was deemed to be --

A. No, it was not, it was not tested. It appeared from the rock description that it wasn't reservoir quality.

Q. Okay, so at that point you decided to go on to the Atoka-Morrow?

A. Right.

Q. And that was a decision made in-house?

A. Right.

Q. Were any of the working interests notified of that?

A. Yes. I don't know if we had a formal -- I think I probably verbally spoke with them, with Fasken and Bonneville.

Q. And Altura?

A. No, I had no idea that Altura would have had an interest. I thought we had them leased in this entire section, that this would not have been an issue, but --

MR. KELLAHIN: Mr. Examiner, by letter agreement

Bonneville and Fasken agreed to participate in the deepening of the well. There is an agreement about that, if you'd like to have it.

EXAMINER ASHLEY: Sure.

MR. KELLAHIN: Okay.

Q. (By Examiner Ashley) Well, what happened to Altura then?

A. I wasn't --

Q. Don't they have an interest in the 320?

A. I wasn't aware that they have interests, so I never made contact with them. It was land that came back after that, saying that we did not have a lease with them. It was my understanding that we had leased all their interest in that section.

Q. So it was not after the well was TD'd that Altura even knew that the well had been deepened; is that correct?

MR. KELLAHIN: That's right, and it was Chesapeake's belief, with the operational people, that everything had been leased in the 320. And that turned out not to be true.

Q. (By Examiner Ashley) Is Southeastern included in the 320 --

A. Yes, sir.

Q. -- heir interest in the 320?

A. Yes, sir.

Q. Just the deep?
A. Right.
Q. Okay. So then what happened when you --
A. So I made contact with both the other working interest owners. They concurred with the idea of going deeper, and we went to the agreed-upon total depth and logged the well and ran casing.
And land came back saying that we have some unleased parties that we need to try to reach an agreement with, and we've been doing that since October.
Q. And now the well is shut in; is that correct?
A. Nothing has been done.
Q. So what's the status of completing in the Atoka and Morrow right now?
A. It's waiting the outcome of this hearing.
Q. So where does the Wolfcamp play into this?
A. It plays in on whether the Atoka is successful or not.
Q. So you're banking on the Atoka-Morrow right now?
A. Right now, just one step at a time.
Now, Altura has brought to our attention their desire to make some completion attempts in the Wolfcamp, but we have concurred with those desires. We'll look at that if we fail.
Q. On your cross-section, the Inexco Oil Hobbs B

Number 1 --

A. Yes, sir.

Q. -- doesn't Bonneville Fuels --

A. Yeah, I think they now operate that, that's right.

Q. What did that DST in the Wolfcamp show there?

A. It recovered some oil, and that's why those perforations were made, that completion was made.

Q. I'm having a hard time locating the Fasken Hobbs B Number 1 well, number two on the cross-section.

A. That's -- This is the second well on the cross-section.

Q. Where is that on your --

A. It's that dryhole symbol that's on Tract 2 on your map.

Q. Okay, so these are essentially the same wellbore, the second and third well are the same wellbore?

A. No, one -- On your map plan you seen how that line takes you to a different bottomhole location.

Q. Okay.

A. So this wellbore that's right next to it that we're referring to as the College of the Southwest is representative of that wellbore, that directional wellbore --

Q. Okay.

A. -- which is 400 feet away from that original wellbore.

EXAMINER ASHLEY: Okay. I have nothing further. Thank you.

THE WITNESS: Thank you.

MR. KELLAHIN: May we have a short recess, Mr. Examiner? Perhaps five minutes?

EXAMINER ASHLEY: Let's go ahead and take a 15-minute recess. We'll come back at five after three.

(Thereupon, a recess was taken at 2:50 p.m.)

(The following proceedings had at 3:15 p.m.)

EXAMINER ASHLEY: This hearing will now come to order.

Mr. Kellahin?

MR. KELLAHIN: Mr. Examiner, the certificate of notification to the parties that we were asking to be pooled is marked as Exhibit 12. We would move its introduction at this time.

EXAMINER ASHLEY: Exhibit 12 will be admitted as evidence at this time.

MR. KELLAHIN: And that concludes my presentation, Mr. Examiner.

EXAMINER ASHLEY: Mr. Kellahin, this is just notification of the hearing; is that correct?

MR. KELLAHIN: Yes, sir.

EXAMINER ASHLEY: Okay. Mr. Kellahin, there was a mention of another witness that would testify on drilling costs?

MR. KELLAHIN: And I apologize, the witness I have available is not an expert in drilling costs and AFE costs, so I have the wrong witness today to talk about that issue. So that is why I've chosen not to put him on.

EXAMINER ASHLEY: Mr. Carr?

MR. CARR: May it please the Examiner, at this time we would call Stella Welsh.

EXAMINER ASHLEY: Mr. Carr?

STELLA WELSH,

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

DIRECT EXAMINATION

BY MR. CARR:

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

A. Stella Fleming Welsh.

Q. How do you spell your last name?

A. W-e-l-s-h.

Q. Where do you reside?

A. Houston, Texas.

Q. And by whom are you employed?

A. Altura Energy, Limited.

Q. And what is your position with Altura Energy?

A. I am a reservoir engineer.

Q. Ms. Welsh, have you previously testified before this Division and one of its Examiners?

A. No, I have not.

Q. Could you summarize your educational background for Mr. Ashley?

A. I have a bachelor of science in mechanical engineering from Rice University in Houston, Texas. I received that in 1979.

Q. And since graduation from Rice, for whom have you worked?

A. Initially I worked in aerospace for McDonnell-Douglas for about a year and a half. After that I worked for Amoco Production Company from 1981 till 1997. At that time Altura Energy, Limited, was formed between Amoco and Shell. I became employed by Altura Energy in 1997, I am still employed there.

Q. And while working for Amoco and Altura, have you been employed as an engineer?

A. Yes.

Q. A reservoir engineer or petroleum engineer? What type of engineering have you done?

A. I have done reservoir and production engineering.

Q. Are you familiar with the Application filed in this case on behalf of Chesapeake Operating, Inc.?

A. Yes, I am.

Q. And are you familiar with the well and the interest of Altura in this particular section?

A. Yes.

MR. CARR: We tender Ms. Welsh as an expert witness in reservoir engineering.

EXAMINER ASHLEY: Ms. Welsh is so qualified.

MR. KELLAHIN: May I ask a few questions, Mr. Examiner?

EXAMINER ASHLEY: Oh, that's fine, Mr. Kellahin.

VOIR DIRE EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Carr tendered you as an expert in reservoir engineering, Ms. Welsh. Do your current duties involve any expertise in analyzing AFEs?

A. I examiner AFEs, I help prepare AFEs on occasion.

Q. So when I go to Altura as an employee and ask for the drilling or production engineer, would that drilling or production engineer be responsible for preparing AFEs for your company?

A. Yes, I would work jointly with the drilling engineer to prepare an AFE.

Q. What would be your participation in that activity? What is it that you provide to that person so that they can analyze an AFE?

A. I would provide the completion cost.

Q. The completion cost?

A. Uh-huh.

Q. Are there any other components of the AFE that you would have expertise on, other than completion cost?

A. I have familiarity in looking at AFEs, what is appropriate for inclusion or exclusion.

Q. Altura's prehearing statement indicated that they were opposed to the risk-factor penalty. It made no disclosure or indication that they were complaining about the AFE. Are you here to oppose any of the AFE costs?

A. I disagree with some of the AFE costs. In a verbal conversation with Mr. Gassaway I had pointed out that there is quite a difference between the actual cost to date and the referenced AFE.

Q. Are you here to testify with regards to the risk factor penalty?

A. Yes, I am.

Q. So in addition to the reservoir engineering aspects of the risk, you're here to talk about the completion costs?

A. That's correct.

MR. KELLAHIN: All right. No further questions.

EXAMINER ASHLEY: Ms. Welsh is so qualified to testify.

DIRECT EXAMINATION (Resumed)

BY MR. CARR:

Q. (By Mr. Carr) Could you briefly state why Altura Energy is appearing in this case?

A. We are seeking an order that would limit Altura's obligation to pay for the costs associated with drilling the subject well to the Wolfcamp, to the Atoka-Morrow. And further, we are seeking an order which limits the risk penalty to the risk which remains. The well has already been drilled, the well has already been cased.

Q. What remains, in your understanding, to be done to the College of the Southwest 15 Well Number 1?

A. As I said, the well has been drilled, it's been cased. What remains to be done is to actually complete the well.

Q. In both the Atoka-Morrow and potentially the Wolfcamp; is that correct?

A. Potentially the Wolfcamp, yes.

Q. Do you have any idea how much the completion cost should run for a well in the Atoka-Morrow formation?

A. In the Atoka it would cost approximately $90,000 on a gross basis.

Q. That includes tangible and intangible, right?

A. Yes, it does.

Q. And how much does Chesapeake seek from Altura if it's to pay its share of estimated well costs?

A. In a letter dated October 21st they requested about $100,000 dryhole cost. In a letter dated November 23rd they requested $110,000 on a completed well-cost basis.

Q. So what is being proposed to you is, your share of participation in the well exceeds your understanding of what it would cost to complete the well now in the Atoka-Morrow?

A. Yes, that's correct.

Q. How much will a Wolfcamp completion add to these cost figures?

A. On a gross basis, about $100,000.

Q. What interest did Altura own in the dryhole drilled and completed by Chesapeake in the Strawn formation?

A. Altura owned no working interest in that.

Q. And that is at approximately what depth, do you know?

A. That's approximately 11,400 feet.

Q. And how deep is the well? Were you here when Ms. -- I believe it was Ms. Townsend testified to that, or maybe Mr. Hefner?

A. 12,050.

Q. So do you know how many feet it was drilled below the Strawn attempt and the now-proposed completions in the Atoka-Morrow formation?

A. They drilled about 600 feet.

Q. In your opinion, is the request or the requirement that Altura contribute $100,000 to the well to participate in the Atoka-Morrow excessive?

A. Yes, it is.

Q. And why do you characterize it as that?

A. We're being asked to pay about $100,000, which is equivalent to what it would cost. The other reason I think it's excessive is that if I look at Chesapeake's daily reports, which include cost, they are substantially lower than the referenced AFE cost.

Q. You've looked at the AFEs?

A. Yes, I have.

Q. And these are estimates of cost, correct?

A. They are estimates of cost.

Q. At this point in time, the well is at total depth, right?

A. Yes.

Q. And you now have some actual figures?

A. Yes, we do.

Q. And those actual figures are taken from what source? The daily activity report?

A. That's correct, from Chesapeake's daily.

Q. And when you compare those to the AFE costs, how do they compare?

A. They are roughly 70 percent of the AFE cost.

Q. Now, when you look at these numbers, are you including the seismic charge of $50,000 that's reflected on the AFE?

A. Yes, the daily report actually includes the $50,000 for the seismic, so that is included in that.

Q. There are also contingencies in the AFE, are there not?

A. Yes, there are. For both the tangible and intangible cost, a 20-percent contingency factor was applied.

Q. In your opinion, is a 20-percent contingency now appropriate since the well has been drilled?

A. Not at this time, no.

Q. In your experience reviewing AFEs, is it typical to include the charge for seismic?

A. No, it is not.

Q. Are you prepared to make a recommendation to the Examiner as to the risk penalty which should be assessed against anyone, including Altura, who does not participate in the well?

A. Yes, I am. I would recommend that no penalty be applied on the well that is drilled to date. I think that Chesapeake has drilled the well, they've set casing, they have information on the formations. And the well was drilled at its own risk.

Q. If a penalty is set on the remaining risk, what do you recommend it be?

A. Well, I think it should be very small if it is assessed. The well's drilled, there are gas shows in the original wellbore, the Barbara Fasken well, there are shows in Chesapeake's wellbore.

To me, that indicates two things. It's an indication of productivity. Furthermore, because of the difference in bottomhole locations of the two wells, it also indicates the presence of a reservoir.

Q. Do you understand that under New Mexico statute, a 200-percent penalty could be imposed?

A. Yes, I do.

Q. In your opinion, is there less risk once you've drilled the wellbore than you had when you started the project?

A. Yes, there's substantially less risk.

Q. Is the risk of making the well reduced by having an opportunity to view the log on the section in question and finding that there is reservoir present?

A. Yes, there is.

Q. Is the risk reduced by having gas shows on the mud log?
A. Certainly.
Q. Do you have anything further to add to your testimony?
A. No.
MR. CARR: That's all I have of this witness.
EXAMINER ASHLEY: Mr. Kellahin?
MR. KELLAHIN: Thank you, Mr. Ashley.

CROSS-EXAMINATION

BY MR. KELLAHIN:
Q. Ms. Welsh, did Chesapeake provide Altura and have you examined the log on the directional well, the new College of the Southwest 17 well?
A. Yes, that was provided.
Q. So you have that information?
A. Yes, I do.
Q. Are you able to analyze that yourself, or did you have the assistance of a geologist with your company look at it as well?
A. I had the assistance of a geologist.
Q. Have you and your geologist come to any conclusion about whether Altura will participate in a completion in the Wolfcamp?
A. We would consider participating.

Q. What about participating in the Atoka?
A. We would consider participating. We have attempted to work with Chesapeake to reach an agreement to do that.
Q. And we're stuck over the contribution for participation, the dollar amount, right?
A. We're stuck over two things.
Q. Okay.
A. One is the dollar amount, and the other is the costs that are being AFE'd.
Q. Okay. Let's look at the costs that are being AFE'd. Regardless of the AFE cost, you understand that Altura's obligation if they participate would be just their share of the actual cost; that's true, isn't it?
A. I think that's been presented verbally --
Q. Have you read any of the compuls- --
A. -- to Mr. Champlin.
Q. Have you read any of the compulsory pooling orders of the Division?
A. Have I read any of the compulsory -- No, I have not --
Q. You haven't?
A. -- reviewed the records for compulsory pooling of the Commission, no, I have not.
Q. Are you aware it's the practice of the Division

to require you to contribute only the actual cost? You might prepay, or there may be some contribution based upon the AFEs, but there's a process in those orders by which you will ultimately only pay your share of actual costs, okay?

A. Mr. Kellahin, I understand that.

Q. All right. When you look --

A. Let me make one more point, if I might.

Q. Yes.

A. I think that in looking at the actual cost, there's also a disparity there, in my opinion, that being in the daily actuals as reported by Chesapeake. They have already included the $50,000 gross expenditure for the seismic. Now, Altura has not had benefit of viewing the seismic.

Q. Are you aware that the Division orders for compulsory pooling provide a mechanism by which you can also object to the actual cost? So after the cost bill, the actual cost bill, is submitted to Altura, you have a period of time to register a protest about any of those costs?

A. Uh-huh.

Q. Doesn't that provide you full protection, then?

A. It would if we had been given the appropriate opportunity to participate prior to the Morrow being drilled.

Q. Aren't you being given a better opportunity now, because you have the log data, you have some actual cost information, and you're more fully informed about whether you want to make your election to participate with this new information? Is that not true?

A. Our choice at the outset was to not -- was to retain the acreage for development. At this point, the way I see it is that we have been placed in the position of our formation being developed without being consulted, and I think that is inappropriate.

Q. When you look at the actual cost comparison to the AFE, Chesapeake has done substantially better with its actual cost than with the estimated? There's some substantial savings already realized; is that not true?

A. I don't know that I'd characterize them as savings, no. Yes, it is less than the AFE cost. I think the AFE was inflated.

Q. So you're going to pay actual costs, which are less than the AFE costs, so what's your complaint?

A. My complaint is that Chesapeake developed a well without the acreage to produce it --

Q. And you're now being --

A. -- Altura's acreage.

Q. You're now being afforded the opportunity to participate, let's say on the Wolfcamp, and your choice for participation, as you characterize it, is some share of the completion costs, true?

A. Would you repeat that, please?

Q. Yes. You responded to Mr. Carr that 100 percent of what you think are the justifiable completion costs attributable to the Wolfcamp are about $100,000; did I understand that correctly?

A. Yes.

Q. That would be --

A. -- on a gross basis, uh-huh.

Q. -- on a gross basis, meaning that's the total for all the working interest owners to divide up, right?

A. Uh-huh.

Q. Okay. If we look at your working interest in the Wolfcamp, if Mrs. Townsend is correct, you've got 13.3 percent, right?

A. Uh-huh.

Q. You're proposing to pay $13,000 in order to participate in future production from the Wolfcamp, true?

A. It's a proportionate share.

Q. When we look at proportion to share, have you ever utilized the COPAS Bulletin Number 2 for cost allocations?

A. No, I have not.

Q. Were you aware of that bulletin until you came to the hearing today?

A. Yes, sir, I was.

Q. So when we look at the Atoka, your participation in the Atoka is 20 percent, right? Did Ms. Townsend get that number right?

A. I believe she did.

Q. Okay. You're talking about the remaining completion costs attributable to Atoka of about $90,000, true?

A. Yes.

Q. You propose to pay your 20 percent of the $90,000?

A. I have no problem with paying our proportionate share of the completion cost.

Q. That's what I'm trying to get from you. You say your proportionate share of the completion costs are going to be $18,000, right?

A. If that's -- Are you taking 20 percent of $100,000 --

Q. I'm taking 20 percent of $90,000 that you gave me.

A. Okay.

Q. All right, $18,000, right?

A. Yes.

Q. Even a lawyer can do that math. And that's all. You don't propose to pay for anything else in that wellbore?

A. I think it would be appropriate for Altura to pay for drilling the Morrow section. I don't have a problem with that. But it would be the section from the point where Chesapeake left their stated objective in the Strawn, not from the point where they kicked off in the wellbore.

Q. Okay. So you're proposing that there is going to be no contribution made by Altura for utilizing the wellbore from the surface down to that particular depth; it's just the remaining interval that you're proposing to help pay for, right?

A. That's correct.

MR. KELLAHIN: No further questions.

EXAMINER ASHLEY: Mr. Carr?

REDIRECT EXAMINATION

BY MR. CARR:

Q. You're proposing that Altura not contribute anything for the wellbore -- well, for the Fasken wellbore from the surface to where Chesapeake kicked off, correct? You're not going to be contributing to that?

A. No.

Q. And you're not going to be contributing to the wellbore from where they kicked off for the Strawn, correct?

A. That's correct.

Q. You had no interest in any of that?

A. No.

Q. You say you would be willing to contribute from the base of the Strawn, the additional hole drilled to the Atoka-Morrow; is that your testimony?

A. That's my testimony.

MR. CARR: Thank you.

EXAMINATION

BY EXAMINER ASHLEY:

Q. Ms. Welsh, can you tell me what Chesapeake is wanting you to pay? Can you give me a dollar amount of what they're expecting you to pay for this well?

A. They're asking us to pay -- Their correspondence says reference the AFE cost. From listening to Mr. Kellahin, and I think it's accurate to say they'd be expecting us to pay the actuals, which would be, according to the calculation they've submitted, about 11 to 12 percent of their total cost from their -- including the seismic and the cost to drill from their kickoff point in the Fasken well down to TD.

So if I estimate that, I think, from a verbal conversation with Mr. Gassaway of Chesapeake, he was anticipating a total cost of $650,000 to $680,000 actual, if the Atoka completion was attempted and if they completed in the Wolfcamp. So we'd be looking at paying about an eighth of that. Mr. Kellahin may be able to help me with the math there. I guess that would be about $80,000?

Q. Excuse me?

A. I'm estimating about $80,000.

Q. Okay. That was if they completed in the Wolfcamp?

A. Yes. Now, if they completed in the Atoka, I think the total cost we looked at, based on their actuals to date, and the estimated cost, would be a gross cost of about $570,000. Using the COPAS calculation that they've proposed, then that would be about $70,000 net to Altura.

Q. Now, that $70,000 includes part of the cost of re-entering the well; is that correct? That's not just from the kickoff point from the base of the Strawn into --

A. That's correct, it includes the seismic, it includes the cost --

Q. Okay.

A. -- to re-enter the Fasken well.

Q. Now, if they had decided not to go to the Atoka-Morrow and recompleted in the Wolfcamp, and say they were proposing a cost of approximately $80,000, just as a reference point, would you have paid that?

A. $80,000 net to Altura? In my opinion, the appropriate cost would be the cost that they incurred from drilling and completing from the base of the Strawn to TD. The estimated cost for that, just back-of-the-envelope, right, their actual cost to drill through the Atoka was $50,000 gross. Say the cost to case through that section would probably be another, say, $20,000. So we're looking at $70,000 plus the completion cost -- We're talking about the Atoka; is that right?

Q. No, I was talking about the Wolfcamp.

A. Talking about the Wolfcamp, okay.

Q. Well, let me change that, rephrase that question. You had already agreed -- Had you all already agreed to participate if the well was recompleted in the Wolfcamp? Is that -- Was the primary target the Strawn, and then secondary being the Wolfcamp?

A. No, sir, from our standpoint their primary target was Strawn. The Strawn was dry, or it did not look prospective on the logs. So then their objective became the Atoka.

Q. Okay.

A. Now, when we were contacted after the Atoka had been drilled through and they had the mud log information on it, then their objective became the Atoka.

Q. Right. But Altura already had an agreement with Chesapeake if the well was completed in the Strawn; is that correct?

A. Yes, we had leased the Strawn to them.

Q. Okay.

A. For the 80 acres.

Q. Okay.

A. When they came back to us and requested another lease after they drilled through the Atoka, at that time Altura was unable to grant a lease, because Altura is currently for sale. And so our -- We were unable to do that, we could not grant a lease. However, we did have money where we could consider contributing. It was not our intent to impede the completion of the well.

EXAMINER ASHLEY: I have nothing further. Thank you, Ms. Welsh.

Mr. Carr?

MR. CARR: May it please the Examiner, at this time we would call Robert Light.

ROBERT S. LIGHT,

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

MR. LIGHT: Being duly sworn, I'd like to make the following testimony, and I'd like you to know where I'm coming from.

I am the secretary of Southeast Royalties. My name is Robert S. Light. I've appeared before the Oil

Conservation Commission many years ago in expert testimony, and now you're the Oil Conservation Division. But nevertheless, it's the same group.

I thank you for allowing me to make a statement, and I thank Mr. Carr and Mr. Kellahin for allowing me to make a statement.

I am the secretary of the organization. And the president, Mr. Garringer, who has been in contact with Chesapeake on the purchase of our rights below 11,800 feet, 11,870 feet, we have not been able to come to terms. And I want to say that it isn't anyone's particular fault, except we deal only in royalty interests; we have no working interests.

The reason for that is, in the past -- and I've been in the business since 1949, I was with Continental Oil Company for three years and then joined Barber Oil in Carlsbad, New Mexico, in 1952, is approximately the date. The reason for that is, we did participate in wells with major companies and found it a bad experience.

For instance, we joined Getty in a $3-million Morrow well that should have probably cost about $1.5 million. And in their casing program they came up with ten-inch, 10-5/8 casing, and it was just double the price I could have bought the same brand-new casing in Artesia for on the price.

And so I called Getty and I said, Look, guys -- this is their Midland office -- you're charging double what I can buy that same pipe for.

And he said, Look, we're the operators, and that's our cost in our yard, and you will pay that cost.

Well, that kind of cooled me. The well was a dry hole, and that even cooled me further. And it's kind of a sad experience when you participate with other people and you don't have any control. We're a small oil company and produced -- We had about 150 wells through the years. They're all sold now, we're completely out of production, and we took our interest in cash for the wells and an overriding royalty and everything, and we sold it. So we're strictly a royalty company, and we do not want to re-enter operations.

Now, I think we explained that to Chesapeake, but nevertheless, in our operations with Chesapeake -- and if you'll look at your -- because you have it in your folder -- just before Tab 9, there are two pages there of a letter that they proposed to us, which we were not interested in at all, with the AFE, and it's at the end of Section 8, Tab 8.

And Lynda Townsend was very kind, we were very kind to them, we had no problems as far as any personality problems. But we told them no, that we proposed -- and you'll find in the page just ahead of Lynda's letter -- our counterproposal was to do a bonus of some sort with a 10-percent overriding royalty.

Now, let me say this, that Inexco took our assignment of our lease some years back to drill the Barry Hobbs Number 1 in the northeast of the northeast of 17, and we kept a five-percent overriding royalty. It already had a 25-percent royalty interest on it. So that was burdened with a five-percent, and they paid us -- I don't even remember what kind of bonus, but we made a deal with Inexco, and they drilled the Barry Hobbs Number 1 in the northeast corner.

Now, we kept everything below the Strawn, which they set the depth after drilling, it was 100 feet below the depth drilled, and that was the 11,870 feet. We have everything below that, and have always had it for many years. We get a royalty check from Bonneville every month for our five-percent interest, overriding royalty interest. We are not operating with anybody.

We wanted to do that with Chesapeake, and we just felt like since they had drilled us a free well -- in my opinion, they drilled a nice well down there, and it was right into our zone, and my God, I wanted to thank them, and I thought, Well, it isn't fair just to say thanks, so we have proposed a 10-percent royalty interest and some sort of a bonus. They offered $250. I don't care what it is, we're talking about $1250. It's peanuts. It costs me that much to come up here to talk to you.

So the bonus was not a big thing. If they have something of value, we'd like to have a part of the production. And so we suggested a 10-percent override because that was just five percent over what we have with Inexco, which is now Bonneville. And I didn't think it was unreasonable.

They evidently did, because we never heard another word from them.

And then we get Mr. Kellahin's letter stating that you're being force pooled. Well, we didn't like that at all because we don't want to be force pooled.

So we went to George Hunker in Roswell, and I said, George, write us a response. I just do not want to be force pooled.

So in our response -- and it was very well written, I thought -- to the Oil Conservation Division, we merely said that it's prejudicial to the philosophy of the company and the way we do business, and that's what we put in the letter.

Now that kind of, I guess, bothered Mr. Kellahin just a little bit, and I don't know exactly why, but he said, Would you advise me how you think the Division's exercise of its authority -- we had nothing to say about the Division's authority -- is prejudicial to the philosophy of the company and the related method of doing business?

Well, our way of doing business is strictly on an overriding royalty basis, and we do not want to operate with Chesapeake, don't care to operate with Getty ever again, and we have had joint operations. But they've been with people like us. J. Penrod Tolls, we operate with them all the time, no problems. L.S. Hall years ago out of Roswell -- I mean out of Albuquerque. We operated with them, joint operations. Never a problem one. But we had a relationship that was a lot different than you do with a major company.

So I just plead with you to allow us not to be force pooled but to send us back to the bargaining table with Chesapeake and find out if 10 percent is a ridiculous thing. I didn't think it was, but they never replied to our letter. And I'm a little bit disappointed that we didn't get together and hash out some sort of an override, something better than five percent, because in my opinion they've drilled us a neat well, if it makes production. We don't know, they haven't completed it yet, but it's all done, and they've got 12,050 feet of 5-1/2-inch casing all set and cemented, ready to do something.

And I just feel like that I want to thank them. And if they want me to be an operating partner, why, I'd just like to do it on the basis that they'd take their interest out and carry us for the operational costs. They get their money back. But I don't want to give them 200 percent and it's -- may never get a dime out of it.

So I'd just like to say, we want to remain a royalty interest company. That's all we have. We did used to produce wells, and we've sold everything, we're no longer in production and don't wish to return.

And that's why I'm here, is to make that statement, and I do it with respect to Chesapeake and Lynda Townsend and Mr. Kellahin. His father used to represent us when we were up here in Santa Fe thirty -- forty years ago, we were in Santa Fe doing oil and gas leases in the name of Eugenia Bate, and you may remember Eugenia.

So these are all friends of mine. Bill Carr's a friend of mine from the Legislature days. So I just want to say that all of you are my friends, and I just don't want to be force pooled.

Now I'd be glad to answer any questions. I hope I didn't take too long -- make too long a statement.

EXAMINER ASHLEY: Mr. Kellahin?

MR. KELLAHIN: I have no questions for Representative Light, thank you.

EXAMINER ASHLEY: Mr. Carr?

MR. CARR: I have no questions for my client Mr. Light.

MR. LIGHT: Am I through?

EXAMINER ASHLEY: One minute, just a second.

MR. LIGHT: Okay.

EXAMINER ASHLEY: I just have a couple questions.

EXAMINATION

BY EXAMINER ASHLEY:

Q. You're a working interest owner, but you want your working interest to be converted to an overriding royalty interest; is that correct?

A. Well, we own the lease. We own the lease below 11,700 feet.

Q. Okay.

A. -- eight hundred, whatever -- It's a hundred feet below the depth drilled in the Strawn in the Barry Hobbs Number 1.

Q. Okay.

A. And we just own the rights, and we probably would never -- We'll never go out there and drill it. I wouldn't do what they're doing at all. But that's their business. But I just want you to know that I don't want to be force pooled, operating with someone that I hardly even know -- I never heard of Chesapeake out of Oklahoma City until Lynda

Townsend darkened our door. And we told them at the time we did not want to be a working interest partner.

And I can see flaws in some of their AFE too. You know, authority for expenditure is supposed to be something that everyone relates to. In fact, your partner should understand that at the time, and it should be fair.

But I don't want to be their partner, really. I really don't. And I don't want to be Altura's partner either. But I do like both companies. Altura's a good company. And Chesapeake, I don't know a thing about them except they're out of Oklahoma City. I went to work in Ponca City, Oklahoma, with Continental Oil, and I know a little bit about Oklahoma oil, and I was with them for three years.

EXAMINER ASHLEY: Okay, just a minute.

Mr. Kellahin?

MR. KELLAHIN: Sir.

EXAMINER ASHLEY: His response to Chesapeake's letter was never answered; is that correct?

MR. KELLAHIN: Ms. Townsend testified for you earlier this afternoon that the request for the 10-percent additional burden put the interest at a 65-percent net revenue interest, and it was below their company's policy to do that.

EXAMINER ASHLEY: Did they ever contact Mr. Light about that?

MR. KELLAHIN: I don't have a letter that confirms that, and if there's not I apologize because there should have been.

MR. LIGHT: We never heard another word till we heard from Mr. Kellahin, really. That's to my knowledge. I'm in and out of the office a lot. I'm very busy with other items, and Mr. Garringer is president of the company and he does run it, let me tell you, he runs it well. I'm just the secretary, but I kind of own it.

MR. KELLAHIN: Mr. Examiner, to finish the point, there is no written correspondence. Lynda Townsend confirms that for me. If you want to recall her, she would testify that she talked to Mr. Garringer -- is that --

MR. LIGHT: Mr. Garringer is --

MR. KELLAHIN: -- talked to Mr. Garringer and informed him orally that the 10 percent was too big a burden and they couldn't make a deal. So there was verbal contacts between the president of the company and Mrs. Townsend.

MR. LIGHT: There may be some question as to that because Mr. Garringer said he had not heard from them since -- He sent them the letter by fax, and they misplaced it and called him later and said, Where is this return letter? He said, I faxed it to you. And she had evidently given it to the wrong person in the office, and so we faxed it again. And that was the last we heard from Chesapeake, to my knowledge.

MR. KELLAHIN: Ms. Townsend's testimony would be different, Mr. Examiner, if you'd like to hear it.

EXAMINER ASHLEY: Is Mr. Garringer here? Is Mr. Garringer here today?

MR. LIGHT: Yes, Mr. Garringer is president of Southeast Royalties.

EXAMINER ASHLEY: Is he here today?

MR. LIGHT: Oh, no, he's working. We're a two-man office. I'm in the office, he's in the office, we both can't leave at the same time.

EXAMINER ASHLEY: Thank you, Mr. Light.

MR. LIGHT: My pleasure.

EXAMINER ASHLEY: I'd like for Ms. Townsend to take the stand and testify to that, please.

LYNDA F. TOWNSEND (Recalled),

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

EXAMINATION

BY EXAMINER ASHLEY:

Q. Ms. Townsend, can you go over again what happened after you submitted the letter -- Let's see, can we refer to the letters that you sent to Mr. -- or to Southeastern

Royalties?

A. May I get my book?

Q. That would be fine.

A. Sorry. All right, I had -- Let's see, the broker had written in first, on October the 21st, he had tried to take a term assignment, and they had 1.667 percent out of the whole 320-acre unit.

We offered $250 an acre for a three-year term assignment.

I came back on -- After they had refused, I came back on November the 29th and wrote Mr. Garringer a letter. We offered to do the same thing with the $250 bonus and reduce it to two years. Or as an alternative -- or they could participate in the well, and I sent the AFE at the time.

Then on November the 30th I received the fax letter from them wanting a bonus of 10 percent override on 8/8, plus the bonus. Or they wanted a carried revenue interest.

I did not write back a response to this. I took it to management, because I always take every offer, regardless of what kind of offer it is, knowing that management was going to tell me, no, we don't take anything other than 75 percent. I did call Mr. Garringer and tell him that.

When he refers to re-faxing me the letter, I did have him re-fax me the letter. I had given the letter to management in a meeting and told him it would be much faster if he would fax me a copy of the letter. He did, I went back and talked to them again. I asked him, could he please come up with something else, could he lower it, that 10 percent we would not take -- or we would not give.

And that was basically the last time I talked to him.

EXAMINER ASHLEY: Mr. Kellahin, do you have any questions you want to ask Ms. Townsend?

MR. KELLAHIN: No, sir.

EXAMINER ASHLEY: Mr. Carr, do you have any questions?

MR. CARR: No, I do not.

EXAMINER ASHLEY: Thank you.

Mr. Carr?

MR. CARR: That concludes our presentation.

I have a closing argument, unless Mr. Kellahin has additional testimony.

MR. KELLAHIN: Nothing further, Mr. Examiner.

MR. CARROLL: Didn't you have three witnesses?

MR. CARR: No.

EXAMINER ASHLEY: Just one, or just two?

MR. CARROLL: You had three witnesses?

MR. KELLAHIN: Yes.

EXAMINER ASHLEY: One didn't --

MR. CARR: We could find one if you would like.

MR. CARROLL: No, no, no.

EXAMINER ASHLEY: Mr. Kellahin, do you have any closing statements?

MR. KELLAHIN: Yes, sir. I believe the practice is to let the opponents go first.

MR. CARR: That's the practice, I believe.

EXAMINER ASHLEY: Go for it.

MR. CARR: May it please the Examiner, today we've heard a substantial amount of testimony about company policy and how it impacts individuals' ability to negotiate. We've heard about COPAS forms and touted them as simple answers to complex solutions.

But what we really have here is a situation which, if it isn't unique it's unusual. We have Chesapeake coming before you, asking you to enter an order pooling the interests of Altura, of Southeast Royalties, in the Atoka-Morrow and in the Wolfcamp formations for a well that has already been drilled, a well that already has established that it is in a section in the Atoka-Morrow where there is reservoir, where they have gas shows.

And they're here because they didn't form these units when they first decided to drill the well. They didn't come to you and obtain approval for the spacing units they now want to dedicate to the well. They drilled the well.

We have concerns about what they have done, we have objections to what has happened. We believe the costs and the offers that are now being made to us are excessive, we believe their proposals are unreasonable, and Southeast Royalties objects to being included in this prospect at all.

When you look at what Chesapeake has come before you with, I think you see first of all there is no dispute they were proposing a Strawn well. That's what they leased, that's what they acquired from both other parties, that's what they came to you and sought approval for, and that's what their initial AFE reflected.

And when that well was drilled, and if it had been completed in the Strawn, Chesapeake and its partners in that interval would have owned all the working interest, they would have shared in the production; Altura, Southeast Royalties would not have.

The costs of drilling that well were reduced, and they were reduced because there was a usable wellbore on this tract, and it provided them a vehicle by which they could access the minerals in the Strawn for less cost. It reduced their cost of drilling. But at any cost, you still have a problem when you drill a dry hole.

And there they were with -- Chesapeake and its partners, having to face the fact that they were going to have to pay for the well. They had no one else that they could bring in.

But they devised a new plan, they took the well to the Morrow. They were at, say, 11,800 feet. They could drill an additional 400 or 500 feet of hole, and they could be in the Morrow. They could add just a small bit to the well. And then because of what they had done, as they testified, they changed the deal.

They changed the deal, they changed it to what they had done. They, in essence, though, had set themselves up to give really what amounts to a free look at the Atoka-Morrow. They could drill and collect from other people more than it would cost to go to that depth, and it would, in effect, bail out part of the costs they had incurred in drilling to the Strawn. They could get other people to pay, and that is why we are here.

When you look at this case and you look at the evidence, Mr. Kellahin and I have very different views. Mr. Kellahin is surely going to say, Well, we're asking people to pay a reasonable share, everyone benefits; if they want in, pay their share and come in.

We see it differently. We see an action by

Chesapeake which was outside the rules of this agency, which was inconsistent with their representations to us, which was a radical change in the plans they had made to access minerals in the Strawn, which contains a tremendous benefit to them in the form of additional contribution for their share for the costs that they incurred in drilling the well.

You know, it's interesting. They may have a reason to want to go and complete in the Atoka-Morrow, if they can get there with a well they've already paid for and the additional cost of getting to it being paid by somebody else.

It's a very different situation for the rest of us, and if we're going to share, we have to pay not only what it costs to get from the Strawn down to the Atoka-Morrow but what it costs to get from Barbara Fasken down to the Strawn as well.

You know, the Fasken well was a benefit to everyone. It provided a way to reduce cost to test the Strawn. They proposed a well, they drilled a well to the Strawn, they were unsuccessful. That wellbore, we believe, ought to stand just like the Barbara Fasken well. And we, at that point in time, all could benefit by drilling down to Morrow and Atoka reserves that were risky because we had existing wellbores that made it economically reasonable for all of us, not just Chesapeake, to go down and take a look. And that's why it's different.

And when you're asked to look at how we view the case and compare it to how Chesapeake does, remember what Chesapeake did. They proposed a Strawn well, they came to you for an order for a Strawn well, they AFE'd an original well.

And then what did they do? Well, they went to the Morrow, and they didn't propose it to us. They went to the Morrow, and they didn't get it approved by you. They went to the Morrow, and they had not acquired the rights for a Morrow spacing unit.

And the truth of the matter is, it's not very different when you look at the Wolfcamp. Because although now when we see the Wolfcamp, because maybe we can use that to kick in the COPAS form, we didn't see the Wolfcamp as much before we drilled the well. We didn't see it, even though on this -- We knew we were going to have a wellbore through it, at least Chesapeake should have. And they knew there was a well on the section that had produced 76,000 barrels of oil out of that particular zone, that if you had a wellbore to the Strawn someday you could complete it. But oh, no, they didn't think the Wolfcamp was a prospective interval.

Yes, for them COPAS is nice, the form is great.

It means tag costs on to us. And we believe, in fact, what it is, it's really a way to share the costs of their bad judgment and bad luck with somebody else. Under their new plan we believe we're the ones that take the hit. We're being asked if we're going to share in the reserves that are there.

We're put in an untenable position in terms of cost, because we have to pay much more to get there than they did, because when we were going to the Atoka and Morrow together was not when they were kicking out of the Barbara Fasken well but when they decided to depart from the Strawn and drill deeper. And that's what we believe is appropriate.

We believe what we have to pay is an excessive amount. Sure, it's a great remedy, we can come back and have another hearing, another fun day, just like this one, squabbling over whether seismic is appropriate, whether what they say is actual really should include seismic and other things.

But that's absurd. Right now there's confusion about -- We don't even really know whether we're going to pay dryhole costs -- we don't have a dry hole anymore; we've cased it -- of whether we're going to pay completed well costs. Well, that's a gas zone, but we've got a pumping unit in the AFE and we've got surface equipment that's for an oil well.

I mean, the fact of the matter is, every time you turn around there's a way that Chesapeake is asking for more money and asking you to excuse what they did, and that was, they made a decision that was outside the rules and inconsistent with what they had told everyone before they were going to do. We think they're asking for a precedent that you should not set.

We think they assumed the risk and they drilled to the Strawn, and having done that, that's the point where we go forward. They drilled a well. I think Representative Light is correct, we should say thank you for that.

And if you really recognize it when somebody goes out and takes it on themselves to drill a well on somebody else's property -- that's just what they've done -- then I think what we should be obligated to pay is our share of completion costs.

But if you take an alternative view and say, yes, well, from the base of the Strawn down you're all in this together and you can all share the benefits together, then perhaps the alternative would be to pay our share from that point down.

But I think when you look at this case you see something that doesn't look right when it walks in the door, and it has been supported by land work that was incorrect, it didn't combine the spacing units. It was combined by very unusual geology where you threw out the Wolfcamp when you had 76,000 barrels of oil coming out of a Wolfcamp well on the same section.

You have engineering -- Well, we didn't present the engineering.

And what they want you to do is approve something after the fact, which amounts to nothing more than retroactively setting the clock in a way that impairs the rights of Altura and changes the obligations to Chesapeake.

We ask you to enter an order that imposes a risk penalty limited -- and a small risk penalty, because they have a well where they have proven reservoir and have gas shows, and that penalty should apply to completion costs and certainly nothing more than drilling from the Strawn.

EXAMINER ASHLEY: Mr. Kellahin?

MR. KELLAHIN: It's always a treat and a thrill to hear my friend Mr. Carr give a closing statement. And sometimes he doesn't let the facts get in the way of a good argument.

But let's talk to some of the facts that he wants to ignore, which he wants to pretend don't exist. This is not an abandoned wellbore. These are active operations, ongoing in the field, with a well that is drilled.

Mr. Carr and I have been through this contest with Santa Fe Energy and Landreth. We've talked about force pooling, what happens with drilling wells. This is a drilling well. The people in the field have penetrated through the Strawn, it's unsuccessful, they make a field decision to continue with the rig on location. This is a drilling well with rig and personnel on site, doing the work. The well is drilled.

They believe, incorrectly -- after checking with Chesapeake, without Lynda Townsend's knowledge -- they believe, incorrectly, that they have the 320 under lease. And they're wrong.

And so what happens when you're wrong? We do what the statute provides, Mr. Ashley. You can force pool for a drilled well, you can take care of issues like this that happen on occasion.

What Altura wants is a free well. Representative Light says thank you for the free well, but Representative Light doesn't want a free wellbore. He says it's not fair. It's free, but it should not be fair.

And how do we resolve it? I didn't dream up the COPAS bulletin, Mr. Ashley, I'm not smart enough to figure out how to do this, but I was aware it was there. It's been in existence since at least September, 1965. And if you'll turn with me to the introduction before the COPAS bulletin, let's look at the first sentence. You'll get disputes like this. This is not an unusual dispute, it will occur on occasion.

And what does the COPAS bulletin tell you? The basic purpose of this bulletin is to set forth what is considered by the industry in general to be the most equitable basis for the determination of values to be used in conjunction with well-cost adjustments. They answered this question for you 30 years ago.

And you don't have to take this in a vacuum, Mr. Ashley. All you have to do is rely on the past precedence of this agency.

Mr. Carr wrongly suggests you're about to set a new precedent. Let me remind him of a case that Yates had against Chevron back in 1990, and let's look at what this Division did in this precedent.

If you'll turn to page 2 of the order, it's Order Number R-9093-C, and start with (5). Yates spuds the well, and on February, 1990, they drill to a total depth of about 9000 feet, and they test the Bone Springs and it's nonproductive. To get to that point, they had force-pooled Chevron, only as to the Bone Springs interval. For whatever reason, they failed to obtain a pooling order or leases or agreements on the shallower San Andres.

When they failed to produce the Bone Springs, they come back up the hole to about 4600 feet, and what do they do? They complete the well. This is a completed producing oil well at 82 barrels a day. Chesapeake hasn't completed these formations, but Yates did. They've got a completed zone in a formation where they haven't committed Chevron's 25-percent interest. The Division tells both Chevron and Yates to go back and figure it out. Negotiations are unsuccessful.

And so we go back to hearing before Examiner back in October of 1990, and if you turn to page 3 you'll see in paragraph (11) what Yates proposed. They're proposing that the total well costs for completing this well, including all tests and all equipment and all materials down to and through the Bone Springs be charged back to the San Andres. That was their position.

Chevron came forward with the 1965 COPAS bulletin, and Examiner Stogner adopted that bulletin for cost allocation.

And so you have the precedent here of resolving what happens between the Bone Springs and the San Andres. You have it in the Chesapeake case today, to see what happens between allocating costs back to the Wolfcamp. You can use that same bulletin, if you read it, to allocate costs among three zones so you have a shallow, intermediate and a deep zone. It tells you exactly how to do this.

Mrs. Townsend did it for you, she's made the calculation for you.

And what's interesting to note is, look at finding (14). What is Yates awarded for drilling a producing oil without pooling Chevron? Is it risk-free? Is it a free ride? Is it a free well? No. They get their costs back, plus 150 percent.

There's a means and a method by which you resolve this, Examiner Ashley. We suggest that this is how you do it. It's how the Division has done it in the past. It's reasonable and appropriate. And if you look at this order or any other order of the Division, then you can answer the questions that concern Mrs. Welsh when you talk about actual versus estimated costs.

We ultimately deal with actual costs. They're going to enjoy the cost savings that Chesapeake achieved by reducing the actual costs by $100,000 less than the AFE cost. If she doesn't like the 3-D seismic stuff being AFE'd, there is a process by which we can have a hearing in the event Mr. Carr and I can't resolve that issue.

I wasn't aware it was an issue. You couldn't find that out in their prehearing statement. I did not know about it until today. But we can talk about those issues, we can figure that out. And if we can't solve it, we can come back, because there is a method by which we do that.

They get the advantage of taking advantage of the risk we bore. We've paid for this wellbore, it's our money. And now what they want to do is give us loose to get 13 percent of production out of the Wolfcamp, or loose change in terms of shares of completion cost to get 20 percent of the Atoka. That's a free wellbore, and they're not entitled to it under the COPAS instructions, they're not entitled to it under Division past precedent.

We say that they've got more information that typically is provided. They've got the log, they can analyze it. And if they don't want to pay and participate, then the consequence ought to be they go nonconsent, and we will recover our money that we advanced for their share of these costs out of future production, if there's enough of it to do so.

I'm sorry for Representative Light's difficulty here with the royalty issue and not wanting to be a working interest owner. You know that Chesapeake's practice is to continue to try to negotiate solutions. In the interim between orders and hearings, and even after orders are issued, we will approach Representative Light and his partner again to see if we can resolve it.

Ultimately, if we can't, it's not our fault that the statutory process in New Mexico affords the opportunity for him to participate with part of his share as a royalty, one-eighth. The other part is a seven-eighths. And there's a means and a mechanism by which that happens. If he doesn't like it, I'm sorry, I can't do anything about it. It's the statute. He's over at the Legislature; maybe he can figure out a way to make the statute better. But right now, this is what we have to work with.

We appreciate your time and attention to our case. We believe we're entitled to the relief we've sought, and we would ask that you enter an order in accordance with our presentation.

EXAMINER ASHLEY: Okay, at this time I have nothing further, but I would ask that both parties provide me a draft order by February 1st.

MR. KELLAHIN: All right, sir.

EXAMINER ASHLEY: And with that in mind, there being nothing further in this case, Case 12,325 will be taken under advisement.

(Thereupon, these proceedings were concluded at 4:25 p.m.)

* * *

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 12325, heard by me on 1-20 2000.

______________________, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL January 28th, 2000.

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002