

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:) CASE NO. 12,775
)
APPLICATION OF CONCHO OIL AND GAS CORP.)
FOR COMPULSORY POOLING, AN UNORTHODOX)
OIL WELL LOCATION AND VARIOUS)
NONSTANDARD PRORATION AND SPACING UNITS,)
LEA COUNTY, NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID R. CATANACH, Hearing Examiner

December 6th, 2001

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, December 6th, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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December 6th, 2001
Examiner Hearing
CASE NO. 12,775

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A P P E A R A N C E S

FOR THE DIVISION:

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By: W. THOMAS KELLAHIN

* * *

1 WHEREUPON, the following proceedings were had at
2 8:15 a.m.:

3 EXAMINER CATANACH: Call the hearing to order
4 this morning for Docket Number 40-01. I'll call the
5 continuances and dismissals at this time.

6 (Off the record)

7 EXAMINER CATANACH: And at this time we'll call
8 Case 12,775, the Application of Concho Oil and Gas Corp.
9 for compulsory pooling, an unorthodox oil well location and
10 various nonstandard proration and spacing units, Lea
11 County, New Mexico.

12 Call for appearances.

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

17 EXAMINER CATANACH: Call for additional
18 appearances?

19 Will the witnesses -- Please swear in the
20 witnesses at this time?

21 (Thereupon, the witnesses were sworn.)

22 MR. KELLAHIN: Mr. Examiner, I'd like to give you
23 a brief opening outline of what we're proposing to present
24 to you this morning.

25 Concho has what I consider to be a conventional,

1 routine compulsory pooling case. There is an unorthodox
2 well location component to the case.

3 If you'll look at the exhibit packages, we've
4 marked the exhibits A-1. If you'll turn to A-2, you can
5 see that it's an irregular section. If you'll look down
6 into Lot 11, you can see the small dot that shows the
7 proposed well location. The primary target is to be an
8 Atoka-Morrow test, and it this will be a dedication
9 consistent with 320-acre gas spacing.

10 Location is standard as to the deep gas.

11 It is unorthodox as to any potential oil zone.
12 You can see that it encroaches towards Lots 12 and Lots 13.
13 The testimony will be that the ownership in Lot 11 is
14 identical to the two lots towards which the well
15 encroaches.

16 We have a geologic presentation by Concho's
17 geophysicist to show you the basis for its location. In
18 addition to the geologic justification, there is a
19 topographic problem that affects the location. You can see
20 on the exhibit there is a northeast-to-southwest line.
21 That's a pipeline. We are precluded from being in the
22 right-of-way for the pipeline, so based upon the topography
23 limitation and the geology, Concho wants approval to move
24 to the west.

25 The interests to be pooled, I forgot the exact

1 percentage, but Mr. Mike Gray, the landman for Concho --
2 It's 8 percent, give or take. He has, with the assistance
3 of other Concho landmen, gone through a substantial effort
4 to get those parties to voluntarily join. So in that sense
5 it's a conventional pooling case.

6 What is unusual about it is, we've chosen this
7 opportunity to discuss with you, Mr. Catanach, and you, Mr.
8 Brooks, the possibility of including subsequent operation
9 language, and we've used as a starting point the Division
10 order issued recently in the Yates pooling case. Mr. Gray
11 and I have participated on behalf of his company and the
12 industry in a committee process that went on for some time
13 under the chairmanship of prior Division staff attorneys.

14 So with Mr. Gray's expertise we would like to
15 have a more informal discussion with you as we move into
16 that process, and we have an outline where we can compare
17 the points of the Yates order and give you some suggestions
18 on some possible areas that you might want to consider
19 making further changes to integrate the concept of a force
20 pooling order that has subsequent operating provisions and
21 how those provisions are consistent with or different from
22 what the parties to the voluntary agreement agree to do.

23 MR. BROOKS: Mr. Kellahin, can I interrupt on
24 that point? You have in this package or elsewhere copies
25 of those orders?

1 MR. KELLAHIN: Yes, sir, we do.

2 MR. BROOKS: Okay, I was going to say, it would
3 be helpful to have both the committee draft, the work group
4 draft and the Yates order in front of us.

5 MR. KELLAHIN: We have those, sir.

6 MR. BROOKS: Okay, thanks.

7 MR. KELLAHIN: All right, if I may proceed then,
8 Mr. Catanach.

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

12 DIRECT EXAMINATION

13 BY MR. KELLAHIN:

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

16 A. Michael M. Gray, I'm a landman for Concho Oil and
17 Gas Corp in Midland, Texas.

18 Q. On prior occasions, Mr. Gray, have you testified
19 before the Division and qualified as an expert petroleum
20 landman?

21 A. Yes.

22 Q. As part of your responsibilities for your company
23 as a landman, are you familiar with the ownership of the
24 interest involved in the spacing unit?

25 A. Yes.

1 Q. And have you and others been responsible on
2 behalf of Concho for an attempt to consolidate on a
3 voluntary basis those interest owners?

4 A. Yes.

5 MR. KELLAHIN: We tender Mr. Gray as an expert
6 witness.

7 EXAMINER CATANACH: Mr. Gray is so qualified.

8 Q. (By Mr. Kellahin) Mr. Gray, let's turn to the
9 first series of exhibits and have you take a moment and
10 identify for us what is marked as Concho Exhibit A Number
11 1.

12 A. Exhibit A Number 1 is a locator map showing the
13 320-acre unit to be dedicated to our well in the northwest
14 two-thirds of Section 6, which is an elongated section in
15 Township 16 South, Range 34 East.

16 Q. We're dealing with an irregular section when we
17 look at the ownership of Section 6, are we not?

18 A. That's correct.

19 Q. All right. We'll attempt to identify these by
20 lot numbers as we move through the exhibits. I want to
21 show you for a moment the Division docket in Case 12,775 so
22 that you will have before you the numbers associated with
23 the various size spacing units. The primary objective is
24 to configure a 320-acre spacing unit or acreage as close as
25 you can to achieve that number for purposes of drilling a

1 deep gas well, correct?

2 A. That's true.

3 Q. All right, let's turn to Exhibit Number 2. When
4 we look at Exhibit Number A-2, Mr. Gray, what are we
5 looking at?

6 A. Exhibit A-2 is a location plat, again depicting
7 the 320-acre unit with the dimensions of the -- or the
8 dimensions of the location from the obstructing pipeline
9 and the property line between Lots 11 and 12.

10 It also has a list of the ownership within the
11 unit as to the Lots 3, 4, 5 and 6, which would be the north
12 half, and Lots 11, 12, 13 and 14, which would be the south
13 half of the unit.

14 Q. When we look back at the Division advertised
15 docket, it indicates that the mathematical total of the
16 lots to be assigned to the 320-acre spacing units is, in
17 fact, 298.36 acres?

18 A. That's correct.

19 Q. Is that your best effort to consolidate an
20 acreage configuration that matches 320 acres?

21 A. Yes, sir.

22 Q. To the best of your knowledge, are there any
23 other 320-acre spacing units dedicated to existing
24 producing wells in Section 6?

25 A. No.

1 Q. Okay, so it's now open for a choice as to how the
2 acreage is configured?

3 A. That's correct.

4 Q. If we use this configuration, is there any
5 difference in the ownership between the drill site tract,
6 Lot 11, and the adjoining tracts 12 and 13, towards whom
7 the well encroaches?

8 A. No, the interest in those lots are common.

9 Q. When we look in the bottom half of the tabulation
10 or the Exhibit Number A-2, Mr. Gray, what is set forth
11 there?

12 A. That's the percentage ownership of each of the
13 leasehold owners in the unit as a whole, as depicted,
14 again, as Lots 3, 4, 5 and 6, as one group of -- as one
15 separate group of owners, and Lots 11, 12, 13 and 14 as
16 another group of owners.

17 Q. All right. For purposes of convenience, I am
18 going to refer to Lots 3, 4, 5 and 6 as the northwest
19 quarter equivalent, and then the ownership in Lots 11
20 through 14 as the southwest quarter equivalent for the
21 spacing unit.

22 A. Okay.

23 Q. When we look at the southwest quarter equivalent,
24 you have a tabulation on the right side of the display?

25 A. Yes.

1 Q. That represents what as to that portion of the
2 spacing unit?

3 A. That represents all of the owners of the
4 leasehold in the southwest quarter.

5 Q. So if this is a deep gas spacing unit, you'll
6 have to do some additional math to consolidate the
7 percentage?

8 A. That's correct.

9 Q. In fact, you just divide everything by half?

10 A. Yes.

11 Q. All right. Let's turn to Exhibit Number A-3, and
12 identify for me what that is.

13 A. Exhibit A-3 is the drilling permit for the well
14 which was issued by the OCD.

15 Q. All right. Let's turn through A-3 and find the
16 locator exhibit. You should find a C-102 at the second
17 page; is that not true?

18 A. The -- the --

19 Q. There you go.

20 A. Yes.

21 Q. Okay. And the well has been staked and located
22 and approved to the best of your knowledge at this point?

23 A. Yes.

24 Q. All right. Let's turn past Exhibit A-3, then,
25 and let me have you address the limitations on surface use

1 placed upon the spacing unit because of the presence of
2 this pipeline.

3 A. The pipeline, which is clearly marked on Exhibit
4 A-2 and is also marked on the top map attached to the
5 permit -- the fourth page of the permit, the location
6 verification map -- is -- Exhibit A-4 is a letter from the
7 operator of that pipeline company, Natural Gas Pipeline
8 Company of America, advising us to -- that they do not wish
9 us to build or trespass on their pipeline right of way with
10 our pad. This is a major transportation line for Natural
11 Gas Pipeline Corporation, and they were very concerned
12 about us doing any construction on their right of way.

13 Q. Have you communicated that information to the
14 technical people with Concho that make the decision about
15 where to locate the well?

16 A. Yes.

17 Q. And you have, to the best of your knowledge,
18 adjusted the pad and the well location farther west to
19 avoid conflict with the pipeline easement?

20 A. Yes.

21 Q. Let's turn now to a different chapter, Mr. Gray.
22 Let's talk about Concho's efforts to consolidate any
23 working interest ownership or unleased mineral ownership in
24 the spacing unit that has not reached a voluntary agreement
25 with you. When we look at the tabulation, Exhibit A-2 --

1 A. Yes.

2 Q. -- can you identify for us on this exhibit how we
3 might find the interest owners for which you're seeking to
4 have a force pooling --

5 A. Well, I can tell you who the interest owners
6 are.

7 Q. All right, sir.

8 A. In the left -- Well, let's see, let's do it in
9 the right-hand column, which the Lots 11, 12, 13 and 14,
10 Larry Hunnicutt, Frank Holtemann, B&P Resources, Inc.,
11 William J. Rome, George B. Rome, Linda L. Tuggle, William
12 G. Kluck and Nancy Kluck, Robert D.L. Gardiner, Rodney A.
13 Weary, John C. Cory, Avalon Petroleum Company, and an
14 unnamed party representing several of these previously
15 mentioned parties, which is TrinAca Investment Corporation.

16 Q. All right. To make this clear, Mr. Gray, let me
17 have you take out of order the certificate of notice of
18 hearing, which will be the very last display in the package
19 of exhibits. It's marked A-16.

20 A. Yes.

21 Q. If you'll turn past the certificate, turn past
22 the notice letter, there's an Exhibit A attached to that.

23 A. Yes.

24 Q. It's a two-page exhibit?

25 A. Yes.

1 Q. When we look at the first two entries --

2 A. Yes.

3 Q. -- the Holtemann and the Hunnicutt interest, they
4 are separate from the ownership group on the balance of
5 Exhibit A, correct?

6 A. That's correct.

7 Q. And when we look at the balance of that ownership
8 group -- for convenience let's call it TrinAca -- Is that
9 how you say it?

10 A. TrinAca. I don't know how you say it, yes.

11 Q. We'll call it TrinAca.

12 A. All right.

13 Q. All right, what was -- Who is the principal with
14 TrinAca that you and others with Concho have been dealing?

15 A. Jeff Ramsey.

16 Q. Let's turn to Exhibit A-5 now. Exhibit A-5
17 represents what?

18 A. Exhibit A-5 represents a letter from Jeff Ramsey
19 with TrinAca, with an unexecuted assignment attached
20 indicating that the parties named in the assignment will be
21 the owners of these particular leases, rather than TrinAca.

22 Q. Your search of information concerning the
23 ownership of the spacing unit led you to Mr. Ramsey?

24 A. Yes.

25 Q. Because -- Why?

1 A. The record title was in TrinAca Investment
2 Corporation.

3 Q. As part of that process, then, you contacted
4 TrinAca and became familiar with the name Jeff Ramsey?

5 A. Yes.

6 Q. Mr. Ramsey represented to you what?

7 A. That TrinAca was a holding company, holding these
8 interests on behalf of the parties on the Exhibit A, below
9 Larry Hunnicutt, the group we're talking -- the TrinAca
10 group.

11 Q. Did Mr. Ramsey negotiate on behalf of this
12 ownership group for their participation or lack of
13 participation in this spacing unit for the proposed well?

14 A. Yes.

15 Q. When we look at Exhibit A-5, what is attached to
16 Exhibit A-5?

17 A. The attachment to Exhibit A-5 is an assignment of
18 contract and oil and gas operating rights from TrinAca to
19 the TrinAca group of investors.

20 Q. All right. Mr. Ramsey represented to you that
21 this was a document that was going to be fully executed,
22 signed and recorded?

23 A. Yes.

24 Q. All right, let's turn past that exhibit for the
25 moment, and let's come back and talk about your efforts

1 with regards to the two parties that are not associated

2 with TrinAca, starting with Mr. Frank Holtemann. If you'll
3 turn to Exhibit A-6, what does this represent?

4 A. Exhibit A-6 is a copy of the letter presenting
5 the initial well proposal to Mr. Holtemann, which also had
6 attached to it the authority for expenditure.

7 Q. All right. We'll come to the AFE in a moment as
8 a subsequent exhibit, Mr. Gray.

9 Am I correct in understanding that August 2nd is
10 the first formal proposal in writing by Concho to the
11 various interest owners, including Mr. Holtemann?

12 A. Yes.

13 Q. And similar letters went out to all the interest
14 owners that you were aware of?

15 A. That's correct.

16 Q. And it included an AFE?

17 A. (Nods)

18 Q. All right. What response did you have from Mr.
19 Holtemann concerning Concho's well proposal?

20 A. In Mr. Holtemann's case, as is evidenced by his
21 writing on the bottom of Exhibit A-6, he elected not to
22 participate in the drilling of the well.

23 Q. All right, sir. I'm going to take these a little
24 out of order because I miscollated them. If you'll turn to
25 Exhibit A-9, we will deal with Mr. Larry Hunnicutt's

1 interest, if you'll just pull that out in turn there, Mr.
2 Gray.

3 On August 13th, did representatives of Concho
4 communicate in writing a well proposal, including an AFE
5 for this well, to Mr. Hunnicutt?

6 A. Yes.

7 Q. To the best of your knowledge, what if any
8 response have you received from Mr. Hunnicutt concerning
9 the proposal?

10 A. Mr. Hunnicutt has indicated a desire not to
11 participate in the drilling of the well.

12 Q. All right, let's come back now and deal with the
13 TrinAca interest and come back and pick up Exhibit A-7 and
14 A-8. What do these represent? In fact, they're the same
15 letter, aren't they?

16 A. Yes.

17 Q. It was getting late last night, Mr. Gray, so
18 they're the same letter. Were similar letters sent to all
19 the TrinAca Investment group?

20 A. Yes, and I believe those letters are in this
21 package as Exhibit A-10.

22 Q. All right. So when we look at these letters in
23 total, then, to the best of your knowledge you have sent
24 notice through TrinAca to each of the investors that
25 they've represented to you would have the interest in the

1 spacing unit and the opportunity to make choices?

2 A. That's correct.

3 Q. All right, let's turn to Exhibit A-11. This is
4 an AFE dated July of this year?

5 A. Yes.

6 Q. What does this represent?

7 A. This is the AFE that was submitted to the working
8 interest -- or to the leasehold owners, along with the
9 letters that we talked about in Exhibit A-6 through A-10.

10 Q. Have you had communications and conversations, or
11 conversations, with Mr. Ramsey concerning these interests?

12 A. Yes.

13 Q. At this point in time, as of today's hearing, do
14 you have written, signed AFEs from any of the TrinAca
15 interest owners?

16 A. No.

17 Q. Do you have their signature on a proposed
18 operating agreement?

19 A. No.

20 Q. So at this point you're proposing to include
21 TrinAca and all of the participants in that interest, to
22 have them included in a pooling order, and that, if you're
23 able to reach an agreement, will simply exclude them?

24 A. Yes.

25 Q. Let's turn to the change now in the AFE.

1 A. Okay.

2 Q. We've looked at A-11. Let's look at A-12, and
3 tell me what that is.

4 A. A-12 is an AFE dated October 19, 2001, which was
5 prepared because the July 16th -- Exhibit 11, the July 16
6 AFE, had gotten a little age on it, and we prepared a new
7 AFE which represented the change in drilling cost from July
8 to October.

9 Q. It appears that the October change has resulted
10 in a total well cost that is less than originally proposed
11 in July?

12 A. That's correct.

13 Q. Did you communicate this change to all the
14 parties that you were attempting to get voluntary agreement
15 with?

16 A. Yes, we communicated it to all of those parties
17 and all of the parties we already had the voluntary
18 agreement with.

19 Q. All right, sir. Turn with me to Exhibit A-13.
20 What does this letter of November 19th represent?

21 A. Exhibit A-13 actually relates to the unorthodox
22 location. There were some parties that acquired a
23 leasehold interest, or that we learned had acquired a
24 leasehold interest in these properties after the notices
25 have been sent out, and it's a letter whereby those parties

1 have waived objection to our unorthodox location.

2 Q. Am I correct in understanding that the owners of
3 the drill-site tract, Lot 11 --

4 A. Yes.

5 Q. -- are the same owners towards whom the well
6 encroaches in Lots 12 and 13?

7 A. That's correct.

8 Q. To the best of your knowledge, have any of those
9 owners objected as to the well location?

10 A. No. In fact, they -- All of the parties except
11 for the parties being pooled have executed an operating
12 agreement agreeing to that location.

13 Q. Turn to Exhibit A-14 with me, Mr. Gray, and
14 identify that.

15 A. Exhibit A-14 is a letter from Concho Oil and Gas
16 Corp. to TrinAca investments and to Mr. Jeff Ramsey with --
17 reissuing or rescinding the operating agreements which have
18 been previously sent to him and requesting that his
19 investors or the people that he represented execute the
20 operating agreements and the AFE and return them if they
21 desire to participate in a well.

22 Q. All right, sir. And then let's turn to Exhibit
23 A-15 and have you identify and describe what this exhibit
24 is.

25 A. Exhibit A-15 is a letter to all of the

1 uncommitted working interest owners, submitting the revised
2 authority for expenditure that was dated October 19th.

3 Q. As part of this written submittal, did you
4 specifically include AFEs that had information on the
5 bottom of the AFE that allowed that interest owner to know
6 what you thought his percentage was so he could calculate
7 what his share of the cost would be?

8 A. That's correct.

9 Q. Finally, let's come back to A-16, which is the
10 certificate of mailing. We've talked about the parties to
11 be pooled. If you'll turn midway back, there is an Exhibit
12 B --

13 A. I'm sorry, which exhibit, Tom?

14 Q. It's Exhibit A-16. If you'll turn halfway back,
15 there is an exhibit attached as B.

16 A. Yes.

17 Q. To the best of your knowledge, do those parties
18 listed represent the interest owners in the two lots
19 towards whom this well encroaches?

20 A. Yes.

21 Q. Okay.

22 A. With the exception of the parties that executed
23 the waiver, dated -- whichever exhibit that was, the
24 parties that we learned about after the notices had been
25 sent.

1 MR. KELLAHIN: All right. Let me turn to a
2 different topic now, and it's what I mentioned in my
3 opening comments was an opportunity for you and me to
4 discuss with the Division possible changes to the
5 compulsory pooling order issued in the Yates case so that
6 you could comment on suggested changes or inform the
7 Division as to what you understand the process is. So let
8 me take a moment and distribute that additional
9 information.

10 Mr. Brooks, what I have distributed as Exhibit
11 A-17, which is the operating agreement that Concho has
12 chosen to utilize for this particular well.

13 Exhibit A-18, for convenience, is a copy of the
14 Yates order that was entered by the Division in September,
15 in which the Division incorporates at Yates' request
16 certain portions of Article VI of their operating
17 agreement.

18 Exhibit A-19 is Mr. Gray and my effort to give
19 you a checklist so that we could look at the operating
20 agreement, compare it to the Yates order, and you would
21 have a written summary of our suggestions and comments.

22 In addition, while I have not marked it as an
23 exhibit, there is a letter I've given you over Mr. Steve
24 Smith's signature from EOG, and it represents, as Mr. Gray
25 will tell you, an effort by a substantial number of expert

1 petroleum landmen associated with this process. You may
2 remember from looking at that, that Mr. Smith is dealing
3 only with the concept of how you handle the infill well in
4 a 320-acre deep gas spacing unit.

5 MR. BROOKS: Right.

6 MR. KELLAHIN: So that process involved a certain
7 portion of what has been incorporated into the Yates order.

8 In addition, Mr. Gray and I would like to comment
9 on other things, but for your information we do have that.

10 Q. (By Mr. Kellahin) With that introduction, then,
11 let me have Mr. Gray lead us through some of these talking
12 points, starting first of all with having you identify
13 Exhibit A-17, Mr. Gray. What are we looking at?

14 A. Exhibit A-17 is the operating agreement for the
15 drilling of the subject well that has been voluntarily
16 entered into by all of the parties except the uncommitted
17 parties that we're pooling.

18 Q. For the record, what draft or what form of the
19 model form operating agreement is Concho proposing to
20 utilize for this well?

21 A. This is an AAPL Form 610 1982 operating
22 agreement.

23 Q. This is the 1982 form?

24 A. Yes.

25 Q. All right. Have you participated on behalf of

1 your company in various study groups or working groups to
2 talk about recommendations to the Division concerning how
3 to modify the compulsory pooling order to take into
4 consideration certain procedures or processes that take
5 place among the voluntary owners under a joint operating
6 agreement?

7 A. Yes.

8 Q. In addition, have you reviewed the Yates
9 Petroleum Order R-11,645?

10 A. Yes.

11 Q. And have you and I prepared Exhibit A-19 for
12 discussion this morning?

13 A. Yes.

14 Q. All right, sir. Let's start with A-19, and
15 address the first portion.

16 A. The first recommendation is a recommendation that
17 the pooling order or pooling orders in general contain a
18 list of the parties that are -- a list of the pooled
19 parties and in a certification so that it can be recorded
20 in the county in which the well is located, to put people
21 on notice of the order and of the parties that have been
22 named in the pooling.

23 Q. Currently are you aware of any requirement that a
24 pooling order be filed of record?

25 A. I don't know that there -- I don't know of one.

1 Q. Have you and title attorneys examining spacing
2 units encountered difficulty in determining if any of the
3 interests are subject to compulsory pooling orders for any
4 particular well or spacing unit?

5 A. Yes.

6 Q. Would this help resolve that problem?

7 A. Yes, it sure would.

8 Q. Let's turn to a question of definition. If
9 you'll turn to the Yates order, turn to page 3, let's look
10 at Finding Number (9). I want to make sure that you and I
11 are clear on what we're talking about when we're -- want
12 that population of interest owners who have not agreed to a
13 joint operating agreement, have been force pooled and have
14 failed to become voluntary owners or committed owners under
15 the pooling owner.

16 So we're dealing with that group that is
17 uncommitted working interest owners or mineral owners that
18 have failed either to join voluntarily or make elections
19 under the pooling order. All right?

20 A. Yes.

21 Q. Okay. The suggestion for number 5 is what, sir?
22 I'm sorry, for Finding (9)?

23 A. For Finding (9) is that the definition of
24 nonconsenting working interest owners be defined as those
25 parties who failed to elect pursuant to the pooling order.

1 MR. KELLAHIN: All right. Mr. Brooks, we're
2 suggesting that subject to your review, that there may be
3 some ambiguity here or opportunity for difference about
4 exactly identifying this category. If you're satisfied
5 this is good enough, then our comments are not necessary.

6 MR. BROOKS: Well, I may want to get into that,
7 but I was following the usual OCD etiquette of allowing you
8 to make your presentation --

9 MR. KELLAHIN: All right, sir.

10 MR. BROOKS: -- with the idea that I would
11 question later, which is whatever, you know, what is most
12 expedient in getting this done. If you would like me to
13 discuss it paragraph by paragraph, I wouldn't mind.

14 MR. KELLAHIN: It's certainly your choice, Mr.
15 Brooks, as to how you want us to proceed. But that sort of
16 ends our comments on our desire to make sure that we're all
17 clear on what category of interest owner is being affected
18 by these subsequent choices.

19 MR. BROOKS: Right.

20 Q. (By Mr. Kellahin) Let's go to Finding (12), Mr.
21 Gray. The Division practice, as you are aware, is to
22 require Concho and others to bring technical personnel to a
23 hearing like this and to present geologic or engineering
24 support to justify the 200-percent penalty. You have
25 participated in past hearings concerning that issue, have

1 you not?

2 A. Yes, I have.

3 Q. Are you aware of any instance where your company
4 or others have been awarded less than the maximum penalty
5 for a well that has not yet been drilled?

6 A. No, sir.

7 Q. Do you have a recommendation for the Division as
8 to how they might change that procedure?

9 A. Inasmuch as, since it's uncommon, or so uncommon
10 to provide for a penalty less than 200 percent, it would
11 seem to be an essential thing to do from the standpoint of
12 the industry and of the Division, to save time and effort,
13 to make the 200-percent penalty automatic, unless one of --
14 the pooled party files for an appearance to argue
15 otherwise.

16 Q. All right, let's move past that suggestion, and
17 let's talk about what I think is one of the first
18 substantive issues. So let's have a clear understanding of
19 what you think the Yates order does.

20 If you'll turn to Exhibit Number A-19, which is
21 our comment section, if you'll look at Finding Number (18)
22 and relate to the Division your comments and observations
23 about what you think the Division order does.

24 A. The Yates order, the way I read it, it does
25 appear that the entire unit is pooled in the Yates order,

1 rather than just the wellbore, which had, I think, been
2 more common in Division practice before.

3 Q. In addition, what else do you find in Finding
4 (18)?

5 A. The order provides that the unit will have a
6 single operator, which is -- I guess has not ever been made
7 absolutely clear in the past, that a nonconsenting working
8 interest owner may propose operations -- subsequent
9 operations for the drilling of the new well, and in this
10 particular order it provides the nonconsenting working
11 interest owner to be able to propose operations in the
12 existing -- in the wellbore in which they went nonconsent.
13 And the -- I think that's pretty much what that finding
14 says.

15 Q. All right, sir. Let's deal with the additional
16 well. Let's start with what we call the parent well or the
17 initial well.

18 A. Uh-huh.

19 Q. If you and Concho proposed the initial well, such
20 as the one we have here --

21 A. Yes.

22 Q. -- is it your understanding that the Yates order
23 will provide pooled parties an election on that initial
24 well?

25 A. It's my understanding, the way I read the order,

1 is that the nonparticipating pooled parties would have an
2 election to participate in the initial well --

3 Q. All right.

4 A. -- or not.

5 Q. Okay, that's consistent with current practice, is
6 it not?

7 A. Yes, that's correct.

8 Q. When we deal with an operating agreement, there
9 is no such concept within an operating agreement on the
10 initial well, correct?

11 A. In the standard operating agreement, since it's a
12 voluntary agreement to agree to drill a well, it's not --
13 there's nothing contemplated in the standard operating
14 agreement that one would not participate in the initial
15 well.

16 Q. So in order to make the connect, you have to take
17 the operating agreement, look at the subsequent operation
18 provisions under Article VI --

19 A. Yes.

20 Q. -- for operations on the initial well subsequent
21 to drilling, or additional wells, and apply the appropriate
22 portions to the pooling order for those nonconsenting
23 parties on the initial well?

24 A. I think that's the only way you can do it, yes.

25 Q. And that's what Yates' order attempts to do?

1 A. Yes.

2 Q. When we look at some of the elections now, in
3 addition to making an election on the initial well, does
4 the order allow a pooled party that's not committed to make
5 additional elections on that initial wellbore?

6 A. The way I read the Yates order, the
7 nonparticipating pooled parties would be allowed a new
8 election for every recompletion in the initial wellbore,
9 even prior to the recovery of the cost of the wellbore and
10 the -- the penalty or even 100 percent of the cost of the
11 wellbore, that an election would be given to the
12 nonparticipating pooled parties to participate in plugbacks
13 or recompletions of the well.

14 Q. Okay, let's take that concept, move it to the
15 joint operating agreement for subsequent operations after
16 the initial well. Can a voluntary party under an operating
17 agreement make -- or is he afforded additional elections on
18 the wellbore for which he's gone nonconsent?

19 A. In the operating agreement that we're discussing,
20 the operations-by-less-than-all-parties provision, provides
21 that a party not participating in the drilling of a well is
22 not to participate in plugbacks, reworks, recompletions
23 until the participating parties have recovered the entire
24 amount allowed under the operating agreement, which in this
25 operating is 400 percent.

1 Q. Am I correct in understanding your position, then
2 that a party pooled going nonconsent under this pooling
3 order, for Yates, has additional elections in the pooled
4 wellbore that would not be afforded to the voluntary
5 parties under a joint operating agreement?

6 A. Yes, that's correct. In fact, I think in the
7 Yates order, the nonparticipating pooled parties have the
8 ability to elect to participate in plugbacks and
9 recompletions in a well that hasn't even recovered its
10 initial cost, much less the 200-percent penalty.

11 Q. Let's take a moment and skip to how the cost
12 allocation is handled. If you'll go to the Yates order,
13 let's turn to page 7, look at Finding (20) at the bottom of
14 page 7, and you'll find that the allocation of production
15 to cost is subdivided into two categories. Category (a)
16 has to do with whether or not production from another well
17 can be applied to pay for the costs of the initial pooled
18 well. That would be one example, correct?

19 A. Yes.

20 Q. All right. What happens under an operating
21 agreement where you have parties that are the same in two
22 wells? Part of those parties go nonconsent on the first
23 well, and some of them go nonconsent on the second well.
24 Can you take production from the second well and apply it
25 to pay for costs on the first well?

1 A. No, you can only take production from the
2 wellbore itself.

3 Q. So (12) (a) [sic] is consistent with industry
4 practice under an operating agreement?

5 A. That's correct.

6 Q. Let's turn to (20) (b). (20) (b) says that in
7 that same wellbore, if you have costs associated, for
8 example, in the Morrow --

9 A. Yes.

10 Q. -- and you only have production from, say, the
11 Atoka --

12 A. Yes.

13 Q. -- in that wellbore you are precluded from taking
14 a token production applying to Morrow costs? Did I read
15 that right?

16 A. In paragraph (20) (b) I think that's correct.

17 Q. Okay. Is that consistent with industry practice
18 under a joint operating agreement?

19 A. No, sir, it's not.

20 Q. Do you have a recommendation as to a paragraph
21 contained within your operating agreement that solves that
22 issue?

23 A. Yes, on page 6 of the operating agreement,
24 beginning with line 28, that particular paragraph, I think,
25 sets forth what we believe would be an equitable treatment

1 of the participating and nonparticipating parties in an
2 operating agreement.

3 Q. Okay, you've got two issues going on here. One
4 issue is whether or not a pooled party gets what I
5 characterized a split-depth election where they could
6 apportion their election between consenting in the Morrow,
7 for example, and nonconsent -- nonconsent in the Morrow and
8 consent in the Atoka. Is that permitted under the
9 operating agreement?

10 A. No, it's not.

11 Q. In addition, the cost allocation between
12 production is allowed to be commingled and paid, the way we
13 just --

14 A. The cost allocation is on a wellbore basis in the
15 operating agreement.

16 Q. Do you have a recommendation as to the first
17 issue, as to whether or not a pooled party should be able
18 to split his election?

19 A. I think it is unfair to the participating parties
20 for a nonparticipating pooled party to be able to elect
21 after the fact, after a well has been drilled, as to
22 whether or not to participate in uphole zones as they are
23 recompleted before the cost recovery allowed under the
24 pooling order.

25 Q. We've addressed the cost allocation issue in (20)

1 (b). Let's come back to Finding (18) and talk about the
2 election. If you'll turn to the Yates order, let's look at
3 Paragraph 18 --

4 MR. BROOKS: -- Yates order, okay.

5 MR. KELLAHIN: In the Yates order it's on the
6 bottom of page 4. Finding (18) is the concept.

7 MR. BROOKS: Okay.

8 Q. (By Mr. Kellahin) Under 18, Mr. Gray, is it your
9 understanding that if you were the operator under the Yates
10 order, and if you had drilled the initial well to the
11 Morrow, were unsuccessful and desired to recomplete at a
12 shallower depth, that this provision obligates you to send
13 a new notice and afford additional election to the party
14 that was pooled and went nonconsent on that wellbore?

15 A. Yes.

16 Q. And that is inconsistent with industry practice,
17 is it not?

18 A. Yes, it is.

19 Q. Do we have a portion of Article VI that you can
20 direct Mr. Brooks' attention to, that resolves that in a
21 manner that's consistent?

22 A. Yes. Again, it's -- I think you're referring to
23 the paragraph on page 6, beginning on line 28.

24 Q. Yes, sir. In addition, I wanted to direct your
25 attention not only to lines 28 through -- I believe it's

1 line 33 -- but up to lines 2 through 8 on that same page.

2 A. Yes, lines 2 through 8 deal with the same issue.

3 Q. The complexity of the language is even amazing
4 for an attorney that's supposed to understand that; but the
5 concept is, you can take production in that wellbore, apply
6 it to the cost of another zone and, subject to certain
7 conditions, do that?

8 A. Yes, during the recoupment period of the
9 nonconsent penalty.

10 Q. Okay, let's turn now to a different chapter.
11 Let's talk about how the Yates order handles the issue of
12 the risk factor penalty, okay? If you'll turn with me --
13 Turn to page 6 of the Yates order. If you look at the
14 first full paragraph, and if you read down to halfway in
15 that paragraph, the Division sets forth a process where the
16 nonconsenting interest owner is notified of his election
17 for subsequent operations and, in addition, afforded the
18 opportunity to register an objection and require a hearing
19 to adjust the risk factor penalty. Do you see that?

20 A. Yes.

21 Q. Is that not what this does?

22 A. Yes.

23 Q. Okay. What is your recommendation to the
24 Division concerning resolution of this issue? Let's assume
25 you drilled the parent well subject to this pooling order,

1 that you have pooled on a unit concept and you now propose
2 the infill well. And the parties to be pooled will get an
3 election on the second well, true?

4 A. That's correct.

5 Q. So the election on the first doesn't constitute
6 an election on the second?

7 A. That's correct.

8 Q. All right. So you get an election on the second.
9 This order allows those parties to also contest the 200-
10 percent risk factor?

11 A. Yes.

12 Q. Okay. Do you have a recommendation as to whether
13 that practice ought to be maintained in the pooling orders?

14 A. I think my preference -- and I think it would be
15 better if the Division's orders were more consistent with
16 the operating agreement, which continues to apply the same
17 nonconsent penalty throughout the agreement, regardless of
18 what the proposal is.

19 Q. All right, let's talk about that. If I'm
20 committed under an operating agreement and I choose not to
21 participate in the second well under subsequent operations,
22 and I have knowledge about the results of the first well,
23 does the operating agreement provide a mechanism where my
24 penalty is reduced?

25 A. No.

1 Q. The penalty under your proposed operating
2 agreement is 400 percent?

3 A. Yes.

4 Q. And the statutory maximum for the Division is
5 cost plus 200?

6 A. That's correct.

7 Q. All right. Do you think a party pooled and
8 making elections under a pooling order for a subsequent
9 well ought to, in addition, have the opportunity to have
10 the risk factor adjusted?

11 A. I think from the standpoint of equity, it is
12 inequitable for the nonparticipating party to gain the
13 advantage of the risk taken by the participating parties in
14 the first well, to then not participate in the second well
15 and suffer less of a risk factor than was applied to the
16 first well.

17 Q. All right. Do you and others share the opinion
18 that the Division in the pooling process ought to encourage
19 people to reach voluntary agreement?

20 A. Yes.

21 Q. Does the Yates order, the way it currently
22 stands, encourage that process?

23 A. I think the Yates order is a great advantage to
24 the nonparticipating party in -- over and above -- a great
25 advantage relative to the industry practice set forth in

1 the standard joint operating agreement.

2 MR. KELLAHIN: That concludes my questions of Mr.
3 Gray.

4 We would at this time, Mr. Examiner, move the
5 introduction of Conoco Exhibits A-1 through A-19.

6 EXAMINER CATANACH: Exhibits A-1 through A-19
7 will be admitted as evidence.

8 EXAMINATION

9 BY MR. BROOKS:

10 Q. Okay. First of all, let's just go over the nuts
11 and bolts here and make sure I have things right. I have
12 not looked at the Application, and there are a couple of
13 things you didn't comment on, but what formations are being
14 pooled? What is the vertical interval?

15 A. The deepest interval is the Morrow formation.

16 Q. So you're going to the base of the Morrow?

17 A. Yes, sir.

18 Q. Are you going from surface?

19 A. Yes, sir.

20 Q. Okay. And if you're familiar with the way we
21 write our orders -- and I assume you are -- we need to take
22 care of the various sizes of units that may be encountered
23 in this vertical interval --

24 A. Yes.

25 Q. -- so what would those be?

1 A. The Morrow and Atoka would be on 320-acre
2 spacing.

3 Q. Okay, and those are gas, right?

4 A. Yes, sir.

5 Q. And the -- what other --

6 A. The other objectives are the -- primary
7 objectives are the Strawn and the Wolfcamp, which in this
8 area would be on 40-acre spacing.

9 Q. And would those be oil?

10 A. Yes, sir.

11 Q. Okay.

12 A. More than likely. You know, you never know for
13 sure, but --

14 Q. Yeah. Is there anything in between?

15 A. Not that we expect to encounter.

16 Q. Okay, so -- but would you request our pooling
17 order include any other size units or --

18 A. Yes, sir.

19 Q. Okay. What would they be?

20 A. They would be any 160-acre units.

21 Q. How would you configure a 160-acre --

22 A. That would be what Tom called the southwest
23 quarter, which is actually Lots 11, 12, 13 and 14.

24 Q. It would be the west central quarter?

25 A. Yes, sir. You kind have to describe them by lots

1 to get them right because it's --

2 Q. Right. Well, I know you do when you're writing
3 the order --

4 A. Yeah --

5 Q. -- but I think --

6 A. -- right --

7 Q. -- I think you --

8 A. -- okay --

9 Q. -- understand what I'm saying.

10 A. -- yes.

11 Q. The south half of the proposed unit --

12 A. Yes.

13 Q. -- would be for 160 --

14 A. And -- Yes, and then the -- Lots 11 and 12, which
15 would be the east half of the south half of the proposed
16 unit, would be an 80-acre spacing unit in the event that
17 happened to occur.

18 Q. And Lot 11 would be a 40.

19 A. And 11 would be the 40, yes, sir.

20 Q. Okay, the actual acreage for this unit is 292.36
21 acres?

22 A. I think it's a little bigger than -- I was
23 thinking it was 298, but I've got to look at that.

24 Q. Well, I wasn't sure I got --

25 A. Yeah, 298.36 acres.

1 Q. 298.36. And what is the actual acreage of Lot
2 11?

3 A. 40 acres.

4 Q. It is 40?

5 A. Yes, sir.

6 Q. Okay. Is this in any designated pools or --

7 A. It's within the boundaries of -- or it's within a
8 mile of -- Let's see, the Hume-Morrow Gas Pool.

9 Q. Hume?

10 A. H-u-m-e.

11 Q. Okay.

12 A. The Hume-Atoka Gas Pool, and the Kemnitz-Cisco
13 Pool.

14 Q. Kimets?

15 A. K-e-m- -- I'm sorry, K-e-m-n-i-t-z.

16 Q. K-e-m- --

17 A. -- -m-n-i-t-z.

18 Q. -- -m-n-i-t-z, Kemnitz-Cisco?

19 A. Yes, sir.

20 Q. And is that also 320, in the Cisco?

21 A. I think it's possibly 160s. To tell you the
22 truth, I'm not sure.

23 MR. KELLAHIN: I believe it's 160s, Mr. Brooks.

24 Q. (By Mr. Brooks) Okay. And what is the name of
25 your well? Oh, Big "D" State Number 1?

1 A. Yes, sir.

2 Q. Now, is this all state land, this --

3 A. Yes, this entire unit --

4 Q. I didn't see any --

5 A. -- is state.

6 Q. -- royalty owners on your list, so... Okay.

7 Did you make recommendation on the overhead
8 rates?

9 A. We didn't discuss that. What I'd like to have,
10 which is what our voluntary agreement has, is \$6000 for a
11 drilling well and \$600 a month operating expenses.

12 Q. Okay. And --

13 A. With the COPAS escalators.

14 Q. You're going to bottom this well in the Morrow,
15 you're not going to try to go below --

16 A. No, sir. There's -- It's always possible that
17 you could have some rathole --

18 Q. All right.

19 A. -- below the base of the Morrow, but --

20 Q. Sometimes they --

21 A. -- the base of the Morrow is our objective.

22 Q. From the testimony I've heard in a lot of these
23 cases, a lot of times they want to drill below the base
24 just to make sure they've gotten all the way through it.

25 A. Right.

1 MR. BROOKS: Okay. I believe those are the nuts-
2 and-bolts questions. Now I will move to the operating
3 agreement. Some of these concepts are a little slippery,
4 and the -- or I guess a little complex is what it is. I've
5 dealt with operating agreements for many years, but I've
6 never tried to sit down and work my way through all the
7 various alternatives, what could happen in every
8 permutation of circumstance, which is what you need to do
9 to write one of these orders.

10 And if it's acceptable to you, Mr. Examiner, I
11 would like, because of the nature of what we're doing here,
12 to be a little bit unorthodox. I mentioned to our Director
13 the other day that something the Commission did seemed a
14 little unjudicial. She said, Well, it was very
15 administrative. And I may be being more administrative
16 here. I would like to allow either the witness or counsel
17 to respond to these questions, because some of them, I
18 think, the witness may be more capable of responding, and
19 some of them Mr. Kellahin would be more capable of
20 responding to.

21 The first recommendation is to list the parties
22 pooled and their respective interests. Mr. Kellahin, I
23 think probably this is a question more directed to you.
24 What would be the legal effect, in your opinion, of
25 including such a list in the pooling order if it was wrong?

1 MR. KELLAHIN: Then you've made a mistake. But
2 then that's the Applicant's mistake, and not yours.

3 MR. BROOKS: Well, I agree with that. But
4 wouldn't it be very confusing -- wouldn't it really confuse
5 the issue for title examiners because they've got that list
6 there in front of them that the Commission has adopted, but
7 we know that -- the Division, but the Division doesn't have
8 any authority to communicate title? So it really doesn't
9 mean anything.

10 It's not notice, because it's subsequently filed
11 to anybody who has an interest at the time it's filed, and
12 subsequently filed instruments are not in the chain of
13 title.

14 MR. KELLAHIN: Here is my point of view. The
15 title examiner goes through a very precise process to
16 identify the parties to be pooled. In addition, the
17 applicant is obligated to go through a very precise process
18 to identify and send notice for due process reasons to the
19 parties to be pooled. And yet we have this language in the
20 ordering paragraph that says any interest owner. How can
21 you commit an interest owner that never got notice of the
22 pooling process and have a title examiner declare his
23 interest to be pooled if they were never told?

24 MR. BROOKS: That's an interesting question. And
25 of course, if the applicant knew of an interest owner and

1 didn't notify them, then that's a clear case. That's the
2 *Johnson* case, and the order doesn't apply to that interest.

3 But if there's an interest out there that nobody
4 knew about, notice was published as required by the
5 Division rules, then I think it's at least an open
6 question. But I'm speculating here.

7 MR. KELLAHIN: Well, if that's the purpose of
8 having that inclusive language --

9 MR. BROOKS: Yeah.

10 MR. KELLAHIN: -- I'm not sure it accomplishes
11 anything material, because you're really looking at the
12 people that are identified and known. If the title
13 examiner and the applicant have an unclaimed or unknown
14 percentage, it's their obligation to tell you. And so you
15 only pool only those parties that they know about. May not
16 be able to find them --

17 MR. BROOKS: Right.

18 MR. KELLAHIN: -- but you certainly can trace
19 them to some person or interest that has a name associated
20 with it, and you could pool it on that basis.

21 So if the only thing you're capturing in the
22 ordering provision is this global concept of some unknown
23 interest, I think it's flawed.

24 MR. BROOKS: Okay. Let's see, now, what is
25 addressed in (9).

1 Now, we've used this phrase nonconsenting working
2 interest owners, and I am aware of its lack of precision.
3 I've been reluctant to depart from it because it's been
4 used for years, but when you try to incorporate it into the
5 operating agreement you run into the problem.

6 But the way -- Well, I put in the definition of
7 nonconsenting working interest owner into the order,
8 because the form we'd been using before that did not have
9 any definition. And it works as long as you're dealing
10 with our standard order which provides for only one well,
11 and if they want to drill another well on the unit they
12 have to come in and get another proceeding to amend the
13 order.

14 I disagree with what the witness said, that our
15 standard order pools only the wellbore. I think that is
16 not correct. I think our standard order pools the unit,
17 but it provides no authorization -- contains no provisions
18 as to how an additional well in the unit is to be handled.

19 MR. KELLAHIN: And we've all struggled with that
20 issue.

21 MR. BROOKS: Right, that's what the purpose of
22 this work group, as I understand it -- Of course, it was
23 before I came here.

24 MR. KELLAHIN: The Yates order clearly does what
25 I think we all want it to do, is to make a declaration that

1 the pooling order is on a unit basis and then give us a
2 process to handle that.

3 MR. BROOKS: But we have to make, do we not, a
4 few more changes than what is suggested here, because the
5 phrase "nonconsenting working interest owner" as used in
6 the order is then used in the phraseo- -- as defined in the
7 order, is then used to identify those persons who will have
8 the initial election, which has the rather strange
9 consequence that a nonconsenting working interest owner, as
10 the term is used in our order, may in fact become a
11 consenting party as that term is used in the standard form
12 operating agreement if that nonconsenting working interest
13 owner elects to participate in the initial well, correct?

14 MR. KELLAHIN: I had understood precisely what
15 you were doing in the order, and you and I agree, but
16 that's only because you and I deal with this.

17 MR. BROOKS: Right.

18 MR. KELLAHIN: And I was raising this as a
19 possible opportunity for all of us to re-think how we're
20 defining this interest, and is there reason to further
21 define it? And so it was just more of a question than a
22 solution.

23 MR. BROOKS: I believe that you're correct, and I
24 believe that we ought to get away from using the phrase
25 "nonconsenting working interest owner" because I think

1 you're right, it's going to be confusing to people who are
2 familiar with the JOA and are not familiar with our form of
3 order. But again -- And I think it's somewhat confusing
4 even in our form of order, but I think we're going to have
5 to go a little beyond this, because we're going to have to
6 in some way, one, identify those class of people whom the
7 order gives an election, correct?

8 MR. KELLAHIN: Yes.

9 THE WITNESS: Uh-huh.

10 MR. BROOKS: And, two, separately identify those
11 people whom the order gives an election, who elect not to
12 participate.

13 THE WITNESS: Yes.

14 Q. (By Mr. Brooks) Have you had substantial
15 experience with force-pooled units in New Mexico?

16 A. Yes, sir, I've done a number of them.

17 Q. Have you seen -- Have you ever seen an instance
18 in which a force-pooled party elected to participate?

19 A. Oh, yes.

20 Q. I guess it would happen, because sometimes they
21 force-pool significant operators. I've seen a few.

22 A. There are generally not industry -- or what you
23 would call -- I would call -- a standard, run-of-the-mill
24 industry person likes to sign an operating agreement.

25 Q. Right.

1 A. There are people that don't like to sign them,
2 and they'll wait -- they'll join under a pooling order, or
3 they'll execute an AFE in which, in that case, I think the
4 Commission won't force-pool them once they've signed an
5 AFE.

6 So you've got -- which is maybe something we
7 ought to discuss, because in the case where a party signs
8 an AFE but no operating agreement, and therefore there's no
9 pooling proceeding against them, then you have all these
10 unanswered issues that we're discussing right here with
11 that party as well.

12 Q. But of course a party -- a working interest owner
13 gets a better deal by a force-pooling order with a 200-
14 percent penalty than is customary in operating agreements
15 signed these days?

16 A. I would say the 300-percent number is still
17 probably more customary -- is fairly customary. You do
18 seem some 400 and -- in this case it is 400 -- 400 and 500
19 percents, but 300 percent is certainly not unusual.

20 Q. Well --

21 A. It's probably more usual than unusual.

22 Q. Of course, New Mexico has got so many units, that
23 -- so much of our drilling is in units created quite a long
24 time ago --

25 A. Yes.

1 Q. -- that there are a lot of old operating
2 agreements.

3 A. Yes.

4 MR. BROOKS: Okay, this is addressed primarily to
5 Mr. Kellahin. You'll remember I discussed when you and
6 Bill Carr and I and several other people from the Division
7 met last fall, this 200-percent risk penalty, I think what
8 you're proposing can be done and should be done. My
9 opinion is that it should be done by rule. Do you believe
10 it can be done any way other than by rule? Can --

11 MR. KELLAHIN: No, sir, I'm not suggesting --
12 This was a checklist of things to talk to you about.

13 MR. BROOKS: Okay.

14 MR. KELLAHIN: It will have to be done by rule.

15 MR. BROOKS: That was my feeling, that is has to
16 be done by rule.

17 Q. (By Mr. Brooks) And of course, I don't know --
18 In regard to your testimony, you are aware that a different
19 policy exists with regard to the Basin Fruitland Coal,
20 right?

21 A. No, sir, I don't know that.

22 MR. KELLAHIN: I am, and that's something --

23 MR. BROOKS: Yes --

24 MR. KELLAHIN: -- that has to be taken into
25 consideration.

1 MR. BROOKS: -- that is something that would be
2 taken into consideration. It is customary to do -- I can't
3 remember the percentages.

4 MR. KELLAHIN: It's 158 percent.

5 EXAMINER CATANACH: 156, Mr. Kellahin.

6 MR. BROOKS: I was going to say it was
7 approximately 160, but I couldn't --

8 MR. KELLAHIN: You did that, didn't you, Mr.
9 Catanach?

10 EXAMINER CATANACH: I was part of that, yes.

11 MR. KELLAHIN: Yes, you were.

12 MR. BROOKS: Okay, let's see. I want to be sure
13 I discuss the things that you brought up.

14 Okay, now, two, you mentioned that the order
15 provides for a single operator for all wells in the unit.
16 Is that something you -- Is that an objection to the order
17 or just an observation about it?

18 MR. KELLAHIN: It was just an observation.

19 MR. BROOKS: Okay.

20 MR. KELLAHIN: It's a dilemma sometimes, but it's
21 an observation. I know of instances where, in the infill
22 well situation, the operator of the parent well doesn't
23 necessarily want to be the operator of an infill well.

24 MR. BROOKS: Correct.

25 MR. KELLAHIN: The Division practice is to have

1 one declared operator, and the industry has to resolve
2 that. And there is lots of discussion among certain
3 operators about what to do.

4 MR. BROOKS: Well, there are some states in which
5 it's permitted to have the same wells -- wells in the same
6 spacing unit operated by different operators, correct?

7 MR. KELLAHIN: Yes, and I frankly think that the
8 reason we're doing a single operator is not for regulatory
9 reasons here, but the lack of the ONGARD system over Tax
10 and Rev to track multiple wells operated by different
11 operators in the same spacing unit. And if you could fix
12 that, you might satisfy a number of our operators who want
13 to operate individual wells.

14 MR. BROOKS: The present NMOCD rules, though,
15 within the context of our rules, you have to have a single
16 operator per unit, correct? Rule 104 seems very specific.

17 MR. KELLAHIN: I'll defer to you. I don't
18 remember.

19 MR. BROOKS: Okay. Now, you did mention
20 something here which I think was frankly an oversight on my
21 part in drafting this order. It allows a nonconsenting
22 working interest owner to propose subsequent operations,
23 and your suggestion, I believe, was that they should not be
24 allowed to propose subsequent operations until after the
25 cost-recovery period. Is that -- Did I understand that

1 correctly?

2 MR. KELLAHIN: I believe that was Mr. Gray's
3 testimony, and that would be a practice consistent with the
4 JOA operations.

5 Q. (By Mr. Brooks) Okay, where is that provided in
6 the operating agreement, Mr. Gray?

7 MR. KELLAHIN: It's on page 6, is it not? My --

8 THE WITNESS: Yes.

9 MR. KELLAHIN: -- starting on line number 28?

10 THE WITNESS: Yes.

11 Q. (By Mr. Brooks) Okay. And -- Now, Finding (19),
12 I gather that the biggest problem we have here has to do
13 with the options that may be made available where a well is
14 going to be possibly completed in more than one zone?

15 A. Yes, I think the well that we're talking about
16 today, when you see the geological testimony, is a perfect
17 example. The primary objectives are actually the shallower
18 objectives, the Strawn and the Wolfcamp. We're drilling to
19 the Morrow and the Atoka somewhat as an afterthought, it
20 being that we're very close to those objectives with the
21 wellbore at TD so we'll take it -- and it is prospective --

22 Q. Right.

23 A. -- so we'll take it to the Morrow because the
24 incremental cost to get it to the Morrow is very small
25 relative to the total cost of the well.

1 If -- What concerns me about giving the
2 nonparticipating parties -- Well, first of all, I think the
3 participating parties ought to be able to get their money
4 back and the penalty out of the wellbore, regardless of
5 which zone.

6 But if it's -- In the case of the Yates order and
7 this particular well we're drilling, or any well, the
8 participating parties would be put in a position of having
9 drilled the wellbore, logged it, and having multiple
10 potential zones to complete in.

11 If the -- the ordinary practice, or -- It's
12 common that you start at the bottom and work your way up.
13 So you start at the Morrow, then the Atoka, then the
14 Strawn, then the Wolfcamp to see what you've got. And if
15 you make a Morrow well, then you don't see this problem
16 with the Atoka for a while.

17 Q. Right.

18 A. So -- But let's say in this case you drilled --
19 you had a Morrow zone that looked commercial but it didn't
20 look great, you know, it looked like you might get 200 or
21 300 million cubic feet out of it, or something, to make it
22 worthwhile completing, and then you've got a Strawn zone
23 that looks just absolutely fabulous.

24 Allowing the nonparticipating owners to make
25 those elections as you go, it's going to put the operator

1 in a position to say, We'd better go complete that Strawn,
2 because we're never going to get -- we're not going to get
3 all of our money out of this Morrow zone. And if we get --
4 you know, if we pay back the completion on the Morrow zone
5 but we haven't paid back the well, and then we abandon the
6 Morrow zone and go to the Strawn, then the nonparticipating
7 party, I think under the Yates order, has an election to
8 join in the Strawn only as to the cost of the completion
9 and not as to the cost of the wellbore.

10 And in the case I was discussing, we haven't
11 recovered the cost of the wellbore yet before we plug back
12 and go to the Strawn.

13 And also it gives these guys a free look. They
14 don't have to pay -- In the plugback scenario in the Yates
15 field, they don't have to pay for the cost of the wellbore
16 to see the Strawn, but they get an election to participate
17 in the completion.

18 Q. What would happen in, under a joint operating
19 agreement, if you had parties who owned interests in the
20 shallower formations and did not own any interest in the
21 primary-objective formation?

22 A. The practice -- as a practical matter, having
23 worked for companies that have drilled a lot of Morrow
24 wells out in eastern New Mexico -- and there are a lot of
25 severed depths -- is to pretty much leave them alone, that

1 if party A owns from the surface to the base of the Queen
2 and party B owns from the base of the Queen to the base of
3 the Morrow and wants to drill a Morrow well, generally the
4 party that drills a Morrow well drills through the Queen,
5 they have the right to test the Morrow, they don't even
6 consult the shallow owner at that point.

7 If they have common interest in the shallow zones
8 and they differ from the interest in the deep zones, that's
9 where you run into a problem.

10 Q. (By Mr. Brooks) Well, that was the question --

11 A. Yeah --

12 Q. -- I was --

13 A. -- right.

14 Q. -- asking.

15 A. And it's really -- It's a deal that's negotiated
16 on a case-by-case basis.

17 Q. But if you're going to force pool, you're going
18 to have to deal with it in some manner, correct? A force-
19 pooling order, if it's to cover -- if it's to include zones
20 that have some discrepancy in ownership, it's going to have
21 to be dealt with in some way?

22 A. Yes.

23 MR. KELLAHIN: I would agree also, Mr. Brooks.

24 MR. BROOKS: We did add that in the Yates
25 order --

1

MR. KELLAHTN: Yes, sir --

2

MR. BROOKS: -- by the way --

3

MR. KELLAHIN: -- and the Supreme Court case, *Viking Petroleum vs. the Commission and Heyco*, had to do with a split election. It wasn't a different ownership, but Viking Petroleum had a preference to the Atoka and was trying to go consent on the shallower zone and nonconsent on the lower zone. The Commission said no, the District Court reversed the Commission, the Supreme Court affirmed the Commission. And in its decision the Supreme Court said those issues would be decided on a case-by-case basis.

12

13

And I think if you have those circumstances, you would deal with them on a case-by-case basis.

14

MR. BROOKS: What is this --

15

16

MR. KELLAHIN: I've got a copy, I'll give it to you.

17

MR. BROOKS: Okay.

18

19

20

MR. KELLAHIN: It's *Viking Petroleum vs. Heyco*. I think it's in 100 New Mexico -- I forgot the page number. It's a 1983 case.

21

22

23

24

25

In addition the Division on occasion has assigned costs between a shallow and a deeper zone using the COPAS Accounting Bulletin Number 2 to make that cost allocation. So again, it's handled on a case-by-case basis when those issues are present.

1 Q. (By Mr. Brooks) Okay. Now, the Division has
2 never afforded an initial casing point election in
3 compulsory pooling orders, although they always have a
4 casing point election in operating agreements. Do you
5 propose incorporating a casing point election into this?

6 A. Well, the operating agreement -- It's common to
7 have a casing point election, but the operating agreement
8 generally has both elections. Both cases are available to
9 the operator in the printed form.

10 Q. Yes, I'm aware of that. In fact, I took certain
11 language in the Yates order from the other alternative in
12 the printed form.

13 But in your experience, is it not considerably
14 more common than not to have a casing point election?

15 A. It's very rare not to have a casing point
16 election.

17 Q. I can't recall that I've seen an operating
18 agreement where the other alternative was checked, although
19 I'm sure --

20 A. You get them in Oklahoma sometimes, because of
21 force pooling.

22 MR. BROOKS: Yeah. But do you have any kind of
23 recommendation on whether we ought to incorporate a casing
24 point election in a force-pool order?

25 MR. KELLAHIN: With your permission, I'd like to

1 respond after the hearing. I need to think about that --

2 MR. BROOKS: Okay.

3 MR. KELLAHIN: -- to see what we do. I hadn't
4 thought about that until this moment. So let me, with your
5 permission, send you a letter on that question. Because
6 I'm not sure.

7 Q. (By Mr. Brooks) Your suggestion with regard to
8 the depth, the split-depth situation, I take it, is that
9 the costs of drilling and of the attempted completion at
10 the greater depth and of the attempted completion at the
11 shallower depth all be recovered before the
12 nonparticipating owner -- with the appropriate penalties be
13 recovered before the nonparticipating owner comes back?

14 A. Are you speaking -- In the case of where the
15 ownership is --

16 Q. Well, either way.

17 A. -- is split as to depth?

18 Q. Yeah.

19 A. I think if the ownership is common --

20 Q. Yeah.

21 A. -- then I don't think there should be an issue.

22 I mean, the party's been presented with the opportunity to
23 drill the well --

24 Q. Right.

25 A. -- the OCD wants to encourage the well to be

1 drilled. If there's no question as to severed rights at
2 that depth, then yes, I think the wellbore -- I think the
3 cost of the wellbore should be recovered with the penalty
4 out of all of the zones up and down the hole from the
5 nonparticipating parties before they come back. And that's
6 consistent with the AAPL operating agreement.

7 In the case where you have severed depths, which
8 is --

9 Q. Right.

10 A. -- can become terribly complicated --

11 Q. And which we did have. In the Yates situation we
12 didn't have any owners in the shallower zones that didn't
13 have interest in the deeper zones, but we did have some
14 differences in the percentage interests among the
15 parties --

16 A. For one thing, the parties being pooled have an
17 opportunity -- If they object to the drilling of the deep
18 well they have an opportunity to come to a hearing and say,
19 We want to drill a Yates well and they want to drill a
20 Strawn well, and the Hearing Examiner, I think, would have
21 to decide who got to drill what.

22 Q. Well, of course that's always the case --

23 A. Yeah --

24 Q. -- if there's rival --

25 A. -- right --

1 Q. -- proposals for development --

2 A. -- but the --

3 Q. -- the Division has to make a decision --

4 A. -- I think one solution to that could be that the
5 nonparticipating party at a split depth that owns the
6 shallow rights --

7 Q. Right.

8 A. -- could -- I'm not sure it's fair to make him --
9 It's not fair to make him pay for the cost of drilling the
10 well from the base of his shallow rights to total depth --

11 Q. Right.

12 A. -- and a formula could be used, then, not
13 unsimilar to the COPAS formula to allocate the cost of
14 drilling the well from the surface through his objective.
15 And again, it's so difficult to negotiate it, I'm not sure
16 that it's possible to write a rule for it.

17 Q. Now, after the nonconsenting interest owner comes
18 back in, if there are any subsequent operations on the well
19 he would then again get an election, correct?

20 A. I'm sorry, could you repeat the question?

21 Q. After the nonconsenting interest comes back in --

22 A. Yes.

23 Q. -- if there are any subsequent -- I'm talking
24 about how it works under the joint operating agreement --

25 A. Yes.

1 Q. -- if there are any subsequent operations on that
2 well, then that nonconsenting interest owner would get
3 another election, correct?

4 A. Then he gets another election, but still subject
5 consistently to the same penalty --

6 Q. Yes.

7 A. -- if he elects not to participate.

8 Q. But if the election is proposed before the cost
9 recovery, then he doesn't get the opportunity to elect to
10 participate?

11 A. That's correct, the parties that took the risk of
12 drilling the well are entitled to get their money back,
13 plus penalty.

14 Now, the operating agreement does differ somewhat
15 from the Yates order, in that in the operating agreement
16 the participating parties recover only 100 percent of the
17 cost of subsequent operations.

18 Q. Right.

19 A. And in the Yates order I think that they were
20 given the opportunity to recover 300 percent of the cost of
21 subsequent operations, but not necessarily to recover the
22 cost of the wellbore.

23 Q. Right. Now, the next comment is with regard to
24 the opportunity to seek a modification of the risk penalty
25 for subsequent operations, and you do understand that

1 that's simply an opportunity to ask the Commission -- or
2 the Division or the Commission, whichever, to modify it --

3 A. Yes.

4 Q. -- it doesn't mean that there's any presumption
5 that there will be a modification?

6 A. Yes, but I think you can think of it from the
7 perspective of the participating parties in the initial
8 test well that take, by definition, the 300 percent or 200-
9 percent risk granted by the OCD in drilling the first well,
10 that the risk -- at that point in time, the risk of
11 drilling the second well is equal to the risk of drilling
12 the first well, and they're both unproven locations at that
13 point.

14 So I think it's equitable to the participating
15 parties to not afford the nonparticipating parties the
16 right to ride the second well down for a lesser penalty
17 than was applied in the first well, where the greater risk
18 was taken.

19 MR. BROOKS: Yeah. Let me ask you, Mr. Kellahin,
20 because at the time that I put that provision in the Yates
21 order, I did so primarily because I had some concern about
22 whether the Division can commit itself for the future.

23 And I felt like that the discretion that we
24 have -- there needed to be some procedure to re-invoke the
25 discretion that we have under the Oil and Gas Act, feeling

1 like, though, that we probably wouldn't do it, since we
2 don't really exercise that discretion very much anyway.

3 But what would be your opinion about it? Is
4 there not a statutory problem there? We don't have some
5 kind of provision where that risk penalty can be reviewed
6 at future time?

7 MR. KELLAHIN: That kind of legal sensitivity
8 used to bother me too, until I took a case to the
9 Commission where the Commission established what amounts to
10 compulsory pooling on a unit basis. It's the Exxon case.
11 And quite frankly, I think the Supreme Court decided under
12 your global authority you could do anything you want.

13 MR. BROOKS: That sounds like a good case.

14 MR. KELLAHIN: I think the sensitivity is more
15 than sufficiently outweighed by this problem, and I think
16 the work group we had -- There were 20 landmen from
17 Midland, most of them highly knowledgeable experts in the
18 area, and they agreed that if you have an election -- and
19 they were putting themselves in the worst position --

20 MR. BROOKS: Right.

21 MR. KELLAHIN: -- if they were electing on the
22 second well, that's all they wanted, and if they chose to
23 go nonconsent they ought to suffer the maximum penalty.

24 Here's the dilemma. You go nonconsent on the
25 first parent well, and it's a terrific Morrow well. And I

1 race in here and I say, Mr. Catanach, the penalty has got
2 to be less because now we're right immediately adjacent to
3 wonderful production. How dare you make me subject to a
4 greater penalty? I'm not sure I want all that exercise.
5 He's more than adequately protected by getting to go
6 consent or nonconsent, and if you give him this little
7 wrinkle in the rule -- I have problems with it, and I think
8 quite frankly it's an additional remedy that the pooled
9 party doesn't need.

10 MR. BROOKS: Okay, have I missed anything? Any
11 important points I haven't touched on, Mr. Kellahin?

12 MR. KELLAHIN: I believe that covers it, Mr.
13 Brooks. We talked about the fact that the Committee and
14 Mr. Gray agrees that you should not take production from
15 one well and apply it to the cost of the second well. They
16 disagree with the Yates order in that there ought to be a
17 provision like the joint operating agreement for that
18 initial well where you can take production from one zone
19 and apply it to the cost of the other, but we've talked
20 about that. So I think we've covered all the issues that
21 we wanted to raise with you.

22 Q. (By Mr. Brooks) Now, let me ask, then, one more
23 question. When you're talking about applying production
24 from one well to a second well, is this something I --
25 Under a JOA you're correct, of course; the normal provision

1 of the JOA is, they all commit to participate in the first
2 well. I have seen exceptions to that, but they would be
3 very unusual.

4 Well, actually, I don't know if they're that
5 unusual. I was thinking about that. The standard form is
6 drawn where you're drilling an exploratory location and
7 everybody agrees to participate. But my experience has
8 been -- and that comes in from being involved with a very
9 small working interest -- the people who want to drill the
10 location would rather the owner of a small working interest
11 would sign a joint operating agreement that gives them the
12 right to go nonconsent on the first well, rather than
13 having to force pool.

14 A. If you have time to read all of these exhibits,
15 you'll find I attempted to do that with some of these
16 nonconsenting owners --

17 Q. Yeah.

18 A. -- and in this case it was some of the TrinAca
19 group, and Mr. Ramsey representing them said, What is the
20 penalty under a pooling order?

21 And I said it's what they call cost plus 200
22 percent.

23 And he said, Oh, well, that's better than what's
24 in this operating agreement; I think I'd rather you just
25 pool me.

1 So the -- Yes, it's not difficult to do, but --

2 Q. Well, of course they're not going to agree to a
3 400-percent penalty if they can get a 300-percent penalty
4 from us.

5 A. Right, yeah.

6 Q. That would not be smart.

7 A. So that's where we are. But I did -- And you'll
8 find in here a letter that I did attempt to get them to
9 execute this agreement, in which case, then, they would be
10 nonconsent in the initial well and would suffer all of the
11 nonconsent penalties provided for in the operating
12 agreement, which would not allow them to participate in the
13 next plug-back or rework in the well --

14 Q. Okay, that --

15 A. -- until full cost recovery --

16 Q. -- that was leading up to my --

17 A. -- yes.

18 Q. -- next question. Since the standard form
19 operating agreement is drawn with the idea that everybody
20 participates in the initial well and then you have an
21 election on each subsequent well, if you are a party to
22 such an agreement, you elect to go nonconsent on the second
23 well. As I understand it, if the third well, well number
24 three, is proposed before well number two has paid out, you
25 still have an election --

1 A. That's true.

2 Q. -- on well number three?

3 A. That's true.

4 Q. And in your proposal for how we ought to draw our
5 orders, if the person goes nonconsent in the first well,
6 the involuntarily pooled party, they go nonconsent on the
7 first well, would you say they should or should not be
8 allowed to elect into the infill well -- to participate in
9 the infill well if it's proposed before --

10 A. They should be allowed to participate --

11 Q. Okay.

12 A. -- but we would like to keep the penalty
13 consistent.

14 Q. Right. Well, the penalty would only apply if
15 they don't participate?

16 A. Right, yes.

17 Q. Okay. I'm trying to think if there's anything
18 else. Oh, I don't know if it has anything to do with this,
19 but did you offer these people -- did you have any
20 discussions about the possibility of acquiring their
21 interest for an override?

22 A. Two of the parties -- not to me, but to someone,
23 to other people in our office -- expressed an interest in
24 selling out, but not necessarily in -- These are people
25 that -- they own interest in a number of our properties --

1 Q. Yeah.

2 A. -- and they're interested in selling us all of
3 them, and we're not interested in buying them right now.
4 So their attitude is that they're not going to join and
5 they're not going to sign anything at this point.

6 MR. BROOKS: Okay. Mr. Catanach, sorry I was so
7 long.

8 EXAMINER CATANACH: No problem.

9 EXAMINATION

10 BY EXAMINER CATANACH:

11 Q. Just a few, Mr. Gray.

12 Were you on the committee that originally looked
13 at the compulsory pooling issues?

14 A. Yes.

15 Q. And the result of that was the letter to the
16 Division from EOG; is that correct?

17 A. From -- Yeah, that --

18 MR. KELLAHIN: Steve Smith?

19 THE WITNESS: -- Steve Smith wrote, yeah.

20 Q. (By Examiner Catanach) Do you know why the
21 Division never acted on this letter or made any of the
22 recommended changes?

23 A. I think it was because Mr. Brooks' predecessor
24 quit about three weeks after that.

25 EXAMINER CATANACH: I'm greatly concerned,

1 because I'm not sure that -- I appreciate what you guys are
2 trying to do in this specific case, but I'm not sure that
3 we're going in the right direction as far as -- Before
4 long, I can see that we may have several different versions
5 of pooling orders that are going out, depending on what the
6 Applicant asks for.

7 And I'm certainly not recommending that we
8 reconvene the committee, but it may be in the best interest
9 of everybody concerned if we try and standardize this
10 somehow so it can apply to all operators and not have
11 different forms of the pooling order going out.

12 MR. KELLAHIN: That certainly would be our
13 intent, Mr. Catanach. We don't want a Yates version and a
14 Conoco version and a Conoco or -- version. But one thing
15 to do was a forum for us to discuss this with Mr. Brooks.

16 If you want to, you certainly can drop it out of
17 this pooling order. We have a well we need to drill in the
18 next 60 days. You can forget about it for this case.
19 We're pooling 8 percent. Give us a standard order without
20 this concept in it.

21 But let us continue to try to help you give us a
22 standardized order that corrects what we think are some of
23 the areas in the Yates order that need fix, and then an
24 opportunity for the Division to decide and then to share
25 that decision with the industry so we can give you feedback

1 before we start doing this on a piecemeal, case-by-case
2 basis.

3 So you and I are saying the same thing.

4 Q. (By Examiner Catanach) Okay. The TrinAca
5 interest, Mr. Gray, that --

6 A. Yes.

7 Q. -- being -- now the parties that are a part of
8 that group, now, they're able to make an election on their
9 own; is that correct?

10 A. Mr. Catanach, here's my problem with the TrinAca
11 interest, is, the exhibit that we presented to you with the
12 letter from TrinAca with the assignment attached, we took
13 that at face value and assumed that --

14 MR. KELLAHIN: That's A-5.

15 THE WITNESS: -- that TrinAca had, in fact,
16 assigned these interests to these people. On a record
17 check this week prior to the hearing, we discovered that
18 the assignment that they presented to us has not been
19 recorded.

20 There has been one assignment given to one of
21 these parties, and that party is a committed interest owner
22 to the operating agreement.

23 We did not formally notice TrinAca, although
24 TrinAca got notice -- every one of these letters went to
25 TrinAca, and every one was signed by -- all of the green

1 cards were signed by Mr. Jeff Ramsey.

2 And like I say, we had just learned that
3 TrinAca -- although TrinAca treats this as if this interest
4 is owned separately by each of these parties, the record
5 title is still in TrinAca.

6 So I think from our viewpoint we need to name
7 TrinAca as a pooled party, because they are the record
8 title owner.

9 Q. (By Examiner Catanach) So if you got an election
10 to participate from one of these interest owners, would you
11 not accept --

12 A. No, we will accept the elections from the
13 individual interest owners.

14 Q. Even though they're not record title owners?

15 A. Even though TrinAca is the record title owner.
16 Frankly, my assumption is that TrinAca will fix this
17 eventually. But right now it's in a -- it's a kind of a
18 mess.

19 Q. Okay, so as it stands right now, all the parties
20 on Exhibit A, those are the parties that are being pooled
21 currently?

22 A. Those are the parties that are being pooled, and
23 TrinAca's name is not on that list, and we would like to
24 add it to that list.

25 Q. Now, with regards to the unorthodox location, you

1 testified that -- I believe it was Twodubyah, LLC, had
2 signed or assigned some of their interest to some other
3 parties? Is that correct?

4 A. That's correct.

5 Q. Okay. Now, Twodubyah, LLC is -- they have --

6 A. Twodubyah, LLC, was an interest owner committed
7 to the operating agreement and to the drilling of the well.

8 Q. Okay, so by virtue of assigning their interest to
9 somebody else, those interest owners are still committed,
10 right?

11 A. Yes, and -- those interest owners are still
12 committed to the drilling of the well, and I think maybe
13 out of an abundance of caution I got those new interest
14 owners to sign a letter waiving objection to this
15 proceeding since they had not been noticed.

16 EXAMINER CATANACH: Okay. Just a comment, Mr.
17 Kellahin.

18 I don't know if we need to deal with the
19 nonstandard proration unit issue in the text of this case,
20 because there's a rule that allows for the Division
21 District Office to approve a nonstandard proration unit if
22 it's within 75 percent --

23 THE WITNESS: And we already have a permit, so I
24 think that's a moot issue.

25 EXAMINER CATANACH: Okay, so we may be able to

1 just dismiss that portion.

2 MR. KELLAHIN: I was aware of the rule. I wasn't
3 sure how the District handled --

4 EXAMINER CATANACH: I think --

5 MR. KELLAHIN: There's another rule that talks
6 about a less difference and refers to an acreage variation.
7 So I'll defer to you, Mr. Catanach. If you think we need
8 it from you, then please give it to us. If not, then
9 forget it.

10 EXAMINER CATANACH: I had some discussion with
11 Mr. Stogner who authored Rule 104, and he assured me that
12 it was in there, and I think the way the District handles
13 it is just by signing the APD.

14 MR. KELLAHIN: I've authored a number of your
15 rules that I would be unwilling to stand behind at this
16 point, but I'll defer to Mr. Stogner.

17 EXAMINER CATANACH: Okay. I have no further
18 questions of --

19 THE WITNESS: Thank you.

20 EXAMINER CATANACH: -- this witness may be
21 excused.

22 MR. KELLAHIN: We would like to take a few
23 minutes and present our geologic expert, if that's all
24 right, Mr. Catanach.

25 EXAMINER CATANACH: Certainly.

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

4 DIRECT EXAMINATION

5 BY MR. KELLAHIN:

6 Q. All right, sir, would you please state your name
7 and occupation?

8 A. My name is Jasha Cultreri. I am a geophysicist,
9 consulting geophysicist, currently working for Concho Oil
10 and Gas.

11 Q. Mr. Cultreri, for the court reporter would you
12 please spell your last name?

13 A. My last name is spelled C-u-l-t-r-e-r-i.

14 Q. Mr. Cultreri, on prior occasions have you
15 testified as an expert in any capacity before the Division?

16 A. I have not.

17 Q. Summarize for us your education.

18 A. I obtained a bachelor of science degree from New
19 Mexico Tech in physics and a bachelor of science degree in
20 geophysics from New Mexico Tech.

21 Q. Summarize your employment experience as a
22 geophysicist.

23 A. I worked for almost 20 years for Arc Oil and Gas
24 in a variety of capacities as a geophysicist. For the last
25 nine years I have been an independent consultant, working

1 in Midland for a variety of clients.

2 Q. Do your clients include among them Concho Oil and
3 Gas Corporation?

4 A. Yes, they do.

5 Q. And have you prepared for them a geologic
6 recommendation concerning the location and the drilling of
7 this particular well?

8 A. Yes, I have.

9 MR. KELLAHIN: We tender Mr. Cultreri as an
10 expert geophysicist.

11 EXAMINER CATANACH: Mr. Cultreri is so qualified.

12 Q. (By Mr. Kellahin) Show us where we are. Would
13 you take Exhibit 1?

14 A. Exhibit 1 is a regional production map showing a
15 good bit of Lea County, New Mexico. The box in the upper
16 left-hand corner, highlighted in kind of a pink color, is
17 the location of the prospect we're talking about today
18 where the Big "D" is located.

19 Q. Do you have a recommendation to the Examiner as
20 to what, in your opinion, is the appropriate risk factor
21 penalty to assign in this case to parties that decide not
22 to participate?

23 A. Yes, this is an exploratory well, and I would
24 recommend the maximum penalty to nonparticipants.

25 Q. Mr. Gray talked about the fact that you and

1 others on behalf of Concho have to deal with the presence
2 of a pipeline that cuts across part of the spacing unit.
3 Have you dealt with that issue?

4 A. Yes, I have.

5 Q. In terms of looking at the geology, have you
6 found an alternative location in the spacing unit that
7 takes into consideration the pipeline right away and yet
8 does not compromise your well location?

9 A. Yes, sir.

10 Q. Let's talk about how you got there. If you'll
11 turn to the next series of exhibits -- they start with B-2,
12 B-3 and B-4 -- let's go through each of those and show the
13 Examiner what has happened in terms of actual drilling,
14 starting with B Number 2.

15 A. B-2 is a production plat showing production from
16 the Morrow formation. You can see there are two wells, one
17 in Section 12 and one in Section 8, that produce from the
18 Morrow. The rest of the wells on the plat are dry holes or
19 nonproductive in the Morrow.

20 Q. Turn to Exhibit --

21 A. I think that really goes to risk.

22 Q. Yes, sir.

23 A. Okay, looking at Exhibit B-3, this is a
24 production plat showing production from the Atoka. There
25 are four productive wells from the Atoka, and the rest of

1 others on behalf of Concho have to deal with the presence
2 of a pipeline that cuts across part of the spacing unit.
3 Have you dealt with that issue?

4 A. Yes, I have.

5 Q. In terms of looking at the geology, have you
6 found an alternative location in the spacing unit that
7 takes into consideration the pipeline right away and yet
8 does not compromise your well location?

9 A. Yes, sir.

10 Q. Let's talk about how you got there. If you'll
11 turn to the next series of exhibits -- they start with B-2,
12 B-3 and B-4 -- let's go through each of those and show the
13 Examiner what has happened in terms of actual drilling,
14 starting with B Number 2.

15 A. B-2 is a production plat showing production from
16 the Morrow formation. You can see there are two wells, one
17 in Section 12 and one in Section 8, that produce from the
18 Morrow. The rest of the wells on the plat are dry holes or
19 nonproductive in the Morrow.

20 Q. Turn to Exhibit --

21 A. I think that really goes to risk.

22 Q. Yes, sir.

23 A. Okay, looking at Exhibit B-3, this is a
24 production plat showing production from the Atoka. There
25 are four productive wells from the Atoka, and the rest of

1 the wells on the map are nonproducing in the Atoka.

2 Q. All right, sir, and then finally B-4?

3 A. Similarly, B-4 is a production plat showing
4 production from the Wolfcamp, the green dots indicating the
5 productive wells. The rest of the wells are dry holes.

6 The thing I haven't really pointed out is the Big
7 "D" location in Section 6, and note that it's flanked on
8 both sides by a dry hole.

9 Q. At this location, Mr. Cultreri, identify for us
10 the formations that you think are prospective and provide
11 an opportunity to recover hydrocarbons.

12 A. The horizons we are most interested in are
13 Morrow, Atoka, Strawn and Wolfcamp.

14 Q. In view of the information shown by the actual
15 drilling of wells of those types on Exhibit B-2, -3 and -4,
16 why would you ever want to drill this location?

17 A. This is an exploratory well, and typically in
18 exploratory wells we look for rates of return of six to
19 seven to eight times your investment. We believe there's a
20 possibility that we would find a good pool or reservoir
21 that would provide that kind of return at the Big "D"
22 location, although it does carry significant risk.

23 Q. Give us a short summary of what you've done as a
24 geophysicist to help to identify this opportunity and make
25 a selection as to where to place the well.

1 A. This prospect was originally generated using 2-D
2 seismic data. We have since -- or we have subsequently
3 shot 3-D seismic data, of which I will be showing several
4 displays, that show that the Big "D" location is a place
5 where we believe there could be an accumulation.

6 Q. Let's start with Exhibit B-5. Would you identify
7 this for me?

8 A. B-5 is a Strawn depth map generated from the
9 seismic and well control.

10 Q. What's the significance of the color code?

11 A. Yellow indicates the highest subsea elevation,
12 grading down through the oranges and browns, down to the
13 blues and purples, which are the lowest.

14 Q. In your opinion, does structure matter to you in
15 locating a well in the Strawn formation?

16 A. Yes, it does.

17 Q. And why would that be?

18 A. The oil and gas tends to migrate updip and be
19 riding above the water in the formation.

20 Q. Can you project the Strawn depth map to give you
21 a geologic opinion about the structural features in the
22 Atoka and Morrow which are below the Strawn, or do you have
23 to prepare a different map?

24 A. The answer is, yes, I can, but it's better to
25 present multiple maps.

1 Q. All right. In terms of seeing other horizons
2 below the Strawn, are we going to see anything that is
3 materially different for you to make a decision about those
4 formations?

5 A. No.

6 Q. Okay. Have you integrated the 3-D seismic data
7 to have taken into consideration the log data available
8 from wells that drilled to or through any of these depths?

9 A. Yes, I have. This actually is a small portion of
10 about a seven-square-mile seismic shoot. There are roughly
11 20 wells that were tied into the seismic shoot to help
12 improve its accuracy and orientation.

13 Q. Help me figure where I am on this Exhibit Number
14 5. Can you orient us as to how we will see Exhibit 6 --
15 I'm sorry, Section 6 on this exhibit?

16 A. Yes, I can. Section 6 is depicted by the bold
17 black lines that are square, that surround most of the map.
18 On the far northern edge, just about a quarter inch south
19 of the edge of the map, is the east-west line. That's the
20 north line of the section.

21 Q. All right, so we're looking at the whole
22 section --

23 A. Yes --

24 Q. -- as opposed to just --

25 A. -- the whole section.

1 Q. -- the spacing unit?

2 A. That's correct.

3 Q. All right. Can you give us a view of the
4 structure from a vertical profile in a couple of dimensions
5 or directions?

6 A. Yes. I have prepared Exhibits B-6 and B-7 which
7 are, as long as we're still looking at the map -- the first
8 one, B-6, is an east-west line that runs through the Big
9 "D" location just straight east-west, and the next exhibit
10 will be a north-south line directly through the Big "D"
11 location.

12 Q. All right, let's look at B-6.

13 A. Okay.

14 Q. Identify that for me.

15 A. B-6 is an east-west seismic line extracted from
16 the 3-D volume. It only shows the depth from the top of
17 the Wolfcamp double-X marker down to an interval just below
18 the base of the Morrow lime.

19 Q. You've got three vertical lines. The center
20 vertical line is red. Identify those lines for us.

21 A. The center vertical line, which is red, is the
22 location of the Big "D" map -- or, I'm sorry, the Big "D"
23 location. On the left is the Humble well location, which
24 is similarly identified on the map, and on the right is the
25 Great Western dryhole location which is also identified the

1 same way on the map.

2 Q. If we read down vertically and find the notation
3 on the left side that says "Strawn", it's directly
4 associated with a wavy black line?

5 A. That's correct.

6 Q. What does that represent?

7 A. That peak is the reflection of the sound waves
8 from the top of the Strawn formation. So when you look at
9 that black line as it goes up and down, it represents --
10 the higher it is, the higher the structure is, and the
11 lower it is, the lower the structure is.

12 Q. What does this map show you at the proposed
13 location of the Big "D" well?

14 A. The thing we're really concerned with here is
15 getting high enough structurally between the Great Western
16 well and the Humble well. You can see on this seismic
17 section that there's definitely a structural high between
18 the two. The seismic trace spacing here is 110 feet, so
19 between each one of the vertical wiggle traces is 110
20 faces.

21 You can see this is a very narrow feature, yet
22 well defined, and so that's the basis of our mapping in
23 here.

24 Q. Summarize for us what you see when we move down
25 to the Atoka.

1 A. As we move downstructure, the Atoka formation has
2 a similar structural position, still fairly narrow. And as
3 a matter of fact, it sharpens, it gets a little narrower as
4 you go deeper.

5 Q. And what do you see when you get down to the
6 Morrow lime below the Atoka?

7 A. Same thing, it gets narrower. Now, the Morrow we
8 will be interested in is the Morrow clastics, which are
9 right in that zone between the Atoka and the Morrow lime.
10 the closest thing I can map to that is the Morrow lime,
11 which is that green line that you see at the base of the
12 section.

13 Q. Let's look at the structure from a northwest --
14 I'm sorry, from a north-to-south direction.

15 A. Right. On this section north is on your right.

16 Q. This is B-7?

17 A. Yes, I'm sorry.

18 Q. All right, sir, go ahead.

19 A. On B-7 north is on the right, south is on the
20 left. The scale on the section we were just looking at and
21 this section are the same. The location of the Big "D" is
22 highlighted again in red.

23 Here particularly at the Strawn you can see
24 there's a nice structural bump there, fairly well defined
25 but fairly narrow.

1 Do you want me to go ahead and go --

2 Q. Yes, please.

3 A. -- into the Atoka? As you get to the Atoka you
4 can see that bump is fairly well defined, and even down to
5 the Morrow lime. Not a tremendous amount of relief, but
6 still very distinct.

7 Q. Let's move from the structural interpretation and
8 have you tell us if you've attempted to analyze the
9 opportunity in any other way.

10 A. One of the risks in exploring for the Strawn
11 particularly is to find good porosity. It is possible to
12 drill a well that's high in the Strawn, high enough to be
13 above the water, and yet still be tight. What we've done
14 is a process called seismic tracing version, wherein we
15 process the seismic oil trace data that we've been looking
16 at, mathematically to convert it to pseudo-sonic logs.

17 The pseudo- -- The sonic log actually is a fairly
18 good tool for measuring porosity in carbonates. The
19 velocity we see in the carbonate is directly proportional
20 to the porosity in the carbonate.

21 Q. As we look at the next series of exhibits,
22 starting here with Exhibit B-8 -- Well, let me ask you
23 again.

24 When we look at Exhibit B-8, are we seeing that
25 methodology applied to the Strawn?

1 A. That's right, B-8 is a map that shows the seismic
2 -- I'm sorry, shows the Strawn depth over the average
3 velocity as determined from the inversion in the Strawn.
4 So the colors you see are a depiction of the velocities in
5 the Strawn. On the right you see a color bar that
6 indicates the velocities determined from the inversion.

7 Q. If I go higher on your color code scale on the
8 right, I have a more dense reservoir and therefore higher
9 velocity?

10 A. That's correct.

11 Q. How do you as a geophysicist decide at what
12 density you're most likely to have appropriate porosity for
13 the opportunity to produce Strawn hydrocarbons?

14 A. This is a very empirical process, and the numbers
15 actually that I use are arrived at by quite a bit of
16 experience. We've looked at a number of wells and a number
17 of surveys in the Strawn. Basically I chose a color code
18 that breaks at about 19,000 feet per second, it goes from
19 blue to purple. The purple colors, I believe, are too fast
20 to be porous.

21 Below that, down in the 18,000-foot-per-second
22 range, are the blue colors, and those rocks I believe will
23 be porous. And that's based on calibrating porosity logs
24 to the velocities that I see in the inversion.

25 Q. When we look at the exact location for the Big

1 "D" well, in your opinion as a geophysicist is this the
2 optimum opportunity in the spacing unit at which to locate
3 a well?

4 A. Actually, no, the best location for the Big "D"
5 location is under the pipeline.

6 Q. In moving it west to avoid the surface
7 restrictions, have you compromised your preference to such
8 an extent that you diminish the opportunity?

9 A. No, I believe the current location is the next
10 best alternative.

11 Q. All right, sir. Let's turn to Exhibit B-9.
12 Identify and describe that for me.

13 A. B-9 is a Wolfcamp depth map. The Wolfcamp is our
14 secondary -- or second most prospective objective in the
15 wellbore.

16 Q. Okay. What do you conclude from this map?

17 A. This map again is a structure map, same type of
18 color scheme, showing a broad high in the Wolfcamp. The
19 Big "D" I believe is optimally located within the spacing
20 unit. You can see that if we were to move farther west, we
21 would drop off significantly, farther south we'd drop off
22 significantly. So within that spacing unit, that's a good
23 location for the Wolfcamp.

24 Q. All right, sir. Let's turn to Exhibit B-10 and
25 have you identify and describe this display.

1 A. B-10 is the Atoka time map. Also contoured on
2 this map is the Atoka sand isopach. What we see on this --
3 Shall I go ahead?

4 Q. Yes, please.

5 A. What we see on this map, color-scale-wise, the
6 yellows are the highest, grading down to the reds, and you
7 can see the Big "D" location is in the middle of a
8 structural high. It's a very localized structural high.

9 The other thing we see on here, if you look down
10 on the southeast corner, that Kaiser well has 28 feet of
11 sand. It's on a structural high. And yet the Mark
12 Production well just west of there, also on a structural
13 high, only has ten feet of sand.

14 There is not a good correlation between
15 structural configuration and sand isopach. I can't really
16 address sand isopach, but I can say that structurally we're
17 in a reasonably good position. If we have the sand, we
18 should make a well. If we don't have the sand -- Well, if
19 we don't have the sand, we won't. So there's a lot of risk
20 as far as sand there. But if you get downdip, you get wet
21 as well. So really this location is determined mostly on
22 structure.

23 Q. Let's turn to your final exhibit, B-11. Would
24 you identify and describe that display?

25 A. B-11 is a Morrow lime time-structure, again a

1 time map, very, very similar to the maps we've previously
2 shown, showing that Big "D" is in a structurally high
3 position. And you may have noticed as we go from the Atoka
4 down to the Morrow, that circle has gotten even smaller,
5 that structural pinnacle --

6 MR. BROOKS: The reds.

7 THE WITNESS: The red is the highest point there.

8 MR. KELLAHIN: Mr. Examiner, that concludes my
9 examination of Mr. Cultreri.

10 We move the introduction of his Exhibits 1
11 through 11.

12 EXAMINER CATANACH: Exhibits 1 through 11 will be
13 admitted as evidence.

14 EXAMINATION

15 BY EXAMINER CATANACH:

16 Q. Mr. Cultreri, can you rate for me the prospects,
17 which is the best prospect and which is the worst, as far
18 as the four that you've told me earlier. Is the Morrow the
19 best or --

20 A. I would say the best is the Strawn.

21 Q. Strawn. And you're in an area that you believe
22 will be gas-productive; is that correct?

23 A. In the Strawn it's primarily oil, I believe.

24 Q. In this area?

25 A. Yes.

1 Q. So we have the potential for having a 40-acre

2 or -- probably a 40-acre Strawn unit if it's oil; is
3 that --

4 A. Yes, sir.

5 Q. So you're just west of all the various Strawn
6 pools in that area, Lovington-Strawn --

7 A. Right.

8 Q. -- and all that?

9 A. We're quite a ways west. There's no Strawn
10 production really anywhere near here. You notice on my
11 nine-section plat there was no Strawn production.

12 Q. Do you think this is the same kind of Strawn
13 situation that we have to the east here, the algal-mounds-
14 type situation?

15 A. We hope so, yes, sir.

16 Q. Okay.

17 A. There is a little bit of indication in the wells
18 that we might be developing that kind of rock.

19 Q. And the other formations, Morrow, Atoka and the
20 Wolfcamp, you anticipate gas production?

21 A. Yes, sir. And the gas in the Atoka is really
22 significant. If you find an Atoka well, it could be really
23 big. There's a 1.4-BCF and a 2.5-BCF well, these Atoka
24 wells just south of us are really good, so -- You know,
25 we're talking about is it going to be oil, is it going to

1 be gas? If it's Atoka, it could be really good.

2 And you know, that's -- but it's very risk at the
3 same time. So it's sort of a trade-off there.

4 Q. Is there anything up from shallower, in any
5 shallower formations that you have hope for?

6 A. Not really. There's no significant production
7 anywhere in the area. There's a little bit of Queen
8 production to the south, but it's not -- It wouldn't pay
9 out the well.

10 EXAMINER CATANACH: Okay, I have nothing further,
11 Mr. Kellahin.

12 MR. KELLAHIN: All right, sir, thank you.

13 EXAMINER CATANACH: Did you have any questions?

14 MR. BROOKS: None of this witness.

15 I did want to say something to Mr. Kellahin, but
16 I assume we're probably going to take a break after this
17 hearing, so...

18 EXAMINER CATANACH: Yes, we are.

19 MR. BROOKS: Okay, then I'll talk to Mr. Kellahin
20 at the break.

21 EXAMINER CATANACH: Okay, this witness may be
22 excused.

23 MR. KELLAHIN: I'm not going to have to stand i
24 the corner, am I?

25 MR. BROOKS: No. I may have to.

1 EXAMINER CATANACH: Is there anything further,
2 Mr. Kellahin?

3 MR. KELLAHIN: No, sir.

4 EXAMINER CATANACH: There being nothing further
5 in this case, Case 12,775 will be taken under advisement.

6 Let's take a 10-minute break.

7 (Thereupon, these proceedings were concluded at
8 10:21 a.m.)

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CERTIFICATE OF REPORTER

[illegible]

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 December 18th, 2001.

John H. Kern

STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002