

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. 12,992
)
APPLICATION OF SAN JUAN RESOURCES, INC.,)
FOR COMPULSORY POOLING, SAN JUAN COUNTY,)
NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID K. BROOKS, JR., Hearing Examiner

February 20th, 2003

Santa Fe, New Mexico

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Oil Conservation Division

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID K. BROOKS, JR., Hearing Examiner, on Thursday, February 20th, 2003, 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.

* * *

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

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February 20th, 2003
 Examiner Hearing
 CASE NO. 12,992

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A P P E A R A N C E S

FOR THE DIVISION:

DAVID K. BROOKS, JR.
Attorney at Law
Energy, Minerals and Natural Resources Department
Assistant General Counsel
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

FOR THE APPLICANT:

KELLAHIN & KELLAHIN
117 N. Guadalupe
P.O. Box 2265
Santa Fe, New Mexico 87504-2265
By: W. THOMAS KELLAHIN

* * *

ALSO PRESENT:

DAVID R. CATANACH
Hearing Examiner
New Mexico Oil Conservation Division
1220 South Saint Francis Drive
Santa Fe, NM 87505

WILLIAM V. JONES, JR.
Petroleum Engineer
New Mexico Oil Conservation Division
1220 South Saint Francis Drive
Santa Fe, NM 87505

BOBBIE LEE MOSLEY
Aztec, New Mexico

* * *

1 WHEREUPON, the following proceedings were had at
2 11:26 a.m.:

3 EXAMINER BROOKS: We'll call Case Number 12,992,
4 Application of San Juan Resources, Inc., for compulsory
5 pooling, San Juan County, New Mexico.

6 MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of
7 the Santa Fe law firm of Kellahin and Kellahin. I'm
8 appearing this morning on behalf of the Applicant, and I
9 have two witnesses to be sworn.

10 EXAMINER BROOKS: Other appearances?

11 Okay, we've got some correspondence from Mr.
12 Mosley, but --

13 MR. KELLAHIN: I believe -- Mr. Mosley? This is
14 Mr. Mosley in the back of the room. Would you like to come
15 forward so you can participate?

16 EXAMINER BROOKS: Do you want to enter an
17 appearance in the case?

18 MR. MOSLEY: Yes, sir.

19 EXAMINER BROOKS: Okay, and you --

20 MR. MOSLEY: Where do you want me?

21 EXAMINER BROOKS: Over there at that other table
22 will be good.

23 Would you state your name for the record?

24 MR. MOSLEY: Bobbie Lee Mosley.

25 EXAMINER BROOKS: And do you intend to testify or

1 make a statement, or both?

2 MR. MOSLEY: I intend to show that this has not
3 been in good faith, that he has lied to me about --

4 EXAMINER BROOKS: Okay, let me just say that
5 apparently you probably are going to want to put on some
6 sworn testimony --

7 MR. MOSLEY: Yes, sir.

8 EXAMINER BROOKS: -- so we'll have you sworn.
9 Would the witnesses stand to be sworn, please?
10 (Thereupon, the witnesses were sworn.)

11 EXAMINER BROOKS: Okay, thank you.

12 You may proceed when ready, Mr. Kellahin.

13 MR. KELLAHIN: Mr. Examiner, our first witness is
14 Mr. Jerry McHugh.

15 JEROME P. McHUGH, JR.,

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

18 DIRECT EXAMINATION

19 BY MR. KELLAHIN:

20 Q. For the record, Mr. McHugh, would you please
21 state your name and occupation?

22 A. My name is Jerry McHugh, Jr. I'm the owner of
23 San Juan Resources, Inc., from Denver, Colorado.

24 Q. Have you and your family operated oil and gas
25 wells in the San Juan Basin, New Mexico?

1 A. Yes, sir.

2 Q. And you currently do that?

3 A. I currently operate a number of wells in the San
4 Juan.

5 Q. Your dad was involved back in 1984 in the
6 Gavilan-Mancos hearings, was he not?

7 A. That's right.

8 Q. And you participated in those hearings but were
9 never called as a witness?

10 A. That's correct.

11 Q. And you now have your own business?

12 A. Yes, sir.

13 Q. And you're doing business as San Juan Resources?

14 A. Yes, sir.

15 Q. As part of your responsibilities as president of
16 this company, do you personally assume the responsibilities
17 for negotiating with parties in trying to reach a voluntary
18 agreement so that you can consolidate your acreage?

19 A. In some cases I do. Oftentimes I will use
20 contract landmen to work with me, or people who may know a
21 party. But it's usually me directly, at least who
22 supervises it, correct.

23 Q. In this case there was a contract landperson
24 involved?

25 A. Yes, sir.

1 Q. Are you also acting on title opinions or search
2 documents made by title experts to give you information
3 within a spacing unit about interest owners?

4 A. Yes, sir, that's correct. We did exhaustive
5 title report research in this particular section in San
6 Juan County, and we're relying on those reports to give us
7 the interests and owners that we had in the wells.

8 Q. When we look at the AFE in a moment, that has
9 been prepared by experts under your direction?

10 A. Yes, sir, I use a contract petroleum engineer out
11 of Denver by the name of Jack Wanner, and he prepared the
12 AFEs.

13 Q. We'll talk about those in a moment. In addition,
14 do you have technical people that you hire on a contract
15 basis to aid you in geologic and engineering components for
16 your wells?

17 A. Yes, sir, that's correct.

18 Q. Is Mr. Gary Johnson one of those individuals?

19 A. Yes, sir, Mr. Johnson has worked for my family
20 back in the 1980s and 1990s, I guess it was, and he's
21 testified before the Commission in the past, and we're good
22 friends, so we're -- He's stepping in for Mr. Wanner also.

23 Q. Have you utilized Mr. Johnson to aid you in
24 assessing what your recommendation is for the Commission,
25 for the risk factor penalty associated with the pooling

1 case?

2 A. Yes, sir.

3 MR. KELLAHIN: We tender Mr. Jerry McHugh as an
4 expert witness.

5 EXAMINER BROOKS: Any objection?

6 Very good, he's so qualified.

7 Q. (By Mr. Kellahin) Mr. McHugh, if you'll turn to
8 the exhibit book, and if you'll look behind Exhibit Tab 1,
9 let's start with the orientation of your project. When we
10 look at this map, where is the spacing unit you're
11 proposing to dedicate to the well?

12 A. The spacing unit is the south half of Section 18,
13 30 North, 11 West, San Juan County.

14 Q. I see on this display there's a color code
15 associated with wells. When we look in the south half of
16 the section in your proposed spacing unit, there are some
17 other well symbols in here. Is this spacing unit available
18 for you having the operations of a wellbore that produces
19 from the Dakota and the Mesaverde?

20 A. Yes, sir, that's correct. The red Dakota well
21 indicated on there is the Fannie Ward well. We have a code
22 ZA, which means zone abandoned. I don't believe that well
23 has been plugged, but we've received an approved APD from
24 the OCD out of Aztec.

25 The other wells noted in there are either

1 Fruitland wells or abandoned Pictured Cliff wells or
2 Farmington sand, so it's been drilled out there in other
3 horizons.

4 Q. If you'll turn that page and look at Exhibit
5 Number 2, what are we looking at here?

6 A. This is our approved APD from the OCD out of
7 Santa Fe.

8 Q. And following the first page of the approval
9 permit, what's the next attachment?

10 A. This is our C-102 where the well has been staked
11 in Unit Letter J of said Section 18.

12 Q. To the best of your knowledge, does this location
13 conform to the requirements for a well to be produced in
14 the Mesaverde and/or the Dakota?

15 A. Yes, sir, I believe it's my understanding it's a
16 standard location.

17 Q. Following that let's turn to the next page, which
18 is Exhibit Number 3. What does this represent, Mr. McHugh?

19 A. This is our sample application for applying for
20 downhole commingling on the subject well.

21 Q. Have you yet applied for and obtained approval
22 from the Division for commingling?

23 A. I have not yet.

24 Q. But your intent is to drill this well for
25 purposes of downhole commingling production from both those

1 zones?

2 A. That's correct.

3 Q. Let's turn to Exhibit 4. When you take the south
4 half of Section 18 and subdivide it into various lots and
5 components, how is that configured?

6 A. Well, there's about ten different tracts that in
7 most cases would have contiguous mineral owners. They're
8 usually owners that are all in one particular tract. So
9 our title report brought out this information. I just show
10 the breakdown of the ten tracts in this proration unit for
11 your information.

12 Q. To the best of your knowledge, Mr. McHugh, have
13 you satisfied yourself that based upon this tract breakdown
14 for the half section you've had people search the public
15 records to try to find the identity of those interest
16 owners?

17 A. That's correct, we've spent a lot of time and
18 money determining who the interest owners are, and then
19 checking on their addresses and various things like that,
20 so we've spent --

21 Q. You're aware that the Dakota and the Mesaverde
22 are both spaced upon 320 acres?

23 A. That's correct, yes.

24 Q. So the individual tract separation here has no
25 consequence to the parties that are going to pay for and

1 participate in the well?

2 A. Yes, sir, I'm aware of that.

3 Q. Let's turn to Exhibit 5. This exhibit has three
4 pages?

5 A. Yes, sir.

6 Q. What have you tabulated on this spreadsheet?

7 A. These are the leasehold owners which we have
8 determined are the owners of record, via the county
9 records, in the Mesaverde and Dakota formations, which we
10 plan to drill and attempt to complete.

11 These are from the records -- If you go across
12 the spreadsheet here, we indicate their working interest in
13 the well, and then we indicate in which tract number they
14 are located from Exhibit 4, we show the lease that is tied
15 to the particular interest owner and, if applicable, an
16 override which is also tied to said interest owner.

17 Q. In this Application, Mr. McHugh, you're asking
18 Examiner Brooks to pool two different categories of owners:
19 the unleased mineral owners -- there's a group of those --
20 plus the parties that are subject to a lease that haven't
21 signed your joint operating agreement?

22 A. That is correct, two different sets of -- two
23 different types of owners.

24 Q. When we look at the leasehold ownership list, can
25 you take us through the list, not by individual item, but

1 read down and find us where you have parties that have
2 agreed to participate using your joint operating agreement?

3 A. It would probably be best to back up, and the
4 ones who have agreed to participate on page 2 --

5 EXAMINER BROOKS: What exhibit are you looking
6 at?

7 THE WITNESS: This is Exhibit 5, page 2 of 3.

8 EXAMINER BROOKS: Okay, under what tab?

9 THE WITNESS: It's still under Tab Number 1.

10 EXAMINER BROOKS: Okay, go ahead.

11 THE WITNESS: The parties who have agreed to
12 participate are Conoco, Inc.; Maralex Resources; and also
13 Manana Gas, Inc., has agreed to participate.

14 Q. (By Mr. Kellahin) In obtaining the participation
15 of those working interest owners, have they agreed to your
16 form of joint operating agreement?

17 A. Yes, they have agreed to our joint operating
18 agreement form and have forwarded us a signed AFE.

19 Q. The AFE that they've forwarded back to you is the
20 same one that you submitted to Mr. Mosley and all other
21 interest owners in the spacing unit?

22 A. Yes, sir, that's correct. I submitted, when we
23 started the process, an AFE to the entire group of interest
24 owners on Exhibit 5, and then the leasehold owners on
25 Exhibit 6 -- or the mineral owners, excuse me, on Exhibit

1 6, which we'll get to momentarily.

2 Q. Let's turn now to Exhibit 6. Identify for me
3 what you're showing on this spreadsheet.

4 A. This is a list of the mineral owners we've
5 determined on their minerals in Section 18, their interest
6 for the entire proration unit, and then the tracts that we
7 believe they're -- in which they're located.

8 Q. In trying to obtain additional leases or new
9 leases for your account, have you obtained recorded leases
10 for certain interests, and have they been recorded?

11 A. Yes, the James R. Williams Estate, we leased that
12 from the personal representative, Eloy Trujillo, and we
13 obtained a one-eighth royalty lease, net proceeds language
14 in the lease. I think it was a five-year lease at \$150 per
15 acre.

16 Q. Are those the lease terms that you offered Mr.
17 Mosley and his group?

18 A. Approximately.

19 Q. Yeah, that's where you started with that
20 negotiation?

21 A. That's where we -- I think we started at one-
22 eighth and \$75.

23 Q. All right.

24 A. We also leased a Mrs. Sarah Norwood -- she has 76
25 acres in the proration unit -- for \$30 an acre, one-eighth

1 royalty interest, net lease language, for five years.

2 We also leased the Nathan Good interest for a
3 one-eighth royalty interest, \$120 per acre net lease
4 language, for five years also.

5 Q. Let's go back to the last exhibit, Exhibit 5, and
6 look at the third page of that exhibit.

7 A. Okay.

8 Q. I forgot to ask you a question. You indicate the
9 Driscoll interest --

10 A. Yes, sir.

11 Q. -- that you're seeking to have those interests
12 pooled at this time?

13 A. That's right.

14 Q. Is there any title conflict here that the pooling
15 order would allow you to address?

16 A. I'm not --

17 Q. I didn't say that very well.

18 A. I'm not sure what your question is.

19 Q. This interest that is designated under Driscoll,
20 do you have leases from other interest owners as to this
21 interest?

22 A. Yes, that's right. It appears that there's a --
23 three tracts -- tracts 1, 6 and 4 -- which indicate that
24 Mr. Driscoll had various percentages of interest in those
25 tracts. Like I said, this is a very complicated area

1 leasewise and interest-ownerwise, and so, you know, we're
2 relying on our title reports and in the midst of a standup
3 title opinion. So we're requesting to force pool that
4 entire interest, should he own that entire interest.

5 Q. Your belief is otherwise, that you already have
6 that interest through a different chain of title?

7 A. That's correct, that's correct. Well, we -- You
8 know, it depends who your title attorney is and how
9 aggressive you want to do it, but we do have other
10 interests in Mr. Driscoll's underlease, correct.

11 Q. Let's turn to the Exhibit Tab 3, which are not
12 numbered in sequence. We're just picking up with Exhibit
13 7. Behind Exhibit Tab Number 2 are the applications for
14 hearing, are there not?

15 A. That's correct.

16 Q. I'm not going to ask you about these. I'm going
17 to ask you to flip past those, and we'll go to Tab 3. Tab
18 3 is the notice information?

19 A. (Nods)

20 Q. Did you send a notice letter to Mr. Mosley and
21 the other parties to be pooled, and are copies of those
22 return receipt cards and confirmation of mailings contained
23 behind Exhibit Tab 3?

24 A. Yes, sir, they are.

25 Q. And some of those were sent out of my office and

1 some of them out of your office?

2 A. That's correct.

3 Q. Let's turn past that, and let's deal first of all
4 with your efforts to locate, find and obtain agreement of
5 parties that were subject to leases --

6 A. Okay.

7 Q. -- and then we'll talk about Mr. Mosley and the
8 unleased mineral owners.

9 Under this next tab, Mr. McHugh -- I'm looking at
10 Tab 4 and I'm starting with Exhibit 10.

11 A. Okay.

12 Q. Are these notes that you have prepared and
13 reduced to a tabulation?

14 A. That's correct. Exhibit 10, item number 1 starts
15 with Mr. Driscoll, deceased.

16 Q. I don't want you to read all this stuff.

17 A. Oh, okay.

18 Q. Tell us the party and tell us the in-conclusion.

19 A. Mr. Driscoll was an interesting fellow. He died
20 intestate, and he apparently had a lot of debts when he
21 died. We put a landman on it in Dallas, where he did pass
22 -- to track down his whereabouts, and she has a report here
23 of item number 12 -- excuse me, Exhibit Number 12, later
24 on.

25 Anyways, within her report she talks about how

1 she tracked him down, tried to find a death certificate.
2 You have to be an heir to find a death certificate. She
3 did find the death certificate for Mr. Driscoll, but they
4 wouldn't give it to her, and found his closest living heir
5 was Mr. McManus in Dallas.

6 When she contacted Mr. McManus and when I
7 contacted Mr. McManus, she had washed his hands of anything
8 to do with Mr. Driscoll. There apparently are 30 years
9 associated with his estate, and they all don't want to
10 inherit anything because they'll just inherit a bunch of
11 debts. So it's all written in here as to our process on
12 it.

13 Q. So you chased that interest in all the logical --

14 A. Really chased that pretty exhaustively, I
15 thought, and we have an obituary on him and lots of
16 interesting information in the files.

17 Q. Let's talk about the next entry, this St. Xavier
18 Church.

19 A. Well, items 2 through 4 are churches. They're
20 all still in existence, and they all called me up and all
21 didn't know they had an interest. These interests might
22 have been owned by an interest owner who conveyed them to
23 the church 30 years ago and it still is of record.

24 They all -- I offered to buy them out for -- Oh,
25 I forget what I offered them, but I essentially returned

1 them letters, gave them three options: They could either
2 sell out to me for the offer I was willing to do on their
3 small percentage, they could join the well, which was their
4 interest of .79 percent times \$600,000, which was our AFE
5 cost, or they could go nonconsent. And most all of them,
6 when they did get back to me, they agreed to go nonconsent
7 or just to do nothing. They said they want to keep their
8 interest and roll the dice. That's what some of them said.

9 Q. The rest of your tabulation here analyzes your
10 efforts with regard to the various groups?

11 A. That's right. Number 5, I did get a call back
12 from Mr. William Neidringhaus's son. I tracked him down
13 because the senior Neidringhaus address was almost in the
14 same neighborhood of Philadelphia as the junior
15 Neidringhaus address. And he said he just wants to wait
16 and we how the well does before he does anything.

17 Items 6 through 8 -- excuse me, 6 through --
18 yeah, 6 through 7 are a commentary of which certified
19 letters we received back. The first on the -- We received
20 green cards back, excuse me. We received green cards from
21 Mr. Simpson and Mr. Ruffin, but we've yet to hear from
22 either of the parties.

23 In the other group we also received certified
24 letters back from -- did not receive -- We actually
25 received the certified letter back, not the green card; we

1 received the actual letter back from all the people in item
2 7.

3 Q. Once that happened, did you continue to make
4 Internet searches and other efforts to try to locate better
5 addresses for those parties?

6 A. Yes, we did, and we only came up with one, and
7 that was Mr. Stanley de J. Osborne, and we sent one to
8 where his maid told us he used to work and to where he
9 lives in New York City. And went -- an Internet search
10 looking on the zip codes and the last names, and we have
11 those in our records of the exhaustive search that we did
12 do.

13 Q. As to all the leasehold interest owners that
14 you're now seeking a force pooling order against, have you
15 made your best effort to try to find them and, if so,
16 obtain participation by them in some fashion?

17 A. Yes, sir, I think we have.

18 Q. Let's turn to Exhibit 11. When you started this
19 process of formally proposing the well to all this category
20 of ownership, did you send them a written proposal and an
21 AFE?

22 A. That is correct.

23 Q. What is represented by Exhibit 11?

24 A. Exhibit 11 is the letter we sent out to all
25 working interest owners and all mineral owners in the well

1 that we did not have an agreement with. This one is a
2 sample we sent to Mr. Driscoll. The Mosley group also
3 received the same letter.

4 Q. So this letter, although it says Driscoll, is
5 representative of the same letter?

6 A. That is correct.

7 Q. Except for the addressee, it's identical?

8 A. That's correct.

9 Q. When you sent out that letter did you attach the
10 next document, which is this three-page AFE?

11 A. That's correct.

12 Q. And what are the total costs of the well, for a
13 completed well?

14 A. Total drilled and completed cost is \$604,425.

15 Q. This is dated in November of last year. Are
16 these costs still current, to the best of your knowledge?

17 A. Pretty much, to the best of my knowledge.
18 They're right in line with what -- going for, for a Dakota-
19 Mesaverde well.

20 Q. There is no substantial change, then, in the
21 total number of dollars spent?

22 A. No, sir, no substantial change.

23 Q. Is this the AFE that you would recommend the
24 Division Examiner rely upon to determine that the proposed
25 well is at a reasonable cost?

1 A. Yes, sir.

2 Q. Let's turn past that. Exhibit 12 you talked
3 about a while ago. I don't want you to read this for us.
4 What does it represent?

5 A. This represents the work that landman Gail
6 Bowline out of Dallas, Texas, performed for me in the
7 search for Mr. Driscoll. You know, essentially what we
8 came up with was the closest living heir was Mr. Steven
9 McManus, and the McManuses were not interested in pursuing
10 anything further on Mr. Driscoll's estate.

11 Q. Let's turn behind Exhibit Tab 5, and we're going
12 to start looking at those exhibits that are numbered with
13 Exhibit 13.

14 A. Okay.

15 Q. This will be the package of letters and
16 correspondence dealing principally with Mr. Bob Mosley,
17 who's here, and other members of his family whom he
18 represents?

19 A. Yes, sir, that's correct.

20 Q. So let's start that discussion. When you had the
21 title examined for unleased mineral owners, does this
22 represent the tabulation, to the best of your knowledge, of
23 those interest owners and the percentage interest they
24 would have in the spacing unit?

25 A. That's correct.

1 Q. Let's start at the bottom, this James Williams
2 Estate. What's the status of that interest?

3 A. Mr. Eloy Trujillo, who's the personal
4 representative of the estate of James R. Williams, he
5 agreed to lease with us, oh, a month and a half ago, a one-
6 eighth royalty interest, \$150 per acre for five years.

7 Q. Help us with the vocabulary. There's a
8 difference between you and Mr. Mosley, not only of royalty
9 percentage or fraction, but also with the difference
10 between a gross lease and a net lease?

11 A. That's right. Mr. Trujillo agreed to lease with
12 us using a lease that we -- use it with the net proceeds
13 lease language. Net proceeds --

14 Q. Let me ask you this: For the activity in this
15 spacing unit, do you have any gross leases?

16 A. No, sir, I do not.

17 Q. They're all net leases?

18 A. These are all net proceeds lease language,
19 correct.

20 Q. In using your business in San Juan Basin, do you
21 use a gross lease?

22 A. Have not.

23 Q. What's your understanding of the difference
24 between a gross lease and a net lease?

25 A. Well, what -- Gross-proceeds lease language

1 indicates in there that gathering/treating/processing
2 charges will not be paid by the interest owner or the
3 royalty owner on the lease. They're used in various places
4 where interest owners want to not have to pick up those
5 charges.

6 Net lease language is really kind of like the old
7 traditional lease, but it clarifies that the proceeds from
8 the wellhead will be netted back to the interest owner
9 based on what the actual charges are.

10 For instance, we may sell our gas at the tailgate
11 of a plant, but we have to pay freight, we have to pay
12 gathering, we have to pay treating, processing field
13 charges which are loaded on us by the gathering company to
14 get it to the marketable place. So we have just used the
15 net proceeds lease language as a clarification because, as
16 you know, across the Rockies there have been suits where
17 things have been challenged and the old leases just don't
18 stack up. I don't want to get into all that, but --

19 EXAMINER BROOKS: Yes, I'm very familiar with
20 that, some of that litigation anyway.

21 Q. (By Mr. Kellahin) So that turned out to be one
22 of the issues of difference between you and Mr. Mosley?

23 A. That's correct, that's correct.

24 Q. Let's go up the spreadsheet. there's a John Ford
25 listed here. Were you ever able to locate him?

1 A. We got a green card back on the first letter we
2 sent to him, but did not get one back on the notice of the
3 Commission hearing. We tried to call him and didn't hear
4 anything back, so -- didn't hear a thing from him.

5 Q. Let's turn to the Mosley interest, and I'll refer
6 to them collectively.

7 A. Okay.

8 Q. Has Mr. Bob Mosley told you that he is
9 representing that group?

10 A. Yes, he told me on our first conversation in July
11 of 2002, and you know, in those kind of situations our
12 initial contact was to send everybody out a letter, cover
13 letter and a lease and a draft and this is our offer,
14 because, you know, you don't always know how families are
15 going to -- if they're going to be working together or
16 working apart, so -- But after our first conversation he
17 told us he was working for -- or he was trying to help
18 everyone get on the same page.

19 Q. And so you honored that request, and that's --

20 A. Yes, sir.

21 Q. These letters that are exchanged are directed to
22 Mr. Mosley --

23 A. That's right.

24 Q. -- or Bob Mosley.

25 A. And actually, on this -- when we did send

1 certified, we send certified to everybody. And when we did
2 do a new lease proposal or a new lease clarification we
3 sent everybody the same correspondence.

4 Q. Let's turn to Exhibit 14.

5 MR. MOSLEY: Can I -- At any time can I say
6 something here, or --

7 EXAMINER BROOKS: Well, you'll have an
8 opportunity to question the witness --

9 MR. MOSLEY: Okay.

10 EXAMINER BROOKS: -- after Mr. Kellahin has
11 finished his questions.

12 MR. MOSLEY: Okay.

13 EXAMINER BROOKS: You may proceed.

14 MR. KELLAHIN: Thank you.

15 Q. (By Mr. Kellahin) Mr. McHugh, let's look at
16 Exhibit 14. You've tabulated some of the activities with
17 Mr. Mosley, the Ford and the Williams interests?

18 A. That's correct.

19 Q. I'm going to pass those so we can talk
20 specifically, and you can give us oral testimony about --

21 A. Okay.

22 Q. -- the Mosley interest. Let's start, then, with
23 Exhibit 15. This is a letter over your letterhead dated
24 June 25th of last year. It's executed by this Richard
25 Frazey?

1 A. That's right.

2 Q. Who is he?

3 A. He's a landman that works for me on a consulting
4 basis, contract basis.

5 Q. What were you asking him to do?

6 A. I asked him send out parameters described in this
7 letter to the Mosley clan of -- this was our initial
8 contact -- offering them one-eighth royalty interest, \$75
9 per acre for a five-year paid-up lease, and with delay
10 rentals for four years of the lease.

11 And so Mr. Frazey did this, and then --

12 Q. Yeah, let's look at this. The first paragraph
13 is, you propose the -- I use the fractions. It's an
14 eighth-interest royalty?

15 A. That's right.

16 Q. Was it your intention to present to the Mosley's
17 a net lease?

18 A. It was not my intention. When Mr. Frazey sent
19 out the lease form, if you look farther back in there, this
20 is a copy that he sent to Mrs. Mary Gwendolyn Mosley, which
21 she sent back. He had sent out a one-eighth gross-proceeds
22 form.

23 Q. Was that your intent, to have a gross-proceeds
24 lease --

25 A. It was not my intent to do that, right.

1 Q. -- sent out?

2 A. He has on his computer a list of leases, and he
3 apparently had been working on gross-proceeds leases at the
4 time -- this was back in July of last year -- and he sent
5 this lease form along. And so it wasn't really -- and that
6 was my -- I take responsibility for not catching that when
7 it went out.

8 Q. The second paragraph of the letter says, If this
9 is acceptable, please sign the lease, return it back to me
10 and execute the check. That was the direction that you
11 asked that the Mosleys use to accept --

12 A. Right.

13 Q. -- this proposal?

14 A. Right.

15 Q. In response to that initial proposal, what is the
16 next thing that happened?

17 A. The next thing that happened is, I got a call
18 from Mr. Mosley, Mr. Bob Mosley here, and he indicated he
19 and his siblings were all working together, and he
20 indicated he wanted a one-fifth royalty interest.

21 Q. So you already had a difference between you about
22 the royalty percent?

23 A. That's right. And then he wanted \$150 per acre.

24 Q. Which was twice what you offered?

25 A. That's correct. And then he wanted a shut-in

1 well payment of \$250 per lessor, per year for -- I think it
2 was a four-year lease. You know, I agreed with that on him
3 at the time and sent him a new lease and a new cover
4 letter.

5 Q. Were you in agreement with increasing the royalty
6 interest to a fifth as opposed to an eighth?

7 A. I was willing to do that to get him leased,
8 right.

9 Q. It was your understanding, though, in doing so
10 that you thought you were dealing with a net lease?

11 A. That's right, that's right. And when I did send
12 him back a lease, Exhibit 17, I --

13 Q. Well, Exhibit 16 was returned to you by the
14 various Mosleys?

15 A. That's right.

16 Q. Were they all done in the same fashion where it
17 says "No Sale", "No Sale", "Void"?

18 A. Yeah I think three out of the five of them came
19 back that way.

20 Q. Well, turn now to Exhibit 17.

21 A. Exhibit 17, I agreed to do that, but I changed
22 the form from a one-fifth -- or from a one-eighth gross-
23 proceeds lease to a one-fifth net-proceeds lease.

24 Q. Which was your intention all along?

25 A. Which was my intention all along. And I

1 indicated to Mr. Mosley when I visited him -- I was in
2 Farmington on business August 1st, and I indicated to Mr.
3 Mosley that, you know, we just can't live with the gross-
4 proceeds language at that royalty rate. We had a 30-minute
5 visit, I think, at your place, and we -- very cordial.

6 And at that time, Mr. Mosley produced an addendum
7 saying that they would accept the net lease form, but they
8 had to have, then, an addendum which said that the lessors
9 would not bear any of the gathering, treating or processing
10 charges.

11 And I said, Well, I can't live with that. I
12 mean, this is turning into -- a one-fifth lease is turning
13 into a one-half lease, the way some of these charges are.
14 So I was -- you know. And I'll take responsibility --

15 Q. So you and Mr. Mosley were not able to make an
16 agreement based upon what your proposal --

17 A. That's correct. And then what I did do on August
18 6th, Exhibit 18 -- Do you want me to go along and --

19 Q. Yes, yeah --

20 A. Okay.

21 Q. -- please go --

22 A. I got back from Farmington on August 2nd or 3rd,
23 so that following week, on August 6th, I sent him a letter
24 and I used the word clarifying the SJR offer with the net
25 lowest lease proceeds language, and here I was still

1 offering him the one-fifth royalty, \$150 per acre, the
2 delay rentals, four years, everything.

3 And you know, even at the time of our visit he
4 said he had another party who was going to go with him on
5 his terms and everything else, so I wanted to make sure if
6 everything was equal, maybe I'd have a chance of getting
7 the lease at the one-eighth and the net, that's all I was
8 willing to do. Or excuse me, the one-fifth royalty
9 interest and the net-lease language.

10 Q. Following the August 5th letter, when was your
11 next conversation or discussion with Mr. Mosley? Was there
12 a piece of correspondence between any more conversations
13 and Exhibit 18?

14 A. There was -- We might have had some telephone
15 conversations. But I just reiterated my point to him, and
16 I think I might have told him on the telephone, Well, if
17 you've got somebody else, you know, to go with, go for on
18 that.

19 Q. Well, let me understand, then. If I'm looking at
20 the August 6th letter --

21 A. Uh-huh.

22 Q. -- making a comparison to the next letter,
23 Exhibit 19, which is September 19 --

24 A. Uh-huh.

25 Q. -- what's the difference?

1 A. Okay, this was a kind of a -- not a final offer,
2 but I would agree to use the gross proceeds lease and a
3 one-eighth royalty, or use the one-fifth royalty lease and
4 a net language. And so my September 15th letter gave him
5 two options.

6 Q. September 19th letter?

7 A. Excuse me, September 19th letter. Two options,
8 and again, the explanation of our position.

9 Q. The next letter, Exhibit 20, I think is out of
10 sequence here, and there is another copy later of this same
11 letter.

12 A. So we ignore that.

13 Q. So let's ignore Exhibit 20 because it's repeated
14 and it's out of chronology.

15 So after the September 19th letter, we've given
16 Mr. Mosley both alternatives. What then did you do?

17 A. I believe at that point I had a telephone
18 conversation with him and I said, you know, if he can get
19 that deal with another company go ahead, because I can't do
20 it and, you know, if we end up drilling a well, we'll work
21 with that company. And I even think I mentioned, well, how
22 about, you know, we -- I even mentioned attaching a gas
23 balancing agreement to the lease so that if he wanted to
24 market his own gas that he could do that, and he didn't
25 want to do that.

1 So I mean, I was just trying to make a deal here,
2 which I thought was pretty generous in light of other parts
3 of the proration unit that I've worked.

4 Q. When we get to Exhibit 22 --

5 A. Uh-huh.

6 Q. -- what was your purpose in Exhibit 22?

7 A. This was the letter that went out certified mail
8 to all the interest owners that either we couldn't find or
9 that we couldn't make a deal with on the wells. So this
10 letter was sent to all the Mosleys -- and they're included
11 in this mailing -- to ask them if they wanted to join in
12 the well.

13 Q. And then in December, Exhibit 23, you've got a --
14 you received a letter from Mr. Tully in Farmington on
15 behalf of Mr. Mosley?

16 A. Right, I got this letter received in my office on
17 December 11th, and it was rundown of what the Mosley group
18 now wanted. And I responded to that on --

19 Q. Well, let's see where the difference is.

20 A. Oh, okay.

21 Q. They're still back on a fifth royalty, and they
22 want it to be net -- they want it to be gross.

23 A. They want it to be a gross lease, correct.

24 Q. And then there's a bonus of \$350 per mineral acre
25 and a two-year term at this point?

1 A. Right.

2 Q. And then you pay up the lease. What did you
3 respond to Mr. Tully? Well, I guess that's not the next
4 correspondence.

5 The next correspondence is Exhibit 24, which is
6 Mr. Tully's letter to me.

7 A. Yeah, I responded in --

8 Q. Later on. Let's finish the sequence so that the
9 Examiner --

10 A. Okay.

11 Q. -- has all the correspondence. So there's
12 Tully's letter to you, there's Tully's letter to me. And
13 that's followed, then, by Mr. Mosley's letter to the
14 Division dated January 22nd. That's Exhibit 25. Do you
15 have that?

16 A. Yes.

17 Q. Okay. After that, then, your letter of January
18 25th is Exhibit 26.

19 A. Uh-huh.

20 Q. You're responding to this latest proposal by Mr.
21 Tully, trying to get a voluntary agreement. How did you
22 respond --

23 A. I just said, Well, it looks like we're going to
24 go to the Commission, and what I want is a one-sixth
25 royalty, paid lease form on a net-proceeds lease, \$150 per

1 acre for three years.

2 Q. Okay. Now, Exhibit 27 is the January 30th letter
3 from Mr. Tully to me. What's Mr. Tully now proposing? Has
4 there been any change in positions here?

5 A. Yeah, he did propose that they have a one-sixth
6 -- or, excuse me, a 3/16 royalty interest.

7 Q. So he's dropped from a fifth now to 3/16?

8 A. And they're still hanging on the --

9 Q. -- gross lease?

10 A. -- gross lease that will not bear any production
11 costs and expenses.

12 Q. Did you respond to Mr. Tully's letter?

13 A. Yes, sir, I responded on February 6th, and I
14 agreed to --

15 Q. What was your last offer to Mr. Mosley?

16 A. I agreed to come up to \$200 per acre, one-sixth
17 royalty interest, paid-up lease form, net-proceeds lease
18 and a shut-in provision of \$50 per lease per year.

19 Q. Since the February 6th correspondence, have there
20 been any acceptance or further counteroffers by Mr. Tully
21 or Mr. Mosley?

22 A. No, sir.

23 Q. So that's sort of the end of the line with that
24 interest, is it not?

25 A. That's right.

1 MR. KELLAHIN: Mr. Brooks, that concludes my
2 examination -- No, I forgot to ask you about your operating
3 agreements.

4 Q. (By Mr. Kellahin) In your operating agreement,
5 what are your operating overhead charges on a monthly basis
6 for a producing well and a drilling well that you've got
7 Conoco and others to accept? What are you using?

8 A. Our monthly operating rates for a producing well
9 are \$890 per month, the drilling overhead rates are \$4905
10 per month. Both of these rates were checked via COPAS and
11 a survey of similar rates in the San Juan Basin.

12 Q. And that's your recommendation to the Examiner
13 for overhead rates to apply in the pooling order?

14 A. Yes, sir.

15 MR. KELLAHIN: That concludes my examination of
16 Mr. McHugh.

17 We would move the introduction of his Exhibits 1
18 through Exhibit 28.

19 EXAMINER BROOKS: Any objections to the exhibits,
20 Mr. Mosley?

21 MR. MOSLEY: No, sir.

22 EXAMINER BROOKS: Do you wish to cross-examine
23 this gentleman?

24 MR. MOSLEY: (Nods)

25 EXAMINER BROOKS: You may proceed.

1 MR. MOSLEY: He was right on the -- or the first
2 was a gross proceeds, first lease, I've got it right here.

3 I talked to him on the phone and I told him what
4 we wanted. He agreed over the phone and I told him it was
5 gross proceeds.

6 EXAMINER BROOKS: Excuse me just a minute. We
7 need to have a certain etiquette here, because if I let you
8 give your testimony now, then the question will arise as to
9 what do I do next? Do I let Mr. Kellahin cross-examine you
10 or so forth? So to keep this in sequence, you can ask this
11 gentleman questions if you want to at this time, and then
12 after the two witnesses for San Juan have testified, then
13 we'll let you testify, and then Mr. Kellahin can ask you
14 questions. Okay?

15 MR. MOSLEY: Okay, I'll just --

16 EXAMINER BROOKS: Yeah, you can ask this
17 gentleman questions, any questions you want to ask him
18 about his testimony.

19 CROSS-EXAMINATION

20 BY MR. MOSLEY:

21 Q. And you came to my house on -- somewhere around
22 the 1st of August; is that correct?

23 A. That's correct.

24 Q. Okay. And we talked in my living room about the
25 lease?

1 A. That's right.

2 Q. At that time there was an attachment to it; is
3 that correct?

4 A. Right, the addendum that you had, or Exhibit A, I
5 think it was. I never got a copy because I think you kept
6 it. I looked at it and I just said, Well, I -- I just
7 don't see how we can do all these things. I need to talk
8 about it, need to get back and -- Part of the problem was,
9 I was trying to clarify in my mind what lease we'd
10 initially sent out and what lease -- what the whole picture
11 was, gross versus net. So there was some confusion in my
12 mind when I met with you as to what I had agreed to over
13 the telephone and whether we were using the correct lease
14 form also.

15 My letter of August 6th was a clarification of
16 our offer.

17 Q. And did I just hear you say that I didn't give
18 you a copy of this? Is that correct?

19 A. Yeah, I think -- You know, you had that
20 attachment on there, and I don't -- I think I sent it back
21 to you. I think I sent it back to you. I didn't keep a
22 copy.

23 Q. Is it correct that I gave you a copy after you
24 approved it in my living room, and you -- this copy right
25 here was already notarized, and you took it to Denver with

1 you? Is that not correct?

2 A. I don't believe I approved in the living room. I
3 said I would look at it and try to understand what the
4 story was and make sure we were on the right lease form.

5 Q. Did you not say, You're driving a hard bargain,
6 Bob, but we will -- we will go with this?

7 A. I don't recall saying that. I know I felt very
8 uneasy bearing all the gathering and processing charges and
9 that I took it with me.

10 And then you said, Well, send it back. If you
11 can't do it, then send it back.

12 So I sent the whole thing back. So to me it
13 wasn't an agreement, and I was still getting -- That's why
14 I sent this June -- or this August 6th letter clarifying
15 our position and our offer, what we could and could not do.

16 Q. Did you send me another lease on October 1st,
17 after we had talked on the phone about gross proceeds?

18 A. I sent you a letter of September 19th, and I
19 included two lease options, one-eighth royalty lease, using
20 a gross-proceeds lease language, and a one-fifth royalty
21 interest lease using a net proceeds lease language. And I
22 believe those leases were dated October 1st. And that is
23 Exhibit Number 21.

24 Q. Is there a case in San Juan County against you
25 for this same manipulation, a court case?

1 A. I don't believe so. I don't know what you're
2 talking about.

3 Q. And you're saying that you did not approve that
4 lease in my living room?

5 A. I didn't think I did. I told --

6 Q. Well, this is not --

7 A. -- I had to look at it and talk about it and talk
8 to my landman and see -- try to get straight on gross
9 versus net and then look at how much it's going to cost us,
10 and that's when I sent back the August 6th letter back
11 clarifying our offer and what our position was.

12 Q. This is not, I didn't think. This is the truth.

13 MR. KELLAHIN: He's arguing with the witness. If
14 he wants to testify to his version he'll have a chance.

15 EXAMINER BROOKS: I sustain that objection.

16 Any further questions, Mr. Mosley? I sustained
17 the objection to the last one.

18 MR. MOSLEY: Okay, now can I tell -- How do I
19 tell my side of it?

20 EXAMINER BROOKS: Well, after both of Mr.
21 Kellahin's witnesses have been examined by him and by you
22 and by me, then you'll have an opportunity to tell your
23 side, and then Mr. Kellahin can ask you questions, and I
24 can. Okay?

25 MR. MOSLEY: Okay.

1 MR. KELLAHIN: I have no redirect.

2 EXAMINATION

3 BY EXAMINER BROOKS:

4 Q. Okay. I'm sorry, what is your name?

5 A. Jerry McHugh.

6 Q. Mr. McHugh, I should remember that.

7 This is a Mesaverde and Dakota prospect only; is
8 that correct?

9 A. Yes, sir.

10 Q. And what is the vertical limits that you're
11 asking us to pool?

12 A. From the -- probably the base of the PC to the
13 base of the Dakota. We plan to complete in the Mesaverde
14 and the Dakota --

15 Q. Yeah, but you're not --

16 A. -- formations.

17 Q. -- you're not looking at the Fruitland or the PC
18 on this?

19 A. That's correct. There's an existing Fruitland
20 well on the proration unit.

21 Q. Is that the Fannie Ward?

22 A. No, it's the Scott Number 1.

23 Q. Okay.

24 A. It's not indicated on the map.

25 Q. Where is this located in reference to --

1 A. We're just west of Aztec about two and a half
2 miles.

3 Q. Is it close to the Animas River?

4 A. We're probably a half mile from the Animas.

5 Q. I think we've -- Okay, yeah, and you want a
6 south-half spacing unit here?

7 A. Yes, sir.

8 Q. Let's see, now, hang on a second. This is in
9 Basin-Dakota?

10 A. Yes, sir.

11 Q. And do you know the name of the pool in the
12 Mesaverde?

13 A. It's the Blanco-Mesaverde.

14 Q. Blanco-Mesaverde. And those are both spaced on
15 320, correct?

16 A. That's right.

17 Q. Yeah, the two wells per unit, 320, okay.

18 A. Actually it's four wells per --

19 Q. Four wells.

20 A. I think it's been downsized.

21 Q. Okay, very good, I stand corrected.

22 Now, your overhead rate was \$4905 for drilling,
23 and did you say \$890 for producing?

24 A. \$890, correct.

25 Q. And you say that's the survey standard up there?

1 A. Well, I think in our process we checked through
2 COPAS and then did a survey as to what we were charging our
3 current wells, and because this was a commingled well,
4 there's going to be a little bit more work to do as far as
5 divvying up the interests and working on the locations. I
6 mean, just office work, essentially.

7 Q. The producing rate seems a bit higher than what
8 we've normally encountered. The drilling rate is well in
9 line, maybe a little low, but the producing rate seems a
10 little high. That's the reason I asked the question.

11 A. Okay. We thought it was pretty much in line
12 since it was a commingled well.

13 Q. Well, that may be the difference.

14 And you understand that you will have to apply
15 separately for the downhole commingling --

16 A. Yes, sir --

17 Q. -- under the --

18 A. -- I realize that.

19 Q. -- OCD Rules?

20 Now, I'm not sure I got down correctly the
21 various terms that you mentioned that you had made with
22 various people. You said, one, that you did a five-year
23 lease at \$150 per acre with a one-eighth royalty; is that
24 correct?

25 A. That's right, that's with Mr. Williams, Mrs.

1 Norwood, and I believe that's also the same rate with Mr.
2 Good.

3 Q. And I thought you said it was \$120 per acre with
4 him. Did I mis- --

5 A. Mr. Good was about \$120. Ms. Norwood, I think,
6 was \$30. And Mr. Williams' Estate was, I think, \$150.

7 Q. Okay. They were all one-eighth royalty?

8 A. Yes, sir.

9 Q. And those are all five-year leases?

10 A. Yes, sir.

11 EXAMINER BROOKS: Okay, I believe that's all I
12 have.

13 MR. KELLAHIN: No further questions.

14 EXAMINER BROOKS: Very good, you may call your
15 next witness.

16 MR. KELLAHIN: Mr. Johnson's exhibits are found
17 behind -- in the exhibit book, behind Exhibit Tab Number 6,
18 and he's going to discuss Exhibits 29, 30 and 31.

19 EXAMINER BROOKS: Very good, you may proceed.

20 GARY J. JOHNSON,
21 the witness herein, after having been first duly sworn upon
22 his oath, was examined and testified as follows:

23 DIRECT EXAMINATION

24 BY MR. KELLAHIN:

25 Q. Mr. Johnson, for the record, sir, please state

1 your name and occupation.

2 A. Gary J. Johnson. I live in Sedalia, Colorado,
3 and I'm a consulting petroleum engineer.

4 Q. On prior occasions have you testified before the
5 Division as an expert in petroleum engineering?

6 A. Yes, I have.

7 Q. You were part of the Gavilan hearing at one time,
8 were you not?

9 A. Yes. Yes, I spent a lot of time here.

10 Q. Have you been asked by Mr. McHugh to make a study
11 of the Mesaverde and the Dakota in this area, in terms of
12 reaching your own expert opinion about the appropriate risk
13 factor penalty to apply in this case?

14 A. Yes, I have.

15 Q. Based upon that study do you have an opinion?

16 A. Yes, I do.

17 MR. KELLAHIN: We tender Mr. Johnson as an expert
18 witness.

19 EXAMINER BROOKS: Any objection, Mr. Mosley?

20 MR. MOSLEY: No, sir.

21 EXAMINER BROOKS: So qualified.

22 Q. (By Mr. Kellahin) What is your opinion?

23 A. My opinion is that there are risks associated
24 with this well and that the cost plus 200 percent is an
25 appropriate risk factor.

1 Q. Let's look to see how you support that
2 conclusion.

3 A. Okay. First thing I did was to look at the area
4 that's been shown to you on the map, as far as production
5 from both the Mesaverde and the Dakota, and I drew what I
6 call production contour maps that are Exhibits 29 and 30.

7 Exhibit 29 is a contour map based on the
8 cumulative production from wells that are completed in the
9 Dakota, and Exhibit 30 is a contour map based on the
10 cumulative production on wells from the Mesaverde.

11 After looking at those, what it indicated to me
12 -- I'll talk about the Mesaverde in 30 first. As you can
13 see, there's no Mesaverde completions to the southwest area
14 in this map.

15 And also as you can see on that, the larger
16 cumulatives are to the north and to the west, and as you go
17 to the south -- or to the north and to the east. As you go
18 to the south and to the west there's not much data, or the
19 cumulatives are decreasing as you go kind of down into that
20 part of the field. So what that exhibits to me is that
21 there's a lot of risk in the Mesaverde of, number one,
22 encountering production and, number two, encountering
23 cumulative production that would indeed pay for this well.

24 In the Dakota on Exhibit 29, there's production
25 in all four directions from the proposed location, but what

1 this illustrates to me is that there's a real sweet spot,
2 if you will, here in the south part of Section 7 and a
3 trend that goes east to west across that area around the
4 sweet spot. And then there's more good production to the
5 south.

6 But in the center of the map, in Sections 17, 18
7 and then over in the next township in Section 13, the
8 cumulative productions here seem to be somewhat limited.
9 And my conclusion on that, adding that to the look at the
10 Mesaverde, is that there is some geologic risk, and there
11 is quite a bit of production risk involved with this
12 location.

13 I used these cumulatives, then, to look at the
14 economics of drilling a well here, and I used these
15 cumulative maps to come up with what I thought a well out
16 here might recover for cumulative production.

17 Based on this, I basically said you do have some
18 risk that one or the other of these formations -- probably
19 the Mesaverde -- may not produce. And so I came up with
20 two economic scenarios, and those are attached --

21 Q. That's Exhibit 31, is it not?

22 A. Yeah, Exhibit 31. And what I did there was used
23 a cumulative in the 700 million area for the commingled
24 well and then ran a second case based on a 300 million
25 cumulative if indeed the Mesaverde formation didn't

1 produce, and ran economics on that.

2 And then in addition to that, I also looked at
3 the price assumptions for gas and oil. And based on the
4 history that we have in the San Juan Basin, the prices that
5 we're looking at today are looking pretty good, but there
6 is some risk that they could return to what they've been
7 historically. So in addition to the geologic and
8 production risk, there also is price risk involved with
9 this well.

10 I don't know how much detail you want to go into
11 on the --

12 Q. Well, let's give them a short answer.

13 A. Yeah, basically --

14 Q. Let me ask you this, Mr. Johnson: If I'm going
15 to invest -- what is it, \$600,000 and change --

16 A. Yes --

17 Q. -- in the well?

18 A. -- \$604,425.

19 Q. For every dollar I put in initially, what am I
20 going to get back?

21 A. My best-case analysis of this basically would
22 say, if prices stay up and production is good you're going
23 to get in the neighborhood of two dollars back for every
24 dollar you invest.

25 Q. And it's going to take me at least 14 years to

1 accomplish all that?

2 A. Seventeen year well life on the high case, and
3 that case has about a two-and-a-half-year payout on it.

4 Q. There will be a period of time in which I'm going
5 to have to accept the fact that for every dollar I get
6 back, I may be able to distribute only a dollar and a
7 penny?

8 A. Yes, there are cases that I've run here. On the
9 lower reserve case, even with the high prices, the
10 discounted net investment -- discounted net return per
11 dollar invested is actually \$1.01.

12 Q. In conclusion, then, your analysis supports your
13 opinion of the maximum penalty that's justified?

14 A. I believe it does for me, yes.

15 Q. And that's your recommendation to the Examiner?

16 A. Yes.

17 MR. KELLAHIN: That concludes my examination of
18 Mr. Johnson.

19 We move the introduction of his Exhibits 29, 30 and
20 31.

21 EXAMINER BROOKS: Any objections to the exhibits,
22 Mr. Mosley?

23 MR. MOSLEY: No.

24 EXAMINER BROOKS: Twenty-nine through 31 are
25 admitted.

1 Mr. Mosley, do you have any questions for Mr.
2 Johnson?

3 MR. MOSLEY: No, sir.

4 EXAMINER BROOKS: Well, you're obviously not Mr.
5 Johnson the mountain climber.

6 THE WITNESS: But I do get a lot of attention
7 when I call on the phone here.

8 EXAMINER BROOKS: I imagine so. No, I have no
9 questions of this witness.

10 THE WITNESS: Thank you.

11 EXAMINER BROOKS: I would, however, like to
12 recall Mr. McHugh for a moment. I forgot to ask him some
13 things.

14 JEROME P. MCHUGH, JR. (Recalled),
15 the witness herein, having been previously duly sworn upon
16 his oath, was examined and testified as follows:

17 EXAMINATION

18 BY EXAMINER BROOKS:

19 Q. What I forgot to ask you about, Mr. McHugh, is
20 the Driscoll interest.

21 A. Yes, sir.

22 Q. If I understood you correctly -- Well, first of
23 all, this Driscoll interest is fairly large, right?

24 A. That's right.

25 Q. Thirty-something percent of the prospect; is that

1 correct?

2 A. It's about 39. We have a lease that overlaps
3 with it.

4 Q. Well, that was what I was going to ask you about.
5 If I understood you correctly, there's some title
6 controversy or potential title controversy involved in some
7 of this interest and that you have some leases that
8 conflict with what Driscoll may acquire?

9 A. Mr. Driscoll's interests we estimated to be, at
10 most, 39 percent; and at least, it could be around 11,
11 based on these three leases and tracts involved here.

12 Q. Be at most thirty --

13 A. 39.45.

14 Q. 39.45.

15 A. And at least -- I'm just guesstimating off the
16 top of my head, around, oh, 11 percent.

17 Q. And what is the source of -- Can you give me any
18 kind of idea what the source of the uncertainty about the
19 title is, as far as what Mr. Driscoll --

20 A. There were -- This tract number 4 in Exhibit 5,
21 page 3, at the bottom of Exhibit 5, page 3, on the Fannie
22 Ward lease, there have been four leases taken out. I
23 checked back in production history and saw that there were
24 some gaps in production, so we're not a hundred percent
25 sure that the Fannie Ward lease is in effect, because there

1 were other lease taken out after --

2 Q. Right.

3 A. -- the Fannie Ward lease was taken, and I think
4 that was -- I don't think I have the documents. It was
5 about nineteen maybe fifty-five. There were two or three
6 others that were taken afterwards, different zones. And so
7 I'm having the standup title opinion done to ascertain
8 that.

9 But we're requesting the entire -- what could be
10 as the force-pooled percentage.

11 Q. Right. And you own -- Do you own the Fannie Ward
12 lease?

13 A. No, I own --

14 Q. I mean, does San Juan own the Fannie --

15 A. No, I don't own that one.

16 Q. But you own a lease that covers --

17 A. That's right.

18 Q. -- that interest that's junior to the Fannie Ward
19 lease?

20 A. That's right.

21 Q. And the issue, then, I take it, is one of lease
22 expiration, basically, what lease may have been in force
23 or --

24 A. Right, lease expiration, whether the leases were
25 ratified or not during the term of the primary lease and

1 what other wells in the lease might have held that lease --

2 Q. Now Mr. Driscoll --

3 A. -- are at issue.

4 Q. -- is he an unleased mineral owner?

5 A. No, he's a --

6 Q. Or is he an owner?

7 A. -- working interest owner.

8 Q. So he's an owner of an interest in one or more

9 leases that --

10 A. Right, he's an interest in these three, in tract

11 1, 6 and 4.

12 Q. But his interest is a leasehold interest, not --

13 A. Correct --

14 Q. -- mineral interest?

15 A. -- that's correct.

16 Q. Okay. And so the issue, then, is whether the

17 leases that the Driscoll Estate owns are the current ones

18 that are in force and effect, or whether the leases that

19 San Juan owns --

20 A. Right --

21 Q. -- are in current --

22 A. -- right.

23 Q. -- force and effect? Very good.

24 And you say you're having a title opinion done?

25 A. We're having a standup title opinion done right

1 now, just because there is uncertainty on some of the
2 tracts, and just trying to ascertain what we actually do
3 own and make sure we're prudent in doing it.

4 EXAMINER BROOKS: Very good, thank you.

5 Any further questions from either of you?

6 MR. KELLAHIN: No, sir.

7 MR. MOSLEY: (Shakes head)

8 EXAMINER BROOKS: Very good, you may stand down.

9 Anything further, Mr. Kellahin?

10 EXAMINER BROOKS: Very good.

11 Mr. Mosley?

12 MR. MOSLEY: I would like you to hear my side of
13 it.

14 EXAMINER BROOKS: Go ahead.

15 BOBBIE LEE MOSLEY,

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

18 DIRECT TESTIMONY

19 MR. MOSLEY: As the first lease says, gross
20 proceeds. And the reason I went with this 20 percent, I
21 had settled one with Bayless on some other properties with
22 a 20-percent lease.

23 Over the phone Jerry agreed on it. When he sent
24 me the lease he changed it from gross to net. I put the
25 exhibit on it. He come to my house, he looked it over. He

1 said, You sure drive a hard bargain but we're going to go
2 ahead and take it.

3 And he takes the lease -- this lease right here,
4 which is already certified and everything -- takes it to
5 Denver with him as final.

6 EXAMINER BROOKS: Okay, so that we can make a
7 clear record, would you mark that lease, that document that
8 you're referring to as an exhibit and introduce it in the
9 record? We'll allow you to have a copy made -- We'll have
10 a copy made for the record, and return it to you.

11 MR. MOSLEY: What exhibit do you want?

12 EXAMINER BROOKS: Mosley Exhibit 1. Okay, if
13 you'll show it to Mr. Kellahin.

14 MR. KELLAHIN: Thank you, Mr. Mosley.

15 You would like to have this up here?

16 EXAMINER BROOKS: I would like to have it in the
17 record. I think we need to return the original to Mr.
18 Mosley, but we need to have the court reporter make a copy,
19 and I assume you'll want the court reporter to make a copy
20 for you also.

21 MR. KELLAHIN: Please.

22 MR. MOSLEY: After that, I received a letter
23 dated August 6th, where he says the counteroffer was not
24 acceptable.

25 EXAMINER BROOKS: Okay.

1 MR. MOSLEY: We had --

2 EXAMINER BROOKS: Hold on a minute. Mr.
3 Kellahin, can you tell me if there's -- Is there an August
4 6th letter in your book?

5 MR. KELLAHIN: I'm looking as we speak. Exhibit
6 18.

7 EXAMINER BROOKS: Okay. If you would look at
8 Exhibit 18, which is several pages back behind Tab 5, Mr.
9 Mosley, do you have a copy of Mr. Kellahin's book?

10 MR. MOSLEY: Yes, sir.

11 EXAMINER BROOKS: Is that the letter you were
12 referring to --

13 MR. MOSLEY: Yes, sir --

14 EXAMINER BROOKS: -- the August 6th letter?

15 MR. MOSLEY: -- I've got a copy of it right here.

16 EXAMINER BROOKS: Okay, would you look at Exhibit
17 18 and tell us if that's a true copy of the letter that you
18 have?

19 MR. MOSLEY: That is a true copy of the letter.

20 EXAMINER BROOKS: Okay, continue.

21 MR. MOSLEY: Then after this, we talked on the
22 phone again. He said, We'll go ahead and go with that,
23 I'll just send you a new lease, which is dated the 1st day
24 of October, which he also did not show gross on it like we
25 had discussed. He changed it to net proceeds.

1 EXAMINER BROOKS: Okay, would you go, then, in
2 the book to Exhibit Number 21? That should be just a few
3 pages back behind 18.

4 MR. MOSLEY: I've got Exhibit 21, yes, sir.

5 EXAMINER BROOKS: Okay, then there is a -- what
6 appears to be a form of oil and gas lease appearing on the
7 two pages behind Exhibit 21. Is that a copy of the one he
8 sent you?

9 MR. MOSLEY: Yes, sir.

10 EXAMINER BROOKS: Okay, you may continue.

11 MR. MOSLEY: At that time I looked at it and I
12 told him that he had not held up what he had told me, that
13 we had decided on a gross proceeds instead of net proceeds.
14 And after that, the negotiations pretty well broke down.
15 Let me see what I've got.

16 Then on the first day of February he comes back
17 with a lease of one-sixth net and then drops the shut-in
18 price to \$25 a year after he had already agreed to the \$250
19 a year. And he does have a lawsuit against him in San Juan
20 County.

21 MR. KELLAHIN: I'm going to object unless he's
22 got documentation to establish that.

23 MR. MOSLEY: I can send it to you.

24 EXAMINER BROOKS: Well, we'll let him testify to
25 it, for whatever evidentiary value it has. So overrule the

1 objection.

2 Go ahead.

3 MR. MOSLEY: On the same deal where he's told
4 someone that he would do certain things and then changes it
5 in the lease. And I can send you the docket number or
6 whatever you want on it, if you want me to.

7 EXAMINER BROOKS: Okay, well, I actually think
8 it's -- what may have happened in some other case is
9 basically irrelevant, so I don't it will be necessary to
10 supplement the record on that, but we will let your
11 testimony stand.

12 Anything further, Mr. Mosley?

13 MR. MOSLEY: But some of the things that he
14 testified to is not correct in the way that we talked about
15 stuff. He very -- very much misrepresented himself today.

16 EXAMINER BROOKS: Is that all? Are you through?

17 MR. MOSLEY: I guess that's...

18 EXAMINER BROOKS: Very well.

19 Mr. Kellahin?

20 MR. KELLAHIN: Thank you, Mr. Brooks.

21 CROSS-EXAMINATION

22 BY MR. KELLAHIN:

23 Q. Mr. Mosley, would you turn to Exhibit 13 in Mr.
24 McHugh's exhibit book for me? It's right behind Exhibit
25 Tab 5. We pick up with Exhibit 13.

1 A. Okay.

2 Q. There's a spreadsheet here. It has your name as
3 the third one down. The other Mosleys on this list, are
4 they related to you?

5 A. Yes, they are.

6 Q. In what way, sir?

7 A. Siblings.

8 Q. To the best of your knowledge, has Mr. McHugh
9 correctly identified the percentage of mineral interest
10 that your family owns?

11 A. Yes, sir.

12 Q. You have no disagreement that he's at least got
13 that number right?

14 A. That's --

15 Q. That's your understanding of what you believe you
16 own?

17 A. -- my understanding, that it's correct.

18 Q. If you'll turn past that and come to Mr. McHugh's
19 Exhibit 15, this is the cover letter that included the
20 lease that you signed and just handed to Examiner Brooks?

21 A. No, sir.

22 Q. All right. Is there a lease associated with this
23 letter?

24 A. No, sir, I do not have a lease associated with
25 this letter.

1 Q. When you turn the page, Exhibit 16, there's a
2 letter of the same date to Mary Mosley. She's your sister?

3 A. Yes.

4 Q. Attached to that letter is a check made out to
5 Mary Mosley and a proposed lease dated July 1st of last
6 year. Do you see that?

7 MR. McHUGH: Exhibit 16.

8 THE WITNESS: Yes, sir.

9 Q. (By Mr. Kellahin) Sixteen. Do you see on the
10 cover letter and on the check and on the lease that someone
11 has written "No Sale", "No Sale", "Void", "No Sale",
12 "Void"?

13 A. I see that she did that.

14 Q. Did you instruct her to do that?

15 A. No, sir.

16 Q. Did all the rest of your siblings return leases
17 to Mr. McHugh in this manner?

18 A. I am not aware of how they returned them.

19 Q. Do you talk to them?

20 A. Yes, I talk to them. I don't know how they
21 returned their leases.

22 Q. The lease you handed Mr. Brooks that you signed
23 was transmitted to you by which transmittal letter for Mr.
24 McHugh? What letter goes with that lease?

25 A. It's --

1 Q. Okay, I think you're looking at Exhibit 17. Let
2 me see if I can help us get on the same page.

3 A. Okay.

4 Q. If you'll look at Mr. McHugh's Exhibit 17, it's
5 the July 24th letter. If you look past that, there's a
6 copy of a check, followed by a lease dated August 1st of
7 last year?

8 A. Yes, sir, that's the one I just handed --

9 Q. -- Mr. Brooks?

10 A. Yes.

11 Q. And when you look at the lease form itself, it
12 says one-fifth net proceeds, does it not?

13 A. Yes, it does, yeah. That's where the discrepancy
14 is.

15 Q. Well, that's right.

16 A. Because over the phone he said gross. He told me
17 a number of times.

18 I said, That's what we're going for, is gross,
19 without post-production cost.

20 Q. Did you ever sign and deposit the check?

21 A. Yes, because it said this -- He took the lease
22 from my house in agreement that it was a done deal.

23 Q. There's no addendum attached to this lease, is
24 there, in the exhibit book?

25 A. What?

1 Q. Your addendum that you stapled onto the lease in
2 August, I don't have that here.

3 A. Well, that's not -- I've got it right here if you
4 want to look at it.

5 Q. No, it's attached to the one you gave Mr. Brooks,
6 did you not?

7 A. And here's a copy of it, right here.

8 Q. In your conversation with Mr. McHugh on August
9 19th, did you tell Mr. McHugh that you had another company
10 that would take your deal at a fifth --

11 A. No, sir, I did not.

12 Q. You did not say that to him?

13 A. I said, I've got another company interested, I
14 will not even talk to them until we decide whether we're
15 going to close the deal or not.

16 Q. Who was the company you had in mind?

17 A. I don't have to disclose that.

18 Q. Is that the Bayless group that you were talking
19 about earlier?

20 A. I don't have to disclose that because of...

21 MR. KELLAHIN: I don't have any further
22 questions, thank you.

23 THE WITNESS: I've got the letters at the house,
24 if I have to prove --

25 MR. KELLAHIN: I'm done, thank you.

EXAMINATION

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BY EXAMINER BROOKS:

Q. Mr. Mosley, if I understand your testimony correctly you handed this lease which has been marked as Exhibit Number 1 to Mr. McHugh when he was at your house?

A. Yes, sir.

Q. And that would have been in approximately August of 2002?

A. Just August 2nd or 3rd, somewhere in there.

Q. Now, at the time you handed it to Mr. McHugh, was it signed as it is today, by you?

A. Yes, sir, it was signed.

Q. Was it acknowledged by -- or notarized --

A. Yes.

Q. -- by --

A. It was exactly the way you've got it in your hand?

Q. -- R.G. Hunnicutt, as it is today?

A. Yes, sir, just the way you've got it.

Q. And did it have the second page attached as --

A. And he --

Q. -- Exhibit "A", attached --

A. Yes, sir, and he sat down and read it and agreed on it, right there in my living room.

Q. And he took Mosley Exhibit 1 with him --

1 A. He took --

2 Q. -- when he left?

3 A. -- that one that you've got in your hand, took it
4 with him.

5 Q. And he subsequently returned it to you?

6 A. After I got the August 6th letter I asked him to
7 return it.

8 Q. Okay, he did not return it with the August 6th
9 letter?

10 A. No, sir.

11 Q. He returned it to you at a later date by mail?

12 A. By mail, he returned it by itself.

13 Q. Was there a letter that came with that?

14 A. No, he just sent it -- just in one of his
15 envelopes, sent it back to me.

16 Q. Very good.

17 A. There was nothing attached to it, no letter with
18 it.

19 EXAMINER BROOKS: Thank you.

20 MR. KELLAHIN: I have one follow-up question.

21 EXAMINER BROOKS: Go ahead.

22 FURTHER EXAMINATION

23 BY MR. KELLAHIN:

24 Q. Mr. Mosley, do you have a signed copy of the
25 addendum that's signed by Mr. McHugh? Did he execute a

1 copy of the addendum that you've put on that lease?

2 A. No, he just said that --

3 Q. I don't care what he said; did he sign it?

4 A. No, he hasn't signed it yet.

5 MR. KELLAHIN: No further questions.

6 EXAMINER BROOKS: One more.

7 FURTHER EXAMINATION

8 BY EXAMINER BROOKS:

9 Q. This exhibit, Mosley Exhibit 1, is signed only by
10 you, correct, Mr. Mosley?

11 A. Yes.

12 Q. Not by anyone else.

13 Now, did any of the other members of your family
14 for whom you had said you were negotiating, did any of them
15 sign leases like this?

16 A. No, because it says in there if one of us signs,
17 that it goes for all of us, in one of the leases.

18 Q. Where does it say that?

19 A. I...

20 Q. Well, I have it in the record, I can read it,
21 so... Make a note so I'll remember to.

22 A. But he was going to go ahead and send them their
23 leases.

24 EXAMINER BROOKS: Okay. Very good.

25 THE WITNESS: To get them signed.

1 EXAMINER BROOKS: Anything further, Mr. Kellahin?

2 MR. KELLAHIN: Just a short statement, Mr.

3 Brooks.

4 EXAMINER BROOKS: Okay, is there anything further
5 you wanted to say, Mr. Mosley? Have you had your say?

6 MR. MOSLEY: Well, it depends on his statement.

7 EXAMINER BROOKS: Okay. Well, we'll give you a
8 chance to respond after he makes his statement.

9 Very good, you may make your statement.

10 MR. KELLAHIN: Mr. Brooks, it's obvious that
11 there is no meeting of the minds here, there's a difference
12 of agreement over the lease form.

13 But I think what decides this for me is to look
14 at Mr. Tully's letter of January of this year. Mr. Tully
15 is -- That's Exhibit 27.

16 EXAMINER BROOKS: Okay. Go ahead.

17 MR. KELLAHIN: If Mr. Tully is claiming there is
18 a lease executed in effect by his client that was done
19 months earlier, why in the world is Mr. Tully proposing
20 lease terms or continuing to negotiate over these prices?
21 It simply confirms to me --

22 MR. MOSLEY: What exhibit is that?

23 MR. KELLAHIN: Exhibit 27.

24 It represents to me that the parties have not
25 reached an agreement. And I think that does it for me, to

1 say if Mr. Tully, who's a litigator and an experienced
2 lawyer in Farmington, is going to represent Mr. Mosley,
3 he's going to come back to the same lease you have there
4 and say, Mr. McHugh, you're done, this is the deal, you've
5 committed to it, we have an enforceable agreement.

6 He does just the opposite, he continues to
7 negotiate and proposes different terms. So it confirms
8 from his own lawyer that there is no contract.

9 EXAMINER BROOKS: Mr. Mosley?

10 MR. MOSLEY: Well, there wasn't when he sent it
11 back after he agreed on it, so there wasn't a contract.

12 EXAMINER BROOKS: So you're contending that there
13 is a legally binding contract on the basis of this lease as
14 of now?

15 MR. MOSLEY: No, sir, not when he sent it back,
16 there isn't.

17 But when he left my house to go to Denver it was
18 a binding contract, because he told me -- He shook my hand
19 and said, We'll go ahead and go with this.

20 EXAMINER BROOKS: But it's not your contention
21 that there is a valid, binding contract in existence as we
22 speak?

23 MR. MOSLEY: No, because he sent it back to me.

24 EXAMINER BROOKS: Okay, very good.

25 If there's nothing further, then Case Number

1 12,992 will be taken under advisement.

2 MR. KELLAHIN: Thank you.

3 EXAMINER BROOKS: Thank you.

4 (Thereupon, these proceedings were concluded at
5 12:30 p.m.)

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I hereby certify that the foregoing is
a true and correct record of the proceedings in
the examination hearing of Case No. _____,
and by me on _____ 19 ____.

_____, Examiner
Conservation Division

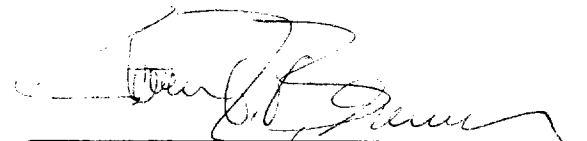
CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL February 23rd, 2003.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 16th, 2006

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