

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. 10801

APPLICATION OF MERRION OIL & GAS CORPORATION

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

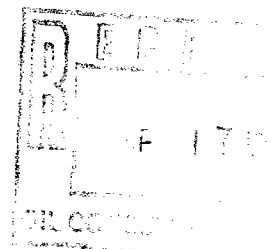
BEFORE: Michael E. Stogner, Hearing Examiner

August 26, 1993

Santa Fe, New Mexico

This matter came on for hearing before the
Oil Conservation Division on August 26, 1993, at
Morgan Hall, State Land Office Building, 310 Old Santa
Fe Trail, Santa Fe, New Mexico, before Deborah O'Bine,
RPR, Certified Court Reporter No. 63, for the State of
New Mexico.

ORIGINAL



I N D E X

August 26, 1993
 Examiner Hearing
 CASE NO. 10801

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A P P E A R A N C E S

FOR THE DIVISION: ROBERT G. STOVALL, ESQ.
General Counsel
Oil Conservation Commission
State Land Office Building
310 Old Santa Fe Trail
Santa Fe, New Mexico 87501

FOR THE APPLICANT: TANSEY, ROSEBROUGH, GERDING
& STROTHER, P.C.
621 W. Arrington
Farmington, New Mexico 87499
BY: TOMMY ROBERTS, ESQ.

FOR THE OPPOSITION: KELLAHIN AND KELLAHIN
117 N. Guadalupe
Santa Fe, New Mexico
BY: W. THOMAS KELLAHIN, ESQ.

1 EXAMINER STOGNER: Hearing will come to
2 order. Call next case, No. 10801.

3 MR. STOVALL: The very routine application
4 of Merrion Oil & Gas Corporation for compulsory
5 pooling, San Juan County, New Mexico.

6 EXAMINER STOGNER: Call for appearances.

7 MR. ROBERTS: Mr. Examiner, my name is
8 Tommy Roberts. I'm with the Tansey law firm in
9 Farmington, New Mexico, appearing on behalf of the
10 Applicant, Merrion Oil & Gas Corporation. I have two
11 witnesses testifying. Both of them have already been
12 sworn.

13 EXAMINER STOGNER: Let the record so show.
14 Are there any other appearances?

15 MR. KELLAHIN: Mr. Examiner, please, I am
16 Tom Kellahin of the Santa Fe law firm of Kellahin and
17 Kellahin. I'm appearing to behalf of the Markham
18 interests, specifically Roderick Allen Markham and his
19 sister, Manon Markham McMullen.

20 EXAMINER STOGNER: Any other appearances?

21 MR. ROBERTS: Call Crystal Williams.

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

25 EXAMINATION

1 BY MR. ROBERTS:

2 Q. Would you state your name and your place of
3 residence for the record?

4 A. Crystal Williams. I reside in Farmington,
5 New Mexico.

6 MR. ROBERTS: Mr. Examiner, rather than go
7 through the line of questioning that I went through
8 previously in Case 10800 regarding employment and
9 qualifications, I'd just ask that you take
10 administrative notice of this witness's testimony in
11 Case No. 10800 regarding prior employment and her
12 qualifications.

13 EXAMINER STOGNER: Mr. Kellahin, I believe
14 you were in the room when Miss Williams was
15 qualified. Do you have any objections or questions?

16 MR. KELLAHIN: No objection.

17 EXAMINER STOGNER: Let the record so show.

18 Q. (BY MR. ROBERTS) Ms. Williams, would you
19 briefly state the purpose of this application?

20 A. To force pool the interest from the surface
21 to the base of the Fruitland Sand Formation in the
22 southwest quarter of Section 22, 30 North, Range 12
23 West.

24 Q. Mrs. Williams, is the proposed location for
25 the recompletion a standard gas well location?

1 A. Yes, it is.

2 Q. And what has precipitated this application
3 for forced-pooling?

4 A. A noncommitted interest of Markham.

5 Q. Does it result from your desire, Merrion
6 Oil & Gas Corporations's desire, to recomplete an
7 existing wellbore in a shallower zone?

8 A. Yes.

9 Q. In what formation was the well originally
10 completed?

11 A. It was completed in the Mesaverde in 1961.

12 Q. What is the current status of that
13 Mesaverde completion?

14 A. It was depleted, and therefore we went up
15 over the Fruitland Sand.

16 Q. And the Mesaverde did plug back?

17 A. Yes, it has.

18 Q. The recompletion objective was the
19 Fruitland Sand. And what is current status of the
20 recompletion operation?

21 A. The recompletion is complete and was
22 produced for one month pursuant to approval of the
23 OCD, and it's currently shut in pending the results of
24 this hearing.

25 Q. Was that well frac'd?

1 A. I believe so.

2 Q. Are you sure of that?

3 A. No, sir.

4 MR. STOVALL: Mr. Sharpe can probably --

5 MR. ROBERTS: We'll have Mr. Sharpe address
6 that question.

7 Q. (BY MR. ROBERTS) Ms. Williams, when was
8 the well plugged back and perforated? When was this
9 operation undertaken?

10 A. In June of -- I'm sorry, May of 1993.

11 Q. I want you to refer to your Exhibit No. 1
12 and identify that exhibit.

13 A. Exhibit No. 1 is an area map of the San
14 Juan Basin, in particular, the Kirtland/Fruitland
15 outcrop. Highlighted in red is the township and range
16 of -- the township of where the Osborn 1 is located.

17 Q. What is the general purpose of this
18 particular exhibit?

19 A. Just to show a general area of where the
20 well actually is.

21 Q. Now, refer to what's been marked as Exhibit
22 No. 2 and identify that exhibit?

23 A. This is a Lease Ownership Plat of the
24 Osborn, well footages of 790 feet from the south line,
25 900 feet from the west line, showing the uncommitted

1 interests and leases involved in crosshatch.

2 Q. Is the proposed spacing unit for this
3 Fruitland Sand completion depicted on this exhibit?

4 A. Yes, it is.

5 Q. How is it depicted?

6 A. With the dotted line of the southwest
7 quarter being 160 acres.

8 Q. Is the location of the Osborn No. 1 Well
9 depicted on this exhibit?

10 A. Yes, it is. It's there in the southwest of
11 the southwest.

12 Q. Is it marked by a black dot?

13 A. Yes, it is.

14 Q. Would you identify the types of leases that
15 we're dealing with that comprise this particular
16 spacing proration?

17 A. All of the leases involved with the spacing
18 are fee leases and are noted within the quarter
19 section.

20 Q. Have all leasehold operating rights
21 interests or unleased mineral interests within this
22 proposed spacing unit, proration unit, been committed
23 to the unit?

24 A. No, they have not.

25 Q. Would you identify the uncommitted interest

1 owners?

2 A. Stated near the bottom is the name of Jack
3 and Mary Markham which has 25 percent working interest
4 in the leases which are crosshatched, which make up
5 4.25 percent working interest in the unit.

6 Q. Mrs. Williams, is it true that there is no
7 operating agreement to which the Markhams are a party
8 which would govern this recompletion operation?

9 A. That's correct.

10 Q. I'd like for you to refer next to what you
11 have marked as Exhibit No. 3 and identify that
12 exhibit.

13 A. Exhibit 3 is correspondence between Merrion
14 Oil & Gas and Rod Markham, a series of eight letters,
15 the first being a letter dated August 18th of '93
16 where we sent a copy of the recent AFE to Mr. Markham,
17 along with a copy of the revised operating agreement.

18 Q. Are these the AFE and the operating
19 agreement that Mr. Sharpe will address in his
20 testimony?

21 A. Yes, they are.

22 Q. Okay. Continue on.

23 A. The second letter noted was dated August
24 16, '93, with a letter that we received from Mr.
25 Markham requesting those changes that were made to the

1 operating agreement.

2 The next letter is dated August 13th of '93
3 where we sent the initial proposed operating
4 agreement.

5 Q. Let me summarize here quickly and tell me
6 if what I say is accurate. On August 13, you sent a
7 proposed operating agreement. Subsequently, Mr.
8 Markham responded, proposing some changes to the
9 operating agreement?

10 A. Correct.

11 Q. You then followed up with a revised
12 operating agreement?

13 A. Yes.

14 Q. Okay. Continue on.

15 A. The fourth letter was dated July 2nd of
16 '93. In actuality, I think it was meant to be dated
17 August 2nd, a mistake I realized at the time that he
18 received the letter, where he stated that the wellbore
19 value that we were suggesting was unfair and suggested
20 that we go to a forced-pool hearing.

21 The fifth letter was faxed and mailed July
22 26th of '93, responding to Mr. Markham's letter of
23 July 17th, requesting a net revenue of 75 percent
24 instead of 70 percent net revenue and restating our
25 position concerning the wellbore value.

1 Q. This particular item of correspondence, was
2 this addressing a farmout proposal?

3 A. At that point in time, it was addressing
4 the net revenue that was counteroffered.

5 Q. Under the terms of the farmout?

6 A. Under the terms of the farmout agreement,
7 yes.

8 Q. Okay. Continue on.

9 A. The sixth letter was dated July 17th, which
10 Rod Markham had sent, stating that Mr. Herd and Mr.
11 Christmann, who also owned a working interest in this
12 area, wished to farm out their interest at the 70
13 percent net revenue, and Mr. Markham still wanted to
14 participate at that time if we would forego the
15 wellbore value.

16 The seventh letter was dated July 9th of
17 '93 wherein Merrion Oil & Gas responded to Mr.
18 Markham's letter of June 26th, where he requested
19 additional data on the Osborn well.

20 The eighth letter is the June 22nd of '93
21 letter requesting a farmout of Mr. Markham's interest
22 or participation in the recompletion of the Osborn
23 well.

24 Q. I believe one item of correspondence here
25 indicates that attached with that correspondence is a

1 proposed farmout agreement and an AFE?

2 A. Correct.

3 Q. That particular AFE, I believe, indicates a
4 total recompletion cost of approximately \$18,000?

5 A. Correct.

6 Q. I believe you've earlier testified that a
7 more recent AFE has been sent to Mr. Markham?

8 A. Yes.

9 Q. Why was the original AFE for \$18,000 sent
10 to Mr. Markham?

11 A. At the time it was sent, it was an in-house
12 AFE, and it was noted that if he decided to
13 participate, the AFE would be part of the costs in
14 addition to a \$57,000 wellbore value.

15 Q. You've indicated that this correspondence
16 had been with Rod Markham and the correspondence
17 evidences that fact, yet Exhibit 2, on Exhibit 2
18 you've indicated that the owner of this particular
19 uncommitted interest is Jack and Mary Markham. Can
20 you explain why you have been corresponding with Rod
21 Markham?

22 A. When the title evaluation was done, it was
23 shown that Jack and Mary Markham owned the working
24 interest. When I tried to reach the individuals that
25 owned the working interest in this area, I was advised

1 in particular by Mr. Christmann that Rod Markham was
2 handling the estate or their affairs. And when I
3 spoke with Mr. Markham, he stated that he and his
4 sister did own the interest. And from that point on
5 all correspondence has gone through him.

6 Q. Have you had any verbal communications with
7 Mr. Markham?

8 A. Yes, I have.

9 Q. What would be the general nature of those
10 communications?

11 A. Just expressing that he did not feel that
12 it was fair to pay his percentage of the wellbore
13 value, and he did agree to participate in the
14 recompletion.

15 Q. So at all times he has indicated a
16 willingness to participate if the issue of wellbore
17 costs could be resolved?

18 A. Correct.

19 Q. Is that the current status of your
20 negotiations with Mr. Markham?

21 A. Yes, it is.

22 MR. STOVALL: Probably not true. I think
23 this is the current status of the negotiations with
24 Mr. Markham.

25 Q. (BY MR. ROBERTS) Now, the correspondence,

1 I believe, indicates that your initial communication
2 with Mr. Markham occurred after the plugging back of
3 the Mesaverde formation?

4 A. Yes.

5 Q. And the perforation of the Fruitland Sand.
6 Why did that initial communication occur after the
7 recompletion operation was initiated?

8 A. When this well was originally completed in
9 the Mesaverde, Jay Gregory Merrion and Robert L.
10 Bayless owned 100 percent of the 320. It was presumed
11 at that time that if we were to reduce the spacing to
12 the 160 that we would still own the 50/50 or 100
13 percent working interest.

14 Q. Basically, an internal error in assessing
15 ownership?

16 A. Correct.

17 Q. Please refer to what you have marked as
18 your Exhibit No. 4 and identify that exhibit.

19 A. Exhibit No. 4 is a letter dated August 3 to
20 Mr. Markham notifying him of the forced-pooling
21 hearing for today.

22 Q. Was that letter sent certified with a
23 return receipt requested?

24 A. Yes, it was.

25 Q. Do you have evidence in the form of that

1 return receipt that Mr. Markham indeed received that
2 communication?

3 A. Yes, I do. That would be page 3 of the
4 said exhibit.

5 Q. In your opinion, have the notice
6 requirements applicable to this application been
7 satisfied?

8 A. Yes, they have.

9 Q. Were Exhibits No. 1 through 4 prepared by
10 you or at your direction and under your supervision?

11 A. Yes, they were.

12 MR. ROBERTS: Mr. Examiner, I would move
13 the admission of Exhibit Nos. 1 through 4.

14 EXAMINER STOGNER: Are there any
15 objections?

16 MR. KELLAHIN: No objections.

17 EXAMINER STOGNER: Exhibits 1 through 4
18 will be admitted into evidence at this time.

19 MR. ROBERTS: I have no other questions for
20 this witness.

21 EXAMINER STOGNER: Thank you, Mr. Roberts.

22 Mr. Kellahin, your witness.

23 MR. STOVALL: I have one just to clear
24 things up so I understand.

25 EXAMINATION

1 BY MR. STOVALL:

2 Q. Is the difference in ownership in area
3 because it's split vertically, the Markhams own
4 shallow and not deep; is that correct?

5 A. Right.

6 EXAMINATION

7 BY MR. KELLAHIN:

8 Q. I'd like to go through the chronology with
9 you so that I have a clear understanding of the
10 sequence. What do your records show as to be the
11 completion date for first production of the Osborn
12 well?

13 A. The completion date that I was given was
14 May of 1993.

15 Q. That is for the recompletion?

16 A. Yes, sir.

17 Q. I didn't make myself clear. The well was
18 originally drilled as a Mesaverde well?

19 A. Correct.

20 Q. What is the vintage of that wellbore?

21 A. It was drilled in 1961 by J. Glenn Turner.

22 Q. I'm sorry, who was the operator?

23 A. J. Glenn Turner.

24 Q. J. Glenn Turner was the operator. Did
25 Merrion Oil & Gas Company have any interest in the

1 wellbore at the time it was drilled?

2 A. No, sir.

3 Q. Do your records reflect what the total cost
4 of that well was when it was drilled in '61?

5 A. No, sir.

6 Q. Do your records reflect whether or not it
7 produced out of any other formation other than the
8 Mesaverde?

9 A. Not that I'm aware of.

10 Q. The well was initially drilled, completed,
11 and produced out of the Mesaverde?

12 A. It's my understanding that is the case.

13 Q. Does your chronology show how long that
14 well produced out of the Mesaverde?

15 A. No, sir.

16 Q. Do you know what the total ultimate
17 cumulative production of gas was from that well out of
18 the Mesaverde?

19 A. No, sir. That is not an area that I am
20 familiar with.

21 Q. When did Merrion Oil & Gas Corporation
22 acquire this well?

23 A. I believe their acquisition started in
24 around 1976.

25 Q. You acquired it as a producing well?

1 A. Correct.

2 Q. And it was still producing at that time in
3 the Mesaverde?

4 A. That I do not know what the status of the
5 wellbore was.

6 Q. At the time it was acquired, do your
7 records reflect any value as to the wellbore in '76?

8 A. I do not know, sir.

9 Q. The recompletion attempt into the Fruitland
10 Coal was -- is it completed now? Is that work
11 accomplished?

12 A. The recompletion of the Fruitland Sand,
13 yes, is completed.

14 Q. Yes, ma'am. What was the date of that
15 effort? Do you know when it started and when the
16 effort was accomplished?

17 A. I don't know the exact date. The date I
18 show is May of '93.

19 Q. May of '93, which would show what?

20 A. Is when it was completed.

21 Q. That's the workover attempt that puts you
22 into the Fruitland Coal pool?

23 A. Correct.

24 Q. Was the work then accomplished before your
25 initial contacts and proposals to Markham?

1 A. Correct.

2 Q. Your initial letter to Markham then is the
3 June 22, '93, letter?

4 A. Yes, sir.

5 Q. Attached to that letter is the AFE for the
6 \$18,120?

7 A. Yes, sir.

8 Q. Do you have anything to do with the
9 itemization of those costs?

10 A. No, sir.

11 Q. Is that something Mr. Sharpe would be
12 involved in?

13 A. Yes, sir.

14 Q. Were you involved in -- I guess there are
15 two letters here, if I follow the chronology. There's
16 the initial letter of June 22 to Mr. Markham. It's
17 the very last in the package, Exhibit No. 3.

18 A. Yes.

19 Q. That letter has the recompletion AFE
20 attached to it?

21 A. Yes.

22 Q. Just ahead of that is another letter with
23 the same date?

24 A. Right. This letter clarifies what the
25 situation is that attached or enclosed, rather, is the

1 farmout agreement which is also dated June 22nd along
2 with the AFE for \$18,000 which states in the letter
3 what we presume the wellbore value to be since that
4 cost was not on that initial AFE.

5 Q. Did you participate in generating the
6 \$57,000 number?

7 A. No, sir.

8 Q. The next correspondence takes us into July
9 and then on -- there's Mr. Markham's letter of July
10 2nd, but that's a mistake, it should have been August
11 2nd?

12 A. Yes, sir, I believe so for the fact that
13 he's agreeing to the forced-pooling hearing.

14 Q. What is the date that the forced-pooling
15 application was transmitted to the Division? I
16 believe I saw --

17 A. July 26th.

18 Q. To the --

19 A. Wait a minute. Let's see.

20 Q. Bear with me a second.

21 A. Exhibit 4, August 3rd is where we notified
22 Mr. Markham. And our actual letter to Michael Stogner
23 was August 2nd.

24 Q. That's your Exhibit No. 4?

25 A. Yes.

1 Q. Look with me in the body of the context of
2 Exhibit 4 in that letter. If you'll look down, I
3 guess the second to last sentence, and pick it up
4 where it says, "Merrion Oil & Gas Corporation requests
5 that such order designates Merrion Oil & Gas
6 Corporation as the operator of the proposed
7 recompletion operation"?

8 A. Yes.

9 Q. ... "and that it provide for the recovery by
10 the joining working interest owners of the costs of
11 recompleting, equipping and operating the well"; do
12 you see that?

13 A. Yes.

14 Q. Do you have a reason that you didn't
15 include a request for the wellbore cost in the
16 application?

17 A. No, sir. This letter was completed by our
18 attorney. I, in turn, present the same exact thing to
19 the OCD.

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

21 EXAMINER STOGNER: Thank you, Mr. Kellahin.

22 MR. ROBERTS: I have nothing further.

23 EXAMINER STOGNER: Mr. Stovall.

24 MR. STOVALL: I don't think so. We're
25 going to have the similar problem in this one.

1 EXAMINER STOGNER: If there are no
2 questions, Miss Williams may be excused.

3 Mr. Roberts?

4 MR. ROBERTS: Call Mr. Sharpe.

5 EXAMINER STOGNER: Let the record show that
6 Mr. Sharpe has been previously qualified and sworn
7 under oath at that time in Case 10800.

8 Mr. Kellahin, I'd ask you at this time if
9 you have any objections or any questions of this
10 witness?

11 MR. KELLAHIN: No, sir, no objection.

12 EXAMINER STOGNER: Mr. Roberts?

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

16 EXAMINATION

17 BY MR. ROBERTS:

18 Q. Mr. Sharpe, would you briefly summarize the
19 production history of the Mesaverde formation in this
20 wellbore?

21 A. The well has produced a cumulative of
22 approximately 2 Bcf of gas and a small amount of
23 associated liquids.

24 Q. Ms. Williams testified that this particular
25 well was acquired by Merrion Oil & Gas, purchased by

1 Merrion Oil & Gas in 1976. Are you familiar with any
2 of the terms of that acquisition?

3 A. I am not.

4 Q. And you're not familiar with any mechanism
5 by which the value of that acquisition was determined?

6 A. I am not.

7 Q. Why did Merrion Oil & Gas elect to
8 recomplete this wellbore in the Fruitland Sand rather
9 than to drill a new one?

10 A. We elected to recomplete it for a number of
11 reasons, the first being that obviously the
12 recompletion is cheaper than drilling a new well
13 because we are utilizing existing wellbore and the
14 value of that existing wellbore.

15 The second reason is that it eliminated the
16 drilling risks, the fact that in drilling a new well,
17 there's always the possibility of losing the hole or
18 having complications at increased costs.

19 And the third reason, it eliminates the
20 geologic risk that indeed the Farmington sand, the
21 target sand, would be there. In this wellbore, those
22 risks were eliminated. We knew it was there.

23 Q. I want you to turn to what you have marked
24 as Exhibit No. 5 and ask you to identify that
25 exhibit.

1 A. That exhibit is an Authority For
2 Expenditure, an AFE, to drill and complete the Osborn
3 No. 1 as if it were a new well in the Fruitland Sand
4 at a depth of 1400 feet. It was prepared by our
5 operations manager, Steve Dunn, and I've had
6 conversations with Steve concerning the numbers, and
7 I'm familiar with how it was derived.

8 Q. What is the total estimated cost of this
9 recompletion operation?

10 A. The total estimated cost of drilling and
11 completing a new well, which is what this AFE
12 represents, is \$85,990. We have broken that up into
13 three categories. The first represents the Sunk
14 Wellbore Costs, what it would cost to drill and set
15 casing at a depth of 1400 feet, using 4-1/2 inch
16 casing. And that cost totals \$45,935.

17 The second item is the value using used
18 equipment values, approximately 60 percent of new, of
19 the existing equipment that will be necessary to
20 produce the Fruitland Sand.

21 And the third item is the completion costs
22 which represents the actual incremental costs to R.L.
23 Bayless and J. Gregory Merrion as owners in the well
24 to go through with the recompletion as we currently
25 plan.

1 Q. Are the values that you use for the
2 existing equipment based on used equipment values?

3 A. Again, yes, they are. They're based on
4 approximately 60 percent of new.

5 Q. With respect to sunk wellbore costs and the
6 casing items, is that valuation based on used pipe?

7 A. That is my understanding is, again, it is
8 based on used, 60 percent of new cost.

9 Q. What portion of the completion costs, those
10 numbers under the category entitled Completion Costs,
11 have been expended today?

12 A. Approximately \$12,000 has been expended to
13 date. The \$31,540 in item No. 3 completion costs
14 would compare to the \$18,000 AFE that was initially
15 submitted to Markham in June of '92 or '93.

16 Q. And there's an item here for stimulation.
17 Has that stimulation cost been incurred as of this
18 time?

19 A. The stimulation cost has not been incurred
20 and indeed is the major difference for the increase
21 from \$18,000 to our current estimate of \$31,540. We
22 now know what the well will produce unstimulated, and
23 we feel that it does need a stimulation job to
24 adequately produce at commercial rates.

25 Q. What was the purpose for formatting this

1 Authority For Expenditure in the manner which it is
2 formatted with the three subcategories of costs?

3 A. The major purpose for formatting like this
4 because it is felt that these three items will all be
5 viewed separately when the Examiner attempts to
6 determine whether or not we should recover these
7 items. Certainly we should be allowed to recover any
8 incremental completion costs. Hopefully, that will
9 not be contested.

10 Second, the existing equipment, again, it
11 is felt that although Merrion has used that equipment
12 for some time, it does have salvageable value. It is
13 valuable piece of equipment that we could turn and
14 sell right now. And it is felt that we -- any new
15 owner in that equipment should have to pay for it at
16 existing value.

17 And the sunk wellbore costs are itemized
18 out because, again, Merrion feels like they are
19 bringing the wellbore to the table at value and that
20 we should be -- any new owner in that wellbore should
21 have to buy into it at the value that it brings to the
22 operation.

23 Q. What is the significance of the Authority
24 For Expenditure which totaled \$18,000, and how did
25 that AFE come to be communicated to Mr. Markham?

1 A. Again, at the time that Merrion Oil & Gas
2 undertook these operations, our impression was that we
3 owned or that our working interest owners owned 100
4 percent of the well. That was an internal AFE to
5 strictly cover the incremental recompletion costs. We
6 were not sure how the well would perform and did not
7 include fracture stimulation in those costs of
8 \$18,000.

9 They were sent to Mr. Markham in a letter
10 stating that these incremental costs would have to be
11 supplemented with a wellbore value of approximately
12 \$57,000.

13 The wellbore value of \$57,000 is slightly
14 greater than the sum of item No. 1 on this AFE, the
15 sunk wellbore costs of approximately \$46,000, and the
16 existing equipment cost of approximately \$9,000, those
17 total slightly less than our initial quote of \$57,000
18 wellbore costs.

19 Q. Are there any contingencies built into this
20 Authority For Expenditure which has been most recently
21 delivered to Mr. Markham?

22 A. There would be some contingency built into
23 the completion costs and the future costs based on the
24 risks of what we still have to spend. There are no
25 contingencies built into the sunk wellbore costs, and

1 there are certainly no contingencies in the existing
2 equipment cost.

3 MR. STOVALL: Just for clarification, let
4 me make sure I understand what you mean when you say
5 there are contingencies built in, Mr. Sharpe. Are you
6 saying by that that some of these costs are -- let me
7 back up. The category 1 and 2 costs are known fixed
8 costs. You know what they are. There's no question;
9 right?

10 THE WITNESS: That is correct. There is
11 not the possibility that we would have complications
12 that would increase those costs, which is something
13 that would normally be included in an AFE.

14 MR. STOVALL: And in No. 3 when you're
15 saying contingencies, what you're really saying is
16 they are -- in some of these items on this are
17 estimates of cost, and they may --

18 THE WITNESS: They are estimates of cost
19 and inflated to some extent under the statistical
20 chance that we will have some unforeseen problems.

21 MR. STOVALL: I understand then the way
22 you've expressed it now. Thank you.

23 Q. (BY MR. ROBERTS) Mr. Sharpe, in your
24 opinion, are these costs represented on the Authority
25 For Expenditure reasonable given the nature of the

1 operation and the nature of your request in this case?

2 A. Yes, they are.

3 Q. Let me have you turn to what's been marked
4 as Applicant's Exhibit No. 6 and ask to you identify
5 that exhibit.

6 A. That exhibit is a wellbore schematic of the
7 Osborn No. 1 in its current state. It depicts the
8 well completed with 7-inch casing. It was set at a
9 depth of 3,332 feet. There is a plug over the open
10 hole. The open hole section was the Mesaverde.
11 Again, a plug was set above that.

12 It shows the Fruitland Sand formation with
13 the perforations from 1,311 to 1,330 feet. It also
14 shows the Fruitland Coal and the Pictured Cliffs
15 formation which are at a depth from 1,622 to 1,670
16 feet that are possible targets still in this
17 wellbore.

18 It shows that the future targets, as well
19 as the Fruitland Sand, both have cement behind pipe,
20 and that the wellbore, it doesn't necessarily depict
21 it, but the wellbore is in good mechanical condition.

22 Q. When you say the wellbore is in good
23 mechanical condition, are you referring to the cement
24 as well as the casing condition?

25 A. I'm referring to the cement behind pipe

1 behind the target zones, as well as the casing
2 condition. After plugging, setting the plug, the
3 casing was pressure tested, and it did withstand the
4 pressure test.

5 Q. You indicated that there is potential
6 within this wellbore as recompleted in the Fruitland
7 Coal zone and the Pictured Cliffs zone. What
8 potential value does that have to the working interest
9 owners?

10 A. That has significant potential value to the
11 working interest owners. A new well drilled just to
12 the Fruitland Sand would certainly not penetrate the
13 Fruitland Coal or the Pictured Cliffs, and, therefore,
14 those zones would not be available, certainly not for
15 the cost that we are offering the wellbore to the
16 Markhams. And both of those zones have production in
17 the area and are possible recompletion targets.

18 In addition, this wellbore has 7-inch
19 casing in it. The AFE cost of \$45,935 assumes that
20 any new well we would drill would run 4-1/2 inch
21 production casing.

22 Q. In your opinion, why is it appropriate to
23 include sunk wellbore costs and costs of existing
24 equipment in the total cost for this recompletion
25 operation?

1 A. There are a number of reasons. The first
2 is if this well were not available, the pooled parties
3 and Merrion would be required to drill a new well at
4 approximately the costs that have been shown on our
5 AFE.

6 The pooled parties are able to buy into our
7 wellbore with no drilling risks that might cause the
8 cost to be higher and no geologic risks that the
9 target formation would not be there. In drilling a
10 new well, you would have both those risks still facing
11 you. So they're able to buy at a base case scenario.

12 In addition, because of the reasons I spoke
13 of with the PC and Fruitland Coal portion and the 7
14 inch versus the 4-1/2 inch casing, they are able to
15 buy a wellbore that actually has greater value than a
16 new wellbore would, drilling on a risk basis.

17 And, finally, Merrion owns the wellbore,
18 and any outside party that would obtain an ownership
19 should have to buy in at the existing market value.
20 The fact that our wellbore may have been paid out and
21 may have been written off our books is irrelevant to
22 the fact that they should have to buy in at the value
23 of that wellbore to them.

24 For instance, again, if we owned a company
25 truck with 100,000 miles on it, we wouldn't be

1 required to give that truck away just because we had
2 fully depreciated it and written it off the books. We
3 would still sell it to a willing purchaser at whatever
4 value that truck would represent to them.

5 Q. Would you turn to what you've marked as
6 Exhibit No. 7 and identify that exhibit?

7 A. Exhibit 7 is a sketch of all the Farmington
8 Sand producers in the Township of 30 North, 12 West.
9 The Osborn well is shown in the southwest of the
10 southwest of Section 22. There are eight other wells
11 depicted on this schematic. And next to each of those
12 wells is the cumulative production from the Fruitland
13 Sand from those wells.

14 The item to be pointed out, we feel that
15 somewhere in excess of 100, and we project
16 approximately 200 million cubic feet, to be the
17 reserves for this well for an economic venture.
18 Certainly there are wells in the area that have
19 produced in excess of 200 million cubic feet; however,
20 the two wells closest to our wellbore are far, far
21 less than that economic criteria; therefore, there's a
22 significant risk.

23 Even though we know that our wellbore or
24 our well is completed and the Fruitland Sand is
25 producing gas, there's significant risk that the

1 reserve volume will not be there in our well to
2 justify an economic venture.

3 Q. When will you make a determination, a
4 company decision with respect to the reserve volume
5 and whether that is sufficient to justify continued
6 operation on this particular well?

7 A. Again, we have a volumetric estimate under
8 which we've made the expenditures to date. However,
9 that is only an estimate. It will require a certain
10 amount of production history and pressure history to
11 justify the fact that indeed we are in tap with the
12 volume of reservoir that we assumed in our
13 volumetrics.

14 We anticipate producing the well. It was
15 tested at 35 to 40 Mcf a day for a month-long test.
16 It is currently shut in. Upon obtaining a
17 communitization agreement and an approved C-104 from
18 the state, we would plan to produce that well for
19 several months to observe the production decline and
20 observe the pressure decline. And if it appears that
21 the reservoir volume is sufficient, we would at that
22 time plan to fracture stimulate the well and try to
23 increase the rates to what we feel would be more
24 commercial.

25 Q. At its current rate of production of 35 to

1 40 Mcf a day, do you consider that to be commercially
2 productive?

3 A. It is marginally commercial in the fact
4 that it pays for the operating expense, but it is not
5 providing a very significant return on the
6 investment. It is a rate that if sustained would
7 suggest some reservoir volume. If it is not
8 sustained, if it declines very quickly, we would
9 probably plug the well. If it is sustained, then we
10 will fracture stimulate the well.

11 Q. And, in your opinion, is there a future
12 risk associated with the stimulation process?

13 A. Absolutely. The well might be sustained
14 for several months, and we may expend the moneys
15 necessary to stimulate the well and may totally lose
16 the well during the stimulation job. In addition, it
17 may not perform after the stimulation job as
18 predicted.

19 Q. Do you propose that a risk factor be
20 charged against an interest owner who does not
21 voluntarily join in in this recompletion operation?

22 A. We would propose that the standard 200
23 percent risk factor be applied to the item No. 3,
24 which is the completion costs in our AFE, in Exhibit
25 No. 5, \$31,540 or whatever the actual costs are that

1 are expended through the completion effort.

2 Q. Why would you not propose that this risk
3 factor be attached to the sunk wellbore costs and the
4 existing equipment costs?

5 A. The reason it shouldn't be attached to the
6 existing equipment costs is because if the stimulation
7 does not work or if we do not have the reserves, then
8 Merrion can turn around and sell that equipment for
9 the value stated or use that equipment elsewhere at
10 the value stated on the AFE.

11 The reason we have not asked for the risk
12 to be applied to the sunk wellbore costs is because
13 those wellbore costs, the value of the wellbore is
14 based on, to some extent, the value of the Farmington
15 Sand. If the Farmington Sand has no value, then the
16 wellbore has limited value.

17 In addition, those are sunk costs to
18 Merrion Oil & Gas. They aren't risk costs that we're
19 taking from here in the future. And we feel it would
20 be unreasonable to expect to receive risk on those
21 costs.

22 Q. Now, refer to what has been marked as
23 Exhibit No. 8. Would you identify that exhibit?

24 A. Exhibit 8 is an AAPL form, model form
25 operating agreement dated August 1, 1993, that was

1 submitted to the Markham party. It is the operating
2 agreement under which we would propose to operate the
3 subject well.

4 Q. Is this the operating agreement that
5 contains the revisions that were made in response to
6 the request of Mr. Markham?

7 A. It is my understanding that it is, yes.

8 Q. Who do you propose to act as operator with
9 respect to the recompletion operation?

10 A. Merrion Oil & Gas Corporation will be the
11 operator.

12 Q. Do you propose the assessment of the
13 supervisory charges during the recompletion and
14 production stages of this operation?

15 A. We would propose supervisory charges for
16 the drilling and recompletion stages at \$4,000 per
17 month prorated on a daily basis, and for the
18 operations of the well, once production ensues, at the
19 rate of \$342 per month.

20 Q. In your opinion, are these rates reasonable
21 and customary given the nature of the operation and
22 the area of operation?

23 A. Yes, they are.

24 Q. What is the basis for your proposal?

25 A. They are based on an Ernst & Young survey

1 of operator rates across the United States and based
2 on rates that are applicable for this type of a well
3 in this area.

4 Q. In your opinion, will the granting of this
5 application be in the best interest of conservation
6 and result in the prevention of waste and the
7 protection of correlative rights?

8 A. Yes.

9 Q. Were Exhibit Nos. 5 through 8 prepared by
10 you or at your direction and under your supervision?

11 A. Yes.

12 MR. ROBERTS: Mr. Examiner, I'd move the
13 admission of Exhibit Nos. 5 through 8.

14 EXAMINER STOGNER: Are there any
15 objections?

16 MR. KELLAHIN: No objections.

17 EXAMINER STOGNER: Exhibits 5 through 8
18 will be admitted into evidence.

19 MR. ROBERTS: I have no other questions on
20 Direct.

21 MR. STOVALL: Mr. Examiner, at this time I
22 would like to point out the testimony in Case 10800
23 was suspended at the end of Direct Examination of Mr.
24 Sharpe because the issues in that case, which was
25 uncontested, and the issues in this case are similar.

1 Both involve the recompletion of a deeper well to a
2 shallower horizon and the forced-pooling of interests
3 in that horizon.

4 By agreement of the parties, as that record
5 will reflect, agreed to cross-examine in this case
6 where there is an adversarial party. And the
7 cross-examination from this point forward, the record
8 will be built for both 10800 and 10801.

9 EXAMINER STOGNER: Thank you, Mr. Stovall.
10 With that in mind --

11 MR. ROBERTS: Mr. Stovall, point of
12 clarification, Mr. Kellahin is involved in Case 10801.

13 MR. STOVALL: I'm glad you brought that up.

14 MR. ROBERTS: So with respect to his
15 cross-examination, that would pertain only to Case
16 10801, as I understand it. Any questions that you may
17 have and the Examiner may have would pertain to both
18 cases.

19 MR. STOVALL: Let's clear that up. Mr.
20 Kellahin is in fact only representing a party in
21 10801, and so you are true except for the fact that he
22 may ask some questions we don't ask because he asked
23 them. So it's not entirely easy, but he is not
24 considered an adversarial party in 10800, and he is
25 not representing anybody in that case. Thank you for

1 reminding me. I meant to say that.

2 EXAMINER STOGNER: Mr. Kellahin?

3 MR. KELLAHIN: Thank you, Mr. Examiner.

4 EXAMINATION

5 BY MR. KELLAHIN:

6 Q. Mr. Sharpe, I may have misspoke a while ago
7 when I talked to Miss Williams about the
8 characterization of the Fruitland. I may have called
9 it the Fruitland Coal Gas pool. For the Osborn No. 1
10 well, you're in conventional Fruitland Sand pool, are
11 you not?

12 A. Yes, sir.

13 Q. For this wellbore, what is the proximity of
14 the Fruitland Sand reservoir to the coal gas
15 reservoir?

16 A. Exhibit 6 would show that the Fruitland
17 Sand that we are producing from is at 1,311 to 1,330
18 feet of depth. The Fruitland Coal is the -- the main
19 Fruitland Coal is from 1,622 to 1,635 feet of depth.
20 There are Fruitland Coal stringers that would be above
21 that main Fruitland Coal interval.

22 Q. When I look at the AFE from April of '93,
23 the \$18,000 AFE, if you'll look at that with me, it
24 was part of Exhibit No. 3? Do you have one of those
25 copies, Mr. Sharpe?

1 A. Yes, I do.

2 Q. That 18,000 number for the recompletion
3 attempt was an effort in the Fruitland Sand pool, was
4 it not?

5 A. Yes, it was.

6 Q. When I look at the Intangibles, if you'll
7 read down, it says, No. 404, under Intangibles,
8 Stimulation; Frac, Acid, it's \$1,850?

9 A. Yes, sir.

10 Q. Was that stimulation work conducted on the
11 Osborn No. 1 Well?

12 A. The line stating Stimulation; Frac, Acid is
13 a standard line on our form. The only thing that was
14 contemplated there was a possible breakdown acid job.

15 MR. STOVALL: Mr. Kellahin, if you would
16 hang on just for one moment.

17 MR. KELLAHIN: Yes, sir.

18 MR. STOVALL: I found my copy of that AFE,
19 and I'm trying to find the Examiner's copy.

20 MR. KELLAHIN: It should be the second to
21 last page of Exhibit 3 under Correspondence.

22 MR. STOVALL: Okay. We haven't gotten
23 there yet. Okay, we're here.

24 Q. (BY MR. KELLAHIN) Directing your attention
25 now to entry 404 where it says Stimulation,

1 correspondingly, there was an estimated cost of 1800
2 bucks. First of all, was that money expended for that
3 process?

4 A. That was not.

5 Q. The Company Supervision, the entry just
6 above that, 408, is that the same kind of charge as
7 you're proposing when you request the overhead
8 supervision costs under COPAS?

9 A. That is not the same charge. That
10 represents on-site supervision.

11 Q. Other than the stimulation item under that
12 AFE, are there any other items under Intangibles that
13 were not expended?

14 A. We have spent approximately \$12,000 to
15 date; so obviously there were more that were not
16 expended. I would not know --

17 Q. Do you know where the difference is?

18 A. It didn't take four days. It only took
19 three so far. That's one item of difference.

20 We didn't have to haul in any of the water
21 under trucking. Item 411, you have some water-hauling
22 costs. So far we have not done a stimulation; so we
23 didn't have to haul any water in for a stimulation.

24 Rental & Tools of \$3,000, we anticipated
25 the possibility of having casing leaks. Once we

1 plugged back, we pressure tested without casing leaks,
2 and therefore did not have to get a bridge plug and
3 packer and go hunt down the leaks and attempt to fix
4 them.

5 Q. That work was completed; the initial
6 potential flow of the well was taken?

7 A. Yes.

8 Q. Was it hooked into a pipeline?

9 A. Yes.

10 Q. How long has it been producing into a
11 pipeline?

12 A. It was allowed to produce for 30 days
13 without a communitization agreement, and we have shut
14 it in. As of July 21st, it has been shut in, awaiting
15 the results of this negotiation.

16 Q. Do you deal with the mechanics of the Joint
17 Operating Agreement in terms of going out to interest
18 owners, perhaps not in this case, but in similar
19 situations where you submit to parties or partners an
20 AFE; you do the work?

21 A. I am involved in it, yes.

22 Q. Under this example here, would you not,
23 having completed the work, would you not have to
24 re-AFE your partners to do the stimulation program
25 that is outlined in the \$86,000 AFE?

1 A. We would write a supplement to this AFE.
2 And, yes, we would send a separate piece of paper
3 asking for additional approval for additional
4 expenditures.

5 Q. And it starts new clocks and new decisions
6 by those partners with regards to the expenditure for
7 the supplemental AFE?

8 A. I would assume so. I am not familiar with
9 the operating agreement to that extent, but I would
10 assume so.

11 Actually, I would like to take that back.
12 My understanding of supplemental AFE's, if it's within
13 the scope of existing work, and that work costs more
14 than you actually anticipate it doing, they are still
15 liable for all the costs, not what was AFE'd.

16 In this case, and under that scenario and
17 after the fact AFE may be submitted merely for
18 informational purposes, telling them where the money
19 was spent.

20 Q. It's that point I want to discuss with you
21 now. Do you as an engineer consider --

22 A. No, I don't.

23 Q. -- the subsequent stimulation program for
24 some \$17,000 to be a new procedure or a continuation
25 of the original AFE?

1 A. It would be outside of the scope of the
2 initial work.

3 Q. When we look at this wellbore, the '61
4 vintage wellbore, do you have any documents or
5 knowledge about what that well originally cost?

6 A. I have no documents.

7 Q. I want to talk to you about your '61 truck
8 that you want my client to pay '93 prices for, Mr.
9 Sharpe. The concept you have here is you've taken
10 what it would cost to drill that well today, using
11 used equipment that met the standards of the industry
12 to be used for a new drill?

13 A. Yes, sir.

14 Q. Those costs are itemized under this AFE,
15 Exhibit 5, as entry 1, Sunk Wellbore Costs?

16 A. Yes, sir.

17 Q. That's the \$86,000 number?

18 A. No. That would be the \$45,935.

19 Q. I misspoke. It's the forty-six or
20 forty-five nine. My question is, in the
21 communications we received from Miss Williams, she
22 referred to \$57,000 as the wellbore item. Where's the
23 difference?

24 A. The major difference is that the \$57,000
25 also included existing equipment. So they were

1 summing item 1 and item 2 on Exhibit 5.

2 That \$57,000 was determined by J. Gregory
3 Merrion, and I have no idea exactly how he went about
4 it. He may have just pulled that out of the air.
5 Steven Dunn went through a detailed engineering
6 analysis to value this as such and --

7 Q. I don't want to quibble over the
8 difference. I just want to understand what you were
9 thinking the \$57,000 was.

10 A. It did include the wellbore and the
11 existing equipment.

12 Q. When we look at existing equipment, that
13 has a salvage value or a market price you told me
14 that's equivalent to the \$8,500?

15 A. Yes, sir.

16 Q. Have you been involved on behalf of your
17 company with selling wellbores that have been
18 temporarily abandoned in circumstances like this?

19 A. I have not been involved.

20 Q. This wellbore last produced out of the
21 Mesaverde in, what, '87?

22 A. Many years ago.

23 Q. After it got some 2 Bcf of gas out of that
24 pool?

25 A. Yes.

1 Q. And it's been inactive for that period of
2 time?

3 A. Yes, it has.

4 Q. Have you, other than trying to generate a
5 price for that wellbore by looking at what replacement
6 cost would be, if you will, have you tried to figure
7 out what that wellbore value would be under any other
8 kind of method?

9 A. No.

10 Q. Describe for me the stimulation cost here
11 on the AFE for the Exhibit No. 5, the \$17,500 number.
12 What's anticipated to be accomplished with that
13 stimulation?

14 A. We would fracture stimulate the well and
15 would hope to increase the rate from its current 35 to
16 40 Mcf a day to in excess of 100 Mcf a day.

17 Q. What kind of treatment are you
18 anticipating?

19 A. I do not know what Steve Dunn has in mind
20 exactly for the size of the treatment, but that would
21 be a very moderate size frac job, maybe in the
22 neighborhood of 50,000 pounds of sand.

23 Q. Would that be a fracture job or a
24 stimulation technique that would pose any opportunity
25 to communicate the Fruitland Sand perforations with

1 the coal gas pool?

2 A. Highly unlikely.

3 Q. Lead me through the risk components again,
4 Mr. Sharpe. I believe you talked about the
5 elimination of a geologic risk. You've got a wellbore
6 that in fact is in the Fruitland Sand reservoir?

7 A. Yes.

8 Q. And you have a wellbore position where you
9 should have sufficient volume or thickness of the
10 reservoir to attempt a completion and a producing gas
11 well?

12 A. Yes.

13 Q. There was elimination of any mechanical
14 risk with this wellbore?

15 A. Yes.

16 Q. It passed all mechanical integrity tests, I
17 assume, for utilizing this old wellbore?

18 A. Yes.

19 Q. You ran through all those procedures, and
20 it certainly is suitable for this purpose?

21 A. Yes.

22 Q. Am I correct in reading the AFE, Exhibit 5,
23 that if I take out the stimulation, the seventeen
24 five, then the numbers are approximately correct on
25 the \$18,000?

1 A. They're in the ballpark. There's several
2 differences. The rental tools are different. Again,
3 I did not prepare either of these. I'm vaguely
4 familiar with what's going on, but that is the major
5 difference.

6 Q. I forgot the number, your volumetric
7 calculation on the reserve potential for the well was
8 what number?

9 A. 200 million cubic feet.

10 Q. Have you made any economic assessments of
11 that volume to determine what the present value is of
12 those reserves?

13 A. They have been made.

14 Q. Can you give me the bottom line number as
15 to what that present value is?

16 A. I say that, and I do not -- okay, excuse
17 me. I misstated the 200. It was initially estimated
18 at 250 million cubic feet. The 20 percent discounted
19 future value, 250 million cubic feet, would be
20 \$56,000, and an estimated IP of 100 Mcf a day.

21 MR. KELLAHIN: Thank you. I have no
22 further questions.

23 EXAMINER STOGNER: Thank you, Mr.
24 Kellahin. Mr. Roberts, any further Redirect.

25 MR. ROBERTS: Mr. Examiner, could I just

1 take a minute and consult with Mr. Sharpe.

2 EXAMINER STOGNER: Let's take a 10-minute
3 recess.

4 MR. ROBERTS: Okay.

5 THE WITNESS: Can we make it five? We've
6 got a plane that leaves at 4:00.

7 MR. ROBERTS: Could we just take a minute
8 and --

9 THE WITNESS: Would that be possible?

10 EXAMINER STOGNER: We'll take a ten-minute
11 recess.

12 THE WITNESS: Thanks.

13 (Thereupon, a recess was taken.)

14 EXAMINER STOGNER: Back on the record.

15 Mr. Robert, any Redirect?

16 MR. ROBERTS: No, we have no questions.

17 EXAMINER STOGNER: Mr. Stovall?

18 MR. STOVALL: Let me look real quick and
19 make sure. I don't have any questions.

20 EXAMINER STOGNER: With that, neither do I.
21 You may be excused.

22 EXAMINER STOGNER: Mr. Kellahin, do you
23 have anything?

24 MR. KELLAHIN: Brief closing statement, if
25 it may be of use.

1 EXAMINER STOGNER: Only you can determine
2 that.

3 MR. KELLAHIN: And I'm having trouble, Mr.
4 Examiner. We have searched all of our indexes, and I
5 cannot find an example of this kind of case that helps
6 to guide you to a solution. I was perhaps as
7 surprised as anybody to see that we have not dealt
8 with the concept of taking a wellbore that is this
9 old, that has paid for itself, been fully depreciated,
10 recovered some 2 Bcf of gas, and sat there on the
11 shelf by the operator for a number of years, and then
12 is utilized to come back and recomplete into a
13 shallower zone.

14 Set that aside for a moment, and there are
15 some of the basic components of the case that we've
16 dealt with quite frequently, one of which is the
17 chronology. Unlike the coal gas case where there is a
18 time constraint to get their recompletion work done by
19 the end of December, in Fruitland Sand there was no
20 reason that Merrion could not have found the Markhams,
21 dealt with them, and given them the opportunity to
22 make elections on recompletions before the work was
23 done.

24 This Commission in the Louise Locke case
25 against BHP decided that was a problem for BHP having

1 drilled the well and done the work before they asked
2 Miss Locke to join, and they denied then to the
3 operator anything more than a nominal penalty for
4 risk, 10 percent or whatever it was.

5 I would suggest that that should be part of
6 the solution here, particularly when Mr. Sharpe tells
7 you that the operator has eliminated the risk of
8 finding the reservoir, he's eliminated the risk of
9 mechanically drilling the well, and I think he has
10 also assumed the risk of undertaking the expense of
11 the recompletion cost entirely on his own ledger.

12 And so I would suggest to you that no risk
13 factor penalty is appropriate in this case because of
14 the sequence that were under control of this operator
15 and the choices that they made.

16 Having said that, it gets back to the tough
17 question. What do you do about an existing wellbore,
18 and what value does it have? My client would argue
19 and urge you that his share of the costs of this
20 project should simply be the actual costs spent in
21 relation to that \$18,000 AFE, since that was the
22 expenditure and that's what he ought to share in.

23 I don't know if that represents an
24 advantage to him, a windfall, or simply a circumstance
25 that you can't account for. It bothers me to take

1 something as old as '61 and to say that you can use
2 current prices and it's now worth \$50,000, \$60,000,
3 certainly not to Merrion but as a cost to my client.
4 I think that's excessive and perhaps unfair.

5 Quite frankly, I don't know what to suggest
6 to you in terms of a solution. There is simply for
7 opportunity for us to have a similar example.

8 Mr. Stovall mentioned prior to the hearing
9 a question whether a Chevron-Yates case might provide
10 some guidance. Mr. Roberts and I have both looked at
11 that case. It's Order No. R-9093C. I think it does
12 not, and I'll tell you why I think that order is
13 different. Yates was dealing with a new wellbore.
14 They had decided to drill to the Bone Springs.
15 Chevron had an interest in the Bone Springs but, if my
16 recollection serves me right, decided not to
17 participate in the deeper zone.

18 After the well is drilled, then Yates comes
19 back and wants to force-pool Chevron on the shallower
20 zone, the San Andres, and there was a question of how
21 to allocate costs on a new wellbore. I represented
22 Chevron in that case, and we urged the examiner and in
23 fact you, Mr. Stogner, issued this order. It's 1990
24 vintage, and maybe you've forgotten it.

25 MR. STOVALL: Are you sure it wasn't Mr.

1 Morrow?

2 MR. KELLAHIN: I don't know. It's got Mr.
3 Stogner's name on it. Anyway, what we had used for
4 guidance at that time was a COPAS bulletin, which had
5 a way to divide the cost among multiple zones, and
6 there's a formula to do it. I guess you could take
7 the costs of the Mesaverde well and allocate it
8 between Fruitland and Mesaverde, but that begs the
9 question. It's really what do you do with a wellbore
10 that's this old and how do you price it.

11 I was hoping Mr. Sharpe could tell us.
12 What does the industry do for themselves when they're
13 finding a wellbore that's temporarily abandoned,
14 another operator wants to utilize it, how do you value
15 it. He said he hadn't experienced it before and
16 didn't know. I have not experienced it before, and I
17 don't know either.

18 I would suggest to you that the \$57,000 is
19 excessive. It represents a windfall to the operator.
20 And it is more than my client ought to be required to
21 pay in order to participate in the well.

22 We think that under the circumstances my
23 client has requested and I would urge to you the
24 adoption of a cost component that equates the original
25 AFE and that it be applied without a risk factor.

1 EXAMINER STOGNER: Thank you, Mr.
2 Kellahin. Mr. Roberts.

3 MR. ROBERTS: Mr. Examiner, I think Mr.
4 Kellahin has touched upon an issue. That issue is any
5 potential windfall to either parties in this case
6 resulting from the decision that you might make.

7 I think it would be apparent that one party
8 or the other is going to receive some significant
9 benefit here, whichever or whatever decision you may
10 make. If the decision is to not hold Mr. Markham
11 accountable for any portion of the existing wellbore
12 from the surface to the Fruitland Sand formation, then
13 he has benefited significantly. He has essentially
14 bought into a wellbore or obtained ownership rights in
15 a wellbore without having to compensate for that
16 particular benefit.

17 The benefit he realizes is the ability to
18 produce his interest in the Fruitland Sand formation.
19 And the only way that can occur is through
20 recompletion of the existing wellbore in the Fruitland
21 Sand or by drilling a completely new wellbore. And in
22 this case it's the contention of Merrion Oil & Gas
23 Corporation that the best measure of that value would
24 be the cost to Mr. Markham of participating in a new
25 drill operation, what it would cost to drill from the

1 surface to the Fruitland Sand.

2 We know of no better way to value that
3 benefit to him, but without that recompletion or
4 without the drilling of a new wellbore, he doesn't
5 realize the benefit of his leasehold operating rights
6 in the Fruitland Sand formation.

7 We think this is an equitable way to
8 address the concerns. Essentially what Merrion Oil &
9 Gas has is ownership of the wellbore. Essentially
10 what Markham would be obtaining here is an interest in
11 that wellbore and the surface equipment on the
12 wellbore. He ought to compensate Merrion Oil & Gas
13 for that benefit derived from buying in or paying the
14 benefit of that existing wellbore and existing
15 equipment.

16 I think the Chevron-Yates case may not
17 offer any specific direction to you given the factual
18 circumstances of this case, but I think it does one
19 thing. It does indicate to you that equities were
20 considered in that case, and Chevron was subsequently
21 ordered to pay on some basis its fair share of the
22 cost of drilling that particular wellbore from the
23 surface to the shallower objective. And if nothing
24 else, I think there's a precedent established by that
25 case that may be relevant in this case.

1 With respect to the risk factor, Merrion is
2 looking at future risk involved in this operation.
3 Mr. Sharpe's testimony has been that at its current
4 rate of production based on one-month history, 40 Mcf
5 per day, the well is marginally productive.

6 He has testified that they would like to
7 produce the well for two or three more months,
8 determine the volume of the reservoir, make a decision
9 at that point what to do. He has testified that if
10 the results of that additional production time
11 indicate that the well is declining, they will plug
12 and abandon the well. That constitutes a risk in and
13 of itself.

14 He has also testified that if the rate is
15 stable at the end of that initial two or three months
16 of production history, that they will go in and
17 stimulate. They'll perform a frac job. And he has
18 testified as to the risk inherent in a fracture
19 operation.

20 So I think the risk that Merrion Oil & Gas
21 seeks here is associated with future risk. It's not
22 risk that has been assumed already by them in what
23 they've accomplished to this point. We think it would
24 be equitable to allocate a risk factor based on that
25 future risk.

1 I'd also like to just point out that they
2 seek only that that risk factor would be allocated to
3 the recompletion cost, not to the sunk wellbore cost,
4 what has been referred to in this testimony as sunk
5 wellbore cost and surface equipment.

6 We appreciate your consideration.

7 EXAMINER STOGNER: Thank you, Mr. Roberts.

8 Anything further in this matter?

9 Anything further in the previous matter,
10 10800?

11 MR. STOVALL: Mr. Examiner, we do have
12 some, a little bit of a procedural thing. I think we
13 can take 10801 under advisement at this time. We've
14 got the problem of making an offer to Phillips in
15 10800.

16 Mr. Roberts, do you want to stick with what
17 you've suggested? My recommendation is what you do,
18 and I think they're not inconsistent, is you send them
19 a letter with an AFE saying, "Here it is. Join or get
20 out, or we'll ask the Division to enter an order."

21 And then if you get a waiver, fine, we'll
22 enter the order.

23 MR. ROBERTS: I talked in terms of a
24 waiver, but I think in essence what we're talking
25 about is the same thing. We reiterate the offer to

1 participate, and if they indicate a waiver of
2 objection, we would obtain that at the same time.

3 MR. STOVALL: My recommendation would be
4 that Miss Williams Fed Ex that to Phillips when she
5 gets back to Farmington, tomorrow at the latest, and
6 request their response, and we continue this for two
7 weeks.

8 MR. ROBERTS: And we'll supplement the
9 record.

10 MR. STOVALL: Yes. You're not going to be
11 down here again for four weeks, are you?

12 MR. ROBERTS: The 23rd.

13 MR. STOVALL: Do you want to continue it to
14 then, or do you want to supplement by mail?

15 MR. ROBERTS: We'll supplement by mail.

16 EXAMINER STOGNER: With that, Case 10801
17 will be taken under advisement.

18 Case 10800 will be continued to the
19 examiner hearing scheduled for September 9, 1993.

20 If there's nothing further, then hearing
21 adjourned.

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)

) ss.

COUNTY OF SANTA FE)

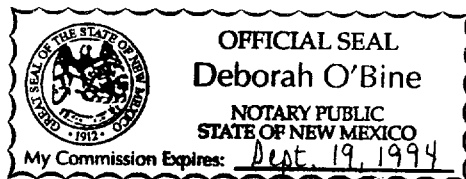
I, Deborah O'Bine, Certified Shorthand Reporter and Notary Public, HEREBY CERTIFY that I caused my notes to be transcribed under my personal supervision, and that the foregoing transcript is a true and accurate record of the proceedings of said hearing.

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, August 28, 1993.

Deborah O'Bine

DEBORAH O'BINE
CCR No. 63



I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 10801 heard by me on 28 August 1993.

[Signature], Examiner
Oil Conservation Division