



1           A           That's right.

2                           MR.   DICKERSON:    I have no  
3 further questions.

4                           MR.   STAMETS:    Any additional  
5 questions for the witness? He may be excused.

6                           Mr. Kellahin?

7                           MR.   DICKERSON:    We rest, Mr.  
8 Examiner.

9                           MR.   KELLAHIN:    We're ready to  
10 proceed, Mr. Chairman.

11                           Call as our first witness Mr.  
12 Bill McCoy.

13  
14                           WILLIAM G. McCOY,  
15 being called as a witness and being duly sworn upon his  
16 oath, testified as follows, to-wit:

17  
18                           DIRECT EXAMINATION

19 BY MR. KELLAHIN:

20                           Q           Mr. McCoy, would you please state your  
21 name and occupation?

22                           A           William G. McCoy. I'm a consulting  
23 engineer and geologist, residing in Santa Fe.

24                           Q           Mr. McCoy, would you describe for the  
25 Commission what has been your educational background and

1 work experience as a geologist and petroleum engineer?

2           A           I graduated from Texas A & M in 1949 with  
3 a Bachelor of Science degree in geological engineering.

4                   I was employed for seven years with Gulf  
5 Oil Corporation in the Exploration Department, directed  
6 mostly toward exploration at the regional level in North  
7 Texas and North Central Texas, supervising drilling wells,  
8 developing prospects, making recommendations for company  
9 drilling programs.

10                   In 1957 I resigned; was employed by the  
11 Denver Company, an independent in Lubbock, Texas, as Manager  
12 of Exploration and Production.

13                   Work in that company consisted of devel-  
14 oping prospects, obtaining farmouts, preparing drilling  
15 AFE's, drilling wells, completing wells, operating the  
16 wells, and assisting in preparation of Division order title  
17 opinions.

18                   In 1960 I resigned from the Denver Com-  
19 pany, returned to Roswell, New Mexico, and began consulting  
20 as an engineer and geologist and have been in that profes-  
21 sion since that time.

22                   The work consisted primarily again of  
23 developing prospects, forming units, obtaining farmouts,  
24 making preparation for drilling (not understood), selling  
25 prospects, determining the economics in order to sell the

1 prospects, drilling a well, completing the well, operating  
2 the well. Also preparing evaluation reports on reserves for  
3 income tax purposes, state purposes, and testimony before  
4 District and Federal Courts.

5 Q Have you previously testified as an en-  
6 gineer and as a geologist before the Oil Conservation Divi-  
7 sion of New Mexico?

8 A I have.

9 Q Have you been retained as a consulting  
10 engineer and geologist by Mr. Sprinkle in this case?

11 A I have.

12 Q Have you appeared in his behalf in the  
13 prior two hearings before Examiner Stogner in Case 8755?

14 A I have.

15 Q And have you participated on Mr. Sprin-  
16 kle's behalf in reviewing the actual well costs in that  
17 hearing before the Division on the Sprinkle No. 1 Well?

18 A I have.

19 Q And pursuant to your employment have you  
20 made an estimate of reasonable well costs for the Sprinkle  
21 No. 3 Well?

22 A I have.

23 MR. KELLAHIN: We tender Mr.  
24 McCoy as an expert petroleum engineer and geologist.

25 MR. STAMETS: Any objection?

1 The witness is considered qualified.

2 Q Let me direct your attention, Mr. McCoy,  
3 first of all to the question of what in your opinion would  
4 be the reasonable well costs to be set forth in any pooling  
5 order entered by the Commission in this case, and I want to  
6 simply have you identify certain documents for me and then  
7 we'll go back and make an analysis of those documents.

8 First of all, do you have before you,  
9 sir, the AFE that Mr. Wood presented in his testimony a few  
10 minutes ago that showed an AFE cost proposed by TXO of about  
11 533,000? Do you have one of those available to you?

12 A I don't have the -- I have one here.

13 Q Do you have one, sir?

14 A Yeah.

15 Q All right.

16 A \$532,950.

17 Q All right, sir, you have that one.

18 A I do.

19 Q I want to set forth a few more in front  
20 of you and then we're going to ask you some questions about  
21 what you've done.

22 I show you Sprinkle Exhibit Number  
23 Eleven, which is the Burleson Federal No. 2 Well --

24 A Affirmative.

25 Q -- proposed by TXO?

1           A           Yes.

2           Q           All right, this is from a case file, Mr.  
3 Chairman.

4                   Let me have you identify another exhibit,  
5 Exhibit Number Twelve, Exhibit Number Twelve, Mr. McCoy.  
6 Would you identify for us what this exhibit is?

7           A           Exhibit Twelve is a report of gross cost  
8 on the No. 2 Sprinkle Federal, prepared by TXO.

9           Q           This is TXO's gross actual costs on the  
10 No. 2 Sprinkle Well that you obtained through their corres-  
11 pondence with Mr. Sprinkle?

12          A           Affirmative.

13          Q           All right, sir. Now, finally, let's now  
14 turn to Exhibit Number Thirteen and have you identify that  
15 exhibit.

16          A           Exhibit Thirteen is an AFE that I pre-  
17 pared for a similar depth test in -- on Mr. Sprinkle's  
18 lease. I did notice, evidently, in the preparation that the  
19 return key deleted the electric log cost on to the casing  
20 point price.

21          Q           All right, let's -- let's correct Exhibit  
22 Thirteen, and if you'll go to the bottom of the drilling  
23 cost, just after contingencies --

24          A           Yeah.

25          Q           -- and above the phrase "estimated cost

1 to the casing point"?

2 A Affirmative.

3 Q All right, what do we put in there?

4 A Electric log, in the intangible column,  
5 \$17,000.

6 That would change the total to the casing  
7 point to the amount of \$312,966, and the total estimated  
8 completed well costs would change to \$448,738.

9 Q Would you describe for us, Mr. McCoy, the  
10 process that you went through in preparing Exhibit Number  
11 Three to satisfy yourself that these represented reasonable,  
12 current costs for a well to be drilled at this depth?

13 A Number one, in starting the preparation of  
14 an AFE I generally contact the suppliers for the casing  
15 equipment, cementing service, electric logging, a drilling  
16 contractor. In this case I had not time to get a formal  
17 submitted bid on the drilling contract and I therefore used  
18 the amount of the No. 2 Burleson Federal of 14.75 per foot,  
19 and the day work at \$4400 per day.

20 Based on that we can calculate the drill-  
21 ling cost and I estimated three days of day work that would  
22 be required during the drilling and logging of the well.

23 Drilling mud and chemicals, I contacted  
24 Mustang Mud Company, who have furnished mud within this area  
25 to get an average price of a drilling well, and the upper

1 limit was, let's see, \$20,000. Of that, \$14,000 was the mud  
2 and chemicals; the balance is my estimate of the water re-  
3 quired to mix the mud.

4           The surface casing, I contacted TXO's  
5 suppliers, Lone Star Steel in Midland, to get current list  
6 prices for casing, which is the total there, and casinghead,  
7 I again contacted TXO's ERC Company to get an estimate on  
8 the well cost for the casinghead, and also on the tubing  
9 head, which is in completion.

10           Geological services and engineering  
11 supervision were based on my past experience for a well at  
12 this depth.

13           Labor, casing crew, again are estimated  
14 from brochures on prices.

15           Drilling overhead is based on the esti-  
16 mate of 40 -- 22 days drilling at \$4700 per day.

17           Abandonment again is an estimate of how  
18 much it would cost to plug and abandon the well.

19           I've had a practice of always adding a  
20 contingency in the drilling cost to provide for any other  
21 excess costs.

22           Completion, I followed the same procedure  
23 and determined those amounts, and I might mention on the --  
24 when you're talking about cementing and completing today,  
25 the prices I list are book prices. You can expect on the

1 current market up to 40 percent discount on those book  
2 prices.

3           On the tank battery I estimated that we  
4 could by with using one separator, one heater-treater, and  
5 one 436-barrel tank to separately meter the No. 3 Well into  
6 a common storage tank -- tank battery on the site, not  
7 necessitating individual tank batteries for each 40-acre  
8 tract.

9           I think that would fully evaluate how I  
10 prepared the AFE.

11           Q           In your opinion is the estimated well  
12 cost that you have calculated and studied of \$448,738 a fair  
13 and reasonable number to use for purposes of this Commission  
14 pooling order?

15           A           It is a reasonable estimate of the drill-  
16 ling costs.

17           Q           Have you had an opportunity to make a  
18 comparison between your proposed AFE and the one Mr. Wood  
19 has submitted earlier today so that you could highlight for  
20 the Commission wherein you and TXO's engineers differ?

21           A           I did, and I placed the figures upon the  
22 far righthand column of their AFE for the No. 3.

23                       For example, on --

24           Q           We're not going through -- just pick the  
25 big ones that constitute the difference --

1           A           Okay.

2           Q           -- and not --

3           A           All right, not --

4           Q           -- any small ones.

5           A           -- the individual. I think they're pret-  
6 ty consistent with the exception that we get to the tank  
7 battery and the pumping equipment.

8                       Normally, when I prepare an AFE I do not  
9 include pumping costs or equipment in the installation. I  
10 expect to produce -- I mean expect that the well will pro-  
11 duce by flowing and not require pumping. That normally  
12 would come after production is established and you determine  
13 that you will have to produce the well by a pump.

14           Q           Is the TXO AFE submitted today one that  
15 includes pumping equipment?

16           A           The No. 3 allows for \$38,500 worth of  
17 pumping equipment.

18           Q           Are there any other differences that ac-  
19 count for appreciable amounts between the two AFE's, other  
20 than the pumping equipment?

21           A           Well, I think the tank battery, my totals  
22 read \$32,000 for their tank battery. My recommended is  
23 \$21,000 -- \$21,800.

24           Q           Could you describe for us under the TXO  
25 proposal what tank battery arrangement you would envision

1 for this property and why you have chosen not to do that?

2 A I believe, although there are no  
3 supporting data based on other invoices, I believe TXO's  
4 tank battery includes a separator, a heater-treater, and  
5 two, no, four 436-barrel tanks.

6 I think, as I mentioned, we do -- and  
7 they have mentioned that the division of interest between  
8 the various wells would require separate metering of each  
9 well. That is true in respect to the working interest only.  
10 The royalty and overriding royalty will not change with a  
11 well.

12 Q How had TXO proposed to account for the  
13 oil production because of the separate working interest own-  
14 ers in the four Sprinkle wells?

15 A They have recommended a separate tank  
16 battery on each 40-acre tract.

17 Q Do you concur in that recommendation, Mr.  
18 McCoy?

19 A I would not. I would prefer the separate  
20 metering with the separator, heater-treater, and one tank to  
21 account for the well -- production from each well, which  
22 could be then put into a commingled main storage battery.  
23 You would have separate metering for each well that way.

24 Q Is your proposed method for accounting to  
25 the separate wells for the production for those owners one  
that is accepted and used in the industry?

1           A           It is with commingled tank batteries.

2           Q           Would your method of metering for the  
3 well be one that would insure accuracy of accounting for the  
4 production for the various interest owners?

5           A           It will with a one tank, heater-treater,  
6 separator, will account for the oil and gas and water pro-  
7 duction out of each well.

8           Q           Will that method be just as good as hav-  
9 ing separate tank batteries for each well? Contrasting your  
10 proposal --

11          A           Yeah.

12          Q           -- to TXO's proposal.

13          A           Well, I was trying to figure out the best  
14 answer. It's more convenient to have four batteries but  
15 it's not economical.

16          Q           What is the corresponding savings under  
17 your proposal versus TXO's proposal for the metering system?

18          A           Well, this shows approximately \$11,000  
19 times three additional locations, so that would be \$33,000  
20 -- well, plus the fittings, you'd have more fittings for  
21 each tank battery on each location than you would have for  
22 the one tank battery metering set-up.

23          Q           Are there any other significant items  
24 that show a material difference between the two AFE's that  
25 you'd like to direct our attention to?

1           A           Not significant but figures, for example,  
2 on the casing, for production casing they show \$56,700. My  
3 calculations from Lone Star show \$47,107, about a \$10,000  
4 difference there.

5                   I would think that would be the only --  
6 well, let's see, on cementing there's a big difference of  
7 about \$14,000 on that. My estimate from Dowell of a 2000-  
8 foot fill-up is 21 -- is \$7215. Their estimate is \$21,000.  
9 So there's another significant difference.

10                   But my prices are determined by giving  
11 Dowell in this case the size of the hole, casing to be run,  
12 the amount of fill-up I require. From that they make their  
13 volumetric calculations, add on the centralizers, float  
14 shoe, and other equipmetn and give me a total back.

15           Q           Do you have an opinon as to whether or  
16 not the TXO AFE submitted today is one that's reasonable?

17           A           It would be, in my opinion, on the high  
18 side.

19           Q           In your opinion which is the appropriate  
20 AFE to utilize for purposes of a pooling case?

21           A           Well, given the option, I would prefer  
22 mine.

23           Q           Do you have any further recommendations  
24 to the Commission with regards to how costs are handled in  
25 terms of the AFE with regards to the possibility of material

1 transfers of equipment by the operator?

2 A Definitely. I have a very strong opinion  
3 on that based on analysis of invoices on the No. 1 Sprinkle.

4 For one example, using material  
5 transfers, TXO production casing amounted to \$117,000, round  
6 figures.

7 The same casing, well, not the same, but  
8 the casing required that they did run from Lone Star, the  
9 same supplier, amounted to approximately \$58,000.

10 Their invoices were marked up as much as,  
11 taking casing out of stock, marking it up as much as 27 per-  
12 cent to the lease, which is not standard industry practice.

13 Q Would you define for us for the record,  
14 Mr. McCoy, what you mean by the phrase "material transfer"?

15 A Material transfers are used by companies  
16 who have warehousing facilities. They go out and buy, for  
17 instance, maybe 100,000 feet of casing at a time, put it in  
18 the stock, and use it on their wells as they drill.

19 It's a -- it's a normal procedure if the  
20 charges are based on actual well cost -- I mean actual mar-  
21 ket prices at the time that they transfer it out to the  
22 well.

23 We're finding out that -- I can give you  
24 a good example of, say, 4-1/2 inch casing was transferred  
25 out of their inventory for a cost at \$6.74 per foot. It was

1 billed to the No. 1 Sprinkle at \$9.56 a foot, which is a 42  
2 percent mark-up. And I've got several other invoices; we  
3 can --

4 Q Well, my question for you, Mr. McCoy, is  
5 do you have a recommendation to the Commission about lan-  
6 guage to include in this pooling order --

7 A Yes.

8 Q -- about cost --

9 A Okay.

10 Q -- so that a well drilled for the No. 3  
11 Well will not be subject to the kind of accounting cost con-  
12 troversy that's involved in the No. 1 Well?

13 A I would make a stipulation that material  
14 transfers, if used, will be subject to the non-operators'  
15 approval and that they not exceed market price, current mar-  
16 ket price, at the time they are delivered to the location.

17 Q In your opinion will that be an adequate  
18 phrase in which to avoid controversy for the No. 3 Well over  
19 the costs involved in material transfers?

20 A It would give a good protection for the  
21 non-operators.

22 Q Let's go on to a different subject, Mr.  
23 McCoy.

24 You testified back in January with  
25 regards to what, in your opinion, would constitute

1 reasonable overhead charges to be applied for drilling of  
2 this well. TXO's introduced today Exhibit Number Eight,  
3 which was a TXO interoffice memorandum establishing certain  
4 overhead rates and I show you a copy of that exhibit.

5 Do you have an opinion, Mr. McCoy, as to  
6 what you would recommend for the Commission in terms of an  
7 overhead charge while drilling and while producing for the  
8 subject well?

9 A Well, my recommendations are based on  
10 Ernst and Whinney's annual reports of operators and then  
11 this result -- the results I have for 1985, West Texas and  
12 Eastern New Mexico. I prefer their prices as being an aver-  
13 age of their survey and their depth brackets are more con-  
14 sistent with what I've seen in the past.

15 For example, they go from zero to 5 for  
16 the first depth, 5 to 10, 10 to 15, and so forth. I think  
17 it is a more reasonable division of depth for determining  
18 overhead rates.

19 And in this case I would prefer to use  
20 the average, or mean, for this depth range, 5 to 10,000  
21 feet, which amounts to \$3753 for a drilling well and \$392  
22 for a producing well.

23 Q Let me direct your attention to the next  
24 exhibit. Exhibit Number Fourteen is a copy of the Ernst and  
25 Whinney Survey that formulated the basis upon which you made

1 your recommendation of reasonable overhead charges?

2 A Yes.

3 Q That's marked as Exhibit Fourteen.

4 Let me turn to Exhibit Fifteen, sir. My  
5 copy of Exhibit Fifteen is the reservoir parameters for the  
6 Sprinkle Federal Lease acreage.

7 A Yes, sir.

8 Q Are we all looking at the same document?

9 A Right.

10 Q Would -- would you identify what you have  
11 done in terms of beginning an analysis of the reservoir par-  
12 ameters as the basis for your study?

13 A I've used the standard method of ana-  
14 lyzing, beginning with the electric log on the well, deter-  
15 mining the porosity, water saturation, and reservoir temper-  
16 ature, and of course, the oil gravity is given.

17 The gas/oil ratio I had a problem with.  
18 On their completion on August 6th they had 369 as a tested  
19 gas/oil ratio and ten -- ten days later on the C-116 they  
20 turned in 2400-to-1. For ten days difference it seemed to  
21 be a radical difference and it did not fit with the analysis  
22 for bubble point pressure.

23 I therefore used an average, what I con-  
24 sider to be the average, gas/oil ratio to determine the bub-  
25 ble point pressure. This is using standard correlation com-

1 puter program that uses the API gravity and the gas/oil ra-  
2 tio and the gas gravity.

3 Gas gravity I've taken from Phillips Pet-  
4 roleum. They had just tested a well and based on that we  
5 can come up with a bubble point pressure of 3616.

6 The bottom hole pressure shows that we're  
7 producing below the bottom -- below the bubble point, so  
8 we're operating under a solution gas drive reservoir.

9 Formation volume factor was determined  
10 also at the same time that we ran the bubble point pressure,  
11 and get a PVT analysis. That tells us what the formation  
12 volume factor will be from beginning pressure to ending  
13 pressure; gives us the oil viscosity, and the gas/oil ratio  
14 projection, so that's where the other factors, formation  
15 volume factor, and the oil viscosity came from, and those  
16 are at bubble point conditions.

17 Q In taking these reservoir parameters,  
18 have you made a calculation of the oil in place underlying  
19 the 40-acre tract at the Sprinkle 1 --

20 A I have.

21 Q -- Well location? And what do you calcu-  
22 late as an engineer?

23 A Original oil in place, 425,268 barrels.

24 Q And what do you calculate to be the re-  
25 coverable primary reserves from the Sprinkle No. 1 Well?

1           A           106,317 barrels.

2           Q           Mr. Wood, on his Exhibit Number Fifteen  
3 at today's hearing calculated recoverable reserves of  
4 65,460. I show you a copy of that exhibit.

5                       Do you have an opinion, Mr. McCoy, as to  
6 whether or not your recoverable primary reserve number is  
7 one that's reasonable and accurate?

8           A           I consider my interpretation to be  
9 reasonable and accurate.

10          Q           Where do you and Mr. Wood differ and how?

11          A           Well, without the summary of equivalent  
12 factors, I do think our interpretations are essentially the  
13 same. I think our only difference being the recovery factor  
14 used to determine the recoverable oil.

15          Q           That would be the principal factor in  
16 here that would account for the greatest change between the  
17 65,000 and the 106,000 barrels of oil?

18          A           I would believe that if we take a propor-  
19 tion it would come out pretty close.

20          Q           Would you describe for us the basis that  
21 you have selected 25 percent recovery factor as being the  
22 recovery factor that is fair and reasonable to project for  
23 the No. 1 Well?

24          A           Well, in the absence of any detailed re-  
25 servoir data, which we do not have, other than bottom hole

1 pressure --

2 Q Neither you nor Mr. Wood have that data,  
3 do you?

4 A No, neither one of us had that. I'd like  
5 to see a PVT analysis of fluid and actual substantiated  
6 gas/oil ratio tests, data like that, to determine more ac-  
7 curately a recovery factor.

8 In the absence of that, an industry  
9 standard would be 20 percent for a solution gas drive reser-  
10 voir. I've added 5 percent because of the potential of a  
11 partial water drive, not a water drive repressuring the for-  
12 mation or anything, but a partial water drive, giving added  
13 impetus to the solution gas drive.

14 Q What causes you to believe that 5 percent  
15 is an appropriate amount to attribute to a partial water  
16 drive?

17 A Well, it's just an assistant. A partial  
18 water drive empirically can be up to 30 percent.

19 Q What factors or information do you see in  
20 this reservoir that would cause you to believe that utiliz-  
21 ing a 5 percent towards a partial water drive to aid in ul-  
22 timate recovery is a reasonable factor?

23 A I think one factor to consider is the  
24 high initial water saturation. According to my estimate  
25 it's 45 percent, and the other data furnished is about 37

1 percent, so we're dealing with a high initial water satura-  
2 tion.

3                   There is water production, I believe, for  
4 the month of December, the last data I have. It was 450  
5 barrels, roughly, about 10-12 barrels a day, so just data  
6 like that, I think that would be a hunch guess on that 5  
7 percent.

8                   Q                   The balance of Exhibit Number Fifteen  
9 shows some prices that you have subsequently used in other  
10 calculations?

11                   A                   Yes, it does. Normally when I try to  
12 make an economic analysis I'll check with a purchaser, and  
13 the ones I know who purchase oil, Navajo Refining, all pur-  
14 chasers standardize pretty well with the prices. I check  
15 with Navajo in Artesia and their current posted price for 41  
16 gravity oil is \$17 a barrel less 65 cents a barrel for  
17 trucking.

18                                   I checked that for two factors, not only  
19 the current price but I want to know the base price for  
20 windfall profits. That is \$17.80, so we have no deduction  
21 for windfall profits tax now, which we did originally.

22                                   The gas price is just estimated on the  
23 BTU content of 1248 BTUs.

24                   Q                   Have you made an analysis, Mr. McCoy, of  
25 the economic impact on Mr. Sprinkle --

1           A           I have.

2           Q           -- should the Commission continue to  
3 adopt the Examiner's 150 percent factor?

4           A           I did.

5           Q           Let's turn to Exhibit Number Sixteen and  
6 let me ask you does that represent your analysis with re-  
7 gards to the --

8           A           Yes.

9           Q           -- impact on Mr. Sprinkle of the 150 per-  
10 cent penalty?

11          A           It does with the exception of the well  
12 cost which we have previously changed.

13          Q           All right, sir, would you take us through  
14 the calculation of the analysis?

15          A           All right. The well cost, of course, was  
16 recently changed from previous data.

17                    Estimated primary recovery comes from  
18 previous data.

19                    I have assumed over a payout period 160-  
20 barrel a day average production rate.

21                    The net price for crude was determined  
22 previously; adding the price of gas gives us a total of  
23 \$17.06 net production per barrel -- dollars per barrel.

24                    The average monthly production is deter-  
25 mined on 160-barrel a day and the gross monthly income cal-

1     culated by 17.06 times the 4864, giving us a gross of  
2     \$82,980.

3                     The net working interest lease is 87 per-  
4     cent. Take that out and the operating costs I've estimated  
5     \$1200 a month, leaving us a net working interest income of  
6     \$70,922.

7                     Based on that the payout of the well  
8     would be approximately six months and the return on invest-  
9     ment would be the original cost of the well times the dollar  
10    amount of the primary reserves, times the 17.06, and that  
11    would give us a return of 3.2 on our investment.

12                    The gross barrels to payout would be just  
13    taking the gross barrels per month times the six months.  
14    That will tell us how many barrels we actually have to pro-  
15    duce to get back our well cost. From that we can, in this  
16    case of 150 percent additional risk means we would be --  
17    that TXo would be allowed to recover 44,360 barrels addi-  
18    tional production to account for the risk.

19                    If you add the two figures together, the  
20    gross to payout and the risk, means the total production  
21    from the well would be 73,933 before Mr. Sprinkle would be-  
22    gin to participate. At that time we would have a remaining  
23    reserve of 32,384 barrels, of which Mr. Sprinkle would have  
24    8805.

25                    Originally, based on the original re-

1 serves he should have 28,905 barrels. Reserves lost due to  
2 the drilling cost and risk penalty, 20,000, and the value at  
3 17.06 would be \$342,912.

4 Now if you take out Mr. Sprinkle's cost,  
5 his net loss due to the penalty would be \$207,994.

6 Q What were the total original reserves  
7 producable that are attributable to Mr. Sprinkle's share?  
8 Is that the 29,000 barrels?

9 A 20 --

10 Q 28,000?

11 A 28,905.

12 Q And if 150 percent penalty is applied  
13 that results in taking 20,000 of those 29,000 barrels as a  
14 part of the penalty?

15 A Yes.

16 Q You provided for us an opinion in Jan-  
17 uary, Mr. McCoy, with regards to your assessment of what you  
18 would believe to be an appropriate risk factor in which to  
19 compensate TXO for the risk that they take with regards to  
20 the No. 3 Well. What was your opinion on January on that  
21 point?

22 A 25 percent.

23 Q Would you describe for us the basis upon  
24 which you reached that opinion in January?

25 A At that time I reviewed the current drill-

1 ling program, completed wells, and determined that we had  
2 not, since the No. 1 Well, the discovery well, was a wildcat  
3 entitled to 200 percent penalty, that since that time we had  
4 not seen a dry hole drilled on the prospect, prospecting  
5 Section 26.

6 Subsequent to that I've checked and  
7 brought myself up to date on current activities.

8 Q Let me show you a copy of Exhibit Nine,  
9 which is Mr. O'Hare's production map to give you a point of  
10 reference.

11 What factors do you think are important  
12 in terms of confirming or refuting your 25 percent number  
13 that you gave us in January? What else has happened that  
14 either support or refute that occurrence?

15 A I believe the subsequent completions in  
16 the area, completions or in the process of completing, I  
17 think beginning with Section 22, it does not show on this  
18 map, the 330 out of the southeast corner there is Mewbourne  
19 No. 2-H Well that is drilling.

20 In Section 23, the southwest quarter,  
21 Marshall and Winston Well is not potentialized but it is com-  
22 pleting and is indicative of a good producer. I visited  
23 with Mr. Tom Brandt, their geologist on this well, to bring  
24 myself up to date.

25 In Section 24 we have a drilling well by

1 TXO.

2 In Section 25, the Nortex, in the north-  
3 west of the southwest, has an application on record to re-  
4 enter and attempt completion in the Bone Spring, same inter-  
5 val as the Sprinkle well.

6 In Section 26, Unit A, the well is com-  
7 pleted -- not completed but pipe has been run and in the  
8 process of being completed; logs are run but I do not have  
9 those at this time.

10 Unit B, a completed well; Unit C, a com-  
11 pleted well; Unit D, a completed well, 3 and 4 are proposed,  
12 southwest northeast, 330 out of that corner, the No. 3 Bur-  
13 leson is down, logs run, and as we've heard previously, has  
14 good sand section in it.

15 Mr. Burleon informed me on Monday that  
16 the well looked better than the No. 2 Well and he is antici-  
17 pating a good completion.

18 In Section 26, it also does not show on  
19 this map, GFG Enterprises staked a location for an 11,000  
20 foot Wolfcamp well and 1980 feet out of the south and west  
21 lines of Section 26, a direct south offset to the No. 4  
22 Sprinkle, proposed.

23 Moving to Section 27 we have the 11-E  
24 Mewbourne is in the process of completing; last production  
25 report on Monday had 99 barrels of oil, 6 barrels of water,

1 175 MCF of gas on an 18/64th choke, 250 pounds tubing pres-  
2 sure.

3 It appears to be a good completion.

4 On unit -- the direct west offset to the  
5 No. 3 proposed Sprinkle well is a location, No. 12-E Mew-  
6 bourne Well, which will be drilled on completion of the 2-H  
7 in Section 22. The rig will be moved from that well to the  
8 No. 12 and be spudded.

9 Based on that data we see that we have  
10 one, two, three, four, five, six, seven, seven producing  
11 wells and not a dry hole. I think that would go back to our  
12 industry-wide standard for production or development wells  
13 of between 75 and 80 percent success ratio; therefore, I  
14 think the 25 percent penalty would be more than adequate to  
15 cover what we see here is a limited risk type proposition.

16 Eliminating time constraints, a prudent  
17 operator on the northwest of 26 would await the drilling of  
18 the south offset and the west offset and there you've got an  
19 east offset, so we would be surrounded. We would have es-  
20 sentially no risk if the wells turn out as they look.

21 Q Are you prepared to make a recommendation  
22 to Mr. Sprinkle on whether or not he participates in the  
23 subject No. 3 Well?

24 A At this time, no. I would require infor-  
25 mation on the No. 2 and 3 Burleson Wells; a revision of what

1 that -- as I see the data presented today, the thickness of  
2 those two wells radically changed the picture in the area,  
3 that we have an actual thickening of the sand over the 3 and  
4 4 locations, apparently. I can't verify it, but I would  
5 like to see that data first.

6 I would also like to see up to date pro-  
7 duction data on the No. 1 and No. 2 Sprinkle, and Mr. Burle-  
8 son, I believe, I could obtain some information on his well.

9 Q What is the significance to you in terms  
10 of the information that's been given to us on the Burleson  
11 No. 3 Well in re-examining the way Mr. O'Hare has contoured  
12 the Isopach as it comes through the No. 4 location?

13 A Well, at his -- I think what you would  
14 have to do, I believe, I'm looking without a map, I believe  
15 it's 35 feet on the No. 3 Burleson, you cannot bring any  
16 other value between that and the Hendon Well. The Hendon  
17 has 20 feet, therefore the 20 feet would have -- and the 30  
18 feet contour line would have to go south of the Burleson  
19 Well, over to the Nortex Well. You would not have a low in-  
20 ferred in that area.

21 Q Has the geologic information obtained  
22 subsequent to the January 29th hearing increased or de-  
23 creased the risk as we discussed in January?

24 A Well, based on the thickness, particular  
25 ly in the No. 3 Burleson, it would reduce the risk to make

1 the south half of the northwest quarter of 26 look better,  
2 based on that one well.

3 Q Would you give us a specific list, Mr.  
4 McCoy, of those items of information that you would want in  
5 order to make a final recommendation to Mr. Sprinkle on  
6 whether he participates in this well?

7 A I'd like to see on existing -- I don't  
8 know if we can outside the limits of the TXO-Sprinkle lease,  
9 but I do think on the No. 1 and 2 Sprinkle I would like to  
10 see a recent production test of each well. This is not un-  
11 usual in a developing area. Typically you would take those  
12 at, oh, probably sixty day intervals until you establish a  
13 production.

14 We have data up through the November 15th  
15 of the 1985, and that's the last available to me.

16 In addition, I'd like to see the logs on  
17 the No. 2 and 3 Burlison, and the No. 1 Marshall and Winston  
18 Well. ~~That well;~~ I talked to Tom Brandt again, who's send-  
19 ing me a copy of the log on the well, and the bottom hole  
20 pressure which they're running. That will be significant  
21 data and give us an answer to this idea is there communica-  
22 tion between the 40 acres.

23 Let's see their bottom hole pressure.  
24 That would be significant.

25 I'd like to see a gas/oil ratio run on

1 the No. 1 and 2 Sprinkle that actually measures the gas vol-  
2 ume, specific gravity of the gas coming out of each well  
3 separately and the tank MCF and gravity to determine an ac-  
4 tual gas/oil ratio.

5 I think within those data it would take  
6 me, probably, seven days, if I have all that data laid  
7 before me, to make a recommendation to Mr. Sprinkle.

8 Q Are you asking for proprietary informa-  
9 tion that is the exclusive property and possession of TXO?

10 A No, that type data is normal to a prudent  
11 operator's normal field operations. He needs to know.  
12 We've had a discussion here about the economics, the risk.  
13 If I'm that much worried about a particular lease for drill-  
14 ing a well, I'd make every effort to acquire that informa-  
15 tion.

16 Talk about the recovery factor, if we  
17 would run a bottom hole pressure on the No. 1, we have an  
18 ~~initial, we have a second one, we have a volume produced, we~~  
19 can get an indication of what the recovery factor will be.  
20 That would be significant.

21 You're not talking about three days pro-  
22 duction and maybe \$750; not significant, but there would be  
23 valuable information.

24 Q Is this information that is commonly made  
25 available to working interest owners that participate in a

1 well?

2 A Yes, they are.

3 Q If that information was furnished to you  
4 by TXO on or before March 5th of 1986, would that give you  
5 sufficient time between March 5th and March 14th, the spud  
6 date for the subject well, in which to analyze and make  
7 recommendations to Mr. Sprinkle --

8 A Yes, it would.

9 Q -- so he would be able to make an  
10 informed choice on whether he participates or not?

11 A It would be sufficient time.

12 Q In your opinion would those matters be  
13 fair and reasonable in order to properly allow Mr. Sprinkle  
14 to make an adequate election?

15 A Yes.

16 MR. KELLAHIN: That concludes  
17 my examination of Mr. McCoy.

18 We would move the introduction  
19 of Exhibits Eleven through Sixteen.

20 MR. STAMETS: These exhibits  
21 will be admitted.

22 Let's go off the record for a  
23 moment.

24

25 (Thereupon a discussion was had off the record.)

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CROSS EXAMINATION

BY MR. STAMETS:

Q Mr. McCoy, I would gather from your experience that you would consider yourself sophisticated and knowledgeable in oil and gas operations, oil and gas investments.

A Yes, sir.

Q Is TXO correct when they -- they say that it's -- when they're looking at an investment, it's appropriate to be looking at an investment where you would expect to get a 3-for-1 payback?

A I think on a 3-to-1 that would be my criteria if I were to originate a prospect. Let's say I'm going to go sell you a deal, I would not bring a prospect to you that would return less than 3-to-1.

Q What about Mr. Sprinkle? I'm not familiar with him and perhaps there's another witness who will answer this question, do you -- is Mr. Sprinkle a sophisticated oil operator with many operations, has drilled wells, or is he new to the business, or --

A I would say this, that based on my limited knowledge of his background, I have known of him by name over a period to 20-25 years (not clearly understood) not me type approach, but I mean he has invested -- in fact,

1 I represented a Mr. Anderson in North Young Bone Springs  
2 Unit, which is in the north part of 18, 32, and Mr. Sprinkle  
3 is also a partner in that and I believe we were talking at  
4 lunchtime about the relationship, but I think there was  
5 something like, give us a little leeway, but thirty wells  
6 that has participated in that area, and he has also picked  
7 up interest that other people went nonconsent; he's picked  
8 up that.

9 So I would call that an indication of the  
10 sophisticated investor.

11 Q Thank you.

12 You've asked for some information from  
13 wells that Mr. Sprinkle does have an interest in, either as  
14 a -- receiving royalties or actually having a working inter-  
15 est.

16 In your -- in your past experience, what  
17 has been industry standard when one operator was attempting  
18 to get another to invest in a well, how much information did  
19 they give? Would it be industry standard for TXO to share  
20 the logs and production information off of the Burleson  
21 Wells with Mr. Sprinkle?

22 A Let's put it this way. Let's put it in a  
23 position I'm TXO and you're the -- you're Mr. Sprinkle. If  
24 my intentions are to convince you to join, this is a good  
25 prospect, let's join, and you say, no, I don't want to, and

1 I say, well let me show you the data and let me give you my  
2 analysis of the data, you take it and have someone else  
3 evaluate it and decide, but I'm going to give you this in-  
4 formation so you can say, well, you're withholding or you're  
5 not, not giving me something, I can't make a decision, or  
6 anything.

7 I think I would do everything I could to  
8 furnish you whatever information I had available, including  
9 my interpretation of the data, to convince you that this is  
10 a good prospect and you ought to participate. But if you do  
11 go under, in this case, in the number one penalty, 200 per-  
12 cent, you'll never see a nickel out of the well; no future  
13 in that, or let's try to make some type of deal.

14 But I would make every effort, bend over  
15 backwards, and I've seen this in the past, that there is no  
16 profit in a penalty. A person loses with a penalty.

17 MR. STAMETS: We'll recess this  
18 hearing until 9:00 in the morning in the Oil Conservation  
19 Division Conference Room.

20

21 (Hearing recessed.)

22

23

24

25

1  
2 (Thereafter at the hour of 9:00 o'clock a. m.  
3 on the 27th day of February, 1986, the hearing  
4 was again called to order and the following  
5 proceedings were had, to-wit:)

6  
7 MR. STAMETS: The hearing will  
8 please come to order.

9 Mr. Dickerson, you have some  
10 questions of Mr. McCoy?

11 MR. DICKERSON: Just a few, Mr.  
12 Stamets.

13  
14 CROSS EXAMINATION

15 BY MR. DICKERSON:

16 Q Mr. McCoy, let's briefly go over again  
17 the principal differences between the Exhibit Thirteen that  
18 you submitted, your proposed AFE, and that submitted by TXO  
19 for the Sprinkle No. 3 Well.

20 As I understand it, you started with, af-  
21 ter your revision, an estimated well cost of \$448,718, cor-  
22 rect?

23 A 448,738.

24 Q 738. Now you briefly summarized, I think,  
25 three areas yesterday afternoon in which most of the dif-

1       ference between the two AFE's occurred, correct?

2                   A               Probably.

3                   Q               And one of those was TXO has AFE'd a  
4       separate tank battery for each of the Sprinkle 3 and 4  
5       wells.

6                   A               Right.

7                   Q               And on that you, in your judgment,  
8       separate metering facilities would account for the  
9       difference and lessen the cost.

10                  A               Yes.

11                  Q               Okay. The second area was in the pumping  
12       equipment. TXO AFE'd pumping equipment for the No. 3 Well  
13       and your AFE contains no estimate of cost --

14                  A               Right.

15                  Q               -- for pumping equipment.

16                                You heard the testimony of Mr. Deen, did  
17       you not, regarding the production history of the Sprinkle 1  
18       and 2 Wells as far as the, in his opinion, relatively steep  
19       decline recently in those two wells?

20                  A               I don't -- I'm not aware of a steep de-  
21       cline in the No. 1.

22                                The No. 2, I have o production. We  
23       haven't been furnished production data on it, so I just have  
24       to rely on what he said. Okay?

25                  Q               You saw his Exhibit Number Fourteen yes-

1 terday --

2 A Yes.

3 Q -- did you not --

4 A Right.

5 Q -- which contained production information  
6 for both the No. 1 and No. 2 Wells.

7 A Right.

8 Q And you recall his testimony that the No.  
9 2 is at the point of being placed on pump right now.

10 A Yes, I did.

11 Q Do you have any information that would  
12 lead you to believe that that's incorrect?

13 A No, I would accept that but, normally,  
14 when I evaluate production history I have to know the number  
15 of days over here that that production results in. In other  
16 words, if it's only ten days a month, that changes the indi-  
17 cation of your production.

18 Q Okay. The point I'm attempting to make  
19 here is to determine whether or not you disagree with Mr.  
20 Deen's expressed opinion that pumping is at some point rela-  
21 tively near or relatively later going to be necessary to be  
22 instituted on these wells.

23 A On the No. 2 I would say that, but on the  
24 basis of the other wells I don't see it as yet and the No. 1  
25 does not indicate it's at a pumping stage.

1 Q As yet.

2 A As yet.

3 Q But it may be at some point, let's say,  
4 prior to payout of the well?

5 A Possibly.

6 Q And the third principal difference, as I  
7 recall your testimony from yesterday, between the two AFE's  
8 came about in the casing tubulars, the casing and tubing  
9 program.

10 TXO, I think, AFE'd 5-1/2 inch production  
11 casing.

12 A Right.

13 Q You AFE'd 4-1/2.

14 A 4-1/2.

15 Q They AFE'd 2-7/8ths --

16 A Right.

17 Q -- tubing and you went with 2-3/8ths.

18 A Right.

19 Q So a substantial amount of the difference  
20 is accounted for in those three things.

21 Q Right.

22 Q Let me direct your attention to one fur-  
23 ther area.

24 You, on your Exhibit Number Thirteen, un-  
25 der the completion portion of that, made reference to

1 cement and services, production casing --

2 A Right.

3 Q -- \$7,215. I wonder if you would tell me  
4 a little bit about the production -- the cementing program  
5 that you contemplated for that price?

6 A As I mentioned yesterday, I called Dow-  
7 ell, who does cementing in this area and specified that  
8 we're going to run 4-1/2 inch casing, 7-7/8ths hole, and  
9 that I wanted a 2000 foot fill-up behind the casing.

10 Q Meaning 2000 feet from the bottom to the  
11 top of the cement.

12 A Affirmative.

13 Q Are you aware, Mr. McCoy, that the BLM in  
14 this area requires that the Queen formation, being possibly  
15 productive, be isolated by cementing that zone off from the  
16 --

17 A Yeah.

18 -- rest of the wellbore?

19 A Yeah.

20 Q Assuming that that is a fact, then your  
21 estimate of \$7200 would be too low. In fact a two stage  
22 cement job is required?

23 A If it's required.

24 Q Okay. Mr. McCoy, yesterday afternoon you  
25 went over certain information that you stated Mr. Sprinkle

1 need -- or you need in order to make a recommendation to  
2 Mr. Sprinkle of whether or not to participate in the No. 3  
3 Well.

4 A Affirmative.

5 Q I'd like you to recall your testimony at  
6 the January 9th hearing along these same lines.

7 Do you recall at that hearing in response  
8 to my question to you:

9 QUESTION: How long do you want TXO to  
10 wait?

11 And this was to wait before commencing  
12 its No. 3 Well, your answer was:

13 ANSWER: Well, I would say if we drill --  
14 Mewbourne ought to be completed within a week; Marshall and  
15 Winston, probably, within two weeks. That's not asking a  
16 lot.

17 QUESTION: This well, given the history  
18 of this dispute, is not going to be drilled in two weeks.

19 ANSWER: No, that's what I'm saying.  
20 We'll have that much ore information and at that time, with  
21 that information, I think Mr. Sprinkle can make a decision  
22 to --

23 And then we went on to other things.

24 Now, you were referring to the two wells  
25 that were drilling on January 9th --

1           A           Right.

2           Q           -- that have now been completed.

3           A           Right.

4           Q           And that you --

5           A           Well, they have not potentialized.

6           Q           But you testified to regarding certain --

7           A           Yes.

8           Q           -- information that you've had from those

9 wells yesterday.

10          A           Right.

11          Q           But with that information you're still

12 not in a position, as I understand your testimony, to make a

13 recommendation now without further additional information.

14          A           Affirmative. I did not know at the time

15 the No. 2 and the No. 3 Burleson were drilling and reaching

16 total depth. That is significant information.

17                    I did not know that at that testimony and

18 today I do know it and I would require that information, al-

19 so.

20                               MR. DICKERSON: I don't think I

21 have any further questions, Mr. Stamets.

22

23                               CROSS EXAMINATION

24 BY MR. STAMETS:

25          Q           Mr. McCoy, I've got one additional ques-

1 tion.

2 Yesterday at the close of the hearing we  
3 were talking about under what circumstances you'd recommend  
4 that an operator proceed with the well, and I believe we  
5 talked about it would be a situation where you perceive that  
6 there was a good opportunity to recover \$3.00 for every  
7 \$1.00 you spent.

8 A Affirmative.

9 Q Okay. Now let's take a sure thing, guar-  
10 anteed of not --no chance of missing, and you're the opera-  
11 tor of the well, and if you put up any money for anybody  
12 else and you get a 200 percent risk factor, how much money  
13 will you get back for every dollar you spend?

14 A Well, let me answer that, and I think on  
15 the exhibit where I showed the risk factor penalty separate  
16 from the payout, I think it was 44,000 barrels of additional  
17 gross production to pay out the penalty. This is an 87 per-  
18 cent lease, therefore it would be approximately 35,000 bar-  
19 rels of oil.

20 Then you would, your penalty would amount  
21 to probably \$350,000; therefore, adding that on to 3-to-1,  
22 you'd increase your rate of return, wouldn't you, if you get  
23 that much penalty.

24 Q If you spend a dollar --

25 A Yeah, okay.

1 Q -- for someone else --

2 A Right.

3 Q How much would you get back if the well  
4 was a sure thing, an individual producer would get back  
5 three dollars for that dollar?

6 A Well, the basic well will return the  
7 three dollars for each dollar expended, you pay for the  
8 other person, you get to recover that out of production,  
9 even if there is no penalty, the standard would be to -- you  
10 get to recover that.

11 In other words, if you carry somebody, at  
12 a minimum you would get his share of the cost back. That's  
13 been done. Well, he's not going to participate, we'll go  
14 ahead and pay the money and then we'll take it out of his  
15 share of the production and recover our money out of that  
16 without penalty.

17 Now that's not unusual; that's been done  
18 in the past.

19 Q That has been done, but when you're talk-  
20 ing about getting 3-to-1 in return, isn't that in essence  
21 what happens when you get a 200 percent penalty --

22 A Yes.

23 Q -- and you pay somebody else's share, you  
24 get essentially a 3-to-1 return.

25 A In addition to the already existing re-

1 turn on your production.

2 In other words, my 3-to-1 has no penalty  
3 in it. In other words, we spend, let's see, we have the re-  
4 serves, 106,000; we have a well cost of 483,000; we take the  
5 price per barrel, in this case, 17 times the ultimate recov-  
6 ery, subtract out that 87 percent working interest is all we  
7 get, subtract the well costs from that, divide that result  
8 by the well cost gives us a rate of return. now that's  
9 without any penalty.

10 Now, I'm tryig to put it in perspective  
11 as far as the additional penalty --

12 Q Let's just make it real simple for the  
13 judge that gets to read this transcript.

14 A Okay.

15 Q If Mr. Sprinkle is going to invest his  
16 money in the well that's going to cost him a milion dollars  
17 --

18 A Right.

19 Q -- you wouldn't recommend that he do that  
20 unless in your opinion he had a real good chance of getting  
21 three million back.

22 A Right.

23 Q Okay. If Mr. Sprinkle is a nonconsent  
24 interest owner in the well and his share is a million dol-  
25 lars --

1           A           Uh-huh.

2           Q           -- which is, you know, unrealistically  
3 high, if his share was a million dollars, someone else put  
4 up the money and they got a 200 percent risk factor for car-  
5 rying Mr. Sprinkle, they'd get back three million dollars,  
6 more or less.

7           A           Right.

8           Q           And that is a 3-to-1 return and that's,  
9 if I understand your testimony, that's the kind of return  
10 that you would -- you tell Mr. Sprinkle he ought to invest  
11 in.

12          A           Huh. I don't think I can relate risk  
13 penalty in the economics without going through and trying  
14 to make another analysis on that basis.

15                    What we're saying when we talk about an  
16 attractive oil investment would be a 3-to-1 return. We  
17 spend \$483,000 to drill the well and complete it, we would  
18 get three times that back. That's without any penalty.

19                    Now that's what I mean by a 3-to-1 re-  
20 turn.

21                    Now the penalty factor on top of that  
22 would in essence give you more reserves, if we relate it to  
23 reserves, would give you more reserves so it would increase  
24 your rate of return.

25          Q           Is it not, though, the person who is mak-

1 ing the investment doesn't really have anything at all to do  
2 with oil, it has to do with how much you're going to get  
3 back.

4 A Right.

5 Q And if -- if, let's say, TXO doesn't get  
6 any risk penalty and they pay Mr. Sprinkle's share, all they  
7 would get back would be dollar for dollar, isn't that cor-  
8 rect?

9 A No, they would get back -- I mean in  
10 this case if he does not participate, they get all the pro-  
11 duction that comes from that well attributable to his  
12 interest. So they spend \$448,000 to drill a well, they  
13 would get \$448,000 back to payout. Then they would get  
14 their pro rata share of the reserves after that and that  
15 would increase the 1-to-1 based on their reserves after pay-  
16 out.

17 Q Nevertheless, they would have invested  
18 how many dollars, it was for Mr. Sprinkle's share and they'd  
19 only get that money back, they wouldn't earn anything on  
20 their investment.

21 A Well --

22 Q They wouldn't have had the opportunity to  
23 recover anything more than what they invested.

24 A Well, now I think I'm reaching what you  
25 are. That's why we said that we could say a 25 percent risk

1 factor. If you add that on to their 1-to-1, they would be  
2 making 25 percent on their money.

3 Q Could you recommend to Mr. Sprinkle that  
4 he drill a well in this area if the best shot he had was  
5 making a 25 percent on his investment?

6 A Well, during the payout period, I think  
7 that would be true. In other words, you drill the well, you  
8 get all the production from the nonparticipating party, plus  
9 25 percent.

10 Then we take the balance of the produc-  
11 tion and I think in that case you'd still be talking about a  
12 good rate of return.

13 In other words, all he's doing is for  
14 five months, or six months in this case, he's making 25 per-  
15 cent on his money for carrying the nonoperating party.

16 Q I thought you told me that you wouldn't  
17 recommend to Mr. Sprinkle to drill well out there unless he  
18 had a good opportunity to get \$3.00 back for every \$1.00 he  
19 spent.

20 A Well, that's true. That's on a well  
21 basis, if we take the, as we presented here, the 3-to-1 re-  
22 turn on your money, based on that, just looking --

23 Q I'm asking you if you would recommend to  
24 Mr. Sprinkle to drill a well where his -- where you thought  
25 his opportunities were real good if he could get \$1.25 back

1 for every \$1.00 he invested.

2 A Well, that's not all he would get back in  
3 a well. That's only up to the payout period of six months.  
4 From then on he's making additional profit.

5 Q But you're not answering my question.

6 A Well, I think --

7 Q You see, what you're saying is he's going  
8 to make more than \$1.25 for every \$1.00, and I'm asking you,  
9 would you recommend to Mr. Sprinkle that he take the chance  
10 to drill a well in this area where he was only going to get  
11 back \$1.25 for every \$1.00 he invested?

12 A All right, now if that's all the well  
13 will return, no.

14 Q If that's the best estimate of what you  
15 could see it bringing back.

16 A No, I couldn't recommend that, but I  
17 don't think, we haven't done an analysis on that basis.

18 Q Okay. That's -- thank you.

19 MR. STAMETS: Do have other  
20 questions?

21 MR. KELLAHIN: I have a couple  
22 of questions.

23

24

25

## 1 REDIRECT EXAMINATION

2 BY MR. KELLAHIN:

3 Q With regard to Mr. Dickerson's question  
4 about pumping equipment, Mr. McCoy, did the Burleson No. 2-A  
5 proposed by TXO, did that include pumping equipment?

6 A No, it did not.

7 Q Did the other Burleson wells in the  
8 northeast quarter of Section 26, have they required pumping  
9 equipment at this time?10 A No, not to my knowledge. Now, I'm not --  
11 I have no information about -- on that.12 Q The potential for having a second or ad-  
13 ditional cementing stage, in response to Mr. Dickerson's  
14 question, what additional increase, if that is required by  
15 the BLM, what additional increase would you estimate would  
16 be plugged into your AFE to cover a second stage cementing  
17 program?18 A Well, there again, we're talking in my  
19 case the 4-1/2 casing is -- you'd require a DV tool for  
20 about \$2400, and probably the same additional volume of  
21 cement, so add \$7000 onto that, would add \$9000 onto your  
22 cost.23 Q All right. And if we add that on, then  
24 we're up to \$457,738.

25 A Right.

1 Q All right. Have you understood what Mr.  
2 Stamets was indicating in terms of redoing an economic  
3 projection assuming your ability to incorporate a risk  
4 factor penalty and translate that into a rate of return for  
5 the operator?

6 A It could be done. It would take -- I'd  
7 have to go back and redo the form, but it could be done.

8 Q How long would it require you, Mr. McCoy,  
9 to rerun that economic calculation using your computer  
10 program, plugging in 200 percent, 150, 100 percent, various  
11 numbers as risk factors in order to give the Commission an  
12 accurate indication of what additional rate of return might  
13 TXO realize under that fact situation?

14 A Under pressure, 24 hours, and possibly  
15 Monday would be --

16 MR. KELLAHIN: No further  
17 questions.

18 MR. STAMETS: Any other  
19 questions of Mr. McCoy?

20 He may be excused.

21 MR. KELLAHIN: Mr. Chairman, we  
22 call Mr. Joe Sprinkle at this time.

23

24

25

1 JOSEPH S. SPRINKLE,

2 being called as a witness and being duly sworn upon his  
3 oath, testified as follows, to-wit:

4  
5 DIRECT EXAMINATION

6 BY MR. KELLAHIN:

7 Q Mr. Sprinkle, would you please state your  
8 name and address?

9 A Joseph S. Sprinkle, Box 6483, Denver,  
10 Colorado.

11 Q Mr. Sprinkle, for the benefit of the Com-  
12 mission, would you give us a summary of your background and  
13 experience in the oil and gas business?

14 A Well, in the last 35 years I've been a  
15 oil scout, petroleum landman, and an independent producer.

16 Q Would you describe for us, Mr. Sprinkle,  
17 what interests you have in Section 26 insofar as the Bone  
18 Springs interval is concerned?

19 A I have a 31.25 percent interest.

20 Q Would you describe for us under what cir-  
21 cumstances you acquired that interest in this acreage?

22 A That lease was won on the BLM simultan-  
23 eous drawing and I and two other people purchased that from  
24 the winner, Mr. Tom Curran, Wichita Falls, Texas.

25 Q Have you made elections to participate or

1 not participate in various oil and gas wells that have been  
2 drilled in the State of New Mexico?

3 A Yes.

4 Q Is that part of the business that you  
5 conduct for yourself, to analyze deals and propositions that  
6 are made to you to determine whether or not you'll partici-  
7 pate?

8 A Yes.

9 Q Other than the TXO cases involved in the  
10 north half of 26, Mr. Sprinkle, have you ever before been  
11 involved in forced pooling cases in the State of New Mexico  
12 --

13 A No.

14 Q -- involving any of your interest?

15 A No, not anywhere else.

16 Q Do you participate with other operators  
17 in New Mexico with regards to oil and gas production in this  
18 state?

19 A Yes.

20 Q Can you describe some of those operators  
21 that you participate with?

22 A Well, principally, the biggest one is  
23 with Yates in the Young Deep Unit, which is just north of  
24 this prospect on the same lease. I think we have about 26  
25 to 30 Bone Springs wells in there now. I participated in

1 every one of them from the very beginning.

2 In addition to that, I've picked up some  
3 interest of nonconsenting working interest owners.

4 Q All right, sir. Would you describe the  
5 circumstances around your election not to participate in the  
6 Sprinkle No. 1 Well?

7 A It was a Morrow test and I didn't want  
8 any part of it.

9 Q Subsequent to having the Sprinkle 1 dril-  
10 led and completed, then, as a Bone Springs discovery, did  
11 you make a decision about participating in the second Sprin-  
12 kle No. 2 Well in the northeast of the northwest of 26?

13 A You lost me a little bit there, Tom.

14 Q All right, sir. On -- on the No. 2 Well,  
15 --

16 A Yeah.

17 Q -- after the No. 1 Well has been pooled,  
18 ~~today~~ you have an opportunity to make an election on your par-  
19 ticipation in that well?

20 A Oh, yes, yes.

21 Q All right, and did you make that elec-  
22 tion?

23 A Yes.

24 Q What amount of money did you pay to TXO  
25 to participate in the No. 2 Well?



1 future. It does not seem to me to be profitable at this  
2 point to pursue that, but if the question is allowed and  
3 this line of inquiry is allowed, we're going to have no  
4 choice but to do it.

5 MR. KELLAHIN: Mr. Chairman,  
6 when we proposed yesterday a proposed order in this case we  
7 discussed generally what items of information Mr. Sprinkle  
8 needed in order to exercise that election.

9 That information was coupled  
10 with a request that an additional election period be allowed  
11 Mr. Sprinkle after the entry of the Commission order.

12 It has been the custom and  
13 practice of this Commission, as well as the Division, to  
14 give any party pooled, such as Mr. Sprinkle, a full thirty  
15 days in which to make his election after not only a Division  
16 order but a Commission order.

17 One of the principal problems  
18 in this case is TXO's contention that a full thirty day  
19 election period following this hearing will give Mr. Sprin-  
20 kle the opportunity to realize the results of the No. 3 Well  
21 within that election period.

22 Now that's not what he seeks to  
23 do, but he wants to make that decision based upon available  
24 information from the 1 and the 2 Wells.

25 Our discussions yesterday had

1 to do with whether or not the parties had had a fair oppor-  
2 tunity to agree on a voluntary basis, and it was my position  
3 yesterday, as it is today, that I was not going to fill the  
4 record with whether or not TXO had been reasonable in terms  
5 of its offer, or whether or not a sufficient period of time  
6 had elapsed in which to reach a voluntary agreement.

7                   The Division transcript which  
8 you admitted yesterday shows that on October 14th TXO sent a  
9 letter to Sprinkle asking him to voluntarily participate in  
10 the No. 3 Well. The very next day they filed to force pool  
11 the man and we have spent months getting data.

12                   Yesterday I asked Mr. McCoy  
13 about the official data that he would feel necessary. The  
14 whole purpose of Mr. Sprinkle's testimony today is to show  
15 not the reasonableness of the offers or the ability of the  
16 parties not to reach a voluntary agreement, but the state of  
17 the information given to him by TXO so that he can make a  
18 fair and informed election on the No. 3 Well.

19                   The tender of proof from Mr.  
20 Sprinkle's testimony is that, despite Mr. Dickerson's pro-  
21 testations, TXO continues to withhold information from two  
22 wells, one of which Mr. Sprinkle paid his way and partici-  
23 pates and yet does not get that information.

24                   We want this order to specif-  
25 ically require TXO to give us that information. We haven't

1 gotten it yet. Mr. Sprinkle's here to testify that he needs  
2 it, and that's the purpose of his testimony. I don't intend  
3 to spend all day talking about reasonable offers, but I do  
4 want to talk about the data that he now feels is necessary  
5 in order to make his choice, and that's the whole purpose of  
6 his testimony.

7 MR. STAMETS: In your proposed  
8 form of order I think the three issues in question, then,  
9 would be the daily production reports from the Sprinkle No.  
10 1 and 2 --

11 MR. KELLAHIN: Yes, sir.

12 MR. STAMETS: -- current bottom  
13 hole pressure tests, production tests on the 1 and 2, and  
14 current gas/oil ratio tests on the Sprinkle 1 and 2, each of  
15 these wells which Mr. Sprinkle has an interest in in some  
16 form or fashion.

17 MR. KELLAHIN: In addition, Mr.  
18 Chairman, we mentioned yesterday that there may be some ad-  
19 ditional items to be added to this list. Mr. Sprinkle wants  
20 to have TXO provide him some -- some cost information, some  
21 price information that he has not gotten.

22 It won't take -- it will take  
23 me less time to ask him the question and get the answer than  
24 it is to tell you what it is, but there are certain items  
25 that he thinks are necessary, and that's all I'm seeking to

1 ask him.

2 MR. DICKERSON: Mr. Stamets,  
3 may I very briefly?

4 You'll recall the --

5 MR. STAMETS: No, thank you,  
6 Mr. Dickerson. I think we'll end the arguments right here.

7 I'm going to at least allow the  
8 question so we can see what it is that Mr. Sprinkle wants.

9 We'll overrule Mr. Dickerson  
10 and allow the question to determine the full extent of what  
11 Mr. Sprinkle seeks.

12 Q Mr. Sprinkle, for the sake of clarity,  
13 would you outline for me, sir, what additional information  
14 that you would like in order to make a decision on your par-  
15 ticipation in the No. 3 Well?

16 A I'm a force pooled working interest owner  
17 in the No. 1. My net revenue interest is .271875. That  
18 well has been producing for seven months; therefore, they  
19 have been selling my product for seven months. I have ask-  
20 ed for an accounting of my cost, how much has been credited  
21 to my account, and when my possible payout might be, I'll be  
22 able to figure that out, so that I can see if I'm going to  
23 realize any profit potential out of the No. 1.

24 They have refused to give me a -- their  
25 perception of my cost and they have refused to give me how

1 much money has been credited to my account for the sale of  
2 my product out of the No. 1.

3 MR. STAMETS: No. 1, let me  
4 confirm here that I've got the right stuff down. You want  
5 to know what your costs are, what's been credited to your  
6 account, and what your payout status is.

7 A No, I'll figure my payout status.

8 MR. STAMETS: Okay, just cost  
9 and credits.

10 A Yes, sir.

11 MR. STAMETS: As current as  
12 they've got them.

13 A Yes, sir. Furthermore, I would like to  
14 know why after seven months production we don't have a Divi-  
15 sion order issued on the No. 1.

16 Q Is there any other information about the  
17 No. 1 Well that you're requesting in order to make your  
18 election?

19 A No, I don't think so.

20 Q All right, sir. We were furnished yes-  
21 terday from Mr. Wood, the production information on the  
22 Sprinkle 1 Well on an average weekly basis.

23 All right, let's turn to the No. 2 Well  
24 now, Mr. Sprinkle. What additional information would you  
25 like from that well in order to exercise your election for

1 the No. 3 Well?

2 A I paid \$192,000 about November the 20th,  
3 which has turned out to be more than \$40,000 too much. No  
4 attempt has been made to give me a credit. No attempt was  
5 made to give me any information, a paid up, over paid up  
6 working interest owner, until there was a response to my  
7 letters early in February to Jeff Bourgeois, the landman for  
8 TXO.

9 I asked for information early in Febru-  
10 ary, which I was entitled to upon receipt of my check in  
11 November, and they finally came through and gave me some in-  
12 formation.

13 I would like for that information to be  
14 given to me on a regular basis, which is not unreasonable  
15 for a working interest owner to expect.

16 Q So that we're clear, Mr. Sprinkle, on the  
17 No. 2 Well, --

18 A Yes.

19 Q -- would you tell us exactly what it is  
20 that you seek to have TXO give you?

21 A Yes.

22 Q Please tell me.

23 A What?

24 Q Tell me once again what the exact items  
25 are that you would like TXO to give you for the No. 2 Well

1 so that you can make your election on the No. 3 Well.

2 A Well, for the No. 2 Well I want on-going  
3 production data timely presented to me, not with a two or  
4 three month wait; not without me having to ask for it; not  
5 without me having to make demands upon them to give me  
6 information which is routinely furnished to a nonoperator.

7 Q Are you asking for any information, Mr.  
8 Sprinkle, that, based upon your experience, would be pro-  
9 prietary information to the operator?

10 A Of course not.

11 Q Is this information that's commonly fur-  
12 nished by an operator to other working interest owners in --

13 A Timely furnished, yes, without having to  
14 make a request to have it, either written or verbal or on  
15 the phone.

16 Q With the exception of Mr. McCoy's need  
17 for technical information with regards to his recommenda-  
18 tions to you, Mr. McCoy made certain recommendations for ad-  
19 ditional data, except for those and apart from what you have  
20 told us now was information that you would request, is there  
21 any other information that you would believe necessary in  
22 order to make your election?

23 A Well, yes. In view of the fact that Mr.  
24 Dickerson said that the No. 1 and No. 2 were in a period of  
25 steep decline, I think that it would be prudent to take a

1 30, 60, or 90-day look at what's going to happen to these  
2 two wells prior to drilling the third well.

3 More information should be gathered to  
4 keep from making a mistake. The flowing tubing pressure has  
5 come down. There's been an increase in the water. The No.  
6 2 has been proposed to enter into a new zone. The No. 2  
7 does not have the pump on it yet, so how bad a well is it?  
8 How can you tell just because it quite flowing? You've got  
9 to get an evaluation with your pump.

10 Q Mr. Bourgeois testified yesterday that he  
11 believed the last date for TXO's commencement of the Sprin-  
12 kle No. 3 Well should be on or before March 19th of 1986.  
13 Do you recall that?

14 A I thought he said March 14th.

15 Q I'm sorry, he did say March 14th at the  
16 latest hearing. March 14th.

17 A At one time a couple of months ago, or  
18 last month, he said March 19th; yesterday it was March 14th.

19 Q All right, sir. By when would you need  
20 this information, Mr. Sprinkle, in order to make an election  
21 to participate that would be prior to the spud date for the  
22 subject well?

23 A Any prudent operator would want to see  
24 the No. 1 and the No. 2 further evaluated because by their  
25 own admission it's in a period of steep decline. How steep

1 is it and when is this decline going to stop, the end of 30  
2 days, 60 days, or 90 days? There's no point in being in a  
3 headlong rush to get to a development well until you have  
4 thoroughly evaluated what you have previously done.

5 Q For the sake of the question, Mr. Sprin-  
6 kle, let's assume the Commission will accommodate a solution  
7 for TXO that extricates them for this -- from this 90-day  
8 obligation they've gotten themselves into, and will require  
9 you to make your election on or before the spud date of the  
10 No. 3 Well, which Mr. Bourgeois tells us has to be March  
11 14th, is there a sufficient time between now and March 14th  
12 for you to make an election to participate in the well?

13 A Yes, I would make an election.

14 Q All right, by what date do you need this  
15 information in order to make a timely election prior to the  
16 March 14th date?

17 A I would say no later than the 10th.

18 Q Mr. Sprinkle, have you attempted to delay  
19 your election in the No. 3 Well in order to have an oppor-  
20 tunity to see the results of the drilling of that well?

21 A No.

22 Q What's -- what's your position with re-  
23 gards to this case, Mr. Sprinkle?

24 What is your position with regards to --  
25 what is your position with regards to your opposition to TXO

1 in this case?

2 A I want to see more data from the No. 1  
3 and the No. 2 before you proceed. Any cautious, prudent,  
4 oil man would want as much data as he could possibly get be-  
5 fore proceeding with additional drilling.

6 MR. KELLAHIN: Thank you.  
7 That's all.

8 MR. DICKERSON: Mr. Sprinkle,  
9 are you concerned with --

10 MR. STAMETS: Excuse me, Mr.  
11 Dickerson, I'm going to exercise my prerogative to go first.

12

13

#### CROSS EXAMINATION

14

BY MR. STAMETS:

15

Q Mr. Sprinkle, I'm not clear on your con-  
16 cerns with No. 2 about production data, you know, the -- TXO  
17 files Form C-115, a monthly production report, with us on or  
18 about the 24th of the month after the production month.

19

Now are you asking that they file a copy  
20 of the C-115 with you, or are you looking for daily produc-  
21 tion reports --

22

A I'm entitled to have, according to the  
23 operating agreement, I'm entitled to have a copy of any do-  
24 cument that they file with any governmental agency, and  
25 that's one of them.

1 Q So that's basically all you're asking  
2 for, is that they send you a copy of the C-115.

3 A Timely. The No. 2 Well has been produc-  
4 ing since the 15th of November. I finally got that data,  
5 well, let's see, from Mr. Bourgeois, his letter was dated  
6 February the 14th, the envelope was postmarked the 18th, the  
7 notice was given to me in my postoffice on the 20th, and I  
8 got this data out of my postoffice box on the 21st of Feb-  
9 ruary.

10 Q Okay, what's the latest month that you've  
11 got production data on the No. 2?

12 A The latest that I have in front of me is  
13 through December. I checked with my office yesterday and my  
14 wife told me that I probably had January now.

15 Q And when did you get December?

16 A February the 21st.

17 Q February the 21st, but you -- she thinks  
18 you've got January now.

19 A She thinks that was in the mail yester-  
20 day, yes.

21 Q Okay, so you've gotten both the recent  
22 months within the last week.

23 A Yes. There was other data that I asked  
24 for which is on hold, such as the No. 2, how much oil and  
25 gas has been sold from this well, copies of the sales agree-

1 ments for each product, and an accounting of the well costs.  
2 I have an accounting of the well cost.

3 Copies of the sales agreements are appar-  
4 ently forthcoming. Apparently some day I will find out how  
5 much oil and gas they have sold and sold to whom and for how  
6 much, but I don't have that data now and that's vital econo-  
7 mic data.

8 MR. STAMETS: Mr. Dickerson, do  
9 you have questions for the witness?

10

11

CROSS EXAMINATION

12 BY MR. DICKERSON:

13 Q Mr. Sprinkle, does your file reflect the  
14 letter to TXO dated February 4, 1986?

15 A Yes.

16 Q It was from you to Mr. Bourgeois?

17 A Yes.

18 Q Would you read that to us, please, the  
19 second paragraph of it?

20 A The whole paragraph?

21 Q Yes.

22 A "Please review Paragraph (d), Article VI  
23 of the operating agreement, dated September the 16th, 1985,  
24 which applies to the Sprinkle Federal No. 2 Well. You are  
25 hereby advised that in accordance with this provision of the

1 operating agreement that I am serving you with my demand no-  
2 tice for copies of all forms or reports filed with govern-  
3 mental agencies, tank tables, daily gauge and run tickets,  
4 and reports of stock on hand at the first of each month.  
5 This request is retroactive to the completion date of the  
6 above described well. Hopefully this data, which I am en-  
7 titled to, will be provided by return mail."

8 Q And your letter was dated February 4th,  
9 1986.

10 Now let me direct your attention to  
11 Article Roman Numeral VI, paragraph (d) of the operating  
12 agreement referred to in --

13 A Let's look at the operating agreement and  
14 see which one it is first.

15 Q Okay. Dated September 23rd, 1985. This  
16 is the AAPL Form 610 Operating Agreement, is it not?

17 A I don't know, but it's not the operating  
18 agreement that I signed.

19 Q Okay, let me -- let me read from you, and  
20 I'll just tell you that this is the Article VI (d) of the  
21 AAPL --

22 A Why don't you read from the one that I  
23 signed?

24 Q Okay. I'm going to read from the one  
25 that I have and just tell you that it's the same.

1 Operator, upon request, shall furnish  
2 each of the other parties with copies of all forms or re-  
3 ports filed with governmental agencies, daily drilling re-  
4 ports, well logs, tank tables, daily gauge and run tickets  
5 and reports of stock on hand at the first of each month, and  
6 then goes on.

7 Your letter made reference to that para-  
8 graph, did it not?

9 A Yes.

10 Q Okay, the letter that you received, that  
11 you stated you received on February 26th --

12 A 21st.

13 Q -- February 21st, excuse me, from Mr.  
14 Bourgeois, do you have a copy of that in your file?

15 A Sure.

16 Q I wonder if you'd read that for us?

17 A The whole letter?

18 Q Yes, sir.

19 A Where do I start?

20 Q I'd try at Dear Mr. Sprinkle.

21 A How about February the 14th?

22 MR. STAMETS: Please, gentle-  
23 men, we won't have any arguing and I think you understand  
24 where he'd like you to start, Mr. Sprinkle.

25 A Yes, but I would like to also say Feb-



1 man.

2 Q Mr. Sprinkle, was the information that  
3 you recited from that letter, said to be enclosed in that  
4 letter, was that in fact received by you?

5 A Yes.

6 Q Number one, the Daily Gauge and Produc-  
7 tion Reports, you did receive this.

8 A Yes, they appear to be here.

9 Q Okay, copies of all forms or reports filed  
10 with governmental agencies, the C-115's, the --

11 A I don't know what all forms are necessary  
12 to be filed.

13 Q You received C-115's for the month of No-  
14 vember and December, then?

15 A Yes.

16 Q And you received certain BLM reports filed  
17 with the BLM on these wells in that letter, too, did you  
18 not?

19 A USGS I believe.

20 Q Yes, right.

21 A Yes.

22 Q Okay.

23 A Sundry Reports, I believe they're called.

24 Q Did you ask for anything in your letter of  
25 February 4th which was either not furnished by TXO with the

1 letter of February 14th or promised to be furnished as soon  
2 as they could obtain it from Dallas?

3 A Question number one, how much oil and gas  
4 has been sold from this well? Is that reflected on the C-  
5 115, which is a form that I'm unfamiliar with?

6 Q I'm not under oath. I can't answer ques-  
7 tions, Mr Sprinkle, but yes, it is.

8 A Is it?

9 Q Yes, sir.

10 A Well, that was pointed out to me yester-  
11 day.

12 Q Cumulative production.

13 A But does it say how much oil and gas has  
14 been sold?

15 MR. STAMETS: For the record,  
16 that is information which is shown on that form.

17 A Well, that's -- I was unfamiliar with it  
18 yesterday and that was pointed out to me.

19 Q Mr. Sprinkle, this technical data that  
20 you're seeking on the No. 1 and 2 Wells, is this to be ob-  
21 tained at the cost of TXO? In other words, they're special  
22 tests to be required to be run by TXO in order to furnish  
23 you the information?

24 A The special things that Mr. McCoy asked  
25 for?

1 Q Uh-huh.

2 A I don't know. Wouldn't they like to have  
3 them for themselves?

4 To tell you the truth about it, I'm  
5 unfamiliar with some of the things that Mr. McCoy asked for.  
6 That's why I hired him as an expert. I'm not an expert pet-  
7 roleum engineer. He is.

8 MR. STAMETS: Mr. Dickerson, I  
9 would ask that when you -- I presume you're going to put on  
10 some more witnesses.

11 MR. DICKERSON: Yes, sir.

12 MR. STAMETS: I would ask that  
13 you tell us at that time whether or not the information that  
14 has been requested is available currently to TXO or whether  
15 those would be special tests which would have to be run.

16 MR. DICKERSON: Okay. I think  
17 I will just leave Mr. Sprinkle and resume with my witnesses,  
18 Mr. Stamets.

19 MR. STAMETS: Do you have any  
20 further questions before you're through?

21 MR. KELLAHIN: Mr. Sprinkle,  
22 anything else?

23 A No.

24 MR. KELLAHIN: All right, sir.

25 MR. STAMETS: The witness may

1 be excused.

2 MR. KELLAHIN: That concludes  
3 our presentation.

4 MR. STAMETS: We'll have a ten  
5 or fifteen minute recess.

6

7 (Thereupon a recess was taken.)

8

9 MR. STAMETS: The hearing will  
10 come to order.

11 Do you have some redirect, Mr.  
12 Dickerson?

13 MR. DICKERSON: Yes, Mr. Exa-  
14 miner.

15 Call Mr. Deen Wood.

16

17 DEEN WOOD,  
18 ~~being recalled as a witness and having been previously~~  
19 sworn, testified as follows, to-wit:

20

21 REDIRECT EXAMINATION

22 BY MR. DICKERSON:

23 Q Mr. Wood, I don't want to belabor this to  
24 any great extent.

25 Have you compared the AFE submitted by

1 Mr. McCoy with the AFE for the Sprinkle No. 3 Well from --  
2 submitted by TXO and can you summarize the differences be-  
3 tween those two AFE's for us?

4 A Yes, sir, I have compared them and the  
5 three areas that contain the majority of the differences are  
6 in, first, the AFE that Mr. McCoy prepared did not contain  
7 the cost of the pumping unit and the associated equipment  
8 required by the pumping unit and --

9 Q What is that portion of the additional  
10 cost?

11 A That would be an incremental \$38,500.

12 Q Okay.

13 A And of the four wells that we have  
14 produced or tried to produce out there, two are in the pro-  
15 cess of being put on pump.

16 One of them, the Burleson Federal No. 2,  
17 had to be put on pump on -- on -- on completion.

18 The Sprinkle Federal No. 2 went for about  
19 six or seven weeks before it finally died and we are cur-  
20 rently putting it on pump also.

21 Q What other elements in the -- or differ-  
22 ences between the two AFE's account for the difference?

23 A The second difference would be in the  
24 pipe prices that Mr. McCoy used. He ran a 4-1/2 inch casing  
25 with 2-3/8ths inch tubing, casing and tubing program.

1                   We AFE'd 5-1/2 inch and 2-7/8ths inch  
2 casing and tubing and that accounts for a difference of  
3 \$20,816.

4                   The third difference is in the cement job  
5 that we went over earlier in Mr. McCoy's testimony. He had  
6 only the primary cementing job for the Bone Springs included  
7 in his estimate. We are required to cover all the producing  
8 zones. The Queen does produce in the area. We have covered  
9 -- it looks productive and we have covered it in all of the  
10 wells that we've drilled out there with the exception of the  
11 Sprinkle Federal No. 2. It was a re-entry of a Queen test  
12 and that Queen zone was already covered by cement when we  
13 re-entered the well.

14                   There is another area of difference. The  
15 difference there, by the way, is about \$14,000.

16                   Q           TXO AFE'd \$22,000 for cement?

17                   A           \$20 - 22,000, and Mr. McCoy AFE'd 7000  
18 without taking into account the two-stage cement job.

19                   Q           Now did you cover the tank battery dif-  
20 ferential?

21                   A           Yes, I did look at the tank battery dif-  
22 ferential.

23                   Q           Those four elements, the difference be-  
24 tween the two AFE's consisting of the judgment call of the  
25 tank battery, the necessity or not of pumping equipment, and

1 related equipment, the size of the casing and tubing, and  
2 the cost attributable to that size difference, and the  
3 cement job, when you take the differences attributable to  
4 those four areas and add them to the AFE submitted by Mr.  
5 McCoy, what do you come up with, Mr. Wood?

6 A \$537,499, \$5000 over the AFE that we had  
7 revised and proposed.

8 MR. DICKERSON: I have nothing  
9 further.

10

11

RECROSS EXAMINATION

12 BY MR. STAMETS:

13 Q Mr. Wood, why -- why does TXO prefer to  
14 set a tank battery instead of metering and commingling this  
15 production?

16 A Okay. First of all, let me state that  
17 I'm not in the Production Department. I'm in the Reservoir  
18 Department, and I didn't prepare the AFE, although I have  
19 been over it in detail.

20 The reason that I would surmise is that  
21 there are separate sets of interests in each well and you  
22 can accurately monitor the production by setting a separate  
23 tank battery in each location. That's the reason that they  
24 set them up that way.

25 The proposal that Mr. McCoy had for a

1 single tank battery, where you meter the production from  
2 each of the wells, is an alternative. I think that it would  
3 be more expensive than he has estimated in the long run if  
4 the production from the lease is as good as everyone hopes  
5 it will be.

6 It also has some difficulties involved in  
7 it in that you start running those pipe -- those flow lines  
8 across the open ground like that, I'm not familiar with the  
9 particular regulations in this particular case, but I know  
10 that in many cases you have to bury the flow lines; that is  
11 an added expense. Also those flow lines, if there is any  
12 water in them at all, they tend to freeze up in cold weather  
13 which results in down time and lost production; not perman-  
14 ently lost but when you have some down time.

15 Also, we've been involved in this sort of  
16 thing in a few cases in the past and some of the interest  
17 owners are not entirely happy with that type of situation  
18 because even with the metering they will sometimes question  
19 whether or not the production is being properly allocated  
20 back to their well. That's just a concern that they have.

21 This is about as efficient a method and  
22 takes away all questions as to how the production is allo-  
23 cated.

24 Q Why would TXO prefer to run 5-1/2 inch  
25 casing and 2-7/8ths tubing as opposed to Mr. McCoy's 4-1/2

1 and 2-3/8ths?

2           A           At this depth with high volume wells, 2-  
3 7/8ths -- especially if you're going to pump them, 2-7/8ths  
4 inch tubing is preferable in a lot of cases, and in this  
5 one, perhaps. When you're working with high liquid volumes  
6 and tubing that's going to eventually have a rod string in  
7 it. If you restrict yourself with the 2-3/8ths inch tubing,  
8 then you restrict the type of size of rods that you can put  
9 into that tubing, in which case if you were going to make a  
10 large volume of oil, but you couldn't get a big enough rod  
11 string in it, you may not be able to make all that oil.

12                       In other words, the rod string that you  
13 could put in would not be large enough and therefore strong  
14 enough to lift the amount of oil that the well was capable  
15 of producing, whereas a larger tubing string size would al-  
16 low a bigger size rod string and could produce everything  
17 that the well was capable of making.

18                       ...We don't always set 5-1/2 when we have it.  
19 AFE'd that way. In some cases we haven't done that, but  
20 it's wiser to be prepared for that, especially in a case  
21 where we think we're going to have high potential wells.

22           Q           I'm not sure that you know the answer to  
23 this, but if any of the witnesses for TXO know, I'd like to  
24 have the answer.

25                       In a standard operating agreement, how --

1 how is the matter of pumping units dealt with? Is that an  
2 up front expense that the partners have to bear or is that  
3 an expense which is only brought up after it's determined  
4 that a pumping unit is needed?

5 A I don't know how that's handled in an  
6 operating agreement.

7 MR. DICKERSON: Mr. Bourgeois  
8 claims to know the answer.

9 MR. STAMETS: Mr. Bourgeois,  
10 we'll let you answer the question.

11 MR. BOURGEOIS: If the pumping  
12 unit is included in the original AFE for the drilling and  
13 completing of the well, as proposed under the operating  
14 agreement, then it is an up front expense that is charged to  
15 all the consenting working interest owners.

16 If it is not contemplated in  
17 the original AFE, it is a subsequent operation which is pro-  
18 posed under the operating agreement and subject to whatever  
19 nonconsent penalties that the operating agreement has in-  
20 cluded.

21 MR. KELLAHIN: Mr. McCoy be-  
22 lieves he has a different answer, perhaps.

23 MR. STAMETS: Well, we'll give  
24 him a chance in a minute.

25 In the case where money has

1 been paid up front, what happens if it's determined a pump  
2 is not needed?

3 MR. BOURGEOIS: When I say the  
4 pumping unit is on the original AFE and it is not needed,  
5 then, of course, it is refunded, but very rarely, under nor-  
6 mal operating procedures under an operating agreement, the  
7 only thing we would require in any kind of prepayment would  
8 be the dry hole cost and then subsequent expenditures for  
9 completion are just billed to interest owners respective in-  
10 terests as the (not understood) are mailed out as we receive  
11 our invoices.

12 MR. STAMETS: And that's in a  
13 voluntary agreement.

14 MR. BOURGEOIS: Correct, yes.

15 MR. STAMETS: Where you're  
16 force pooling would you want all your money up front?

17 MR. BOURGEOIS: When we're  
18 force pooling, if the AFE does contemplate that pumping unit  
19 then we want as part of the up front money all the expenses  
20 that are included in that AFE.

21 And if it ends up being an  
22 overpayment to TXO, TXO is, of course, obligated to refund  
23 any overpayment.

24 MR. STAMETS: Do you have any  
25 idea how long after it's determined that an overpayment has

1 been made that it takes to make that payment back?

2 MR. BOURGEOIS: I don't have a  
3 time frame but I had a visit with our Accounting Department  
4 last week and told them of the differentiation in the Sprin-  
5 kle No. 2 Well, and requested that we refund Mr. Sprinkle's  
6 money as to our invoices as of that date and then any subse-  
7 quent invoices we would just mail out to him on a forced in-  
8 terest billing statement.

9 MR. STAMETS: If I understood  
10 Mr. Sprinkle's testimony, he has joined in the drilling of  
11 that well and is now a voluntary participant.

12 MR. BOURGEOIS: Right, and as  
13 it stands right now we owe him a refund as to what amount  
14 I'm not sure, but that is being handled by our Accounting  
15 Department.

16 MR. STAMETS: Does anybody here  
17 know the status on the Sprinkle No. 1, if Mr. Sprinkle has  
18 been furnished with the costs and credits to date?

19 MR. DICKERSON: That is the  
20 subject of another long drawn out proceeding pending now  
21 we've had two hearings to date, approximately eight hours of  
22 testimony on it.

23 Mr. Sprinkle has objected to  
24 the costs of the No. 1 Well and we are involved in resolving  
25 that.

1 MR. STAMETS: So he has been  
2 furnished with a copy of the costs.

3 MR. DICKERSON: Yes.

4 MR. STAMETS: How about the  
5 credits to that well?

6 MR. BOURGEOIS: As to the  
7 credits, he's a nonconsenting -- he is a force pooled inter-  
8 est.

9 MR. DICKERSON: He is pooled in  
10 that well.

11 MR. BOURGEOIS: And he has no  
12 -- he has put up no money in it.

13 MR. DICKERSON: Determination  
14 of reasonable well costs, which is being disputed.

15 MR. STAMETS: Has Mr. Sprinkle  
16 been furnished anything which would indicate the amount and  
17 value of oil produced from the Sprinkle No. 1 Well, which  
18 would be credited to his account once the costs have been  
19 determined?

20 MR. BOURGEOIS: We haven't pre-  
21 pared a payout statement as to his net interest pulled out  
22 separately from production. Is that the question?

23 MR. STAMETS: No. I think all  
24 Mr. Sprinkle was asking for was a number which represented  
25 how much oil had been produced perhaps on a monthly basis

1 from that well and the value of that which would be credited  
2 to his account once the costs were determined.

3 MR. BOURGEOIS: No, I don't  
4 think so.

5 He has some production informa-  
6 tion on the No. 1, I'm certain, but as to his interest, I  
7 don't believe he has it.

8 MR. STAMETS: This would be a  
9 routine thing that I presume TXO could handle in short or-  
10 der.

11 MR. BOURGEOIS: Yes, I would  
12 believe so.

13 MR. STAMETS: What, four or  
14 five days?

15 MR. BOURGEOIS: Yes, I think we  
16 could handle that in five days.

17 MR. STAMETS: Okay. Are there  
18 other questions of Mr. Wood?

19 MR. KELLAHIN: If you please,  
20 Mr. Chairman.

21

22 RE CROSS EXAMINATION

23 BY MR. KELLAHIN:

24 Q Mr. Wood, I want to clarify my recollec-  
25 tion of the ranges of rate of return that we discussed yes-

1 terday so I have a clear understanding of what TXO's minimum  
2 rate of return would be, for example, in the No. 3 Well.

3 In the January 9th hearing you and I had  
4 a question and answer with regards to minimum rates of re-  
5 turn, and the question was, I asked you:

6 QUESTION: Mr. O'Hare in his testimony in  
7 November 21st advised us in his presentation that the mini-  
8 mum rate of return for TXO that they would assign to this  
9 property was a 2-to-1 rate of return. Now in your -- a 2-  
10 to-1 return on investment, as opposed to rate of return, re-  
11 turn on investment.

12 Your answer was:

13 ANSWER: It depends on the rate of return  
14 involved.

15 I said all right, and then your answer  
16 was:

17 ANSWER: We -- we wouldn't set out parti-  
18 cularly under current -- current market conditions are so  
19 uncertain, we wouldn't set out to drill a 2-to-1 deal. If  
20 we got one and the rate of return was high, we'd be happy  
21 with it.

22 In the context of that discussion, would  
23 you clarify for me, sir, what rate of return TXO considers  
24 the minimum rate of return for the Sprinkle No. 3 Well? I  
25 want to be clear in your testimony in relation to Mr. Sta-

1 mets' question to Mr. McCoy about rate of returns. Mr.  
2 McCoy and Mr. Stamets were talking about a 3-to-1 rate of  
3 return.

4 A No, 3-to-1 is a return on investment.

5 Q All right, I'm confused because of the  
6 vocabulary.

7 Will you straighten me out now? The re-  
8 turn on investment would be 3-to-1.

9 A Right.

10 Q That was Mr. McCoy's testimony.

11 A That's right. That's the kind of deal --

12 Q All right.

13 A -- that we seek to drill.

14 Q All right. If the return on investment  
15 is only 2-to-1, would that preclude TXO from drilling a well  
16 for the No. 3 Sprinkle Well?

17 A Quite possibly.

18 Q All right, when we talk about rate of re-  
19 turn, we are talking about the days or months it will re-  
20 quire you to recover the initial costs of the well? Is that  
21 what we're talking about in rate of return?

22 A That's my understanding, yes.

23 Q All right. In terms of your understand-  
24 ing of rate of return, do you have a projection as to how  
25 long you would anticipate it to take you in months to

1 achieve a 1-to-1 rate of return?

2 A You're asking for payout time?

3 Q Yes, sir.

4 A No, I don't have that number available to  
5 me.

6 Q Okay. Thank you.

7 MR. STAMETS: Any other ques-  
8 tions of Mr. Wood?

9 MR. TAYLOR: Yeah.

10

11 CROSS EXAMINATION

12 BY MR. TAYLOR:

13 Q Could you look at your -- your AFE for  
14 this hearing and the one for the -- I suppose for the Exa-  
15 miner hearing.

16 A I don't have a copy of the Examiner hear-  
17 ing AFE.

18 Q It's in your pile of exhibits, Exhibit  
19 Number Five.

20 It's part of a package of your Exhibit  
21 Five --

22 MR. DICKERSON: I've handed it  
23 to him, Mr. Taylor.

24 A It's for a total of \$615,550.

25 Q That's the -- that is the original AFE

1 that you submitted to Mr. Sprinkle for this well, Sprinkle  
2 No. 3?

3 A I don't know. I think it is. It is,  
4 they tell me.

5 Q Could you go through that and explain to  
6 me why the first forced pooling, which went to hearing, the  
7 well was going to cost 615 and why at this hearing it's 532?  
8 What led to the difference in those?

9 A As I said before, I didn't prepare either  
10 one of these AFE's but I would surmise that the adjustment  
11 in the costs is based on the actual costs that we've seen on  
12 the wells that we've drilled just to the Bone Springs, par-  
13 ticularly over on the Burleson Lease.

14 I'd also comment that based on the actual  
15 costs to drill and complete the wells prior to the installa-  
16 tion of surface facilities, that this \$532,000 appears that  
17 it would be, as I testified yesterday, within a couple of  
18 percent of what we actually spend and that Mr. McCoy's AFE  
19 is going to be too low. We've already spent, or will have  
20 spent, over \$420,000 on each of those Burleson wells before  
21 we even get to the surface facilities.

22 Q If you -- what is the total of Mr.  
23 McCoy's AFE?

24 A I think that after he amended it yester-  
25 day it was 448, 718, is that right?

1 MR. MCCOY: 38.

2 A 448,738.

3 Q So actually, if you look at the two  
4 AFE's, the one you all have done for today and the one Mr.  
5 McCoy has done for today, are both about the same amount  
6 different from the original one he did, both about \$100,000.  
7 You're \$100,000 above him but he's \$100,000 below yours.

8 You're \$100,000 below the original and  
9 he's \$100,000 below yours.

10 A In round numbers, yeah, that's --

11 Q Essentially everybody is agreeing that  
12 the first AFE is either incorrect or was not --

13 A Yes. Having done several of these wells  
14 now, our revised AFE was like it will be closer to the ac-  
15 tual number.

16 MR. TAYLOR: I guess that's all  
17 I have.

18 MR. STAMETS: Other questions  
19 of Mr. Wood?

20 He may be excused.

21 Does either party have anything  
22 -- any other witnesses that they intend to put on?

23 MR. DICKERSON: I need to re-  
24 call Mr. Bourgeois, Mr. Stamets.

25 MR. STAMETS: Okay.

1 MR. DICKERSON: And I need to  
2 make a few copies in connection with that. It will take me  
3 about one minute.

4 MR. STAMETS: Okay.

5  
6 JEFF BOURGEOIS,  
7 being recalled as a witness and being previously sworn upon  
8 his oath, testified as follows, to-wit:

9  
10 REDIRECT EXAMINATION

11 BY MR. DICKERSON:

12 Q Mr. Bourgeois, before we go on to another  
13 matter, would you very briefly and succinctly summarize the  
14 necessity for separate tank batteries or measuring devices  
15 on the Sprinkle lease, northwest quarter of Section 26 for  
16 us all?

17 A As has been discussed, we, with the dif-  
18 ferentiation of working interest owners in these wells, we  
19 had a tank battery for No. 1. In that well Mr. Sprinkle,  
20 Mr. Rhodes, Mr. Berry, and Mr. Burleson are all force pooled  
21 and we had farm-in agreements from Mr. Shogrin and PetroAt-  
22 las Corporation and Mr. Jack Huff. These farm-in agreements  
23 all provided for an option to back in at payout of the test  
24 well, and should TXO propose the drilling of another well in  
25 the farmin area prior to payout of the test well, the three

1 parties who farmed out to TXO would then have a one time  
2 election as to the remaining acreage on the farm-in area,  
3 which was the northwest quarter as to retain their overrid-  
4 ing royalty interest or convert their overriding royalty in-  
5 terest to a working interest back-in 25 percent, and the in-  
6 terests on the No. 1 Well, they would have a separate elec-  
7 tion at payout of the No. 1 Well as to take a working inter-  
8 est or retain their overriding royalty interest.

9 Q Okay. At the time the No. 2 Well was  
10 drilled, what occurred to make title to production in the  
11 No. 2 Well different from that in the No. 1 Well?

12 A Mr. Rhodes participated in the No. 2  
13 Well, as well as Mr. Sprinkle. PetroAtlas elected to take  
14 their working interest, therefore the No. 1 had a royalty  
15 interest whereas the No. 2, they now have a working inter-  
16 est.

17 Mr. Shogrin and Mr. Huff elected to re-  
18 tain their overriding royalty interest, and Mr. Burleson was  
19 again force pooled in the No. 2 location.

20 Q So by one of the parties who had farmed  
21 in to TXO electing to participate with its retained inter-  
22 est, that would have automatically, as well, reduced the in-  
23 terest of TXO in the No. 2 Well as compared to the No. 1,  
24 would it not?

25 A That's correct.

1 Q So that the title to the production was  
2 not the same in both wells at that point.

3 A That's right.

4 Q Okay, what, as regards the Sprinkle 3 and  
5 4 Wells bear on whether or not title to the production from  
6 all four wells could under any circumstances be common?

7 A What we need now in order to have common  
8 ownership between the 2, 3, and 4, would be Mr. Burleson re-  
9 maining to be force pooled on the 3 and 4 locations and Mr.  
10 Sprinkle to participate in the 3 and 4 locations.

11 Should that happen, ownership between the  
12 2, 3, and 4 would be common. We had at this time already in  
13 place a separate tank battery on the No. 2 location and both  
14 Mr. Rhodes and PetroAtlas have signed our AFE's for the No.  
15 3 and 4 locations.

16 Q Okay. Mr. Bourgeois, you've heard the  
17 testimony regarding the disagreement over what has and has  
18 not been furnished to Mr. Sprinkle.

19 Let me hand you what we've marked as TXO  
20 Exhibit Number Sixteen and will you identify that letter and  
21 tell us the background of that letter, how it arose?

22 A As we're all aware, we had a meeting on  
23 December 18th in Mr. Stamets' office regarding a subpoena  
24 that had been prepared by Mr. Kellahin and there was a dis-  
25 cussion as to what information we would actually produce and

1 which we would not, and in response Mr. Kellahin and Mr.  
2 McCoy prepared a list of, I believe, fourteen items of which  
3 they felt would be necessary to make a list or an evaluation  
4 of the No. 3 and 4 locations.

5 In response to that was this letter  
6 prepared by our staff attorney in Midland, Mark Tisdale.

7 Of Items 1 through 14, I don't have that  
8 list, but of Items 1 through 14, we furnished 1 through 3,  
9 number 4, which was an initial gas analysis, we -- at that  
10 time we were waiting on Phillips.

11 Number 5, Number 8, Number 10, Number 11,  
12 and 13 and 14 were all furnished as enclosures with this  
13 letter.

14 Numbers 6, 7, 9, and 12 is information or  
15 tests which TXO did not perform and therefore did not have  
16 that -- those.

17 Q Okay, to your knowledge has TXO performed  
18 those tests or has any additional information as of today  
19 they did not have as of December 16th, 1985?

20 A Not to my knowledge.

21 MR. DICKERSON: Mr. Stamets, we  
22 have ended up here without copies of the transmittals.  
23 We can get those and submit them later. I would suggest  
24 that Mr. Kellahin may have a copy and might be willing to  
25 present to us what was furnished to him with the original of

1 this letter and it would shorten the time frame, but we sim-  
2 ply don't have the copies here. They are in Midland and it  
3 would take us two or three days to get them here.

4 MR. KELLAHIN: I'm sorry, what  
5 am I being asked to do?

6 MR. STAMETS: Let's go off the  
7 record a minute.

8  
9 (Thereupon a discussion was had off the record.)

10  
11 MR. STAMETS: For the record,  
12 Mr. Bourgeois, I believe what you're saying is that you have  
13 furnished Mr. Sprinkle with everyting that he has asked for  
14 that you have and that if you have not given it to him, it's  
15 something which would be a special test or an extra expense  
16 for TXO.

17 A That's correct.

18 MR. STAMETS: Any questions of  
19 the witness?

20 He may be excused.

21 Anyone have any other witen-  
22 ses?

23 MR. KELLAHIN: Yes, sir, I'd  
24 like to recall Mr. McCoy to attempt to answer your last  
25 question awhile ago on rate of return when you add in penal-

1 ty factors, if you don't mind, sir.

2 MR. STAMETS: That's fine.

3

4

WILLIAM G. McCOY,

5 being recalled as a witness and being previously sworn upon  
6 his oath, testified as follows, to-wit:

7

8

REDIRECT EXAMINATION

9 BY MR. KELLAHIN:

10 Q Mr. McCoy, I realize you're still  
11 calculating here, but in order to give Mr. Stamets a more  
12 complete answer to his last questions to you while you were  
13 testifying earlier, and realizing that the calculation would  
14 have to be double checked, have you, sir, had a chance to  
15 make a quick calculation to determine what the return on in-  
16 vestment would be to TXO in the event the Commission imposes  
17 100 -- 150 percent penalty and as an alternative, if they  
18 appoint -- if they assessed 100 percent penalty.

19

Have you made that calculation?

20

A Briefly and subject to correction. I  
21 have one correction immediately on 150 percent.

22

Q I've made a copy of your legal pad work-  
23 sheets, which I'll distribute and identify as Sprinkle Exhi-  
24 bit Number Seventeen, and then let's go through the calcula-  
25 tion.

1           A           Okay.

2                    I think it all is a matter of semantics  
3 trying to put this back into perspective.

4           Q           All right, before we work with the  
5 calculation, let's make sure we're all talking about the  
6 same creature.

7                    If I understood Mr. Stamets' question, he  
8 wanted to know what the effect was on TXO's return on  
9 investment if you added in various penalty factors.

10          A           Uh-huh.

11          Q           All right.

12                   MR. STAMETS: I don't think  
13 that was Mr. Stamets' question.

14                   MR. KELLAHIN: All right, let's  
15 try it again.

16                   MR. STAMETS: You may -- you  
17 may proceed with this.

18          Q           All right. Have you had an opportunity  
19 to calculate what the effect would be on the return on  
20 investment with the addition of 150 percent penalty, as  
21 found by Mr. Stogner in his --

22          A           Yeah.

23          Q           -- Examiner Order?

24          A           I have.

25          Q           All right, would you lead us through what

1 you have concluded?

2 A First of all, we have to work on some as-  
3 sumptions.

4 Number one, the penalty period, the 87  
5 percent net working interest, after payout the assumption is  
6 TXO has a .5981 percent net revenue interest. That's based  
7 on just excepting Mr. Sprinkle's interest. That's all we  
8 can assume.

9 But in order to try to make this as fast  
10 as possible, we've put it in perspective.

11 What I started out with with the 150  
12 percent penalty you would have to recover 76,852 barrels of  
13 oil to payout the well cost and the penalty. That is gross  
14 barrels. Then the working interest only gets 87 percent of  
15 that, which gives us 66,861.

16 The value at 17.06 is 1,140,653.

17 Now, in the exhibit you have copied  
18 there, I took out the cost to drill and complete that I had  
19 of 448, but I think in looking at trying to view this in  
20 TXO's perspective we take out, we should take out only the  
21 additional cost of Mr. Sprinkle's, initially.

22 That would be 140,738, roughly.

23 Subtract that off of the working interest  
24 income, it's 1,915,000 net profit to payout.

25 All right, now we proceed with the well

1 divided up and participation with Mr. Sprinkle, we have a  
2 remaining reserve at that time of 29,465 barrels. Assuming  
3 that TXO's net revenue -- TXO, et al's net revenue interest  
4 is 5981, their share of the remaining reserves would be  
5 17,623 barrels of oil. The value at 17.06 would be  
6 \$300,649.

7 The total profit in the prospect, that  
8 would be the profit to payout and after, total 1,301,-- have  
9 a figure scratched over but let's say \$564.

10 The actual well cost of TXO's straight up  
11 participation would be \$308,731.

12 You would subtract that off of the pro-  
13 fit, divide it into the profit, and my quick calculations  
14 show a 4.22 return overall.

15 Q That would be in excess, then, of the 3-  
16 to-1 return on investment.

17 A Yes, sir.

18 Q All right. Have you done a similar cal-  
19 culation to show what the effect is on return on investment  
20 if a 100 percent penalty factor is applied?

21 A I did, but I have not revised it based on  
22 -- you'll notice that I took out the well cost originally  
23 and also the well cost again of 308,731. I think I need to  
24 revise it as I did in the first place and I think it would  
25 come out -- but as I say, I didn't really have time to re-

1    vise after.

2                   Q            Can you make an approximation of what re-  
3    vision would do to the return on investment at the 100 per-  
4    cent penalty rate in terms of changing the 2.98-to-1 return?

5                   A            Well, if it were 3.2 originally and went  
6    up to 4.2, I would imagine that same ratio would apply. The  
7    2.98 would go up to probably 3.5.

8                   Q            Okay.

9                   A            That's subject to verification.

10                               MR. KELLAHIN:    I have no fur-  
11    ther questions.

12                               MR. STAMETS:    Any questions of  
13    the witness?

14                               MR. DICKERSON:  Yes.

15

16                                       RE CROSS EXAMINATION

17    BY MR. DICKERSON:

18                   Q            Mr. McCoy, I may be a little pedestrian  
19    on this but I'm going to use your projected AFE figure of  
20    \$448,738. Mr. Sprinkle has a 31.25 percent in this No. 3  
21    Well, is that correct?

22                   A            Right.

23                   Q            Therefore his share of the cost of drill-  
24    ing the well, using your figures, would be \$140,231.

25                   A            That's approximate. Well, I'm not --

1 Q Let me --

2 A All right.

3 Q I'm trying to get it exact.

4 A All right, he --

5 Q .3125 times \$448,738, and I get \$140,231.

6 A 140,231, right.

7 Q Okay. Then we're assuming that this Com-

8 mission were to impose a 150 percent factor as a penalty on

9 that amount, so we take 140,000 times \$231 -- or \$140,231

10 times 150 percent, and we get \$210,346, correct?

11 A Uh-huh.

12 Q So we have the cost attributable to the

13 Mr. Sprinkle's interest in this well, using these assump-

14 tions, \$140,231.

15 A Uh-huh.

16 Q Assuming that 150 percent penalty is im-

17 posed, the penalty amounts to \$210,346.

18 A Uh-huh.

19 Q We add those together and the total re-

20 turn of the cost investment to TXO, plus the penalty out of

21 Mr. Sprinkle's interest, would total \$350,577.

22 A According to your figures.

23 Q Okay. Mr. Sprinkle's net revenue inter-

24 est in the well, you testified he has an 87 percent lease.

25 A No, he doesn't. I didn't testify that.

1 I said the lease up to that point is 87 percent net revenue,  
2 the lease.

3 Q Including that to Mr. Sprinkle's inter-  
4 est.

5 A Including Mr. Sprinkle's --

6 Q Right.

7 A -- 27 percent.

8 Q And he owns 31.25 percent of the gross  
9 lease.

10 A Right.

11 Q So his net revenue interest is 31.25 per-  
12 cent times .87.

13 A Right.

14 Q Which yields .271875 net revenue inter-  
15 est.

16 A .2719 (not audible).

17 Q Okay, if we take the figure that we  
18 determined would be necessary in order to return TXO's in-  
19 vestment attributable to Mr. Sprinkle's interest, plus its  
20 150 percent penalty, or \$350,577, and we divide that by Mr.  
21 Sprinkle's net revenue interest in the No. 3 Well, since  
22 that's where all the penalty and costs have to be recovered,  
23 if at all, that would in effect balloon the figures so that  
24 that figure would give us the gross production from the well  
25 necessary to return that penalty plus that cost out of Mr.

1 Sprinkle's interest.

2 A I'm following you.

3 Q Which, I made the calculation and I'll  
4 just tell you, I calculated it to be \$1,289,479 gross pro-  
5 duction -- net production from the well in order to pay not  
6 only TXO's interest and all other interest owners who have  
7 interest in that well, but in order to generate the amount  
8 of cost attributable to Mr. Sprinkle's interest from his  
9 penalty, that would not occur until that amount of money had  
10 been recovered.

11 A That's your calculation.

12 Q Now when I start trying to calculate a  
13 rate of return or you go through it on a net barrels basis  
14 and I'm, as I said, a little pedestrian, and I get lost.

15 The way I do it, I take the amount of  
16 penalty, or the amount of cost attributable to Mr. Sprin-  
17 kle's interest, which was \$140,231.

18 A Uh-huh.

19 Q And I divide that by the total amount  
20 which will be returned to TXO to reimburse it for his cost  
21 plus the penalty at 150 percent assumption, which was  
22 \$350,577, and when I divide those two figures I come up with  
23 40 percent.

24 A What? 40 percent what?

25 Q That the total cost to Mr. Sprinkle's in-

1 interest is 40 percent of the total amount that TXO will re-  
2 ceive forever out of his interest in this well.

3 I then made one other calculation. I'm  
4 not saying that that is return on investment, the same thing  
5 that you were talking about.

6 Mr. Sprinkle's interest in the well at  
7 your assumed AFE figures was \$140,231. TXO gets that back  
8 dollar for dollar. There's no profit involved. If there is  
9 any profit, we should call it, it would come out of the pen-  
10 alty which was previously computed to be \$210,346.

11 So if I take \$140,231, being the costs,  
12 and I divide it by the total money over and above that cost  
13 that TXO can possibly ever realize out of this well at 150  
14 percent penalty, I come up with 66 percent.

15 A Of what?

16 Q Of the cost they invested. They recover  
17 ultimately 66 and some odd percentage points over and above  
18 what they invested.

19 Now if I said, in my layman's way of  
20 looking at it, that their return on investment is they get  
21 their investment back plus an additional 67 percent of that,  
22 is there anything wrong with looking at it that way?

23 A Well, I don't follow your analysis. I  
24 don't do it the same way and it's, like you say, a layman's  
25 analysis. I can't follow it.

1 I do it on barrels of reserves; that's  
2 what we're looking for, barrels of reserves, and I think ap-  
3 proaching it from a barrel standpoint, if you were to take  
4 the payout, let's say if we started at -- the payout period  
5 with the penalty, I think your return on investment would be  
6 lower, but then we have additional reserves to recover after  
7 everything's paid out and everybody comes in for their own  
8 interest, which we realize a profit, also.

9 So that's the way I approach it. So  
10 overall, how many barrels of oil do we recover and how much  
11 could we spend. Then we calculate the return of investment.

12 MR. DICKERSON: I have no fur-  
13 ther questions, Mr. Stamets.

14  
15 RECROSS EXAMINATION

16 BY MR. STAMETS:

17 Q Mr. McCoy, I'd like to take a look at  
18 some of the figures that Mr. Dickerson came up with, based  
19 on the cost to the Sprinkle part of \$140,000, roughly.

20 A Right.

21 Q And when you escalate that 150 percent,  
22 or for the 150 percent, you get a total payback to TXO of  
23 \$350,000, is that correct?

24 A Yeah, okay.

25 Q So if we want to know what the rate of

1 return is on TXO's investment for the Sprinkle, would we not  
2 divide 140 into 350?

3 A That could be reasonable.

4 Q And that's what, 2.5?

5 A Uh-huh, yeah. 2.5, that's affirmative.

6 Q Which is less than the desired 3-to-1.

7 A Well, less than mine. I believe that TXO  
8 would accept lesser. They testified previously that a 2-to-  
9 1.

10 Q Seems like they testified in this hearing  
11 --

12 A Well, I'm going back to our original tes-  
13 timony. They -- a major requires less rate of return than I  
14 would. My values are a little higher. An independent, or  
15 an individual has to realize a greater profit on a prospect  
16 than a major company does.

17 MR. STAMETS: Any other ques-  
18 tions of Mr. McCoy?

19 He may be excused.

20 Does anybody have anything fur-  
21 ther they wish to put on any testimony concerning?

22 I assume everybody has a clos-  
23 ing statement?

24 Tom, do you?

25 MR. KELLAHIN: Yes, sir.

1 MR. McCOY: I would just -- may  
2 I make one? I just -- that last statement we made.

3 MR. KELLAHIN: On your calcula-  
4 tion?

5 MR. McCOY: No, it was just on  
6 the last calculation we made verbally.

7 MR. KELLAHIN: Do you have a  
8 correction to --

9 MR. McCOY: No, I just wanted  
10 to clarify one point. The 350,000 that Mr. Stamets -- 580  
11 divided by Mr. Sprinkle's well cost would be only during the  
12 payout period. That does not take into consideration the  
13 additional profit generated after payout. They will have  
14 extra profit.

15 MR. KELLAHIN: All right.

16 MR. STAMETS: We will admit  
17 Sprinkle Exhibit Sixteen and Sprinkle Exhibit Seventeen.

18 And, Mr. Kellahin, you have a  
19 closing statement?

20 MR. KELLAHIN: Yes, Mr. Chair-  
21 man.

22 Mr. Chairman, this is not a  
23 typical forced pooling case. If it was one we hope we could  
24 have resolved it long ago.

25 We need some direction from the

1 Commission on certain essential points, I think, that are  
2 important for Mr. Sprinkle's dealings with TXO, but on a  
3 larger issue there are some resolutions of this case that  
4 will send a signal to TXO and to other operators on how to  
5 handle force pooling applications.

6 The first one involves a reso-  
7 lution by you of our applications for stays of the notice  
8 periods.

9 As you know, statutory unitiza-  
10 tion is only available for secondary and tertiary recovery  
11 and precludes statutory unitization for primary production.

12 The Sprinkle No. 3 case is but  
13 one of four forced pooling cases. One of Mr. Sprinkle's  
14 primary concerns initially, and it continues to be a concern  
15 of his, is the timing of his elections on multiple forced  
16 pooling cases for wells in the same interval in the same ap-  
17 proximate acreage and on the same lease. It is our hope  
18 that the ultimate resolution of all these cases will allow  
19 Mr. Sprinkle to make elections consecutively rather than  
20 concurrently.

21 As far as today's hearing is  
22 concerned, we would request that you stay his election per-  
23 iod on the Examiner order for the No. 4 Well, which is due  
24 to expire here in a few days, until that case is heard on  
25 the April 9th docket, which I believe is the next available

1 docket for that forced pooling case.

2           The precedent that we're asking  
3 you to set for here is a clear signal that when operators  
4 seek to resolve a problem with multiple forced pooling cases  
5 that in order to protect the interest of the party being  
6 pooled, that a time sequence allowing consecutive elections  
7 after each well is drilled and completed is one that's  
8 reasonable.

9           We think that avoids the prob-  
10 lem of having forced pooling elections running concurrently  
11 and allowing forced pooling to be used, in effect, as a  
12 small statutory unitization. We think it's a problem that  
13 is involved in this case and needs a resolution.

14           The paramount problem with this  
15 case is not one of Mr. Sprinkle's creation. We've heard Mr.  
16 Bourgeois testify that the 90-day election period in these  
17 farmout agreements is a problem that he introduced into this  
18 situation; he suggested it to these farmers; didn't ask for  
19 more or less, it was 90 days and they've locked themselves  
20 into the 90-day problem.

21           We think this is a self-created  
22 problem by TXO. Normally we think it would be prudent for  
23 the operator to drill wells consecutively and wait for com-  
24 pletion information before they commence the next wells.

25           For example, in the next few

1 weeks we're going to know what happened to the Burleson No.  
2 3. I think a prudent operator would want to know those re-  
3 sults before they started the No. 3 Sprinkle.

4 Because of these self created  
5 time impositions, TXO is unable to do that. The risk they  
6 run in drilling the well now is a risk they want to impose  
7 upon Mr. Sprinkle's interest and we think it's unfair.

8 There are several ways to allow  
9 that risk not to be forced upon Mr. Sprinkle.

10 One choice is to extend his  
11 election period so that he has an opportunity to know the  
12 results of drilling around him so that when the No. 3 Well  
13 is drilled he has available information from which to make  
14 that decision.

15 We are not talking about the  
16 situation that TXO created for themselves on the No. 2 Well,  
17 where they started that well a month earlier than they had  
18 to, and sent him a notice in such a way that he had an op-  
19 portunity to have a free look at the results of the No. 2  
20 Well. That's not a result we want. It's not a result that  
21 is intended, and it's a result that you don't have to allow  
22 occur. We could give Mr. Sprinkle the standard 30-day elec-  
23 tion period if an order is entered quickly. We could start  
24 that election period and TXO then can drill the well; they  
25 don't have to complete it; they could tight hole it; and he

1 has his full, normal election period.

2           If you decide to require or ex-  
3 tract from Mr. Sprinkle concession on shortening that elec-  
4 tion period to -- to remove TXO from the risk they've  
5 created for themselves, then you might want to consider  
6 shortening it to the March 19th or the March 14th date. Mr.  
7 Sprinkle testified that if additional information is given  
8 to him, he can -- he can make his election on that basis.

9           We have suggested that that's  
10 one of the ways you can choose to solve the problem.

11           We think one of the better ways  
12 to solve this problem is to reduce the risk factor penalty.  
13 The risk factor penalty, we've had a lot of discussion about  
14 it and I think the range of solutions are wide open for you,  
15 but you can see the course of conduct that TXO has used in  
16 this case.

17           We find that Examiner Stogner,  
18 based upon testimony in January, determined 150 percent to  
19 be reasonable. Since then we have learned a great deal of  
20 information. Mr. -- Mr. O'Hare testified on direct examina-  
21 tion yesterday about the risk and it was only in cross exam-  
22 ination that we discover that the No. 3 Burleson Well had  
23 significantly better thickness of Bone Springs than he had  
24 projected.

25           The geologic risk, we contend,

1 is minimal.

2 The engineering risk, we con-  
3 tend, is minimal.

4 We believe that the testimony  
5 of Mr. Wood ought to be taken as very pessimistic. We be-  
6 lieve that it was -- that if the actual reservoir production  
7 was as bleak as he thinks, no one in their right mind would  
8 drill these wells for a break-even proposition, and we be-  
9 lieve that what occurs is more likely what Mr. McCoy has  
10 projected. He's allocated reserves, recoverable reserves of  
11 106,000 barrels. His calculation on his exhibit showed a  
12 return on investment of more than 3-to-1. I think he had  
13 3.2.

14 And if you want to balance the  
15 risk factor in terms of the success, not only of avoiding  
16 drilling a dry hole, but of getting an economic well, the  
17 return on investment of 3-to-1, we have it in this case. We  
18 think the risk justifies less than 100 percent.

19 Now I know, and you know, and  
20 Mr. Dickerson knows, that it's unusual for you to award less  
21 than 100 percent. We think this case deserves that, less  
22 than 100 percent. It's a development location. You've  
23 asked Mr. Wood questions about his chance for success. He  
24 says using all his information, seven out of ten are going  
25 to be all right; it's low seventies, he says.

1                   Mr. O'Hare says this is a  
2 development well with a 75 percent chance of success.

3                   We think the risk factor ap-  
4 plied ought to bear in direct relation to the risk of the  
5 well.

6                   If you want to take a little  
7 different approach to the solution and try to balance return  
8 on investment with the amount of money that TXO has to ex-  
9 pend to carry Mr. Sprinkle's interest, then I think you can  
10 do a similar analysis as Mr. McCoy did just now and con-  
11 tinues to do for you.

12                   There has been discussion in  
13 previous cases about a desire for delay. We don't want to  
14 delay this thing any more. We think TXO has used forced  
15 pooling as the court of first resort. We are now down to  
16 the point where because of their drilling obligations we  
17 need a solution from you, but the delay in our opinion is  
18 one because Mr. Sprinkle did not have the information in a  
19 timely fashion. That information we hope you will order to  
20 become forthcoming and that we'll have an opportunity to  
21 make a full and conscious election and that he will to be  
22 forced to assume the risk that TXO has created for them-  
23 selves.

24                   The problem we've encountered  
25 here today is, I think, typical of -- of the story that I've

1 read to my kids over the years of Little Red Riding Hood and  
2 the big, bad wolf.

3                   It's our contention that in  
4 this context TXO has every characteristic of the wolf and  
5 Mr. Sprinkle, although he doesn't have the physical appear-  
6 ances of Little Red Riding Hood, the equities and the rela-  
7 tionships between the wolf and Little Red Riding Hood are  
8 very much alike.

9                   We think that TXO is now in  
10 Grandma's bed in the cottage. She has put on her cap, hid-  
11 ing under the cover of a drilling obligation that they have  
12 created and manufactured for themselves, and they have sur-  
13 rounded themselves in the comfort and blanket of the forced  
14 pooling application, and they're waiting for Little Red Rid-  
15 ing Hood to come with her box of goodies so they can bite  
16 her.

17                   Little Red Riding Hood has got  
18 two choices. She can either get in bed with the wolf and  
19 share the goodies and participate, or the fangs of the wolf,  
20 180 percent fang, is going to bite Little Red Riding Hood.

21                   We contend that at 180 percent  
22 or at 150 percent the wolf is going to be overfeed and is  
23 going to kill Little Red Riding Hood.

24                   We've asked Examiner Stogner  
25 for relief and he, as the friendly woodsman has come to our

1 rescue and reduced the fangs, he filed them down to 150 per-  
2 cent. We contend that the fangs are still too sharp and  
3 still too long and if you don't file them down further, the  
4 wolf is going to eat Little Red Riding Hood. We think to  
5 reduce those fangs and make the forced pooling penalty ap-  
6 propriate, and that not only will the wolf be able to live  
7 and feed off and continue for another day, it's not going to  
8 kill Little Red Riding Hood.

9                   Now there's been discussion in  
10 this case that Little Red Riding Hood has delayed and dal-  
11 lied along the way before she got to Grandma's cottage. We  
12 contend that it's been the wolf that's caused the delay for  
13 us. All Little Red Riding Hood was looking for is to exa-  
14 mine the field, understand the production, understand where  
15 she was going, and was going about her way in a direct man-  
16 ner, and every time she seeks more information the wolf  
17 jumps in her way and denies her the information.

18                   We think, sir, that you are the  
19 last woodman in the village to help us, and we would hope  
20 that you would not allow TXO to inflict mortal wounds on  
21 Little Red Riding Hood and allow us to continue to live in  
22 the village.

23                   MR. DICKERSON: Mr. Sprinkle  
24 has the right to participate in this proposed No. 3 and No.  
25 4 Well. He had the right to participate in the No. 1 and

1 the No. 2 Well. He elected to exercise that right in the  
2 No. 2 Well albeit after the well had been drilled, the risk  
3 removed to a large extent.

4 Mr. Sprinkle is invited to par-  
5 ticipate in the No. 3. He has been consistently invited.  
6 It would have tickled TXO to have avoided this some four  
7 months of controversy over one well. He can today elect to  
8 participate in the No. 3 and the invitation to do so is  
9 still extended.

10 The attempt of Mr. Sprinkle has  
11 been from the very first in this case to portray TXO as  
12 tight-holing on the information derived from these wells.  
13 Without belaboring this point, I would simply remind you  
14 that today Mr. Bourgeois testified that TXO has furnished  
15 every shred of information that it has in its possession to  
16 Mr. Sprinkle regarding these wells.

17 It has been Mr. Sprinkle's  
18 practice over the course of this controversy, everytime  
19 something is furnished, something additional is requested.  
20 Everytime something is furnished, no acknowledgement that it  
21 had been furnished. You saw him attempt to do it on the  
22 stand today, on things that he had received by letter -- re-  
23 ceived by him on March 21st, sent by TXO on March 14th. It  
24 was like pulling teeth to get Mr. Sprinkle to acknowledge  
25 that those enclosures in that letter were in fact what he

1 was so piously demanding to be furnished before the 5th of  
2 the month in order for him to finally at long last, lo,  
3 these many weeks later, entitle him to give him sufficient  
4 information on which to enable him and Mr. McCoy, his ad-  
5 viser -- as if he needs an adviser with 35 years experience  
6 in the oil and gas business -- but regardless, to enable Mr.  
7 Sprinkle and Mr. McCoy to determine at this long awaited  
8 date whether or not it would be adviseable or inadvisable  
9 to participate in the No. 3 Well.

10 We think the delay has gone  
11 long enough; for the reasons described by Mr. Bourgeois, TXO  
12 now, from a land standpoint, has to drill this well. It  
13 would have as a practical matter, have drilled this well  
14 prior to this time, except for the delays occasioned by Mr.  
15 Sprinkle. It would have drilled it prior to this time for  
16 the reasons stated forth by Mr. Wood. It is his recommenda-  
17 tion, it is the recommendation of the engineers who have  
18 studied the data from the available production, the same  
19 data which has been furnished to Mr. Sprinkle, it is those  
20 engineers' recommendation to their employer, TXO, that that  
21 informaton justifies further development of this acreage by  
22 drilling the No. 3 well.

23 The fact that TXO has proposed  
24 locations, eight wells total in the north half of Section  
25 26, does not mean that all wells are going to be drilled re-

1 gardless of what happens from any other well. All it means,  
2 as Mr. Wood testified, is that the results of each well are  
3 looked at before a decision on whether and when to commence  
4 the drilling of the next well is looked at. We contend that  
5 a prudent operator does this; orderly, prompt development of  
6 an abviously attractive oil field is what a prudent operator  
7 is called upon to do by his obligations to his shareholders,  
8 his interest owners, to himself.

9           If you recall Mr. Wood's testi-  
10 mony yesterday that his limited reservoir data regarding  
11 drainage, limite though it may be, leads him to conclude  
12 that there are already indications of communication between  
13 the Sprinkle 1 and 2 Wells and some of the other wells in  
14 the vicinity and other sections. The evidence presented by  
15 TXO, you'll recall, showed that TXO interest was limited to  
16 the northwet quarter or the northeast quarter of Section 26,  
17 as far as the adjoining sections directly to the northwest  
18 and south were concerned.

19           Mr. McCoy testified that there  
20 are proposed locations drilling or staked immediately off-  
21 setting this acreage at the present time, another reason why  
22 TXO could not delay drilling the well regardless of its land  
23 problem, its obligation to do so by March the 14th.

24           That is history. The well must  
25 be commenced by March 14th. Mr. Sprinkle is entitled to

1 participate. He's invited to participate, but if he does  
2 not participate, TXO does not request too much, we do not  
3 think; that he make his election to participate prior to the  
4 time that well is -- is -- for certain prior to the time  
5 that well is at total depth for any information gained from  
6 drilling it at TXO's sole cost. We think that it would be  
7 fair to require that election to be made before March 14th,  
8 before the well is commenced.

9 Mr. Sprinkle, in his own testi-  
10 mony, acknowledged that he could do so by March 10th, assum-  
11 ing he had additional information, which TXO has testified  
12 it does not possess.

13 But if Mr. Sprinkle, under  
14 whatever guidelines this Commission establishes, does not  
15 make his election to participate in this well, our statutory  
16 pooling act comes into play and I direct your attention to  
17 the fact that the 200 percent factor that we talk about as  
18 being designed to compensate for risk, is called by our sta-  
19 tute a penalty. It is not merely compensatory in nature to  
20 the party who advanced the costs of drilling this well. It  
21 is not enough merely to compensate that party for the money  
22 that he advanced for the risk that he took for another party  
23 who had the right to take that same risk but for whatever  
24 reason chose not to do it. It is called by our statute a  
25 penalty. It is punitive. It is designed to compensate, we

1 agree, but it's inadequate to really compensate under all  
2 circumstances because of the fact that it obviously must be  
3 recovered, if at all, only out of production. It cannot be  
4 recovered out of a dry hole. This Commission cannot enter a  
5 judgment that Mr. Sprinkle pay his share of costs in this  
6 well. The courts of the State of New Mexico cannot enter  
7 that judgment. He is a co-tenant, a co-operating interest  
8 owner with TXO. They both have the right to participate.  
9 It's this Commission's job to see that both parties' rights,  
10 their correlative rights are protected. The tool that this  
11 Commission is given to protect those rights is our statute  
12 because this Commission is authorized to impose a penalty,  
13 and we should call it what the statute calls it. It is a  
14 penalty. We're not ashamed of it. It is designed, among  
15 other things, to punish one who fails to elect to partici-  
16 pate in a well, who voluntarily, with full knowledge, allows  
17 and in fact forces some other party to take that risk for  
18 him.

19 We're not ashamed to ask for  
20 the penalty. TXO requests, very respectfully, the highest  
21 penalty that this Commission thinks the evidence can in any  
22 way justify. We would be content with the 150 percent pen-  
23 alty authorized by the original order entered by the Exami-  
24 ner in this case.

25 We think it is absurd to even

1 consider a penalty in the neighborhood of 25 percent. That  
2 is not a penalty. Any person owning a 31.25 percent inter-  
3 est in a well costing in the vicinity of half a million dol-  
4 lars would be foolish to participate in a well by paying his  
5 share when he could do so involuntarily by paying a so-cal-  
6 led penalty of 25 percent or anything approaching that.

7 We therefore ask only that the  
8 pooling order be entered, that it be structured in such a  
9 way as to avoid giving Mr. Sprinkle the opportunity to ride  
10 this well down, as we think that's what he desires to do,  
11 and that in the event he fails to make his election, we get  
12 the penalty that the evidence justifies in order to compen-  
13 sate TXO for having taken that risk, but also to penalize  
14 Mr. Sprinkle for having forced them to take that risk.

15 Thank you.

16 MR. STAMETS: Thank you. In  
17 light of the apparent necessity to spud this well by March  
18 5th, I think it's incumbent upon us to reach a decision  
19 this morning, and so I'm going to -- going to make some sug-  
20 gestions and see if we can agree on things.

21 What I would propose that the  
22 Commission do in this case is issue a standard forced pool-  
23 ing order with these particular extra provisions or numbers  
24 in the standard.

25 I would think that what we

1 would do is require that the data on the income for Mr.  
2 Sprinkle's share in the No. 1 Well be required to be fur-  
3 nished to Mr. Sprinkle within five days after today.

4 I would suggest that the elec-  
5 tion date which Mr. Sprinkle would have, that would be on  
6 March 14th, on or before March 14th.

7 What I'd like to do is -- is  
8 ask TXO to take their AFE back and go over it one more time  
9 to be certain that every figure on here represents a current  
10 competitive price before they resubmit it to Mr. Sprinkle,  
11 and any order that we would issue would limit the AFE to a  
12 maximum of \$532,950, so that if they determine it is less  
13 than that, they can come in under that.

14 I would suggest that we use the  
15 Sprinkle Exhibit Number Fourteen, the Ernst and Whinney Sur-  
16 vey for the overhead charges rather than those submitted by  
17 TXO.

18 I think that addresses essen-  
19 tially all of the issues except the risk penalty. We may  
20 have some difference of opinion there.

21 I would -- in my view, based on  
22 the testimony that we have received in this case in the last  
23 two days, that the case is very strong for the 200 percent  
24 penalty in that that would yield a 3-to-1 return.

25 Since TXO only asked for 180

1 percent, I will not recommend going above that.

2 COMMISSIONER KELLEY: I think I  
3 agree with you on the 200 percent, but, also, since they've  
4 only asked for 180 (not clearly understood).

5 MR. KELLAHIN: I believe Mr.  
6 Dickerson in his closing statement said he'd be happy with  
7 150 percent.

8 MR. DICKERSON: Closing state-  
9 ments of counsel are not evidence.

10 MR. STAMETS: I presume Mr.  
11 Dickerson would be happy with 180 percent.

12 I'd ask one other question at  
13 this point.

14 When will TXO know when a  
15 second -- whether or not a second tank battery is necessary,  
16 and I'm talking about whether or not there will be a differ-  
17 ence in interests of the parties?

18 MR. BOURGEOIS: As soon as we  
19 get the elections from Mr. Burleson and Mr. Sprinkle.

20 MR. DICKERSON: See, I think,  
21 Mr. Stamets, it's always been my understanding that the mere  
22 fact -- we don't really need to be on the record here --

23

24 (Thereupon a discussion continued off the record.)

25

1 MR. STAMETS: Is there anything  
2 else?

3 Then that -- that will be the  
4 decision of the Commission in this case. We will get an  
5 order out just as quickly as possible which will confirm in  
6 writing those issues. I believe everybody here understands  
7 them, and should operate accordingly.

8 And with that, we will --

9 MR. KELLAHIN: There's one  
10 further additional that we haven't resolved and that is the  
11 status of the stay allocation on the No. 4 Sprinkle Well,  
12 Mr. Chairman.

13 MR. STAMETS: Okay. I will  
14 stay the order in -- for the Sprinkle Well No. 4. The draft  
15 you gave me the other day, could you re-do that --

16 MR. KELLAHIN: Yes, sir.

17 MR. STAMETS: -- for the  
18 Sprinkle 4?

19 MR. KELLAHIN: Yes, sir.

20 MR. STAMETS: And I will sign  
21 that as soon as we get it.

22 There being nothing further,  
23 then this hearing is adjourned.

24

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(Hearing concluded.)

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C E R T I F I C A T E

I, SALLY W. BOYD, C.S.R., DO HEREBY  
CERTIFY the foregoing Transcript of Hearing before the Oil  
Conservation Division (Commission) was reported by me; that  
the said transcript is a full, true, and correct record of  
the hearing, prepared by me to the best of my ability.

Sally W. Boyd CSR