

1 STATE OF NEW MEXICO  
2 ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT  
3 OIL CONSERVATION DIVISION  
4 CASE 9836

5  
6 EXAMINER HEARING

7  
8 IN THE MATTER OF:

9  
10 Application of Grand Resources,  
11 Inc., for Statutory Unitization,  
12 San Juan County, New Mexico

13  
14  
15 TRANSCRIPT OF PROCEEDINGS

16  
17 BEFORE: MICHAEL E. STOGNER, EXAMINER

18  
19 STATE LAND OFFICE BUILDING  
20 SANTA FE, NEW MEXICO  
21 November 29, 1989

22  
23 **ORIGINAL**

24  
25  
CUMBRE COURT REPORTING  
(505) 984-2244

## A P P E A R A N C E S

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1 HEARING EXAMINER: Call the next case,  
2 Number 9836.

3 MR. STOVAL: Application of Grand  
4 Resources, Inc., for statutory unitization, San Juan  
5 County, New Mexico.

6 HEARING EXAMINER: Call for appearances.

7 MR. CARR: May it please the Examiner, my  
8 name is William F. Carr with the law firm of Campbell  
9 & Black, P.A. Of Santa Fe, New Mexico. I represent  
10 Grand Resources, Inc., and I have two witnesses.

11 HEARING EXAMINER: Are there any other  
12 appearances?

13 MR. BAGGETT: My name is B. J. Baggett, Mr.  
14 Examiner. I'm an attorney from Farmington, New  
15 Mexico, 0155, and I represent Ari-Mex Oil and  
16 Exploration, Incorporated.

17 HEARING EXAMINER: Are there any other  
18 appearances? Mr. Baggett, do you have any witnesses?

19 MR. BAGGETT: I may have one, depending on  
20 what the proponent puts on.

21 MR. STOVAL: Let's go ahead and have him  
22 stand to be sworn, while we do the swearing in.

23 HEARING EXAMINER: Will all witnesses  
24 please stand.

25 (Thereupon, the witnesses were sworn.)

1           MR. CARR: May it please the Examiner, by  
2 way of background, it should be noted that Grand  
3 Resources appeared before the Division in May of this  
4 year with applications for a voluntary unit and a  
5 waterflood project, and those were both approved. The  
6 voluntary unit was approved by Order R-8957. The  
7 waterflood was approved by Order R-8966.

8           Prior to that time we had filed an  
9 application to statutorily unitize this Mesa Gallup  
10 Field. We thought we had reached an agreement.  
11 Following the entry of the order approving the  
12 voluntary unit, some questions developed and we were  
13 unable to get everyone to execute all the documents,  
14 and so we're here again today seeking approval of a  
15 statutory unit.

16           Through most of the day the parties have  
17 been in meeting. They have reached agreement as to  
18 most of the terms that were at issue. They have not  
19 been able to reach agreement as to what the  
20 appropriate risk penalty should be imposed against any  
21 interest owner who remains non-consent. What we  
22 intend to do is present a case for statutory  
23 unitization.

24           I will call, then, Mr. Rubenowicz, who will  
25 be the operator of the Mesa Gallup Field, and I will

1 ask him to identify and summarize for you, on the  
2 record, the amendments to the Unit Agreement which  
3 have been agreed to today. He will address the risk  
4 question. And then, if I haven't stated it accurately  
5 or if there are other matters, then at that time I'll  
6 yield to Mr. Baggett and he can make us honest.

7 So, at this time, I would like to call  
8 Mr. Jack Schrenkel.

9 JACK SCHRENKEL

10 Called as a witness herein, after having been first  
11 duly sworn upon his oath, testified as follows:

12 HEARING EXAMINER: Okay. Mr. Carr?

13 MR. CARR: Thank you, Mr. Stogner.

14 EXAMINATION

15 BY MR. CARR:

16 Q. Will you state your full name and place of  
17 residence, please.

18 A. My name is Jack Schrenkel, and I reside in  
19 Tulsa, Oklahoma.

20 Q. By whom are you employed and in what  
21 capacity?

22 A. Grand Resources, as a consulting petroleum  
23 engineer.

24 Q. Have you previously testified before the  
25 Oil Conservation Division and had your credentials as

1 a petroleum engineer accepted and made a matter of  
2 record?

3 A. Yes, I have.

4 Q. Are you familiar with the Mesa Gallup  
5 Field?

6 A. Yes, sir.

7 Q. How did you first become involved with this  
8 project and when?

9 A. Well, I became involved with it  
10 approximately two and a half to three years ago when  
11 the First National Bank & Trust Company in Tulsa, whom  
12 I'm one of their customers, made me aware there was a  
13 foreclosed interest for sale in the Mesa Gallup Field.

14 Q. Have you made a study, an engineering  
15 study, of this field?

16 A. Yes, sir, I have.

17 Q. Have you prepared the conclusions of your  
18 study in the form of an exhibit for presentation here  
19 today?

20 A. Yes, sir.

21 MR. CARR: Are the witness's qualifications  
22 acceptable?

23 HEARING EXAMINER: They are.

24 Q. Mr. Schrenkel, what does Grand Resources  
25 seek with this application?

1           A.       Grand Resources seeks approval of statutory  
2 unitization.

3           Q.       Could you advise the Examiner as to the  
4 current status of this field?

5           A.       Well, it's my understanding that the, that  
6 we've had a--that all approvals--I'm lost. The  
7 waterflood approvals have been obtained, all the EPA  
8 requirements have been met. We've had the  
9 archaeological reports, and we have everything done  
10 except this statutory unitization.

11          Q.       To bring the last interests in?

12          A.       To bring the last interest in.

13          Q.       If we take a look at the reservoir, where  
14 does it stand in terms of the primary production from  
15 the reservoir?

16          A.       Well, the primary production or the field  
17 is in a marginal status at the present time, and  
18 essentially all of the primary oil has been recovered.

19          Q.       Could you refer to what has been marked for  
20 identification as Grand Resources Exhibit 1?

21          A.       Yes.

22          Q.       Identify this for the Examiner please.

23          A.       This is Exhibit 1.

24          Q.       And it is a study that is entitled,  
25 "Waterflood Study of the Mesa Gallup Field, San Juan



1 County, New Mexico"?

2 A. Yes, sir.

3 Q. Does this contain your conclusions based on  
4 the study you made of this particular field?

5 A. It does.

6 Q. Could you generally describe the nature of  
7 the reservoir we're dealing with in this matter?

8 A. On page 6 of the exhibit is a summary of  
9 the pertinent data of the Mesa Gallup Field. It's  
10 located in Township 32 North, Range 18 West, San Juan  
11 County, New Mexico. It produces from the Gallup  
12 sandstone. It depths of 1,100 to 1,600 feet. There  
13 are 20 producing wells in the field or wells that are  
14 capable of being produced. It's very similar, the  
15 reservoir characteristics, are very similar to a  
16 number of other Gallup fields in the San Juan Basin.

17 Q. Are the basic parameters, in terms of pay  
18 thickness, porosity, permeabilities and things of that  
19 nature, set forth on Table No. 1?

20 A. They are.

21 Q. Could you refer to the plat that is  
22 contained in Exhibit No. 1? I believe it's on page  
23 15. Review the information that is contained on this  
24 plat with the Examiner.

25 A. Map 1 simply shows the location of each

1 well that's been drilled in this area, and the  
2 ownership. The green area, which is located in, I  
3 believe that's Section 15 to the north, is the  
4 property that's owned by Ari-Mex Corporation.

5 The area outlined in yellow are those  
6 leases that Grand Resources, et al., owns. All of the  
7 land is on the Navajo Indian Reservation. You have  
8 one royalty owner under the whole project.

9 Q. I believe you dated that since it's Indian  
10 land, I believe you indicated that EPA approval has  
11 been obtained for injection; is that correct?

12 A. Yes, sir, it has.

13 Q. How is this unitized interval actually  
14 defined?

15 A. The interval is defined on page 13 of the  
16 report or the exhibit, and we are defining the  
17 reservoir as the radioactive marker that's noted above  
18 the sandstone there that's in yellow, and the top of  
19 the Juanita Lopez, I believe, formation. I'm not too  
20 good on some of the New Mexico nomenclature, but  
21 that's the interval we intend to flood.

22 Q. And the log section is shown as figure 2 on  
23 page 13 of Exhibit No. 1?

24 A. Yes, sir.

25 Q. Has the reservoir which is the subject of

1 this unitization application been reasonably defined  
2 by development?

3 A. Yes, sir, it has.

4 Q. Are there any windows within the unit  
5 boundary?

6 A. There are not.

7 Q. Have waterflooding operations, such as you  
8 propose, been successfully implemented in other Gallup  
9 pools in this area?

10 A. Yes, sir, they have. The large Horseshoe  
11 Gallup Field has been flooded for a number of years,  
12 and also a smaller field, such as the Many Rocks, both  
13 of these fields are adjacent to the Mesa Gallup Field,  
14 and their characteristics are compared on page 7, I  
15 believe, of the report. The numbers are in the lower  
16 left-hand corner there.

17 So Table 2 of Exhibit 1 sets out all the  
18 cumulative data of these two reservoirs. Now, the  
19 Horseshoe Gallup Field I've only had data from--or I  
20 had very closely controlled data over about this  
21 Navajo FG & M leases. I'm not implying that this is  
22 the whole Horseshoe Gallup Field which covers, I  
23 think, probably several thousand wells with all the  
24 waterflood developments going on. I'm just simply  
25 taking a lease from the Horseshoe Gallup Field and

1 then the Many Rocks Field, and comparing it with the  
2 characteristics of the Mesa Gallup field.

3 Q. When you make this comparison, the average  
4 porosity is slightly less in the Mesa Gallup, is that  
5 correct?

6 A. That's right.

7 Q. And permeability is also somewhat less than  
8 what is--

9 A. Very slightly. It's the same order of  
10 magnitude.

11 Q. Permeability is also somewhat down?

12 A. Yes, sir.

13 Q. And the water saturation stays about the  
14 same?

15 A. Yes, sir.

16 Q. I think at this time it would be  
17 appropriate to refer to Appendix No. 1 and review the  
18 producing history of each of the leases that are the  
19 subject of this unitization.

20 A. Okay. Appendix 1 starts on page 21. On  
21 20. I'm sorry. 21 is a summary of the production by  
22 leases, and then which shows on this--I'm trying to  
23 see--okay. This production is as of 12/88. I haven't  
24 brought it forward. The production has been  
25 negligible, really.

1           That data is shown graphically on page 22.  
2   You can see how the whole field--the field, I believe,  
3   started producing in 1961 or '62, so we're just  
4   showing about the last nine years of production on  
5   that particular graph on page 22.

6           Then, on the other, there are graphs for  
7   each producing lease that follows, that comprise the  
8   rest, and also the data is tabulated in the remaining  
9   figures in this appendix 1.

10           So we have, really, we have tabulated a  
11   complete history with the cumulatives entered before  
12   1980. We just have the details since 1980. But these  
13   are from the records of the Oil Conservation  
14   Commission.

15         Q.     What does this tell you about the producing  
16   capability of the reservoir?

17         A.     Well, in December of 1988 we produced 352  
18   barrels of oil, and currently the production is--Mr.  
19   Rubenowicz would have a better idea of that--it's  
20   probably not more than 10 barrels a day.

21         Q.     In your opinion, is the field at the end of  
22   its primary producing line?

23         A.     Yes, sir.

24         Q.     Could you summarize the status of the wells  
25   in the proposed unit as set out in appendix 2? And I

1 believe that starts on page 33?

2 A. Yes, sir. Appendix 2 lists, by well, the  
3 pertinent geologic reservoir and completion  
4 characteristics of all the wells in the Mesa Gallup  
5 area, both producing and nonproducing.

6 I might add, when you look at the table, if  
7 you'll look at the very top of the table, we've got  
8 four bits of information in each column, and there's  
9 really a very substantial amount of information there,  
10 such as well name and location, top sand, base of  
11 sand, net pay, porosity, average permeability if we  
12 know it, RC feet, if we would know it, cumulative oil,  
13 initial potential and all of those factors.

14 Q. Mr. Schrenkel, Grand already has obtained  
15 approval from this Division to institute  
16 waterflooding, is that correct?

17 A. That's correct.

18 Q. On table 3, which I believe is page 8 in  
19 this exhibit, the basic parameters for the waterflood  
20 project have been set out. Have those been  
21 subsequently adjusted or changed?

22 A. Yes, sir. We have increased the interests  
23 in Tract 1 and 2 to accommodate Ari-Mex Corporation.

24 Q. Are the new figures set forth in Exhibit  
25 1-A, which is attached inside the back cover of

1 Exhibit 1?

2 A. Yes, they are. They're stapled in the  
3 back.

4 Q. Could you review for the Examiner your  
5 economic projections for the unit?

6 A. The economic projections for the working  
7 interest appears on page 10 of the report. There  
8 again, this report has not been updated. It's  
9 essentially an engineering forecast of what's going to  
10 happen, and we've had some delay, so you can think of  
11 shifting the forecast into the future six months, six  
12 to twelve months.

13 Q. What sort of an additional investment are  
14 you looking at to implement unit operations?

15 A. Well, my estimate was \$372,000.

16 Q. And does this exhibit indicate the future  
17 profit that you are projecting for the waterflood  
18 project?

19 A. Yes, sir, it does.

20 Q. And what is that?

21 A. Well, based on a constant oil price of \$15,  
22 I had a profit of in the order of \$3 million, an  
23 estimated future profit. Now my table--no, on \$15 oil  
24 I had an estimated future profit of \$2,178,000 after  
25 the investment.

1 Q. And that is shown on what page of this  
2 exhibit?

3 A. Well, on page 10 of the exhibit it shows  
4 the future cash flow. Page 10 shows a future profit  
5 based on \$15 oil and a recovery of 440,000 barrels, to  
6 be \$2,178,000.

7 Q. Do you anticipate an increase in the  
8 operating costs?

9 A. Well, my forecast, I had the operating  
10 costs would increase, yes, sir.

11 Q. Do you have an estimate as to what they  
12 might be--the increases?

13 A. Well, I had the estimated operating costs  
14 at \$12,000 increasing in a two-year period to  
15 \$22,000. Now, I think the \$12,000 cost is entirely  
16 too high at current times.

17 Q. But you do anticipate there will be an  
18 increase in the operating costs?

19 A. Yes, that's right.

20 Q. Will the economic limit for the pool be  
21 extended as a result of the unitization?

22 A. Right. My schedule of depletion says that  
23 the economic life of the field will be extended 10 to  
24 12 years, in that range.

25 Q. In your opinion, is unitized management and



1 operation, along with further development of this  
2 pool, reasonably necessary to increase the ultimate  
3 recovery of oil from the pool?

4 A. Yes, it is.

5 Q. Do you believe that you will be able to  
6 receive a reasonable profit over and above increased  
7 investment and operating costs?

8 A. Yes, sir, I do.

9 Q. Could you generally describe the operations  
10 presently being conducted on these lands?

11 A. Well, I believe that there's about five or  
12 six wells currently being produced by Grand Resources,  
13 and Mr. Rubenowicz knows the current status of that.  
14 I'm not familiar with what Ari-Mex has, but the  
15 production is minimal from the field.

16 Q. If a unit plan and waterflooding isn't  
17 implemented, do you have an opinion as to whether or  
18 not reserves will be left in the ground?

19 A. Well, they very definitely will be left in  
20 the ground.

21 Q. In valuing the project and the reserves,  
22 have you used standard methods utilized in the  
23 industry in preparing the data that's set forth on  
24 pages 10 and 11 of this exhibit?

25 A. Yes, I have.

1 Q. In preparing these calculations, were taxes  
2 taken into account?

3 A. They were. I took into account the oil  
4 severance tax and also the estimated effect of the  
5 possessory interest tax to the Navajo Nation.

6 Q. If unitized methods are instituted and  
7 waterflooding is applied to the area, do you believe  
8 that the waterflood project which is being proposed  
9 is, in fact, feasible in this reservoir?

10 A. Yes, it is.

11 Q. Would continued use of such unitized  
12 methods of operation result with reasonable  
13 probability and ultimate in increased recovery of  
14 hydrocarbons?

15 A. They will.

16 Q. Will the unitized methods of operation  
17 which are being proposed by Grand Resources benefit  
18 all interest owners in the area?

19 A. They will.

20 Q. Is unitization necessary if you are, in  
21 fact, going to be able to carry on effective  
22 waterflooding of this unit area?

23 A. It is.

24 Q. What is the basis for participation in the  
25 unit, as set forth in the unit agreement?

1           A.       We've allotted 60 percent to the net  
2 floodable acre feet based on an isopach map, and that  
3 map is on page 16 of the exhibit. We've used 30  
4 percent of the cumulative oil production, which takes  
5 into account the past production, and we've used a  
6 10-percent well factor.

7           Q.       In your opinion, does this formula allocate  
8 production to the separately owned tracts in a fair,  
9 reasonable and equitable basis?

10          A.       It does.

11          Q.       Are you prepared to make a recommendation  
12 to the Examiner as to any penalty that should be  
13 assessed against any interest owner who doesn't  
14 voluntarily pay his share of the costs incurred in  
15 development of the unit?

16          A.       Yes, sir.

17          Q.       And what would that recommendation be?

18          A.       Well, that would be the 300 percent, or  
19 penalty factor which is common in most or in many  
20 operating agreements.

21          Q.       What do you base that recommendation on?

22          A.       Well, I base it on the fact that it's been  
23 more or less of an industry standard in drilling  
24 wells, and it seems quite reasonable here to me.

25          Q.       Mr. Schrenkel, you indicated that you

1 became aware of this project when advised that there  
2 was an interest for sale by a bank, is that correct?

3 A. That's correct.

4 Q. Have you voluntarily joined in unit  
5 operations?

6 A. Yes, sir.

7 Q. Have you executed the Unit Agreement and  
8 Unit Operating Agreement?

9 A. Yes, sir, I have.

10 Q. What penalty is provided in that?

11 A. 300 percent.

12 Q. That's actual plus a 200-percent penalty?

13 A. Right.

14 Q. In your opinion, will granting this  
15 application be in the best interest of conservation,  
16 the prevention of waste and the protection of  
17 correlative rights?

18 A. They will.

19 Q. Were Exhibits 1 and 1-A prepared by you?

20 A. They were.

21 MR. CARR: At this time, Mr. Stogner, I  
22 would move the admission of Exhibits 1 and 1-A.

23 HEARING EXAMINER: Exhibits 1 and 1-A will  
24 be admitted into evidence at this time.

25 MR. CARR: This concludes my direct

1 examination of Mr. Schrenkel.

2 HEARING EXAMINER: Thank you, Mr. Carr.  
3 Mr. Baggett, your witness.

4 MR. BAGGETT: Thank you, Mr. Examiner.

5 EXAMINATION

6 BY MR. BAGGETT:

7 Q. Mr. Schrenkel, you've indicated in the  
8 opening paragraphs of your report that has been  
9 admitted into evidence that this is one of those happy  
10 projects where everyone will benefit?

11 A. I hope that's correct.

12 Q. Have you had occasion to be involved in,  
13 say, the drilling of inside locations?

14 A. No, I haven't.

15 Q. Have you been involved in the drilling of  
16 wildcat locations?

17 A. Oh, yeah.

18 Q. Which of the two, inside drilling or  
19 wildcat locations, constitute the greatest risk, in  
20 your opinion?

21 A. Well, wildcat locations.

22 Q. Now, if this was one of those happy  
23 projects that we're all going to be pleased with and  
24 it's abandoned and joined on the south by two  
25 successful waterflood projects, give us an assessment

1 of the risk involved in this project with a scale of  
2 1 to 10, with "10" being a wildcat which I presume you  
3 would agree is the most risky part of this business?

4 A. Well, let me answer it in another way, that  
5 I feel like this project has an 85-percent probability  
6 of being successful.

7 Q. Okay. That's a good enough answer to that  
8 question. Now, part of the project costs involved in  
9 this thing is the drilling of a water supply well, is  
10 that correct?

11 A. That's true.

12 Q. I notice in your report that you indicate  
13 that a well should be drilled to the Morrison  
14 Formation?

15 A. Well, yes, sir, that's what I'm calling it,  
16 and I have a depth on it, too.

17 Q. Prior to preparing your own report or even  
18 after preparing your report, were you given a copy of  
19 a report that was prepared by Mr. Jack Cook and J. D.  
20 Hicks, in 1972, on this same project?

21 A. Right. I received that probably a year or  
22 several months after this one was prepared, yes, sir.

23 Q. Now, in that report, it indicates that a  
24 well should be drilled to the Dakota Formation for the  
25 water supply. Do you recall that?

1           A.       No, I don't. It's possible I might have my  
2 nomenclature wrong. I had the log for the big water  
3 sands down in the well there that I was proceeding on.

4           Q.       For the purpose of my question, let's  
5 assume--and I could read it to you here, but now I  
6 understand that it is proposed that the water supply  
7 well be drilled to the Dakota Formation, is that  
8 correct?

9           A.       It's the water sand that's at so many feet  
10 there is the one I propose the well be drilled to,  
11 yes, sir.

12          Q.       Now, in looking at your elevations on these  
13 various formations, it would appear that the Dakota  
14 Formation would be the first available water formation  
15 and I think it's--I don't have your pages numbered in  
16 my copy, but it's figure 3 of the chart.

17                 MR. STOVALL: Mr. Baggett, just for  
18 reference in case we have to go back to the  
19 transcript, that's marked as page 14 in my copy of the  
20 book.

21                 MR. BAGGETT: It's not marked as any page  
22 in my book.

23          A.       It is 14.

24          Q.       Thank you, sir. Now, it would appear from  
25 looking at this exhibit that the Dakota is the first

1 water supply formation recommended by at least one of  
2 these waterflood studies for the water supply, is that  
3 correct? It's the one closest to the Mesa Verde that  
4 we're talking about?

5 A. Well, the Morrison on this cross-section  
6 here is shallower--I mean, the Dakota is shallower  
7 than the Morrison.

8 Q. And considerably further down you have the  
9 Entrada Formation?

10 A. Well, let me clarify what we're talking  
11 about here. When I first looked at this project and  
12 had the electric logs in the thing, I was coming up  
13 and it was my determination that there was a major  
14 water source that you would drill all of it by the  
15 time you got to 2,500 or 3,000, feet which I'm  
16 correlating as the Morrison water sands. I'm not a  
17 San Juan geologist.

18 Q. And I'm not trying to make you one. The  
19 report of Mr. Cook and Mr. Hicks done in '72, that you  
20 studied, indicated that the water well should come out  
21 of the Dakota. You have indicated in your report that  
22 you thought it should come out of the Morrison. And  
23 I'm told--and this is subject to being corrected  
24 later--but if Mr. Rubenowicz testifies after you that  
25 he's going to drill it to the Entrada, that's still a



1 deeper formation.

2           Based upon those facts, my question is  
3 this: Do you feel pretty confident you'll get water  
4 if you drill through the Dakota, which is your water  
5 zone, and then through the Morrison, which is another  
6 water zone, and down through the Entrada, which is  
7 still another water zone.

8           A.     Well, my correlations of the water, because  
9 that's a very critical point that water is there, it's  
10 got to be there, was that my correlations were that I  
11 took the wells to the south. You're encountering  
12 water sands at much shallower elevations. It was my  
13 feeling that by drilling to 2,500 feet you had a very  
14 adequate source of water.

15                 And if I've got the nomenclature wrong, I  
16 may very well have the nomenclature wrong, and I  
17 apologize.

18           Q.     Well, is there any doubt in your mind  
19 you're going to get water when you drill this well?

20           A.     I wouldn't think so.

21           Q.     In addition to drilling the water supply  
22 well, what other wells will you be drilling?

23           A.     Well, we plan to drill no additional wells  
24 at this time. We're going to convert three different  
25 wells, which Mr. Rubenowicz has the testimony on that.

1           Q.     Is there something particularly tricky  
2     about converting these wells as opposed to converting  
3     a natural gas well? Any special factors?

4           A.     No. You've got to run integrity tests.  
5     We're in the process of getting ready to do that. And  
6     you've got packers; you've got to put  
7     corrosion-resistant materials, like, the main thing in  
8     the waterflood is that you want to make sure your  
9     operating costs will be at a minimum, hopefully in the  
10    future, because of the absence of corrosion, using the  
11    right type of materials. There's really nothing  
12    tricky about it. It's standard procedure.

13          Q.     You don't anticipate any difficulty out of  
14    this type of operation?

15          A.     No. This would be our initial approach.  
16    The performance of the waterflood will tell us in the  
17    future what other adjustments we need to make to  
18    recover more oil.

19          Q.     And the production wells that you're going  
20    to condition, they're already drilled into the  
21    producing formation?

22          A.     Yes, sir.

23          Q.     And perforated?

24          A.     Right.

25          Q.     Then would it be accurate to say that your

1 assessment of the risk factor involved in this, that  
2 you think it's 85-percent probable, that the risk  
3 factor is 15 percent?

4 A. Of it not being successful?

5 Q. Yes.

6 A. That's probably about right.

7 Q. We all feel comfortable that this is going  
8 to work?

9 A. It's supposed to work. It's going to work.

10 MR. BAGGETT: I believe that's all I have.  
11 Thank you.

12 HEARING EXAMINER: Thank you, Mr. Baggett.  
13 Mr. Carr?

14 FURTHER EXAMINATION

15 BY MR. CARR:

16 Q. Mr. Schrenkel, in your opinion, is there a  
17 possibility that the proposed waterflooding of this  
18 unit might not be an economic success?

19 A. As I've answered previously, I think that  
20 there is 85-percent probability that it will be an  
21 economic success.

22 Q. So there's a 15-percent chance, in your  
23 opinion, that it would not be?

24 A. That it could fail, right.

25 Q. If that happens and certain interest owners

1 have gone non-consent, are you aware of, under the  
2 Unit Agreement or the Unit Operating Agreement, any  
3 way that those who have paid the costs would receive  
4 any contribution from those who did not pay their  
5 share?

6 A. Would you phrase that again?

7 Q. If the project is not a success--

8 A. Oh, if it's not a success, right.

9 Q. Who bears the risk?

10 A. Well, the people that have put the money  
11 up.

12 Q. And if an individual has gone non-consent,  
13 does he have any exposure?

14 A. He has no exposure.

15 Q. And if an interest owner would pay their  
16 proportionate share, they would share that risk, is  
17 that correct?

18 A. That's true.

19 Q. And if they don't, they're asking others to  
20 carry them?

21 A. Yes, sir.

22 Q. In that situation, do you believe that even  
23 with a 15-percent chance of failure, that a risk  
24 penalty should be assessed against those who elect to  
25 go non-consent?

1           A.       It should be assessed, yes, sir.

2           Q.       And does the fact that there's only a  
3 15-percent chance of failure change your opinion that  
4 a 200-percent penalty over actual costs is  
5 appropriate?

6           A.       No.

7                   MR. CARR:  That's all I have.

8                   MR. BAGGETT:  May I ask one more question?

9                   HEARING EXAMINER:  Please.

10                               FURTHER EXAMINATION

11  BY MR. BAGGETT:

12           Q.       Mr. Schrenkel, are you aware of the New  
13 Mexico statute 70-7-7 subpart (F) which requires the  
14 division to establish, in each individual case, the  
15 risk factor?

16           A.       I'm not aware of that, no, sir.

17           Q.       Are you aware that that statute indicates  
18 that 200 percent, what you're asking the Commission to  
19 approve, is the maximum allowable?

20                   MR. CARR:  I'll object.  He said he's  
21 unaware of the statute, so he couldn't be aware of the  
22 provisions of it.

23                   MR. STOVALL:  I would advise the Examiner  
24 that we can take notice of the statute.

25                   Before you leave, Mr. Schrenkel, I would

1 like to ask you a question.

2 EXAMINATION

3 BY MR. STOVALL:

4 Q. Are you aware of any other waterfloods in  
5 this area?

6 A. Oh, yes, sir, there's many waterfloods  
7 north of Farmington.

8 Q. In this particular formation?

9 A. Yes, sir. The Horseshoe Gallup Field has  
10 been successfully waterflooded from the Gallup  
11 Formation from many years, by people like Exxon,  
12 Amoco, on and on, Atlantic Richfield.

13 Q. Most of those have been successful?

14 A. Yes, sir. The ones I have knowledge of  
15 have been successful.

16 MR. STOVALL: No further questions.

17 EXAMINATION

18 BY MR. STOGNER:

19 Q. Which is the closest Gallup waterflood to  
20 this particular project?

21 A. Well, if you'll turn to--let's look  
22 at--turn to page 16. The Horseshoe Gallup Field  
23 starts right down about where page 16 is numbered,  
24 about two miles down here, two or three miles, and  
25 then it goes on to close to Farmington, north of

1 Farmington. It's a huge field.

2           The Many Rocks Field is over just off to  
3 the east about three miles. As I explained earlier, I  
4 have extensive knowledge of some leases in the  
5 Horseshoe Gallup Field, and then I have a study of the  
6 Many Rocks Field. The probability is high that  
7 additional oil will be recovered.

8           Q.     What is the source water for both the  
9 Horseshoe and the Many Rocks?

10          A.     Well, I don't know. I think it's the  
11 Morrison and the Dakota. They have some real high  
12 volume. It's the Dakota, isn't it, and the Morrison?  
13 You get a little bit deeper. It's whatever the--  
14 He's the geologist. Mr. Baggett's the geologist. I'm  
15 not the geologist.

16               MR. BAGGETT: I'm a lawyer.

17               HEARING EXAMINER: Okay. Are there any  
18 other questions of this witness?

19               If not, he may be excused. Mr. Carr?

20               MR. CARR: At this time I would call Marvin  
21 Rubenowicz.

22                       MARVIN RUBENOWICZ

23 Called as a witness herein, after having been first  
24 duly sworn upon his oath, testified as follows:

25

## EXAMINATION

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BY MR. CARR:

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

A. Marvin J. Rubenowicz.

Q. Mr. Rubenowicz, where do you reside?

A. Tulsa Oklahoma.

Q. By whom are you employed and in what capacity?

A. Grand Resources. I'm a petroleum engineer and the owner.

Q. Have you previously testified before the Oil Conservation Division and had your credentials as a petroleum engineer accepted and made a matter of record?

A. Yes, I have.

Q. Are you familiar with the application filed in this case on behalf of Grand Resources seeking statutory unitization of the Mesa Gallup Field?

A. Yes.

Q. Have you, as a petroleum engineer, made independent review of the material that is available on this field in making a decision to go forward with this project?

A. Yes, I have.



1                   MR. CARR: Are the witness's qualifications  
2 acceptable?

3                   HEARING EXAMINER: Are there any  
4 objections?

5                   MR. BAGGETT: No objections.

6                   HEARING EXAMINER: The witness's  
7 qualifications are acceptable.

8           Q.       [BY MR. CARR] Mr. Rubenowicz, I want to  
9 ask you several questions about efforts that have been  
10 undertaken this year to unitize this pool. First of  
11 all, you were the Applicant and received the approval  
12 from the Oil Commission initially for waterflooding in  
13 the voluntary unit, is that correct?

14           A.       Yes, I was.

15           Q.       Why are we here today?

16           A.       Because there were a couple points which  
17 could not be set into the operating agreement,  
18 primarily, that Ari-Mex Corporation wanted and that  
19 myself and the other participants would not agree to.

20           Q.       Following the approval from the Oil  
21 Commission of the voluntary unit and waterflooding,  
22 were you the person who approached EPA to obtain  
23 approval for injection in this particular field?

24           A.       Yes, I was.

25           Q.       Have you, at this time, been able to obtain

1 their approval for the injection of fluids into this  
2 reservoir?

3 A. Yes, I have.

4 Q. Did you also go to the BIA and the BLM,  
5 seeking approval to produce wells to injection?

6 A. Yes, I was.

7 Q. Have you obtained approval to do that?

8 A. Yes, I have.

9 Q. Have you also obtained their approval to  
10 commence the injection of fluids into the reservoir?

11 A. Yes, I have.

12 Q. Have you, at this time, acquired permits to  
13 drill water supply wells?

14 A. Yes, I have.

15 Q. Have you made a decision as to what  
16 formation you intend to drill to to obtain a source of  
17 water for the unit?

18 A. Yes, I have.

19 Q. And at this time what formation do you  
20 intend to drill to?

21 A. That's the Entrada.

22 Q. Is that a deeper formation than the one  
23 recommended in the Cook study that was referenced by  
24 Mr. Baggett?

25 A. Yes, it is.

1           Q.     And because it is deeper, will it cost  
2 more?

3           A.     Yes, it will.

4           Q.     Why did you decide to drill to a deeper  
5 horizon?

6           A.     Upon my investigation of wells in the  
7 surrounding area, I found a dry hole within a mile and  
8 a half of our field that penetrated the Dakota,  
9 Morrison and Entrada Formation. And after reviewing  
10 the electric logs on that well and also spending a  
11 couple days in Arco's office in Midland, Texas,  
12 reviewing their records regarding their water supply  
13 on the Horseshoe Gallup Field, it became apparent to  
14 me that the source of water most prolific, with the  
15 highest probability of delivering adequate reserves of  
16 water for this project, is the Entrada.

17          Q.     Mr. Rubenowicz, what percentage interest in  
18 this waterflood project and unit will Grand Resources  
19 actually own?

20          A.     Seven and a half percent.

21          Q.     And you represent, in addition to that,  
22 interest owners that represent what percent?

23          A.     85 percent.

24          Q.     And will those 85-percent interest owners  
25 pay their share of the cost of the well to the deeper

1 interval?

2 A. Yes, they will.

3 Q. Is the select of an interval in which to  
4 complete a water supply well, in your experience,  
5 customarily a decision that rests with the operator of  
6 the unit?

7 A. Oh, it's usually amongst--the partners  
8 agree. It's not just the operator's responsibility.  
9 You get partners approval.

10 Q. What is the status of right-of-ways for  
11 laying injection lines at this time?

12 A. I have had environmental impact statements,  
13 I've had archaeology reports prepared and submitted to  
14 BLM and BIA. We have all approvals, right-of-ways,  
15 damages have been paid for part of the work to be  
16 done, and we did not want to settle the damages for  
17 the remainder until we were actually ready to do the  
18 work.

19 Q. At this point in time how close are you to  
20 being able to implement a waterflood project in this  
21 unit? What obstacles remain?

22 A. Primarily Ari-Mex's approving our proposed  
23 operation. However, as of today's date, Ari-Mex has  
24 approved all of our recommendations except one.

25 Q. And what is that?

1           A.       That is the penalty clause in the operating  
2 agreement. They are seeking a lesser penalty clause  
3 for non-consent on capital expenditures.

4           Q.       And this is the one outstanding issues that  
5 results in our being before this Commission seeking  
6 statutory unitization, is that correct?

7           A.       Correct.

8           Q.       I would like you to identify what has been  
9 marked as Grand Exhibit No. 2?

10          A.       This is the Unit Agreement which sets out  
11 the percentages that the different parties participate  
12 under the operation of this project by Grand, and all  
13 factors within the Unit Agreement have been approved  
14 by Ari-Mex.

15          Q.       And is this the Unit Agreement that was  
16 approved by the Oil Conservation Division when you  
17 were before them seeking approval of voluntary  
18 unitization?

19          A.       Yes, it is.

20          Q.       Identify what has been marked as Grand  
21 Resources Exhibit No. 3?

22          A.       Exhibit No. 3 is the Unit Operating  
23 Agreement of the same project.

24          Q.       Has this Unit Operating Agreement been the  
25 subject of negotiations here today?

1           A.       Yes, it has.

2           Q.       Could you review for the Examiner those  
3 amendments to this operating agreement which have been  
4 agreed to by the parties?

5           A.       The amendments which we have agreed to in  
6 the modification of this document are as follows:

7                   In the appraisal of the surface equipment,  
8 there are provisions, there's wordings in the  
9 provisions of using 65 percent and 75 percent of the  
10 equipment value, and that's primarily for disposal of  
11 equipment. We have agreed to a mutually accepted  
12 individual by the name of Kenny Osborne, or another  
13 mutually acceptable person, to set the value of all  
14 surface equipment within Ari-Mex and the Grand  
15 Resources leases. Those values we'll be bound by for  
16 contribution into the unit.

17                   The next would be regarding prepayments of  
18 moneys for capital expenditures. We have agreed that  
19 Grand will submit a 30-day expected expenditures for  
20 capital items on the project to be submitted to all  
21 working interest partners, and 15 days after their  
22 receipt of these expected expenditures, they are  
23 expected to prepay. If they do not pay within 15 days  
24 of receipt of the estimated 30-day costs, they will  
25 then be deemed to have gone non-consent on those

1 expenses, and the remaining working interest partners  
2 will be obligated to pay for the non-consenting  
3 party's share.

4               Regarding commingling of funds, we have  
5 agreed that Grand will not commingle revenue generated  
6 by the project into Grand Resources' corporate  
7 account; that those revenues received from production  
8 will be put into a trust account to be managed by  
9 Grand for the account of the working interest  
10 partners, and those moneys will then be distributed to  
11 the working interest partners.

12              We also agreed to eliminate the language  
13 which addressed any non-consenting party's working  
14 interest, cannot be disposed of, that the consenting  
15 parties on matters of capital expenditures or  
16 operating expenses, would pick up the non-consenting  
17 party's interest--under "capital."

18              Under "operating expenses," the operator  
19 and/or the remaining working interest partners would  
20 recoup any deficiencies through production of oil plus  
21 a 1-1/2-percent penalty per month against the  
22 deficiencies.

23              We decided to change the language which  
24 addressed that they are deficient after 60 days in the  
25 operating agreement, that they are deficient after 30

1 days. So they must pay their JIB, their joint  
2 interest billing, their share of the operating  
3 expenses, within 30 days of receipt of the joint  
4 interest billing.

5 We also amended the overhead charge  
6 escalations or modifications, to be tied to the CPI  
7 percentage, or the Ernst & Whinney percentage as we've  
8 described in the operating agreement, and we had  
9 changed the wording to "whichever is less," rather  
10 than "whichever is more." And we started off the  
11 overhead charge at \$325 per month per well. And that  
12 includes producing wells, injection wells and water  
13 supply wells.

14 Those are the points which we have agreed  
15 to modify in the operating agreement voluntarily. And  
16 we will submit at a later date these changes to the  
17 Commission.

18 Q. Do you anticipate any problem having the 85  
19 percent working interest owners who have already  
20 joined in this project, agreeing to any and all of  
21 these changes?

22 A. No problem. I will have no problem.

23 Q. Does this operating agreement contain a  
24 provision for a risk penalty?

25 A. Yes, it does.



1           Q.     What risk penalty is set forth in that  
2 agreement?

3           A.     We have a penalty of 200 percent on, again,  
4 capital expenditures, not operating expenses, to any  
5 non-consenting party, after being provided adequate  
6 AFE's for these expenditures, and for their default in  
7 going non-consent, of not participating with what is  
8 recommended.

9           Q.     This 200 percent figure is a penalty over  
10 and above actual cost?

11          A.     That is correct.

12          Q.     Do you have a recommendation to make to the  
13 Examiner as to the penalty that should be assessed in  
14 the Order that results from this hearing statutorily  
15 unitizing this field?

16          A.     Yes, I do.

17          Q.     And what do you recommend?

18          A.     I recommend a 200-percent penalty be levied  
19 against all non-consenting parties due to the risks  
20 involved in the two primary matters which we're  
21 proposing: One, the probability of the success of a  
22 financially viable successful secondary recovery  
23 project on one side, that includes the drilling of the  
24 water supply well, the implementation of the water  
25 plant, the laying of the injection lines, everything

1 that goes along with implementation of this  
2 waterflood. Those capital expenditures are extensive  
3 and they are required within a very short period of  
4 time. There are no guarantees that these capital  
5 expenditures will be recouped. If this waterflood is  
6 a failure, they will not be recouped. So there is an  
7 elements of risk so far as the secondary recovery  
8 project.

9           On the other side, any additional wells to  
10 be drilled within the unit boundary--these are oil  
11 wells which will be drilled. And, in my mind, there  
12 is no such thing as a lead-pipe-cinch in the oil  
13 business, period. There is risk, whether it be a  
14 wildcat or a developmental well. I've participated in  
15 a lot of developmental wells that were dry holes,  
16 period.

17       Q.     Are you familiar with other waterflood  
18 projects in the area?

19       A.     Yes, I am.

20       Q.     As a petroleum engineer, do you have an  
21 opinion as to whether or not they have all been  
22 successful?

23       A.     They have not.

24       Q.     Are you aware of any in particular that  
25 have not been successful, from an economic point of

1 view?

2 A. Yes, I am.

3 Q. Can you identify any of those for the  
4 Examiner?

5 A. The closest reservoir to the Mesa Gallup  
6 project is the Many Rocks waterflood. And the Many  
7 Rocks waterflood, as per the current owner and the  
8 current operator of Many Rocks, was a financial  
9 failure and is today a very marginal project.

10 Q. Mr. Rubenowicz, in your opinion, will  
11 granting this application, including the imposition of  
12 a 200-percent risk penalty, be in the best interest of  
13 conservation, the prevention of waste and the  
14 protection of correlative rights?

15 A. I believe it will.

16 Q. Will the imposition of a 200-percent  
17 penalty assure that those who advance the costs are  
18 properly compensated for the risks they take by  
19 advancing costs to those that do not join in the  
20 project?

21 A. In reality, in drilling of wells, I have  
22 been involved in numerous wells with 4- and  
23 500-percent penalties for non-consent. A 300-percent  
24 penalty is not the highest penalty I've participated  
25 in personally.

1 Q. Could you identify what has been marked as  
2 Grand Exhibit No. 4?

3 A. Oil Conservation of New Mexico Department  
4 of Energy and Minerals. In the Matter of: Grand, for  
5 Statutory Unitization, State of New Mexico.

6 Q. Is that an affidavit confirming that notice  
7 has been given of this hearing, as required by the Oil  
8 Conservation Division rules?

9 A. It appears to be an affidavit.

10 Q. Is that signed by your counsel?

11 A. Yes, it has been.

12 Q. Were Exhibits 2 and 3 prepared by you or  
13 under your direction and supervision?

14 A. Yes, they were.

15 Q. Is Exhibit No. 4 an affidavit that appears  
16 to have been prepared by your counsel?

17 A. It has been.

18 MR. CARR: At this time I move the  
19 admission of Grand Exhibits 2 through 4.

20 HEARING EXAMINER: Are there any  
21 objections?

22 MR. BAGGETT: No objections.

23 HEARING EXAMINER: Exhibits 2, 3 and 4 will  
24 be admitted into evidence. Mr. Baggett, your  
25 witness.

1 MR. BAGGETT: Thank you.

2 EXAMINATION

3 BY MR. BAGGETT:

4 Q. Mr. Rubenowicz, what relationship do you  
5 have with the prior witness, Mr. Schrenkel?

6 A. None.

7 Q. Did he do any work for you?

8 A. Yes.

9 Q. Don't you consider that to be a  
10 "relationship"?

11 A. I thought a relationship meant, is he my  
12 cousin or my brother.

13 Q. No. Now that we've got it straight--

14 A. Okay. He's a consulting engineer and also  
15 a working interest participant in the Mesa Gallup  
16 waterflood.

17 Q. You heard Mr. Schrenkel's testimony before  
18 you got on the witness stand?

19 A. Yes, I did.

20 Q. Do you agree or disagree?

21 A. I disagree with him.

22 Q. Did you do this before or after you hired  
23 him as your consultant?

24 A. I just realized what he said when I heard  
25 him on the stand. I disagree with what he said.

1 Q. Do you agree with what he said that the 200  
2 percent, some people have the idea that that's an  
3 industry standard of some sort?

4 A. I've never heard of an industry standard,  
5 period. I've never heard of an industry standard.

6 Q. Are you telling us now that you think this  
7 waterflood project has a better than 50-percent chance  
8 of failure?

9 A. No, it does not have a better than  
10 50-percent chance of failure.

11 Q. Give me your estimate of its chance of  
12 failure.

13 A. I think it's got a 60/40, 70/30 chance of  
14 being successful.

15 Q. Okay. Now, you indicated that all working  
16 interest owners will pay their share. Are you sure  
17 that's an accurate statement? Aren't there some  
18 charity working interest owners in this thing?

19 A. Well, there's a net-profits interest in the  
20 project that will bear no financial risk in the  
21 project.

22 Q. He will not pay his share, is that correct?

23 A. Well, they pay their share out of the oil  
24 sales only, but they up-front no moneys or have no  
25 financial obligation to pay bills.

1 Q. And this is an agreement that your people  
2 made with some third parties and not Ari-Mex, is that  
3 correct?

4 A. No, I did not make it. I inherited it. I  
5 inherited the agreement.

6 Q. Do you presently have an agreement which  
7 provides that there are some people in this waterflood  
8 project who will not be putting up any money in  
9 advance for the development of this waterflood  
10 project?

11 A. Yes, there are.

12 Q. And if this project fails, those people  
13 with whom you have contracted under those  
14 circumstances, they will not be paying you anything  
15 either and you'll bear the full cost of this project,  
16 won't you?

17 A. That's correct.

18 Q. Do you feel that when you made that  
19 agreement with these people, do you feel that's a big  
20 risk to you?

21 A. Oh, absolutely. Big risk.

22 Q. Would you explain to the Commission why you  
23 made the agreement?

24 A. I didn't make the agreement. I inherited  
25 it. It's like when you marry someone and they've got

1 a brother that you really don't want to have anything  
2 to do with, but he's her brother. I didn't marry him,  
3 I married her. In this instance we bought this  
4 property with the full knowledge that there was a  
5 net-profits interest associated with it. We have  
6 tried everything in our power to eliminate the  
7 net-profits interest, but some people just are  
8 uneliminatable.

9 And in this particular instance, because  
10 we're the stuckee, we're the stuckee, and we have to  
11 bear the financial risk of their proportionate  
12 exposure versus upside benefits. We are saddled with  
13 it.

14 Q. And whatever you might recover of their  
15 share of costs out of production, is that what you're  
16 saying you will do?

17 A. Yes.

18 Q. Whatever that share might be will be simply  
19 their share of the costs, is that correct, and will  
20 not be 300 percent of the share of costs?

21 A. Costs plus. I think it's a 108-percent  
22 language. It's an eight-percent penalty.

23 Q. It's an eight-percent penalty on those  
24 people?

25 A. Correct.



1 Q. And how much interest is represented by  
2 that type of arrangement?

3 A. About seven and a half percent of the total  
4 revenue to be generated goes to the net profits side.

5 Q. So seven and a half percent of this  
6 waterflood project contains only an eight-percent  
7 penalty, and they do not put their money up in  
8 advance, and if this waterflood project fails you get  
9 nothing from these people, correct?

10 A. That's correct.

11 Q. Now, you're going to drill one water supply  
12 well, is that correct?

13 A. Correct.

14 Q. And you're going to go through the Dakota  
15 and through the Morrison and into the Entrada?

16 A. Correct.

17 Q. Are you aware of the fact that your  
18 consulting engineer's report recommends the Morrison  
19 well?

20 A. Yes, I am.

21 Q. You're going to go deeper because you want  
22 to be sure you get water, is that correct?

23 A. I want to make sure I have adequate water,  
24 correct.

25 Q. Suppose, Mr. Rubenowicz, that you hit quite

1 a good source of water in the Dakota, would you stop  
2 there or would you still go to the Entrada?

3 A. Well, the additional costs of drilling the  
4 well to the Morrison, which is what our engineer  
5 proposed, versus into the Entrada, should be  
6 approximately less than \$10,000 additional cost of  
7 drilling and completing the well in one zone versus  
8 the other, which represents about a 10-percent  
9 increase. We're anticipating a completed water supply  
10 well to cost about \$108,000.

11 So, if I drilled it through the Morrison,  
12 that same well would cost about \$95,000, \$90,000. If  
13 I drilled a Dakota water supply well, I could probably  
14 get away for \$85,000, \$90,000, something like that.  
15 Those are the additional moneys we would spend to  
16 drill an Entrada well.

17 Q. My question to you, though, if you  
18 encounter a good water supply in the Dakota Formation,  
19 which is the shallowest water supply, even though you  
20 encountered that water supply you would still drill  
21 deeper?

22 A. What you're saying is "adequate." Like I  
23 said, I have done extensive investigation into the  
24 water supply of the Horseshoe Gallup, all of their  
25 water supply wells. I looked at their well files and

1 I evaluated how they completed their wells. They felt  
2 that they had quality water supply wells in the  
3 Dakota, and they found out later that they had to  
4 spend extensive amounts of money to make those wells  
5 function as designed. They were inadequate. It cost  
6 tremendous more money than they anticipated. So they  
7 had never done it before.

8 I feel like I've learned from their  
9 experiences what I should be doing, as compared to  
10 what they did. That further reinforces my belief that  
11 the adequate water supply for this project should be  
12 the Entrada because, over the long haul, it should be  
13 the cheapest source of water to use in this project.

14 Q. Let me ask you my question once again. If  
15 you encountered an adequate water supply in the Dakota  
16 Formation, would you drill on down to the Entrada?

17 A. "Adequate"? If it was adequate, yes.

18 Q. Well, you can test the well?

19 A. No, you can't drill one of these water  
20 wells without setting pipe on it. A drill-stem test,  
21 I do not believe, will give you adequate, long-term  
22 projected water source in the Dakota formation.

23 Q. How do you determine, in any well you  
24 drill, whether it's the Morrison, the Dakota or the  
25 Entrada, whether you have an adequate water supply?

1           A.       Very good question. The best way to test  
2 any well, whether it we an oil well, a gas well or a  
3 water supply well, is to produce it for six months.  
4 After six months you know if it's adequate or not.

5           Q.       In answer to my question, you would drill  
6 to the Entrada?

7           A.       Yes.

8           Q.       Even though you felt it might be an  
9 adequate supply in the Dakota?

10          A.       I couldn't test it for six months. There's  
11 no way I can do that.

12          Q.       I'm confused. How would you determine the  
13 adequacy of the water in the Entrada as opposed to  
14 that in the Dakota?

15          A.       The way that you would do it is, if I  
16 wanted to test the Dakota to see if it was adequate, I  
17 would drill it to the Dakota, I would set pipe on it,  
18 I would perforate it and I would put it on to see if  
19 it delivered an adequate source of water.

20                 If it was inadequate, then I would have to  
21 probably drill another well down to the Dakota, or  
22 Morrison water, which would be the next zone. And if  
23 that one was inadequate, then I would have to drill  
24 another one to go down, unless I started off with a  
25 big casing and I just kept drilling a smaller and

1 smaller hole.

2 From an engineering standpoint, I could do  
3 it, but the additional cost of doing it that way,  
4 versus doing it the way I'm proposing it, there's no  
5 comparison.

6 Q. Do you feel reasonably certain you're going  
7 to get an adequate supply of water for this waterflood  
8 project?

9 A. I feel 80-percent comfortable. There's no  
10 lead-pipe cinch to drilling a water supply well. The  
11 Dakota, the Morrison and the Entrada may not be  
12 there. I mean, there's risks involved. This is the  
13 oil business, now.

14 Q. You have two paragraphs in this Unit  
15 Operating Agreement that refers to penalties, and  
16 non-consenting parties. In your Exhibit H, you  
17 indicate that understand certain conditions,  
18 non-consenting parties share the cost of any  
19 newly-acquired surface equipment beyond the well head  
20 will be paid by the non-consenting party only at 100  
21 percent, is that correct?

22 A. Yes.

23 Q. But all those costs that are incurred down  
24 hole, from the well head down hole, you've got in here  
25 300 percent of the costs?

1           A.       Correct.

2           Q.       Now, is part of the down-hole risk some  
3 down-hole equipment, such as tubing or--

4           A.       Well, the down-hole risk is whether what is  
5 down hole produces a substance that is financially  
6 viable for the investment. As compared to surface  
7 equipment, if you put something at the surface and it  
8 doesn't work, you go ahead and sell it and dispose of  
9 it and hope to recoup your moneys.

10          Q.       Except for the casing, you would do the  
11 same thing down hole, wouldn't you?

12          A.       But the costs of down hole is primarily in  
13 the intangible items of drilling the hole itself.  
14 There's no way to recoup your drilling costs,  
15 especially on a water supply well.

16          Q.       In your main portion of this, though, this  
17 agreement, there is no distinction made in that  
18 portion. Do you want to make these read the same, or  
19 are you going to leave them in different languages  
20 like this?

21          A.       We could clarify it. If there's a  
22 discrepancy in your mind as far as what should be  
23 included in 100-percent penalty versus what should be  
24 included in 300-percent penalty, I believe we could  
25 clarify that.

1           Q.       Now, this paragraph A doesn't indicate  
2 there's any penalty, it's just 100-percent share of  
3 the costs.

4           A.       Costs of all surface equipment.

5           Q.       Yeah.

6           A.       Because the surface equipment on an Entrada  
7 well versus a Morrison well versus a Dakota well will  
8 be identically the same. There should be no  
9 difference.

10          Q.       Maybe I'm not making myself clear. I want  
11 to make sure we get this clear.

12          A.       I know.

13          Q.       This 300 percent that's provided for in  
14 paragraph B, it is your understanding, and our  
15 understanding, that this figure will be changed,  
16 perhaps, but it will be subject to what this  
17 Commission rules is an appropriate penalty?

18          A.       Correct.

19          Q.       Okay. And we don't have any disagreement  
20 with that?

21          A.       No. Whatever the Commission rules, that's  
22 what we're bound by.

23          Q.       That will be substituted in this agreement  
24 throughout, wherever it refers to a penalty?

25          A.       If it needs to be changed.

1 MR. STOVALL: Mr. Baggett, may I interrupt  
2 you here and ask which page you are on?

3 MR. BAGGETT: I'm on Exhibit H, and it's  
4 the next to the last page of that one. It begins,  
5 "100 percent of each non-consenting party's share."

6 MR. STOVALL: I'm with you.

7 MR. BAGGETT: All I want to make clear for  
8 the record, Mr. Stovall, is that this agreement, and  
9 we're going to sign off on this agreement, subject to  
10 this Commission fixing, based upon the testimony that  
11 we have, the penalty clause that is appropriate in  
12 this case under the statute.

13 That's all I have, I believe.

14 HEARING EXAMINER: Thank you, Mr. Baggett.  
15 Mr. Carr, do you have any redirect?

16 MR. CARR: No, I do not.

17 MR. STOVALL: Mr. Rubenowicz, let me ask  
18 you a question to get it in the record for the  
19 Examiner.

20 EXAMINATION

21 BY MR. STOVALL:

22 Q. The language that is used in the Exhibit H  
23 that Mr. Baggett is asking you about, where did you  
24 get that language? Is that fairly standard operating  
25 agreement-type language, or is it unique to your



1 agreement?

2           A.       No, I mean, it's pretty much standard as  
3 far as setting the penalties for non-consenting  
4 parties on recommended work to be performed on a  
5 producing oil or gas well. On equipment that we would  
6 buy that would be used at the surface, a  
7 non-consenting party would pay 100-percent penalty  
8 versus the drilling and reworking of a well, that it  
9 should be 300.

10                 Now, the reason we use 300, in the majority  
11 of my operating agreements of close to a hundred wells  
12 that I operate, the great majority of those agreements  
13 call for a 300-, 500-percent penalty. And because the  
14 penalty is so stiff, I have never exercised it to this  
15 day. Never had to. And I don't really anticipate  
16 exercising it in this case. But we wanted to put  
17 enough teeth in it that nobody gets a free ride in the  
18 risks that are involved in what we're proposing. If  
19 they don't want to pay their money, then they should  
20 not get all their benefits of those that do.

21           Q.       And if I understand the intent of this  
22 agreement correctly--and please tell me if you have a  
23 different understanding--the 100-percent provision in  
24 paragraph A relates to equipment and operations for  
25 which there really is no risk attached, because you

1 now have a producing well and you've got recoverable  
2 equipment and costs that are only going to be incurred  
3 if there's production?

4 A. Correct.

5 Q. The 300-percent recovery factor applies in  
6 situations where you don't know what you're going to  
7 end up with for the expenditure of your money,  
8 correct?

9 A. Correct. When you get one foot below the  
10 surface of the ground, I just haven't found a man that  
11 I could lower down there yet that can tell me what's  
12 going to happen.

13 Q. And even worse, you can't lower him down  
14 before you get him down.

15 A. That's right. Someone's got to roll the  
16 dice and pay those bills.

17 Q. If I understand correctly, the disagreement  
18 or the one item of contention between you and the  
19 Ari-Mex parties is not what items will be covered by  
20 that in excess of 100-percent recovery factor, but  
21 rather how much in excess of 100 percent that factor  
22 will be?

23 A. Correct.

24 Q. And that seems to be the item of  
25 disagreement?

1           A.       That's correct.

2                   MR. STOVALL:   Mr. Baggett, would you agree  
3 with that?

4                   MR. BAGGETT:   That's correct.   And I would  
5 like to--your questioning has caused me to ask another  
6 one, though.

7                   MR. STOVALL:   Oh, I'm so sorry, Mr.  
8 Baggett.

9                                   FURTHER EXAMINATION

10          BY MR. BAGGETT:

11           Q.       This Exhibit H, however, did you not inform  
12 me earlier, Mr. Rubenowicz, that this is an exhibit or  
13 a contractual agreement that is used in the  
14 exploration and drilling of oil wells?

15           A.       Yes.

16           Q.       It is not something you've gotten from a  
17 waterflood project, is it?

18           A.       To tell you the truth, where all these  
19 words came from, I don't think that we pulled this out  
20 of one of our operating agreements.  Usually it is a  
21 standard 610 operating agreement is the operating  
22 agreement that I'm used to, and this is not a 610 that  
23 we have in front of us.

24           Q.       I believe you indicated earlier, you don't  
25 know where this thing came from, do you?

1           A.       As far as saying that I supervised every  
2 word in the sentences and punctuation and answers,  
3 no. I understand the gist of it and why it's there  
4 and what it says, but exactly where it came from, was  
5 it dictated by me or was it dictated by counsel, or  
6 did it come out of one of our other operating  
7 agreements, I don't have that answer.

8                   MR. BAGGETT: Okay. Thank you.

9                   MR. STOVALL: I don't have anything  
10 further.

11                  HEARING EXAMINER: Nor do I. Mr. Carr, do  
12 you have anything further in this case?

13                  MR. CARR: I would like to make a very  
14 brief closing.

15                  HEARING EXAMINER: Mr. Baggett, do you wish  
16 to bring your witness on at this time?

17                  MR. BAGGETT: No, Your Honor--I'm  
18 sorry--Mr. Examiner.

19                  HEARING EXAMINER: Would you like to make a  
20 closing statement, Mr. Baggett?

21                  MR. BAGGETT: I would like to make a short  
22 one after his, yes.

23                  MR. CARR: I think, as Applicant, I go  
24 last.

25                  HEARING EXAMINER: That's usually the way I

1 do it. Mr. Baggett, you may go first.

2 MR. BAGGETT: The only thing that I would  
3 like to say in respect to the one bone of contention  
4 that we've thrown on the table is that if 200 percent  
5 penalty is an industry standard, then the statute, as  
6 is written, is inartfully drawn and is redundant and  
7 useless because that statute, if I read it correctly,  
8 says that this Commission will look at each particular  
9 application for statutory unitization and will, I  
10 presume, based upon the risk factors involved in that  
11 particular project, will set a penalty not to exceed  
12 200 percent.

13 Now, if we're just going to set 200 percent  
14 in every case, even in a situation where we have  
15 testimony that the probability of success in this  
16 venture is 85 percent, if that's still going to  
17 require a 200-percent penalty for non-payment, then  
18 the statute, to me, would be relatively worthless.  
19 You might as well just set it and let it be fixed and  
20 not worry about it.

21 I would like to point out that all people  
22 are not in the happy position as most of Mr.  
23 Rubenowicz's working interest partners who have  
24 money. You do have situations where there might be  
25 some interest owners in this particular waterflood

1 project who don't have the money. And so if a unit  
2 operator comes along under, for instance, Exhibit H  
3 and says, we want to drill an oil well out here, the  
4 waterflood is not in effect yet and we think it's  
5 going to be a great thing, but we think we would like  
6 to go ahead and punch a well down, we might get some  
7 pretty good production out of that, now, the working  
8 interest owner has got to decide whether he wants to  
9 go along with that or not.

10 Now, in this case if he doesn't have 15  
11 percent of a hundred thousand dollars to put up, why  
12 should he be penalized 200 percent? He may even  
13 disagree with the analysis of the operator who wants  
14 to punch the well down.

15 So it's not a question of somebody getting  
16 a free ride; you have to consider what the effect  
17 might be on a person who may not have the money to  
18 contribute to all of these projects that the unit  
19 operator is untitled to come up with under these  
20 agreements. He's got full control of this thing.

21 The only protection that a statutorily  
22 unitized person has is what this Commission does. And  
23 the rules say, the statute says in two or three places  
24 and particularly in Section 7, that all things must be  
25 fair and equitable to all the parties, and

1 specifically to the non-consenting parties who are  
2 being forced into this arrangement, in many cases  
3 against their consent. And that, to me, is what this  
4 statute is designed for.

5           It's not a question of, I've got lots of  
6 money and I just don't want to put it up and I want to  
7 be stubborn about it and make Mr. Rubenowicz go spend  
8 his money, if there's a great chance that it's going  
9 to fail, I agree with that. That's not right. But  
10 that's not the only situation you can run into here.

11           And without going into any great detail,  
12 there are many cases and could be cases in this one  
13 right here, where the party who opposes such a project  
14 may oppose it on good grounds, including the ground  
15 that he doesn't have the money to participate. If he  
16 doesn't have the money to participate, the statute  
17 doesn't appear to say that you're just going to be  
18 automatically penalized or pay three times the cost in  
19 that project.

20           What we've come before the Commission for  
21 is to get a ruling on this situation. That's why we  
22 developed the testimony indicating that this  
23 project--and I don't disagree with the testimony--has  
24 an 85-percent chance of success. Based upon that  
25 testimony, it seems it's not a very high-risk venture

1 and should not bear the absolute maximum allowable  
2 penalty under the statute. Thank you.

3 HEARING EXAMINER: Thank you. Mr. Carr?

4 MR. CARR: May it please the Examiner,  
5 Grand Resources is before you today seeking an order  
6 statutorily unitizing the Mesa Gallup Field. We were  
7 happily before this Commission last May, thinking we  
8 had a voluntary agreement as to all terms, and then  
9 things came unraveled. And so we are before you today  
10 seeking an order statutorily unitizing the lands.

11 If voluntary agreements follow and that  
12 order is meaningless, we will advise of you of that,  
13 but we're asking you for an order statutorily  
14 unitizing this unit area.

15 I resent Mr. Baggett's comment that the  
16 statute was inartfully drawn, inasmuch as I'm the  
17 person who drafted it. But I think it's important to  
18 note that whether it's an industry standard or not,  
19 there's a provision in this Act that addresses the  
20 risks that are involved in developing a pool.

21 The oil business is a business that is full  
22 of risk and is full of benefits, potential benefits as  
23 well, and you can't look just at the risk side. You  
24 can't, just because you don't have the money, assume  
25 someone else will carry the risk for you and you can



1 simply derive the benefit.

2 I submit to you the fact that somebody  
3 doesn't have the money, maybe, to pay their share of a  
4 well, is really not an important issue for you to  
5 consider. Correlative rights don't talk about the  
6 financial status of the people coming in, correlative  
7 rights talks about an opportunity to produce your just  
8 and fair share, and there are ways to do it. You can  
9 go into a unit and if somebody else takes the risk for  
10 you because you're unable or unwilling to pay, then  
11 because they took the risk, not because you didn't  
12 pay, they're entitled to recover more than just the  
13 money they put into it for your share, because they  
14 carried your interest and if the project failed, you  
15 were out of it free and clear, having asked someone  
16 else or permitted someone else to make the investment  
17 for you.

18 If you look at the testimony in this case,  
19 you can look at the parameters contained on page 7 of  
20 Exhibit 1 and you can see that in the Mesa Gallup  
21 Field, porosity and permeability are not as good as  
22 even in Many Rocks, and the record shows that Many  
23 Rocks has been a failure. If you look at the record  
24 before you, you can see that 85 percent of the  
25 interest owners in this unit have voluntarily agreed

1 that 200 percent, whether it's industry standard or  
2 not, is an appropriate penalty.

3 What we have here is a situation where  
4 we're being asked potentially to carry someone else  
5 and to assume risk for them. When we do that we think  
6 a 200-percent penalty is appropriate. Just because we  
7 inherited net-profits interest which imposes a burden  
8 on this project doesn't justify imposing additional  
9 burdens by coming in with a risk factor that is  
10 arbitrarily low because somebody else may not be able  
11 to come forward, at sometime now or in the future, and  
12 pay their share of capital costs. We ask you to look  
13 at the evidence, the porosity figures, the  
14 permeability figures, the success in the Many Rocks  
15 project, and we ask you to impose a 200-percent  
16 penalty and an order that statutorily unitizes this  
17 field.

18 HEARING EXAMINER: Thank you, Mr. Carr.

19 MR. BAGGETT: I would like to say for the  
20 record, Mr. Examiner, that I withdraw my statement  
21 about the statute being inartfully drawn. Maybe it's  
22 just been inartfully applied.

23 HEARING EXAMINER: Thank you, Mr. Baggett.  
24 I'm going to take administrative notice in cases in  
25 which orders number R-8957 and R-8966 were issued

1 earlier this year.

2 Does anybody else have anything further in  
3 Case 9836 at this time?

4 MR. CARR: Nothing further.

5 HEARING EXAMINER: Then this case will be  
6 taken under advisement.

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CERTIFICATE OF REPORTER


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

I, Carla Diane Rodriguez Certified  
Shorthand Reporter and Notary Public, HEREBY CERTIFY  
that the foregoing transcript of proceedings before  
the Oil Conservation Division was reported by me; that  
I caused my notes to be transcribed under my personal  
supervision; and that the foregoing is a true and  
accurate record of the proceedings.

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

WITNESS MY HAND AND SEAL December 14, 1989.

  
CARLA DIANE RODRIGUEZ  
CSR No. 91

My commission expires: May 25, 1991

I do hereby certify that the foregoing is  
a complete record of the proceedings in  
the hearing of Case No. 9836,  
heard on 24 November 1989.

 Examiner  
Oil Conservation Division