

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

IN THE MATTER OF THE HEARING CALLED BY)
 THE OIL CONSERVATION DIVISION FOR THE)
 PURPOSE OF CONSIDERING:)

CASE NO. 12,297

APPLICATION OF DAVID H. ARRINGTON OIL)
 AND GAS, INC., FOR COMPULSORY POOLING,)
 EDDY COUNTY, NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MARK ASHLEY, Hearing Examiner

December 2nd, 1999

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MARK ASHLEY, Hearing Examiner, on Thursday, December 2nd, 1999, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

OIL CONSERVATION DIV.
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I N D E X

December 2nd, 1999
 Examiner Hearing
 CASE NO. 12,297

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* * *

A P P E A R A N C E S

FOR THE DIVISION:

RAND L. CARROLL
Attorney at Law
Legal Counsel to the Division
2040 South Pacheco
Santa Fe, New Mexico 87505

FOR THE APPLICANT:

CAMPBELL, CARR, BERGE and SHERIDAN, P.A.
Suite 1 - 110 N. Guadalupe
P.O. Box 2208
Santa Fe, New Mexico 87504-2208
By: WILLIAM F. CARR

FOR SANTA FE SNYDER CORPORATION:

JAMES G. BRUCE, Attorney at Law
3304 Camino Lisa
Santa Fe, New Mexico 87501
P.O. Box 1056
Santa Fe, New Mexico 87504

* * *

1 WHEREUPON, the following proceedings were had at
2 8:21 a.m.:

3 EXAMINER ASHLEY: The Division calls Case 12,297.

4 MR. CARROLL: Application of David H. Arrington
5 Oil and Gas, Inc., for compulsory pooling, Eddy County, New
6 Mexico.

7 EXAMINER ASHLEY: Call for appearances.

8 MR. CARR: May it please the Examiner, my name is
9 William F. Carr with the Santa Fe law firm Campbell, Carr,
10 Berge and Sheridan. We represent David H. Arrington Oil
11 and Gas, Inc., and we have two witnesses.

12 EXAMINER ASHLEY: Additional appearances?

13 MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,
14 representing Santa Fe Snyder Corporation. I have no
15 witnesses.

16 (Thereupon, the witnesses were sworn.)

17 EXAMINER ASHLEY: Mr. Carr?

18 MR. CARR: Thank you, Mr. Ashley.

19 DALE DOUGLAS,
20 the witness herein, after having been first duly sworn upon
21 his oath, was examined and testified as follows:

22 DIRECT EXAMINATION

23 BY MR. CARR:

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

25 A. Dale Douglas.

1 Q. Mr. Douglas, where do you reside?

2 A. Midland, Texas.

3 Q. By whom are you employed?

4 A. I'm a self-employed landman.

5 Q. And what is your relationship with David H.
6 Arrington?

7 A. I perform contract land services.

8 Q. Are you landman responsible for the compulsory
9 pooling which is the subject of this Application?

10 A. Yes, sir.

11 Q. Have you previously testified before this
12 Division?

13 A. Yes, sir.

14 Q. At the time of that testimony were your
15 credentials as an expert in petroleum land matters accepted
16 and made a matter of record?

17 A. Yes, sir.

18 Q. Are you familiar with the Application filed in
19 this case?

20 A. Yes, sir.

21 Q. And are you familiar with the status of the lands
22 in the subject spacing and proration unit?

23 A. Yes, sir.

24 MR. CARR: Are Mr. Douglas's qualifications
25 acceptable?

1 EXAMINER ASHLEY: Yes, they are.

2 MR. CARR: Mr. Ashley, initially I think we
3 should point out that although the case was advertised
4 seeking an order pooling spacing units in the west half of
5 Section 28, including 80-acre and 40-acre tracts, that
6 portion of the case can be dismissed because those
7 interests are all voluntarily committed to the well.

8 EXAMINER ASHLEY: Thank you.

9 Q. (By Mr. Carr) Mr. Douglas, would you summarize
10 for Mr. Ashley what it is that Arrington seeks with this
11 Application?

12 A. Yes, an order pooling all minerals from the
13 surface to the base of the Morrow formation under the
14 following-described acreage in Section 28, Township 20
15 South, Range 24 East, Eddy County, New Mexico: The west
16 half for all formations and/or pools developed on 320-acre
17 spacing, which includes the undesignated Foster Ranch-
18 Morrow Gas Pool, and the southwest quarter for all
19 formations and/or pools developed on 160-acre spacing.

20 Q. And to what well does Mr. Arrington propose to
21 dedicate these spacing units?

22 A. The name of the well is the Orange Stimulator
23 Caddis Federal Com Well Number 1.

24 Q. And what is its footage location?

25 A. It's located 1650 feet from the west line, 1980

1 feet from the south line in Unit K, Section 28.

2 Q. And this is a standard location?

3 A. Yes, sir, it is.

4 Q. Let's go to what has been marked Arrington
5 Exhibit Number 1, and I would ask that you identify this
6 and review the information on this exhibit.

7 A. Okay, this exhibit is a land plat which shows the
8 property in question, the west half of Section 28. The
9 outline is the 320-acre proposed unit for this well. The
10 red circle located in the northeast quarter of the
11 southwest quarter is the proposed location for this well.

12 Q. What is the primary objective in the well?

13 A. The primary objective is a wildcat Cisco/Canyon
14 formation.

15 Q. Is the Morrow also an objective?

16 A. Yes, it's a secondary objective, and that's the
17 Morrow formation in the undesignated Foster Ranch-Morrow
18 Gas Pool.

19 Q. What interest are you seeking to pool in this
20 case?

21 A. Santa Fe Energy, or Santa Fe Snyder, owns a one-
22 half leasehold estate in the southeast quarter of the
23 southwest quarter, which would be 6.25 percent interest in
24 the 320-acre unit and 12.5 percent in the 160-acre unit.

25 Q. Are all other working interests voluntarily

1 committed to the well?

2 A. Yes, they are.

3 Q. And Yates is the other interest owner?

4 A. Yes, Yates Petroleum, and they have executed an
5 AFE and an operating agreement.

6 Q. Could you summarize the efforts made to obtain
7 the voluntary participation of Santa Fe?

8 A. Yes, sir, we first proposed this well to both
9 Yates and Santa Fe in July of this year, and up to this
10 point we've had several phone conversations with, of
11 course, Yates and Santa Fe.

12 Yates wanted to participate in the well. We
13 negotiated and executed an operating agreement. Santa Fe
14 and Arrington have yet to reach an agreement on terms.
15 They have told us they do not want to participate in the
16 well, so we're trying to negotiate some sort of an
17 agreement for their interest.

18 Q. You have not at this time reached a voluntary
19 agreement with Santa Fe?

20 A. That is correct.

21 Q. If an agreement is reached, will you notify the
22 Division as soon as an agreement is reached?

23 A. Yes, sir.

24 Q. In your opinion, have you made a good-faith
25 effort to obtain the voluntary participation of Santa Fe

1 Snyder in this proposed well?

2 A. Yes, sir.

3 Q. Could you identify what has been marked as
4 Arrington Exhibit Number 2?

5 A. These are copies of the letters that were sent to
6 Yates -- or, excuse me, to Santa Fe, proposing the well and
7 asking for their participation or, in the alternative, made
8 a proposal to them wherein we would acquire their interest
9 under the proposed unit.

10 Q. In addition to the letters that are contained in
11 Exhibit 2, have you been in telephone communication with
12 representatives of Santa Fe?

13 A. Yes, sir, we have.

14 Q. Would you identify what is marked as Arrington
15 Exhibit Number 3?

16 A. Exhibit Number 3 is the AFE setting forth the
17 proposed cost for drilling this particular well.

18 Q. And what are the dryhole and completed well
19 costs?

20 A. The dryhole cost we estimate to be \$387,490, and
21 the completed well costs would be a total of \$658,800.

22 Q. Are these costs in line with what has been
23 charged by other operators for similar wells in this area?

24 A. Yes, sir.

25 Q. Can you identify what has been marked as Exhibit

1 Number 4?

2 A. Yes, sir, this is the affidavit setting forth the
3 fact that these parties have been properly noticed.

4 Q. And this advises Santa Fe of today's hearing?

5 A. Yes, sir, it does.

6 Q. And a copy of a letter to Santa Fe is attached to
7 the affidavit?

8 A. Yes, sir, that is correct.

9 Q. Have you made an estimate of the overhead and
10 administrative costs to be incurred while drilling the well
11 and while producing it if it is successful?

12 A. Yes, sir, we have. The drilling well rate would
13 be \$3750 a month, the producing well rate \$375.

14 Q. And what is the source of these?

15 A. The Ernst and Young survey that's published, the
16 1998.

17 Q. 1998. Do you recommend that these figures be
18 incorporated into any order which results from this
19 hearing?

20 A. Yes, sir.

21 Q. Does David H. Arrington Oil and Gas, Inc., seek
22 to be designated operator of the proposed well?

23 A. Yes, sir, he does.

24 Q. Were Exhibits 1 through 4 prepared by you or
25 compiled under your direction?

1 A. Yes, sir.

2 MR. CARR: At this time, Mr. Ashley, we would
3 move the admission into evidence of Arrington Exhibits 1
4 through 4.

5 EXAMINER ASHLEY: Exhibits 1 through 4 will be
6 admitted as evidence at this time.

7 MR. CARR: And that concludes my direct
8 examination of Mr. Douglas.

9 EXAMINER ASHLEY: Mr. Douglas, earlier you
10 mentioned the percentages that Santa Fe had in the two
11 spacing units -- I'm sorry. Yeah, go ahead, Mr. Bruce.

12 EXAMINATION

13 BY MR. BRUCE:

14 Q. Mr. Douglas, who were you dealing with at Santa
15 Fe Snyder Corporation?

16 A. A landman named Meg Muhlinghouse.

17 Q. And did you have several conversations with her
18 during the months of September and October and November?

19 A. Yes, sir.

20 Q. Now, looking your Exhibit 2, go to the November
21 2nd letter. Now in that letter you offered Santa Fe \$200
22 an acre and an override equal -- Well, in essence, Santa Fe
23 would deliver a 75-percent NRI lease; is that correct?

24 A. Yes, sir.

25 Q. Or excuse me, you offered \$75 and a 75-percent

1 NRI?

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

3 Q. Now, if you go to the next letter, you change the
4 NRI. It's only an 80-percent NRI; is that correct?

5 A. That is correct.

6 Q. Isn't that a fairly substantial reduction in your
7 offer to Santa Fe?

8 A. Yes, sir. If you will look at the November 2nd
9 letter -- and I've had a conversation -- several
10 conversations with Ms. Muhlinghouse about this matter.
11 I've attempted to put all -- reduce all of our
12 conversations to writing. I've yet to receive anything in
13 writing from Ms. Muhlinghouse.

14 In that letter she had -- on the phone, had made
15 an offer for a term assignment of \$200 an acre and a
16 quarter royalty.

17 In drafting this letter -- Those terms were
18 unacceptable to Arrington, and in drafting the November 2nd
19 letter I make the comment that we -- our proposal as we had
20 originally proposed was what we wanted to stay with. But
21 then when I recited that proposal, it had an error on the
22 25 percent. It should have been the 81 1/4 percent which
23 was originally proposed when we proposed the well.

24 Q. Well, there's nothing in writing during the next
25 month that retracts that 75-percent NRI, is there?

1 A. I assume when Ms. Muhlinghouse called me and told
2 me that those terms weren't acceptable, that that offer was
3 off the table.

4 Q. You had several discussions with her after
5 November 2nd; is that correct?

6 A. I would say yes, between two and four.

7 Q. And wasn't she always talking in terms of a 75-
8 percent NRI lease?

9 A. She was, we were not.

10 Q. Did you say that over the phone until this letter
11 of November 30th?

12 A. I left her a phone message on Tuesday.

13 Q. November 30th?

14 A. Yes, without the calendar if that's November the
15 30th, it was Tuesday. And I did not hear back from her, so
16 I faxed her this letter, so that she would have it in front
17 of her.

18 Q. Did she call and leave you a voice mail message?

19 A. I don't recall. It was probably about 5:30 or so
20 that I talked to her. I called her back again.

21 Q. Did Santa Fe ever tell you that they would work
22 with you and not hold you up on this deal?

23 A. Yes, they did, and we assumed that they would,
24 but we have still not reached terms that are acceptable to
25 either party.

1 MR. BRUCE: That's all I have, Mr. Examiner.

2 REDIRECT EXAMINATION

3 BY MR. CARR:

4 Q. Mr. Douglas, at any time has there been an
5 agreement reached between Santa Fe and Arrington by which
6 Santa Fe would voluntarily participate in the drilling of
7 this well?

8 A. No, sir.

9 Q. Is Mr. Arrington willing to give Santa Fe an
10 overriding royalty equal to the difference between 25
11 percent of the leasehold burdens?

12 A. No, sir.

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

14 EXAMINATION

15 BY EXAMINER ASHLEY:

16 Q. What's the status of this November 30th letter,
17 Mr. Douglas?

18 A. The November 30th letter, I have not received any
19 formal response, other than the conversations between Ms.
20 Muhlinghouse and myself, that she felt like the offer
21 letter -- or the written correspondence before this that
22 said 25 percent royalty, that she thought that this letter
23 should reflect that. But those are not the terms that
24 Arrington is willing to accept.

25 Q. Okay.

1 A. So she has -- I have not received any formal
2 response to this, yes or no, from Santa Fe.

3 EXAMINER ASHLEY: Okay. Mr. Bruce, do you know
4 what Santa Fe's position is regarding this letter, the
5 November 30th letter?

6 MR. BRUCE: Well, as Mr. Douglas testified, it
7 came in late Tuesday night and they've submitted it to
8 management. But, you know, that's one day to act.

9 Q. (By Examiner Ashley) Okay. Mr. Douglas, in
10 describing the 320 acres that you're trying to pool, what
11 portion of that does Santa Fe have an interest in?

12 A. In the southeast quarter of the southwest quarter
13 of the 40-acre tract Santa Fe and Yates own 50 percent each
14 of the leasehold estate under the 40 acres.

15 EXAMINATION

16 BY MR. CARROLL:

17 Q. Mr. Douglas, so the 75 percent listed on the
18 November 2nd letter, that was a mistake?

19 A. Yes, sir.

20 Q. Did Santa Fe Snyder call and accept the terms of
21 the November 2nd?

22 A. No, sir, they did not. They countered that
23 proposal with additional lease bonus moneys, and they had
24 requested us to reduce the term.

25 Q. And you did back off a little bit on the 81.25,

1 you went down to 80?

2 A. Yes, on this last offer, on the -- Let me get the
3 date of the letter that we had faxed over, which I'll point
4 out was faxed over to Santa Fe Tuesday afternoon, we had
5 increased our bonus offer to \$100 an acre, that they had
6 verbally requested as a response to this previous letter.
7 We reduced the term from two years to one year, and we
8 increased our offer from our original proposal letter from
9 81-1/4-percent to 80-percent net revenue.

10 MR. CARROLL: Okay, thank you. That's all I
11 have.

12 EXAMINER ASHLEY: I have nothing further. Thank
13 you.

14 MR. CARR: At this time we call Mr. Baker.

15 EXAMINER ASHLEY: Mr. Carr?

16 BILL D. BAKER, JR.,

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

19 DIRECT EXAMINATION

20 BY MR. CARR:

21 Q. Will you state your name for the record, please?

22 A. Bill D. Baker, Jr.

23 Q. Mr. Baker, where do you reside?

24 A. Midland, Texas.

25 Q. By whom are you employed?

1 A. David H. Arrington Oil and Gas.

2 Q. And what is your position with Mr. Arrington?

3 A. Exploration manager.

4 Q. Have you previously testified before this
5 Division?

6 A. Yes, sir, I have.

7 Q. At the time of that testimony, were your
8 credentials as an expert in petroleum geology accepted --

9 A. Yes.

10 Q. -- and made a matter of record?

11 A. Yes, sir, they have been.

12 Q. Are you familiar with the Application in this
13 case?

14 A. Yes, sir, I am.

15 Q. Have you made a geological study of the area
16 which is the subject of the Application?

17 A. Yes, sir, I have.

18 Q. And are you prepared to share the results of that
19 work with the Examiner?

20 A. Yes, sir, I am.

21 MR. CARR: Are Mr. Baker's qualifications
22 acceptable?

23 EXAMINER ASHLEY: Mr. Bruce?

24 MR. BRUCE: No objection.

25 EXAMINER ASHLEY: Mr. Baker is so qualified.

1 Q. (By Mr. Carr) Mr. Baker, let's go to what has
2 been marked as Arrington Exhibit Number 5. Would you
3 identify this for Mr. Ashley and then review the
4 information set forth on the exhibit?

5 A. Okay. Exhibit Number 5 is a two-well structural
6 cross-section coming up from the well in South Dagger Draw
7 Pool, moving from east to west, that's going to show the
8 stratigraphic risk of this particular proposal here. And
9 down in the very far left-hand corner I have inset a Canyon
10 isopach, dolomite isopach map, that you can see where the
11 cross-section runs through and then also my gross numbers
12 for the Canyon pay, which is the primary objective of this
13 particular well.

14 If you start on the right-hand side of this two-
15 well cross-section, this is a Yates Petroleum well that is
16 drilled about a mile and a half to the southeast of our
17 proposed location, and this well was drilled by Yates
18 Petroleum in December of 1996, and it encountered about 192
19 feet of gross dolomite in the Canyon formation.

20 This particular well has made 3 BCF and is
21 currently producing at a rate of about 4 million cubic feet
22 of gas per day.

23 I have designated here in purple and then
24 highlighted the porosity in red to show the productive
25 interval in the Canyon pay, this middle Canyon pay

1 interval. This is what we're attempting to get in our
2 Orange Stimulate Caddis proposal.

3 If you move from right to left you'll see where
4 our proposed location is at, and if you also look down at
5 the inset that you can see that we're moving to the west,
6 kind of the northwest, from this proposed -- or from the
7 Yates Petroleum's well. We're anticipating here that
8 there's a possibility of picking up 50 to 60 feet of
9 dolomite, hopefully productive dolomite.

10 From here you move on a little further to the
11 left and you see a Tesoro well. This well was drilled in
12 1975. This particular well identifies what we consider to
13 be the western boundary of the stratigraphic pinchout. As
14 you can see here, they basically have four or five feet of
15 what appears to be porous dolomite there. It was deemed
16 noncommercial, they didn't even test it, and it was a dry
17 hole.

18 Our proposed location is situated updip and to
19 the west of the Yates proposal and slightly back to the
20 east of the Tesoro well.

21 If you'll also look down at the inset here,
22 you'll notice that both to the north and to the south of us
23 there are dry holes that have been drilled by operators in
24 years past. One of them was by Mark Production in Section
25 21, and one was by Bell Petroleum down to south in Section

1 32. Both these two did have shows in the Canyon but did
2 not encounter commercial rock in the Canyon.

3 Q. Are you prepared to make a recommendation to the
4 Examiner as to the risk penalty that should be assessed
5 against any nonparticipating interest owner?

6 A. Yes, sir.

7 Q. And what is that?

8 A. The maximum, 200 percent.

9 Q. And summarize the basis for that recommendation.

10 A. Well, the basis is because of the extreme
11 reservoir risk here. We're playing a stratigraphic
12 pinchout, and it's extremely risky.

13 Q. In your opinion, Mr. Baker, is it possible that
14 you could drill a well at this location that would not be a
15 commercial success?

16 A. Yes, sir.

17 Q. In your opinion, will the approval of this
18 Application and the drilling of this well be in the best
19 interest of conservation, the prevention of waste and the
20 protection of correlative rights?

21 A. Yes, sir.

22 Q. How soon does Mr. Arrington hope to spud the
23 well?

24 A. We would hope to spud it in mid-January, mid- to
25 late.

1 Q. And was Exhibit 5 prepared by you?

2 A. Yes, sir, it was.

3 MR. CARR: May it please the Examiner, at this
4 time we would move the admission into evidence of Arrington
5 Exhibit Number 5.

6 EXAMINER ASHLEY: Exhibit 5 will be admitted as
7 evidence at this time.

8 MR. CARR: And that concludes my examination of
9 Mr. Baker.

10 EXAMINER ASHLEY: Mr. Bruce?

11 MR. BRUCE: No questions of Mr. Baker.

12 EXAMINATION

13 BY EXAMINER ASHLEY:

14 Q. Mr. Baker, I notice there's some other locations
15 on your isopach map, up in Section 21.

16 A. Yes, sir. The one that has the Canyon show on
17 it, that little blue triangle around it?

18 Q. Yeah, and then there's two north of that.

19 A. Yes, sir.

20 Q. What are those?

21 A. Okay, the two north of it, the one up there in
22 the very northwest corner is a dry hole. It did have
23 Canyon rock in it. It was also deemed noncommercial
24 reservoir rock.

25 Now, the one that's located northwest from that

1 little gas well up there, that is a Morrow producer.

2 That's a Yates Petroleum well. I think it's -- I believe
3 it's about .2 of a BCF.

4 Q. And that's your secondary target?

5 A. Yes, sir, it is.

6 Q. What about on the cross-section, the dry hole --

7 A. Yes, sir.

8 Q. -- to the west, DST?

9 A. Yes, sir, and that drill stem test is down in --
10 I would probably call it the Strawn interval. And if you
11 look at the drill stem test, they actually recovered some
12 gas down there. Obviously, they did not deem it
13 commercial. And from my review of this area in here to
14 date, there's not really been anything that's been deemed
15 commercial Strawn production, and I suspect that's why they
16 didn't attempt to run any type of pipeline completed.

17 Q. Okay. And what's your porosity cutoff for this
18 particular --

19 A. Well, Mr. Ashley, we're using a 2-percent cutoff
20 here. The Canyon is a very, very difficult reservoir
21 because of the secondary porosity that's involved in it. A
22 lot of times you don't see it on electric logs. I mean, it
23 has a lot of vugular stuff that you don't see. But I'm
24 using a 2-percent cutoff.

25 EXAMINER ASHLEY: Okay. I don't have anything

1 further, thank you.

2 MR. CARR: That concludes our presentation in
3 this case.

4 MR. BRUCE: Just a very brief statement.

5 EXAMINER ASHLEY: Okay.

6 MR. BRUCE: Mr. Examiner, Santa Fe Snyder is
7 willing to work with David H. Arrington on this matter, but
8 as far as they're concerned, one day ago a material term of
9 the negotiations changed. Mr. Douglas says that the
10 mistake in the NRI was strictly a typo, but that's not
11 reflected in the correspondence. We'd ask that this matter
12 be continued for two weeks to allow further negotiation
13 among the parties.

14 MR. CARR: May it please the Examiner, we object
15 to the request for a continuance. This matter has been in
16 the negotiation phase with Santa Fe since the 1st of
17 September, and in the early part of September a 25-percent
18 proposal from Santa Fe was rejected by Arrington. The only
19 communication we get from Santa Fe is them telephoning to
20 suggest that they've only had one day to consider this is
21 simply untrue.

22 There have been offers on the table sitting there
23 since early November that they have refused or failed to
24 respond to in writing or otherwise, and it would appear to
25 us that the fact that they're running in simply because

1 right before the hearing we have had to confirm in writing
2 what we've been trying to get through over the telephone
3 doesn't create a situation where they are being taken
4 advantage of.

5 They have not been responding to proposals, they
6 have not accepted offers. They only correspond on the
7 telephone, and there's been an offer on the table since
8 November the 2nd that they either would have to agree that
9 they have been working on by telephone or that they have
10 ignored, and in either circumstance that doesn't create a
11 situation where a continuance is appropriate.

12 EXAMINER ASHLEY: Mr. Carr I'll sustain your
13 objection, and Case 12,297 will be taken under advisement.

14 (Thereupon, these proceedings were concluded at
15 8:58 a.m.)

16 * * *

17
18 I do hereby certify that
19 a complete transcript of
the proceedings has been
heard by me on

20
21 *Mark H. Kelly*
22 CCR Conservation
23
24
25

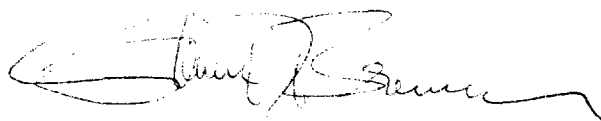
CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL December 3rd, 1999.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002