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. 14160

APPLICANT OF KERNS PETROLEUM, INC., FOR POOL CREATION, A DISCOVERY ALLOWABLE, AND SPECIAL POOL RULES, LEA COUNTY, NEW MEXICO

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID K. BROOKS, Legal Examiner
WILLIAM V. JONES, Technical Examiner
TERRY WARNELL, Technical Examiner

August 7, 2008

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID K. BROOKS, Legal Examiner, WILLIAM V. JONES, Technical Examiner, and TERRY WARNELL, Technical Examiner, on Thursday, August 7, 2008, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico.

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A P P E A R A N C E S

FOR THE APPLICANT:

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MR. JONES: Okay. Let's call Case 14160, Application of Kerns Petroleum Incorporated for Pool Creation, a Discovery Allowable, and Special Pool Rules, Lea County, New Mexico.

Call for appearances.

MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe, representing the applicant. I have two witnesses.

MR. JONES: Any other appearances? Will the witnesses please stand and state your names to be sworn?

[Witnesses sworn.]

KERRY A. JOHNSTON

after having been first duly sworn under oath, was questioned and testified as follows:

DIRECT EXAMINATION

BY MR. BRUCE:

Q. Would you please state your name and city of residence for the record.

A. Kerry Johnston, San Antonio, Texas.

Q. Who do you work for and in what capacity?

A. I work for Kerns Petroleum, Inc. I'm vice president.

Q. Have you previously testified before the Division?

A. No.

Q. Would you please summarize your educational and employment background?

A. I have a Bachelor's in geological engineering from the University of Minnesota, and a Master's in business administration from St. Thomas University. I've worked in the oil and gas business for about 26 years. I worked nine years for Apache Corporation. I did not work for Texaco -- various capacities, business administration and some technical.

Q. And what is your job at current? You said vice president, but what type of matters do you handle?

A. We're a rather small company, so, really, we cover various functions, largely the business end. We cover gas marketing, oil marketing, regulatory, some technical functions -- we wear a lot of hats. It's not a Texaco. We wear hats.

Q. And you are familiar, certainly, with the land matters involved in this application?

A. Yes.

Q. Okay. What precipitated this application, Mr. Johnston?

A. Kerns drilled the Eumont State Well #1 in the NE of the NW of Section 36, Township 21 South, Range 35 East and completed it as an oil well in the Seven Rivers formation. The well is capable of producing more than 300 barrels a day.

Q. In which pool did the Division's Hobbs office place the well?

A. It's classified as an oil well in the Jalmat gas

pool.

Q. What are Exhibits 1 and 2?

A. Exhibits 1 and 2 are the acreage descriptions for the Jalmat gas pool and the Eumont gas pool. The NE -- excuse me -- the NW of Section 36 adjoins both of these pools.

Q. And so that's the reason that the Hobbs office placed it in the Jalmat gas pool?

A. That's correct. The closest wells to our location are in the Jalmat pool.

Q. What rules would apply to an oil well in either the Jalmat or the Eumont pools?

A. The well spacing is 40 acres with wells to be located no closer than 330 feet to a quarter/quarter section line. Depth bracket allowable is 80 barrels of oil per day for this depth, for the producing gas/oil ratio limit of 2000 to 1.

Q. Does Kerns believe it has discovered a separate source of supply, separate from the Jalmat gas pool and the Eumont gas pool?

A. Yes, we do.

Q. And if you would refer to Exhibit 3, what is that based on, Mr. Johnston?

A. Exhibit 3, we'll kind of walk us through what we have in the way of technical and land data describing this discovery. The pages labeled here -- look at page 2 -- and it just shows you generally where this prospect is located

regionally within the flank of the Delaware Basin.

And if we move ahead to page 6, we've got a cross-section line in here. We have the time structure on the top of the Seven Rivers with the cross-section lines with the next exhibit. With the -- in yellow, it is outlining a lease that we have in the 160 acres in the NW of 36. And, as you can see here from the structure map of the Seven Rivers, the time structure map, the structure that is considered to be produceable rests entirely within the NW of 36.

Q. So there's a distinct structural feature?

A. There's a distinct structural feature. We have four-way closure in here, and we have contours at two milliseconds. We've got about 45 to 60 feet of structure closure in here, all contained within Section 36 on our lease.

I should point out that we have one typo, and we can provide an update to this 6 and 7. It lists the Reaho State #1 on this, and it's actually the Atlantic State #1.

Q. Atlantic?

A. Atlantic State #1, that's correct. This exhibit on this page 6 and on page 7, it is the Atlantic State instead of the Reaho.

Q. What specifically does Kerns request in this case?

A. We request the creation of the West Eumont Yates Seven Rivers pool covering the NW/4 of Section 36, special pool

rules and regulations providing for a depth bracket allowable of 350 barrels of oil per day and discovery allowable pool rules to be made effective retroactive to the date of first production from the Eumont State #1.

Q. And what is the Exhibit 4?

A. Exhibit 4 is a form C-109 prepared for this well.

Q. Okay. And that's the Division form for application for creation of new pool and a discovery allowable?

A. That's correct.

Q. And did you search the records to determine operators of wells within a mile of your Eumont State #1 well?

A. Yes, we did.

Q. And are those reflected on page 2 of Exhibit 4?

A. That is correct.

Q. And was notice of this application given to those operators?

A. Yes, it was.

Q. And are your notice letters and the certified cards submitted as Exhibit 5?

A. That is correct.

Q. Have you heard from any of those offsets?

A. No, we haven't.

Q. And I think you mentioned -- and Kerns does have an engineer to testify on this matter, do you not?

A. Bryan is an engineer.

Q. But in as far as production surrounding this well, what type of production is there in the Eumont-Jalmat gas pools?

A. This location is on the -- really on the slope. Most of the production is up on the shelf margin. So as we step off here, we're not really seeing anything to the north and the west to the south of us. And this one structure that we have is the zoning we see in this immediate area in the Seven Rivers.

The other wells that have produced, both from the Yates and from the Seven Rivers to the northeast, east and southeast, the immediate offset wells are perhaps 30,000 to 40,000-barrel wells. As you get further up on the shelf there, they get better, but in the immediate area right at the top of the slope, they're not that good. We have a very distinctly different well there.

Q. Of these offset producing wells, what type of current producing rates do they have?

A. We have a well within one mile that is making about eight barrels a day. Other wells may be three barrels a day. The very closest well is 40 MCF a month. So they're pretty well depleted.

Q. Very marginal production.

A. Right.

Q. Were Exhibits 1 through 4 and 5 prepared by you

or under your supervision or compiled from company business records?

A. Yes, they were.

Q. In your opinion, is the granting of this application in the interests of conservation and the prevention of waste?

A. Yes, we believe so.

MR. BRUCE: Mr. Examiner, I move the admission of Exhibits 1, 2, 4 and 5.

MR. JONES: Exhibit 1, 2, 4 and 5 will be admitted.

[Applicant's Exhibits 1, 2, 4 and 5 admitted into evidence.]

MR. JONES: So 3 is coming, I take it?

MR. BRUCE: Yes.

MR. JONES: Thank you.

EXAMINATION

BY MR. JONES:

Q. Okay. Mr. Johnston, the people in Hobbs, were you personally talking to Paul Kautz?

A. Yes, I did. When we drilled this, I talked with Paul and said we were planning on submitting the completion reports. And I said I wanted to verify which pool is appropriate for this, given the circumstances. And at the time, he looked at the nearby wells in 36 and said, "You should place it in the Jalmat pool." So we filed our completion

report accordingly.

Q. And obviously, it's not gas you got here.

A. That's correct.

Q. The gravity of the oil, is that on here somewhere?

A. Gravity of the oil is not -- Bryan will speak to the engineering and production components. He has that data.

Q. You're covering geology, too, though, right?

A. That is correct.

Q. Okay.

A. The gravity in the 31 degree range.

Q. Okay. And the structure you said was only in the Seven Rivers. Is that also the structure in the Yates?

A. The Yates parallels very closely the structure here. We're not seeing the Yates structure outside of the NW of 36.

Q. What kind of Seven Rivers is it? Is it dolomite or sand or what? I'm not real familiar with this.

A. It's Permian. I can't honestly tell you the composition per se. I'm not the primary geologist on this or the geophysicist on this. But it's carbonate with some pretty good porosity, and that's why we're looking for good results here.

Q. Is the reef right below that Seven Rivers?

A. I'm sorry?

Q. The Capitan Reef, right below that Seven Rivers formation there?

A. I can't speak to that. We've got the Yates above us, and we've got the Queen below us, but I'm not sure --

Q. You got the Queen below you?

A. Yeah. We drilled this through the Queen to take a look at the Queen, and there was nothing there.

Q. Okay. So you don't worry about --

A. Right.

Q. Not that there would be -- the completion? I guess that's the engineer's --

A. Yeah. I'd just as soon refer that to Bryan.

Q. Okay. But the structure -- you say you only want a 40-acre pool. You're starting out, of course, but you think it could grow to the west and maybe north; is that it?

A. You have the one seismic shot in here. That's what we see as the entire limit of this reservoir. And we're looking at, given our location -- we have, you know, some possibilities of drilling to the north and to the south on this feature. But outside of this 160, we don't see anything pertinent to this feature.

Q. Nothing to the west?

A. Nothing to the west. Nothing down slope, no.

Q. And the setbacks, you don't propose any special setbacks?

A. We, at this point in time, we have a total of five additional locations permitted. Those permits were taken before we had this particular upper Seven Rivers zone perforated. We're seeing a deeper possibility, and Bryan will discuss that part of it further. But, you know, this is something that we're obviously wanting to focus on, this particular horizon, given the results that we've had.

Q. This is not your primary horizon?

A. We want to take a look at this Queen -- I mean, this is all a buildup through a system that we were seeing some structure in the Queen, you know, obvious structure here in the Seven Rivers, and obvious structure in the Yates. And we wanted to take a look at all of them. If we didn't find anything in the Queen, we don't need to test the Yates at this point in time because we've got the Seven Rivers that is productive.

Q. You won't be perforating the Yates?

A. Before this well was abandoned, we may. But at this point in time, that's going to be up to our grandchildren.

Q. You think it'll last? Good.

A. We can all hope.

Q. But you want the pool to be called Yates Seven Rivers. You don't want it just to be the Seven Rivers pool?

A. Because we just aren't sure at this point in time if the Yates is productive since we have not tested it.

Q. Okay. But it would be an oil pool. What would be the GOR limit on this? Just the statewide 2,000?

MR. BRUCE: Statewide.

Q. (By Mr. Jones): I mean, 100,000 GOR and statewide rules. Okay. The discovery allowable, you want it retroactive to the date of first production? How long ago was that?

A. We filed the completion report effective May 16. That was the first day when we actually had some oil going to the tank.

Q. And how is it doing?

A. It's doing well. It's a nice well. This is the first well that Kerns Petroleum has drilled in this state and --

Q. You're starting off right.

A. We're happy.

Q. Okay. I probably should ask a lot more questions, but I don't have any right now.

MR. WARNELL: I have no questions.

EXAMINATION

BY MR. BROOKS:

Q. What spacing unit are you proposing? You're still going to leave it 40 acres?

A. Yes.

Q. That makes it a lot easier. I see you gave

notice to several people, all of whom as far as I know, are operators. How were the people that were notified selected? What was the criteria --

A. I went to the OCD online, identified all well bores within two miles, and wanted to check on the status. Those wells that were plugged, I pulled plugging reports and checked those off the list, but basically went through well-by-well through all the OCD records to identify all potential wells and operators and then identified those that were active within the mile distance and included them on the list. And that's the list I have here.

Q. Would that be within one mile of the outer boundaries of the proposed new pool?

A. That's correct.

Q. As well as --

A. That's correct.

Q. Is Kerns the only operator in the proposed pool?

A. That is correct.

MR. BROOKS: Okay. That's all I have.

MR. JONES: Okay.

MR. BROOKS: I just wanted to be sure all those issues were covered. I'll head out.

BRYAN L. WILLIAMS

after having been first duly sworn under oath, was questioned and testified as follows:

DIRECT EXAMINATION

BY MR. BRUCE:

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

A. Bryan L. Williams, San Antonio, Texas.

Q. And who do you work for?

A. Kerns Petroleum.

Q. What's your job with Kerns?

A. I am operations manager. And, like I said, we're a small shop, so I'm basically doing all the engineering as well as the operations.

Q. By education and trade, are you an engineer?

A. Yes. I have a BS in petroleum engineering from Texas A&M and have worked several years in management.

Q. And have you previously testified before the Division?

A. Yes, I have.

Q. And were your credentials as an expert petroleum engineer accepted as a matter of record?

A. Yes, they were.

Q. And are you familiar with the engineering matters related to this application?

A. Yes, I am.

MR. BRUCE: Mr. Examiner, I tender the witness as an expert petroleum engineer.

MR. JONES: Mr. Williams?

THE WITNESS: Yes. Bryan Williams.

MR. JONES: Mr. Williams is qualified as an expert in petroleum engineering.

Q. (By Mr. Bruce): Mr. Williams, let's run through Exhibit 3, and the pages are numbered. And I think Mr. Johnston went through the first several pages. Maybe start off with Exhibit 5 just so you can maybe describe a little bit more how you are on the fringe of those pools.

A. All right. This is a plat showing all of the wells in the Jalmat and Eumont pool and we are, as you see the yellow highlighted area on page 5 basically showing that we are on the western edge of a productive interval, and there's nothing, as Mr. Johnston pointed out, to the west of us.

Q. And again, Exhibit 6, do you agree that this is a separate small reservoir?

A. Yes. This was identified and developed off of 3-D that identifies it as a separate reservoir.

Q. And what does Exhibit 7 reflect insofar as the relationship to the other wells in this area?

A. Exhibit 7?

Q. Page 7. I'm sorry.

A. Page 7 is a cross section that basically shows the structural high on our well with the low in between our well and the main reservoir to the east separating the two.

Q. You appear to be significantly lower than the

offsetting wells; is that correct? In the Seven Rivers?

A. No. Our Seven Rivers is higher than the offsetting, yes.

Q. I'm sorry.

A. Because they are low, and that's why it's non-productive.

Q. Let's move on to Exhibit -- excuse me -- page 8 and discuss the matters, maybe just briefly set forth the matters you're going to discuss in your testimony today.

A. Okay. I'm going to talk about the avoidance of reservoir waste; that our request for an increase allowable is not going to cause reservoir waste; it should not cause reservoir damage; and, will help in economic development of the reserves.

Q. What does page 9 show?

A. Page 9 is a little bit more localized production plot or showing area production. Those are cum productions of the wells in the Seven Rivers Yates pools to the east of us. As Kerry was pointing out, they currently produce marginal rates at best.

Q. Let's move on a couple of pages to page 13.

A. Okay.

Q. And maybe while you're discussing production, you can again discuss the drilling and completion of the well and testify as to what happened when you perforated this well and

commenced production.

A. We drilled the well -- as I said, we went through the Queen, so we TD'd about 5,000. When we were drilling at 4100 we lost all circulation. We attempted to pump to LCM plugs and was unable to get circulation. When we pulled the logs on it, we basically found a cavern where there was no contact with the logs at about 4100. It was about a 12-foot interval. And above that, we had very good porosity development of the Seven Rivers formation.

When we initially completed the well back in December, we completed in the lower section where we lost all -- at 4100, roughly 4100 -- where we lost all returns. We lost roughly 20,000 barrels of water in it, so we spent some time pumping off making sure that we were pumping off -- or making sure that it wasn't -- we were hoping that it wasn't formation water. It took us a while to finally realize that was formation water. So we gave up.

Instead of being at the bottom of the porosity development on the neutron density logs, we were now at the top of it. It's probably about -- I don't remember the numbers -- maybe 100 foot above where we were. But it is, we feel, consistent with porosity development, that it is the same connected reservoir.

This test is -- when we first got it on production, we had a test unit out there, a third party tester out there

doing the hourly rates. Because when we first perforated it, we saw signs that it was going to be producing a well rate, so we wanted to try to understand maybe the size of the reservoir, you know, to see if there was any changes from hour to hour, etc., etc. Changing the choke from a 20 to an 18, just trying to watch some performances.

We spent probably seven days with an hourly tester to a point, and then we just turned it to production and left the choke still so we can continue to monitor how it's performing.

Q. What does page 14 reflect?

A. Page 14? I'm sorry. Some of the additional tests -- just the daily, at the end of the day, rate that we realized during the testing period.

Q. And based on your tests, do you believe it's capable of producing in excess of 350 barrels a day?

A. Absolutely. It is showing that it did.

Q. And as a result, that is the allowable you are requesting at this time?

A. Yes, sir.

Q. What does page 15 show?

A. Page 15 is the initial hourly test that we were talking about showing that the GOR that we were measuring with the oil rates at the various hours. And, as you know, it kind of fluctuates when you go hourly like that. It's a little sporadic, but it shows a 200 to 300 type GOR, very low GOR.

Q. Very low.

A. Very low.

Q. And based on this testing, the GOR was very flat, too; is that correct?

A. Correct.

Q. You have a note over here. The reservoir appears to be a water drive?

A. That's what we believe: one, with the low GOR; and, two, with the water that we produced from that lower interval. I mean, it's definitely -- we were unable -- whenever we were pumping it, the fluid basically stayed consistent until we pumped it down to maybe 100 foot whenever we were pumping it. So it's a rather strong water inflow.

Q. Would you move on to page 16 and discuss why you do not think that increasing the oil allowable in this reservoir would damage the reservoir?

A. Okay. Whenever we were still in the lower initial completion interval, we did get an initial fluid level on our completion around 600 feet. With the water gradient, we estimate what the static bottom hole pressure should be for the reservoir. And then now once we have flowing the upper interval, which we again believe is all connected, it's basic tubing performance curves of, -- you know, it's oil with three barrels of water a day and minor gas.

So we're able to estimate what a flowing bottom hole

pressure is. And basically with that drawdown, you know, we are, I think, about a little above 40 percent drawdown and feel that's a safe, productive position.

Q. What does page 17 show?

A. Page 17 shows the seismic structure off of the seismic end, and it also shows some additional development wells that we had permitted, as Kerry mentioned. Some of these -- there is a lower anomaly that we see that we'd like to test. Unfortunately, the lower anomaly -- the optimal location for it -- is not the same as if we're in this reservoir, as probably mostly always is the case. But we would like to be able to test the lower position and have a chance of a bailout back into this reservoir if the lower anomaly is not here.

With that said, too, there is additional pay in not only the Yates. There's additional Seven Rivers in what we believe is separated Seven Rivers in this same well bore that we have. So, I mean, there's additional pay and additional development potential.

Q. And the perforated interval in this well is again?

A. It's 3815 to 3835.

Q. So a relatively small interval is perforated at this time?

A. Correct.

MR. JOHNSTON: Excuse me. No. The perforations are

3962 to 3968. I think you were looking at tops or something.

THE WITNESS: Okay.

MR. JOHNSTON: Yeah. You're just looking at the top of the zone, not the --

MR. BRUCE: And that is reflected on Exhibit 4, Mr. Examiner.

THE WITNESS: Sorry about that.

Q. (By Mr. Bruce): So that's even a smaller perforation?

A. Yes. It is a very small perforated interval. And part of our problem with this is that whenever we lost circulation, we did a DV tool to get cement to surface. But for probably about 100 foot of these zones, we don't have cement across it. But right above the DV tool is where we are currently completed at. So that's --

Q. And once again, and Mr. Johnston referred that there are several other wells that you had permitted prior to completing the well in this zone --

A. Okay.

Q. -- other than the Yates Seven Rivers, what other zones do you think might still be productive on your lease?

A. I believe the Yates that he's talking, but that's tied into this.

Q. Part of this?

A. And again, I don't know if we want to name the

lower interval that we'll be targeting, because we're not for sure the extent of that.

Q. Okay. Would you move on to page 18.

A. Okay.

Q. And maybe just summarize the reasons why you think the application should be granted?

A. You know, one of the issues is to ensure that the change does not impair or cause a detriment of correlative rights of others. And with our structure being wholly -- as we identified on structure, and as the well -- as it was drilled and came in and confirmed, the well appears to be wholly confined within our 160 acres that we have and that we are asking to be in this pool.

We don't believe there will be waste. The energy drive appears to be water drive, low GOR. We don't believe that increasing this will cause any waste, any issues of waste. And we also don't believe that the reservoir will be damaged by producing at the higher rate.

Q. And insofar as offset leaseholds, page 11 of Exhibit 3 does contain information on the State of New Mexico leases offsetting this; does it not?

A. Yes, it does.

Q. Okay. Let's move on to your Exhibit 6.

A. Okay.

Q. Just overall, what does this exhibit contain?

A. It's some of the detail engineering support for some of the numbers that we talked about previously, some of the fluid levels, the fluid content analysis, etc., just trying to give the detail, if necessary.

Q. Am I reading this right? Your total well costs were 700,000?

A. No. This isn't --

Q. Yeah.

A. There's additional costs there. And trust me, more than reports and actual invoices are different. And you know which one is higher.

Q. I just looked at that, and it seemed awfully low, Mr. Williams.

A. Yeah.

Q. Were Exhibits 3 and 6 prepared by you are or under your supervision?

A. Yes.

Q. And in your opinion, is the granting of this application in the interest of conservation and the prevention of waste?

A. Yes.

MR. BRUCE: Mr. Examiner, I move the admission of Exhibits 3 and 6.

MR. JONES: Exhibits 3 and 6 will be admitted.

[Applicant's Exhibits 3 and 6 admitted into

evidence.]

MR. BRUCE: I have no further questions of the witness.

MR. JONES: Okay. You're not asking for the whole 160 proration, are you?

MR. BRUCE: The spacing remains at 40 acres.

MR. JONES: Okay.

EXAMINATION

BY MR. JONES:

Q. Probably you don't do anything to -- you really don't think choking the well back a little bit will extend the life of it?

A. Yes. I don't see it extending the life of the reservoir by choking it back. And thus, I don't --

Q. In other words, a little 6-foot section that you've got perforated, you don't think -- it's not like there could be some fingering through of a little gas zone or something that would -- or a water zone -- that would harm you if you produce at a higher rate like this?

A. In particular, they were only in the top 6-foot section. We do not feel that that would the case. And that's where our 350 productivity came from.

Q. Okay.

A. So if we went and opened the entire 100 feet of this 125, then you would probably have the potential of

channeling from the lower water drive, etc.

Q. Okay.

A. But that rate will be well above -- we anticipate -- well above 350.

Q. And you guys are the only ones that own any of the -- any other parts of this structure; is that correct?

A. Yes, sir.

Q. So you will know how to complete any of the other wells to try to prevent --

A. We hope so. Yes.

Q. -- watering out --

A. Yes.

Q. -- in a hurry?

A. Yes.

Q. But if it was somebody else that had part of this structure, the game would be different, would it?

A. To where both of you are going after 350 no matter what could be the potential.

Q. Yeah. And also they would have to -- see, once you see something else on our logs, when you run the other wells, are you going to drill down to that six-foot zone and stop and do a drill stem test?

A. No. Remember, that was a second Seven Rivers below it.

Q. The cavern below it?

A. No. It wasn't as good. But I would say where we're at is some of the best porosity, carbonate porosity, that I've seen. But there's some additional pay potential below it. So we definitely want to see it in the second well.

Q. Okay. Yeah. Paul Kautz tells me the Seven Rivers is sometimes indistinguishable with the reef as far as being a massive carbonate. It's very hard to tell the difference on the logs. But now you've got the Queen below you here, so --

A. Right.

Q. This discovery, you want the allowable to be 350, but you want it to be backdated. Did you produce more than 350 at one time?

A. No.

Q. When you say --

A. The allowable --

Q. You mean just basically retroactive allowable?

MR. BRUCE: Yeah. The 350 retroactive to May -- whatever the date is.

MR. JONES: Okay. Okay, Terry, help me out here.

MR. WARNELL: Okay. I have a few questions.

EXAMINATION

BY MR. WARNELL:

Q. You mentioned your second well. Which well? If I look at page 17, you've got the different locations on there.

Would that be the #2?

A. The #2, targeting this interval, would be the #2, correct.

Q. That's going to be the next well drilled?

A. Yes.

Q. And that lower position you're referring to, is that the Seven Rivers, the lower Seven Rivers, or is that --

A. I'm sorry, the #2 well?

Q. Well, on this well here, you mentioned something about there's a lower position that you want to look at on the other wells.

A. Right. We would still drill down to it so we can see it.

Q. What is that lower position?

A. We believe it's still Seven Rivers.

Q. Okay.

A. We believe is an isolated --

Q. It's the lower Seven Rivers that shows up here on the cross section on page 7 of Exhibit 3?

A. Yeah. You should be able to see -- well, it's kind of a hard to see on this, but you should be able -- you'd have to go on a regular log to show the separate interval of the second -- but our second well will still target, and we will complete in the same interval, the #2 well on here.

Q. Okay.

A. But we still want to drill down. I mean, since we're drilling, we want to drill down and be able see it and potentially later on -- and then that will help us understand. Maybe one of these days we twin it to accelerate reserves, etc. at that point.

Q. Would you test that lower zone first, though, and then come up and complete the pool?

A. It's very likely. A potential, but --

Q. On that page 7 on Exhibit 3, your log that you're showing there. What is that?

A. It's just a --

Q. Is that --

A. I wish I knew for sure.

MR. JOHNSTON: If you want a copy of the full log here.

THE WITNESS: It's the beautiful new process logs that have lots of colors that you have to dig out every time to understand.

MR. JOHNSTON: We've submitted this log along with a completion report to the OCD.

MR. JONES: While he's digging that up, are you asking for the pool boundaries to be frozen as far as any undesignated -- no undesignated area around it?

MR. BRUCE: I wasn't -- I mean, you know, if somebody locates a similar feature on theirs within a mile, I would

think that they should be entitled to it also.

MR. JONES: Okay.

THE WITNESS: This is not the color log that we have on here. This color log will have the typical resistivity, typical neutron density, which are what these logs are, as well as some other process data. I believe part of this is -- and you'll see the blue versus the yellow streak.

Q. (By Mr. Warnell): Is that permeability?

A. No. That's a lithology -- I think it's called a CMR, but I don't want to speak on that for sure. But what it tries to do is say this is sand, this is dolomite, etc., and it's a Schlumberger tool.

Q. So that's a Schlumberger product we're looking at here?

A. Yes, the color.

Q. That's their computer process?

A. Right.

MR. WARNELL: I don't have any other questions.

MR. JONES: Is that CMR an open hole?

THE WITNESS: Yes.

MR. JONES: I guess I could ask Terry here about that. But that Atlantic State #1, it is a higher structure; is that correct?

A. Correct.

Q. But it didn't contain -- it hasn't been tested to

contain this same high productivity Seven Rivers zone?

A. I didn't put the perforations to that well. I don't have the perforations on each one of the wells.

Q. It's a ways away anyway.

A. Right.

Q. Okay.

MR. JONES: I think that's it. There's quite a bit you're asking for in this case. But I think we've got a lot of questions answered. It's uncontested, so if we have more, we'll go through Mr. Bruce.

MR. BRUCE: That's all I have in this case, Mr. Examiner.

MR. JONES: Okay. We'll take Case No. 14160 under advisement. And that being the last case of the day in the docket, we are adjourned.

[Hearing concluded.]

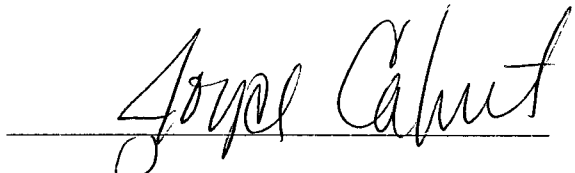
* * *

REPORTER'S CERTIFICATE

I, JOYCE D. CALVERT, Provisional Court Reporter for the State of New Mexico, do hereby certify that I reported the foregoing proceedings in stenographic shorthand and that the foregoing pages are a true and correct transcript of those proceedings and was reduced to printed form under my direct supervision.

I FURTHER CERTIFY that I am neither employed by nor related to any of the parties or attorneys in this case and that I have no interest in the final disposition of this proceeding.

DATED this 7th of August, 2008.



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New Mexico P-03
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STATE OF NEW MEXICO)
)
COUNTY OF BERNALILLO)

I, JOYCE D. CALVERT, a New Mexico Provisional Reporter, working under the direction and direct supervision of Paul Baca, New Mexico CCR License Number 112, hereby certify that I reported the attached proceedings; that pages numbered 1-32 inclusive, are a true and correct transcript of my stenographic notes. On the date I reported these proceedings, I was the holder of Provisional License Number P-03.

Dated at Albuquerque, New Mexico, 7th day of August, 2008.

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