KELLAHIN AND KELLAHIN
ATTORNEYS AT LAW
EL PATIO BUILDING
117 NORTH GUADALUPE
POST OFFICE BOX 2265
SANTA FE, NEW MEXICO 87504-2265

W. THOMAS KELLAHIN*

*NEW MEXICO BOARD OF LEGAL SPECIALIZATION RECOGNIZED SPECIALIST IN THE AREA OF NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

TELEPHONE (505) 982-4285
TELEFAX (505) 982-2047

July 19, 1996

Mr. Michael E. Stogner — **HAND DELIVERED**
Mr. David R. Catanach — **HAND DELIVERED**
Rand L. Carroll, Esq. — **HAND DELIVERED**
Oil Conservation Division
2040 South Pacheco
Santa Fe, New Mexico 87505

RECEIVED
JUL 19 1996
Oil Conservation Division

Re: **HALLWOOD'S MOTION TO DENY MERRION'S REQUEST FOR CONSOLIDATION OF POOLING CASES; TO DISMISS MERRION OIL & GAS APPLICATION FOR LACK OF JURISDICTION; AND FOR FAILURE OF MERRION TO COMPLY WITH DIVISION RULES, REGULATIONS AND DECISIONS**
NMOCD Case 11572
Application of Hallwood Petroleum, Inc.
for Compulsory Pooling
San Juan County, New Mexico

Gentlemen:

On behalf of Hallwood Petroleum, Inc.("Hallwood"), please find enclosed our Motion to Deny Merrion Oil & Gas ("Merrion") request for a continuance of the reference case now set for hearing on July 25, 1996 and Hallwood's Motion to Dismiss Merrion's compulsory pooling case filed on July 9, 1996 and set for hearing on August 8, 1996.

Hallwood seeks Division approval to go forward with its compulsory pooling case now set for hearing on July 25, 1996.

Very truly yours,

W. Thomas Kellahin

fxc: Hallwood Petroleum Inc.
Attn: Connie Heath
Merrion Oil & Gas
Attn: George Sharpe

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

IN THE MATTER OF THE APPLICATION OF HALLWOOD PETROLEUM, INC. FOR COMPULSORY POOLING, SAN JUAN COUNTY, NEW MEXICO **CASE NO. 11572**

HALLWOOD PETROLEUM, INC.'S MOTION TO DENY MERRION OIL & GAS' REQUEST FOR CONSOLIDATION OF POOLING CASES AND TO DISMISS MERRION OIL & GAS' APPLICATION FOR LACK OF DIVISION JURISDICTION TO GRANT MERRION'S REQUEST AND FOR FAILURE OF MERRION OIL & GAS TO COMPLY WITH DIVISION RULES, REGULATIONS AND DECISIONS

Comes now HALLWOOD PETROLEUM, INC. ("Hallwood"), by its attorneys, Kellahin and Kellahin, the applicant in the referenced case and moves the Division to resolve a dispute with Merrion Oil & Gas ("Merrion") concerning compulsory pooling of the N/2 of Section 27, T32N, R13W, by issuing a Division Order which:

(1) denies Merrion's participation in the referenced case and a dismisses Merrion's compulsory pooling case **because** Merrion is not represented by New Mexico counsel as required by law;

(2) denies Merrion's request for a continuance of the Hallwood case so that it can be consolidated with Merrion's compulsory pooling case filed July 9, 1996 and set for hearing on August 8, 1996 **because** Merrion has filed its compulsory pooling so that Merrion can be designated operator in order to avoid paying Hallwood for post production expenses attributed to transporting the gas or disposing of produced water;

(3) acknowledges that the Division lacks jurisdiction under the compulsory pooling provisions of Section 70-2-17(c) NMSA 1978 to resolve Merrion's dispute with Hallwood over (a) the transportation fee Merrion would have to pay to Hallwood if Merrion elected to use Hallwood's gathering line system rather than constructing its own gathering line and, (b) over the costs of disposal of produced water **because** the Division only has jurisdiction to resolve disputes over the costs of drilling and completing the subject well and not the post production expenses attributed to transporting the gas or disposing of produced water; and

(4) denies Merrion's request to be designated operator and dismisses Merrion's compulsory pooling application **because** contrary to the custom and practice before the Division and in violation of Section 70-2-17 (c) NMSA (1978), Merrion has prematurely instituted compulsory action against Hallwood without first undertaking a good faith and reasonable effort to form a spacing unit on a voluntary basis for the drilling of the subject well.

and in support states:

FACTUAL BACKGROUND

(1) On March 22, 1996, Hallwood Petroleum, Inc. (Hallwood"), as Agent for EM Nominee Partnership Company and Hallwood Consolidated Partners, L.P., advises Merrion that Hallwood intends to drill a Fruitland Coal Gas Well in the N/2 of Section 27, T32N, R13W. See Exhibit (1)

(2) On April 12, 1996, Hallwood sent its well proposal letter and AFE to all working interest owners in the N/2 of Section 27, T32N, R13W proposing its Mead 27-1 Well to be drilled at a standard location for production from the Basin Fruitland Coal Gas Pool. See Exhibit (2)

(3) As of the date of this proposal, the working interest owners in this spacing unit consisted of the following owners with the following percentages:

Hallwood	58%
Merrion	36%
Unocal	6%

(4) Unocal has agreed to commit its interest to Hallwood and to Hallwood's terms and conditions for this well.

(5) On June 11, 1996, Hallwood sent a letter to George Sharpe of Merrion responding to various questions raised by Mr. Sharpe. See Exhibit (3)

(6) On June 20, 1996, Merrion sent a letter to Hallwood. See Exhibit (4)

(7) On July 1, 1996, Merrion confirms by letter to Hallwood, that Merrion objections are limited to disputing Hallwood's proposed gas gathering and compression fee, salt water disposal fee and overhead rates. See Exhibit (5)

(8) On July 2, 1996, Hallwood files its compulsory pooling application requesting a hearing on July 25, 1996 and sends a copy to Merrion who receives its copy on July 8, 1996.

(9) On July 9, 1996, George Sharpe sends notification to Hallwood of Merrion's compulsory pooling application which is received by Hallwood on July 15, 1996. Exhibit (6)

(10) On July 10, 1996, George Sharpe files Merrion's compulsory pooling application with the Division and requests an August 8, 1996 hearing.

(11) Also on July 10, 1996, George Sharpe on behalf of Merrion sends Merrion's well proposal and AFE to Hallwood. See Exhibit (7)

(12) On July 12, 1996, Hallwood sends letter confirming that Merrion has no objection to Hallwood's well costs, well location, risk factor penalty, proposed joint operating agreement, recognizes that Hallwood should operate because it has the majority interest and only objects that in the event Merrion does not elect to take its gas in kind then it does not want to pay the gathering line and saltwater disposal fees Hallwood has proposed. See Exhibit (8).

ARGUMENT AND AUTHORITY

UNAUTHORIZED PRACTICE OF LAW:

Mr. George Sharpe's representation of Merrion Oil & Gas before the New Mexico Oil Conservation Division, including filing of a compulsory pooling application and a request for a continuance, constitute the unlawful practice of law in violation of Section 36-2927 NMSA (1978). See also 1957-58 Op. Att'y Gen No. 58-200.

Accordingly, Hallwood requests that the Division dismiss the compulsory pooling application filed of Merrion Oil & Gas.

MERRION'S POOLING APPLICATION IS PREMATURE AND MUST BE DISMISSED:

Merrion has prematurely instituted compulsory action against Hallwood without first undertaking a good faith and reasonable effort to form a spacing unit on a voluntary basis for the drilling of the subject well.

Hallwood requests that Merrion's compulsory pooling application in which Merrion seeks to be designated operator of the well proposed by Hallwood be dismissed because Merrion' conduct is contrary to the custom and practice before the Division and in violation of Section 70-2-17 (c) NMSA (1978).

THE DIVISION LACKS JURISDICTION TO GRANT MERRION ITS REQUESTED RELIEF:

Merrion is asking the Division to **establish a precedent**. Merrion wants the Division to resolve Merrion's dispute with Hallwood over (a) the transportation fee Merrion would have to pay to Hallwood if Merrion elected to use Hallwood's gathering line system rather than constructing its own gathering line and, (b) over the costs of disposal of produced water.

Hallwood has proposed to Merrion that Merrion sign a voluntary agreement (Joint Operating Agreement--AAPL 1989 Model Form) whereby Merrion would agree that Hallwood, as operator and on behalf of the working interest owners, will drill and complete the subject well based upon certain estimated costs for conducting those activities.

Consistent with industry custom and practice and in order to provide each owner in the well with an equal opportunity to sell gas from the well in order to produce their just and equitable share of the gas, Hallwood has proposed the 1989 Model Form Joint Operating Agreement ("JOA") which specifically provides that:

"ARTICLE VI
DRILLING AND DEVELOPMENT

G. Taking Production in Kind:
(Alternative 2) No Gas Balancing Agreement:

> Each party <u>shall take</u> in kind or separately dispose of its proportionate share of all oil and gas produced form the Contract Area....Any extra expenditure incurred in the taking in kind or separate disposition by any party of its proportionate share of the production shall be borne by such party. Any party taking its share of production in kind shall be required to pay for only its proportionate share of such part of Operator's surface facilities which it uses."

> "Any such sale by Operator shall be in a manner commercially reasonable under the circumstances, but Operator shall have no duty to share any existing market or transportation arrangement or to obtain a price or transportation fee equal to that received under any existing market or transportation arrangement."

The Operating Agreement form requires the interest owner to pay for any additional costs required to separately market its share of the gas. This would include such items as additional metering equipment and connections.

Hallwood will elect to take its share in kind and to market that share through its own gas gathering system and has afforded Merrion that same opportunity. Hallwood is not seeking to have Merrion own any interest in this gathering system or to pay any of the capital or interest costs for acquiring the rights of way, constructing the gathering system or financing that investment.

Under the terms of the model Joint Operating Agreement, after initial production is obtained, the operator is **not** obligated to market each owner's ratable share of production from the well. There is no logic or reason that the compulsory pooling order should provide Merrion with more than it would obtain by signing a Joint Operating Agreement.

In the absence of a voluntary agreement, the separate interest are combined under a compulsory pooling order. A compulsory pooling order should do no more than is done under the model JOA and that is to expressly authorize each party to take his share in kind and separately dispose of that share.

Merrion misunderstands the jurisdiction of the Division. The Division does not get into the business of marketing the gas produced under a compulsory pooling order. Therefore, if Hallwood is producing the gas from the well and marketing it for its own account, then it will eventually have to "gas balance" with the other interest owners. Merrion has the option, but not the obligation, to market its share of gas from the well without a split connection provided Hallwood is compensated for transporting that gas through the Hallwood gathering system. If Merrion does not like the terms and conditions of that contractual arrangement, then Merrion has the absolute right to make its own connections or other arrangements for taking its share of gas at the wellhead.

The language of the Division's compulsory pooling orders have remained virtually unchanged for more than twenty years. The Division does not have authority to resolve contractual disputes or make contractual terms for parties. Nor does the Division need to have complicated and lengthy regulatory hearings involving detailed analysis of the economics of gas gathering and marketing and salt water disposal.

Merrion's asserts that "Hallwood has a conflict of interest in operating the well and also being the owner of the gas gathering and water disposal facilities. Therefore, we are filing a parallel application to protect our rights and to attempt to gain control of the operations." See Exhibit (7).

Contrary to Merrion's assertion, it is common tax planning practice for an oil and gas company to have an affiliated company which holds title to its oil and gas leases and another affiliated company to be its "operating company" which is designated as operator. Such an arrangement is legal, appropriate and is not a "conflict of interest".

In addition, it is also common for an oil and gas company (For example, Yates Petroleum Corporation, Nearburg Exploration Company, and others) to create an affiliated company which will finance, construct and operate a salt water disposal facility and then to dispose of produced water charging a fee to Yates and the other working interest owner in those wells. A similar arrangement is also made for gas gathering systems. Such arrangements are legal, appropriate and are not "conflicts of interest".

In these circumstances, the one and only question should be: "Did Hallwood offer all working interest owners, including Merrion, the same charges for gas transportation from this well and for disposal of produced water? If the answer is "Yes" then correlative rights are protected and the Division's jurisdiction stops. Correctly, Division pooling orders do not adopt, ratify, approve, reference or otherwise impose any of the terms and conditions for how the gas is to be gathered and marketed.

The Division's authority is to pool the acreage when there is an absence of a voluntary agreement--not to establish gas gathering rates or salt water disposal fees.

Just as the Division does not set the prices for acquisition of a lease or farmout or provide for the recovery of exploration costs, likewise, the Division does not determine the costs of gathering, transporting, salt water disposal or the price paid for the gas.

Under a New Mexico compulsory pooling order each interest owner is permitted to market their gas in kind and to sell, for their own account, the entire production stream when other owners fail to take or market their proportionate share of gas. In addition, the Division has jurisdiction to resolve balancing problems when one interest owner takes more than their share of gas under a compulsory order, but has no jurisdiction to determine at what price that gas is sold or to what costs it is subject to after it is produced to the surface.

Correlative rights is simply the opportunity to market or share in production. The Division provides such a marketing opportunity to Merrion when Merrion can take its share of gas in kind and make its own gathering/disposal and transportation arrangements. The Division should not get into the business of regulating the terms and conditions **because** the Division only has jurisdiction to resolve disputes over the costs of drilling and completing the subject well and not the post production expenses attributed to transporting the gas or disposing of produced water.

To suggest that the Division can and should decide the costs of gas gathering in a compulsory pooling order is to require the Division to undertake the involved and complicated task of determining transportation rate schedule for gathering gas from a well and transporting it to its next distribution point as that product moves to its market.

Hallwood will be operating the well for benefit of those interest owners willing to pay for the gathering of the gas by Hallwood and if not then those interest owners have the absolute right to take their share of gas production in kind and make their own marketing arrangements to their sole satisfaction.

CONCLUSION

Merrion's dispute with Hallwood over (a) the transportation fee Merrion would have to pay to Hallwood if Merrion elected to use Hallwood's gathering line system rather than constructing its own gathering line and (b) over the costs of disposal of produced water must be dismissed because the Division only has jurisdiction to resolve disputes over the costs of drilling and completing the subject well and not the post production expenses attributed to transporting the gas or disposing of produced water.

The right to take its share of gas in kind **is the statutory** protection of Merrion's opportunity to produce its just and equitable share of gas and there is no need for the Division to attempt to assert jurisdiction over the issue of gas gathering or salt water disposal costs.

WHEREFORE requests that the Division Hearing Examiner grant this motion.

W. Thomas Kellahin
Kellahin & Kellahin
P. O. Box 2265
Santa Fe, New Mexico 87504
(505) 982-4285

CERTIFICATE OF SERVICE

I certify that a copy of this pleading was transmitted by facsimile to ~~counsel for~~ PC Merrion Oil & Gas this 19th day of July, 1996.

W. Thomas Kellahin

4582 South Ulster Street Parkway • Stanford Place III • Suite 1700 • Post Office Box 378111
Denver, Colorado 80237 • (303) 850-7373

March 22, 1996

Merrion Oil & Gas
610 Reilly Avenue
Farmington, NM 87499
Attn: Crystal Williams

Re: T32N-R13W-27: N/2
San Juan County, NM

Dear Ms. Williams:

Pursuant to your letter dated February 21, 1996, please be advised that Hallwood Petroleum, Inc., as Agent for EM Nominee Partnership Company and Hallwood Consolidated Partners, L.P. does not desire to sell or farmout its interest in the referenced lands. Rather, Hallwood wishes to pursue the drilling of a fruitland coal test well with the leasehold owner within the spacing unit.

Hallwood proposes to operate such well where Hallwood and its partners may benefit from Hallwood's extensive gathering system and imminent conversion of the Cardon Com #1 well (1130'FNL, 1050'FEL, 27-T32N-R13W) to a salt water disposal well. Hallwood Petroleum, Inc., plans to use the Cardon Com #1 well for disposal from additional Hallwood operated wells. If water from nonoperated wells are disposed of in the Cardon Com #1 well, such well must be classified as a commercial well and Hallwood does not want to be regulated as an Operator of a commercial salt water disposal well nor does Hallwood wish to sell the Cardon Com well.

Hallwood is not seeking any further acreage acquisition within the spacing unit for its own account and understands that you may be under a verbal or written contract with San Juan Coal Company (BHP) for its mineral interest. In the event you secure the remaining unleased acreage within the spacing unit and wish to pursue drilling a fruitland coal test well jointly with Hallwood, please contact the undersigned at (303) 850-6227 to discuss this matter further.

Sincerely,
HALLWOOD PETROLEUM, INC.

Connie Heath

Connie Heath
District Land Manager
Rocky Mountain/Mid-Continent District

EXHIBIT
1

Hallwood Energy Companies
4582 South Ulster Street Parkway • Stanford Place III • Suite 1700 • Post Office Box 378111
Denver, Colorado 80237 • (303) 850-7373

April 12, 1996

CERTIFIED MAIL

Merrion Oil & Gas
610 Reilly Avenue
Farmington, NM 87499
Attn: Ms. Crystal Williams

Hegarty & Associates
12 Hilltop Avenue
P.O. Box 64
Farmington, NM 87499
Attn: Patrick Hegarty

Union Oil of California
P.O. Box 4551
Houston, TX 77210-4551
Attn: Ms. Judy Fine

Re: Mead 27-1
San Juan County, NM

Ladies and Gentlemen:

Enclosed is Hallwood's AFE 6142005 whereby Hallwood proposes the drilling of a well to a depth sufficient to adequately test the Fruitland Coal formation at approximately 2,050 feet subsurface. The N/2 of Section 27-T32N-R13W will be the spacing unit for the proposed well. Should you desire to participate to the full extent of your interest in the drilling, testing and completion of this proposed well, please return an executed copy of the AFE to the undersigned within thirty (30) days from receipt hereof.

Upon receipt of the executed AFE, Hallwood will prepare a joint operating agreement for your review and execution.

If you have any questions concerning this matter, please contact the undersigned at (303) 850-6227.

Sincerely,
HALLWOOD PETROLEUM, INC.

Connie Heath

Connie Heath
District Land Manager
Rocky Mountain/Mid-Continent District

EXHIBIT
2

OPERATOR: Hallwood Petroleum, Inc.	AFE NO: 6142005
WELL NAME: Mead #27-1	DATE: 4/10/96
LOCATION: SE NE Section 27-T32N-R13W (N/2 Spacing Unit)	
COUNTY: San Juan / STATE: NM	PREPARED BY: Kevin E. O'Connell
PROJECT DESCRIPTION: Drill and complete a 2050' Fruitland Coal well.	

ACCOUNT DRILLING INTANGIBLES	DESCRIPTION	AFE AMOUNT
800.009	Drilling Title Opinion & Legal Fees	$ 5,500
800.085	Permits, Survey, Damages	9,000
800.050	Location, Roads & Lease Restoration	3,500
800.022	Rig Mobilization/Demobilization (included in footage)	----
800.037	Footage/Turnkey Drlg 2050/ft. @ $ 15.50/ft	31,775
800.029	Daywork Drilling 1 days @ $ 4200 day	4,200
800.041	Fuel Lubricants	----
800.047	Bits	----
800.045	Water/Water Well	1,500
800.076	Equipment Rental - Surface	500
800.077	Tool & Equipment Rental - Subsurface	----
800.026	Miscellaneous Equipment/Supplies	500
800.062	Drilling Mud/Additives	----
800.012	Contract Labor	500
800.144	Casing Crews	----
800.040	Cementing Services	2,800
800.079	Mud Logging	----
800.088	Coring	----
800.111	DST: ________/ DST's @ $________/DST	----
800.099	Open Hole Logging	4,000
800.101	Engineering & Supervision ______days @ $________/day	----
800.110	Overhead: Drilling 4 days @ $ 250 /day	1,000
800.014	Geological Services ______days @ $________/day	----
800.017	Water Transportation	1,000
800.070	Risk Management	----
800.165	Environmental	----
800.166	Pipe/Collar Insurance	----
800.444	Other	----
800.663	P & A	----
800.800	Miscellaneous Contingency	2,000
	SUBTOTAL INTANGIBLES	$67,775
	DRILLING TANGIBLES	
810.210	Surface Casing 350 ft, 8 5/8 ", 24 #/ft. @ $ 9.00 /ft	$ 3,150
810.215	Intermediate Casing ______ft, ______", ______#/ft. @ $______/ft	----
810.220	Casing Equipment	750
810.230	Casing Head	1,000
810.800	Miscellaneous Contingency	----
	SUBTOTAL TANGIBLES	$ 4,900
	TOTAL DRY HOLE COSTS	$72,675

WELL NAME: Mead #27-1	AFE NO: 6142005

ACCOUNT	COMPLETION INTANGIBLES DESCRIPTION	AFE AMOUNT
805.040	Cementing Services	$ 5,000
805.050	Dirtwork, Roads & Location	2,500
805.029	Completion Unit Swab Rig 8 days @ $ 1,550/day	12,400
805.076	Equipment Rental - Surface	1,500
805.077	Tool & Equipment Rental - Subsurface	----
805.026	Misc. Equipment & Supplies	1,500
805.045	Water Hauling/Completion Fluids	8,000
805.033	Cased Hole Wireline Service	1,500
805.065	Stimulation & Treatment	60,000
805.067	Testing, BHP Fluid Analysis, etc.	3,000
805.017	Transportation	----
805.012	Contract Labor	3,000
805.144	Casing Crews	----
805.101	Engineering & Supervision 14 days @ $ 250 /day	3,500
805.110	Overhead Completion _____days @ $______/day	----
805.085	Permanent Damages, Permits	----
805.015	Blowout Prevention Equipment	----
805.070	Risk Management	----
805.800	Miscellaneous Contingency	----
	SUBTOTAL TANGIBLES	$101,900
	COMPLETION TANGIBLES	
815.010	Csg: Prod & Liner 2050 ft, 5 1/2 ", 15.5 #/ft, @ $ 5.75 /ft	$ 11,800
815.010	Csg: Accessories	6,000
815.025	Wellhead/Christmas Tree	2,500
815.011	Prod. Tubing 2,000 ft, 2 7/8 ", 6.5 #/ft, @ $ 1.75 /ft	3,500
815.036	Pumping Unit & Prime Mover	7,000
815.077	Subsurface Equipment - Rods	1,800
815.077	Subsurface Equipment - Bottom Hole Pump	1,200
815.044	Surface Separation Equipment	15,000
815.040	Tanks with Fittings, Stairs	8,000
815.050	Lines, Flow, Fuel, SWD	----
815.060	Pipe Line Installation	----
815.055	Valves, Fittings, Misc. Equipment	3,000
815.066	Electrical Equipment	----
815.012	Contract Labor	----
815.100	Platform (Offshore)	----
815.101	Engineering/Supervision	----
815.105	Platform Production Facility	----
815.110	Platform Pipe/Electrical	----
815.120	Platform Waterflood Facility	----
815.152	Purchased Compressor	----
815.800	Miscellaneous Contingency	----
	SUBTOTAL TANGIBLES	$ 59,800
	TOTAL COMPLETION COSTS	$161,700
	TOTAL WELL COSTS	$234,375

AFE9508TB.XC

permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

1. ☐ Addressee's Address
2. ☐ Restricted Delivery
Consult postmaster for fee.

Is your RETURN ADDRESS completed on the r...

3. Article Addressed to:
Union Oil of California
Attn: Ms. Judy Fine
P.O. Box 4551
Houston, TX 77210-4551

4a. Article Number
P 324 481 397

4b. Service Type
☐ Registered ☒ Certified
☐ Express Mail ☐ Insured
☐ Return Receipt for Merchandise ☐ COD

7. Date of Delivery
APR 18 1996

5. Received By: (Print Name)

8. Addressee's Address (Only if requested and fee is paid)

6. Signature: (Addressee or Agent)
X CURTIS NICKERSON

PS Form 3811, December 1994 Domestic Return Receipt

Thank you for using Return Receipt Servic...

Is your RETURN ADDRESS completed on the reverse side?

SENDER:
- Complete items 1 and/or 2 for additional services.
- Complete items 3, 4a, and 4b.
- Print your name and address on the reverse of this form so that we can return this card to you.
- Attach this form to the front of the mailpiece, or on the back if space does not permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

I also wish to receive the following services (for an extra fee):
1. ☐ Addressee's Address
2. ☐ Restricted Delivery
Consult postmaster for fee.

3. Article Addressed to:
Hegarty & Associates
Attn: Patrick Hegarty
12 Hilltop Avenue
P.O. Box 64
Farmington, NM 87499

4a. Article Number
P 324 481 396

4b. Service Type
☐ Registered ☒ Certified
☐ Express Mail ☐ Insured
☐ Return Receipt for Merchandise ☐ COD

FARMINGTON NM USPS

7. Date of Delivery

5. Received By: (Print Name)
Kelly Hegarty

8. Addressee's Address (Only if requested and fee is paid)

6. Signature: (Addressee or Agent)
X Kelly Hegarty

PS Form 3811, December 1994 Domestic Return Receipt

Thank you for using Return Receipt Service.

Is your RETURN ADDRESS completed on the reverse side?

SENDER:
- Complete items 1 and/or 2 for additional services.
- Complete items 3, 4a, and 4b.
- Print your name and address on the reverse of this form so that we can return this card to you.
- Attach this form to the front of the mailpiece, or on the back if space does not permit.
- Write "Return Receipt Requested" on the mailpiece below the article number.
- The Return Receipt will show to whom the article was delivered and the date delivered.

I also wish to receive the following services (for an extra fee):
1. ☐ Addressee's Address
2. ☐ Restricted Delivery
Consult postmaster for fee.

3. Article Addressed to:
Merrion Oil and Gas
Attn: Ms. Crystal Williams
610 Reilly Avenue
Farmington, NM 87499

4a. Article Number
P 324 481 395

4b. Service Type
☐ Registered ☒ Certified
☐ Express Mail ☐ Insured
☐ Return Receipt for Merchandise ☐ COD

7. Date of Delivery
4-17-96

5. Received By: (Print Name)
Esther Greyeyes

8. Addressee's Address (Only if requested and fee is paid)

6. Signature: (Addressee or Agent)
X Esther Grey

PS Form 3811, December 1994 Domestic Return Receipt

Thank you for using Return Receipt Service.

Hallwood Energy Companies
4582 South Ulster Street Parkway • Stanford Place III • Suite 1700 • Post Office Box 378111
Denver, Colorado 80237 • (303) 850-7373

June 11, 1996

Merrion Oil & Gas
610 Reilly Avenue
Farmington, NM 87499
Attn: Mr. George Sharp

Re: Mead 27-1
San Juan County, NM

Dear Mr. Sharp:

Pursuant to our discussion of this date, the following information was gathered in an effort to answer several questions Merrion has concerning Hallwood's impending drilling and subsequent operations of the referenced well. Hallwood anticipates a disposal fee of $1/barrel of salt water disposed in the Cardon Com #1 well to be the going rate for such water facility. This rate is competitive with charges of similar nature paid by Hallwood to other Operators of disposal wells in the LaPlata area. Hallwood will not charge any capitalization costs to users of the Cardon Com #1 well. Hallwood plans to utilize the Cardon Com #1 well for water disposal from other Hallwood operated wells in the area and such disposal fees will be charged on a well by well basis in accordance with monthly water disposal rates.

Hallwood will charge a marketing fee (consulting fee) for any marketing effort performed on behalf of its partners. Such fee is based on a fixed percentage (less than 7%) applied to all value received above the posted index price. In the event the value received is ever below the posted index price, a credit would be applied to your account. This marketing method guarantees Hallwood and its partners a minimum of the posted index price as well as insuring a profit above the posted index price. Such marketing fee is paid to a third party consultant and Hallwood bears its share of these charges along with any partner in the well. In lieu of paying the consulting fee, Merrion is always entitled to market its own share of production.

The producing overhead rate as proposed in the JOA is competitive with other Fruitland Coal Operators at $452/month and well within the published COPAS rates. This rate is necessary to compensate Hallwood for the complexity of operating wells and compressors in a 7 day/week operation. Hallwood operates over thirty Fruitland Coal wells in the San Juan basin and the foregoing overhead rate has been acceptable to its partners. Hallwood continues to strive for low operating costs were feasible and prudent.

EXHIBIT
3

If you have any questions concerning the information provided herein, please call me at (303) 850-6227. Additionally, please execute and return the AFE to the undersigned at your earliest convenience along with your suggested changes and comments to the proposed JOA. Hallwood is moving forward with a Drilling Title Opinion and settlement of surface damages. Hallwood anticipates a late July spud for this well assuming a minimal amount of title curative.

Sincerely,
HALLWOOD PETROLEUM, INC.

Connie Heath

Connie Heath
District Land Manager
Domestic Operations Group

MERRION

OIL & GAS

RECEIVED
JUN 25 1996
ROCKIES/MID. CONT.

June 20, 1996

Ms. Connie Heath
District Land Manager
Hallwood Petroleum, Inc.
P.O. Box 378111
Denver, Colorado 80237

Re: Mead 27-1
San Juan County, NM

Dear Connie:

Thank you for your response to some of the questions I voiced in our phone conversation a few weeks back. This letter outlines some additional questions and concerns that Merrion needs addressed before we will execute an AFE and an Operating Agreement.

1.) AFE Costs - In general, the $234,000 to drill and complete a 2000 foot well seems pricey. Merrion feels that we could drill the well significantly cheaper. Specific issues:

a.) The $15.50/foot drilling cost appears to be for a large rig. Could you use a shallow rig (e.g. Ludwig)?

b.) Is 5 1/2" casing needed? With anticipated water production rates of less than 50 BWPD, would 4 1/2" casing be more prudent?

c.) The AFE did not appear to cover a gas meter or any line pipe to tie the well in for gas sales or to tie the water in to your disposal well.

2.) Overhead Rates - Merrion still feels the $452/month overhead rate is too high. If Hallwood cannot operate for less, then Merrion wants to operate and would be willing to do so at an overhead rate of $300/month. This would be to the benefit of the limited partnerships which Hallwood represents and who are the true working interest owners in the well.

EXHIBIT
4

3). <u>Water Disposal Costs</u> - Merrion feels the \$1.00/Bbl disposal fee that Hallwood Petroleum anticipates charging the producing wells is too high. With true ongoing operating costs in the \$.10 to \$.20/Bbl range, the fee certainly includes allowances for capital recovery. While we acknowledge that Hallwood Petroleum needs to recover the cost to convert the well to injection, we feel that a fee of less than the average \$.73/Bbl we pay at Sunco would be much more reasonable and would certainly benefit Hallwood's limited partnerships that are owners in the producing wells.

4.) <u>Water Disposal Well Operations</u> - Hallwood argues that they, rather than Merrion, should operate the Mead 27-1 so that the water disposal well they operate won't be treated as a commercial facility. Merrion disagrees. First, it appears that Hallwood Petroleum has already set the disposal well up to be a commercial facility, with them owning the injection well and charging rates that are far from a bargain to the working interest owners in the wells (i.e., Merrion, Hallwood's limited partnerships, etc.). Except for the rates charged, Merrion does not have a problem with that. However, regardless of the set up, according to Ernie Busch of the NMOCD, as long as the well has a UIC permit for the injection of Fruitland Coal water, then no matter what wells the water comes from and who operates and/or owns those wells, everything is covered from a regulatory standpoint. A special permit for a commercial facility is only needed if an evaporation pond or other disposal method is used. Therefore, Hallwood could accept water from Merrion operated wells, and with two more wells planned by Merrion, we would want your agreement to do this.

5.) <u>Transfer of Operations</u> - Per our phone conversation, Merrion will not agree to allow operations to automatically transfer to a buyer unless that buyer is a Hallwood related entity.

6.) <u>Gas Balancing</u> - Hallwood's proposal to market Merrion's gas was reasonable. Should Merrion ultimately be the operator, we would offer similar terms. Hopefully, therefore, gas balancing may never be an issue. Nonetheless, a gas balancing agreement is still needed, and we have only one problem with your proposed form. Merrion suggests that any cash settlement at the termination of production be at the <u>then current price, not the price actually received.</u>

Connie, we look forward to amicably working out these issues and ultimately drilling a successful well. If agreeable, please remit a revised AFE and Operating Agreement with the changes outlined herein. Thank you for your consideration.

Sincerely,

George F. Sharpe
Manager - Oil & Gas Investments

xc: CW, TGM

GFS:pag

MERRION

OIL & GAS

July 1, 1996

RECEIVED RM & MC

JUL 8 - 1996

OPER. HPI DENVER

Ms. Connie Heath
District Land Manager
Hallwood Petroleum, Inc.
P.O. Box 378111
Denver, Colorado 80237

Re: Mead 27-1
San Juan County, New Mexico

Dear Ms. Heath:

Thank you for calling me back on the issues outlined in my June 20, 1996 letter. We seem to have agreement in several areas (AFE costs, transfer of operations, and gas balancing). However, Merrion still has some existing concerns that must be addressed before we will execute an AFE and an Operating Agreement. Specifically, those are:

1.) The $1.00/Bbl disposal fee is too high, though it will save money over the competition because of the proximity of the disposal well to the producing well. We would agree to that only if you would agree to allow Merrion to utilize your injection well (should you have excess injection capacity) for our other two coal wells planned for the area under the same provisions.

2.) The $.25/MCF gathering and compression fee (which I just became aware of in our phone conversation) is totally unacceptable, and is not in the best interest of any working interest owner, save Hallwood Petroleum Inc., as the General Partner of your limited partnerships. Only one half mile away, El Paso is obligated to tie in the well at their expense if the well makes over 300 MCFD (which we all think it will or we wouldn't be drilling it). The only incremental cost, therefore, is for compression. Attached is a rough calculation showing that $.05/MCF is the true cost (including capital recovery) of compression.

EXHIBIT
5

610 Reilly Avenue • Farmington, New Mexico 87401-2634 • 505-327-9801 / 505-326-5900 (Fax)

3.) Your counter-proposal of a $375/month overhead rate is still too high. Again, Merrion offers to operate the well at a $300/month overhead rate. However, assuming we can come to terms on water disposal and gas gathering, Merrion would agree to pay Hallwood $350/month for operating overhead. The drilling overhead rate would be adjusted proportionately.

Connie, Merrion does not mean to be contentious. However, we truly believe that the fees you have set for Hallwood Petroleum's services are too high, not negotiated at arms length, and not in the best interest of all the working interest owners in the well. We hope we can come to terms on these issues.

Please call me with any questions. We would still be interested in a field tour the week of July 8th.

Sincerely,

GFSharpe

George F. Sharpe
Manager - Oil & Gas Investments

cc: TGM, CW

tc

MERRION
OIL & GAS

July 9, 1996

RECEIVED
JUL 15 1996
ROCKIES/MID. CONT.

TO ALL INTERESTED PARTIES ENTITLED TO NOTICE OF HEARING OF THE FOLLOWING NEW MEXICO OIL CONSERVATION DIVISION CASE:

RE: Application of Merrion Oil & Gas Corporation
for Compulsory Pooling
San Juan County, New Mexico

Enclosed please find our application for a compulsory pooling for the Mead 27-1 Well which has been set for hearing on the New Mexico Oil Conservation Division Examiner's docket now scheduled for August 8, 1996. The hearing will be held at the Division hearing room located in Santa Fe, New Mexico.

As an interest owner who may be affected by the application, we are notifying you of your right to appear at the hearing and participate in this case, including the right to present evidence either in support of or in opposition to the application. Failure to appear at the hearing may preclude you from any involvement in this case at a later date.

Pursuant to the Division's Memorandum 2-90, you are further notified that if you desire to appear in this case, then you are requested to file a Pre-Hearing Statement with the Division no later than 4:00 PM on Friday, August 2, 1996, with a copy delivered to the undersigned.

Yours truly,

MERRION OIL & GAS CORPORATION

GF Sharpe

George F. Sharpe
Manager-Oil & Gas Investments

cc: By certified mail-Return receipt requested to all parties listed in application.

610 Reilly Avenue • Farmington, New Mexico 87499 • 505-327-9801 / 505-326-5900 (Fax)

EXHIBIT
6

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

IN THE MATTER OF THE APPLICATION
OF MERRION OIL & GAS CORPORATION
FOR COMPULSORY POOLING,
SAN JUAN COUNTY, NEW MEXICO

CASE NO.______________

APPLICATION

Comes now MERRION OIL & GAS CORPORATION, in accordance with Section 70-2-17(c) (1978) applies to the New Mexico Oil Conservation Division for an order pooling all mineral interests in the Basin Fruitland Coal Gas Pool underlying the N/2 of Section 27, T32N, R13W, NMPM, San Juan County, New Mexico, forming a standard 320-acres spacing and proration unit for any production from the Undesignated Basin Fruitland Coal Gas Pool. Said unit is to be dedicated to its Mead 27-1 Well to be drilled and completed at a standard well location in Unit H of said Section 27. Also to be considered will be the costs of drilling and completing said well and the allocation of the costs thereof as well as actual operating costs and charges for supervision, designation of Merrion Oil & Gas Corporation as the operator of the well and a charge for risk involved in said well.

WHEREFORE, Merrion, as applicant, requests that this application be consolidated with the application of Hallwood Petroleum Inc. dated July 2, 1996, covering said well, and be set for hearing on August 8, 1996, before the Division's duly appointed examiner, and that after notice and hearing as required by law, the Division enter its order pooling the mineral interest described in the appropriate spacing unit for the drilling of the subject well at a standard well location upon terms and conditions which include:

1. Merrion Oil & Gas Corporation be named operator;

2. Provisions for applicant and all working interest owners to participate in the costs of drilling, completing, equipping and operating the well;

3. In the event a working interest owner fails to elect to participate, then provision be made to recover out of production, the costs of the drilling, completing, equipping and operating the well, including a risk factor penalty of 200%;

4. Provision for overhead rates per month drilling and per month operating and a provision providing for an adjustment method of the overhead rates as provided by COPAS;

5. Provisions pooling any non-participating royalty interest owners; and

6. For such other and further relief as may be proper.

In accordance with the Division's notice requirements, a copy of this application has been sent by certified mail to the following working interest owners in the well:

EM Nominee Partnership Company
4582 South Ulster Street Parkway, Suite 1700
Denver, CO 80237

Hallwood Consolidated Partners, L.P
4582 South Ulster Street Parkway, Suite 1700
Denver, CO 80237

Union Oil Company of California
P.O. Box 4551
Houston, TX 77210-4551

Yours truly,

MERRION OIL & GAS CORPORATION

George F. Sharpe
Manager-Oil & Gas Investments

MERRION

OIL & GAS

July 10, 1996

RECEIVED

JUL 15 1996

ROCKIES/MID. CONT.

Hallwood Consolidated Partners, LP
c/o Hallwood Petroleum
Attn: Ms. Connie Heath
4582 S. Ulster Street Pkwy., Suite 1700
Denver, Colorado 80237

Re: **Mead 27-1**
San Juan County, New Mexico

Dear Connie:

Per our phone conversation, enclosed are the following:

1.) AFE for $226,250 to drill the Mead 27-1;

2.) Operating Agreement for subject well;

3.) Force Pooling Application for subject well.

As you know, Merrion has been force pooled by Hallwood because we disagree with your plans for operations of the well. We feel that Hallwood has a conflict of interest in operating the well and also being the owner of the gas gathering and water disposal facilities. Therefore, we are filing a parallel application to protect our rights and to attempt to gain control of the operations.

We intend to cooperate with you in preparation for the force-pool hearing, and trust the OCD will make a fair and wise decision. Regardless of the outcome, we intend to cooperate with you in the drilling of what hopefully will be a successful well.

Please call me with any questions.

Sincerely,

George F. Sharpe
Manager - Oil & Gas Investments

xc: TGM, CW, TR

610 Reilly Avenue • Farmington, New Mexico 87401 • 505-327-9801 / 505-326-5900 (Fax)

EXHIBIT

7

Authority for Expenditure (AFE)
Drilling Well Cost Estimate

AFE No. 96031 **AFE Type:** 1 **Lease:** Mead 27 **Well No:** 1

Accounting Well No.		**Project:**	Drill Fruitland Coal Well	**Field:**	Basin Fruitland
Location:	1800' fnl & 790' fel (se ne)	**Lease No:**		**TD:**	2,050 ft
	Sec 27, T32N, R13W	**Spacing:**	320 Acres	**Operator:**	Merrion Oil & Gas
County:	San Juan **State:** NM	**Unit:**		**By:**	Steven S. Dunn

Division of Interest:	[illegible]		[illegible]		[illegible]	
	Dry Hole	Completed	WI	NRI	WI	NRI
1) MERRION OIL & GAS	$ 25,513	$ 81,972	36.250000%		36.250000%	
2) HALLWOOD CONSOLIDATED PARTNERS, LP	$ 18,035	$ 57,946	25.625000%		25.625000%	
3) EM NOMINEE PARTNERSHIP CO.	$ 22,434	$ 62,346	31.875000%		25.625000%	
4) UNION OIL CO. OF CALIFORNIA	$ 4,398	$ 14,133	6.250000%		6.250000%	
Total	$ 70,380	$ 226,130	100.000000%		93.750000%	

Intangibles - Drilling (1605)					Dry Hole	Completed
230 ROW Acquisition & Surface Damages					$ 4,000	$ 4,000
220 Survey, Archaeology, Permitting					$ 1,000	$ 1,000
201 Drilling Rig	Footage Cost	2,050 feet @	$13.50	per foot...	$ 27,700	$ 27,700
202	Daywork	1 days @	$3,800	per day.....	$ 3,800	$ 3,800
203 Location Construction, anchors					$ 3,500	$ 3,500
204 Cement & Cementing	Surface Casing				$ 2,800	$ 2,800
204 Cement & Cementing	Long String				$ 3,800	$ 5,000
206 Open Hole Surveys					$ 4,000	$ 4,000
207 Legal Fees					$ 3,500	$ 3,500
208 Drilling Supervision		2 days @	$350	per day.....	$ 700	$ 700
210 Miscellaneous					$ 1,500	$ 1,500
211 Trucking					$ 350	$ 1,000
212 Drilling Water					$ 250	$ 250
212 Drilling mud					$ 2,000	$ 2,000
213 Administrative & General Expense		12 days @	$115	per day.....	$ 1,380	$ 1,380
Contingency	5%				$ 3,000	$ 3,100
Total Intangibles - Drilling					$ 62,980	$ 65,230

Intangibles - Completion (1610)					Dry Hole	Completed
301 Completion Rig		8 days @	$1,950	per day.....		$ 15,600
303 Perforating & Logging						$ 2,500
304 Stimulation						$ 60,000
306 Location Cleanup					$ 2,500	$ 1,250
308 Company Supervision		12 days @	$350	per day.....	$ 350	$ 4,200
309 Roustabout Labor		4 days @	$900	per day.....		$ 3,600
309 Welder		2 days @	$350	per day.....		$ 700
310 Bit & Scraper						$ 1,000
310 Tool, tbg & equipment Rental						$ 1,000
310 Tank & Miscellaneous rentals						$ 500
311 Water (includes trucking)						$ 3,000
311 Trucking						$ 1,000
Contingency	2.0%					$ 1,900
Total Intangibles - Completion					$ 2,850	$ 96,250
Total Intangibles - Drilling & Completion					$ 65,830	$ 161,480

Tangibles - Drilling & Completion (1640)							Dry Hole	Completed
805 Casing	Surface	8-5/8" 24#	350	feet @	$ 9.25	per foot	$ 3,200	$ 3,200
806	Production	5-1/2 15.5#	2,050	feet @	$ 4.75	per foot		$ 9,700
811 Tubing	2-7/8" 6.5# EUE J55 used		2,000	feet @	$ 2.12	per foot		$ 4,200
851 Flowline	3" Line Pipe		500	feet @	$ 1.50	per foot		$ 800
827 Sucker Rods	3/4" SM Cplg, used		2,000	feet @	$ 0.97	per foot		$ 1,900
820 Wellhead equipment							$ 850	$ 3,500
815 Float equipment							$ 500	$ 1,500
830 Bottomhole Pump								$ 1,350
836 Pumping Unit & Engine	114 API used w/ FM 346 used							$ 15,000
840 Tank & Separator								$ 20,000
860 Fittings, valves, fencing, concrete & miscellaneous								$ 3,000
896 Miscellaneous								$ 500
Total Tangibles							$ 4,550	$ 64,650

Total Estimated Cost $ 70,380 $ 225,130

Approved: T. Greg Merrion Date: 7-10-96
Merrion Oil & Gas Corporation

Approved: ______________________ Date: ______________
Partner

Authority for Expenditure (AFE)

Drilling Well Cost Estimate

AFE No. 96031	**AFE Type:** 1	**Lease:**	**Mead 27**	**Well No:**	**1**
Accounting Well No.		**Project:**	Drill Fruitland Coal Well	**Field:**	Basin Fruitland
Location:	1800' fnl & 790' fel (se ne)	**Lease No:**		**TD:**	2,050 ft
	Sec 27, T32N, R13W	**Spacing:**	320 Acres	**Operator:**	Merrion Oil & Gas
County:	San Juan **State:** NM	**Unit:**		**By:**	Steven S. Dunn

Division of Interest: [redacted]

	Dry Hole	Completed	WI	NRI	WI	NRI
1) MERRION OIL & GAS	$ 25,513	$ 81,972	36.250000%		36.250000%	
2) HALLWOOD CONSOLIDATED PARTNERS, LP	$ 18,035	$ 57,946	25.625000%		25.625000%	
3) EM NOMINEE PARTNERSHIP CO.	$ 22,434	$ 62,345	31.875000%		25.625000%	
4) UNION OIL CO. OF CALIFORNIA	$ 4,398	$ 14,133	6.250000%		6.250000%	
Total	$ 70,380	$ 228,130	100.000000%		93.750000%	

Intangibles - Drilling (1606)

					Dry Hole	Completed
230	ROW Acquisition & Surface Damages				$ 4,000	$ 4,000
220	Survey, Archaeology, Permitting				$ 1,000	$ 1,000
201	Drilling Rig Footage Cost	2,050 feet @	$13.50	per foot...	$ 27,700	$ 27,700
202	Daywork	1 days @	$3,800	per day.....	$ 3,800	$ 3,800
203	Location Construction, anchors				$ 3,500	$ 3,500
204	Cement & Cementing Surface Casing				$ 2,800	$ 2,800
204	Cement & Cementing Long String				$ 3,500	$ 5,000
206	Open Hole Surveys				$ 4,000	$ 4,000
207	Legal Fees				$ 3,500	$ 3,500
208	Drilling Supervision	2 days @	$350	per day.....	$ 700	$ 700
210	Miscellaneous				$ 1,500	$ 1,500
211	Trucking				$ 350	$ 1,000
212	Drilling Water				$ 250	$ 250
212	Drilling mud				$ 2,000	$ 2,000
213	Administrative & General Expense	12 days @	$115	per day.....	$ 1,380	$ 1,380
	Contingency 5%				$ 3,000	$ 3,100
	Total Intangibles - Drilling				$ 62,980	$ 65,230

Intangibles - Completion (1610)

					Dry Hole	Completed
301	Completion Rig	8 days @	$1,950	per day.....		$ 15,600
303	Perforating & Logging					$ 2,500
304	Stimulation					$ 60,000
306	Location Cleanup				$ 2,500	$ 1,250
308	Company Supervision	12 days @	$350	per day.....	$ 350	$ 4,200
309	Roustabout Labor	4 days @	$900	per day.....		$ 3,600
309	Welder	2 days @	$350	per day.....		$ 700
310	Bit & Scraper					$ 1,000
310	Tool, tbg & equipment Rental					$ 1,000
310	Tank & Miscellaneous rentals					$ 500
311	Water (includes trucking)					$ 3,000
311	Trucking					$ 1,000
	Contingency 2.0%					$ 1,900
	Total Intangibles - Completion				$ 2,850	$ 96,250
	Total Intangibles - Drilling & Completion				$ 65,830	$ 161,480

Tangibles - Drilling & Completion (1640)

							Dry Hole	Completed
805	Casing Surface	8-5/8" 24#	350	feet @	$ 9.25	per foot	$ 3,200	$ 3,200
806	Production	5-1/2 15.5#	2,050	feet @	$ 4.75	per foot		$ 9,700
811	Tubing 2-7/8" 6.5# EUE J55 used		2,000	feet @	$ 2.12	per foot		$ 4,200
851	Flowline 3" Line Pipe		500	feet @	$ 1.50	per foot		$ 800
827	Sucker Rods 3/4" SM Cplg, used		2,000	feet @	$ 0.97	per foot		$ 1,900
820	Wellhead equipment						$ 850	$ 3,500
815	Float equipment						$ 500	$ 1,500
830	Bottomhole Pump							$ 1,350
836	Pumping Unit & Engine 114 API used w/ FM 346 used							$ 15,000
840	Tank & Separator							$ 20,000
860	Fittings, valves, fencing, concrete & miscellaneous							$ 3,000
896	Miscellaneous							$ 500
	Total Tangibles						$ 4,550	$ 64,650

Total Estimated Cost $ 70,380 $ 228,130

Approved: Tgregmerrion Date: 7-10-96
Merrion Oil & Gas Corporation

Approved: ____________________ Date: ____________________
Partner

Hallwood Energy Companies

4582 South Ulster Street Parkway • Stanford Place III • Suite 1700 • Post Office Box 378111
Denver, Colorado 80237 • (303) 850-7373

July 12, 1996

CERTIFIED MAIL
OVERNIGHT DELIVERY

Post-it™ brand fax transmittal memo 7671 | # of pages ▸ 6

To Tom Kellahin	From Connie Hedde
Co.	Co. Hallwood
Dept.	Phone # (303) 850-6227
Fax #	Fax #

Merrion Oil & Gas
610 Reilly Avenue
Farmington, NM 87401-2634
Attn: Mr. George Sharp

Re: Mead 27-1
San Juan County, NM

Dear Mr. Sharp:

Pursuant to your letter dated July 1, 1996 and subsequent telephone conference with myself and Kevin O'Connell of Hallwood, it appears Hallwood and Merrion are in agreement over several key issues with regard to drilling the proposed well. It is my understanding that Merrion does not have any objections to the following items as presented by Hallwood to Merrion in mid-April 1996:

1. Well Cost as presented by Hallwood's AFE #6142005
2. Well location, geological prognosis and drilling prognosis as presented with AFE #6142005
3. Proposed risk penalty of 100%/300% as presented in JOA
4. Deletion of Transfer of Operations under Article XVI.D.1 as presented in JOA
5. Acceptance of Gas Balancing Agreement as presented in Exhibit E to JOA

However, Merrion specifically objects to the following matters:

1. A $1.00/Bbl disposal fee into the Cardon Com #1 well which is owned and operated by Hallwood Petroleum Inc., and pending a successful conversion as a disposal well. Merrion would accept the $1.00/Bbl rate if Hallwood granted Merrion the right to utilize the injection well (assuming Hallwood has excess injection capacity) for two additional coal wells proposed by Merrion.

2. A $.25/MCF gathering and compression fee charged by Hallwood to all parties who contract with Hallwood to sell and market gas through the Hallwood owned and operated gathering system. Merrion would prefer to hook-up to the existing pipe line which extends from the Montoya 27-1 well located in the SE/4 of 27-T32N-R13W to the former Snyder Oil Tafoya #1A Mesaverde well in the SE/NW of 35-

EXHIBIT
8

32N-R13W and ties into El Paso's pipeline system. This portion of line was purchased by Hallwood in early 1991 and Hallwood does not currently utilize this portion of the line since completion of our gathering system in a configuration which gives Hallwood access to both El Paso and Williams.

3. A producing well rate of $375/month for overhead charges (reduced by Hallwood from the originally proposed $452/month). Ernst & Young 1995 survey for similar wells shows other Operators to be charging between $421 and $429.

Notwithstanding the foregoing objections, Merrion has offered to allow Hallwood to proceed with drilling the subject well prior to the force pooling hearing, then allowing the Director of the Oil Conservation Division to rule on evidence relative to Operations. While Merrion's option could save on rig move costs with Hallwood's ongoing operations in the area, Hallwood is not in favor of proceeding to drill the well without firmly establishing Operations. Merrion recognizes Hallwood's majority interest in the spacing unit and has suggested that the largest interest owner should be allowed to operate assuming there are no relevant discrepancies in operating costs, geological prognosis, etc.

Merrion's objections to the SWD rate and gathering fees have been addressed by Hallwood and Merrion may elect to take its gas in kind. Again the SWD rate quoted by Hallwood is cheaper than trucking the water to another disposal system and comparable for the Basin. Finally, Hallwood has compromised on the overhead rate and as an established operator of Fruitland Coal wells, Hallwood is well aware of the overhead expenses directly affecting each well and what an Operator is willing to bear.

Please be aware that Hallwood Petroleum, Inc., is the established Operating company for its two limited partnerships, EM Nominee Partnership Company and Hallwood Consolidated Partners, L.P. Hallwood's limited partners bear the same cost that Merrion or any other partner would be expected to bear. Your position that Hallwood is not negotiating at arms length or in the best interest of all the working interest owners in the well is simply not true.

Hallwood is still hopeful that a resolution may be worked out prior to the hearing on compulsory pooling but Hallwood remains firm in its position regarding Merrion's objections.

Sincerely,
HALLWOOD PETROLEUM, INC.

Connie Heath

Connie Heath
District Land Manager
Domestic Operations Group