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:	)	
APPLICATION OF TMBR/SHARP DRILLING, INC., FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	)	CASE NOS. 12,816
APPLICATION OF OCEAN ENERGY, INC., FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	)	12,841
APPLICATION OF DAVID H. ARRINGTON OIL AND GAS, INC., FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	)	12,859
APPLICATION OF OCEAN ENERGY, INC., FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO	)	and 12,860
	)	(Consolidated)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS
EXAMINER HEARING

BEFORE: MICHAEL E. STOGNER, Hearing Examiner

Volume II: May 17th, 2002
Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, MICHAEL E. STOGNER, Hearing Examiner, on Thursday, May 16th, and Friday, May 17th, 2002, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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I N D E X

May 17th, 2002 (Volume II)
Examiner Hearing
CASE NOS. 12,816 12,841 12,859 and 12,860 (Consolidated)

	PAGE
CUMULATIVE INDEX OF EXHIBITS	323
APPEARANCES	325
OCEAN WITNESS:	
RAY PAYNE (Engineer) (Continued)	
Redirect Examination by Mr. Bruce	327
Recross-Examination by Mr. Kellahin	331
Redirect Examination by Mr. Bruce	336
Recross-Examination by Mr. Kellahin	337
Further Examination by Mr. Bruce	337
Further Examination by Mr. Kellahin	339
Further Examination by Mr. Bruce	343
Further Examination by Mr. Kellahin	344
Examination by Examiner Stogner	347
ARRINGTON WITNESSES:	
ENICK DIFFEE (Landman)	
Direct Examination by Mr. Hall	351
Cross-Examination by Ms. Richardson	361
Examination by Mr. Brooks	374
Further Examination by Ms. Richardson	378
Redirect Examination by Mr. Hall	381
BILL BAKER, JR. (Geologist)	
Direct Examination by Mr. Hall	382
Cross-Examination by Mr. Kellahin	394
Redirect Examination by Mr. Hall	413
Examination by Examiner Stogner	414

(Continued...)

ARRINGTON WITNESSES (Continued):

CHARLES W. SLEDGE (Engineer)
Direct Examination by Mr. Hall 416
Cross-Examination by Mr. Kellahin 425
Examination by Examiner Stogner 428
Further Examination by Mr. Kellahin 431
Further Examination by Examiner Stogner 433

CLOSING STATEMENTS
By Mr. Hall 434
By Mr. Bruce 439
By Mr. Kellahin 445

REPORTER'S CERTIFICATE 452

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C U M U L A T I V E I N D E X O F E X H I B I T S

TMBR/Sharp	Identified	Admitted
Exhibit 1	42	113
Exhibit 2	-	113
Exhibit 3	90	113
Exhibit 4	95	113
Exhibit 5	95	113
Exhibit 6	-	113
Exhibit 7	19	113
Exhibit 8	-	113
Exhibit 9	26	113
Exhibit 10	60	113
Exhibit 11		(Withdrawn)
Exhibit 12	31	113
Exhibit 13	57	113
Exhibit 14	86, 91	113
Exhibit 15	-	113
Exhibit 16	45	113
Exhibit 17	79	113
Exhibit 18	-	113
Exhibit 18-A	115	147
Exhibit 18-B	126	147
Exhibit 18-C	136	147
Exhibit 18-D	137	147
Exhibit 18-E	139	147
Exhibit 18-F	141	147
Exhibit 19	212, 216	113, 239
Exhibit 20	214	239

* * *

Ocean	Identified	Admitted
Exhibit 1	177	195
Exhibit 2	180	195
Exhibit 3A	188	195

(Continued...)

C U M U L A T I V E I N D E X O F E X H I B I T S
(Continued)

Ocean	Identified	Admitted
Exhibit 3B	189	195
Exhibit 4	189	195
Exhibit 5	190	195
Exhibit 6	191	195
Exhibit 7	191	195
Exhibit 8	194	195
Exhibit 9	194	195
Exhibit 9A	231	239
Exhibit 10	241	246
Exhibit 11	243	246
Exhibit 12	270	281
Exhibit 13	272	281
Exhibit 14	274	281
Exhibit 15	275	281
Exhibit 16	327	331
Exhibit 17	337	347

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Arrington	Identified	Admitted
Exhibit 1	353	361
Exhibit 2	354	361
Exhibit 3	355	361
Exhibit 4	357	361
Exhibit 5	358	361
Exhibit 6	384	394
Exhibit 7	385	394
Exhibit 8	387	394
Exhibit 9	418	425
Exhibit 10	425	425
Exhibit H-1	100	425

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(Continued...)

A P P E A R A N C E S (Continued)

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* * *

WHEREUPON, the following proceedings were had at 8:18 a.m.:

EXAMINER STOGNER: This hearing will come to order.

I believe last night we finished up with Mr. -- or not finished up, we were in the middle of testimony from Ray Pane.

So Mr. Bruce, do you want to take it?

MR. BRUCE: Just very briefly, Mr. Examiner, and then I'll turn it over to Mr. Kellahin.

RAY PAYNE,

the witness herein, after having been first duly sworn upon h* oath, was examined and testified as follows:

REDIRECT EXAMINATION

BY MR BRUCE:

Q. Mr. Payne, you have in front of you Ocean Exhibit 16. Did you prepare that exhibit?

A. Yes, I did.

Q. And could you describe it briefly for the Examiner so that -- kind of goes over your testimony briefly, yesterday, tomorrow, but make it short and tell what you did to determine the drainage for the Blue Fin 24-1 well.

A. It's a simple gas-in-place equation which uses the geologic parameters and other engineering data to

estimate gas in place.

And using that equation, I solved it for the area on the second line there, A being area in acres, and just calculated the acres based on the reserve estimates that Jeff Phillips testified to yesterday.

Q. When you -- The middle part, where you have the figures that are inserted into the equation, could you go down those briefly and tell where they came from?

A. The H is the net-pay thickness of the reservoir, which is based on the fact that the estimate of the thickness of the Blue Fin 24-1 on the log was 24 feet, and assuming that that's probably a thicker portion of the reservoir, you know, averaging the reservoir thickness at 20 feet --

Q. Is that optimistic?

A. I think that would be an optimistic answer, but it would, you know, be realistically optimistic.

Q. Okay. But you're assuming 20-foot thickness throughout the drainage radius that you calculate?

A. That's right. That would be the average between the zero contour line and the highest part -- thickest part of the reservoir, so...

Q. Okay.

A. The porosity, 15-percent porosity, is based on experience in the area from looking at other logs. The

Blue Fin 24-1 didn't have an open-hole log, which would give you an opportunity to make a good estimate of reservoir pressure in that well.

And this also again is an average porosity for over the entire reservoir. So based on the experience in the area, 15-percent porosity, I think, is reasonable but, you know, also very good, but reasonable.

Water saturation of 25 percent is a number that Jeff Phillips expressed yesterday. I think that's probably a reasonable number also. He also said that it could be -- you know, some of the log calculations showed it to be as high as 30-, 40-percent water saturation. I think he even said 50-percent water saturation, but 25 percent sounds like a reasonable number to me.

B_g is a gas expansion factor, and that's related to the pressure in the reservoir, primarily, and also the composition of the gas. And that converts reservoir cubic feet to standard cubic feet. You take one cubic foot of gas in the reservoir, it's going to be 310 cubic feet of gas at the surface. And that's based on an estimated bottomhole pressure of about 6200 pounds. They didn't have an estimate of bottomhole pressure yesterday, but experience in the area and looking at other wells and the mud weights that these wells are drilled at, I feel like 6200 pounds is a reasonable estimate of bottomhole

pressure.

The recovery factor of 75 percent is also based on experience in the area, in looking at other wells, and related to the abandonment pressure of the reservoir which, in this case, 1000 pounds would not be an unreasonable bottomhole pressure abandonment.

Q. Based on those numbers, what is your reasonable estimate of drainage for the Blue Fin 24-1?

A. 219 acres.

Q. Now, you have in front of you TMBR/Sharp Exhibit 18-D. Do you believe that the dark blue circles on 18-D accurately reflect the reservoir size or the drainage area of the Blue Fin 24-1?

A. No, sir, that's not practical at all and is not consistent with other places. We've encountered similar types of anomalies.

Q. So even though that might be the bowl, the drainage exceeds outside the boundaries of that bowl?

A. Yes, that's correct. The section is thick in the bowl, but the pay section lies within the entire geologic section and it's much thinner than the overall thickness of that and extends outside the bowl.

Q. Okay. If the Blue Fin 25-1 encounters a similar reservoir, you'd expect similar drainage then?

A. Yes, sir.

Q. And if that's the case, would the Blue Fin 25-1 drain the southwest quarter of Section 25?

A. Absolutely.

MR. BRUCE: Mr. Examiner, I'd move the admission of Exhibit 16.

Pass the witness.

EXAMINER STOGNER: Any objection?

MR. KELLAHIN: No, sir.

EXAMINER STOGNER: Exhibit 16 is admitted into evidence.

Mr. Kellahin, your witness.

RECROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Payne, am I correct in understanding that you have take Mr. Phillips' assumption yesterday that the gas in place for the well in 24 was 5 BCF?

A. Yes, sir.

Q. And when you make that assumption, you can add the various parameters necessary to do a volumetric calculation?

A. That's exactly correct.

Q. That's what this shows?

A. Yes, sir.

Q. And one of the ways you can calculate the calculation is to give you a drainage area?

A. Yes.

Q. All right, and that's what you're talking about?

A. Yes.

Q. The assumption you're starting with is the presumption that Mr. Phillips is accurate in his assessment yesterday that there's 5 BCF of gas in place in that bowl?

A. There's 5 BCF of gas in place, not necessarily in the bowl, but --

Q. I understand.

A. Five BCF of gas in place.

Q. And if he makes that assumption and it's correct, then you can run through a rather typical engineering calculation, add these values, and get yourself a drainage area of 219 acres?

A. Correct.

Q. All right. How would you as an engineer develop data to convince yourself that the 5 BCF of gas in place is a reliable number?

A. The best way to check that is using bottomhole pressures, measuring the bottomhole pressure in the existing well over time, and also looking at the decline-curve analysis. Those two methods will independently verify these calculations.

Q. And we can verify this in two ways, the first of which is with pressure data. And if the operator is smart

enough, you're going to be taking accurate bottomhole pressure, at least initially?

A. Yeah, you need an initial bottomhole pressure.

Q. All right.

A. Subsequent bottomhole pressures can be a bit misleading, and we could get into that, but --

Q. Well, no, I've been through all those discussions before. Let's assume that they have measured an actual bottomhole pressure in the well at the time it was completed.

A. Right, and you can use mud weights when you drill through it and different -- you know, perforation, what the tubing pressure was when you perforated. There's various ways to estimate reasonable reservoir pressures, but --

Q. But that's a starting point?

A. Yes, sir.

Q. And you want to find your best estimate of where that starting point is?

A. Yes, sir.

Q. And then the next thing you do is, you try to find a subsequent pressure point so that you can draw a line between the original one that intersects the second and third and fourth or however many you have, and that line can be plotted in such a way that you get to the bottom of the plot, and you will be able to estimate with

certain reasonable engineering certainty what the gas in place is?

A. Yes, sir, P/Z plot, that's exactly correct.

Q. Another way to verify your P/Z plot would be to look at the actual performance of the well. You would start off with a production decline curve, you start at a production point, and over time, because this is, I assume, a gas-expansion reservoir, we're depleting it in a fashion where you would expect the pressure over time to drop?

A. Yes, sir.

Q. And if you plot the production and compare it to the pressure, you can also forecast what you think is going to be the ultimate gas in place in that pod?

A. That's correct.

Q. We do not have the ability at this point to verify either of those?

A. I would -- I think the data may -- it would be possible to have -- The data that is normally collected on a well like this under production, given -- made available, I think, you could make some reasonable engineering estimates of gas in place.

The potential error in that number is greater when the well has only been on line for a short period of time, but I think you can safely say a well performing under this type of production and pressures that were

explained is that a 5-BCF estimate sounds very reasonable to me and is also consistent with similar types of wells that were completed in this area.

Q. All right. Have you attempted to do either a P/Z plot or a production plot for this well?

A. I do not have the data to be able to do that.

Q. So at this point we can't --

A. No, sir.

Q. -- verify the 5 BCF? And so we start at that point and run the calculation?

A. That is correct.

Q. If the calculation is correct, your assumption is that Mr. Mazzullo's bowl is too small? It has to be a reservoir larger than he is inferring from his exhibit?

A. The bowl doesn't produce, the sand produces.

Q. I understand.

A. Okay, I just want to be clear on that. The sand doesn't exist in the bowl.

Q. If the area being affected by the productivity of this well ultimate demonstrates that it's 5 BCF, there's something wrong with the geology?

A. That is correct.

Q. Because he has confined the container, he's built a container that's too small for the gas?

A. That's correct.

Q. If he's right about his geology, then the gas-in-place assumption must be wrong?

A. That is correct.

MR. KELLAHIN: Okay, nothing further.

EXAMINER STOGNER: Any other questions? Redirect?

MR. BRUCE: Just briefly.

REDIRECT EXAMINATION

BY MR. BRUCE:

Q. Mr. Payne, Exhibit 18-D isn't an isopach, is it?

A. No, sir, it is not.

Q. It doesn't show the boundaries of the reservoir in your opinion, does it?

A. No, it does not.

Q. And Mr. Kellahin is asking you questions, questioning the data -- Let's put it this way: Are you aware of a better well in southeast New Mexico that TMBR/Sharp has?

A. No, sir, I'm not.

Q. If Ocean had a well like this, would it be pretty keen on finding data as to what the original gas in place is in this well?

A. Absolutely, I would know off the top of my head, cumulative production pressures and bottomhole would be --

Q. Even if the well is only a few months old?

A. Oh, no doubt.

Q. And so the president of TMBR/Sharp says there's 5 BCF of gas in place. Is that a reasonable estimate in your --

A. Yes, I think it's very reasonable, and it has the potential to be much higher than that.

Q. Okay. And you can only go on what TMBR/Sharp tells you the data is?

A. Yes, sir.

RECROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Payne, let me ask you another question.

Have you taken this and asked your geologist, Mr. Messa, to examine the geology and give you a visual demonstration of a geologic interpretation that will allow you to fit this volume of gas in it?

A. Yes, sir.

Q. Where is it?

A. Can we present this, Frank? We did that last night after the hearing, and I --

MR. KELLAHIN: All right.

FURTHER EXAMINATION

BY MR. BRUCE:

Q. Mr. Payne, I've handed you what's been marked Ocean Exhibit 17, and I realize that this was prepared by

the geologist, but could you just briefly describe -- and we'll bring back the geologist if necessary to get this admitted into evidence, but what does this map show?

A. It's a net sand isopach map, as I understand it. I believe it's net sand, not gross sand. But this is a depiction of the actual tank reservoir, which the Blue Fin 24-1 is producing from.

Q. And this is in the Mississippian, correct?

A. That is correct.

Q. And then the yellow outline is the west half of Section 25, is it not?

A. Yes, sir. You know, to try to maybe clarify a couple issues, as we've testified earlier, these targets are high-risk targets, and the best place to lower the risk of encountering sand is to target these holes or bowls, as they're described here, as that higher likelihood of being sand.

You don't necessarily have to hit the thickest part of the reservoir to get the best drainage, to get a good well, but you do need to hit the sand itself, and they're often very elusive. And direct offsets to good wells don't always find the sand. In some cases you can offset the well in all directions and never find the sand that's obviously much more extensive than just right around the well itself, a 30-acre, you know, offset.

Q. And based on this map and your calculations would then the Blue Fin 24-1 be draining in a diagonal -- in a northwest-southeast manner, in your opinion?

A. Yes, sir, that's the trend of these reservoirs. They lie within these accommodation spaces.

Q. And the same thing if the well in the southwest quarter, northwest quarter of Section 25 is successful, would it also be draining to the north and to the south?

A. If you encountered a similar sand quality that's in the 24-1, there's no doubt that you would be able to drain the entire east half of that section.

Q. The west half?

A. Yeah, west half, I'm sorry, west half of the section.

Q. Of Section 25?

A. Yes, sir.

MR. BRUCE: Thank you. Pass it to Mr. Kellahin.

EXAMINER STOGNER: Mr. Kellahin?

MR. KELLAHIN: Thank you.

FURTHER EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Payne, let's look at Exhibit 19 here.

MR. BRUCE: 17.

Q. (By Mr. Kellahin) I'm sorry, Exhibit 17.

A. Okay.

A. The volumetric calculation makes the assumption of a 20-foot thickness to the container --

A. Yes, sir.

Q. -- that has a uniform 20-foot thickness within the size of that container?

A. That is correct.

Q. Can you tell me what is the area that contains, then, the 219 acres?

A. We haven't gone that far through the process, and I'd have to let the geologist testify how this sand -- you know, is it the biggest the reservoir could be, the smallest, the average-size reservoir? You know, that's a process where the engineering data and the geologic data iterate to come through -- to come to a most likely reservoir size, and we just haven't had the time to go through that process.

Q. Look to the south in Section 25, and you see the Number 25, the drilling well. Do you see that?

A. Yes, sir.

Q. It's been positioned on this interpretation where it's in excess of the 40-foot contour line?

A. Yes, sir.

Q. Right? And if you follow the 40-foot contour line, that 40-foot contour line extends into the southwest quarter of 25, does it not? The southwest of 25?

A. Yes, sir.

Q. That shape where you would want to encounter the greatest potential thickness extends down into the southwest quarter of 25?

A. Yes, sir.

Q. All right. And you told me just now it is not necessary to be in the absolute lowest portion of the bowl to have a well. Right?

A. That is correct.

Q. All right. Why don't we lay these spacing units down, dedicate the south half and let you drill a well in the southwest quarter and access your share of the bowl while within the 40-foot contour line?

A. I believe that one well can adequately drain that reservoir, and an additional well would not be necessary.

Q. We would know that, would we not, if the Blue Fin 25 well is completed, a bottomhole pressure test is taken, and we can compare that pressure to the Blue Fin 24 and see if there's any effect between the two pods?

A. Well, if you made the west-half unit and you determined that the Blue Fin 25-1 was not adequately draining the entire reservoir, I believe the field rules allow you to drill an additional well there. So I think having the unit as a standup would afford you that opportunity also.

Q. Have you done a similar analysis on any other Chester well in this area?

A. No, sir, this is the best Chester well that I've looked at.

Q. Well, this is your first attempt, then, at analyzing a Chester well in this way?

A. Yes, sir. The reservoir configurations are very similar in the Atoka and Morrow sections, so I feel like that analog is reasonable.

Q. Let's look at Exhibit Number 10, the Brunson map. I'll give you my copy. Do you have a recommendation to the Examiner of any other analog on Section 10 that might be utilized to conduct a similar calculation that you performed for the Number 24 Blue Fin well?

A. Yeah, this map doesn't show cumulative production, and I would have to go back and look at my records and try to find a well that, you know, has produced 4 or 5 BCF, and we could take a look at it.

Q. Well, you haven't done that yet, have you? You can't find one on that map, right?

A. I just don't recall the cumulative productions from these wells.

Q. Let me ask you this, what is --

A. Yes, I have looked at this area, looked at the cumulative production and have done drainage-area

calculations; I just don't recall the figures.

A. Let me ask you this: What is your criteria as an engineer for selecting an analog to the Blue Fin 24 well so that we would have a method to compare what you're saying?

A. I would look for a well that had high cum and compare that to the geologic map and try to fit those reserves in the net isopach map. So I would take this isopach map that Frank has got, I would planimeter it, come up with a volumetric estimate of the reservoir, take the production from all these wells and see how that fits with the volumetric estimate of the reservoir.

Q. Well, those are Brunson wells you're talking about on that map?

A. Yes, sir.

Q. I'm looking at the Chester wells.

A. Yes, sir.

Q. Is there any Chester well on that map identified by the color code by which you can make an analog?

A. No, sir.

MR. KELLAHIN: Thank you.

MR. BRUCE: Mr. Examiner, if I could -- couple of questions.

FURTHER EXAMINATION

BY MR. BRUCE:

Q. Mr. Payne, is there any difference between

analyzing the Brunson wells and the Mississippian wells in this area?

A. No significant difference.

Q. Okay. And once again, if there's laydown units, instead of having one well in the west half of 25, Ocean is going to be compelled to go protect its interest, so there will immediately be two wells in the west half of 25?

A. Yes, we wouldn't wait for six months or two years to determine whether the well is draining, we would go ahead and spud our well as soon as possible to try to protect our interest.

Q. And you may have an unnecessary well in the west half of 25?

A. Yes, sir.

Q. Thank you.

MR. KELLAHIN: One follow-up, Mr. Examiner.

FURTHER EXAMINATION

BY MR. KELLAHIN:

Q. When you take the 24, have you calculated the gas in place under this analysis to tell me how much gas in place is in the entire section?

A. No, sir, we certainly would follow through with that, but we haven't had time to do those calculations.

Q. If I take your assumption and the visualization of this map, it would appear to me that there are enough

gas-in-place volumes to support more than one well.

A. That could very well be true, and that's something that the engineering data and the geologic data need to iterate on, to come up with the most likely case, scenario, you know. My opinion of this map, first look, I would have to say this would probably be an optimistic depiction of the reservoir. It could be smaller than this.

Q. Our ability to refine our estimates at this point would be made more accurate if we waited to have this discussion till after the Blue Fin 25 well had been completed and tested, right?

A. I believe since sands trend in a north-south direction, that regardless if we determine that the well will just drain a small area or a large area, then the appropriate shape of the proration unit should be a stand-up west-half unit.

Q. Well, that's not what I'm asking you. I didn't ask you if it was a standup. I asked you, would you be able to refine your calculations if you had pressure data and information from the drilling well?

A. Yes, sir that is true.

Q. So why shouldn't we just postpone all this until after we have those results?

A. For the reasons I just explained. I think a west-half unit would cover either/or option. It gives

you -- If the well drains the entire 320, then that makes sense. And if it just drains the northwest section, then you're afforded another opportunity to drill another well in the southwest section.

Q. Have you talked to the Arrington experts about why they are going forward with a pooling case for the east half of Section 25?

A. Not in detail. I'm not -- No, sir.

Q. All I'm asking for, can you tell us what formations they're targeting with an east-half spacing unit?

A. I'm trying to think. I couldn't say with any certainty.

Q. I can't find one on this interpretation, can you, for the Brunson, Chester?

A. No, sir.

Q. Any of these maps?

A. No, sir.

Q. Up to date, there's no maps that you have seen that support a well in the east half?

A. I have not seen the map for the east half.

MR. KELLAHIN: All right, sir.

MR. BRUCE: I don't have any follow-up questions, Mr. Examiner.

I would like to admit 17. If I need to bring Mr.

Messa back up to qualify this as an exhibit, I'll do so.

MR. KELLAHIN: We have no objection to its introduction.

EXAMINER STOGNER: Exhibit 17 will be admitted into evidence at this time.

Mr. Hall?

MR. HALL: I have no questions, Mr. Stogner.

EXAMINER STOGNER: Mr. Carr?

MR. CARR: No questions.

EXAMINATION

BY EXAMINER STOGNER:

Q. Mr. Payne, under the current -- I'm going to refer to Exhibit Number 17. Now, you said you believe this one well would drain the west half?

A. Yes, sir, I think that's possible.

Q. Would that drainage also come from over in the southeast quarter?

A. Yes, I think it could potentially drain over there as well. I think it could drain the entire reservoir, potentially.

Q. Okay. So if that well was allowed to -- or if it -- But this is not unitized, so therefore that's why there's more than one well at this particular point for acreage?

A. (Nods)

Q. Is that a yes?

A. Yes, sir.

Q. Okay.

A. Yes, sir. I've seen wells produce as much as 30 BCF in these type of reservoirs.

Q. So under the current configuration that I have in front of me today, these four cases, I've got one well for the north half, proposed by TMBR/Sharp, you're proposing -- Ocean is proposing two wells in the west half, and it looks like Arrington is proposing one well in the northeast quarter, northeast quarter. Of that well configuration, how is the southeast quarter's interest being protected?

A. Could I get a copy of the exhibit you're referring to, the location?

Q. It's not an exhibit, this is the public document called the docket. That's what I'm referring to. TMBR/Sharp is drilling their Blue Fin 2, ; is that correct? And that's in the northwest quarter?

A. Yes, sir.

Q. Okay. Now, Ocean is proposing to drill a well in the northwest quarter, and this is Case 12,841, and this is where you're showing the T.H. Dragon Number 1; is that correct?

A. Yes, sir.

Q. Okay. You're also proposing to drill a well in

Unit K -- that would be the northeast of the southwest -- in Case 12,860. That would be your second well. And I'm just now referring just to the Chester or Austin formation. And in Case 12,859 -- this is Arrington -- they're proposing a well in the northeast quarter, northeast quarter of 25. And I'm referring to your Exhibit Number 17.

Since we've got a proposed well in the northeast quarter, a well drilling or a proposed well in the northwest quarter, and your proposed well in the southwest quarter, how is the Chester production in the southeast quarter being protected? Are any of these wells -- Would the Arrington well be draining the Chester, from your data?

A. Yes, sir, I think potentially it could.

Q. Well, I pinpoint a well where they want to drill, it's in the white portion in the northeast quarter of the northeast of 25.

MR. BRUCE: Mr. Payne, do you know where the Arrington well is located?

THE WITNESS: No, I do not.

Q. (By Examiner Stogner) Okay, well, let's put it in. They're proposing a well to be drilled 803 feet from the north line -- do you want to mark that on there? -- and 902 feet from the east line. This is the northeast, northeast quarter, Unit A.

MR. KELLAHIN: Let me give him a copy, Mr. Examiner.

THE WITNESS: Okay, I don't see, based on this map, that the Chester is prospective at that location.

Q. (By Examiner Stogner) Okay. So with the drainage of your proposed two wells, or one well, then the southeast quarter, the Chester that you're showing as being under the southeast quarter is not being adequately -- how would you say? -- compensated?

A. I would have to say yes.

EXAMINER STOGNER: Any other questions of this witness?

MR. KELLAHIN: No, sir.

EXAMINER STOGNER: Okay. You may be excused, Mr. Payne. Thank you.

Mr. Bruce, do you have anything further or wish to recall anybody at this time?

MR. BRUCE: No, sir.

EXAMINER STOGNER: Okay, I guess we're ready for you, Mr. Hall.

MR. HALL: At this time, Mr. Examiner, we would call Enick Diffee to the stand.

EXAMINER STOGNER: Okay, just a reminder to everybody. Everybody was sworn in yesterday, all eleven witnesses, and you remain under oath today.

ENICK DIFFEE,

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

DIRECT EXAMINATION

BY MR. HALL:

Q. For the record, please state your name, sir.

A. Enick Diffee.

Q. Why don't you spell that for the court reporter?

A. Yes, first name Enick spelled E-n-i-c-k, last name Diffee, D-i-f-f-e-e.

Q. Now, Mr. Diffee, where do you live and by whom are you employed?

A. I reside in Roswell, New Mexico, and I work on a consulting basis for David H. Arrington Oil and Gas out of Midland.

Q. What is your professional background and experience?

A. Petroleum landman, I've been involved in that capacity for some 22 years.

Q. All right, you're familiar with the Application that's been filed in this case on behalf of Arrington, as well as the lands that are the subject of the Application; is that correct?

A. Yes.

Q. And you've previously testified before the

Division and had your credentials accepted as a matter of record?

A. Yes.

MR. HALL: At this point, Mr. Examiner, we'd offer Mr. Diffee as an expert petroleum landman.

EXAMINER STOGNER: Any objections?

MS. RICHARDSON: No objection.

EXAMINER STOGNER: Mr. Diffee is so qualified.

Q. (By Mr. Hall) Mr. Diffee, for the first time we're focusing our attention on the east half of Section 25; is that correct?

A. That's correct.

Q. Would you please summarize what Arrington is proposing by its Application?

A. Mr. Examiner, Arrington seeks to pool all interests in pools spaced on 80, 160 and 320 acres, including the Undesignated Shoe Bar-Atoka Gas Pool, Undesignated Townsend-Morrow Gas Pool and Undesignated North Townsend-Mississippian Gas Pool formation, underlying the east half, being 320 acres, all 160-acre units underlying the northeast quarter, and the east half, northeast quarter for all 80-acre units in Section 25 in Township 16 South, Range 35 East, Lea County, New Mexico, for the drilling of the Glass Eyed Midge Well Number 1.

We propose to drill the well at a standard

location 803 feet from the north line and 962 feet from the east line of the section, and the well will be drilled to approximately 12,650 feet to test the Mississippian formation, as well as the Atoka and Morrow formations.

Q. I believe the Application and advertisement show the well location as 902 feet from the east line. Can you --

MR. CARR: Could I get a set of exhibits? If I could even borrow the court reporter's, I'll not mark them and return them. Thank you.

Q. (By Mr. Hall) Mr. Diffee, again, I believe the Application and the advertisement for the case show the well location 902 feet from the east line, and you indicate it's 962 feet. What's the reason for the move?

A. Again, the APD, et cetera, everything that's been filed with the OCD office reflects the 962 feet, so --

Q. Was there a surface obstruction at 902 feet?

A. Yes, there was.

Q. All right, let's look at your Exhibit 1, please, sir. Do you have that in front of you?

A. Yes, I do.

Q. What does that show?

A. It's a surface plat showing the east half of Section 25 as being the proposed proration unit, and it also shows the proposed location of the well, being the

northeast quarter, northeast quarter of Section 25.

Q. Now, what's the primary objective for the well?

A. Mr. Examiner, that would be the lower Atoka.

Q. Let's look at Exhibit 2, if you could explain that, please, sir.

A. Exhibit 2 on the heading, you'll see that we're intending to cover the entire east half of Section 25, being the 320 gross acres. There's a separate chain of title as far as mineral ownership and also leasehold ownership covering the east half, northeast quarter of Section 25, being 80 acres.

Then on the second page we have the leasehold and also unleased mineral interest calculations covering the west half of the southeast quarter of Section 25. Towards the lower portion of page 2 you see the leasehold ownership for the southeast quarter of Section 25.

And then for your convenience the last page of the exhibit covers the entire east half, and you'll see owners and percentage of ownership as to leasehold and also unleased minerals covering the entire east half.

Q. Now, Mr. Diffee, I think we all understand you're covering in part for Mr. Dale Douglas, who's in the hospital today, but you are familiar with the chain of title into Arrington for east-half acreage, are you not?

A. Yes.

Q. Can you give the Hearing Examiner a brief overview of that chain of title?

A. Again, the title is very diverse, broken into the tracts that appear on the exhibit that we've just discussed.

And again, the mineral ownership is relatively diverse, not perhaps as diverse as some areas that we've been involved in in Lea County, New Mexico, but we have made every attempt to locate unleased mineral owners to this point. We're still continuing our efforts, but of course it's been a very competitive area as far as other companies obtaining leasehold under the east half of Section 25.

Q. How long has Arrington owned its lease interest under the east half of 25?

A. We commenced our efforts to acquire leasehold in this area beginning in the spring of year 2001.

Q. Now, is Arrington's ownership interest in the east half of 25 affected at all by the title dispute currently pending in the District Court between Arrington and TMBR/Sharp over the Stokes Hamilton top lease issue?

A. There's no effect no the east half.

Q. Look at Exhibit 3. Is that the C-101 and C-102 Arrington filed for its Glass Eyed Midge 25 Number 1 well?

A. Yes.

Q. When were those filed?

A. November the 29th, year 2001.

Q. All right. Mr. Diffee, tell us what percentage of the acreage in the 320-acre pools or formations in the east half is currently voluntarily committed to Arrington's proposed well.

A. All right. I would refer you to the exhibit identifying the east half of Section 25 in its entirety, and we've listed David H. Arrington Oil and Gas, Inc., and Dale Douglas, Dale Douglas, of course, being an independent landman working on behalf of Arrington. So if you add the 14.688 percent and the 2.66, I believe you arrive at 17.348 percent.

Q. Now, are the interests that Arrington seeks to pool both working interests and unleased mineral interests?

A. Yes.

Q. If you would identify the owners of each of those interests and the quantum of interest owned by each. Is that reflected in Exhibit 2 as well?

A. Yes, it is. We can break this down by simply, I guess, tract. This might take a little bit of time, so if you'd bear with me here --

Q. Well -- Yeah, I think you can be brief about it.

A. Okay. Maybe, then, we can just turn to the last page of the exhibit, and I'll call your attention to the

latter portion of the page where we have the unleased mineral owners that exist within the east half of Section 25, Harle, Inc.; Jonathan S. Roderick and his wife Carol Roderick; Bran Resources, Inc.; Virginia H. Bernhart; and Robert M. Edsel.

And then, of course, at the to part of the page if you'd begin with Yates Petroleum and work through the name of Chesapeake Exploration, L.P., those would be the parties that presently own leasehold under the east half of Section 25.

Q. All right, let's talk about the efforts to sign up the interests of the unleased mineral interest owners specifically. Let's refer to Exhibit 4. What is that?

A. These are letters that have been sent by certified mail, dated January the 24th of year 2002, and again for Harle, Inc.; Bran Resources; Virginia H. Bernhart; and Robert M. Edsel. We mailed these letters to them proposing the well in the east half of Section 25. We've extended the invitation for these parties to participate in the well.

The letter also contains a provision, if they choose to not participate in the drilling of the well, that they could certainly contact us so that other arrangements might be made.

Also attached to the letter was an AFE pertaining

to the costs associated with the drilling of the well.

I would make note at this time that I have been informed as of the day before yesterday, Robert M. Edsel has executed an oil and gas lease on behalf of David H. Arrington. That lease has not been received in Arrington's office at this point in time, to my knowledge, and so therefore it does not appear of record in Lea County, New Mexico, but we anticipate that lease to be in our possession in the near future.

Q. Does Arrington request that the Division pool these unleased mineral interests with an assumed 1/8 royalty interest and a 7/8 working interest?

A. Yes.

Q. And does Arrington seek the imposition of a 200-percent risk penalty against the assumed 7/8 working interest?

A. Yes, we do.

Q. All right. Now, let's talk about the unjoined working interest owners. Turn to Exhibit 5, please, sir.

A. Okay. Again, you have copies of the certified letters that were mailed to each company or individual, again dated January the 24th, year 2002, again proposing the well with an invitation to participate or, perhaps in the alternative, to contact us so that other arrangements might be made. And again attached to the letters would

have been an AFE associated with the drilling cost of the well.

Q. And again, that batch of letters went out January 24th of this year?

A. Yes, they did.

Q. All right. Does Arrington seek the imposition of 200-percent risk penalty against those unjoined working interests, as well as against the assumed 7/8 working interests attributable to the mineral interests?

A. Yes, they do.

Q. And does Arrington seek to be designated operator for the well?

A. Yes.

Q. In your opinion, Mr. Diffee, as an expert petroleum landman, has Arrington made a good-faith effort to locate all the unleased mineral interest owners, as well as the working interest owners and communicate with them in order to obtain their voluntary participation in the well?

A. Yes.

Q. Now, let's point out the circumstance with the one mineral interest owner who we've had a problem tracking down. Is that Virginia Bernhart?

A. Yes, the last known bit of information as to her location was a mineral deed that was executed in 1983. The mineral deed was executed in favor of Mr. Robert Edsel.

Again, there was no address on that particular mineral deed. The only way we knew that she was in Belmont County, Ohio, as of 1983 was just by virtue of the acknowledgement on the mineral deed.

I even went so far yesterday as to talk to the landman at TMBR/Sharp, and we compared our notes as far as what we had attempted to do to locate this individual, and we'd gone down pretty much the same path. And to this point in time we've no been able to locate her or determine, you know, if she's alive or who her heirs might be.

But as always in these situations, we continue to make a diligent effort to locate individuals prior to the time maybe even a well is spud.

Q. You conducted a complete and thorough search of the records at file at the Lea County Clerk's Office to try to locate her?

A. Yes, we did. And we've, you know, gone so far as to do a name search through the Internet and other means of just picking up the telephone and making a call. And I personally haven't visited with Mr. Edsel, but I believe a representative from Arrington's office even asked him to question as to if he knew where she might be located at this time, and he did not.

Q. All right, Mr. Diffee, were Exhibits 1 through 5

prepared by you or at your direction?

A. Yes.

MR. HALL: At this time, Mr. Examiner, we'd move the admission of Exhibits 1 through 5. That concludes our direct of this witness.

EXAMINER STOGNER: Any objections?

Exhibits 1 through 5 will be admitted into evidence at this time.

Thank you, Mr. Hall.

Mr. Kellahin.

MS. RICHARDSON: Thank you.

CROSS-EXAMINATION

BY MS. RICHARDSON:

Q. Mr. Diffee, how long have you been doing independent land work for Mr. Arrington?

A. Close to five years.

Q. And can you describe for me the relationship between Arrington Oil and Gas and Dale Douglas?

A. Again, Dale Douglas is an independent petroleum landman, and Mr. Douglas has again represented Mr. Arrington in various capacities as a petroleum landman, doing again landwork relative to the creation of prospects and also perhaps marketing of prospects.

Q. And the leases which were taken in Section 25 by Mr. Douglas were taken on behalf of Mr. Arrington?

A. To my knowledge, that's correct.

Q. Okay. The leases which were taken in both Section 24 and 25 by Mr. Huff were taken on behalf of Arrington?

A. That's my understanding.

Q. Were you at the NAPE conference in Houston in 2001?

A. No, Mr. Examiner, I was not present at that meeting or that particular event.

Q. Do you know what prompted Arrington Oil and Gas on March 27th, 2001, to top lease Madeline Stokes and Erma Stokes Hamilton?

A. Again, this had been a prospect that I had even done title research on, beginning during the -- probably spring of year 2000. So it was a geological prospect that had been generated through Arrington's geological department. So again, it was just following up on a prospect that we had had an interest in.

Even as of December of year 2000, I was again following up to review information in the County Clerk's Office, the OCD Office in Hobbs, to try to determine if the mineral interest was available for lease.

Q. Was Arrington Oil and Gas aware that a permit to drill had been granted to TMBR/Sharp on Section 24 to drill the Blue Fin 24?

A. I knew that an APD and an acreage dedication plat had been filed with the OCD as of November of 2000.

Q. Okay. And were you all aware that a location had been cleared and drilling was getting ready to be done?

A. No, this is very unusual, because I use the OCD Office extensively in my efforts to assure that any oil and gas leases that we might obtain are not presently being held by production or activities, and I have made a full and complete copy of the well file for the Blue Fin 24 Number 1 well in Lea County and provided that to Arrington's attorneys just very recently.

And from the time that the APD was filed of record in November of year 2000, there was not a single piece of paper, not a single sundry notice of whatsoever filed with the OCD Office in Hobbs, New Mexico, until June the 19th of year 2001, which is very unusual for standard practices of operators, simply because, you know, you file sundry notices to allow the OCD to know when operations have commenced, when you've moved in a rig, et cetera. And again, there was no evidence for me as a petroleum landman to know that any activity had taken place on the subject lands.

Q. When did you become aware of the Blue Fin 24 permit granting by the OCD on Section 24, for the Blue Fin 24?

A. Again, the APD and the acreage dedication plat was filed of record on November of year 2000, and it was probably in December when I was again still trying to determine if the leases filed of record in Lea County that were due to expire on December the 7th of year 2000, I was in the OCD office prior to that date to find the APD and the acreage dedication plat.

Q. And you knew that TMBR/Sharp had dedicated the west half of Section 24 to that well?

A. That was indicated.

Q. Okay. And that that dedication included Stokes-Hamilton acreage?

MR. HALL: Mr. Examiner, I wonder if I might interpose a relevance objection at this point. We're focusing on the east half of 25 now.

MS. RICHARDSON: Mr. Examiner, I will move along, but I think this history is essential to this question.

EXAMINER STOGNER: I'm going to overrule your objection. And answer the question, please.

THE WITNESS: And your question again?

MS. RICHARDSON: If I only remembered. Could the court reporter possibly help me out?

COURT REPORTER: "And that that dedication included Stokes Hamilton acreage?"

THE WITNESS: The Stokes Hamilton acreage was a

portion of the proration unit prescribed. I think I'd like to add, though, if you're leading me down that road to think that the --

MS. RICHARDSON: Well, let me ask the questions, please, and the --

THE WITNESS: Well, I have a comment --

MR. HALL: Let him answer.

THE WITNESS: -- my opinion. If it's so important that the acreage dedication plat be filed of record in the OCD office, okay, and if that's their basis by which they're making their case in the District Court in Lea County, New Mexico, I would certainly think that they would have been more diligent about filing sundry notices, et cetera.

Q. (By Ms. Richardson) Can you quote me a rule? Because I'm not nearly as familiar with the OCD rules as you may be. Can you quote me a rule which requires any filing after a permit to drill is requested prior to actually commencing drilling? Is there a rule that TMBR/Sharp violated?

A. I do not know that.

Q. You don't know of any rule?

A. I do not.

Q. And you're not able to tell the Examiner that TMBR/Sharp violated any OCD rule?

A. I'm simply saying as a general practice, for us to do our work on a diligent basis, that the OCD usually requires those forms to be filed on a timely basis.

Q. Mr. Diffee, can you tell the Examiner whether TMBR/Sharp violated any rule of the -- rule or regulation of the OCD, with respect to what they filed in regard to the Blue Fin 24?

A. I cannot.

Q. Okay. You are aware, are you not, that Judge Clingman, District County [*sic*] in Lea County, has held that the Stokes-Hamilton top leases are not valid?

A. I am aware of that.

Q. Okay. In Section 25, in the acreage that you are attempting to pool, it does not involve any of the Stokes Hamilton acreage; is that correct?

A. That's correct.

Q. But you are also aware, are you not, that the Commission has ordered, in its Order of April 26th in Case Number 12,731 and 12,744, that the permits of Arrington Oil and Gas to drill this Glass Eyed Midge well are withdrawn?

A. I am aware of that.

Q. And that Mr. Williams has actually sent a letter out to that effect, withdrawing the permit to drill?

A. I am aware of that.

Q. And you're aware that without a permit to drill,

Arrington Oil and Gas cannot drill the Glass Eyed Midge?

A. I am aware of that.

Q. Other than letters being sent to Tom Brown and TMBR/Sharp and other members of the TMBR/Sharp investor group, was any contact, personal contact, made with Mr. Brown or Mr. Phillips or Mr. Nearburg or Mr. Mazzullo concerning the pooling of this Glass Eyed Midge?

A. Again, I reside in Roswell, New Mexico, I'm not a party to Arrington's day-to-day activities, and I cannot feel comfortable responding to that question in any way. I do not know.

Q. So other than sending the letter, you're not personally aware of any contact about the pooling of this well?

A. I'm not.

Q. Have you received any instruction that probably personal contact might not be appropriate, since TMBR/Sharp and Arrington Oil and Gas are involved in litigation?

A. I have not received any instructions.

Q. Is it the normal practice of Arrington Oil and Gas, if they send out a pooling request, to follow up with personal contact?

A. Usually the letter is written for the party to respond to the letter, for them to call us and for us to make specific arrangements. Again, it's an ongoing process

of, you know, the parties being affected to be in contact with each other.

Q. When did Mr. Arrington first acquire any leasehold position in Section 25?

A. Let's see, I would think that would have been in April of 2001. It could have been as early as March, March 22nd, 2001.

Q. And you're not -- What lease was acquired in March, March 22nd, 2001?

A. A lease from Jerry L. Hooper and his wife Margaret A. Hooper.

Q. When were the first leases acquire by Mr. Arrington in Section 24?

A. It would have been what we referred to in prior testimony as the top leases from Ms. Hamilton and Stokes, and I don't have anything covering Section 24 with me to --

Q. That's fine. Was Arrington acquiring leases, looking for leases that might be expiring in this area because they knew TMBR/Sharp was drilling the Blue Fin 24?

A. Again, we didn't have knowledge of the fact that they were drilling the Blue Fin 24, because nothing had been filed with the OCD to give us any indication that well was being drilled.

Q. Okay. Did you have any personal contact with the Stokes and Hamiltons?

A. No, I did not, I've never visited with them.

Q. So you don't know whether they communicated to Mr. Huff that a well was being drilled and they knew a well was being drilled?

A. Not to my knowledge. The only thing that was told to Mr. Huff was that, you know, a six-month extension had been granted to TMBR/Sharp to extend the lease from December the 7th of year 2001 until June the 7th of 2001.

Q. All right. If you'll look with me at your Exhibit Number 3, please, sir, which is your -- Arrington's application for permit to drill the Glass Eyed Midge Number 25 -- do you see that?

A. Yes.

Q. Okay. Down at the bottom it's got an approval date of December 17th, 2001.

A. I see that.

Q. Okay. And then it's covered up a little bit with the Exhibit sticker but it says, "Can not produce without communitization agreement." Who wrote that?

A. I don't know.

Q. Do you know if it was Mr. Williams?

A. I don't.

Q. What does that mean?

A. I don't know, other than the fact that, you know, this was going to be on a 320-acre proration unit, and, you

know, as a standard practice you would have to pool the divided tracts of land to form your 320-acre proration unit.

And I guess if you look at the handwriting, maybe it's -- Well, it would just be pure speculation out of my part to even respond to who may have written that note.

Q. What is a communitization agreement?

A. Well, in my way of thinking, a communitization agreement comes about whenever you have a State of New Mexico mineral lease that has to be pooled with perhaps a fee tract or a federally owned mineral interest. So it's by virtue of regulations that you have to file the communitization agreement in order to pool state or federal or even perhaps fee lands, prior to production.

Q. Are there state or federal fee lands in the east half of Section 25?

A. I believe the lease in the southeast quarter -- I'll just verify it. Yes, the lease in the southeast quarter of Section 25 of 16-35 is a State of New Mexico oil and gas lease which is now owned by Yates Petroleum Corporation, et al., scheduled to expire March 1st, year 2004.

Q. Did Arrington obtain a communitization agreement?

A. The well itself has not been spud. We will probably prepare a communitization agreement shortly before

the well is to be spud or during the drilling process.

Q. Well, in this application which was -- When was this application filed?

A. Well, I can't read my filing date. It looks like it was in May. I'm looking at the stamp date.

Q. Well, it was approved December 17th, 2001?

A. Yeah, I just can't read the stamp date from the OCD office as to when it was actually received and filed.

Q. May of what year?

A. Does somebody's copy show a file date that's more legible than the copy that I have?

Q. Well, let me ask you this. Did you have an approved permit -- You had an approved permit prior to notifying the owners in Section 25; is that correct?

A. I can't tell the date, I'm sorry.

Q. No, approval, the approval date. You had an approved permit prior to notifying --

A. The December 17th, 2001?

Q. Right.

A. And you're saying, again, that we had this --

Q. Did you have this in hand prior to notifying people about the well proposal?

A. We had this AP- -- Well, the date of the approval by the OCD is December 17th, 2001, and I guess our letters are January the 24th of 2002.

Q. Okay. But as of this date, Arrington has made no effort to get a communitization agreement?

A. Not that I'm aware of.

Q. The date -- the spud date for this well was ASAP. What does that mean?

A. As soon as possible.

Q. And why has Arrington not drilled that well?

A. Because we are here before the Commission trying to get our compulsory pooling approved. So we're trying to do these things in accordance with regulations.

Q. But your understanding is that a well could have been drilled prior to pooling?

A. As a general rule, we don't do that. But I guess according to the regulations that have been made available in prior testimony that that is possible.

Q. Did Mr. Arrington -- or excuse me, Arrington Oil and Gas, didn't mean to personalize it. Did Arrington Oil and Gas respond to -- make any response to Exhibit Number 5 in the blue book, sir? The blue book? That's TMBR/Sharp's exhibits. This is a letter dated May 1st, 2002, to Arrington Oil and Gas and Dale Douglas on Section 25 concerning the Blue Fin 25 Number 1 well. To your knowledge, did Arrington Oil and Gas make any response to that?

A. I do not know.

Q. Do you know whether Arrington Oil and Gas is going to put up any money for drilling the 25 well?

A. I do not know that.

Q. Does Arrington Oil and Gas have an internal land manager?

A. No, they have a lady that serves as internal lease administration and land coordinator.

Q. You had no discussions with anyone at Arrington Oil and Gas concerning whether they were going to conditionally put up their money to drill the Section 25 well?

A. No.

Q. What is the overhead rate that Arrington is proposing on this well?

A. I'm going to defer that question to our technical personnel.

MS. RICHARDSON: I don't think I have anything further. Thank you, Mr. Examiner.

EXAMINER STOGNER: Any redirect?

MR. HALL: Nothing further, Mr. Examiner.

EXAMINER STOGNER: Mr. Bruce?

MR. BRUCE: No questions.

EXAMINER STOGNER: Mr. Carr?

MR. CARR: No questions.

MR. BROOKS: I have a couple.

EXAMINATION

BY MR. BROOKS:

Q. I'm trying to understand, of course, this whole picture, not just the northeast quarter, so some of my questions may not relate specifically to the application that you're testifying about, and if you don't know the answer, feel free to say you don't know.

A. Thank you.

Q. Does David Arrington Oil and Gas own an interest -- Did I correctly understand that David H. Arrington Oil and gas owns an interest in the Ocean farmout in the southwest quarter of Section 25?

A. It's my understanding that there's a voluntary agreement in which Ocean has agreed to assign Arrington a certain percentage of the leasehold that they've acquired via a farmout.

Q. Okay. Does that agreement contemplate that Ocean will acquire any interest in the east half? Because I don't see Ocean on your spread anywhere.

A. I'm sorry, go back to -- Is it my understanding that Arrington would acquire any interest in the -- or Ocean would acquire --

Q. Ocean, yeah.

A. -- any interest in the east half? No.

Q. Okay, so Ocean is not a party of interest in the

east half, except insofar as it affects the --

A. That's correct --

Q. -- of the northeast --

A. -- to my knowledge, the only interest that Ocean has is in the southeast quarter.

Q. Okay.

A. Arrington will have interest in the southeast quarter and perhaps the west half.

Q. You have no knowledge of any agreement by which Ocean will acquire any of Arrington's interest in the east half?

A. No.

Q. Okay. Now, going back to the Stokes Hamilton top lease, because I think I understand the chronology, but I want to get it a little bit -- Now, you were asked about the date of the Stokes Hamilton top lease, and you did not have that information; is that correct?

A. That's correct. I believe the effective date of the top lease is going to be June the 7th of 2002.

Q. Well, the effective date would be whenever the bottom lease expired?

A. That's right, and I don't recall the date that maybe the instrument was actually entered into.

Q. You don't recall when it was signed?

A. I don't.

Q. Okay --

MS. RICHARDSON: Mr. Brooks, I don't mean to interrupt, but it's Exhibit 2, the top leases -- our Exhibit 2 in our blue book.

MR. BROOKS: In the blue book?

MS. RICHARDSON: Yes, sir.

MR. BROOKS: Not the blue book of the Uniform System of Citation.

MS. RICHARDSON: It's been supplemented now.

Q. (By Mr. Brooks) So it was acknowledged, then, on April 4th of 2001, if I read correctly; is that --

A. Yes.

Q. -- the right instrument?

A. Yes, sir.

Q. Okay. Now, the APD, I believe you testified, the APD for the Blue Fin 24 was filed in November of 2000?

A. Yes.

Q. And you didn't have any knowledge of the status of that well, you testified, until June of 2001?

A. That's correct.

Q. Which would have been after the negotiation of the top lease?

A. That's right.

Q. Now, were you monitoring the filings in the District -- not District -- the County Clerk's Office in

Lea County --

A. Yes.

Q. -- to see if there was a unit designation filed?

A. Absolutely, I probably looked as many as a half dozen times between December and June.

Q. That, then, was a matter that Arrington was vitally interested in?

A. Very much so.

Q. And you did not find it?

A. No, I believe the only time that a designation of pooled unit was filed by TMBR/Sharp and its partners, I believe, was in July of year 2001.

Q. Okay. And absent a legally effective unitization, however that might be accomplished under the applicable law, absent the legally effective creation of a unit, then the TMBR/Sharp Stokes Hamilton lease would have expired in June of two thousand --

A. June 7th, 2001.

Q. Okay.

A. Given credit to the six-month extension.

Q. Okay.

A. That again wasn't filed of record until July, it wasn't filed of record until after the six-month --

Q. But you don't dispute the validity of the six-month extension?

A. No, we were made aware by Ms. Hamilton and Ms. Stokes that the six-month extension did exist --

Q. So you didn't --

A. -- and we gave credit to that.

Q. -- Arrington does not in any way claim to be a purchaser for value without notice of that extension?

A. That's correct.

MR. BROOKS: Okay, thank you. I just wanted to clarify that chronology.

MS. RICHARDSON: May I ask a few questions?

MR. HALL: Go ahead.

EXAMINER STOGNER: Okay.

FURTHER EXAMINATION

BY MS. RICHARDSON:

Q. You have the -- If you'll look at Exhibit Number 1, which are the original Stokes Hamilton leases, and turn your attention to paragraph 5 -- and it is a poor copy, and I apologize for that, but the first line reads, "Lessee is hereby granted the right and power, from time to time, to pool or combine this lease..." Do you see that?

A. Yes, I do.

Q. Okay. And that's a typical leasehold provision?

A. Yes.

Q. Okay. Then it says, "Lessee shall file written unit designation in the county in which the premises are

located..." Correct?

A. Yes.

Q. Okay. You understand that Judge Clingman has held that the filings by TMBR/Sharp were sufficient to pool the Stokes Hamilton acreage and preserve that lease?

A. I have been made aware of that.

Q. Okay. And you've also testified that you knew that TMBR/Sharp had filed a dedication plat in the OCD in Hobbs?

A. I have.

Q. In November of 2000?

A. I have.

Q. Okay. This lease goes on to say, "and such units may be designated from time...either before or after the completion of wells." Do you see that language?

A. Yes.

Q. Okay. Are you aware that TMBR/Sharp also, in addition to the OCD filing, filed a unit designation in the County Clerk's records?

A. In July, I believe it was.

Q. Right, 2001. Correct?

A. Yes.

Q. Okay. And Arrington, I guess, respectfully disagrees with Judge Clingman about his order?

A. That's correct.

Q. But nevertheless, Arrington Oil and Gas understands that at this time the Court has ruled that the top leases are not valid and TMBR/Sharp's leases are valid?

A. Yes.

Q. And you are also aware that TMBR/Sharp was granted a permit to drill the Blue Fin Section 25 Number 1 well by the OCC?

A. Yes.

Q. Okay. And you -- Arrington Oil and Gas is not here suggesting to the Commission that TMBR/Sharp did anything wrong by spudding the Section 25 well?

A. Okay.

Q. Is that true?

A. Yes.

Q. Are you aware of leases that sometimes say in order to pool you have to record a pooling designation, as opposed to file?

A. I have not seen the word "record". I've seen "file".

MR. BROOKS: If I may interrupt, if these questions are precipitated by my questioning, I would simply say that, because I would like to get this proceeding over as soon as possible --

MS. RICHARDSON: Sure.

MR. BROOKS: -- I would simply say that I'm aware

of Judge Clingman's rulings. I was just trying to get the -- and I don't -- you know, while I might have ruled differently if I had been the judge, I'm aware also that I'm no longer a district judge. So I think that if we're talking about the facts, the chronology, that was what I was trying to get straight --

MS. RICHARDSON: Surely, sure.

MR. BROOKS: -- but if we're talking about whether or not there's a question about Judge Clingman's rulings and what people's various arguments may be, I don't think that's really before this body to be considered --

MS. RICHARDSON: Yes, sir --

MR. BROOKS: -- so I --

MS. RICHARDSON: -- and that's fine, that --

MR. BROOKS: -- think that's irrelevant.

MS. RICHARDSON: -- that will conclude my questioning. Thank you.

EXAMINER STOGNER: Redirect?

REDIRECT EXAMINATION

BY MR. HALL:

Q. Yes, Mr. Diffee, I don't intend to get into the events that transpired with respect to the east half of Section 25 except to this extent, because of an answer you gave to one of Mr. Brooks' questions. I believe you testified that Ocean Energy had interests in the southeast

quarter of Section 25. Did you mean the southwest quarter?

A. I did mean the southwest, I'm sorry. They have interest in the southwest quarter and nothing in the east half.

MR. HALL: All right. That's all, Mr. Examiner.

EXAMINER STOGNER: Other questions of this witness?

You may be excused.

Let's take about a ten-minute recess at this time.

(Thereupon, a recess was taken at 9:38 a.m.)

(The following proceedings had at 9:55 a.m.)

EXAMINER STOGNER: This hearing will come to order.

Mr. Hall?

MR. HALL: At this time, Mr. Examiner, we would call Bill Baker to the stand.

BILL BAKER, JR.,

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

DIRECT EXAMINATION

BY MR. HALL:

Q. Mr. Baker, if you would, please, state your full name and place of residence.

A. Bill Baker, Jr., in Midland, Texas.

Q. And by whom are you employed and in what capacity?

A. David H. Arrington Oil and Gas, Inc. I'm exploration manager.

Q. And what is your particular expertise, sir?

A. Geology or -- Yeah, exploration.

Q. All right. And you've previously testified before the Division and had your credentials accepted as a matter of record?

A. Yes, sir.

Q. You're familiar with the Application that's been filed in this case --

A. Yes.

Q. -- and the lands that are the subject of the Application?

A. Yes, sir.

Q. You need to indicate for the record --

A. Yes, I'm sorry.

MR. HALL: At this time, Mr. Examiner, we'd offer Mr. Baker as an expert petroleum geologist.

EXAMINER STOGNER: Any objection?

MR. KELLAHIN: No.

EXAMINER STOGNER: Mr. Baker is so qualified.

Q. (By Mr. Hall) If you would, Mr. Baker, provide the Hearing Examiner with an overview of the geology of the

Atoka, Morrow and Mississippian formations in this particular area.

A. Okay. Mr. Examiner, first of I'd like to state that I'm going to have three exhibits today. All of these exhibits were prepared utilizing subsurface well control, basically electric logs.

The first exhibit that I would like to go over is Exhibit Number 6, and this is a structure map on the top of the Morrow limestone, which is a regional marker out in here, pretty well defined everywhere.

What this map basically shows is two northwest-southeast-trending structural features. One is known as the Shoe Bar field. There's Shoe Bar ridge that heads on up towards the northeast -- or, excuse me, the North Shoe Bar field. And then over on the east side of the map we have the East Shoe Bar field.

Our proposed location for the Glass Eyed Midge well will be located on the northwest portion of the East Shoe Bar structure. We are going to be kind of up on top of the structure or structural ridge.

You should note on here that I have cross-section A-A'. It goes from northwest to southeast. And what I'd like to do at this particular time is move to it and show you the primary target in which we will be going.

Q. For the record, that's Exhibit 7?

A. Yes, sir.

Q. Go ahead.

A. Exhibit 7 is a three-well cross-section. And if I might start on the left-hand side and go through these wells. As I've mentioned, our primary target is here. It's what I call the lower Atoka Brunson sand. The Brunson is simply a local name, and it was developed by Yates Petroleum, actually, when they drilled a well up in Section 10 called the Brunson well. I believe Mr. Mazzullo designated it as just a lower Atoka clastic system, but I'm targeting that particular pay horizon, the lower Atoka Brunson interval.

The lower Atoka Brunson interval is a very prolific sand that is produced across multiple townships in this area. It's an old producing horizon. This horizon historically has produced -- the average out here is 5.5 BCF and 120,000 barrels of condensate.

So it's a very, very prolific reservoir when you get one that doesn't show any type of depletion and has the proper reservoir parameters. And that is one of the reasons that it's a primary target for us out here.

Now, what I'd like to do, once again, start on the left-hand side of the cross-section, and the first well I'd like to show you is the David H. Arrington Oil and Gas Mayfly 14 State Com Number 1, and this well was drilled

back in late 1998, early 1999, and it is an Atoka Brunson producer. As indicated, the perforated interval right here is 11,884 to 11,910. This well has currently cum'd about 1.2 BCF and 20,000 barrels of oil, and it's currently producing at a rate of 1.4 million cubic feet of gas per day.

Moving on to the right, you will encounter the Mesa Petroleum Monsanto State Number 1 well. This was one of the early wells drilled over on this kind of eastern part of Township 16-35. This well was drilled in 1975.

Now here, early on, they noted the perforations as being, quote, unquote, the Morrow. And I think at that particular time it was everybody's impression that this was a Morrow sand, because I think they thought the first limestone out from under this was the Mississippian.

Subsequent drilling in this area by wells going deeper, we have come to find out that that was not the Mississippian, that is the top of the Morrow, which ends up making this actually an Atoka interval, not the Morrow.

But anyway, this well was completed in the Atoka Brunson for 1.9 million cubic feet of gas per day. It's currently cum'd 4.2 BCF and 90,000 barrels of oil and is currently producing at a rate of 200 MCF per day.

You continue on to the right on this cross-section, and you'll come to our proposed location for the

Glass Eyed Midge 25 Number 1. It's my interpretation that we will be structurally high to both the two previous wells, and I'll show you in the next exhibit that we anticipate encountering probably between 15 to 20 feet of the Atoka Brunson pay interval.

What makes this prospect even more attractive is the last well on the cross-section, and this is the Jake L. Hamon well, located in Section 33 of 16-36, and this is on to the southeast. And basically what this does is extends this lower Atoka Brunson interval, that it does run in this northwest-southeast orientation.

Now, this well was completed in 1984. Once again, they called it Morrow, 11,719 to 11,727. They CAOF'd it at 680 MCF per day. It's currently made .48 BCF and 13,000 barrels of condensate and is producing at a rate of 40 MCF per day.

And with that what I'd like to do is go to the final exhibit that I have, which is the isopach map.

Q. And that's Exhibit 8?

A. Yes. Exhibit 8 is a net interval isopach of the Atoka Brunson interval across this particular portion of 16-35 out here. I'm interpreting these to be re-worked fluvial sandstones, probably reworked in some sort of a barrier-bar-type system.

If you'll look at the log character on the cross-

section, you'll see that it has a coarsening upwards-tight appearance, which is indicative of a barrier bar system. What you see here is that it's pretty much, once again, in a north-northwest/south-southeast orientation. It's my belief that there's probably a series of these reworked barrier-bar systems in here. But our proposed Glass Eyed Midge well should be directly on strike with the wells coming out of 14 and headed down towards the well in Section 30. We should encounter approximately 15 to 20 feet of the Atoka Brunson interval.

Q. Refer back briefly to your Exhibit 6.

A. Yes, sir.

Q. You've been present through the testimony of all the geologic witnesses here for the last two days. Is it accurate to say that everybody is in agreement that all of the legitimate Morrow development targets anyway are in the west half of Section 25?

A. Yes, sir, I should state that I agree with the geology that has been put on by both TMBR/Sharp and Ocean that the principal place, the principal structural and prospective area for a Morrow target would be centered in the west half of Section 25.

The clearcut structural low, the axis of the low in between these two features, is situated across, you know, kind of the southwest quarter of 24, the southeast

quarter of 23 and then most of the west half of 25.

Q. All right. Isn't it also accurate to say that it's Arrington's proposed well for the Brunson Atoka sand that presents the only legitimate stand-alone discrete development target in the east half of Section 25?

A. Yes, sir, and once again, because of the nature of how fast we're rapidly coming up on the east Shoe Bar structure, it's my opinion that the Morrow here is not going to be a target. I don't anticipate seeing any type of Morrow sands over here.

Q. Okay.

A. Or, should I say, Chester-Austin clastic system which Mr. Mazzullo and Ocean alluded to.

Q. And you're not targeting that?

A. No, sir, we are not targeting that.

Q. All right, geologically, what well location would be best suited to develop the interval targeted by Arrington, the Glass Eyed Midge 25-1 well in the east half?

A. Right now it would be in that northeast quarter of the section. Obviously, that's the proposed best, thickest part of the apparent Atoka isopach.

Q. And TMBR/Sharp's Blue Fin 25-1 well isn't even a contender to produce those same hydrocarbons, is it?

A. No, sir, their Blue Fin 24 well pretty well broke these barrier bar systems in what I believe is two

stratigraphic or three stratigraphic barrier bar systems, and the system that we're going to be testing in the east half of the section will not be affected by anything that's drilled in the west half. If they find Atoka Brunson in Section 25 down there, it in no way will drain the northeast or the east half of this section, based on this interpretation.

Q. All right. Should the Division grant TMBR/Sharp's proposal to create a laydown unit in the north half of the section, will Arrington drill to its target interval at a well location from the southeast quarter?

A. Well, at this particular time, without some additional well control up there in that northeast quarter, no, sir, I don't think we would probably drill that southeast quarter. It is more risky location.

Q. Just based on what we have --

A. Yes.

Q. -- in front of us today?

A. Correct.

Q. So there is some chance the east half wouldn't be developed at all?

A. Yes, sir, there's a good chance the east half would not be developed.

Q. Should TMBR/Sharp get its north-half laydown unit, will it be necessary for the owners in the southwest

quarter of 25 to drill the well to that same interval to protect their correlative rights?

A. Yes, sir.

Q. In your opinion, does the geology indicate that Section 25 is best developed with two wells on standup 320-acre units?

A. Yes, sir, it does. And this is kind of supported by a very interesting thing that popped out to me when I was working here, and what I'd like to do is look at Exhibit 8 here, and with the exception of Section 25 I have outlined approved OCD proration units on here. And these proration units are by four independent companies out here, and that's Yates Petroleum, Chesapeake, Arrington, and actually two of them are TMBR/Sharp's. And coincidentally, they all appear to be north-south -- or excuse me, east-west-type orientated units, is what they are.

What that suggests to me, one of the things that we always look at when creating a spacing unit or how the unit orientation be done is geology. And I think most of the companies out here, the first thing they'll consider is geology. So this would suggest to me -- this pattern would suggest to me that everybody believes that the geological orientation here is best suited to the east-half versus west-half proration units.

Q. So let me make sure I understood what you just

said. Is the predominant spacing development pattern in this area on standups --

A. Yes, they're on standup units, that's what has appeared to happen for the last however many years --

Q. Okay.

A. -- through all these different companies.

Q. And that's shown by your Exhibit 8?

A. Yes, sir.

Q. I wonder if you'd be willing to opine on Mr. Mazzullo's conclusions that the so-called low bowls in the Chester appear to be in four-way closure. Do you have any view on that?

A. Well, I think -- you know, Mr. Mazzullo's presentation, I agreed with everything with the exception of the sands being confined strictly to the bowls. I believe that the graben systems is the preferential area in which the eroded material from the Chester is deposited.

But from a lot of extensive work that we have done -- and we've been involved in, gosh, 10 to 15 wells in this particular -- what I call the trench and/or graben play, most of this stuff is to the north of us. We have not seen that these things are confined strictly to the bowls.

Q. All right.

A. Granted the bowls may -- or -- I hate to call

them bowls -- the lowest part can contain the thickest part of the sand interval, but that doesn't mean that -- outside that you don't have sand.

Q. All right. Mr. Baker, in your opinion is there a geologic risk that the Glass Eyed Midge 25-1 well won't be completed as a commercially successful well?

A. Well, yes, sir. I believe -- you know, there are several wells around us that were dry holes, that didn't get the Brunson. So that's always a risk, and I believe it's a risk here, that we could have a noncommercial or a dry hole, yes, sir.

Q. And you're seeking the 200-percent risk penalty --

A. Yes, sir, the maximum, yes, sir.

Q. -- for that reason?

A. Yes, sir.

Q. In your opinion, Mr. Baker, will granting Arrington's Application be in the interest of conservation, the prevention of waste and protection of correlative rights?

A. Yes, sir, it will.

Q. And will it also avoid the drilling of unnecessary wells?

A. Yes, sir, we believe so.

Q. Were Exhibits 6 through 8 prepared by you or at

your direction?

A. Yes, sir, they were.

MR. HALL: That concludes our direct of the witness. We move the admission of Exhibits 6 through 8.

EXAMINER STOGNER: Any objection?

MR. KELLAHIN: No.

EXAMINER STOGNER: Exhibits 6, 7 and 8 will be admitted into evidence at this time. Thank you, Mr. Hall.

Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Examiner.

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Baker, where are your maps on the Chester?

A. I didn't submit any maps on the Chester.

Q. Why not?

A. It was not prospective at my proposed location.

Q. Isn't that an issue in the whole section?

A. It's not an issue for the east half from my force-pooling cases.

Q. How about in the west half?

A. Yes, sir, but I was not testifying as to the west half.

Q. Have you prepared any Chester maps for Section 25?

A. Well, first off, I would like to clarify that

what I consider what they call the Chester, I classify as, quote, unquote, the Austin Morrow. I have a different nomenclature for it. But yes, sir, I have conducted independent studies of that clastic system.

Q. So with your expertise in this area, you're not prepared this morning to aid us in your understanding of the Chester by giving us any maps?

A. I did not bring any exhibits to show, no, sir.

Q. All right, sir. Let's look at Exhibit Number 6. Does David H. Arrington have 3-D seismic data?

A. Yes, sir, we do.

Q. When did you acquire it and from whom?

A. We shot it, it's proprietary data that we shot, and it was shot in late -- probably October, November of 2001. Or excuse me, 2000.

Q. October of 2000?

A. Of 2000.

Q. Okay. Do you have any other seismic data?

A. Not in this immediate area, no, sir. We have substantial seismic data across the Lovington area.

Q. The October, 2000, seismic data covers what area?

A. A fairly large, extensive area that goes to the west and both to the east and slightly a bit to the south too.

Q. Let's look at our Big Tuna area, the four

sections, using TMBR/Sharp's nomenclature. In 23, did you have any seismic data in October of 2000?

A. We were shooting that in October. We did not have the data in hand until early January, 2001.

Q. I'm just talking about that data set.

A. Yes, sir.

Q. Did that data set include any portion of Section 23?

A. Yes, sir it did. 23?

Q. Yes, sir.

A. Yes, sir.

Q. Move over into Section 24. Does that shoot or that data set include anything in 24?

A. Only about the bottom -- a little more than the bottom 80 acres. Our northern unit of our shoot is just north of the Blue Fin well.

Q. It stops where?

A. Just north of the Blue Fin well.

Q. At what point in the section? Would it include any portion of the southwest quarter of 24?

A. Yes, sir, about the south half of the southwest quarter.

Q. The south half of the southwest quarter?

A. The south half -- well, yes, sir, the south half of the southwest quarter. It's basically tail, is what it

was.

Q. Okay. Does it include any portion of the north half of the southwest quarter of 24?

A. No, sir.

Q. Okay, so you just have the south 80 out of the southwest quarter of 24?

A. Pretty close, yes, sir.

Q. When we go down into 25, what portion of that shoot includes Section 24 -- I'm sorry, 25?

A. All of it.

Q. You have covered all of 25, both the west half and the east half of 25?

A. Yes, sir.

Q. How about in 26? Does it cover any portion of Section 26?

A. All of it.

Q. Did you have access to any other seismic 3-D data, other than this October shoot?

A. No, sir.

Q. Nothing else?

A. No, sir.

Q. You didn't have or did not utilize any of the Chesapeake data that --

A. No, sir.

Q. -- was utilized by TMBR/Sharp?

A. No, sir, we certainly do not.

Q. When I look at this amplitude map, to what extent have you utilized seismic data to make this interpretation?

A. Excuse me, you said amplitude map?

Q. Yeah, it says --

A. Attribute map?

Q. Attribute --

A. The structure map.

Q. All right, the structure map, is there any seismic data integrated into that map?

A. No, sir. It's all subsurface.

Q. All right, I'm just trying to make sure what you used.

When I look at the structure, and I'm looking at Section 25 --

A. Yes, sir.

Q. -- do you attach any significance that the drilling well in Section 25 is within the 8300 contour line of that structure?

A. Well, I mean, I think just simple subsurface control indicates that that's the bottom part of the low in between the two structures.

Q. All right, so I'm looking at a structural interpretation that shows that's the bottom of the low?

A. Well, I mean just using contours -- I mean, we

didn't use any type of seismic to get to that subsea depth, if that's where you're headed.

Q. All right. I'm just --

A. Okay.

Q. -- trying to forget my English literature degree and trying to look at this map.

A. Uh-huh.

Q. I'm looking at a low --

A. Uh-huh.

Q. -- and if I am low in the Morrow --

A. Uh-huh.

Q. -- in Section 23 -- 25 --

A. Uh-huh.

Q. -- the lowest point under your interpretation is below the 8300 contour line?

A. Yes, sir.

Q. That gives me the lowest point?

A. Uh-huh.

Q. How have you defined the size, shape and location of that low? What's the control points that allow you to do that?

A. Well, I think you can just look at the subsurface geology out here and see how both the two structures -- the Shoe Bar structure is plunging off to the east, the east Shoe Bar structure is plunging off to the west, the

TMBR/Sharp well there is the lowest known well out there in between these two features at a subsurface depth of minus 8212. And so you just use contour patterns and say, well, everything looks like it's just heading down into a low there in 25.

Q. All right. There is no adjacent well-control data to help you define the size and the shape of that low, right?

A. No, sir. No, sir. Huh-uh.

Q. Is it appropriate exploration strategy to try to access the Morrow in this area by drilling a low?

A. Yes.

Q. Okay.

A. Uh-huh.

Q. And if I'm going to drill a low and I'm looking at Section 25 --

A. Uh-huh.

Q. -- it looks to me, if that's my criteria --

A. Uh-huh.

Q. -- I have that opportunity in the northwest quarter of Section 25.

A. Yes, sir.

Q. And I also have that opportunity in the southwest quarter of 25?

A. You sure do, yes, sir.

Q. And when we rank the rest of the quarter sections, how would you rank the east half of 25 in terms of the best opportunity in the Morrow?

A. The northeast quarter has almost no potential whatsoever. The southeast quarter would have very minimal, minimal Morrow potential.

Q. Have you prepared an isopach in association with the Morrow?

A. Yes, sir. Not here, no, I didn't bring one.

Q. Oh, you didn't bring one?

A. No, because it doesn't affect my case in the east half.

Q. Well, if you're targeting the Morrow in the northeast quarter of the Section, what is your strategy for that well location in the Morrow?

A. I'm not targeting the Morrow, I'm targeting the lower Atoka Brunson --

Q. No --

A. -- in the northeast quarter.

Q. -- I'm looking at your well symbol in the northeast quarter of 25 --

A. Yes, sir.

Q. -- and I'm looking at the legend. It says it's a structure map of the top of the Morrow lime.

A. Uh-huh.

Q. Are you telling me there is no opportunity for you at this location for Morrow production?

A. Not for Morrow production, no, sir.

Q. Okay. The best opportunity to do that remains the two quarter sections I've just described?

A. Which two were those?

Q. The northwest quarter and the southwest quarter --

A. Yes, sir.

Q. -- of 25?

A. Correct.

Q. And that can be accessed if the spacing units are laydown spacing units?

A. It could be, but that's not the preferential way it should be done.

Q. I'm trying to say that you could subdivide that feature and have a north-half spacing unit and a south-half spacing unit?

A. You could, but that's not the preferential way, once again.

Q. Okay. Do you have a seismic presentation to make on any of these features in Section 25 today?

A. No, sir, I don't.

Q. When I look at the cross-section --

A. Uh-huh.

Q. -- let's start in A' --
A. Okay.
Q. -- at the Jake Hamon well.
A. Uh-huh.
Q. Did that produce in the Morrow?
A. That's what they call it, yes, sir.
Q. I see by the color-coding and where you located the perforation, that you have located it in what we've characterized as the Brunson sand of the lower Atoka?
A. Yes, sir.
Q. The caption below that well says December of 1984, and it calls it Morrow perforations?
A. Yes, sir, but I think they were wrong in their classification. I think subsurface well control out here now will clearly show that's an Atoka producer.
Q. All right, I'm just trying to understand the difference.
A. Correct, right.
Q. So you're looking on this cross-section for the Brunson sand --
A. Yes, sir.
Q. -- you find it in the Hamon well --
A. Yes, sir.
Q. -- and that well is in the southeast quarter section of 30?

A. Yes, sir.

Q. And the next control point we have for your analysis is the Mesa Petroleum well?

A. Yes, sir.

Q. Where's that well?

A. That well is located in the southwest quarter of Section 14.

Q. We have to go almost two miles to get to that control point?

A. Yes, sir. And it's amazing that they still correlate as well as they do that far away.

Q. You can correlate potential hydrocarbon-containing portions of a reservoir that may be geologically separated, right?

A. Absolutely.

Q. Have you attempted to integrate any of the faulting that is known in this area?

A. I have not seen any Atoka faulting that would affect this particular drill site, no, sir, I haven't seen anything that would affect it.

Q. Do you subscribe to Mr. Mazzullo's hypothesis that you can have a lower Chester bowl that is discontinuous from the next associated bowl?

A. Not without some type of faulting.

Q. Okay. Have you reached any conclusion with

regards to the Chester potential in the east half of Section 25?

A. Yes, sir.

Q. And what's that?

A. I don't think there is any.

Q. All right. So you disagree with both the Ocean geologist and with Mr. Mazzullo about where each of those have drawn the Chester pods spilling over and extending into the southeast quarter of that section?

A. Well, okay, if you're going to address -- I thought you were talking about at my specific location.

Q. I'm talking about --

A. Okay.

Q. -- your option of the fact that you thought their testimony was acceptable to you --

A. It is.

Q. -- as an expert.

A. It is.

Q. And so when I look at these maps --

A. Right.

Q. -- both the TMBR/Sharp map and the Ocean map, you do not disagree with their conclusion that the Chester spills over into the southeast quarter of Section --

A. The southeast quarter could contain maybe 10 or 15 percent of the Morrow section over there. That's a

guess.

Q. And that will be captured in which way?

A. Well, basically the way we would probably attempt to capture it is, you would independently determine if that's an economic drill site and we're within our rights to go down there and propose a well and drill it.

Q. Okay. In the absence of doing so, who's going to take those gas reserves?

A. In the absence of us proposing a well down there?

Q. Yes, sir.

A. Well, it's going to be whoever is draining the west half.

Q. All right. And if you're Yates with the ownership of the southwest quarter of 25, how are you going to participate in production from a well that drains your portion of the pod?

A. Well, basically what you do is, you can propose a well. And I mean, Yates is equally right to propose the well, if they deem it economic, to go in and capture that 15 percent that appears to be on their acreage or whatever small percentage that is. If they deem that that's an economic target, they can propose it just as easy as I can, go down there and drill a well for that Morrow target.

Q. Let's look at your Brunson map.

A. Yes, sir.

Q. It's Exhibit 8. Here I have an isopach, or your isopach, of the Brunson sand?

A. Yes, sir.

Q. Do you have a copy of the Ocean --

A. Yes, sir.

Q. -- isopach for the Brunson interval? It's Ocean Exhibit 10.

A. Yes, sir.

Q. Would you please find that for me?

A. Uh-huh.

Q. When I look at your interpretation in Section 25 --

A. Uh-huh.

Q. -- would your strategy in the Brunson be a strategy where you attempt to locate the Brunson well at the point of greatest isopach thickness?

A. It's dependent on which one of those two Brunson intervals I was going for, the one on the east half or the west half. But yes, you always want to try to identify where the thickest, most porous section of the pay sands would be. But I have two sands coming down through there.

Q. All right, let's talk about your sands. Let's look at Section 25.

A. Yes, sir.

Q. Visually on your map --

A. Uh-huh.

Q. -- if I am going to rank each quarter section starting with the quarter section that has the highest priority in terms of greatest maximum thickness, I'm going to look at the southwest quarter of the section?

A. Correct.

MR. HALL: Mr. Kellahin, just so I'm clear, we're looking at Arrington Exhibit 8?

MR. KELLAHIN: Yes, sir, we are.

MR. HALL: Okay.

MR. KELLAHIN: We haven't moved to Ocean 10 yet.

Q. (By Mr. Kellahin) On Arrington's Exhibit 8, the quarter section with the greatest thickness and the best opportunity in the Brunson sand is the southwest quarter section?

A. Correct.

Q. The next best would be the northwest, apparently?

A. No, sir, it would be the northeast.

Q. I'm sorry, the northeast. You have northeast priority over the --

A. Well, going over my isopach, then, I have 20 feet of sand in the northeast, and I have 20 feet in the southwest, so --

Q. Well, help me reach your values. I am looking at the northwest quarter of 25. Your projection is, that well

is located at a contour line at what thickness?

A. It would be about five feet for the -- the approximate well that's being drilled right now. Now, that's -- the location I have on there is the one that we had proposed that has been taken away, but TMBR/Sharp's isn't but about a hundred feet from that, but --

Q. I'm sorry, I --

A. -- roughly around five feet.

Q. -- I may have misspoken, Mr. Baker. In Section 25, in the northeast quarter section --

A. Yes, sir.

Q. -- where you proposed your well for the east half --

A. Yes, sir.

Q. -- I see a -- It's a little hard for me to pick out. Is that a ten-foot or an eight-foot number.

A. Our well location is at a 20-foot.

Q. All right, that's a 20-foot?

A. Yes, sir.

Q. All right. When I move over to the drilling well, the TMBR/Sharp well in the northwest quarter section --

A. Yes.

Q. -- what have you projected for the footage in the Brunson sand on your map?

A. Approximately five feet.

Q. All right. So you say the best Brunson sand opportunity is going to be the southwest quarter of 25?

A. For that western channel system, yes, sir --

Q. All right.

A. -- or rework system, whatever, uh-huh.

Q. Have you looked at the Ocean isopach of the Brunson sand, Exhibit 10?

A. Yes, sir.

Q. Do you have that before you? When you look at the positioning of the Brunson sand in the southwest quarter of Section 25, you and Ocean have a disagreement about the size, shape and location of the 20-foot contour line, do you not?

A. Yes, sir, that's probably just interpretation. There's nothing to guide it.

Q. Let's look for our guides. If you go to the Ocean Exhibit 10 and I look in Section 26, in the southwest quarter section, I have a Brunson sand well on the Ocean map that has 14 over 20.

A. Uh-huh.

Q. Did you utilize that data point?

A. No, sir, I didn't.

Q. Why not?

A. Because I was -- once again, I was more concerned

with the east half of Section 25, and I really wasn't concerned with what was happening -- you've probably just got a little isolated sand. Even Mr. Messa didn't really utilize it for his isopach.

Q. Well, I'm trying to understand your methodology, Mr. Baker. If the only way I can infer the location and the thickness of the Brunson sand in 25 is to use associated well data beyond that section, how do you interpret the location of the thick if you ignore the well in 25?

A. I'm not ignoring the well from 25.

Q. The well from 26 has been ignored.

A. Once again, sir, I mean, that was way up on a high. Everything I was interpreting back to the east, I have solid well control defining my eastern edge there, I have a good trend coming right out of Section 14 down through there, and that was the way I determined my location.

Q. Well, how does the well in the southwest quarter of 26 produce from the Brunson interval?

A. Probably very similar to the one down in 30 did, you've probably got a little isolated sand sitting up on top of that structural high.

Q. And it's so small that you're unable to show us on this map its size, shape and orientation?

A. I just neglected to put it on there.

Q. Isn't that your closest western control to the thickness of the channel system in the Brunson sand that you've displayed through Section 25?

A. I would actually have to come up to the TMBR/Sharp Eidson well in Section 23 and say that's more definitive.

Q. Okay. What do you think in Section 24 of the opportunity for the TMBR/Sharp well, 24, to encounter the Brunson interval?

A. The one in 24, sir?

Q. Yeah, the drilled well, the 24 --

A. They've got about nine feet of tight Brunson sand in my interpretation.

Q. And under nine feet -- Has it been tested, do you know?

A. I do not know if it's been tested, but based off their logs I would say it would be noncommercial.

Q. All right. So the Brunson sand interval for the 24 well doesn't exist?

A. I don't think so.

Q. All right. What controls the thickness of the Brunson sand interval in the northeast quarter of Section 25? You've got 20 feet for me. What controls --

A. I'm just extrapolating the last known points

coming out of Section 14.

Q. You've simply done it by inference out of Section 14?

A. Yes, sir.

Q. Nothing more to it than that?

A. Nothing else you can use.

Q. Okay. At one point in time, did not Arrington have an approved APD, in July of last year, for a west-half spacing unit in Section 25?

A. Yes, sir, they did.

Q. And that well was to be located in the northwest quarter, was it not?

A. Yes, sir, it was.

Q. And the location of that well in the northwest quarter, for purposes of accessing the Brunson sand, is inferior to a well location in the southwest quarter?

A. Yes, sir, it was.

MR. KELLAHIN: No further questions.

EXAMINER STOGNER: Thank you, Mr. Kellahin.

Any redirect?

MR. HALL: Briefly, Mr. Examiner.

REDIRECT EXAMINATION

BY MR. HALL:

Q. Mr. Baker, Mr. Kellahin asked you why you didn't utilize that well control data point in the southwest of 26

there. If you'll refer to Exhibit 6, did that faulting along that section have any bearing on your decision not to utilize that data point?

A. Well, in all honestly, I mean, that thing was sitting up on top of a high, and it really didn't affect anything that -- in my opinion, that I was doing to the east of it over there. I didn't have that log available to me, so I just didn't put it in.

Q. Your data point in Section 30 is somewhat closer anyway, isn't it?

A. Yes, sir, it is.

MR. HALL: Nothing further, Mr. Examiner.

EXAMINER STOGNER: Thank you. Mr. Bruce?

MR. BRUCE: No questions.

EXAMINER STOGNER: Mr. Carr.

MR. CARR: No questions.

EXAMINER STOGNER: Any other questions of this witness?

EXAMINATION

BY EXAMINER STOGNER:

Q. Referring to Exhibit Number 8, you were talking about the orientation of the spacing units?

A. Yes, sir.

Q. When did drilling occur out here, when did these proration units start getting formed?

A. Well, Mr. Stogner, I have not gone back and researched when each one of these was done, but I mean if you just simply go off when the Mesa well was drilled, that was 1975, and that was the one in Section 14.

So just based off of that, I would say the earliest one was in 1975. Now, I know most of Yates Petroleum wells that were up in Section 11 and Section 10 were all centered around the time that Carlisle well blew out, which was probably 1997.

MR. BRUCE: 1998.

THE WITNESS: 1998, thereabouts. I know Chesapeake's wells there in Section 15 were in 1999 to 2000. Our Mayfly leases were in 1999. TMBR/Sharp's well, their Eidson well, I'm not sure. I think that was 1998, thereabouts.

So I would have to say that with the exception of the Monsanto well, most of them have been the last five years.

Q. Okay, five years ago what were the rules and regulations? How many wells could you have on a 320-acre spacing unit?

A. I'm pretty sure it was just one, is what it was at that time.

Q. Would that have some bearing on how a proration or spacing unit was oriented, over the ability to have two?

A. Well, it very well could have. Because then once again, I mean, you would orient that unit believing that you might have a cause for an increased density well. So it would almost become a geological unit, although I don't think the State of New Mexico lives and dies by geological units. But that would be a reason to do, so that you could drill a secondary well within it.

Q. So there's other factors besides geology on orientation, like drainage?

A. Oh, I'm sure there are, yes, sir.

EXAMINER STOGNER: Are there any other questions of this witness?

You may be excused.

MR. HALL: Nothing further of this witness.

EXAMINER STOGNER: Mr. Hall?

MR. HALL: At this time, Mr. Examiner, we would call Chuck Sledge to the stand.

CHARLES W. SLEDGE,

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

DIRECT EXAMINATION

BY MR. HALL:

Q. For the record, sir, please state your name.

A. My name is Chuck Sledge.

Q. Mr. Sledge, where do you live and by whom are you

employed?

A. I live in Midland, Texas. I work for David H. Arrington Oil and Gas, Inc.

Q. And what do you for Arrington?

A. I'm the operations manager.

Q. And what is your particular technical background?

A. For David H. Arrington, since I've been there just short of two years, I have done all of the drilling, all the completions and overseen all of the operations, general operations to get the wells on production that we drill.

Q. You're a petroleum engineer?

A. Yes, sir, I am.

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

A. Yes, sir, I have.

Q. And you're familiar with the Application filed in this case and the lands that are the subject of the Application?

A. Yes, sir, I am.

MR. HALL: At this time, Mr. Examiner, we tender Mr. Sledge as a qualified expert petroleum engineer.

EXAMINER STOGNER: Any objection?

MR. KELLAHIN: No, sir.

EXAMINER STOGNER: So qualified.

Q. (By Mr. Hall) If you would, please, Mr. Sledge, would you give Examiner Stogner an overview of Arrington's operations in the area we've been talking about the last two days?

A. Yes, sir, in the last three and a half, four years, I believe David Arrington has drilled approximately 25 wells in this vicinity that we've been talking about. Since I've been there over the last two years, just about, I've drilled about 17 or 18 wells, including re-entries and different projects.

Q. In your view, has Arrington developed a particular expertise in drilling and completing Atoka, Morrow and Mississippian wells in this immediate vicinity?

A. Most certainly.

Q. Let's look at Exhibit 9 briefly. Is that your AFE exhibit?

A. Yes, sir, it is.

Q. Would you review the well totals on there for us, please?

A. Yeah, the completed cost for an Atoka Brunson well would be approximately $876,000, and -- the dryhole cost, excuse me, is $876,000. And the completed cost would be $1.36 million.

Q. Now, are those costs in line with what's being charged by other operators in the area for similar wells?

A. Yes, sir, it is.

Q. Have you made an estimate of the overhead and administrative costs while drilling and producing the well?

A. Yes, it would be $6000 per month drilling overhead and $600 a month producing overhead.

Q. And are those costs also in line with what's being charged by other operators in the area?

A. I believe they are, yes, sir.

Q. And are you recommending that those drilling and producing overhead rates be incorporated into any order that results from this hearing?

A. Yes, sir.

Q. And it's been previously testified to that Arrington seeks a 200-percent risk penalty in this case?

A. Yes, sir, we do.

Q. And do you believe that rate is appropriate?

A. Yes, I do.

Q. Is there a risk from an engineering standpoint that the well may not be successful?

A. I think with my experience in this area, anytime you go below 11,000 feet in this area, the risk factor goes up substantially due to reservoir concerns, shales you encounter and overpressure zones.

Q. Now, Mr. Sledge, in your opinion is Section 25 best developed with standup 320-acre units?

A. Yes, sir, I believe so.

Q. What's the basis of your opinion?

A. Well, I have two reasons for thinking through this here, in listening to all this the last couple days, is, standup 320-acre units would be the most accommodating to Ocean Energy's geological and David Arrington's geological interpretations in the section, particularly in our case, the Atoka Brunson, northeast quarter.

And secondly, and probably more important, I believe that the standup 320s in this section prevents the drilling of an unnecessary well, which I think Ocean would have to do if the north-half laydowns were granted. And they have to protect their correlative rights, so I believe that's a very important reason why the standup 320s are more applicable.

Q. Now, if the laydown 320s are imposed, is there a substantial likelihood the east half would go undeveloped?

A. Yeah, I think that -- first of all, I think that it would certainly delay or prevent the development of that Atoka sand that we're very interested in, in the northeast quarter. And again, secondly, you know, to follow up on that is, it would again force Ocean to do something that I don't think is economically prudent right now.

Q. And that is drilling of additional --

A. Drilling another well, yes.

Q. Is a single well located in the northwest quarter of 25 capable of efficiently draining the reserves underlying the west half of this section?

A. Yes, I believe it is.

Q. And in your opinion, are the reserves underlying the east half best developed, a single well on an east-half unit?

A. Well, I believe that if Ocean is forced to drill a well over there, it paints kind of an ugly picture in what happens here. First of all, you've got the 24-1 well, and it is approximately -- from my understanding of the placement of the 25-1 well by TMBR/Sharp, they're only 2600 feet apart. And if Ocean drills in what I've heard their location would be, 1980 from the south line and 1980 from the west line of Section 25, that would be approximately -- my limited geometry -- 1400 feet from the 25-1 well currently being drilled.

So in a span of 4000 feet, let's say, from the 24-1 well to the well that Ocean would be forced to drill to protect their correlative rights, in 4000 feet you'd have 3 wells in this reservoir, and I think that's way overkill in trying to develop the reserves in this area.

Q. Would that additional well have an adverse effect on the economics of development for this section?

A. I certainly think so. As we drill these -- let's

call them graben -- in fact, when I first got there I think they showed me geologically what we were drilling for and to help me understand, because I like to understand what kind of targets we're going after, and I've always considered them, in the geophysics I've seen, as graben trends or elongated graben trenches, let's say.

So I started looking at wells in this immediate area, and whenever we drill wells, we do some in-house economics based on what we think are recoverable reserves. And I've looked at several wells in the area, and periodically I update production curves, or I get production curves, I'll look at potential reserves for these wells that are producing. From my understanding and from my knowledge in the area, there's not a lot of wells that are producing out of these grabens, not a tremendous amount.

In this vicinity I've done a little bit of decline work on some wells, decline-curve analysis, and the good wells, I've found, might make 3 to 4 or 5 BCF. The great wells that produce from these grabens might be upwards of 6 to 8 BCF reserves.

That said -- and to confirm that number, Jeff Phillips testified that he believed the 24-1 might produce 5 BCF, and I think I heard him say that they anticipate at least 4 BCF from the 25-1 well, and I believe I heard him

say that there's in his opinion, 1 BCF reserves in the southwest quarter. I believe I heard him right. That would be -- what's that? -- 9 BCF.

Well, it is my opinion, and I believe our geological interpretation, or at least Ocean's presented today, that that's contiguous. So the 5 he gave the 24-1 and the 4 he gave the 25-1 really are shared reserves, in my mind. They share the same reservoir. The 219 acres, as defined by Ray Payne with Ocean, I think, is shared with the 25-1 well, and I think ultimately they'll find that there will be drainage from the 24-1 well to the 25-1 well once it's completed.

That said, that kind of confirms my decline-curve work of -- say a good well might make 6 to 8 B. So you take his and you get close to 6 or 7 BCF in that reservoir.

If you have two wells, let's just say, to the Morrow, at $1.5 million apiece, sharing 6 BCF, that is far more economical than a third, fourth well prematurely drilled for the wrong reasons. That would mean $4.5 million having to split 6 BCF.

So the answer is yes, in short.

Q. So you've got three wells leading into the same 9-BCF reservoir. Economics simply do not --

A. Assuming it's that big, yes. I think two could sufficiently drain it.

Q. And three would result in economic waste?

A. Certainly.

Q. If Arrington's Application is granted, will it result -- will the drilling of an unnecessary well be prevented?

A. If Arrington's --

Q. Let me rephrase that. Will granting Arrington's Application prevent the drilling of an unnecessary well --

A. Oh, yeah.

Q. -- in Section 25?

A. Yes.

Q. And in addition to that, in your opinion, would granting Arrington's Application for an east-half unit in this compulsory case be in the interests of conservation, the protection of correlative rights --

A. Yes, sir.

Q. -- and prevention of waste as well?

A. Yes.

Q. Now, was Exhibit 9 prepared by you?

A. Yes, it was.

MR. HALL: That concludes my direct of this witness, Mr. Stogner. We move the admission of Exhibit 9.

And also, because this is my last witness, I'd move the admission of Exhibit H-1 we talked about yesterday. It's Hopkins 1.

EXAMINER STOGNER: Exhibit H-1, that was presented during the testimony and TMBR/Sharp; is that right?

MR. HALL: That's right.

EXAMINER STOGNER: Is there any objection?

MR. KELLAHIN: No, sir.

EXAMINER STOGNER: Exhibit H-1 of Arrington will be admitted into Arrington will be admitted into evidence at this time.

And any objection to Exhibit 10?

MR. KELLAHIN: No, sir.

EXAMINER STOGNER: Now, what about Exhibit -- I mean, Exhibit 9 is admitted.

And Exhibit 10 is your notice?

MR. HALL: Yes, I move the admission of Exhibit 10 as well. That's my Rule 1207 affidavit.

MR. KELLAHIN: No objection.

EXAMINER STOGNER: Exhibit 10 is hereby admitted into evidence at this time.

Thank you, Mr. Hall.

Mr. Kellahin, your witness.

CROSS-EXAMINATION

BY MR. KELLAHIN:

Q. Mr. Sledge, why did Arrington gather and attempt to lease well -- leases in the northeast quarter of Section

25? What's the reason for doing that?

A. I'm not sure I'm the right guy to ask that question. It would be my belief, because Bill's subsurface geology indicated a good Atoka Brunson potential.

Q. Are Arrington's lease acquisitions based upon a technical evaluation of the data?

A. I would say most certainly.

Q. You do that first, and then you go out and acquire a lease position?

A. I would say most of the time.

Q. Is that what occurred here, in the northeast quarter of Section --

A. I'm not sure --

Q. -- 25?

A. -- I can honestly answer that, because I can't say I know that as a fact.

Q. Talk to me about the distances between wells. We were looking at Section 25. You said if you have two laydown spacing units, you would have to drill a second well in the southwest quarter, and it could be a certain distance between the wells?

A. Well --

Q. What were you saying?

A. -- it is my understanding that if TMBR/Sharp is granted a north half --

Q. All right.

A. -- that Ocean Energy, based on their expiration of their farmout and their inability to get a *force majeure* granted in court, that it is my understanding that they would drill the well -- a well, a Morrow -- or excuse me, a Chester well, 1980 from the south line and 1980 from the west line in order to protect their correlative rights.

That being the case, my quick geometry indicates that it would be approximately 1400 feet away from the 25-1 well apparently being drilled.

Q. When we look at Exhibit 8, the geologic map that Mr. Baker presented, he spots the Brunson wells on that map. Which of these wells are Arrington wells on this map? Are there any?

A. We have no production in that section.

Q. All right. So if we're using your criteria about keeping wells a certain distance apart, look up in Sections 10, 11, 12 and 15. Are you concluding that these wells have been drilled too close together?

A. I don't know at what depth, I'll have to dig this out. But it is my interpretation that those wells would be from a different reservoir than the Morrow or Chester that's been discussed here today. They may be shallower, they may be tighter, and they may have smaller proration units and density developments. I don't think that's

analogous to the Chester that we've been talking about.

MR. KELLAHIN: Thank you, Mr. Stogner.

EXAMINER STOGNER: Any redirect?

MR. HALL: Nothing further, Mr. Examiner.

EXAMINER STOGNER: Mr. Bruce?

MR. BRUCE: No questions.

EXAMINER STOGNER: Mr. Carr?

MR. CARR: No questions.

EXAMINATION

BY EXAMINER STOGNER:

Q. In referring to Exhibit Number 9, did you prepare this?

A. I'm sorry, Number 9, is that the AFE, sir?

Q. Yes.

A. Yes, sir, I did.

Q. Okay. Now, up at the top it says "Objective". Now, does that signify the total depth or the primary objective for a well?

A. Generally in the AFEs I put together, our objective -- my objective that I put down is the lowermost interval we want to penetrate to TD.

Q. Through your testimony today, is it my understanding that you're opposed to the optional infill that the state has for southeast development of deep gas in New Mexico?

A. State that question again, please, sir.

Q. What I'm hearing is that you're thinking -- you're saying that there would be too many wells out here, under the current rules and regulations allowing two wells per 320.

A. That's not my indication. I'm more concerned of too many wells draining reserves that can be drained by two wells.

Q. Okay. Are you proposing a unit that everything would be equal, then, throughout this reservoir?

A. No, sir.

Q. Okay. So you do recognize the ability for other people to protect their correlative rights by placing wells as they see fit?

A. Sure, certainly.

Q. Under your development proposal -- or under this plan, are you proposing, or does Arrington -- will they be proposing a well in the southeast corner to protect what drainage is coming out of the Chester?

A. I think that that decision will be based on the results of what happens with the 25-1 well and -- you know, you have one more control point when this well is through the reservoir. I don't think that can be determined at this time.

I mean, Bill Baker's -- I have seen Bill Baker's

interpretation of the Morrow or Chester isopach. It's not here today, and when we were -- first had a well proposed in the northwest quarter, I saw his isopach map, and it didn't show even as much pay as Ocean Energy or TMBR/Sharp has shown to be in that southeast quarter.

I think that, as Bill stated earlier, if the owner of that southeast quarter found it to be sufficient to develop that little piece of reserves that people have indicated here the last two days, they could certainly propose a well. I don't believe we would, based on what we know today, and I certainly believe that that little piece of reserves will be drained if it is at -- or the reserves established for it will be drained by the 25-1 well.

I couldn't recommend anyone drilling a well in the southwest quarter, especially being forced into doing it for various reasons as an economic decision. I think those reserves in the southwest quarter will be drained by the 25-1 well and the 24-1 well, because I believe that reservoir is contiguous.

Q. But there would be drainage -- According to your answer, as I understand it, there would be drainage off that southeast corner?

A. If there's actual pay over there, there may very well be. But just to drill a well in that southwest quarter to protect someone's rights on a laydown south half

doesn't mean it's economic. I don't think it would be economic to drill a well in the southwest quarter for the reserves you'd get in the southwest quarter added to the reserves that might be in the southeast quarter.

So it doesn't make economic sense to drill in the southwest quarter, in my mind, or the southeast quarter for those reserves. There's not enough information to justify that action. And based on my look at the area up there, I don't see a lot of -- three wells defining a graben development in this area. I've seen one and I've seen two, but I certainly haven't seen a third well that would be economic at all.

Q. So you're basing your answer purely on economics and not on the protection of correlative rights?

A. That's correct.

EXAMINER STOGNER: Any other questions of this witness?

MR. HALL: Nothing further.

EXAMINER STOGNER: Have you got one, Mr. Kellahin?

MR. KELLAHIN: Yes, sir.

FURTHER EXAMINATION

BY MR. KELLAHIN:

Q. TMBR/Sharp as afforded Arrington the opportunity to conditionally participate in the drilling well in

Section 25. Is Mr. Arrington going to afford himself of that opportunity?

A. I don't really know that answer. I believe --

Q. Aren't you the operations manager?

A. Yes, sir, I am, but --

Q. Wouldn't you know that?

A. Yeah -- Well, there's a trick to that question because there is a title dispute. And there being a title dispute, I don't think we're going to knee-jerk into any pooling unit based on that. I think that, you know, based on the results of that title dispute, we would have a bigger interest -- I may be wrong, but I believe a bigger interest in a west-half spacing than a north-half spacing. So it's in our interest there to support the north-half -- the west-half spacing.

Q. Well, the proposal from TMBR/Sharp to Arrington is a conditional proposal, so you can conditionally participate and protect your rights to have that result changed?

A. I think we'd have to sit down with our attorneys to make that call. I'm not --

Q. There was a May 1st letter sent to Mr. Arrington and Mr. Douglas on this topic. It's in the TMBR/Sharp exhibit book behind Exhibit Tab 5. Have you addressed that letter yet?

A. No, sir.

MR. HALL: Mr. Examiner, I'm going to object to this line of questioning. It's really not relevant to the east-half pooling case at all. And it also calls for speculation on the part of the witness what they may or not do, based on several different scenarios, given what may transpire in the District Court litigation.

MR. KELLAHIN: Well, that's true, Mr. Stogner, he said he doesn't know.

EXAMINER STOGNER: Okay, are there any other questions at this time?

THE WITNESS: Mr. Stogner, may I just add that, yes, we based that decision on economics moreover than correlative rights. But if we don't base it on economics, we'll go out of business. I mean, that has to be the number-one -- You know, if we don't make money drilling these wells, you know, there will be no wells drilled and no one will get revenues from oil and gas out there. At least that's my thought.

FURTHER EXAMINATION

BY EXAMINER STOGNER:

Q. Okay, that stirs me to another question, then. Are you proposing special pool rules to limit the number of wells in this pool?

A. Not at this point, I don't think there's --

Q. Why not?

A. I don't believe there's enough reservoir data yet. Let's get the second well down. Let's get more information, pressure buildup data, drainage radiuses. I mean, there's a lot that you can obtain from reservoir data.

EXAMINER STOGNER: Any other questions?

MR. HALL: No, Mr. Examiner.

EXAMINER STOGNER: You may be excused.

I believe we're ready for closing statements at this time.

Since we started with Mr. Kellahin, I'll let him be the last. And I will afford to Mr. Bill Carr the first opportunity to make any statement, since he's here representing Yates, who has the leasehold of the state lease in the southeast quarter and has remained kind of quiet. I will offer you the first portion.

MR. CARR: Thank you for the offer, but I'm going to stay consistent with my performance here today. I have no closing statement.

EXAMINER STOGNER: Okay. Then, let's see, Mr. Hall?

MR. HALL: Very briefly, Mr. Stogner, my comments on all of these related matters are that it seems to me this entire dispute is affected by TMBR/Sharp's overall

approach, net approach, as characterized as an afterthought throughout.

It's TMBR/Sharp who neglected to diligently file pool designation unit, Lea County records. The rest is history. That's why we're here, three competing compulsory pooling application cases right now.

And I think that also characterizes the quality of TMBR/Sharp's compulsory pooling case that you heard yesterday. When you sit down with the record and the exhibits and go through them and try to base your findings on what's been presented to you by TMBR/Sharp, I think you'll find that the quality of evidence that they presented you is lacking, it's an afterthought in their case.

They presented four witnesses, they only bothered to qualify two of them as experts. They really didn't ask any of them to opine on the statutorily required criteria in a pooling case, whether there is prevention of waste, protection of correlative rights, whether we're avoiding the drilling of unnecessary wells, those things. They really didn't even touch on waste either.

So you don't have in the record before witness-based testimony to support the findings that TMBR/Sharp would like you to enter in this case.

I think this thing goes for -- with what they

presented to you on their AFE well costs. That was an afterthought. Their risk-penalty-assessment testimony, that was an afterthought as well.

I think they presented capable geologic testimony through Mr. Mazzullo, he was qualified as an expert. He presented his closed-bowl theory about Chester reserves. In my view, his theory about four-way containment on those closed bowls was belied by the production data that was delivered to us by Mr. Phillips from the Blue Fin 24-1 well. I think Mr. Mazzullo's conclusions are suspect for that very reason.

I want you to focus particularly on the land testimony that was presented to you. They did have a qualified witness, Mr. Hopkins, presenting their land testimony. They failed to ask the magic question, they failed to ask under the statute whether there was a good-faith effort to consolidate interest for their proposed unit. They just flat-out failed to give you any evidence on that.

I think that's because they couldn't give you any evidence on that. It's pretty clear that they ran out, filed their pooling application before they made any serious effort at all to consolidate interests.

And remember, TMBR/Sharp has taken the attitude all along that compulsory pooling is not necessary in this

case. And again, that's the product of their afterthought approach to the development of this area. They have to take that position because they're contending in District Court the mere filing of a C-102 in the Hobbs District Office is sufficient to perpetuate their lease interest. That's why they're presenting their case the way they have.

Too bad, because I think we're in a situation where the tail has wagged the dog, and it's prevented them from making a *prima facie* showing under the statute entitling them to a compulsory pooling order.

And at this point I would make a speaking motion to you to dismiss their case. They have failed to make a *prima facie* case to you. I think it is Statute 70-2-1 and 70-2-18, Application must be dismissed.

Focus primarily on Arrington's compulsory pooling Application, won't dwell too much on the Ocean Application.

Arrington came forward with a fairly standard compulsory pooling case. I think it's a simple, uncomplicated case. It was not burdened with these title issues that have plagued the development in the northwest quarter of Section 25. We didn't have to deal with that here. We don't have to decide who is entitled to a drilling permit for Arrington in this case.

I think Arrington did -- unlike TMBR/Sharp, Arrington did make all the statutorily required showings

entitling them to a compulsory pooling order. They showed the continuity of reserves in the east half, they showed -- Arrington's the only party proposing a stand-alone, discrete development proposal for the east half. Nobody else did. All the other cases focused on the west half, and I think everybody's in agreement that all of the other reserves are in the west half. Only Arrington comes before you with a legitimate proposal to develop the east half.

Arrington met all the required land issues, they established -- they made good-faith efforts to acquire everybody's voluntary participation, including the unleased mineral interest owners. Recalling back, I don't think TMBR/Sharp presented you any evidence about what they did to try to join the unleased mineral interest owners.

I think most importantly, Mr. Stogner, Arrington demonstrated quite sufficiently that Section 25 is best developed with standup units, with two wells rather than three wells, because that will bring us to the most important point in all of these cases, that we will avoid waste because we are preventing the drilling of an unnecessary third well. That's the way the section ought to be developed.

So I think, in conclusion, you must deny TMBR/Sharp's Application on its face, you must grant Arrington's east-half Application. And I think also you

must grant Ocean's Application in the west half, based on the evidence that has been presented.

Thank you, Mr. Examiner.

EXAMINER STOGNER: Thank you.

Mr. Bruce?

MR. BRUCE: Mr. Examiner, Ocean is here requesting a west-half well unit. Because of the drilling of the well, they're requesting that TMBR/Sharp's location and rig be used to avoid any unnecessary expense, that TMBR/Sharp operate the well until TD is reached and that operations be turned over to Ocean for completion. Finally, we would ask that the Hobbs office, Hobbs District Office, be required to approve Ocean as operator of a west-half unit.

TMBR/Sharp claims it has a north-half APD, and thus the unit must be the north half. However, the Commission, in its most recent order, paragraph 34, states that the issuance of an APD "does not prejudge the results of a compulsory pooling proceeding..."

Therefore, you must look at the normal factors considered by the Division and the Commission in force-pooling cases. Those are set forth in a couple of places. One is Commission Order Number R-10,731-B at pages 8 and 9, and by a memorandum dated April 5th, 1995, from Examiner Catanach to William LeMay.

The primary factor, first and foremost, is geology.

Another important factor is working interest ownership.

A third one is good-faith negotiations. I would say with the third factor, it's clear that Ocean has proposed its wells and sought to obtain the joinder of the parties.

There are some other subsidiary factors, well costs, ability to operate, et cetera, but those don't appear to be at issue today.

If you look at the geology as reinforced by the engineering, there's no question that a west-half unit is mandated. There are two primary zones of interest, the Atoka and the Mississippian. The Atoka is entirely in the west half of Section 25, and the Mississippian is 90-percent-plus in the west half.

Now, TMBR/Sharp would have you believe by its -- I think it's Exhibit 18-D -- that the Mississippian reservoirs are confined to 40 or 50 acres. However, the gas-in-place estimates which were presented by TMBR Sharp show that these wells will drain in excess of 200 acres.

Therefore, as Mr. Payne testified, one well in the northwest quarter will essentially drain the entire west half in the Mississippian. Approving laydown units

will require that a second well, an unnecessary well, will have to be drilled in the southwest quarter. We think this violates the pooling statute, which was enacted to prevent the drilling of unnecessary wells.

Mr. Examiner, I understand from your questioning that you're worried about the correlative rights in the southeast quarter. As Mr. Baker stated, those interest owners can evaluate that and see what they have to do, but I would point out that correlative rights is subsidiary to the prevention of waste. And certainly another Mississippian well in the southwest quarter at this point, from the knowledge we have, will cause waste.

As to working interest ownership, as we all know, this northwest quarter is in litigation. I won't go into the details. I would put it this way: If Arrington is ultimately successful, what you have is 100 percent of the working interest owners in the west half, who desire a west-half unit. And if a north-half unit is mandated, you're ignoring the interest ownership in this section.

Now, TMBR/Sharp has commenced the well, and I suppose one thing they could say is, We've started it, leave us alone, we've incurred the expense. The fact is, Ocean's case was set for hearing in March but was continued at TMBR/Sharp's request until now. They can't be allowed to cause the delay and then claim the benefit of the delay.

They've also claimed that they would have drilled last fall without the, quote, unquote, interference of Arrington or Ocean or both. The problem with that is, if you look at their documents, their proposal letters, their AFEs, their JOAs, they didn't even propose their well until this year. Also, as Mr. Maney has testified, Ocean would have taken action to protect its interests last fall if TMBR/Sharp had taken action.

So let's summarize. As I said in my opening, if you look at TMBR/Sharp Exhibit 9, which is their comparative analysis, as I said, there are two zones, the Atoka and the Morrow. There's no Mississippian in the northeast quarter. But TMBR/Sharp wants it included in its unit, solely because it owns about 75 percent of the working interest in the northeast quarter. TMBR/Sharp's need for a north-half unit is not based on the technical evidence, it's simply a land play.

Looking at Exhibit 9, their first issue is correlative rights. Well, due to the reservoir being in the west half -- and I'm talking of all the potential zones -- correlative rights mandate a west-half unit.

If you look at TMBR/Sharp's correlative-rights analysis, which is their Exhibit 17, I would note that it's not based on geology placed in the record. Mr. Phillips stated that it was based on something else that he looked

at. Thus, the exhibit is meaningless, because it has no substantiation in the record.

Second, if you look at the unnecessary wells line on the exhibit, if a north-half unit is mandated, that would probably mandate one Atoka well and a separate Mississippian well in the southwest quarter. Thus, you'll have three wells in the west half with laydown units, versus potentially just one well in the west half of standup units.

Their third line is the geology. Again, this is just reiteration. There's little dispute that the prospective zones are in the west half of Section 25, and from an engineering analysis, one well in the southwest, northwest of 25 will test those zones.

As you look at this exhibit, just take those X's that are in the north-half unit, move them over to the west-half unit, because that's what the evidence shows.

With respect to TMBR/Sharp's pooling Application, as Mr. Hall said, the pooling statutes require an operator to make a good-faith effort to obtain the voluntary joinder of interest owners in a proposed well before it files a pooling application.

In this case, if you look at the exhibits, Exhibit 3 of TMBR/Sharp's, their first letter, January 22, 2002, to Mr. Huff, that was their proposal letter. They

filed the pooling application two or three days later.

This problem has arisen before. In Case Number 11,927 the Applicant, Redstone Oil and Gas Company, filed its pooling application before it had proposed the well in writing to the interest owners. Upon the motion of the party being pooled, the Division held that such action did not meet the statutory requirement of good-faith negotiations and dismissed the case. Now, that order was entered despite the fact that several months of verbal negotiations had preceded the filing of the pooling application. The order in that case is R-10,977.

Here, the proposal letter preceded the filing of the pooling application by a couple of days. We don't think that's sufficient. For that reason alone, TMBR/Sharp's Application should be dismissed.

If the Division desires, we would like to present a proposed order within a reasonable time to the Division. We request that Ocean's pooling application be granted, and furthermore, because of our expiring farmout, we would request that an order in this matter be issued a reasonable period of time before July 1st so Ocean can plan its activities accordingly.

Thank you, Mr. Examiner.

EXAMINER STOGNER: Thank you.

Mr. Kellahin?

MR. KELLAHIN: Thank you, Mr. Stogner.

The parties before this agency have spent a great amount of time and energy in discussions with the Division Examiners and with the Commission itself on the sequencing of how the procedure should be handled for the activity taking place in Section 25.

Great effort was made by Ocean and Arrington to have the Commission not decide the permitting issues until after the pooling Applications had been heard by a Hearing Examiner. There were motions about that issue.

Mr. Brooks determined, based upon his judgement, that it was best to proceed to the Commission *de novo* hearing on the issue of permitting before you engaged in the process of deciding the compulsory pooling cases.

It's been a long time since I sat down with some care to read the compulsory pooling statute, 70-2-17, in association with -18. When you read it with some care and look at the pieces of the puzzle, you're quick to see that you can pool the interest in a spacing unit after the well has been drilled. The Commission has confirmed that as an option.

When the Commission approved our application for a permit to drill and voided the Arrington ones, it was clear in our testimony and in our presentation that we intended to go forward and commence the drilling of the

well, and we've done so.

Richardson has asked the opposition if there was any rule, regulation, order or procedure that we have violated in engaging in that process. They could show us none. We have commenced that well in accordance with the decision made by the Commission.

It also should be clear to you in the record that Arrington obtained his applications for permit to drill in July of last year as an effort to block TMBR/Sharp's attempts to get those approved. Mr. Arrington has told Jeff Phillips that he intended to block TMBR/Sharp, he told them, you'll never -- you've gotten the well drilled in the southwest quarter of 25, but you'll never get the other two drilled.

Mr. Carroll got up in the Commission hearing and said that Mr. Arrington had no intention at the Commission hearing to drill these wells. You can presume that he never intended to do it, and what other reason did he have but to block the efforts of TMBR/Sharp?

TMBR/Sharp had to go to District Court, we obtained relief from the conditions of our leases, we had the District Court determine that the base leases were still good, the top leases were invalid, and we have proceeded through the hearing process.

One of the other things that you learn when you

re-read the pooling statutes in association with the language, not only do you find that you can pool after the fact, you also find language to say that the compulsory pooling of the acreage to conform to the spacing unit that you have been permitted and you are now drilling is for an effort to consolidate that tract for the interest owners yet not committed in the north half.

And that's why we're here before you, is not to ask you to re-change the orientation. Your ability and authority to do that in this case is of concern to us.

But be that as it may, if you want to take the technical science, you find a substantial problem with all of the data. It shows that the southwest -- the southeast quarter of Section 25 is going to make a contribution under various analysis, and they will not share in that product, they're going to be excluded.

What better way to share the reservoir opportunity than with two laydown spacing units? They criticize Mr. Mazzullo's pod. They say his bowl is too small. And when we find out this morning that they've done some engineering calculations on 5 BCF and we now see an isopach which they tell us spills over the reservoir, a substantial portion of the southeast quarter is going to contribute. There's more than enough reserves under their spreading out of the reservoir to justify their well. They

tell us in their own exhibits the best place to locate the opportunity in the Brunson sand is now in the southeast quarter of that section. Let them go drill it.

I think what is most troublesome is the notion that we have done something wrong with the process. We've asked that the pooling matters be delayed until the well in 25 has been completed and we have more data. Most of these experts and some of the lawyers have conceded that would be the best point in time to make the best decision. We now have pressure data, we will have more information about the thickness of the reservoir and what to do.

Quite frankly, we would encourage you to change your mind about what you decided to do on Tuesday. The best answer in this problem may be simply to postpone this case until this well has been completed. It won't be produced until we come back here and justify it at that point.

You'll find as we came to this hearing today, the interest in the north half had been substantially consolidated. There were 75 percent of the interest owners voluntarily committed. The remaining interest owners, as of yesterday, were either committed to Arrington or committed to TMBR/Sharp.

And if you want to take Mr. Catanach's summary of how you might want to process pooling cases, all you have

to do is read the first entry. It says, "any information related to prehearing negotiations conducted by the parties".

By the time we get here, all this conversation and negotiation has happened. The parties have aligned themselves in one camp or the other. That's been done. In this case we have chosen, and because of necessity in commencing the well have had to do that process after the Application was filed.

I find it incredibly interesting that Mr. Hall finds fault with our presentation. He suggests and criticizes that we failed to ask our experts some of the boilerplate questions. He complains that we should have asked them in a conclusionary sort of way, will approval of this Application prevent waste, protect correlative rights and avoid the drilling of unnecessary wells? Those are ultimate findings that you're going to make, and we're not going to presume to tell you how to make those, other than to look at the data that you have before you.

How many times have we had one of those experts give you those conclusionary statements, and then you follow up and ask him -- and you've done it, I've done it -- ask him to define correlative rights? You would think it was a new concept, he has no clue.

I think what you do is look at the record before

you, and you make those decisions about those ultimate facts. We have given you all the information necessary to reach the proper conclusion.

What decides this case for me is the fact that there should be substantial emphasis placed on the part that developed this concept in the Big Tuna area.

Louis Mazzullo, in association with a former geophysicist from Ocean, develops this concept in the Chester of looking for these lows below the top of the Chester in which they think hydrocarbons are going to be trapped. The come forward with this hypothesis that they spend considerable time and effort on to develop it as an opportunity to find production that might not otherwise have been located.

Mr. Mazzullo takes his database, he goes to Houston to Ocean's office, and on one occasion -- and Mr. Phillips says it's more than one occasion -- they have given Ocean private showings so they had an equal opportunity to share in the development of Section 25.

And you know what they told us? It was too low and too wet, and they took a walk.

Now they're back before us after they find the success of our hypothesis, the fact that we do have a good well in the southwest quarter of 24, and they want to take our play away from us. Shame on them.

Thank you.

EXAMINER STOGNER: If there's nothing further in this matter, then I'm prepared at this time to take Cases Numbers 12,859, 12,860, 12,841 and 12,816 under advisement.

Would two weeks be sufficient as far as rough drafts?

MR. KELLAHIN: May I ask the court reporter, Mr. Stogner, Mr. Stogner, how soon he might have available a transcript? There is so much technical information, and I would like to look at what he reports before I submit you a draft. I don't want to misstate the technical stuff.

EXAMINER STOGNER: I'll tell you what, let me do this. I'll say two weeks at this time. If additional time is needed, then I'll have you give me a written statement or a written request --

MR. KELLAHIN: All right, sir.

EXAMINER STOGNER: -- and I will take that under consideration.

MR. BRUCE: And my only comment, Mr. Examiner, is, we need to know pretty soon.

EXAMINER STOGNER: We'll keep that in mind.

With that, this hearing is adjourned.

(Thereupon, these proceedings were concluded at 11:25 a.m.)

* * *

I do hereby certify that the foregoing is a complete record of the proceedings in the Examiner hearing of Case No. 12816, 12841, 12859, 12860 heard by me on 17 May 2002.

STEVEN T. BRENNER, CCR
(505) 989-9317

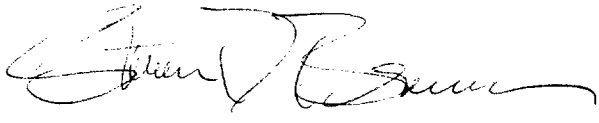
CERTIFICATE OF REPORTER

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 May 26th, 2002.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002