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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION
CASE (9867) CASE ~~9887~~ (CONSOLIDATED)
9868

EXAMINER HEARING

IN THE MATTER OF:

Application of Mallon Oil Company for
Compulsory Pooling, Eddy County, New Mexico.

Application of George Mitchell d/b/a/ G.P. II
Energy, Inc., for Compulsory Pooling,
Eddy County, New Mexico.

ORIGINAL

TRANSCRIPT OF PROCEEDINGS

BEFORE: DAVID R. CATANACH, EXAMINER

STATE LAND OFFICE BUILDING

SANTA FE, NEW MEXICO

February 7, 1990

CUMBRE COURT REPORTING
(505) 984-2244

A P P E A R A N C E S

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I N D E X

Page Number

Appearances

2

Certificate of Reporter

32

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1 EXAMINER CATANACH: At this time we'll call
2 case 9867.

3 MR. STOVALL: Application of Mallon Oil
4 Company for compulsory pooling, Eddy County,
5 New Mexico.

6 MR. PADILLA: Mr. Examiner, Earnest L.
7 Padilla of Santa Fe, New Mexico, for the applicant,
8 Mallon Oil Company, in this case.

9 MR. CARR: May it please the Examiner, my
10 name is William F. Carr with the law firm of Campbell
11 and Black, P.A., Santa Fe. I represent George
12 Mitchell in opposition to the Mallon application.

13 I also am the applicant in the following
14 case, which is a case I filed on behalf of
15 Mr. Mitchell to pool the same land seeking designation
16 of operator of the same tract, and I would request
17 that the cases be consolidated for the purpose of
18 hearing and that separate orders be entered.

19 EXAMINER CATANACH: At this time we'll call
20 Case 9868.

21 MR. STOVALL: Application of George
22 Mitchell d/b/a G.P. II Energy, Inc. for compulsory
23 pooling Eddy County, New Mexico.

24 EXAMINER CATANACH: These cases will be
25 consolidated.

1 MR. STOVALL: Mr. Examiner, the purpose of
2 opening the hearing this afternoon and calling the
3 cases is to discuss solely the issue of whether the
4 subpoena filed and issued in behalf of Mitchell
5 directing Mallon to provide certain information with
6 respect to the subject well, which was drilled on a
7 proration unit which is sought to be formed by these
8 applications, should be enforced.

9 Mitchell filed the subpoena requesting logs
10 and other information pertaining to the well which
11 Mallon has already drilled on the subject proration
12 unit. Mallon has filed a motion to quash that
13 subpoena. The basic argument, I believe -- I'm going
14 to let the attorneys go into this further -- is that
15 that, in effect, gives Mitchell a free look to decide
16 whether they want to be force pooled or join the well.

17 Does that fairly summarize the issue before
18 us at this moment?

19 MR. PADILLA: It does to me, Mr. Stovall.

20 MR. STOVALL: Mr. Carr, please expand, if
21 you feel it's necessary.

22 MR. CARR: Well, I think the question is
23 very narrow, and that is whether or not the subpoena
24 will be quashed. Period. I think that's the one
25 thing you have to decide. You don't have to decide

1 the case today. They are closely related.

2 MR. STOVALL: I understand. And please
3 understand that my statement with respect to the look
4 is -- I'm expressing as concisely as I can
5 Mr. Padilla's argument, not whether it's true or not.

6 MR. CARR: Sure.

7 MR. STOVALL: Procedurally, the subpoena
8 has been issued, and we're actually here on
9 Mr. Padilla's motion to quash. So, Mr. Padilla, would
10 you like to proceed.

11 MR. PADILLA: Yes, I would. By way of
12 offer of proof, as I understand that I can make an
13 offer of proof today at this hearing, or at least this
14 portion of the hearing regarding the subpoena, that as
15 background I would like to offer or make an offer of
16 proof as to what Mallon's testimony and basic position
17 is.

18 At the hearing of this matter we will show
19 that this is a standard compulsory pooling case
20 involving a nonconsenting working interest owner who
21 is George Mitchell d/b/a G.P. II Energy. Mallon has
22 communicated with Mr. Mitchell since June or July of
23 1989 in an attempt to get voluntary joinder in the
24 drilling of proposed well or the well that has been
25 drilled by Mallon. From June 1989, or in the summer

1 of 1989, Mallon has continued to make an effort to
2 join Mitchell. Previous to that, Mallon had been
3 involved with Red Bluff Water Power Control District
4 and had attempted to secure joinder, since Red Bluff
5 was the owner at that time.

6 Our evidence will show that Mallon had a
7 drilling obligation under a farm out agreement with
8 Amoco production company. Roughly, the acreage under
9 the Amoco farm out constitutes about 75 percent of the
10 proration unit. The remaining 25 percent is held by
11 the Mitchell interest.

12 Mallon has communicated extensively and had
13 meetings with Mr. Mitchell regarding the voluntary
14 joinder of this well. It wasn't until December of
15 1989 that Mr. Mitchell decided not to participate in
16 the drilling of the well. Previous to that, he had
17 actually agreed to drill the well or to join, and at
18 the last minute, up until the time that Mallon had to
19 spud the well under its farm out with Amoco, Mallon
20 could no longer extend the time period and had to
21 actually spud the well. It attempted to spud the well
22 with the spudder rig. That didn't work, and so after
23 that they put in a rotary and drilled the well.

24 It is Mallon's position at this time that
25 extensive amount of geological data, even as late as

1 last week, has been supplied to Mr. Mitchell in an
2 attempt to have him decide whether to drill the well.
3 Mr. Mitchell has absolutely paid nothing for the
4 information that he seeks under the subpoena. We
5 believe that the risk factor to Mallon would be
6 destroyed by virtue of showing this information, the
7 log information, to Mr. Mitchell.

8 And, certainly, being in Mr. Mitchell's
9 position, I think that I would have advised my client
10 to try and get that information. But when you look at
11 the compulsory pooling statute, and based on the
12 evidence that we will present and the extent of the
13 information that has been supplied to Mr. Mitchell,
14 Mr. Mitchell is a nonconsenting working interest owner
15 who waited to the last minute -- we're not here to say
16 whether he did it purposely or not -- the point is
17 that he is a nonconsenting working interest in
18 December, right at the time that Mallon had to spud
19 the well. He had not agreed to drill the well, and
20 now he wants that information to decide whether or not
21 he will join the well.

22 It's an easy proposition once the well is
23 down to have a look at the information that has been
24 obtained by the drilling of that well.

25 I should also point out that with respect

1 to the economics of drilling of this well,
2 Mr. Mitchell's proposal to farm out is unacceptable at
3 this time. We will also present economic data to show
4 that the well under Mr. Mitchell's farm out proposal,
5 when he actually refused to join in drilling the well
6 or participate in drilling the well, is unacceptable.

7 Mallon's testimony and evidence will show
8 attempts in reducing the overriding royalty in the
9 Amoco lease, which contains a 70 percent net revenue
10 interest. Economics will show that an 80 percent
11 lease is the only way to make money in drilling this
12 well.

13 So, in addition I should point out, from
14 June to December of last year due to the archaeology,
15 Mallon had to change its location and actually had to
16 get a nonstandard authority from the Oil Conservation
17 Division and which it did. But all this time there
18 had been communications with Mr. Mitchell. It's
19 unfair, and I think it's totally improper to request
20 this information at this time to get a free look at
21 whether to join or not join the well.

22 Again, Mr. Mitchell is perfectly entitled
23 to have that information if he had joined. He has not
24 joined; therefore, he should not be allowed to enforce
25 the subpoena in order to look at the information

1 obtained from drilling the well.

2 MR. STOVALL: Mr. Carr.

3 MR. CARR: Yes, sir. The evidence in this
4 case is going to show the full gamut of the
5 negotiations between the parties, I am sure. For the
6 purposes of this motion and this hearing there are
7 only certain facts which I think you have to consider.
8 One, they negotiated. Two, there was never an
9 agreement as to the terms of how they could jointly
10 develop the property. Three, both parties sent AFE's
11 to the other; offered to drill the well. They're not
12 in agreement now, so you have more than one interest
13 owner in a spacing of a proration unit. They haven't
14 reached an agreement for the development of that
15 tract.

16 Beyond that the compulsory pooling statute
17 has -- I would suggest -- fairly little application,
18 because that isn't the issue. The issue is whether or
19 not, when somebody goes out and acquires some data and
20 is bringing an application under the jurisdiction of
21 this commission, whether or not they may keep that
22 secret.

23 Mallon is an experienced oil and gas
24 operator. He knows how to drill and develop
25 properties in New Mexico. And what he did was he

1 waited too long, and he, for whatever reason, drilled
2 a well without either having a voluntary agreement or
3 a pooling order. And when he does that, he takes the
4 risk. And the well is at total depth and the well has
5 been logged and he knows what he has. And he took
6 that risk. And he now has that information.

7 And so we obtained a subpoena pursuant to
8 Section 70-2-8, which is the section of the Oil and
9 Gas Act which governs subpoena power. And it provides
10 that the director of the division -- in this case it
11 was Mr. LeMay -- is empowered to subpoena witnesses
12 and he also is permitted to require production of
13 books, papers, records -- we submit well logs fall
14 within that category -- in any proceeding before the
15 commission or division.

16 We obtained the subpoena. We have a valid
17 subpoena that they are now trying to quash. The
18 statute goes on to say, "No person should be excused
19 from obedience to the subpoena," and it goes on to
20 say, "relative to matters within the jurisdiction of
21 commission or division." We submit this data is
22 certainly within your jurisdiction. But no one is
23 excused on the grounds or for reasons that the
24 testimony or evidence, documentary or otherwise,
25 may -- otherwise required of him may tend to subject

1 him to a penalty or forfeiture.

2 Mr. Mallon took the risk and now he wants
3 to come in -- he's been outside the Oil and Gas Act,
4 and now he wants to run in and say, "Whoa, whoa, not
5 fair. You can't subpoena data because I'm going to
6 have to forfeit -- give up data that I, on my own,
7 acquired."

8 I submit to you if you look at the statute,
9 there are really only two defenses. One, you don't
10 subpoena data and you quash it if it wasn't within
11 your jurisdiction -- this certainly is -- or it goes
12 on and it says you don't subpoena data if it isn't
13 pertinent to some question lawfully before the
14 commission. And the risk is a central question, if
15 not the only one. It's one of the major questions
16 that's presented to you for consideration.

17 I think your actions are governed by the
18 Act. I think you have to look at the subpoena power
19 as set out in Section 70-2-8. And when you do, they
20 haven't alleged grounds that would authorize you
21 coming in now and quashing the subpoena, for we have a
22 subpoena requesting information within your
23 jurisdiction pertinent to the issues of this case.

24 I think that's basically the whole thing.
25 There is a suggestion that, willfully or not, we

1 waited until very late and Mr. Mallon had some
2 problems getting the well spudded within the term of
3 his farm out agreement from Amoco. But the documents
4 that both sides, I suspect, will present -- we
5 certainly will -- show a letter from Mitchell
6 confirming that he wouldn't participate in the well
7 but would farm out, dated December the 5th.

8 They didn't file an application to pool
9 until January the 3rd. If they had filed it December
10 the 5th, they could have been heard January the 27th.
11 And in view of the fact they spudded the well,
12 according to Oil Commission forms, on January 7th,
13 they could have had a hearing and had requested an
14 expedited order two weeks before they spudded the
15 well.

16 We didn't back them up against the wall.
17 They didn't do it. They stood outside the Act. They
18 drilled a well. We weren't in it. And now that they
19 drilled it, they want to run back under the Act and
20 they want to hit us with a penalty. And we're going
21 to talk tomorrow about what that penalty will do to
22 us, but today we think we have a proper subpoena, and
23 you should not act on the motion to quash the
24 subpoena.

25 MR. STOVALL: I understand your statement

1 is to the limited nature of the issues before us
2 today, but unfortunately, the reason we're doing this
3 now is because I'm not going to be here tomorrow. So
4 for the purpose of hearing this motion, I may have to
5 ask for a little advance peek at the testimony, if I
6 might. But let me find out some things first.

7 Mr. Carr, you said Mitchell notified Mallon
8 on December 5th that they wouldn't join the well?

9 MR. CARR: They confirmed by letter and
10 telephone conversation that they would not participate
11 on that date.

12 MR. STOVALL: You referenced the January
13 27th hearing. I assume you mean the December 27th
14 hearing?

15 MR. CARR: That's right.

16 MR. STOVALL: So that an order could issue --

17 MR. CARR: Thereafter.

18 MR. STOVALL: The well was spudded on the
19 7th of January, is that right, Mr. Padilla?

20 MR. PADILLA: I'm not sure.

21 MR. STOVALL: Confirm with your witness.

22 MR. COX: Spudding was probably December --
23 with the Rat Hole Rig, December 29th, various --

24 MR. CARR: My data comes from the form
25 filed with the Division.

1 MR. STOVALL: What type of lease is this
2 on?

3 MR. PADILLA: Both are federal leases. The
4 The Amoco lease a federal lease. The Red Bluff lease
5 is also a federal lease.

6 MR. STOVALL: And when was the permit to
7 drill filed, approximately, the APD and your notice of
8 staking, or whatever first filing was made with the
9 Feds?

10 MR. PADILLA: Maybe you have a quick answer
11 for that.

12 MR. COX: I'm going to have to look at it.

13 MR. STOVALL: And, again, remember I asked
14 this question in the context of knowing that it could
15 come out under sworn testimony tomorrow.

16 EXAMINER CATANACH: Could you also identify
17 the party that is presenting this.

18 MR. PADILLA: This is Mr. Joe Cox with
19 Mallon Oil.

20 EXAMINER CATANACH: Thank you.

21 MR. PADILLA: That date is July 6, 1989.

22 MR. STOVALL: The APD was filed on July 6?

23 MR. COX: Yes. Prior to the location
24 change due to the archaeological problem.

25 MR. STOVALL: When was the permit actually

1 issued? Does that also appear in your records? The
2 APD? When was it approved such that you could go out
3 and drill a well?

4 MR. PADILLA: November 22nd, 1989.

5 MR. CARR: What was that date?

6 MR. PADILLA: November 22nd.

7 MR. STOVALL: For the actual location that
8 was eventually spudded; is that correct?

9 MR. COX: Right.

10 MR. STOVALL: When did the Mallon farm out
11 from Amoco require that it be spudded? What was the
12 initial spud date required?

13 MR. PADILLA: I believe it was
14 December 31st, and then there was a short extension to
15 January 15th.

16 MR. STOVALL: Mr. Padilla, if I'm not
17 mistaken, digging back in memory, I believe that you
18 have represented Mallon Oil previously before this
19 commission in a pooling in this area, specifically
20 against Red Bluff itself?

21 MR. PADILLA: Yes, that's correct.

22 MR. STOVALL: In fact, that went to a
23 de novo; did it not?

24 MR. PADILLA: That's correct.

25 MR. STOVALL: Is that the same farmout? If

1 I remember correctly, that was an Amoco farm out with
2 a continuing drilling obligation for quite a bit of
3 acreage; is that correct?

4 MR. PADILLA: That's correct.

5 MR. STOVALL: And this is the same farm
6 out?

7 MR. PADILLA: This is the same farm out.

8 MR. STOVALL: When did Mitchell acquire the
9 interest in the Red Bluff land?

10 MR. CARR: June or July 1989.

11 MR. STOVALL: I'm going to make a
12 recommendation to the Examiner at this time and not
13 ask for ruling, because I think there may be some
14 things that might come out in the testimony tomorrow,
15 but to give him guidance as to what I feel is
16 appropriate, I think Mr. Carr's recitation of the
17 statute here is accurate. Subpoena powers -- I don't
18 think there is any question of the subpoena power of
19 the commission or division in this case. I don't
20 think there is any question that this is a relevant
21 document, because you are talking about the well that
22 we're trying to pool into. One other question,
23 Mr. Carr. Does Mitchell still want to be operator of
24 the well?

25 MR. CARR: Yes, we do. And we'll explain

1 the reason for that tomorrow.

2 MR. STOVALL: Mr. Mallon has been operating
3 in this state for quite some time. I know he's
4 familiar with the rules. I know he's familiar with
5 this farm out. It's not a new deal. It's not
6 something that they just acquired that they had to
7 hurry up on. What you've indicated, and I assume the
8 testimony tomorrow will support what you've told me
9 today, that negotiations went on for at least six
10 months prior to this date.

11 There may be some testimony come out as to
12 what other drilling activity has taken place in this
13 farm out. I don't know if that would have any impact
14 or bearing on this or not, as far as I am concerned,
15 but it appears to me that given the statute, the
16 language of the statute authorizing the Commission to
17 issue subpoenas -- and specifically the language which
18 Mr. Carr has referenced regarding the subpoena will be
19 issued in effect in spite of the fact that it may
20 cause a penalty or forfeiture -- given the fact that
21 this application for forced pooling -- let me ask when
22 the Mitchell application was filed, if I may.

23 MR. CARR: The Mitchell application was
24 only filed after this. And we'll, again, tomorrow go
25 into that.

1 MR. STOVALL: The application was filed by
2 Mallon two-and-a-half months after the APD was
3 approved. Was actually filed after the well was
4 spudded. I don't see that there are any equities
5 which would suggest that the statutory authority and
6 requirements with respect to a subpoena should be
7 overridden, particularly with regard to the penalty
8 issue.

9 I'm going to recommend to the Examiner that
10 unless some sort of evidence comes out tomorrow -- and
11 I don't think we need to get a ruling on it today
12 because I think it's something you can act on tomorrow --
13 unless some sort of evidence appears in tomorrow's
14 hearing that would go against what I've suggested,
15 that there is no equitable reason why the subpoena
16 should not issue; that the motion to quash be denied
17 and that that information be requested to be provided.

18 In the alternative -- and I will recommend,
19 again, because I won't be here for the hearing -- I'm
20 going to say this now on the record that I think that
21 the failure to provide that information would
22 certainly concern me with respect to any requests for
23 penalty. And I assume Mallon is asking for maximum
24 penalty in this case?

25 MR. PADILLA: That is correct, Mr. Stovall.

1 MR. CARR: And we will request a zero
2 penalty even if we assume operation.

3 MR. PADILLA: Mr. Stovall, in lieu of your
4 recommendation, does that also go to the admissibility
5 of this evidence?

6 MR. STOVALL: I don't believe admissibility
7 has been raised as an issue.

8 MR. CARR: No.

9 MR. PADILLA: Your recommendation only goes
10 to whether or not the subpoena should be quashed?

11 MR. STOVALL: Correct.

12 MR. PADILLA: On the very narrow issue.
13 Since we have essentially complied with the spirit of
14 the subpoena by having that information available,
15 does your recommendation go so far as to say that we
16 have to disclose that at the hearing tomorrow?

17 MR. STOVALL: Well, the subpoena requires
18 you disclose it. It requires you to produce that
19 evidence at the hearing. I don't think that could be
20 interpreted to mean that you have to put it in as an
21 exhibit. That may be for Mr. Carr to do if he wishes.

22 And how it would then be applied and
23 interpreted by the Examiner is -- and I'm assuming,
24 again, that the primary -- or the relevance is A,
25 whether to join, and B, what the penalty would be.

1 That would be the relevance of it, I'm assuming, since
2 we're talking about an existing well bore. You say
3 you've complied with the spirit. I assume that means
4 you've brought it with you?

5 MR. PADILLA: Yes.

6 MR. STOVALL: You've not yet disclosed it
7 or made it available to Mr. Carr or his client?

8 MR. PADILLA: No, sir.

9 MR. STOVALL: The ball is in his court to
10 get access to it. Assuming that the Examiner finds no
11 compelling reasons to go against my recommendations,
12 if he requests it at the hearing and requests that it
13 be offered --

14 MR. PADILLA: I guess I have a hard -- I'm
15 in a hard position here. At least the ball is in my
16 court now. But it just seems to me that at this
17 point, given your recommendation -- and I don't see
18 any other way out once we go on to hearing, we don't
19 question the division's subpoena power, but we
20 certainly question the taking -- in effect what we
21 have here is the taking of information that is a
22 property right of Mallon Oil without due process or
23 without compensation to Mallon.

24 With that in mind, I think that we would
25 have to ask for continuance of this hearing and

1 proceed to get a Writ of Prohibition from the district
2 court regarding the use of that -- or not so much the
3 use of that information, but turning that information
4 over to Mr. Mitchell, because that's the only purpose
5 that it can serve is whether or not he is going to
6 decide to use that or to join.

7 MR. STOVALL: Is that a formal request for
8 continuance?

9 MR. PADILLA: I'm compelled to ask for a
10 formal continuance at this time and go decide this
11 matter somewhere else, because I think that we're
12 compelled to not disclose that information. And I
13 think the initial ruling here is adequate to me that
14 we're going to have to turn that information over
15 tomorrow.

16 MR. STOVALL: Any response to the motion
17 for continuance?

18 MR. CARR: Well, the problem that we have
19 is that I'm not certain that we would be interested in
20 continuing our case -- the two cases here. And the
21 problem that we have -- and I guess I should go ahead
22 and disclose this -- is that the log is useful to us
23 in making decisions of course as to participation, but
24 the log is of most critical importance to us in our
25 effort to take over operations of the well, because we

1 think that's the real issue here.

2 I hate to do that to you, but that's really
3 true. And that's going to the the thrust of the case.
4 The problem with charging off to the court -- I don't
5 know what the time frame would be. I really don't on
6 something like that.

7 MR. PADILLA: I don't know. It's important
8 enough to my client that the purpose of this
9 information is to gain control of the log to decide
10 whether or not to join the well. There's never been
11 any formal proposal to take over operations. There's
12 been discussion about taking over operations, but
13 Mallon --

14 MR. CARR: I mean, that's an issue for you
15 to decide, not Mr. Mallon by spudding the well. I
16 mean, that is a question for the Commission. Just
17 because you run out and drill a well, doesn't decide
18 the question of operator. You do that at your risk,
19 too.

20 MR. STOVALL: Congratulations, gentlemen,
21 you always keep this Commission stirred up with new
22 and exciting activity.

23 MR. CARR: I mean, without the data --
24 suppose we went through the hearing tomorrow and
25 suppose that at the end of the hearing we were given

1 the log, and if the log showed it was not a good
2 prospect, we probably would then -- it would affect
3 what we were all doing, and we would be back trying to
4 change things. We do need the data to go forward with
5 the hearing. That is true.

6 MR. STOVALL: Quite frankly, as a legal
7 matter, I think the extent and the authority of the
8 subpoena power is an issue that's never been
9 challenged before in such a manner. It's always been
10 resolved by an agreement. I'm trying to think of a
11 way that most effectively deals -- and I assume your
12 motion is in both cases, is that correct, Mr. Padilla?

13 MR. PADILLA: Well, I think, logically,
14 both cases would have to be continued.

15 MR. STOVALL: They are the same issue.
16 They are just different applicants fighting the same
17 issue.

18 MR. PADILLA: They are the same issue, same
19 proration unit.

20 MR. STOVALL: I think for purposes of that,
21 I think it would be meaningless to grant a continuance
22 in one case and not the other and leave the subpoena --

23 MR. CARR: I could say, but I won't, that
24 refusal to honor a subpoena shouldn't be grounds for
25 continuing my case, but I don't say that. With your

1 permission, could I have just a minute or two to talk
2 to my clients that are here?

3 MR. STOVALL: Please.

4 (Thereupon, a recess was held.)

5 MR. STOVALL: What have you decided or
6 accomplished in this --

7 MR. CARR: Well, I think I can say that
8 there are people in the room who don't have ultimate
9 authority to make certain calls that need to be made.

10 MR. STOVALL: Like whether to release the
11 information or whether to go to court or whether to --

12 MR. CARR: Basically, the question of what
13 to do. And I think the question is on both sides.
14 The George Mitchell in the room is the son of George
15 Mitchell.

16 MR. STOVALL: Not an enviable position, I
17 understand.

18 MR. CARR: And I'm sure that Ernie's
19 clients need to visit with Mallon's folks, too. So
20 it's hard to make a final call at this time. I think
21 it's pretty clear that if we can't get the data, that
22 we would concur in a request to continue.

23 MR. STOVALL: In other words, if I
24 understand, what you're saying is that if -- to crack
25 the nut -- if the Mallon management people will agree

1 to release the information, the hearing can proceed
2 tomorrow? And if management Mallon management will
3 not agree -- if Mallon insists that they are entitled
4 to keep that quiet and tell you to go to court, you
5 will continue it tomorrow; is that correct?

6 MR. CARR: Both of them.

7 MR. STOVALL: Both cases.

8 MR. PADILLA: I think what you said was
9 that -- the way you stated that -- it would have to be
10 subject to going through a full evidentiary hearing
11 before we decide that the information had to be
12 submitted.

13 MR. CARR: You see, the only problem that
14 we have in that scenario is that before it's right to
15 go get a writ, we might have to march to that point.

16 MR. STOVALL: Present the case up to that
17 point, and then --

18 MR. CARR: I mean, Ernie, with a
19 continuance, can't do anything with a recommendation --
20 with all due respect -- from the commission counsel
21 that doesn't translate into a ruling, you know.

22 MR. STOVALL: We could turn it into a
23 ruling if you want to. If the Examiner --

24 MR. CARR: Well, I'm not that --

25 MR. PADILLA: Well, I think think that's

1 probably correct is that we would have to have some
2 kind of a ruling, whether it's a letter ruling or
3 something from which I could then take it on. But at
4 the same time, I think that cooler heads might prevail
5 in the morning, in terms of looking at the relative
6 positions, in light of the recommendation made by you
7 today.

8 MR. STOVALL: So at this time you're going
9 to withdraw your motion for continuance until tomorrow
10 and possibly remake it.

11 MR. PADILLA: Correct.

12 MR. STOVALL: That sounds reasonable. So
13 we'll have a hearing tomorrow. As far as your concern
14 at this point, you will go forward with the evidence
15 up to the point of needing a ruling.

16 MR. CARR: Either that or we can simply ask
17 you to rule on the motion.

18 MR. STOVALL: Well, let me ask you,
19 Mr. Padilla: Do you believe that there is any
20 evidence which will be presented tomorrow which will
21 justify Mallon's failure to file this action before
22 they drilled the well and get the record established
23 in the case before they spudded the well?

24 MR. PADILLA: Well, obviously, I'm going to
25 say yes to that.

1 MR. STOVALL: Would you like to offer proof
2 of that evidence?

3 MR. PADILLA: However, I'm not the trier of
4 fact, obviously, as to whether or not that is
5 sufficient or not -- or even whether, legally, failure
6 to file a compulsory pooling prior to spudding the
7 well -- but I think the reliance that Mallon had, and
8 that will be testified to tomorrow with regard to
9 Mr. Mitchell's conduct, I think is very important in
10 the division's ultimate ruling.

11 MR. STOVALL: It's interesting, because
12 usually the problem we have here is that people come
13 in with their cases without having really conducted
14 any substantial negotiations. They send a letter one
15 day saying, "Join my well," and the next day they send
16 out a notice of application of forced pooling. Here
17 we're faced with a problem of, "Join my well, join my
18 well, join my well, join my well -- oh, by the way, I
19 drilled the well. Let me force pool you."

20 MR. PADILLA: I wouldn't characterize it
21 that way. I would say that Mallon understood all
22 along at some point that Mitchell had agreed to drill
23 the well. When they went to get the paperwork
24 completed, not only for Mr. Mitchell but everybody
25 else -- all the other working interest owners --

1 Mr. Mitchell decided not to join the well at that
2 time.

3 MR. CARR: Well, we can argue the facts --

4 MR. STOVALL: You can go on --

5 MR. CARR: I would say state that your
6 characterization was superbly accurate.

7 MR. STOVALL: Of course.

8 MR. CARR: And we can argue whether there
9 was agreement as to the facts or not, but the bottom
10 line is there's certain responsibilities that fall on
11 the person who is going forward --

12 MR. STOVALL: And that's my concern.

13 MR. CARR: -- in the drilling of a well.
14 And a lot of questions, I think, will really not be
15 relevant to that issue, but that's what the hearing
16 will be about when and if we get there.

17 MR. STOVALL: And let me make it clear that
18 I'm not placing any merit or weight on who was
19 negotiating in better faith than the other, because we
20 don't look at those issues. And it very well may be
21 that Mr. Mitchell's group was not, in fact,
22 negotiating in good faith. That they were trying to
23 extract a deal beyond reasonable acceptance.

24 MR. CARR: And you don't have anything to
25 base that on now, right? Do you?

1 MR. STOVALL: I'm speculating, purely
2 speculating. There is no factual basis for that. The
3 point is, the thing I am concerned about specifically
4 is that there has been a large amount of time -- there
5 was plenty of time to file an application. As you
6 well know, we can reach agreement after an application
7 has been filed, after an order has been issued. And,
8 unfortunately, Mallon did not avail themselves of
9 that, and that now places us in this bind because we
10 have a well down and a case that still has to be
11 heard.

12 Do you want a ruling tonight, or do you
13 want to go through the process tomorrow?

14 MR. PADILLA: Well, at least I would like
15 to defer my motion till tomorrow morning, till we have
16 an opportunity to talk to management.

17 MR. STOVALL: Okay.

18 MR. CARR: I, of course, would like the
19 ruling, but I understand Mr. Padilla's position and,
20 certainly, I think that's reasonable.

21 MR. STOVALL: Mr. Carroll will be here to
22 supervise this. I will be in transit, so I will
23 probably be hard to get ahold of. Well, I'll add the
24 additional fact that, if necessary, after the hearing
25 if you feel we need more input, we can continue the

1 case without a ruling and I can review the transcript
2 and help you if it gets down to that. I hope it
3 doesn't. I hope you guys figure it out tonight.

4 MR. CARR: I think it would also be a
5 possibility to continue to a set period of time, just
6 continue the hearing so the issue could be pursued
7 again with you.

8 MR. STOVALL: After testimony tomorrow, you
9 mean?

10 MR. CARR: Yes. That's all just, you know,
11 "what if."

12 MR. STOVALL: As of this time you're
13 requesting that the case be heard tomorrow or at least
14 initiated tomorrow, and proceed from there?

15 MR. CARR: At 8:15?

16 EXAMINER CATANACH: More or less. Is that
17 it?

18 MR. STOVALL: Shall we adjourn this hearing
19 until tomorrow morning at 8:15?

20 EXAMINER CATANACH: Let's adjourn this
21 hearing at this time.

22 I do hereby certify that the foregoing is
23 a complete record of the proceedings in
the Examiner hearing of Case No. 9867, 9868
24 heard by me on February 7 19 90;

25 David R. Catanach, Examiner
Oil Conservation Division

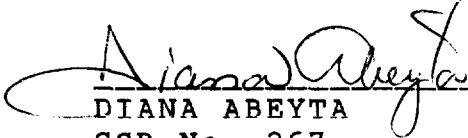
1 CERTIFICATE OF REPORTER

2
3 STATE OF NEW MEXICO)
4) ss.
5 COUNTY OF SANTA FE)

6 I, Diana Abeyta, Certified Shorthand
7 Reporter and Notary Public, HEREBY CERTIFY that the
8 foregoing transcript of proceedings before the Oil
9 Conservation Division was reported by me; that I
10 caused my notes to be transcribed under my personal
11 supervision; and that the foregoing is a true and
12 accurate record of the proceedings.

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

17
18 WITNESS MY HAND AND SEAL April 5, 1990.

19
20
21 
22 DIANA ABEYTA
CSR No. 267

23 My commission expires: May 7, 1993
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STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

CASE 9867 CASE 9887 (CONSOLIDATED)
9868

EXAMINER HEARING

IN THE MATTER OF:

Application of Mallon Oil Company for
Compulsory Pooling, Eddy County, New Mexico.

Application of George Mitchell d/b/a/ G.P. II
Energy, Inc., for Compulsory Pooling,
Eddy County, New Mexico.

ORIGINAL

TRANSCRIPT OF PROCEEDINGS

BEFORE: DAVID R. CATANACH, EXAMINER

STATE LAND OFFICE BUILDING

SANTA FE, NEW MEXICO

February 8, 1990

CUMBRE COURT REPORTING
(505) 984-2244

A P P E A R A N C E S

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I N D E X

Page Number

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Appearances	2
KAREN McCLINTOCK	
Examination by Mr. Padilla	5
Examination by Mr. Carr	42
Examination by Hearing Examiner	53
JOE COX	
Examination by Mr. Padilla	56
Examination by Mr. Carr	92
TERRY LEWIS	
Examination by Mr. Carr	116
Examination by Mr. Padilla	133
Examination by Hearing Examiner	146
Certificate of Reporter	165

E X H I B I T S

Admitted

Mallon's Exhibits 1 & 2	132
Mitchell's Exhibits 1 - 5	133

1 EXAMINER CATANACH: Call the hearing to
2 order this morning and continue with Case 9867 and
3 Case 9868.

4 I believe at this time it would be helpful
5 in the proceedings to hear the negotiation part of the
6 case, what transacted in the negotiations between the
7 two parties, if that's agreeable to counsel.

8 MR. PADILLA: Mr. Examiner, we have not
9 actually negotiated with the other side; however,
10 after conferring with management of Mallon last night,
11 we're instructed to proceed with the hearing up until
12 such time as the information that we have tried to
13 prevent from having to disclose needs to be submitted.

14 Mr. Carr and I have talked about that this
15 morning, and we thought that procedurally, I should
16 proceed with my case. As part of his
17 cross-examination he would obviously request that, and
18 we thought that maybe it would be appropriate for the
19 Examiner to defer ruling on that until the close of
20 all evidence.

21 MR. CARR: And the reason for that is that
22 it's important not only to have the negotiation part
23 of the case presented by Mallon, but also we would
24 want to put on our part of the case, and beyond that,
25 the issues are fairly narrow and we might as well make

1 a complete record as to just that portion of it.

2 I will at some point request the
3 information, and then if you desire to defer the
4 ruling at that time, we will go to the end of the
5 presentation of evidence, and I'll renew it at that
6 time.

7 EXAMINER CATANACH: Mr. Padilla, you may
8 proceed with your case.

9 MR. PADILLA: Mr. Examiner, I have two
10 witnesses to be sworn.

11 MR. CARR: And I have one.

12 (Thereupon, the witnesses were sworn.)

13 KAREN McCLINTOCK

14 The witness herein, after having been first
15 duly sworn upon her oath, was examined and testified
16 as follows:

17 EXAMINATION

18 BY MR. PADILLA:

19 Q. Ms. McClintock, for the record, would you
20 please state your full name.

21 A. Karen McClintock.

22 Q. How do you spell your last name?

23 A. M-c-C-L-I-N-T-O-C-K.

24 Q. Ms. McClintock, are you an employee of
25 Mallon Oil Company?

1 A. Yes, I am.

2 Q. In what capacity?

3 A. I am their landman.

4 Q. Have you previously testified before the
5 Oil Conservation Division and had your credentials
6 accepted, as a matter of record, as a petroleum
7 landman?

8 A. Yes, I have.

9 Q. Are you familiar with the nature of the
10 case today, and have you compiled certain information
11 for presentation at this hearing?

12 A. Yes, I have.

13 MR. PADILLA: Mr. Examiner, we tender
14 Ms. McClintock as a petroleum landman.

15 EXAMINER CATANACH: She is so qualified.

16 Q. (BY MR. PADILLA) Ms. McClintock, would you
17 tell us briefly what the nature of this hearing is.

18 A. Yes. Mallon Oil Company has drilled a
19 well, the Amoco Red Bluff Federal No. 3, located in
20 the northwest of the northeast of Section 28 in
21 Township 26 South, Range 29 East, in Eddy County,
22 New Mexico.

23 Mallon Oil Company currently does not
24 control 100 percent of the 40-acre proration unit.
25 And Mallon Oil Company is present today in order to

1 force pool the remaining 28.46 percent of the well,
2 which is controlled by George Mitchell, II.

3 Q. Ms. McClintock, let's get into what we have
4 marked as Exhibit No. 1 and have you identify what
5 that is.

6 A. I compiled this file for the purpose of
7 this hearing, and it just basically outlines or lists
8 various documents, including plats, agreements --
9 those types of documents -- that are relevant to this
10 case.

11 Q. Let's go to the tab that is identified as
12 "Plats" and have you start there.

13 A. Okay.

14 MR. PADILLA: For the record, that's on the
15 left-hand side of the folder, Mr. Examiner.

16 Q. Go ahead and explain the the plats that are
17 identified in that.

18 A. There's only two plats under this tab. The
19 very bottom one just outlines where the Amoco Red
20 Bluff Federal No. 3, is identified by the blue dot.
21 And also highlighted in pink is the outline of the Red
22 Bluff reservoir, to show where the reservoir is
23 located in reference to our acreage.

24 The plat on top was one that I prepared
25 personally. It just identifies the various interests

1 and the acreage allocated to -- we can refer to it as
2 Red Bluff acreage and acreage identified as the Amoco
3 acreage.

4 Q. I take it the pink is the Red Bluff
5 acreage?

6 A. That is correct. That is Federal Lease NM
7 NM-71599.

8 Q. The yellow is the Mallon acreage?

9 A. That's correct. That's NM-38636.

10 Q. In the other plat, the second plat under
11 that tab, what is the yellow outline? What does that
12 depict?

13 A. The yellow outline is the acreage that can
14 be referred to as the Amoco farm out acreage. That is
15 acreage we picked up through the Amoco farm out.

16 Q. What is the acreage highlighted by the
17 pink?

18 A. The pink is the outline of the Red Bluff
19 reservoir that has been excluded from the Federal
20 Lease NM-38636.

21 Q. Did that acreage under the reservoir, as
22 outlined by that pink highlighting, does that cover
23 the Red Bluff lease?

24 A. Not in its entirety but as it is concerned
25 with this particular case, yes.

1 Q. And the meandering lines in the second plat
2 correspond, more or less, to the meandering line
3 across or transecting the 40-acre tract in the first
4 plat?

5 A. That is correct.

6 Q. Ms. McClintock, is there any dispute
7 between yourselves and Mr. Mitchell regarding the
8 amount of acreage attributed to each party insofar as
9 interests in the 40-acre proration unit is concerned?

10 A. I've notified Mr. Mitchell through various
11 correspondence, whether it be an AFE identifying the
12 interests, and I've never received any indication that
13 it was not acceptable.

14 Q. Did you submit to him correspondence that
15 you had had with the Bureau of Land Management or
16 anyone connected with the federal agency having
17 control of this acreage?

18 A. Yes. I sent him a document, a letter, from
19 Mr. Gumert from the BLM.

20 Q. Is that letter contained in this Exhibit 1?

21 A. Yes, it is.

22 Q. Can you identify it for the Examiner.

23 A. Yes. It's under Amoco Red Bluff No. 3
24 Well.

25 Q. Is that the tab?

1 A. Yes. I'm sorry. That is the tab.

2 Q. As you're leafing through this portion of
3 this tab, why don't you explain what this tab
4 contains, as you go through that.

5 A. What I tried to do, anything that pertains
6 to the well in terms of overhead costs, our approved
7 APD, our approved non-standard location and with
8 attached archaeological documentation, and also the
9 letter addressed to myself from John Gumert --

10 Q. Where is the letter of John Gumert?

11 A. It is the bottom document under this tab.
12 It's attached -- it's hard to tell. There's two plats
13 and some field notes and then a letter dated May the
14 11th.

15 Q. Is that the letter dated May 11, 1989?

16 A. That's correct.

17 Q. What is the affect of that letter,
18 Ms. McClintock?

19 A. We found when we drilled Amoco Red Bluff
20 Federal No. 1 Well, in researching the title, that
21 there was an error in the original survey. The error
22 was identified by John West Engineering Company, and
23 the error, as identified by John West -- it was simply
24 he made an additional interpretation to correct it.
25 It didn't close. The survey did not close. So we

1 wrote to a letter to Mr. Gumert and explained to him
2 the situation. He reviewed the plat, he reviewed the
3 field notes, and he concurred that there was an error
4 and that John West Engineering Company's
5 interpretation is reasonably accurate.

6 Q. Ms. McClintock, has this issue been brought
7 before the Oil Conservation Division of the Oil
8 Conservation Commission in the past in a prior
9 hearing?

10 A. Yes, it has.

11 Q. Did the commission or the division at that
12 time accept the documents presented in relation to
13 this survey error?

14 A. Yes, they did.

15 Q. Let's go now, Ms. McClintock, to the tab
16 identified as "Miscellaneous Information."
17 That's also on the left-hand side of the folder.

18 What is contained in that portion of the
19 folder?

20 A. This is miscellaneous documentation as it
21 pertains to this case, correspondence from our
22 attorney, Mr. Padilla, requesting the compulsory
23 pooling, the letter from Mr. Carr; there is also
24 calculations that I prepared for this well in terms of
25 the nonconsenting and the effect of George Mitchell,

1 II, going nonconsent, and how it affects our interest.

2 There is also reconstruction of phone
3 conversations and miscellaneous notes from myself and
4 Mr. Cox.

5 Q. Is the notice of the hearing to George P.
6 Mitchell, II, in that portion of the packet?

7 A. Yes, it is.

8 Q. Let's go on to have you identify the rest
9 of the tabs in brief summary now. Let's continue on
10 the left side. We have already identified the Amoco
11 Red Bluff No. 3 tab. Can you tell us what is
12 contained under the tab of "Amoco Production Company"?

13 A. Certainly. Under Amoco Production Company
14 I included the farm out contract, dated February 1st,
15 1983, between Amoco Production Company and Harry M.
16 Bettis, Jr., which is the farm out contract that
17 Mallon Oil Company is now operator of.

18 There's also two letters, the first one
19 dated August the 2nd, and it was the extension
20 acceptance from August 31st to December 31st to drill
21 our 15th well, which is Amoco Red Bluff Federal No. 3
22 Well, the one we just drilled.

23 There's also a letter dated January 5th
24 from Amoco to myself, and it extended the drilling
25 deadline from December 31st, 1989, to January 15th,

1 1990, for commencement of the well.

2 Q. Let's go on to the next tab which is
3 identified as "Royalty Reduction." What is royalty
4 deduction?

5 A. Under this particular tab -- for quite a
6 long period of time Mallon Oil Company has realized
7 that the net revenue interest for the Amoco farm out
8 has been too low, and we wanted to increase the net
9 revenue interest by reducing the existing overriding
10 royalty burden. We've been attempting to do this for
11 some time.

12 So if you start at the bottom documentation
13 first, there's a memo, and it's from Joe Cox to our
14 royalty owners in the entire Federal Lease NM-38636,
15 and it is requesting that -- let me rephrase that --
16 to everyone except Amoco, and we're requesting a 75
17 percent reduction. It would only affect the wells
18 that we are proposing -- it would not affect existing
19 wells that we've already drilled -- in an effort to
20 reduce the overriding royalty and burden on this
21 lease.

22 Q. That is the memorandum dated May 30, 1989?

23 A. I'm sorry. Yes, that is correct.

24 MR. CARR: I can't find that. Is it at the
25 very bottom?

1 THE WITNESS: It's under Royalty Reduction,
2 and it's at the very bottom.

3 MR. CARR: Thank you.

4 THE WITNESS: On top of that particular
5 memo is a letter dated June the 9th, 1989, to Amoco,
6 Mr. Dennis James, from Joe Cox in our office. He was
7 handling this particular situation because it
8 concerned the economics of why we wanted to reduce the
9 overriding royalty.

10 The overriding royalty owners were
11 concerned that we were not including Amoco in our
12 proposal to reduce the royalty. Subsequently, Mr. Cox
13 mailed this letter to Amoco requesting different
14 proposals as to reduction of the overriding royalty.

15 Q. Ms. McClintock, is Mr. Cox going to testify
16 concerning the contents and the reasons for the
17 memorandum and the royalty reduction?

18 A. Yes, he will. The next group of paperwork,
19 then we mailed another memorandum to them, our
20 overriding royalty owners, dated August the 3rd, 1989.
21 Effectively, what this did was include an actual
22 agreement to reduce the overriding royalty interest
23 whereby we proposed that all overriding royalty
24 interest would be reduced by 40 percent with the
25 exception of Harry Bettis and L.E. Oppermann, who

1 would eliminate their overriding royalty entirely.
2 What this would do was bring our net revenue from the
3 lease from a 70 percent to a 80 percent inclusive of
4 the existing royalty for the MMS.

5 Q. Tell us about whether you had any success
6 in reaching agreement?

7 A. Yes, we did. We had difficulty deciding --
8 after discussing verbally with each of the overriding
9 royalty owners, we prepared this agreement. We
10 received in writing agreements from everyone but JSM.
11 We had a verbal agreement with JSM. We felt very
12 confident that we would have an increased net revenue
13 interest as late as the middle of December, when Mr.
14 Cox received a call from JSM stating that the
15 individual Mr. Cox talked to did not have the
16 authority to agree to reduce the overriding royalty.

17 So at this point, and I've included
18 documentation showing the signed agreements from
19 everyone but JSM and a letter from Amoco stating they
20 would reduce -- at this time we do not have the
21 reduced overriding royalty, but we will continue to
22 work on that. We feel that the agreements we have in
23 place will stand, and we need to contact JSM and see
24 if we can talk to the right person concerning this
25 issue.

1 Q. So Amoco agreed to also reduce their --

2 A. Yes, they did.

3 Q. Are all these agreements to reduce
4 overriding royalty contingent upon everybody signing,
5 or does each signature stand on its own?

6 A. No. It is contingent upon all overriding
7 royalty owners executing the document.

8 Q. You have not exhausted your negotiations
9 with JSM, I take it?

10 A. Absolutely not. We're still pursuing this
11 issue.

12 Q. So if you can't get JSM to consent to
13 royalty reduction, then this falls like a house of
14 cards; is that --

15 A. That is accurate. What we would try to do
16 if that happens, we will attempt to try to
17 renegotiate. I don't know how successful -- everyone
18 has indicated everyone must participate in this
19 reduction.

20 Q. What about the royalty of JSM?

21 A. If you look on the first page, JSM
22 currently -- as to 100 percent of that federal lease --
23 has a two-and-a-half percent, and we requested that
24 they reduce their royalty to a 1.5.

25 Q. What is the general time span that you had

1 in trying to get this royalty reduction? In other
2 words, when did you start your efforts to reduce the
3 royalty?

4 A. The initial memo that I have in here from
5 Joe Cox was dated May 30th, but there were verbal
6 conversations prior to that. But, in writing, we
7 initiated contact with the overriding royalty owners
8 May the 30th.

9 Q. When did you find that JSM would not
10 participate in royalty reduction?

11 A. Mr. Cox received a phone call on December
12 the 15th from Robert Mclosky at JSM. And that's
13 identified under the phone and conversation log of Mr.
14 Joe Cox under Miscellaneous, the tab Miscellaneous.

15 Q. December 15th, 1989?

16 A. Yes. December 15, 1989.

17 Q. Is that all you have concerning this
18 particular set of materials on royalty reduction,
19 Ms. McClintock?

20 A. Yes, it is.

21 Q. Let's go on to the right side of the
22 folder, and let's start at the bottom of that and
23 progress from the bottom to the top. Let me direct
24 your attention to the tab identified as "Operating
25 Agreements." Can you tell us what that tab contains.

1 A. This is the operating agreement between
2 Mallon and all nonoperators within the Amoco farm out.
3 It's dated October 1st, 1986.

4 Q. Was this a farm out that you inherited when
5 you took over operations -- well, let me rephrase that
6 question. When did you get involved in that area?

7 A. Mallon Oil Company was initially a
8 nonoperator in this particular prospect. It was
9 originally operated by Worth Petroleum. And the
10 agreement between Amoco and Bettis was inherited by
11 Mr. Michael Easton at Worth Petroleum February 1st,
12 1983, or around that time. That's when the original
13 farm out was executed by Bettis and Amoco. Mallon Oil
14 Company has participated in all the wells commenced by
15 Mr. Gleason of Worth Petroleum from the beginning of
16 the prospect.

17 Q. How many wells has Mallon participated in?

18 A. Mallon has participated in 15 wells.

19 Q. Is Mallon the operator of those wells
20 today?

21 A. Mallon is currently the operator. We took
22 over the operations October 1986.

23 Q. When you took over operations in 1986 was
24 this operating agreement, being the first item in
25 here, executed by all parties?

1 A. Yes, that is accurate. All parties --
2 nonoperators within the Pecos River prospect, which is
3 our Amoco farm out, have executed this document.

4 Q. How many wells has Mallon itself drilled
5 out there?

6 A. Mallon Oil Company has drilled six wells.

7 Q. And they have been drilled pursuant to this
8 operating agreement?

9 A. That is correct.

10 Q. Ms. McClintock, please refer the Examiner
11 to the portion of the operating agreement which calls
12 for overhead charges and non-consent penalties.

13 A. Non-consent penalties, located on Page 6 --
14 it's 400 percent. And the overhead charges under the
15 COPAS, page 4, and it's \$3,100 for drilling and 325
16 for producing.

17 Q. Has that overhead charge been changed since
18 taking over the -- well, is that the same today as it
19 was in 1986?

20 A. No. It has been adjusted in accordance
21 with the COPAS.

22 Q. What are the current rates for overhead
23 charges?

24 A. You can find that under the tab "Amoco Red
25 Bluff No. 3 Well," directly on top.

1 Q. That is on the left-hand side?

2 A. That is correct. Dated February 6, 1990.

3 Q. What are those overhead charges?

4 A. It's identified under the Administrative
5 and Overhead Costs. During drilling it's \$3,056.60 a
6 month. During completion it's \$3,056.60 a month. And
7 during production operations it's \$334.88 a month.

8 Q. Ms. McClintock, are these figures based on
9 historical experiences that you have had in operating
10 the wells in this area?

11 A. That is correct.

12 Q. In your opinion, are those figures
13 reasonable?

14 A. Yes, they are.

15 Q. Are those figures based on -- to some
16 extent are they based on the original operating
17 agreement with Worth Petroleum?

18 A. Yes. The original operating agreement with
19 Worth Petroleum -- when I prepared this new operating
20 agreement, after we took over operations, I took in
21 the adjusted COPAS figures. That is why I've
22 identified it with initials, to evidence the adjusted
23 figures.

24 Q. Let's go back to the non-consent penalty.
25 Is that non-consent penalty of 400 percent typical of

1 the figures found in that area of southeast
2 New Mexico?

3 A. Yes.

4 Q. Should an order be issued in your
5 application or Mallon's application, does Mallon want
6 to be named the operator under that agreement?

7 A. Yes, they do.

8 Q. -- or under that order, I should say.

9 A. Yes, they do.

10 Q. Did you submit an operating agreement to
11 George Mitchell?

12 A. Yes, I did.

13 Q. What else did you submit to Mr. Mitchell --
14 well, let me ask you this question first. Was that
15 operating agreement in the form substantially as that
16 identified under Operating Agreement, in the tab
17 labeled "Operating Agreements"?

18 A. Yes. It was identical with the exception
19 of Exhibit A, which would obviously differ in terms of
20 identification of working interest partners and the
21 location we identified on the well. And it also
22 differed in pages 14A and 14B. I had language in Mr.
23 Mitchell's operating agreement in reference to
24 assignability of the document, notification to Mallon
25 when they have assigned, and also on payment defaults.

1 Q. Was that added language for Mitchell?

2 A. Yes, it was.

3 Q. And why was that added language put in
4 there?

5 A. The payment default language and
6 notifications of assignment is standard for Mallon Oil
7 Company in the event we are not familiar with that
8 participant in terms of history of payment and that
9 type of thing.

10 Q. Did Mr. Mitchell ever indicate that that
11 language is unacceptable?

12 A. No. We discussed the operating agreement.
13 He had questions concerning the operating agreement.
14 He called me on them, and he questioned the nonconsent
15 and the overhead, that type of thing, but pages 14A
16 and 14B were never discussed.

17 Q. Let's go on now to the Red Bluff tab, or
18 "Red Bluff Documentation" tab and have you identify
19 that portion of the file.

20 A. Prior to Mr. Mitchell receiving or
21 negotiating with Red Bluff, Red Bluff Water Power
22 Control District had control over this acreage, and
23 Mallon Oil Company attempted, after our last forced
24 pooling, to contact Red Bluff and work out with them
25 some type of agreement so we wouldn't have to go to

1 forced pooling.

2 Our initial contact was on December 2nd,
3 1988. And at that time we were looking at drilling
4 what we were calling the Amoco Red Bluff Federal No. 2
5 Well, located in the southeast of the northeast of
6 Section 28. We wanted to drill the well prior to
7 May 1st. And I mailed on December 2nd, an authority
8 for expenditure and an operating agreement. And I
9 requested that they review them and call me with any
10 questions.

11 Q. Did they ever call you back and ask you --
12 were there any questions or response to your
13 correspondence?

14 A. I had several conversations with Red Bluff,
15 and I've identified them in my phone correspondence
16 under Miscellaneous.

17 Q. What's the essence of those telephone
18 conversations?

19 A. The conversations with Red Bluff were that
20 they definitely did not want to participate but that
21 they wanted to sell their acreage. When I realized
22 that they were not going to be signing the authority
23 for expenditure or the operating agreement, I
24 contacted them in an effort to negotiate some type of
25 farm out.

1 Initially, my offer was based on just one
2 well, just so we could get going on it and not have to
3 force pool. Mr. Fuller contacted me and said that
4 they were planning on perhaps putting together some
5 type of package and would Mallon Oil Company be
6 interested. And we said, "Yes, we would be
7 interested."

8 There was some additional letters
9 reiterating my offer, which this, at a later date,
10 became five percent for the first well, but if they
11 would agree to farm out a package to us, we would be
12 willing to give them 7 1/2 percent. Knowing that
13 would not have to go through forced pooling
14 proceedings every single time, we wanted to propose a
15 well. If I may refer to my notes so I can get the
16 exact date -- on June 30th --

17 Q. You're referring to what now?

18 A. My notes of my phone conversations. It's
19 under the "Miscellaneous" tab. It's the legal-size
20 document. On June the 30th, 1989, Mr. Fuller called,
21 from the Red Bluff Water Power Control District and
22 told me that he had farmed out to G.P. II Energy,
23 Inc., and that I could call Mr. Mitchell.

24 Q. Did you call Mr. Mitchell?

25 A. Yes, I did.

1 Q. When did you first call Mr. Mitchell?

2 A. I called him July the 10th, 1989.

3 Q. Is that contained in your chronology of
4 your notes there?

5 A. Yes, it is.

6 Q. What was the substance of your initial
7 contact with Mr. Mitchell?

8 A. When I contacted Mr. Mitchell, the
9 information I had received from Mr. Fuller was they
10 were firming up the deal. That it had not been
11 finalized. I called Mr. Mitchell. I explained the
12 situation, the deadline, and such. We were very
13 pleased to see that something was going to happen with
14 this acreage in terms of we knew Red Bluff was not
15 going to be participating, we knew we probably would
16 have to force-pool, so we were very happy to see
17 someone else in there. Mr. Mitchell indicated they
18 wanted to participate. They were not looking to go
19 nonconsent. They wanted to develop the acreage also.

20 Q. In what manner did they want to develop the
21 acreage? Did they want to develop by joining in your
22 drilling, or did they want to do it independently?

23 A. In that phone call Mr. Mitchell indicated
24 that they were interested in operations, but I
25 explained to him that we wanted to maintain the

1 operations for the area. I explained to him that I
2 would mail him an AFE and an operating agreement,
3 which I did.

4 Q. What was the result of that mailing?

5 A. I'm not quite sure what you mean.

6 Q. Well, you mailed him an AFE and an
7 operating agreement. What happened after that?

8 A. There were some phone calls from
9 Mr. Mitchell explaining that he felt our AFE was too
10 high.

11 Q. When were those phone calls made?

12 A. They were in the latter part of July.

13 Q. Are those conversations detailed in your
14 chronology on the Miscellaneous --

15 A. On my chronology, no, they are not.

16 Q. Let's identify the date, more or less, of
17 when you first started talking to Mr. Mitchell.

18 A. My initial contact was July the 10th, 1989.

19 Q. When did you send the AFE and the operating
20 agreement?

21 A. July the 12th, 1989.

22 Q. Then you had other conversations in July of
23 1989?

24 A. Correct. Mr. Mitchell called and expressed
25 that he felt the AFE was too high, and Mr. Mitchell

1 and Mr. Lewis would like to come up and talk with Joe
2 Cox and myself concerning this issue.

3 Q. Did they come up?

4 A. Yes, they did.

5 Q. What happened? Did you have a meeting --
6 what happened at that meeting?

7 A. The meeting itself took place in Mallon Oil
8 Company's offices. And there was no documentation
9 brought by Mr. Lewis or Mr. Mitchell in terms of where
10 there were problems. Again, I am not an engineer.
11 There was some discussion between Mr. Cox, Mr. Lewis,
12 and Mr. Mitchell after I left the meeting. If there
13 were specific discussions as to cost of AFE, something
14 like that, I was not present.

15 Q. What was your understanding of the action
16 that you were going to take or that Mitchell was going
17 to take as a result of the meeting -- at least during
18 the time that you were present?

19 A. During this meeting we were concerned,
20 obviously, with Red Bluff not wanting to participate.
21 And so, like I said, when Mr. Mitchell had farmed-in
22 the acreage from Red Bluff and he indicated his
23 initial willingness to participate, we asked, you
24 know, were they planning on participating, or as to
25 that fact. And they said regardless that they wanted

1 to participate. They wanted to develop the area also.
2 They would participate in our well.

3 Q. What subsequent conversations or contacts
4 did you have with Mr. Mitchell?

5 A. Mr. Mitchell called me, again -- well, I
6 believe I referenced it before -- a phone call
7 concerning his questions about the operating
8 agreement. And, again, he indicated that he felt the
9 AFE was too high. I explained to him that, you know,
10 that's not my area and he needed to contact Mr. Cox.

11 Q. After that time, when did you again talk to
12 Mr. Mitchell?

13 A. I did not talk to him. I did mail out an
14 additional AFE on November 28, 1989, to Mr. Mitchell.

15 Q. And what resulted from that?

16 A. On December 5th, I received a phone call
17 from Mr. Mitchell stating that he would not
18 participate but that he would interested in farming
19 out his interest for a 75 percent net revenue
20 interest.

21 Q. Why didn't you do anything between November
22 and July, or August, whenever you had talked to
23 Mr. Mitchell, or during the time you had the meeting,
24 why didn't you try to get a joinder or get him to sign
25 up at that time, during that interim time?

1 A. Between July and November?

2 Q. Yes.

3 A. We were waiting on other partners, also,
4 and so there wasn't a rush for us in terms of we
5 wanted to get the paperwork in. The indication that
6 we had received was that he would participate, and we
7 had other partners we were waiting on to execute AFE's
8 also.

9 Q. To the best of your knowledge and
10 recollection did you iron out the problems with the
11 AFE? His concerns about the cost of the AFE?

12 A. No, we did not. I was not involved. I do
13 know in my conversation with him on December 26, 1989,
14 when I notified him that the 75 percent net revenue
15 interest was too low, I wanted to clarify why he would
16 not participate in the well. And he said, two
17 reasons. He did not want to drill the No. 3 location.
18 And the second reason, the AFE was too high.

19 Q. Had he ever told you he didn't want to
20 drill the No. 3 location?

21 A. They had indicated in their meeting in
22 August, when Mr. Lewis and Mr. Mitchell came up, that
23 there was a preference for the No. 2 location. I
24 believe there was some additional conversation between
25 Mr. Cox, Mr. Lewis and Mr. Mitchell that I was not

1 involved in.

2 Q. Was Mr. Mitchell aware that you had a
3 drilling deadline of December 31st?

4 A. Yes. He was originally aware of our
5 deadline of August 31st. We did receive an extension
6 from Amoco, December 31st 1989. And he was aware of
7 both deadlines.

8 Q. You testified just a while ago that you did
9 talk to him sometime in December. When was that in
10 December?

11 A. I spoke with him three different times in
12 December of 1989.

13 Q. What was substance of those conversations?

14 A. The first conversation, he called me on
15 December 5th to let us know he would not participate
16 in the well.

17 On December 26, I called him to let him
18 know that what he had offered -- in this December 5th
19 conversation, I requested he put it in writing. On
20 December 26th I called to let him know the net revenue
21 interest was too low, and could we work something out.
22 I had suggested going back or having Mr. Mitchell go
23 back to Red Bluff Water Power Control District and see
24 if they could give us some type of relief on their
25 heavy burden, so Mr. Mitchell could -- you know, they

1 could proportionately reduce their interest and
2 Mr. Mitchell would be able to maintain some type of
3 overriding royalty.

4 Mr. Mitchell indicated he had already done
5 that, and he could not get Red Bluff to come down from
6 their -- either 7 1/2 percent overriding royalty.

7 At the time that's when he told me the two
8 reasons he was not participating in the well was the
9 AFE was too high, and they would rather drill the
10 No. 2 location instead of the No. 3 location. And I
11 felt that at that point if he's already talked to Red
12 Bluff -- I told him I would talk to my people and see
13 what we can do. I called him again on the 29th to let
14 him know that we were going to be force pooling the
15 Red Bluff interest.

16 Q. That was prior to the December 31st
17 drilling deadline?

18 A. That is correct.

19 Q. Did you subsequently follow up with a
20 compulsory pooling hearing?

21 A. Yes, we did.

22 Q. And that was when?

23 A. January the 3rd.

24 Q. You had actually notified Mr. Mitchell that
25 you would proceed with the compulsory pooling hearing

1 prior to to January 3rd?

2 A. Yes, that is correct.

3 Q. Did you ever receive from Mr. Mitchell any
4 correspondence or any proposals for drilling either
5 the No. 2 well or No. 3 well?

6 A. Proposals?

7 Q. Yes.

8 A. I would not classify them as proposals. A
9 cost estimate was mailed to Mr. Cox. If any
10 additional conversations took place between Mr. Cox
11 and Mr. Mitchell and Mr. Lewis, Mr. Cox would have to
12 testify to that.

13 Q. Did Mr. Mitchell ever call you and tell
14 you, "We want to drill the No. 3 Well. Here is our
15 AFE and here is our operating agreement, or "Here are
16 the terms that we want in drilling the well"?

17 A. No. I've never received an operating
18 agreement. As I said earlier, a cost estimate was
19 mailed to Mr. Cox, but I did not have any
20 conversations with Mr. Mitchell concerning a proposal
21 of a well.

22 Q. By them?

23 A. By Mitchell. I contacted them. We
24 proposed the well.

25 Q. Let's go on now to the tab identified as

1 the -- well, it's a top tab, "George Mitchell"
2 Notification. Would you go through those documents
3 for the Examiner, please.

4 A. Starting at the bottom, two documents at
5 the bottom are documents I received from my abstracts,
6 from my division order title opinion from my Amoco Red
7 Bluff Federal No. 1 Well. I had requested this
8 information. I hadn't received it from Mr. Mitchell,
9 but I did get this from my abstract. And it just
10 identifies that Mr. Mitchell, indeed, has at least
11 operating rights to the interest.

12 Q. Ms. McClintock, in all your dealings, were
13 your dealings always with Mr. Mitchell, II?

14 A. Yes. Initially with Red Bluff and then
15 when Red Bluff transferred it to Mr. Mitchell, George
16 Mitchell, II, I talked with him.

17 Q. Is that Mr. Mitchell present in this room?

18 A. Yes.

19 Q. Can you identify him?

20 A. Mr. Mitchell (indicated).

21 Q. The gentleman in the gray suit?

22 A. Yes.

23 Q. That is the person you dealt with at all
24 times?

25 A. Yes.

1 Q. Did he ever at any time tell you he was
2 dealing for anyone else?

3 A. No.

4 Q. Would you continue with your explanation of
5 the material under this particular tab.

6 A. There is a letter dated July the 12th,
7 1989, to Mr. Mitchell from myself, where I have mailed
8 to him the operating agreement and the AFE for the
9 Amoco Red Bluff Federal No. 3 Well. I also sent him
10 copies of the corrected survey plat, so he had them
11 for his file -- you know, so there would be no
12 confusion as to the breakdown. Also the APD for the
13 well. The letters from John Gumert, accepting the
14 correct John West plat. And also the forced pooling
15 decisions. I didn't know what he had in his file,
16 what Red Bluff had supplied him, so I wanted to make
17 sure he had a complete file from Mallon.

18 Q. You sent Mr. Mitchell everything that you
19 had sent Red Bluff in the attempts you had made in
20 dealing with Red Bluff?

21 A. Yes, that is correct.

22 Q. Why did you do that?

23 A. Mr. Mitchell had indicated that he was
24 going to participate in the well, and -- at least he
25 wanted to review the AFE and operating agreement.

1 Obviously, everything is contingent upon the review of
2 the operating agreement and AFE and discussing it and
3 trying to work any problems out. I mailed it to him
4 for his review and approval.

5 Q. What else is contained in this tab that you
6 may have sent?

7 A. The next document is not one I sent but I
8 will just tell you it's there. It's July 17, 1989 --
9 it's a letter to George Mitchell and Terry Lewis. It
10 is from Joe Cox.

11 Q. And Mr. Cox will testify to that letter; is
12 that correct?

13 A. That is correct.

14 Q. What else do you have in there?

15 A. There is another document dated October 26,
16 1989, from George Mitchell to Joe Cox in our office,
17 and it is pursuant to the meeting that we had in our
18 office. And it is what they identify as an AFE for
19 either the Red Bluff No. 2 or the No. 3 well.

20 Q. That was his AFE?

21 A. That is correct.

22 Q. Tell us about your understanding of how
23 that AFE got sent to you.

24 A. Both Mr. Mitchell and Mr. Lewis had
25 indicated in their meeting in Mallon's offices in

1 August that they felt that they could drill the well
2 cheaper than Mallon Oil Company.

3 Mr. Cox and I had assumed that they would
4 be bringing documentation to this meeting to
5 substantiate that claim. They didn't. And so we
6 requested -- or Mr. Cox requested something in writing
7 from them giving Mallon Oil Company an idea of what
8 type of operations they would conduct.

9 Q. Did they ever send an operating agreement
10 with this thing?

11 A. No. Not to my -- no.

12 Q. Do you have any knowledge of Mr. Mitchell's
13 experience in this area? And I'm referring to
14 Mitchell, II.

15 A. I am not personally aware of any wells that
16 Mr. Mitchell, II, or G.P. Energy operates, but perhaps
17 Mr. Cox would be much more qualified to answer that
18 question.

19 Q. Ms. McClintock, at some point in time were
20 you or Mallon, or were you under the impression that
21 Mr. Mitchell was going to participate in your well?

22 A. Was I under the impression?

23 Q. Yes, ma'am.

24 A. Yes, I was.

25 Q. When did you form that impression?

1 A. My initial phone conversation with him he
2 indicated that, obviously, he did not have possession
3 of an AFE or operating agreement. They discussed it
4 again in the meeting in August, and then when he
5 called me to discuss certain points of the operating
6 agreement, it was never mentioned that he would not
7 participate.

8 Q. Was it ever mentioned that he would
9 participate?

10 A. He had indicated to Mr. Cox and myself in a
11 meeting that, yes, he would participate regardless of
12 the situation with the operator. Whether -- at that
13 point we were discussing operations and that type of
14 thing, and he would participate.

15 Q. Did you deem Mr. Mitchell as having
16 consented, at least verbally?

17 A. Yes.

18 Q. And when you corresponded with him in
19 November of 1989 by sending him another AFE, why did
20 you do that?

21 A. There were two reasons. First, there was a
22 location footage change from the original AFE dated in
23 June. In fact, that AFE is right on top of the next
24 document. When I mailed it to Mr. Mitchell, it was
25 November 28th, I wanted to identify the location

1 footage change. And I identified that in the letter
2 that that AFE is identical to the June AFE.

3 There was also another reason. We had
4 extremely poor response from our working interest
5 owners on our June AFE, very poor response. And at
6 this point on November 28, we felt like we had the
7 reduction of the overriding royalty interest on our
8 Amoco lease. So I sent out another AFE to our
9 partners. I have included a copy of the letter in
10 this file, and it's under "Working Interest
11 Notification," where I even state that we feel
12 confident that we would have an 80 percent net revenue
13 interest. We were hoping to generate a little bit
14 more interest because we had a drilling deadline of
15 December 31st and we needed more participation.
16 Mallon Oil Company really wasn't in a position to take
17 on additional interest.

18 Q. Nonetheless, were you still willing to go
19 forward with drilling this well?

20 A. Oh, yes.

21 Q. You just simply wanted more participation?

22 A. Yes. Or we wanted full participation --
23 participation from all working interest owners.

24 Q. Are those working interest owners your
25 partners in the other wells?

1 A. The other wells, it varies from well to
2 well. And each well is identified in our operating
3 agreement. I've broken it out under Exhibit A, under
4 operating agreement, well by well. But, basically,
5 the interest owners, a majority of them, are interest
6 owners in all the wells.

7 Q. Did you have any dealings with the Oil
8 Conservation Division or the federal regulatory
9 agencies concerning the location change?

10 A. Yes. We applied for a nonstandard
11 location.

12 Q. Why did you do that?

13 A. Mr. Cox, would be better qualified to
14 answer that.

15 Q. Did he do most of that work, or did you do
16 that work?

17 A. I handled the paperwork in terms of
18 notification to the offsetting lessees.

19 Q. And when did you do that?

20 A. May I --

21 Q. Sure. Please tell us where you're at.

22 A. It's under the "Amoco Red Bluff No. 3
23 Well." The nonstandard location was granted to us
24 November 27, 1989. And I mailed out the paperwork,
25 addressed to Mr. Mike Stogner, New Mexico Oil

1 Conservation Division, September 26th. And I received
2 approval from the offsetting operators.

3 Q. Why was the location change necessitated?

4 A. We had some archaeological problems with
5 the original location.

6 Q. Did Mr. Cox handle the actual talking with
7 the archaeologists and all that sort of thing?

8 A. Yes, that is correct.

9 Q. Roughly, how long did that change take to
10 authorize?

11 A. I mailed the letter September 26, and we
12 did not receive approval until November 27th. And the
13 very next day is when I mailed out my AFE's.

14 Q. When did the other interest owners finally
15 join in response to your November 27th AFE?

16 A. November 28th.

17 Q. November 28th AFE.

18 A. I had requested in my letter to all the
19 partners, including Mr. Mitchell, that please respond
20 by December 10. And everyone responded by December
21 10th, and I knew who would be participating and who
22 would not be participating.

23 Q. From December 10th to December 29th, is
24 that the last time you talked to Mr. Mitchell?

25 A. I spoke with Mr. Mitchell on December the

1 5th. He contacted me prior to the December 10th
2 deadline and verbally told me he would be going
3 nonconsent and would be like farming his interest.

4 Q. Let me see if I've got this scenario
5 straight. What did you do between December 10th and
6 December 29th -- or December 5th -- whenever you had
7 the conversation with him?

8 A. In terms of Mr. Mitchell's interest --

9 Q. Right.

10 A. -- or the well in general?

11 I requested Mr. Mitchell put his offer in
12 writing. Unfortunately, I did not receive it. The
13 office received it two days later. He prepared the
14 letter that very day. I did not receive -- the office
15 received the letter on the 7th, but I did not receive
16 it. I, unfortunately, was out of the country for two
17 weeks starting December 12th. And when I got back on
18 the 26th, the letter was in my box. It had been
19 routed to everyone in the company but myself. But
20 Mr. Mitchell did notify me verbally that he was going
21 nonconsent.

22 Q. Did you immediately take action on the 26th
23 to force pool or notify Mr. Mitchell that you were
24 going to force pool?

25 A. No. I called Mr. Mitchell on the 26th to

1 see if we could work something out. When I was
2 telling you I had asked him whether or not he could go
3 to Red Bluff and see if they could give us some type
4 of relief on the burden, and he said he had already
5 done that. He had already attempted that. Therefore,
6 there was nothing else to do -- the 75 percent net
7 revenue interest was very firm.

8 Q. Then three days later you notified him you
9 were going to force-pool?

10 A. That is correct.

11 MR. PADILLA: I believe that's all the
12 questions I have for Ms. McClintock. I'll pass the
13 witness at this time, Mr. Examiner.

14 EXAMINATION

15 BY MR. CARR:.

16 Q. Ms. McClintock, I have several questions
17 concerning when the well was spudded, how and when an
18 application for permit to drill was obtained. Are
19 these questions I should direct to Mr. Cox?

20 A. I believe so, Mr. Carr.

21 Q. If we go to your exhibit -- you're going to
22 have to help me wade through this.

23 A. Okay.

24 Q. If we go to the plat, and the second plat
25 under on the left side, under the tab "Plat," has an

1 area outlined in yellow, and I believe that indicates
2 the area that was included in the Amoco farm out; is
3 that correct?

4 A. That is correct. I should perhaps even
5 further identify that is the acreage identified under
6 Federal Lease 38636.

7 Q. Does the Amoco farm out include all of the
8 interest in that tract or just a portion of interest
9 in that tract?

10 A. We are limited in formation.

11 Q. There is one 40-acre tract that's outlined
12 in yellow over on the right-hand side of the plat,
13 with the well with the word "El Paso" above it. What
14 is that? Is that a window in this lease?

15 A. Yes, it is.

16 Q. You acquired this farm out in what year?

17 A. 1983.

18 Q. And was it acquired by you or your
19 predecessor?

20 A. Our predecessor, Worth Petroleum Company.

21 Q. You succeeded Worth when?

22 A. October 1986.

23 Q. Is there a continuous drilling requirement
24 to keep this farm out in effect?

25 A. Yes, there is.

1 Q. And so since October 1986, Mallon has been
2 developing the acreage?

3 A. That is correct.

4 Q. And it requires what? One well every 180
5 days?

6 A. That is correct.

7 Q. On this plat there are a number wells to
8 the right of the Red Bluff reservoir. Have those
9 wells actually been drilled by Mr. Mallon?

10 A. No. They have been drilled by Worth
11 Petroleum, Wells 1 through 9. And Mallon Oil Company
12 became operators on Wells 10, 11, 13, 14, Amoco Red
13 Bluff Federal No. 1 and Amoco Red Bluff Federal No. 3.

14 Q. 14?

15 A. Right.

16 Q. Is one down in the extreme northeast corner
17 of the farm out?

18 A. No. The one identified is Amoco Red Bluff
19 No. 1. It's in writing.

20 Q. Okay.

21 A. That is Mallon. Wells 1 through 9 were
22 drilled by Worth Petroleum.

23 Q. Now, in the spacing unit, Mallon represents
24 a group of other working-interest owner partners; is
25 that correct?

1 A. That is correct.

2 Q. Are those the interest owners that are set
3 out in the letter behind the tab that says "Working
4 Interest Notification"? Are they set out there? That
5 December 28, 89 letter? It starts: "Mallon," and
6 "Charles Simmons, Weldon Aston." Are those the other
7 partners that you are talking about?

8 A. Yes; that is correct.

9 Q. These are the people that you wrote and
10 asked them to indicate to you by December the 10th
11 whether or not they were going to participate in this
12 well?

13 A. Yes. In addition, I notified one of the
14 persons that elected to go nonconsent, and that is
15 Dennis Johnston.

16 Q. Is Johnston one of those partners?

17 A. Dennis Johnston elected to go nonconsent.
18 He was not listed on this particular letter. This
19 letter was for notification purposes. He is
20 identified on my computer printout that I have under
21 miscellaneous.

22 Q. So when we have those people on that letter
23 and Mr. Johnston, those are your partners?

24 A. That is correct.

25 Q. I think you indicated that they all

1 responded by the 10th of December?

2 A. Yes.

3 Q. Did they all agree to participate in the
4 well?

5 A. Everyone but Mr. Johnston.

6 Q. You have been concerned about the net
7 revenue -- Mallon's net revenue interest in this
8 prospect. If I understood your testimony, you've been
9 attempting to reduce that?

10 A. Yes.

11 Q. The reduction is prospective only. It will
12 only reduce the net revenue interest of the other
13 participants and increase Mallon's when you get
14 everyone in; is that right?

15 A. I'm sorry. Would you repeat.

16 Q. If you're able to effect the change in the
17 net revenue interest, when will be it become
18 effective?

19 A. When we are able to get all overriding
20 royalty owners.

21 Q. So you still need to get JSM?

22 A. JSM. Correct.

23 Q. Under the present farm out with Amoco, what
24 is Mallon's net revenue interest?

25 A. Seventy percent.

1 Q. Is a 70 percent net revenue interest for
2 all of working interest partners at this time?

3 A. Yes.

4 Q. So you're attempting to increase that to an
5 80 percent?

6 A. That is correct.

7 Q. So when you drilled early this month the
8 well that is the subject of this hearing, you were
9 doing that under a 70 percent net revenue interest?
10 That was Mallon's net revenue interest?

11 A. That is correct.

12 Q. And you have rejected a 75 net revenue
13 interest from Mr. Mitchell?

14 A. That is correct.

15 Q. So he was offering, actually, five percent
16 more to Mallon than the net revenue interest Mallon
17 held when he drilled the well?

18 A. That's correct.

19 Q. Let's go now to the tab called
20 "Miscellaneous Information," and go to the long sheets
21 that you discussed which document contacts concerning
22 this well.

23 When did you find out that Mr. Mitchell had
24 acquired the interest in this property?

25 A. June 30, 1989.

1 Q. Then it was on the 10th of July that you
2 contacted Mr. Mitchell?

3 A. That's correct.

4 Q. And he expressed a willingness to
5 participate, but said he would need an AFE?

6 A. Of course.

7 Q. Then there were some calls, if I
8 understood, that occurred after that that aren't on
9 the log from Mr. Mitchell in late July?

10 A. That's correct. I did not keep dates on
11 that.

12 Q. At that time he inquired whether or not you
13 would be willing to give up operations?

14 A. Yes.

15 Q. And you said no?

16 A. That's correct.

17 Q. He also at that time questioned whether or
18 not the AFE costs were too high?

19 A. Yes. I explained to him that that was not
20 my area of expertise. That he needed to contact Joe
21 Cox.

22 Q. To your knowledge, was his concern about
23 the AFE cost being too high ever resolved?

24 A. To my knowledge, no.

25 Q. In fact, even in December, that was still

1 the outstanding issue, was it not?

2 A. That's what he indicated to me.

3 Q. In terms of the impact of a 70 percent net
4 revenue interest on the Mitchell interest, as opposed
5 to say a 75 net revenue interest on their interest in
6 this well, would you be the person who would make any
7 calculations to determine how much of an actual dollar
8 impact that might be on that?

9 A. Joe Cox prepares all the economics.

10 Q. This is going to make your testimony a lot
11 shorter.

12 When we look at the overhead administrative
13 costs that are included in the new operating agreement
14 that you provided to Mitchell, do you know what items
15 are included within those costs? Would your figure
16 include pumping costs?

17 A. Mr. Cox would be better qualified to answer
18 those questions.

19 Q. Originally you were concerned and
20 approached Red Bluff about drilling the Amoco Red
21 Bluff No. 2. This was back -- I have a letter dated
22 April the 4th, where you're communicating with them
23 concerning your need to drill this well.

24 A. Yes.

25 Q. That was the well you wanted to drill

1 before the end of June to perpetuate the farm out; is
2 that correct?

3 A. I am not sure the date when Mr. Cox
4 recommended that the location be changed to the No. 3.

5 Q. Was another well drilled at the end of
6 June, or was there just an extension obtained?

7 A. An extension.

8 Q. Again, as to the contents of the July 17
9 letter from -- I guess -- well, this is signed by
10 Mr. Cox and contains some figures, so I should again
11 address those with him?

12 A. That's correct.

13 Q. This is the benefit of being the first
14 witness.

15 And then on the 5th of December you talked
16 to Mr. Mitchell, and Mr. Mitchell said that he decided
17 he wouldn't participate. You asked him to put it in
18 writing, and you've included the letter.

19 A. That's correct.

20 Q. You indicated that when you got back from
21 overseas, the letter had been circulated to everyone
22 at the company?

23 A. That's correct.

24 Q. Did that include Mr. Cox?

25 A. Actually, it sat on one individual's desk,

1 and she brought it to me on the 26th.

2 Q. Do you know, other than this one
3 individual, who would have seen the letter?

4 A. No.

5 Q. So that it might not have actually been
6 circulating through the company?

7 A. I understand we went through four
8 receptionists in a very short period of time who were
9 handling the mail, and it went to this individual's
10 desk. She wasn't sure what to do with it. It sat
11 there. It went on someone else's -- in the accounting
12 department, even though my name is on the letter. We
13 don't understand it. But Mr. Mitchell did contact me
14 on the 5th.

15 Q. When he told you that on the 5th, you
16 didn't have any reason to doubt that he was in fact
17 intending not to participate, did you?

18 A. Oh, no.

19 Q. Who is responsible in your company for
20 assuring that wells would be drilled in a timely
21 fashion to perpetuate the farm out? Is that your
22 responsibility, or is it just your job to try and
23 round everybody up and get them in?

24 A. We all work in cooperation for that effort,
25 to make sure that the wells are drilled in a timely

1 manner.

2 Q. Would it have been your responsibility to
3 see to it that actually that a well was commenced in
4 time to perpetuate the farm out?

5 A. I make sure that everyone is aware of any
6 drilling deadlines, but as for being responsible for
7 lining up rigs, that type of thing, Mr. Cox handles
8 that.

9 Q. You knew on December the 5th that the farm
10 out would expire unless an extension was obtained at
11 the end of the year, did you not?

12 A. That's correct.

13 Q. Did you notify anyone at that time you had
14 an interest owner who was not participating in the
15 well?

16 A. Yes. I did not personally -- as I said, I
17 was out of the country, but Mr. Cox had to contact our
18 working interest owners. Mallon Oil Company was not
19 in a position to take the additional 28.46 percent
20 that Mr. Mitchell was going nonconsent on. So we
21 would try to see if any working interest owners would
22 elect to take not only their proportionate share, but
23 perhaps an increased share.

24 Q. Did you do that?

25 A. Mr. Cox had to do that. I was still out of

1 the office.

2 Q. In all of your dealings with Mr. Mitchell,
3 you were never able to obtain any kind of a resolution
4 of the question concerning AFE costs; isn't that
5 right?

6 A. Yes. I was not the one handling that.
7 It's my understanding that Mr. Cox and Mr. Mitchell
8 did not reach -- I'm not sure if there was any term
9 negotiations. I'm not even sure if that was
10 discussed. I know it was mailed to us. After that,
11 I'm not really sure.

12 Q. You never were able to obtain a signature
13 or joinder in the well from Mr. Mitchell?

14 A. Not from the paperwork I mailed him. And
15 he never mailed any paperwork to me.

16 MR. CARR: I have no further questions.

17 Thank you very much.

18 MR. PADILLA: Nothing further,

19 Mr. Examiner.

20 EXAMINATION

21 BY EXAMINER CATANACH:

22 Q. Ms. McClintock, when was the application
23 for forced pooling filed with the division?

24 A. January 3rd, and I believe that's under
25 Miscellaneous. There's a copy of the letter

1 Mr. Padilla mailed to Mr. LeMay on January 3rd, the
2 application.

3 Q. Do you know when the case was scheduled for
4 hearing?

5 A. February 7th.

6 Q. Ms. McClintock, do you know why at the time
7 that you were advised that Mr. Mitchell would not be
8 participating, why an application for forced pooling
9 wasn't filed at that time?

10 A. At the time I received Mr. Mitchell's
11 verbal, concerning his nonconsent status and his
12 willingness to farm out the interest at a 75 percent
13 net revenue interest, I was waiting actually for
14 something in writing, but I did have his verbal.

15 I discussed it briefly with certain
16 individuals in the office, whether or not we could
17 live with a 75 percent. At that point in time, we
18 were still under the impression that we would have an
19 80 percent net revenue interest on the Amoco portion.
20 We did not realize until the middle of December that
21 JSM was not going to sign the reduction in royalty.

22 We did not know what our options were in
23 terms of economics in terms of whether or not going to
24 a forced pooling, that type of thing, those things
25 needed to be decided. Unfortunately, I had to leave

1 the country for two weeks and no one else picked it up
2 until I got back.

3 I know Mr. Cox contacted Mr. Mitchell to
4 find out what's going on, and Mr. Mitchell had
5 indicated, "Well, I've mailed the letter," and I had
6 not personally received it, and that's what we were
7 waiting on.

8 Q. Could Mallon have applied for another
9 drilling extension from Amoco?

10 A. We had requested a drilling extension from
11 December 31st, 1989, through the end of March, 1990,
12 and it was rejected.

13 Q. Do you have that in evidence in this case?

14 A. No, I don't.

15 MR. PADILLA: Mr. Examiner, if the Examiner
16 desires to have that, we can provide it.

17 EXAMINER CATANACH: It may be helpful,
18 Mr. Padilla.

19 I think that's all we have of the witness
20 at this time. You may be excused.

21 (Thereupon, a recess was held.)

22 EXAMINER CATANACH: Before we proceed to
23 the next witness, I have just one more question for
24 Ms. McClintock, if I could.

25 Q. The extension that we talked about that you

1 requested, do you know what date that was sent to
2 Amoco?

3 A. Yes. November the 2nd, and I was able to
4 get ahold of my secretary. She's faxing it to
5 Mr. Padilla's office, and we will have it in just a
6 few minutes.

7 EXAMINER CATANACH: You may proceed,
8 Mr. Padilla.

9 MR. PADILLA: Mr. Examiner, at this time
10 we'll call Joe Cox.

11 JOE COX

12 The witness herein, after having been first
13 duly sworn upon his oath, was examined and testified
14 as follows:

15 EXAMINATION

16 BY MR. PADILLA:

17 Q. Mr. Cox, please state your full name.

18 A. Joe Cox, Jr.

19 Q. And do you spell your last name C-O-X?

20 A. Yes.

21 Q. Mr. Cox, have you testified before the Oil
22 Conservation Division previously?

23 A. Yes, I have.

24 Q. In what capacity?

25 A. As production manager for Mallon.

1 Q. Mr. Cox, what are you trained as?

2 A. I have a degree in geology and petroleum
3 engineering.

4 Q. Has your previous testimony before the Oil
5 Conservation Division included testimony concerning
6 this Red Bluff area under consideration today?

7 A. Yes, it has.

8 Q. Have you compiled certain documents for
9 introduction that are included in Exhibit No. 1?

10 A. Yes.

11 MR. PADILLA: Mr. Examiner, we tender
12 Mr. Cox as an expert petroleum engineer and geologist.

13 EXAMINER CATANACH: He is so qualified.

14 Q. (BY MR. PADILLA) Mr. Cox, explain to me
15 your duties as production manager. What do you do for
16 Mallon? What do those duties include?

17 A. It involves just about anything related to
18 production operations, drilling, and there is a lot of
19 crossover between what I do and land, so Karen and I
20 work together a lot.

21 Q. When you say Karen, you mean Karen
22 McClintock?

23 A. Karen McClintock, yes.

24 Q. Can you briefly tell us about your dealings
25 with Mr. Mitchell?

1 A. Well, as Karen stated, we -- I guess our
2 first conversation with Mr. Mitchell was a telephone
3 conversation shortly after he obtained ownership of
4 this Red Bluff acreage. And we discussed our plans.
5 We were glad to hear that there was someone from the
6 oil business that had obtained that acreage.

7 Q. Why were you glad that Mr. Mitchell had
8 acquired the acreage?

9 A. We'd had a long frustrating process working
10 with Red Bluff, various people in the organization.
11 They weren't geared up for drilling any wells or
12 anything and weren't sure how to proceed with working
13 with getting wells drilled. And, of course, we have
14 the deadlines that we were working with continuously
15 with Amoco's farm out.

16 Q. Mr. Cox, to get down to the root of the
17 matter here, let's have you refer to the George
18 Mitchell Notification tab, and let me refer you to the
19 correspondence that you addressed to or received from
20 Mr. Mitchell. And I would like for you to start from
21 the top and go to the bottom of that with regard to
22 correspondence that may have been authored by you or
23 received by you.

24 A. This whole section?

25 Q. Yes, sir.

1 A. The first item that I put out was this
2 Amoco Red Bluff Federal No. 3 AFE. I'll skip over the
3 stuff that Karen did. I assume you want me to do
4 that?

5 Q. Yes.

6 A. This is the AFE that reflected the changed
7 location due to the archaeological problems in there
8 and everything else was identical to the original AFE
9 we'd sent.

10 Q. That is the AFE dated November 27th, 1989?

11 A. That's correct.

12 Q. The only thing you changed on that AFE,
13 compared to other data, was just the location; is that
14 correct?

15 A. That's right.

16 Q. The drilling costs remained the same?

17 A. (Nodded head up and down.)

18 Q. Is that a yes?

19 A. Yes. I'm sorry.

20 Q. After that AFE is a letter addressed to you
21 dated November 26, 1989. How did that come to you?

22 A. This letter came -- this October 26, 89? I
23 believe you said November.

24 Q. Oh, I'm sorry.

25 A. This was the second of a AFE form that had

1 come to us. This is the first typewritten
2 correspondence. And the letter generally refers to
3 some discussions we had in our meeting in our office
4 in August.

5 Q. What happened at that meeting in August in
6 your office?

7 A. Well, the meeting was held following our
8 earlier phone discussions with Mr. Mitchell and Mr.
9 Lewis. Their concerns were the site we had selected
10 to drill next and then the cost, our proposed drilling
11 completion cost.

12 Q. In his letter of October 26, Mr. Mitchell
13 says, "Enclosed please" -- among other things, he says
14 "Enclosed please find the AFE which we discussed
15 covering the captioned wells." I guess that refers to
16 the Amoco Red Bluff No. 2 or No. 3 Well.

17 Explain why the AFE was sent to Mallon, or
18 to you, and in what context was that sent to you.

19 A. We had requested -- at the meeting we held
20 in Denver, Mr. Mitchell and Mr. Lewis reiterated that
21 they thought our cost was too high. And, really,
22 nothing specific had ever been discussed about what
23 portion of our cost they felt was high or anything.
24 And I had requested at that time a detailed breakdown
25 of what their costs would be. And I had told

1 Mr. Mitchell in that meeting that we were indeed out
2 there to make money, and that if things -- we're
3 comparing apples and apples, and if his costs were
4 that much lower, that we could sure talk about him
5 being an operator of the well.

6 Having as much experience as we do out
7 there, I was a little bit skeptical that somebody
8 could come out and drill that much cheaper and really
9 do everything we felt was important. This was in
10 response to that request for detailed information and
11 gave me an opportunity to compare -- this also is the
12 second of two, a little more formal than the first AFE
13 forms that we received.

14 Q. How does this differ from the first one
15 that you received?

16 A. I don't have that to make a line by line
17 comparison here, but I believe the cost was about the
18 same. This one was typed.

19 Q. Was a proposal ever made by Mitchell to
20 Mallon, to your knowledge, for drilling either the
21 No. 2 or the No. 3 Red Bluff Wells?

22 A. No. No actual proposal. We left that
23 conversation off in our August meeting that we'd be
24 willing to talk about it. Mr. Lewis and I talked on
25 the phone, and that was September.

1 Q. You're referring to what now? Or are you
2 referring to another portion of the exhibit?

3 A. I was just trying to refresh my memory by
4 looking under the Miscellaneous Information tab, the
5 phone log here.

6 Q. That is included in the Miscellaneous
7 Information section?

8 A. Right. On the second page, final note, was
9 that around September 8th Terry Lewis and I had spoken
10 about my concerns about their proposed costs. And
11 we'd set up a phone meeting that George Mitchell would
12 be involved in on September 12 at 10 o'clock. I did
13 not receive the phone call on that date, and I was
14 busy on other things, and since it was designated they
15 would be calling me and since they didn't, I didn't
16 pursue it any further. I assumed that they were not
17 interested in pursuing that.

18 Q. You mentioned earlier that Mr. Mitchell had
19 indicated that your AFE was too high. Did he ever
20 identify in what respects your AFE was too high?

21 A. Not verbally in any of our meetings, but I
22 was able to compare our AFE with their form and come
23 up with where the differences lay.

24 Q. What is your version of what the
25 differences are?

1 A. Well, primarily, the biggest items were
2 production casing. There's about \$12,000 in
3 difference there. And this is one of the things I
4 wanted to talk about, and we just never got our
5 meeting together on. We had a \$12,000 difference in
6 stimulation, also. And these are both areas that I
7 felt were critical to a good well completion, and that
8 that we wouldn't want to compromise. And unless they
9 had a source for good cheaper casing -- I had pretty
10 well canvassed all the west Texas sources for casing.
11 I knew what the market was like, and my concern was
12 what they were proposing was poor quality casing that
13 we'd be unwilling to run and also compromising the
14 size and design of the frac job to come down with the
15 lower cost.

16 Q. Why was the frac job and the casing
17 critical to concerns that you may have had?

18 A. Well, first of all, the casing string, we
19 frac down the casing string out there. We have to
20 have fairly a high rate fracs, so we need good
21 integrity. The pipe is set through an assault section
22 that is oftentimes not covered with cement, due
23 oftentimes to cementing problems, and the life of the
24 wells is considerable, 15 years or so on primary, and
25 we have been kicking around the possibility of

1 secondary, which would probably add another 15 years
2 of life to these wells. So we really needed to have a
3 good casing string in the hole. And my interpretation
4 of that lower cost was that we would be cutting that
5 pretty short.

6 Q. When you say kicking around the thought of
7 secondary, what do you mean by that? '

8 A. Well, internally at Mallon we have done
9 some study on analogous fields and secondary recovery.
10 Two weeks ago yesterday there was a meeting in Midland
11 that I and Kevin Fitzgerald from Mallon attended, as
12 well as Mr. Mitchell and Mr. Lewis -- operators from
13 Brushy Draw Field that were getting together as an
14 initial meeting to discuss the possibility of a
15 secondary recovery project in there. So it's gotten
16 that far at this time.

17 Q. In terms of differences between the two
18 AFE's, in your opinion, is there a substantial
19 difference between the two?

20 A. Well, the differences -- I said I'm
21 skeptical just because we have worked out in that area
22 quite a while. The differences were those two major
23 items. He didn't have any overhead included, although
24 he did have a company expense line that may be his
25 equivalent of overhead. Did not have a mud log. His

1 logging suite was a cost that I felt would put that
2 below the minimum data that we would need.

3 And many of the things, stimulation,
4 logging, mud logging, would affect the ultimate share
5 that would be received if a secondary unit was formed.
6 Without that data or with a steeper decline from
7 smaller frac job or something, we would sacrifice part
8 of our portion in the secondary unit, because those
9 parameters would be used to evaluate that.

10 Q. With respect to the AFE you submitted to
11 Mr. Mitchell, did you ever come to any kind of an
12 understanding about your AFE and the costs contained
13 in your AFE?

14 A. There really has not been a lot of
15 discussion on that. As I mentioned, we had this phone
16 meeting for September 12th set up. It was a period of
17 time I was very busy. I did prepare for the meeting.
18 Was expecting the phone call. When it didn't happen,
19 I just assume that they had looked it over again and
20 decided they really couldn't compare apples to apples.
21 I mean, that was the conclusion that I had drawn
22 earlier, that our discounts were about like anybody
23 else's on services. And I knew the materials and the
24 sources pretty well, so --

25 Q. In terms of Mr. Mitchell agreeing to the

1 AFE, is it your opinion he agreed to your AFE or the
2 costs expressed in your AFE?

3 A. I can't say that he's ever expressed
4 agreement with it, but he has not specifically come
5 back and disagreed with it. He just said he was
6 concerned. We asked for more specific information.
7 We got the AFE form, but we never have really
8 discussed it.

9 Q. In terms of the second portion of this
10 letter, he indicates he would like to operate the well
11 or operate other wells in the area. Where did that
12 go?

13 A. Well, it didn't go anywhere. This
14 originated, I'm sure, with comments we made in our
15 August meeting, which I simply said that if, indeed,
16 they could do the same thing we're doing for that much
17 less money, that we may not be able to afford not to
18 have them operating the well. I was skeptical that
19 they could do the same things. That's the reason I
20 wanted the detailed breakdown of what they were doing.
21 And I still have the same conclusions, that there
22 would be some compromises that wouldn't be acceptable
23 to Mallon under his costs.

24 Q. Let's go on now, Mr. Cox, to the letter
25 that you wrote to Mr. Mitchell and Mr. Lewis on

1 July 17, 1989, and have you tell us what that letter
2 essentially says. I realize the letter speaks for
3 itself, but tell us why you sent that letter and
4 generally what its contents are.

5 A. This followed what I believe was our first
6 phone contact, at least mine. Karen and I and George
7 Mitchell and Terry Lewis had a speaker phone
8 conference call regarding the drill site, the Amoco
9 Red Bluff No. 3. And I think that must have been
10 right after we sent the Red Bluff 3 AFE to them. I'm
11 not sure exactly what date that was sent.

12 They said basically they wanted to drill
13 the No. 2, which was offset by two producers. This
14 letter goes through and explains my interpretation of
15 the general geology of the field. The fact that the
16 better wells had been found along the primary channel
17 trends in the field, and having recently drilled and
18 completed and put on production the Amoco Red Bluff
19 No. 1, we learned from the logs and from the
20 production history to that point that it wasn't in the
21 channel. We had to do some reinterpreting, which is
22 attached with this letter, showed the channel going
23 north from where we thought it was. And the No. 3
24 location looked like it was more likely to encounter
25 that.

1 Q. Would you explain that in the attachments
2 to your letter. And please identify for Mr. Catanach
3 the geologic information that you're referring to in
4 answer to my question.

5 A. I will just go top to bottom. The first
6 map is just a structure map on the top of the
7 Williamson Sand, which is the Cherry Canyon pay in
8 that field, the primary pay.

9 The second map is an isopach of Williamson
10 Sand greater than or equal to 20 percent density
11 porosity. And this shows the interpretation with the
12 Amoco Red Bluff No. 1 log data included.

13 Amoco Red Bluff 1 is in the northwest
14 southwest of 27. And since we encountered zero feet
15 greater than 20 percent, it appeared that the
16 channel -- and we had already drilled the 13 at the
17 time and seen seven feet in that well, the assumption
18 was that the channel was turning more northerly and
19 that the Red Bluff 3, in northwest northeast of 28,
20 would be more likely to encounter it than the Red
21 Bluff 2, which is in the southeast northeast.

22 Q. What is the third page -- the third
23 attachment?

24 A. This is a gross isopach of the Williamson.
25 The interval ranges from 85 to 100 feet thick across

1 the field. And this just shows interpretation with
2 the new well data at that time what was happening and
3 possibly the way the isopach would look. It's revised
4 on a previous map base, both of the -- the last map I
5 showed and this one are pencil revisions on my earlier
6 maps with the new well data.

7 Q. What do the copies of the logs following
8 that indicate?

9 A. Well, these were part of a cross section
10 that showed the channel trend across the field. The
11 well numbers, I believe, are on the top of all these
12 logs, but the first one, No. 5, is one of the better
13 wells -- this is a neutron density -- these are all
14 neutron density logs. And you can see in the lower
15 part of the Williamson 5,026 -- that's the fat of the
16 pay there. And we get several feet in excess of 20
17 percent porosity. No. 6 well, it has thinned
18 considerably just a few feet --

19 Q. When you say No. 6 Well, you're referring
20 to the No. 5 between --

21 A. Right. In the depth track on the log the
22 well number is penciled in there. These are going
23 from east to west, across the north part of our lease
24 there.

25 Q. Okay.

1 A. The next well jumps down to No. 3. And
2 there is quite a bit of header edge, and the sand out
3 there -- these logs vary quite a bit -- but again,
4 probably on the edge of the channel with No. 3, but
5 not right in the middle of it.

6 Number 9 had a fairly good section. We
7 felt like it was pretty much in the channel again.

8 I believe this is No. 10, even though the
9 number didn't come through very clearly on the next
10 log. And I don't know what well that is, to tell you
11 the truth. It's not No. 10. That's probably Amoco
12 Red Bluff 1.

13 Q. But these are all wells in the area?

14 A. Right.

15 Q. And you provided portions of these logs of
16 all those wells to Mr. Mitchell?

17 A. Right. Just to help him understand how we
18 we're interpreting this trend.

19 Q. Did Mr. Mitchell ever have any difference
20 of opinion with respect to your geologic presentation
21 to him?

22 A. Again, it never was specifically presented
23 to us. They did bring up later on again that they had
24 problem with the location, but we never had either
25 Mr. Mitchell or Mr. Lewis come to us and say, "This is

1 why we have a problem with it." And we were pretty
2 set, really, on drilling the No. 3 location. We would
3 have needed to have some specific reasoning to have
4 changed it.

5 Q. Mr. Cox, I believe I asked you this
6 question before, and I'm not sure whether I asked it
7 in the same fashion, but is it your testimony that you
8 never received a definite proposal from Mr. Mitchell
9 to drill either the No. 2 or the No. 3 well?

10 A. That's true. You mean as operator?

11 Q. Yes.

12 A. He mentioned that he would like to, but
13 there never was a definite proposal.

14 Q. Let's go on to your chronology. And I
15 would like for you to go through your chronology,
16 which is under the Miscellaneous Information tab, and
17 have you span through that, telling us what your
18 contacts with Mr. Mitchell were.

19 A. Okay. The first entry there is a July
20 21st. Conversation. I think Terry Lewis had called
21 me to find out what we knew about this Amoco Red Bluff
22 Federal No. 2, which is in Section 29. It was the
23 only dry hole out of 15 that have been drilled out
24 there. And just to expand on that a little bit, it
25 did not have open hole logs, but we did have a mud log

1 that we were able to get some data from. And I filled
2 Mr. Lewis in on what the mud log had told us. I don't
3 recall if I sent him a copy of that or not.

4 On August -- would you like just contact
5 with Mitchell and Lewis, sir?

6 Q. Yes, sir.

7 A. August 17, I had tried calling -- I believe
8 this was in response to a phone message that I had
9 from Mr. Lewis -- and left a message. And I don't
10 believe I got a response back from that.

11 Q. Tell us, what was Mr. Lewis' function in
12 this whole thing, to your understanding?

13 A. He was introduced to us as a consulting
14 engineer and, I believe, a partner in some wells; is
15 that correct? No.

16 Q. Well, just state your understanding.

17 A. That was my recollection from our meeting.
18 I thought he was consulting engineer. And as I
19 recall, he also had some interest, joint interest, in
20 some other wells in Texas or something.

21 Q. Did you understand when you talked to him,
22 that he was speaking on behalf of Mr. Mitchell?

23 A. That was my assumption. Whenever I spoke
24 with Mr. Lewis, I assumed that he was on
25 Mr. Mitchell's behalf, yes.

1 Q. Did Mr. Lewis ever express any concerns
2 about the AFE to you?

3 A. Yes. As mentioned, I didn't have a
4 specific date or exact date from my notes, but at the
5 end of this phone chronology, I had called him in
6 regard to his concerns. And that's when he said we
7 probably ought to get Mr. Mitchell, all three of us
8 involved in it. And then that next phone meeting
9 never happened. It was very specific that I would be
10 called at a certain time and just didn't receive it.
11 And it was at that time I didn't have time to follow
12 up on it.

13 Q. Let's go through this thing again. Did you
14 talk to Mr. Mitchell or Mr. Lewis in November?

15 A. No. The next conversation was on December
16 14, and that was when Karen had gone to Costa Rica on
17 business, and I had been told by Karen that George
18 Mitchell had called saying that he would not
19 participate as a working interest partner in the well
20 and realized that something needed to be done in her
21 absence, so I called to make sure I knew where things
22 stood with him. He told me that he had made a
23 proposal to her and was waiting on a response from her
24 on that proposal.

25 Q. What was the nature of the proposal? Was

1 that the farm out of 75 percent?

2 A. Seventy-five percent net revenue interest
3 farm out.

4 Q. Did you do any computing with respect to
5 that 75 percent net revenue interest to see whether or
6 not it was acceptable to Mallon?

7 A. Well, at the time that -- well, I can step
8 down one more step here. The date that I talked to
9 George Mitchell, I thought that we still had 80
10 percent net revenue interest, I believe, because of
11 the royalty reduction work that we had been doing. We
12 were lacking one signed document from JSM Oil and Gas.
13 And I had been passing phone calls back and forth with
14 JSM. The next day I talked to Robert Mclosky, and he
15 said he would not be sending it. Mr. Mclosky was the
16 second party that I had talked to at JSM. The other
17 man had indicated that they would go along with
18 whatever two of the other royalty owners did earlier.

19 Q. That was on December 15th?

20 A. December 15th, right.

21 Q. What did you do after December 15 when
22 Mr. Mclosky told you he wouldn't go along with the
23 royalty reduction?

24 A. Well, the deadline, of course, was closing
25 in on us rapidly at that point. I knew Karen wouldn't

1 be in town for a while. So without making a decision
2 on this farm out, I went ahead and started contacting
3 partners, letting them know that, No. 1, Mr. Mitchell
4 would not be participating, so we had some 28-plus
5 percent working interest that was going to need to be
6 distributed if we were going to drill the well.

7 No. 2, because of the voluntary nature of
8 our royalty reduction and one party that had indicated
9 they wouldn't be signing it, that we did not have the
10 royalty reduction. We had earlier put out a letter
11 saying it looked like we were going to have it.

12 Q. Why was it important to have the royalty
13 reduction?

14 A. Well, in the five wells we have drilled and
15 produced with Mallon as operator out there, we have
16 been fighting these marginal and negative economics.
17 We have been intrigued by the fact that we seem to
18 have proven up a fairly large area of tighter but oil
19 saturated sand on the updip side of this reservoir,
20 and even though the primary on these things was not
21 paying out, when you go back and average out the
22 wells, we were intrigued enough by the secondary not
23 to want to give out our farm out acreage. The
24 secondary, is by no means a given that the project
25 will even happen or that it will work if it happens.

1 So, really, we felt like we wanted to hang on to
2 things, but we really needed to get the primary
3 production at least to a break-even point in order to
4 keep drilling.

5 Q. What economics have you done with regard to
6 whether or not 80 percent or 75 or 77 percent is
7 economic or not economic?

8 A. Well, the economics that are enclosed with
9 this material are under the Royalty Reduction tab.

10 Q. Would you go to that please, and tell the
11 Examiner what that is. First of all, is that attached
12 to your memorandum to royalty owners?

13 A. Right. That's the May 30th memo. The memo
14 outlines for the royalty owners our situation. I
15 think at that point we had drilled five wells, we had
16 production history on four wells. We realized that
17 the fifth well was looking poor. And basically, we
18 just said, "Look we can either quit drilling, and it's
19 going to be hard for anybody else to justify coming
20 back in there and drilling, because the economics are
21 not going to change very much, or we can continue
22 drilling with a lower net revenue interest on future
23 wells only -- or a higher net revenue interest.
24 Excuse me -- and the royalty owners and the working
25 interest partners would benefit from that scenario.

1 And attached to the tail end of this memo
2 are several economic runs that were based on
3 historical production up to the date of the memo and
4 then projected from those trends, forward from there.

5 Q. What do those economic runs -- would you go
6 through one of those things and explain to the
7 Examiner how your calculations are computed,
8 essentially.

9 A. Okay. Well, they are all from the origins
10 of the wells, which vary here, until --

11 Q. Let's just take the first page there and go
12 to the 1986 line, and go across the page and tell the
13 Examiner what those figures mean.

14 A. I think you might be on the the second run
15 there. I guess not. What well number are you looking
16 at?

17 Q. Well, I'm about a fourth of the page down
18 where you start -- I guess it would be the Amoco
19 Federal No. 10 Well.

20 A. Okay. 86 has nothing. The well was not
21 producing in 86. 87, we had 11 months production.
22 The gross water production column, the first column on
23 top there, shows the actual water production for that
24 period of time, 11 months in 87. The gross oil
25 production shows the actual oil production. Gross gas

1 production, the same, the actual gas production. It
2 shows the eight-eighths working interest, and then the
3 net revenue interest that the well was producing
4 under.

5 And then the next columns show the net to
6 that 70 percent, net revenue interest in terms of
7 oil-gas production. The effective oil price column
8 shows the actual prices up to May of 89 and same with
9 gas.

10 We had actual severance and ad valorem
11 taxes and lease operating expenses input down on the
12 bottom set of columns down here. And then the rest of
13 it is calculated. The other input was the net total
14 investment line. That's actual drilling completion
15 cost for the various wells.

16 Q. What do those bottom lines show? Is there
17 a profit or a loss? Or in terms of that, how do we
18 make sense -- for me anyway?

19 A. The most useful line, actually, if you were
20 a working interest partner would be to look down at
21 the last column, lower right side of the page,
22 cumulative before tax cash flow discounted 10 percent.
23 And that well, No. 10, comes up with a minus \$2,580
24 value. So on a discount basis you loose \$2,580
25 through the life of the well on your investment. On a

1 nondiscounted basis it makes \$63,000 but this
2 considers the time value of money you spent back in
3 87.

4 Q. Is it prudent to discount in this fashion?

5 A. Yes. I think business-wise it's the only
6 way to look it at.

7 Q. How about the rest of the wells that you
8 have listed here, what do they show?

9 A. Just skipping, the next one down is No. 11.
10 It was a poor well. It's the first one we drilled out
11 there, actually. It was drilled in late October,
12 November of 86 and had a short economic life.
13 Discounted value on it is a minus \$154,000. That well
14 was more expensive. It was drilled deeper, and we did
15 some additional testing on it. \$155,000 loss on it,
16 actually.

17 The next well, No. 13, encountered some
18 drilling problems, so the price was a little higher
19 than projected on it, but it was \$292,000 to drill it.
20 After all of our revenue stream we, on a discounted
21 basis, lose \$4,600.

22 No. 14, was another deeper well. We were
23 hoping to find some additional pays to help our
24 situation out there. So we were taking some of these
25 wells down a little deeper and testing additional

1 zones. That well would have been quite a higher cost
2 because of the additional frac job in another zone and
3 a third zone that was perforated and acidized, to lose
4 nearly \$100,000. And then the next page is a summary
5 page of the four wells, and overall on a discount
6 basis we lose \$261,000.

7 Q. What is the proximity of these wells to the
8 well that you just now drilled?

9 A. Well, just going back, No. 14 is across the
10 lake.

11 Q. Can you refer back -- do you have anything
12 on the information you've sent to Mitchell that
13 contains that information?

14 A. In the memo discussing geology, under the
15 George Mitchell Notification tab on on the right side,
16 or the letter -- I'm looking at the net isopach map --
17 any of them would have the well locations -- but 14 is
18 in the southwest of the southeast of the Section 28,
19 which places it across the lake.

20 What's one reason the loss was greater on
21 14, we were having to truck produced water from that
22 well, so that operating expense is higher.

23 No. 13 is in the northeast northeast of 28.
24 No. 11, northwest northwest of 27. No. 10 is in the
25 southwest northwest 27. And the Red Bluff 1, which we

1 don't have the economics for but had been looked at at
2 that time was in the northwest southwest of 27.

3 Q. Mr. Cox, how do you evaluate the risk in
4 drilling these wells in terms of risk factor?

5 A. The risk of encountering -- you know,
6 there's two ways to look at it here, I suppose. The
7 risk is very high in getting a commercial well,
8 obviously. I mean our history has shown that with the
9 70 percent net revenue interest. That's the reason
10 we're pursuing the higher net revenue interest. The
11 risk of encountering produceable oil is quite low. We
12 feel like that the drilling we had done had delineated
13 a pretty fair area but the trend has been that the
14 reservoir is tightening up as its goes from east to
15 west, and updip across this field.

16 Q. In terms of a recommendation to the
17 division as to a risk factor, what would you
18 recommend? Would you go along with the same kind of
19 risk factor that is contained in the operating
20 agreement?

21 A. Yes. I'd say anybody who is putting their
22 money into one of these wells is putting their money
23 at risk. And I have discussed with the partners and
24 discussed when we called for additional interest and
25 whatnot, that water flood was something that was being

1 looked into but was a long way down the road -- just
2 to make sure that they are aware of that. That's the
3 only upside that we really see. So there is a lot of
4 risk.

5 Q. Would you recommend maximum penalty under
6 an order issued by the Oil Conservation Division?

7 A. Yes. I think anybody who does put their
8 money into one of these should have benefit of the
9 maximum penalty on those who don't.

10 If you don't mind going on this same -- a
11 little further.

12 Q. Okay.

13 A. The next set of economics down here shows
14 our original proposal would have brought the net
15 revenue interest up to 79.375. I suppose the quickest
16 way to get through this is to skip right to the
17 summary page on those economics, showing the higher
18 net revenue interest.

19 So with this nearly 80 percent net revenue
20 interest we still lose about \$50,000 on these four
21 wells. So that 80 percent that we're after was not
22 going to make a real profitable outlook for future
23 drilling, but it would make it a little more tolerable
24 to keep the farm out in effect and be in a position to
25 benefit from this water flood, should it occur.

1 Q. So, even at 80 percent net revenue
2 interest, you're still losing money under your
3 economics?

4 A. That's correct.

5 Q. Mr. Cox, in all of your discussions with
6 Mr. Lewis or Mr. Mitchell, did you at some time arrive
7 at an understanding that Mr. Mitchell was going to
8 participate in drilling the No. 3 Well?

9 A. In our August meeting, the only
10 face-to-face meeting we had had, which was in our
11 office in Denver, Mr. Mitchell stated that he would
12 participate -- he gave his preference that he would
13 like to operate. And we told him we would take that
14 under consideration. Told him what we needed
15 data-wise. But he did state at that time that no
16 matter what arrangement we arrived at as far as
17 operatorship, he would participate in the well.

18 Q. Was that based on your AFE?

19 A. Yes. That was the only -- at the time he
20 had our AFE.

21 Q. Mr. Cox, do you know whether under your
22 operating agreement you had to allow your partners a
23 right to participate in a nonparticipating interest?

24 A. Yes. We do have to offer each partner a
25 proportionate share of any nonconsenting partner in a

1 well.

2 Q. Did you seek to do that anytime in
3 December?

4 A. I did. And I spent three or four days in
5 this phone log -- again, it's probably not important
6 what days -- around the 19th through 22nd, I think --
7 calling partners and offering them an additional
8 interest because of Mr. Mitchell's nonconsent and also
9 asking if they would take more than their
10 proportionate share because of the fact that we were
11 concerned about finding enough places to put this
12 interest. We knew about the situation, as far as what
13 everybody would be interested in.

14 Q. Mr. Cox, with respect to the change in the
15 well location, tell us what you had to do in order to
16 get that change effected and why you had to get the
17 change effected?

18 A. This is in regard to the archaeological
19 find?

20 Q. Yes, sir.

21 A. Well, we had gotten word from the BLM that
22 the archaeological study had found some -- I can't
23 remember exactly what their terminology is -- kind of
24 low primary artifacts. And these were flakes from
25 arrowhead making out there or something. Their

1 archaeologist from Carlsbad went down and inspected
2 the site and said that it was a big enough problem to
3 him that we would not be able to drill there without
4 doing an archaeological inventory, which is an
5 expensive process.

6 So I asked him if he would try and approve
7 another site that we could use, and which he did. He
8 ended up getting together with their surface guy down
9 there and the surveyor and staking the site we have
10 drilled, which is 130 feet from the north line, 1805
11 from the east line of Section 28. That put us close
12 enough to the north line, which is the lease line, to
13 require a nonstandard location to be filed.

14 Q. Roughly, how much time did that take?

15 A. Well, I think that's probably -- the first
16 contact I had was August 3rd. That was just George
17 Reubleman, the BLM archaeologist, saying he hadn't
18 received the survey.

19 I contacted Pecos Archaeological, the
20 service that had done the work for us, and they got it
21 lost in the shuffle. They said they'd get it right to
22 him.

23 On August 11th he called me about the
24 problem. September 7th they went out on the site and
25 resurveyed the new location. I had been on site back

1 in July when we staked the original location because
2 of the fact we were out on kind of a promontory above
3 the lake. BLM had a lot of input about where would
4 could actually drill. There was more than just the
5 archaeological problem.

6 And then the next -- that was pretty much
7 done as far as getting it staked. And the only thing
8 that was holding the permit up at that point was a
9 nonstandard location which came through in
10 November 27th. And I think it was filed before, on
11 August 27 or something like that.

12 Q. Mr. Cox, in your opinion, did you
13 diligently pursue your efforts to drill this well by
14 the deadline, in terms of securing all of the permits
15 that you required?

16 A. Yes. We went through the usual procedure
17 of the BLM permitting. Of course, we ran into this
18 problem, which delayed it. It did allow -- you know,
19 gave Amoco good reason to give us an extension, which
20 we did receive, until December 31st. And we used
21 quite a bit of that time getting everything finalized.

22 Q. In terms of the geologic information that
23 you supplied to Mr. Mitchell, is it customary
24 ordinarily to supply this type of information to
25 someone who has not participated in drilling the well?

1 A. Like I mentioned earlier, we were glad to
2 have Mr. Mitchell involved because of our experience
3 with Red Bluff Water Power Control District. They
4 simply were not in the business of drilling. They did
5 not have a budget for drilling. We knew that we were
6 going to have a problem with them. So when
7 Mr. Mitchell came on the scene, understood about
8 drilling wells and whatnot, it was a nice change.
9 And, really, at that point, he was enthusiastic about
10 drilling, and I considered him a working interest
11 partner. And it's not that unusual for me to supply
12 this kind of data to a working interest partner if he
13 requests it.

14 Q. Was this information that you supplied to
15 him sufficient information for him to decide whether
16 or not he wanted to participate?

17 A. Well, I felt like it was. I think he had
18 indicated to us that he was planning on participating
19 or wanted it to drill. I don't know, if in our
20 initial contact, whether he said that, you know, we
21 discussed who would be operator or anything, but he
22 was very interested in getting wells drilled out
23 there.

24 Q. Mr. Cox, when did you spud the well, the
25 Red Bluff No. 3?

1 A. Well, the fact that we finally got all of
2 the working interest lined up fairly late in the game
3 here, I contacted the drilling contractor on --
4 actually, I had contacted them prior to this, but gave
5 them kind of a final "Yes, we're really going to drill
6 the well" on December 21st. They were drilling for
7 Exxon at the time.

8 Q. Who was that drilling contractor?

9 A. This was CapStar Drilling, and they drilled
10 all six of the holes we drilled out there. The reason
11 we've used CapStar is because they are \$2 cheaper and
12 because of the obvious economic problems we have, we
13 have kept our costs down with them. The nearest
14 competition is nearly \$2 higher than they are.

15 Q. \$2 in terms of what, per foot?

16 A. Excuse me. Per foot of drilling, yes.

17 Q. How much of a savings is that?

18 A. This ended up being a 5100-foot hole, and
19 so it's \$10,200.

20 Q. What did you do after December 21st?

21 A. On that date he told me that we were on
22 their list. They thought they were going to have to
23 drill an Exxon hole and another hole and it was going
24 to be somewhere around the 15th of January. I went
25 ahead and contacted Frank's Rat Hole Service, who we

1 have used to set conductor pipe out there in the past.
2 We got the dirt work initiated in the meantime, also,
3 to build location, including the BLM's specified berms
4 and whatnot, around location.

5 We drilled the rat hole on, I believe it's
6 the 29th. And set conductor pipe to 30 feet. I said
7 drilled rat hole -- we drilled conductor hole with the
8 rat hole rig. And then we were awaiting on the rotary
9 rig at the time.

10 Q. When did the rotary rig come on location?

11 A. It ended up -- they moved our hole next
12 after they finished Exxon's hole, so it was January
13 6th.

14 Q. How long did they take to drill the well to
15 the bottom total depth?

16 A. It was right at 11 days, I think. It may
17 have been the 7th day they moved it, come to think of
18 it. The 6th was the original date they gave me, but I
19 think it was the 7th when we got drilling under
20 conductor.

21 Q. Was there any other option that you had in
22 order to stall drilling the well prior to compulsory
23 pooling hearing?

24 A. No. You know, things got as late as they
25 did here. Amoco had been quite firm in their last --

1 as indicated by the letter that we got by fax -- in
2 their last correspondence to our request for another
3 extension, saying they absolutely won't give us
4 another extension. So we felt like if we were going
5 to keep the farm out in effect, we had to drill.

6 Q. You're referring to the extension that they
7 denied; is that correct?

8 A. That's right.

9 Q. Is this the letter that you're referring
10 to?

11 A. Yes. And to tell you the truth, I got the
12 letter contents verbally from Karen, so -- but this
13 would be the right date. Karen had gotten the letter
14 and told me about it. Well, yeah. This is --

15 Q. Mr. Cox, would granting this application
16 with a maximum penalty be in the best interest of
17 conservation of oil and gas and protection of
18 correlative rights, in your opinion?

19 A. Yes, I believe so. You know, it really is
20 my opinion that our costs are about as cheap as
21 anybody's, as far as drilling out there, and our
22 economics are about as good as anybody's, and that the
23 fact that we are able to continue to drill gives the
24 best likelihood this oil is going to be recovered.

25 Q. Would submittal of log information that you

1 acquired in drilling this well be disadvantageous and
2 detrimental to Mallon?

3 A. There again, we have Mallon Oil Company as
4 well Mallon's working interest partners in this well
5 that have put out the money to get to the point where
6 we were able to see the logs, and I think from the
7 standpoint that Mr. Mitchell did not elect to
8 participate and put the money up to get to that point,
9 I think it would be disadvantageous for an outside
10 party to be privy to that at this time.

11 Q. In your opinion, would it have worked an
12 injustice to Mallon should Mallon be required to
13 submit that information to Mr. Mitchell at this time?

14 A. Yes. I mean, you know, without risk and to
15 be able to make an election, I think is unjust to
16 Mallon and its partners.

17 Q. When you say making an election, you mean
18 in Mr. Mitchell making an election to participate?

19 A. Correct.

20 Q. Is Mallon ready, willing, and able to
21 accept Mr. Mitchell's joinder based upon your AFE?

22 A. Yes. I think we could say that's true.
23 You know, because of the economics prior to the well,
24 we were happy to have his -- our history prior this
25 well, we were happy to have him join, and I assume

1 that that would still be the case.

2 MR. PADILLA: Mr. Examiner, let me
3 introduce this, or include this letter as part of our
4 Exhibit No. 1 at the appropriate place. If we could
5 do that, or I would be willing to stamp it as
6 Exhibit No. 2. This is the letter that you requested
7 earlier in the hearing.

8 EXAMINER CATANACH: Let's just go ahead and
9 submit that as Exhibit No. 2.

10 MR. PADILLA: I have no further questions
11 of this witness at this time.

12 EXAMINER CATANACH: Mr. Carr.

13 EXAMINATION

14 BY MR. CARR:

15 Q. Mr. Cox, if I understand your testimony on
16 Exhibit No. 2, your last request for an extension was
17 denied by Amoco on November 21st?

18 A. That's correct.

19 Q. You knew that you had to drill a well by
20 December 31st if you were to perpetuate the farm out?

21 A. That's correct.

22 Q. And you contacted the drilling contractor
23 on December 21st?

24 A. That's correct.

25 Q. A month after you knew you were not getting

1 another extension?

2 A. Right.

3 Q. Now, prior to receiving Mr. Mitchell's
4 December 5th letter, was Mallon debating on whether or
5 not to go forward with this well?

6 A. The biggest holdup at that time was trying
7 to -- and the item that was missing in our business
8 decision at the time was the royalty reduction and
9 whether it was complete or not. And, of course, that
10 significantly changed the picture.

11 Q. But it significantly did not change the
12 picture, isn't that right? It left it just like it
13 was?

14 A. As it turned out, yes.

15 Q. So you were confronted with having to drill
16 this well under the same terms you drilled other wells
17 in the area in terms of the relationship with your
18 partners?

19 A. Yes. Where this has been left off, I spoke
20 with Mr. Mclosky at JSM and told him that we were in a
21 position we were probably going to have to drill this
22 well or not drill it depending on response from our
23 partners, and at the time he said that he would be
24 more interested in a royalty reduction proposal that
25 allowed them to back in for their full royalty

1 interest at some point in pay out. I told him we
2 would come back to him on that and possibly on this
3 well. And that issue hasn't been resolved yet.

4 Q. But you drilled the well under the terms
5 that you drilled, say, the Amoco No. 1 Red Bluff
6 Federal?

7 A. That's correct. But with no certainty of
8 anything different than that.

9 Q. Was your decision to go forward with
10 another well and perpetuate the farm out dependent
11 upon getting the net royalty reduction? Did you delay
12 making a decision until you were able to learn on
13 that?

14 A. Yes. That was a big factor -- and I see
15 where you're headed with this -- that we went ahead
16 and drilled. Another thing that had come up in the
17 meantime was the proposal by J.C. Williamson to have a
18 meeting regarding water flood. That put us one step
19 closer to possibly seeing some secondary.

20 And that was probably the decision factor
21 that at that time made us go ahead and decide to keep
22 the farm out in effect.

23 Q. It was an open question during this entire
24 period, was it not, as to whether or not you would go
25 forward with the well?

1 A. That's quite true. It depended a lot on
2 what our response from our partners was. Mallon,
3 coincidentally, had funding that we didn't anticipate
4 would be available to us prior to this. And that's
5 what allowed us to pick up the large percentage in
6 this well that we weren't anxious to pick up, but we
7 did to get the well drilled.

8 Q. Well, my question really is, throughout
9 this period of time you were still hoping to drill
10 this well?

11 A. I was hoping to keep the farm out in
12 effect.

13 Q. And to do that you had to drill the well?

14 A. Yes.

15 Q. And were there any other wells you were
16 considering to drill to keep the farm out in effect?

17 A. No. This was our --

18 Q. So throughout this period you were hoping
19 you were going to be able to drill this well and
20 perpetuate the farm out?

21 A. Right.

22 Q. In that regard you knew you wanted to be
23 operator of the well?

24 A. Yes. Although, had I gotten data that
25 convinced me that Mr. Mitchell could have operated the

1 well at significantly lower cost, we may very well
2 have allowed him to operate this well.

3 Q. Is it your responsibility for getting the
4 well together and doing whatever needs to be done to
5 get the well drilled?

6 A. It is.

7 Q. If you were going to be operator of the
8 well, you knew then, did you not, that it was your
9 responsibility to get all the interest owners who were
10 in the dedicated acreage committed to the well?

11 A. Yes. And it was also my responsibility to
12 let them know what their particular situation would be
13 in the well, as far as net revenue interest and --

14 Q. When we talk about this net revenue
15 interest and the option of other interest owners to
16 participate, we're talking about a contract between
17 you and the other working interest owners that you
18 represent; isn't that right?

19 A. That's correct.

20 Q. That's not a government form that involves
21 the commission?

22 A. No, it's not.

23 Q. It's a private agreement?

24 A. Yes.

25 Q. But you did know that you were responsible

1 for complying with the state and federal regulations
2 to get this thing going; isn't that right?

3 A. Which we did.

4 Q. You knew it was your responsibility, as the
5 operator, to get all the interest owners committed as
6 well?

7 A. Yes.

8 Q. And at no time did you have a signed
9 agreement with Mr. Mitchell?

10 A. We did not have a signed agreement; you're
11 correct.

12 Q. At no time had you ever resolved the
13 questions concerning the AFE charges?

14 A. Mostly due to the fact that I had never
15 received a response to my inquiry.

16 Q. And partially because when you were going
17 to pursue it further and didn't hear from them, you
18 didn't call them either, did you?

19 A. That's correct.

20 Q. And it was your responsibility to get the
21 interest owners together; isn't that right?

22 A. But it was not my responsibility to present
23 their data to show their operating expenses.

24 Q. Well, the bottom line is that whether it
25 was November the 21st when you didn't have an

1 extension from Amoco, or December the 5th when they
2 wrote you and said no, or December 21st when you
3 called the drilling contractor, at no time did you
4 have their agreement in writing so that you could go
5 forward with the well?

6 A. That's right.

7 Q. Now, were you the engineer that was
8 involved in the drilling of the Amoco Federal No. 1?

9 A. Yes.

10 Q. Was that the last well drilled?

11 A. Pardon me. You said the Amoco Federal
12 No. 1?

13 Q. I think it was the Amoco Red Bluff No. 1.

14 A. Yes, I was.

15 Q. Was that the last well drilled to
16 perpetuate the farm out?

17 A. That's right.

18 Q. In drilling that well what sort of problems
19 did you encounter?

20 A. We had a loss of circulation zone and a gas
21 zone that were giving us problems on the well. And
22 then the greatest problem we had, we had a failure of
23 the blowout preventer on the drilling rig.

24 Q. You had lost circulation. Is that when
25 you're drilling the well -- what do you drill them

1 with, mud or --

2 A. Yes. It's a brine mud system out there.

3 Q. And then when you have lost circulation, is
4 that what gets away from you?

5 A. Right. The fluid level drops in the hole
6 because some interval is taking fluid down there.

7 Q. About what depth that did occur,
8 approximately?

9 A. It was in the Bell Canyon formation, I
10 would say somewhere around 3,000 feet where we had our
11 first -- maybe 3500 feet -- had some loss of
12 circulation.

13 Q. Because of that did you make any changes
14 that would show up in the AFE that you proposed for
15 the No. 3 well?

16 A. Well, we hadn't had that problem on other
17 wells and the only reason we really had a problem on
18 this well was because of the blowout preventer failure
19 on the rig. Ordinarily this could have been
20 controlled quite easily.

21 Q. Then I think you said you had another
22 problem with a gas flow?

23 A. Right.

24 Q. What was that?

25 A. Well, as the fluid level and resulting down

1 hole pressure dropped due to loss of circulation, when
2 we had gas entry from another zone we had some kicks
3 of brine, the drilling fluid.

4 Q. Was that at about the same time as this
5 loss of circulation?

6 A. Yes. They were cause and effect.

7 Q. Then you had some sort of a blowout, did
8 you say, was the third thing you said?

9 A. Yes. Because the blowout preventer on the
10 rig was not functional for a while, we had gas and
11 water blowing up over the casing. We kept our
12 circulation going so it was at no time completely out
13 of control, but it was --

14 Q. Was this about the same time as the other
15 two problems?

16 A. Yes. That was all related.

17 Q. And so none of this experience would
18 translate into numbers in the AFE?

19 A. No. I don't feel like they would.

20 Q. Did you have other problems with the Amoco
21 No. 1 Red Bluff Federal?

22 A. Probably due to the flow in the period of
23 time we were on the hole we had trouble getting casing
24 down, but that was resolved.

25 Q. Anything else?

1 A. On the tail end of our frac we had a screen
2 out. But the bulk of the frac job was in.

3 Q. And so did that affect the ability of the
4 well to produce?

5 A. I don't think so. The initial production
6 on the well was, you know, like I said, we had most of
7 frac job in, so it was pretty much stimulated. The
8 frac job is what affects the early production, I mean,
9 any frac stimulation. And early production on this
10 well was lower than normal. I think it was pressure
11 depletion from offsetting wells that affected the
12 performance here.

13 Q. So, really, the problems you incurred in
14 that well were during the drilling of the well?

15 A. Primarily, yes.

16 Q. At this point in time with the No. 3 well,
17 you've already drilled it to total depth?

18 A. That's correct.

19 Q. So you've already taken the risk for what
20 might happen while drilling it?

21 A. For that stage, yes.

22 Q. When we look at your AFE, are these costs
23 based on your prior drilling in the area?

24 A. Yes.

25 Q. Are these figures in line with what you've

1 used for prior wells?

2 A. Yes. And then most of them are
3 historically based.

4 Q. When you got an AFE from Mr. Mitchell, it
5 ran about 50,000 below your cost; isn't that right?

6 A. About 49. Yes.

7 Q. I think you testified that you never
8 received a formal proposal from Mr. Mitchell seeking
9 that he be designated operator of the well; is that
10 fair?

11 A. Yes.

12 Q. That was discussed from time to time,
13 however, throughout your negotiations?

14 A. He expressed an interest in it, but like I
15 mentioned earlier, he did say in any eventuality he
16 would be willing to participate.

17 Q. If we look at the cost that you've incurred
18 for completing and drilling the well -- I mean the
19 additional frac charges and the additional casing
20 charges, which you mentioned were primary differences
21 between the two AFE's, because of this have you been
22 able to obtain better wells in the area than other
23 operators?

24 A. I think, considering the quality of
25 reservoir we're in, we have been able to obtain wells

1 in reservoir rock that would have been doubtful in
2 other places. We're in a part of the reservoir that
3 is not easily compared. Oryx, for instance, is
4 developing on the western edge of this same reservoir,
5 and they drilled one well a year and three or four
6 months ago, I guess, and have not drilled any further.

7 Q. Oryx is implementing a pilot water flood in
8 the area, are they not?

9 A. Yes.

10 Q. That offsets his acreage to the north and
11 east?

12 A. North.

13 Q. Is it due north?

14 A. Yes.

15 Q. Does it immediately offset this acreage?

16 A. Yes.

17 Q. The meeting concerning secondary recovery
18 called by Mr. Williamson, was that to discuss the Oryx
19 pilot flood or just generally discuss water flooding?

20 A. In general for the field. And just to find
21 a level of interest.

22 Q. Other than the Oryx pilot water flood,
23 there is no significant water flooding in this area in
24 this formation, is there?

25 A. It depends on what you're limiting to this

1 area. There's Cherry Canyon water flood going on in
2 the basin and in Eddy County.

3 Q. On a wide-scale basis?

4 A. Yes.

5 Q. Where that is taking place, did they
6 initially incur the high water flows that you're
7 experiencing in this area?

8 A. Initial production? Water production?

9 Q. Yes.

10 A. Yes. In the analogous field that we worked
11 with, they did.

12 Q. Do you feel that the well density is
13 sufficient for an effective water flood project
14 without substantial additional drilling in this area?

15 A. Again, in the analogy that we worked with,
16 and it's not an exact analogy, but they did produce
17 and inject on the same spacing we're on now without
18 additional drilling.

19 Q. At this point in time there's no firm plan
20 for water flood in the area?

21 A. No.

22 Q. It's just a long-range potential in the
23 overall scenario?

24 A. Yes.

25 Q. Did anything come out of the meeting with

1 Mr. Williamson in terms of any formal plan to go
2 forward with efforts to develop water flooding?

3 A. Well, another step actually has been taken.
4 We have received another letter from Mr. Williamson's
5 office. He does not want to take the lead on this
6 thing but agreed to send a letter out to operators,
7 and, I believe, basically asking them to contact their
8 working interest or supply working interest owner's
9 names so that the general contacting of interest
10 owners in the field can be made.

11 Q. I would like to look at your July 17 letter
12 that you wrote to Mr. Mitchell. That's behind the
13 first tab on the right side of the exhibit.

14 A. Okay.

15 Q. If you look at the end of the second
16 paragraph, where you're talking about the No. 11 well,
17 is that the well we're talking about -- middle of the
18 paragraph -- "our No. 11 well, which was drilled away
19 from the channel thread and affected depletion-wise by
20 existing producers is an example of what we are trying
21 to avoid."

22 A. Right.

23 Q. Are you with me? That well you're
24 projecting for a cumulative production of 24,000
25 barrels of oil?

1 A. That's correct.

2 Q. And you're anticipating a loss of 140,000
3 on that?

4 A. Right.

5 Q. If we go two paragraphs down, the last
6 sentence, we're talking about the No. 14 well. And
7 you're saying that that well should produce -- and I
8 guess these are cumulative figures -- 45,000 barrels?

9 A. Right.

10 Q. Which would place that well somewhat short
11 of payout?

12 A. That short of payout would be not on the
13 actual cost of that well because it was drilled deeper
14 and tested out of zone, but that would be based on the
15 cost of a Williamson depth well completed only in that
16 zone.

17 Q. Are you aware that other operators in that
18 area consider wells that make 20,000 barrels a well,
19 that pays out, as a successful well?

20 A. Are you talking about just wells in
21 general, or are you talking about Williamson depth
22 wells?

23 Q. I'm talking about Williamson depth wells.

24 A. No, I was not aware of that.

25 Q. Have you looked at any other operator costs

1 or projections as to what it takes to make a
2 commercial well?

3 A. Well, I know what other operators are doing
4 and basically what they have to pay for it.

5 Q. You don't know what they consider to be a
6 commercial venture in terms of production?

7 A. No. That's nothing that you would have of
8 record or anything.

9 Q. Studying this area, have you looked at the
10 field of this particular area to get an overall feel
11 for the kind of cumulative productions you're
12 encountering in the area?

13 A. Per well, or --

14 Q. By area of feet of reservoir.

15 A. Cumulative to current date, or --

16 Q. Yes. Or projected total production from a
17 well.

18 A. Yes, we have studied that.

19 Q. If we look at the field and we go one
20 section to the east of the proposed well, that's
21 Section 22, I think, and you draw us a north-south
22 line to the center, is there anything west of midline
23 of 22 that you project will cumulate more than 45,000
24 barrels of oil?

25 A. The only wells that I've done projections

1 on -- I've done volumetrics on the field -- but the
2 only wells I've done producing projections on are
3 within our lease.

4 Q. Anything in your lease west of the midline
5 of 22 that you anticipate will make 45,000 barrels of
6 oil or more?

7 A. Yes.

8 Q. Which wells are those?

9 A. No. 13.

10 Q. What do you project on that?

11 A. I think we figured it would make 56,000
12 barrels, or something like that.

13 Q. Is that the best one?

14 A. It's not the best well in the lease, but
15 it's the best well that's been drilled recently.

16 Q. Being realistic about the No. 3 Well, do
17 you anticipate that it could be substantially better
18 than the No. 13 well?

19 A. You know, that would be disclosing the
20 information that we're talking about not disclosing
21 here, so I won't comment on that.

22 Q. Well, let me ask you this. If you get a
23 well that is comparable to the No. 13 well -- is the
24 No. 13 -- is that the best well west of the midline of
25 Section 22?

1 A. No. Probably No. 9 is.

2 Q. What do you anticipate the cumulative
3 production on that? Approximate.

4 A. I imagine No. 9 is going to be 75,000
5 barrels or so, and I don't recall just exactly.

6 Q. Just assume with me that the No. 3 well is
7 as good as the No. 9 and it makes 75,000 barrels of
8 oil. It wouldn't pay out, I would assume based on
9 your July 13 letter until it exceeded at least 45,000
10 barrels?

11 A. It depends on how fast it produced that.

12 Q. Do you think it could pay out at 75,000
13 barrels?

14 A. Oh, I would think any well that would --
15 you know, unless there was some tremendous cost in it
16 or very slow production history on it or something
17 like that, would pay out with 75,000 barrels.

18 Q. At any rate of production, do you think it
19 would pay out if it only made 25,000 barrels?

20 A. It depends on a person's pricing scenario
21 and everything. If you've got 25,000 barrels fast
22 enough, you might very well get payout out here,
23 because the operating expense is a big factor in
24 whether a well will pay out or not.

25 Q. Do you think it's a realistic possibility

1 for the No. 3?

2 A. Again, I won't comment on potential for
3 that well. It would be getting too far into the data
4 that we're --

5 Q. It would have to pay out, however, three
6 times -- if Mr. Mitchell goes nonconsent -- before he
7 would share at all; isn't that true?

8 A. Under the operating agreement?

9 Q. If he goes nonconsent and you obtain a
10 pooling order and get the penalty you've requested, it
11 would have to pay out three times; would it not?

12 A. That is correct.

13 Q. And if it is like the No. 14 well and
14 45,000 barrels is a marginal well from an economic
15 point of view, it would to do at least three times
16 that before he would share; isn't that right?
17 Assuming it's like the No. 14.

18 A. It depends. Fourteen has got the higher
19 operating expense because of its position east -- or
20 west of the lake and everything, so it's not apples
21 and apples there. But just to get to the end of this
22 discussion, yes, under those same circumstances it
23 would have to make three times as much production.

24 Q. And without disclosing the information that
25 you're unwilling to disclose, the chances of having a

1 well that pays out times three in this area is
2 unlikely?

3 A. Yes. I would agree with that. But that's
4 using my pricing scenarios, my operating expenses and
5 everything.

6 Q. Right. I didn't get the day you actually
7 spudded. Is it a cable tool -- whatever the initial
8 tool?

9 A. It's an auger-type rat hole rig, and it was
10 the 29th of December.

11 Q. And you drilled 30 feet on that day; is
12 that what happened?

13 A. Yes. That was the total depth for
14 conductor pipe.

15 Q. What are the total costs you have expended
16 to date on the No. 3? Do you know that?

17 A. I don't know if I do have -- casing point
18 costs ended up being just about exactly as our AFE had
19 indicated. And, of course, the only additional cost
20 to that is casing and cementing, which had no
21 problems.

22 Q. Were you satisfied that when you were able
23 with Frank's Rat Hole to drill 30 feet that you had in
24 fact perpetuated the farm out agreement?

25 A. We felt like we had, and to be certain we

1 contacted Amoco. And they confirmed that they found
2 that acceptable. And I think that the issuance of a
3 short extension was a formality just to make no
4 question about that.

5 Q. The well has been drilled to total depth?

6 A. That's correct.

7 Q. What is the status of it now?

8 A. It's cased and awaiting completion.

9 Q. Are you suspending completion activity
10 until this matter is resolved?

11 A. Yes.

12 Q. Let me hand you what's been marked as
13 Mitchell Exhibit No. 5 and ask you to look at that.

14 A. I've seen a fax copy of this.

15 Q. Mr. Cox, that is a subpoena, is it not,
16 signed by William J. LeMay, Director of the Oil
17 Commission?

18 A. That's correct.

19 Q. On the second page it's requesting all logs
20 on the well and daily drilling reports; is that
21 correct?

22 A. Among other things, yes.

23 Q. What else did it request?

24 A. Well, in the body of this thing it
25 requests, basically, anything that was related to this

1 well.

2 Q. And then the last paragraph defines it
3 further as the logs and the daily drilling reports;
4 correct?

5 A. And it says, "not limited to the logs and
6 drilling reports," yes.

7 Q. Have you brought that data with you?

8 A. We have it, yes.

9 Q. You have it?

10 A. Here.

11 Q. Are you willing to submit it to us pursuant
12 to this subpoena?

13 A. No. We discussed that yesterday, and I
14 think Mr. Padilla can give you our position on that.

15 Q. It's correct, then, to assume that you're
16 refusing to comply with this subpoena?

17 MR. PADILLA: That is correct.

18 MR. CARR: May it please the Examiner, at
19 this time --

20 MR. PADILLA: Let me clarify that. Insofar
21 as the information requested in items 1A and B, yes.

22 MR. CARR: And I can stipulate that the
23 rest of it is a general preface and the things we are
24 interested in receiving are the items in 1A and 1B.

25 MR. PADILLA: Right.

1 MR. CARR: Therefore, I'm going to move
2 that Mallon Oil Company be required to comply with the
3 subpoena or in the alternative, I would request that
4 the hearing be continued or, further, I would request
5 that if Mallon refuses to honor the subpoena and
6 provide the data that we have subpoenaed, that their
7 application for compulsory pooling be dismissed.

8 EXAMINER CATANACH: Mr. Carr, do you have
9 another copy of the subpoena?

10 MR. CARR: Here.

11 EXAMINER CATANACH: Mr. Padilla, as I
12 understand it, you're refusing to submit the
13 information described in part 1A and part B; is that
14 correct?

15 MR. PADILLA: That's correct, Mr. Examiner.
16 That information we believe, as we have stated before,
17 is information that if we have to turn it over to
18 Mr. Mitchell, would have the effect of confiscating a
19 property right without compensation.

20 At this point we would also move or ask to
21 leave to seek a judicial determination as to whether
22 our position is correct in that we have a
23 constitutional violation of due process and a taking
24 that is, that the -- we're not challenging the
25 subpoena itself, we are challenging the effect of the

1 subpoena in that it requires submission of this
2 information to Mr. Mitchell. We believe that when a
3 constitutional violation is occurring we have the
4 right to seek a judicial intervention in this case.

5 THE COURT: If we may have a couple of
6 minutes here.

7 (Thereupon, a recess was held.)

8 EXAMINER CATANACH: For the record, I just
9 want to get everything straight on all these motions.

10 Mr. Carr, I understand you have a motion to
11 have the division enforce the subpoena?

12 MR. CARR: Either require them to produce
13 or dismiss their case.

14 EXAMINER CATANACH: Mr. Padilla, you
15 also -- which didn't come out right then and there,
16 you also have a motion to quash the subpoena?

17 MR. PADILLA: That's right.

18 EXAMINER CATANACH: In addition, Mr. Carr,
19 you have a motion for either a continuance or a
20 dismissal of the Mallon case dependent on --

21 MR. CARR: The outcome of the prior ruling
22 on Mr. Padilla's motion.

23 EXAMINER CATANACH: Under advice of counsel
24 we have decided to defer the decision on the motion at
25 this time. Would that have an adverse effect on

1 either case or would you be willing to proceed with
2 the case at this point?

3 MR. CARR: Mr. Catanach, it makes sense to
4 me that since Mallon has made his record, it probably
5 is appropriate for us to go ahead and do the same, and
6 then we'll renew our motion at the end of our
7 presentation and you can do whatever you want to with
8 it then -- rule on it then or continue it further. I
9 mean it will be up to you at that time.

10 EXAMINER CATANACH: We'll defer the ruling
11 until the end of your presentation, Mr. Carr.

12 MR. CARR: Ready?

13 EXAMINER CATANACH: Yes, sir.

14 TERRY LEWIS

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

18 EXAMINATION

19 BY MR. CARR:

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

22 A. My name is Terry Lewis.

23 Q. Where do you reside?

24 A. 4901 Lancashire in Midland, Texas.

25 Q. Mr. Lewis by whom are you employed and in

1 what capacity?

2 A. I'm self-employed. I'm an independent oil
3 and gas producer.

4 Q. What is your interest in the property which
5 is the subject of this case?

6 A. I own one-third of the acreage position
7 listed as Mr. Mitchell's.

8 Q. Have you been employed by Mr. Mitchell to
9 assist in the engineering aspects of this matter?

10 A. Yes. We worked together on it. There is
11 really no employment there, but it is a joint
12 property, and I'm taking care of my part of the joint
13 property.

14 Q. Have you previously testified before the
15 New Mexico Oil Conservation Division?

16 A. No, sir. I have not.

17 Q. Would you summarize your educational
18 background and your work experience.

19 A. I've got a degree in chemical engineering
20 from Texas Tech University. I've been employed as a
21 petroleum engineer for approximately 15 years by
22 Amoco, Texas Oil and Gas, Texas Crude, Newman Oil
23 Company, and Murphy & Associates.

24 Q. Are you familiar with the applications
25 filed in these consolidated cases?

1 A. Yes, sir, I am.

2 Q. Are you familiar with the subject area?

3 A. Yes, sir, I am.

4 MR. CARR: We tender Mr. Lewis as an expert
5 witness in petroleum engineering.

6 EXAMINER CATANACH: He is so qualified.

7 Q. (BY MR. CARR) Mr. Lewis, what does
8 Mitchell seek in this hearing?

9 A. We seek an order of pooling the acreage
10 under the Amoco Red Bluff Federal No. 3 and appointing
11 Mitchell as operator. We further seek -- we further
12 wish to oppose the application of Mallon Oil Company.

13 Q. Have you prepared certain exhibits for
14 presentation in this hearing?

15 A. Yes, sir, I have.

16 Q. Would you refer to what has been marked as
17 Mitchell No. 1 and identify this and review it for the
18 Examiner?

19 A. Yes, sir. This is the location map of the
20 general area of the Amoco Red Bluff Federal No. 3. It
21 shows Brushy Draw Field and most of the wells
22 completed in the general area thereof. In Section 28
23 you will notice the colored acreage, the acreage
24 colored brown belongs to Mallon Oil Company, et al.
25 The acreage colored yellow belongs to Mitchell, et al.

1 The proration unit for the Amoco Red Bluff Federal No.
2 3 is designated by a dashed line, and the location of
3 Amoco Red Bluff No. 3 is listed with an open circle
4 and labeled.

5 Q. Does Mitchell operate any wells in the
6 area?

7 A. Yes, sir. He operates four wells in
8 Section 34 of the same block and range.

9 Q. And they are indicated on this exhibit to
10 the south and west?

11 A. Yes, sir. South and east.

12 Q. To the south and east of the shaded area,
13 and they have the words "Gulf Littlefield" printed on
14 the tract?

15 A. Yes, sir.

16 Q. How were these wells acquired? Were they
17 purchased or were they drilled by Mitchell?

18 A. One well was purchased, and then three
19 wells were subsequently drilled starting in about
20 1984.

21 Q. And through what formation are they
22 drilled?

23 A. Williamson Sand.

24 Q. And that's the same objective that is
25 involved in this hearing today?

1 A. Yes, sir.

2 Q. Have you reviewed the cumulative production
3 data available to you on the reservoir?

4 A. Yes, sir, I have.

5 Q. Are there any patterns in the cumulative
6 production that you have been able to discern?

7 A. May I?

8 Q. Yes.

9 A. Starting at a center line of Section 27,
10 same block and township, going west, the latest
11 cumulative production figures that we have indicate
12 that no well has a current cumulative over 45,000
13 barrels.

14 Q. When we look at the wells in 34 that are
15 operated by Mr. Mitchell, what have they cumed to
16 date?

17 A. None of the wells have cumed over 45,000
18 barrels. The highest one appears to have cumed about
19 38,000 barrels.

20 Q. What sort of a total cumulative production
21 does Williamson need to -- based on its economic
22 projects -- make a commercial well?

23 A. You mean George Mitchell?

24 MR. PADILLA: I'm sorry. You said
25 Williamson.

1 MR. CARR: I'm sorry. In the Williamson
2 Sand. I mean the Mitchell Wells.

3 Q. What total cumulative production does
4 Mitchell need to make a commercial well?

5 A. Approximately 15 to 18,000 barrells.

6 Q. Are all of the wells operated by
7 Mr. Mitchell in Section 34 considered by Mitchell to
8 have paid out?

9 A. Yes. All of the wells have paid out and
10 are producing at commercial rates and commercial
11 profitability.

12 Q. You've heard Mallon's testimony concerning
13 the ownership under the spacing unit. Do you concur
14 in that?

15 A. Yes, sir.

16 Q. And you represent the 28.4 percent that has
17 been attributed to the Mitchell interest?

18 A. Yes, sir.

19 Q. Would you identify what has been marked as
20 Exhibit No. 2, please.

21 A. Exhibit No. 2. is an AFE submitted by G.P.
22 II Energy, Inc., to Mallon Oil Company,
23 approximately -- I want to say the AFE is dated --
24 well, I don't see the date right now, but I think it
25 was submitted approximately October of this year.

1 Q. What are the costs as reflected on this?

2 A. The dry hole cost is \$78,650. The total
3 completed well cost is \$195,440.

4 Q. This is the AFE that was submitted to Mr.
5 Mallon?

6 A. Yes, sir, it is.

7 Q. Do you concur with Mr. Cox's testimony that
8 the main differences are in casing and frac costs?

9 A. There are differences in both the casing
10 and the frac costs, but I would not consider those to
11 be the only differences. Our AFE or George's AFE --
12 G.P. II Energy's AFE, to get it perfect -- also
13 includes cost of a segregated production facility, and
14 there are general decreases throughout the AFE. So I
15 don't think that it is completely true to say that all
16 the costs differences are in the frac job and the
17 casing, although those cost differences are
18 significant.

19 Q. Are these costs in line with what's being
20 charged by other operators for similar wells in the
21 area?

22 A. They are exactly in line with the three
23 other wells that Mitchell has drilled and completed,
24 all of which have paid out and are projected to have a
25 ROI of 2.5 to 1. They are also consistent with other

1 independent operators' costs in this area. Two
2 examples might be Williamson and Meridian.

3 Q. Mr. Lewis, these costs are in line with the
4 wells that Mitchell drilled. They were drilled
5 several years ago; correct?

6 A. One well was drilled in 84 and the other
7 two wells were drilled and completed in the very last
8 part of 86 and the early part of 87.

9 Q. Do you believe these costs would be still
10 applicable today for drilling a well in 1990?

11 A. Yes. I believe that they would still be
12 applicable.

13 Q. To get this exactly correct, what is the
14 relationship between G.P. II Energy, Inc., and
15 Mitchell?

16 A. G.P. II Energy is an operating company
17 owned wholly by George Mitchell.

18 Q. So they are really one and the same?

19 A. Yes, sir.

20 Q. At least the principals are the same?

21 A. Exactly.

22 Q. I'd like for you now to summarize the
23 efforts made to obtain voluntary joinder by all
24 working interest and mineral interest owners in the
25 proposed spacing unit, and I think you're going to

1 have to refer to Exhibit 3 in doing this. Much of
2 this has already been covered. I would like for you
3 focus on anything that you may have that is additional
4 or would supplement what's already been said.

5 A. Okay. The basic scenario that has been
6 previously testified to is true. In July of 1989, we
7 obtained this acreage from Red Bluff Water
8 Conservation District, or whatever, and in July -- in
9 the same month Mallon had contacted us, and we were
10 both interested in developing that acreage in a fairly
11 rapid way. At least to meet their contractual
12 agreements and to meet our contractual agreements.

13 To this end, Mallon sent us an AFE in the
14 amount of 244,000 in July, and also an operating
15 agreement. Well, at that time we felt that the AFE
16 was significantly too high. Significantly higher than
17 the cost Mitchell had experienced in Section 34 in the
18 same area at the same depth. We were also concerned
19 about the operating agreement, several parts of which
20 were unacceptable to us, but it was not of great
21 importance because the cost of the well was the
22 primary thing.

23 In September, August, the latter part of
24 August, early September, we went to Denver to meet
25 with Ms. McClintock and Joe Cox, as more of a

1 get-acquainted meeting and see if we had common
2 territory. It was our idea that we would be unable to
3 participate in this well at the drilling cost, the AFE
4 costs that they had, and the operating costs that they
5 had.

6 Subsequent to that visit, Mitchell
7 submitted an AFE in October of 89 for the
8 aforementioned amount of \$195,440. We subsequently
9 had conversations with Joe Cox, as he has previously
10 testified, which were basically true. In November
11 Mallon resubmitted their AFE for the same amount under
12 the same operating agreement, and we felt at this time
13 that we would be unable to participate under that AFE.

14 And George, on December 5th, offered to
15 farm out our interest in that location for 75 percent
16 net revenue interest. And then the last week of
17 December -- there were additional conversations taking
18 place but the last week of December we were notified
19 that Mallon had rejected our farm out and was going to
20 force pool us into the unit, which led us to the
21 conclusion that Mallon was attempting to enhance their
22 net revenue by taking over our net revenue under our
23 acreage, or, in effect, seizing our acreage.

24 Q. Let me ask you, Exhibit No. 3 contains both
25 your AFE and Mallon's --

1 A. Yes, sir.

2 Q. -- certain correspondence and the operating
3 agreement that was proposed; is that correct?

4 A. That's correct.

5 Q. All of these documents were included in
6 Mallon Exhibit No. 1?

7 A. Yes, sir.

8 Q. What is your or Mitchell's net revenue
9 interest under this tract?

10 A. 78.5 percent.

11 Q. So you couldn't give an 80 percent net
12 revenue?

13 A. No, sir, I could not.

14 Q. In addition to the 75 percent net revenue
15 interest, you were proposing to carve out a 3 percent
16 overriding royalty interest?

17 A. Yes, sir. On our 28.46 percent interest.

18 Q. Have you estimated what the cost
19 differentials are in terms of the total costs of well,
20 looking at, say, a 70 percent net revenue interest or
21 a 75 or an 80? Have you done any of that?

22 A. Yes, sir, I have.

23 Q. Approximately what does a 5 percent change
24 in a net revenue interest mean to the overall cost of
25 the well?

1 A. A 5 percent change in net revenue interest,
2 based on our 28.46 percent working interest and a
3 total recovery of 50,000 barrels on one well, allowing
4 for taxes, which in this case is all you would have,
5 amounts to about \$11,248 based on \$17 oil over the
6 life of the well.

7 Q. To give Mallon an 80 percent net revenue
8 interest, you would have to give them everything you
9 have plus something else; isn't that right?

10 A. That's correct.

11 Q. Was there ever an agreement reached by you
12 with Mallon concerning the terms under which you could
13 participate in this well?

14 A. There was never an agreement. I think
15 there was a mistake early on in what we told them.
16 What we actually told them was that we would not stand
17 in their way to drill this well -- that we would
18 participate in the well, farm out, or trade acreage
19 with them -- but we could under no circumstances make
20 any blanket agreement to participate in any venture
21 under a no-matter-what situation. It's just not
22 something that neither George could commit me to nor
23 could I commit my partner to. So it's not something
24 that we could do.

25 Q. Have you ever been able to reach an

1 agreement on any of those terms, either to farm out or
2 to trade acreage or anything?

3 A. The two that we specifically discussed are
4 the participation and the farm out, both of which we
5 have -- to my analysis, we have extensively tried to
6 do. We have never tried to swap acreage for them,
7 because we, frankly, could not come up with a
8 situation to where we wanted to do it.

9 Q. At this point in time no voluntary
10 agreement has been reached for the development of the
11 tract?

12 A. No, none at all.

13 Q. In your opinion have the parties made a
14 good-faith effort to obtain that joinder?

15 A. Yes, sir. I think that we have had a very
16 long and extensive period of trying to work this thing
17 out.

18 Q. Could you identify what has been marked as
19 Mitchell Exhibit No. 4, please.

20 A. Yes, sir. This appears to be a --

21 Q. Is this an affidavit and letters from
22 Campbell and Black showing that notice of the hearing
23 has been provided?

24 A. Yes, sir, it certainly is.

25 Q. Are you prepared to make a recommendation

1 to the Examiner as to the penalty that should be
2 assessed against Mallon if you were named operator of
3 the well?

4 A. Yes, I am. I recommend that there be no
5 penalty.

6 Q. Why is that?

7 A. Well, the well has been drilled. What
8 geological risks there were has been taken.

9 Q. What effect would the imposition of a 200
10 percent penalty on you -- what would the effect on you
11 be if a 200 percent penalty -- if Mallon should
12 prevail?

13 A. Under any reasonable scenario on production
14 of that well, we would never get a dime out of it.
15 Our property would have effectively been seized and
16 given to someone else.

17 Q. Have you made an estimate of overhead
18 administrative costs to be assessed while the well is
19 actually, I guess, just being produced?

20 A. About \$200 a month overhead is a reasonable
21 figure there, is comparable to what George is
22 currently drilling the wells for.

23 Q. If you take over the well and complete it,
24 what would your monthly cost be while you're
25 completing the well?

1 A. \$2,000 a month.

2 Q. Do you believe this would also be in line
3 with what other operators in the area charge?

4 A. Yes, I think it would be in line with what
5 most independent operators in that area would charge.

6 Q. Do you recommend that these figures be
7 incorporated into any order which results from this
8 hearing?

9 A. Yes, sir, I do.

10 Q. Does Mitchell seek to be designated
11 operator of the proposed well?

12 A. Yes, sir, he does.

13 Q. And why is that?

14 A. Well, number one, he has experience in the
15 area, and I might add that he's had experience in
16 developing profitable wells in that area which has not
17 been, apparently, done that well by Mallon. The costs
18 are reasonable. They are costs that are comparable to
19 wells that he has already drilled in the area with
20 very successful results. Plus we had no trouble in
21 any of his completions, such as Mallon had on the
22 Amoco Red Bluff Federal No. 1, which is a very poor
23 well, drilled in a very good location.

24 If Mallon operates the well, everything
25 that we have heard from them indicates that this well

1 will never pay out and we have effectively lost all
2 our reserves. They have been seized and given to
3 someone else.

4 Q. In your opinion, can Mitchell operate the
5 well for less, in terms of operating costs, than are
6 being proposed by Mitchell?

7 A. Yes, sir.

8 Q. Do you believe that you can drill a well
9 that will pay out and return a profit at this
10 location?

11 A. Yes, sir, I do. I believe that the
12 reserves here are at least in the range of 30,000
13 barrels, and I think our payout number is firm. I
14 think that we can pay one out on 18,000 barrels and
15 return a significant profit at 30,000.

16 Q. Would Mitchell be interested in taking over
17 the existing -- the recently drilled well bore or
18 drilling an add additional well, or do you know at
19 this time?

20 A. We would be interested in operating the
21 tract, but we have no idea what the condition of the
22 current well bore is or its serviceability as to
23 developing the reserves at this location.

24 Q. Could you make that call if you were able
25 to review log on the well?

1 A. Yes, sir, I could.

2 Q. In your opinion, will granting the
3 application and the designation of Mitchell as
4 operator result in the most efficient development and
5 production of the reserves from this tract?

6 A. Yes, sir, I do.

7 Q. Do you believe that granting the
8 application will otherwise be in the best interest of
9 conservation, the prevention of waste, and the
10 protection of correlative rights?

11 A. I think that our break-even point is much
12 lower than Mallon's and that we would, in fact, be
13 able to develop more reserves here than Mallon will
14 develop.

15 Q. Were Exhibits 1 through 3 prepared by you
16 or compiled under your direction?

17 A. Yes, sir, they were.

18 MR. CARR: At this time, Mr. Catanach, I
19 will move the admission of Exhibits 1 through 3, which
20 are the exhibits Mr. Lewis has testified to and also
21 Exhibits 4 and 5, which are Campbell and Black's
22 affidavit and a copy of the subpoena.

23 EXAMINER CATANACH: Exhibits 1 through 5
24 will be admitted as evidence in this case.

25 MR. CARR: That concludes my examination of

1 Mr. Lewis.

2 MR. PADILLA: I have a few questions,
3 Mr. Examiner. Before we do that, I'm not sure whether
4 I moved for the admission of our Exhibits 1 and 2. I
5 move that at this time if I've forgotten to do that.

6 EXAMINER CATANACH: We'll admit Mallon's
7 Exhibits 1 and 2 into evidence in this case.

8 EXAMINATION

9 BY MR. PADILLA:

10 Q. Mr. Lewis, you indicated you owned a third
11 of the farm out from Red Bluff; is that correct?

12 A. That's correct.

13 Q. Who owns the other two-thirds?

14 A. One-third is owned by George Mitchell.

15 One-third is owned by John Huffman.

16 Q. Who is John Huffman?

17 A. He is a long-time partner of mine. He
18 lives in Albany. He is president of First National
19 Bank in Albany, Texas.

20 Q. Let me get this straight. Yesterday
21 Mr. Carr indicated that Mr. Mitchell had to call his
22 father.

23 Is Mr. Mitchell's father also George
24 Mitchell?

25 A. Well, he's also George Mitchell, but he's

1 not involved in this acreage.

2 Q. Who operates this well in Section 34?

3 A. George Mitchell G.P. II Energy under George
4 H. Mitchell, who is George's father. George H.
5 Mitchell is operator of record in New Mexico. The
6 wells are operated by George P. Mitchell, his son.

7 Q. The records of Oil Conservation Commission
8 shows George H. Mitchell as the operator?

9 A. Yes, sir, that is correct.

10 Q. But Mr. Mitchell who is present in this
11 room, operating G.P. II Energy, is the actual
12 operator?

13 A. Yes, sir, that's correct. Mr. Mitchell
14 owns those wells 100 percent.

15 Q. Who is Mr. Mitchell?

16 A. Mr. Mitchell elder -- the elder
17 Mr. Mitchell owns those wells 100 percent. And they
18 are operated by his son. G.P. II.

19 Q. Mr. Lewis, did you ever send any
20 correspondence -- or did Mr. Mitchell, the younger, if
21 I may call him that -- send any information or
22 correspondence to Mallon indicating that Mr. Mitchell,
23 the younger, wanted to operate the wells and that he
24 proposed to drill a well, either the No. 3 Red Bluff
25 or the No. 2?

1 A. It's been my experience -- I never expected
2 to have to send anything like that. It's always been
3 my experience that when you send an AFE, that well was
4 proposed and you were proposing to operate it. But to
5 answer your question specifically, no, we never said
6 anything in writing that we wanted to operate the
7 well, either the No. 2 or the No. 3, other than the
8 AFE that's already been presented in evidence, which
9 we concluded was a formal proposal to operate the
10 well.

11 Q. But you weren't decided as to whether it
12 would be the No. 2 or the No. 3 well; is that correct?

13 A. No. That was under discussion the whole
14 time. We always preferred the No. 2 location to the
15 No. 3 location.

16 Q. Did you ever submit any geology that would
17 show a preference for the No. 2 location to Mallon?

18 A. No. We agreed with their geology. We were
19 in agreement on them, and they agreed with us. The
20 reason for the No. 2 location was that the No. 3
21 location was a better shot at developing more reserves
22 but was a higher risk location. And we did not want
23 to take the higher risk location. We could live with
24 the lower reserves because our cost and operating
25 costs were much lower.

1 Q. When you talk about a high-risk well, what
2 are you talking about -- or the higher risks, to use
3 your words. What do you mean by higher risks?

4 A. It's a higher geological risk. You're
5 stepping further out from the known producing limits
6 of the field.

7 Q. Wasn't your testimony that there's no risk
8 in drilling this well at all?

9 A. The risk has been taken. The well has been
10 drilled. In our mind the risk is not the geology any
11 more. It's the simple fact that everything which has
12 been presented to us says that that well will never
13 make any money. It's an economic risk. And that's
14 what we're worried about.

15 Q. Aren't you in effect saying that there
16 never was any risk in drilling this well?

17 A. No, I don't think I'm saying that. I think
18 there is definitely a geological risk that they took
19 and know what the risk is now. Are fully capable of
20 assessing those risks. Have already done so.

21 Q. Isn't it true that you want to obtain the
22 logs of this well to minimize your risk as to whether
23 to join or not to join the well?

24 A. Well, as a matter of fact -- let me think
25 that over for just a second. To me, the greatest risk

1 is not the logs. The greatest risk is the economic
2 viability of that well. And that hinges on who
3 operates it, and it doesn't make a flip what those
4 logs look like. The only way that we can operate it --

5 Q. Why do you need the logs, then, Mr. Lewis?

6 A. We need to evaluate that that well is
7 capable of production from the formation and in the
8 manner that we -- well, we need to know that that well
9 is mechanically a sound well to produce from the
10 Williamson formation.

11 Q. Assuming the well is mechanically fit --
12 that it meets your soundness requirements, then isn't
13 it your testimony that you don't need the logs?

14 A. No, sir. Absolutely not. We need it to
15 complete -- we need to know the evaluation.

16 Q. I want you, Mr. Lewis, to make an
17 assumption that the well is sound.

18 A. Well, that's not what I'm trying to explain
19 to you. That's not where it stops.

20 Q. I understand what your contention is. Your
21 contention is that you want to see whether it's sound
22 or unsound insofar as its completion. Assuming that
23 the well is sound, why do you need the logs?

24 A. Well, we would like to evaluate the
25 formation for thickness, porosity, permeability so we

1 can design a frac job for it and to determine whatever
2 else we need to do to complete the well.

3 Q. Isn't it also true that you need the logs
4 to evaluate whether or not to join in participating in
5 the well?

6 A. I don't think so. You're not giving them
7 to us, so that indicates to me that they must be good
8 enough to complete. That's the truth.

9 Q. Wouldn't that information also tell you
10 whether or not you may have a commercial well?

11 A. I would certainly hope so. I hope that
12 it's already told you all that, and that the answer is
13 yes.

14 Q. You would agree that there are some wells
15 in this field -- that there are wells that are better
16 than others?

17 A. Yes, sir.

18 Q. And you would want to look at those logs to
19 decide whether or not this well is a good well or a
20 bad well; right? At least as far as information.

21 A. Certainly. We would do that.

22 Q. It would be prudent to look at the well
23 logs; isn't that true?

24 A. Yes, sir.

25 Q. It's also true that you haven't paid

1 anything towards or made any offer of payment for
2 joining in this well; is that correct?

3 A. No, sir. We never offered to pay. We're
4 being forced pooled. We have tried every way in the
5 world to come to an agreement with them to get this
6 well drilled. We have tried in every respect. My
7 conscience is completely clear. We do not want to
8 stand in the way of this well, but we are being forced
9 pooled into it, and are being forced to invest our
10 money into the well.

11 Q. Have you seen anything so far that would
12 say that Mallon is an imprudent operator?

13 A. Well, he drilled this well with 28 percent
14 of the acreage uncommitted. That's not something I
15 would do. The last well they drilled out there I was
16 not wild about the results. They drilled a very poor
17 well in an excellent location. So I have to answer
18 yes.

19 Q. When is your drilling deadline?

20 A. It's already passed. I think January 15th
21 was our deadline.

22 Q. Are you counting this well as a well
23 drilled to hold your farm out agreement with Red
24 Bluff?

25 A. Yes, sir, we are.

1 Q. Tell me about how you reached an agreement
2 with Red Bluff.

3 A. We approached them on that acreage after we
4 heard that it was up for lease. We asked under what
5 terms they would farm out that acreage, and as it
6 turned out we got a lease on the operating rights, but
7 it's basically the same thing, and they gave us the
8 terms and we thought that it was an economically
9 viable agreement.

10 Q. At 78 percent?

11 A. Yes, sir. 78.5.

12 Q. 78.5 percent. Taking your percentage, you
13 would receive, essentially, 28 percent of the net
14 revenue from this well; isn't that correct?

15 A. Well, divide it three ways.

16 Q. How much more proportionately are you
17 having to pay under -- you would have to pay under the
18 Mallon AFE more than what your AFE states?

19 A. Yes, sir. That's correct.

20 Q. Wouldn't it be 28 percent of the \$49,000
21 difference?

22 A. That's the way I understand it. It sounds
23 perfectly reasonable to me.

24 Q. That's roughly \$15,000?

25 A. I believe that's correct.

1 Q. That's holding you back now in terms of
2 deciding whether to join or not join or signing the
3 AFE?

4 A. No. That's not the point. The point is
5 that the AFE cost, in my mind, is not as significant
6 as the overall operating cost of the well long term.
7 The problem is that we can pay these wells out in 15
8 to 18,000 barrels and that Mallon does not seem to be
9 able to do that. That is the problem we have with it.
10 It makes no difference whether it's in the AFE or the
11 operating costs or where. It's, bottom line, the deal
12 that bothers us.

13 Q. Isn't your main contention, as I understand
14 it, that there was a big difference in the AFE, and,
15 therefore, you hadn't reached an agreement on the AFE
16 and that was the hang up?

17 A. That was part of it. Certainly, that was a
18 large part of it.

19 Q. Did you ever express to Mallon, in writing
20 or otherwise, that you questioned their operating
21 practices?

22 A. No, we did not. We told them that we could
23 operate more cheaply, but I don't think that it's -- I
24 see where we gain nothing going out there and
25 questioning how they do things.

1 Q. Did you ever challenge the overhead charges
2 that they had in their COPAS section of the operating
3 agreement they sent you?

4 A. No, we did not. We had no argument with
5 the overhead charges.

6 Q. Did you ever ask Mallon to explain why
7 their operating costs seem so high?

8 A. Well, no. Again, we're not in business to
9 question what they do. They have an operation, it's
10 working for them --

11 Q. Mr. Lewis --

12 MR. CARR: Objection. Let him answer the
13 question.

14 Q. (BY MR. PADILLA) Mr. Lewis, you understand
15 that you have to pool these particular lands under
16 40-acre spacing in southeast New Mexico in order to
17 develop these wells on 40-acre spacing; right?

18 A. That's what I understand.

19 Q. And you have to deal with the other working
20 interest owners?

21 A. Yes, sir.

22 Q. As I understand, all the dialogue was from
23 Mallon to you, but there was never anything back; is
24 that a fair assessment?

25 A. No. I don't think that's fair. We talked

1 to them often and extensively on the phone. We
2 traveled to Denver to meet with them. We put a great
3 deal of thought and effort into how this land should
4 be developed and how it should be operated. So I feel
5 like we never made a specific proposal, as far as
6 operating agreement or operating cost. And other than
7 that, I think that -- we never got to that point. We
8 just couldn't get past the AFE deal.

9 Q. What are the plans you have for developing
10 your acreage out there? Do you have another well
11 staked at this time?

12 A. No, we do not. We haven't got past this
13 one yet.

14 Q. Did you ever stake any wells out there on
15 this farm out?

16 A. No, we did not.

17 Q. Mr. Lewis, how many wells have you
18 participated in drilling out there?

19 A. In this general area?

20 Q. In this area.

21 A. I have not participated in any wells in
22 that general area. The closest thing I would have
23 would be in Winkler County, which would be about 50
24 miles away.

25 Q. One further question, Mr. Lewis. Since you

1 had a drilling obligation of January 15, 1990, I
2 suppose, under your farm out agreement, what steps had
3 you taken to drill your well?

4 A. Well, we were obviously either going to
5 have to work out something with Red Bluff or to spud a
6 well on our own acreage or -- excuse me. Let me start
7 that over. We were obviously going have to work out
8 something with Mallon Oil Company or spud a well on
9 our acreage elsewhere. The only possible drilling
10 locations we had all involved Mallon Oil Company
11 acreage. Therefore, we figured, "Well, if you can't
12 work out the first one, there's not much sense in
13 starting out No. 2." We approached Red Bluff and
14 asked for an extension of our farm out, if necessary,
15 past the January 15th deadline, and they said there
16 was no problem to it. To go ahead and work out what
17 you can.

18 Q. Once you saw Mallon going after the No. 3
19 well, essentially, did you take any efforts to drill
20 the No. 2 well?

21 A. No. There was no need to. It would have
22 been extremely imprudent to drill an offset to a well
23 that was drilling. We will certainly wait and until
24 we see that that well produces before we spud the
25 No. 2 well.

1 Q. But you had the geology, and it's your
2 testimony that the No. 2 seemed like a better prospect
3 from the very beginning anyway.

4 A. Well, that's true, but, you know, I could
5 be wrong. And I'm willing to admit it, and I'm
6 willing to wait and see what that other well is like.
7 We have no deadlines to meet. The well that they
8 spudded met our drilling commitment, and there would
9 be no reason to why we would want to rush out and
10 drill an offset to a well that we didn't even know was
11 going to be a producing well.

12 Q. Well, wasn't there another producing well
13 that was an offset to the No. 2?

14 A. Well, certainly, but there is one to the
15 east, the No. 13 would be to the north, and the No. 3
16 would be to the northwest. But we're not going to
17 risk \$200,000 when we haven't got all the information
18 we can get on it.

19 Q. Isn't it true that there's substantial risk
20 in drilling these wells?

21 A. I don't think so. I think most of it is
22 economic risk. I think most of it is you keep your
23 cost down, you don't spend any money you don't have to
24 spend, you'll be all right.

25 MR. PADILLA: Well, I don't want to argue

1 with you. I think that we'll go round and round and
2 differ on whether there is risk or not.

3 That's all I have.

4 EXAMINER CATANACH: Anything further,
5 Mr. Carr?

6 MR. CARR: Nothing.

7 EXAMINATION

8 BY MR. CATANACH:

9 Q. Mr. Lewis, you mentioned that your drilling
10 costs or your proposed drilling costs are in line with
11 other operators in the area. Do you have any proof of
12 that?

13 A. No, sir. Not with me I sure don't. We
14 would be happy to provide you, at a later date, with
15 what we can come up with.

16 Q. Okay. That may be important. And your
17 overhead rates are lower than Mallon's, and you said
18 your overhead rates are in line also with other
19 operators in the area?

20 A. Yes, sir. I think most independent
21 operators dealing among themselves do it for about
22 two-high, 3-350.

23 Q. Can you provide us something that shows us
24 those overhead rates are more in line with operators
25 in that area?

1 A. I cannot provide you with it right now. We
2 can provide you with it at a later date.

3 MR. CARR: We'll have it here within a
4 week.

5 MR. PADILLA: Mr. Examiner, we would like
6 the opportunity to supply the same kind of
7 information.

8 EXAMINER CATANACH: That would be fine, Mr.
9 Padilla.

10 Q. Mr. Lewis, on December 5th, when you
11 advised Mallon that you would not be participating in
12 the well, did you have any plans at that time on what
13 you were going to do?

14 A. That's when we approached Red Bluff for an
15 extension of our farm out so that we could -- at that
16 time it was not clear to us that they were going to be
17 able to get all of their working interest owners
18 together to drill that well.

19 Q. So at that time you weren't aware that the
20 well was going to be spudded later on that month, or
21 were you?

22 A. No, sir. I was not certain.

23 Q. The proposal that you had to Mallon, as far
24 as the farm out was concerned, they wanted, as I
25 understand it, 80 percent net revenue interest? They

1 wanted you to deliver that?

2 A. I think that was the general gist of the
3 conversation, which our reply was, "We only have a
4 78.5. That's as high as we could get, and we're not
5 inclined to do that as the 75 is higher than what
6 you've got right now."

7 Q. So they didn't know that you did not have
8 80 percent?

9 A. Well, it's my understanding they did. But
10 you know, it's hard for me to speak for them.

11 Q. Am I correct in understanding if Mitchell
12 is designated the operator of this proration unit,
13 there is a possibility that you would drill another
14 well?

15 A. If the current well bore is not serviceable
16 to the task at hand, then there is definitely that
17 possibility.

18 Q. Serviceable meaning --

19 A. Now, it's not something that we want to do,
20 by any means. And it would have to be a situation
21 whereby that well that has been drilled is in such
22 shape that it could not be fixed and used. We do not
23 propose drilling another well on that unit until we
24 have information that says we have to.

25 EXAMINER CATANACH: I believe that's all

1 the questions I have of this witness at this time.

2 Anything further?

3 MR. CARR: Nothing further.

4 EXAMINER CATANACH: The witness may be
5 excused.

6 THE WITNESS: Thank you.

7 EXAMINER CATANACH: Is that your last
8 witness, Mr. Carr?

9 MR. CARR: That's the end of my case.

10 And I guess at this time I renew my
11 motions, or you know, at the pleasure of the Examiner
12 we can close and then we can renew our motions.

13 EXAMINER CATANACH: Why don't you go ahead
14 and close.

15 MR. CARR: We can close and you can defer
16 ruling on the motions until you're ready to rule. My
17 hope is, having put on the evidence, that we at least
18 have made the record in the case and that we're not
19 looking at having to reopen again in an examiner
20 level, assuming we get the logs and don't see anything
21 in there that requires it.

22 MR. PADILLA: Mr. Examiner, an issue has
23 been raised in the case put on by Mitchell that the
24 well may be unsound as presently cased. In terms of
25 that information demonstrating to the division as to

1 whether or not that well is sound or unsound, we would
2 be willing to submit that information to the division
3 on a confidential basis for the division to decide
4 whether or not the well is sound or unsound.

5 For purposes of Mr. Mitchell's request,
6 which we feel is to obtain the information to decide
7 whether to participate or not, then, our objection
8 remains.

9 MR. CARR: That, of course, does not met
10 our objective at all. We have not stood before you
11 and said the well is unsound. We said we don't know.
12 And we have someone who has gone out, drilled a well,
13 has our -- they're now trying to dedicate to it, a
14 well that we have been willing to drill and operate
15 all along, and since they have taken the risk, we're
16 entitled to the data. That's the point. They can
17 give it to anybody they want, but until they give it
18 to us, they will not have confirmed or complied with
19 the subpoena or met our objective.

20 EXAMINER CATANACH: Does that about sum it
21 up?

22 MR. CARR: I guess.

23 EXAMINER CATANACH: Give us a couple of
24 minutes, please.

25 (Thereupon, a recess was held.)

1 MR. CARROLL: After considering the motions
2 at length yesterday and early today, and noticing the
3 fact that the Oil Conservation Division does have the
4 power to issue a subpoena to compel pertinent
5 documents necessary to their determination of relevant
6 issues, and doubly noticing the fact that that
7 information has to be pertinent, it is our decision to
8 quash -- or to deny the motion to quash and limit the
9 admission of the requested documents to the issue of
10 risk penalty assessment and to limit the admission for
11 purposes of this hearing only. In other words, no
12 copying and taking the records outside of this
13 hearing.

14 MR. PADILLA: I don't know what to say. I
15 think I have to confer with my clients as to whether
16 they want to do that, but I think that's it's a
17 forgone conclusion that Mr. Lewis is an expert -- and
18 I assume that Mr. Mitchell also is familiar with
19 reading a log and information and can readily assess
20 from those logs whether they are able to participate,
21 and I think that's the basis of our objection.

22 I think that if it went to even for risk
23 purposes, where we turn the materials over to the
24 division to assess the risk, then, I don't think we
25 have any problem, but for the purpose of making a

1 decision as to whether Mr. Mitchell and Mr. Lewis want
2 to participate in the well, then I think we still have
3 grave problems with turning the material over.

4 And so I would respectfully request leave
5 to seek judicial intervention.

6 EXAMINER CATANACH: Certainly we would
7 grant the leave you request. I guess a continuance of
8 both cases would be the best thing to do at this
9 point.

10 MR. CARR: I would like to respond, if I
11 might.

12 EXAMINER CATANACH: Sure.

13 MR. CARR: I recognize Mr. Padilla's
14 position and his desire to seek judicial intervention.
15 We would, however, move -- and you don't have to rule
16 on this at the moment, but we want this motion on file --
17 we would move the division enforce its subpoena by
18 denying their application and going ahead and entering
19 an order in our case. I would like that motion on the
20 record pending.

21 EXAMINER CATANACH: That motion will remain
22 on the record for the time being. Do you have any
23 objection, Mr. Carr, to continuing these cases at the
24 present time?

25 MR. CARR: Well, I would object to

1 continuing ours, for the record.

2 EXAMINER CATANACH: Mr. Padilla, do you
3 have any idea of a time period which maybe sufficient?

4 MR. PADILLA: I don't want to ask for a
5 continuance of two weeks, because I don't know when we
6 can get heard on this thing. I do know that
7 considering the -- that the well needs to be completed
8 and that sort of thing, and from the conferences I've
9 had with my clients, that we need to get this
10 resolved. And so I would assume that this weekend I
11 would be busy filing -- preparing a petition to submit
12 early next week.

13 EXAMINER CATANACH: Are you saying that
14 this may be -- we should continue these for two weeks?

15 MR. PADILLA: I'm saying that we should
16 continue these cases indefinitely, but it may be only
17 two weeks, or it may be -- I think we could get heard
18 within a month in court, but I don't know. I think
19 the fact that we have had a hearing on the merits
20 here, that it will certainly shorten any kind of
21 proceeding that we have over there.

22 In other words, I don't think that we now
23 need to have an evidentiary proceeding before the
24 court. That we can introduce certain portions of the
25 record here and simply make an argument as to the

1 validity of our decision.

2 EXAMINER CATANACH: You would then suggest
3 that these cases be continued indefinitely or until
4 such time as you know what the outcome of the court
5 case would be?

6 MR. PADILLA: Yes. And I don't see any
7 reason why we can't be heard fairly soon, once we ask
8 for a hearing on this thing. It's not a matter of
9 asking for a hearing for a full day or half a day. I
10 don't think it will involve that.

11 EXAMINER CATANACH: Depending on the
12 outcome of the court decision, do you think that we
13 will actually need to reappear and bring the witnesses
14 back and do some more stuff in either of these two
15 cases?

16 MR. PADILLA: I don't think so. I think
17 that we will -- the court decision will decide whether
18 we -- assuming we lose, then we'd have to turn over
19 the materials, and I think that -- I don't know for
20 what purpose -- we certainly wouldn't be analyzing --
21 I don't think we have any further testimony concerning
22 those exhibits. There may be some limited things on
23 them, but I don't know why we couldn't do it by way of
24 affidavit or something else to where witnesses would
25 not have to come here.

1 EXAMINER CATANACH: Do you agree with that,
2 Mr. Carr?

3 MR. CARR: I think we would not have to
4 have another hearing. I think it might be appropriate
5 in that event to go ahead and permit us to give brief
6 closing argument and this record will be a complete
7 unit. And I can't imagine, unless there is something
8 really suprising, that we would have to come back for
9 further hearing.

10 EXAMINER CATANACH: Procedurally, I'm not
11 sure how we would continue a case indefinitely.

12 MR. CARR: I think that if you are going to
13 deny my application to just continue theirs and take
14 mine to an order, it could be continued for two weeks,
15 and I would be perfectly willing to stipulate with
16 Mr. Padilla that if the matter is not resolved by
17 then, that we would not oppose further continuances,
18 so that you would procedurally be able to continue it
19 until this issue has been resolved by the court.

20 MR. PADILLA: That would be no problem.

21 EXAMINER CATANACH: So we can continue it
22 for two weeks and until such time as we have the
23 court's decision, it would be continued, in effect.

24 MR. PADILLA: Right.

25 EXAMINER CATANACH: Okay, let's go ahead

1 and do that. At that time, when we rehear or bring
2 you back in, do you wish the opportunity to give
3 closing statements?

4 MR. CARR: I think we could actually do
5 that right now and be done with it.

6 MR. PADILLA: That would be fine.

7 EXAMINER CATANACH: Okay. Let's go ahead
8 and do that then.

9 MR. PADILLA: I'll try to be very brief,
10 Mr. Examiner. I think all the issues are very clear
11 here as to the compulsory pooling portion of the case.
12 And I'll to confine my argument just simply to that.

13 What we have here is two parties who
14 essentially have not agreed. One says that they have
15 agreed and the other says there has been no joinder.
16 But, when you look at this stack of documents
17 presented by Mallon on the one side, all of
18 preparation for drilling this well has been made by
19 Mallon. When you look at the evidence submitted by
20 Mr. Lewis and the exhibits presented through his
21 testimony, you see that most of those documents are
22 the documents that have been manufactured by Mallon.

23 The only new item in this whole stack of
24 stuff that was submitted by Mr. Mitchell's side is
25 that (indicated), their AFE. We're talking about an

1 AFE that, apparently, there seems to be some
2 disagreement on. The only difference appears to be a
3 \$15,000 difference. Mr. Mitchell was under an
4 obligation to drill his well by January 15th, and he
5 seems perfectly happy to be willing to use the well
6 drilled by Mallon as fulfilling his drilling
7 obligation. There is just no evidence on their side
8 saying, "We proposed to drill this well."

9 Mr. Lewis says, well, in our business we
10 simply call somebody and send them an AFE, and all
11 that sort of stuff. The AFE that he sent was
12 submitted, according to Mr. Cox's testimony, as
13 something for discussion, not necessarily as a formal
14 submittal. There was never any kind of formal
15 proposal and there never has been. They have never
16 staked a well. They have never gone out there and
17 assumed they were going to drill the wells.

18 Yes, they do operate four wells in an
19 adjoining section. Those wells are not owned by
20 Mr. Mitchell. Mr. Lewis has never been even around
21 that area, and they have apparently no other plans to
22 drill other wells, except maybe to meet their
23 obligations under the Red Bluff farm out.

24 When you look at the information submitted
25 here, Mallon has been out there for a long time. They

1 have been out there since 1983. In 1986 they became
2 the operator of the area, and they have continued
3 operating. There's never been any claim by anyone, at
4 least certainly their partners who are here to say,
5 "No, Mallon, is not a good operator." We have raised
6 those allegations or Mitchell has raised those
7 allegations here, presumably to become operator. They
8 have raised issues as to whether or not this well is
9 properly done, but there's been no other allegation or
10 any instance, other than losing circulation here and
11 there, that there are problems with the wells. But
12 those wells have been drilled and they are producing
13 in accordance with the requirements of the Oil
14 Conservation Division. There's no allegations here at
15 all that Mallon is an imprudent operator.

16 Yes, Mallon did get itself right up into
17 its drilling deadline, but by the same token, Mallon
18 did inform Mr. Mitchell on December 26, I believe,
19 that they were going to force pool and after that they
20 commenced the well, there seems to be some notion that
21 by commencing the well, prior to having an order from
22 this Division, that you waive the risk or assume the
23 risk of having drilled the well. Well, there is some
24 risk that has been taken but that certainly has not
25 been waived as to Mr. Mitchell, and so the well is not

1 completed. We don't know whether the well is going to
2 ultimately produce or how it's going to produce, and,
3 therefore, I think it's appropriate, from the pattern
4 and the experience and the production history out
5 there that a force pooling application order be issued
6 carrying a maximum penalty.

7 Mr. Mitchell is a nonconsenting working
8 interest owner, and that's just the way it is. He
9 says, "Well, we're going to forfeit everything."
10 Well, he has the option of putting up his money or
11 forfeiting. That's what the compulsory pooling
12 statute is all about, but the compulsory pooling
13 statute has been upheld, and that's not even an issue
14 here, as to whether or not he ought to be forced
15 pooled. He can participate or not participate and
16 that's the way it is.

17 Mallon has said, and has shown adequately,
18 and I don't think it's been refuted by Mr. Mitchell
19 that an 80 percent revenue interest lease is
20 inappropriate. I think the overriding royalty
21 interest owners on the Amoco lease recognize that in
22 order, in the long haul, to operate this field in a
23 prudent way they had to reduce their royalty. Period.
24 But for the one person who has refused so far, that
25 would have been accomplished, and that recognition is

1 apparent.

2 Finally, I just feel that this is a
3 straight-forward compulsory pooling case. The
4 requested materials that we have objected to
5 submitting are relevant to any determination or risk.
6 Oh, it may be helpful, but it certainly is going to be --
7 Mr. Mitchell has had adequate opportunity to decide
8 whether to join or not join and participate in this
9 well. We feel that we have met all the elements to
10 have a compulsory pooling order issued for Mr. Mallon
11 or Mallon Oil Company.

12 Thank you.

13 EXAMINER CATANACH: Mr. Carr.

14 MR. CARR: May it please the Examiner, we
15 have heard a lot today that really is of no relevance
16 to the issues that are before you. I don't think
17 there is any relevance that can be attached to the
18 size of the stack of paper one witness lays out as
19 opposed to another, especially when you look at it and
20 you realize that most of everything that Mallon
21 presented today was nothing more than a smoke screen.

22 We talked about net revenue interest and we
23 need to get it up. That's a matter of private
24 contract. That doesn't have any bearing on your
25 decision whatsoever. They talk about having a delay

1 because they have to go back to their other working
2 interest partners. Private contract. Nothing for the
3 OCD to consider.

4 What are we doing to perpetuate our farm
5 out arrangement with Red Bluff? No relevance to
6 anything that's here. None whatsoever. And there is
7 no real question on most of things that are before you
8 and properly before you in a compulsory pooling case.

9 And there's no dispute the parties
10 negotiated. They couldn't reach voluntary agreement.
11 There's no dispute that the farm out arrangements that
12 were proposed by both sides were rejected by the
13 other. There's no dispute that Mr. Mallon went out
14 and drilled a well before he had voluntary joinder or
15 had come to this commission and invoked the police
16 power of the state to bring the tracts together.

17 Under the act, all you have to do is file
18 an application. None was filed. The well was
19 spudded. When you do that you don't have the
20 protection of the act. That's just simply where it
21 boils down. You stand up and cite the act on one side
22 and say, "Well, heck, they're pooled. They can come
23 in or they can not. That's just the fact of life."
24 You can't step inside the act one minute when you're
25 acting outside the act the other.

1 I represent the one party before you whose
2 every act they have taken has been within the confines
3 of the New Mexico Oil and Gas Act, and I think that's
4 important and relevant when you start determining who
5 ought to be the operator of this property.

6 The bottom line is that there's no
7 agreement, and Mr. Mallon went forward. He drilled a
8 well. He has the data. He has developed it, which
9 has real relevance to our property, and we're entitled
10 to it. And this won't be resolved until that issue is
11 resolved.

12 Let's look at the options. They're not
13 just simple options like Mr. Padilla says, "Jump in,
14 pay your money, or get out." We have to pay a share
15 based on an AFE that's \$40,000, \$50,000, in that
16 range, more than ours for additional casing, for
17 additional frac costs -- costs we think are
18 unnecessary. To get in we have to let someone operate
19 who has economic figures -- in these exhibits the
20 letter from Mr. Cox, I think it's the 17th of July --
21 that show he has to get over two times the production
22 out of his well that Mr. Mitchell believes he has to
23 get to get to an economic breaking point in the
24 project.

25 If we join, we give away everything under

1 that economic scenario. It all gets consumed in costs
2 in what we think are too costly operations. If we go
3 nonconsent, the penalties imposed -- I don't think
4 anyone in this room would suggest that that's not
5 virtually a forfeiture of the interest under this 40
6 acres for Mitchell to Mallon if Mallon prevails.

7 The viable option is for us to take over
8 operations. Do it efficiently. Pay our share of
9 what's been incurred to date and operate it so that
10 everybody shares and that the costs are reasonable.

11 Can Mitchell be operator? You bet they can
12 be. They've talked about it. They've gone and
13 proposed an AFE -- no agreement has been reached on
14 that either. That's a decision for you, not
15 Mr. Mallon by running out and spudding the well.
16 That's an open question.

17 And can Mr. Mitchell operate? Yes. He is
18 producing and operating four wells in the immediate
19 area. And he's been in the area, too, a long time.
20 He's promptly pursued the development of the tract.
21 He acquired it in July. He hasn't had it for years.
22 His operations are less costly. He's acting within
23 the rules of the division. He can take over and
24 reduce the costs. And we're not saying that what
25 Mr. Mallon did was improper in the other well, but we

1 were pursuing it, and any suggestion that it was
2 improper only came up during Mr. Padilla's
3 cross-examination of our witness.

4 If you go with us, it's not going to result
5 in the taking of property. It's not going to condone
6 unilateral acts outside the Oil and Gas Act. It's
7 going to, on the other hand, let us control costs,
8 protect our correlative rights by letting us receive a
9 share of the reserves that are produced. And we think
10 if you rule for us with a zero penalty -- which we
11 think is appropriate. The risk has been taken -- you
12 will commit your duties under the Oil and Gas Act.

13 EXAMINER CATANACH: Thank you, gentlemen.
14 With that, we'll continue Case 9867 and 9868 until the
15 February 21st, 1989 docket if we can make that docket.
16 If not, it will be the next one.

17 MR. CARR: Thank you.

18 EXAMINER CATANACH: Thank you.

19
20
21 I do hereby certify that the foregoing is
22 a complete record of the proceedings in
the Examiner hearing of Case No. 9867, 9868
23 heard by me on February 8 19 90.

24 David R. Catanach, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

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

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

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

WITNESS MY HAND AND SEAL April 5, 1990.


DIANA ABEYTA
CSR No. 267

My commission expires: May 7, 1993