



# Notes

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OIL AND GAS EXPLORATION

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December 4, 1998

FACSIMILE: 915/686-6714

Santa Fe Energy Resources, Inc.  
550 W. Texas, Suite 1330  
Midland, Texas 79701

ATTN: Mr. Gregory Wilhelm

RE: Gaucho Unit Well Nos. 2 and 2-Y  
NMOCD Case No. 12008

Dear Mr. Wilhelm:

The purpose of this letter is to set out our position in the captioned matter, dealing with the determination of reasonable well costs in conjunction with the drilling of the captioned wells. Everything in this letter is submitted by way of compromise and settlement.

By letter to Santa Fe dated June 29, 1998, we made it clear that what we were seeking in this matter was a determination by the NMOCD that the costs associated with the drilling of the original Gaucho Unit #2 well could not be included in "reasonable well costs" and thereby made a part of the sums permitted to be recovered under the Compulsory Pooling Order for this well. That letter attempted to obtain Santa Fe's agreement to that principle without having to go to hearing on the matter. Since Santa Fe was not agreeable to our proposal, we have pushed ahead with our request to have this matter determined through hearing and ruling from the NMOCD. By mutual consent the hearing date had been postponed on two or three occasions, primarily to allow the audit of drilling expenses to be completed. This was done, and we received our copy of the audit report on October 26, 1998.

In the course of preparing our case, our counsel, Bill Carr, advised us that we could not argue simply for an exclusion of the costs associated with the Gaucho #2 well, but rather our argument had to be that the compulsory pooling order applies only to well #2 but does not apply to well #2-Y. Therefore, we cannot be subjected to a penalty on any of the costs associated with the drilling and/or completion of either well since the Gaucho #2 was abandoned and the #2-Y was not subject to the compulsory pooling order.



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If I were to accept the conclusion that both wells can be made subject to the force pooling penalty, Santa Fe would wind up realizing 300% of 28.125% of \$2,529,000, or \$2,134,000 out of my share of income from this well. When you include the fraction for which I joined, I would wind up paying for 93.75% of the total cost of both wells, despite the fact that I made every effort to negotiate a trade with Santa Fe under which any working interest for which I did not join would be farmed out, rather than force pooled. To the best of my ability, I am not going to allow that to happen. I think it is more than enough that Santa Fe recover \$1,519,000 out of my interest under the proposal which we put forth in our June 29, 1998 letter.

Santa Fe filed a last minute Motion to Dismiss the hearing that was scheduled for yesterday, based on the transparently false contention that my execution of the Operating Agreement constituted a voluntary waiver of the force pooling order. The examiner's continuation of the case to January 21, 1999 requires that lawyers for both sides file additional materials within 10 days. If Santa Fe wants to continue to delay the inevitable hearing date and force the expenditure of several thousand dollars in additional attorneys fees, fine. We are certainly prepared to do so. But that will be a 'winner take all' situation and if we happen to prevail, there will be no negotiation at that point.

On the other hand, I am renewing my prior proposal of June 29, 1998 to exclude the costs associated with the Guacho #2 from reasonable well costs. I will be traveling to Honduras on Friday, December 11 and will be inaccessible for the following ten to twelve days. This proposal is therefore valid until Thursday, December 10, at 5:00 P.M.

Yours very truly,



Robert E. Landreth

cc: Southwestern Energy Production Company  
2350 N. Sam Houston Parkway East  
Houston, Texas 77032  
ATTN: Mr. Sam Thompson