

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

IN THE MATTER OF THE HEARING CALLED BY)
THE OIL CONSERVATION DIVISION FOR THE)
PURPOSE OF CONSIDERING:)

CASE NO. 12,043

APPLICATION OF SANTA FE ENERGY)
RESOURCES, INC., FOR COMPULSORY)
POOLING, LEA COUNTY, NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: MARK W. ASHLEY, Hearing Examiner

September 17th, 1998

Santa Fe, New Mexico

98 OCT -5 AM 9:57

OIL CONSERVATION DIV.

This matter came on for hearing before the New Mexico Oil Conservation Division, MARK W. ASHLEY, Hearing Examiner, on Thursday, September 17th, 1998, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

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 Examiner Hearing
 CASE NO. 12,043

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A P P E A R A N C E S

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ALSO PRESENT:

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* * *

1 WHEREUPON, the following proceedings were had at
2 9:48 a.m.:

3 EXAMINER CATANACH: For the record, Mr. Mark
4 Ashley will be the Examiner for this case, this next case.

5 EXAMINER ASHLEY: At this time we want to call
6 Case 12,043.

7 MR. CARROLL: Application of Santa Fe Energy
8 Resources, Inc., for compulsory pooling, Lea County, New
9 Mexico.

10 EXAMINER ASHLEY: Call for appearances.

11 MR. KELLAHIN: Mr. Examiner, I'm Tom Kellahin of
12 the Santa Fe law firm of Kellahin and Kellahin, appearing
13 on behalf of the Applicant, and I have two witnesses to be
14 sworn.

15 EXAMINER ASHLEY: Any additional appearances?

16 MR. OWEN: Paul Owen of the Santa Fe law firm
17 Campbell, Carr, Berge and Sheridan, for Robert E. Landreth.
18 I have no witnesses.

19 MR. CARROLL: Will the witnesses please stand and
20 be sworn?

21 (Thereupon, the witnesses were sworn.)

22 MR. KELLAHIN: Mr. Examiner, this case involves a
23 proposal by Santa Fe Energy Resources to drill a deep gas
24 well. The primary target is going to be the Morrow
25 formation. You can see from the advertisement in the

1 docket, the principal spacing unit for that target
2 formation is going to be 320 acres, and Santa Fe is
3 proposing to dedicate the north half of this particular
4 section. It's Section Number 4.

5 It's irregular only to a certain extent. There's
6 some small lots across the top of the section that give us
7 a slightly different size to the spacing unit. It's 320.03
8 acres. That certainly is standard under Division
9 definitions.

10 The reason we're here today is, there's a certain
11 sense of urgency to at least have the availability to Santa
12 Fe of a compulsory pooling order in the event that our
13 negotiations with the last of the working interest owners,
14 for reasons beyond our control, are unable to be completed,
15 and that interest owner is Robert Landreth.

16 Mr. Smith will describe for you in detail rather
17 complicated, and tedious, negotiations with Mr. Landreth
18 that have gone on for weeks and have consumed hours and
19 days. It is our hope to complete that transaction.

20 However, if not, we must have the flexibility of
21 being able to proceed with this well. There is a drop-dead
22 date to commence the well on November 18th. In the event
23 that Santa Fe fails to do that, they forfeit a substantial
24 interest in Section 4.

25 In order to have sufficient time to prepare for

1 the drilling of that well, and to provide Mr. Landreth with
2 the 30-day notice under a pooling order, we are compelled
3 to come to hearing today, but Mr. Smith is prepared to tell
4 you and counsel for Mr. Landreth that he will continue to
5 make his best effort, as he's already done, to see if he
6 can't complete this matter in the next week or so.

7 If Mr. Landreth should change his position from
8 what it's been represented to us as of this point, Santa Fe
9 does need to have the option to say that we are unable to
10 meet terms and proceed under a pooling order. So that's
11 our position here this morning, sir.

12 EXAMINER ASHLEY: Okay.

13 STEVEN J. SMITH,

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

16 DIRECT EXAMINATION

17 BY MR. KELLAHIN:

18 Q. Mr. Smith, for the record, sir, would you please
19 state your name and occupation?

20 A. My name is Steven J. Smith. I'm a senior staff
21 landman for Santa Fe Energy Resources, Inc.

22 Q. Mr. Smith, you have been involved in other
23 compulsory pooling processes that have involved testifying
24 before the Division in past cases?

25 A. That's correct.

1 Q. As part of your experience and knowledge as a
2 petroleum landman, have you made yourself knowledgeable
3 about the ownership in irregular Section 4?

4 A. Yes, I have.

5 Q. Are you the primary individual responsible for
6 identifying the interest owners in the section and, once
7 identified, negotiating with those interest owners to try
8 to reach a voluntary agreement?

9 A. Yes, I am.

10 MR. KELLAHIN: We tender Mr. Smith as an expert
11 petroleum landman.

12 EXAMINER ASHLEY: Mr. Smith is so qualified.

13 Q. (By Mr. Kellahin) Mr. Smith, let me direct your
14 attention, sir, to the package of exhibits.

15 Mr. Examiner, Mr. Smith's exhibits, for the most
16 part, have been stapled together collectively. But you'll
17 find as we turn through them, there will be exhibits
18 numbered 1 through 14, and they will be identified
19 individually.

20 Let's orient the Examiner, Mr. Smith, to what we
21 are trying to accomplish in this section. First of all,
22 take a moment, identify for us Exhibit 1, and explain to us
23 how you have coded this exhibit.

24 A. Okay. Exhibit 1 is a land plat which has Section
25 4 centered in the plat. There's a red dot in Section 4

1 which represents the location of our well, our proposed
2 well.

3 There's a -- The anticipated proration unit for
4 that well is outlined in red, being the north half of
5 Section 4.

6 The prospect designated area, which relates to a
7 contract we have with Altura, is outlined in green,, and
8 that prospect is all of Section 4.

9 The orange acreage is owned by Amoco, now Altura,
10 and is subject to an exploration agreement between Santa Fe
11 and Amoco, and the yellow acreage is Santa Fe's leasehold.

12 The various tracts within Section 4 are numbered,
13 and there is a corresponding summary on the next page which
14 gives the current ownership of the operating rights on a
15 tract-by-tract basis, with notes relative to that
16 ownership.

17 Q. When we direct your attention to a proposed
18 north-half 320 spacing unit, and assuming the well is
19 successful as a Morrow well, what would be Mr. Landreth's
20 proportionate interest in a spacing unit of that size and
21 configuration?

22 A. Just right at 51 percent, slightly over 50.

23 Q. You made mention of an agreement with Altura.
24 Summarize for us what the time component is, in order for
25 Santa Fe to earn its contractual rights under that

1 agreement.

2 A. This agreement is an old agreement. It dates
3 back to November 18, 1988. It's an agreement between Santa
4 Fe and Amoco, now Altura, that gives Santa Fe the exclusive
5 right to explore on certain Altura acreage.

6 Under that agreement, the way Santa Fe earns an
7 interest is to designate a prospect to Altura, and in
8 designating, we must provide our geological proof that it
9 is a viable prospect, and we offer Altura the opportunity
10 to participate in that well. If they choose to, they
11 participate for 50 percent, and we earn 50 percent of their
12 interest. That's if the well's located on their acreage.

13 If it is not located on their acreage, as is this
14 matter before you, we still earn 50 percent of their
15 interest. But they do not participate in a well unless
16 they choose to acquire any additional acreage we've
17 acquired during the term of that agreement.

18 In this case, we offered Altura acreage we had
19 acquired and the opportunity to participate. They declined
20 to participate but approved our prospect as a viable,
21 drillable prospect. So at this point we stand to have
22 equitable title to 50 percent of Altura's acreage in
23 Section 4.

24 Under that agreement, in order to earn this
25 interest, we must drill a well before November 18 of 1998.

1 After that date the relationship goes away, and all our
2 rights expire.

3 Q. Under this expiration agreement, has Santa Fe
4 utilized itself of the opportunity for all extensions?

5 A. Yes, we have. We -- This is a very expansive
6 agreement. We have several other areas that are in a
7 similar situation, where we're right at the very end in
8 trying to get something done, and we have contacted Altura
9 in an attempt to extend it, and they've declined our
10 request.

11 Q. So the November 18th date is a very firm --

12 A. Drop-dead date.

13 Q. -- date, by which you must take action?

14 All right. I think you've summarized for us what
15 is contained within the basic terms of Exhibit 3. It's a
16 letter dated July 10th, 1998. Is that the document to
17 which you've been referring?

18 A. That is our prospect-designation letter to Altura
19 with their corresponding signature on it, reflecting their
20 acceptance of the prospect.

21 Q. All right. The next exhibit is Exhibit 4, and
22 it's a letter over your signature that is dated July 14th,
23 1998?

24 A. That's correct.

25 Q. At this point in time, Mr. Smith, what working

1 interest owners are outstanding?

2 A. At this point in time, Santa Fe has -- would have
3 owned a half interest in the yellow acreage on the plat,
4 First Roswell Company would have had the other half.

5 I've gotten out of order. Tract 1, Robert
6 Landreth and Hunt Oil Company would have each had half
7 interest in Tract 1. In Tract 2, Robert Landreth has 100
8 percent interest. And in Tract 3, Santa Fe has half and
9 First Roswell has half, or 12.5 percent in the proposed
10 working interest unit.

11 Q. The July 14th letter was sent to Mr. Landreth?

12 A. That's correct.

13 Q. Was it sent to the other parties with whom you
14 had not yet reached an agreement?

15 A. Yes, it was.

16 Q. As a result of your efforts, have you been able
17 to reach an agreement with Hunt Oil Company?

18 A. Yes, I have.

19 Q. And based upon your efforts, have you now been
20 able to reach an agreement with First Roswell Company?

21 A. Yes, I have.

22 Q. You are continuing to negotiate with Mr.
23 Landreth?

24 A. Yes, I am.

25 Q. Let's go through the various documents and have

1 you summarize for us your efforts to consolidate Mr.

2 Landreth's interest, starting with the July 14th proposal.

3 Within the context of that proposal, did you also
4 include for Mr. Landreth a copy of Santa Fe's proposed
5 costs for the well as indicated on the AFE attached to that
6 letter?

7 A. Yes, I did.

8 Q. When we get to the subject of the AFE, Mr. Smith,
9 did any of the parties object to the cost, or the
10 itemization of those costs, for the well?

11 A. None.

12 Q. Do you recommend to the Examiner that he approve
13 this AFE as reasonable costs for the inclusion within the
14 context of a compulsory pooling order?

15 A. Yes, I do.

16 Q. Within the context of a pooling order, do you
17 have a recommendation to him for the overhead rates to be
18 charged on a monthly basis for drilling and then for
19 operation?

20 A. Yes, I do. We've drilled many wells in this
21 area, and the rate we have proposed and had accepted by all
22 parties today is a \$6000-a-day drilling well rate and a
23 \$600-a-day producing well rate.

24 Q. And that is a rate that has been approved by the
25 Division in other pooling orders issued at the request of

1 Santa Fe for Morrow gas wells farther north of this
2 location?

3 A. That's correct.

4 MR. KELLAHIN: For your reference, Mr. Examiner,
5 the order I am alluding to is R-10,764, and it contains
6 rates which approve those consistent with Mr. Smith's
7 testimony.

8 Q. (By Mr. Kellahin) When you offered to Mr.
9 Landreth, without going into great detail, Mr. Smith, what
10 did you propose to him?

11 A. Initially, we proposed the well and requested
12 that he participate for his share. If he chose not to, we
13 offered him the opportunity to farm out on what we
14 considered to be a fairly industry-standard farmout, which
15 would allow him to deliver to us a 75-percent net-revenue
16 interest, with the opportunity to convert his retained
17 override at payout of the well to a 25-percent working
18 interest, proportionately reduced.

19 Q. Those percentage and terms are reasonably
20 standard for your company and other companies when they put
21 together proposals for wells at this depth in this area?

22 A. I think so.

23 Q. Were you successful in reaching agreements with
24 Hunt Oil Company and First Roswell on similar terms?

25 A. Yes, I was.

1 Q. All right. With the exception of Mr. Landreth,
2 then, you have had other people accept these terms and
3 conditions?

4 A. Yes, exactly as they're stated in the letter.

5 Q. All right. Mr. Landreth received the letter as
6 indicated by the documents, and then we go to the next bit
7 of correspondence of August 20th. Prior to August 20th,
8 describe for us what if any contacts you had with Mr.
9 Landreth or employees under his direction and control?

10 A. On July 14th, the date of the proposal letter,
11 before sending it out by fax or mail, I called all the
12 parties, including Robert Landreth's office. When I called
13 Mr. Landreth's office I was advised by Scott Tanberg, his
14 geologist, that Mr. Landreth was then on vacation, but Mr.
15 Tanberg assured me that if I faxed him our proposal, he
16 would in turn fax it to where Mr. Landreth was in order to
17 get the process started.

18 I did mail it and fax it at that point, and on
19 August 4th I called his office, Mr. Landreth's office, to
20 determine if Mr. Landreth had gotten our letter and was, in
21 fact, back from his vacation, available to discuss it

22 I was told that he would be in at two o'clock
23 that day and would call me back. And he did.

24 And in that August 4th conversation, Mr. Landreth
25 informed me that it was his preference to -- rather than

1 accept our farmout proposal, to -- he proposed a rather
2 nonstandard agreement, which would allow him to participate
3 for one-fourth of his working interest and farm out the
4 remaining three-fourths. And in addition to that, he
5 wanted a 30-percent back-in instead of a 25-percent back-
6 in. And he also wanted to convert only a portion of his --
7 of record override in exchange for the back-in.

8 Q. Let's summarize those two points again, Mr.
9 Smith. Are the differences in those two items --

10 A. Yes.

11 Q. -- of significance to you in trying to put
12 together deals like this?

13 A. The two items I guess you're pointing out are the
14 increased back-in and converting only a portion --

15 Q. Yes.

16 A. -- of the override?

17 Q. And then splitting the interest between a
18 participating percentage and an override percentage?

19 A. The increased back-in, of course, in a well of
20 this depth, is burdensome. It just wreaks havoc on
21 economics, the more you have to allow someone after payout,
22 just really does wreak havoc. Of course, also allowing him
23 to only convert a portion of his override also affects the
24 profitability of the person who's taking the risk.

25 Q. Let's put some specifics to that conclusion. As

1 a result of this proposal, should you accept it, then Mr.
2 Landreth's net revenue interest, the portion at which he
3 actually calculates his share of the cost, is reduced to
4 less than is usually accepted by companies such as yours?

5 A. That's correct.

6 Q. So that's an issue?

7 A. Absolutely.

8 Q. Let's go to the second issue and have you
9 articulate the reasons for that one.

10 If you approach a company that has a working
11 interest, the proposal is that they participate with that
12 full interest or not?

13 A. Right.

14 Q. Mr. Landreth has proposed to take that working
15 interest and to divide it so that part of it is cost-
16 bearing and part is not?

17 A. Correct.

18 Q. Okay, that is also unusual?

19 A. I've never done it anywhere else in my entire
20 career.

21 Q. Okay. He has described that to you in an oral
22 conversation on August 4th. Is that same proposal set
23 forth in this letter of August 20th, Exhibit 5?

24 A. Yes, it is. It's a reiteration of what he
25 explained to me his position was and what he was seeking.

1 Q. On August 4th, did you advise Mr. Landreth that
2 you did not have authority from Santa Fe to concede to his
3 special terms?

4 A. And I also indicated that I didn't have a great
5 deal of hope of being able to obtain management approval
6 for such a trade.

7 Q. All right, you get the letter on August 20th, and
8 then what happens?

9 A. On August 20th, again, he's basically simply
10 reiterated his position, and we had also spoken the day
11 before he mailed this letter to us. Basically, I had at
12 that time again explained to him that that deal was simply
13 not one I could take to management, because it just wasn't
14 acceptable.

15 And at that point, I guess, is when we decided to
16 get on the docket.

17 Q. The pooling case was filed on August 25th, and
18 Mr. Landreth was served with the pooling Application on
19 August 27th. What happened after that?

20 A. On August 28th, I mailed him a letter, and faxed
21 him a letter, as your Exhibit 6, when I again explained to
22 him that his proposed farmout was, in our opinion,
23 excessive in light of the risk, and reminded him again that
24 we had already struck a trade with Hunt Oil Company, based
25 upon the very terms that I had originally proposed, and had

1 also struck a trade with First Roswell Company on the
2 second option that I had proposed -- in essence, we took a
3 term assignment from them on the same terms that we had
4 proposed in the original letter. And I just reminded him
5 that in an effort, I would be glad to work with him along
6 those lines of either option, we would work out a farmout
7 or take his interest under the same terms that we have
8 already agreed to with these other parties.

9 Q. What then happens, Mr. Smith?

10 A. On August the same date, he faxed -- or he pens a
11 letter that I received by fax on the 31st that is a lengthy
12 letter. He, in essence, at the very end of it, tells me
13 what his absolute bottom-line position is on the trade.

14 Q. All right, at this -- Within the context of the
15 August 28th letter, then, he modifies his proposal from
16 that originally proposed to you?

17 A. That's correct.

18 Q. What has he now requested?

19 A. He has -- He's standing firm on his desire to
20 participate for a fourth of his interest and farm out
21 three-fourths and again only convert a part of his
22 override, although -- I'll be honest -- at this point he's
23 made it clear that this override has been somewhat
24 contractually obligated to Mr. Tanberg, and therefore it's
25 not available to be discussed or converted.

1 Q. Mr. Tanberg is Mr. Landreth's geologist?

2 A. That's correct.

3 Q. And he has advised you that he wants that man to
4 be carved out a five-percent override?

5 A. It's a two percent of eight-eighths, against the
6 interest of Mr. Landreth.

7 Q. All right. So what is the difference between
8 this proposal and the earlier one?

9 A. He's in essence just come down to accepting a 25-
10 percent back-in, as opposed to a 30-percent back-in.

11 Q. All right. What then happened?

12 A. I feel like, in light of the desire to move
13 forward and compromise, that this was a trade that I could
14 take to management and propose, and -- do so, and as part
15 of that process I have to have economics run. I have to
16 test this proposed trade for the sensitivity as it would
17 apply to the profitability of drilling the well in light of
18 the risk, and that takes a little bit of time. Again, I
19 received this from Mr. Landreth on August 31st, and I had
20 run the traps to get the approval of management to do the
21 trade.

22 Q. What's your next communication, then, with Mr.
23 Landreth?

24 A. On --

25 Q. On September 9th, then, Exhibit Number 8, you

1 are --

2 A. That's correct --

3 Q. -- advising him what?

4 A. -- by letter, September 9th -- I send Mr.

5 Landreth a letter formally advising him that we will accept
6 the trade he has proposed and that I will begin preparation
7 of the formal agreements as quickly as I can get them to
8 him.

9 Q. All right. At this point, then, you believe
10 you've got a solution with Mr. Landreth?

11 A. Yes, I do, because this type of trade has been
12 done with him once before, and I had a document that Mr.
13 Landreth had signed that I felt could be easily manipulated
14 and put before him so that it could be executable upon
15 arrival.

16 Q. There would be a farmout similar to one he's
17 already signed --

18 A. That's correct.

19 Q. -- that you could edit to fit the particulars of
20 this transaction?

21 A. Correct.

22 Q. In addition, he was a participant in a joint
23 operating agreement as to his other interest, which he was
24 already --

25 A. Exactly.

1 Q. -- participating under?

2 A. That's correct.

3 Q. So you had existing documents in which he was a
4 party --

5 A. That's correct.

6 Q. -- that you thought you could edit?

7 A. Just easily edit to fit this situation, comply
8 with all of the requests that he had in his letter where he
9 informed us he would do the trade, and we tediously, with
10 great effort, went to great lengths to make sure that
11 document fit exactly what he said he would do.

12 And we got it to him -- I faxed the farmout
13 agreement to him on Monday morning, the 14th. I worked all
14 weekend to get it prepared. And I hand-carried the JOA to
15 him later in the day when it was finally prepared, on
16 Monday the 14th.

17 Q. Mr. Smith, I show you what's marked as Exhibit 15
18 and ask you if you can identify this document.

19 A. This is the operating agreement that I had
20 prepared for submittal to Mr. Landreth. It is a 1982 model
21 form, AAPL standard agreement, that has been modified along
22 the same lines that it had been modified in the previous
23 agreement that Mr. Landreth had signed.

24 Q. On Monday, the -- September 14th, on Exhibit 9,
25 then, you have forwarded to him the farmout?

1 A. Right.

2 Q. In addition, you've hand-carried over a copy of
3 the operating agreement?

4 A. That day, correct.

5 Q. And then Exhibit 10 is Mr. Landreth's response to
6 you also on September 14th, where he has reviewed the
7 proposed farmout, and now he is suggesting further changes
8 in the deal?

9 A. That's correct.

10 Q. All right. What then happens and what do you do?

11 A. Well, I review his proposed changes, get a -- In
12 an effort to compromise and move forward I got a -- I
13 really didn't need management approval to do any of the
14 changes, but all of the proposed changes he asked for were
15 acceptable to us, except for item 5 on the last page of his
16 letter.

17 Q. What is he now asking you to concede to in his
18 counterproposal?

19 A. Well, in essence, he's asking us to guarantee him
20 that we will market his production for him, in all
21 instances.

22 Q. Is that an unusual request?

23 A. It is, again, yes. I've never -- It's not
24 standard and the operating agreement which normally
25 controls these matters clearly allows the operator to sell

1 production not taken in kind by nonoperators, but it
2 clearly states that it is not an obligation of the operator
3 to do so.

4 Q. In your opinion, was this a substantial change in
5 structure of the transaction that required further
6 management approval --

7 A. Absolutely.

8 Q. -- beyond your level?

9 A. I could not grant that one without --

10 Q. What then happens?

11 A. I went after approval to get to do -- at least
12 try to accommodate Mr. Landreth on item 4, and was allowed
13 to tell Mr. Landreth in writing, or express to him, that we
14 would, as I stated in this fax which is Exhibit 11, we
15 would be willing to make our best efforts to market his gas
16 for him, but in the event there was any contractual reason
17 for us not to, then we would be free to not market his gas.
18 We can't guarantee him that we would do it in every
19 situation.

20 Q. What happens then, Mr. Smith?

21 A. In that same fax, I have -- I modified the
22 farmout agreement again, giving him word for word all the
23 changes he requested and sent it over to him for his
24 approval. A copy of that farmout is also included in your
25 exhibit.

1 Q. All right. When we turn past the document, the
2 revised farmout that you've edited to comply with his
3 latest changes, on September 15th, and he responds yet
4 again to the proposed amended farmout agreement --

5 A. That's correct.

6 Q. -- what does he ask you to do now?

7 A. Well, as it starts off, after a second reading of
8 the contract, he now wants to make more changes to the
9 agreement.

10 Q. When we look at the most important change he's
11 proposing now to you, which one is that?

12 A. Well, the second one, item II in his letter, is
13 something that Santa Fe is not willing to do. And in
14 essence, what that provision says is that if the net
15 proceeds from the production from the well ever drop below
16 300 percent of the overhead rates, then it allows Mr.
17 Landreth to step in and take over the well.

18 Q. He would then become the operator of the well, in
19 the event the economics shifted and the cost level was not
20 achieved?

21 A. That's correct.

22 Q. All right. Was that acceptable to Santa Fe?

23 A. It was not.

24 Q. What happens then?

25 A. At this point Mr. Landreth and I speak again for

1 the first time in an extended period. He called --

2 Q. Prior to that, he had asked you not to talk to
3 him in person --

4 A. That's correct.

5 Q. -- but to communicate in writing?

6 A. He wanted all correspondence negotiations to be
7 in writing. At his request I followed through.

8 He called me and we began discussing civilly the
9 situation, and I explained to him that we were willing to
10 give him item I, this takeover -- the well-takeover
11 provision, which, in essence, in the event we drilled the
12 first well as a dry hole and wanted to P and A the well as
13 a dry hole, he would have the right to step in and take
14 over the well if he wanted to. That's fairly standard,
15 where you have working interest owners of the size,
16 relative size, that we were, and I had no problem with
17 that.

18 Q. That's the first provision on a takeover for a
19 dryhole issue, but not the second provision?

20 A. The second provision, I made it abundantly clear
21 that that was something that I was not even willing to go
22 to management with; that is a totally unacceptable change,
23 and I was unwilling to do it.

24 There are items III and IV in this letter of his,
25 which I also have now obtained management approval,

1 subsequent to my conversation with him, to grant. We will
2 modify our gas-balancing agreement exactly as he requests,
3 and we will give him item IV in his letter as well. Again,
4 in essence, we will acquiesce to all his requirements,
5 required changes, except for item II in his letter.

6 Q. Within the last paragraph of his letter of
7 September 5th, he expressed concern about having sufficient
8 time to study the operating agreement.

9 A. Right.

10 Q. Have you been advised about his position
11 concerning the details of the operating agreement?

12 A. He has -- we -- In the conversation that I had
13 with him on Wednesday, he by that point had had time -- or
14 maybe it was Thursday morning -- he had by that time, had
15 spoken to his attorney, and there were two minor changes to
16 the model form operating agreement, in the Article XV --

17 Q. All right, this had to be Wednesday, Mr. Smith --

18 A. It was --

19 Q. -- today's Thursday.

20 A. -- Wednesday. Excuse me, it was Wed- -- it might
21 have -- Well, it was Wednesday.

22 Q. All right.

23 A. Two minor changes to the Article XV in the
24 operating agreement. I have acquiesced to one of those.
25 The other one expands the scope of the legal relationship

1 of the parties, and I have to have that question approved
2 by our attorneys and approved before I can grant it.

3 Q. Finally, when we turn to the conclusions to the
4 efforts at this point, there is a letter dated September
5 16th, Exhibit 13. Now, what does this represent?

6 A. Well, again, we'll go back to his request to make
7 Santa Fe be obligated to market their gas. He faxed me a
8 letter, which is Exhibit 14, where Santa Fe had previously,
9 on a limited basis, agreed to market his gas, and he
10 requested that we include -- now include this language,
11 modified but -- modify the language in this letter to fit
12 the farmout agreement, and again thereby obligating us to
13 market his gas for him on a limited basis.

14 And again, I had to have that proposal reviewed
15 and approved by management before I could give it to him.
16 And I have since talked with our gas marketing people, and
17 we will be willing to work around and include most of the
18 language that's in this letter, in our farmout with Mr.
19 Landreth, and it is acceptable to us, but we've still got
20 some negotiating about how this letter will be incorporated
21 in the farmout.

22 Q. Mr. Smith, why are you seeking a compulsory
23 pooling order in this case at this point in the
24 negotiations and transactions?

25 A. Well, again, as has been stated, we have an

1 absolute drop-dead date to spud this well by November 18th.

2 We also -- Because of the risk associated with
3 this well, we'll sell it down, we will find a partner to
4 join in with us. We have several people waiting in the
5 wings to show it to, but I can't really present them with
6 an opportunity to get in the well until I know what I have
7 to sell.

8 So basically, we need an order to make sure that
9 if -- I don't find myself in a situation where I get
10 another letter from Mr. Landreth that says upon the third
11 or fourth or fifth reading of this letter I now want this
12 change to the farmout agreement.

13 I would stress that -- I started from a document
14 that Mr. Landreth had already signed, and manipulated it
15 only to fit his demand letter. I feel like we have bent
16 over backwards to accommodate Mr. Landreth, and I really
17 need this as an insurance policy to make sure that we can
18 get this well drilled before our November 18th drop-dead
19 date.

20 I will also say that I have assured Mr. Landreth
21 that everything that we have discussed and negotiated with
22 him that's on the table right now will remain on the table,
23 and that I will be glad to meet with him Monday morning and
24 finalize the trade based upon what we have in front of us.

25 Q. Your concern, then, is what, sir?

1 A. Again, that I will reach an agreement with him
2 verbally as to certain changes, and then I'll get another
3 letter that says upon a third or fourth reading of this
4 document, I now want this, this included in the farmout.
5 We can't continue under that scenario and have time to get
6 the well drilled and seek an interested partner. We've got
7 to move forward.

8 Q. Let me ask you to identify Exhibit 16, insofar as
9 you can authenticate the correctness of the parties that
10 were notified of this Application.

11 A. Okay. This is Mr. Kellahin's notice of the
12 hearing and certified return receipt. Copies on the back
13 are representative of all the parties who would have been
14 notified of this hearing.

15 MR. KELLAHIN: Mr. Examiner, that concludes my
16 examination of Mr. Smith. We move the introduction of
17 Santa Fe's Exhibits 1 through 16.

18 EXAMINER ASHLEY: Exhibits 1 through 16 will be
19 admitted as evidence at this time.

20 Mr. Owen, do you have any questions?

21 MR. OWEN: Just a couple.

22 EXAMINATION

23 BY MR. OWEN:

24 Q. Mr. Smith, the letter of September 16th, 1998,
25 near the back of the packet, marked Exhibit Number 13, is

1 it your testimony that the terms contained in that letter
2 are acceptable to Santa Fe?

3 A. Not without further review and approval of the
4 letter which Mr. Landreth is asking to be modified.

5 Q. And is the letter that Mr. Landreth is asking to
6 be modified attached as Exhibit Number 14?

7 A. That's correct.

8 Q. And I think you testified that you're willing
9 to -- Santa Fe is willing to include most of the language
10 of the letter; is that right?

11 A. Well, I have our energy-marketing people looking
12 at -- When I left, and I had to leave mid-day yesterday, I
13 faxed our energy-marketing people this September 16th
14 letter, Exhibit 13, and asked them to review this in light
15 of his previous request to include it, and try to come up
16 with a compromise position.

17 So my statement is that we are willing to work
18 with him to include the intent of what he's -- largely what
19 he's after. But it still needs to be reviewed and approved
20 so that it will fit into the context of the farmout and the
21 situation at hand, because the letter applies to another
22 situation.

23 Q. So it's possible that Santa Fe may have a
24 counterproposal in terms of different language, or
25 different provisions?

1 A. It is possible that in order to make it fit into
2 the context of the situation, we will need to modify the
3 language, that's correct.

4 Q. Okay. I want to backtrack a little bit. Let's
5 go to your letter of September 15th, addressed to Mr.
6 Landreth.

7 A. Exhibit -- ?

8 Q. It does not have -- Exhibit Number 11.

9 A. The faxed letter, that's correct, yes.

10 Q. In that letter, you state that Santa Fe has
11 accepted most of the terms proposed by Mr. Landreth, but
12 not all, correct?

13 A. Well, we -- All the provisions in his September
14 -- except for the language in item 4, which is his
15 requirement that we market his share of gas.

16 Q. Okay.

17 A. And then I go on to say in that letter that we
18 would make our best efforts, but if there was a reason
19 contractually why we could not market his share, we would
20 be free not to.

21 Q. Okay. Now, let's backtrack a couple more to
22 Exhibit Number 8, which is your letter of September 9th to
23 Mr. Landreth.

24 A. That's correct.

25 Q. In that letter you state that it appears that

1 you've reached an agreement, but you had not yet prepared
2 the specific terms of the farmout or the JOA --

3 A. That's correct.

4 Q. -- is that right?

5 A. In essence, I was informing him that I had at
6 that point in time received management approval and was
7 informing him that we would accept his terms, and that I
8 would begin preparation --

9 Q. But the specific language of the JOA and the
10 farmout had not been --

11 A. That's correct.

12 Q. -- agreed upon by the parties?

13 A. We -- I was speaking in terms of accepting the
14 trade as he had outlined in his letter.

15 MR. OWEN: Okay. That's all the questions I have
16 at this time, Mr. Examiner.

17 EXAMINATION

18 BY EXAMINER ASHLEY:

19 Q. Mr. Smith, there was several items that you had
20 mentioned, in your words, as something that you hadn't seen
21 before, that were very out of the ordinary in this
22 agreement. Could you summarize those again for me? One of
23 them was, in Exhibit 10, Number 5.

24 A. That would be the requirement for a company to
25 market someone else's production.

1 I came to work for Santa Fe in January of this
2 year. My previous experience has been in this area with
3 another company. I personally have never granted anyone a
4 guarantee, in any agreement I've ever had anything to do
5 with, that the company, the operator, would guarantee to
6 market someone else's share of production. There can be
7 many reasons why that guarantee would rear its ugly head on
8 you.

9 If, let's say -- I can think of one instance from
10 my past where the company I worked for had the ability to
11 extract an exceptionally good price on gas because of a
12 contract settlement elsewhere, and in that settlement it
13 was made clear that the contents of the settlement and the
14 price you were to receive would be made known to no one
15 else. It was private between the parties. And in that
16 scenario, I couldn't guarantee to market anyone else's gas
17 under that contract, because that contract is exclusive
18 between me and the seller, or the purchaser.

19 That's just one example of why that can't -- that
20 provision really cannot be a guarantee.

21 Q. Okay. Another one that I made a note of was
22 Exhibit 12, Number 2.

23 A. That is the request on his part that in the event
24 the production -- net revenue, or the revenues from
25 production, should ever drop below 300 percent of the

1 overhead rate, it gives any nonoperator the right to step
2 in and take over the well as operator. That's another one
3 that I have never had any -- never seen, never -- and I'm
4 not going to be the first to grant something like that.

5 Q. And there was another circumstance that you
6 mentioned earlier about -- I can't remember exactly what it
7 was -- him wanting to farm out part of his --

8 A. Yes, the --

9 Q. Can you explain that again?

10 A. Well, again, every farmout I've ever had anything
11 to do with, when you reach an agreement to farm out, the
12 party delivers to you the entirety of their interest within
13 the proposed proration unit, retains an override, agreed
14 to, with the right to convert that override at payout to a
15 working interest.

16 In this situation, Mr. Landreth wants to be able
17 to participate for a portion of his interest under the JOA,
18 pay his share and then, as to the other portion, farm out.
19 It simply makes it the dynamics of the subsequent wells.

20 If you had to drill under the continuous-
21 development provision under the farmout, you have a
22 situation where he can nonconsent you on your well proposal
23 under the JOA and still have a back-in under the farmout,
24 carrying a big override throughout, or -- and he can do
25 that on a well-by-well basis.

1 I mean, it creates a situation where he can -- he
2 has an exceptionally good net revenue going in to start
3 with, because he has not only a cost-bearing interest for
4 the part that he is participating for, he has an override
5 off of his farmout position. So he has -- It's a very nice
6 trade for him, let's just say that.

7 Q. Can you state for me which exhibit that proposal
8 was?

9 A. His first response letter, being Exhibit -- the
10 August 20th letter, Exhibit 5, is the first written
11 correspondence evidencing, I believe, his desire to
12 participate for a portion and farm out a portion.

13 Q. Okay. One other question I have is, I'm still a
14 little bit confused about this prospect designation in
15 Exhibit 1 --

16 A. Okay --

17 Q. -- and how Amoco is involved in this.

18 A. Okay, the reason that -- Our urgency to drill
19 this well is born out of this -- the acreage within the
20 green outline, and that -- If you look at Exhibit 3, prior
21 to proposing this well to anyone else, Santa Fe, under a
22 previously-existing exploration agreement, had to designate
23 this prospect to Altura in order to receive their
24 blessings.

25 And if they blessed it, then we earned their

1 interest in the orange acreage shown on the plat. And we
2 at least earned an equitable interest in it. In order to
3 get record title to it, we must drill the well by November
4 18th, 1998. And in doing so, we will then have a
5 recordable interest in that tract and also have the right
6 to earn the balance of Altura's acreage in that tract by
7 drilling a subsequent well.

8 So we could, in essence, end up owning all of
9 that acreage in orange by drilling wells.

10 EXAMINATION

11 BY EXAMINER CATANACH:

12 Q. Mr. Smith, you would have to -- Would that
13 involve drilling a well in the south half of Section 4?

14 A. To earn the other half. By drilling the well
15 in -- the first well, we will get a 50-percent interest in
16 that tract.

17 If we propose -- The next step would be to
18 propose a second well, if we chose to, within the
19 designated prospect, and if Amoco elected not to
20 participate in it, we would then earn the balance of their
21 acreage. And that's how that exploration agreement, or the
22 dynamics within it worked.

23 Q. The south half of the northwest quarter, that is
24 owned by Santa Fe --

25 A. That is correct.

1 Q. -- and that is not a part of the Amoco lease?

2 A. That is correct, we own that -- the operating
3 rights, by assignment.

4 Q. With respect to a 320-acre north-half proration
5 unit, can you outline the percentage ownership for us?

6 A. In tract 1, that tract is owned of record, 50
7 percent Hunt Oil Company and 50 percent Robert Landreth, as
8 shown on Exhibit 2. The interest of Hunt is now subject to
9 an executed farmout agreement between Hunt and Santa Fe
10 that requires that we commence a well, again -- another
11 drop-dead date of November 30th of this year.

12 And again, we also have an option. The farmout
13 from Hunt gives us the right to drill a well in the
14 southwest quarter. So we have tied Hunt's interest up in
15 both the northeast and the southwest under the farmout.

16 Q. Okay, with regards to the north half, does
17 Landreth essentially own 50 percent of the north-half
18 dedication?

19 A. And he does by virtue of having half interest in
20 tract 1 and 100 percent in tract 2.

21 Q. And Hunt would own the other 25 percent?

22 A. In the proration unit.

23 Q. Right.

24 A. But they have farmed that out to Santa Fe.

25 Q. And you own 25 percent?

1 A. That's correct.

2 Q. Mr. Smith, it appears that your negotiations have
3 reached a -- somewhat of a critical point. What is your
4 opinion on whether or not the issuance of a force-pooling
5 order is going to give Santa Fe an advantage in these
6 negotiations?

7 A. I have -- Well, again, I want to point out that
8 we started with an agreement Mr. Landreth had already
9 signed, and modified it only to fit the situation here,
10 with an operating agreement attached that he had already
11 signed.

12 I feel like we have accepted, in the interest of
13 compromise and moving forward, the vast majority of Mr.
14 Landreth's changes to a document he's already agreed to in
15 the past.

16 I have assured Mr. Landreth before I left at nine
17 o'clock yesterday, that I would leave all the issues -- I
18 mean, what we've agreed to, to that point, is going to be
19 good Monday morning. If we can reach an agreement on what
20 we have before us, we will gladly enter into that farmout
21 agreement. It behooves us from the standpoint that when
22 you go to sell down to a partner, it's better to have a
23 farmout than a force-pooling order. So we desire to enter
24 into a farmout with Mr. Landreth.

25 Our concern is that he has established a pattern

1 of sending me a letter that says, Upon a second or third or
2 fourth reading, I now want this change. I want to preclude
3 -- or have the option to move forward under an order if he
4 wants any changes beyond what we've talked about and what
5 was submitted as evidence.

6 Q. So you fully intend to continue negotiations?

7 A. Absolutely. I've told Mr. Landreth that I've got
8 -- I'm committed for Friday, I can't work with him then,
9 but Monday morning I'm -- at his convenience will sit down
10 and begin work again to get this resolved.

11 MR. CARROLL: Yeah, I have a couple questions.

12 EXAMINATION

13 BY MR. CARROLL:

14 Q. So it appears in this proration unit you both
15 control 50 percent?

16 A. Well, because of the correction section, he has a
17 50.3, and we have 49.7.

18 Q. And then state again, please, the terms proposed
19 by Landreth that Santa Fe won't agree to.

20 A. In his original October 20th letter, he proposed
21 to again farm out only a portion of his interest.

22 Q. And you won't agree to that?

23 A. We have.

24 Q. Okay.

25 A. We've accepted that part of his requirement.

1 Q. And then his right to take over the well if the
2 overhead rate --

3 A. We'll do that. There's a provision in there that
4 he wants us to be responsible for cleaning up the surface
5 after he takes over the well, and I've told Mr. Landreth
6 that if you take over the well, you take over the well. We
7 won't -- You're going to be responsible for that well if
8 you take it over. So that part of that provision is not
9 available to him.

10 Q. But besides the surface cleanup --

11 A. He'll have that provision, we'll strike one
12 sentence.

13 Q. Okay, and then the duty to market --

14 MR. KELLAHIN: No, I think it's -- Excuse me, Mr.
15 Carroll. I'm not sure you're answering the question. Mr.
16 Carroll was asking you about losing control of the well if
17 the operating costs --

18 THE WITNESS: Oh, we're talking two different --

19 MR. KELLAHIN: Yes, sir.

20 MR. CARROLL: Right.

21 THE WITNESS: That -- The 300 percent, no, we
22 will not do that.

23 MR. CARROLL: Okay, that's what I thought.

24 THE WITNESS: And in his last letter to me, he
25 has agreed to drop that demand in exchange for the

1 inclusion of some language where we will agree to market
2 his gas.

3 Q. (By Mr. Carroll) So that's the only provision
4 that you're in disagreement?

5 A. At this point I do -- still do not have, and I've
6 told Mr. Landreth, the authority to modify the Article XV
7 to the JOA to expand the legal relationship between the
8 parties. And so that issue has still not been resolved.

9 And the issue of modifying this letter, the last
10 exhibit in the pack -- the last stapled exhibit, being
11 Exhibit 14, I've not gotten -- we do not have a workable
12 modification of that letter to insert in the farmout. In
13 principle, we will work him along the lines that are
14 contained in that letter.

15 MR. CARROLL: Okay, that's all I have.

16 EXAMINER ASHLEY: I have no further questions.

17 FURTHER EXAMINATION

18 BY MR. KELLAHIN:

19 Q. One point of clarification, Mr. Smith. When we
20 look at Exhibit 1, there is a necessity to have a
21 compulsory pooling order for all the 320 gas-spacing units?

22 A. That's correct.

23 Q. And in the event there is shallow gas production,
24 you'll need a pooling order for 160 acres?

25 A. That's correct.

1 Q. But you have consolidated a tract that would be
2 voluntary for a 40-acre oil well?

3 A. That is also correct.

4 MR. KELLAHIN: All right. Mr. Examiner, we could
5 delete that portion of the pooling Application that asks
6 for 40-acre pooling, because that has been consolidated.

7 EXAMINER ASHLEY: Okay.

8 EXAMINER CATANACH: Is that all, Tom?

9 MR. KELLAHIN: Yes.

10 MR. OWEN: I do have a couple of additional
11 questions.

12 EXAMINER ASHLEY: Okay.

13 FURTHER EXAMINATION

14 BY MR. OWEN:

15 Q. Mr. Smith, it's your position that your close to
16 an agreement with Mr. Landreth; is that --

17 A. I feel fairly -- Yeah, I really feel, to be
18 honest with you, that we will probably be able to work
19 something out.

20 Q. And your perception is, the only barrier to that
21 agreement is that Mr. Landreth makes second and third
22 readings of the farmout agreement and the JOA and adds --

23 A. Comes up with new, heretofore not discussed,
24 additional changes.

25 Q. Okay. Now, you started with a farmout and a JOA

1 that he had previously signed, right?

2 A. That's correct.

3 Q. On another prospect --

4 A. Very --

5 Q. -- that did not contain the terms that are the
6 specific --

7 A. Yes.

8 Q. -- issues in these -- in this --

9 A. Truly, the only difference in this one and that
10 one is, in the previous, he had a single consolidated
11 interest that had one flat net revenue, meaning he had one
12 lease in the proration unit that had a standard -- In this
13 one he has two leases with varying net revenues that
14 necessitated modifying the agreement to what happens if you
15 drill a Morrow well, you complete in the Delaware, and you
16 must then start developing on 40-acre proration units?
17 That had to be modified.

18 Q. Okay.

19 A. Other than that, it was the same agreement that
20 he signed --

21 Q. Was that the farmout? Santa Fe was a party to
22 that farmout; is that right?

23 A. We were the operator that proposed the well.

24 Q. Okay. And in that farmout, Mr. Landreth did have
25 the provision where he participated with a portion of his

1 interest and did not with another; is that --

2 A. That's not an issue that's even argued anymore.

3 Q. But that was an issue that Santa Fe had been
4 confronted with before, right?

5 A. Prior to me arriving at Santa Fe.

6 Q. Okay. Now, the first time that you provided this
7 specific farmout agreement --

8 A. That's correct.

9 Q. -- to Mr. Landreth was on the 14th of September?

10 A. That is correct.

11 Q. And he responded to that within a day; is that
12 right?

13 A. With changes, that's correct.

14 Q. Okay, with changes, but that was just three days
15 ago; is that right?

16 A. That's correct, I'm not -- The time --

17 Q. All right.

18 A. -- line speaks for itself.

19 Q. Sure. And the first time you provided the JOA
20 was on the 14th?

21 A. The same day that I got --

22 Q. And he's had a total a three days to review that?

23 A. That's correct.

24 Q. And you all have negotiated significantly since
25 that point?

1 A. Marathon, until late in the evenings.

2 Q. And that's marathon negotiating on both Mr.
3 Landreth's part --

4 A. That's absolutely correct --

5 Q. -- and your part; is that correct?

6 A. -- we are -- we are both working towards a
7 compromise settlement, and I will acknowledge that, and I
8 feel like we can get there.

9 Q. But these second and third readings of the
10 farmout and the JOA that you're talking about have all
11 occurred in three days; is that right?

12 A. Yes, but I will -- again, it's a -- I'll point
13 out that these are documents that he has been a party to in
14 the past, that I didn't submit to him in an instrument that
15 he was not already knowledgeable of.

16 Q. But the terms that we're talking about are terms
17 that are specific to this agreement, right?

18 A. I don't think that there's significantly
19 difference in the scenario. The farmout is in essence the
20 same. He's participating for farming out a part. The only
21 difference is that he has different net revenues in the
22 contract, and we had to modify the agreement to accommodate
23 that situation.

24 Q. And the other differences are the specific
25 provisions about which you still have disagreement; is that

1 right?

2 A. Which were not included in the previous agreement
3 that he had signed.

4 Q. Sure. So the previous agreement that he signed
5 did not contain the provisions that you're currently --

6 A. That he --

7 Q. -- negotiating; is that correct?

8 A. That's correct.

9 Q. Okay. And so you're negotiating over provisions
10 which you have inserted --

11 A. I've agreed --

12 Q. -- and which -- and which both of you have had a
13 total of three days to review and negotiate over, right?

14 A. Correct.

15 MR. OWEN: Okay, that's all I have.

16 EXAMINER ASHLEY: The witness may be excused at
17 this time.

18 THOMAS J. TINNEY, III,

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

21 DIRECT EXAMINATION

22 BY MR. KELLAHIN:

23 Q. Mr. Winfree, would you please state your name and
24 occupation?

25 A. Tinney.

1 Q. I'm sorry. All right, I'm already --

2 A. That's close.

3 Q. -- on the next case. All right.

4 A. I'm sure they wish you were too.

5 MR. KELLAHIN: Mr. Examiner, this is Tom Tinney.
6 He's a geologist with Santa Fe.

7 THE WITNESS: Yes, Thomas Jordan Tinney, III.

8 Q. (By Mr. Kellahin) Mr. Tinney, on prior occasions
9 have you testified as a petroleum geologist before the
10 Division?

11 A. Yes, I have.

12 Q. In fact, you have participated in examining
13 geology to focus in on the topic of the appropriate risk-
14 factor penalty to apply in a compulsory-pooling case for
15 deep gas formations?

16 A. That's correct.

17 Q. Pursuant to your employment in that capacity,
18 have you prepared a geologic presentation to focus in on
19 that particular issue?

20 A. I have.

21 Q. And based upon that study, have you reached
22 conclusions and recommendations for the Examiner concerning
23 a risk-factor penalty?

24 A. Yes, sir.

25 MR. KELLAHIN: Mr. Examiner, we tender Mr. Tinney

1 as an expert petroleum geologist.

2 EXAMINER ASHLEY: Mr. Tinney is so qualified.

3 Q. (By Mr. Kellahin) Mr. Tinney, based upon your
4 study, your conclusion is what concerning a risk-factor
5 penalty?

6 A. We conclude that the -- with the depth of the
7 formation here and the depositional environments that are
8 involved, with the primary objective of the Morrow, that we
9 seek 200 percent penalty.

10 Q. Before we look at the Exhibits, can you give us a
11 short summary of the type of Morrow prospect that's
12 involved in this well location?

13 A. Yes, I can. The primary objective for this well
14 is the Grama Ridge "A" sand. It's deposited in a fluvial-
15 deltaic system. It's a series of thin, discontinuous sands
16 that prograde to the south.

17 Also, we feel prospective, is an additional
18 Morrow, what we call middle Morrow "C" sand, which is more
19 of a fluvial channel system that trends north-south through
20 the prospect but is relatively thin and what we consider a
21 narrow system.

22 In addition to the risk of just finding the sand,
23 we feel like there's a structural risk involved which adds
24 to the risk of the overall prospect.

25 Q. When we look at the various potential intervals

1 to be penetrated or accessed with this wellbore, the
2 greatest opportunity, in your opinion, is in what
3 formation?

4 A. In the Morrow.

5 Q. And that's the presentation you're about to give?

6 A. That's correct.

7 Q. If there is an opportunity in a shallower
8 formation uphole, does that present a greater or a lesser
9 degree of risk than the Morrow?

10 A. We feel like that there's really a greater risk
11 of -- in any shallower formations, there are -- there is
12 production out of shallower formations in the area, but to
13 date there hasn't been any significant accumulations of
14 hydrocarbons in any of these formations, and it's more just
15 the serendipity of southeast New Mexico that plays a factor
16 in finding them.

17 Q. Does your conclusion, then, about a 200-percent
18 risk-factor penalty, apply to all the gas formations?

19 A. That's correct.

20 Q. Let's look specifically at how you have defined
21 the nomenclature of the Morrow you're targeting. And to
22 help us illustrate that to the Examiner, would you turn to
23 Exhibit Number 17 and identify that for us?

24 A. Yes, Exhibit 17 is a type log, a well to the
25 north, about two miles to the north. It's the Gaucho Unit

1 Number 1. It's a producing well out of the Grama Ridge "A"
2 sand. You can see the perforations marked. The sand is
3 colored in yellow, the porosity is in red.

4 Q. Before you leave the Grama Ridge "A" sand, you
5 can find it on this type log, right?

6 A. Yes, it's -- I'm sorry, it's a depth of 12,954,
7 and it's clearly marked on the type log.

8 Q. As you find that same interval in other logs that
9 you use for correlation purposes and attempt to assimilate
10 them into an isopach map, are we looking at one continuous
11 sand member when you map that interval, or is it made up of
12 a multiplicity of layers?

13 A. As I mentioned previously, we feel like this is a
14 series of discontinuous sands, and the next exhibit,
15 Exhibit 18, is a map that is a -- basically a composite map
16 where we've just added all the sands within that interval,
17 and those thicknesses are shown on that map.

18 So you get a sense that the target maybe has a
19 wider fairway, but in essence, when you're dealing with the
20 sands deposited in this type of depositional system, the
21 risk factor involved trying to find not only one sand, or
22 sometimes in cases we find two sands stacked together,
23 almost on top of each other, but there is a risk that you
24 may not even find the sand at all.

25 Q. Mr. Tinney, let's set the type log aside for a

1 moment and keep it as a reference point, and have you go
2 specifically, then, to Exhibit 18, which you have
3 summarized for us. When we look at that display, the
4 opportunity for refining your interpretation is limited by
5 the sparse nature of the well control, is it not?

6 A. That's correct. This well is two miles from any
7 known production out of this interval, and the control --
8 the nearest control would be in the North Bell Lake Unit,
9 which is to the west there.

10 Q. There are Morrow gas wells up to the northwest,
11 some -- what? Two miles or more away?

12 A. That's correct.

13 Q. Your inference here is to extrapolate that data
14 and infer that there's a continuation of this Morrow
15 channel system that in some fashion is approximate in your
16 orientation as to Section 4?

17 A. That's correct. We basically interpreted the
18 progradation nature of this sand trending south, and the
19 idea is to test that idea from this wellbore.

20 Q. Do you have an opinion as to whether or not you
21 could minimize the risk in Section 4 by moving this
22 location somewhere else in the section?

23 A. I feel like this is the -- really an optimum
24 location to test this idea.

25 Q. And even at that optimum location, the risk is

1 what?

2 A. It's great. We've found that -- from the
3 drilling activity we've done in the area that there's a
4 substantial risk in finding this sand.

5 Q. Let's go back to the type log and look at the
6 other opportunities, as indicated on the type log, as we
7 move farther down into the Morrow intervals.

8 A. The middle Morrow "C", we think, has the greatest
9 opportunity for finding production. Once again, there
10 isn't any middle Morrow "C" production this far south, so
11 there's a -- it's a high risk in terms of finding this to
12 be productive. We've tested it to the north; it has not
13 been commercial. But we still feel like that there is
14 potential there that it could be productive, but the risk
15 is high.

16 Q. Mr. Tinney, let's now take Exhibit 19, which is
17 the isopach of that middle Morrow "C" interval, and have
18 you identify and describe it.

19 A. Right, this map shows the north-south-trending
20 channel that we've inferred coming through the prospect.
21 As you can see, to the west, in the North Bell Lake Unit,
22 none of those wells have the sand.

23 There is wells to the north that basically set up
24 this trend, but we really don't have any evidence that --
25 at least in this particular area, that the sand will be

1 present.

2 Q. Again, here your ability to infer the location
3 orientation and the size of the channel is substantially
4 removed from the well control?

5 A. That's correct.

6 Q. You've had to make a general regional inference
7 based upon data?

8 A. Yes.

9 Q. Let's go to the topic of risk that you associated
10 with structure. If you'll turn with us to Exhibit Number
11 20, Mr. Tinney, would you identify and describe this
12 display?

13 A. This is a structure map on the middle Morrow
14 marker. It's shown on your type log. It's just below the
15 Grama Ridge "A" sand. We feel like it's a marker that can
16 be carried throughout the area.

17 You can see to the west the north Bell Lake
18 structure, based on the well control. We feel like we're
19 going to be on the flank of that feature and moving in a
20 downdip position to the east.

21 Q. What have you applied as a potential gas-water
22 contact within the structural display you've shown on the
23 exhibit?

24 A. We feel like that there's a substantial amount of
25 risk involved below 9600, in getting production below that,

1 that there's a risk involved with a water leg that could be
2 below the 9600 contour. Obviously, we'll test that idea
3 with this well.

4 MR. KELLAHIN: Mr. Examiner, that concludes my
5 examination of Mr. Tinney.

6 We move the introduction of his Exhibits 17
7 through 20.

8 EXAMINER ASHLEY: Exhibits 17 through 20 will be
9 accepted as evidence at this time.

10 Mr. Owen?

11 MR. OWEN: No questions.

12 EXAMINATION

13 BY EXAMINER ASHLEY:

14 Q. Mr. Tinney, in Exhibit 18, what did you use for a
15 porosity cutoff on that isopach map?

16 A. The net sand is density porosity greater than or
17 equal to eight percent. If you'll note -- It's kind of
18 hard to see, but on the bottom left-hand corner the net
19 clean sand says 18/12, and then in the net clean sand it's
20 marked on the map.

21 Q. Okay, thank you.

22 A. Yes, sir.

23 Q. You also mentioned shallow production. Could you
24 go into a little more detail about what zones in particular
25 you'd be looking at?

1 A. We feel like that there is some potential in the
2 area for Delaware. There's some Delaware production to the
3 east in the Antelope Ridge-Cherry Canyon Pool. There's
4 about, as I recall, three wells that produce in that pool.
5 There's a number of dry holes offsetting the production.

6 Also, there's scattered Bone Springs. There's
7 some Bone Springs production to the south of this well,
8 there's also some Bone Springs production along the
9 Antelope Ridge feature. To date, none of that production
10 has been very good. It's not something that Santa Fe would
11 go drill for, but if you found it, it's nice to have it as
12 far as a plugback potential, to add some reserves. But the
13 reserves don't really justify us drilling a well for it.

14 There's also -- To the north there's some Strawn
15 production. I don't think the Strawn really moves this far
16 south.

17 To the east there's Atoka production, the
18 Antelope Ridge field. It's -- along that trend. We feel
19 like that we're really too far west for that production.
20 That production is out of an Atoka carbonate. But if we
21 somehow lucked into it, obviously that would be great. But
22 we really feel like we're too far west for that particular
23 production.

24 And that really summarizes the other potential in
25 the area.

1 Q. In Exhibit 19, you indicate one of the wells to
2 the east is a middle Morrow "C" sand producer. What about
3 the remainder of these wells located to the east of your
4 prospect?

5 A. The majority of those wells are Atoka producers.
6 There are a few producers out of the middle Morrow "A", but
7 the majority of those are all Atoka.

8 EXAMINER ASHLEY: Okay.

9 EXAMINATION

10 BY EXAMINER CATANACH:

11 Q. Mr. Tinney, what data did you guys use to
12 determine that there may be a water contact at 9600 feet?

13 A. We've just drilled a well to the north, and we
14 had a -- we found the Grama Ridge "A" sand at a minus 9680,
15 and the sand was wet.

16 We have other producers that are structurally
17 high to that, so there's a gas-water contact somewhere
18 between those points. And exactly where that
19 is -- We know that it's below 9641 -- or -- yeah, below
20 9641, but above 9682.

21 Q. So where would that point fall within the well
22 you propose to drill? Where would that structural fall?
23 Up in the "A" sand as well?

24 A. In the Grama Ridge "A", sir?

25 Q. Yes.

1 A. Our particular location, if you look at the map,
2 looks like it's going to be about a 9640, and that's
3 cutting it pretty close to think that we're good enough
4 to -- or that I'm good enough to say, Yeah, this sand is
5 going to be at 9640 and not 9680. So to me, that adds
6 quite a bit of risk involved in this prospect.

7 Q. The well that you did drill, where is that well?

8 A. That well is to the north in the Gaucho Unit, in
9 Section 17. It's off this map.

10 Q. So about what? Two or three miles away?

11 A. Yes, sir.

12 FURTHER EXAMINATION

13 BY EXAMINER ASHLEY:

14 Q. I have another question, Mr. Tinney. Did you
15 have any seismic control in this?

16 A. There are seismic lines spotted on this map.
17 Unfortunately, the seismic in this area is of marginal
18 value.

19 There's a Cenozoic fill that trends north-south
20 through this area, goes up through the Gaucho Unit. That
21 Cenozoic fill renders your seismic -- essentially, you
22 can't do any stratigraphic analysis with it, not that, even
23 with good seismic, that you can do some stratigraphic
24 interval when you're talking about a 20-foot sand at 13,000
25 feet. The technology just -- for us, is just not there.

1 We don't that it's capable of doing that.

2 But from a structural standpoint, you can get
3 some members as faulting, but the data quality is just --
4 because of that field, is not very good.

5 EXAMINER ASHLEY: I have no further questions.
6 You may be excused.

7 THE WITNESS: Thank you.

8 MR. OWEN: I do have a --

9 EXAMINER ASHLEY: Okay.

10 MR. OWEN: -- a question.

11 EXAMINATION

12 BY MR. OWEN:

13 Q. You say you do have some seismic data covering
14 this prospect?

15 A. Well, it's not really covering the prospect, no,
16 sir, it's on -- If you look on the Exhibit Number 20, the
17 structure map --

18 Q. Uh-huh.

19 A. -- there is a seismic line that goes east-west to
20 the south of the prospect, and that was more or less just
21 to find the orientation of the faulting in the area, and to
22 get some relationship to the North Bell Lake structure.

23 Q. Did that data influence Santa Fe's decision to
24 drill the well at all?

25 A. No, sir.

1 MR. OWEN: Thank you.

2 EXAMINER ASHLEY: You may be excused.

3 THE WITNESS: Thank you.

4 MR. KELLAHIN: That concludes the presentation,
5 Mr. Examiner.

6 EXAMINER ASHLEY: Okay. At this time, Case
7 12,043 will be taken under advisement.

8 (Thereupon, these proceedings were concluded at
9 10:02 a.m.)

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I do hereby certify that the foregoing is
a complete record of the proceedings in
the Examiner hearing of Case No. 12043,
heard by me on Sept 17 1978.
Mark Kahler, Examiner
Oil Conservation Division

CERTIFICATE OF REPORTER

STATE OF NEW MEXICO)
) ss.
COUNTY OF SANTA FE)

I, Steven T. Brenner, Certified Court Reporter and Notary Public, HEREBY CERTIFY that the foregoing transcript of proceedings before the Oil Conservation Division was reported by me; that I transcribed my notes; and that the foregoing is a true and accurate record of the proceedings.

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

WITNESS MY HAND AND SEAL September 19th, 1998.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 1998