

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. 12,654

APPLICATION OF CHI ENERGY, INC., FOR)
COMPULSORY POOLING, EDDY COUNTY,)
NEW MEXICO)

ORIGINAL

REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING

BEFORE: DAVID BROOKS, Hearing Examiner

September 20th, 2001

Santa Fe, New Mexico

OIL CONSERVATION DIV.
01 OCT -4 AM 10:11

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID BROOKS, Hearing Examiner, on Thursday, September 20th, 2001, at the New Mexico Energy, Minerals and Natural Resources Department, 1220 South Saint Francis Drive, Room 102, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

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September 20th, 2001
Examiner Hearing
CASE NO. 12,654

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* * *

A P P E A R A N C E S

FOR THE APPLICANT:

JAMES G. BRUCE, Attorney at Law
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 Santa Fe, New Mexico 87501
 P.O. Box 1056
 Santa Fe, New Mexico 87504

ALSO PRESENT:

MICHAEL E. STOGNER
 Hearing Examiner
 New Mexico Oil Conservation Division
 1220 South Saint Francis Drive
 Santa Fe, NM 87501

* * *

1 WHEREUPON, the following proceedings were had at
2 9:05 a.m.:

3
4
5 EXAMINER BROOKS: Okay, at this time we will call
6 Case Number 12,654, Application of Chi Energy, Inc., for
7 compulsory pooling, Eddy County, New Mexico.

8 Call for appearances.

9 MR. BRUCE: Mr. Examiner, Jim Bruce of Santa Fe,
10 representing the Applicant. I have two witnesses to be
11 sworn.

12 EXAMINER BROOKS: Okay. How is the Applicant's
13 name correctly pronounced, Mr. Bruce?

14 MR. BRUCE: Chi.

15 EXAMINER BROOKS: Chi, okay, thank you for
16 correcting me.

17 Will the witnesses please identify themselves for
18 the record?

19 MR. QUALLS: John Qualls, Chi Energy.

20 MR. DAVIS: Gene Davis, Chi Energy.

21 EXAMINER BROOKS: Will the witnesses be sworn?
22 (Thereupon, the witnesses were sworn.)

23 EXAMINER BROOKS: You may proceed when ready, Mr.
24 Bruce.

25 MR. BRUCE: Call Mr. Qualls to the stand.

1 JOHN W. QUALLS,
2 the witness herein, after having been first duly sworn upon
3 his oath, was examined and testified as follows:

4 DIRECT EXAMINATION

5 BY MR. BRUCE:

6 Q. Would you please state your name and city of
7 residence?

8 A. John Qualls, Midland, Texas.

9 Q. Who do you work for?

10 A. Chi Energy, Inc.

11 Q. And what is your job at Chi?

12 A. I'm a landman.

13 Q. Have you previously testified before the Division
14 as a petroleum landman?

15 A. Yes.

16 Q. And were your credentials as an expert petroleum
17 landman accepted as a matter of record?

18 A. Yes.

19 Q. And are you familiar with the land matters
20 involved in this case?

21 A. Yes.

22 MR. BRUCE: Mr. Examiner, I would tender Mr.
23 Qualls as an expert petroleum landman.

24 EXAMINER BROOKS: His credentials will be
25 accepted.

1 Q. (By Mr. Bruce) Mr. Qualls, what does Chi Energy
2 seek in this case?

3 A. We seek an order pooling the west half of Section
4 9, 22 South, 25 East, from the surface to the base of the
5 Morrow formation --

6 Q. Okay.

7 A. -- for all pools or formations spaced on 320
8 acres. Also we seek to pool the southwest quarter for a
9 160-acre unit and the northeast of the southwest quarter
10 for a 40-acre unit.

11 Q. What is Exhibit 1?

12 A. Exhibit 1 is a land plat outlining the proposed
13 well unit. The well is at an orthodox location 1650 from
14 the south line and 1780 from the west line.

15 Q. Now, looking at maybe both Exhibits 1 and 2
16 together, what is the leasehold ownership of the west half
17 of Section 9?

18 A. The west half of Section 9 is comprised of three
19 tracts. There's a federal lease covering the northwest
20 quarter, a federal lease covering the south half of the
21 southwest quarter and a fee tract covering the north half
22 of the southwest quarter.

23 Q. And who owns the leasehold interest in those
24 tracts?

25 A. Chi Energy and its partners own the entire

1 leasehold on the federal tracts. In the fee tract, all
2 interest owners are leased or committed except for an
3 unleased 1/24 mineral interest.

4 Q. And that combined 1/24 interest is detailed on
5 Exhibit 2; is that correct?

6 A. Yes.

7 Q. Now, that's a 1/24 interest in the north half of
8 the southwest. What is the total interest of those
9 interests in the well?

10 A. It would be a 1/96 interest of the working
11 interest, which is 1.04166 percent.

12 Q. Okay, so we're only here pooling a little more
13 than a one-percent interest?

14 A. Yes, sir.

15 Q. Okay. Let's discuss your efforts to obtain the
16 voluntary joinder of these interest owners in the well.
17 What is Exhibit 3A?

18 A. Exhibit 3A is -- When we first attempted to lease
19 all the mineral owners, Sam Shackelford, who's the broker
20 that I hired, sent letters dated February the 1st, 2001,
21 requesting an oil and gas lease or purchasing their
22 minerals.

23 Q. Now, did he have follow-up phone calls with these
24 people?

25 A. Yes, he followed up with phone calls contacting

1 as many owners as he could.

2 Q. Okay. And when you couldn't purchase them, what
3 did you do? And I refer you to Exhibit 3B.

4 A. When we couldn't obtain the leases, we mailed a
5 proposal letter on March the 1st, 2001. The letter
6 enclosed an AFE and requested participation in the well.

7 Q. Now, these letters were sent in March and
8 February, and have the phone calls persisted to this date?

9 A. Yes, Sam has been in contact -- Sam Shackelford
10 has been in contact with these people, continued to follow
11 up via phone calls to determine what they wanted to do.

12 Q. At this point, have any of these -- oh, I don't
13 know what it is, 45 or 50 interest owners, signed a lease?

14 A. There's one or two leases that have come in that
15 they scratched out the royalty that we offered to give
16 them, and I have them in my office in Midland.

17 Q. Okay, but they have increased the royalty among
18 them?

19 A. Yes, sir.

20 Q. So you have not accepted those at this point?

21 A. No, sir, hasn't been addressed.

22 Q. And has anybody agreed to sell their unleased
23 mineral interest?

24 A. No.

25 Q. Okay. In your opinion, has Chi Energy made a

1 good faith effort to obtain the voluntary joinder of the
2 interest owners in the well?

3 A. Yes.

4 Q. Now, would you please identify Exhibit 4 and
5 discuss the cost of the proposed well?

6 A. Exhibit 4 is a copy of the AFE for the well.
7 It's approximately an 11,900-foot test with an estimated
8 dryhole cost of \$843,000 and a completed well cost of \$1.2
9 million.

10 Q. And are these costs in line with the cost of
11 other wells drilled to this depth in this area of New
12 Mexico?

13 A. Yes, sir.

14 Q. Does Chi request that it be designated operator
15 of the well?

16 A. Yes, sir.

17 Q. And do you have a recommendation for the amounts
18 which Chi Energy should be paid for supervision and
19 administrative expenses?

20 A. Yes, we request that \$6000 a month be allowed for
21 the drilling of the well and \$700 a month be allowed for
22 producing the well.

23 Q. Are these amounts equivalent to those normally
24 charged by Chi Energy and other operators in this area for
25 wells of this depth?

1 A. Yes, sir.

2 Q. And were the interest owners notified of this
3 hearing?

4 A. Yes.

5 Q. Is Exhibit 5 my affidavit of notice regarding the
6 mailings to the interest owners who had addresses?

7 A. Yes, sir.

8 MR. BRUCE: Now, Mr. Examiner, Exhibit 6 is a
9 notice published in the Carlsbad newspaper. There were
10 certain interest owners who could not be located, and they
11 are named in that ad.

12 Q. (By Mr. Bruce) Mr. Qualls, what steps were taken
13 to locate these -- I forget how many there are, four or
14 five interest owners that you could not locate?

15 A. We ran a record check in the county records,
16 telephone calls we made, different counties, Eddy County,
17 Chaves County, Lea County, and also an Internet search.

18 Q. Now, this 1/24 interest -- or actually these -- I
19 think these unlocatable people came out of what's marked in
20 Exhibit 2 as the Gladdus Berryhill interest; is that
21 correct?

22 A. Yes, sir.

23 Q. But all of these interest owners are related?

24 A. Yes, sir.

25 Q. And many of the addresses were obtained from

1 family members; is that correct?

2 A. Yes, sir.

3 Q. And even through contacts with the family
4 members, the people in the advertisement, Exhibit 6, were
5 not -- they had no addresses for them either?

6 A. Right.

7 Q. Were Exhibits 1 through 6 prepared by you or
8 under your supervision or compiled from company business
9 records?

10 A. Yes, sir.

11 Q. And in your opinion is the granting of Chi
12 Energy's Application in the interests of conservation and
13 the prevention of waste?

14 A. Yes, sir.

15 MR. BRUCE: Mr. Examiner, I move the admission of
16 Exhibits 1 through 6.

17 EXAMINER BROOKS: Exhibits 1 through 6 will be
18 admitted in evidence.

19 Are you passing the witness?

20 MR. BRUCE: I am passing the witness, Mr.
21 Examiner.

22 EXAMINER BROOKS: Thank you, Mr. Bruce.

23 EXAMINATION

24 BY EXAMINER BROOKS:

25 Q. The well is to be located in the northeast of the

1 southwest, it looks like?

2 A. Yes, sir.

3 Q. Do you have the footages, or is that something I
4 should ask the next witness?

5 A. 1650 from the south line, 1780 from the west
6 line.

7 Q. 1650 from the south line, 1780 or --

8 A. Yes, sir, 1780.

9 Q. 1780 from the west, okay. And it's to be a
10 Morrow test, you said?

11 A. Yes, sir.

12 Q. Now, you said that you offered these people a
13 lease, and they returned it with a different royalty
14 written in; is that correct?

15 A. Yes, sir.

16 Q. Some of them?

17 A. Yes, sir.

18 Q. How many were returned? Do you --

19 A. I believe it was three.

20 Q. The royalty that you proposed was 1/6, it looks
21 like --

22 A. Yes, sir.

23 Q. -- looking at Exhibit 3A. What was the royalty
24 they wrote in?

25 A. Well, some of them changed it. They wanted a

1 quarter royalty.

2 Q. And the others you just didn't get anything back
3 from?

4 A. No, sir.

5 Q. Now, on the administrative overhead you said
6 \$6000 a month for drilling rate, and was it \$700 a month
7 for producing?

8 A. Yes, sir.

9 EXAMINER BROOKS: Okay. I guess that's all I
10 have on the land matters. I'll reserve my other questions
11 for the next witness.

12 (Off the record)

13 EXAMINER BROOKS: Very good. You may proceed,
14 Mr. Bruce.

15 GENE H. DAVIS,
16 the witness herein, after having been first duly sworn upon
17 his oath, was examined and testified as follows:

18 DIRECT EXAMINATION

19 BY MR. BRUCE:

20 Q. Would you please state your name and city of
21 residence for the record?

22 A. Gene H. Davis, and I live in Midland, Texas.

23 Q. By whom are you employed and in what capacity?

24 A. I'm employed by Chi Energy, Inc., and I'm a
25 geologist.

1 Q. Have you previously testified before the
2 Division?

3 A. Yes, I have.

4 Q. And were your credentials as an expert petroleum
5 geologist accepted as a matter of record?

6 A. Yes, they were.

7 Q. And are you familiar with the geology involved in
8 this Application?

9 A. Yes, I am.

10 MR. HALL: Mr. Examiner, I'd tender Mr. Davis as
11 an expert petroleum geologist.

12 EXAMINER BROOKS: His credentials are accepted.

13 Q. (By Mr. Bruce) Mr. Davis, could you identify
14 Exhibit 7 for the Examiner and talk about the primary zones
15 of interest within this well?

16 A. Certainly. Exhibit 7 is a type log from a well
17 in Section 9 in the east half. It is a Belco Petroleum
18 Corporation Jones Com Number 1 well. This well was drilled
19 and logged in 1976. It has since been re-entered by Chi
20 Energy, Inc., and recompleted from the Morrow formation.

21 The type log that you're looking at is basically
22 the Morrow formation. I've colored in the -- Well,
23 actually there's two portions of the Morrow formation that
24 are depicted on here, the middle Morrow section and the
25 lower Morrow section. The top of the middle Morrow

1 clastics is indicated on the type log at around ten
2 thousand one hundred and -- it looks like seventy-four
3 feet, plus or minus.

4 The middle Morrow formation, I've colored the
5 sands there in yellow, and you can see those depicted on
6 the right-hand column of the log, and -- excuse me, on the
7 left-hand column of the log. And then on the right-hand
8 column of the log, which is the density neutron track, you
9 can see the crossover, and the density neutron is colored
10 in red, and that also indicates the presence of sands.

11 The lower Morrow is depicted there at about
12 10,444 feet, and just above that is a middle Morrow basal
13 shale marker, which is persistent throughout the area of
14 southeast New Mexico and is generally accepted by the
15 geological community to be a good marker for the top of the
16 lower Morrow formation. And we'll show you a structural
17 map here in a little while that will be drawn on top of
18 that Morrow, on the base of that Morrow shale marker, which
19 is the top of the lower Morrow.

20 This well is basically -- This well that we're
21 looking at here is located approximately 3100 feet east of
22 the proposed In Bounds well.

23 EXAMINER BROOKS: Let's see, do you have a map
24 that shows the relative location?

25 THE WITNESS: Yes, sir, Exhibit 8, which is the

1 next map that you're looking at currently. That location
2 is indicated as the type log. You can see the indication
3 there in Section 9 with an arrow pointing to it.

4 EXAMINER BROOKS: Yes, sir.

5 THE WITNESS: Okay. This well is currently
6 producing from -- Just so you understand, in the center
7 column, in the depth track of this type log there are
8 indicated perforations, they're indicated as rectangles
9 there down the well track. You'll notice that some of them
10 have lines drawn through them. Those were perforations
11 that were originally made by Belco and its successor
12 companies, probably Hallwood.

13 This well, when it was re-entered, we set a
14 2-3/8-inch tubing through a packer at 10,365 feet and
15 reopened the perforations below that interval, and that's
16 what we're currently producing from, and that would be from
17 the D sands and the middle Morrow sand -- section.

18 Q. (By Mr. Bruce) Well, why don't you move on to
19 your isopach, Exhibit 8, Mr. Davis, and discuss the trend
20 of the Morrow in this area?

21 A. I will, thank you.

22 Exhibit 8 is a net clean sand isopach map of the
23 combined C and D sand intervals of the middle Morrow
24 clastics in this portion of Eddy County, New Mexico. These
25 sands are the most predominant producer in the area, and

1 that's why we made a map on these. This is the sands that
2 we think have the greatest potential for being found in the
3 proposed well.

4 The isopach map that you're looking at suggests
5 that there would be over 60 feet of sand to be encountered
6 at the proposed location.

7 This map also shows the Morrow producers in the
8 area; they're colored red. And in the nine-square-mile
9 area around the well that we're proposing, there are five
10 Morrow completions with production ranging from .03 to .96
11 BCF of gas. The only current well that is still producing
12 from the Morrow is that well in the east half of Section 9
13 that Chi Energy, Inc., is currently operating, and it is
14 still producing at a rate of 500,000 to 600,000 a day.

15 Q. On this map, the cumulative production is the red
16 numbers at the upper left of the red circle?

17 A. That's correct, and the thickness is the black
18 numbers that are located usually in the lower right corner
19 or immediately below the well space.

20 Q. Okay. So at this point there is no Morrow
21 production to the immediate area west of the Jones well in
22 the east half of Section 9; is that correct?

23 A. That's correct. A well was drilled in Section 8
24 by Pennzoil United, the Annie Brown Number 1, and that well
25 did encounter some middle Morrow sands and also some lower

1 Morrow sands but did not produce the well. The logs show
2 the Morrow sands to be extremely tight.

3 Q. Okay. Why don't you move on to your Exhibit 9
4 and discuss the structure in this area briefly?

5 A. Exhibit 9 is a structure map. As I said, it is a
6 structure map that's drawn on the top of the lower Morrow.
7 It is an extremely good marker in this area, and that's why
8 we produced a map based on it. The structure here, as you
9 can see, there is a nose, structural nose that basically
10 trends northeast to southwest across the prospect area, and
11 in fact the proposed well location there in Section 9, you
12 can see, is on the flank of one of those -- of this nose
13 that is trending and going higher to the south.

14 This nose here, it helps and aids in the
15 production of Morrow gas and the trapping of Morrow gas,
16 both to the north in the Catclaw Draw field, which is --
17 they're just to the north of us in Township 21 South, 25
18 East, and then also to the south of us, in the Rock Tank
19 field, in the immediate township south of this.

20 Q. Okay. Why don't you move on to your Exhibit 10,
21 the cross-section, and discuss maybe in a little more
22 detail the problems with the Annie Brown well to the west
23 of your proposed location?

24 A. Exhibit 10 is a two-well cross-section, basically
25 oriented east-west immediately across Section 9. It

1 involves the formation type log, on the east the Jones Com
2 Number 1 well, and extends over to the -- through the
3 location that we propose, to the Pennzoil United Annie
4 Brown Number 1 well in Section 8.

5 Basically, looking at the middle Morrow section
6 there, this is the same basic sands that are colored on the
7 type log that are colored on here as well. They're
8 depicted in yellow. And you can see that there are sands
9 that extend across the -- or are expected to extend across
10 the proposed location.

11 There are two different logs here. The Annie
12 Brown Number 1 is a sonic neutron log, composite log. And
13 the Jones Com Number 1 well is a neutron density log. To
14 assist in evaluating this, I had to pick a porosity cutoff.
15 I used 8 percent, and the 8-percent line is depicted on
16 both of the logs in the cross-section. You'll note that it
17 is the -- I guess it would be the leftmost line drawn down
18 through the logs, the blue line, and you can see that, for
19 instance, on the Annie Brown well.

20 The sonic curve that deflects to the left of that
21 8-percent line is colored in red, and the neutron density
22 crossover is colored on the Jones Com Number 1 well, and
23 you can see that the red crossover -- or the red zone
24 across from the 8-percent line in the Jones Com well is
25 also showing the porosity greater than 8 percent in that

1 well, basically a density curve.

2 Comparing the two, you can see pretty clearly
3 that there is a greater amount of porosity in the sands in
4 the Jones Com well than there are in the Annie Brown well.
5 The sands that are producing in the Jones Com in the D zone
6 are barely present in the Annie Brown Number 1 well. And
7 in fact, porosity -- in fact, the way it is present, is a
8 lot less than the Jones Com Number 1.

9 When you look at the correlations between the two
10 wells you'll note that the sands do carry between wells,
11 but the problems are that they thin and thicken across
12 there, and also the porosity changes as well. Probably the
13 permeability is affected as well. It usually goes hand in
14 hand in the Morrow formation.

15 Q. Are there any secondary objectives in your
16 proposed well?

17 A. The secondary potential in the proposed well,
18 there is some potential in the lower Morrow, and I've
19 depicted those sands in orange on both the type log and on
20 the cross-section. There has not been any production in
21 the immediate nine-square-mile area around the well, but
22 both north and south in the Catclaw field and also in the
23 Rock Tank field the lower Morrow sands produce rather
24 prolifically.

25 So, you know, with drilling the well here, you

1 look at the entire Morrow formation, we hope that we might
2 get successful and encounter some lower Morrow porosity as
3 well.

4 Additionally, there is a Strawn producer in the
5 area, in Section 16, immediately south and east of the
6 proposed location. You can see it's colored on the Exhibit
7 Number 9, on the structure map. It is colored in blue.
8 That is a Strawn producer. It has actually made 3.7 BCF of
9 gas from the Strawn porosity in the Strawn carbonates. But
10 notably you'll notice that there's no other Strawn
11 producers in the area, so there is a little risk in trying
12 to explore for that by itself. And it's a good secondary
13 objective. We hope we're successful in finding it, but
14 like anything else, it's a little elusive.

15 Q. What penalty do you recommend against non-
16 consenting interest owners?

17 A. Three hundred percent.

18 Q. The statutory cost plus --

19 A. Yes.

20 Q. -- 200 percent?

21 A. Yes, that would be what we recommend, yes.

22 Q. Were Exhibits 7 through 10 prepared by you or
23 under your direction?

24 A. Yes, they were.

25 Q. And in your opinion is the granting of Chi

1 Energy's Application in the interests of conservation and
2 the prevention of waste?

3 A. Yes, it is.

4 MR. BRUCE: Mr. Examiner, I'd move the admission
5 of Chi Exhibits 7 through 10.

6 EXAMINER BROOKS: Exhibits 7 through 10 will be
7 admitted.

8 MR. BRUCE: And I pass the witness.

9 EXAMINER BROOKS: Very good.

10 EXAMINATION

11 BY EXAMINER BROOKS:

12 Q. The Morrow, you said, is the objective. What is
13 the -- Is this a designated pool, or is this undesignated?
14 What's the pool name here?

15 A. Mr. Examiner, I'm not really sure what the pool
16 name is. I think it's Revelation, as a matter of fact.

17 Q. Revelation?

18 A. Yes.

19 Q. And what formations are you seeking to have
20 pooled here?

21 A. We seek to pool the Wolfcamp, the Cisco, the
22 Canyon, the Strawn, the Atoka and the Morrow.

23 Q. So you're going from the top of the Wolfcamp to
24 the base of the Morrow, or are you going from the surface?

25 MR. BRUCE: We are going from the surface, but

1 for 320-acre --

2 THE WITNESS: For 320-acre spacing, yes.

3 MR. BRUCE: Mr. Davis was correct.

4 EXAMINER BROOKS: Okay. So what, then, you're
5 asking for is all formations on 320-acre to be the east
6 half of -- or --

7 MR. BRUCE: West half.

8 EXAMINER BROOKS: West half, I'm sorry. Are
9 there formations that are pooled on different spacing
10 units?

11 MR. BRUCE: Mr. Examiner, I looked and I did not
12 see any -- We are seeking to force-pool 40-acre units and
13 160-acre units if they occur, but I checked the Division's
14 records and I could find no shallow pools within a mile.

15 THE WITNESS: We're a long way from Delaware or
16 Bone Spring production here, although it could occur. And
17 if it did, then we would need to pool for 40-acre spacing.

18 Q. (By Examiner Brooks) Okay. The testimony has
19 been that some of the mineral interest owners requested a
20 one-quarter royalty. Is it your opinion that this would
21 not be a desirable prospect for the one-quarter royalty?

22 A. It would make it a little more difficult.
23 There's a significant amount of risk chasing the Morrow
24 here. The reserves are obviously a little skinny, and it
25 is going to make it a little more difficult to make the

1 economics.

2 EXAMINER BROOKS: Very good, I'll pass the
3 witness.

4 MR. BRUCE: I have no further questions.

5 THE WITNESS: Thank you, Mr. Examiner.

6 EXAMINER BROOKS: Okay, if there is nothing
7 further, Case Number 12,654 will be taken under advisement.

8 (Thereupon, these proceedings were concluded at
9 9:29 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. _____,
heard by me on _____ 19____.

_____, Secretary
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 21st, 2001.



STEVEN T. BRENNER
CCR No. 7

My commission expires: October 14, 2002