

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. 14947
ORDER NO. R-13693

APPLICATION OF CHI ENERGY, INC. FOR A NON-STANDARD OIL
SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY
COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on January 24, 2013 at Santa Fe, New Mexico, before Examiner William V. Jones.

NOW, on this 8th day of April, 2013, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) Chi Energy, Inc. ("Applicant") seeks approval of a non-standard 160-acre oil spacing and proration unit and project area ("the Unit") in the Bone Spring formation [Turkey Track-Bone Spring Pool (60660)] consisting of the W/2 of the W/2 (Units D, E, L and M) of Section 25, Township 19 South, Range 29 East, NMPM, in Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit in the Bone Spring formation.

(3) The Unit is to be dedicated to Applicant's Peacekeeper State 25 Well No. 3H (API No. 30-015-40819) ("the proposed well"), a horizontal well to be drilled from a surface location 200 feet from the South line and 400 feet from the West line (Unit M) of Section 25. The well will penetrate the Bone Spring formation in Unit M of Section 25 and continue horizontally in the Bone Spring to a standard terminus, or bottomhole location, 330 feet from the North line and 400 feet from the West line (Unit D) of Section

25. The well's completed interval will be entirely within the 330-foot setbacks from the outer boundaries of the well's project area.

(4) There are no special pool rules for the Turkey Track-Bone Spring Pool. Accordingly, spacing is governed by statewide Rule 19.15.15.9.A NMAC, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section. The Unit consists of four adjacent quarter-quarter sections.

(5) Applicant appeared at the hearing through counsel and presented geologic evidence by affidavit to the effect that:

(a) this area is suitable for development by horizontal drilling; and

(b) all quarter sections to be included in the Unit are expected to be productive in Bone Spring, so that formation of the Unit as requested will not impair correlative rights.

(6) No other party appeared at the hearing, or otherwise opposed the granting of this application.

The Division concludes that:

(7) Approval of the proposed non-standard unit will enable Applicant to drill a horizontal well that will efficiently produce the reserves underlying the Unit, thereby preventing waste, and will not impair correlative rights.

(8) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(9) Applicant is an owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

(10) There are interest owners in the Unit that have not agreed to pool their interests. There is an unlocated owner in the Unit. Accordingly, provision should be made to escrow funds for the account of such owner.

(11) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(12) Chi Operating, Inc. should be designated the operator of the proposed well and of the Unit.

(13) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the well.

(14) Reasonable charges for supervision (combined fixed rates) should be fixed at \$6,500 per month while drilling and \$650 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations."

IT IS THEREFORE ORDERED THAT:

(1) A non-standard 160-acre oil spacing and proration unit (the Unit) is hereby established in the Bone Spring formation [Turkey Track-Bone Spring Pool (60660)] consisting of the W/2 of the W/2 (Units D, E, L and M) of Section 25, Township 19 South, Range 29 East, NMPM, in Eddy County, New Mexico.

(2) Pursuant to the application of Chi Energy, Inc., all uncommitted interests, whatever they may be, in the oil and gas in the Bone Spring formation underlying the Unit, are hereby pooled.

(3) The Unit shall be dedicated to Applicant's Peacekeeper State 25 Well No. 3H (API No. 30-015-40819) ("the proposed well"), a horizontal well to be drilled from a surface location 200 feet from the South line and 400 feet from the West line (Unit M) of Section 25. The well will penetrate the Bone Spring formation in Unit M of Section 25 and continue horizontally in the Bone Spring to a standard terminus, or bottomhole location, 330 feet from the North line and 400 feet from the West line (Unit D) of Section 25. The well's completed interval will be entirely within the 330-foot setbacks from the outer boundaries of the well's project area.

(4) The operator of the Unit shall commence drilling the proposed well on or before April 1, 2014, and shall thereafter continue drilling the well with due diligence to test the second Bone Spring sand.

(5) In the event the operator does not commence drilling the proposed well on or before April 1, 2014, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the unit and project area created by this order shall terminate, unless operator appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence. If the proposed well is not completed in all of the quarter-quarter sections included in the proposed unit within 120 days after commencement of drilling, then the operator shall apply to the Division

for an amendment to this Order to contract the Unit so that it includes only those quarter-quarter sections in which the well is completed.

(7) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled unit created by this Order shall terminate, unless this order has been amended to authorize further operations.

(8) Chi Operating, Inc. (OGRID 4378) is hereby designated the operator of the well and of the Unit.

(9) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(10) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(11) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(12) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(13) The operator is hereby authorized to withhold the following costs and charges from production:

- (a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and
- (b) as a charge for the risk involved in drilling the well, 200% of the above costs.

(14) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(15) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$6,500 per month while drilling and \$650 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

(16) Except as provided in Paragraphs (13) and (15) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Eddy County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership. The operator shall notify the Division (Attention: Records Clerk) of the name and address of the escrow agent not later than one year from the date of issuance of this Order.

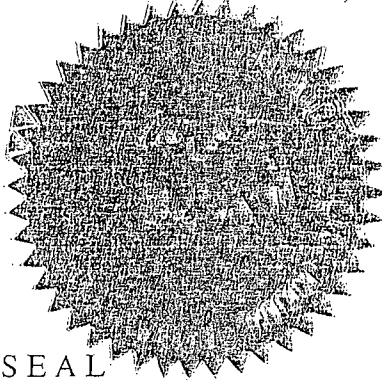
(17) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(18) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(19) The operator of the well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this order.

(20) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in cursive script, appearing to read "Jami Bailey".

JAMI BAILEY
Director