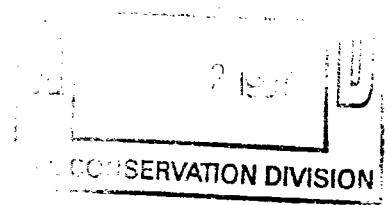


STATE OF NEW MEXICO
ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

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



CASE NO. 11850

APPLICATION OF DIAMOND HEAD
PROPERTIES, L.P., et al, FOR
CLARIFICATION OF ORDER R-10731-B,
EDDY COUNTY, NEW MEXICO.

PRE-HEARING STATEMENT

This pre-hearing statement is submitted by Diamond Head Properties, L.P., et al.,
as required by the Oil Conservation Division.

APPEARANCE OF PARTIES

APPLICANT

Diamond Head Properties, L.P.
P. O. Box 2127
Midland, Texas 79702
(915) 683-9137
attn: Rosalind A. Grover

ATTORNEY

W. Thomas Kellahin
KELLAHIN & KELLAHIN
P.O. Box 2265
Santa Fe, NM 87504
(505) 982-4285

OPPONENT

KCS Medallion Resources

ATTORNEY

James Bruce, Esq.
P. O. Box 1056
Santa Fe, NM 87504
(505) 982-2043

STATEMENT OF CASE

(1) On January 13, 1997, the Division entered Order R-10731 in Case 11677 which granted the compulsory pooling application of Intercoast Oil and Gas Company, now KCS Medallion Resources, Inc. pooling the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, and correspondingly denied the competing application filed in Case 11666 by Yates Petroleum Corporation ("Yates").

(2) Order R-10731 pooled all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, T20S, R28E, forming a standard 320-acre gas spacing unit for any and all formations and/or pools spaced on 320-acre gas spacing including but not limited to the Burton Flat-Morrow Gas Pool, to be dedicated to its KCS' State "20" Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of said Section, Eddy County, New Mexico.

(3) Diamond Head Group who controlled 23.416% working interest, was neutral in the dispute between Yates and KCS and had indicated its desire to join which ever operator was approved by the Division.

(4) As a result of the entry of Division Order R-10731 granting the application of KCS, the Diamond Head Group elected to participate with KCS as operator and on January 17, 21, 27, 1997 signed KCS's Joint Operating Agreement dated September 26, 1996 covering the E/2 of Section 20, T20S, R28E., Eddy County, New Mexico.

(5) On January 21, 1997, KCS had obtained an extension of its Kerr-McGee farmout until March 30, 1997;

(6) On January 21, 1997, Yates filed an Application for Hearing De Novo. At that time, the next Commission hearing was scheduled for February 13, 1997.

(7) On January 28, 1997, the Diamond Head Group signed KCS' Authority for Expenditure ("AFE").

(8) On Saturday, February 8, 1997, KCS placed a drilling rig on location and commenced drilling this well even though it had obtained an extension of its Kerr-McGee farmout until March 30, 1997.

(9) On February 13, 1997, the Commission held its hearing in these cases, and on February 28, 1997, the Commission entered Order R-10731-B granting KCS' application and denying Yates' application.

(10) Order R-10731-B contains a "carried interest" provision which provides that:

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

(A) The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs by March 7, 1997.

(B) As a charge for the risk involved in drilling the well, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs by March 7, 1997.

(7) The operator **shall distribute said costs and charges withheld from production to the parties who advanced the well costs.** (emphasis added).

(11) The Diamond Head Group is one of the "parties who advanced the well costs" and is entitled to its proportionate share of any non-consenting working interest owner's "carried interest."

(12) Yates Petroleum Corporation with approximately 37.7% percent working interest did not pay its share of well costs by March 7, 1997 and is a "non-consenting owner" whose share of costs are "carried" by those consenting working interest owners who agreed to pay their share ("consenting owners") pursuant to Order R-10731-B.

(13) In violation of Order R-10731-B, KCS failed to notify the Diamond Head Group that Yates had gone "non-consent" and would be a "carried interest", failed to provide an opportunity to the Diamond Head Group to pay its share of Yates' carried interest and has refused to distribute production attributed to said carried interest to the Diamond Head Group as one of the parties who advanced the well costs.

(14) On March 19, 1997, upon learning that Yates had "gone non-consent", Diamond Head Group notified KCS that the Diamond Head Group was claiming its share of Yates' carried interest [estimated to be an additional 8.8218%] and the right to pay its proportionate share of Yates' costs and to recoup those costs from Yates' share of production plus a proportionate share of the 200% non-consent penalty.

(15) On June 23, 1997, and in violation of Order R-10731-B, KCS wrongfully rejected Diamond Head Group's right to receive Diamond Head's proportionate share of any carried interest including penalty, said share including but not being limited to Yates' carried interest.

Applicants request that the Division enter an order requiring KCS Medallion Resources, Inc. to comply with Order R-10731-B and to distribute to Diamond Head Properties and its joint owners its proportionate share of any nonconsenting working interest owner's share of production plus the 200% risk factor penalty.

PROPOSED EVIDENCE

APPLICANT:

WITNESSES

Rosalind A. Grover

EST. TIME EXHIBITS

45 min. @ 10 exhibits

PROCEDURAL MATTERS

None anticipated at this time.

KELLAHIN AND KELLAHIN



By: _____
W. Thomas Kellahin
P.O. Box 2265
Santa Fe, New Mexico 87504
(505) 982-4285