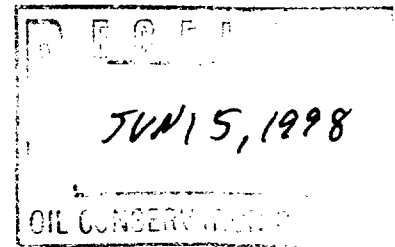


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June 15, 1998

Hand Delivered

Michael E. Stogner
Oil Conservation Division
2040 South Pacheco Street
Santa Fe, New Mexico 87505

Re: Case Nos. 11958, 11959, and 11934 (Ocean Energy/Yates)

Dear Mr. Stogner:

Pursuant to your request, enclosed is a proposed order submitted by Ocean Energy, Inc. Also enclosed is a disk with the order on it.

Very truly yours,

James Bruce

Attorney for Ocean Energy, Inc.

cc: William F. Carr (w/encl.)
W. Thomas Kellahin (w/encl.)

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:

APPLICATION OF OCEAN ENERGY, INC.
FOR COMPULSORY POOLING AND AN
UNORTHODOX WELL LOCATION, LEA
COUNTY, NEW MEXICO.

Case No. 11958

APPLICATION OF OCEAN ENERGY, INC.
FOR COMPULSORY POOLING, LEA
COUNTY, NEW MEXICO.

Case No. 11959

APPLICATION OF YATES PETROLEUM
CORPORATION FOR COMPULSORY
POOLING, LEA COUNTY, NEW MEXICO.

Case No. 11934

ORDER NO. R- _____

ORDER OF THE DIVISION
(Proposed by Ocean Energy, Inc.)

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on May 14, 1998, at Santa Fe, New Mexico before Examiner Michael E. Stogner.

NOW, on this _____ day of July, 1998, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) In Case No. 11958, Ocean Energy, Inc. ("Ocean") seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the following described acreage in irregular Section 2, Township 16 South, Range 35 East, N.M.P.M., in the following manner: Lots 9-16 to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, including the Undesignated Townsend-Morrow Gas Pool and the Undesignated North Townsend-Mississippian Gas Pool; and Lots 13 and

14 to form a standard 80-acre oil spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within said vertical extent, including the Undesignated South Big Dog-Strawn Pool. Said units are to be dedicated to the Townsend State Com. Well No. 2, located 3250 feet from the South line and 1400 feet from the West line (Unit N) of Section 2.

(3) In Case No. 11959, Ocean seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the S $\frac{1}{2}$ of irregular Section 2, Township 16 South, Range 35 East, N.M.P.M., to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, including the Undesignated Townsend-Morrow Gas Pool and the Undesignated North Townsend-Mississippian Gas Pool. Said unit is to be dedicated to the Townsend State Com. Well No. 6, located 930 feet from the South line and 1650 feet from the West line (Unit V) of Section 2.

(4) In Case No. 11934, Yates Petroleum Corporation ("Yates") seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the following described acreage in irregular Section 2, Township 16 South, Range 35 East, N.M.P.M., in the following manner: Lots 11-14 and the SW $\frac{1}{4}$ to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent; Lots 11-14 to form a standard 160-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent; and Lots 13 and 14 to form a standard 80-acre oil spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within said vertical extent. Said units are to be dedicated to the Field APK State Com. Well No. 3, located 3300 feet from the South line and 760 feet from the West line (Unit M) of Section 2.

(5) Case Nos. 11958, 11959, and 11934 were consolidated for purposes of hearing.

(6) Amerind Oil Company, Ltd. and Michael Shearn entered appearances in this matter, but did not state a position.

(7) There are interest owners in the proposed proration units who have not agreed to pool their interests.

(8) The land testimony presented in this matter showed the following:

- (a) Interest ownership in the proposed 320-acre units is as follows:

- (1) Ocean North 320-Acre Laydown Unit
Ocean Energy, Inc..... 37.5%
Yates Petroleum Corporation, et al..... 37.5%
Sol West, III..... 10.0%
Michael Shearn..... 2.5%
Lot 12 Interest Owners..... 12.5%
- (2) Ocean South 320-Acre Laydown Unit
Ocean Energy, Inc..... 75.0%
Yates Petroleum Corporation, et al..... 12.5%
SW $\frac{1}{4}$ SW $\frac{1}{4}$ Interest Owners..... 12.5%
- (3) Yates Standup 320-Acre Unit
Ocean Energy, Inc..... 37.5%
Yates Petroleum Corporation, et al..... 37.5%
Lot 12 and SW $\frac{1}{4}$ SW $\frac{1}{4}$ Interest Owners..... 25.0%

Several small interest owners have joined in both the Ocean and Yates well proposals. Other interest owners are awaiting the outcome of the hearing.

- (b) Regarding the proposed 80-acre unit covering Lots 13 and 14, Ocean and Yates, et al. each own 50% of the working interest.
- (c) Ocean and Yates have been working on development of the S $\frac{2}{3}$ of Section 2 since January 1997. In July 1997, Ocean proposed to Yates the Townsend State Well No. 2, at essentially the same location requested in Case No. 11958, to test the Strawn formation. However, due to the drilling of an Atoka well in the E $\frac{1}{2}$ of Section 10, Ocean suggested in August 1997 that the well be drilled to a depth sufficient to test the Morrow formation. In September 1997 the well in the E $\frac{1}{2}$ of Section 10 was completed as a producer in the Atoka formation, and the parties spent the next 2-3 months evaluating data from the well. In addition, in December 1997, Yates completed an Atoka well in the W $\frac{1}{2}$ of Section 11, further encouraging the parties to test the Atoka formation in Section 2.
- (d) During the fall of 1997, Ocean repeatedly proposed forming two laydown units in the S $\frac{2}{3}$ of Section 2. In early December 1997, Yates proposed a standup unit. In

mid-January 1998, Yates proposed two laydown units, and Ocean responded with a counter-proposal in early February 1998. However, the next correspondence received by Ocean from Yates was notice of its compulsory pooling application. Subsequently, Ocean filed its two compulsory pooling applications.

During the next three months, Ocean offered several settlement proposals to Yates, all of which Yates refused. Yates made no counter-offers to any of Ocean's proposals.

- (e) In addition to interest ownership for the proposed wells in Section 2 set forth in ¶8(a) above, the following ownership figures are significant:

- | | | |
|-----|--|------|
| (1) | <u>W½ of Section 10 (Carlisle Well)</u> | |
| | Ocean Energy, Inc..... | 75% |
| | Yates, et al..... | 25% |
| (2) | <u>E½ of Section 10 (Brunson and Big Flat Wells)</u> | |
| | Ocean Energy, Inc..... | 50% |
| | Yates, et al..... | 50% |
| (3) | <u>W½ of Section 11 (Shell Lusk Well)</u> | |
| | Ocean Energy, Inc..... | 0% |
| | Yates, et al..... | 100% |
| (4) | <u>E½ of Section 11</u> | |
| | Ocean Energy, Inc..... | 0% |
| | Yates, et al..... | 100% |

- (9) Ocean presented the following geological and geophysical evidence:

- (a) The Strawn pool in this area is comprised of small reservoirs. One such reservoir underlies Lots 13 and 14 of Section 2.
- (b) The Atoka reservoir in this area trends northeast-southwest across Section 2, and corresponds with a structural low and an Atoka/Morrow isopach thick. The heart of the Atoka reservoir is located in the SW¼ of Section 2.
- (c) Ocean's proposed well in Lot 14 (and Yates' proposed well in Lot 13) should encounter both the Strawn and the

Atoka. The main objective in Ocean's proposed well in the SE $\frac{1}{4}$ SW $\frac{1}{4}$ of Section 2 is the Atoka, with possible secondary objectives in the Strawn, Morrow, and Wolfcamp.

- (d) The entire S $\frac{1}{2}$ of Section 2 is underlain by the Atoka, and should contribute to production. However, the best location for a single Atoka well in Section 2 is in the SW $\frac{1}{4}$ of the Section.
- (e) Drilling only one Atoka well in a standup unit, as proposed by Yates, means that the Atoka reservoir in the S $\frac{1}{2}$ of Section 2 will ultimately be developed by two edge wells, which is not the optimum method to develop the reservoir.
- (10) Ocean presented engineering evidence which shows:
 - (a) Compartmentalization of the Atoka reservoir is believed to exist, based upon the pressure and production data from the following Atoka wells:
 - (1) Skelly State No. 1: This well, located in the NE $\frac{1}{4}$ SE $\frac{1}{4}$ of Section 14, had an original reservoir pressure of 4849 psi in 1973. However, the well produced only 260 MMCF of gas in two years, and is depleted, although it offsets the Monsanto State No. 1, which has produced 3.86 BCF of gas to date. Thus, a limited reservoir existed in the Skelly State No. 1.
 - (2) Brunson No. 1 and Shell Lusk No. 1: These wells, located in the NE $\frac{1}{4}$ §10 and NW $\frac{1}{4}$ §11, were completed in late 1997 with reservoir pressures of 3854 and 3019 psi, respectively. The large difference in pressures in these wells also suggests that the reservoir is compartmentalized.
 - (b) The Shell Lusk No. 1 (in the NW $\frac{1}{4}$ §11) and the Monsanto State No. 1 (in the SW $\frac{1}{4}$ §14) are thought to be in communication. Although the original pressure in the Monsanto State No. 1 is unavailable, it is believed to have been similar to that of the Brunson No. 1, or about 3850 psi. The Shell Lusk No. 1 and the Monsanto State No. 1 were drilled 22 years apart, and reservoir pressure had only declined about 800 psi during that period, even though the Monsanto State No. 1 has already produced 3.86 BCF of gas. The small pressure decline over 22 years

shows that the reservoir is not being effectively drained by the Shell Lusk and Monsanto wells. Thus, Yates' proposal for a standup unit in Section 2 will not result in effective drainage of the northern portion of this reservoir, and will not recover the maximum amount of gas. This conclusion is reinforced by the compartmentalization of the reservoir.

(11) Yates' geologist testified that, in drilling an Atoka well, the biggest problem is "finding the Atoka sand." **Testimony of B. May, Transcript at 34.** However, Yates proposal in Case 11934 will mean that the Atoka reservoir in the S $\frac{1}{2}$ of Section 2 will be developed by a well stepping out one mile from established Atoka production, substantially increasing risk and potentially causing waste.

Yates' geologist also testified that Yates does not want to drill edge wells. **Transcript at 48.** But, Yates proposal will result in the drilling of two Atoka edge wells in Section 2.

(12) Yates' engineer testified that only one well is needed to drain the Atoka reservoir in Section 2. However, he also testified that if Yates' proposed well is drilled in Lot 13, Yates' Shell Lusk well in the W $\frac{1}{2}$ of Section 11 will drain Atoka reserves in the southern portion of Section 2. **Testimony of D. Pearson, Transcript at 88-89.** This will adversely affect the correlative rights of interest owners in Section 2.

Yates' engineer also testified that they believe the wells should be placed at orthodox locations to compete for gas. In addition, in other areas of this reservoir, Yates has located wells only one-quarter mile from existing production in cases where Yates has a majority interest in the new well. (See Ocean Exhibit 16 and ¶(8)(e) above.)

(13) Moreover, Yates is attempting to further develop the Atoka formation, and possibly the Strawn formation, in Section 11 by means of the following wells:

<u>Well</u>	<u>Location</u>
Simmons Witt ANB No. 1	2310' FSL & 2080' FWL ¹
Runnels ASP No. 1	1980' FNL & 1980' FEL

Both of these wells have E $\frac{1}{2}$ units. Division records show that

¹Yates testified at hearing that this was a re-entry which failed.

Yates had filed a Form C-101 to re-enter the Runnels well before the hearing, but did not inform the Division of its plans at hearing. These wells are only one-quarter mile from the 100% Yates, et al. Shell Lusk well in the W $\frac{1}{4}$ of Section 11, and discredit Yates' testimony that only one Atoka well is needed in the S $\frac{1}{4}$ of Section 2.

(14) The geologists for both Ocean and Yates agreed that a 200% non-consent penalty is a proper risk factor for drilling the proposed wells. In addition, the AFE's and operating costs of Ocean and Yates are comparable. Also, Ocean had offered operatorship of the proposed wells to Yates.

(15) As a result of the foregoing, the primary issue in this case is well location.

(16) Ocean's geology better honors the subsurface and seismic data, and shows that an Atoka well in the SW $\frac{1}{4}$ of Section 2 is necessary to prudently and adequately develop the reservoir and protect the correlative rights of all interest owners in Section 2. Therefore, the applications of Ocean in Case Nos. 11958 and 11959 should be approved, and the application of Yates in Case No. 11934 should be denied, unless Ocean does not timely commence its wells hereunder.

(17) Approval of the proposed unorthodox well location for the Townsend State Well No. 2 (Case 11958) will afford the parties the opportunity to produce their just and equitable share of the oil and gas in the affected pools, will prevent the drilling of unnecessary wells, and will otherwise prevent waste and protect correlative rights.

(18) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to the owner of each interest in said units the opportunity to recover or receive without unnecessary expense his just and fair share of the production in any completion resulting from this order, the subject application should be approved by pooling all mineral interests, whatever they may be, within said units.

(19) Ocean should be designated the operator of the subject wells and units.

(20) Any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(21) Any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in drilling the well.

(22) Any non-consenting working interest owner should be afforded the opportunity to object to the actual well costs, but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(23) Following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(24) \$5,400.00 per month while drilling and \$540.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates). The operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject wells, not in excess of what are reasonable, attributable to each non-consenting working interest.

(25) All proceeds from production from the subject wells which are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(26) Upon the failure of the operator of said pooled units to commence drilling operations on the Townsend State Com. No. 6 on or before October 1, 1998, this order pooling the subject units should become null and void and of no effect whatsoever.

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

(28) The operator of the wells and units shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) The applications of Ocean in Case Nos. 11958 and 11959 to pool all mineral interests, whatever they may be, from the surface to the base of the Mississippian formation in the following described acreage, are hereby approved:

- (a) Case 11958: Underlying Lots 9-16 of Section 2, Township 16 South, Range 35 East, N.M.P.M., to form a 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Undesignated Townsend-Morrow Gas Pool and the Undesignated North Townsend Mississippian Gas Pool, and underlying Lots 13 and 14 of Section 2 to form a standard 80-acre oil spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within said vertical extent, which presently includes but is not limited to the South Big Dog-Strawn Pool. Said units shall be dedicated to the Townsend State Com. Well No. 2, located at an unorthodox well location 3250 feet from the North line and 1400 feet from the West line (Unit N) of Section 2, which location is hereby approved; and
- (b) Case 11959: Underlying the S $\frac{1}{4}$ of Section 2 to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Undesignated Townsend-Morrow Gas Pool and the Undesignated North Townsend-Mississippian Gas Pool. Said unit shall be dedicated to the Townsend State Com. Well No. 6, located 930 feet from the South line and 1650 feet from the South line (Unit V) of Section 2.

(2) The application of Yates in Case No. 11934, to pool Lots 11-14 and the SW $\frac{1}{4}$ of said Section 2, is hereby conditionally denied.

PROVIDED HOWEVER THAT, the operator of said units shall commence drilling operations on the Townsend State Com. Well No. 6 on or before the 1st day of October, 1998, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Mississippian formation.

The operator of said units shall commence the drilling of the

Townsend State Com. Well No. 2 within 90 days of rig release of the Townsend State Com. Well No. 6.

PROVIDED FURTHER THAT, in the event said operator does not commence drilling operations on the Townsend State Com. Well No. 6 on or before the 1st day of October 1, 1998, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division Director for good cause shown.

If Ocean does not timely commence the drilling of its Townsend State Com. Well No. 6, then Yates shall be permitted to drill its proposed Field APK State Com. Well No. 3 under the conditions of this order, except that Yates shall have until January 1, 1999 to commence the drilling of its well.

PROVIDED FURTHER THAT, should said wells not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Ordering Paragraph No. (1) of this order should not be rescinded.

(3) Ocean is hereby designated the operator of the subject wells and units.

(4) After the effective date of this order and within 90 days prior to commencing operations, the operator shall furnish the Division and each known working interest owner in the unit for the Townsend State Com. Well No. 6 an itemized schedule of estimated well costs. An itemized schedule of estimated well costs for the Townsend State Com. Well No. 2 shall not be furnished to interest owners in the well unit until after the rig is released from the Townsend State Com. Well No. 6.

(5) Within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(6) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the 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 said schedule,

the actual well costs shall be the reasonable well costs; provided however, if there is objection to actual well costs within said 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(7) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated well costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

(8) The operator 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 within 30 days from the date the schedule of estimated well costs is furnished to him.

(b) As a charge for the risk involved in the drilling of 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 within 30 days from the date the schedule of estimated well costs is furnished to him.

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

(10) \$5,400.00 per month while drilling and \$540.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rate). The operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such wells, not in excess of what are reasonable, attributable to each non-consenting working interest.

(11) 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 the

terms of this order.

(12) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(13) All proceeds from production from the subject wells which are not disbursed for any reason shall immediately be placed in escrow in Lea County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; and the operator shall notify the Division of the name and address of said escrow agent within 30 days from the date of first deposit with said escrow agent.

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

(15) The operator of the wells and units shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(16) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

[Seal]

LORI WROTENBERY
Director