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JUN - 8 1998

June 4, 1998

Ocean Energy, Inc.
410 Building
410 17th Street, Suite 1400
Denver, Colorado 80202

Attention: Ms. Laura B. Smith

Re: Oil Conservation Division Cases 11934, 11958 and 11959 (Consolidated):
Applications of Yates Petroleum Corporation and Ocean Energy, Inc. for
Compulsory Pooling, Lea County, New Mexico

Dear Laura:

In response to the request of Examiner Stogner that Yates Petroleum Corporation and Ocean Energy, Inc. attempt to reach a voluntary agreement for the development of the Morrow formation in the southern portion of irregular Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico, Yates has reviewed all prior proposals for the development of this acreage and the testimony presented at the May 14, 1998 Examiner hearing. From this review it appears the following three issues must be resolved for a voluntary resolution of this dispute to be possible:

1. The number of wells/spacing units which are required to develop the reserves under this acreage,
2. Drainage and counter drainage of the reserves between this tract and the Yates operated offsetting tract to the South, and
3. The ownership position of the parties in each of these wells/spacing units.

Yates Petroleum Corporation has reviewed the settlement proposal of Ocean Energy, Inc. contained in your letter of May 22, 1998. As you are aware, this proposal is similar to the last proposal made by Ocean (UMC) which was unacceptable to Yates. We believe that your proposal does not address the issues set out above and therefore offer the following as a counter proposal for the voluntary development of this acreage.

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Yates will amend its application in Case 11934 to change the location for its proposed Fields APK State Com. No. 3 Well to a location 1880 feet from the South and West lines of Section 2 to be dedicated to a standup spacing unit comprised of Lots 11 through 14 and the SW/4 of Section 2. Yates shall be named operator of this well which will commence drilling by August 15, 1998 or within 30 days of receipt of a final order from the Division granting the application, whichever is later.

Ocean will agree to one well on the above referenced standup 320-acre spacing unit in Section 2 in the Morrow formation, will dismiss its applications in cases 11958 and 11959 and will support the amended application of Yates Petroleum Corporation.

Yates believes this proposal will resolve the issues which have prevented a voluntary agreement for the development of this acreage in the past. First, the spacing unit will follow the underlying Morrow channel and will not include acreage which does not contain commercial reserves. Furthermore, our proposal will avoid the drilling of an unnecessary well since only one well is needed to effectively drain the Morrow reserves under this acreage. This fact has been recognized by the parties since all applications for the development of this acreage place the well on the spacing unit proposed by Yates.

Moving the location of the Fields APK State Com Well No. 3 as proposed by Yates should resolve the drainage issue. As you will recall, at the Examiner hearing Ocean stated its belief that the only reason for the Yates proposal was to protect its Shell Lusk Well located 1980 feet from the North line and 1980 feet from the West line of Section 11 from a competing well in the SW/4 of Section 2. The Yates amended application will eliminate this issue for the Fields APK State Com Well No. 3 will be 1880 feet from the South line of Section 2 or 100 feet closer to the common boundary between these spacing units than the Shell Lusk well in Section 11. The Yates proposal also will result in an equal allocation of the reserves between Yates and Ocean. Under a 320-acre unit comprised of Lots 11 through 14 and the SW/4 of Section 2, Yates and Ocean will each own 37.5% of the working interest. In a lay down Strawn unit for the well, each will own 50% of the working interest.

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Yates believes this proposal will resolve the underlying issues which have prevented a voluntary agreement for the development of this acreage in the past and will avoid the drilling of unnecessary wells. If this proposal meets with your approval, please sign on the space below and return one copy to Yates. If you have questions concerning this proposal please call me at Yates Petroleum Corporation (505) 748-1471. We remain available to discuss this matter with you and hope that we will be able to reach a voluntary agreement which will enable us to drill a well at the earliest possible time.

Very truly yours,

YATES PETROLEUM CORPORATION



Robert Bullock
Landman

AGREED TO AND ACCEPTED THIS _____ DAY OF JUNE, 1998.

OCEAN ENERGY, INC.

By _____
Title _____

cc: Michael E. Stogner, Hearing Examiner
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New Mexico Department of Energy,
Minerals and Natural Resources
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