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. 12325
ORDER NO. R-_____

APPLICATION OF CHESAPEAKE OPERATING, INC. FOR COMPULSORY POOLING AND AN UNORTHODOX SUBSURFACE LOCATION, LEA COUNTY, NEW MEXICO.

ALTURA ENERGY LTD.'S
PROPOSED ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on January 20, 2000, at Santa Fe, New Mexico, before Examiner Mark Ashley.

NOW, on this ____day of February, 2000, the Division Director, having considered the testimony, the record, and the recommendation 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) The applicant, Chesapeake Operating, Inc. ("Chesapeake"), seeks an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the following described acreage in Section 17, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico:

(a) the S/2 to form a standard 320-acre lay-down gas spacing and proration unit for formations and/or pools developed on 320-acre spacing within that vertical extent, including the West Lovington Pennsylvanian Gas Pool; and

(b) the SW/4 to form a standard 160-acre spacing and proration unit for formations and/or pools developed on 160-acre gas spacing within that vertical extent, including the North Shoe Bar-Wolfcamp Gas Pool.

(3) These units are to be dedicated to Chesapeake's College of the Southwest "15" Well No. 1 ("College of the Southwest Well") which has been drilled as a directional wellbore to total depth in the Morrow formation at an unorthodox subsurface location 580 feet from the South line and 1085 feet from the West line of this section.

(4) The West Lovington Pennsylvanian Pool is governed by Rule No. 104.C(2) of the Division's General Rules and Regulations which provides for 320-acre spacing and requires wells to be located no closer than 660 feet from the outer boundary of the quarter section and no closer than 10 feet to any quarter-quarter section line or subdivision inner boundary.

(5) The North Shoe Bar-Wolfcamp Gas Pool is governed by Special Pool Rules and Regulations which provide for 160-acre spacing and proration units and requires wells to be located within 150 feet of the center of a governmental quarter-quarter section or lot.

(6) The Northeast Shoe Bar-Strawn Pool which is governed by Special Pool Rules and Regulations that provide for 80-acre oil spacing and requires wells to be located no closer than 330 feet to any quarter-quarter section line.

(7) Chesapeake drilled the College of the Southwest Well by re-entering the existing Fasken Berry Hobbs "17" Well No. 1 ("the Fasken Well") at a surface location 981feet from the South line and 991 feet from the West line of Section 17, kicking off at an approximate depth of 9,000 feet, and directionally drilling to the Strawn formation at a proposed standard bottomhole location 606 feet from the South line and 1096 feet from the West line of said Section 17. (Chesapeake Exhibit No. 4).

(8) The College of the Southwest Well was drilled as proposed and was dry in the Strawn formation. Chesapeake then decided to drill to and test the Atoka-Morrow formation. Prior to extending the well to the Atoka-Morrow formation, Cheasapeake did not seek or obtain authorization from the Oil Conservation Division, or contact the other working interest owners in the additional acreage which would have to be dedicated to the well in deeper formations. The well has been drilled to an unorthodox subsurface gas well location 580 feet from the South line and 1085 feet from the West line of said Section 17 in the Atoka-Morrow formations. (Testimony of Townsend).

(9) Chesapeake is the operator of the offsetting acreage to the south and no affected party appeared at the hearing and/or objected to the unorthodox subsurface location. (Testimony of Townsend).

(10) Chesapeake is a working interest owner in the subject spacing and proration units and therefore has the right to drill for and develop the minerals underlying these units.

(11) At the hearing, Altura Energy LTD. ("Altura") and Southeast Royalties, Inc. ("Southeast"), working interest owners in the Atoka-Morrow and Wolfcamp proration units that have not agreed to pool their interests, appeared and presented testimony in opposition to: (a) the compulsory pooling portion of Chesapeake's application; and, (b) the costs which Chesapeake is now proposing to charge to other owners before they will be able to participate in production from other formations it now seeks to pool.

(12) The evidence established that, prior to re-entering the Faskin well, Chesapeake only proposed to drill the College of the Southwest Well to test the Strawn formation:

(a) When Chesapeake reentered the Fasken Well and drilled the College of the Southwest Well to the Strawn formation, it did not consider the Atoka-Morrow formations to be productive of hydrocarbons at this location even though it had reviewed a log from the Fasken Well which showed Atoka-Morrow reservoir to be present. Accordingly, Chesapeake only attempted to combine the interests in, and obtain approvals from the Oil Conservation Division, for an 80-acre spacing unit comprised of the S/2 SW/4 of Section 17. Chesapeake did not attempt to form a 320-acre spacing unit for the Atoka-Morrow formation,

did not obtain a permit for a 320-acre spacing unit from the Oil Conservation Division, and did not propose a well to test these formations to other owners of working interest in the spacing units for 320-acre deep gas wells. (Testimony of Townsend)

(b) When Chesapeake reentered the Fasken Well and drilled the College of the Southwest Well to the Strawn formation, it did not consider the Wolfcamp formation to be productive of hydrocarbons at this location even though there was Wolfcamp production from adjoining sections and there is a well in the NE/4 NE/4 of Section 17 with cumulative production from the Wolfcamp formation of over 76,000 barrels of oil. (Testimony of Hefner, Testimony of Welsh). Accordingly, Chesapeake did not form a 160-acre spacing unit for the Wolfcamp formation, did not obtain a permit from the Oil Conservation Division for a 160-acre spacing unit and did not propose a well to this formation to the other owners of working interest in the 160-acre Wolfcamp spacing unit for this well. (Testimony of Townsend)

(c) Chesapeake did not combine the interests below the base of the Strawn formation for the drilling of a well in the S/2 of Section 17. (Testimony of Hefner).

FINDING: WHEN CHESAPEAKE REENTERED THE FASKEN WELL AND DRILLED TO THE STRAWN FORMATION, IT DID NOT PROPOSE A WELL TO TEST OR PRODUCE THE WOLFCAMP OR THE ATOKA-MORROW FORMATIONS, DID NOT COMBINE THE INTERESTS IN WOLFCAMP OR ATOKA-MORROW SPACING UNITS, AND DID NOT OBTAIN REGULATORY AUTHORITY FOR A WOLFCAMP OR ATOKA-MORROW WELL.

(13) Although the information available would not justify the drilling of a new well to test the Atoka-Morrow formation, Chesapeake reduced the cost of drilling the College of the Southwest Well to test the Strawn formation by reentering and utilizing the wellbore of the Fasken Well. (Testimony of Hefner).

(14) Chesapeake drilled its College of the Southwest Well as a dry hole in the

Strawn formation to an approximate depth of 11,800 feet. At that time, neither Altura nor Southeast owned any working interest in the well to the Strawn formation nor in the 80-acre spacing unit dedicated to it. (Testimony of Townsend).

FINDING: CHESAPEAKE DRILLED A DRY HOLE IN THE STRAWN FORMATION

(15) To drill from the Strawn formation to the Atoka-Morrow formation, Chesapeake only had to drill several hundred additional feet. The well has been drilled, logged and there have been gas shows in the Atoka-Morrow formation on the mud logs of the well. (Testimony of Hefner).

FINDING: CHESAPEAKE DRILLED A WELL TO TEST THE ATOKA-MORROW FORMATION

(16) Chesapeake asks the Division to impose the maximum risk penalty allowed under the New Mexico Oil and Gas Act of 200% on the interests of Altura and Southeast if they do not voluntarily join in the well. (Testimony of Hefner).

(17) While Chesapeake testified that the risk associated with the drilling of this well was not reduced by having drilled the well to total depth, nor by having a log which established that the Atoka-Morrow formation was present in the well bore nor by having gas shows on the mud log of the well, (Testimony of Hefner) Altura's engineering testimony established that the only risk which remains is that associated with the completion of the well in the Wolfcamp and Atoka-Morrow formations.

(18) Chesapeake has assumed the risk associated with drilling the College of the Southwest Well from its dry hole in the Strawn formation to the Atoka-Morrow formation without first combining the lands to be dedicated to the well either by voluntary agreement of the interest owners therein or by obtaining a compulsory pooling order from the Oil Conservation Division.

FINDING: CHESAPEAKE HAS ASSUMED THE RISK OF DRILLING THE COLLEGE OF THE SOUTHWEST WELL TO TOTAL DEPTH.

(19) Chesapeake seeks an order whereby Altura and Southeast, as working interest owners in the interval below the base of the Strawn, will be required to pay a share of the costs of the entire wellbore. (Testimony of Townsend, *See* Chesapeake Exhibit No. 7).

(20) In its closing statement, Chesapeake asked the Division to allocate the costs incurred in the drilling of the College of the Southeast Well to the Atoka-Morrow formation to Altura and Southeast in accordance with the provisions of COPAS Bulletin No. 2, "Determination of Values for Well Cost Adjustments - Joint Operations". Chesapeake cited Oil Conservation Division Case 9998 and Order No. R-9093-C entered therein as a precedent for this request.

(21) The facts and issues presented to the Division in Case 9998 and decided by Order No. R-9093-C are distinguishable from the facts and issues presented to the Division in this case in the following ways:

(a) Case No. 9998 involved the amendment of a compulsory pooling order to add only **uphole** formations not included in the original order. This case involves an application for a new compulsory pooling order to combine the interests of working interest owners in formations **below** the total depth of the original wellbore

(b) In Case No. 9998 all affected formations were developed on 40-acre spacing units. This case involves the horizontal expansion of the subject spacing units to combine lands in formations spaced on larger and different spacing units than those dedicated to the Chesapeake Strawn well.

(c) In Case No. 9998, the affected parties were the same in the new formations as in formations subject to the original pooling order. In this case, the interest owners subject to pooling owned no interest in the original wellbore.

(d) In Case No. 9998, the owners in the formations to be added to the original compulsory pooling order had negotiated with the applicant prior to drilling, concerning their voluntary participation in the well. In this case, prior to drilling the well to total depth, the owners whose interest Chesapeake seeks to pool had not been involved in negotiations concerning their voluntary

participation in the original well.

(e) Before the original compulsory pooling order was entered in Case 9998, the owners who were subject to the pooling application had been offered an opportunity to participate in the well and had declined to do so. In this case, the owners subject to pooling were not contacted about participation in the well until in had already been drilled and was a dry hole in the Strawn formation–the well's principal objective.

(f) In Case No. 9998, the COPAS Bulletin No. 2 formula was utilized to **decrease** the costs other interest owners would have to pay to participate in production from the new formations which were added to the pooling order. In this case, unlike Order No. R-9093-C, Chesapeake is attempting to use the formula in COPAS Bulletin No. 2 to **increase** the share of the costs other interest owners would have to pay to participate in production from the new formations which it is attempting to now force pool to their original Strawn well.

FINDING: ORDER NO. R-9093-C IS NO PRECEDENT FOR THE ISSUES PRESENTED TO THE DIVISION IN THIS CASE

(22) The share of well costs which Chesapeake seeks from Altura exceeds the total costs of drilling this well from the Strawn to the Atoka-Morrow formation. (Testimony of Hefner).

(23) If Chesapeake's application is granted and the interests of Altura and Southeast are required to pay a share of the costs of Chesapeake's entire wellbore, Altura and Southeast will pay an amount which equals or exceeds the total costs of drilling from the Strawn to the Atoka-Morrow, and Chesapeake will share in Atoka-Morrow production for no additional cost over those incurred in drilling the dry hole in the Strawn.

FINDING: REQUIRING ALTURA AND SOUTHEAST TO PAY A SHARE OF THE COSTS INCURRED IN DRILLING THE DRY HOLE IN THE STRAWN IS UNREASONABLE AND SHOULD NOT BE ORDERED.

(24) The information available on the Atoka-Morrow formation from the logs of the

College of the Southwest Well shows that the formations are present in the well and that there are gas shows in this interval. However, the data available also shows that the well is likely to be of only marginal quality and probably will not pay out the costs of drilling the entire wellbore and any applicable risk charges. Accordingly, other interest owners in the Atoka-Morrow formation, which may desire to participate in the well under the same conditions as Chesapeake, are not able to do so if they must pay a share of the entire well bore while, as to the Atoka-Morrow, Chesapeake will only have to assume its share of the additional costs incurred in drilling from the Strawn to the Atoka-Morrow formation.

(25) Altura and Southeast should be afforded the opportunity to participate in Atoka-Morrow production from the College of the Southwest Well by paying their proportionate share of the costs of the well only as drilled from the Strawn formation to the Atoka-Morrow formation.

(26) To require Altura and Southeast to pay a share of the costs of the entire well bore amounts to a confiscation of their interests as the direct consequence of the Chesapeake's unilateral decision to drill to the Atoka-Morrow formation.

FINDING: TO REQUIRE ALTURA AND SOUTHEAST TO PAY THEIR SHARE OF THE COSTS OF DRILLING THE STRAWN DRY HOLE WOULD RESULT IN THE CONFISCATION OF THEIR INTERESTS AND SHOULD BE DENIED.

(27) Chesapeake would have realized all the benefits, and assumed all the risks, associated with drilling of the College of the Southwest Well to the Strawn formation. Instead, Chesapeake has drilled a dry hole, and Altura and Southeast only own working interest in the intervals below the base of the Strawn formation. (*See,* Testimony of Townsend).

(28) Altura and Southeast should only be required to pay, or have their share recouped out of production, their respective shares of the actual well costs incurred below the base of the Strawn formation.

(29) Any working interest owner in the 320-acre spacing and proration unit dedicated to the College of the Southwest Well in the Atoka-Morrow formation should pay

its share of the actual well costs incurred in the drilling of the vertical interval from the base of the Strawn formation to the total depth of the well.

FINDING: ANY WORKING INTEREST OWNER IN THE 320-ACRE SPACING AND PRORATION UNIT DEDICATED TO THE COLLEGE OF THE SOUTHWEST WELL SHOULD BE REQUIRED TO PAY ITS SHARE OF THE ACTUAL WELL COSTS INCURRED IN DRILLING THE VERTICAL INTERVAL FROM THE BASE OF THE STRAWN FORMATION TO TOTAL DEPTH OF THE WELL, OR SHOULD HAVE ITS SHARE OF THESE COSTS WITHHELD FROM PRODUCTION.

(30) Chesapeake has not completed the well and will not complete the well until a decision is rendered in this case. (Testimony of Hefner).

(31) Altura presented engineering testimony that the risk associated with the completion of the College of the Southwest Well in either the Wolfcamp or the Atoka-Morrow formations is very small. (Testimony of Welsh).

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

(33) Any non-consenting working interest owner who does not pay its share of estimated completion costs should have withheld from production its share of reasonable completion costs plus an additional 100 percent thereof as a reasonable charge for the risk involved in the completion of the well.

FINDING: ANY WORKING INTEREST OWNER IN THE 320-ACRE SPACING AND PRORATION UNIT DEDICATED TO THE COLLEGE OF THE SOUTHWEST WELL, WHO DOES NOT PAY ITS SHARE OF ESTIMATED COMPLETION COSTS IN EITHER THE WOLFCAMP OR THE ATOKA-MORROW INTERVAL, SHOULD HAVE WITHHELD FROM PRODUCTION ITS SHARE OF REASONABLE COMPLETION COSTS PLUS AN ADDITIONAL 100 PERCENT

THEREOF AS A REASONABLE CHARGE FOR THE RISK INVOLVED IN THE COMPLETION OF THE WELL.

(34) To avoid the drilling of unnecessary wills, to protect correlative rights, to prevent waste and to afford to the owner of each interest in the S/2 of said Section 17 the opportunity to recover or receive without waste a just and fair share of hydrocarbon production from any unit covered by this order, this application should be approved by pooling all mineral interests, whatever they may be, within the units subject to the conditions and limitations of this order.

(35) Chesapeake Operating, Inc. should be designated operator of the well and subject units.

(36) Any interest owner should be afforded the opportunity to object to the actual well costs and completion costs but in the absence of such objection, actual costs should be adopted as the reasonable costs.

(37) Following determination of reasonable costs, any working interest owner who has paid its share of estimated costs should pay to the operator any amount by which reasonable costs exceed estimated costs, and should receive from the operator any amount that paid, estimated costs, exceed reasonable costs.

(38) Reasonable charges for supervision (combined fixed rates) should be fixed at $6,000.00 per month while drilling and $600.00 per month while producing.

(39) All proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the owner thereof upon demand and proof of ownership.

(40) Chesapeake testified that it would continue to negotiate with Altura and Southeast for their voluntary participation in the well. If all the parties subject to this order reach voluntary agreement subsequent to the entry of this order, this order should become of no effect.

(41) The operator of the well and units should notify the Director 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) Pursuant to the application of Chesapeake Operating, Inc. ("Chesapeake"), all mineral interests, whatever they may be, in all formations from the surface to the base of the Atoka-Morrow formation underlying a portion of Section 17, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico, are hereby pooled in the following manner:

the S/2 to form a standard 320-acre gas spacing and proration unit for formations and/or pools spaced on 320 acres within that vertical extent which presently include the West Lovington-Pennsylvanian Gas Pool; and

the SW/4 to form a standard 160-acre gas spacing and proration unit for formations and/or pools spaced on 160 acres within that vertical extent which presently includes the North Shoe Bar-Wolfcamp Gas Pool.

These units shall be dedicated to the applicant's College of the Southwest "17" Well No. 1 which it has directionally drilled by reentering the Fasken Berry Hobbs "17" Well No. 1 at a surface location 981 feet from the South line and 991 feet from the West line to an unorthodox subsurface location in the Atoka-Morrow formation, 580 feet from the South line and 1085 feet from the West line (Unit M) of Section 17 which is hereby approved.

(2) Chesapeake Operating, Inc. is hereby designated operator of the subject well and units.

(3) The operator shall furnish the Division and each known working interest owner in the 320-acre unit comprised of the S/2 of Section 17 an itemized schedule of the actual well costs incurred in drilling the College of the Southwest "17" Well No. 1 from the base of the Strawn formation to total depth of the well. In no event shall Altura or Southeast be charged with any well costs incurred in drilling above the base of the Strawn formation.

(4) Within 30 days from the date that the schedule of actual costs incurred in drilling from the base of the Strawn to total depth is furnished, any working interest owner

in the subject well shall have the right to pay its share of these well costs to the operator and thereby participate in the well. No working interest owner who does not voluntarily pay its share or otherwise voluntarily participate in the well shall be responsible for payment of any costs which are not recovered by the operator out of production.

(5) If no objection to the actual well costs incurred in drilling the subject well from the base of the Strawn formation to total depth is received by the Division within 45 days of the date the schedule of actual costs is provided to working interest owners pursuant to Paragraph 3 of this order, the actual well costs shall be the reasonable well costs.

(6) After the effective date of this order and within 90 days prior to commencing the recompletion of this well in either the Atoka-Morrow or the Wolfcamp formation , the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated completion costs for completing the well in the Atoka-Morrow formation or the Wolfcamp formation.

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

(8) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual completion costs within 90 days following completion of each formation in the well. If no objection to the actual completion costs is received by the Division and the Division has not objected within 45 days following receipt of the schedule, the actual completion costs shall be the reasonable completion costs; provided, however, that if there is an objection to actual completion costs within the 45-day period the Division will determine reasonable completion costs after public notice and hearing.

(9) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated well 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 its share of the amount that estimated well costs exceed reasonable well costs.

(10) The operator is hereby authorized to withhold the following costs and charges from any non-participating interest owner share of production:

(a) the proportionate share of reasonable completion costs attributable to each non-consenting working interest owner who has not paid its share of estimated completion costs within 30 days from the date the schedule of estimated well costs is furnished; and

(b) as a charge for the risk involved in completing the well, 100 percent of the above costs.

(11) The operator shall distribute the costs and charges withheld from production pursuant to this order to parties who advanced the well costs.

(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000.00 per month while drilling and $600.00 per month while producing.

(13) Any unleased mineral interest shall be considered a seven-eights (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order.

(14) Any well costs or charges that are to be paid out of production pursuant to this order 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.

(15) All proceeds from production from the well that 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. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent.

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

(17) 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.

(18) 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 day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

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