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February 12, 2001

Hand Delivered

Michael E. Stogner
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Ocean/Yates
Case Nos. 12535, 12567, 12569, and 12590

Dear Mr. Stogner:

Enclosed are the following:

1. Ocean's proposed order (hard copy and disk).

2. Copies of Order Nos. R-10731-A and R-10977, cited at hearing.

3. Ocean's Motion to Dismiss Yates' applications.

4. A copy of the last correspondence from Ocean to Yates.

Very truly yours,

James Bruce

cc: William F. Carr w/encl.

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

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

APPLICATION OF OCEAN ENERGY RESOURCES,
INC. FOR COMPULSORY POOLING AND FOUR
NON-STANDARD SPACING AND PRORATION UNITS,
LEA COUNTY, NEW MEXICO. No. 12535

APPLICATION OF OCEAN ENERGY RESOURCES,
INC. FOR COMPULSORY POOLING AND FOUR
NON-STANDARD SPACING AND PRORATION UNITS,
LEA COUNTY, NEW MEXICO. No. 12567

APPLICATION OF YATES PETROLEUM CORPORATION
FOR COMPULSORY POOLING AND A NON-STANDARD
SPACING AND PRORATION UNIT, LEA COUNTY,
NEW MEXICO. No. 12569

APPLICATION OF YATES PETROLEUM CORPORATION
FOR COMPULSORY POOLING AND A NON-STANDARD
SPACING AND PRORATION UNIT, LEA COUNTY,
NEW MEXICO. No. 12590

ORDER NO. R-_____

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

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on January 11, 2001 and February 8, 2001 at Santa Fe, New Mexico before Examiner Michael E. Stogner.

NOW, on this ____ day of _____, 2001, 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 these cases and their subject matter.

(2) In Case No. 12535, Ocean Energy Resources, 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 3, Township 16 South, Range

35 East, N.M.P.M., and in the following manner:

(a) Lots 1-8 to form a non-standard 355.80-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, including the Undesignated North Shoe Bar-Atoka Gas Pool and Undesignated North Shoe Bar-Morrow Gas Pool;

(b) Lots 3-6 to form a non-standard 177.21-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within that vertical extent;

(c) Lots 3 and 4 to form a non-standard 97.21-acre oil spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within that vertical extent, including the Undesignated South Big Dog-Strawn Pool; and

(d) Lot 4 to form a non-standard 48.43-acre oil spacing and proration unit for any and all formations and/or pools developed on 40-acre spacing within that vertical extent, including the Townsend-Permo Pennsylvanian Pool.

The units are to be dedicated to the proposed Townsend State Com. Well No. 10, to be located 800 feet from the North line and 660 feet from the West line (Unit D) of Section 3. Case No. 12535 was filed as to the working interest owners in the proposed well.

(3) In Case No. 12567, Ocean seeks an order pooling the same well units as in Case No. 12535. Case No. 12567 was filed to pool the unleased mineral interest owners in the proposed well.

(4) In Case No. 12569, Yates Petroleum Corporation ("Yates") seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying Lots 1-8 of irregular Section 3, Township 16 South, Range 35 East, N.M.P.M., to form a non-standard 355.80-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, including the Undesignated North Shoe Bar-Atoka Gas Pool and Undesignated North Shoe Bar-Morrow Gas Pool The unit is to be dedicated to the proposed Daisy AFS State Com. Well No. 2, to be located 660 feet from the North and East lines (Unit A) of Section 3.

(5) Case No. 12590 seeks an order pooling the same interests as in Case No. 12569. It was filed because Case No. 12569 was filed before a proposal letter was sent to interest owners, in an attempt to cure the defect in filing Case No. 12569.

(6) Case Nos. 12535, 12567, 12569, and 12590 were consolidated for purposes of hearing.

(7) David H. Arrington Oil & Gas, Inc. ("Arrington") entered an appearance in this matter in support of Yates.

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

(9) For convenience, throughout the hearing the parties referred to Lots 1, 2, 7, and 8 of Section 3 as the "NE¼," and Lots 3-6 as the "NW¼."

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

(a) Interest ownership in the proposed 355.80-acre units is as follows:

Ocean Energy Resources, Inc. 41.072056%
Yates Petroleum Corporation, et al. 50.193929%
David H. Arrington Oil & Gas, Inc. 5.331300%
Unleased Mineral Interest
Owners in Lots 3-6 ..... 3.402715%

Several unleased interest owners have joined in the Ocean or Yates well proposals.

(b) Ocean proposed its well to Yates and Arrington in May 2000, and sent an operating agreement regarding the proposed well to these parties in June 2000. It also met in person with Yates, and spent approximately six months attempting to gain their voluntary joinder in the well.

(c) Ocean began trying to lease the unleased mineral interests in July 2000, and continued that effort for approximately three months before sending a well proposal and AFE to the unleased owners.

(d) Ocean conducted months of negotiations with all interest owners before filing its pooling applications.

(e) **The first correspondence that interest owners received from Yates regarding its proposed well was the notice of the compulsory pooling application in Case No. 12569, which was filed with the Division on December 19, 2000. Yates did not send a well proposal to interest owners until December 27, 2000, after the pooling application was filed.**

(11) Ocean presented the following geological and geophysical evidence:

(a) The Morrow development in this area is based primarily on seismic data. The same seismic data set was available to both Ocean and Yates.

(b) Morrow reservoirs in this area are formed at structural lows. However, if a structural low does not contain Morrow sand, a well will not be a successful.

(c) Ocean's proposed well in Lot 4 is at a slightly higher structural position than Yates' proposed well in Lot 1. However, the seismic data shows that Morrow sand is present at Ocean's location, and may not be present at Yates' location. **Ocean Exhibit 8.**

(d) The importance of sand being present is shown by the successful Mesa Townsend Well No. 1, in Unit O of Section 3. That well is not at the lowest structural position in the section, but has substantial Morrow sand development and is a commercial well. **Ocean Exhibits 6 and 8.**

(e) The closest well to Yates proposed well is Yates' Daisy AFS State Com. Well No. 1, located in Unit G of Section 3. That well was dry in the Morrow due to lack of Morrow sand development.

(f) The best Morrow well in the immediate area is Ocean's Panther Martin Well No. 1, located in Unit S of Section 3, which initially produced gas at a rate of 1437 MCF/day, and is currently producing at a rate of 3576 MCF/day.

(g) The Mesa sand, the primary Morrow sand in this area, is present in the Panther Martin Well No. 1 and in the Mesa Townsend Well No. 1. **Ocean Exhibit 8.** With its proposed location, Ocean is attempting to duplicate the success of these two wells.

(h) Both parties agreed that two wells may eventually be drilled in the N½ of Section 3. However, the optimum location for the first Morrow well in the N½ of Section 3 is in the NW¼ of the section.

(12) Yates' theory in drilling Morrow wells in this area is that a well should be drilled at the lowest structural position. However, Yates' theory ignores the following:

(a) The Morrow well at the lowest structural position in the area, Yates' Baer Well No. 3 in the SE¼SE¼ of Section 35, Township 16 South, Range 35 East, N.M.P.M., had no Morrow sand and was a dry hole. **Yates Exhibit 8.**

(b) Yates' model would not have predicted the successful Mesa Townsend Well No. 1, in Unit O of Section 3. That well is not at the lowest structural position in the section, but has substantial Morrow sand development and is a commercial well. **Ocean Exhibit 8; Yates Exhibit 8.**

(c) Yates' proposal will result in the Morrow reservoir in the N½ of Section 3 being developed by a well stepping out from a Morrow dry hole in Lots 7, substantially increasing risk and potentially causing waste.

(13) The geologists for both Ocean and Yates agreed that a 200% non-consent penalty is a proper risk factor for drilling a well in the N½ of Section 3. In addition, the AFE's and operating costs of Ocean and Yates are comparable.

(14) The primary issues in this matter are (i) good faith efforts to obtain the voluntary joinder of interest owners in the proposed well, and (ii) geology or well location. **See Commission Order No. R-10731-B.**

(15) The undisputed evidence shows that Yates did not make a good faith effort to obtain the voluntary joinder of the interest owners in its proposed well, as required by statute and Division precedent. Therefore, Yates' Case Nos. 12569 and 12590 must be dismissed. **NMSA 1978 §§70-2-17, 18; Division Order No. R-10977.**

(16) In addition, Ocean's geology and geophysics better honors the subsurface and seismic data, and shows that a Morrow well in the NW¼ of Section 3 will encounter Morrow sand and is necessary to prudently and adequately develop the reservoir and protect the correlative rights of all interest owners in Section 3.

(17) The applications of Ocean in Case Nos. 12535 and 12567 should be approved, and the application of Yates in Case Nos. 12569 and 12590 must be denied, unless Ocean does not timely commence its well hereunder.

(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 these units the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbon production in any pool resulting from this order, Ocean's two applications should be approved by pooling all mineral interests,

whatever they may be, within these units.

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

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

(21) Any non-consenting working interest owner who does not pay its share of estimated well costs should have withheld from production its 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 its 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) $6,000.00 per month while drilling and $600.00 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 well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(25) All proceeds from production from the subject well 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 the pooled units to commence drilling operations on the Townsend State Com. Well No. 10 on or before June 1, 2001, or if all parties to this forced pooling reach voluntary agreement subsequent to entry of this order, the compulsory pooling provisions of this order should become of no effect.

(27) The operator of the well and units should notify the Division in writing of the subsequent voluntary agreement of all parties to the compulsory pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) The applications of Ocean Energy Resources, Inc. in Case Nos. 12535 and 12567 are hereby approved, and all uncommitted mineral interests, whatever they may be, from the surface to the base of the Mississippian formation in the following described acreage in Section 3, Township 16 South, Range 35 East, N.M.P.M., are hereby pooled in the following manner:

(a) Lots 1-8 to form a non-standard 355.80-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, including the Undesignated North Shoe Bar-Atoka Gas Pool and Undesignated North Shoe Bar-Morrow Gas Pool;

(b) Lots 3-6 to form a non-standard 177.21-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within that vertical extent;

(c) Lots 3 and 4 to form a non-standard 97.21-acre oil spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within that vertical extent, including the Undesignated South Big Dog-Strawn Pool; and

(d) Lot 4 to form a non-standard 48.43-acre oil spacing and proration unit for any and all formations and/or pools developed on 40-acre spacing within that vertical extent, including the Townsend-Permo Pennsylvanian Pool.

These units are to be dedicated to the applicant's proposed Townsend State Com. Well No. 10, to be located 800 feet from the North line and 660 feet from the West line (Unit D) of Section 3.

PROVIDED HOWEVER THAT the operator of the units shall commence drilling operations on the Townsend State Com. Well No. 10 on or before the 1st day of _____, 2001, and shall thereafter continue the drilling of the well with due diligence to a depth sufficient to test the Mississippian formation.

PROVIDED FURTHER THAT in the event the operator does not commence drilling operations on the well on or before the 1st day of _____ 1, 2001, Ordering Paragraph No. (1) shall be of no effect, unless the operator obtains a time extension from the

Division Director for good cause shown.

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

(2) The applications of Yates Petroleum Corporation in Case Nos. 12569 and 12590 are hereby dismissed.

(3) Ocean Energy Resources, Inc. is hereby designated the operator of the subject well and units.

(4) After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners." After the effective date of this order and within 90 days prior to commencing the well, the operator shall furnish the Division and each known non-consenting working interest owner in the units an itemized schedule of estimated well costs.

(5) Within 30 days from the date the schedule of estimated well costs is furnished to it, any non-consenting 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, 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.

(6) The operator shall furnish the Division and each known non-consenting 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 the schedule, the actual well costs shall be the reasonable well costs; provided however, if there is objection to actual well costs within the 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 its share of estimated well costs in advance as provided above shall pay to the operator its pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator its 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 its share of estimated well 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 drilling the well, 200 percent of the above costs.

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

(10) 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, provided that this rate shall be adjusted annually pursuant to Section III.1.A.3 of the COPAS form titled "Accounting Procedure-Joint Operations." 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 well 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 the escrow agent within 30 days from the date of first deposit with the 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 well 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

LORI WROTENBERY
Director

[Seal]

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

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND A NON-STANDARD SPACING AND PRORATION UNIT, LEA COUNTY, NEW MEXICO. **No. 12569**

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND A NON-STANDARD SPACING AND PRORATION UNIT, LEA COUNTY, NEW MEXICO. **No. 12590**

OCEAN ENERGY RESOURCES, INC.'S
MOTION TO DISMISS

I. FACTS.

1. These cases involve the pooling of Lots 1-8 of irregular Section 3, Township 16 South, Range 35 East, N.M.P.M., from the surface to the base of the Mississippian formation. Yates Petroleum Corporation's ("Yates") well is proposed to be located in Unit A of Section 3.

2. On December 19, 2000, Yates filed its pooling application in Case No. 12569.

3. The first correspondence that interest owners received from Yates regarding the proposed well was notice of the compulsory pooling application in Case No. 12569, mailed on December 21, 2000.

4. Yates did not mail a proposal letter to the interest owners in the well until December 27, 2000, after the pooling application was filed. Ocean Energy Resources, Inc. ("Ocean") did not receive Yates' proposal letter until January 3, 2001. **Ocean Exhibit 3A.**

5. On January 11, 2001 Case No. 12569 was consolidated for hearing with Case Nos. 12535 and 12567 (pooling applications on the

N½ of Section 3 filed by Ocean).

6. At the January 11th hearing, it was determined that the pooling applications requested pooling only to the base of the Morrow formation, although the wells are projected to test the Mississippian formation. Therefore, the three cases were re-advertised for the February 8, 2001 hearing so that notice could be given as to the proper depth.

II. ARGUMENT.

A. New Mexico's pooling statutes require an operator to make a good faith effort to obtain the voluntary joinder of interest owners in a proposed well before it files a pooling application. **NMSA 1978 §§70-2-17, 18.** Where, as in this matter, a party does not make a sufficient effort to secure voluntary joinder in a specific well before filing a pooling application, the case must be dismissed. **Commission Order No. R-10731-B** (copy enclosed).

B. This problem has arisen before: In Case No. 11927, the applicant (Redstone Oil & Gas Company) filed its pooling application before it had proposed its well in writing to the interest owners. Upon motion of one party being pooled, the Division held that such actions did not meet the statutory requirement of good faith negotiations, and dismissed the case. The order was entered despite the fact that several months of verbal negotiations had preceded the filing of the pooling application. **Order No. R-10977** (copy enclosed).

C. The circumstances in Yates' cases are identical to the facts in Case No. 11927: Although there had been verbal

discussions between Yates and Ocean,[1] Yates' well was not proposed until after the pooling application was filed.[2]

III. CONCLUSION.

The undisputed evidence shows that Yates did not make a good faith effort to obtain the voluntary joinder of the interest owners in its proposed well, as required by statute and Division precedent. Therefore, Case Nos. 12569 and 12590 must be dismissed. **NMSA 1978 §§70-2-17, 18; Division Order No. R-10977; Commission Order No. R-10731-A.** If Yates applications are not dismissed, interest owners will, in the future, be allowed to file pooling applications before contacting working interest owners. This is contrary to the Oil and Gas Act, and Division precedent.

WHEREFORE, Ocean requests that Case Nos. 12569 and 12590 be dismissed.

Respectfully submitted,

James Bruce
Post Office Box 1056
Santa Fe, New Mexico 87504
(505) 982-2043

Attorney for Ocean Energy Resources, Inc.

[1]The other working interest owners in the N½ of Section 3 have received only the December 27, 2000 letter from Yates.

[2]Case No. 12590 was filed on or about January 16, 2001. It was obviously filed because Case No. 12569 was defective due to the filing of that application before a proposal letter was mailed. However, the interest owners only received Yates' proposal letter about 10-12 days before the application was filed, and Case No. 12590 suffers from the same defect as Case No. 12569.

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

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

DE NOVO
CASE NO. 11666
CASE NO. 11677
Order No. R-10731-B

APPLICATION OF KCS MEDALLION RESOURCES, INC. (FORMERLY INTERCOAST OIL AND GAS COMPANY) FOR COMPULSORY POOLING AND UNORTHODOX GAS WELL LOCATION, EDDY COUNTY, NEW MEXICO.

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, EDDY COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9:00 a.m. on February 13, 1997, at Santa Fe, New Mexico, before the Oil Conservation Commission, hereinafter referred to as the "Commission."

NOW, on this 28th day of February, 1997, the Commission, a quorum being present, having considered the testimony, the record, and being fully advised in the premises,

FINDS THAT:

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

(2) Case Nos. 11666 and 11677 were consolidated at the time of the hearing for the purpose of testimony, and, inasmuch as approval of one application would necessarily require denial of the other, one order should be entered for both cases.

(3) The applicant in Case No. 11666, KCS Medallion Resources, Inc. ("Medallion") formerly known as InterCoast Oil and Gas Company, seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool. Said unit is to be dedicated to the applicant's proposed State of New Mexico "20" Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20.

(4) The applicant in Case No. 11677, Yates Petroleum Corporation ("Yates"), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool. Said unit is to be dedicated to the applicant's proposed Stonewall "AQK" State Com Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20.

(5) The subject wells and proration unit are located within the Burton Flat-Morrow Gas Pool and within one mile of the West Burton Flat-Atoka Gas Pool, both of which are currently governed by Rule No. 104.C. of the Division Rules and Regulations which require standard 320-acre gas spacing and proration units with wells to be located no closer than 1650 feet from the end boundary nor closer than 660 feet from the side boundary of the proration unit nor closer than 330 feet from any quarter-quarter section line or subdivision inner boundary.

(6) Both Yates and Medallion have the right to drill within the proposed spacing unit and both seek to be named operator of their respective wells and the subject proration unit.

(7) Yates and Medallion have conducted negotiations prior to the hearing but have been unable to reach a voluntary agreement as to which company will drill and operate the well within the spacing unit.

(8) According to evidence and testimony presented by both parties, the primary objective within the wellbore is the Morrow formation with other formations comprising secondary objectives.

(9) Both Yates and Medallion are in agreement that the well which will ultimately develop the subject proration unit should be located at the unorthodox gas well location requested by both parties. In support of this request, both parties presented geologic evidence and testimony at the Examiner hearing which indicates that a well at the proposed unorthodox location should penetrate the Upper and Lower Morrow sand intervals in an area of greater net sand thickness than a well drilled at a standard gas well location thereon, thereby increasing the likelihood of obtaining commercial gas production. Since both parties agreed on the proposed location, prospect geology, as it relates to the proposed well location, should not be a factor in deciding this case.

(10) Oxy U.S.A. Inc., the affected offset operator to the north of the proposed location, did not appear at the hearing in opposition or otherwise object to the proposed unorthodox gas well location. No other offset operator and/or interest owner appeared at the hearing in opposition to the proposed unorthodox gas well location.

(11) Approval of the proposed unorthodox gas well location will afford the operator within the E/2 of Section 20 the opportunity to produce its just and equitable share of the gas in the Burton Flat-Morrow Gas Pool, prevent the economic loss caused by the drilling of unnecessary wells, avoid the augmentation of risk arising from the drilling of an excessive number of wells and otherwise prevent waste and protect correlative rights.

(12) Both Yates and Medallion submitted AFE's for the drilling of their respective wells within the subject spacing unit. The AFE's are not substantially different and should not be a factor in deciding these cases.

(13) The overhead rates proposed by Yates and Medallion are not substantially different and also should not be a factor in deciding these cases.

(14) Both parties proposed that a risk penalty of 200 percent be assessed against those interest owners who do not participate in the drilling of a well within the subject spacing unit.

(15) A brief description of the chronology of events leading up to the hearing in these cases is summarized as follows:

By letter dated August 30, 1996, Medallion sought a farmout from Yates in Section 20 in order to drill an 11,250 foot Morrow test at a location 990 feet from the North and East lines (Unit A). The proposal did not specify which spacing unit will be utilized;

September 17, 1996--By phone conversation Yates informed Medallion of its desire not to farmout the subject acreage;

September 26, 1996--Medallion filed compulsory pooling application seeking a N/2 spacing unit in Section 20 for a well to be drilled in Unit A. Yates received notice of Medallion's compulsory pooling application on September 30, 1996. A hearing was set for October 17, 1996;

By letter dated October 1, 1996, complete with operating agreement and AFE, Medallion formally proposed the drilling of its well in Unit A of Section 20. Yates received Medallion's letter October 9, 1996. Medallion's hearing was postponed until November 7, 1996, to allow Yates the opportunity to review the proposal;

October 24, 1996--Yates informed Medallion that it preferred a different well location in the N/2 of Section 20;

By letter dated October 29, 1996, complete with operating agreement and AFE, Yates proposed the drilling of the Stonewall "DD" State Com Well No. 3 at a location 990 feet from the North and West lines (Unit D) of Section 20 to the interest owners in the Stonewall Unit. The proposed spacing unit was the N/2. By letter dated October 31, 1996, Yates made the same proposal to Medallion;

November 7, 1996--Yates and Medallion met in Artesia to discuss development of Section 20. Each company insisted on drilling its respective well location. Both companies agreed that developing Section 20 with stand-up E/2 and W/2 spacing units would allow both wells to be drilled and agreed to pursue management approval of this option;

By letter dated November 11, 1996, Medallion formally proposed to drill a well within Unit A (990 feet from the North and East lines) within a stand-up proration unit comprising the E/2 of Section 20;

November 12, 1996--Medallion filed a compulsory pooling application for proposed E/2 spacing unit;

November 13, 1996--By phone conversation, Yates informed Medallion that it agrees to develop Section 20 with stand up proration units but proposed that it be allowed to drill both wells. Medallion responded that it desires to drill and operate the well in the E/2;

By letter dated November 14, 1996, Yates formally proposed the drilling of the Stonewall "DD" State Com Well No. 3 on a W/2 spacing unit to the "Stonewall Unit" interest owners;

By letter dated November 22, 1996, Yates formally proposed to Medallion the drilling of the Stonewall "AQK" State Com Well No. 1 at a location 990 feet from the North and East lines (Unit A) of Section 20. The proposed spacing unit is the E/2;

November 26, 1996--Yates filed an application for the compulsory pooling of the E/2 of Section 20;

December 2-13, 1996--Ongoing discussions between the parties.

December 19, 1996--Competing pooling applications of Yates in Case 11677 and Medallion in Case 11666 came up for hearing before Division Examiner David R. Catanach.

January 13, 1997--The Division entered Order No. R-10731 granting the application of Medallion and denying the companion application of Yates. Order No. R-10731 pooled the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, designated Medallion operator of the well, and provided that the well shall be commenced on or before April 15, 1997.

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

January 21, 1997--Medallion had obtained an extension of their farmout.

January 24, 1997--Yates requested a Stay of Division Order No. R-10709 to enable it to have the Commission review these competing pooling applications in a de novo hearing prior to Medallion commencing to drill the well. Medallion objected to the stay.

January 31, 1997--The Division Director denied the Stay because, among other things, granting the "Stay" would delay the drilling of the well which would risk the loss of valuable farmout rights. See Order No. R-10731-A.

February 8, 1997--Medallion moved a drilling rig on location and commenced drilling State of New Mexico "20" Well No. 1.

(16) Land testimony presented by both parties in this case, which is generally in agreement, indicates that:

a) 100 percent of the SE/4 and 5 percent of the NE/4 of Section 20 are subject to an existing unit agreement, the Stonewall Unit Agreement, in which Yates is the operator;

b) Yates Petroleum Corporation, Yates Drilling Company, Abo Petroleum Corporation and Myco Industries, Inc., (the "Yates Group") collectively own 37.7 percent of the proposed spacing unit. In addition, Yates testified that by virtue of the Stonewall Unit Agreement, it controls an additional 14.765 percent of the proposed spacing unit;

c) the 95 percent working interest in the NE/4 of Section 20 which is not subject to the Stonewall Unit Agreement is owned approximately as follows:

Kerr-McGee Corporation----------48 percent
Diamond Head Properties, L.P.------47 percent

d) by virtue of a farmout agreement with Kerr-McGee Corporation, Medallion will "earn" approximately 24.101 percent of the proposed spacing unit. Under the terms of the farmout agreement, a well must be commenced by February 17, 1997, or the farmout agreement will expire. Land testimony by Medallion further indicates that the subject farmout agreement will remain in effect even if Yates is named operator of the well and unit, provided however, such well must be commenced by the drilling deadline described above.

(17) Diamond Head Properties, L.P. submitted correspondence to the Division in these cases on December 12, 1996, in which it stated that it will remain neutral as to its preference of operator and that it will most likely join in the drilling of the well in the E/2 of Section 20 regardless of who operates.

(18) Interest ownership within the spacing unit is summarized as follows:

Yates Petroleum Corporation	19.635%
Yates Drilling Company	7.742%
Abo Petroleum Corporation	2.581%
Myco Industries, Inc.	7.742%
Stonewall Unit Owners (Other than the Yates Group)	14.765%
Medallion	24.101%
Diamond Head Properties, L.P.	23.416%

(19) Yates and the Yates Group own approximately 19.635 percent and 37.7 percent, respectively, within the spacing unit. Medallion, by virtue of the farmout agreement with Kerr McGee, will earn 24.101 percent of the spacing unit upon the drilling of a well in the E/2 of Section 20.

(20) Yates testified that if named operator of the subject spacing unit, it will take over the position and contract obligations of Medallion as operator and continue drilling the State of New Mexico "20" Well No. 1 without interruption.

(21) Yates contends it should be allowed to operate the State of New Mexico "20" Well No. 1 and operate the E/2 of Section 20 for the following reasons:

a) collectively, the Yates Group owns a larger percentage of the spacing unit than Medallion--37.7 percent to 24.101 percent;

b) Yates has the support of several of the interest owners in the Stonewall Unit, while Medallion has been unable to secure the support of any of these interest owners;

c) Yates has drilled and operated twenty-one wells in the Stonewall Unit since 1973;

d) the Stonewall Unit area is very complex and as operator, Yates is the most familiar with it and best able to deal with the land, accounting and distribution of production proceeds.

(22) Medallion contends that it is an experienced operator and due to the fact that it took the initiative in developing the prospect and was the moving force in getting the well drilled, it should be allowed to operate its State of New Mexico "20" Well No. 1 and operate the E/2 of Section 20.

(23) An evaluation of the evidence, testimony and information obtained from Division records indicates that:

a) within the Stonewall Unit area, which encompasses all or portions of Sections 19, 20, 29 and 30, Yates has drilled five wells to a depth sufficient to produce the Morrow formation. Most of the drilling and production from the Burton Flat-Morrow Gas Pool within the Stonewall Unit area occurred during the period from approximately 1973 to 1987, and, with the exception of the Stonewall "EP" State Well No. 1, located in Unit N of Section 19, which is currently an active producing well in the Morrow formation, all of the other wells have been plugged and abandoned;

b) even though Yates has had the opportunity to develop the N/2 or E/2 of Section 20 in the Burton Flat-Morrow Gas Pool since 1973, it apparently chose not to do so until such time as Medallion, on September 3, 1996, sought a farmout of its acreage in Section 20;

c) as a result of the agreement reached with Medallion to develop Section 20 with stand-up proration units, Yates will have the opportunity to develop the W/2 of this section by drilling its Stonewall "DD" State Com Well No. 3 in Unit D;

d) there is a fairly significant difference in interest ownership in the E/2 of Section 20 between the "Yates Group" and Medallion with Medallion controlling 24.1% by virtue of its Kerr-McGee farmout and Yates controlling 37.7% by virtue of its relationship with the "Yates Group." The uncommitted acreage as to operational preference is owned by Diamond Head Properties, L.P. which comprises 23.4% of the proration unit and should be credited to the account of Medallion for purposes of deciding the party controlling majority interest. It was because of the efforts of Medallion that this acreage will be participating in the well that is being drilled. Yates on the other hand should be credited with the Stonewall Unit's 14.8% of the spacing unit because they are operators of that unit and have the support of the majority of interest owners in the unit. Incorporating these two credits the breakdown of proration unit control is as follows: Medallion 47.5% and Yates 52.5%;

e) the controlling percentage under a 160 or 40 acre proration unit would be different from the controlling percentage under the subject 320 acre unit. If the State of New Mexico "20" Well No. 1 was completed from the Delaware, Bone Spring or Strawn formation the resultant proration unit would probably be 40 or 160 acres depending upon whether it is an oil or Permian gas completion. Paying interest for these completions would be different than paying interest under the 320 acre proration unit and would reflect acreage ownership under the assigned 40 or 160 acres. In analyzing which parties have the most at stake in drilling the well, additional weight must be given to secondary objectives and the resultant ownership under those prospective proration units. The breakdown of interest under 40 or 160 acre proration units under the currently drilling State of New Mexico "20" Well No. 1 is as follows: Yates (Stonewall Unit) 5% and Medallion 95%;

f) the most important consideration in awarding operations to competing interest owners is geologic evidence as it relates to well location and recovery of oil and gas and associated risk. Since Yates and Medallion agree on geology and location, this is not a factor;

g) good faith negotiation prior to force pooling is a factor. If the force pooling party does not negotiate in good faith, the application is denied and the applicant is instructed to try to negotiate an agreement prior to refiling the force pooling application. Both Yates and Medallion conducted adequate discussions prior to filing competing force pooling applications, so this is not a factor in awarding operations;

h) both parties stipulated that 200% was the appropriate risk factor for non-consulting working interest owners pooled under this order so this is not a factor in awarding operations;

i) both parties are capable of operating the property prudently so this is not a factor in awarding operations;

j) differences in AFE's (well cost estimates) and other operational criteria are not significant factors in awarding operations and have only minor significance in evaluating an operator's ability to prudently operate the property.

(24) In the absence of compelling factors such as geologic and prospect differences, ability to operate prudently, or any reason why one operator would economically recover more oil or gas by virtue of being awarded operations than the other, "working interest control," as defined and modified by findings 23 (d), and (e) should be the controlling factor in awarding operations.

(25) Since the adjusted "working interest control" under the proration unit was relatively even, Medallion 47.5% to Yates 52.5%, the fact that Medallion would have 95% of the "working interest control" over completions in all formations spaced on 40 or 160 acres should be the critical factor in deciding who operates the State of New Mexico "20" Well No. 1 and the proposed spacing unit.

(26) Medallion should be designated operator of the State of New Mexico "20" Well No. 1 and the proposed spacing unit.

(27) The application of Yates Petroleum Corporation in this case should be denied.

(28) 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 unit the opportunity to recover or receive without unnecessary expense his just and fair share of the production in any pool completion resulting from this order, the application of Medallion Resources, Inc. should be approved by pooling all mineral interests, whatever they may be, within the E/2 of Section 20.

(29) 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.

(30) 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 the drilling of the well.

(31) 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.

(32) 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.

(33) $5819.00 per month while drilling and $564.00 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 well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(34) All proceeds from production from the subject well 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.

(35) Upon the failure of the operator of said pooled unit to commence the drilling of the well to which said unit is dedicated on or before April 15, 1997, the order pooling said unit should become null and void and of no effect whatsoever.

(36) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, the portion of the order concerning the compulsory pooling of the subject proration unit shall thereafter be of no further effect.

(37) The operator of the well and unit 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 application of Yates Petroleum Corporation in Case No. 11677 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool, said unit to be dedicated to the applicant's proposed Stonewall "AQK" State Com Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20, is hereby denied.

(2) The application of Medallion in Case No. 11666 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool, said unit to be dedicated to the applicant's proposed Medallion State of New Mexico "20" Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20, is hereby approved.

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the 15th day of April, 1997, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Morrow formation.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the 15th day of April, 1997, 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.

PROVIDED FURTHER THAT, should said well 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.

(2) KCS Medallion Resources, Inc. is hereby designated the operator of the State of New Mexico "20" Well No. 1 and subject proration unit.

(3) 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. Since the State of New Mexico "20" Well No. 1 is currently drilling the election time to participate is extended to March 7, 1997.

(4) 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.

(5) 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.

(6) 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 by March 7, 1997.

(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 by March 7, 1997.

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

(8) $5819.00 per month while drilling and $564.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); 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 well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(9) 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.

(10) 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.

(11) All proceeds from production from the subject well which are not disbursed for any reason shall immediately 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 of the name and address of said escrow agent within 30 days from the date of first deposit with said escrow agent.

(12) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, the portion of the order concerning the compulsory pooling of the subject proration unit shall thereafter be of no further effect.

(13) The operator of the well and unit 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.

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

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JAMI BAILEY, Member

WILLIAM W. WEISS, Member

WILLIAM J. LEMAY, Chairman

S E A L

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. 11927
Order No. R-10977

APPLICATION OF REDSTONE OIL & GAS COMPANY FOR COMPULSORY POOLING AND UNORTHODOX GAS WELL LOCATION, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on February 19 and March 5, 1998, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 17th day of April, 1998, the Division Director, having considered the record and the recommendations of the Examiner, and being fully advised,

FINDS THAT:

(1) The applicant, Redstone Oil & Gas Company (Redstone), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the following described acreage in Section 12, Township 23 South, Range 24 East, NMPM, Eddy County, New Mexico, and in the following manner:

> all of Section 12 thereby forming a standard 640-acre gas spacing and proration unit for any and all formations and/or pools spaced on 640 acres within said vertical extent which presently includes but is not necessarily limited to the Rock Tank-Upper Morrow and Rock Tank-Lower Morrow Gas Pools; and,
>
> the N/2 thereby forming a standard 320-acre spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent.

Said units are to be dedicated to a well to be drilled at an unorthodox gas well location 500 feet from the North line and 2515 feet from the East line (Unit B) of Section 12.

(2) This case was consolidated with Case No. 11877 at the February 5, 1998 hearing for the purpose of testimony. In competing companion Case No. 11877, Fasken Land and Minerals, Ltd. (Fasken) seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying all of Section 12, Township 23 South, Range 24 East, NMPM, Eddy County, New Mexico, thereby forming a standard 640-acre gas spacing and proration unit for the Rock Tank-Upper Morrow and Rock Tank-Lower Morrow Gas Pools, and the N/2 of said Section 12 thereby forming a standard 320-acre spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent. Said units are to be dedicated to the applicant's proposed Carnero "12" Federal Com Well No. 1 to be drilled at an unorthodox gas well location 500 feet from the North line and 2265 feet from the West line (Unit C) of Section 12.

(3) Subsequent to the February 5, 1998 hearing, Fasken filed a motion to dismiss Redstone's application in Case No. 11927 on the basis that Redstone's attempt to reach a voluntary agreement with the various interest owners in Section 12 for the drilling of its proposed well is insufficient for the following reasons:

a) On January 26, 1998, counsel for Redstone Oil & Gas Company filed a compulsory pooling application with the Division seeking to pool acreage within Section 12, Township 23 South, Range 24 East, NMPM (Case No. 11927); and,

b) Redstone did not formally propose the drilling of its well to the various interest owners in Section 12 until February 9, 1998.

(4) Oral arguments were presented to the Division on March 5, 1998, at which time the Division granted Fasken's motion to dismiss.

(5) Case No. 11927 should therefore be dismissed.

IT IS THEREFORE ORDERED THAT:

(1) The application of Redstone Oil & Gas Company for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying all of Section 12, Township 23 South, Range 24 East, NMPM, Eddy County, New Mexico, thereby forming a standard 640-acre gas spacing and proration unit for any and all formations and/or pools spaced on 640 acres within said vertical extent which presently includes but is not necessarily limited to the Rock Tank-Upper Morrow and Rock Tank-Lower Morrow Gas Pools, and the N/2 of Section 12 thereby forming a standard 320 acre spacing and proration unit for any and all formations and/or pools spaced on 320-acres within said vertical extent, said units to be dedicated to a well to be drilled at an unorthodox gas well location 500 feet from the North line and 2515 feet from the East line (Unit B) of Section 12, is hereby dismissed.

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery

LORI WROTENBERY
Director

S E A L

Ocean Energy

January 30, 2001

VIA CERTIFIED MAIL
7000 0520 0022 2978 6701

Yates Petroleum Corporation
105 S. Fourth Street
Artesia, NM 88210-2118
Attn: Mr. Robert Bullock

Re: T16S, R35E
Section 3, Lots 1 through 8
Lea County, New Mexico

Dear Mr. Bullock:

Thank you for your letter dated January 23, 2001, regarding voluntary agreement for the development of the referenced lands. Ocean has evaluated your proposals and has concluded that our location in Lot 4 of Section 3 is the best location to drill the initial well on the 355.80 acre unit.

Ocean requests that Yates reconsider the alternatives offered in Ocean's proposal letter dated May 31, 2000.

Yours very truly,

OCEAN ENERGY RESOURCES, INC.,
a subsidiary of OCEAN ENERGY, INC.

Derold Maney
Senior Staff Landman

cc: Jim Bruce