

Correspondence

Renovo

Case No. 12744

March 2002

KELLAHIN AND KELLAHIN
ATTORNEYS AT LAW
EL PATIO BUILDING
117 NORTH GUADALUPE
POST OFFICE BOX 2265
SANTA FE, NEW MEXICO 87504-2265

TELEPHONE (505) 982-4285
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W. THOMAS KELLAHIN*

*NEW MEXICO BOARD OF LEGAL SPECIALIZATION
RECOGNIZED SPECIALIST IN THE AREA OF
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

March 27, 2002

HAND DELIVERED

Ms. Lori Wrotenbery, Director
Oil Conservation Division
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

MOTION TO CONTINUE

- Re: Case 12816 N/2 Section 25, T16S, R35E**
Application of TMBR/Sharp Drilling, Inc.
for compulsory pooling, Lea County, New Mexico
- Re: Case 12841 W/2 Section 25, T16S, R35E**
Application of Ocean Energy, Inc.
for compulsory pooling, Lea County, New Mexico

Dear Ms. Wrotenbery:

On behalf of TMBR/Sharp Drilling's ("TMBR/Sharp") we request that the reference cases set for hearing of the Examiner's docket for April 4, 2002, be continue until the New Mexico Oil Conservation Commission enters an order decide Cases 12744 and 12731 heard at the De Novo hearing on March 26, 2002.

At the conclusion of the Commission hearing yesterday afternoon, Commissioner Wrotenbery announced that the Commission would attempt to reach a decision about the permit dispute between Tmbr/Sharp and Arrington by its April 26, 2002 hearing.

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Oil Conservation Division
March 27, 2002
-Page 2-

At a Pre-Hearing Conference for the compulsory pooling cases held on March 19, 2001, Mr. David Brooks, for the Division, continued the reference compulsory pooling case then set for March 21 to April 4, 2001, so that the Commission could decide the Permit (APD) dispute has a prerequisite to the Division hearing the compulsory pooling case. Mr. Brooks further advised that the pooling cases maybe continue further until the Commissions decides the permit dispute.

A Commission decision in favor of TMBR/Sharp will eliminate the need for the Division to decide the Ocean compulsory pooling case. In the event the Commissions decides against TMBR/Sharp's position, we estimate that the pooling case with require a 1-2 day hearing.

Ocean complains that any delay in hearing its pooling case will increase it risk that its July 1, 2002 Farm-in will expire. Ocean's remedy is in District Court and is not before the Division which has no obligation to help save Ocean's farm--in. Correlative rights is the "opportunity afforded, as far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share." Ocean join forces with Arrington and as a result has waste its opportunity. Ocean also had plenty of opportunity from July 23, 2001 to propose its own well and file a pooling application prior to February 2, 2002. If is now time for Ocean to seek District Court protection like TMBR/Sharp was required to do.

Based on the foregoing, TMBR/Sharp requested that the pooling cases be continued to a Special Examiner Docket set after the Commission entered an order decide the permit dispute between Arrington and TMBR/Sharp.

Very truly yours,



W. Thomas Kellahin

cc: David K. Brooks,
Division Attorney
Steve Ross, Esq. Commission Attorney
James Bruce, Esq.,
Attorney for Ocean Energy, Inc.
Earnest Carroll, Esq.
Attorney for David H. Arrington Oil & Gas Inc.

KELLAHIN AND KELLAHIN

ATTORNEYS AT LAW
EL PATIO BUILDING

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W. THOMAS KELLAHIN*

*NEW MEXICO BOARD OF LEGAL SPECIALIZATION
RECOGNIZED SPECIALIST IN THE AREA OF
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1981)

March 21, 2002

**HAND DELIVERED
AND FACSIMILE**

Steve Ross, Esq.
Oil Conservation Commission
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

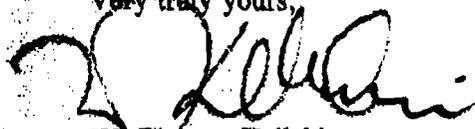
**Re: NMOCD Case 12731 (De Novo)
Application of TMBR/Sharp Drilling, Inc.
for an order staying David H. Arrington
Oil & Gas, Inc. from commencing
operations, Lea County, New Mexico.**

**NMOCD Case 12744 (De Novo)
Application of TMBR/Sharp Drilling, Inc.
appealing the Hobbs District Supervisor's
decision denying approval of two applications
for permit to drill filed by TMBR/Sharp
Drilling, Inc., Lea County, New Mexico**

Dear Mr. Ross:

On behalf of TMBR/Sharp Drilling, Inc., please find enclosed our
response to Arrington's Motion to Continue

Very truly yours,


W. Thomas Kellahin

cc: Earnest Carroll, Esq.
Attorney for Arrington
cc: TMBR/Sharp
Rick Montgomery, Esq.

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

**APPLICATION OF TMBR/SHARP DRILLING, INC.
FOR AN ORDER STAYING DIVISION APPROVAL
OF TWO APPLICATIONS FOR PERMIT TO DRILL
BY DAVID H. ARRINGTON OIL & GAS, INC.
LEA COUNTY, NEW MEXICO**

CASE NO. 12731

**APPLICATION OF TMBR/SHARP DRILLING, INC.
APPEALING THE HOBBS DISTRICT SUPERVISOR'S
DECISION DENYING APPROVAL OF TWO
APPLICATIONS FOR PERMIT TO DRILL FILED
BY TMBR/SHARP DRILLING INC.
LEA COUNTY, NEW MEXICO**

CASE NO. 12744

**TMBR/SHARP DRILLING, INC.
OPPOSITION TO
DAVID H. ARRINGTON OIL & GAS
MOTION TO CONTINUE**

COMES NOW TMBR/Sharp Drilling, Inc. ("TMBR/Sharp") and in opposition to David H. Arrington Oil & Gas Inc. ("Arrington") motion to continue the referenced case now set for hearing on March 26, 2002 before the New Mexico Oil Conservation Commission states:

Arrington, based upon the unsupported allegation that two compulsory pooling cases pending before the Division will resolve the issues before the Commission, seeks to delay the two captioned Commission cases until the Division decides compulsory pooling cases. Those cases are as follows: (i) TMBR/Sharp Drilling, Inc. (case 12816, N/2 Section 25, T16S, R35E) and (ii) Ocean Energy Inc. (case 12841, W/2 Section 25, T16S, R35E). Nothing could be more wrong.

NMOCD Case 12731 and 12744 (De Novo)
TMBR/Sharp Drilling, Inc. Opposition to Continue
-Page 2-

TMBR/Sharp obtained their leasehold interest the NW/4 in Section 25, and other acreage from Ameristate on December 7, 1997 and entered into a Joint Operating Agreement in July, 1998. On August 7, 2001, TMBR/Sharp filed for an APD for the N/2 of Section 25. Ocean did not acquire an interest in the SW/4 of Section 25 until July 23, 2001. Ocean did not file an APD for the W/2 of Section 25, and it waited until February 2, 2002 to file a compulsory pooling application. Ocean and Arrington seems to relying on the illegal APD obtained by Arrington on July 17, 2002.

The District Court in Lea County has ruled that Arrington had no interest in the W/2 of Section 25 based on its the Stokes/Hamilton Top Leases. Therefore, when Arrington acquired its APD, it had no interest in the W/2 of Section 25. Consequently, Arrington did not qualify as a operator entitled to an APD under the definition of OCD's regulations.

Arrington have admitted in its filings in the District Court that its possession of a APD prevented TMBR/Sharp from obtaining a permit. But for Arrington's APD for the W/2 of Section 25 granted on July 19, 2002, it is undisputed that TMBR/Sharp would have been granted an APD. TMBR/Sharp not only had the Stokes/Hamilton acreage but other acreage in the NW/4 of Section 25 which entitled it to an APD.

TMBR/Sharp would not have had to file a compulsory pooling application prior to drilling a well in the NW/4 of Section 25. Its intention was to drill the well and after drilling to obtain voluntary consent or pool the small percentage of interest remaining

NMOCD Case 12731 and 12744 (De Novo)
TMBR/Sharp Drilling, Inc. Opposition to Continue
-Page 3-

uncommitted. In August 7, 2001 when TMBR/Sharp tried to obtain its APD, TMBR/Sharp would not have had to compulsory pooling either Arrington or Ocean because neither own an interest of record in the N/2 of Section 25.

Arrington wants to argue that the District Court order on December 27, 2001 is interlocutory. There is no Division or Commission precedent for that position. TMBR/Sharp's APD preceded Ocean's compulsory pooling application by 6 months. Either the Commission must honor the District Court's decision that TMBR/Sharp's title is superior to Arrington's, or it must acknowledge that neither permitting to drill nor any pooling can be decided by the Commission until the title question is ultimately determined by the courts of the State of New Mexico. The Commission have stated unequivocally that it has no power to decide the contented title issues.

If the Commission decide that the Division must proceed with the pooling application, it effectively denies TMBR/Sharp its administrative remedies regarding its APD. If it prefers the pooling application filed after the request for a permit to drill, it has ex post facto determined which administrative proceeding is superior. Since the pooling statutes (1978 NMSA 72-02-17.C) specifically permit drilling under an APD prior to pooling, the Division should honor the superiority of the permitting process or abate all of proceedings regarding Section 25 until the title issues are finally decided.

The regulations regarding compulsory pooling and the regulations regarding the issuance of permits to drill are two separate rules and procedures which govern the

NMOCD Case 12731 and 12744 (De Novo)
TMBR/Sharp Drilling, Inc. Opposition to Continue
-Page 4-

Division's conduct. In this instance, to prefer the pooling process over the APD process when the APD process was initiated first is arbitrary and capricious and a violation of TMBR/Sharp's fundamental property rights.

If the Commission goes forward with the pooling applications, without addressing the superiority of TMBR/Sharp's request for a permit to drill, it is denying TMBR/Sharp's fundamental property rights. Either the Commission must honor the decision regarding title by the Lea County District court and vacate Arrington's APD and grant the permit to drill of TMBR/Sharp, or it must stay all proceedings regarding Section 25 until the title issues are decided by the court of New Mexico.

Ocean raised the issue that its farm-in's will expire on July 1, 2002, TMBR/Sharp was faced with the same expiration issue regarding the Stokes/Hamilton leases in Section 25 and elsewhere. Arrington argued to the Division that TMBR/Sharp could and should seek protection from such a loss by filing for an injunction with the District Court. TMBR/Sharp filed its injunction and obtained its relief. Ocean is free to do the same. It is not within the legal province of the Commission to protect Ocean against leasehold loss. Ocean must seek that relief elsewhere.

Resolution of the compulsory pooling applications, if appropriate at all, will not render the APD issue moot. A well cannot be drilled in New Mexico without an approved APD. Ocean has no permit to drilling. Arrington has not filed a pooling application but its APD's block TMBR/Sharp from receiving a permit. It would be

NMOCD Case 12731 and 12744 (De Novo)
TMBR/Sharp Drilling, Inc. Opposition to Continue
-Page 5-

unorthodox and inconsistent with Division procedures to vacate the APD proceeding based on a pooling proceeding between different parties.

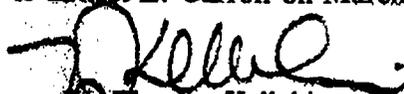
It is important that the matter of the APD be decided independently of the pooling issues pending before the Division. A decision in the pooling cases does not resolve the prior dispute about which party was entitled to the APD. Since TMBR/Sharp's request for an APD was an independent filing with the Division and has been pending five months prior to the filing of Ocean's pooling application, the Commission should go ahead and decide the permit dispute. The issue of the invalidity of the Arrington APD and the validity of the TMBR/Sharp APD is a matter between those two parties. The pooling issues are pending between TMBR/Sharp and another party, Ocean Energy. Arrington's motion to vacate should not be granted on the basis of a pooling application filed by a different party.

KELLAHIN AND KELLAHIN

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

SERVICE

I hereby certify that a copy of the foregoing has transmittal by facsimile to Ernest L. Carroll on March 21, 2001


W. Thomas Kellahin



NEW MEXICO ENERGY, MINERALS and NATURAL RESOURCES DEPARTMENT

GARY E. JOHNSON
Governor
Betty Rivera
Cabinet Secretary

Lori Wrotenbery
Director
Oil Conservation Division

March 19, 2002

Via Facsimile and First Class Mail

W. Thomas Kellahin
Kellahin & Kellahin
117 North Guadalupe
P.O. Box 2265
Santa Fe, New Mexico 87504-2265

Ernest L. Carroll
Losee, Carson, Haas & Carroll, P.A.
P.O. Box 1720
Aretsia, New Mexico 88211-1720

Re: Case No. 12,731, Application of TMBR/Sharp Drilling Inc. for an Order Staying
Division Approval of Applications to Drill, Lea County

Case No. 12744, Application of TMBR/Sharp Drilling Inc. appealing an Order of the
Artesia District Supervisor Denying Approval of Applications to Drill, Lea County

Gentlemen,

I have before me TMBR/Sharp's Motion to Re-open the above-referenced division cases and a response thereto filed by David H. Arrington. I note that the Oil Conservation Commission has these cases on its docket pursuant to an application of TMBR/Sharp for *de novo* review.

I have discussed this somewhat unusual filing with David Brooks, Division counsel and with the Director. We all agree that filing of the *de novo* vests jurisdiction of this dispute in the Commission. Thus re-opening division cases appears to be problematic, both as a jurisdictional matter and for practical reasons. If such an application were to be granted, it would make inconsistent results possible and result in accompanying procedural snafus.

The case is scheduled for hearing before the Oil Conservation Division on Tuesday, March 26, 2002. I suggest that all issues be dealt with before that body. If you have any questions, please do not hesitate to give me a call at (505) 476-3451.

Sincerely,

Stephen C. Ross
Assistant General Counsel
Counsel to the New Mexico Oil Conservation Commission

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

**IN THE MATTER OF THE APPLICATION OF :
TMBR/SHARP DRILLING INC. FOR AN ORDER :
STAYING DIVISION APPROVAL OF TWO :
APPLICATIONS FOR PERMIT TO DRILL BY :
DAVID H. ARRINGTON OIL & GAS, INC., LEA :
COUNTY, NEW MEXICO : CASE NO. 12731**

**IN THE MATTER OF THE APPLICATION OF :
TMBR/SHARP DRILLING INC. APPEALING :
THE ARTESIA DISTRICT SUPERVISOR'S :
DECISION DENYING APPROVAL OF TWO :
APPLICATIONS FOR PERMIT TO DRILL :
FILED BY TMBR/SHARP DRILLING, INC. :
LEA COUNTY, NEW MEXICO : CASE NO. 12744**

**DAVID H. ARRINGTON OIL & GAS, INC.'S
RESPONSE TO MOTION OF TMBR/SHARP DRILLING, INC.
TO REOPEN CASES 12731 AND 12744 AND AMEND
ORDER R-11700 BASED UPON NEW EVIDENCE**

COMES NOW David H. Arrington Oil & Gas Inc. ("Arrington") by and through its attorneys, LOSEE, CARSON, HAAS & CARROLL, P.A. (Ernest L. Carroll), and responds to the Motion of TMBR/Sharp Drilling, Inc. to Reopen Cases 12731 and 12744 and Amend Order R-11700 Based Upon New Evidence (TMBR/Sharp's Motion).

The basis of TMBR/Sharp's Motion is the notion that the December 27, 2001, ruling by the District Court in CV-2001-315 C, Fifth Judicial District, Lea County, New Mexico (the "Order") constitutes new evidence in this matter because the District Court ruled that the TMBR/Sharp leases are still valid. The Order does not constitute new evidence in this matter.

TMBR/Sharp mischaracterizes the Order as "a final order" and erroneously states that the Order conclusively resolved the matter against Arrington and demonstrates that Arrington

wrongfully obtained the approval of its APD's from the Division. The Order is not "a final order" and therefore can not be considered as "new evidence." Moreover, the Order does not conclusively resolve the matter against Arrington and demonstrate that Arrington wrongfully obtained the approval of its APD's from the Division.

The Order is not a final order. It is an interlocutory order.¹ An interlocutory order is an order or decision which does not practically dispose of all of the merits of an action. Interlocutory orders are subject to be overturned, modified or changed at any time prior to the issuance of a final order and is thereafter subject to appeal. Interlocutory orders may be revisited at any time prior to a final judgment. Sims v. Sims, 1996-NMSC-078, 122 N.M. 681; Barker v. Barker, 94 N.M. 162, 165-166, 608 P.2d 138, 141-142 (1980); Universal Constructors, Inc. v. Fielder, 118 N.M. 657, 659, 884 P.2d 813, 815 (Ct. App. 1994). An interlocutory order does not conclusively resolve any issue and therefore should not be considered as "new evidence" until such time as a final order has been rendered.

TMBR/Sharp's argument that the Order "demonstrates that Arrington wrongfully obtained the approval of its APDs from the Division," could not be further from the truth. In the District Court matter, TMBR/Sharp filed a motion for partial summary judgment alleging that Arrington was guilty of tortious interference with their contractual rights with respect to the Stokes and Hamilton leases. In its motion TMBR/Sharp alleged that Arrington knew it had wrongfully obtained the approval of the Triple Hackle Dragon "25" Well No. 1 and the Blue Drake "23" Well No. 1. On March 12, 2002, the District Court issued its Order Denying Partial Summary Judgment Regarding Tortious Interference stating:

¹ Arrington requested that the District Court amend its December 27, 2001, order so that it would be "a final order." The District Court declined to do so.

“The pivotal issue is whether the first element of the tort, that Arrington had knowledge of the TMBR/Sharp-Stokes lease, is at issue. Plaintiff asserts that Arrington knew that TMBR/Sharp had a valid lease to drill on the property when Arrington obtained the permit to drill. Arrington denies such knowledge asserting it reasonably believed that the TMBR/Sharp-Stokes lease (and Plaintiff’s rights thereunder ceased to exist) had expired and that the Huff Top Leases were valid and in effect. Herein exists a genuine issue of material facts as to this element which can only be resolved by a jury.” See copy of March 12, 2002, Order Denying Partial Summary Judgment Regarding Tortious Interference attached hereto as Exhibit “1”.

Clearly the issue as to whether Arrington “wrongfully obtained the approval of its APD’s from the Division” is a matter which is still under consideration by the District Court and which the District Court has determined is a matter for the jury to decide.

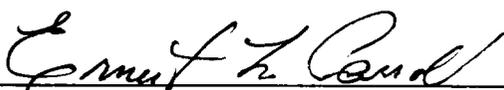
Additionally, TMBR/Sharp’s Motion is also based upon the notion that Arrington has no independent right to drill and operate the APD’s at issue because it does not own an interest in either the E/2 of Section 23 or the W/2 of Section 25. TMBR/Sharp is mistaken. Pursuant to certain farmout agreements with Ocean Energy, Arrington has an undivided 15% of the operating rights in the proration unit designated for the Triple Hackle Dragon “25” No. 1 Well. The leases, with respect to the farmout agreements with Ocean Energy, are not at issue herein. Arrington’s acquisition of these operating rights give Arrington an independent right to seek a permit to drill a well and to be the operator of such well which does not rely upon the disputed ownership of the Stokes and Hamilton leases. See a copy of the Ocean Farmout agreement attached hereto as Exhibit “2”. Further, Arrington has advised TMBR/Sharp of its agreement to release the APD for the Blue Drake “23” Well No. 1 to allow TMBR/Sharp to drill the Leavelle “23” Well No. 1. See a copy of February 11, 2002, letter to opposing counsel attached hereto as Exhibit “3”. To date TMBR/Sharp has not responded to

Arrington's offer to release the APD.

For the foregoing reasons TMBR/Sharp's Motion to Reopen Cases 12731 and 12744 and Amend Order R-11700 Based Upon New Evidence should be denied.

Respectfully submitted,

LOSEE, CARSON, HAAS & CARROLL, P.A.

By: 

Ernest L. Carroll

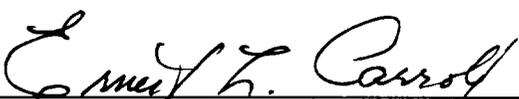
P.O. Box 1720

Artesia, NM 88211-1720

(505)746-3505

Attorneys for David H. Arrington Oil & Gas, Inc.

I hereby certify that I caused a true and correct copy of the foregoing to be mailed to counsel of record this March 15, 2002.


Ernest L. Carroll

FIFTH JUDICIAL DISTRICT COURT
COUNTY OF LEA
STATE OF NEW MEXICO

TMBR/SHARP DRILLING, INC.,
Plaintiff,

FIFTH JUDICIAL DISTRICT
LEA COUNTY NM
FILED IN MY OFFICE
02 MAR 12 PM 3: 16
JANIE G. HERNANDEZ
DISTRICT COURT CLERK

vs.

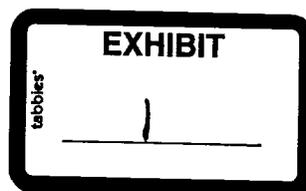
No. CV2001-315C

DAVID H. ARRINGTON OIL & GAS,
INC., JAMES D. HUFF, MADELINE
STOKES, ERMA STOKES HAMILTON,
JOHN DAVID STOKES, and TOM STOKES,
Defendants.

ORDER DENYING PARTIAL SUMMARY JUDGMENT REGARDING TORTIOUS
INTERFERENCE

THIS MATTER HAVING come before the Court upon the Plaintiff's Motion for Partial Summary Judgment Regarding Tortious Interference. The Defendant, David H. Arrington Oil and Gas, Inc. raises the defense of justification and privilege and asserts it "had a reasonable belief that the original Stokes Leases had expired by their own term and that Arrington had the right to seek such permits pursuant to the terms of the Huff Top Leases." (see affidavit of Jeffery G. Bane ¶ 7 which is Exhibit 1 to Defendant's Response filed February 12, 2002) It should be noted Bane does not set forth specific admissible facts supporting what gave rise to this "reasonable belief." In argument, counsel asserted that the "reasonableness" of this "belief" would be proved at trial by introducing industry standards and expert testimony to the jury. Counsel further asserted that Defendant's good faith and reasonable belief created genuine material issues of fact for the jury to resolve. For purposes of this Motion the Court will assume Defendant acted upon a good faith "reasonable belief."

The Defense has not cited to the Court any authority from New Mexico or any other jurisdiction in support of his position that reasonableness and good faith equate justification or privilege. The Court can find no decision from New Mexico stating that reasonable people acting in good faith are privileged to commit this tort or that the laws of New Mexico are such that reasonable people acting in good faith to advance their own business fortunes have a lawful excuse to commit the tort. The Court however does not resolve this motion on that basis.



The pivotal issue is whether the first element of the tort, that Arrington had knowledge of the TMBR/Sharp-Stokes lease, is at issue. Plaintiff asserts that Arrington knew that TMBR/Sharp had a valid lease to drill on the property when Arrington obtained the permit to drill. Arrington denies such knowledge asserting it reasonably believed that the TMBR/Sharp-Stokes lease (and Plaintiff's rights thereunder ceased to exist) had expired and that the Huff Top Leases were valid and in effect. Herein exists a genuine issue of material facts as to this element which can only be resolved by a jury. Whether the remaining elements of the tort are controverted need not be addressed by the Court at this time.

Plaintiff's Motion for Partial Summary Judgement Regarding Tortious Interference is not well taken and IS DENIED.

IT IS SO ORDERED.


Gary L. Clingman
District Judge

CERTIFICATE

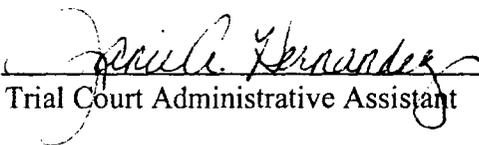
I HEREBY CERTIFY that a true and correct copy of the foregoing Notice was mailed to all parties on the 23rd day of March, 2002:

Richard Montgomery, Esquire
P.O. Box 2776
Midland, Texas 79702-2776

Phil Brewer, Esquire
P.O. Box 298
Roswell, NM 88202-0298

Ernest L. Carroll, Esquire
P.O. Box 1720
Artesia, NM 88221-1720

Michael J. Canon, Esquire
303 W. Wall, Suite 1100
Midland, Texas 79701

By: 
Trial Court Administrative Assistant

214 West Texas
Suite 400, (Zip 79701)
P.O. Box 2071
Midland, Texas 79702

DAVID H. ARRINGTON OIL & GAS, INC.

Phone: (915) 682-6685
Fax: (915) 682-4139

September 10, 2001

Mr. Derold Mancy
Ocean Energy, Inc.
1001 Fannin, Suite 1600
Houston, TX 77992

Re: Assignment Of Rights In And To Certain Farmout Agreements Concerning The
SW/4 Of Section 25, T16S, R35E, Lea County, New Mexico
South Payday "25" Prospect

Gentlemen:

When executed by the parties hereto, this letter agreement (this "Agreement") shall set forth the agreement between Ocean Energy, Inc. a Louisiana corporation ("Ocean") and David H. Arrington Oil & Gas, Inc. ("Arrington") concerning the assignment of thirty percent (30%) of Ocean's right in and to those certain farmout agreements covering the SW/4 of Section 25, T16S, R35E, Lea County, New Mexico, more particularly described on Schedule 1 hereto (such agreement as may be amended, supplemented, restated or otherwise modified from time to time, a "Farmout Agreement", and collectively, the "Farmout Agreements"). For good and valuable consideration, the sufficiency of which is hereby acknowledged, the parties do hereby agree as follows:

1. On or before July 1, 2002, but not earlier than January 10, 2002, time being of the essence, Arrington shall commence actual drilling of a test well (the "Test Well") to be located in the NW/4 of Section 25, T16S, R35E, Lea County, New Mexico, referred to as the Triple Hackle Dragon 25 #1 Well, and shall thereafter prosecute drilling of the Test Well to penetrate and test the lower Mississippian Lime formation (as hereinafter defined) or to a depth of approximately thirteen thousand two hundred feet (13,200'), whichever is the lesser depth (the "Contract Depth") and shall complete the Test Well as capable of producing oil and/or gas in paying quantities or plug and abandon the same. Ocean shall participate in the drilling of this Test Well for its proportionate share. The Lower Mississippian Lime formation is defined as that certain gas and condensate bearing zone encountered at the stratigraphic equivalent depth of twelve thousand four hundred and four feet (12,404'), as shown on that certain compensated neutron three detector density log measurement in the Mayfly "14" State Com # 1 Well, located in Section 14, Township 16 South, Range 35 East, Lea County, New Mexico.



Mr. Derold Maney
Ocean Energy, Inc.
September 10, 2001
Page 2 of 6

In the event that the drilling title opinion rendered by a law firm licensed to do business in the State of New Mexico shall contain title requirements such that Arrington or Ocean as a reasonable and prudent operator is unable to commence drilling operations on the Test Well prior to July 1, 2002, Arrington or Ocean shall no later than January 5, 2002, initiate force pooling proceeding for a 320 acre unit comprised of the W/2 of Section 25, T16S, R35E, Lea County, New Mexico. Arrington or Ocean shall diligently and expeditiously pool such lands in order to cure such title requirements so that the Test Well may be drilled prior to July 1, 2002.

Should Arrington or Ocean fail to successfully cure such title defects through force pooling proceeding or otherwise and fail to timely commence drilling operations on the Test Well by July 1, 2002, then Ocean shall have the right, but not the obligation, to become the designated Operator under the Operating Agreement for the drilling of the Test Well through the point of first production; subsequently, Ocean shall relinquish operations under said Test Well to Arrington, and Arrington shall be the designated Operator under the Operating Agreement. Notwithstanding anything contained in this Agreement to the contrary Ocean shall not be obligated to participate in the drilling of the Test Well for a share of costs greater than thirty-five percent (35%) and Ocean is satisfied in its sole discretion that the remainder of the costs for the Test Well will be paid, either by Arrington or another third party with title to the leasehold interest in the lands contained within the pooling order issued by the New Mexico Oil Conservation Division.

2. In the event any well is lost for any reason prior to being drilled to Contract Depth or Arrington has encountered, during the drilling of any well, mechanical difficulty or a formation or condition which would render further drilling impracticable or impossible, Arrington may plug and abandon that well and may continue its rights under this agreement by commencing a substitute well (or wells) ("Substitute Well(s)") for any such well which has been lost or abandoned within sixty (60) days from the date the drilling rig is removed from the location of the prior well. Any Substitute Well drilled shall be drilled subject to the same terms and conditions and to the same depth as provided for the well so lost or abandoned. Any reference in this agreement to the Test Well shall be deemed to be a reference to any well or wells, which may be drilled as a Substitute Well. In the event that either party elects to drill a Substitute Well as provided herein, the other party must participate in same, or forfeit to the participating party any interest which it would have otherwise earned by virtue of its participation in such Substitute Well.
3. Contemporaneously herewith, Arrington and Ocean shall have entered into that certain Operating Agreement attached hereto as Exhibit A (the "Operating Agreement"), covering the W/2 of Section 25, T16S, R35E, Lea County, New Mexico (the "Contract Area"). Exhibit "A" to the Operating Agreement shall be completed based upon the results of the drillsite title opinion being prepared covering the W/2 of said Section 25.
4. Subject to the terms and conditions (i) of this agreement, (ii) each Farmout Agreement and (iii) the Joint Operating Agreement, Ocean hereby assigns unto Arrington, an undivided

Mr. Derald Maney
Ocean Energy, Inc.
September 10, 2001
Page 3 of 6

thirty percent (30%) of Ocean's right in and to each Farmout Agreement. In the event that any Farmout Agreement contains a requirement that the Farmor (as defined in such Farmout Agreement) thereunder consent to any such assignment, Ocean shall use its best efforts to obtain such consent; provided, however, that in the event that Ocean is unable to acquire such Farmor's consent to assign, then Ocean shall assign additional interest(s) from such other of the Farmout Agreements as Ocean may elect in its discretion such that the aggregate of Arrington's right to earn rights under all Farmout Agreements will entitle Arrington to an assignment of Ocean's interest in the Contract Area equal to an undivided thirty percent (30%), proportionately reduced to Ocean's interest in the Contract Area. The terms and conditions of this letter agreement shall apply to any extensions or renewals of each Farmout Agreement acquired by either Arrington or Ocean within 180 days of the expiration of the farmout agreement.

5. Arrington has acquired proprietary 3D seismic data across certain lands, including, without limitation; T16S, R35E, Lea County, New Mexico (i) Section 23: E/2E/2; (ii) Section 24: All that Arrington has in the SW/4; (iii) Section 25: W/2, W/2E/2; (iv) Section 26: E/2E/2; (v) Section 35: NE/4NE/4; and (vi) Section 36: N/2NW/4, NW/4NE/4 (such 3D seismic data, collectively, the "Arrington 3D Data"). Arrington agrees (and represents to Ocean that Arrington has the right to so agree) that Ocean shall (i) have access to the Arrington 3D Data in Arrington's offices during normal business hours, in order to work and interpret the Arrington 3D Data and (ii) have access to and copies of, Arrington's interpretations of the Arrington 3D Data (the Arrington 3D Data together with such interpretations thereof, the "Arrington Evaluation Material"). Arrington shall retain full ownership rights to the Arrington 3D Data, and no ownership or license to the Arrington 3D Data shall be conveyed to Ocean. Except as provided for in this Paragraph 5, Arrington makes no representations or warranties to Ocean (i) as to the Arrington 3D Data (ii) or in respect of Ocean's reliance upon the Arrington Evaluation Material. Ocean shall keep the Arrington Evaluation Material confidential; provided however, that such obligation of confidentiality shall not apply to information which (i) was or becomes available to the public other than as a result of a disclosure by Ocean, (ii) was or becomes available to Ocean on a non-confidential basis from a source other than Arrington, provided that such source is not known by Ocean to be bound by a confidentiality agreement with Arrington or otherwise prohibited from transmitting the information by a contractual, legal or fiduciary obligation, (iii) was within Ocean's possession prior to its being furnished by Arrington, (iv) is developed or derived without the aid, application or use of the Arrington Evaluation Material, (v) is disclosed following receipt of the written consent of Arrington to such disclosure being made, or (vi) is disclosed pursuant to Paragraph 6 hereof.
6. In the event that Ocean is requested or required (by oral questions, interrogatories, requests for information or documents, subpoenas civil investigative demand or other process) to disclose any of the Arrington Evaluation Material, Ocean agrees that it will provide Arrington with prompt notice of any such request or requirement (written if practical) so that Arrington may seek an appropriate protective order or waive compliance with the provisions of this Agreement. If, failing the entry of a protective order or the receipt of a waiver hereunder prior to the time such disclosure is required to be made, Ocean may disclose that

Mr. Derold Maney
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portion of the Arrington Evaluation Material which Ocean's counsel advises that it is compelled to disclose and will exercise reasonable efforts to obtain assurance that confidential treatment will be accorded to that portion of the Arrington Evaluation Material which is being disclosed. Arrington agrees that Ocean shall have no liability hereunder for any disclosure of the Arrington Evaluation Material made in compliance with this Paragraph 6.

7. Ocean has acquired proprietary 3D seismic data across certain lands, including, without limitation, T15S, R35E, Lea County, New Mexico (i) Section 7: W/2, W/2NE/4, W/2SE/4, SE/4SE/4; (ii) Section 17: W/2NW/4, NW/4SW/4; and (iii) Section 18: N/2, N/2S/2 (such 3D seismic data, collectively, the "Ocean 3D Data"). Ocean agrees (and represents to Arrington that Ocean has the right to so agree) that Arrington shall (i) have access to the Ocean 3D Data in Ocean's offices during normal business hours, in order to work and interpret the Ocean 3D Data and (ii) have access to and copies of, Ocean's interpretations of the Ocean 3D Data (the Ocean 3D Data together with such interpretations thereof, the "Ocean Evaluation Material"). Ocean shall retain full ownership rights to the Ocean 3D Data, and no ownership or license to the Ocean 3D Data shall be conveyed to Arrington. Except as provided for in this Paragraph 7, Ocean makes no representations or warranties to Arrington (i) as to the Ocean 3D Data (ii) or in respect of Arrington's reliance upon the Ocean Evaluation Material. Arrington shall keep the Ocean Evaluation Material confidential; provided however, that such obligation of confidentiality shall not apply to shall not apply to information which (i) was or becomes available to the public other than as a result of a disclosure by Arrington, (ii) was or becomes available to Arrington on a non-confidential basis from a source other than Ocean, provided that such source is not known by Arrington to be bound by a confidentiality agreement with Ocean or otherwise prohibited from transmitting the information by a contractual, legal or fiduciary obligation, (iii) was within Arrington's possession prior to its being furnished by Ocean, (iv) is developed or derived without the aid, application or use of the Ocean Evaluation Material, (v) is disclosed following receipt of the written consent of Ocean to such disclosure being made, or (vi) is disclosed pursuant to Paragraph 8 hereof.
8. In the event that Arrington is requested or required (by oral questions, interrogatories, requests for information or documents, subpoena civil investigative demand or other process) to disclose any of the Ocean Evaluation Material, Arrington agrees that it will provide Ocean with prompt notice of any such request or requirement (written if practical) so that Ocean may seek an appropriate protective order or waive compliance with the provisions of this Agreement. If, failing the entry of a protective order or the receipt of a waiver hereunder prior to the time such disclosure is required to be made, Arrington may disclose that portion of the Ocean Evaluation Material which Arrington's counsel advises that it is compelled to disclose and will exercise reasonable efforts to obtain assurance that confidential treatment will be accorded to that portion of the Ocean Evaluation Material which is being disclosed. Ocean agrees that Arrington shall have no liability hereunder for any disclosure of the Ocean Evaluation Material made in compliance with this Paragraph 8.

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9. It is not the intention of the parties to create a partnership, nor shall this agreement be construed as creating a mining or other partnership, joint venture, agency relationship or other association, or to render the parties liable as partners, co-venturers or principals. Unless provided for to the contrary in the Operating Agreement, (i) the liability of the parties shall be several, not joint or collective and (ii) each party shall be responsible only for its obligations, and shall be liable only for its proportionate share of the costs, if any, to be incurred hereunder. No party shall have any liability hereunder to third parties to satisfy the default of any other party in the payment of any expense or obligation.
10. This Agreement and all matters pertaining hereto, including, but not limited to, matters of performance, non-performance, breach, remedies, procedures, rights, duties and interpretation or construction, shall be governed and determined by the law of the State of Texas. **THE PARTIES HEREBY CONSENT TO THE EXCLUSIVE VENUE OF THE PROPER STATE OR FEDERAL COURT LOCATED IN MIDLAND COUNTY, TEXAS, AND HEREBY WAIVE ALL OTHER VENUES.**
11. This Agreement, the Exhibits and Schedules hereto and the Operating Agreement set forth all understandings between the parties respecting the subject matter of this transaction, and all prior agreements, understandings and representations, whether oral or written, respecting this transaction are merged into and superseded by this written agreement.
12. This agreement shall be binding upon and shall inure to the benefit of the parties and their respective successors and permitted assigns and the terms hereof shall be deemed to run with the lands described herein. If any transfer is effected by a party pursuant to the terms of this agreement, or by any of its successors or assigns, the transfer will be made expressly subject to this agreement, and the transferor shall remain responsible for the obligations of the transferee until the transferee expressly assumes in writing all of the existing duties and obligations of the transferor.
13. This agreement may not be altered or amended, nor any rights hereunder waived, except by an instrument, in writing, executed by the party to be charged with such amendment or waiver. No waiver of any other term, provision or condition of this agreement, in any one or more instances, shall be deemed to be, or construed as, a further or continuing waiver of any such term, other provision or condition or as a waiver of any other term, provision or condition of this agreement.
14. **EACH PARTY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY WITH RESPECT TO ANY SUIT, ACTION OR PROCEEDING RELATING TO THIS AGREEMENT.**
15. If any provision of this agreement is invalid, illegal or incapable of being enforced, all other provisions of this agreement shall nevertheless remain in full force and effect, so long as the economic or legal substance of the transactions contemplated hereby is not affected in a materially adverse manner with respect to either party.

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If this properly sets forth your understanding of our agreement, please so indicate by signing in the space provided below, and returning to my attention.

Mr. Derold Maney
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Yours truly,

DAVID H. ARRINGTON OIL & GAS, INC.

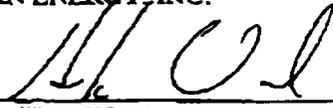


David H. Arrington
President

DD/trd

ACCEPTED AND AGREED THIS 14th DAY OF ~~SEPTEMBER~~ November, 2001

OCEAN ENERGY, INC.

By: 
Hank Wood
Attorney-in-Fact 



LAW OFFICES

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P. O. BOX 1720

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JOEL M. CARSON
JANE SHULER GRAY
JAMES E. HAAS
OF COUNSEL
A. J. LOSEE

11 February 2002

W. Thomas Kellahin
Kellahin and Kellahin
117 North Guadalupe
P.O. Box 2265
Santa Fe, NM 87504-2265

Re: Oil Conservation Commission Hearings Case 12744 and Case 12731

Dear Tom:

The purpose of this letter is to memorialize our last telephone conversations concerning the above two referenced cases. As you will recall I sought continuances in the above two cases in order to allow us time to reach some sort of an agreement with respect to the two applications for permit to drill ("APDs") at issue. The APD in Section 23, I advised you that Arrington would be willing to release and to allow TMBR/Sharp to drill the well in that section. With respect to the APD in Section 25, Arrington has other lease hold acreage thus entitling it to operate a well. Arrington would not release that APD but would proceed with preparations to drill the well.

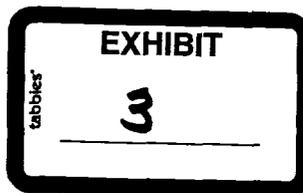
I have also been informed of the fact that you have recently had a stroke and that these two cases were put off from their February 14th date until the following Commission date in March. If it is necessary and if we are unable to reach some sort of an agreement, then I will work with you in whatever way necessary to allow you to recover from the stroke. As you are well aware I have gone through the same thing recently and am in a position to most appreciate your predicament. I wish you well and hope that you are able to recover as quickly as I have. Best wishes to you Tom.

Very truly yours,

LOSEE, CARSON, HAAS & CARROLL, P.A.

Ernest L. Carroll

ELC:ct
cc: Rick Montgomery



mailed out 2-11-02

KELLAHIN AND KELLAHIN

ATTORNEYS AT LAW

EL PATIO BUILDING

117 NORTH GUADALUPE

POST OFFICE BOX 2266

SANTA FE, NEW MEXICO 87504-2266

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W. THOMAS KELLAHIN*

*NEW MEXICO BOARD OF LEGAL SPECIALIZATION
RECOGNIZED SPECIALIST IN THE AREA OF
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

March 15, 2002

**HAND DELIVERED
AND FACSIMILE**

Steve Ross, Esq.
Oil Conservation Commission
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: NMOCD Case 12731 (De Novo)
Application of TMBR/Sharp Drilling, Inc.
for an order staying David H. Arrington
Oil & Gas, Inc. from commencing
operations, Lea County, New Mexico.

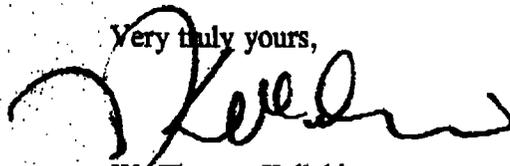
NMOCD Case 12734 (De Novo)
Application of TMBR/Sharp Drilling, Inc.
appealing the Hobbs District Supervisor's
decision denying approval of two applications
for permit to drill filed by TMBR/Sharp
Drilling, Inc., Lea County, New Mexico

Dear Mr. Ross:

On behalf of TMBR/Sharp Drilling, Inc., I wish to inform you that we will proceed to the March 26, 2002 hearing of the reference cases now set before the Commission.

In accordance with my phone call this afternoon with the Commission Secretary we will file a Pre-Hearing Statement on Monday, March 18, 2002

Very truly yours,



W. Thomas Kellahin

cc: Earnest Carroll, Esq.
Attorney for Arrington
cc: TMBR/Sharp
Rick Montgomery, Esq.