

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. 13248
ORDER NO. R-12098-A

APPLICATION OF CHI ENERGY, INC. FOR OMPULSORY POOLING, EDDY
COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on April 15, 2004, at Santa Fe, New Mexico before Examiner Michael E. Stogner.

NOW, on this 3rd day of May, 2004, 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 this case and its subject matter.

(2) By Order No. R-12098, issued in Case No. 13206 on February 10, 2004, the Division granted the application of Chi Energy, Inc. (herein referred either as "Chi" or "Applicant") to pool all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the following acreage in Section 3 in the following manner:

(a) the S/2, forming a standard 320-acre deep gas spacing unit [Division Rule 104.C (2)] for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated Happy Valley-Strawn Gas Pool (78070), Undesignated Happy Valley-Atoka Gas Pool (78055), Undesignated Happy Valley-Morrow Gas Pool (78060), and Undesignated South Carlsbad-Morrow Gas Pool (73960);

(b) the SW/4, forming a standard 160-acre shallow gas spacing unit for any and all formations **and/or** pools developed on 160-acre spacing within that vertical extent; and

(c) the SW/4 SW/4, forming a standard 40-acre oil spacing and proration unit for any and all formations **and/or** pools developed on 40-acre spacing within that vertical extent.

(3) Division Order No. R-12098 further: (i) provided that these three units be dedicated to the Applicant's West Carlsbad ("WC") "3" Well No. 2 (API No. 30-015-31772), located at a standard location for all three units 990 feet from the South and West lines (Unit M) of Section 3; (ii) designated Applicant the operator of this well and of these three units; **(Hi)** required Applicant to commence drilling the WC "3" Well No. 2 on or before May 31, 2004; and (iv) provided that a risk penalty of 200 percent be assessed against all uncommitted mineral interest owners in each unit for the risk involved in drilling the WC "3" Well No. 2.

(4) Applicant spudded this well on December 5, 2003 and is currently evaluating its potential for commercial production.

(5) Chi now seeks: (i) to include an additional well within the aforementioned 320-acre pooled deep gas spacing unit; and (ii) an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the SE/4 of Section 3 to form a shallow standard 160-acre gas spacing unit [Division Rule 104.C(3)] for any and all formations **and/or** pools developed on 160-acre spacing within that vertical extent.

(6) Applicant proposes to drill its WC "3" Well No. 3 (API No. 30-015-33258) at a location considered standard for both gas spacing units [Division Rules 104.C(2)(a) and (b) and 104.C(3)] 660 feet from the South and East lines (Unit P) of Section 3.

(7) Within both of the units (S/2 and SE/4 of Section 3), two or more separately owned tracts are embraced within the unit, **and/or** there are royalty interests **and/or** undivided interests in oil and gas minerals in one or more tracts included in the unit that are separately owned.

(8) The Applicant is a working interest owner within both the 320-acre and 160-acre unit and therefore has the right to drill for and develop the minerals underlying these units.

(9) At this time, however, not all of the working interest owners in the two units that are the subject of this case (S/2 and SE/4 of Section 3) have agreed to pool their interests. After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(10) No party affected by this application appeared at the hearing or objected to this application.

(11) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste, and afford to the owner of each interest in these two units the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by: (i) amending Division Order No. R-12098 to include an additional well within the 320-acre unit comprising the S/2 of Section 3; and (ii) pooling all uncommitted interests, whatever they may be, within the SE/4 of Section 3 being a standard 160-acre shallow gas spacing unit.

(12) Applicant should be designated the operator of the subject well and of the 160-acre unit.

(13) Pursuant to Division Rule 35.A, any pooled working interest owner that does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the proposed WC "3" Well No. 3.

(14) Reasonable charges for supervision (combined fixed rates) should be fixed at \$ 6,000.00 per month while drilling and \$ 600.00 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3 of the COP AS form titled "Accounting Procedure-Joint Operations." The operator should be authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each pooled working interest.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Chi Energy, Inc. (herein referred either as "Chi" or "Applicant"), Division Order No. R-12098, issued in Case No. 13193 on February 10, 2004, is hereby amended to include an infill well within the S/2 of Section 3, Township 22 South, Range 26 East, NMPM, Eddy County, New Mexico, being a standard 320-acre deep gas spacing unit [Division Rule 104.C(2)] for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated Happy Valley-Strawn Gas Pool (78070), Undesignated Happy Valley-Atoka Gas Pool (78055), Undesignated Happy Valley-Morrow Gas Pool (78060), and Undesignated South Carlsbad-Morrow Gas Pool (73960).

(2) Further, all uncommitted mineral interests, whatever they may be, underlying the SE/4 of Section 3 from the surface to the base of the Morrow formation are hereby pooled to form a standard 160-acre shallow gas spacing unit [Division Rule 104.C(3)] for any and all formations and/or pools developed on 160-acre spacing within that vertical extent.

(3) These two units (S/2 320-acre and SE/4 160-acre) are to be dedicated to the Applicant's proposed WC "3" Well No. 3 (API No. 30-015-33258) to be drilled at a location considered standard for both gas spacing units [Division Rules 104.C (2) (a) and (b) and 104.C (3)] 660 feet from the South and East lines (Unit P) of Section 3.

(4) The operator shall commence drilling the proposed well on or before July 31, 2004, and shall thereafter continue drilling the well with due diligence to a depth sufficient to test the Morrow formation.

(5) In the event the operator does not commence drilling the proposed well on or before July 31, 2004, this order shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, the operator shall appear before the Division Director and show cause why this order should not be rescinded.

(7) For the 320-acre deep gas spacing unit that is the subject of Division Order No. R-12098 as amended herein, upon final plugging and abandonment of the last unit well within the S/2 of Section 3, this Order shall terminate as to this unit, unless this Order has been amended to authorize further operations.

(8) For the 160-acre shallow gas spacing unit comprising the SE/4 of Section 3, upon final plugging and abandonment of the above-described WC "3" Well No. 3, the pooled unit created by this Order shall terminate, unless this Order has been amended to authorize further operations.

(9) Applicant is hereby designated the operator of the subject well and of the 160-acre unit.

(10) Uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the units, including unleased mineral interests, who are not parties to an operating agreement governing these units.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the units an itemized schedule of estimated costs of drilling, completing, and equipping the proposed well ("well costs").

(11) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled 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 as hereinafter provided, 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. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(12) The operator shall furnish the Division and each known pooled working interest owner (including each non-consenting working interest owner) an itemized schedule of actual well costs within 90 days following completion of the proposed 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 deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(13) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated well costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs that it has paid exceeds its share of reasonable well costs.

(14) The operator is hereby authorized to withhold the following costs and charges from production:

- (a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and
- (b) as a charge for the risk involved in drilling the well, 200 percent of the above costs (Division Rule 35.A).

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

(16) 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 COP AS form titled "Accounting Procedure-Joint Operations." The operator is hereby authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each pooled working interest owner.

(17) Except as provided in Ordering Paragraphs (12) and (14) above, all proceeds from production from the well that are not disbursed for any reason shall 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 the escrow agent within 30 days from the date of first deposit with the escrow agent.

(18) 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 this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

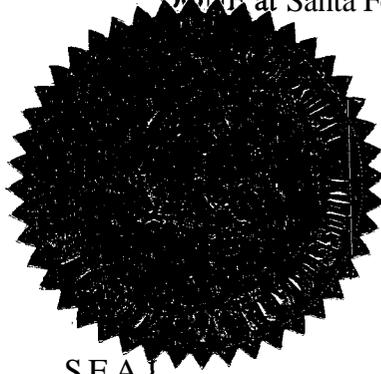
(19) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, that portion of this order authorizing compulsory pooling shall thereafter be of no further effect.

(20) The operator of the above-described well and units shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this Order.

(21) Division Order No. R-12098 shall remain in full force and effect except to the extent amended hereby.

(22) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

JOANNA PRUKOP
Cabinet Secretary/Interim Director