

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. 13193
ORDER NO. R-12098

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

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on December 18, 2003 before Examiner William V. Jones and at 8:15 a.m. on January 22, 2004 before Examiner Michael E. Stogner.

NOW, on this 10th day of February, 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 of the subject matter.

(2) Chi Energy, Inc. ("Applicant") seeks an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the S/2 of Section 3, Township 22 South, Range 26 East, NMPM, Eddy County, New Mexico, in the following manner:

(a) the S/2, forming a standard 320-acre gas spacing and proration unit (the "320-Acre Unit") for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, including but not limited to the **Undesignated Happy Valley-Strawn** Gas Pool, the **Undesignated Happy Valley-Atoka** Gas Pool, and the **Undesignated Happy Valley-Morrow** Gas Pool;

(b) the SW/4, forming a standard 160-acre gas spacing and proration unit (the "160-Acre 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 (the "40-Acre Unit") for any and all formations and/or pools developed on 40-acre spacing within that vertical extent.

(3) Applicant proposes to dedicate these Units to its proposed West Carlsbad 3 Well No. 2 (API No. 30-015-31772), "the proposed well", to be drilled at a standard location in the SW/4 SW/4 of Section 3. The proposed well will be drilled to 12,000 feet or a depth sufficient to test the Morrow formation.

(4) Two or more separately owned tracts are embraced within each of the Units, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in each of the Units that are separately owned.

(5) In support of its application, the Applicant presented the following land testimony.

(a) Applicant has made a good-faith effort to obtain the voluntary joinder of all interest owners in the south half of Section 3.

(b) At the time of the hearing, the Applicant had approximately 85 percent of the mineral interests leased and desired to pool the remaining unleased mineral interest owners.

(c) Applicant has made a good-faith effort to notify all interest owners or their representatives of this Division hearing.

(d) Applicant has notified all affected interests of its intentions to drill and produce at the proposed well location.

(6) Roy G. Barton, Jr., entered an appearance through mailed correspondence to the Division on December 23, 2003. Mr. Barton desires to participate with his interest in the well and asks to not be included in the forced pooling. No other parties entered an appearance in this case.

(7) Applicant is an owner of an oil and gas working interest within these Units. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within these Units.

(8) There are interest owners in these Units that have not agreed to pool their interests.

(9) Applicant should be designated the operator of the proposed well and these Units.

(10) Reasonable charges for supervision (combined fixed rates) should be fixed at \$6,000 per month while drilling and \$600 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations."

(11) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and 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 hydrocarbons, this application should be approved by pooling all uncommitted mineral interests, whatever they may be, within these Units.

IT IS THEREFORE ORDERED THAT ;

(1) Pursuant to the application of Chi Energy, Inc. ("Applicant"), all uncommitted mineral interests from the surface to the base of the Morrow formation in the S/2 of Section 3, Township 22 South, Range 26 East, NMPM, Eddy County, New Mexico, are hereby pooled in the following manner:

(a) the S/2, forming a standard 320-acre gas spacing and proration unit (the "320-Acre Unit") for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, including but not limited to the Undesignated Happy Valley-Strawn Gas Pool, the Undesignated Happy Valley-Atoka Gas Pool, and the Undesignated Happy Valley-Morrow Gas Pool;

(b) the SW/4, forming a standard 160-acre gas spacing and proration unit (the "160-Acre 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 (the "40-Acre Unit") for any and all formations and/or pools developed on 40-acre spacing within that vertical extent.

The Units shall be dedicated to Applicant's proposed West Carlsbad 3 Well No. 2 (API No. 30-015-31772), "the proposed well", to be located at a standard well location in the SW/4 SW/4 of Section 3.

(2) Applicant is hereby designated the operator of the proposed well and of the Units.

(3) The operator of the Units shall commence drilling the proposed well on or before May 31, 2004, and shall thereafter continue drilling the well with due diligence to test prospective formations including the Morrow formation.

(4) In the event the operator does not commence drilling the proposed well on or before May 31, 2004, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) Should the subject well not be drilled and completed within 120 days after commencement thereof, Ordering Paragraph (1) shall be of no further effect, and the unit created by this Order shall terminate unless the operator appears before the Division Director and obtains an extension of time to complete the well for good cause demonstrated by satisfactory evidence.

(6) Upon final plugging and abandonment of the West Carlsbad 3 Well No. 2, the pooled Units created by this Order shall terminate, unless this order has been amended to authorize further operations.

(7) After pooling, 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 the Units.)

(8) 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, deepening, completing and equipping the proposed well ("well costs").

(9) 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."

(10) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) 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.

(11) 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 its share of the amount that estimated well costs exceed reasonable well costs.

(12) 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 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% of the above costs.

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

(14) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$6,000 per month while drilling and \$600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is 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 is reasonable, attributable to pooled working interest owners.

(15) Except as provided above, all proceeds from production from the proposed 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.

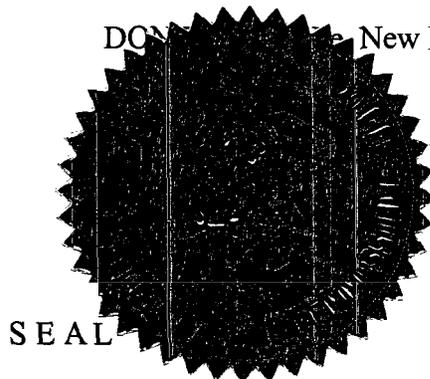
(16) Any **unleased** mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(17) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, the forced pooling provisions of this order shall thereafter be of no further effect.

(18) The operator of the 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.

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

Done at the City of Santa Fe, New Mexico, on the day and year hereinabove designated.



STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery
LORI WROTENBERY, Director