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

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

CASE NO. 12325
ORDER NO. R-11327

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

ORDER OF THE DIVISION

BY THE DIVISION:

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

NOW, on this 9th day of March, 2000, 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) The applicant, Chesapeake Operating, Inc. ("Chesapeake"), seeks an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the following acreage in Section 17, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico:

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

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

(c) the S/2 SW/4 to form a standard 80-acre oil spacing and proration unit for formations or pools developed on 80-acre spacing within that vertical extent, including the Undesignated Northeast Shoe Bar-Strawn Pool.

NOTE: After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(3) On September 24, 1999, in accordance with the directional drilling provisions of Division Rule 111, the Division approved Chesapeake's administrative application to re-enter the College of the Southwest "17" Well No. 1 **(API No. 30-025-29535)** and deepen it to the Strawn formation and designated the S/2 SW/4 of the section as an 80-acre project area for this well.

(4) At the time of the hearing Chesapeake testified that all the interests within the 80-acre oil spacing and proration unit had been voluntarily committed; therefore, that portion of the application requesting the pooling of the 80-acre oil spacing and proration unit should be dismissed.

(5) The subject proration units are to be dedicated to the applicant's College of the Southwest "17" Well No. 1, which was directionally drilled to the Morrow formation at a subsurface location 580 feet from the South line and 1085 feet from the West line (Unit M) of Section 17. The applicant drilled the College of the Southwest "17" Well No. 1 by re-entering the plugged and abandoned David Fasken Berry Hobbs Well No.1, located at a surface location 981 feet from the South line and 991 feet from the West line (Unit M) of Section 17.

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

(7) Pursuant to Order No. R-4657, as amended, issued in Case No. 5081 and dated October 17, 1973, the North Shoe Bar-Wolfcamp Gas Pool is governed by Special Pool Rules that provide for 160-acre spacing and proration units and require wells to be located within 150 feet of the center of a governmental quarter-quarter section or lot.

(8) Pursuant to Order No. R-4658, as amended, issued in Case No. 5082 and dated October 17, 1973, the Northeast Shoe Bar-Strawn Pool is governed by Special Pool Rules that provide for 80-acre oil spacing and require wells to be located no closer than 330 feet to any quarter-quarter section line.

(9) The subsurface location of the applicant's College of the Southwest "17" Well No. 1 is unorthodox for the subject proration units.

(10) Chesapeake testified that it is the operator of the offsetting acreage to the south, and no affected party appeared at the hearing or objected to the unorthodox subsurface locations.

(11) The unorthodox locations should be approved.

(12) Chesapeake re-entered this wellbore based upon its analysis of 3-D seismic data, which indicated a potential Strawn reservoir just to the south of the original bottom-hole location. Accordingly, Chesapeake attempted only to combine the interests in and obtain approval from the Division for an 80-acre spacing unit comprising the S/2 SW/4 of Section 17. Chesapeake did not attempt to form a 320-acre spacing unit for the Atoka-Morrow formation, did not obtain a permit for a 320-acre spacing unit from the Division, and did not propose a well to other owners of working interest in a 320-acre spacing unit. Additionally, Chesapeake did not form a 160-acre spacing unit for the Wolfcamp formation, did not obtain a permit from the Division for a 160-acre spacing unit, and did not propose a well to the other owners of working interest in a 160-acre Wolfcamp spacing unit.

(13) The applicant is a working interest owner within the subject proration units and therefore has the right to drill for and develop the minerals underlying these units.

(14) During the drilling of this wellbore, Chesapeake's operational personnel at the well site determined that the Strawn formation was non-productive and elected to continue drilling through the Strawn formation to the base of the Morrow formation. To drill from the Strawn formation to the Atoka-Morrow formation, Chesapeake only had to drill several hundred additional feet. The well has been drilled and logged, and there have been gas shows in the Atoka-Morrow formation on the mud logs of the well.

(15) Chesapeake's operational personnel elected to continue drilling this well without obtaining the concurrence of all working interests owners to continue drilling, without voluntarily consolidating the working interests of all owners in the S/2 of this section, and without authorization from the Division.

(16) There are interest owners in the subject proration units that have not agreed to pool their interests.

(17) After drilling, but prior to completion, Chesapeake determined that the Altura Energy, Ltd. ("Altura") interest in the N/2 SW/4 and in the SE/4 of this section was still held by Altura and not by Chesapeake. In addition, Chesapeake determined that Southeast Royalties, Inc. ("Southeast") owned an undivided 1.666% of the working interest in the 320-acre gas spacing unit to be dedicated to the well if it produced from the Atoka formation.

(18) Altura and Southeast, working interest owners in the Atoka-Morrow and Wolfcamp proration units, appeared at the hearing and objected to the following:

(a) the compulsory pooling portion of Chesapeake's application; and

(b) the costs Chesapeake is now proposing to charge to other owners before they will be able to participate in production from formations it now seeks to pool.

(19) Altura testified that Chesapeake's cost allocation is unreasonable and that for the Atoka-Morrow formation Altura should pay only its proportionate share of the costs to drill below the base of the Strawn formation to the Atoka-Morrow formation and then the costs to complete that zone. Regarding the Wolfcamp formation, Altura testified that it should pay its proportionate share of the costs to complete that zone only if and when a completion is attempted.

(20) Chesapeake asked the Division to allocate the costs incurred in the drilling of the College of the Southeast Well No. 1 to the Atoka-Morrow formation to Altura and Southeast in accordance with the provisions of COPAS Bulletin No. 2, "Determination of Values for Well Cost Adjustments - Joint Operations." Chesapeake cited Order No. R-9093-C, issued in Case No. 9998 and dated November 29, 1990, as a precedent for this request.

(21) The facts and issues presented to the Division in Case No. 9998 are distinguishable from the facts and issues presented to the Division in this case in the following ways:

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

(b) In Case No. 9998 all affected formations were developed on 40-acre spacing units. This case involves formations developed on larger and different spacing units than those dedicated to the original Strawn well.

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

(d) Before the original compulsory pooling order was entered in Case No. 9998, the owners who were subject to the pooling application had been offered an opportunity to participate in the well and had declined to do so. In this case, the owners subject to the pooling application were not contacted about participating in the well until in had already been drilled.

(e) In Case No. 9998, the COPAS Bulletin No. 2 formula was used to decrease the costs other interest owners would have to pay to participate in production from the new formations that which were added to the pooling order. In this case Chesapeake is attempting to use the formula in COPAS Bulletin No. 2 to increase the costs other interest owners would have to pay to participate in production from the new formations.

(22) Order No. R-9093-C does not set a precedent for the issues in this case.

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

(24) Requiring Altura and Southeast to pay a share of the costs incurred in drilling the dry hole in the Strawn formation, pursuant to the provisions of COPAS Bulletin No. 2, "Determination of Values for Well Cost Adjustments - Joint Operations," is unreasonable and this portion of Chesapeake's application should be denied.

(25) Altura and Southeast should be afforded the opportunity to participate in Atoka-Morrow production from the College of the Southwest "17" Well No. 1 by paying their proportionate share of the costs of drilling the well from the Strawn formation to the Atoka-Morrow formation and their proportionate share of the completion costs in the Atoka-

Morrow formation. Additionally, Altura and Southeast should be afforded the opportunity to participate in Wolfcamp production from the College of the Southwest "17" Well No. 1 by paying their proportionate share of the costs to complete that zone if and when a completion is attempted.

(26) Chesapeake is requesting a 200 percent risk factor penalty despite the fact that the well has been drilled and logged because there is no Atoka production within three miles of this well and the nearest Wolfcamp well is the Yates Petroleum Corporation Robert AGX State Well No 1 in Unit A of Section 20, which has only produced 1,451 barrels of oil from the Wolfcamp since 1996.

(27) Altura's witness testified that the only risk remaining is the very small risk associated with the completion of the subject well in the Wolfcamp and Atoka-Morrow formations; therefore, Altura has recommended to the Division that the risk factor penalty be reduced to 100 percent.

(28) Chesapeake has assumed the risk associated with drilling the College of the Southwest "17" Well No. 1 from the Strawn formation to the Atoka-Morrow formation without first combining the lands to be dedicated to the well either by voluntary agreement of the interest owners or by obtaining a compulsory pooling order from the Division. The risk factor penalty should therefore be reduced to 100 percent and should be applied only to the costs of completion.

(29) Additionally, Chesapeake is requesting that Altura's and Southeast's period of election should be shortened from 30-days to 15-days.

(30) Since Chesapeake failed to form a 320-acre spacing unit for the Atoka-Morrow formation and a 160-acre spacing unit for the Wolfcamp formation prior to re-entering the subject well, Altura and Southeast should be allowed the full 30-day period of election.

(31) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the above-described proration units the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbon, this application should be approved by pooling all uncommitted mineral interests, whatever they may be, within the subject proration units.

(32) Chesapeake should be designated the operator of the subject well and units.

(33) Any non-consenting working interest owner should be afforded the opportunity to pay its share of actual drilling costs from the Strawn formation to the Atoka-

Morrow formation and its share of estimated completion costs in the Atoka-Morrow formation to the operator in lieu of paying its share of costs out of production.

(34) Any non-consenting working interest owner who does not pay its share of actual drilling costs from the Strawn formation to the Atoka-Morrow formation and its share of estimated completion costs in the Atoka-Morrow formation should have withheld from production its share of reasonable costs plus an additional 100 percent of the reasonable completion costs as a charge for the risk involved in the completion of the well.

(35) Any non-consenting working interest owner should be afforded the opportunity to object to the actual drilling costs from the Strawn formation to the Atoka-Morrow formation and the actual completion costs in the Atoka-Morrow formation, but actual costs should be adopted as the reasonable costs in the absence of such objection.

(36) Following determination of reasonable costs, any non-consenting working interest owner who has paid its share of actual drilling costs and estimated completion costs should pay to the operator any amount that reasonable costs exceed actual drilling costs and estimated completion costs and should receive from the operator any amount that paid actual drilling costs and estimated completion costs exceed reasonable costs.

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

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

(39) Any non-consenting working interest owner should be afforded the opportunity to object to the actual completion costs in the Wolfcamp formation, but actual completion costs should be adopted as the reasonable costs in the absence of such objection.

(40) Following determination of reasonable completion costs in the Wolfcamp formation, any non-consenting working interest owner who has paid its share of estimated completion costs should pay to the operator any amount that reasonable costs exceed estimated costs and should receive from the operator any amount that paid estimated costs exceed reasonable costs.

(41) Reasonable charges for supervision (combined fixed rates) should be fixed

at $6,000.00 per month while drilling and completing and $600.00 per month while producing. 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 non-consenting working interest.

(42) All proceeds from production from the well that 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.

(43) If all the parties subject to this forced pooling reach voluntary agreement subsequent to entry of this order, this order should become of no effect.

(44) The operator of the well and units should notify 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) Pursuant to the application of Chesapeake Operating, Inc., all uncommitted mineral interests from the surface to base of the Morrow formation underlying the following acreage in Section 17, Township 16 South, Range 36 East, NMPM, Lea County, New Mexico, are hereby pooled in the following manner:

(a) the S/2 to form a standard 320-acre gas spacing and proration unit for formations or pools developed on 320-acre spacing within that vertical extent, including the Undesignated South Shoe Bar-Mississippian Gas Pool; and

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

NOTE: After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(2) The portion of the application relating to the 80-acre oil spacing and proration unit is hereby dismissed.

(3) The 320-acre and 160-acre units are to be dedicated to the applicant's College of the Southwest "17" Well No. 1 (**API No. 30-025-29535**), which was directionally drilled to the Morrow formation at an unorthodox subsurface location 580 feet from the South line and 1085 feet from the West line (Unit M) of Section 17. The applicant drilled the College of the Southwest "17" Well No. 1 by re-entering the plugged and abandoned David Fasken Berry Hobbs Well No.1, located at a surface location 981 feet from the South line and 991 feet from the West line (Unit M) of Section 17.

(4) The unorthodox locations for the subject units are hereby approved.

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

(6) The request of Chesapeake Operating, Inc. to allocate the costs incurred in the drilling of the College of the Southeast Well No. 1 to the Atoka-Morrow formation to Altura and Southeast in accordance with the provisions of COPAS Bulletin No. 2, "Determination of Values for Well Cost Adjustments - Joint Operations," is hereby denied.

(7) After the effective date of this order and within 90 days prior to completing the well in the Atoka-Morrow formation, the operator shall furnish the Division and each known working interest owner in the 320-acre unit comprising the S/2 of Section 17 an itemized schedule of the actual costs incurred in drilling the College of the Southwest "17" Well No. 1 from the base of the Strawn formation to total depth of the well and estimated completion costs for the Atoka-Morrow formation.

(8) Within 30 days from the date the schedule of actual costs incurred in drilling from the base of the Strawn formation to total depth of the well and estimated completion costs for the Atoka-Morrow formation is furnished, any working interest owner shall have the right to pay its share of actual drilling costs and actual completion costs to the operator in lieu of paying its share of costs out of production, and any such owner who pays its share of actual drilling costs and actual completion costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(9) The operator shall furnish the Division and each known non-consenting working interest owner an itemized schedule of actual completion costs within 90 days following completion of the well in the Atoka-Morrow formation. If no objection to the actual costs incurred in drilling and completing the subject well is received by the Division and the Division has not objected within 45 days following receipt of the schedule, the actual

drilling and completion costs shall be the reasonable costs; provided, however, that if there is an objection to the actual drilling and completion costs within the 45-day period, the Division will determine reasonable costs after public notice and hearing.

(10) Within 60 days following determination of reasonable costs, any non-consenting working interest owner who has paid its share of costs in advance as provided above shall pay to the operator its share of the amount that reasonable costs exceed estimated costs and shall receive from the operator its share of the amount that estimated costs exceed reasonable costs.

(11) After the effective date of this order and within 90 days prior to completing the well in the Wolfcamp formation, the operator shall furnish the Division and each known working interest owner in the 160-acre unit comprising the SW/4 of Section 17 an itemized schedule of the estimated completion costs incurred in completing the College of the Southwest "17" Well No. 1 in the Wolfcamp formation.

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

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

(14) Within 60 days following determination of reasonable completion costs in the Wolfcamp formation, any non-consenting working interest owner who has paid its share of estimated completion costs in advance as provided above shall pay to the operator its share of the amount that reasonable costs exceed estimated costs and shall receive from the operator its share of the amount that estimated costs exceed reasonable costs.

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

(a) the proportionate share of reasonable costs incurred in drilling from the base of the Strawn formation to the total depth of the well attributable to each non-consenting working interest owner who has not paid its share of actual drilling costs within 30 days from the date the schedule of actual drilling costs is furnished;

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

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

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

(17) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000.00 per month while drilling and completing and $600.00 per month while producing. 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 are reasonable, attributable to each non-consenting working interest.

(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.

(19) 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.

(20) All proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Lea County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the

escrow agent.

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

(22) 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.

(23) 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

SEAL