

**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. 13381
ORDER NO. R-12359**

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

ORDER OF THE DIVISION

BY THE DIVISION:

This case came for hearing at 8:15 a.m. at Santa Fe, New Mexico on April 7, 2005 before Examiner William V. Jones.

NOW, on this 2nd day of June, 2005, 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 Oil Conservation Division has jurisdiction of this case and of the subject matter.

(2) The applicant, 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 17, Township 22 South, Range 27 East, NMPM, Eddy County, New Mexico, in the following manner:

the S/2 forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated East Carlsbad-Wolfcamp Gas (74160), the South Carlsbad-Strawn Gas (74120), and the South Carlsbad-Morrow Prorated Gas (73960) Pools; and

the SE/4 forming a standard 160-acre spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent; and

the NE/4 SE/4 forming a standard 40-acre spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated South Carlsbad-Cherry Canyon (9680) Pool.

(3) The above-described units ("the Units") are to be dedicated to the applicant's Kodiak Well No. 1 (API No. 30-015-33961), to be drilled at a standard well location in the NE/4 SE/4 (Unit I) of Section 17. This well will be drilled to an approximate depth of 12,000 feet.

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

(5) Applicant is an owner of an oil and gas working interest within the Units. Applicant has the right to drill and proposes to drill to a common source of supply within the NE/4 SE/4 of Section 17.

(6) No other parties entered an appearance in this case or otherwise opposed this application.

(7) This case was presented by affidavit with written testimony from Mr. John W. Qualls representing Chi Energy, Inc.

(a) Because of the proximity of this well to the City of Carlsbad, many mineral interest owners are to be pooled.

(b) The primary and the deepest geologic target is the Morrow formation.

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

(9) At the applicant's request, Chi Operating, Inc. should be designated the operator of the proposed well and of the Units.

(10) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the well.

(11) Reasonable charges for supervision (combined fixed rates) should be fixed at \$6,500 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.*"

(12) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the 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 interests, whatever they may be, in the oil and gas within the Units.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Chi Energy, Inc. ("applicant"), all uncommitted mineral interests, whatever they may be, in the oil and gas from the surface to the base of the Morrow formation underlying the S/2 of Section 17, Township 22 South, Range 27 East, NMPM, Eddy County, New Mexico, are hereby pooled, as follows:

the S/2 forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated East Carlsbad-Wolfcamp Gas (74160), the South Carlsbad-Strawn Gas (74120), and the South Carlsbad-Morrow Prorated Gas (73960) Pools; and

the SE/4 forming a standard 160-acre spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent; and

the NE/4 SE/4 forming a standard 40-acre spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated South Carlsbad-Cherry Canyon (9680) Pool.

The above-described units ("the Units") are to be dedicated to the applicant's Kodiak Well No. 1 (API No. 30-015-33961), to be drilled at an orthodox well location in the NE/4 SE/4 (Unit I) of Section 17.

(2) The operator of the Units shall commence drilling operations on the proposed well on or before September 30, 2005 and shall thereafter continue drilling the well with due diligence to test the Morrow formation at an approximate depth of 12,000 feet.

(3) In the event the operator does not commence drilling operations on the proposed well on or before September 30, 2005, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(4) Should the proposed 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.

(5) Upon final plugging and abandonment of the Kodiak Well No. 1, the pooled units created by this Order shall terminate, unless this order has been amended to authorize further operations.

(6) Chi Operating, Inc. (OGRD 004378) is hereby designated the operator of the proposed well and of the Units.

(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.) 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").

(8) 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."

(9) 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.

(10) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated 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 it has paid exceed its share of reasonable well costs.

(11) 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% of the above costs.

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

(13) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$6,500 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 are reasonable, attributable to pooled working interest owners.

(14) Except as provided in Ordering Paragraphs (11) and (13) 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.

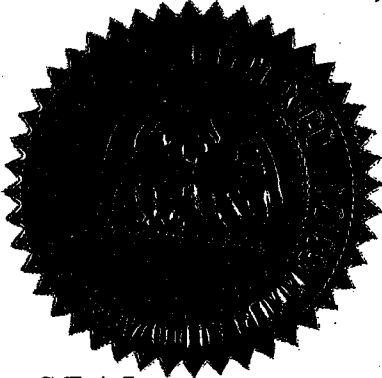
(15) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working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

(16) 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.

(17) 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.

(18) 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.



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STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in cursive script, reading "Mark E. Fesmire".

MARK E. FESMIRE, P.E.
Director