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September 14, 2005

**HAND DELIVERED**

Mr. William E. Jones, Hearing Examiner  
Oil Conservation Division  
1220 South St. Francis Drive  
Santa Fe, New Mexico 87505

**RECEIVED**

SEP 14 2005

Oil Conservation Division  
1220 S. St. Francis Drive  
Santa Fe, NM 87505

- Re: (1) NMOCD Case 13492  
Application of Samson Resources Company,  
Kaiser-Francis Oil Company and Mewbourne  
Oil Company for cancellation of two drilling  
permits and approval of a drilling permit,  
Lea County, New Mexico
- (2) NMOCD Case 13493  
Application of Chesapeake Operating, Inc.  
for Compulsory pooling, Lea County, New Mexico

Dear Mr. Jones:

In accordance with your direction at the conclusion of the hearing of the referenced cases held on August 22-23, 2005, and on behalf of Chesapeake Operating, Inc. as its closing argument, please find enclosed:

- (1) Chesapeake's proposed order on the Division,
- (2) Chesapeake's Post-Hearing Brief

WTD 9/15/05

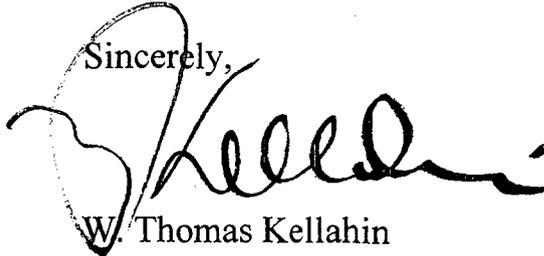
Oil Conservation Division

September 14, 2005

-Page 2-

3) Chesapeake's volumetric calculations for the six 160-acre tracts in Section 4 marked as Chesapeake's Exhibit "B".

Sincerely,

A handwritten signature in black ink, appearing to read "W. Thomas Kellahin". The signature is written in a cursive style with a large initial "W".

W. Thomas Kellahin

cc

David R. Brooks, Esq. (OCC)

James Bruce, Esq.

J. Scott Hall, Esq.

Earl DeBrine, Jr. Esq.

Charles Smith, Esq.

Recoverable Gas In-Place/160 Ac  
Shown in BCF

NW/4 160 Ac	1.30	0.05	NE/4 160 Ac
Middle W/2 160 Ac	0.64	0.00	Middle E/2 160 Ac
SW/4 160Ac	5.53	2.01	SE/4 160Ac

**Constant Reservoir Parameters used for the volumetric calculation are as follows:**

Porosity =	12 %
Water Saturation =	10 %
Initial Pressure =	7000 psia
Abandonment Pressure =	1000 psia
Bgi =	0.0030 resv cu ft/SCF
Bga =	0.0165 resv cu ft/SCF
Recovery Factor =	82%

**Estimated Original Recoverable Gas In Place in Spacing Unit**

Standard Reservoir Engineering Volumetric Equations:

$$RGIP = 43,560 * A * h * \text{porosity} * (1 - S_w) * (1/B_{gi} - 1/B_{ga}), \text{ cu ft}$$

$$B_g = 0.0283 * T * z / P \quad (T \text{ in degrees Rankine})$$

	Bulk Volume (Ac-Ft)	MCF/Ac-FT	RGIP/160 Ac (BCF)
SW/4	4,310	1,283	5.53
SE/4	1,564	1,283	2.01
W/2 Middle	496	1,283	0.64
E/2 Middle	0	-	0
NW/4	1,015	1,283	1.30
NE/4	37	1,283	0.05

BEFORE THE  
OIL CONSERVATION DIVISION  
Case # 13492&13493 Exhibit No. **B**  
Submitted By:  
*Chesapeake Inc.*  
Hearing Date: August 22, 2005  
BEFORE THE

**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 HEARING:**

**APPLICATION OF SAMSON RESOURCES  
COMPANY KAISER-FRANCIS OIL COMPANY,  
AND MEWBOURNE OIL COMPANY FOR  
CANCELLATION OF TWO DRILLING PERMITS  
AND APPROVAL OF A DRILLING PERMIT,  
LEA COUNTY, NEW MEXICO**

**CASE 13492**

**APPLICATION OF CHESAPEAKE OPERATING, INC.  
FOR COMPULSORY POOLING,  
LEA COUNTY, NEW MEXICO**

**CASE 13493**

**CHESAPEAKE'S POST-HEARING BRIEF**

Chesapeake Operating, Inc. and Chesapeake Permian, L.P. (collectively "Chesapeake") submit the following Post-Hearing Brief which responds to matters raised in the Joint Hearing Memorandum filed by Kaiser-Francis Oil Company, Samson Resources Company and Mewbourne Oil Company (collectively "Kaiser") in the above referenced cases before the Division.

- I. THE PLAIN LANGUAGE OF THE OIL & GAS ACT AND PRIOR PRECEDENT ESTABLISH THAT THE DIVISION IS NOT REQUIRED TO GIVE ANY PREFERENCE TO A VOLUNTARY COMMUNITIZATION AGREEMENT IN ESTABLISHING THE SPACING UNIT FOR A WELL.**

The Division's authority to establish spacing and proration units for wells based on its statutory directive to prevent waste and protect correlative rights is well

established. The contention by Kaiser that the Division is somehow required to accept a proposed spacing unit formed under a voluntary communitization agreement without considering whether the proposed spacing unit will prevent waste and protects correlative rights is specious.

The Pooling statute, NMSA 1978, Section 70-2-17(C), provides in part:

C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. *Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit.*

NMSA 1978, § 70-2-17(C) (emphasis added). In every compulsory pooling dispute, the objecting parties have the right to oppose application on the basis that the unit should be comprised of different property with a proposal for different or competing spacing or proration unit than the one advocated by the applicant for pooling. That property may be the subject of an operating agreement, voluntary communitization agreement, farmout or other document that carries with it certain expectation of development. The basic function of the Division is to determine whether the agreement contemplated would prevent waste, protect correlative rights and prevent the unnecessary drilling of wells, ensuring that the reservoir at issue can be most efficiently drained with each party owning interests in the same receiving their fair allocation of minerals.

Here, the evidence established that Chesapeake sought a voluntary pooling of interests, which was initially approved by one of the interest owners in the contiguous

tracts, Samson Resources. When Samson subsequently attempted to withdraw its election to participate in the drilling at the well, and the other interest owner of record refused to participate, Chesapeake filed its application for compulsory pooling with the Division. Kaiser, knowing that Chesapeake had received approval for its APD for the KF "4" State No. 1 well, embarked on a course to deprive Chesapeake of its rights through the execution of a voluntary communitization agreement that was approved by the Commissioner of Public Lands. However, the Division has no jurisdiction to determine whether that agreement is valid and has ruled to exclude a letter from the Commissioner stating that "the Land Office believes that geology should *solely* dictate the correct spacing and all the parties will have their opportunity to be heard at the Oil Commission proceeding." The only conceivable basis for excluding this letter is if the Division, as required by the Oil and Gas Act, is resolving the parties competing proposals for the configuration of the spacing unit without regard to the validity or supposed precedence of Kaiser's communitization agreement.

The New Mexico Supreme Court has ruled that the Commission has ample authority under the Oil and Gas Act in passing upon applications to establish well spacing units comprised of acreage that differ from standard units, over objection that there is in place an agreed plan of development comprised of a standard sized unit. *See Rutter & Wilbanks Corp. v. Oil Conservation Comm'n*, 87 N.M. 286, 289, 532 P.2d 582, 585 (1975). The court held that not only did the Commission have compulsory pooling authority to pool separately owned tracts within a spacing or proration unit, it had the power to pool separately owned tracts within an oversize non-standard spacing unit comprised of tracts that had a completed well and could have been dedicated to standard

320-acre spacing units for the Washington Ranch-Morrow Gas Pool. See OCC Order Nos. R-4353 and R-4354). In doing so, the Court noted the broad powers of the Commissioner to establish well spacing units:

The authority of the Commission to create spacing units is found in § 65-3-11, N.M.S.A. 1953, as amended. The second paragraph of this section provides:

"Apart from any authority, express or implied, elsewhere given to or existing in the commission by virtue of this act or the statutes of this state, the commission is hereby authorized to make rules, regulations and orders for the purposes and with respect to the subject matter stated herein, viz.:

\* \* \*

"(10) To fix the spacing of wells;

But R & W then makes an unlawful delegation argument based on inadequate standards regarding the Commission's authority under § 65-3-14.5, *supra*, or under a Commission rule or regulation. It contends the Commission exceeded its authority because it had no standards to follow in creating the non-standard spacing units in excess of the 320 acre standard spacing unit provided for in Rule 104(C), *supra*. We disagree.

Section 65-3-10, N.M.S.A. 1953 provides:

"The commission is hereby empowered, and it is its duty, to prevent the waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the commission is empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purposes of this act, whether or not indicated or specified in any section hereof."

Additionally, N. M. Oil Conservation Com'n, Rules and Reg. No. 104(L) (1971) specifically provides:

"In order to prevent waste the Commission may, after notice and hearing, fix different spacing requirements and require greater acreage for drilling tracts in any defined oil pool or in any defined gas pool notwithstanding the provisions of B and C above."

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We hold these standards sufficient to allow the Commission's power to prorate and create standard or non-standard spacing units to remain intact. The fact that more explicit standards appear in particular sections of the conservation statutes does not dictate a different result.

*Id.* The quoted statutes have not changed and parties clearly cannot dictate to the Division the configuration for a spacing unit by entering into a voluntary communitization agreement.

Similarly, in *Sims v. Mechem*, 72 N.M. 186, 382 P.2d 183 (1963), the New Mexico Supreme Court considered the compulsory pooling powers of the Commission and determined that any agreement between owners may be modified by the Commission:

Unquestionably the commission is authorized to require pooling of property when such pooling has not been agreed upon by the parties . . . and it is clear that the pooling of the entire west half of Section 25 had not been agreed upon. ***It is also clear from sub-section (e) of the same section (citing to what is now 70-2-17.E) that any agreement between owners and leaseholders may be modified by the commission.*** But the authority of the commission to pool property or to modify existing agreements relating to production within a pool under either of these sub-sections must be predicted on the prevention of waste."

72 N.M at 189, 382 P. 2d at 185 (emphasis added). The Supreme Court has also held that the Commission can order the force pooling of multiple zones when an adjacent working interest owner only agrees to participate in the pooling of one of the zones. *Viking Petroleum, Inc. v. Oil Conservation Comm'n*, 100 N. M. 451, 455, 672 P. 2d 280, 284 (1983).

There are also many examples where the Commission or Division has approved the establishment of a spacing unit notwithstanding a contrary plan of development. Chief among those of course is the recent *Pride* decision. Additionally, in Case 11434, the Division held a hearing on the application of Meridian Oil Company for a compulsory pooling order for a Mesaverde infill well against Doyle Hartman and Four Star Oil & Gas Company. Four Star and Hartman contended the Division did not have the authority to

authorize the compulsory pooling of a Mesaverde infill well because the original parties in the spacing unit had signed a 1953 operating agreement which contained a plan for the spacing of but one single Mesaverde well within a 320-acre spacing unit. The Division entered Order R-10545 ruling that the Division, in accordance with Section 70-2-17(E), had the authority and would exercise that authority to modify this 1953 operating agreement to the extent necessary to prevent waste and to issue a compulsory pooling order to permit the drilling of an infill well.

A further review of previous pooling orders demonstrates that the Division has on several occasions ordered the compulsory pooling of acreage despite the existence of contrary agreement for development. The Division issued Order R-9332 on October 24, 1990 granting an application by Doyle Hartman for compulsory pooling in which he was allowed to pool his undeveloped acreage in the Eumont Gas Pool into an existing gas spacing unit already operated by Chevron and containing a existing well. Hartman was further authorized to drill a second "infill well" over Chevron's objection. In doing so, the Division necessarily ruled that it was not bound to follow the existing voluntary agreement of Chevron for the operations of its existing spacing unit for its well. Instead, in order to prevent waste and protect correlative rights the Commission required the inclusion of additional acreage in the spacing unit.

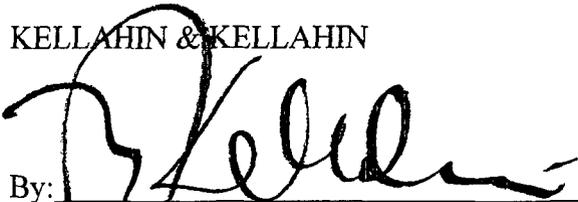
Conservation laws and the rules, regulations and orders promulgated thereunder have the effect of modifying the provisions of existing leases and other contracts and agreements. Without that effect, then parties could make agreements which are contrary to or inconsistent with what the Division or Commission determines are appropriate rules for the development of a pool, including the economic waste caused by drilling too many

or to few wells, well locations, well density, spacing unit sizes, production allowables, gas-oil ratios, etc.

New Mexico law confers exclusive authority upon the Division and Commission to make determination about spacing units, utilizing established statutory and regulatory criteria. The Division has the authority and the responsibility to issue a compulsory pooling order in accordance with Section 70-2-17(C) or Section 70-2-17(E) NMSA (1978) where, like here, the parties owning interests in the proposed spacing unit cannot reach agreement and the Division must decide which of two competing proposals will best serve the interests underlying the conservation laws of the State.

The geologic evidence and reservoir data introduced at the hearing clearly demonstrated that the K-F State 4 Well No. 1 that the greatest potential for commercial production clearly lies in the S/2 lay-down spacing unit proposed by Chesapeake. Accordingly the Division is duty bound to approve the unit that will offer the greatest opportunity to protect correlative rights, prevent drainage and ensure that the reservoir is efficiently developed notwithstanding the fact that Kaiser, *after* Chesapeake had already begun it course to establish a lay-down unit for the south half of irregular Section 4, entered into agreement to establish a competing and inferior proposed spacing unit..

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WE HEREBY CERTIFY that a true and correct copy of the foregoing pleading was hand-delivered to the following counsel of record this 14<sup>th</sup> day of September, 2005:

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KELLAHIN & KELLAHIN

By: 

W. Thomas Kellahin

**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 HEARING:**

**APPLICATION OF SAMSON RESOURCES  
COMPANY KAISER-FRANCIS OIL COMPANY,  
AND MEWBOURNE OIL COMPANY FOR  
CANCELLATION OF TWO DRILLING PERMITS  
AND APPROVAL OF A DRILLING PERMIT,  
LEA COUNTY, NEW MEXICO**

**CASE 13492**

**APPLICATION OF CHESAPEAKE OPERATING, INC.  
FOR COMPULSORY POOLING,  
LEA COUNTY, NEW MEXICO**

**CASE 13493**

**CHESAPEAKE'S HEARING BRIEF**

Chesapeake Operating, Inc. and Chesapeake Permian, L.P. (collectively "Chesapeake") submit the following brief addressing the issues to be decided at the August 22, 2005 hearing in the above referenced cases before the Division.

**INTRODUCTION AND FACTUAL BACKGROUND**

This case calls for the Division to apply the Oil and Gas Act and prior Division and Commission precedent in determining whether Chesapeake's proposal for the formation of a compulsory pooling of all mineral interests from the top of the Wolfcamp formation to the base of the Morrow formation underlying the S/2 of Section 4, T21S, R35E is appropriate. Chesapeake is the current lessee of State of New Mexico Oil & Gas Lease #VO-7063-1, effective May 1, 2004, covering the SW/4 of Irregular Section 4.

The SE/4 of this section is subject to a State of New Mexico Oil & Gas Lease #B1481, effective December 19, 1932 that as of March 9, 2005 the working interest owners are Kaiser Francis Oil Company with 36.5625% interest, Mewbourne Oil Company with a 7.1875% interest and Samson Resources Company with 6.25% interest (sometimes collectively referred to herein as "Kaiser").

On March 9, 2005, Chesapeake, by letter including an AFE, proposed the drilling of its KF State 4 Well No. 1 for an estimated completed well costs of \$2,012,000.00 to be dedicated to a standard 320-acre gas spacing unit consisting of the S/2 of this irregular section to both Kaiser Francis Oil Company and Samson Resources Company. The AFE was initially approved by Samson but Samson subsequently attempted to withdraw its approval. Chesapeake negotiated a surface damages and easement from the surface owner obtained the requisite approval from the Division to drill the well and sought further approval to form a proration unit for the well in accordance with the prior orders by the Division and Oil Conservation Commission. Specifically, the following events transpired:

- On March 10, 2005 Chesapeake staked the subject well and on March 11, 2005, obtained Division approval of Chesapeake's application for permit to drill ("APD") this wellbore.
- On April 26, 2005, Chesapeake filed its compulsory pooling application for a S/2 spacing unit to be dedicated to its K-S 4 State Well No. 1.
- On April 27, 2005, Chesapeake in accordance with the Division approval APD and in compliance with Division rules spudded the KF State 4 Well No 1 located in Unit X of this section.
- On April 27, 2005, Mewbourne filed its application to cancel Chesapeake's approval ADP docketed as Case 13492 and as an attempt to stop the drilling and as a vehicle to dispute Chesapeake's orientation of the spacing unit for the K-F State 4 Well No. 1.

- On May 2, 2005, the Director denied Mewbourne's application for an emergency order to stop Chesapeake from drilling the K-F 4 State Well No. 1.
- On May 3, 2005, the State District Court denied Samson's application, based upon a claim of trespass, for a restraining order to stop Chesapeake from continuing to drill the K-F 4 State Well No.1.
- On May 24, 2004 the Division Order R-12343-A that, among other things, denied Kaiser's joint motion to limit drilling operations for the K-F 4 State Well No.1.
- On August 9, 2005, Chesapeake completed the K-F State 4 Well No.1 and there is every indication that it will be a commercial well.

At all times, Chesapeake has conducted its operations in good faith and has complied with the Division's orders and subpoena and voluntarily produced information to Kaiser. By contrast, Kaiser Francis has made unfounded accusations against Chesapeake and filed frivolous motions before the Division in an effort to avoid a decision on the merits. The Division should reject Kaiser's efforts to consider the false issue of whether Chesapeake committed a trespass in this proceeding. Instead, all relevant evidence necessary to decided issues properly within the Division's jurisdiction will demonstrate that the Division acted properly in issuing the APD to Chesapeake and allowing the continued drilling, thereby allowing the Division to consider the matters with the benefit of data developed from the drilling and completion of the well.

Now that the well has been completed it is clear that Chesapeake's proposal for the orientation of the spacing unit is superior the competing proposal by Kaiser. Accordingly, the Division should deny Kaiser's application to revoke Chesapeake's APD for the well and grant Chesapeake pooling application and assess an appropriate risk penalty allowing Chesapeake to recover the costs of drilling the well.

**I. THE COMMISSION'S RULING IN *PRIDE* CONCLUSIVELY ESTABLISHES THAT CHESAPEAKE HAD THE AUTHORITY REQUIRED TO CONDUCT DRILLING OPERATIONS.**

Chesapeake obtained a valid permit to drill this well from the Division and has dedicated to this well a standard spacing unit consisting of the S/2 of Irregular Section 4, T21S, R35E. *See* API # 30-025-37129. In accordance with Division rules and the Oil & Gas Act, Chesapeake commenced drilling of this well prior to obtaining a compulsory pooling order. Chesapeake's conduct was in conformity with New Mexico precedent, as determined by the Commission in the *Pride* case.

In *Pride*, the Division determined that "the compulsory pooling statute NMSA 1978, 70-2-17) provides sufficient flexibility to allow the operator of a pooled unit to conduct operations anywhere on that unit, *regardless of whether the owner of the land on which the well is located has consented thereto.*" *See* Order R-12108, findings (18), (19) and (23) (Emphasis added). Thus, Division's order in *Pride* gave Chesapeake ample authority for drilling the KF State conducting the operations at issue here.

In the *Pride* case, the Division allowed *Pride* to: (1) re-enter a well on the Yates tract in which *Pride* had no interest; (2) compulsory pool a stand-up W/2 spacing unit dedicated to this well even though Yates had previously formed a lay-down N/2 spacing unit in which *Pride* had no interest; (3) compulsory pool Yates into the *Pride* spacing unit even though Yates had formed a voluntary spacing unit that require no compulsory pooling order; (4) change the orientation of Yates' spacing unit; and (5) cause Yates' approved APD to be revoked and to obtain an approved APD for *Pride* reinstated.

On rehearing, the rule established by the Commission in the *Pride* case in the Commission's December 9, 2004 order was:

***[a]n owner who would have a right to drill at its proposed location in the event of a voluntary or compulsory pooling of the unit it proposes has the necessary good faith claim of title to permit it to file an APD even though it has not yet filed a pooling application.***

Order No R-12108-C ¶8(i) (Emphasis added). Significantly the Commission's decision in *Pride* was issued several months after its decision in the *Valles Caldera* which is relied upon the Kaiser. Chesapeake clearly had a right to rely upon the Commission's most recent interpretation of the Oil and Gas Act and its establishment in that case of the requirements for establishing a good faith claim of title for the filing of an APD.

There is no material difference between what Chesapeake seeks in this proceeding and what was approved by the Division in the *Pride* case. The only difference between the two cases is that in *Pride* the Division had cancelled *Pride's* APD after Yates filed a competing APD for the well. Here, the Division approved Chesapeake's APD and rejected the one submitted by Kaiser. Thus, based on *Pride*, it is clear that Chesapeake had the authority to conduct the operations at issue here.

**II. ISSUES SURROUNDING TITLE DISPUTES AND CLAIMS OF TRESPASS ARE BEYOND THE DIVISION'S JURISDICTION, THOUGH CHESAPEAKE'S CONDUCT HAS ALWAYS BEEN IN GOOD FAITH.**

It is improper for the Division to consider issues surrounding property rights, including allegations of trespass; as such issues lie outside of its jurisdiction. Indeed, there is no New Mexico statute which confers jurisdiction upon the Division to adjudicate issues relating to trespass or title disputes, particularly *claims* of trespass or title disputes. The Division is vested with authority over the conservation of oil and gas. NMSA 1978, § 70-2-6 (1935). Such authority is not unbounded, and thus, the Division cannot rule on matters outside of its jurisdictional power. *See Continental Oil Co.*, 70 N.M. 310, 321,

373 P.2d 809, 816 (1962); *Santa Fe Exploration Co.*, 114 N.M. 103, 112, 835 P.2d 819, 828 (1992).

Trespass and title disputes do not implicate the Division's duty to prevent waste or to protect correlative rights. Rather, they involve issues of property ownership and are inherently judicial in nature. As such, matters relating to trespass and title disputes do not fall within the jurisdictional ambit of the Division. The Oil Conservation Commission's and Division's past precedent support this principle. See Order No. R-11700 (concluding that the Division had "no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease," leaving these issues for the District Court to decide); *Pride* ("As this Commission observed in Order No. R-11700-B... the *Division has neither the responsibility nor jurisdiction to determine whether an applicant for a permit to drill has the requisite title to the land in question.*") (Emphasis added).

Furthermore, Chesapeake has at all times acted in good faith as established by the rules and precedent of the Division and Commission. Chesapeake has 100% of the working interest ownership ("WIO") in the SW/4 of Section 5, which is 50% of the WIO in the proposed spacing unit. Prior to initiating drilling activity, Chesapeake negotiated a surface use and damages agreement with the surface owner and at all times had the surface owner's permission to enter upon the property. And, the Commissioner of Public Lands has taken the position that Chesapeake's entry onto state trusts land was not in bad faith, making clear that the SLO makes no allegation that Chesapeake trespasses onto state lands. The issue of "good faith" is therefore confined to whether Chesapeake could validly rely upon prior rulings by the OCD and OCC which have allowed an operator to

apply for an APD for well on a tract that will included in a spacing unit for the well though a compulsory pooling.

Finally, the *Pride* case stands for the proposition that Chesapeake's conduct was in good faith. In Order R-12108-A, an owner, Pride, had the right to drill at a proposed location in the event of a voluntary or compulsory pooling of the unit it proposed to dedicate to the well. As noted above, the Commission held that Pride had the necessary good faith claim of title to permit it to file an APD, even though it had not yet filed a pooling application. Chesapeake's conduct was in complete conformity with the order in *Pride*. The Division cannot, consistent with the Due Process Clause, change the rules for obtaining an APD for a well that will be forced pooled. *See, e.g., Hobbs Gas Co. v. New Mexico Pub. Serv. Comm'n*, 115 N.M. 678, 684, 60, 858 P.2d 54, 60 (1993) (regulatory body cannot, without prior notice, abruptly depart from past practice on which the regulatee has relied); *State v. Alderette*, 111 N.M. 297, 300, 804 P.2d 1116, 1119 (Ct. App. 1990) (The Due Process Clause prevents retroactive application of a changed construction of a statute and that application of the new construction must be prospective only).

Because it has no jurisdiction to hear claims involving property rights, all evidence regarding Kaiser's allegations of trespass should be excluded from the hearing. However, to the extent the Division intends to hear argument on this issue, the weight of the evidence establishes that Chesapeake possessed the requisite good faith when it proposed and was granted its APD for the well and has acted in good faith at all times.

### **III. THE EVIDENCE WILL DEMONSTRATE THAT CHESAPEAKE'S PROPOSAL FOR A LAY DOWN SPACING UNIT IS SUPERIOR TO KAISER'S PROPOSAL**

Section 4 is an Irregular Section containing 960 and consists entirely of lands leased by the Commissioner of Public Lands ("SLO"). Chesapeake's proposed orientation for the spacing unit is for a lay down unit in the S/2 while Kaiser's proposal is for a stand up unit containing lots 9, 10, 15, 16, and the SE/4 (hereafter referred to as "E/2") of Section 4. Regardless of the orientation, the royalty interest of the Commissioner of Public Lands is unaffected and although Kaiser has attempted to inject the false issue of trespass in this proceeding, the Commissioner of Public Lands has stated his position that:

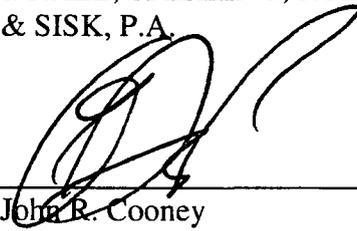
The SLO does not believe that this entry onto State Trust Lands by Chesapeake was in bad faith and understands that issues pertaining to the configuration for the spacing unit for this well will be resolved in the proceedings pending in the Oil Conservation Division. As expressed at our meeting the Land Office believes that geology should solely dictate the correct spacing and all the parties will have their opportunity to be heard at the Oil Commission proceeding.

The geologic evidence will demonstrate that the K-F State 4 Well No.1 will likely be a commercial well, is in communication with the same geologic formation as the Osudo No. 9 well which presents the risk of drainage to lands in the S/2 of Section 4. The geologic evidence demonstrates that the greatest potential for commercial production lies in the lay-down unit proposed by Chesapeake. By contrast, there is no indication that there are commercial sands to the north in the same zone that would support the orientation of the standup unit proposed by Kaiser. As such, the lay down unit proposed by Chesapeake offers the greatest opportunity to protect correlative rights, prevent drainage and ensure that the reservoir is efficiently developed.

## CONCLUSION

Chesapeake respectfully requests that the Division: (1) deny the Application by Kaiser seeking to cancel Chesapeake's APD for the KF 4 State No. 1 well; (2) approve the spacing unit for the well proposed by Chesapeake; (3) grant Chesapeake's Application for compulsory pooling of all mineral interests from the top of the Wolfcamp formation to the base of the Morrow formation underlying the S/2 of Section 4, T21S, R35E to form a standard spacing unit for the well; and (4) set appropriate allocations of the costs of drilling the same with a 200% risk penalty.

MODRALL, SPERLING, ROEHL, HARRIS  
& SISK, P.A.

By: 

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WE HEREBY CERTIFY that a true and correct copy of the foregoing pleading was hand-delivered to the following counsel of record this 22<sup>nd</sup> day of August, 2005:

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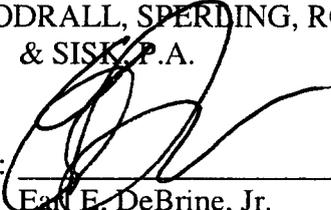
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By: \_\_\_\_\_

  
Earl E. DeBrine, Jr.

**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. 13492**

**APPLICATION OF SAMSON RESOURCES COMPANY,  
KAISER-FRANCIS OIL COMPANY AND MEWBOURNE  
OIL COMPANY FOR CONCELLATION OF TWO DRILLING  
PERMITS AND APPROVAL OF A DRILLING PERMIT  
LEA COUNTY, NEW MEXICO.**

**APPLICATION OF CHESAPEAKE OPERATING, INC.      CASE NO. 13493  
FOR COMPULSORY POOLING,  
LEA COUNTY, NEW MEXICO**

**APPLICATION OF CHESAPEAKE OPERATING, INC.      CASE NO. 13505  
FOR COMPULSORY POOLING,  
LEA COUNTY, NEW MEXICO**

**ORDER NO. R-12343-B**

**CHESAPEAKE'S PROPOSED  
ORDER OF THE DIVISION**

Chesapeake Operating, Inc. and Chesapeake Permian, L.P. (collectively "Chesapeake") submit the following proposed order for entry by the Division reflecting the resolution of the above-referenced cases.

**BY THE DIVISION:**

This case came on for hearing at 8:15 a.m. on August 22-23, 2005, at Santa Fe, New Mexico, before Examiner William E. Jones.

NOW, on this \_\_\_ day of September, 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 Division has jurisdiction of these cases and of the subject matter.

*WED 9/14/05*

(2) In Case 13492, Chesapeake Operating Company seeks an order pooling all uncommitted mineral interests from the top of the Wolfcamp to the base of the Morrow formation underlying the S/2 of Irregular Section 4, Township 21 South, Range 35 East, NMPM, Lea County, New Mexico, to form a standard 320-acre gas spacing and proration unit ("GPU") for all formations or pools spaced on 320-acres within this vertical extent (for convenience referred to as the S/2 lay-down unit) This spacing unit is to be dedicated to its K-F State "4" Well No. 1 (API No. 30-025-37129) that has been drilled from a surface location of 660 feet FSL and 990 feet FEL to a bottom hole location ("BHL") of 688 feet FSL and 1947 feet FEL (SE/4).

(3) In Case 13505, Chesapeake Operating Company seeks an order pooling all uncommitted mineral interests from the top of the Wolfcamp to the base of the Morrow formation underlying Lots 1, 2, 7, 8, 9, 10, 15 & 16 of Irregular Section 4, Township 21 South, Range 35 East, NMPM, Lea County, New Mexico, to form a standard 320-acre gas spacing and proration unit ("GPU") for all formations or pools spaced on 320-acres within this vertical extent to be dedicated to its Cattleman "4" State Com Well No. 1 (API No. 30-025-37150) to drilled at a surface location of 3300 feet FSL and 990 feet FEL.

(4) In Case 13492, Mewbourne Oil Company ("Mewbourne") seeks an order cancellation the two drilling permits ("APDs") issued to Chesapeake for Chesapeake's K-F State "4" Well No. 1 and for Chesapeake's Cattleman "4" State Com Well No. 1 and the approval of Mewbourne's APD for Mewbourne's proposed Osudo "4" State Com Well No. 1 to be located 660 feet FSL and 1650 feet FEL of Section 4 (SE/4)

(5) At the request of Chesapeake and without opposition, Case 13505 should be dismissed without prejudice.

(6) Because these two remaining cases ultimately involve a dispute over the orientation a 320-acre spacing unit, they were consolidated for purposes of hearing. The granting of one application will require the denial of the other.

#### **PARTIES AND INTERESTS**

(7) In the SW/4 of Section 4, Chesapeake Permian, L.P. is the current holder of a State of New Mexico oil & gas lease No. V-7063 controlling 100% of the working interest ownership for that tract.

(8) In the SE/4 of Section 4, Kaiser Francis Oil Company ("Kaiser"), Samson Resources Company ("Samson") and Mewbourne Oil Company ("Mewbourne") currently share the working interest ownership in another State of New Mexico oil & gas lease No. B-1481 such that Kaiser has 36.5625%, Samson has 6.25% and Mewbourne has 7.1875%.

(9) In the middle one-third of Irregular Section 4, Samson controls 100% of the working interest ownership in another State of New Mexico oil & gas lease No. V-7054.

(10) In the northern one-third of Irregular Section 4 Chesapeake controls 100% of the working interest ownership in another State of New Mexico oil & gas lease No. V-7062.

(11) If the Division approves Chesapeake's proposed S/2 laydown spacing unit orientation, then the working interest ownership is Chesapeake with 50%, Samson with 6.25%, Mewbourne 7.1875% and Kaiser with 36.5625%

(12) If the Division approves Mewbourne's E/2 stand-up spacing unit orientation, then Mewbourne and Kaiser's interests remain unchanged but Samson's interest is 56.25% and Chesapeake has no interest.

## JURISDICTION

(13) The Division's jurisdiction in this matter is set forth in the Oil and Gas Act, including NMSA (1978), Section 70-2-17 and provides, in part, that:

"Where, however, such owner or owners have not agreed to pool their interests,...the Division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste shall pool all or any part of such lands, or interest or both in the spacing unit or proration unit as a unit."

"All orders effecting such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owners of owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas, or both."

(14) In other cases, the Oil Conversation Commission (“OCC”) has entered certain orders that established precedents that control the Division action in the subject cases:

(a) In TMBR/Sharp’s compulsory pooling dispute with Ocean, the OCC ultimately resolved the dispute over spacing unit orientation upon which orientation dedicated the greatest reservoir volume to the well. See Order R-11700-D, finding 16;

(b) In Pride, the OCC determined that “the compulsory pooling statute NMSA 1978, 70-2-17, provided sufficient flexibility to allow the operator of a pooled unit to conduct operations anywhere on that unit, regardless of whether the owner of the land on which the well is located has consented thereto. See Order R-12108.C para 8 (i);

(c) In TMBR/Sharp’s permit dispute with Arrington, the OCC determined that an operator can drill first and obtain a compulsory pooling order afterwards stating that “It is the responsibility of the operator filing an application for a permit to drill to do so under a good faith claim of title and a good faith belief that it is authorized to drill the well applied for.” See Order R-11700-B, finding 28);

(d) In Valles Caldera Trust, the OCC determined that APD had not yet been approval by the OCD and that the applicant did not have approval for surface access. Significantly, the OCC decision in Pride was issued several months after its decision in the Valles Caldera which is relied upon by Kaiser.

#### UNDISPUTED FACTS

(15) The following facts are undisputed (*See* Chesapeake Exhibit 8):

(a) On March 9, 2005, Chesapeake, by letter including an AFE, proposed the drilling of its K-F “4” State Well No. 1 for an estimated completed well costs of \$2,012,000 to be dedicate to a standard 320-acre gas spacing unit consisting of the S/2 of this irregular section (referred to an the S/2 lay-down spacing unit) to both Kaiser and Samson.

(b) On March 10, 2005 Chesapeake, after obtaining verbal permission from the surface lessee, staked the subject well at a surface location 660 feet FSL & 990 feet FEL of this section.

(c) On March 11, 2005, the OCD-Hobbs approved Chesapeake's application for permit to drill ("APD") that was filed on March 10, 2005.

(d) On March 16, 2005, Chesapeake received Samson's letter electing to participate in the K-F "4" State Well No 1.

(e) On March 30, 2005, Chesapeake received a letter from Samson attempting to withdraw its election to participate in the K-F "4" State Well No. 1.

(f) On March 30, 2005, Chesapeake obtained the consent of the surface lessee for the SE/4 of this section for a surface easement.

(g) On March 30, 2005, Mewbourne attempted to file an APD for its Osudo "4" State Well No 1 to be drilled as a location 660 feet FSL and 1650 feet FEL of Section 4 and dedicated to a 320-acre spacing units consisting of the SE/4 and Lots 17, 18, 23, & 24 (referred to as the E/2 stand-up unit). This APD was rejected by the OCD-Hobbs because of the prior approval of Chesapeake's APD for the K-FD "4" State Well No. 1.

(h) After Mewbourne filed its APD for its proposed Osudo "4" State Well No. 1, Mewbourne and Samson signed a joint operating agreement covering this well on March 24, 2005, April 4, 2005 and April 14, 2005, respectively.

(i) On April 20, 2005, Mewbourne filed a Communitization Agreement for the E/2 stand-up unit with the State Land Office.

(j) On April 26, 2005, Chesapeake filed a compulsory pooling application for the S/2 of Section 4.

(k) On April 27, 2005, Chesapeake spudded its K-F "4" State Well No. 1

(l) On April 27, 2005, Mewbourne filed an application to cancel Chesapeake's APD for the K-F "4" State Well No. 1

(m) On April 27, 2005, the State Land Office approved the proposed Mewbourne Communitization Agreement.

(n) On April 28, 2005, Mewbourne requested that the Division grant an emergency order to stop Chesapeake from drilling the K-F "4" State Well No. 1.

(o) On May 3, 2005 following a hearing, the Division entered Order R-12343, dated May 5, 2005 denying Mewbourne's application.

(p) On May 3, 2005, the District Court for Lea County held a hearing on the Application of Samson for a Preliminary Injunction to stop Chesapeake from drilling and denied the request for injunctive relief by an order entered on May 13, 2005.

(q) On May 16, 2005, the Division held a pre-hearing conference to, among other things, to hear argument on Samson-Kaiser-Mewbourne's motion to limit Chesapeake's drilling.

(r) On May 24, 2005, the Division entered Order R-12343-A, denying the motion to limit drilling and allowing Chesapeake to continue drilling and complete the K-F "4" State Well No.1.

(s) On June 2, 2005, Chesapeake filed and on June 3, 2005, the OCD-Hobbs approved its request to directional drill towards the location advocated by Samson. Ultimately the K-F "4" State Well No. 1 bottom hole location was 668 feet FSL & 1947 feet FEL of Section 4.

(t) On August 9, 2005 the K-F "4" State Well No 1 was completed and tested for Morrow production at a rate of 2.6 MMcf per day and shut-in pending further order of the Division.

### **ORIENTATION AND GEOLOGIC EVIDENCE**

(16) As required by OCC precedent, the Division finds that the key issue in dispute is what orientation of the spacing unit for the K-F State 4-1 well will contain the greatest potential reservoir volume. (See Order R-11700.D finding 16) The answer is dependent upon whether the primary pay sand in the Osudo 9-1 well is oriented north-south as contended by Samson or northwest to southeast as contended by Chesapeake. If Samson is correct then the spacing unit for the K-F "4" State No.-1 well should be an E/2 stand-up, but if Chesapeake is correct then the spacing unit should be a S/2 lay-down.

## LOG DATA

(17) Chesapeake, Exhibit 25, and Samson, Exhibit C, arrived at different net thickness for certain key of wells as follows:

- (a) WEK#1 Unit F, Section 15:
  - i. Chesapeake = 36 feet
  - ii. Samson = 8 feet
  
- (b) PQ Osudo #1, Unit G, Section 16
  - i. Chesapeake = 30 feet
  - ii. Samson = 14 feet
  
- (c) Hunger Buster #3, Unit I, Section 9
  - i. Chesapeake = 11 feet
  - ii. Samson = 32 feet
  
- (d) Osudo 9-1, Unit H, Section 9
  - i. Chesapeake = 54 feet
  - ii. Samson = 42 feet
  
- (e) Apaches' State WEL Com #2, Unit E, Section 10
  - i. Chesapeake = 0 feet
  - ii. Samson = 4 feet

(18) The differences between Chesapeake and Samson's log analysis are significant. While Samson's method allowed it to obtain net thickness numbers that it contended are supportive of its north-south orientation, Samson admitted that its numbers also supported Chesapeake's northwest-southeast orientation. Chesapeake contended that Samson's numbers did not support a north-south orientation.

(19) Chesapeake determined the net clean sand thickness by Neutron/Density sandstone crossover log character for lithology identification, the PE (photoelectric absorption coefficient) value for a secondary lithology indicator and the GR (gamma ray) curve as a clay volume indicator.

(20) Samson purported to calculate the net clean sand as determined by the GR log with cross-plot porosity greater than or equal to 6%. Samson used the cross-plot porosity curve as a cutoff. No specific GR cutoff was indicated by Samson.

(21) The Division finds that:

(a) If the sand content is determined properly, the application of a porosity cutoff, as used by Samson, should only serve to decrease the net sand content. In many instances, Samson's values are far greater than those of Chesapeake which applied no porosity cutoff limit.

(b) Although there was a substantial difference of method used by Samson's geologist and Chesapeake's geologist in selecting the footage thickness of the key interval of productive sand in the Middle Morrow formation, the Division finds that Chesapeake's geologic data and evaluation for the Morrow formation in the area, including Section 4, is based on reliable, supporting data and is more credible than Samson's data and evaluation.

(c) Samson contended that the Hunger Buster 9 #3 have almost twice the thickness of sand as the KF 4 State #1 and nearly as much as the Osudo 9 State #1. Yet, the KF 4 State #1 tested from a natural completion at a rate of 2.23 MMcf per day with 2000# FTP on a 14/64" choke. The Osudo 9 State #1 wellbore was also a natural completion achieving rates of over 21 MMcf per day. The Hunger Buster 9 State #3 has achieved a rate of only 700 Mcf per day after fracture stimulation. This is a clear indicator that Samson's evaluation of sand content for the wellbores is incorrect.

(d) Chesapeake's evaluation of net sand content agrees much closer to the relative productivity of these three respective producers.

(e) Samson calculates a thickness of 4 ft of sand in the recently P&A Apache State WEL Com #2 (10E). Chesapeake calculates 0 ft. Apache determined that there was no net pay in the wellbore and plugged the wellbore. With the proximity of the high rate Osudo well to the State WEL Com wellbore if there truly were 4 net ft. of sand greater than 6% porosity then Apache should have attempted a completion.

(f) Chesapeake's method it utilized for determining net feet of sand is based upon accepted engineering and geologic practices: Net clean sand was determined by the Neutron/Density sandstone crossover log characteristic, the PE (photoelectric absorption coefficient) value and the GR (gamma ray) character. The Neutron/Density relationship has been recognized and used as the primary source of lithology

determination for over 30 years. The PE curve was used as a secondary lithology indicator.

(g) The PE curve was introduced to the industry as a lithology indicator in 1978 and has been in common usage since the mid 1980's. The GR curve was used as a secondary lithology indicator. It is not a true lithology indicator but has been commonly used as a shaliness (clay volume) indicator within the industry for over 50 years. In every case, the Neutron/Density plot for sandstone crossover was used as the overriding indicator for lithology determination and therefore the determination of net clean sand. The PE and GR curves were used as secondary lithology indicators.

(h) Chesapeake's use of 11 feet for the net thickness of sand in the Hunger Buster well is a better-reasoned interpretation of logging data for the well and is consistent with the production data for the well.

(i) Production and logging data for the control wells, including the K-F "4" State Well No. 1, the Hunger Buster #3 and the Apache dry hole support Chesapeake's analysis.

(22) The Division finds that the log analysis performed by Chesapeake is superior to Samson's evaluation and the Division finds that Chesapeake's evaluation demonstrates the most reliable geological evidence of sand trends in the area in and around Irregular Section 4, Township 21 South, Range 35 East, MPM, Lea County, New Mexico.

## **THE ISOPACH**

(23) Based upon Chesapeake and Samson's difference in log analysis, each prepared and submitted Isopachs that are substantially different.

(24) Samson's method allowed it to submit an isopach that is supportive of its north-south orientation of its isopach while Chesapeake's isopach is supportive of its northwest-southeast orientation.

(25) Chesapeake demonstrated that its Isopachs were established by several mapping techniques including:

(a) Chesapeake's interpretation is based upon sand thickness data points that are clearly defined and repeatedly demonstrated from wireline log data. The Samson datum points are not.

(b) Chesapeake mapped net sand as determined by Neutron/Density log of sandstone crossover character for lithology identification, the established technical criteria used routinely throughout the industry. Samson did not.

(26) Based upon Samson's method for determining net sand content from its log analysis, it submitted an Isopach, Exhibit C", that the Division finds is flawed for reasons that include the following:

(a) Samson's used "over-stated" net thickness for the Hunger Buster #3 well and others wellbores.

(b) Samson's Isopach is based upon incorrect values of sand thickness in many of the key wells, rendering the entire map invalid.

(c) Samson used a value of 0 net feet of sand and mapped as such the Devon PQ Osudo State Com #2 (16P). This is a commercial Morrow producer producing from 6 net ft. of sand.

(d) Samson also mapped in the CHK San Simon 21 State #2 in section 21E as having 0 net feet of sand. This wellbore is also a commercial Morrow producer having 24 net feet of sand.

(e) Samson's geologist admitted in cross-examination, that his Isopach map, Exhibit "C," could be rotated counter-clockwise to a northwest-southeast orientation and all of his control points would be honored,

(f) The Division finds that the absence of well control points north of the K-F "4" State Well No. 1 create serious doubts about the reliability of Samson's north-south orientation and its attempt to extend this reservoir north of the K-F "4" State Well No. 1. To the contrary, it is reasonable to assume that Chesapeake's Exhibit 25, "0" pay contour for the CC "3" State Well No. 3 extends between this well and the K-F "4" State Well No. 1, limiting the reservoir thickness to the north.

(g) Samson's Isopach map, Exhibit "C" erroneously assumed that the CC "3" State Well No. 3 in the SWS/4SW/4 of Section 3 was in the same reservoir as the K-F State "4" Well No. 1 and the Osudo 9-1 well,

while in fact, gas analysis submitted by Chesapeake, Exhibits 41, 42 and 43, conclusively proved that it is not. A build-up was also ran in the CC "3" showing that the well went from virgin pressure to a BHP of 1264# in thirty days. This results in a limited reservoir that is not connected with the K-F "4" State Well No. 1, the Hunger Buster Well No. 3 and the Osudo 9-1 Well

(h) Samson's Isopach map lacks well control points to the south of the Hunger Buster #3 well creating serious doubts about the reliability of Samson's north-south orientation.

(i) Samson's own geological evidence, including Samson Exhibit "C", condemned the Western half of the middle third of Section 4. Thus, if the Division approved the E/2 stand-up unit, then Chesapeake, in order to drill a well in the SW/4, will be forced to dedicate a W/2 stand-up unit and share 50% of production with Samson who will not contribute any productive acreage to the spacing unit.

## **STRUCTURE**

(27) Samson premised its north-south orientation upon a Structure map, Exhibit "B" with sand diversion around the structural high stating that the sand trend would go through the low on the east side of the high yet Samson mapped the sand not through this saddle but wandering up the regional structure to the east.

(28) Samson relied upon the structural high mapped in the NW/4 of section 4 and the NE/4 of section 5 as a positive feature during deposition of the Morrow and as such had a direct influence on sand distribution. Samson stated that the sands were diverted around this high, citing the thin sand development in the Jake L. Hamon State E 8321-1 wellbore (4L) and the Wilson J-1 (5O).

(29) Samson stated that the all the sediment source for the Morrow was the Pedernales Uplift, that the central basin platform "CBP" was not a sediment source and therefore all sand trends was sourced from the north trending south.

(30) Chesapeake contended that this is in direct conflict with the proven regional geology, stating that immediately north of the Samson map, as seen on the Chesapeake's mapping of exhibits 22, 25, 26 and in the industry literature in exhibits 28, 30 and 31 the CBP extends to the west, further than the KF State 4 #1 area. There is no Morrow present in this area. This renders the Samson contention of north-south trending sand sourced only from the Pedernales Uplift as invalid.

(31) The Division finds that Samson's Structure map is flawed for reasons that include the following:

(a) the British American Oil N. Wilson Deep Unit #2 wellbore (5F) is structurally high to the Wilson J-1 on the same structure and has produced over 28 Bcf gas from Morrow sand. This is the most prolific Morrow producer in the map area, yet according to the Samson premise it should not even have sand in the wellbore.

(b) Samson indicated that the faulting shown on their structure map (exhibit B) was present by Mississippian time and therefore controlled sand deposition. Yet in Samson's composite structure and Isopach map exhibit K, Samson trends the sands uninterrupted across various faults several times. This is contrary to Samson's stated sand deposition premise.

(c) Of the three sand trends drawn by Samson, the Osudo/KF sand thick is the thickest on the map yet it is the narrowest of the three. This is not reasonable.

(d) The Samson interpretation does not honor the proven data points in the known well control for the area, does not honor the regional geology as accepted by the industry and demonstrated by Chesapeake's mapping, does not honor the pressure decline data of the producers in the vicinity, and does not even honor their own stated controls on sand deposition.

## **ORIENTATION**

(32) The Division finds that the orientation proposed by Chesapeake presents the greatest potential for the development of reservoir volume, will prevent waste and protect correlative rights, for reasons that include the following:

(a) The Net Middle Morrow Sand Isopach (exhibit 25) indicates the regional trend of the sand deposition in an easterly to westerly orientation from the Central Basin Platform ("CBP") into the Delaware basin

(d) There is substantial evidence supporting the conclusion that the Central Basin Platform is a local source for the deposition of sands in an east-west orientation and that sands were distributed in an east-west orientation through fluvial streams in and around Section 4.

(c) Chesapeake's geologic data and evaluation for the Morrow formation in the area, including Section 4, is superior to Samson's data and evaluation.

- i. Detailed stratigraphic correlations between the wellbores differentiating the distinct sand units yield net sand Isopach maps (exhibits 34, 35, 36) in this same easterly to westerly sand orientation. Samson did not attempt to differentiate the individual sand units.
- ii. Chesapeake's mapping fits well within the regional geologic framework as established by the published literature and the regional mapping submitted by Chesapeake. The industry literature (exhibits 28, 29, 30, 31, 32, 33) indicates the nearest local depositional influence for Morrow sediment source is the CBP with sedimentation trending in an easterly to westerly direction from the CBP into the Delaware Basin. Chesapeake's Regional Gross Morrow Isopach (exhibit 26) is in agreement with the literature. Samson submitted no regional geology.

(33) Samson's proposal for the E/2 spacing unit is inferior and will not prevent waste and protect correlative rights because:

(a) Samson premises it's mapping upon a north-south sand trend which is contrary to the pressure data presented by Chesapeake which invalidates that sand trend direction. There is no well control point north of the KF 4 State #1 to justify the extension of the sand trend northerly as drawn by Samson.

(b) Samson's own geological evidence, including Samson Exhibit "C", condemned the Western half of the middle third of Section 4. Thus, if the Division approved the E/2 stand-up unit, then Chesapeake, in order to drill a well in the SW/4, will be forced to dedicate a W/2 stand-up unit and share 50% of production with Samson who will not contribute any productive acreage to the spacing unit.

(c) Samson's geologist admitted in cross-examination, that his Isopach map, Exhibit "C," could be rotated counter-clockwise to a northwest-southeast orientation and all of his control points would be honored,

(d) The Division finds that the absence of well control points north of the K-F "4" State Well No. 1 create serious doubts about the reliability of Samon's north-south orientation and its attempt to extend this reservoir north of the K-F "4" State Well No. 1. To the contrary, it is reasonable to assume that Chesapeake's Exhibit 25, "0" pay contour for the CC "3" State Well No. 3

extends between this well and the K-F "4" State Well No. 1, limiting the reservoir thickness to the north.

(e) Samson's Isopach map, Exhibit "C" erroneously assumed that the CC "3" State Well No. 3 in the SWS/4SW/4 of Section 3 was in the same reservoir as the K-F State "4" Well No. 1 and the Osudo 9-1 well, while in fact, gas analysis submitted by Chesapeake, Exhibits 41, 42 and 43, conclusively proved that it is not.

### **CHESAPEAKE'S PRESSURE DATA SUPPORTED ITS GEOLOGIC INTERPRETATION AND REFUTED SAMSON'S INTERPRETATION**

(34) Chesapeake submitted substantial petroleum engineering evidence for wells in Sections 15 and 16 demonstrating that:

(a) the wells in Section 15 and 16 are in an East-West communication trend due to the pressure profiles of the WEK Well No. 1 (Unit F, Sec 15) the State "15" Well No. 1 (Unit N, Sec 15) and the PQ Osudo Well No. 1 (Unit G, Sec 16) are synonymous in time. (See Chesapeake's exhibit 25)

(b) the WEK Well No. 1, commenced production at virgin pressure (approx. 7354 #) produced 6.4 Bfc. This volume of gas removed from this Morrow reservoir had a direct impact upon the poor performance of the State "15" Well No. 1 and the PQ Osudo Well No.1

(c) the State "15" Well No. 1 had a virgin bottom hole pressure but quickly dropped to fit the BHP vs Time profile of the WEK Well No. 1. (See Chesapeake Exhibit 39)

(d) the PQ Osudo Well No. 1, directly west of the WEK Well No 1, had an initial reservoir pressure of 5326# that exhibits depletion from the WEK Well No. 1

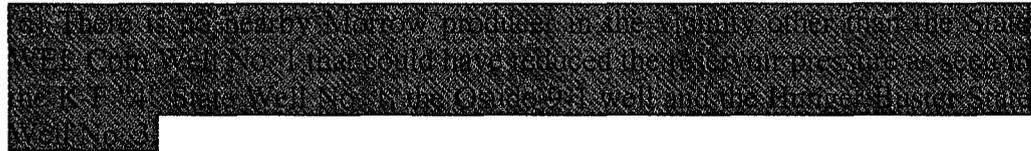
(e) the PQ Osudo Well No 1 also quickly dropped to fit the BHP vs. Time profile of the WEK Well No. 1 and the State "15" Well No.1 (See Chesapeake Exhibit 39)

(35) Chesapeake submitted substantial evidence for the wells in Sections 3, 4, 9, and 10, T21s, R35E demonstrating that:

(a) the wells in Section 9 and 10 are not in a north-south communication trend because the BHP vs. Time profile of the State WEL Com Well No. 1 (Unit K, Section 10) and the profile of the WEK Well No. 1 (Unit F, Section 15) are not synonymous BUT would have been had the reservoir been orientated north-south.

(b) the State WEL Com Well No. 1, with an initial virgin reservoir pressure, produced 2.9 Bcfg. With the WEK Well No. 1 (Unit F Sec 15) producing 3.0 Bcfg, once the WEL Com Well No. 1 went into production, the WEL Com Well No. 1's pressure should have been less than virgin pressure but was not thus refuting the claim by Samson that this reservoir is orientation north-south.

(c) the K-F "4" State Well No. 1, the Osudo 9-1 well and the Hunger Buster State Well No. 3 all came in below virgin reservoir pressure due to the partial depletion from the State WEL Com Well No. 1. The CC "3" State Well No. 1 came in at virgin pressure and thirty days later had a BHP of 1264# resulting in a limited reservoir that is not connected with the K-F "4" State Well No. 1, the Hunger Buster Well No. 3 and the Osudo 9-1 Well.



(e) The CC-3 and the Apache State WEL Com Well No. 2 are in essence dryholes. With these two dryholes, it is not reasonable to map this reservoir with a north-south orientation with the two dryholes directly north of the State WEL Com Well No. 1.

(36) Samson submitted no engineering data.

(37) The Division finds that Chesapeake's geological interpretation is supported by the pressure data available in the area. Chesapeake's analysis (Exhibits 38, 39) shows there is no north-south connection between producers in the vicinity of the KF 4 State #1, and in fact demonstrates east-west connection of reservoirs. The pressure data shows east-west connectivity between the WEK State Com #1, the State 15 #1; both in Sec. 15, and the PQ Osudo #1 in Sec. 16. Chesapeake's analysis further indicates connectivity in an east-west orientation from the WEL Com #1 (10K) to the Osudo 9 State #1 (9H) and the KF 4 State #1 (4W) as indicated by the subsurface isopach mapping.

#### **RELATIVE VALUE OF THE 160-ACRE TRACTS IN SECTION 4**

(38) The Division finds that another key issue is the relative “value” of each of the 160-acre. Samson failed to submit reservoir engineering in support of its geologic interpretation. Chesapeake’s calculation utilized a volumetric method.

(39) At the request of the Division’s attorney, Chesapeake, following the hearing, submitted estimates that the reservoir volume for each of the six 160-acre tracts in Section 4 consisting of the following:

1. SW/4	5.53 Bcf
2. SE/4	2.01 Bcf
3. W/2 of middle third (lots 11, 12, 13 & 14)	0.64 Bcf
4. E/2 of middle third (lots 9, 10, 15, & 16)	“0” Bcf
5. NE/4 (lots 1, 2, 7, & 8)	0.05 Bcf
6. NW/4 (lots 3, 4, 5, & 6)	1.30 Bcf

The Division finds that this evidence is consistent with other evidence introduced at the hearing and is credible and reliable evidence of the estimated reservoir volumes for the six 160-acre tracts in Section 4.

(40) In order to avoid drilling unnecessary wells, protect correlative rights and prevent waste, the Division finds that a 320-acre gas spacing unit consisting of the S/2 of Section 4 will contain the greatest volume of potential reservoir and therefore should grant Chesapeake’s application

#### **PRE-DRILLING AND DRAINAGE**

(41) Chesapeake demonstrated that prior to permitting its K-F “4” State Well No. 1, it had developed a Morrow geological study from which it was reasonable for Chesapeake to have concluded that production from Mewbourne’s Osudo 9-1 well could cause drainage from the S/2 of Section 4.

(42) The K-F “4” State No. 1 well appeared to be correlative to the main pay interval being produced in the Osudo 9-1 well and that pressure data demonstrated that K-F “4” State No. 1 has less than virgin pressure. The most probable source of the pressure depletion in the K-F State 4 No. 1 well is from the Osudo 9-1 well that has collectively produced approximately 2.0 Bcf and has produced at daily rates in excess of 21 mmcfpd since first production in March 2005.

(43) The Division finds that it was reasonable for Chesapeake to assume that the Osudo 9-1 well might expose the S/2 of Section 4 to drainage and therefore is was reasonable for Chesapeake to commence drilling the K-F "4" State Well No. 1 prior to obtaining a compulsory pooling order.

(44) At the time of the hearing, it appeared that Kaiser and Samson's efforts have resulted in potential drainage of acreage in the S/2 of Section by the Mewbourne's Osudo 9-1 Well in which neither has an interest.

### AMENDED WELL LOCATION

(45) At the Division hearing held May 3, 2005 to consider Mewbourne's application for an emergency order, Mewbourne proposed a different location but it did not offer any evidence that its location was superior to that proposed in Chesapeake's APD. See Order R-12343, finding (5).

(46) Chesapeake testified that:

(a) It believed that there was no material difference between the well locations;

(b) It was concerned that Mewbourne, Kaiser and Samson would claim that the Mewbourne location was better than that proposed by Chesapeake and that they were damaged as a result of Chesapeake's drilling the well in that location and

(c) therefore during drilling Chesapeake obtained OCD-Hobbs approval to directionally drill the K-F "4" State Well No. 1 to a bottom hole location closer to the location sought by Mewbourne.

(47) As the hearing, contrary to its prior protestations, Samson submitted an Isopach map that showed that the Mewbourne proposed location was west of the thickest portion of the main pay interval in the K-F "4" State Well No. 1 and testified that Samson believed that the "best" location would have been at Chesapeake's original surface location.

(48) Samson's geological interpretation appears to be somewhat unorthodox and its changing position about the well location is troublesome.

(49) The Division finds that Chesapeake's interpretation of the Morrow in and around Section 4 is superior to Samson and finds the differences in well locations are minor and do not affect the issues in these cases.

## PERMITTING

(50) The Division finds that Mewbourne filed its application to cancel Chesapeake's approved APD as an attempt to stop Chesapeake's drilling and as a vehicle to dispute Chesapeake's lay-down orientation of the spacing unit for the K-F "4" State Well No.1.

(51) As part of its opposition to Chesapeake, Samson-Kaiser-Mewbourne contended that the OCD-Hobbs had improperly approved Chesapeake's APD and subpoenaed Mr. Paul Kautz, the Division's geologist in the Hobbs office who approved the APD.

(52) Mr. Kautz testified that his approval of Chesapeake's APD and C-102 was consistent with the OCD-Hobbs practice that the Division does not require ownership information for the proposed spacing unit, that ownership information is not a mandatory field for the electronic APD forms, and that the Division had never denied an APD for the reasons advanced by Samson-Kaiser-Mewbourne. To the contrary, he testified that Division had approved hundreds of APD that did not include information regarding ownership in the proposed spacing unit.

(53) The Division finds that the Commission's ruling in the Pride Case conclusively established that Chesapeake had the authority required to file its APD and conduct drilling operations.

(54) The Division finds that Chesapeake's approved APD was "prima-facie" valid and confers rights that should not be revoked arbitrarily and the Division properly approved it and that to grant Mewbourne's application would arbitrarily and capriciously deprive Chesapeake of its rights established by prior Commission Orders.

(55) The Division rejects Kaiser's efforts to demonstrate the alleged lack of "good faith" by Chesapeake and specifically finds that Chesapeake has conducted its operations in good faith and has complied with the Division's orders and regulations.

(56) In Pride, the OCC concluded "that the owner who would have a right to drill at its proposed location in the event of a voluntary or compulsory pooling of the unit it propose to dedicate to the well has the necessary good faith claim of title to permit it to file an APD even though it has not yet filed a pooling application."

(57) Chesapeake's APD obtained the consent of the surface lessee before staking the well and conducting operations for drilling. Chesapeake's APD contained all information required by the Division for filing and approving the APD and the Division's approval of the same is consistent with past Commission precedent.

(58) As in Pride, Chesapeake has demonstrated the required "good faith."

(59) The Division finds that it is improper for the Division to consider issues surrounding property rights, including allegations of trespass, or the validity of the Communitization Agreement as such issues lie outside its jurisdiction. The issue of "good faith" is therefore confined to whether Chesapeake could validly rely upon prior rulings of the OCD and OCC which have allowed an operator to apply for an APD for a well on a tract that will be included in a spacing unit for the well though a compulsory pooling.

(60) The Division finds that Chesapeake had a right to rely upon the OCC decision in Pride, an order that was issued several months after the order in the Valles Caldera case.

(61) The Division finds that at all times Chesapeake has acted in good faith by establishing a good faith claim of title for the filing of an APD as established by the rules, practice and precedents of the Division and the Commission. See TMBR/Sharp, Order R-11700-B, finding 35.

## **COMMUNITIZATION AGREEMENT V. COMPULSORY POOLING**

(62) As part of its opposition to Chesapeake, Samon-Kaiser-Mewbourne contended that the State Land Office approval of a voluntary communitization agreement for the E/2 spacing unit agreement precludes the Division from issuing a compulsory pooling for the S/2 spacing unit

(63) Such a contention requires that the Division interpret its own rules and render a legal opinion based on current Division Rules and the Oil & Gas Act. In doing so, the Division has concluded that such a contention is without merit and should be rejected for reasons that include the following:

(a) The Division is charged with the statutory duty of preventing waste and protecting correlative rights and any request by an operator to drill a well or form a spacing unit for the drilling of a well must be evaluated with respect to these criteria.

(b) In Pride, the Division determined that “the compulsory pooling statute NMSA 1978, 70-2-17) provides sufficient flexibility to allow the operator of a pooled unit to conduct operations anywhere on that unit, regardless of whether the owner of the land on which the well is located has consented thereto.” See Order R-12108, findings (18), (19) and (23).

(c) The compulsory pooling statute does not limit the Division’s authority to order compulsory pooling when the owners of the interest sought to be pooled have entered into a voluntary communitization agreement involving some, but not all of the same interests.

(d) When operators have proposed competing spacing units for the drilling of a well, each must be evaluated on its own merits and the Division must approve the proposed spacing unit that presents the greatest potential for the recovery of reservoir volume, will best prevent the unnecessary drilling of wells, will prevent waste and will protect correlative rights.

(64) In Pride, the OCC allowed Pride to: (a) re-enter a well on the Yates tract in which Pride had no interest; (b) compulsory pool a stand-up W/2 spacing unit dedicated to this well even though Yates had previously formed a lay-down N/2 spacing unit in which Pride had no interest; (c) compulsory pool Yates into the Pride spacing unit even though Yates had formed a voluntary spacing unit; (d) change the orientation of the Yates’ spacing unit and (e) cause Yates’ approved APD to be revoked and to obtain an approved APD for Pride to be reinstated.

(65) The Division finds that there is no material difference between what Chesapeake seeks in this proceedings and what was approved by the OCC in the Pride case.

(66) Because of the acreage dispute, the parties have not been able to reach a voluntary agreement about the orientation of the spacing unit and the issuance of the compulsory pooling order by the Division is now necessary.

## WELL COSTS

(67) Chesapeake has demonstrated that its AFE is fair and reasonable and should be approved by the Division.

(68) In the event of a dispute over actual well costs, then the Division’s standard pooling order and the order to be entered in this case will make provisions for further hearings on that issue.

### **RISK FACTOR CHARGE**

(69) Kaiser amended its pre-hearing statement to contest the awarding of a 200% risk factor in the compulsory pooling case. In doing so, Kaiser had the "burden of proof" was obligated and required to submit evidence in support of a reducing in the risk factor charge. See Division Rule 35.B, reference Order R-11992.

(70) Kaiser failed to present any evidence in support of its challenge of a 200% risk factor.

(71) Part of the "risk" associated with the risk factor charge is whether the well is likely to recover sufficient gas to pay for all its costs and return a profit. While it appears that the K-F "4" State Well No. 1 may be "commercial," there was no evidence presented by Kaiser from which estimate in this well will "pay-out"

(72) In the event that Kaiser elects not to participate in this well, Kaiser and any other other nonconsenting working interest owner should be subject to a 200% risk charge.

### **SUMMARY**

(73) The approval of Chesapeake's application will:

- (a) allow Samson, Kaiser and Mewbourne to have the benefit of knowing the result of the drilling and completion of the K-F "4" State Well No.1 without having to share in any of the allocated risk.
- (b) provide an opportunity to Samson, Kaiser and Mewbourne who hold 50% of the WIO in the S/2 of Section 4 to elect to participate after the well has been drilled, completed and tested.
- (c) provide Samson, Kaiser and Mewbourne with the choice of sharing with Chesapeake the risk of the determining if the well will recover its costs or to require Chesapeake to carry Samson, Kaiser and Mewbourne's WIO interest;

## CONCLUSION

(74) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons in the reservoir in Section 4, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(75) The application of Chesapeake should be granted and the application of Mewbourne should be denied.

(76) Chesapeake should be designated the operator of the proposed well and of the Unit.

(77) 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.

(78) Reasonable charges for supervision (combined fixed rates) should be fixed at \$5,000 per month while drilling and \$500 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.*"

### **IT IS THEREFORE ORDERED THAT:**

(1) Chesapeake's request for an order pooling all uncommitted mineral interests from the top of the Wolfcamp to the base of the Morrow formation underlying the S/2 of Irregular Section 4, Township 21 South, Range 35 East, NMPM, Lea County, New Mexico, to form a standard 320-acre gas spacing and proration unit (the "GPU") for all formations or pools spaced on 320-acres within this vertical extent is hereby **GRANTED**.

(2) Mewbourne's application to cancel to drilling permits ("APDs") issued to Chesapeake for Chesapeake's K-F State "4" Well No. 1 and for Chesapeake's Cattleman "4" State Com Well No. 1 and the approval of Mewbourne's APD for Mewbourne's proposed Osudo "4" State Com Well No. 1 to be located 660 feet FSL and 1650 feet FEL of Section 4 (SE/4) is hereby **DENIED**.

(3) Division Case 13505 is hereby **DISMISS** without prejudice.

(4) The K-F "4" State Well No. 1 is hereby dedicated to a standard 320-acre gas spacing unit consisting of the S/2 of said Irregular Section 4,

(5) Chesapeake Operating, Inc., as the Division approved operator of this well and spacing unit shall continue to act as operator this well and may immediately commence producing and selling the hydrocarbons therefrom.

(6) Upon final plugging and abandonment of the proposed well, the pooled unit 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 Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit 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 wells 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) 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 \$5,000 per month while drilling and \$500 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 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.

(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 Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

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(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.

**STATE OF NEW MEXICO  
OIL CONSERVATION DIVISION**

**MARK FESMIRE, P.E.  
Director**

**S E A L**