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July 2, 1997

Mr. Michael E. Stogner
Mr. Rand Carroll, Esq.
Mr. David R. Catanach
Oil Conservation Division
2040 South Pacheco
Santa Fe, New Mexico 87504

HAND DELIVERED

JUL - 2

Re: ***PROPOSED NEW FORM FOR COMPULSORY POOLING ORDERS***
NMOCD Case 11774
Application of Marathon Oil Company
for compulsory pooling, Lea County, New Mexico

Gentlemen:

On behalf of Marathon Oil Company and with the concurrence of their attorney, Thomas C. Lowry, Esq., please find enclosed a proposed order for Mr. Stogner to consider for entry in this case.

On Monday, Mr. Carroll raised the issue of why the Division pooling orders pool "all mineral interests, whatever they may be..." when in fact Section 70-2-17.C NMSA 1978 limits the Division's compulsory pooling authority to be used only against owners who are **not** voluntarily committed to the unit. For numerous years and at various times we all have had discussions about this and other issues concerning the form the Division now uses for compulsory pooling.

I have taken the opportunity to use this proposed order to suggest to you revisions of the current form for compulsory pooling orders in various substantive ways to address Mr. Carroll's issue and other issues including an attempt to "link" the compulsory pooling order to the Joint Operating Agreement ("JOA"). I have found it odd that the applicant goes through all the effort to submit at the pooling hearings a copy of the JOA and then no reference is made to it in either the findings or the ordering paragraphs of the order.

In addition, I am of the opinion that Section 70-2-17.C identifies a particular type of carrying provision as being a "carried interest type" who is deemed non-consent by his failure to voluntarily commit to the unit or timely elect to participate under the pooling order. Professor Patrick Martin, one of the current editors of William & Myers **Oil & Gas Law,** defines the "carried interest type" of Working Interest Owner as one who has permanently limited his liability for future unit or well costs so that they are paid only out of his share of any future production plus a penalty factor.

In any event, the current pooling order form is ambiguous on a number of points and creates the opportunity for disagreement. One of the potential problem is that it creates the ambiguity Mr. Carroll is concerned about. What is "all mineral interest, whatever they may be" supposed to mean and do? Does the OCD force pooling order only apply to an owner who fails to initially join ("uncommitted owners") who then becomes a carried interest type owner **or in the alternative** does this mean that any of the owner who have already signed the Joint Operating Agreement ("voluntarily committed owner") is now entitled to ignore that contract and, among other things, claim after the well is drilled and proven to be a "dry hole" that he can use the compulsory pooling order to become a carried interest owner who is only responsible for paying costs out of production? Can a voluntarily committed owner argue that his non-consent penalty is limited to 200% rather than the higher penalties included in current JOAs? Can the voluntarily committed owner who is subject to debt collection provision under the JOA, now claim that the pooling order allows him to ignore those multiple debt collection remedies and limit his debt to only his share of production?

Accordingly, and in an attempt to comply with 70-2-17.C NMSA 1978, I have highlighted the changes to limit the compulsory pooling order to only an owner **not** voluntarily committed ("uncommitted owner"), to make sure that nobody can construe the pooling order as modifying any existing contract and to define the uncommitted owner who is **involuntarily committed** to the spacing unit ("force pooled") by the Division's use of the police powers of New Mexico as a carried type working interest owner with a non-consent election subject to a maximum penalty of 200%.

I would be pleased to meet and discuss this matter with you if you desire.

Very truly yours,

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 CONSIDERING:

CASE NO. 11774 (Reopened)
ORDER NO. R-10825

APPLICATION OF MARATHON OIL COMPANY FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, EDDY COUNTY, NEW MEXICO

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ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on May 1, 1997, May 29, 1997 and was reopened for hearing on June 26, 1997 at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this _____ day of July, 1997, the Division Director, having considered the testimony, the record and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction over the parties, of this cause and the subject matter thereof.

(2) The applicant, Marathon Oil Company, seeks an order pooling uncommitted mineral interest owners who have failed to agree to voluntarily commit their interests from 500 feet below the top of the San Andres formation to the base of the Morrow formations underlying the following described acreage in Section 11, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico, and in the following manner:

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(a) the S/2 to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 230-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Undesignated Empire-Pennsylvanian Gas Pool, Undesignated Bear Grass Draw-Atoka Gas Pool, Undesignated Palmillo Draw-Atoka Gas Pool, Undesignated North Turkey Track-Morrow Gas Pool, Undesignated Empire-Morrow Gas Pool, and Undesignated North Illinois Camp-Morrow Gas Pool;

(b) the SE/4 to form a standard 160-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent; and

(c) the SE/4SE/4 to form a standard 40-acre oil spacing and proration unit for any and all formations and/or pools developed on 40-acre spacing within said vertical extent, which presently includes but not necessarily limited to the Undesignated East Illinois Camp-Bone Spring Pool.

(3) Said units are to be dedicated to the applicant's proposed Jim Bowie "11" Federal Well No. 1 **(API No. 30-015-29660)** which applicant originally requested be approved at an unorthodox gas well location for all three sized units 1000 feet from the South line and 700 feet from the East line (Unit P) of said Section 11 but which was later amended to a proposed unorthodox gas well location 990 feet from the South and East lines (Unit P) of said Section 11.

(4) Marathon Oil Company has the right to develop the subject units and produce any hydrocarbons underlying the same, however, as of June 3, 1997, the date this application was filed, the following working interest owners and/or unleased mineral owners in the above described 320, 160 and 40 acre spacing and proration units have not agreed to pool their interests:

Atlantic Richfield Company ("ARCO")
Yates Petroleum Corporation

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(5) Section 70-2-17.C NMSA (1978) 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."

(6) Marathon Oil Company submitted a sworn affidavit verifying that each and every compulsory pooled party received actual notice of this hearing in accordance with Division Rule 1207 and the Division finds that each said party has been afforded a fair and reasonable opportunity to appear and participate. The Division further finds that none of the compulsory pooled parties appeared and they have waived their rights to object.

(7) Among the offset operators and/or mineral interest owners in Sections 12 and 13, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico towards whom this unorthodox location(s) encroaches, Harvey E. Yates Company ("HEYCO") is the only operator to appear at these hearings.

(8) In support of its application, Marathon Oil Company submitted the following evidence through its exhibits and the testimony of its witnesses which the Division finds to be substantial:

(a) the primary zone of interest for the subject well is the Morrow formation, therefore it was reasonable to limit applicant's geologic testimony to this interval. Based upon this evidence, including "three-dimensional" seismic data, the Morrow formation in this area is expected to be a series of river channels and that a well at the proposed unorthodox gas well location should penetrate a thicker portion of the Morrow sand than a well drilled at the closest standard gas well location.

(b) approval of the amended unorthodox location will increase the likelihood of intersecting commercial grade gas bearing zones within the Morrow formation.

(c) Marathon Oil Company has proposed the subject well and its appropriate spacing units(s) to the uncommitted owners in the spacing units as identified in Finding ( ) above.

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(d) Despite its good faith efforts, Marathon Oil Company has been unable to obtain a written voluntarily agreement from all of these uncommitted owners voluntarily pooling their interests.

(e) Marathon's witness testified in support of the approval of an Authority for Expenditure ("AFE") for a total completed well costing and estimated $798,600.00 and to use of its Joint Operating Agreement with overhead rates of $5,000/month drilling and $540/month producing.

(f) Since risk of an unsuccessful completion is very high, the risk penalty to be applied to the compulsory pooled parties who elect to be carried should be set at 200% of their proportionate share of actual total completed well costs.

(g) to avoid the drilling of unnecessary wells, to protect correlative rights, to prevent waste and to afford to the owners of each interest in said units the opportunity to recover or receive without unnecessary expense his just and fair share of hydrocarbon production in any pool, the subject application should be approved by compulsory pooling of any working interest owner and/or mineral owner who owned an interest not voluntarily committed to the drilling of this well as of June 3, 1997 (date the application was filed) and any said party's successors, grantees, or assignees.

(9) In addition, at the hearing held on June 26, 1997, Marathon Oil Company submitted evidence that:

(a) this case was continued to May 29, 1997 in order to provide HEYCO, the offset operator towards whom the location encroaches, with an opportunity to object.

(b) subsequent to that hearing, HEYCO objected and as a result Marathon entered into a Stipulated Agreement by letter dated May 13, 1997.

(c) as part of the Stipulation, Marathon has agreed to amend its requested location to an unorthodox gas well location 990 feet from the south and east lines of Section 11.

(d) by affidavit, Marathon's geologic witness testified that:

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(i) although the location originally requested by Marathon Oil Company would be the optimum location in this spacing unit for this very risky well, in his opinion, Marathon Oil Company can still expect to encounter more than 30 feet of Lower Morrow Sand at the new location.

(ii) the risk of the well, though still quite high, is not significantly increased by the agreed change in location and is still better than the closest standard well location at which he would except to encounter less than 20 feet of Lower Morrow Sand.

(10) Marathon Oil Company has entered into a production limitation agreement with HEYCO as the offset operator and Marathon Oil Company as an offsetting working interest owner towards whom the subject well encroaches.

(11) As part of a settlement with HEYCO, Marathon has agreed to place a production limitation limit of 75% on the well (being a 25% penalty).

(12) Said penalty factor is based upon the stipulation of the parties.

(13) The Division has historically utilized various factors in calculating producing penalties including the stipulation of the parties, the encroachment distances from a standard well location factor, productive acreage factor, drainage date, etc.

(14) The production allowable factor should be applied to the Jim Bowie "11" Federal Well No. 1's ability to produce as determined by deliverability tests conducted on the well on the following basis: every three (3) months for the first two (2) years of production and every six (6) months thereafter with HEYCO being furnished copies of said test information within ten (10) days following each test. "Deliverability" in this case should be defined as the total volume produced into the production pipeline for a 24-hours period. Said test should be conducted only after notice has been provided to the supervisor of the Artesia district office of the Division and to HEYCO and a reasonable opportunity is provided to each to witness such test.

(15) The above penalty based upon stipulation of the parties is an appropriate method to apply in this case and will provide a reasonable restriction to protect correlative rights of offsetting operators but is sufficient to afford the applicant the opportunity to protect its correlative right to recover its share of potentially recoverable gas underlying its spacing unit(s).

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(16) Approval of the application will afford the applicant the opportunity to produce its just and equitable share of the gas in these formations/pools, will prevent the economic loss caused by the drilling of unnecessary wells, avoid the augmentation of risk arising from the drilling of an excessive number of wells and will otherwise prevent waste and protect correlative rights.

(17) Pursuant to Section 70-2-17(C) NMSA (1978) and in order to obtain its just and equitable share of potential production underlying these spacing units, Marathon Oil Company should be granted an order by the Division pooling the identified and described mineral and/or working interest owners set forth in Finding (4) above (hereinafter "compulsory pooled parties") so as to prevent waste and protect correlative rights for the drilling of the subject well at an unorthodox well location upon terms and conditions which include:

(a) Marathon Oil Company be named operator;

(b) Provisions for all compulsory pooled parties to participate in the costs of drilling, completing, equipping and operating the well;

(c) In the event a compulsory pooled party fails to timely elect to voluntarily commit its interest and participate pursuant to this order, then said compulsory pooled party's interest is hereby involuntarily committed to participation pursuant to the terms and conditions of the compulsory pooling provisions of this order and shall be deemed a non-consenting owner whose interest shall be carried so the carrying parties can recover out that compulsory pooled party's share of production, that compulsory pooled party's share of the costs of the drilling, completing, equipping and operating the well, including a risk factor penalty of 200%;

(d) Provisions for a compulsory pooled party to pay his share of overhead rates per month drilling and per month operating and a provision providing for an adjustment method of the overhead rates as provided by COPAS;

(18) Approval as set forth above and in the following order will avoid the drilling unnecessary wells, protect correlative rights, prevent waste and afford the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the production in any pool resulting from this order.

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IT IS THEREFORE ORDERED THAT:

(1) The application of Marathon Oil Company in this case is hereby **GRANTED**. and Marathon Oil Company is hereby designated operator of the subject well and the corresponding spacing unit(s).

(2) Each and every compulsory pooled party received actual notice of this hearing in accordance with Division Rule 1207 which the Division finds to have afforded each said party a fair and reasonable opportunity to appear and participate and that none of the compulsory pooled parties appeared and they have waived their rights to object and are **hereby compulsory pooled as set forth herein.**

(3) Effective as of the date of the filing of the application in this case, the interests of the working interest and/or mineral owners ("compulsory pooled parties") identified in Finding ( ) above, including, if any, their assignees, successor and grantees, from the 500 below the top of the San Andres formation to the base of the Morrow formations underlying the following described acreage in Section 11, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico, **are hereby pooled** for purposes of involuntary commitment to participate in Marathon's Jim Bowie "11" Federal Well No. 1 and in the following manner:

(a) the S/2 to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 230-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Undesignated Empire-Pennsylvanian Gas Pool, Undesignated Bear Grass Draw-Atoka Gas Pool, Undesignated Palmillo Draw-Atoka Gas Pool, Undesignated North Turkey Track-Morrow Gas Pool, Undesignated Empire-Morrow Gas Pool, and Undesignated North Illinois Camp-Morrow Gas Pool;

(b) the SE/4 to form a standard 160-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent; and

(c) the SE/4SE/4 to form a standard 40-acre oil spacing and proration unit for any and all formations and/or pools developed on 40-acre spacing within said vertical extent, which presently includes but not necessarily limited to the Undesignated East Illinois Camp-Bone Spring Pool.

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(3) Marathon Oil Company is hereby authorized to drill its Jim Bowie "11" Federal Well No. 1 at an unorthodox gas well location 990 feet from the South and East lines (Unit P) said Section 11.

PROVIDED HOWEVER THAT:

(4) The Jim Bowie "11" Federal Well No. 1 is hereby assigned a production limitation factor of 75 percent (25% penalty factor). This production limitation factor shall be applied against the well's ability to produce as determined by deliverability tests conducted on the well on the following basis: every three (3) months for the first two (2) years of its production life and every six (6) months thereafter with HEYCO being furnished copies of said test information within ten (10) days following each test. "Deliverability" in this case shall be defined as the total volume produced into the production pipeline for a 24--hour period. Said test should be conducted only after notice has been provided to the supervisor of the Artesia district office of the Division and to HEYCO and a reasonable opportunity is provided to each to witness such test. In addition, Marathon shall provide HEYCO with copies of the Division Form C-115 for this well on a monthly basis.

(5) Marathon Oil Company's proposed drilling-completion program and the corresponding Authority for Expenditures ("AFE") is hereby **APPROVED**.

(6) The terms and conditions of the AAPL Form 610-1989 Model Form Operating Agreement are incorporated herein by reference and shall be binding upon all compulsory pooled parties, **subject to the following:**

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the ____th day of _____, 1997, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test both the Morrow formation.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the ___th day of _____, 1997, Decretory Paragraph No. (___) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER THAT, should said well not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Decretory Paragraph No. (2) of this order should not be rescinded.

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(7) After the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish the Division and each compulsory pooled party in the subject unit an itemized schedule of estimated well costs.

(8) Within 30 days from the date the schedule of estimated well costs is furnished to him, any compulsory pooled party shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and any such compulsory pooled party who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk factor penalty charges.

(9) The operator shall furnish the Division and each compulsory pooled party with an itemized schedule of actual well costs within 90 days following completion of the well; if no objection to the actual well cost is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, if there is an objection to actual well costs within said 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 compulsory pooled party who has paid his share of estimated costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

(11) The operator is hereby authorized to withhold from the compulsory pooled party the following costs and charges from production:

A. The pro rata share of reasonable well costs attributable to each compulsory pooled party who has not paid his share of estimated well costs within 30 days from the date of schedule of estimated well costs is furnished to him; and

B. As a charge for the risk involved in the drilling of the well, 200 percent of the pro rata share of reasonable well costs attributable to each compulsory pooled party who has not paid his share of estimated total completed well costs within 30 days from the date the schedule of estimated costs is furnished to him.

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

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(13) $5,400 per month while drilling and $540 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each compulsory pooled party, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each compulsory pooled party's interest.

(14) The operator shall furnish the Division and each compulsory pooled party with an itemized schedule of actual **operating** well costs to be charged on a monthly basis in the form of a joint interest billing within 90 days following completion of the well; if no objection to the actual operating well cost or the joint interest billing is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided however, if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(15) Any unleased mineral interest who is a compulsory pooled party 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 the terms of this order.

(16) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(17) All proceeds from production from the subject well which 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 said escrow agent within 30 days from the date of first deposit with said escrow agent.

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

(19) The operator of the subject well and units shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this order.

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