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. 13036

APPLICATION OF OCEAN ENERGY, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

CASE NO. 13039

APPLICATION OF DAVID H. ARRINGTON OIL & GAS, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER NO. R-11956

ORDER OF THE DIVISION

BY THE DIVISION:

These cases came on for hearing at 8:15 a.m. on March 27, 2003, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 13th day of May, 2003, 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.

(2) In Case No. 13036, Ocean Energy, Inc., ("Ocean"), seeks an order pooling all uncommitted mineral interests from the surface to the top of the Mississipian formation underlying the E/2 of Section 8, Township 17 South, Range 35 East, NMPM, Lea County, New Mexico, in the following manner:

> The E/2, forming a standard 320-acre gas spacing and proration unit (the "Unit") for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated North Vacuum-Atoka Morrow Pool.

(3) Ocean proposes to dedicate the Unit to its proposed Dirt Devil State Com. 8 Well No. 1 to be drilled at a standard gas well location 660 feet from the South line and 1,980 feet from the East line (Unit O) of Section 8.

(4) In Case No. 13039, David H. Arrington Oil & Gas, Inc. ("Arrington") seeks an order pooling all uncommitted mineral interests from the surface to the top of the Mississipian formation underlying the E/2 of Section 8, Township 17 South, Range 35 East, NMPM, Lea County, New Mexico, in the following manner:

> The E/2, forming a standard 320-acre gas spacing and proration unit (the "Unit") for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated North Vacuum-Atoka Morrow Pool.
>
> The NE/4, forming a standard 160-acre gas spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent.

(5) Arrington proposes to dedicate the above-described unit to its proposed Pink Cahill State 8 Well No. 1 to be drilled at a standard gas well location 1300 feet from the North line and 990 feet from the East line (Unit A) of Section 8.

(6) The primary objective of the wells proposed by the applicants is the lower Atoka Brunson sand within the North Vacuum-Atoka Morrow Gas Pool.

(7) Inasmuch as approval of one of the subject applications would necessarily require denial of the other, one order should be entered for both cases.

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

(9) Both Ocean and Arrington are owners of oil and gas working interests within the Unit. Each applicant has the right to drill and proposes to drill to a common source of supply at its proposed location.

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

(11) Nadel and Gussman Permian, L.L.C. appeared through counsel in support of the application of Ocean, and in opposition to the application of Arrington.

(12) Land testimony and exhibits introduced at the hearing support the following findings:

(a) Arrington owns 50% of the working interest in the Unit, based on its ownership of 100% of the leasehold estate in the E/2 E/2 of Section 8.

(b) The remaining 50% of the working interest in the Unit is divided among Ocean (26.67%), McCombs Energy (13.33%) and Nadel and Gussman Permian, L.L.C. (10%), based on their ownership of undivided interests in the leasehold estate in the W/2 E/2 of Section 8.

(c) McCombs and Nadel and Gussman have agreed to join in Ocean's proposal.

(d) Ocean's interest in this prospect arose at least as early as November of 2001, when Ocean solicited a term assignment of the leasehold interest in the E/2 E/2 of Section 8 then owned by Exxon Corporation.

(e) When Exxon's lease expired, Ocean nominated the acreage with the State Land Office. Arrington acquired this interest at the State land sale on January 21, 2003.

(f) Each applicant thereafter solicited participation of the other in its drilling proposal.

(13) Geologic and engineering testimony and exhibits introduced at the hearing support the following findings:

(a) Wells that have been completed as highly productive gas wells in the Atoka Brunson sand in the W/2 of Section 8 and in the sections to the south and west of Section 8 indicate the existence of a "tank," or area of high productivity, along a structural high lying to the south of the Unit, and trending in a northwesterly/southeasterly direction.

(b) Recently completed producing wells in the Atoka Brunson sand to the north and northeast of the Unit indicate the existence of a "nose" or branch of this reservoir that trends in a northeasterly direction, bounded, however, by dry holes lying to the east and northwest of the

Unit.

(c) Ocean's geologic witness interprets this evidence as indicating that the "tank," or area of greatest net pay, is stretched across the Unit from the area of established high productivity to the south toward the relatively less productive wells to the north and northeast. He accordingly expects to find the greatest thickness of pay and highest permeability in the southerly part of the Unit, most proximate to the wells to the south and west.

(d) The recently completed wells to the north and northeast have exhibited relatively high initial bottom-hole pressures (relative to recent bottom-hole pressures in the wells to the south). Arrington's witnesses interpret these higher pressures as indicating the existence of a separate Atoka Brunson reservoir in the northerly part of the Unit and in the sections to the north and northeast, a reservoir separated from the "tank" to the south by a permeability barrier or zone of restricted permeability lying across the Unit. They believe that the best plan for development of this tract is to drill in the northeast part of the 320-acre unit in order to tap into this separate reservoir and take advantage of its relatively high bottom-hole pressures.

(e) All of the experts agreed that the wells to the north and northeast of the Unit would likely drain reserves from the Unit. However, even Arrington's experts could not opine with confidence either that a well located at Arrington's proposed location would actually encounter the postulated separate reservoir, or that the separate reservoir would be of sufficient extent to provide economic justification for a third well (in addition to the existing wells to the north and northeast).

(f) Ocean's proposed location represents the location in the Unit most proximate to the highly productive wells in the vicinity; whereas Arrington's proposed location is based on proximity to two less productive wells to the north and northeast and to a dry hole to the east.

(g) Despite the fact that the wells producing from the Atoka Brunson sand to the south and west of the Unit were drilled in the 1970s and 1980s, no witness opined that a well at Ocean's proposed location would be rendered uneconomic due to depletion. Even Arrington's witnesses testified that Ocean's proposed location represents a reasonable prospect.

(h) Recent bottom hole pressures in wells to the south ranged in the vicinity of 500 to 600 psi.

(i) Ocean's engineering witness testified that where permeability was adequate wells in the Atoka Brunson sand could be produced to very low abandonment pressures, perhaps as low a 100 psi.

(14) A reasonable conclusion from the above-described engineering and geologic testimony is that Ocean's proposed location represents the optimal plan for development of the Unit at this time.

(15) Ocean's AFE for its proposed well is greater than Arrington's for its proposed well to the same approximate depth. However, the difference is not large, and this factor is outweighed by the conclusion that Ocean's location is preferable, and by the fact that Ocean was involved in generation of this prospect from an earlier date.

(16) Each applicant has 50% working interest control, the applicants recommend identical risk charges and identical overhead charges, and both applicants have participated in good faith negotiations. Accordingly, these factors do not affect the decision in these cases.

(17) 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, the application of Ocean in Case No. 13036 should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(18) Because Ocean's proposed location appears to be the preferable location at this time, the Unit should be dedicated to Ocean's proposed Dirt Devil State Com. 8 Well No. 1 to be drilled at a standard gas well location 660 feet from the South line and 1,980 feet from the East line (Unit O) of Section 8.

(19) Ocean should be designated the operator of the proposed well and of the Unit.

(20) 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.

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

(22) Because there is evidence that reserves will likely be drained from the Unit by wells to the north and east unless an infill well is drilled in the NE/4 of Section 8, provision should be made in this order for any owner of a working interest or unleased mineral interest ("owner") to propose such an infill well and to recover well costs associated with such infill well, together with a risk charge as herein provided, from any pooled working interest owner who elects not to pay in advance its share of estimated well costs of such an infill well.

(23) The application of Arrington in Case No. 13039 for creation of a 320-acre unit consisting of the E/2 of Section 8 with Arrington as operator should be denied.

(24) Since Arrington's request for a 160-acre unit is apparently ancillary to its request for a 320-acre unit, the application of Arrington for a 160-acre unit consisting of the NE/4 of Section 8 with Arrington as operator should be dismissed.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Ocean Energy, Inc., in Case No. 13036, all uncommitted interests, whatever they may be, in the oil and gas estate from the surface to the top of the Mississipian formation underlying the E/2 of Section 8, Township 17 South, Range 35 East, N.M.P.M., Lea County, New Mexico, are hereby pooled, as follows:

> The E/2, forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent which presently include but are not necessarily limited to the Undesignated North Vacuum-Atoka Morrow Pool.

The Unit shall be dedicated to Applicant's Dirt Devil State Com. 8 Well No. 1, to be drilled at a standard gas well location 660 feet from the South line and 1,980 feet from the East line (Unit O) of Section 8.

(2) The operator of the Unit shall commence drilling the proposed well on or before August 31, 2003, and shall thereafter continue drilling the well with due diligence to test the Atoka-Brunson sand within the Morrow formation.

(3) In the event the operator does not commence drilling the proposed well on or before August 31, 2003, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(4) Should the proposed well not be drilled to completion, or be abandoned, within 120 days after commencement thereof, the operator shall appear before the Division Director and show cause why Ordering Paragraph (1) should not be rescinded.

(5) Upon final plugging and abandonment of the well or wells drilled pursuant to this order, the pooled unit created hereby shall terminate, unless otherwise ordered by the Division.

(6) Ocean is hereby designated the operator of the proposed well and of the Unit.

(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, testing 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) as a charge for the risk involved in drilling the well, 200% of the above costs.

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

(13) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000 per month while drilling and $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what 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) In addition to the proposed well, an optional infill well authorized by Rule 104 may be drilled within the Unit upon the terms herein provided.

(16) The operator of the Unit shall be the operator of the infill well, except as herein otherwise provided.

(17) The operator or any owner subject to this order may propose drilling an infill well by giving written notice of the proposed infill well to all owners within the Unit. Any such proposal shall specify the location, proposed depth, and objective formation or formations of the proposed infill well, and shall contain a schedule of the estimated well costs of the proposed infill well, and a schedule showing the percentage of such cost allocable to each owner.

(18) The owners receiving such a notice shall have thirty (30) days after receipt of the notice within which to notify the proposing owner whether they elect to participate in the cost of the infill well. Any election to participate shall be ineffective unless accompanied by payment of the electing owner's share of estimated well costs of the proposed infill well. Failure of an owner receiving such notice to elect to participate within the thirty (30) day period shall constitute an election by that owner to pay its share of costs of the proposed infill well out of production therefrom as hereinafter provided.

(19) If all owners elect to participate in the infill well, the unit operator shall, within ninety (90) days after the expiration of the notice period of thirty (30) days, actually commence drilling the proposed infill well, and thereafter proceed with due diligence to drill the well to a depth sufficient to test the objective formation(s) specified in the proposal described in Ordering Paragraph 17, at the risk and expense of all owners.

(20) If less than all owners elect to participate in the infill well, then those owners who elect not to participate shall be deemed non-consenting working interest owners as to such infill well, and all of the provisions of this Order applicable to the proposed well shall apply to the drilling of the infill well with the following exceptions:

(a) The owner that originally proposed the infill well shall be solely responsible for carrying the non-consenting working interest owners' interests, subject however, to any existing or subsequent agreement that provides for the sharing of the non-consenting interests by the consenting owners or any of them. The proposing owner, at its election, may withdraw such proposal if there is insufficient participation.

(b) If the unit operator is a non-consenting working interest owner in the infill well, the consenting owners shall either: (a) request the unit operator to drill the well for the account of the consenting owners; or (b) designate one of the consenting owners as operator of the infill well. If the participating parties are

unable to agree on an operator, and the unit operator refuses to drill the proposed infill well, the Division, upon application of any participating party, shall appoint an operator to drill the infill well. If the infill well is drilled under option (b) and results in a producer of oil and/or gas in paying quantities, the participating owner designated as operator shall complete and equip the infill well to produce at the sole risk and expense of the participating owners, and the well shall then be turned over to the unit operator and shall be operated by it at the expense and for the account of the participating owners until the participating owners have recovered the well costs of the infill well, together with the 200% risk charge herein provided.

(c) If an infill well is proposed pursuant to this order, the unit operator or the designated operator of the infill well shall, within ninety (90) days after expiration of the thirty (30) day notice period, actually commence drilling the proposed infill well, and thereafter proceed with due diligence to drill the well to a depth sufficient to test the objective formation(s) specified in the proposal described in Ordering Paragraph (17), at the sole risk and expense of the participating owners subject to the provisions of this order. If the infill well is not commenced within the time provided, the proposal and any election by any owner with respect thereto shall be of no further force or effect.

(d) If operations for the drilling of an infill well result in a dry hole, the operator of the infill well shall plug and abandon the well and restore the surface location at the sole risk and expense of the participating owners.

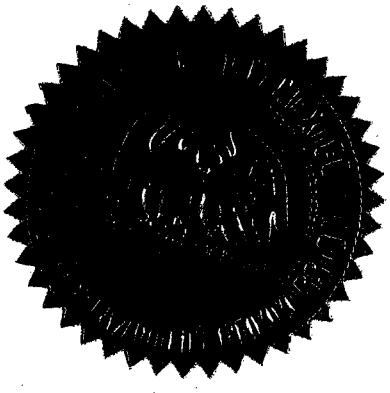
(21) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working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

(22) 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.

(23) 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.

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

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery

LORI WROTENBERY
Director

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