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RECOGNIZED SPECIALIST IN THE AREA OF  
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

August 12, 1997

**HAND DELIVERED**

Mr. William J. LeMay, Director  
Oil Conservation Division  
2040 South Pacheco  
Santa Fe, New Mexico 87505

RECEIVED  
AUG 14 1997  
OIL CONSERVATION DIVISION

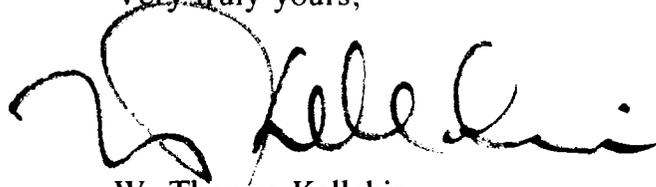
Re: Application of Diamond Head Properties, L.P., et al,  
for enforcement of Order R-10731-B,  
Eddy County, New Mexico

Dear Mr. LeMay:

On behalf of Diamond Head Properties, L.P. et al, please find enclosed our referenced application which we request be set for hearing on the next available Examiner's docket now scheduled for September 4, 1997.

Also enclosed is our proposed advertisement of this case for the NMOCD docket.

Very truly yours,



W. Thomas Kellahin

cc: Diamond Head Properties, L.P.

PROPOSED NOTICE FOR HEARING

Case 11850: Application of Diamond Head Properties, L.P., et al, for enforcement of Division Order R-10731-B, Eddy County, New Mexico. Applicants, Diamond Head Properties, L.P. and its joint interest owners, Grover Family, L.P. Dugan Production Corp, Pennant Petroleum Inc. and Glenn S. Brant, (collectively "Diamond Head Group") seek to enforce Order R-10731-B, issued February 2, 1997, by requiring KCS Medallion Resources, Inc. ("KCS") to distribute to Diamond Head Properties and its joint owners their proportionate share of any nonconsenting working interest owner's share of production plus the 200% risk factor penalty. Said pooled unit is located approximately 10 miles north of Carlsbad, New Mexico.

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Oil Conservation Division

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

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

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FEB 11 1997  
Oil Conservation Division

CASE NO. 11850

**APPLICATION OF DIAMOND HEAD PROPERTIES, L.P.  
FOR ENFORCEMENT OF ORDER R-10731-B,  
EDDY COUNTY, NEW MEXICO**

**APPLICATION  
OF  
DIAMOND HEAD PROPERTIES, L.P., ET AL**

Comes now DIAMOND HEAD PROPERTIES, L.P. and its joint owners, Grover Family, L.P. Dugan Production Corp, Pennant Petroleum Inc. and Glenn S. Brant, (collectively "Diamond Head Group") by and through its attorneys, Kellahin & Kellahin, and petitions the New Mexico Oil Conservation Division ("Division") to enforce Order R-10731-B, issued February 2, 1997, by requiring KCS Medallion Resources, Inc. ("KCS") to distribute to Diamond Head Properties and its joint owners their proportionate share of any nonconsenting working interest owner's share of production plus the 200% risk factor penalty.

And in support states:

*NMOCD Application*  
*Diamond Head Properties, L.P.*  
*Page 2*

(1) On January 13, 1997, the Division entered Order R-10731 in Case 11677 which granted the compulsory pooling application of Intercoast Oil and Gas Company, now KCS Medallion Resources, Inc. pooling the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, and correspondingly denied the competing application filed in Case 11666 by Yates Petroleum Corporation ("Yates").

(2) Order R-10731 pooled all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, T20S, R28E, forming a standard 320-acre gas spacing unit for any and all formations and/or pools spaced on 320-acre gas spacing including but not limited to the Burton Flat-Morrow Gas Pool, to be dedicated to its KCS' State "20" Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of said Section, Eddy County, New Mexico.

(3) Section 20 is divided such that the W/2, the SE/4 and 5% of the NE/4 is subject to a working interest owner agreement ("Unit Agreement") operated by Yates and the balance of NE/4 is subject to a lease held by Kerr-McGee. (now owned by Devon).

(4) As of December 19, 1996, the date of the Examiner hearing:

(A) Yates controlled approximately 52.465% of the working interest ownership within the spacing unit:

(i) Yates Group: 37%

Yates Petroleum Corporation	19.635%
Yates Drilling Company	7.742%
Abo Petroleum Corp.	2.581%
Myco Industries, Inc.	7.742%

(ii) Stonewall Unit Owners: 14.765 %

(B) KCS controlled only 24.101 % of the working interest ownership within the spacing unit as a result of a farmout from Kerr-McGee Corporation.

(C) Diamond Head Group who controlled the remaining 23.416 % interest, was neutral in this matter and had indicated its desire to join which ever operator was approved by the Division.

(5) As a result of the entry of Division Order R-10731 granting the application of KCS, the Diamond Head Group elected to participate with KCS as operator and on January 17, 21, 27, 1997 signed KCS's Joint Operating Agreement dated September 26, 1996 covering the E/2 of Section 20, T20S, R28E., Eddy County, New Mexico.

(6) On January 21, 1997, KCS had obtained an extension of its Kerr-McGee farmout until March 30, 1997;

(7) On January 21, 1997, Yates filed an Application for Hearing De Novo. At that time, the next Commission hearing was scheduled for February 13, 1997.

(8) On January 28, 1997, the Diamond Head Group signed KCS' Authority for Expenditure ("AFE").

(9) On Saturday, February 8, 1997, KCS placed a drilling rig on location and commenced drilling this well even though it had obtained an extension of its Kerr-McGee farmout until March 30, 1997.

(10) On February 13, 1997, the Commission held its hearing in these cases.

(11) On February 28, 1997, the Commission entered Order R-10731-B granting KCS' application and denying Yates' application.

(12) Order R-10731-B contains a "carried interest" provision which provides that:

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

(A) The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs by March 7, 1997.

(B) As a charge for the risk involved in drilling the well, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs by March 7, 1997.

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

(13) The Diamond Head Group is one of the "parties who advanced the well costs" and is entitled to its proportionate share of any non-consenting working interest owner's "carried interest."

(14) Yates Petroleum Corporation with approximately 37.7% percent working interest did not pay its share of well costs by March 7, 1997 and is a "non-consenting owner" whose share of costs are "carried" by those consenting working interest owners

who agreed to pay their share ("consenting owners") pursuant to Order R-10731-B.

(15) In violation of Order R-10731-B, KCS failed to notify the Diamond Head Group that Yates had gone "non-consent" and would be a "carried interest", failed to provide an opportunity to the Diamond Head Group to pay its share of Yates' carried interest and has refused to distribute production attributed to said carried interest to the Diamond Head Group as one of the parties who advanced the well costs.

(16) On March 19, 1997, upon learning that Yates had "gone non-consent", Diamond Head Group notified KCS that the Diamond Head Group was claiming its share of Yates' carried interest [estimated to be an additional 8.8218%] and the right to pay its proportionate share of Yates' costs and to recoup those costs from Yates' share of production plus a proportionate share of the 200% non-consent penalty.

(17) On June 23, 1997, and in violation of Order R-10731-B, KCS wrongfully rejected Diamond Head Group's right to receive Diamond Head's proportionate share of any carried interest including penalty, said share including but not limited to Yates' carried interest.

(18) Notification of this application has been sent to KCS as set forth on Exhibit "A" attached.

(19) Applicants request that this matter be set for hearing on the Division's Examiner docket now scheduled for September 4, 1997.

WHEREFORE, applicant requests that, after notice and hearing, this application be granted and an order entered requiring KCS Medallion Resources, Inc. to comply with Order R-10731-B and to distribute to Diamond Heard Properties and its joint owners its proportionate share of any nonconsenting working interest owner's share of production plus the 200% risk factor penalty.

KELLAHIN & KELLAHIN

A handwritten signature in black ink, appearing to read 'W. Thomas Kellahin', written over a horizontal line.

BY  
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