

CAMPBELL, CARR, BERGE
& SHERIDAN, P.A.
LAWYERS

MICHAEL B. CAMPBELL
WILLIAM F. CARR
BRADFORD C. BERGE
MARK F. SHERIDAN
MICHAEL H. FELDEWERT
ANTHONY F. MEDEIROS
PAUL R. OWEN
KATHERINE M. MOSS
JACK M. CAMPBELL
OF COUNSEL

JEFFERSON PLACE
SUITE 1 - 110 NORTH GUADALUPE
POST OFFICE BOX 2208
SANTA FE, NEW MEXICO 87504-2208
TELEPHONE: (505) 988-4421
FACSIMILE: (505) 983-6043
E-MAIL: ccbspa@ix.netcom.com

July 28, 1998

HAND-DELIVERED

Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87505

98 JUL 28 AM 9:41
OIL CONSERVATION DIV.

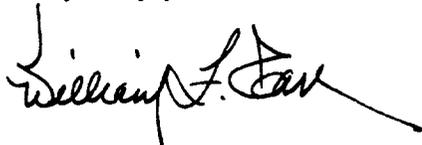
Re: ***Oil Conservation Division Case No. 11985:
Application of Saga Petroleum L.L.C. for an Unorthodox Well Location,
Eddy County, New Mexico***

Dear Ms Wrotenbery:

Enclosed for your consideration is Saga Petroleum L.L.C.'s proposed Order with reference to the July 9, 1998 Examiner hearing in the above-referenced case. For your easy reference, I have also provided it on disk.

If you need anything further from Saga Petroleum L.L.C. to proceed with your consideration of this matter, please advise.

Very truly yours,



WILLIAM F. CARR
WFC:mlh
Enclosure

cc: Mr. Michael E. Stogner, Hearing Examiner (w/enc.)
Mr. Joe Clement (w/enc.)
Mr. Lorin Rulla (w/enc.)

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

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

**APPLICATION OF SAGA PETROLEUM L.L.C.
FOR AN UNORTHODOX WELL LOCATION,
EDDY COUNTY, NEW MEXICO.**

CASE NO. 11985

**98 JUL 28 AM 9:41
OIL CONSERVATION DIV.**

**SAGA PETROLEUM L.L.C.'S
PROPOSED ORDER OF THE DIVISION**

BY THE DIVISION:

This cause came on for hearing at 8:15 a. m. on July 9, 1998 at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this ____ day of July, 1998, 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 of this cause and the subject matter thereof.

(2) The applicant, Saga Petroleum L.L.C., ("Saga"), seeks approval of an unorthodox well location for its Dero "A" Federal Com Well No. 3 to be drilled at a point 1980 feet from the South line and 660 feet from the West line (Unit L) of Section 35, Township 19 South, Range 28 East, NMPM, Eddy County, New Mexico. The S/2 of Section 35 is to be dedicated to this well for all pools developed on 320-acre spacing including the Winchester-Morrow Gas Pool, the Undesignated Winchester-Atoka Gas Pool, the Winchester-Strawn Gas Pool, the Undesignated Winchester-Upper Pennsylvanian Gas Pool, and the Undesignated Winchester-Wolfcamp Gas Pool.

POOL RULES:

(3) The Strawn and Morrow formations are the principal zones of interest in the Saga Dero Federal Well No. 3 and each formation is governed by the Division's Statewide Rules which provide for 320-acre spacing with wells to be located 1650 feet from the side boundary and 660 feet from the end boundary of the dedicated spacing or proration unit. Accordingly, the proposed Saga well location is 60% too close to the offsetting tract to the West which is operated by OXY USA, Inc. ("OXY").

(4) At the hearing OXY appeared and presented evidence in opposition to the proposed unorthodox location for the Saga Dero Federal Well No. 3 and recommended a well at the proposed location be subject to a production penalty.

(5) OXY operates the E/2 of Section 34, the direct west offset to the proposed unorthodox well location, which is dedicated to its DWU Federal Well No. 6 located at a standard location 1980 feet from the South line and 660 feet from the East line of said Section 34. The DWU Federal Well has produced since May, 1996 and in December, 1997 had a cumulative production of 2.5 BCFG and 76 MBO.

(6) OXY has also proposed a well to test the Strawn and Morrow formations at an unorthodox well location 1650 feet from the North line and 660 feet from the West line of the N/2 of Section 35. Although this well location, like Saga's proposed well location in the S/2 of Section 35, is 660 feet from the West line of Section 35 and thereby encroaches on the OXY operated E/2 of Section 34, OXY does not recommend that their well be penalized.

(7) The primary producing horizons in the proposed Saga well in the S/2 of Section 35, the OXY well in Section 34 and the proposed OXY well in the N/2 of Section 35 are in the Strawn formation, Winchester-Strawn Gas Pool and the Morrow formation, Winchester-Morrow Gas Pool.

(8) The geological evidence presented on the Strawn formation establishes:

- A. The Strawn formation is comprised of algal mounds of localized porosity development with rapid facies changes. Strawn porosity is found in three lenses located along a Northeast-Southwest trending stratigraphic trend. Testimony of Rulla, Saga Exhibit 3.

- B. The Winchester-Strawn Pool is a small reservoir with comparable reservoir under the OXY and Saga tracts. The productive Strawn reservoir is located under the western portion of the Saga acreage and a well must be drilled at the proposed Saga location to be able to effectively produce the reserves under its spacing unit. Testimony of Rulla, Saga Exhibit 3.

FINDING: A well at the proposed unorthodox location will effectively produce the Strawn reserves under the S/2 of Section 35, Township 19 South, Range 28 East, NMPM, Eddy County, New Mexico.

- (9) The geologic evidence presented on the Morrow formation establishes that:
 - A. The Saga Petroleum Dero Federal Well No. 1-A located 660 feet from the South line and 1980 feet from the West line of Section 35 currently produces at marginal rates from the middle and lower Morrow formation. Testimony of Rulla.
 - B. The OXY DWU Federal Well No. 6 in Section 34 has been drilled into the Morrow formation and OXY intends to produce the Morrow formation in this well after the Strawn formation has been depleted. Testimony of Kavarack.
 - C. Saga's proposed unorthodox location is equidistant from the common boundary between it and the offsetting OXY well thereby enabling Saga to offset drainage with counter-drainage in the Morrow formation and is at a favorable location to encounter additional Morrow reserves. Testimony of Rulla, Saga Exhibit No. 7

FINDING: A well at the proposed location will effectively produce the Morrow reserves under the S/2 of Section 35, Township 19 South Range 28 East, NMPM, Eddy County, New Mexico.

FINDING: To offset drainage in the Strawn and Morrow formations from the OXY well in Section 34, Saga must drill a well at the proposed unorthodox location in Section 35.

FINDING: The application of Saga for an unorthodox well location 660 feet from the West line and 1980 feet from the South line of Section 35, Township 19 South, Range 28 East, NMPM, Eddy County, New Mexico should be **granted**.

(10) The Winchester-Morrow Gas Pool is a non-prorated gas pool. The Division prohibits the continuous and concurrent production of multiple wells on a non-prorated spacing unit except under certain limited circumstances where there is compelling evidence that both wells must be produced to protect correlative rights. To comply with this policy, Saga agreed to produce only one Morrow well in the S/2 of Section 35 at any one time. Testimony of Rulla.

FINDING: One well should be allowed to produce from the Morrow formation at any time on the spacing and proration unit comprised of the S/2 of Section 35, Township 19 South, Range 28 East, NMPM.

(11) OXY requested that a well at the proposed unorthodox well location be subject to a production penalty until it drills and completes a well in the Strawn formation in the N/2 of Section 35. Testimony of Kavarack.

(12) The evidence established that a well at the proposed Saga unorthodox location in Section 35 will result in the no flow boundary between the wells in Sections 34 and 35 being on the common boundary between the spacing units dedicated thereto and that a well at the proposed Saga unorthodox location would therefore be able to offset drainage with counter-drainage in the Strawn and Morrow formations. Testimony of Rulla and Kavarack.

FINDING: A well at the proposed unorthodox location would not drain reserves from nor otherwise gain an advantage on the offsetting OXY operated tract to the west.

(13) The evidence also established that the proposed unorthodox well location is a standard set back from the northern boundary of the S/2 spacing unit dedicated thereto and is therefore a standard set back from the N/2 spacing unit operated by OXY in Section 35. Testimony of Rulla and Kavarack.

(14) OXY has the right to drill, and proposes to drill, a well in the N/2 of Section 35 which will offset the well Saga proposes in the S/2 of the Section. Testimony of Kavarack.

FINDING: A well at the proposed unorthodox location will not gain an advantage on the OXY operated offsetting spacing unit in the N/2 of Section 35 because it will be drilled at a location which is a standard setback from the offsetting tract under statewide spacing rules.

FINDING: A well at the proposed unorthodox location will not gain an advantage on the OXY operated offsetting spacing unit in the N/2 of Section 35 because OXY has the right to drill and proposes to drill an offsetting well on its spacing unit.

(15) OXY proposes that production from the Saga well in the S/2 of Section 35 be penalized until such time as OXY drills its well in the N/2 of the Section. Testimony of Kavarack.

(16) The recommendation of OXY to penalize the production from the Saga well until it has drilled a well in the N/2 of the Section imposes unreasonable conditions on the correlative rights of Saga which are contrary to the provisions of the Oil and Gas Act for it would make the correlative rights of Saga dependant on whether or not OXY avails itself of its opportunity to produce its reserves, or what decision OXY may make to maximize the pay out of its costs of developing its offsetting tract. Testimony of Kavarack.

(17) A production penalty should not be used to justify the failure of another operator to timely develop its reserves or otherwise exercise its correlative rights.

(18) Division Rule 104 G authorizes the imposition of a production penalty on a well drilled at an unorthodox location "as will offset any advantage which the person securing the exception may obtain over other producers by reason of the unorthodox well location."

FINDING: No advantage is gained by the Saga proposed unorthodox location for its Dero Federal Well No. 3 on other producers and no production penalty should be imposed on this well.

FINDING: Approval of the application of Saga Petroleum L.L.C. for an unorthodox well location with out the imposition of a production penalty will prevent waste, protect correlative rights and should be **granted**.

Case No. 11985

Order No. R- _____

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IT IS THEREFORE ORDERED THAT:

(1) The application of Saga Petroleum, L.L.C. for an unorthodox well location for its Dero Federal Well No. 3 to be drilled at a point 1980 feet from the South line and 660 feet from the West line (Unit L) of Section 35, Township 19 South, Range 28 East, NMPM, Eddy County, New Mexico to be dedicated to a standard 320-acre spacing and proration unit comprised of the S/2 of said Section 35 for all pools developed on 320-acre spacing including the Winchester-Morrow Gas Pool, Undesignated Winchester-Atoka Gas Pool, the Winchester-Strawn Gas Pool, the Undesignated Winchester-Upper Pennsylvanian Gas Pool and the Undesignated Winchester-Wolfcamp Gas Pool is hereby approved.

PROVIDED, HOWEVER, the operator shall assure that only one well is produced from any one pool at a time on this spacing or proration unit.

(2) Jurisdiction is hereby 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
DIRECTOR

S E A L

**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. 11985
Order No. R-**

**APPLICATION OF SAGA PETROLEUM, L.L.C.
FOR AN UNORTHODOX GAS WELL LOCATION,
EDDY COUNTY, NEW MEXICO**

**OXY USA INC.'S
PROPOSED
ORDER OF THE DIVISION**

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on July 9, 1998, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this ____ day of _____, 1998, 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 of this cause and the subject matter thereof.

Q-51

(2) The applicant, Saga Petroleum, L.L.C. ("Saga"), seeks approval to drill its Dero Well No. 3 (API No. _____) at an unorthodox gas well location 660 feet from the West line and 1980 feet from the South line (Unit L) Section 35, Township 19 South, Range 28 East, NMPM, to be dedicated to a standard 320-acre gas proration and spacing unit consisting of the S/2 of said Section 35, including the Winchester-Morrow Gas Pool, the Winchester-Atoka Gas Pool the Winchester-Strawn Gas Pool, the Winchester-Upper Pennsylvanian Gas Pool and the Winchester-Wolfcamp Gas Pool.

(3) OXY USA Inc., the operator of a gas well currently producing from the Winchester-Strawn Gas Pool said well being the DWU #6 Well located at a standard gas well location 660 feet from the East line and 1980 feet from the South line of Section 34, T19S, R38E and dedicated to a standard 320-acre gas proration and spacing unit consisting of the E/2 of said Section 34, appeared in opposition to the applicant.

(4) Both Saga's expert and attorney argued that the Dero #3 Well should not be penalized in the Morrow formation because the Dero #3 well's spacing unit was being drained by offsetting wells.

(5) The Division finds that:

(a) such an argument is contrary to the undisputed facts in this case which demonstrate that there is no offset drainage occurring in the Morrow formation.

(b) Saga is advancing an argument which is contrary to undisputed facts in this case.

(c) an examination of Saga's Morrow geology demonstrates that the proposed Dero #2 well will penetrate Morrow intervals already produced in Saga's existing Dero #2 well.

(d) contrary to its argument, the only drainage in the Morrow formation underlying the S/2 of Section 35 has been from Morrow gas wells located on that acreage.

(e) the owners in the S/2 of Section 35 have already recovered more than 2.7 times the amount of original recoverable gas underlying the S/2 of Section 35 and thereby have exhausted their correlative rights.

(f) the Dero #3 well is an unnecessary well because Saga proposes to re-work the Dero #2 well at an estimated cost of \$20,000 in an effort to recover an additional 1.3 BCF of gas from the same Morrow reservoirs it proposes to penetrate with the Dero #3 well for a cost of \$898,000.

(g) Saga's request should be denied because it will cause the waste of approximately 1.3 BCF of gas from the Morrow formation in the Dero Federal Com Well No. 2.

(h) Saga's request for approval of Morrow location for the Dero #3 well should be denied until such time as the Dero #2 well has been re-worked and produced and finally abandoned.

(6) Both Saga's expert and attorney argued that Saga should be allowed to encroach upon the E/2 of Section 34 with the Dero #3 Well without a penalty in Strawn formation because:

(a) OXY as operator of the N/2 of Section 35 had obtained an administrative order for an unorthodox location, without a penalty, which also encroaches on the E/2 of Section 34;

(b) all Saga was seeking was what counsel for OXY recommended when he appeared on behalf of Amerind Oil Company in Consolidated Cases 11934, 11958 and 11959 to argue in support of approval Ocean's application and denial of Yates' application.

(c) Saga needs this unorthodox location in the Strawn so that it could recover its share of Strawn gas before it was produced by the OXY DWU #6 well located at a standard location in the E/2 of Section 34.

(d) OXY proposed to impose a production limit on the Dero #3 well only until the DWU #7 well was drilled in the N/2 of Section 35 which is contrary to the concept of correlative rights;

(7) The Division finds that Saga's arguments are without merit and should be rejected for the following reasons:

(a) the fact that OXY's proposed Well #7 encroaches upon the E/2 of Section 34 is an issue between those owners and is no excuse for Saga to also encroach upon the E/2 of Section 34;

(b) OXY's well location in the N/2 of Section 35 is standard as to the S/2 of Section 35 and therefore Saga has no standing to object to the OXY well location;

(c) the fact that the OXY DWU #7 location was approved without timely objection from the owners in the E/2 of Section 35 who were properly notified, is no justification for Saga to be able to encroach upon the E/2 of Section 35 over the objection of those owners.

(d) OXY's application for the DWU Well No 7 was properly filed, notice was properly given in accordance with Rule 104. Additional notice was given to Saga even though such notice was not required.

(e) Saga was provided an opportunity to appear and protest, but they did not timely do so. Therefore, Saga waived their opportunity to complain about the location of the OXY DWU Well No. 7 and are barred from arguing that issue in the subject case.

(f) the owners in the S/2 of Section 35 has already recovered over 1 BCF of gas from the Strawn formation while the owners in the N/2 have never recovered any gas from the Strawn pool.

(g) In addition to what has already been recovered from the Strawn pool by the owners in the S/2 of Section 35, Saga's only witness testified that Saga's Dero Well No 1 still has potentially recoverable hydrocarbons remaining in the Strawn pool. Saga proposes to forgo this opportunity to use a wellbore that has no other utility, in favor of drilling a new wells at a location that encroaches on its neighbors.

(h) Even though both the OXY DWU Well No. 7 and the Saga Dero Well No. 3 are located 660 feet from the common boundary with OXY's DWU Well No. 6, the Saga well is 793 feet closer and hence will more directly compete for the remaining recoverable gas reserves than will the OXY DWU Well No. 7.

(i) Saga's spacing unit only has 14% of the reservoir, being approximately half as much as the N/2 of Section 35.

(j) If the Saga well is allowed to produce unpenalized, it will recover far more than its fair share of the remaining recoverable hydrocarbons underlying its spacing unit. Therefore it should be penalized in such a way as to all a reasonable opportunity to produce only its portion of the recoverable gas from the pool. The 530 MCFPD restriction will afford Saga such an opportunity.

(k) a comparison of the facts of this case with those presented in the Ocean case demonstrates that Saga's counsel has made a totally ridiculous argument--contrary to his argument, the fact in this case are readily distinguished from the Yates/Ocean cases. Here, Saga seeks to be 60% too close to Oxy's #6 Well while in the Yates/Ocean cases, Amerind supported Ocean's request for a standard well location as to the Yates' spacing unit.

(l) If Saga wants to be in an equivalent position in the reservoir as that of the E/2 of Section 34, then Saga needs to dedicate the W/2 of Section 35 to a Strawn well rather than the S/2 of Section 35.

(m) Saga's Dero Well No. 3 must be penalized in the Strawn formation in order to adjust for the inequities created by a well in a laydown spacing unit encroaching upon a standup spacing unit. The unrefuted testimony shows that Saga's spacing unit contains far less of the productive area of the reservoir compared to the spacing unit for OXY's DWU Well No. 6. OXY is limited to only one well in the Strawn pool on its standup spacing unit. To allow Saga to locate it well

equidistant from the common boundary line but on a laydown spacing unit, is the same as allowing somebody to offset a single-well standup unit with a multi-well standup unit. This is inequitable and a penalty is the only way to avoid this if the well is drilled.

(n) Saga's own geologic witnesses admitted that 60% of Saga's spacing unit does not contain porosity;

(o) in its administrative application to the Division dated April 21, 1998, Saga conceded that there "is no porosity at the nearest legal location between Saga's Dero Federal #3, SW/4 and the Dorchester DWU Federal #2 well..."

(p) while contending it had recoverable Strawn gas underlying its spacing unit, Saga failed (i) to present any petroleum engineering calculations to demonstrate what that volume might be and (ii) failed to present any geology showing the size, shape and location of the net pay for this Strawn pool.

(q) Counsel for Saga, by the use of smoke and mirrors, has misconstrued the definition of correlative rights in an effort to misdirect the Division's attention away from the fact that Saga has very little productive acreage in its spacing unit, cannot drill at a standard location and wants to encroach upon a good well in order to recover gas that Saga is not entitled to produce.

(r) the Division defines correlative rights as the opportunity for Saga to recover its share of the remaining recoverable gas underlying the S/2 of Section 35 "substantially in the proportion that quantity of recoverable gas....bears to the total recoverable gas in the pool..."

(s) the practice of the Division has been to impose production limitations on unorthodox well location when there is an objection so that (i) existing wells at standard locations will not be impaired and (ii) so that offsetting spacing units which do not have wells will be provided time to drill those wells before the encroaching well takes their share of that gas.

(t) OXY presented appropriate petroleum engineering calculation which demonstrate that:

(i) that in the absence of a production limit, Saga will recover 50% of the remaining recoverable gas in the Strawn reservoir while Saga only has 14% of the productive acreage in this Strawn reservoir:

(ii) of the 2.1 BCF of gas remaining to be recovered, Saga is entitled to no more than 0.5 BCF

(iii) that a production limit on Saga's Dero #3 well of 530 MCFPD will allow it to recover 0.5 BCF of gas in approximately 31 months;

(u) A review of Division cases demonstrates that counsel for Saga has recommended to the Division that unorthodox gas well locations should be penalized based upon factors including productive acres. For example see order R-9619 in which Mr. Carr signed a stipulated penalty for his client, Apache Corporation, using productive acreage as one of the penalty factors. In addition, also see Order R-9575, Order R-6310, R-5802-A, R-9487, R-9619, R-9526, R-4172.

(v) Counsel for Saga ridiculed OXY's offer that the production limited on the Saga well be removed when OXY's DWU #7 well commenced production from the Strawn carbonate formation, contending that it violated the definition of correlative rights by denying Saga is opportunity to produce case unit OXY could drill another well to compete from the remaining recoverable gas.

(w) Once again, Counsel for Saga misunderstands correlative rights--it in fact is accomplished in this case by limiting the Saga well so that it does not drain its neighbors but instead gets only its share of remaining recoverable gas. It is Saga who desires to be at an unorthodox well location.

(x) the fact that OXY's DWU Well NO 7 and Saga's Dero #3 well are to be located the same distance away from the common boundary line with OXY's DWU Well No. 6, is only relevant if and when OXY drills and completes the DWU Well NO 7 in the Strawn formation. When that occurs, OXY proposed that any penalty assessed on Saga's production from the Strawn formation in the Dero #3 Well be deleted thus allowing all three wells to produce at capacity.

(y) However, because counsel for Saga considers it inappropriate to remove the production penalty on the Sage Dero #3 well, said penalty should remain upon that well for its entire producing life.

(z) A production limitation of 530 MCFPD on Saga's Dero #3 well as requested by OXY is reasonable and appropriate in order to protect the correlative rights of the owners in the E/2 of Section 34 and therefore said penalty should be adopted.

(8) Denial of access to the Morrow formation and the above penalty formula method for the Strawn formation and a footage encroachment penalty of 60 % for all other formations is appropriate 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 remaining recoverable gas underlying its spacing unit.

(9) Adoption of production limitations and denial of the Morrow location will afford the applicant the opportunity to produce its just and equitable share of the gas in the appropriate formations, will prevent the economic loss caused by the drilling of unnecessary wells, avoid the abandonment of recoverable reserves, avoid the augmentation of risk arising from the drilling of an excessive number of wells and will otherwise prevent waste and protect correlative rights.

(10) The request for an unorthodox location for any production from the Winchester-Wolfcamp Gas Pool is not necessary because the well is located at a standard location for any Wolfcamp production which will be spaced on 160-acre gas spacing and not on 320-acre spacing and therefore this portion of the application should be dismissed.

IT IS THEREFORE ORDERED THAT:

(1) The applicant, Saga Petroleum, L.L.C. ("Saga"), is hereby drill its Dero Well No. 3 (API No. _____) at an unorthodox gas well location 660 feet from the West line and 1980 feet from the South line (Unit L) Section 35, Township 19 South, Range 28 East, NMPM, to be dedicated to a standard 320-acre gas proration and spacing unit consisting of the S/2 of said Section 35, limited to the Winchester-Atoka Gas Pool the Winchester-Strawn Gas Pool, the Winchester-Upper Pennsylvanian Gas Pool, **subject to the following penalties and limitations:**

(a) production limit of 530 MCFPD for any production from the Strawn formation;

(b) precluded from penetrating the Morrow formation;

(c) production limitation in all other formations of 60 % of the well's ability to produce into a pipeline as determined by deliverability tests conducted on the well on a bi-annual basis.

(2) The applicant shall advise the supervisor of the Artesia district office of the Division and OXY USA Inc. of the date and time of conducting the above described test(s) in order that they may be witnessed.

(3) The request for an unorthodox location for any production from the Winchester-Wolfcamp Gas Pool is dismissed.spaced on 160-acre gas spacing with standard wells

(4) Jurisdiction is hereby 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
Director