

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:

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

Case No. 12157

**APPLICATION OF CHI ENERGY, INC. FOR AN
UNORTHODOX GAS WELL LOCATION OR IN THE
ALTERNATIVE FOR A NON-STANDARD SUBSURFACE
GAS WELL LOCATION/PRODUCING AREA, LEA
COUNTY, NEW MEXICO.**

Case No. 12158

Order No. R-11232

ORDER OF THE DIVISION

BY THE DIVISION:

These cases came on for hearing at 8:15 a.m. on April 15, May 13, May 27, and June 10, 1999, at Santa Fe, New Mexico, before Examiners Michael E. Stogner and David R. Catanach.

NOW, on this 18th day of August, 1999, 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 their subject matter.

(2) In Case No. 12158 the applicant, Chi Energy, Inc. ("Chi"), seeks approval to drill its Greenstone Federal Com. Well No. 1 as a straight hole from an unorthodox gas well location 480 feet from the South line and 1650 feet from the East line (Unit O) of Section 19, Township 20 South, Range 34 East, NMPM, Lea County, New Mexico, in order to test

the Morrow formation underlying the E/2 of Section 19, which is a standard 320-acre stand-up gas spacing and proration unit within either the Undesignated West Lynch-Morrow Gas Pool or the Undesignated Quail Ridge-Morrow Gas Pool. IN THE ALTERNATIVE, the applicant, in accordance with Division Rules 104.F and 111.C(2), seeks approval for a non-standard subsurface gas well location/producing area for either the Undesignated West Lynch-Morrow Gas Pool or the Undesignated Quail Ridge-Morrow Gas Pool for the proposed Greenstone Federal Com. Well No. 1 to be drilled from the above-described surface location to a proposed bottomhole location no closer than 760 feet to the South line of Section 19 nor closer than 990 feet to the western boundary of the proposed 320-acre unit.

(3) In Case No. 12157, Chi seeks an order pooling all uncommitted mineral interests from the top of the Wolfcamp formation to the base of the Morrow formation underlying the E/2 of Section 19, Township 20 South, Range 34 East, NMPM, Lea County, New Mexico, to form a standard 320-acre stand-up gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include the Undesignated West Lynch-Morrow Gas Pool and the Undesignated Quail Ridge-Morrow Gas Pool. This unit is to be dedicated to the proposed Greenstone Federal Com. Well No. 1.

(4) Since these two cases involved the same well and 320-acre unit, Cases No. 12157 and 12158 were consolidated for purposes of testimony and the issuance of an order.

(5) All gas producing intervals within the vertical limits sought by Chi to be forced pooled will be subject to either Division Rule 104.B(1)(a) or 104.C(2)(b), both of which require 320-acre spacing and proration units with wells to be located no closer than 660 feet to the nearest side (long) boundary of the unit nor closer than 1650 feet from to the nearest end (short) boundary nor closer than 330 feet to any quarter-quarter section or subdivision inner boundary, and Rule 104.D(3), which limits the number of wells per spacing unit to one.

(6) The applicant is a working interest owner within the proposed 320-acre unit and therefore has a right to drill for and develop the minerals underlying this unit.

(7) Chi originally filed its request to drill the Greenstone Federal Com. Well No. 1 with the Division on February 15, 1999 for administrative review pursuant to the provisions of Division Rules 104.F and 111.C(2).

(8) An objection filed by Santa Fe Energy Resources, Inc. ("Santa Fe"), now called Santa Fe Snyder Corporation, caused this application to be set for hearing. Santa Fe appeared at the April 15, 1999 hearing and presented evidence in opposition to both Chi's proposed unorthodox straight hole location and its proposed directionally drilled unorthodox

subsurface location. Santa Fe operates the standard 320.56-acre stand-up gas spacing and proration unit within the West Lynch-Morrow Gas Pool to the southwest of Chi's proposed 320-acre unit. Santa Fe's unit comprises Lots 1 through 4 and the E/2 W/2 (W/2 equivalent) of Section 30, Township 20 South, Range 34 East, NMPM, Lea County, New Mexico, and is currently dedicated to the Topaz "30" Federal Com. Well No. 1 (**API No. 30-025-33375**), located at a standard gas well location 1980 feet from the North line and 660 feet from the West line (Lot 2/Unit E) of Section 30.

(9) Chi testified that it preferred to drill at a standard gas well location within the SE/4 of Section 19, but the proposed surface location is necessary due to the potash enclave.

(10) The technical evidence presented by both parties in this matter has merit and cumulatively supports the further exploration and development of the Morrow formation within the unit.

(11) On June 7, 1999, Santa Fe's legal counsel notified the Division in writing of the withdrawal of its objection to Chi's proposed alternate bottomhole location 760 feet from the South line and 990 feet from the West line of Section 19.

(12) The geological evidence presented at the hearing indicates that the alternate bottomhole location will allow Chi to adequately test the Morrow formation at a location that is more geologically favorable than the nearest orthodox location in the SE/4 of Section 19, thereby increasing the likelihood of obtaining commercial Morrow gas production. To assure the adequate protection of correlative rights and the prevention of waste, the alternate unorthodox subsurface gas well location/producing area should be approved. Consequently, the proposed unorthodox gas well location to be drilled as a straight hole 480 feet from the South line and 1650 feet from the East line of Section 19 is hereby dismissed.

(13) At this time Chi represents 99.25% of the working interests in the unit. The remaining owners of working interest have not agreed to pool their interests.

(14) No interested or affected party appeared at the hearing in opposition to the compulsory pooling portion of this application.

(15) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste, and afford each interest owner in the unit the opportunity to recover or receive without unnecessary expense its just and fair share of the gas underlying the unit, the application should be approved by pooling all uncommitted mineral interests, whatever they may be, within this unit. NOTE: After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(16) Chi requested that Louis Dreyfus Natural Gas Corporation, another interest owner in the proposed unit, be designated the operator of the well and unit.

(17) Any non-consenting working interest owner should be afforded the opportunity to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production.

(18) Any non-consenting working interest owner who does not pay its share of estimated well costs should have withheld from production its share of the reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(19) Any non-consenting interest owner should be afforded the opportunity to object to the actual well costs but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(20) Following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated costs should pay to the operator any amount that reasonable costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(21) At the time of the hearing, Chi proposed fixed overhead and administrative costs for the Greenstone Federal Com. Well No. 1 of \$6,000.00 per month while drilling and \$749.00 per month while producing.

(22) The latest available "Fixed Rate Overhead Survey" for 1998-99, published by Ernst & Young, LLP of Houston, Texas, shows average overhead rates of \$610.00 while producing for gas wells within a depth range of 10,000 feet to 15,000 feet in southeast New Mexico.

(23) Reasonable charges for supervision (combined fixed rates) should be fixed at \$6,000.00 per month while drilling and \$610.00 per month while producing. The operator should be 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 each non-consenting working interest.

(24) All proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(25) If the operator of the pooled unit fails to commence drilling the well to which the unit is dedicated on or before November 15, 1999, or if all the parties to this compulsory pooling reach voluntary agreement subsequent to entry of this order, this order should become of no effect.

(26) The operator of the well and unit should notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Chi Energy, Inc. in Case No. 12157, all uncommitted mineral interests, whatever they may be, from the top of the Wolfcamp formation to the base of the Morrow formation underlying the E/2 of Section 19, Township 20 South, Range 34 East, NMPM, Lea County, New Mexico, are hereby pooled to form a standard 320-acre stand-up gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include the Undesignated West Lynch-Morrow Gas Pool and the Undesignated Quail Ridge-Morrow Gas Pool. NOTE: After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners."

(2) This unit is to be dedicated to the proposed Greenstone Federal Com. Well No. 1, hereby authorized to be vertically drilled from a surface location 480 feet from the South line and 1650 feet from the East line (Unit O) of Section 19 to an approximate depth of 8,550 feet, kicked-off to the north, and directionally drilled to a bottomhole location no closer than 760 feet to the South line of Section 19 nor closer than 990 feet to the western boundary of the unit.

(3) The operator shall commence drilling the well on or before November 15, 1999, and shall thereafter continue drilling the well with due diligence to a depth sufficient to test the Morrow formation.

(4) In the event the operator does not commence drilling the well on or before November 15, 1999, Ordering Paragraph No. (1) shall be of no effect, unless the applicant or operator obtains a time extension from the Division Director for good cause shown.

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

(6) Louis Dreyfus Natural Gas Corporation is hereby designated the operator of the well and unit.

(7) After the effective date of this order and within 90 days prior to commencing the well, the operator shall furnish the Division and each known non-consenting working interest owner in the unit an itemized schedule of estimated well costs.

(8) Within 30 days from the date the schedule of estimated well costs is furnished, any non-consenting 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, 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.

(9) The operator shall furnish the Division and each known non-consenting working interest owner an itemized schedule of actual well costs within 90 days following completion of the 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 the reasonable well costs; provided, however, that 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 non-consenting 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 its share of the amount that estimated well costs exceed 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 who has not paid its share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished; and
- (b) as a charge for the risk involved in drilling the well, 200 percent of the above costs.

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

(13) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$6,000.00 per month while drilling and \$610.00 per month while producing. The operator is hereby 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 each non-consenting working interest.

(14) 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.

(15) 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) 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.

(17) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, that portion of this order authorizing compulsory pooling shall thereafter be of no further effect.

(18) The operator shall comply with all provisions of Division Rule 111 applicable to the directional drilling of this well.

(19) The operator of the well and unit shall notify 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 case is retained for the entry of such further orders as the Division may deem necessary.

Case Nos. 12157/12158

Order No. R-11232

Page 8

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



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery
LORI WROTENBERY
Director