STATE OF NEW MEXI

ENERGY [illegible] AND NATURAL RES[illegible] DEPARTMENT

[illegible] OIL CONSERVATION [illegible]

[illegible] MATTER [illegible] THE HEARING CALLED [illegible]
[illegible] OIL CONSERVATION DIVISION FOR THE [illegible]
[illegible] PURPOSE OF CONSIDERING:

[illegible] APPLICATION OF [illegible] SOUTHEASTERN DRILLING [illegible] CASE No. [illegible] 12,486
[illegible] COMPANY FOR COMPULSORY POOLING, LEA [illegible]
[illegible] COUNTY, NEW MEXICO.

[illegible] APPLICATION OF DAVID F. ARRINGTON [illegible] CASE 12,942
[illegible] ARRINGTON OIL & GAS, INC., FOR COMPULSORY POOLING, [illegible]
[illegible] LEA COUNTY, NEW MEXICO.

(Consolidated)

OFFICIAL EXHIBIT [illegible]
[illegible]: 2. Arrington Hearing [illegible]
EXAMINER HEARING

[illegible] BEFORE: DAVID R. CATANACH, Hearing Examiner

November 14th

Santa Fe, New Mexico

[illegible] matter came on for [illegible] before the New Mexico Oil Conservation Division. [illegible] EXAMINER Hearing [illegible] Examiner, on Thursday, November 14th [illegible] at the New Mexico Energy, Minerals and Natural [illegible] Department, [illegible] South Saint Francis Drive, Room [illegible] Santa Fe, New [illegible]. Steven T. Brenner, Certified [illegible] Reporter, and [illegible] the State of New Mexico.

* * *

STEVEN T. BRENNER

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. 11666
CASE NO. 11677
Order No. R-10731

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

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on December 19, 1996, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 13th day of January, 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 of this cause and the subject matter thereof.

(2) Division Case Nos. 11666 and 11677 were consolidated at the time of the hearing for the purpose of testimony, and, inasmuch as approval of one application would necessarily require denial of the other, one order should be entered for both cases.

(3) The applicant in Case No. 11666, InterCoast Oil and Gas Company (InterCoast), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool. Said unit is to be dedicated to the applicant's proposed InterCoast 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 Section 20.

(4) The applicant in Case No. 11677, Yates Petroleum Corporation (Yates), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool. Said unit is to be dedicated to the applicant's proposed Stonewall "AQK" State Com Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20.

(5) The subject wells and proration unit are located within the Burton Flat-Morrow Gas Pool and within one mile of the West Burton Flat-Atoka Gas Pool, both of which are currently governed by Rule No. 104.C. of the Division General Rules and Regulations which require standard 320-acre gas spacing and proration units with wells to be located no closer than 1650 feet from the end boundary nor closer than 660 feet from the side boundary of the proration unit nor closer than 330 feet from any quarter-quarter section line or subdivision inner boundary.

(6) Both Yates and InterCoast have the right to drill within the proposed spacing unit and both seek to be named operator of their respective wells and the subject proration unit.

(7) Yates and InterCoast have conducted negotiations prior to the hearing but have been unable to reach a voluntary agreement as to which company will drill and operate the well within the spacing unit.

(8) According to evidence and testimony presented by both parties, the primary objective within the wellbore is the Morrow formation.

(9) Both Yates and InterCoast are in agreement that the well which will ultimately develop the subject proration unit should be located at the unorthodox gas well location requested by both parties. In support of this request, both parties presented geologic evidence and testimony which indicates that a well at the proposed unorthodox location should penetrate the Upper and Lower Morrow sand intervals in an area of greater net sand thickness than a well drilled at a standard gas well location thereon, thereby increasing the likelihood of obtaining commercial gas production.

(10) Oxy U.S.A. Inc., the affected offset operator to the north of the proposed location, did not appear at the hearing in opposition or otherwise object to the proposed unorthodox gas well location. No other offset operator and/or interest owner appeared at the hearing in opposition to the proposed unorthodox gas well location.

(11) Approval of the proposed unorthodox gas well location will afford the operator within the E/2 of Section 20 the opportunity to produce its just and equitable share of the gas in the Burton Flat-Morrow Gas Pool, 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.

(12) Both Yates and InterCoast submitted AFE's for the drilling of their respective wells within the subject spacing unit. The AFE's are not substantially different and should not be a factor in deciding these cases.

(13) The overhead rates proposed by Yates and InterCoast are not substantially different and also should not be a factor in deciding these cases.

(14) Both parties proposed that a risk penalty of 200 percent be assessed against those interest owners who do not participate in the drilling of a well within the subject spacing unit.

(15) A brief description of the chronology of events leading up to the hearing in these cases is summarized as follows:

> By letter dated August 30, 1996, InterCoast seeks a farmout from Yates in Section 20 in order to drill an 11,250 foot Morrow test at a location 990 feet from the North and East lines (Unit A). The proposal does not specify which spacing unit will be utilized;
>
> September 17, 1996--By phone conversation Yates informs InterCoast of

its desire not to farmout the subject acreage;

September 26, 1996--InterCoast files compulsory pooling application seeking a N/2 spacing unit in Section 20 for a well to be drilled in Unit A. Yates receives notice of InterCoast's compulsory pooling application on September 30, 1996. A hearing is set for October 17, 1996;

By letter dated October 1, 1996, complete with operating agreement and AFE, InterCoast formally proposes the drilling of its well in Unit A of Section 20. Yates receives InterCoast's letter October 9, 1996. InterCoast's hearing is postponed until November 7, 1996, to allow Yates the opportunity to review the proposal;

October 24, 1996--Yates informs InterCoast that it prefers a different well location in the N/2 of Section 20;

By letter dated October 29, 1996, complete with operating agreement and AFE, Yates proposes the drilling of the Stonewall "DD" State Com Well No. 3 at a location 990 feet from the North and West lines (Unit D) of Section 20 to the interest owners in the Stonewall Unit. The proposed spacing unit is the N/2. By letter dated October 31, 1996, Yates makes the same proposal to InterCoast;

November 7, 1996--Yates and InterCoast meet in Artesia to discuss development of Section 20. Each company insists on drilling its respective well location. Both companies agree that developing Section 20 with stand-up E/2 and W/2 spacing units would allow both wells to be drilled and agree to pursue management approval of this option;

By letter dated November 11, 1996, InterCoast formally proposes to drill a well within Unit A (990 feet from the North and East lines) within a stand-up proration unit comprising the E/2 of Section 20;

November 12, 1996--InterCoast files a compulsory pooling application for proposed E/2 spacing unit;

November 13, 1996--By phone conversation, Yates informs InterCoast that it agrees to develop Section 20 with stand up proration units but proposes that it be allowed to drill both wells. InterCoast responds that it desires to drill and operate the well in the E/2;

By letter dated November 14, 1996, Yates formally proposes the drilling of the Stonewall "DD" State Com Well No. 3 on a W/2 spacing unit to the "Stonewall Unit" interest owners;

By letter dated November 22, 1996, Yates formally proposes to InterCoast the drilling of the Stonewall "AQK" State Com Well No. 1 at a location 990 feet from the North and East lines (Unit A) of Section 20. The proposed spacing unit is the E/2;

November 26, 1996--Yates files an application for the compulsory pooling of the E/2 of Section 20;

December 2-13, 1996--Ongoing discussions between the parties.

(16) Land testimony presented by both parties in this case, which is generally in agreement, indicates that:

a) 100 percent of the SE/4 and 5 percent of the NE/4 of Section 20 are subject to an existing unit agreement, the Stonewall Unit Agreement, in which Yates is the operator;

b) Yates Petroleum Corporation, Yates Drilling Company, Abo Petroleum Corporation and Myco Industries, Inc., (the "Yates Group") collectively own 37.7 percent of the proposed spacing unit. In addition, Yates testified that by virtue of the Stonewall Unit Agreement, it controls an additional 14.765 percent of the proposed spacing unit;

c) the 95 percent working interest in the NE/4 of Section 20 which is <u>not</u> subject to the Stonewall Unit Agreement is owned approximately as follows:

Kerr-McGee Corporation----------48 percent
Diamond Head Properties, L.P.------47 percent

d) by virtue of a farmout agreement with Kerr-McGee Corporation, InterCoast will "earn" approximately 24.101 percent of the proposed spacing unit. Under the terms of the farmout agreement, a well must be commenced by February 17, 1997, or the farmout agreement will expire. Land testimony by InterCoast further

indicates that the subject farmout agreement will remain in effect even if Yates is named operator of the well and unit, provided however, such well must be commenced by the drilling deadline described above.

(17) Diamond Head Properties, L.P. submitted correspondence to the Division in these cases on December 12, 1996, in which it stated that it will remain neutral as to its preference of operator and that it will most likely join in the drilling of the well in the E/2 of Section 20 regardless of who operates.

(18) Interest ownership within the spacing unit is summarized as follows:

Yates Petroleum Corporation	19.635%
Yates Drilling Company	7.742%
Abo Petroleum Corporation	2.581%
Myco Industries, Inc.	7.742%
Stonewall Unit Owners (Other than the Yates Group)	14.765%
InterCoast Oil and Gas Company	24.101%
Diamond Head Properties, L.P.	23.416%

(19) Yates and the Yates Group own approximately 19.635 percent and 37.7 percent, respectively, within the spacing unit. InterCoast, by virtue of the farmout agreement with Kerr McGee, will earn 24.101 percent of the spacing unit upon the drilling of a well in the E/2 of Section 20.

(20) Yates testified that if named operator of the subject spacing unit, it will commence drilling the Stonewall "AQK" State Com Well No. 1 by the drilling deadline in order to preserve InterCoast's farmout agreement.

(21) Yates contends it should be allowed to drill its Stonewall "AQK" State Com Well No. 1 and operate the E/2 of Section 20 for the following reasons:

a) collectively, the Yates Group owns a larger percentage of the spacing unit than InterCoast--37.7 percent to 24.101 percent;

b) Yates has the support of several of the interest owners in the Stonewall Unit, while InterCoast has been unable to secure the support of any of these interest owners;

c) Yates has drilled and operated twenty-one wells in the Stonewall Unit since 1973;

d) the Stonewall Unit area is very complex and as operator, Yates is the most familiar with it and best able to deal with the land, accounting and distribution of production proceeds.

(22) InterCoast contends that due to the fact that it developed the prospect, it should be allowed to drill its InterCoast State "20" Well No. 1 and operate the E/2 of Section 20.

(23) The evidence, testimony and information obtained from Division records indicates that:

a) within the Stonewall Unit area, which encompasses all or portions of Sections 19, 20, 29 and 30, Yates has drilled five wells to a depth sufficient to produce the Morrow formation. Most of the drilling and production from the Burton Flat-Morrow Gas Pool within the Stonewall Unit area occurred during the period from approximately 1973 to 1987, and, with the exception of the Stonewall "EP" State Well No. 1, located in Unit N of Section 19, which is currently an active producing well in the Morrow formation, all of the other wells have been plugged and abandoned;

b) even though Yates has had the opportunity to develop the N/2 or E/2 of Section 20 in the Burton Flat-Morrow Gas Pool since 1973, it apparently chose not to do so until such time as InterCoast, on September 3, 1996, sought a farmout of its acreage in Section 20;

c) as a result of the agreement reached with InterCoast to develop Section 20 with stand-up proration units, Yates will have the opportunity to develop the W/2 of this section by drilling its Stonewall "DD" State Com Well No. 3 in Unit D;

d) although there is a fairly significant difference in interest ownership in the E/2 of Section 20 between the "Yates Group" and InterCoast, this criteria should not be the deciding factor in this case. InterCoast does have a substantial stake in the proposed well;

e) Yates' land witness testified under cross examination that in the

event InterCoast is named operator of the E/2 of Section 20, accounting and distribution of production proceeds should not be a problem for InterCoast.

(24) In the absence of other compelling factors, the operatorship of the E/2 of Section 20 should be awarded to the operator who originally developed the prospect, developed the geologic data necessary to determine the optimum well location, and initially sought to obtain farmout or voluntary agreement to drill its well.

(25) InterCoast should be designated operator of its proposed well and the proposed spacing unit.

(26) The application of Yates Petroleum Corporation in this case should be denied.

(27) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to 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 completion resulting from this order, the application of InterCoast Oil and Gas Company should be approved by pooling all mineral interests, whatever they may be, within the E/2 of Section 20.

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

(29) Any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his 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.

(30) Any non-consenting working 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.

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

(32) $5819.00 per month while drilling and $564.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(33) All proceeds from production from the subject well which 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.

(34) Upon the failure of the operator of said pooled unit to commence the drilling of the well to which said unit is dedicated on or before April 15, 1997, the order pooling said unit should become null and void and of no effect whatsoever.

(35) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, the portion of the order concerning the compulsory pooling of the subject proration unit shall thereafter be of no further effect.

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

IT IS THEREFORE ORDERED THAT:

(1) The application of Yates Petroleum Corporation in Case No. 11677 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool, said unit to be dedicated to the applicant's proposed Stonewall "AQK" State Com Well No. 1 to be drilled at an unorthodox gas well location 990 feet from the North and East lines (Unit A) of Section 20, is hereby denied.

(2) The application of InterCoast Oil and Gas Company in Case No. 11666 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy

County, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool, said unit to be dedicated to the applicant's proposed InterCoast 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 Section 20, is hereby approved.

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the 15th day of April, 1997, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Morrow formation.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the 15th day of April, 1997, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division Director 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 Ordering Paragraph No. (1) of this order should not be rescinded.

(2) InterCoast Oil and Gas Company is hereby designated the operator of the InterCoast State "20" Well No. 1 and subject proration unit.

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

(4) Within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner 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 owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(5) The operator shall furnish the Division and each known 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 said schedule, the actual well costs shall be the reasonable well costs; provided however, if there is objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(6) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated well 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.

(7) The operator 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 within 30 days from the date the schedule of estimated well costs is furnished to him.

(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 non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

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

(9) $5819.00 per month while drilling and $564.00 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 non-consenting working interest, 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 non-consenting working interest.

(10) 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 the terms of this order.

(11) 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.

(12) All proceeds from production from the subject well which are not disbursed for any reason shall immediately 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.

(13) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, the portion of the order concerning the compulsory pooling of the subject proration unit shall thereafter be of no further effect.

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

(15) 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

WILLIAM J. LEMAY
Director

S E A L