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COMMISSIONER

State of New Mexico
Commissioner of Public Lands

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April 10, 2012

Yates Petroleum Corporation
105 South Fourth Street
Artesia, New Mexico 88210-2118

Attn: Ms. Janet Richardson

Re: Herradura State Exploratory Unit
Rejection of 2012 Plan of Development
Eddy County, New Mexico

Dear Ms. Richardson:

We received your 2012 plan of development dated March 27, 2012 for the Herradura State Unit agreement, Eddy County, New Mexico. Your plan as proposed is to connect the Herradura Unit Well No. 3 well to a pipeline and monitor production from both wells (#1 and #3) and request a commercial determination.

Our records reflect the following:

1. Your letter of May 6, 2010 requested designation of the proposed Herradura Unit Area. Your letter states that Yates Petroleum Corp. would be drilling to a depth of 6,500' or to test the Bone Spring formation, whichever is the lesser depth, unless commercial production in paying quantities, as defined in the Unit Agreement, is encountered at a lesser depth, be approved as the required depth. A geologic report was also submitted.
2. The Geologic report submitted proposes the formation of the Herradura Unit in Eddy County, New Mexico to test the Bone Spring formation. The Herradura Unit will support the drilling of two horizontal wells one in Section 16-24S-25E and the other in Section 2-24S-25E.
3. Preliminary approval was granted from this office on May 18, 2010.
4. The Bureau of Land Management designated the Herradura Unit area as logically subject to exploration and development on May 26, 2010. The unit agreement submitted for the area designated must provide for a well to test the Bone Spring formation, or to a depth of 6,500 feet, whichever is the lesser depth.
5. OCD Case No. 14473, Order No. R-1320 approved the Herradura Exploratory for all oil and gas in all formations from the surface to the base of the Bone Spring formation on June 15, 2010. The applicant submitted testimony by affidavit as follows: The initial well, the Herradura Unit Well No. 1H, is planned to be drilled horizontally from a standard surface location within the NE/4NE/4 of Sec. 16-24S-25E, NMPM, Eddy County, NM, in a northerly direction to a bottomhole location within the NE/4NE/4 of Section 9. The vertical hole will be drilled to an approximate depth of

6,500 feet to test all formations from the surface to within the Bone Spring formation. The primary target is oil production from the Bone Spring formation Avalon shale.

6. The initial well, the Herradura Unit Well No. 1 was initially proposed to test the Bone Spring formation, then was completed as a vertical Morrow well in the NE/4NE/4 Sec. 16-24S-25E with an E/2 320.00 acre spacing unit on March 9, 2011. A commercial determination has not been submitted for this well. This well is considered non-commercial until a commercial well determination has been approved by this office and the BLM.
7. An application for permit to drill the Herradura Unit Well No. 2H in the SE/4SE/4 of Section 2-24S-25E in the Bone Spring formation was approved by the NMOCD on 6/13/2010. This well was never drilled.
8. Our letter of May 6, 2011 granted approval to drill the second obligation well in Section 4-24S-25E.
9. The Herradura Unit Well No. 3 was drilled as a vertical Morrow well in the NW/4NE/4 of Section 4-24S-25E with an E/2 320.00 acre spacing unit on 2/3/2012. This well is considered non-commercial until a commercial well determination has been approved by this office and the BLM.
10. Article 9 of the Herradura Unit Agreement provides for the drilling of an adequate test well at a location approved by the AO and Land Commissioner, unless on such effective date a well is being drilled in conformity with the terms hereof, and thereafter continue such drilling until the Bone Spring formation has been tested or until at a lesser depth Unitized Substances shall be discovered which can be produced in paying quantities.
11. Article 9 (A) also provides for 2 wells to be drilled with not more than 6 months time elapsing between the completion of the first well and commencement of drilling operations for the second well regardless of whether a discovery has been made in any well drilled under this provision. Both the initial well and the second well must be drilled in compliance with the above specified formation or depth requirements in order to meet the dictates of this section.
12. Article 10 provides that within 6 months after completion of a well capable of producing Unitized Substances in paying quantities, the Unit Operator shall submit for the approval of the AO, the Land Commissioner and Division an acceptable plan of development and operation for the Unitized Land which when approved by the AO, the Land Commissioner and the Division, shall constitute the further drilling and development obligations of the Unit Operator under this agreement for the period specified therein.

In addition this office and the Bureau of Land Management have the following questions:

- Since the Herradura Unit was approved as a Bone Spring unit, please provide justification as to why the first two obligation wells were drilled as Morrow gas wells?
- Are there plans to amend the unit agreement in any way to include the Morrow formation instead of the Bone Spring formation as the primary zone of interest?
- Your plan as submitted does not mention how the Bone Spring formation in this unit will be developed. What are your plans to develop the Bone Spring formation as initially proposed?
- Has the Bone Spring interval been tested?
- Has Yates Petroleum Corporation abandoned their initial proposal to drill two horizontal Unit wells to test the Bone Spring formation?
- Please justify and provide additional details on how the two non-commercial Morrow gas wells can be considered as complying with Article 9 of the Agreement - Drilling to Discovery.


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In view of the above your 2012 Plan of Development cannot be approved and the unit is considered to still be in the drilling to discovery phase. The next Bone Spring obligatory well is due on or before August 3, 2012.

If you have any questions or if we may be of further help, please contact Pete Martinez at (505) 827-5791.

Very truly yours,

RAY POWELL, M.S., D.V.M.
COMMISSIONER OF PUBLIC LANDS

BY: 
Larry J. Roybal, Director
Oil, Gas and Minerals Division
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RP/LR/pm
cc: Reader File,
OCD-Attention: Mr. Ed Martin
BLM-Attention: Mr. Wesley Ingram