

**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. 13663
ORDER NO. R-12629**

**APPLICATION OF SYNERGY OPERATING, LLC FOR COMPULSORY
POOLING, SAN JUAN COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on March 30 and June 22, 2006, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 12th day of September, 2006, 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 this case and its subject matter.

(2) The applicant, Synergy Operating, LLC ("applicant" or "Synergy"), seeks an order pooling all uncommitted mineral interests from the surface to the base of the Fruitland Coal formation underlying the following-described acreage in Section 8, Township 29 North, Range 11 West, NMPM, San Juan County, New Mexico, in the following manner:

the W/2 to form a standard 320-acre gas spacing and proration unit for all formations and/or pools spaced on 320 acres within this vertical extent, which presently include the Basin-Fruitland Coal Gas Pool; and

the SW/4 to form a standard 160-acre spacing and proration unit for all formations and/or pools spaced on 160 acres within this vertical extent.

(3) The above-described spacing and proration units (the "Units") are to be dedicated to the applicant's proposed Duff 29-11-8 Well No. 105 (API No. 30-045-33427) to be drilled at a standard gas well location 1885 feet from the South line and 1085 feet from the West line (Unit L) of Section 8.

(4) Jerry Walmsley, Trustee of the June H. Walmsley Trust ("Mr. Walmsley"), Joseph C. Robbins ("Mr. Robbins"), Ed Smith and Ed Smith, LLC ("Mr. Smith"), all interest owners within the SW/4 of Section 8, appeared at the hearing in opposition to the application.

(5) By Order No. R-12376, as amended, the Oil Conservation Division ("Division") and the Oil Conservation Commission ("Commission"), upon the application of Synergy, pooled all uncommitted mineral interests from the surface to the base of the Fruitland Coal formation underlying the W/2 of Section 8, Township 29 North, Range 11 West, NMPM. This unit was to be dedicated to Synergy's proposed Duff 29-11-8 Well No. 104 (API No. 30-045-33350) which was to be drilled at a standard gas well location 955 feet from the North line and 885 feet from the West line (Unit D) of Section 8.

(6) Synergy presented testimony to the effect that it has drilled and completed its Duff 29-11-8 Well No. 104 in compliance with the provisions set forth in Order No. R-12376, as amended. Synergy further testified that the well is not yet producing.

(7) The proposed Duff 29-11-8 Well No. 105 is to be drilled and completed as an infill well within the Basin-Fruitland Coal Gas Pool. Secondary targets include the Fruitland sand interval, which is currently spaced on 160 acres.

(8) Synergy presented evidence that demonstrates that:

- (a) the NE/4 of Section 8 is a Federal Lease owned by Burlington Resources Oil & Gas Company ("Burlington"). Burlington has executed a Joint Operating Agreement ("JOA") with Synergy covering the W/2 of Section 8, and has participated in the drilling of the Duff 29-11-8 Well No. 104. As of the hearing date, Burlington has not signed an Authority for Expenditure ("AFE") for the drilling of the Duff 29-11-8 Well No. 105; however, by virtue of Burlington having executed a JOA, its interest in the W/2 of Section 8, and in the proposed Duff 29-11-8 Well No. 105 are effectively committed, and the force-pooling of Burlington's interest is not necessary;
- (b) the SW/4 of Section 8 is a fee lease that was initially owned as follows:

Heirs of Julia H. Keller

| | |
|------------------|-------|
| Annemarie Keller | 6.25% |
| Margaret K. Dunn | 6.25% |

Heirs of May H. Kouns

| | |
|--------------------|--------|
| Charla Varner | 3.125% |
| Robert E. Kouns | 3.125% |
| Kimberly Brautigam | 3.125% |
| Jodie Yates | 3.125% |

Heirs of Jenny H. Hill

| | |
|---------------|-------|
| June Walmsley | 12.5% |
|---------------|-------|

Heirs of Margaret H. Jones

| | |
|----------------|-------|
| David F. Jones | 12.5% |
|----------------|-------|

| | |
|--------------------------|--------|
| <u>Joseph C. Robbins</u> | 3.125% |
|--------------------------|--------|

| | |
|---------------------------------|---------|
| <u>Edwin & Ernest Smith</u> | 46.875% |
|---------------------------------|---------|

- (c) Synergy owns a 25% working interest within the SW/4 of Section 8 that it obtained from the Heirs of Julia H. Keller, and the Heirs of May H. Kouns. Synergy also owns an additional 3.125% of the working interest in the SW/4 of Section 8 by virtue of its obtaining a farmout agreement from Mr. Robbins;
- (d) Mr. Walmsley executed Synergy's JOA covering the W/2 of Section 8 effective March 1, 2005;
- (e) Synergy has recently acquired some, but not all, of the interest owned by the Heirs of Margaret H. Jones. Synergy has been unable to reach a voluntary agreement with Leola Kellogg, an Heir of Margaret H. Jones; and
- (f) As of the date of the hearing, Synergy contends that the interest ownership within the W/2 of Section 8 is as follows:

| | |
|------------------|----------|
| Burlington | 50% |
| Edwin Smith, LLC | 23.4375% |
| Walmsley Trust | 6.25% |
| Leola Kellogg | .78125% |

Synergy 19.53125%

(9) In the immediate case, Synergy only seeks to pool the interest of Leola Kellogg and Edwin Smith, LLC.

(10) Mr. Walmsley, as trustee, contends that he owns the interest within the SW/4 of Section 8 that previously belonged to the Heirs of Julia H. Keller, the Heirs of May H. Kouns and the Heirs of Margaret H. Jones. This position is based upon its assertion that this interest was held in "joint tenancy", and that upon the death of Julia H. Keller, May H. Kouns and Margaret H. Jones, this interest became the property of Mr. Walmsley;

(11) Mr. Walmsley has initiated quiet title litigation proceedings in the 11th Judicial District Court in San Juan County, New Mexico to determine the rightful ownership of the interest within the SW/4 of Section 8 that previously belonged to the Heirs of Julia H. Keller, the Heirs of May H. Kouns and the Heirs of Margaret H. Jones.

(12) Accordingly, Mr. Walmsley requests that any order issued in this case require Synergy to place the production proceeds from the Duff 29-11-8 Well No. 105 attributable to the disputed interest in suspense until such time as the ownership issue is resolved in District Court.

(13) Mr. Robbins entered into a farmout agreement with Synergy on or about June 6, 2005 for the development of the W/2 of Section 8. It is now Mr. Robbins' position that at the time this agreement was negotiated, Synergy misrepresented to him that it owned an interest in the W/2 of Section 8, when in fact this interest ownership was, and remains, in dispute. Accordingly, Mr. Robbins presented, as evidence in this case, a "Notice of Rescission of Farmout Agreement", which instrument, he contends, rescinds the farmout agreement between himself and Synergy.

(14) Synergy contends that the farmout agreement it executed with Mr. Robbins is a bilateral agreement that cannot be rescinded without the consent of both parties. Further, Synergy stated that the Division does not have the authority to rule on contract matters.

(15) Mr. Smith's position is that Synergy owns no interest in the W/2 of Section 8 and therefore does not have the right to drill the Duff 29-11-8 Well No. 105.

(16) Mr. Smith currently operates the Claude Smith Well No. 1 (API No. 30-045-08442) located 790 feet from the South and West lines (Unit M) of Section 8, Township 29 North, Range 11 West, NMPM. This well is currently completed in and producing from the Fulcher Kutz-Pictured Cliffs Gas Pool.

(17) At the hearing, Mr. Smith presented, as evidence, an application to recomplete the Claude Smith Well No. 1 in the Basin-Fruitland Coal Gas Pool, and to downhole commingle the Pictured Cliffs and Fruitland Coal intervals in the well.

(18) Mr. Smith contends that by recompleting the Claude Smith Well No. 1 in the Basin-Fruitland Coal Gas Pool, it would not be necessary to drill the proposed Duff 29-11-8 Well No. 105. This would result in considerable savings to the interest owners within the W/2 of Section 8.

(19) After review of the evidence presented by all parties in this case, the Division finds that:

- (a) the Division has no jurisdiction to determine title to any interest in real property;
- (b) the W/2 of Section 8 has previously been pooled for the development of the Basin-Fruitland Coal Gas Pool by Order No. R-12376, as amended. In that order, Synergy was authorized to develop the Basin-Fruitland Coal Gas Pool by drilling the initial well on the unit, the Duff 29-11-8 Well No. 104, and was named operator of the unit;
- (c) the farmout agreement between Synergy and Mr. Robbins is a contractual agreement. The Division does not have the jurisdiction to rule on contractual matters, and Mr. Robbins presented no legally admissible evidence to show that this agreement has been rescinded;
- (d) by virtue of the interest that it obtained from Mr. Robbins, Synergy owns at least a 3.125% working interest within the SW/4 of Section 8, therefore, Synergy has the right to drill the proposed Duff 29-11-8 Well No. 105;
- (e) the proposal by Mr. Smith to recomplete the Claude Smith Well No. 1 to the Basin-Fruitland Coal Gas Pool should not be considered in this case because:
 - i) the W/2 of Section 8 is an existing spacing and proration unit in the Basin-Fruitland Coal Gas Pool that is currently operated by Synergy pursuant to a compulsory pooling order; ii) Synergy, as operator of the W/2 of Section 8, opposes the proposal set forth by Mr. Smith; iii) due to the nature of Mr. Smith's proposal, it appears that Mr. Smith's application would require a hearing before the Division; iv) Mr. Smith's proposal, at the very least, would require the consent of all the interest

owners within the W/2 of Section 8; and v) Mr. Smith's proposal is beyond the scope of the matters to be considered in this case;

- (f) the proposal by Mr. Walmsley to require Synergy to place the production proceeds from the Duff 29-11-8 Well No. 105 attributable to the disputed interest in suspense until such time as the issue is resolved in District Court should not be approved because: i) Synergy is investing considerable money up-front to drill the Duff 29-11-8 Well No. 105; ii) approval of this proposal would preclude Synergy from recovering, through production, its drilling costs for an unknown and possibly lengthy period of time; and iii) if it is ultimately determined that Synergy does not own the disputed interest, all drilling costs and production proceeds can be balanced among the parties at that time based upon the interest ownership.

(20) Approval of Synergy's application is in the best interest of conservation and protection of correlative rights.

(21) Two or more separately owned tracts are embraced within the Units, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Units that are separately owned.

(22) Applicant is an owner of an oil and gas working interest within the Units. Applicant has the right to drill and proposes to drill its Duff 29-11-8 Well No. 105 at a standard gas well location within the SW/4 of Section 8 to test the Basin-Fruitland Coal Gas Pool.

(23) There are interest owners in the proposed Units that have not agreed to pool their interests.

(24) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Units the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Units.

(25) The applicant should be designated the operator of the subject well and of the Units.

(26) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well

costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the well.

(27) Reasonable charges for supervision (combined fixed rates) should be fixed at \$5,000.00 per month while drilling and \$500.00 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*."

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Synergy Operating, LLC, all uncommitted mineral interests from the surface to the base of the Fruitland Coal formation underlying the following-described acreage in Section 8, Township 29 North, Range 11 West, NMPM, San Juan County, New Mexico, are hereby pooled in the following manner:

the W/2 to form a standard 320-acre gas spacing and proration unit for all formations and/or pools spaced on 320 acres within this vertical extent, which presently include the Basin-Fruitland Coal Gas Pool; and

the SW/4 to form a standard 160-acre spacing and proration unit for all formations and/or pools spaced on 160 acres within this vertical extent.

(2) The above-described spacing and proration Units shall be dedicated to the applicant's Duff 29-11-8 Well No. 105 (API No. 30-045-33427) to be drilled at a standard gas well location 1885 feet from the South line and 1085 feet from the West line (Unit L) of Section 8.

(3) The operator of the Units shall commence drilling the proposed well on or before December 15, 2006, and shall thereafter continue drilling the well with due diligence to test the Fruitland Coal formation.

(4) In the event the operator does not commence drilling the proposed well on or before December 15, 2006, this order, which effectively authorizes subsequent operations within an existing 320-acre gas spacing and proration unit comprising the W/2 of Section 8 in the Basin-Fruitland Coal Gas Pool, shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) Should the subject well not be drilled and completed within 120 days after commencement thereof, this order shall be of no effect, and the Unit comprising the SW/4 of Section 8 created by this Order shall terminate unless the operator appears before the Division Director and obtains an extension of time to drill and complete the wells for good cause demonstrated by satisfactory evidence.

(6) Upon final plugging and abandonment of the Duff 29-11-8 Wells No. 104 and 105, the pooled Units created by this Order shall terminate, unless this order has been amended to authorize further operations.

(7) Synergy Operating, LLC is hereby designated the operator of the subject well and of the Units.

(8) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Units, including unleased mineral interests, who are not parties to an operating agreement governing the Units.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Units an itemized schedule of estimated costs of drilling, completing and equipping the subject wells ("well costs").

(9) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled 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 as hereinafter provided, 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. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(10) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed 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 deemed to be the reasonable well costs. 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.

(11) Within 60 days following determination of reasonable well costs, any pooled 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 the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(12) 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; and

- (b) as a charge for the risk involved in drilling the well, 200% of the above costs.

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

(14) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$5,000.00 per month while drilling and \$500.00 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is 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 pooled working interest owners.

(15) Except as provided in Ordering Paragraphs (12) and (14) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in San Juan 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.

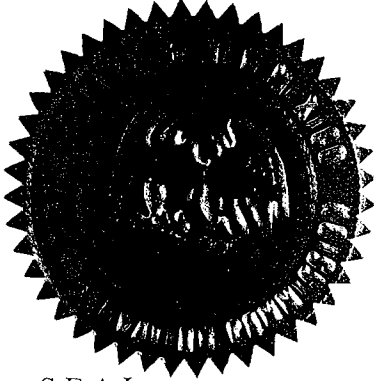
(16) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

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

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

(19) Jurisdiction of this case is 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.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in dark ink, appearing to read "Mark E. Fesmire", written over a horizontal line.

MARK E. FESMIRE, PE
Director