

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

APPLICATION OF GILLESPIE-CROW, INC.
FOR UNIT EXPANSION, STATUTORY
UNITIZATION, AND QUALIFICATION
OF THE EXPANDED UNIT AREA FOR
THE RECOVERED OIL TAX RATE AND
CERTIFICATION OF A POSITIVE
PRODUCTION RESPONSE PURSUANT
TO THE "NEW MEXICO ENHANCED
OIL RECOVERY ACT,"
LEA COUNTY, NEW MEXICO.

CASE NO. 11727
(DE NOVO)

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OIL CONSERVATION DIV.

APPLICATION OF HANLEY PETROLEUM INC.
AND YATES PETROLEUM CORPORATION
FOR UNIT EXPANSION, STATUTORY UNITIZATION,
AND QUALIFICATION OF THE EXPANDED UNIT
AREA FOR THE RECOVERED OIL TAX RATE AND
CERTIFICATION OF A POSITIVE PRODUCTION
RESPONSE PURSUANT TO THE NEW MEXICO
ENHANCED OIL RECOVERY ACT,
LEA COUNTY, NEW MEXICO.

CASE NO. 11954

APPLICATION OF EEX CORPORATION FOR
UNIT EXPANSION, STATUTORY UNITIZATION
AND QUALIFICATION FOR THE RECOVERED
OIL TAX RATE, LEA COUNTY, NEW MEXICO.

CASE NO. 11987

**MEMORANDUM OF
HANLEY PETROLEUM INC. AND YATES PETROLEUM CORPORATION
IN RESPONSE TO SNYDER RANCHES, INC. MOTION TO DISMISS,
AND IN SUPPORT OF THEIR APPLICATION FOR ALLOWABLE
REDUCTION AND MOTION FOR RECONSIDERATION OF STAY**

The current status of the development of the West Lovington Strawn Pool and the
fiasco that has resulted from the efforts of Gillespie-Crow, Inc. and EEX Corporation to form

and subsequently expand the West Lovington Strawn Unit ("the Unit"), create a situation which requires immediate action by the Oil Conservation Commission if it is to meet its statutory duty to protect correlative rights.

The current problem is the result of an initial unitization proposal which grossly underestimated the size of the West Lovington Strawn reservoir. This problem is compounded by efforts to expand the Unit which were based on limited reservoir data -- in large part due to the unwillingness of certain interest owners in the unit to share the data upon which depend the rights of all parties. The problem is further aggravated by a novel approach to unitization whereby the Unit is created under one set of parameters (inclusion of the entire reservoir as defined by development and the allocation of unit production based on a reservoir interpretation negotiated by the unit owners regardless of well locations) and expanded under a different set of parameters (only spacing units dedicated to certain commercial wells can be included). The result is the impairment of the correlative rights of interest owners in the expansion area because these owners are denied information on unit operations and not paid for their share of unit production.

To understand the issues presented by the Application for Allowable Reduction and the Motion for Reconsideration of Stay as well as the other questions surrounding the Unit, it is necessary to review the current status of this dispute.

The West Lovington Strawn Unit was originally intended to encompass the entire

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productive reservoir in the West Lovington-Strawn Pool. However, due to additional drilling in the area, it was known on October 1, 1995, the effective date of the Unit, that these boundaries did not encompass the entire reservoir. Although Yates Petroleum Corporation ("Yates") attempted in early 1996 to get the unit operator, Gillespie-Crow, Inc. ("Gillespie") to expand the unit to include the entire reservoir, Gillespie failed to timely respond.

In June 1996, a working interest meeting was called by Yates to consider unit expansion. Although the working interest owners voted on the question of unit expansion, Gillespie never announced the result of the ballot and, instead, sought the reduction of pool allowables to rates equal to the rate at which it decided to produce wells in the unit. *See Case 11599, October 3, 1996, Testimony of Boneau at pp. 111 through 115, Yates Exhibit No. 4.* No application for unit expansion was filed by Gillespie until January 24, 1997-- more than 15 months after it was known that the Unit boundaries were wrong.

Gillespie first sought unit expansion in January 1997, (Case 11724). Unlike the original unit which included acreage that contained hydrocarbon pore volume but no well, the proposed expansion only included the spacing units dedicated to two new wells offsetting the unit and excluded the spacing unit dedicated to the Gillespie Snyder "EC" Com Well No. 1 which also offsets the unit. Hanley Petroleum Inc. ("Hanley") and Yates Petroleum Corporation appeared at the Division hearing in opposition to the proposed expansion. The Gillespie application was granted and, following the denial of the motion of Hanley and

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Yates for a stay of the Division's order pending review by the Commission, the unit was expanded effective November 1, 1998. On that date, Gillespie assumed operations of the Chandler Well No. 1 which Hanley had drilled and was operating north of the original unit boundary in Section 28, Township 15 South, Range 35 East, NMPM.

Hanley and Yates have appealed this decision to the Commission and since that time have sought, by subpoena, the data utilized to establish the original unit boundaries and the allocation of production therein. Although the Commission has ruled that this seismic data must be produced, no data has been produced to Hanley and Yates, due first to the unreasonable terms of the Confidentiality Agreement proposed by EEX and now due to the EEX appeal of the Commission's ruling to the District Court of Lea County, New Mexico.

Without access to this seismic data, Hanley and Yates have made interpretations of this reservoir and have proposed expansions of the unit boundaries to include all acreage in the pool which contain hydrocarbon pore volume. The most recent of these applications has been docketed by the Division as Case 11954.

Two additional wells have recently been drilled outside the West Lovington Strawn Unit. North of the Unit, Hanley drilled its State 28 Well No. 2 located 2310 feet from the North line and 1650 feet from the West line of Section 28, Township 15 South, Range 35 East, NMPM. To the east of the Unit, Gillespie drilled the Snyder "C" Well No. 4 located 510 feet from the North line and 990 feet from the East line of Section 6, Township 16

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South, Range 36 East, NMPM.

Because of the drilling of the Gillespie Snyder "C" Well No. 4, EEX filed an application to expand the unit to include the spacing unit dedicated to this well (Case No. 11987). If this application is granted, the unit would be expanded to include a non-contiguous tract in this pressure maintenance project further impairing the correlative rights of other interest owners in the pool.

Due to this additional drilling, Snyder Ranches, a non-working interest owner in the original unit area, has filed a Motion to Dismiss both the Yates and Hanley application for unit expansion (Case 11954) and the EEX application for unit expansion (Case 11987).

I.

RESPONSE TO SNYDER RANCHES' MOTION TO DISMISS

In its Motion to Dismiss, Snyder Ranches observes that if either of the two additional wells which have recently been drilled in close proximity to the West Lovington Strawn Unit is in communication with the unit, the expansions proposed by Yates and Hanley and by EEX are now moot because they fail to include all acreage in the pool which contains Strawn hydrocarbon pore volume.

Snyder seeks an order from the Commission directing Yates and Hanley and/or EEX to do the following:

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1. determine if either or both of these new wells is in communication with this Strawn reservoir,
2. remap the Strawn hydrocarbon pore volume if either well is in communication with the unit, and,
3. based on this remapping, "propose an expansion area consisting of hydrocarbon pore volume acreage which is contiguous to the original unit regardless of whether that acreage includes a producing well."

The motion of Snyder Ranches correctly identifies the fundamental problems with the current efforts to expand the unit: no proposed expansion before the Commission includes all acreage which contains hydrocarbon pore volume and therefore is affected by unit operations. However, the relief sought by Snyder Ranches suffers from certain basic shortcomings. First, Snyder Ranches asks the Commission to direct Hanley and Yates, the parties who have been denied access to the seismic data on this reservoir, to remap the Unit. Second, Snyder Ranches' request does not require the sharing of seismic and other reservoir data. Until all data on this reservoir is shared, any interpretation of the reservoir limits will be inaccurate.

II.

THE COMMISSION MUST ACT NOW TO PROTECT CORRELATIVE RIGHTS

It is important to remember that "correlative rights" is defined by statute as "the **opportunity** afforded" to each owner in the pool to produce its fair share of the reserves in the pool. NMSA 1978, § 70-2-33(H)(1986). An owner can avail itself of this opportunity by drilling a well or by committing its interest to a unit plan. In this case, neither Hanley nor Yates committed their interest to the West Lovington Strawn Unit. Their interests have been committed by the State--by the Oil Conservation Division--under the Statutory Unitization Act.

Before these property interests were taken, the Division found that the Gillespie proposed expansion was "fair, reasonable and equitable" to Hanley and to Yates and that their correlative rights were protected. But now, because of additional drilling, we know these findings are incorrect. All parties now agree that there is additional acreage in this pool which should be included in the unit. Because of the need to include this acreage, there can be no dispute that there are additional working interest owners and royalty owners--including the State of New Mexico--who should share in unit production. Furthermore, we now know that every day the current unit is operated there are owners of interest who are not receiving their "fair, reasonable and equitable" allocation of unit production. These owners, like Yates and Hanley, are having their correlative rights impaired. We also know that until the Oil

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Conservation Commission acts -- as it is required by statute to act -- the impairment of correlative rights will continue. NMSA 1978, § 70-2-17 (B) (1973). The Commission may not ignore this situation any longer.

III.

APPLICATION FOR ALLOWABLE REDUCTION AND MOTION FOR RECONSIDERATION OF STAY OF DIVISION ORDER NO. R-10864

The property interests of Hanley and Yates which the Division and the Commission are directed by statute to protect have been confiscated and their correlative rights denied by manner in which the West Lovington Strawn Unit has been expanded. The events which have caused this loss of property rights are as follows:

1. By Order No. R-10864 the Division approved the expansion of the Unit to include two tracts in which Hanley and Yates own oil and gas interests.
2. Hanley and Yates sought a *de novo* review of this order and a stay of unit expansion pending the Commission hearing.
3. The request for stay was denied, the expanded unit became effective November 1, 1997, and, on that day, Gillespie assumed operations of the Hanley Chandler Well No. 1.
4. Since November 1, 1997, and in disregard of the requests for information and

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payment,¹ Gillespie has paid nothing to Hanley or Yates for the unit production attributed to their interests. Furthermore, although Hanley turned over operations of its Chandler Well No. 1 to Gillespie in November 1997, pursuant to Division Order No. R-10864, Gillespie has not paid Hanley for lease and well equipment on the Chandler lease, nor paid for the oil in the tanks on this tract on the date Gillespie assumed operations. Hanley and Yates have been denied the opportunity to produce their share of the reserves under their tracts, the Chandler well has been confiscated, and the correlative rights of Yates and Hanley have been and will continue to be impaired.

5. Hanley is the lessee under State of New Mexico Oil and Gas Lease No. VA-880 covering the 360-acres of land in Section 28, Township 15 South, Range 35 East, NMPM, Lea County, New Mexico. The primary term of this lease ran out on May 1, 1998. Because the geologic interpretation of every party to this dispute shows hydrocarbon pore volume under this tract, Hanley sought an extension of the primary term of this lease from the Commissioner of Public Lands. On August 20, 1998, the Commissioner advised Hanley that if the drilling operations on the State 28 Well No. 2 resulted in a producing well the lease

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On April 15, 1998, Hanley wrote Gillespie and requested written confirmation that royalty was being paid on the Chandler lease. It also requested that it be paid for its share of unit production, the lease and well equipment on the lease and the oil in the tanks at the time Gillespie assumed operations of the Chandler well. No response has been received to that letter. At a working interest meeting held in Midland, Texas on April 28, 1998 Gillespie was again asked about these payments. To date no response or payment has been received.

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would be held by production. It then read:

If, however, the well is not productive, then the lessee should conduct no further lease operations until the Oil Conservation Commission makes a decision on your hearing (Case No. 11724). If the Commission grants approval to the application and provides for a retroactive effective date before the cessation of drilling operations, then the lease has remained active and the term of the lease will continue as long as there is unit production. If the commission denies the application or grants the application with an effective date after the cessation of drilling activities, then the lease will have expired on the date the drilling operations ceased."

A copy of the Commissioner's letter is attached hereto as Exhibit "A."

6. In these consolidated cases, Hanley and Yates seek only the expansion of the Unit based on current reservoir data and adoption of a participation formula which will allocate production among the working interest owners in the Unit on a fair, reasonable and equitable basis. Once they have access to the data upon which this unit was formed, an appropriate decision can be made. However, the chief characteristic of the development of this unit, as well as this case, has been the refusal of Gillespie and EEX to produce the data upon which rest the rights of interest owners in the Unit.

7. The delays will continue. EEX now seeks District Court review of the Commission's decision to compel the production of the data necessary for expansion. Once this issue is addressed by the courts, substantial additional delays can be expected from Gillespie and EEX because each delay works to their benefit. They have been able to expand the unit to include the only well outside the original unit area which they did not operate that

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could impact unit operations. Non-unit acreage which can be drained is not included and does not share in unit production. Nothing is being paid to the owners of interest in the tracts covered by the initial unit expansion. The simple truth of this dispute is that until the Commission acts, Gillespie and EEX have won. Each day without Commission action is one more day when the correlative rights of Hanley and Yates and others are ignored and thereby denied.

This case is a fiasco because the operator and the other owners in the original unit failed to propose a proper boundary when the unit was formed. Since that time, there has been a piecemeal approach to unit expansion. Data which is essential to the determination of a proper unit boundary and the unit participation formula has not been shared with those whose interests are affected by unitization. Delay has become the name of the game -- the object of which is to keep the Division's examiner decision in place rather than permitting the Commission to decide on the appropriate unit expansion after a review of all the technical data.

In the late 1980's the interest owners in the North King Camp-Devonian Pool were at war with each other. The case they brought to the Commission was one that could not be resolved in a way where the correlative rights of the parties could be protected by a Commission order. More was needed from the operators in the pool, and they refused to cooperate with each other or with the Commission. The Commission determined that the

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pool should have been unitized, and reduced the pool allowables from 1,030 barrels to 235 barrels per day until "all interest owners in the pool reach a voluntary agreement to provide for unitized operation of the pool." Oil Conservation Division Order No. R-9035, November 2, 1989.

The interest owners in the North King Camp Devonian Pool were finally in agreement on something. They agreed that the Commission could not order the formation of a unit. But the Supreme Court in *Santa Fe Exploration Co. v. Oil Conservation Comm'n*, 114 N.M. 103, 835 P.2d 819 (1992) rejected their arguments noting that the Commission is given a broad grant of power to prevent waste and protect correlative rights which allow it "to require wells to be drilled, operated and produced in such a manner as to prevent injury to neighboring leases or properties." *See* NMSA 1978, Sec. 70-2-12 (B) (7). The Court also observed that "the Division and the Commission are 'empowered to make and enforce rules, regulations and orders, and do whatever may be necessary to carry out the purpose of this act, whether or not indicated or specified in any section hereof.'" *Santa Fe Exploration*, 114 N.M. at 113, 835 P.2d at 829.

In this case, like in *Santa Fe*, the parties have not done their job. Unless the interest owners in the unit area share their technical data and propose to the Commission a unit expansion based upon an honest interpretation of this data, the Commission will be unable to enter an order which protects the correlative rights of all interest owners in this pool.

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Without a sharing of data it will be impossible for the parties as well as the Commission to define the appropriate unit boundary and adopt an allocation formula which will allocate unit production to the owners thereof on a fair, reasonable and equitable basis. The Commission will be exactly where the Examiner who heard the original case found himself. It will be attempting to carry out its statutory duty to protect correlative rights without the data necessary to make an informed decision.

The Commission cannot sit by and let the parties' games continue. The Commission has a duty to protect the correlative rights of **each** owner in the pool. Especially, as here, where interest owners are asking the Commission to act and where these owner's correlative rights are in jeopardy only because the state--through the actions of the Division and Commission -- has given their property interests to another party.

CONCLUSION

Hanley and Yates request that the Commission stay the expansion of the West Lovington Strawn Unit approved by Order No. R-10864.

Hanley and Yates also request that the Commission grant the application which it has filed contemporaneously with this motion and enter an order which:

1. reduces the depth bracket allowable for wells in the West Lovington-Strawn Pool to a level, to be determined at the time of hearing, which will only permit operators of wells in the pool to avoid lease terminations for the failure of

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wells thereon to produce in paying quantities;

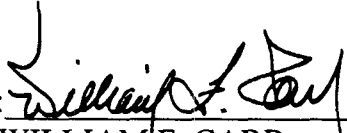
2. provides for termination of the reduced depth bracket allowable established by this order when the West Lovington Strawn Unit is expanded pursuant to a ratified statutory unitization order of the Oil Conservation Commission in Case 11724 (*de novo*) to include all lands which are affected by the pressure maintenance project being conducted in this pool; and
3. requires Gillespie to escrow all payments received for production from the Unit, less payments made for royalty and taxes thereon, from the date of the order resulting from this hearing until the unit has been expanded pursuant to a ratified statutory unitization order of the Oil Conservation Commission in Case 11724 (*de novo*) to include all lands which are affected by the pressure maintenance project being conducted in this pool.

The entry of a stay and the requested order will force the interest owners in this pool to quit playing games. It will result in a unitization application with a sufficient technical record behind it to enable the Commission to enter an order which will protect the correlative rights of all owners in the West Lovington-Strawn Pool thereby discharging its statutory duties under the Oil and Gas Act.

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Respectfully Submitted,

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

By: 
WILLIAM F. CARR
Post Office Box 2208
Santa Fe, New Mexico 87504-2208

ATTORNEYS FOR YATES
PETROLEUM CORPORATION AND
HANLEY PETROLEUM INC.

**MEMORANDUM OF HANLEY PETROLEUM, INC. AND YATES PETROLEUM CORPORATION
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Memorandum of Hanley Petroleum Inc. and Yates Petroleum Corporation in Response to Response to Snyder Ranches, Inc. Motion to Dismiss, and in Support of Their Application for Allowable Reduction and Motion for Reconsideration of Stay was hand-delivered this 8th day of October, 1998 to the following counsel of record:

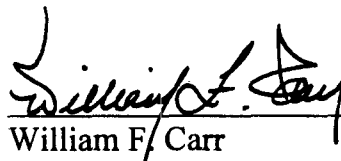
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William F. Carr

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State of New Mexico
Commissioner of Public Lands
Ray Powell, M.S., D.V.M.
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Santa Fe, New Mexico 87504-1148
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LEGAL
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(505)-827-5752

August 20, 1998

Campbell, Carr, Berge & Sheridan, P.A.
P. O. Box 2208
Santa Fe, New Mexico 87504-2208

Attention: Mr. William F. Carr

Re: Hanley Petroleum Inc.
Request for Lease Extension
New Mexico Oil and Gas Lease No. VA-880
Lea County, New Mexico

Dear Mr. Carr:

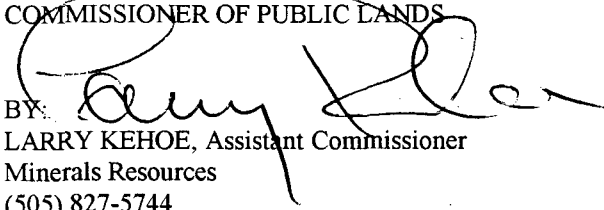
We are in receipt of your application of June 23, 1998 requesting an extension of State of New Mexico Oil and Gas Lease No. VA-880.

Please be advised that VA-880 will be considered active until the current drilling operations are concluded. Hanley is currently drilling the State 28 Well No. 2 located 2310 feet from the North line and 1650 feet from the West line (SE/4NW/4) of Section 28, Township 15 South, Range 35 East, NMPM to test the Strawn and Atoka formations. If the operations result in a producing well, the lease will be held by production. If, however, the well is not productive, then the lessee should conduct no further lease operations until the Oil Conservation Commission makes a decision on your hearing (Case No. 11724). If the Commission grants approval to the application and provides for a retroactive effective date before the cessation of drilling operations, then the lease has remained active and the term of the lease will continue as long as there is unit production. If the Commission denies the application or grants the application with an effective date after the cessation of drilling activities, then the lease will have expired on the date that the drilling operations ceased.

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 KEHOE, Assistant Commissioner
Minerals Resources
(505) 827-5744

RP/LK/pm

pc: Reader File,
Commissioner's File
Larry Kehoe
Gary Carlson

EXHIBIT A

"WE WORK FOR EDUCATION"

RECEIVED

AUG 24 1998

CAMPBELL, CARR, et. al