

**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. 11660
CASE NO. 11667
Order No. R-10742**

**APPLICATION OF SANTA FE ENERGY
RESOURCES INC. FOR COMPULSORY
POOLING, EDDY COUNTY, NEW MEXICO.**

**APPLICATION OF PENWELL ENERGY
INC. FOR COMPULSORY POOLING, EDDY
COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on November 21 and December 19, 1996, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 16th 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. 11660 and 11667 were consolidated at the time of the hearing for the purpose of testimony, and, inasmuch as the 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. 11660, Santa Fe Energy Resources, Inc. (Santa Fe), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the following described acreage in Section 29, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico, and in the following manner:

the E/2 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 Undesignated Frontier Hills-Strawn Gas Pool and the Undesignated South Carlsbad-Morrow Gas Pool; and,

the NE/4 forming a standard 160-acre spacing and proration unit for any and all formations and/or pools spaced on 160 acres within said vertical extent.

Said units are to be dedicated to the applicant's proposed Sheep Dip "29" Federal Com Well No. 1 to be drilled at a standard gas well location 1980 feet from the North line and 660 feet from the East line (Unit H) of Section 29.

(4) The applicant in Case No. 11667, Penwell Energy Inc. (Penwell), seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the following described acreage in Section 29, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico, and in the following manner:

the E/2 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 Undesignated Frontier Hills-Strawn Gas Pool and the Undesignated South Carlsbad-Morrow Gas Pool; and,

the SE/4 forming a standard 160-acre spacing and proration unit for any and all formations and/or pools spaced on 160 acres within said vertical extent.

Said units are to be dedicated to the applicant's proposed F. H. "29" Federal Com Well No. 1 to be drilled at a standard gas well location 1980 feet from the South line and 660 feet from the East line (Unit I) of Section 29.

(5) Both of the proposed wells are located within one mile of the South Carlsbad-Morrow Gas Pool and the Frontier Hills-Strawn Gas Pool. The South Carlsbad-Morrow Gas Pool is currently a prorated gas pool governed by the General Rules for the Prorated Gas Pools of New Mexico/Special Rules and Regulations for the South Carlsbad-Morrow Gas Pool as contained within Division Order No. R-8170, as amended, which require standard 320-acre gas spacing and proration units with wells to be located no closer than 1980 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. The Frontier Hills-Strawn Gas Pool is 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 well 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) By Order No. R-10328 dated March 27, 1995, the Oil Conservation Commission suspended gas proration in the South Carlsbad-Morrow Gas Pool until such time as production data or other information indicates the pool should again be prorated.

(7) Both Santa Fe and Penwell have the right to drill within the proposed spacing units and both seek to be named operator of its respective well and the subject proration units.

(8) Santa Fe and Penwell have conducted limited 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 E/2 of Section 29.

(9) According to evidence and testimony presented by both parties, the primary objective within subject wells is the Morrow formation. Although both companies propose to drill at a standard gas well location within the E/2 of Section 29, there is disagreement between the parties with regards to what is the optimum well location.

(10) Both companies proposed overhead rates of \$5828.00 while drilling and \$546.00 while producing, and both 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.

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

November, 1995--Penwell acquires an interest in Sections 28 and 29, Township 23 South, Range 26 East, NMPM;

Early 1996--Penwell seeks and obtains a farmout of Santa Fe's and J. M. Huber's interest in the N/2 of Section 28. In August, 1996, Penwell and its partners, Co-Energy Central Exploration Inc. (Co-Energy) and S & P Company, spud its F. H. "28" State Com Well No. 1, located in Unit C of Section 28, as a Morrow test. As of the date of the hearing, completion efforts are underway on this well;

By letter dated September 25, 1996, complete with operating agreement and AFE, Santa Fe formally proposes to Penwell and Co-Energy the drilling of its proposed Sheep Dip "29" Federal Com Well No. 1 at a location 1980 feet from the North line and 660 feet from the East line. The proposed spacing unit is the E/2 of Section 29.

On or about the time Santa Fe proposes drilling its well to Penwell and Co-Energy, it stakes a well location on Penwell's lease in Section 29;

By letter dated October 1, 1996, complete with operating agreement and AFE, Penwell formally proposes to Santa Fe the drilling of its F. H. "29" Federal Com Well No. 1 at a location 1980 feet from the South line and 660 feet from the East line. The proposed spacing unit is the E/2 of Section 29;

October 15, 1996--Penwell files a compulsory pooling application for its proposed F. H. "29" Federal Com Well No. 1. The hearing is set for November 7, 1996. The case is mistakenly dismissed at the November 7th hearing.

October 24, 1996--Santa Fe files a compulsory pooling application for its Sheep Dip "29" Federal Com Well No. 1. The hearing is set for November 21, 1996.

During this time period, Penwell formally proposes to Santa Fe the drilling of its F. H. State "28" Com Well No. 2 in Unit K of Section 28. Santa Fe elects to participate in the drilling of this well and on November 7, 1996, Santa Fe returns a signed AFE to Penwell;

November 12, 1996--Penwell re-files a compulsory pooling application for its proposed F. H. "29" Federal Com Well No. 1. The hearing is set for December 5, 1996;

November 21, 1996--Consolidated hearing for Case Nos. 11660 and 11667 takes place.

(12) Land testimony presented by both parties in these cases, which is generally in agreement, indicates that the interest ownership within the proposed spacing units is as follows:

Co-Energy Central Exploration Inc.	36.125%
Penwell Energy Inc.	8.250%
S & P Company	5.625%
Santa Fe Energy Resources, Inc.	50.000%

(13) Both Co-Energy and S & P Company have signed Penwell's AFE and operating agreement for the drilling of the F. H. "29" Federal Com Well No. 1.

(14) Both Santa Fe and Penwell effectively control 50 percent of the proposed spacing units.

(15) Both Santa Fe and Penwell presented as evidence AFE's for the drilling of their respective wells within the subject spacing unit. The well costs are summarized as follows:

<u>Company</u>	<u>Completed Well Costs</u>	<u>Dry Hole Costs</u>
Penwell	\$791,071	\$634,000
Santa Fe	\$942,000	\$628,000

(16) Santa Fe presented evidence which shows that during 1996, it participated in the drilling of two Morrow gas wells drilled by Penwell. This evidence further shows that in these two instances, Penwell under-estimated its well costs by approximately 40 and 75 percent.

(17) Proposed well costs should not be a factor in deciding these cases.

(18) Both Santa Fe and Penwell presented their respective geologic interpretations of the Strawn and Morrow formations within this area.

(19) Santa Fe's geologic interpretation indicates that:

- a) a well drilled at its proposed location should encounter a greater amount of gross limestone within the Strawn formation than a well drilled at Penwell's proposed location;

- b) a well drilled at its proposed location should encounter ten feet or more of Lower Morrow "A" sand, while a well drilled at Penwell's proposed location should encounter zero feet of Lower Morrow "A" sand; and,
 - c) Penwell's F. H. "28" State Com Well No. 2, currently being drilled in the S/2 of Section 28, should encounter a minimal amount of gross limestone in the Strawn formation and zero feet of Lower Morrow "A" sand.
- (20) Penwell's geologic interpretation indicates that:
- a) a well drilled at its proposed location should encounter a greater amount of Strawn carbonate than a well drilled at Santa Fe's proposed location; and,
 - b) a well drilled at its proposed location should encounter ten feet of the Lower Morrow sand interval, while a well drilled at Santa Fe's proposed location should encounter approximately 3-4 feet of sand in this interval.
- (21) The evidence and testimony presented by both parties in these cases indicates that:
- a) Penwell initially developed the prospect in the N/2 of Section 28 by first proposing to drill the F. H. "28" State Com Well No. 1;
 - b) in lieu of participating in the drilling of the aforesaid well, Santa Fe sought to minimize its risk by farming out its interest to Penwell in the N/2 of Section 28;
 - c) Penwell has recently completed drilling its F. H. "28" State Com Well No. 1. The well was production tested in the Morrow formation at a rate of approximately 2.0 MMCFGD and was DST'd in the Strawn formation at a rate of approximately 7.0 MMCFGD;
 - d) Penwell is currently drilling its F. H. "28" State Com Well No. 2 in Unit K of Section 28;

- e) Santa Fe, an interest owner in the aforesaid F. H. "28" State Com Well No. 2, has elected to voluntarily participate in the drilling of this well even though its geologic interpretation shows that a well at this location has little or no chance of being productive in the Strawn and Morrow intervals; and,
- f) Penwell's geologic interpretation of the Strawn formation appears to be more accurate than Santa Fe's when initial reservoir pressure data is integrated into the interpretation.

(22) In the absence of other compelling factors, the operatorship of the E/2 of Section 29 should be awarded to the operator who initially developed the prospect, who initially undertook the risk involved in the drilling of the F. H. "28" State Com Well No. 1, and whose geologic interpretation appears to more accurately depict the Strawn reservoir underlying the subject acreage.

(23) Penwell should be designated operator of its proposed well and the proposed spacing units.

(24) The application of Santa Fe Energy Resources, Inc. in Case No. 11660 should be denied.

(25) 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 units 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 Penwell Energy Inc. in Case No. 11667 should be approved by pooling all mineral interests, whatever they may be, within the E/2 and SE/4 of Section 29.

(26) 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.

(27) 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.

(28) 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.

(29) 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.

(30) \$5828.00 per month while drilling and \$546.00 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.

(31) 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.

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

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

(34) The operator of the well and units 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 Santa Fe Energy Resources, Inc. in Case No. 11660 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 and NE/4 of Section 29, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico, said units to be dedicated to the applicant's proposed Sheep Dip "29" Federal Com Well No. 1 to be drilled at a standard gas well location 1980 feet from the North line and 660 feet from the East line (Unit H) of Section 29, is hereby denied.

(2) The application of Penwell Energy Inc. in Case No. 11667 for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the following described acreage in Section 29, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico, and in the following manner, is hereby approved:

the E/2 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 Undesignated Frontier Hills-Strawn Gas Pool and the Undesignated South Carlsbad-Morrow Gas Pool;

the SE/4 forming a standard 160-acre spacing and proration unit for any and all formations and/or pools spaced on 160 acres within said vertical extent.

Said units shall be dedicated to the applicant's proposed F. H. "29" Federal Com Well No. 1 to be drilled at a standard gas well location 1980 feet from the South line and 660 feet from the East line (Unit I) of Section 29.

PROVIDED HOWEVER THAT, the operator of said units 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) Penwell Energy Inc. is hereby designated the operator of the subject well and units.

(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 units 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) \$5828.00 per month while drilling and \$546.00 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.

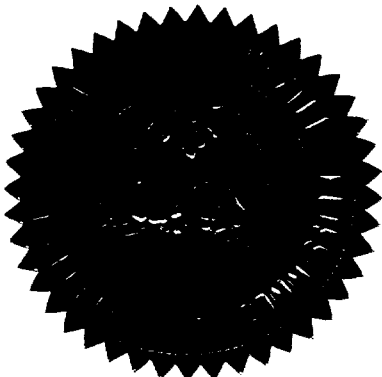
(12) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Eddy County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; the operator shall notify the Division of the name and address of said 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, this order shall thereafter be of no further effect.

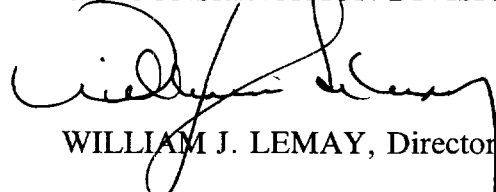
(14) The operator of the well and units shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(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