

**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

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

CASE NO. 11677

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

ORDER NO. R-__

**YATES PETROLEUM CORPORATION'S
PROPOSED
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 _____ day of January, 1997, The Division Director, having considered the testimony, the recorded 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, the parties hereto and the subject matter thereof.

(2) The applicant in Case 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, T20S, R28E, forming a standard 320-acre gas spacing unit for any and all formations and/or pools spaced on 320-acre gas spacing including but not limited to the Burton Flat-Morrow Gas Pool, to be dedicated to its 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 said Section, Eddy County, New Mexico.

(3) The applicant in Case 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, T20S, R28E, forming a standard 320-acre gas spacing unit for any and all formations/pools spaced on 320-acres, including but not limited to the Burton Flat-Morrow Gas Pool, to be dedicated to its 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 said Section, Eddy County, New Mexico.

(4) Each applicant (InterCoast and Yates) has the right to drill and each proposes to drill a well in this spacing unit, as described above in Findings (2) and (3), to a depth sufficient to test the Morrow formation.

(5) Cases Nos. 11666 and 11677 were consolidated for the purpose of hearing and should be consolidated for purpose of issuing an order since the granting of one application would require the denial of the other because these cases involve a dispute over operatorship and development of the same 320-acre spacing unit.

(6) Because of the dispute over who should operate the well, InterCoast and Yates have been unable to agree on a voluntary basis for the pooling of their respective interests in either the proposed well or spacing unit.

(7) Section 20 is divided such that the W/2, the SE/4 and 5% of the NE/4 is subject to a Unit Agreement operated by Yates and the balance of NE/4 is subject to a lease held by Kerr-McGee.

(8) As of the date of the hearing, Yates controlled approximately 52.465 % of the working interest ownership within the spacing unit:

Yates Group: 37 %	
Yates Petroleum Corporation	19.635 %
Yates Drilling Company	7.742 %
Abo Petroleum Corp.	2.581 %
Myco Industries, Inc.	7.742 %
Stonewall Unit Owners:	14.765 %

(9) As of the date of the hearing, InterCoast controlled only 24.101 % of the working interest ownership within the spacing unit as a result of a farmout from Kerr-McGee Corporation, less a 23.416 % interest controlled by Diamond Head Properties.

(10) As of the date of the hearing:

- (a) sixteen other working interests owners with a total of 4.03 % had approved Yates as operator;
- (b) no other working interest owner had approved of InterCoast as the operator.

Efforts to obtain voluntary agreement and willingness to negotiate a voluntary agreement:

(11) Yates desires to be designated operator of a spacing unit consisting of the E/2 of said Section 20 for the drilling and operating of a well to be drilled 990 feet from the north and east lines of said Section 20.

(12) InterCoast Oil & Gas Company ("InterCoast") has obtained a farmout from Kerr-McGee Corporation and also seeks to be designated operator of this spacing unit.

(13) InterCoast's farmout from Kerr-McGee has been extended to February 17, 1997, and provides that InterCoast "earns" its interest so long as a well is commenced on or before February 17, 1997 by either Yates or InterCoast.

(14) This dispute originally involved N/2 of Section 20, T20S, R28E, Eddy County, New Mexico, containing two separate State leases divided between the NE/4 and the NW/4 of the section.

(15) On September 3, 1996, Yates received a letter from InterCoast dated August 30, 1996 which is referenced a "**Farmout Request**" and in which InterCoast requested Yates to farmout its interest in the NE/4 of said Section 20, **but failed** to submit an AFE, failed to designate a spacing unit and failed to request Yates to join in the well.

(16) InterCoast did not indicate to Yates that there was any urgency to this matter nor did InterCoast request a reply to the farmout request by any specific date.

(17) InterCoast failed to put Yates on notice that InterCoast would institute compulsory pooling action against Yates in the absence of Yates' acquiescence to InterCoast's request.

(18) On September 17, 1996, InterCoast advised that it would provide Yates with a proposed Authority for Expenditure ("AFE") and Joint Operating Agreement.

(19) Instead, on September 24, 1996, InterCoast filed its compulsory pooling application for the N/2 of said Section 20 (NMOCD Case 11634) with the Division without first providing Yates with a written well proposal or an AFE.

(20) On October 9, 1996, more than 14 days after InterCoast filed its compulsory pooling application, Yates received InterCoast's first written proposal for a N/2 spacing unit which included a AFE for the well.

(21) InterCoast refuses to allow Yates to operate the well in the E/2 of Section 20 despite the fact that this spacing unit (in which Yates is the largest owner) is in the Stonewall Unit which Yates has drilled and operated 21 wells since 1973.

(22) On November 12, 1996, InterCoast filed its compulsory pooling application seeking to operate the E/2 of Section 20 (NMOCD Case 11666).

(23) On November 18, 1996, Yates received InterCoast's well proposal for the E/2 of Section 20.

(24) Yates has continued to attempt to obtain InterCoast's agreement that Yates should operate this well and this spacing unit but InterCoast has refused to discuss this matter further.

(25) On November 22, 1996, Yates sent its AFE and well proposal to InterCoast.

(26) By its conduct, InterCoast has rejected Yates' proposal, has refused to discuss this matter with Yates, and has refused to consider Yates' effort to voluntarily form a spacing unit for this well to be operated by Yates.

(27) On November 26, 1996, in order to provide the Division with an opportunity to grant Yates' request to be operator, Yates filed a competing compulsory pooling case which is docketed as Case 11677

DIVISION FINDINGS

(28) The Division FINDS THAT IT should decide this case based upon its statutory obligation to prevent waste and protect correlative rights utilizing the following criteria and analysis:

(a) Efforts to obtain voluntary agreement and willingness to negotiate a voluntary agreement:

(i) On September 24, 1996, InterCoast filed its compulsory pooling for the N/2 of Section 20 some 15 days **before** Yates received InterCoast's AFE and well proposal letter on October 9, 1996. (NMOCD Case 11634).

(ii) On November 12, 1996, InterCoast filed its compulsory pooling application seeking to operate the E/2 of Section 20 some 6 days **before** Yates received InterCoast's AFE and well proposal letter on November 18, 1996. (NMOCD Case 11666).

(iii) The Division finds that this case cannot be decided based upon which applicant first developed this prospect then proposed its well and then filed a pooling application because in this case InterCoast filed compulsory pooling application **prior** to formally proposal the well(including AFE) to Yates.

(iv) the activities initiated by **InterCoast** amount to "bad faith" contrary to the Division's policy and practice that compulsory pooling be used as a last resort only after the applicant has engaged in good faith negotiations rather than as "negotiating weapon" to be used against other working interest owners.

(b) Party Controlling Majority Interest:

(i) The Division has established the precedent of awarding operations to the applicant who has control of the largest percentage of working interest ownership when there is not substantial difference in geologic issues or well costs.

See: Order R-10626 (Findings 6 and 9)

(ii) Even in cases where there are geologic disputes and differences in AFEs, the percentage controlled is a significant factor in deciding these disputes:

See: Order R-10358 (Findings 13 and 27)

See: Order R-10520 (Findings 13 and 15)

See: Order R-10434 (Findings 10, 27 and 28)

(iii) The Yates Group (Yates Petroleum Corporation, Yates Drilling Company, Abo Drilling Corp. and Myco Industries, Inc. and Nearburg, in cases where there is no geologic dispute, are now settling the issue of operations based upon the operator who has consolidated and controlled the largest working interest in the spacing unit.

(iii) In summary, Yates should be awarded operations because it controls 55 % of the working interest and has the support of 16 different working interest owners while InterCoast controls only 24 % has been unable to obtain the approval of any working interest owner.

c) Geologic Evidence-Well Location:

(i) Both Yates and InterCoast are in agreement as to the proposed well locations and both have relied upon similar geologic evidence and evaluations.

(ii) The Division finds that this case cannot be decided based upon geologic evidence.

(d) Estimated Well Costs ("AFE"):

(i) InterCoast failed submit an analysis of its AFE, failed to present a petroleum engineer to compare the type of well it proposed to drill with that proposed by Yates.

(ii) Yates presented its petroleum engineer who prepared a comparison between the InterCoast AFE and Yates' AFE which demonstrated that:

InterCoast's AFE failed to provide adequate estimates of casing, logging, cementing, and drilling costs,

that when proper adjustments were made, the AFE's are within \$23,000 of each others estimate, and

the InterCoast AFE was a total of \$755,725; that the Yates' AFE was \$861,500 **but** that the \$105,775 difference when appropriate adjustments of \$82,650 were made, then the Yates' AFE was only \$23,000 more than the InterCoast AFE;

(iii) The Division finds that it is concerned that he InterCoast AFE has failed to properly account for the costs of drilling and completing this well

(iv) The Division finds that Yates should be awarded operations because it's AFE is more realistic, because Yates operates some 20 wells in this immediate area while Intercoast has no operations and no experience in this area.

(e) Issues Irrelevant in the Subject Case:

The Division finds that while in certain cases these topics may have some relevance, they are not of significance in deciding this case: risk factor penalty or overhead rates.

(f) Unorthodox well location:

Both Yates and InterCoast have agreed with OXY USA Inc. (the offset operator in Section 16 and 17) that in exchange for OXY waving any objection to the unorthodox well location, they will provide to OXY USA Inc. all well data from the subject well and will waive any objection to a similar unorthodox location for OXY in Sections 16 and 17 not closer than 990 feet to the common section line or corner.

(29) Based upon the forgoing, Yates' application should be approved and Yates Petroleum Corporation should be designated as operator. Overhead charges for supervision should be set at \$5,400.00 while drilling and \$540.00 while producing.

(30) Since risk of an unsuccessful completion at this location is very high, the risk penalty should be set at 200%.

(31) Approval as set out in the above findings and in the following order will avoid the drilling unnecessary wells, protect correlative rights, prevent waste and afford 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 resulting from this order.

IT IS THEREFORE ORDERED THAT:

(1) The application of InterCoast in Case No. 11666 as described in this order is hereby DENIED.

(2) The application of Yates in Case 11677 as described in this order is hereby GRANTED.

(3) All mineral interests, whatever they may be, from the surface to the base of the Morrow formation including but not limited to Burton Flat-Morrow Gas Pool underlying the E/2 of Section 20, Township 20 South, Range 28 East, NMPM, Eddy County, New Mexico, are hereby pooled to form a standard 320-acre gas spacing and proration unit to be dedicated to a well to be drilled at an unorthodox well location 990 feet from the North line and 990 feet from the East line (Unit A) of said Section 20.

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

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the ___th day of _____, 1997, Decretory Paragraph No. (3) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER THAT, should said well not be drilled to completion, or abandonment, within 180 days after commencement thereof, said operator shall appear before the Division Director and show cause why Decretory Paragraph No. (3) of this order should not be rescinded.

(4) Yates Petroleum Corporation is hereby designated the operator of the subject well and unit.

(5) After the effective date of this order and 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.

(6) 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.

(7) 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 cost 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 an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

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

(9) 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 of schedule of estimated well costs is furnished to him; and
- 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 costs is furnished to him.

(10) \$5,400.00 per month while drilling and \$540.00 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.

(11) 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.

(12) 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.

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

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

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

(16) Jurisdiction of this cause 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY,
Director