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June 25, 2001

HAND DELIVERED

Mr. Michael Stogner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

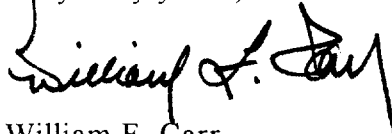
Re: Case 12622: Application of Nearburg Exploration Company, L.L.C. for Two
Non-standard gas spacing and proration units, Lea County, New Mexico.

Dear Mr. Stogner:

Enclosed please find a draft of a proposed order in the referenced case for your use. I
have also enclosed a diskette of the draft order.

Thank you for your assistance in this matter.

Very truly yours,



William F. Carr
Attorney for Nearburg Exploration
Company, L.L.C.

WFC/keh
Enclosures

cc: Bob Shelton
Bryan Birkeland

6-25-01 7:11 AM
M. Stogner

**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:**

**APPLICATION OF NEARBURG EXPLORATION
COMPANY, L.L.C. FOR TWO NON-STANDARD
GAS SPACING AND PRORATION UNITS,
LEA COUNTY, NEW MEXICO.**

**CASE NO. 12622
ORDER NO. R-_____**

**PROPOSED ORDER OF THE DIVISION OF
NEARBURG EXPLORATION COMPANY, L.L.C.**

BY THE DIVISION:

These cases came on for hearing at 8:15 o'clock a. m. on June 28, 2001, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this ____ day of August, 2001, the Division Director, having considered the testimony, the record, and the recommendation 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 these causes and the subject matters thereof.

(2) Nearburg Exploration Company, L.L.C. ("Nearburg") seeks an exception to the spacing provisions of Division Rule 104.C(2) to create two non-standard 160-acre gas spacing and proration units within the East Grama Ridge-Morrow Gas Pool comprising: (i) the NE/4 of Section 34, Township 21 South, Range 34 East, to be dedicated to the Nearburg Producing Company's existing Grama Ridge East "34" State Well No. 1 (**API No. 30-025-34948**), located at a standard gas well location 1548 feet from the North line and 990 feet from the East line (Unit H) of Section 34; and (ii) the SE/4 of Section 34 to be dedicated to the EOG Resources, Inc. operated Llano "34" State Well No. 1 (**API No. 30-025-26318**), located at a standard gas well location 1650 feet from the South line and 660 feet from the East line (Unit I) of Section 34.

(3) Redrock Operating Ltd., Co. ("Redrock"), an overriding royalty interest owner in the SE/4 of Section 34 appeared at the hearing in opposition to the application. Raptor Natural Pipeline LLC, and EOG Resources, Inc. operators of wells in Section 34 and Wayne Newkumet, James D. Brown, Brent D. Hilliard, Wendel R. Creech and David Alderks, overriding royalty interest owners in the N/2 of Section 34 also appeared through legal counsel but did oppose the application.

STATUS OF INTERESTS IN SECTION 34

(4) Pursuant to current Oil Conservation Division rules and orders, the Morrow formation under Section 34 is divided into two Morrow gas pools. The E/2 of the section is defined as being in the East Grama Ridge Morrow Gas Pool and the W/2 of the section is in the Grama Ridge Morrow Gas Pool. Although the section is divided into two Morrow Gas Pools, The Grama Ridge Morrow Gas Storage Unit, which was unitized for the purposes of injection, storage and withdrawal of gas, currently crosses the pool boundaries. The vertical limits of this unit include the portion of the Morrow formation sands encountered between log depths of 12,722 feet and 13,208 feet on the Shell Oil Company State GRA Well No. 1 (API No. 30-025-21336).

(5) Nearburg and its partners own the working interest under the N/2 of Section 34 on which the Nearburg Grama Ridge East "34" Well No. 1 ("the Nearburg well") is located at a point 1548 feet from the North line and 990 feet from the East line of the section. Although the Nearburg well is completed in and producing from the Morrow formation, it is not in communication with the Grama Ridge Morrow Gas Storage Unit.

(6) EOG is the current lessee of the SE/4 of Section 34 on which the EOG Llano "34" State Well No. 1 ("the Llano well") is located at a point 1650 feet from the South line and 660 feet from the East line of the section. This well last produced in 1991. The E/2 of Section 34 was communitized for the Llano well on October 19, 1979. The well last produced in 1991 and the Communitization Agreement for the well was terminated by the New Mexico State Land Office effective March 31, 1991 (Nearburg Exhibit No. 5).

(7) Redrock acquired the working interest in the SE/4 of Section 34 by assignment on March 1, 1998 (Nearburg Exhibit No. 3) and assigned this interest away on May 27, 1999 reserving to itself a 10% overriding royalty interest in this acreage (Nearburg Exhibit No. 4). Accordingly, Redrock did not share in any production proceeds from the Llano Well.

(8) Section 35 is comprised of State of New Mexico lands. The State owns a 1/8th base royalty interest in the SE/4 of the section and a 1/6th base royalty in the NE/4 of the section.

FINDING: Redrock owns a 10% overriding royalty interest in the SE/4 of Section 34 which it acquired in 1999, almost eight years after the well last produced from this acreage and the communitization agreement covering this acreage had been terminated.

FINDING: No interest owner who shared in the production from the Llano well currently owns an interest in this Section or previously shared in production from the Llano well.

BACKGROUND

(9) The evidence presented by Nearburg established:

- A. State of New Mexico Oil and Gas Lease No. K-03592 covering the N/2 of Section 34 was cancelled by the State of New Mexico in January 1999 for non-payment of rental. (Nearburg Exhibit No. 2, Tab 1)
- B. A new Oil and Gas Lease covering the N/2 of Section 34 was offered by the New Mexico State Land Office at the December 1999 State of New Mexico Oil and Gas Lease Sale. The State Land Office request for bids contained no stipulations or reservations concerning the existence of a gas storage project in portions of the Morrow formation under Section 34. (Nearburg Exhibit No. 2, Tab 2)
- C. Great Western Drilling was the successful bidder and received a new Oil and Gas Lease covering the N/2 of Section 34. The lease was effective January 1, 2000. (Nearburg Exhibit No. 2, Tab 2)
- D. Nearburg acquired 75% of the interest of Great Western Drilling in the N/2 of Section 34 and on February 28, 2000 the Oil Conservation Division approved Nearburg's Application for Permit to Drill the Grama Ridge East "34" State Well No. 1 at a standard gas well location on a spacing unit comprised of the N/2 of Section 34. (Nearburg Exhibit No. 2, Tab 3)
- E. The Grama Ridge East Well No. "34" was drilled in March 2000 and completed as a Morrow gas well on June 9, 2000. On June 19, 2000 the Division approved Nearburg's Request for Allowable and Authorization to Transport and on June 22, 2000 approved a test allowable for the well. (Nearburg Exhibit No. 2, Tab 5)

- F. In July 2000, Nearburg was notified by the Division's District Office in Hobbs, New Mexico that the previously approved N/2 spacing unit included acreage which is in two Morrow Gas Pools. The NE/4 of Section 34 is in the East Grama Ridge-Morrow Gas Pool and the NW/4 of the Section is in the Grama Ridge-Morrow Gas Pool. (Testimony of Shelton at 19)
- G. Nearburg proposed the creation of two non-standard spacing units in the E/2 of Section 34 to other interest owners in this acreage. Following negotiations with these owners in which it reviewed its technical data, Nearburg was able to obtain waivers from EOG Resources, Inc. the operator of the SE/4 of Section 34 (Nearburg Exhibit 2, Tab 10), the Commissioner of Public Lands owner of the royalty under this acreage (Nearburg Exhibit No. 2, Tab 13) and the overriding royalty owners in the NE/4 of the Section (Testimony of Shelton at 24-25). No other owner of an interest in this acreage except Redrock opposes the creation of these units.
- H. Nearburg filed an administrative application seeking approval of two 160-acre non-standard units in the E/2 of Section 34 on December 13, 2000. Because of Redrock's objection to this application and it was set for hearing before a Division Examiner. (Nearburg Exhibit 2, Tab 16)

GEOLOGICAL EVIDENCE

(10) Nearburg presented geological evidence which established:

- A. The Morrow formation in this area consists of the following three pay packages:
 - 1. The Morrow "A" Package. The lower Morrow "A" sand, which is above the storage interval in the Grama Ridge Morrow Gas Storage Unit, is potentially productive in the Nearburg Grama Ridge East "34" State Well No. 1 (Nearburg Exhibit No. 6, Testimony of Gawloski at 71).
 - 2. The Morrow "B" Package. The Morrow "B" Package is comprised of a number of separate sands. The lower Morrow "B" GRE sand is the interval which is producing zone in the Nearburg Well. This zone is not productive in any other well in the Grama Ridge area. The remainder of the Morrow "B" interval calculates wet in the Nearburg Well. (Nearburg Exhibit No. 6, Testimony of Gawloski at 68-69).

3. The Morrow "C" Package. The Morrow "C" Package is not a target in the Grama Ridge Area (Testimony of Gawloski at 68).

B. The GRE sand, the producing sand in the Nearburg Well 1, is present in the N/2 of Section 34 and is not present in the S/2 of this section (Nearburg Exhibit No. 7 Testimony of Gawloski at 74-75).

C. the Lower Morrow "A" Sand is a zone of limited areal extent which is potentially productive in the Nearburg Well 1. This sand is not present in the S/2 of Section 34 (Nearburg Exhibit 8, Testimony of Gawloski at 75).

D. No acreage in the S/2 of Section 34 contributes reserves to the Nearburg Well. (Testimony of Gawloski at 77).

(11) Redrock presented no geologic evidence.

FINDING: The SE/4 of Section 34 in which Redrock owns its overriding royalty interest contains no recoverable Morrow reserves which can be produced by the Nearburg Well located in the NE/4 of the section.

FINDING: The dedication of the SE/4 of Section 35 to the Nearburg Well would result in the recoverable reserves produced from the NE/4 of the section being shared with the owners of lands which will not contribute to the well thereby reducing the working, royalty and overriding royalty payments to the owners of these reserves.

ENGINEERING EVIDENCE

(12) Nearburg presented engineering evidence which showed that the reservoir is probably smaller than shown by Nearburg's geological evidence (Testimony of Friesen at 107); that the Nearburg Well will only drain approximately 140 acres (Testimony of Friesen at 105); and that no reserves are being contributed to the well from the SE/4 of Section 34.

(13) Redrock presented no engineering evidence.

FINDING: The SE/4 of Section 34 does not contribute reserves to the Nearburg Well.

FINDING: The Nearburg Well will not drain reserves from the SE/4 of Section 34.

(14) Redrock does not disputing the evidence which establishes that the SE/4 of Section 34 will not contribute reserves to the Nearburg Well, however, it contends that the SE/4 of this section should share today in production from the NE/4 of the

section because ten years ago production from the Llano Well was shared by the prior owners of the E/2 of the section. (See, Transcript at 116-117)

(15) It is the duty of the Oil Conservation Division to protect the correlative rights of the owner of each property in a pool. (NMSA 1978, §§ 70-2-11, 70-2-33)

(16) "Correlative Rights" is defined by the Oil and Gas Act as follows:

"correlative rights" means the opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas or both in the pool, being an amount, so far as can be practicably determined and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool and, for such purpose, to use his just and equitable share of the reservoir energy;" NMSA 1978, §. 70-2-33

(17) The Division is required by statute to afford Nearburg the opportunity to produce its share of the recoverable reserves under the NE/4 of Section 34.

(18) To require that half of the reserves under the NE/4 of Section 34 be shared with the owners of the SE/4 of Section 34 when the evidence presented establishes that there are not recoverable reserves under the SE/4 of Section 34 violates the correlatives rights of the working, royalty and overriding royalty interest owners of the oil and gas under the NE/4 of the section and would constitute the confiscation of the property rights of Nearburg in the NE/4 of Section 34.

FINDING: Sharing production from the NE/4 of Section 34 with the owners of acreage in the SE/4 of the section which will not contribute reserves to the Nearburg well only because past production from these lands from another Morrow interval was shared by the prior owners of this acreage impairs the correlative rights of Nearburg for it would deny the Nearburg the opportunity to produce the its just and equitable share of the recoverable reserves under its lands.

FINDING: Approval of the application of Nearburg and the creation of a 160-acre non-standard gas spacing unit comprised of the NE/4 of Section 34 will afford to Nearburg the opportunity to produce its just and equitable share of the recoverable reserves under its property thereby protecting its correlative rights.

FINDING: There are no recoverable reserves under the SE/4 of Section 34 which can be produced by the Nearburg Well and the creation of a 160-acre non-standard gas spacing unit will not impair the correlative rights of the

owners of that acreage for they will be afforded the opportunity to produce their fair share of the reserves, if any, under their lands.

- (19) Redrock objects to the creation of two non-standard 160-acre units in the E/2 of Section 34 because it contends a bad precedent would be set whereby other operators might also seek the creation of non-standard units. (See, Transcript at 17)

(20) Non-standard units have been approved by the Division when evidence in support of the unit establishes, as here, that a non-standard unit is necessary to protect the correlative rights of the owners of oil and gas interests in a property.

(21) Approval of the application of Nearburg for the creation of two 160-acre gas spacing and proration units in the E/2 of Section 34, Township 21 South, Range 34 East, NMPM will not cause waste, will protect the correlative rights of all interest owners in the E/2 of Section 34, Township 21 South, Range 34 East, is otherwise in the best interest of conservation and should be granted.

IT IS THEREFORE ORDERED THAT:

(1) The application of Nearburg Exploration Company, L.L.C. for an exception to the spacing provisions of Division Rule 104.C(2) to create two non-standard 160-acre gas spacing and proration units within the East Grama Ridge-Morrow Gas Pool Comprising : (i) the NE/4 of Section 34, Township 21 South, Range 34 East, to be dedicated to the Nearburg Producing Company's existing Grama Ridge East "34" State Well No. 1 (API No. 30-025-34948), located at a standard gas well location 1548 feet from the North line and 990 feet from the East line (Unit H) of Section 34; and (ii) the SE/4 of Section 34 to be dedicated to the EOG Resources, Inc. operated Llano "34" State Well No. 1 (API No. 30-025-26318), located at a standard gas well location 1650 feet from the South line and 660 feet from the East line (Unit I) of Section 34. is hereby granted.

(2) 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

LORI WROTENBERY
Director

S E A L