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. 12922

APPLICATION OF DAVID H. ARRINGTON OIL AND GAS, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

CASE NO. 12943

APPLICATION OF GREAT WESTERN DRILLING FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER NO. R-11869

ORDER OF THE DIVISION

BY THE DIVISION:

Case No. 12922 came on for hearing at 8:15 a.m. on September 5, 2002 before Examiner David K. Brooks. The case was continued and subsequently consolidated for hearing with Case No. 12943. The consolidated cases came on for hearing on October 10, 2002, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 6th day of December, 2002, 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 these cases and of the subject matter.

(2) In Case No. 12922, David H. Arrington Oil and Gas, Inc., ("Arrington"), seeks an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 34, Township 15 South, Range 34 East, N.M.P.M., Lea County, New Mexico, as follows:

(a) the E/2, forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced

on 320 acres within this vertical extent which presently include but are not necessarily limited to the Eidson North-Morrow Gas Pool;

(b) the SE/4, forming a standard 160-acre gas spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent;

(c) the N/2 SE/4, forming a standard 80-acre oil spacing and proration unit for all formations or pools spaced on 80 acres within this vertical extent, which presently include, but are not necessarily limited to, the Eidson North-Strawn Pool; and

(d) the NE/4 SE/4, forming a standard 40-acre oil spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Townsend Permo-Penn Pool.

(3) Arrington proposes to dedicate the above-described units ("the Units") to its proposed Huma Huma 34 Well No. 1 to be drilled at a standard well location 1700 feet from the South line and 950 feet from the East line (Unit I) of Section 34.

(4) In Case No. 12943 Great Western Drilling Company ("Great Western") seeks an order pooling the same lands, forming exactly the same units to be dedicated to Great Western's proposed GWDC Federal 34 Com. Well No. 1 to be drilled at the same identical location as proposed for Arrington's Huma Huma 34 Well No. 1.

(5) The primary objective of the wells proposed by each of the applicants is the Morrow formation.

(6) Inasmuch as approval of one of the subject applications would necessarily require denial of the other, one order should be entered for both cases.

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

(8) Both Arrington and Great Western are owners of oil and gas working interests within each of the Units. Each applicant has the right to drill and proposes to drill to a common source of supply at the proposed location.

(9) There are interest owners in each of the proposed units that have not agreed to pool their interests.

(10) Yates Petroleum Corporation, David Petroleum Corporation, Edward N. David, Keith E. McKamey, Michael A. McMillan, McMillan Ventures, L.L.C., McMillan Production Company, William B. Owen and Permian Exploration Corporation ("the Yates Group") appeared through counsel in support of the application of Great Western, and in opposition to the application of Arrington.

(11) A brief description of the chronology of events leading to the hearings in these cases follows:

(a) In the 1970s Great Western initially acquired a working interest in the subject land.

(b) In January of 2001, Arrington initially acquired a working interest in the subject land.

(c) In late 2001 or early 2002, Great Western's interest was focused on the immediate area when Yates Petroleum Corporation solicited a proposal for a farm-out from Great Western.

(d) On April 18, 2002, Arrington staked a location for a well it contemplated drilling in the E/2 of Section 34.

(e) On June 18, 2002, KuKui, Inc. completed a well in adjacent Section 6 which, according to testimony offered by both applicants, was a material inducement to interest in drilling in Section 34.

(f) On June 18, 2002, Arrington proposed its Huma Huma Well No. 1 by letter to working interests owners, which letter, however, contained material errors.

(g) On June 21, 2002, Arrington staked the currently proposed location for its Huma Huma Well No. 1.

(h) On June 27, 2002, Arrington re-proposed its Huma Huma Well No. 1.

(i) On July 1, 2002, Arrington commenced its archeological study for the proposed location.

(j) On August 2, 2002, Arrington filed an Application for Permit to Drill (APD) for its proposed well with the United States Bureau of Land Management.

(k) On August 13, 2002, without any preliminary negotiations with Great Western or the Yates Group beyond mailing its proposal, Arrington filed Case No. 12922.

(l) On September 3, 2002, Great Western entered its appearance in Case No. 12922.

(m) On September 5, 2002, Great Western filed its application in Case No. 12943.

(n) On September 5, 2002 a hearing was conducted in Case No. 12922, and the case was continued to the Division's October 10, 2002 docket for consideration in connection with Case No. 12943.

(o) On September 5, 2002, Great Western proposed its GWDC Federal 34 Com. Well No. 1. The record does not reflect whether the proposal was mailed before or after the time that the application was filed.

(p) On September 5, 2002, Arrington received its approved APD from the BLM for the proposed location.

(q) During September and October of 2002 both parties negotiated for participation of the Yates Group, which negotiations resulted in all of the members of the Yates Group joining in Great Western's proposal, and rejecting Arrington's proposal. The record does not reflect any negotiations between Arrington and Great Western.

(12) Land testimony and exhibits presented at the hearings indicate that:

(a) at the time of the hearing on October 10, 2002, Arrington owned a 32.03125% gross working interest in the 320-Acre Unit;

(b) Great Western owns a 16.11900% gross working interest in the 320-Acre Unit;

(c) the remaining working interest is owned by thirteen parties in the proportions reflected on Arrington Exhibit No. 18, admitted in

evidence at the September 5, 2002 hearing;

(d) ownership is the same as to all depths; however there is no evidence concerning the respective ownership percentages in any of the Units other than the 320-Acre Unit;

(e) all of the working interest owners except Arrington have joined in Great Western's well proposal either by executing an AFE prepared by Great Western, or by executing a joint operating agreement naming Great Western as operator of the subject lands, or both. None of the working interest owners, except Arrington, has joined in Arrington's well proposal;

(f) Arrington owns a significant portion of its working interest in the Units pursuant to a term assignment under which its interest will terminate if a well is not commenced on the subject land on or before March 1, 2003; and

(g) Great Western has represented that if it is designated operator of the Units it plans to commence drilling its proposed well prior to March 1, 2003.

(13) Arrington contends that the application of Great Western should be dismissed because Great Western first circulated its well proposal on the same day that it filed its application, contrary to an alleged division policy requiring circulation of a well proposal at least thirty (30) days in advance of filing an application for compulsory pooling.

(14) Although the Division, in Order No. R-10977, filed in Case No. 11927, dismissed an application for compulsory pooling where the well proposal was not circulated until fourteen (14) days *after* the filing of the application, neither Order No. R-10977 nor any other order cited by the parties references or indicates the existence of a rule or policy requiring circulation of a proposal thirty days prior to filing an application.

(15) If a policy exists or has existed requiring circulation of a proposal prior to filing an application, such policy should not be applied to a competing well proposal filed after the filing of a compulsory pooling application by another party, inasmuch as such a policy would encourage the first party proposing a well to file a compulsory pooling application at the earliest possible time in order to pretermit competition.

(16) Even if an established policy has existed as contended by Arrington, which the Division believes is not the case, no due process right of Arrington is infringed

by not applying such policy in this case because no criminal or civil penalty is involved. Hence the decision in *General Electric Company v. United States Environmental Protection Agency*, 53 F.3d 1324 (D.C.Cir 1995), cited by Arrington, is not in point.

(17) Great Western's application should not be dismissed due to its not having proposed its well prior to the date of filing of its application.

(18) The testimony and evidence offered by the parties at the hearing bearing on the factors the Division deems relevant to the issue of operator appointment indicate that:

(a) no meaningful negotiations have taken place between the applicants;

(b) the "adjusted working interest control" (as such term is used by the Oil Conservation Commission in Finding Paragraph (25) of Order No. R-10731-B) in the 320-Acre Unit is: Arrington 32.03125%; and Great Western 67.96875%;

(c) there is no evidence regarding the applicable percentages as to any of the other Units;

(d) the applicants propose the same location and objective, and there is no material difference in their geologic interpretations;

(e) although, both parties did independent exploratory work in the area, Arrington was the first to propose a well on the subject lands;

(f) the proposed overhead rates and risk penalties are identical;

(g) differences between estimated well costs, as reflected in the AFEs placed in evidence by the respective applicants, are not significant; and

(h) both applicants are experienced operators, and the evidence does not justify a conclusion that either applicant could not operate the Units prudently.

(19) The Oil Conservation Commission has admonished in Order No. R-10731-B, entered in Cases No. 11666 and 11667 that:

In the absence of compelling factors such as geologic and prospect

differences, ability to operate prudently, or any reason why one operator would economically recover more oil or gas by virtue of being awarded operations than the other, "working interest control," as defined [in this order] should be the controlling factor in awarding operations.

(20) Anecdotal evidence of cost overruns experienced by an operator on unrelated projects does not justify a finding that the operator cannot operate prudently, especially since the costs recoverable from a non-operator under a compulsory pooling order are limited to "reasonable costs," as determined by the Division, if necessary, after notice and hearing.

(21) Ordinarily, the failure of the parties to negotiate would require dismissal of both applications. However, the proximity of the expiration of Arrington's interest held pursuant to a term assignment that expires on March 1, 2003 militates against dismissal in this case.

(22) 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, the application of Great Western in Case No. 12943 should be approved by pooling all uncommitted mineral interests, whatever they may be, within the Units.

(23) Because Great Western has significantly larger adjusted working interest control, and no other compelling factor exists, Great Western should be designated the operator of the proposed well and of the Units.

(24) The application of Arrington in Case No. 12922 should accordingly be denied.

(25) Because of the impending termination of Arrington's term assignment, this order should be made contingent upon commencement of a well within the Units not later than January 31, 2003.

(26) Any non-consenting 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 $6,000 per month while drilling and $600 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 Great Western Drilling Company in Case No. 12943, all uncommitted mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 34, Township 15 South, Range 34 East, N.M.P.M., Lea County, New Mexico, are hereby pooled, as follows:

(a) the E/2, forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent which presently include but are not necessarily limited to the Eidson North-Morrow Gas Pool;

(b) the SE/4, forming a standard 160-acre gas spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent;

(c) the N/2 SE/4, forming a standard 80-acre oil spacing and proration unit for all formations or pools spaced on 80 acres within this vertical extent, which presently include, but are not necessarily limited to, the Eidson North-Strawn Pool; and

(d) the NE/4 SE/4, forming a standard 40-acre oil spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not necessarily limited to, the Townsend Permo-Penn Pool.

The Units shall be dedicated to Applicant's proposed GWDC Federal 34 Com. Well No. 1 ("the proposed well") to be drilled at a standard gas well location 1700 feet from the South line and 950 feet from the East line (Unit I) of Section 34.

(2) Great Western Drilling Company is hereby designated the operator of the proposed well and of the Units.

(3) The operator of the Units shall commence drilling the proposed well on or before January 31, 2003, and shall thereafter continue drilling the well with due diligence to test the Morrow formation.

(4) In the event the operator does not commence drilling the proposed well on or before January 31, 2003, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) Should the proposed well not be drilled to completion, or be abandoned, within 120 days after commencement thereof, the operator shall appear before the Division Director and show cause why Ordering Paragraph (1) should not be rescinded.

(6) After pooling, uncommitted working interest owners are referred to as non-consenting working interest owners. ("Uncommitted 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 non-consenting working interest owner in the Units an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(7) Within 30 days from the date the schedule of estimated well costs is furnished, any non-consenting 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.

(8) The operator shall furnish the Division and each known non-consenting working interest owner 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 shall determine reasonable well costs after notice and hearing.

(9) Within 60 days following determination of reasonable well costs, any non-consenting 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 its share of the amount that paid, estimated well costs exceed reasonable well costs.

(10) 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 who has not paid its share of estimated well costs within 30 days after receipt of the schedule of estimated well costs is furnished; and

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

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

(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000 per month while drilling and $600 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 each non-consenting working interest.

(13) Except as provided in Ordering Paragraphs (10) and (12) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Lea 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.

(14) 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.

(15) 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.

(16) 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.

(17) The application of Arrington for pooling of the Units with Arrington as operator and for dedication thereof to Arrington's proposed Huma Huma 34 Well No. 1 is hereby **denied.**

(18) 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

Lori Wrotenbery

LORI WROTENBERY
Director