STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

IN THE MATTER OF THE APPLICATION OF JOSEPH S. SPRINKLE FOR A DETERMINATION OF REASONABLE WELL COSTS, LEA COUNTY, NEW MEXICO

CASE NO. 8807

BRIEF IN OPPOSITION TO REQUEST OF JOSEPH S. SPRINKLE TO ALLOCATE TOTAL WELL COSTS BETWEEN BONE SPRING AND LOWER HORIZONS

PROCEDURE

By Order No. R-7850 in Case No. 8494, TXO Production Corp. ("TXO") obtained a final and binding order pooling the interest of Joseph S. Sprinkle ("Sprinkle") in its Sprinkle Federal No. 1 Well, located 660 feet from the north line and 660 feet from the west line of Section 26, Township 18 South, Range 32 East, N.M.P.M., Lea County, New Mexico. Such order imposed the maximum statutory risk penalty of 200% of reasonable well costs. Thereafter, TXO drilled such well to a total depth sufficient to test the Morrow formation, and subsequently plugged back and completed such well in the Bone Spring formation, upon determination that all lower zones in the well were incapable of commercial production.

Sprinkle then filed his objection to the actual well costs incurred by TXO in the drilling and completion of such well, and such objection came on for hearing on January 22, 1986, continued to February 19, 1986.

At the initial hearing in this matter on January 22, 1986, Sprinkle, by his attorneys, submitted a "Brief in Support of Application," reflecting that Sprinkle contends that the penalty imposed on Sprinkle by Order No. R-7850 in Case No. 8494, can be imposed only upon that portion of reasonable well costs allocated to the Bone Spring formation, and not toward that portion of costs incurred below the productive Bone Spring interval. Briefs of counsel were requested by the Examiner to address such contention.

FACTS

The Amended Application of TXO was filed on February 11, 1985, in Case No. 8494, seeking among other things, to pool the interest of Sprinkle in the then proposed Sprinkle Federal No. 1 Well "from 4,825 feet through the base of the Morrow formation underlying N/2 Section 26 . . . ." For clarity, and in recognition of the acreage and well location requirements of Rule 104(B)(I) of the Oil Conservation Division Rules and Regulations, Paragraphs 3 and 4 of the Amended Application pointed out that a Bone Spring oil completion would require 40 acres to be dedicated to such well, while a gas well completion below the Bone Spring interval would require 320 acres to be dedicated.

TXO's Application came on for hearing February 27, 1985, and Sprinkle elected not to appear either in person or by counsel. Order No. R-7850 was thereafter entered on March 14, 1985, following which TXO drilled its proposed well as indicated

in its Application. Following testing and evaluation of all zones encountered in the well, TXO determined that all zones below the Bone Spring were incapable of commercial production, but succeeded in successful completion of a Bone Spring oil well, on 40-acre spacing.

The proceedings in Case No. 8494 reflect that Sprinkle owns 31.25% leasehold interest in NW/4 Section 26 (location of the well in question), and no interest in NE/4. Since the well was projected as a Morrow test, his net interest in the well as proposed was 15.625% (31.25% of 160/320). TXO Exhibits 5 and 7 in Case No. 8494. No option was extended by TXO to any party to participate in some, but less than all of the costs to be incurred in the well. Sprinkle made no such request, and did not at any time express any interest or intent to participate in a test of the Bone Spring, but not in deeper zones. To state the obvious, his cost in a Bone Spring test alone would have been 31.25%, or twice that in a Morrow test.

ARGUMENT

TXO understands that the question to be addressed by this Brief is whether the costs of the entire well, plus the penalty imposed by Order No. R-7850, can be recovered entirely out of production from the Bone Spring. No cases directly on point have been found, but closely related cases permit analogy to the correct answer.

While in recent years, the Oil Conservation Division has on occasion issued orders permitting a party to participate in some, but less than all of the zones to be evaluated, it had no occasion to do so in Case No. 8494, as Sprinkle made no such request. Had such an order been entered, Sprinkle's position now put forth would have obvious merit, but is without basis under the facts and law of this case, and in fact amounts to a collateral attack on Order No. R-7850, which is clearly not permitted.

In Viking Petroleum, Inc. v. Oil Conservation Commission of the State of New Mexico, 100 N.M. 451, 672 P.2d 280, the denial by the Commission of Viking's intent to participate in a well as to the Abo formation, but not as to deeper zones to be tested in the well, was upheld by the New Mexico Supreme Court. The opinion of the Court strongly implies, however, that the Commission has sufficient authority under New Mexico law to do so, in a proper case, where supported by substantial evidence of such intent being in the interest of conservation, the prevention of waste, and the protection of correlative rights. Administrative notice may be taken of subsequent cases in which this Division has done so.

The Supreme Court of Oklahoma has addressed similar problems in two cases. In the first, C. F. Braun & Company, et al v. Corporation Commission, et al, 609 P.2d 1268, 65 O&GR 391, Fowler filed an application to pool 13 "common sources of supply" underlying a 640-acre tract, each of which would require dedica-

tion of 640 acres to it. The deepest formation to be tested was the Hunton at 13,500 feet. Appellants desired to drill a well only to test the Morrow at 11,000 feet. The Corporation Commission Order granted to Appellants the right to participate in some, but not all of the common sources of supply, but provided that the decision to participate to a specified formation would amount to an election to participate in all shallower formations, since obviously the shallower must be penetrated to test the deeper. Appellants attempted to participate in only the Morrow, accepting the bonus and overriding royalty provided under Oklahoma law for all zones above and below the Morrow. Although the Court reversed the Corporation Commission on its cost allocation formula because of lack of substantial evidence in the record, it upheld the balance of the order. The Court stated, in language relevant to this proceeding, at 65 O&GR 291, pages 396 and 397:

> Appellee was authorized to include in his pooling application any or all of the thirteen spacing units, and he included all thirteen. Appellee proposed to drill a well to a sufficient depth to test the Hunton formation, and his evidence, in effect, treated the entire thirteen separate common sources of supply or thirteen spacing units as a single unit . . .

In Marathon Oil Company v. The State Corporation Commission of the State of Oklahoma, 651 P.2d 1051, 74 O&GR 80, a dispute very similar to the principle in question here was decided. Kaiser-Francis Oil Company sought to drill a well on the NE/4 of Section 7, and to pool all interests from the Douglas to the Mississippian Lime, which interval included the following forma-

tions: Tonkawa, Cottage Grove, Cleveland, Oswego, Cherokee, Atoka, Morrow and Chester. All such zones were spaced on 640 acres, except the Atoka, to which was dedicated 160 acres. Marathon owned no interest in the Atoka in the NE/4 (where the well was located) but owned 310 net acres in the entire section in a well drilled to the Mississippian. In the pooling order, Marathon was required to bear its proportionate share of total well costs (310/640 = 48.4375%). Marathon appealed, on the basis that since it owned no interest in the Atoka, it should not have to bear costs attributable to that formation. The Court answered such contention at 74 O&GR 80, pages 83 and 84, as follows:

> The argument here advanced fails to attend to the operative fact that in this application for a forced pooling order the applicant looks at a test of the Mississippi formation. Concededly, a protestant can object effectively to a pooling order requiring him to test a formation in which he has no ownership. In the cause here appealed such is not the case, however. Appellant has been pooled to require an election relative to a test of the Mississippi. Protestant has a 310/640 interest in the formation in the governmental section drilling and spacing unit. The Atoka is agreed to lie above the formation this well was targeted for. It is equally clear that a test well must traverse the horizon of the Atoka to reach the Mississippi. Neither the fact the hole to be drilled will pass through the anticipated Atoka depth, nor the fact that Marathon owns no interest in that formation, has a bearing upon the Commission's power to pool the rights of the owners of the right to drill to the Mississippi. The bore must pass through all intermediate strata before reaching the target formation and the protestant was required only to pay for a test of his lease interest in the section. The order correctly limits itself to costs of a Mississippi completion or dry hole, and under that order if the lower formation is dry the Marathon Company is responsible for its share of the

> non-producing hole. If the bottom is nonproductive and the Atoka is completed, the additional cost of that completion is borne solely by Kaiser-Francis. The order does not require Marathon to contribute to a completion other than the Mississippi [footnote omitted]. The appellant is thus shown to be properly assessed for his proportionate share of total cost of the deeper strata's test. The Commission's provision for payment of the cost of participant as an election is within the Commission's authority. . . . (emphasis added)

The critical difference in the facts of Marathon and in this proceeding, is that Marathon owned no interest in the Atoka on the 160-acre well location, whereas Sprinkle owns an undivided 31.25% interest in the entire NW/4 of the section in which the TXO Sprinkle Federal No. 1 Well is located. TXO's evidence in Case No. 8494 clearly sought to pool all zones on the basis of the ownership of the deepest. As stated, Exhibits 5 and 7, the Joint Operating Agreement and AFE, respectively, credited Sprinkle with 15.625% of costs (31.25% of 160/320). Exhibit 9 was a production map showing all Delaware, Bone Spring and Pennsylvanian production in the area. Exhibits 10, 11 and 12 were geological maps of the Morrow formation. Exhibits 13 and 14 were geological maps of the Bone Spring.

Order No. R-7850 was clearly "responsive to the evidence" presented by TXO. It recognized that a Bone Spring completion would have dedicated to it 40 acres, and a Morrow completion would have dedicated to it 320 acres. It also recognized that in order to test the deepest zone (the Morrow) all intermediate intervals, below 4,825 feet, would be tested by the

single well to be drilled, but the only election extended to Sprinkle was "to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production . . ." Sprinkle elected not to do so.

CONCLUSION

TXO submits that it is clear from the facts of this case, and the law discussed above, that Sprinkle is to be charged with his proportionate share of total well costs, plus 200% penalty, inasmuch as his interest in all formations tested was pooled. Had Sprinkle sought to participate only in the Bone Spring portion of the test, an entirely different question would be presented, and the Division, upon proper evidence presented and in accordance with its past practices, may have permitted such an election. This, however, did not occur in this case, and Sprinkle is foreclosed from rewriting the order entered in this case by the argument he now advances.

Respectfully submitted,

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