

**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. 13489
ORDER NO. R-12386**

**APPLICATION OF MCQUADRANGLE, LC FOR STATUTORY UNITIZATION OF
THE SOUTH RED LAKE II UNIT AREA, EDDY COUNTY, NEW MEXICO**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on June 16, 2005, at Santa Fe, New Mexico before Examiner David R. Catanach.

NOW, on this 19th day of July, 2005, 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 this case and its subject matter.

(2) The applicant, McQuadrangle, LC ("McQuadrangle" or "applicant"), seeks: (i) the statutory unitization, pursuant to the Statutory Unitization Act, Sections 70-7-1 through 70-7-21, NMSA 1978, of 961.61 acres, more or less, of all mineral interests in the Grayburg and San Andres formations, Red Lake Queen-Grayburg-San Andres Pool, Eddy County, New Mexico, and to be known as the South Red Lake II Unit Area, hereinafter referred to as the "Unit Area"; and (ii) approval of the Unit Agreement and the Unit Operating Agreement, which were submitted in evidence as applicant's Exhibits No. 3 and 5, respectively, in this case.

(3) The proposed South Red Lake II Unit consists of five (5) federal and nine (9) state oil and gas leases located in Eddy County, New Mexico, and comprises 961.61 acres, more or less, described as follows:

TOWNSHIP 17 SOUTH. RANGE 27 EAST. NMPM

Section 35: E/2, E/2 SW/4, SE/4 NW/4

Section 36: W/2, SW/4 NE/4

TOWNSHIP 18 SOUTH. RANGE 27 EAST. NMPM

Section 1: Lot 4

Section 2: Lots 1, 2 and 3

(4) At the hearing, McQuadrangle testified that the San Andres formation is to be excluded from the "Unitized Interval". The applicant further presented evidence that demonstrates that:

- (a) the South Red Lake II Unit Agreement submitted as applicant's Exhibit No. 3 incorrectly describes the Unitized Interval as that interval from the top of the Grayburg formation to the base of the San Andres formation;
- (b) 100% of the working interest owners and approximately 77% of the overriding royalty interest owners have ratified the Unit Agreement; however, these interest owners ratified the Unit Agreement that incorrectly describes the Unitized Interval; and
- (c) McQuadrangle will revise its Unit Agreement to correctly describe the Unitized Interval and will re-submit this document to all interest owners in the Unit Area for their re-ratification.

(5) McQuadrangle presented evidence that demonstrates that:

- (a) all of the acreage within the proposed South Red Lake II Unit was previously contained within the South Red Lake Grayburg Unit Area. The South Red Lake Grayburg Unit Area was approved by the Division as a voluntary unit by Order No. R-2875 dated March 5, 1965. This unit was initially operated by Archie M. Speir;

- (b) by Division Order No. R-2882 dated March 25, 1965, the Division authorized Archie M. Speir to institute a waterflood project within the South Red Lake Grayburg Unit Area by the injection of water into the Grayburg formation through eighteen (18) wells completed as injection wells;
- (c) the United States Bureau of Land Management ("BLM") terminated the South Red Lake Grayburg Unit in 1998 due to lack of production. The operator of the South Red Lake Grayburg Unit at that time was Mason Phillips Properties; and
- (d) McQuadrangle assumed operatorship of the wells within the South Red Lake Grayburg Unit in 1999.

(6) McQuadrangle testified that injection operations within the proposed Unit Area have been conducted on a continuous and ongoing basis since waterflood operations were approved in 1965.

(7) Division records show that McQuadrangle currently operates fourteen (14) active water injection wells within the proposed Unit Area.

(8) McQuadrangle plans to continue conducting secondary recovery operations within the South Red Lake II Unit area after unitization.

(9) The proposed Unitized Interval is that interval underlying the Unit Area, the vertical limits of which extend from an upper limit described as 100 feet below mean sea level or at the top of the Grayburg formation, whichever is higher, to a lower limit at the base of the Grayburg formation; this vertical interval having been found to occur at a depth of 1,430 feet to 1,762 feet on the Welex Electric Log run on March 28, 1960 on the Carper-Sivley Joint Account Magruder Well No. 13 located 330 feet from the South line and 480 feet from the East line (Unit P) of Section 35, Township 17 South, Range 27 East, NMPM, Eddy County, New Mexico.

(10) The Red Lake Queen-Grayburg-San Andres Pool is present throughout the entire Unit Area.

(11) The Red Lake Queen-Grayburg-San Andres Pool underlying the Unit Area has been reasonably defined by development and has been subject to secondary recovery operations for more than forty (40) years.

(12) The proposed Unit Area contains sixteen (16) separate tracts of land owned by two (2) different working interest owners and approximately sixty-one (61) different overriding royalty interest owners. Royalty interest within the Unit Area is owned by the State of New Mexico and the United States Government.

(13) As of the hearing date, 100% of the working interest owners and approximately 77% of the overriding royalty interest owners have ratified the Unit Agreement; however as stated in Finding No. (4), McQuadrangle will revise its Unit Agreement to correctly describe the Unitized Interval and will resubmit this document to the interest owners in the Unit Area for their re-ratification.

(14) The BLM and the Commissioner of Public Lands for the State of New Mexico have both approved McQuadrangle's plan for unit operations.

(15) The applicant has made a good faith effort to secure the voluntary participation of all interest owners in the Unit Area.

(16) Notice of this application was provided to all affected interest owners in the Unit Area. No interest owner appeared at the hearing in opposition to the application.

(17) The continued implementation of secondary recovery operations within the Unit Area under a unitization plan will enable McQuadrangle to efficiently and effectively recover additional oil and gas reserves from the Unit Area.

(18) The applicant projects that the unitized management, operation and further development of the Unitized Interval within the Unit Area will result in the recovery of an additional 62,000 barrels of secondary oil reserves that would otherwise not be recovered, thereby preventing waste.

(19) The statutory unitization of the Unitized Interval within the Unit Area in accordance with the plan embodied in the Unit Agreement and Unit Operating Agreement will prevent waste and protect correlative rights and is upon terms and conditions that are fair, reasonable, equitable and in accordance with the Statutory Unitization Act, including all of the elements necessary for the entry of an order.

(20) The proposed unitized method of secondary recovery operations within the Unit Area is feasible and will result with reasonable probability in the recovery of substantially more oil and gas from the unitized portion of the pool than would otherwise be recovered.

(21) The estimated additional costs of such operations will not exceed the estimated value of the additional oil recovered plus a reasonable profit.

(22) Statutory unitization and adoption of applicant's proposed unitized method of operation will benefit the working interest and royalty interest owners within the proposed secondary recovery project area.

(23) The Unit Agreement and Unit Operating Agreement, applicant's Exhibits No. 3 and 5 in this case, should be incorporated by reference into this order.

(24) The South Red Lake II Unit Agreement and the South Red Lake II Unit Operating Agreement provide for unitization and unit operation upon terms and conditions that are fair, reasonable and equitable, and include:

- (a) an allocation to the separately owned tracts in the Unit Area of all oil and gas that is produced from the Unit Area and that is saved, being the production that is not used in the conduct of unit operations or not unavoidably lost;
- (b) a provision for the credits and charges to be made in the adjustment among the owners in the Unit Area for their respective investments in wells, tanks, pumps, machinery, materials and equipment contributed to the unit operations;
- (c) a provision governing how the costs of unit operations including capital investments shall be determined and charged to the separately owned tracts and how such costs shall be paid, including a provision specifying when, how and by whom such costs shall be charged to the owners, or the interests of such owners, and how their interests may be sold and the proceeds applied to the payment of their costs;

- (d) a provision for carrying any working interest owner on a limited, carried or net-profits basis, payable out of production, upon terms and conditions that are just and reasonable and that allow an appropriate charge for interest for such service payable out of production, upon such terms and conditions determined by the Division to be just and reasonable;
- (e) a provision designating a Unit Operator and providing for supervision and conduct of unit operations, including the selection, removal and substitution of an operator from among the working interest owners to conduct unit operations;
- (f) a voting procedure for matters to be decided by the working interest owners under which each working interest owner shall have a voting interest equal to its participation; and
- (g) a provision specifying the time when the unit operation shall commence and the manner in which, and the circumstances under which, the operations shall terminate and provision for the settlement of accounts upon such termination.

(25) The statutory unitization of the South Red Lake II Unit Area is in conformity with the above findings, and will prevent waste and protect correlative rights of all interest owners within the proposed Unit Area, and should be approved.

IT IS THEREFORE ORDERED THAT:

(1) The application of McQuadrangle, LC for the statutory unitization of 961.61 acres, more or less, being a portion of the Red Lake Queen-Grayburg-San Andres Pool, Eddy County, New Mexico, to be known as the South Red Lake II Unit, is hereby approved pursuant to the Statutory Unitization Act, Sections 70-7-1 through 70-7-21, NMSA 1978.

(2) The South Red Lake II Unit shall comprise the following-described 961.61 acres, more or less, of federal and state lands in Eddy County, New Mexico:

TOWNSHIP 17 SOUTH. RANGE 27 EAST, NMPM

Section 35: E/2, E/2 SW/4, SE/4 NW/4
Section 36: W/2, SW/4 NE/4

TOWNSHIP 18 SOUTH, RANGE 27 EAST, NMPM

Section 1: Lot 4
Section 2: Lots 1, 2 and 3

(3) The Unitized Interval shall comprise that interval underlying the Unit Area, the vertical limits of which extend from an upper limit described as 100 feet below mean sea level or at the top of the Grayburg formation, whichever is higher, to a lower limit at the base of the Grayburg formation; this vertical interval having been found to occur at a depth of 1,430 feet to 1,762 feet on the Welex Electric Log run March 28, 1960 on the Carper-Sivley Joint Account Magruder Well No. 13 located 330 feet from the South line and 480 feet from the East line (Unit P) of Section 35, Township 17 South, Range 27 East, NMPM, Eddy County, New Mexico.

(4) The South Red Lake II Unit Agreement and South Red Lake II Unit Operating Agreement, which were submitted to the Division at the time of the hearing as Exhibits No. 3 and 5, respectively, are hereby incorporated by reference into this order.

(5) The applicant shall continue with its current waterflood activities within the South Red Lake II Unit Area.

(6) The applicant shall revise its South Red Lake II Unit Agreement to reflect the correct Unitized Interval as being the Grayburg formation only, and shall submit this revised document to all interest owners in the Unit Area for their ratification or re-ratification.

(7) This order shall not become effective unless and until the owners of 75 percent of the working interest and 75 percent of the royalty interest in the South Red Lake II Unit have approved the plan for unit operations as required by Section 70-7-8, NMSA 1978.

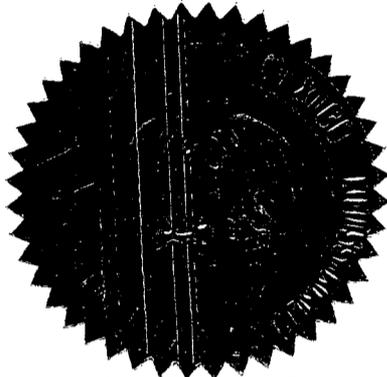
(8) If the persons owning the required percentage of interest in the South Red Lake II Unit, as set forth in Section 70-7-8, NMSA 1978, do not approve the plan for unit operations within a period of six months from the date of entry of this order, this order shall cease to be effective unless the Division shall extend the time for ratification for good cause.

(9) When the persons owning the required percentage of interest in the South Red Lake II Unit have approved the plan for unit operations, the interests of all persons in the Unit Area are unitized whether or not such persons have approved the plan of unitization in writing.

(10) The applicant shall notify the Division Director in writing of any removal or substitution of the applicant as unit operator by any other working interest owner within the Unit Area.

(11) Jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.

DONE in Santa Fe, New Mexico, on the day and year hereinabove designated.



S E A L

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P.E.
Director