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. 15224
ORDER NO. R-14199

APPLICATION OF SOVEREIGN EAGLE, LLC FOR COMPULSORY POOLING, ROOSEVELT COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on December 4, 2014, at Santa Fe, New Mexico, before Examiner Michael McMillan.

NOW, on this 9th day of August, 2016, 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 of the subject matter.

(2) Sovereign Eagle, LLC ("Sovereign" or "Applicant") seeks an order pooling all uncommitted interests from the surface to the base of the Montoya formation underlying the N/2 of Section 26, Township 2 South, Range 29 East, NMPM, Roosevelt County, New Mexico, in the following manner:

(a) the N/2 to form a standard 320-acre gas spacing and proration unit for all formations and/or pools spaced on 320 acres within this vertical extent, including, but not limited to the Tule; Penn (Gas) Pool (pool code 86443) and the Tule; Montoya (Gas) Pool (pool code 86442);

(b) the NW/4 to form a standard 160-acre spacing and proration unit for all formations and/or pools spaced on 160 acres within this vertical extent, including, but not limited to the Tule; San Andres (Gas) Pool (pool code 86444); and

(c) the SE/4 NW/4 to form a standard 40-acre spacing and proration unit for all formations and/or pools spaced on 40 acres within this vertical extent.

(3) The above-described spacing and proration units (the "Units") are to be dedicated to Applicant's Stoltenberg Well No. 2 (the "subject well"; API No. 30-041-20965), a vertical well drilled at a location 1650 feet from the North line, and 2260 feet from the West line (Unit F) of Section 26.

(4) Applicant appeared at the hearing through counsel and presented land, engineering, and geologic evidence to the effect that:

(a) Applicant provided lease proposals to the locatable, uncommitted mineral interest owners.

(b) Applicant had attempted good faith efforts to ascertain the whereabouts of unlocatable interest owners.

(c) The subject well had been drilled, but had not been completed at the time of the hearing;

(d) The pipeline company that owns the only facility through which gas from the subject well can practicably be transported requires Nitrogen to be removed prior to the gas entering their transmission line. As a result, the operator and other working interest owners are burdened with costs of removing Nitrogen and of near well head well processing, and equipment rental, necessary to satisfy that requirement (Post Production Processing Costs). The associated equipment rentals alone, including generators and nitrogen skid, are in excess of $50,000/month.

(e) Most royalty interest owners have signed leases that allow for a proportionate part of Post Production Processing Costs of the gas to be deducted from royalties.

(f) Yates Holdings, LLP (Yates) and R.B. Cowden Properties (Cowden), lessees, did not want to be subjected to the Post Production Processing Costs.

(g) Geological evidence supported drilling of the subject well.

(h) Final well costs were not presented at the hearing, since the well had not been completed; however, an AFE was admitted in evidence.

(i) Applicant argues that the requirement stipulated in Division Order No. R-13165, issued on September 15, 2009 in Cases Nos. 14368, *et al.*, wherein the Division stated that an applicant for compulsory pooling must deliver a well proposal and AFE to each locatable owner of a working interest does not apply to owners of unleased interests.

(5) Yates Holdings, LLP (Yates) and R.B. Cowden Properties (Cowden) appeared through counsel and presented land evidence to the effect that:

(a) Yates and Cowden are owners of unleased mineral interests in the Units, and received lease proposals from Applicant.

(b) Neither party had received a well participation proposal or an Authorization for Expenditure (AFE) for drilling and completion of the subject well from the applicant prior to the hearing. Without the AFE, neither party would be able to determine the economics of drilling the subject well;

(c) Neither party, after many discussions with the Applicant, could reach acceptable terms for a lease.

(d) Both parties stated that the net royalty would be reduced by approximately 40% to 50% due to Post Production Processing Costs to which Applicant's land witness testified.

(e) All of the lease offers proposed by Applicant would have required the lessor to agree to reduction of its royalty by a proportionate amount of such Post Production Processing Costs.

(f) Yates and Cowden together protest the compulsory pooling because the Applicant did not provide an AFE.

(g) Prior to the hearing, neither party was aware that the subject well had been drilled.

The Division concludes that:

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

(7) Applicant is owner of an oil and gas working interest within the Units. Applicant has the right to drill and has drilled the subject well to a common source of supply within the Units.

(8) There are interest owners in the Units that have not agreed to pool their interests.

(9) Because Applicant offered to lease the uncommitted interests and evidenced a willingness to negotiate some lease terms, we do not find that Applicant failed to negotiate in good faith with the owners who have not agreed to pool their interests.

(10) Order No. R-13165, requiring delivery of a well proposal and AFE to each interest owner prior to applying for compulsory pooling, is not, by its terms, limited to owners of leasehold interests, and we do not read the earlier orders that Applicant's counsel cited as requiring such an exception.

(11) Accordingly, Applicant should have provided a proposal and an AFE to the unleased mineral interest owners prior to filing a compulsory pooling application. However, this should not preclude the compulsory pooling of the unleased mineral interests in view of the time that has now elapsed since this information was furnished at the hearing.

(12) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(13) In the gas delivery situation described at the hearing, it is fair and reasonable to require the unsigned mineral interest owners to pay their share of Post Production Processing Costs out of their deemed 7/8ths working interest. No costs, however, may be deducted from the mineral owners' deemed $1/8^{th}$ royalty, because the last sentence of Section 70-2-17.C provides that, "he [the unleased mineral owner] shall *in all events* be paid one-eighth of all production from the unit and creditable to his interest." [emphasis added]

(14) Sovereign Eagle, LLC, should be designated the operator of the subject well and of the Unit.

(15) Any pooled working interest owner who does not pay its share of estimated well costs, should have withheld from production its share of reasonable well costs involved in drilling the subject well.

(16) Reasonable well costs include cost of drilling, reworking, diverting, deepening, plugging back, and testing the well; completing the well in formations where it has been completed since the hearing, or is completed prior to commencement of production; and equipping the well for production, along with applicable post production charges, including charges associated with Nitrogen removal and condensate production.

(17) Recompletion means the subsequent completion of a well in a different pool from the pool or pools in which it is initially completed prior to commencement of production. Any recompletion should require a separate proposal and a separate opportunity for election unless accomplished prior to payout of the well costs and risk penalty herein provided.

(18) At the hearing, the Applicant requested that the overhead rates be fixed at $13,660.13 per month while drilling and $681.65 per month while producing. The rates are substantially higher than the Division has allowed in recent cases involving comparable wells, and we conclude they are not reasonable. Accordingly, only the rates provided below should be allowed.

(19) Reasonable charges for supervision (combined fixed rates) should be fixed at $7,500 per month while drilling, and $681.65 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 Sovereign Eagle, LLC, all uncommitted interests, whatever they may be, in the oil and gas in the N/2 of Section 26, Township 2 South, Range 29 East, NMPM, in Roosevelt County, New Mexico, are hereby pooled as follows:

(a) the N/2 to form a standard 320-acre gas spacing and proration unit for all formations and/or pools spaced on 320 acres within this vertical extent, including, but not limited to the Tule; Penn (Gas) Pool (pool code 86443) and the Tule; Montoya (Gas) Pool (pool code 86442);

(b) the NW/4 to form a standard 160-acre spacing and proration unit for all formations and/or pools spaced on 160 acres within this vertical extent, including, but not limited to the Tule; San Andres (Gas) Pool (pool code 86444); and

(c) the SE/4 NW/4 to form a standard 40-acre spacing and proration unit for all formations and/or pools spaced on 40 acres within this vertical extent.

(2) The Unit shall be dedicated to the Applicant's Stoltenberg Well No. 2 (the "subject well"; API No. 30-041-20965), a vertical well drilled at a location 1650 feet from the North line and 2260 feet from the West line (Unit F) of Section 26.

(3) Upon final plugging and abandonment of the subject well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit

created by this Order shall terminate, unless this Order has been amended to authorize further operations.

(4) Sovereign Eagle, LLC (OGRID 269340) is hereby designated the operator of the well and the Unit.

(5) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(6) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following the later of completion of the subject well or the issuance of this Order. 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 will determine reasonable well costs after public notice and hearing.

(7) Within 60 days following determination of reasonable well costs, any pooled 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 the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(8) The operator is hereby authorized to withhold the following costs and charges from production from each well:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

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

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

(10) Reasonable charges for supervision (combined fixed rates) for the well are hereby fixed at $7,500 per month while drilling and $681.65 per month while producing. 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 pooled working interest owners. Reasonable charges include all charges associated with the Nitrogen removal and near wellhead processing of condensate.

(11) Except as provided in Paragraphs (8) and (10) above, all proceeds from production from the proposed well that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8A-1 through 70-8A7-8A-28, as amended).

(12) Any unleased mineral interests 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, including all post production costs, 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.

(13) 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.

(14) The operator of the well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this Order.

(15) 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

David R. Catanach

DAVID R. CATANACH
Director