

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:

Sheet 3 #781
1 - 14 - 20-7

CASE NO. 11899
Order No. R-10961

APPLICATION OF DUGAN PRODUCTION
CORPORATION FOR TWO-NON STANDARD
GAS SPACING AND PRORATION UNITS, RIO
ARRIBA COUNTY, NEW MEXICO

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ORDER OF THE DIVISION OIL CON. DIV.
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BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on January 8, and February 5, 1998, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 18th day of February, 1998, the Division Director, having considered the testimony, the record and the recommendations of the Examiner, and being fully advised,

FINDS THAT:

- (1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.
- (2) Division Case Nos. 11899 and 11897 were consolidated at the time of the January 8th hearing for the purpose of testimony. In addition, testimony was taken at the January 8th hearing in related Case No. 11920 which appeared on the Examiner Hearing Docket for February 5, 1998.
- (3) The applicant, Dugan Production Corporation (Dugan), seeks:
 - a) approval of two 160-acre non-standard gas spacing and proration units in the Blanco-Mesaverde and Basin-Dakota Gas Pools comprising, respectively, the SE/4 and SW/4 of Section 14, Township 26 North, Range 7 West, NMPM, Rio Arriba County, New Mexico;
 - b) to be named operator of the proposed 160-acre non-standard gas spacing and proration unit comprising the SE/4 of Section 14, said unit to be dedicated to its proposed Mona Lisa Well No. 2 to be drilled at a standard gas well location 1620 feet from the South line and 1850 feet from the East line (Unit J) of Section 14; and,

- c) to have Caulkins Oil Company (Caulkins) designated operator of the proposed 160-acre non-standard gas spacing and proration unit comprising the SW/4 of Section 14, said unit to be dedicated to Caulkins' proposed Breech "B" 781 well to be drilled at a standard gas well location 1800 feet from the South line and 1150 feet from the West line (Unit L) of Section 14.

ALTERNATIVELY:

In companion Case No. 11897, Dugan seeks an order pooling all mineral interests in the Blanco-Mesaverde and Basin-Dakota Gas Pools underlying the S/2 of Section 14, Township 26 North, Range 7 West, NMPM, thereby forming a standard 320-acre gas spacing and proration unit for said pools, said pooled unit to be dedicated to the aforesaid Mona Lisa No. 2. Dugan further seeks authority to downhole commingle Blanco-Mesaverde and Basin-Dakota Gas Pool production within the subject Mona Lisa No. 2.

In companion Case No. 11920, Caulkins seeks an order pooling all mineral interests in the Blanco-Mesaverde and Basin-Dakota Gas Pools underlying the S/2 of Section 14, Township 26 North, Range 7 West, NMPM, thereby forming a standard 320-acre gas spacing and proration unit for said pools, said pooled unit to be dedicated to the aforesaid Breech "B" 781 well. Caulkins further seeks authority to downhole commingle Blanco-Mesaverde and Basin-Dakota Gas Pool production within the subject Breech "B" 781 well.

(4) The S/2 of Section 14 is within the Blanco-Mesaverde and Basin-Dakota Gas Pools which are currently governed by the General Rules and Regulations for the Prorated Gas Pools of New Mexico/Special Rules and Regulations for the Blanco-Mesaverde and Basin-Dakota Gas Pools, respectively, as contained within Division Order No. R-8170, as amended. These rules provide that two wells may be drilled on a standard 320-acre gas spacing and proration unit.

(5) Both Dugan and Caulkins prefer that the S/2 of Section 14 be developed in the Basin-Dakota and Blanco-Mesaverde Gas Pools by the formation of two 160-acre non-standard gas spacing and proration units as Dugan has proposed. In the event, however, that the Division does not approve this method of development, both Dugan and Caulkins seek an order pooling the interests within the S/2 of Section 14 and both seek to be named operator of the proposed standard 320-acre proration unit (the subject of companion Case Nos. 11897 and 11920).

(6) Dugan and Caulkins presented evidence and testimony in this case which indicates that:

- a) Dugan and Caulkins have been unable to reach a voluntary agreement as to who will operate a standard 320-acre gas spacing and proration unit comprising the S/2 of Section 14;

- b) in the event the Division approves the application and establishes two 160-acre non-standard gas spacing and proration units:
 - i) Dugan is prepared to commence drilling operations on its Mona Lisa No. 2 which is proposed to be downhole commingled in the Mesaverde and Dakota formations;
 - ii) Caulkins is prepared to commence drilling operations on its Breech "B" 781 well which is proposed to be downhole commingled in the Mesaverde and Dakota formations and dually completed in the Chacra formation;
- c) Dugan is the lessee and 100% working interest owner of Federal Oil & Gas Lease No. NM- 99002 which comprises the SE/4 of Section 14. This tract is subject only to a standard 12.5% royalty with no additional overriding royalty burdens. The net revenue interest on this tract is 87.5 %;
- d) the SW/4 of Section 14, comprising Federal Oil & Gas Lease No. NM-03381, is currently owned as follows:

Caulkins Oil Company	55 %
Marathon Oil Company (Marathon)	22.5 %
Louis Dreyfus Natural Gas Corp. (Louis Dreyfus)	22.5 %

This tract is subject to a standard 12.5 % royalty, a 3.0 % overriding royalty and an additional overriding royalty interest equal to 1/3 net profits. The net revenue interest on this tract is 51 %. In addition, a Joint Operating Agreement (JOA) is currently in effect for this tract;
- e) due to the excessive royalty burdens currently in effect for the SW/4 of Section 14, Dugan presented evidence which indicates that it will be extremely difficult for it to drill an economic well within a standard 320-acre proration unit comprising the S/2 of Section 14;
- f) Caulkins expressed no concern about drilling its Breech "B" 781 as an economic producer either within the proposed 160-acre non-standard gas proration unit or within a standard 320-acre gas proration unit;

- g) Dugan has attempted to reach a voluntary agreement with the various interest owners within the SW/4 of Section 14 with regards to the formation of a standard 320-acre proration unit, but has been unable to reach an agreement with Louis Dreyfus and Caulkins. Marathon has indicated that it would farm-out its interest to Dugan;
- h) both Marathon and Louis Dreyfus are aware of Dugan's proposal to form two 160-acre non-standard gas proration units, and both are supportive of such a proposal;
- i) Dugan has provided notice of its application to Caulkins, Marathon and Louis Dreyfus in conformance with Division Rule No. 1207.A.(6);
- j) Dugan has examined the geologic data available and concludes that the geology in the Mesaverde and Dakota formations is very similar within the SE/4 and SW/4 of Section 14. Utilizing its geologic interpretation, Dugan testified that a well drilled within the SW/4 of Section 14 should exhibit similar producing characteristics to a well drilled within the SE/4 of Section 14.

(7) Subsequent to the hearing, Dugan submitted a letter from the United States Bureau of Land Management (USBLM), which indicates that it does not object to the proposed formation of two 160-acre non-standard gas proration units.

(8) Upon consideration of the evidence presented by both parties in this case, the Division finds that:

- a) the S/2 of Section 14 is unique in the respect that no previous development has occurred in the Blanco-Mesaverde and Basin-Dakota Gas Pools;
- b) the SE/4 and SW/4 of Section 14 appear to be equal in terms of the potential for gas production from the Mesaverde and Dakota formations;
- c) all of the working interest owners in the S/2 of Section 14 are in agreement that this acreage should be developed by the formation of two 160-acre non-standard gas proration units;
- d) approval of the application will in effect allow the simultaneous drilling of wells within both the SE/4 and SW/4 of Section 14 which will serve to protect the correlative rights of all the various interest owners within the S/2 of Section 14;

- e) approval of the subject application will allow Dugan and Caulkins to economically recover the gas reserves within the Mesaverde and Dakota formations underlying the SE/4 and SW/4 of Section 14, respectively;
- f) approval of the subject application will allow Caulkins to recover gas reserves from the Chacra formation through the proposed Breech "B" 781, which may otherwise have to be recovered by drilling an additional wellbore within the SW/4 of Section 14;
- g) no other offset operator and/or interest owner appeared at the hearing in opposition to the application.

(9) Approval of Dugan Production Corporation's application in Case No. 11899 is in the best interest of conservation and protection of correlative rights and should therefore be approved.

IT IS THEREFORE ORDERED THAT:

(1) The application of Dugan Production Corporation for approval of two 160-acre non-standard gas spacing and proration units in the Blanco-Mesaverde and Basin-Dakota Gas Pools comprising, respectively, the SE/4 and SW/4 of Section 14, Township 26 North, Range 7 West, NMPM, Rio Arriba County, New Mexico, is hereby approved.

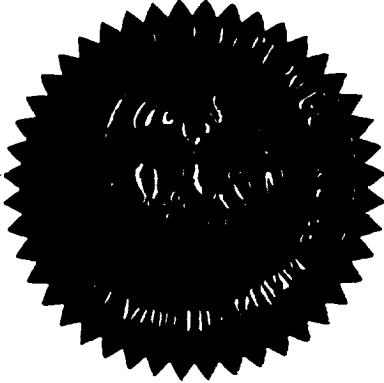
(2) Dugan Production Corporation is hereby designated operator of the subject 160-acre non-standard gas spacing and proration unit comprising the SE/4 of Section 14. This unit shall be dedicated to its proposed Mona Lisa Well No. 2 to be drilled at a standard gas well location 1620 feet from the South line and 1850 feet from the East line (Unit J) of Section 14.

(3) Caulkins Oil Company is hereby designated operator of the subject 160-acre non-standard gas spacing and proration unit comprising the SW/4 of Section 14. This unit shall be dedicated to its proposed Breech "B" 781 well to be drilled at a standard gas well location 1800 feet from the South line and 1150 feet from the West line (Unit L) of Section 14.

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

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



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STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

Lori Wrotenbery

LORI WROTENBERY
Director