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:

APPLICATION OF OCEAN ENERGY RESOURCES, INC. FOR COMPULSORY POOLING AND FOUR NON-STANDARD OIL AND GAS SPACING AND PRORATION UNITS, LEA COUNTY, NEW MEXICO. CASE NO. 12535

APPLICATION OF OCEAN ENERGY RESOURCES, INC. FOR COMPULSORY POOLING AND FOUR NON-STANDARD OIL AND GAS SPACING AND PRORATION UNITS, LEA COUNTY, NEW MEXICO. CASE NO. 12567

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND A NON-STANDARD GAS SPACING AND PRORATION UNIT, LEA COUNTY, NEW MEXICO. CASE NO. 12569

APPLICATION OF YATES PETROLEUM CORPORATION FOR COMPULSORY POOLING AND A NON-STANDARD GAS SPACING AND PRORATION UNIT, LEA COUNTY, NEW MEXICO. CASE NO. 12590

ORDER NO. R-11566

ORDER OF THE DIVISION

BY THE DIVISION:

These cases came on for hearing at 8:15 a.m. on January 11 and February 8, 2001, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 17th day of April, 2001, 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 their subject matter.

(2) **Division Cases No. 12535, 12567, 12569, and 12590** were consolidated for the purpose of presenting testimony. Inasmuch as the issues involved encompass the same acreage and the approval of one of the proposals would necessarily require denial of the others, one order should therefore be entered for all four cases.

(3) Section 3, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico is irregular in size and shape due to the convergence of meridians and is one mile in width and in excess of one and one-half miles in length. Irregular Section 3 comprises a total area of 995.80 acres. It consists of: Lot 1 with 49.47 acres; Lot 2 with 49.12 acres; Lot 3 with 48.78 acres; Lot 4 with 48.43 acres; Lots 5 through 16 each with 40 acres; and the S/2, which is considered to be a regular subdivision or aliquot part of this section and can be further divided into two quarter sections (SW/4 and SE/4) or eight quarter-quarter sections (NE/4 SW/4, SE/4 SE/4, NW/4 SE/4, etc.). See Division Order No. R-10803, issued in consolidated Cases No. 11716, 11717, 11739, 11740, 11741, and 11753, which describes this anomaly in greater detail.

(4) In **Cases No. 12535 and 12567** the applicant, Ocean Energy Resources, Inc. ("Ocean"), seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the following described acreage in irregular Section 3:

> (**a**) Lots 1 through 8 to form a 355.80-acre lay-down gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated North Shoe Bar-Atoka Gas Pool, Undesignated Townsend-Morrow Gas Pool, Undesignated North Shoe Bar-Morrow Gas Pool, and Undesignated North Hume-Morrow Gas Pool;
>
> (**b**) Lots 3 through 6 to form a 177.21-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within that vertical extent;
>
> (**c**) Lots 3 (Unit C) and 4 (Unit D) to form a 97.21-acre lay-down oil spacing and proration unit for any pool developed on 80-acre spacing within that vertical extent, which presently includes only the Undesignated South Big Dog-Strawn Pool; and

(d) Lot 4 (Unit D) to form a 48.43-acre oil spacing and proration unit for formations and/or pools developed on 40-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated Northeast Townsend-Abo Pool, Undesignated Townsend-Permo Upper Pennsylvanian Pool, Undesignated Big Dog-Strawn Pool, Undesignated Townsend-Strawn Pool, and Undesignated Northeast Eidson-Mississippian Pool.

(5) The above-described units are to be dedicated to Ocean's proposed Townsend State Com. Well No. 10 to be drilled 800 feet from the North line and 660 feet from the West line (Lot 4/Unit D) of irregular Section 3. This location is considered to be standard for all four sized units.

(6) In **Cases No. 12569 and 12590** the applicant, Yates Petroleum Corporation ("Yates"), seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying Lots 1 through 8 of irregular Section 3 to form a 355.80-acre lay-down gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated North Shoe Bar-Atoka Gas Pool, Undesignated Townsend-Morrow Gas Pool, Undesignated North Shoe Bar-Morrow Gas Pool, and Undesignated North Hume-Morrow Gas Pool. Yates's proposed 355.80-acre gas unit is to be dedicated to its Yates Daisy "AFS" State Well No. 2 to be drilled at a standard gas well location 660 feet from the North and East lines (Lot 1/Unit A) of irregular Section 3.

(7) **Cases No. 12535, 12567 and 12569** originally sought to pool all of the mineral interests from the surface to the base of the Morrow formation. These three cases were consolidated and initially heard at the January 11, 2001 hearing. However, the applicants requested these cases be amended to include the deeper Mississippian formation. **Case No. 12590**, which was filed later, included the Mississippian interval. At the February 8, 2001 hearing the record of the January 11, 2001 hearing was incorporated into and became the record for **Case No. 12590**. At that time this matter was concluded and the Examiner took all four cases under advisement.

(8) Each applicant proposes to locate its well on a tract of land that is equivalent to a quarter section in which it either controls or owns the working interest.

(9) The primary zone of interest to both parties is the gas-bearing Morrow formation, which became the main focus of each party's argument.

(10) By Order No. R-11231, issued by the New Mexico Oil Conservation Commission in Case No. 12119 on August 12, 1999, Division Rule 104 was changed so that deep gas wells in southeast New Mexico developed on 320-acre spacing, which includes wells in the Morrow and Mississippian formations, could be located not closer than 660 feet to any quarter section line and that each 320-acre unit be allowed one infill gas well so long as the infill is located in the quarter section adjacent to the original well.

(11) The geological evidence presented by both applicants shows that both locations are viable Morrow prospects and that each quarter section equivalent that comprises the proposed 355.80-acre lay-down gas spacing and proration unit has the potential of containing commercial quantities of gas in the Morrow interval.

(12) The land testimony presented in this matter shows the working interest ownership in the proposed lay-down 355.80-acre unit to be as follows:

Ocean	41.072056%
Yates	50.193929%
Arrington	5.331300%
Unleased mineral interest in Lots 3 through 6	3.402715%

(13) Several small interest owners have joined in both the Ocean and Yates well proposals. Other interest owners are awaiting the outcome of the hearing.

(14) Yates owns or represents 100% of the working interest within that quarter section equivalent that comprises Lots 1, 2, 7, and 8 of Section 3 (containing 178.59 acres); therefore, Yates has 100% participation in all formations or pools developed on 160, 80, and 40-acre spacing. However, Yates owns no interest in the opposing quarter section equivalent that comprises Lots 3, 4, 5, and 6.

(15) David H. Arrington Oil and Gas, Inc. ("Arrington"), who appeared at the hearing through legal counsel in support of Yates' proposal, owns interest in Lots 3, 4, 5, and 6 only.

(16) Since Yates and Ocean both own an interest within the proposed lay-down 355.80-acre deep gas spacing unit in Section 3, both have the right to drill for and develop the minerals underlying its proposed acreage.

(17) Yates and Ocean have been negotiating and have both attempted to reach a mutually acceptable agreement for the testing and development of reserves underlying the

proposed 355.80-acre unit; however, they have been unable to voluntarily reach an agreement as to how this acreage should be developed.

(18) Both parties agreed at the hearing that:

(a) the "*Authority for Expenditures*" ("AFE") and operating costs of Ocean and Yates are comparable; and

(b) a 200% non-consent penalty is a proper risk factor for drilling the first deep gas well within the proposed 355.80-acre deep gas unit.

(19) A point of contention between Ocean and Yates was the proposed overhead and administrative costs (combined fixed rates) to be attributed to each non-consenting working interest. Yates' proposed overhead rates were $5,400.00 per month while drilling and $540.00 per month while producing and Ocean's proposed overhead rates were $6,000.00 per month while drilling and $700.00 per month while producing.

(20) From the testimony presented:

(a) Ocean first proposed a deep gas well within the proposed 355.80-acre unit to Yates and Arrington at a location 800 feet from the North line and 660 feet from the West line (Lot 4/Unit D) of Section 3 in May, 2000;

(b) when Ocean proposed this well, Yates requested Ocean move the location east to the 178.59-acre area that comprises Lots 1, 2, 7, and 8 of Section 3, but Ocean declined to do so;

(c) during the succeeding seven months there were numerous discussions between the parties concerning the drilling of a deep gas well in the proposed 355.80-acre lay-down unit;

(d) on September 29, 2000, Arrington proposed the drilling of a deep gas well 660 feet from the North line and 1980 feet from the West line (Lot 3/Unit C) of Section 3, which is within the 177.21-acre area (quarter section equivalent) that Ocean controls and where Ocean is seeking

to drill its well;

(e) in October and December, 2000, Ocean filed compulsory pooling applications with the Division; and

(f) Yates initially filed its pooling application with the Division on December 20, 2000 and on December 27, 2000 sent well proposals to the interest owners.

(21) Having proposed a deep gas well to the Morrow formation within the subject 355.80-acre lay-down gas spacing and proration unit first, Ocean's proposal set forth in **Cases No. 12535 and 12567** should be approved, and the applications of Yates in **Cases No. 12569 and 12590** should be denied, unless Ocean fails to timely commence its well hereunder.

(22) However, Ocean's proposed overhead rates appear to be excessive in comparison to Yates's proposed rates. Ocean's reasoning for these higher rates as inadequate; therefore, the overhead rates to be issued in this order should be adjusted to reflect those more reasonable rates proposed by Yates.

(23) To avoid the drilling of unnecessary wells, to protect correlative rights, to prevent waste and to 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 hydrocarbon production in any pool resulting from this order, Ocean's two applications should be approved by pooling all uncommitted mineral interests, whatever they may be, within the units described above in Finding Paragraph No. (4).

(24) Ocean should be designated the operator of the subject well and units.

(25) Any non-consenting working interest owner should be afforded the opportunity to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production.

(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 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(27) Any non-consenting interest owner should be afforded the opportunity to object to the actual well costs, but actual well costs should be adopted as the reasonable well

costs in the absence of such objection.

(28) Following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(29) Reasonable charges for supervision (combined fixed rates) should be fixed at $5,400.00 per month while drilling and $540.00 per month while producing, provided that this rate should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" The operator should be 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.

(30) All proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(31) If the operator of the pooled units fails to commence drilling the well to which the units are dedicated on or before July 15, 2001, or if all the parties to this forced pooling reach voluntary agreement subsequent to entry of this order, this order should become of no effect.

(32) The operator may request from the Division Director an extension of the July 15, 2001 deadline for good cause.

(33) The operator of the well and units should notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) The applications of Ocean Energy Resources, Inc. ("Ocean") in **Cases No. 12535 and 12567** are hereby approved, and all uncommitted mineral interests, whatever they may be, from the surface to the base of the Mississippian formation underlying the following described acreage in irregular Section 3, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico, are hereby pooled in the following manner:

(a) Lots 1 through 8 to form a 355.80-acre lay-down gas

spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated North Shoe Bar-Atoka Gas Pool, Undesignated Townsend-Morrow Gas Pool, Undesignated North Shoe Bar-Morrow Gas Pool, and Undesignated North Hume-Morrow Gas Pool;

(**b**) Lots 3 through 6 to form a 177.21-acre gas spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within that vertical extent;

(**c**) Lots 3 (Unit C) and 4 (Unit D) to form a 97.21-acre lay-down oil spacing and proration unit for any pool developed on 80-acre spacing within that vertical extent, which presently includes only the Undesignated South Big Dog-Strawn Pool; and

(**d**) Lot 4 (Unit D) to form a 48.43-acre oil spacing and proration unit for formations and/or pools developed on 40-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated Northeast Townsend-Abo Pool, Undesignated Townsend-Permo Upper Pennsylvanian Pool, Undesignated Big Dog-Strawn Pool, Undesignated Townsend-Strawn Pool, and Undesignated Northeast Eidson-Mississippian Pool.

These units are to be dedicated to Ocean's proposed Townsend State Com. Well No. 10 to be drilled 800 feet from the North line and 660 feet from the West line (Lot 4/Unit D) of irregular Section 3. This location is considered to be standard for all four sized units.

PROVIDED HOWEVER THAT, the operator of the units shall commence drilling the well on or before July 15, 2001, and shall thereafter continue drilling the well with due diligence to a depth sufficient to test the Mississippian formation.

PROVIDED FURTHER THAT, in the event the operator does not commence drilling the well on or before July 15, 2001, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

PROVIDED FURTHER THAT, should the well not be drilled to completion or

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.

(2) The applications of Yates Petroleum Corporation in **Cases No. 12569 and 12590** seeking to pool all mineral interests from the surface to the base of the Mississippian formation underlying Lots 1 through 8 of irregular Section 3 to form a 355.80-acre lay-down gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within that vertical extent, which presently include but are not necessarily limited to the Undesignated North Shoe Bar-Atoka Gas Pool, Undesignated Townsend-Morrow Gas Pool, Undesignated North Shoe Bar-Morrow Gas Pool, and Undesignated North Hume-Morrow Gas Pool, for its proposed Yates Daisy "AFS" State Well No. 2 to be drilled at a standard gas well location 660 feet from the North and East lines (Lot 1/Unit A) of irregular Section 3, are hereby denied.

(3) Ocean is hereby designated the operator of the well and units described in Ordering Paragraph No. (1) above.

(4) After pooling, uncommitted working interest owners are referred to as "non-consenting working interest owners." After the effective date of this order and within 90 days prior to commencing the well, the operator shall furnish the Division and each known non-consenting working interest owner in the units an itemized schedule of estimated well costs.

(5) 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, 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.

(6) 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 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 the reasonable well costs; provided, however, that 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 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 estimated well costs exceed reasonable well costs.

(8) 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 from the date the schedule of estimated well costs is furnished; and

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

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

(10) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5,400.00 per month while drilling and $540.00 per month while producing, provided that this rate shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is hereby 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.

(11) 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.

(12) 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.

(13) 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) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, that portion of this order authorizing compulsory pooling shall thereafter be of no further effect.

(15) 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.

(16) 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

SEAL