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. 12942

APPLICATION OF DAVID H. ARRINGTON OIL AND GAS, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

CASE NO. 12956

APPLICATION OF GREAT WESTERN DRILLING FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER NO. R-11870

ORDER OF THE DIVISION

BY THE DIVISION:

Case No. 12942 came on for hearing at 8:15 a.m. on October 10, 2002 before Examiner David K. Brooks. The case was continued and subsequently consolidated with Case No. 12956. The consolidated case came on for hearing on November 14, 2002, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 6th day of December, 2002, 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 of the subject matter.

(2) In Case No. 12942, David H. Arrington Oil and Gas, Inc., ("Arrington"), seeks an order pooling all uncommitted mineral interests from the surface to the base of the Morrow formation underlying Lots 1, 2, 7, 8, 9, 10, 15 and 16, being a portion of the E/2 of irregular Section 1, Township 16 South, Range 34 East, NMPM, Lea County, New Mexico, in the following manner:

> Lots 1, 2, 7, 8, 9, 10, 15 and 16, forming a standard 328.34-acre gas spacing and proration unit for all formations or

pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated Townsend-Morrow Gas Pool.

Arrington proposes to dedicate the above-described unit ("the Unit") to its proposed Triple Teaser Federal Com. Well No. 1 (the "proposed well") to be drilled at a standard well location 1200 feet from the North line and 1665 feet from the East line (Unit B) in Lot 2 of Section 1.

(3) In Case No. 12956, Great Western Drilling Company ("Great Western") seeks an order pooling the same lands as follows:

Lots 1, 2, 7, 8, 9, 10, 15 and 16, of Section 1 forming a standard 328.34-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated Townsend-Morrow Gas Pool;

Lots 1, 2, 7 and 8 (NE/4 of the north 2/3rds) of Section 1 forming an approximate 160-acre spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent;

Lots 1 and 2 (N/2 of the NE/4 of the north 2/3rds) of Section 1 forming an approximate 80-acre spacing and proration unit for all formations or pools spaced on 80 acres within this vertical extent; and

Lot 1 (NE/4 of the NE/4 of the north 2/3rds) of Section 1 forming an approximate 40-acre spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent.

These units are to be dedicated to Great Western's proposed Lovington Federal Well No. 1 to be drilled at the same identical location as proposed for Arrington's Triple Teaser Federal Com. Well No. 1.

(4) Great Western's application in fact asks for a 40-acre unit to consist of the NE/4 NE/4, by which is presumably meant Lot 1, although its proposed well location is in Lot 2. It is assumed that this is an error, but it is rendered irrelevant by the disposition herein made of Great Western's application.

(5) The primary objective of the wells proposed by each of the applicants is the Morrow formation.

(6) Inasmuch as approval of one of the subject applications would necessarily require denial of the other, one order should be entered for both cases.

(7) Two or more separately owned tracts are embraced within the units, 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.

(8) Both Arrington and Great Western are owners of oil and gas working interests within the units. Each applicant has the right to drill and proposes to drill to a common source of supply at the proposed location.

(9) There are interest owners in the proposed units that have not agreed to pool their interests.

(10) No interest owner other than the applicants appeared at either hearing.

(11) A brief description of the chronology of events leading to the hearings in these cases follows:

(a) In the 1970s Great Western initially acquired an acreage position in the subject area, apparently including a working interest in the units.

(b) In January of 2001, Dale Douglas, an independent petroleum landman, apparently acting on behalf of Arrington, acquired a working interest in the Unit.

(c) In early 2002, Great Western's interest was focused on the immediate area when Yates Petroleum Corporation solicited a proposal for a farm-out from Great Western.

(d) On January 31, 2002, Arrington staked a location for a well it contemplated drilling in Lot 2 of Section 1.

(e) On February 28, 2002, Arrington completed an archeological survey of the proposed location.

(f) In March, 2002, Arrington received archeological survey

clearance from the United States Bureau of Land Management for the proposed location.

(g) On June 18, 2002, KuKui, Inc. completed a well on adjacent Section 6 which, according to testimony offered by both applicants, was a material inducement to interest in drilling in Section 1.

(h) On July 23, 2002, Arrington, by letter to working interest owners, proposed its Triple Teaser Federal Com. Well No. 1, to be drilled at a location 1200 feet from the North line and 1335 feet from the East line of Section 1.

(i) On August 27, 2002, Arrington staked the currently proposed location for its Triple Teaser Federal Com. Well No. 1.

(j) On September 13, 2002, Arrington received archeological survey clearance from the United States Bureau of Land Management for the currently proposed location.

(k) On September 17, 2002, without any preliminary negotiations with Great Western beyond mailing its proposal, Arrington filed Case No. 12942.

(l) On September 27, 2002, Tom Brown, Inc. executed a farm-out of its interest in Section 1 to Arrington.

(m) On September 30, 2002, Great Western, by letter to working interest owners, proposed its Lovington Federal Com. Well No. 1, to be located at the same location originally proposed by Arrington on July 23, 2002, namely 1200 feet from the North line and 1335 from the East line of Section 1.

(n) On October 4, 2002, Great Western entered its appearance in Case No. 12942.

(o) On October 4, 2002, Dale Douglas executed an assignment of a working interest in the Unit to Arrington, dated (effective) March 1, 2002.

(p) On October 9, 2002, Great Western filed its application in Case No. 12956.

(q) On October 10, 2002 a hearing was conducted in Case No. 12942, and the case was continued to the Division's November 14, 2002 docket for consideration in connection with Case No. 12956.

(r) On or about October 21, 2002, Great Western re-proposed its Lovington Federal Com. Well No. 1 at the location currently proposed by both parties. Apparently Arrington never formally proposed its Triple Teaser Well No. 1 at the currently proposed location. However, Arrington's witnesses testified to the change of location and the reasons therefor at the October 10, 2002 hearing.

(s) On November 8, 2002, brief negotiations took place between representatives of applicants. However the negotiations were unproductive.

(t) On November 13, 2002, the assignment from Dale Douglas to Arrington executed on October 4, 2002, was recorded in the office of the County Clerk of Lea County, New Mexico.

(12) Land testimony and exhibits presented at the hearings indicate that:

(a) at the time of the hearing on November 14, 2002, Arrington owned a 50% gross working interest in the Unit;

(b) Great Western owns a 32.238% gross working interest;

(c) Davoil, Inc., which owns the remaining 17.762% gross working interest, has executed a joint operating agreement naming Great Western as operator of the Unit and has joined in Great Western's well proposal by executing an AFE prepared by Great Western; and

(d) Arrington owns a significant portion of its working interest in the Unit under a term assignment under which its interest will terminate if a well is not commenced on the subject land not later than March 1, 2003.

(13) Arrington contends that the application of Great Western should be dismissed because Great Western first circulated its well proposal less than thirty (30) days before it filed its application, contrary to an alleged division policy.

(14) Although the Division, in Order No. R-10977, filed in Case No. 11927,

dismissed an application for compulsory pooling where the well proposal was not circulated until fourteen (14) days *after* the filing of the application, neither Order No. R-10977 nor any other order cited by the parties references or indicates the existence of a rule or policy requiring circulation of a proposal thirty days prior to filing an application.

(15) If a policy exists or has existed requiring circulation of a proposal prior to filing an application, such policy should not be applied to a competing well proposal filed after the filing of a compulsory pooling application by another party, inasmuch as such a policy would encourage the first party proposing a well to file a compulsory pooling application at the earliest possible time in order to pretermit competition.

(16) Even if an established policy has existed as contended by Arrington, which the Division believes is not the case, no due process right of Arrington is infringed by not applying such policy in this case because no criminal or civil penalty is involved. Hence the decision in *General Electric Company v. United States Environmental Protection Agency*, 53 F.3d 1324 (D.C.Cir 1995), cited by Arrington, is not in point.

(17) Great Western's application should not be dismissed due to its not having proposed its well prior to the date of filing of its application.

(18) Great Western contends that Arrington's application should be dismissed because Arrington did not have record or paper title to any interest in the Unit when it filed its application.

(19) Great Western does not claim any part of the interest in the Unit claimed by Arrington, and there is no evidence of any adverse claim to any of Arrington's interest by any person.

(20) Great Western did not present any testimony or evidence indicating that it took or omitted to take any action in reliance on any defect of Arrington's paper or record title.

(21) Arrington's application should not be dismissed due to its not having held paper or record title when it filed its application.

(22) Great Western further contends that Arrington's application should be dismissed because Arrington never formally proposed its Triple Teaser Federal Com. Well No. 1 at the location presently proposed by both applicants.

(23) Both applicants are in agreement that the well should be drilled at the presently proposed location (1200 feet from the North line and 1665 feet from the East line of Section 1), and neither party testified that the relocation of the well was in any

way material to its evaluation of this prospect.

(24) Arrington's application should not be dismissed due to its failure to formally propose the revised location.

(25) The testimony and evidence offered by the parties at the hearing bearing on the factors the Division deems relevant to the issue of operator appointment indicate that:

(a) minimal negotiations have taken place between the applicants;

(b) the "adjusted working interest control" (as such term is used by the Oil Conservation Commission in Finding Paragraph (25) of Order No. R-10731-B, entered in Cases No. 11666 and 11677) in the 320-Acre Unit is: Arrington 50%; and Great Western 50%;

(c) there is no evidence of different percentages as to any relevant subdivision of the subject land;

(d) the applicants propose the same location and objective, and there is no material difference in their geologic interpretations;

(e) both parties did independent exploratory work in the area, however, Arrington was the first to propose a well in the Unit;

(f) the proposed overhead rates and risk penalties are identical;

(g) differences between estimated well costs, as reflected in the AFEs placed in evidence by the respective applicants, are not significant; and

(h) both applicants are experienced operators, and the evidence does not justify a conclusion that either applicant could not operate the units prudently.

(26) Division precedent has established that in the absence of other controlling factors, the party who first developed a prospect and first proposed a well should be designated operator.

(27) Anecdotal evidence of cost overruns experienced by an operator on unrelated projects does not justify a finding that the operator cannot operate prudently,

especially since the costs recoverable from a non-operator under a compulsory pooling order are limited to "reasonable costs," as determined by the Division, if necessary, after notice and hearing.

(28) The minimal negotiations between the parties might, in another case, require dismissal of both applications. However, the proximity of the expiration of Arrington's interest held pursuant to a term assignment on March 1, 2003 militates against dismissal in this case.

(29) 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, the application of Arrington in Case No. 12942 should be approved by pooling all uncommitted mineral interests, whatever they may be, within the Unit.

(30) Because Arrington initially proposed a well at the approximate location and with the objective currently proposed, and no other compelling factor exists, Arrington should be designated the operator of the proposed well and of the Unit.

(31) Inasmuch as Arrington did not apply for designation of any unit other than the 328.34-acre Unit, only such unit should be formed.

(32) The application of Great Western in Case No. 12956 should be **denied**.

(33) 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% thereof as a reasonable charge for the risk involved in drilling the well.

(34) Reasonable charges for supervision (combined fixed rates) should be fixed at $6,000 per month while drilling and $600 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 David H. Arrington Oil & Gas, Inc. in Case No. 12942, all uncommitted mineral interests from the surface to the base of the Morrow formation underlying Lots 1, 2, 7, 8, 9, 10, 15 and 16 of Section 1, Township 16 South, Range 34 East, N.M.P.M., Lea County, New Mexico, are hereby pooled to form a standard 328.34-acre gas spacing and proration unit ("the Unit") for all formations or pools spaced on 320 acres within this vertical extent which presently include but are not

necessarily limited to, the Undesignated Townsend-Morrow Gas Pool. The Unit shall be dedicated to Arrington's proposed Triple Teaser Federal Com. Well No. 1 ("the proposed well") to be drilled at a standard gas well location 1200 feet from the North line and 1665 feet from the East line (Unit B) in Lot 2 of Section 1.

(2) David H. Arrington Oil & Gas, Inc. is hereby designated the operator of the proposed well and of the Unit.

(3) The operator of the Unit shall commence drilling the proposed well on or before March 1, 2003, and shall thereafter continue drilling the well with due diligence to test the Morrow formation.

(4) In the event the operator does not commence drilling the proposed well on or before March 1, 2003, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) Should the proposed well not be drilled to completion, or be 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.

(6) After pooling, uncommitted working interest owners are referred to as non-consenting working interest owners. ("Uncommitted 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 non-consenting working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(7) 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 as hereinafter provided, 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.

(8) 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 proposed 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 deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division shall determine reasonable well costs after notice and hearing.

(9) 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 paid, estimated well costs exceed reasonable well costs.

(10) 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% of the above costs.

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

(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6,000 per month while drilling and $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" 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 each non-consenting working interest.

(13) Except as provided in Ordering Paragraphs (10) and (12) above, 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) 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. 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.

(15) 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.

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

(17) The application of Great Western for pooling of the units with Great Western as operator and for dedication thereof to Great Western's proposed Lovington Federal Com. Well No. 1 is hereby **denied.**

(18) 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

LORI WROTENBERY
Director