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. 10956
Order No. R-9178-A

APPLICATION OF CONSOLIDATED OIL & GAS INC. TO AMEND DIVISION ORDER NO. R-9178, SAN JUAN AND RIO ARRIBA COUNTIES, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on April 14, 1994, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 16th day of June, 1994, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

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. 10955, 10956 and 10957 were consolidated at the time of the hearing for the purpose of testimony.

(3) By Order No. R-9178 issued in Case No. 9894 on May 23, 1990, the Division, upon application of Richmond Petroleum Inc. (Richmond), pooled all mineral interests in the Basin-Fruitland Coal Gas Pool underlying Lots 1 through 4 and the S/2 N/2 (N/2 equivalent) of Irregular Section 11, Township 32 North, Range 6 West, NMPM, San Juan and Rio Arriba Counties, New Mexico, thereby forming a non-standard 232.80-acre gas spacing and proration unit for said pool, said unit to be dedicated to the applicant's Miller 32-6-11 Well No. 1 to be drilled at an unorthodox coal gas well location 1130 feet from the North line and 760 feet from the West line (Unit E) of Section 11.

(4) Division records indicate that the Miller 32-6-11 Well No. 1 was spudded on June 23, 1990.

(5) Division records and testimony presented further indicate that on June 26, 1990, the subject well reached a total depth of 2,900 feet at which point casing was set and drilling operations ceased. Apparently no further operations were performed on the well until December, 1992, at which time Richmond perforated the coal seam interval from 2,650 feet to 2,664 feet. The successor operator of the Miller 32-6-11 Well No. 1, Consolidated Oil & Gas Inc., has not performed any work on the well.

(6) The applicant, Consolidated Oil & Gas Inc. (Consolidated), seeks to amend Division Order No. R-9178 by designating Consolidated the operator of the Miller 32-6-11 Well No. 1, to provide a supplemental election to participate, to add additional parties, to revise the various reporting dates in this order and to otherwise reissue and renew the subject order including the recovery of both actual and future costs of drilling and completing the subject well including a charge for the risk involved.

(7) At the time of the hearing, Consolidated sought to have the amended order apply to the following party and interest:

a) James J. Rubow (Rubow), Passport Energy, Inc., who owns a 0.00257732 net revenue interest in the spacing unit as a result of 0.6 net acres/3 gross acres in the SE/4 NE/4 of Section 11;

(8) With the exception of the above-described interest, the applicant has consolidated, voluntarily, the remaining interests in the spacing unit.

(9) James J. Rubow submitted a written letter of objection to the application.

(10) According to evidence and testimony presented, the sequence of events leading up to the hearing in this matter are as follows:

a) At the time Division Order No. R-9178 was issued, Rubow's interest was subject to an oil and gas lease dated May 20, 1988 from Stella M. Quintana to T. H. McElvain, Jr., in which Quintana retained a 1/8 royalty and granted to McElvain a 7/8 working interest. The primary term of the lease was four years and as long thereafter as oil or gas or either was produced from those lands or lands with which it was pooled;

b) On June 16, 1989, McElvain signed a farmout agreement with Richmond which would have allowed Richmond to "earn" 2/3 of McElvain's 7/8 interest in the Quintana lease provided Richmond drilled, completed and produced the proposed Miller 32-6-11 Well No. 1 prior to May 20, 1992;

c) Unable to secure the voluntary joinder of all interest owners within the proposed proration unit, Richmond sought to compulsory pool said interests by appearing at a Division hearing on April 4 and May 2, 1990;

d) The Division issued Order No. R-9178 on May 23, 1990, granting the compulsory pooling application of Richmond. Under the terms of the order, Richmond was required to spud the well, unless extended by the Division Director, before August 1, 1990. Richmond was also required to complete the well within one hundred and twenty days after commencing drilling;

e) Richmond spudded the Miller 32-6-11 Well No. 1 on June 23, 1990, and drilled the well as described in Finding No. (5) above;

f) Richmond did not complete the Miller 32-6-11 Well No. 1 as per the terms of Order No. R-9178, and did not perform any subsequent operations on the subject well until December, 1992;

g) The lease agreement between McElvain and Quintana expired on or about May 20, 1992, inasmuch as Richmond did not complete and produce the Miller 32-6-11 Well No. 1 as per the terms of the lease agreement;

h) In January, 1994, Consolidated purchased the Miller 32-6-11 Well No. 1 as well as several other properties in New Mexico and Colorado from Richmond;

i) Consolidated contacted Rubow on March 4, 1994, advising him that it had acquired the Miller 32-6-11 Well No. 1. Consolidated offered to allow Rubow to participate in subject well by paying his proportionate share of the drilling costs incurred by Richmond ($142,872.67). In the alternative, Consolidated offered to lease Rubow's interest;

j) To date, Rubow and Consolidated have been unable to reach a voluntary agreement concerning the subject acreage.

(11) Consolidated's position in this case is that Rubow should be allowed to voluntarily participate in the subject well provided that he pays his proportionate share of the well costs incurred by Richmond, plus all future costs incurred by Consolidated in the completion of the well. In the alternative, Rubow may lease his interest in the spacing unit to Consolidated. In the absence of any voluntary agreement, Consolidated seeks to force pool the interest of Rubow.

(12) Rubow, in his written letter of objection in this case, states and contends that:

a) He did not receive adequate notice of the force pooling hearing in this matter;

b) He has not seen any evidence that Consolidated is the owner of the oil and gas rights underlying the subject acreage;

c) McElvain is still the owner of record of his interest in the subject acreage inasmuch as McElvain has not "released" his lease;

d) Consolidated has failed to provide him with a proposed Joint Operating Agreement, proposals for gathering and marketing gas, and well data including logs and drilling reports;

e) Inasmuch as his interest was subject to an oil and gas lease at the time the Miller 32-6-11 Well No. 1 was drilled, he should not be liable for his proportionate share of well costs incurred by Richmond;

f) The risk factor penalty cannot be awarded because the well has already been drilled and because Consolidated did not drill the well and incur the risk.

(13) The evidence shows that notice of the hearing in this case was mailed by the applicant certified mail on March 21, 1994, which fulfills the requirements of Division Rule No. 1207.

(14) At the request of the Division, the applicant, subsequent to the hearing, contacted McElvain in order to ascertain McElvain's opinion as to the status of the Quintana lease.

(15) Subsequent to the hearing, the applicant filed with the Division a copy of a "Partial Release of Lease" executed by McElvain on April 15, 1994, as to the Quintana interest.

(16) As a result of the "Partial Release of Lease" Rubow should be considered the owner of the interest in question and subject to the jurisdiction of the Division in this case.

(17) The remaining point of dispute between the parties involves Rubow's contention that he should not be liable for his proportionate share of well costs incurred by Richmond in the drilling of the Miller 32-6-11 Well No. 1. Rubow stated in his letter that he is willing to pay his share of the future costs of completion for the subject well.

(18) Relative to the well cost issue, the following items were presented as evidence and testimony in this case:

a) Richmond spent $142,872.67 in the drilling of the Miller 32-6-11 Well No. 1;

b) The original purchase price Consolidated offered Richmond for four properties in New Mexico, including the Miller 32-6-11 Well No. 1 was $722,400. Of this amount $186,000 or 25.75 percent was allocated as the value of the subject well;

c) On January 24, 1994, Consolidated and Richmond agreed to a reduction in the purchase price because Richmond failed to earn and therefore did not acquire any of the oil and gas lease interest which it might have earned through various farmout agreements, including the McElvain agreement. The actual purchase price was reduced to $400,000.

d) The purchase price not only included the value of the wellbore(s), but also the value of gas reserves in place underlying each respective tract.

(19) Rubow's argument is that when a mineral owner leases, he gives up all right and control over drilling and producing a well, and is excused of all costs in connection with drilling, completing, producing and operating a well except for those costs specifically designated in the lease.

(20) In exchange for being excused from all drilling, completing, producing and operating costs, a mineral owner who executes a lease compensates the lessee by assigning him a portion of the mineral interest. Specifically, in the instance of the Quintana/McElvain lease, Quintana assigned McElvain a 0.225515 percent interest (7/8 x 0.257732 percent) and retained a 0.032216 percent interest (1/8 x 0.257732 percent) in the spacing unit.

(21) Rubow currently owns and controls a 0.257732 percent interest in the spacing unit.

(22) It is not fair and reasonable that Rubow should retain his full 0.257732 percent interest in the spacing unit and not be required to compensate the applicant for his share of well costs.

(23) Rubow should be liable for his share of well costs.

(24) Consolidated's request to utilize $142,872.67 as well costs is also not fair and reasonable.

(25) Well costs, excluding future completion costs, should be determined as follows:

Original allocation of the Miller 32-6-11 Well No. 1 (25.75 percent) x Actual purchase price ($400,000) =
$103,000

In the absence of any evidence or testimony to indicate the value of the wellbore and gas reserves relative to the total purchase price, the Division should assign values as follows:

33.0 percent- Value of wellbore
67.0 percent- Value of gas reserves

Well costs, as determined from the above values, should be equal to:

$103,000 X 33 percent = $33,990.00

(26) $33,990.00 should be utilized as reasonable well costs.

(27) Total well costs should be $203,990.00, determined as follows:

$33,990.00- Existing Well Costs
\+ $170,000.00-Estimated future completion costs

(28) Division Order No. R-9178 should be superseded by this order.

(29) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the production in the Basin-Fruitland Coal Gas Pool, the applicant's request to effectively compulsory pool the interests underlying the N/2 of Irregular Section 11 should be approved.

(30) Consolidated Oil & Gas Inc. should be designated the operator of the subject well and unit.

(31) Any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated well costs ($203,990.00) to the operator in lieu of paying his share of reasonable well costs out of production.

(32) The applicant requested that a risk penalty of 156 percent be assigned as a reasonable charge for the risk involved in drilling and completing the subject well.

(33) Inasmuch as the subject well has already been drilled, the remaining risk should apply only to completion operations to be conducted on the well. The risk penalty should therefore be reduced accordingly.

(34) Any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 50 percent thereof as a reasonable charge for the risk involved in the completion of the well.

(35) Any non-consenting working interest owner should be afforded the opportunity to object to the actual completion costs but actual completion costs should be adopted as the reasonable costs in the absence of such objection.

(36) Following determination of reasonable well costs, any non-consenting working interest owner who has paid his 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.

(37) $3500.00 per month while completing and $350.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(38) All proceeds from production from the subject well which 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.

(39) Upon the failure of the operator of said pooled unit to commence completion operations on the Miller 32-6-11 Well No. 1 on or before August 1, 1994, the order pooling said unit should become null and void and of no effect whatsoever.

(40) Should all the parties to this forced pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(41) The operator of the well and unit shall notify the Director of 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) All mineral interests, whatever they may be, in the Basin-Fruitland Coal Gas Pool underlying Lots 1 through 4 and the S/2 N/2 (N/2 equivalent) of Irregular Section 11, Township 32 North, Range 6 West, NMPM, San Juan and Rio Arriba Counties, New Mexico, are hereby pooled to form a non-standard 232.80-acre gas spacing and proration unit for said pool, said unit to be dedicated to the existing Miller 32-6-11 Well No. 1 located at an unorthodox coal gas well location 1130 feet from the North line and 760 feet from the West line (Unit E) of Section 11.

PROVIDED HOWEVER THAT, the operator of said unit shall commence completion operations on the Miller 32-6-11 Well No. 1 on or before August 1, 1994.

PROVIDED FURTHER THAT, in the event said operator does not commence completion operations on said well on or before the 1st day of August, 1994, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division Director for good cause shown.

PROVIDED FURTHER THAT, should said well not be completed within 60 days after commencement thereof, said operator shall appear before the Division Director and show cause why Ordering Paragraph No. (1) of this order should not be rescinded.

(2) Consolidated Oil & Gas Inc. is hereby designated the operator of the subject well and unit.

(3) After the effective date of this order and within 30 days prior to commencing completion operations, the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated completion costs.

(4) Within 30 days from the date the schedule of estimated completion costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs ($203,990.00) to the operator in lieu of paying his share of reasonable well costs out of production, and any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(5) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual completion costs within 90 days following completion of the well; if no objection to the actual completion costs is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual completion costs shall be the reasonable well costs; provided however, if there is objection to actual completion costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(6) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated well costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

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

(A) The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(B) As a charge for the risk involved in the completion of the well, 50 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

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

(9) $3500.00 per month while completing and $350.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(10) 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 the terms of this order.

(11) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(12) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in San Juan 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 said escrow agent within 30 days from the date of first deposit with said escrow agent.

(13) Should all the parties to this forced 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 Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(15) Division Order No. R-9178 is hereby superseded by this order.

(16) Jurisdiction of this cause is hereby 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

WILLIAM J. LEMAY
Director

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