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. 10957
Order No. R-9179-A

APPLICATION OF CONSOLIDATED OIL & GAS INC. TO AMEND DIVISION ORDER NO. R-9179, 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-9179 issued in Case No. 9895 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 the S/2 of Irregular Section 11, Township 32 North, Range 6 West, NMPM, San Juan and Rio Arriba Counties, New Mexico, thereby forming a standard 320-acre gas spacing and proration unit for said pool, said unit to be dedicated to the applicant's Carnes 32-6-11 Well No. 1 to be drilled at an unorthodox coal gas well location 1800 feet from the South line and 230 feet from the West line (Unit L) of Section 11.

(4) Division records indicate that the Carnes 32-6-11 Well No. 1 was spudded on June 5, 1990.

(5) Division records and testimony presented further indicate that on June 8, 1990, the subject well reached a total depth of 2,517 feet at which point casing was set and drilling operations ceased. Subsequently, the subject well was deepened to a total depth of 2,839 feet into the Basin-Fruitland Coal Gas Pool. Apparently no further operations were performed on the well until March, 1994, at which time Consolidated Oil & Gas Inc., the successor operator, perforated the coal seams and obtained a gas sample.

(6) The applicant, Consolidated Oil & Gas Inc. (Consolidated), seeks to amend Division Order No. R-9179 by designating Consolidated the operator of the Carnes 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 parties and interests:

a) James J. Rubow, Passport Energy, Inc., who owns a 5.0 percent net revenue interest in the spacing unit as a result of 16 net acres in the N/2 SE/4 of Section 11;

b) Edmund T. Anderson IV, individually and as Trustee of the Mary Anderson Boll Family Trust, who owns a 0.031250 net revenue interest in the spacing unit as a result of a 10 net acre/40 gross acre interest in the SE/4 SW/4 of Section 11;

c) Manuel A. Rodriguez, who owns a 0.0018702651 net revenue interest in the spacing unit as a result of an interest in Tract No. 4, and;

d) Richard G. Clark, who owns a 0.0018702651 net revenue interest in the spacing unit as a result of an interest in Tract No. 4.

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

(9) Evidence and testimony in this case indicate that neither Richmond Petroleum Inc. nor Consolidated has been able to locate the owners of the Manuel A. Rodriguez and Richard G. Clark interests.

(10) Edmund T. Anderson IV (Anderson), on behalf of himself and as Trustee of the Mary Anderson Boll Family Trust, appeared at the hearing in opposition to the application. James J. Rubow (Rubow) submitted a written letter of objection to the application. It appears from the letter that Rubow's position in this case is nearly identical to that of Edmund T. Anderson IV.

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

a) On July 19, 1988, Anderson leased his undivided 1/4 mineral interest in the SE/4 SW/4 of Section 11 to T. H. McElvain, Jr. (McElvain). Anderson, by virtue of the lease agreement, retained a 1/5 royalty interest and granted McElvain a 4/5 working interest. The primary term of the lease was two years and as long thereafter as oil or gas or either was produced from those lands or lands with which it was pooled;

b) At the time Division Order No. R-9179 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;

c) On June 16, 1989, McElvain signed a farmout agreement with Richmond which would have allowed Richmond to "earn" 2/3 of McElvain's 4/5 interest in the Anderson lease and 2/3 of McElvain's 7/8 interest in the Quintana lease provided Richmond drilled, completed and produced the proposed Carnes 32-6-11 Well No. 1 prior to July 19, 1990 for the Anderson lease and prior to May 20, 1992 for the Quintana lease;

d) Unable to secure the voluntary joinder of all interest owners within the S/2 of Irregular Section 11, Richmond sought to compulsory pool said interests by appearing at a Division hearing on April 4 and May 2, 1990;

e) The Division issued Order No. R-9179 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;

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

g) Richmond did not complete the Carnes 32-6-11 Well No. 1 as per the terms of Order No. R-9179, and did not perform any operations on the subject well subsequent to the completion of drilling operations on June 8, 1990;

h) The lease agreement between McElvain and Anderson expired on or about July 19, 1990, and the lease agreement between McElvain and Quintana expired on or about May 20, 1992, inasmuch as Richmond did not complete and produce the Carnes 32-6-11 Well No. 1 as per the terms of the lease agreements;

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

j) Consolidated contacted Anderson on March 1, 1994, and contacted Rubow on March 4, 1994, advising them that it had acquired the Carnes 32-6-11 Well No. 1. Consolidated offered to allow Anderson and Rubow to participate in subject well by paying their proportionate share of the drilling costs incurred by Richmond ($224,616.72). In the alternative, Consolidated offered to lease Anderson's and Rubow's interest;

k) On March 14, 1994, Anderson advised Consolidated that he would not accept the terms of their offer;

l) On March 7, 1994, Rubow proposed a counter offer to Consolidated which was subsequently rejected;

m) On or about March 23, 1994, Consolidated re-entered the Carnes 32-6-11 Well No. 1 and perforated the Basin-Fruitland Coal Gas Pool in order to obtain a gas sample in order to timely qualify the well for the Internal Revenue Code Section 29 Tax Credit. This work was performed at an AFE'd cost of $24,850 and at an actual cost of $20,200.

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

(13) Anderson contends that the Division has no jurisdiction over his interest in this case for the following reasons:

a) Although he believes the lease agreement between himself and McElvain has expired under its own terms, Anderson testified that McElvain is still the owner of record of his interest in the subject acreage inasmuch as McElvain has not "released" his lease;

b) "Owner" is defined by Section 70-2-33, N.M.S.A. as follows: "owner means the person who has the right to drill into and to produce from any pool and to appropriate the production either for himself or for himself and another";

c) Since the status of the lease agreement and resulting ownership of the Anderson interest remains unclear, Anderson cannot be considered to be an "owner" and under the jurisdiction of the Division.

(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 Anderson and Rubow leases.

(15) Subsequent to the hearing, the applicant filed with the Division a copy of a "Release of Lease" executed by McElvain on April 15, 1994, as to the Anderson interest, and 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 "Release of Lease" Anderson and Rubow should be considered "owners" and subject to the jurisdiction of the Division in this case.

(17) The remaining point of dispute between the parties involves Anderson's and Rubow's contention that they should not be liable for their proportionate share of well costs incurred by Richmond in the drilling of the Carnes 32-6-11 Well No. 1. Anderson testified and Rubow stated in his letter that they are willing to pay their share of the future costs of completion and costs incurred thus far by Consolidated (as described in Finding No. (11)(m)).

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

a) Richmond spent $224,616.72 in the drilling of the Carnes 32-6-11 Well No. 1;

b) The original purchase price Consolidated offered Richmond for four properties in New Mexico, including the Carnes 32-6-11 Well No. 1, was $722,400. Of this amount $192,300 or 26.62 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) Anderson argued 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 Anderson/McElvain lease, Anderson assigned McElvain a 2.5 percent interest (4/5 x 3.125 percent) and retained a 0.625 percent interest (1/5 x 3.125 percent) in the spacing unit.

(21) Anderson and Rubow currently own and control a 3.125 percent and 5.0 percent interest, respectively, in the spacing unit.

(22) It is not fair and reasonable that Anderson and Rubow should retain their full 3.125 percent and 5.0 percent interest in the spacing unit and not be required to compensate the applicant for their share of well costs.

(23) Anderson and Rubow should be liable for their share of well costs.

(24) Consolidated's request to utilize $224,616.72 as well costs is also not fair and reasonable.

(25) Well costs, excluding the costs incurred thus far by Consolidated in perforating the subject well and future completion costs, should be determined as follows:

Original allocation of the Carnes 32-6-11 Well No. 1 (26.62 percent) x Actual purchase price ($400,000) =
$106,480

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:

$106,480 X 33 percent = $35,138.40

(26) $35,138.40 should be utilized as reasonable well costs.

(27) Total well costs should be $205,338.40, determined as follows:

$35,138.40- Existing Well Costs
\+ $20,200.00- Costs incurred thus far by Consolidated
\+ $150,000.00-Estimated future completion costs

(28) Division Order No. R-9179 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 S/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 ($205,338.40) 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 Carnes 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 the S/2 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 standard 320-acre gas spacing and proration unit for said pool, said unit to be dedicated to the existing Carnes 32-6-11 Well No. 1 located at an unorthodox coal gas well location 1800 feet from the South line and 230 feet from the West line (Unit L) of Section 11.

PROVIDED HOWEVER THAT, the operator of said unit shall commence completion operations on the Carnes 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 ($205,338.40) 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-9179 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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