

**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 TO CONSIDER:**

CASES NO. 16115 and 16116

APPLICATION OF CHISHOLM ENERGY OPERATING, LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

ORDER NO. R-14876

ORDER OF THE DIVISION

BY THE DIVISION:

These cases came on for hearing at 8:15 a.m. on May 3, 2018, at Santa Fe, New Mexico, before Examiner Michael A. McMillan.

NOW, on this 18th day of September 2018, 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 the subject matter.

(2) Cases No. 16115 and 16116 were consolidated for hearing and a single order is being issued.

(3) In Case No. 16115, Chisholm Energy Operating, LLC ("Applicant" or "Chisholm") seeks approval of a 640.31-acre, more or less, non-standard gas spacing unit and project area (the "Unit") for oil and gas production from the Wolfcamp formation, Purple Sage; Wolfcamp (Gas) Pool (Pool code 98220), comprising the E/2 of Section 31, Township 22 South, Range 26 East, and Lot 1, Lot 2, S/2 NE/4, and SE/4 (E/2 equivalent) of Section 6, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit for the Wolfcamp formation.

(4) The Unit would be dedicated to the following "Proposed Well" to be completed at an orthodox location within the Unit:

Ocotillo 6 31 State Com WCB Well No. 2H, API No. 30-015-44835

SHL: 245 feet from the South line and 1190 feet from the East line,
(Unit P) of Section 6, Township 23 South, Range 26 East, NMPM.
BHL: 330 feet from the North line and 400 feet from the East line
(Unit A) of Section 31, Township 22 South, Range 26 East, NMPM.

(5) The proposed well is within the Purple Sage; Wolfcamp (Gas) Pool (Pool code 98220), which is governed by statewide Rule 19.15.15.10.B NMAC which provides for 320-acre gas spacing units, and by special pool rules established by Division Order R-14262 which requires wells to be located no closer than 330 feet from the unit outer boundary. The proposed Unit and project area consists of four (4) adjacent quarter sections oriented south to north.

(6) In Case No. 16116, Chisholm seeks approval of a 320.18-acre, more or less, non-standard oil spacing unit and project area (the "Unit") for oil and gas production from the Bone Spring formation, WC-015 G-04 S232628M; Bone Spring Pool (Pool code: 98056), comprising the E/2 E/2 of Section 31, Township 22 South, Range 26 East, and Lot 1, SE/4 NE/4 and E/2 SE/4 (E/2 E/2 equivalent) of Section 6, Township 23 South, Range 26 East, NMPM, Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit for the Bone Spring formation.

(7) The Unit would be dedicated to the following "Proposed Well" to be completed at an orthodox location within the Unit:

Ocotillo 6 31 State Com 3BS Well No. 4H, API No. 30-015-44837

SHL: 245 feet from the South line and 1260 feet from the East line,
(Unit P) of Section 6, Township 23 South, Range 26 East, NMPM.
BHL: 330 feet from the North line and 525 feet from the East line
(Unit A) of Section 31, Township 22 South, Range 26 East, NMPM.

(8) The proposed well is within the WC-015 G-04 S232628M; Bone Spring Pool (Pool code 98056) and is subject to Division Rule 19.15.15.9(A) NMAC, which provides for 330-foot setbacks from the unit boundaries and standard 40-acre units each comprising a governmental quarter-quarter section. The proposed Unit and project area consists of eight (8) adjacent quarter-quarter sections oriented south to north.

(9) Premier Oil & Gas, Inc. ("Premier") did not file competing applications but objects to the granting of both Chisholm applications and instead proposes that wells should be drilled in an East-West direction. Premier entered an appearance and a pre-hearing statement in both cases and appeared at hearing through counsel in active opposition.

(10) No other party appeared at the hearing, or otherwise opposed the granting of this application.

(11) Prior to the hearing, Premier filed a motion to dismiss the Chisholm cases.

(12) Chisholm appeared through counsel and presented the following through testimony and exhibits.

- a. The Bone Spring and Wolfcamp formations in this area are both suitable for development by horizontal drilling.
- b. Each tract in the proposed units can be expected to contribute substantially to production from the target formations.
- c. Applicant has a voluntary agreement with approximately 90 percent of the working interest owners in the Units.
- d. The lands subject to this hearing, and the proposed wells, are subject to two different voluntary agreements. One agreement area entails Section 31 and the W/2 of Section 32, Township 22 South, Range 26 East in which the Applicant and Premier Oil & Gas, Inc. are subject to. The other voluntary agreement area covers the E/2 of Section 6, Township 23 south, Range 26 East, in which only Chisholm [but not Premier] is subject to.
- e. Hearing Order No. R-14140 provided a basis for compulsory pooling portions of lands for horizontal wells in which one portion of the Unit is subject to a voluntary agreement, and another portion is not subject to the voluntary agreement.
- f. The target interval in the Bone Spring formation is located near the top of the Wolfcamp formation. Ownership is identical in the Bone Spring and Wolfcamp formations.
- g. The orientation of the proposed horizontal wells from South to North is appropriate for the proposed Units. The South-North drilling direction is supported by a regional geology study by the United States Geological Survey of the maximum stress direction near the proposed units. Regional Isopach maps of the Upper Bone Spring, the Second Bone Spring, and the Third Bone Spring, all suggest that the South-North is the preferred orientation of the proposed Bone Spring well.
- h. The stress direction and corresponding natural fracture direction indicates that the preferred orientation of the proposed wells is South to North. Chisholm obtained stress and fracture orientation in the McCord Enterprises 23 WCA Well No. 4H (API 30-015-44283; "McCord Well") from FMI and Dipole Sonic logs supporting this conclusion. That well is located four to five miles to the Southeast.
- i. Chisholm has an agreement with the City of Carlsbad for the surface locations and a casing design to adequately protect the City of Carlsbad drinking water.

Chisholm has experience in other basins successfully constructing well pads with severe surface topography issues.

- j. Notice by certified mail was provided to all uncommitted interest owners in the proposed Unit whose interests were evidenced by a conveyance instrument, either of record or known to Applicant when the Application was filed, and to heirs known to Applicant of deceased persons who appear as owners in such instruments.
- k. Those potentially affected parties whose whereabouts could not be ascertained were noticed by publication as provided in Rule 19.15.4.12.B NMAC.

(13) Premier appeared through counsel and presented the following through testimony and exhibits:

- a. The application by Chisholm should be dismissed in part because the lands in question, the E/2 of Section 32, are subject to an existing voluntary agreement.
- b. Premier did not dispute that the lands in Section 31 and E/2 of Section 32, both in Township 22 South, Range 26 East, are subject to a voluntary agreement in which both parties are subject to. Premier also did not dispute that it was not a party to the other voluntary agreement in Section 6, Township 23 South, Range 26 East.
- c. Premier prefers an east-west orientation of the proposed wells;
- d. Premier presented a counter proposal for four wells for Section 31 and Section 32. Premier did not present these well proposals to the parties subject to the voluntary agreement;
- e. The Premier proposed wells may be either 1.5 or 2 miles in length and the 1.5-mile wells could be drilled under the existing voluntary agreement. The 2-mile wells would require creation of a new voluntary agreement or compulsory pooling.
- f. Premier also prefers east-west oriented wells because of surface issues and concerns about the Carlsbad water well field. Premier stated that the surface topography and the proximity of the surface location of Chisholm's proposed wells to the Carlsbad City Water Field creates environmental issues.
- g. Premier provided engineering testimony in the form of decline curve analysis that East-West oriented wells have greater oil and gas reserves versus wells that were drilled North-South. The comparison wells were from the same operator and were selected based on similar completion methods and

intervals. The comparison wells are operated by Matador Production Company and located approximately 10 miles to the east/southeast in Section 12, Section 13, Section 14, Section 23, Section 24, and Section 25, all in Township 23 South, Range 27 East (collectively the "Matador Wells").

- h. Premier provided a summary of findings of work compiled by Devon Energy Production Company, LP in the Burton Flat Area that showed that east-west wells outperform north-south wells.
- i. Premier stated that one East-West well, the Daisy Duke 31 State Com Well No. 3H, whose project area is the S/2 N/2 (equivalent) of Section 31 in the Bone Spring formation has been a poor well because of casing issues and only five stages were completed [conclusion was disputed by Chisholm].
- j. Premier stated that the drilling cost estimates (the "AFE's") submitted by Chisholm are abnormally low, based on total AFE costs of other operators [this was disputed by Chisholm].
- k. Another study presented as Exhibit No. 19 from Premier showed that East-West orientation in the Bone Spring in the Burton Flat which is 13 miles East of the Unit shows the preferred direction of proposed wells should be East-West.

The Division finds that

(14) Chisholm and Premier have presented competing arguments over the preferred drilling direction, where the facilities of the wells should be located, the AFE accuracy, the ability of existing joint operating agreements to restrict formation of a horizontal spacing unit, and other issues. The contest entered and presented by Premier has debated critical issues that should be considered prior to committing to development. Chisholm has measured the stress/fracture direction in a well located closer to the proposed wells than the analogous Matador Wells which data was presented by Premier. Chisholm has brought the compulsory pooling cases and already controls the majority interest in the proposed units.

(15) Chisholm's proposed non-standard units should be approved to enable it to drill horizontal wells that will efficiently produce the reserves underlying the Units, thereby preventing waste and protecting correlative rights.

(16) 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.

(17) Applicant is owner of an oil and gas working interest within the Units. Applicant has the right to drill and proposes to drill the Proposed Wells to a common source of supply within the Units at the described locations.

(18) There are interest owners in the Units that have not agreed to pool their interests.

(19) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Units the opportunity to recover or receive without unnecessary expense a just and fair share of hydrocarbons, these applications should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Units.

(20) The motion of Premier Oil & Gas, Inc. to dismiss Cases No. 16115 and 16116 should be denied. Chisholm's applications in Cases No. 16115 and 16116 should be approved.

(21) Chisholm Energy Operating, LLC (OGRID 372137) should be designated the operator of the Proposed Wells and the Units.

(22) Infill wells within the Units should be subject to Division Rules 19.15.13.9 NMAC through 19.15.13.10 NMAC, and to the terms and conditions of this order.

(23) Any pooled working interest owner who does not pay its share of estimated well costs of any well should have withheld from production from such well its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the Proposed Wells.

(24) Reasonable charges for supervision (combined fixed rates) should be fixed at \$7500 per month, per well, while drilling and \$750 per month, per well, while producing, provided that these rates should be adjusted annually pursuant to the overhead adjustment provision of the COPAS form titled "*Accounting Procedure-Joint Operations*."

IT IS THEREFORE ORDERED THAT

(1) The motion of Premier Oil & Gas, Inc. to dismiss Cases No. 16115 and 16116 is denied.

(2) The applications of Chisholm Energy Operating, LLC in Cases No. 16115 and 16116, as detailed below, are approved.

(3) In Case No. 16115, a 640.31-acre (more or less) gas spacing unit and project area, the "Unit", for oil and gas production from the Wolfcamp formation, [Purple Sage; Wolfcamp Gas Pool (Pool Code 98220)] comprised of the E/2 of Section 31, Township 22 South, Range 26 East and the E/2 of Section 6, Township 23 South, Range 26 East NMPM, Eddy County, New Mexico, is hereby approved.

(4) The Unit shall be dedicated to the following "Proposed Well" to be completed at an orthodox location within the Unit:

Ocotillo 6 31 State Com WCB Well No. 2H, API No. 30-015-44835

SHL: 245 feet from the South line and 1190 feet from the East line,
(Unit P) of Section 6, Township 23 South, Range 26 East, NMPM.
BHL: 330 feet from the North line and 400 feet from the East line
(Unit A) of Section 31, Township 22 South, Range 26 East, NMPM.

(5) In Case No. 16116, a 320.18-acre (more or less) oil spacing unit and project area, the "Unit", for oil and gas production from the Bone Spring formation, [Wildcat; Bone Spring Oil Pool (Pool Code 98056)] comprised of the E/2 E/2 of Section 31, Township 22 South, Range 26 East and the E/2 E/2 of Section 6, Township 23 South, Range 26 East NMPM, Eddy County, New Mexico, is hereby approved.

(6) The Unit shall be dedicated to the following "Proposed Well" to be completed at an orthodox location within the Unit:

Ocotillo 6 31 State Com 3BS Well No. 4H, API No. 30-015-44837

SHL: 245 feet from the South line and 1260 feet from the East line,
(Unit P) of Section 6, Township 23 South, Range 26 East, NMPM.
BHL: 330 feet from the North line and 525 feet from the East line
(Unit A) of Section 31, Township 22 South, Range 26 East, NMPM.

The following shall apply respectively to each of the two approved Units

(7) All uncommitted interests, whatever they may be, in the oil and gas in the Unit, are hereby pooled.

(8) The operator of the Unit shall commence drilling the Proposed Well on or before September 30, 2019 and shall thereafter continue drilling that Proposed Well with due diligence to test the target formation.

(9) In the event the operator does not commence drilling the Proposed Well on or before September 30, 2019, then the Unit and pooling approval granted herein shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(10) Unless the Proposed Well is drilled and completed within 120 days after commencement of such well, then the approved Unit and Pooling shall be of no further effect, and that Unit and project area created by this order shall terminate, unless operator requests in writing an extension of the time for completion of the Proposed Well for good cause shown by satisfactory evidence and the Division issues written approval. If the proposed well is not completed in all of the standard spacing units included in the proposed project area (or Unit) then the operator shall apply to the Division for an amendment to this order to contract the Unit so that it includes only those standard spacing units in which the well is completed.

(11) Upon final plugging and abandonment of the Proposed Well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit shall terminate, unless this Order has been amended to authorize further operations.

(12) Infill wells within the Unit shall be subject to the terms and conditions of this order.

(13) Chisholm Energy Operating, LLC (OGRID 372137) is hereby designated the operator of the Proposed Well and the Unit.

(14) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled 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 pooled working interest owner in the Unit a separate itemized schedule of estimated costs of drilling, completing and equipping the Proposed Well ("well costs").

(15) Within 30 days from its receipt of the schedule of estimated well costs for any well, any pooled 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 for any well shall remain liable for operating costs but shall not be liable for risk charges for such well. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(16) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs of each well 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 will determine reasonable well costs after public notice and hearing.

(17) Within 60 days following determination of reasonable well costs for any well, any pooled working interest owner who has paid its share of estimated costs of such well or wells 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 the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(18) The operator is hereby authorized to withhold the following costs and charges from each non-consenting working interest owner's share of production from each well:

- a. The proportionate share of reasonable well costs attributable to such interest;
- b. As a charge for the risk involved in drilling the well, 200% of the above costs.

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

(20) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$7500 per month, per well, while drilling and \$750 per month, per well, while producing, provided that these rates may, at the election of the operator, be adjusted annually pursuant to the overhead adjustment provisions of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is authorized to withhold from each pooled working interest owner's share of production from each well the proportionate share of both the supervision charges and the actual expenditures required for operating such well, not more than what are reasonable.

(21) During the cost recovery period, the operator shall furnish to the Division and to each known non-consenting pooled working interest owner, annually, and within 90 days after payout occurs, a schedule of all revenues attributable to each Proposed Well, and all charges for supervision and operating costs charged against such revenues. Operating costs shall include all reasonable costs incurred for the maintenance and operation of the well, except for "well costs" reported pursuant to requirements herein, that are properly chargeable to the joint account pursuant to COPAS procedures. If no objection to the operating costs is received by the Division, and the Division has not objected, within 45 days following receipt of any schedule, the costs shall be deemed to be the reasonable operating costs. If there is an objection to the accuracy or reasonableness of operating costs reported within the 45-day period, the Division will determine reasonable operating costs after public notice and hearing.

(22) Except as provided above, all proceeds of production from the Proposed Well that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8A-1 through 7-8A-31, as amended).

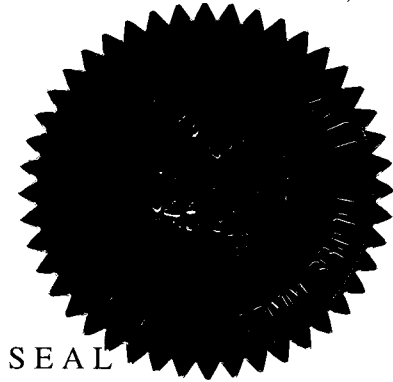
(23) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for allocating costs and charges under this Order. Any costs that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs shall be withheld from production attributable to royalty interests.

(24) Should all the parties to this compulsory pooling order reach voluntary agreement after entry of this order, this order shall thereafter be of no further effect.

(25) The operator of the well and the Unit shall notify the Division in writing of the subsequent voluntary agreement of any party subject to the compulsory pooling provisions of this order.

(26) 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


HEATHER RILEY
Director