

**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. 16079
ORDER NO. R-14685**

**APPLICATION OF LLANO ENERGY, LLC FOR A NON-STANDARD SPACING
AND PRORATION UNIT, COMPULSORY POOLING, AND UNORTHODOX
WELL LOCATION, LEA COUNTY, NEW MEXICO**

ORDER OF THE DIVISION

BY THE DIVISION:

This case 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 16th day of May, 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 this case and the subject matter.

(2) Llano Energy, LLC ("Applicant or "Llano") seeks approval of a 320-acre non-standard oil spacing unit (the "Unit") for oil and gas production from the San Andres formation, Gladiola; San Andres Pool (Pool code 27810), comprising the E/2 of Section 29, Township 12 South, Range 38 East, NMPM, Lea County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit for the San Andres formation.

(3) The Unit will be dedicated to Applicant's Sarah Well No. 1H (the "proposed well"; API No. 30-025-pending), a horizontal well to be drilled from a surface location 480 feet from the North line and 1300 feet from the East line (Unit A) of Section 32, to a bottom-hole location 100 feet from the North line and 1300 feet from the East line (Unit A) of Section 29, both in Township 12 South, Range 38 East, NMPM. The location of the completed interval will be unorthodox for oil production within the Unit.

(4) The proposed oil well will be within the Gladiola; San Andres Pool (pool code 27810) 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.

(5) Applicant appeared through counsel and presented the following land, engineering, and geologic evidence:

- (a) The San Andres formation in this area is suitable for development by horizontal drilling;
- (b) the proposed orientation of the horizontal well from south to north or north to south is appropriate for the Unit;
- (c) Applicant requested that Special Energy Corporation (OGRID 138008) be designated the operator of the Unit. Further, Llano Energy is an affiliated company of the Special Energy Corporation;
- (d) Applicant has interest in each of the standard spacing units within the proposed Unit;
- (e) Applicant is requesting to compulsory pool non-participating royalty interest owners;
- (f) all quarter-quarter sections to be included in the Unit are expected to be productive in the San Andres formation, so that the Unit as requested will not impair correlative rights;
- (g) the planned drilling and completion techniques of the proposed well will ensure that the proposed well will develop all of the eight quarter-quarter sections included in the Unit;
- (h) Applicant stated that the development plan for the Unit involves drilling one well, then later drilling two wells to fully develop the Unit. Further, Applicant stated it has plans to drill three wells within the proposed Unit;
- (i) the non-standard location was requested because the penetration point (first perforation) of 100 feet from the south line and last perforation of 100 feet from the north line may add an additional 10 percent oil and gas reserves versus completing the well within the required 330-foot setbacks from the north and south boundaries of the Unit. Therefore, the Applicant requested that the penetration point (first perforation) be located 100 feet from the South line and 1300 feet from the East line (Unit P), and the final perforation be

100 feet from the North line and 1300 feet from the East line (Unit A) of Section 29;

- (j) notice was provided to lessees or operators of surrounding tracts as affected parties of the proposed non-standard spacing unit;
- (k) notice was provided to all affected parties for the non-standard location of the application;
- (l) 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; and
- (m) those potentially affected parties whose whereabouts could not be ascertained were noticed by publication as provided in Rule 19.15.4.12.B NMAC.

(6) No other party entered an appearance or otherwise opposed this application.

The Division concludes as follows:

(7) The proposed non-standard unit should be approved to enable Applicant to drill a horizontal well that will efficiently produce the reserves underlying the Unit, thereby preventing waste and protecting correlative rights.

(8) Even though the W/2 E/2 of Section 29 will not be penetrated by this well, the W/2 E/2 of Section 29 should be included in the Unit. This is based on the Applicant's testimony that portions of the W/2 E/2 of Section 29 will be developed by the drilling and completion techniques in the proposed well. Further, quarter-quarter sections cannot be subdivided.

(9) The non-standard portion of the application should be approved. It was properly noticed per Division Rule 19.15.4.12 A (2) NMAC. Applicant also provided engineering testimony that lost oil and gas reserves would result if not approved.

(10) If the applicant requests additional wells within the Unit, those proposed wells should be considered infill wells and should be subject to Division Rule 19.15.13.9 NMAC.

(11) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(12) Applicant is owner or affiliate of an owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

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

(14) 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 a just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(15) Special Energy Corporation should be designated the operator of the proposed well and the Unit.

(16) Any pooled 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 proposed well.

(17) Royalty interest owners would not be subject to the risk penalty.

(18) Reasonable charges for supervision (combined fixed rates) should be fixed at \$7,500 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 COPAS form titled "*Accounting Procedure-Joint Operations*."

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Llano Energy, LLC , a 320-acre non-standard oil spacing and proration unit (the "Unit") is hereby established for oil and gas production from the San Andres formation, Gladiola; San Andres Pool (Pool code 27810), comprising the E/2 of Section 29, Township 12 South, Range 38 East, NMPM, Lea County, New Mexico.

(2) All uncommitted interests, whatever they may be, in the oil and gas in the San Andres formation underlying the Unit, are hereby pooled.

(3) The Unit shall be dedicated to Applicant's Sarah Well No. 1H (the "proposed well"; API No. 30-025-pending), a horizontal well to be drilled from a surface location 480 feet from the North line and 1300 feet from the East line (Unit A) of Section 32, to a bottom-hole location 100 feet from the North line and 1300 feet from the East line (Unit A) of Section 29, both in Township 12 South, Range 38 East, NMPM.

(4) The requested Non-Standard location is hereby approved. The completed interval of the proposed well shall be no closer than 100 feet from the North Line and 1300 feet from the West line (Unit P), and the last perforation shall be no closer than 100 feet from the North line and 1300 feet from the East line (Unit A), both in Section 29, Township 12 South, Range 38 East.

(5) The operator of the Unit shall commence drilling the proposed well on or before June 30, 2018, and shall thereafter continue drilling the proposed well with due diligence to test the San Andres formation.

(6) In the event the operator does not commence drilling the proposed well on or before June 30, 2018, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(7) The operator shall notify each pooled working interest owner for whom it has a valid address before it files with the Division any request for extension of the time to commence drilling and shall certify its compliance with this requirement in its request for extension. The Division may grant an extension at its discretion after 20 days from receipt of the request if no objection is received. Otherwise, the Division shall not grant the extension without a hearing.

(8) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the Unit and project area created by this order shall terminate, unless operator appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence.

(9) 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 created by this order shall terminate, unless this Order has been amended to authorize further operations.

(10) Special Energy Corporation (OGRID 138008) is hereby designated the operator of the well and the Unit.

(11) 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 an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(12) Within 30 days from the date the schedule of estimated well costs is furnished, 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 shall remain liable for operating costs but shall not be liable for risk charges. 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."

(13) 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 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.

(14) Within 60 days following determination of reasonable well costs, any pooled 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 the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(15) The operator is hereby authorized to withhold the following costs and charges from production attributable to each non-consenting working interest owner from each well:

- (a) the proportionate share of reasonable well costs attributable to each such owner; and
- (b) as a charge for the risk involved in drilling the well, 200% of the above costs.

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

(17) Reasonable charges for supervision (combined fixed rates) for the well are hereby fixed at \$7,500 per month while drilling and \$750 per month while producing, provided that these rates shall be adjusted annually pursuant to the overhead provisions 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 more than what are reasonable, attributable to pooled working interest owners.

(18) Except as provided above, all proceeds from 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).

(19) 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.

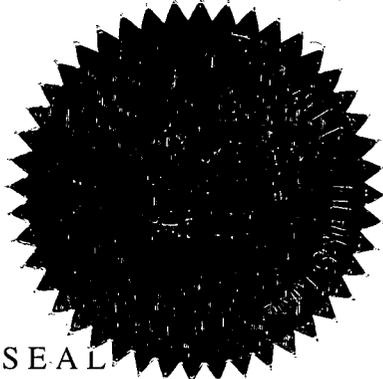
(20) Should all the parties to this compulsory pooling order reach voluntary agreement after entry of this order, this order shall thereafter be of no further effect.

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

(22) If the applicant proposes infill wells within the Unit, the proposed infill wells shall be subject to Division Rule 19.15.13 NMAC.

(23) 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.



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STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in cursive script that reads "Heather Riley".

HEATHER RILEY
Director