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. 14115
ORDER NO. R-12957

APPLICATION OF T.H. MCELVAIN OIL & GAS LIMITED PARTNERSHIP FOR COMPULSORY POOLING, SAN JUAN COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on May 1, 2008, at Santa Fe, New Mexico, before Examiners William V. Jones and David K. Brooks.

NOW, on this 6th day of June, 2008, 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 of the subject matter.

(2) T.H. McElvain Oil & Gas Limited Partnership ("Applicant"), seeks an order pooling all uncommitted interests from the surface to the base of the Fruitland Coal formation in the N/2 [Lots 1 through 4 and the S/2 N/2, comprising the N/2 equivalent] of Section 1, Township 29 North, Range 13 West, NMPM, in San Juan County, New Mexico, to form a standard 320-acre, more or less, 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 Basin-Fruitland Coal Gas Pool (71629).

(3) The Unit is to be dedicated to Applicant's proposed Hutchinson Well No. 2 (API No. 30-045-34241), (the "proposed well") to be drilled at a standard location 705 feet from the North line and 1315 feet from the West line (Unit C) of Section 1.

The Issue of "Title Costs"

(4) At the hearing, Applicant appeared through counsel and presented land testimony in support of the Application. Applicant's witness also testified to the amount of title examination and title clearing costs Applicant had incurred with respect to this proposed Unit, and that these costs included costs of examination of title to royalty interests in the Unit for "division order" purposes, as well as costs of examination of title to the oil and gas leasehold interests. Applicant's witness testified that it was reasonable and prudent to incur these costs.

(5) ConocoPhillips Company ("Respondent") appeared at the hearing through counsel. Respondent did not object to the formation of the Unit, but did object to the inclusion of title examination and title clearing costs as "well costs" that could be charged to a consenting working interest owner, or recovered from a non-consenting working interest owner, under any compulsory pooling order entered in this case.

(6) Respondent presented land testimony in support of its position. Respondent's witness testified, *inter alia*, that the title examination costs incurred by Applicant were excessive, that title clearing was primarily for the benefit of the Applicant and not the other working interest owners, and that a "division order" title opinion covering title to royalty interests subsequent to leasing was not necessary for drilling purposes.

Division Findings Concerning the Title Cost Issue

(7) NMSA 1978, Section 70-2-17 authorizes the Division to issue compulsory pooling orders pooling units "upon such terms and conditions as are just and reasonable."

(8) It is prudent for an oil and gas operator to incur reasonable and necessary title examination and title clearing costs prior to drilling a well. These costs contribute to the development of the property. All owners stand to benefit from the development of the property. Thus it is just and reasonable to provide for recovery of title costs, along with other development costs, by the operator of a compulsory pooled Unit. Accordingly, the Division concludes, in principal, that title costs should be included in the category of "well costs" for which recovery should be provided in a compulsory pooling order.

(9) Because of the liability imposed on the operator by NMSA Section 70-2-18.B, if it fails to properly consolidate all interests in the Unit, a prudent operator would ordinarily consolidate those interests by agreement or compulsory pooling prior to investing its money in drilling. Accordingly, in New Mexico, the costs of title clearing as to all working interests, not only those for the lease covering the drillsite tract, are reasonable and necessary costs of development.

(10) Though it is ordinarily not necessary for an operator to incur the costs of examination of title to royalty interests prior to drilling, it is a cost that must be incurred

prior to placing the well on production, and is similar to development costs, rather than operating costs, since this cost must be incurred whether the well produces much or little.

(11) Division compulsory pooling orders do not provide for a "casing point election," but require a consenting working interest owner to advance its share of estimated costs of completing and equipping the well as well as the cost of drilling. Accordingly, costs of a "division order" title opinion are appropriate for inclusion in "estimated well costs" under such an order. However, since it is not necessary to incur such costs prior to drilling, if the proposed well is a dry hole, actual title costs should be adjusted to exclude those costs attributable to the "division order" title opinion.

(12) Since Respondent, whether or not it elects to participate in the proposed well, will have an opportunity to object to the amount of title costs Applicant has incurred when the operator files its schedule of actual costs as provided in this order, the Division need not now determine whether the title costs incurred by Applicant were reasonable.

Division Findings Concerning Compulsory Pooling

(13) 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.

(14) Applicant is 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.

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

(16) 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, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(17) Pursuant to the request of Applicant, McElvain Oil & Gas Properties, Inc. should be designated the operator of the proposed well and of the Unit.

(18) 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 well.

(19) Reasonable charges for supervision (combined fixed rates) should be fixed at $5,000 per month while drilling and $500 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 T.H. McElvain Oil & Gas Limited Partnership, all uncommitted interests, whatever they may be, in the oil and gas from the surface to the base of the Fruitland Coal formation in the N/2 [Lots 1 through 4 and the S/2 N/2, comprising the N/2 equivalent] of Section 1, Township 29 North, Range 13 West, NMPM, in San Juan County, New Mexico, are pooled to form a standard 320-acre, more or less, 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 Basin-Fruitland Coal Gas Pool (71629).

(2) The Unit shall be dedicated to Applicant's proposed Hutchinson Well No. 2 (API No. 30-045-34241), (the "proposed well") to be drilled at a standard location 705 feet from the North line and 1315 feet from the West line (Unit C) of Section 1.

(3) The operator of the Unit shall commence drilling the proposed well on or before August 31, 2008, and shall thereafter continue drilling the well with due diligence to test the Fruitland Coal formation.

(4) In the event the operator does not commence drilling the proposed well on or before August 31, 2008, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(5) Should the proposed well not be drilled and completed within 120 days after commencement thereof, Ordering Paragraph (1) shall be of no further effect, and the Unit created by the Order shall terminate unless the operator, prior to the expiration of such 120-day period, files an application with the Division for extension of the time for completion of the proposed well. Such application shall include an affidavit or affidavits setting forth good cause for an extension, supported by satisfactory evidence. The Division Director may grant such application without hearing.

(6) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 36, the pooled unit created by this Order shall terminate, unless this order has been amended to authorize further operations.

(7) Pursuant to the request of Applicant, McElvain Oil & Gas Properties, Inc. (OGRID 22044) is hereby designated the operator of the proposed well and of the Unit.

(8) 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, including estimated costs of abstract and title examination for drilling and division order purposes, and title-clearing costs ("well costs").

(9) 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."

(10) 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 subject well, but in no event later than one (1) year of the date of issuance of this order. 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, or any item or times included therein, within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(11) If the proposed well is completed as a well capable of production, the schedule of actual well costs should include actual costs of title examination and title clearing, subject to objection as to reasonableness, in the same manner as other costs. If the proposed well is a dry hole, the schedule of actual costs should be adjusted to exclude costs associated with examination or clearing of title to royalty interests.

(12) 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.

(13) 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; and

(b) as a charge for the risk involved in drilling the well, 200% of the above costs.

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

(15) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5,000 per month while drilling and $500 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 pooled working interest owners.

(16) 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.

(17) 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.

(18) 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.

(19) 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

MARK E. FESMIRE, P.E.
Director