

**STATE OF NEW MEXICO
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION**

IN THE MATTER OF THE APPLICATION OF
NEARBURG EXPLORATION COMPANY FOR
COMPULSORY POOLING, EDDY COUNTY,
NEW MEXICO

CASE NO. 11233

IN THE MATTER OF THE APPLICATION
OF YATES PETROLEUM CORPORATION FOR
COMPULSORY POOLING, EDDY COUNTY,
NEW MEXICO

CASE NO. 11234

APPLICATION OF YATES PETROLEUM CORPORATION
FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

ORDER NO. R-_____

**YATES PETROLEUM CORPORATION'S PROPOSED
ORDER OF THE DIVISION**

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on April 6, 1995, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this ___ day of April, 1995, the Division Director, having considered the testimony, the recorded transcript 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, the parties hereto, and the subject matter hereof.

(2) The applicant in Case 11233, Nearburg Exploration Corporation ("Nearburg"), seeks an order pooling all mineral interest underlying the SW/4 of Section 13, T19S, R25E, forming a standard oil/gas spacing and proration unit for the North Dagger Draw-Upper Pennsylvanian Pool. Said unit is proposed to be dedicated to the Fairchild "13" No. 2 well to be located at a standard location 660 feet FSL and 1980 feet FWL of said section, Eddy County, New Mexico.

(3) The applicant in case 11234, Yates Petroleum Corporation ("Yates") seeks an order pooling all mineral interest underlying the SE/4 of Section 13, Township 19 South, Range 25 East, NMPM, Eddy County, New Mexico, thereby forming a standard 160-acre

oil/gas spacing and proration unit for the North Dagger Draw-Upper Pennsylvanian Pool. Said unit is proposed to be dedicated to the Bert "APB" No. 1 well to be located at a standard location 660 feet from the south line and 660 feet from the west line of Section 13.

(4) The working interest owners in this spacing unit are as follows:

Nearburg Exploration Company	50%
Yates Petroleum Corporation and Related Companies	33.33%
Holmquist Disputed Interest	16.67%

(5) At the hearing of this case the Examiner addressed a dispute between Nearburg and Yates in which each claims to have the Holmquist interest leased as follows:

Counsel for Nearburg offered a tender of proof that Nearburg should be credited with the Holmquist interest based upon the following:

(a) that on January 26, 1995, Nearburg received a Drilling Title Opinion from Rudi Woerndle, a New Mexico attorney specializing in preparing oil and gas title opinions that the Holmquist interest was unleased.

(b) that on February 7, 1995, Holmquist signed a lease to Nearburg for a primary term of three years which was recorded on March 3, 1995;

(c) that at the time Nearburg obtained the Holmquist lease, Nearburg was without knowledge that Yates had obtained from Holmquist a lease dated October 24, 1991, but which was not recorded until March 30, 1995;

(d) that on March 3, 1995, Holmquist had verified with Nearburg that his interest was not leased to Yates; and

(e) that on March 23, 1995, Nearburg received Mr. Woerndle's Supplemental Title Opinion showing the Holmquist 16.67% of the working interest in the spacing unit.

Counsel for Yates offered a tender of proof that Yates should be credited with the Holmquist interest based on the following:

(a) that on December 10, 1981, Yates obtained a five-year lease from Holmquist which was recorded on February 9, 1982;

(b) that on February 1, 1987, Yates obtained a five-year lease from Holmquist which was recorded on February 18, 1987;

(c) that on October 24, 1991, Yates obtained a five-year lease to expire on January 31, 1997, from Holmquist which was recorded on March 30, 1995;

(d) that on December 27, 1994, Nearburg proposed to Yates a Morrow gas well for the S/2 of said Section 13 which included a Joint Operating Agreement with an attached Exhibit "A" showing Nearburg with 72.265625% interest in the 320 acres. Crediting Nearburg with 72.265625% of the 320 acres necessarily acknowledges that Yates owned 50% of the SW/4 while Nearburg owned almost 100% of the SE/4.

(e) Yates declined to participate in a Morrow test, based upon two dry Morrow tests completed by Nearburg during the same time period.

(f) that on March 3, 1995, Nearburg received Yates' well proposal for the SW/4 of said Section 13 which included a proposed JOA with an attached Exhibit "A" showing the Holmquist lease interest credited to Yates.

(g) therefore Yates should be credited with the disputed 16.67% Holmquist interest because Yates contended that Nearburg had knowledge of Yates' unrecorded Holmquist lease before Nearburg obtained its lease from Holmquist.

(6) The Division Examiner denied counsel for Nearburg's and counsel for Yates' respective offers of proof and ordered that for purposes of deciding this pooling matter, neither Nearburg nor Yates shall be entitled to claim credit for this interest.

(7) No portion of Section 13, is currently dedicated to production from this pool.

(8) The development of this spacing unit in the Cisco/Canyon formation is subject to the Special Rules and Regulations for the

North Dagger Draw-Upper Pennsylvanian Pool pursuant to Division Order R-4691-D issued effective April 1, 1991.

(9) Each applicant (Nearburg and Yates) has the right to drill and each proposes to drill a well in this spacing unit, as described above in Findings (2) and (3), to a depth sufficient to test the Upper Pennsylvanian formation (i.e., Cisco/Canyon).

(10) Cases Nos. 11233 and 11234 were consolidated for the purpose of hearing and should be consolidated for the purpose of issuing an order since the granting of one application would require the denial of the other because these cases involve a dispute over operatorship and development of the same 160-acre spacing unit.

(11) Because of the dispute over the location of the proposed well and who should operate the well, Nearburg and Yates have been unable to agree on a voluntary basis for the pooling of their respective interest in either proposed well or spacing unit.

(12) The Division should decide this case based upon its statutory obligation to prevent waste and protect correlative rights utilizing the following criteria and analysis:

(a) Prospect Development and Well Proposals:

Nearburg and Yates presented the following uncontested evidence: that the SW/4 of Section 13 became prospective when Nearburg failed in its attempt to drill an Atoka/Morrow test and recompleted the Fairchild 24 No 1 Well in the Cisco/Canyon formation which prior to that time was not even considered a secondary objective; that on March 1, 1995, Yates filed and obtained OCD approval of an Application for Permit to Drill its proposed well; that Yates then, on March 3, 1995, proposed its well, closely followed by Nearburg's well proposal on March 7, 1995; and that Yates filed its pooling application on March 3, 1995, prior to Nearburg's application, which was filed on March 13, 1995.

(b) Efforts to Obtain Voluntary Agreement and Willingness to Negotiate a Voluntary Agreement:

(i) Nearburg presented the following:

- 1) Unilateral testimony was presented that Nearburg had previously proposed to Yates that their mutual

dispute over operatorship in six other spacing units in the same pool be resolved based upon which operator had the majority interest and that in each of these cases Yates agreed to and accepted that criteria for resolving the matter. Nearburg presented no written evidence of any agreement between Nearburg and Yates, and upon cross-examination, agreed that the criteria used by Nearburg included the fact that Yates had a substantial majority of the interest in the proration unit or Yates already had production and water disposal facilities in use in the area.

- 2) Nearburg presented testimony that by letter dated March 29, 1995, Nearburg proposed to Yates that their dispute in these pending NMOCD cases be resolved by them acquiescing to Yates' operatorship in the NE/4 of Section 24 in return from Yates' acquiescence to Nearburg operation in the SW/4 of Section 13. In the March 29, 1995, letter, Nearburg did not reference any of the six proration units shown on its locator map, Nearburg Exhibit No. 1; the March 29, 1995, letter was not addressed to Yates Petroleum Corporation, but rather to Mr. Douglas Hurlbut representing S. P. Yates and the Estate of Martin Yates III.
- 3) Nearburg presented testimony that Yates orally rejected Nearburg's proposed settlement.

(ii) The Division finds that in this case it cannot grant Nearburg any advantage for offering to trade operatorships in two totally different prospects which had dissimilar characteristics, especially in light of the fact that Mr. Shelton had testified that as of the hearing date he had been unable to secure support for Nearburg's proposal from the other interest owners in Section 13. The Division finds that it is unreliable to use Section 13 as a comparable because there are substantial interests owned by parties other than Yates and Nearburg, and the record is silent as to the wishes of those parties.

(iii) The Division finds that it cannot place significance upon the fact that there may have been previous settlements between the parties concerning operatorship of other proration units. Each case must be decided on its own merits because to do otherwise

would do disservice to the Division's statutory obligation to prevent waste and protect correlative rights.

(c) Geologic Evidence-Well Location

(i) Nearburg's geologist, Jerry Elger, presented a subsurface geologic interpretation which included a structure map and cross section integrated with seismic data purporting to show the following:

- 1) The trapping mechanism for the presence of oil at the Fairchild "24" Well No. 1 location was predicated upon the non-productive limits of the dolomite being immediately updip to the west of that well.
- 2) That there are no other data points available to establish the non-productive limits of the reservoir outside of the immediate area of the Fairchild 24 No. 1 Well; the seismic data which has data reference points in close proximity to both well locations showed a reflection between shale and carbonate indicating the top of the Canyon Bank which was then projected to the dolomite reservoir from which it was determined that the Nearburg location had a structural advantage of approximately 40 feet over the Yates location; any advantage structurally that the Nearburg had over the Yates interpretation could be explained by the fact that the data points shown on the seismic line, Nearburg Exhibit No. 16, were incorrectly shown or by the fact that Nearburg improperly assumed that the top of the Canyon limestone corresponded with the top of the Canyon dolomite reservoir.

Yates presented evidence that the top of the Canyon limestone and the top of the Canyon dolomite were not consistent even over short distances.

- 3) Nearburg's geologic interpretation, which indicated that the oil/water contact would lie at -4380 feet subsea and that the western limit of the productive dolomite would lie in close proximity to the Yates proposed location, was based only on data provided by the drilling of the Fairchild 24 No. 1 Well and is supported only by a subjective interpretation based upon inconclusive seismic data predicated upon improper assumptions.

(ii) Yates' geologist, Brent May, presented the following:

- 1) a geologic interpretation which showed that the Yates location had a structural advantage of 35 feet to 40 feet over the Nearburg location;
- 2) a geologic interpretation which further explained that the only claimed successful use of seismic by Nearburg for a Cisco/Canyon test was the drilling of the Nearburg well in the SW/4 of Section 27, T19S R25E which was a direct offset to a Yates productive well, being the Tackitt "AOT" No. 1.
- 3) He further testified that the industry, i.e., other operators in the Dagger Draw area, considered seismic data to be inconclusive, primarily because of the problem of the unpredictability of the thickness of the Canyon limestone overlying the Canyon dolomite reservoir. Mr. May did admit in cross-examination that Nearburg's geologist, in all probability, had correctly defined the trapping mechanism to explain the presence of oil at the Fairchild 24 No. 1 Well location, but further stated that that had no implication for Section 13 because there were no other data points available in the area other than the Fairchild 24 No. 1 Well.

(iii) The Division is unable to give Nearburg any special credit for its proposed location based upon the existence of its seismic data because there were no additional data points available to substantiate the seismic data in the area of the proposed well sites.

(iv) The Division finds that the Yates geologic interpretation projecting a structural advantage of 30 to 40 feet at its proposed location must be adopted due to the unreliability of Nearburg's geologic interpretation which was premised upon an established faulty seismic model.

(d) Estimated Well Costs ("AFE")

(i) The Division finds that AFE's are merely an estimation of the actual costs of drilling a well, and further recognizes that there is no industry-accepted established relationship between costs estimated in an AFE, and the actual drilling costs that may be encountered in the drilling of a well.

(ii) The Division finds that the only credible evidence with respect to drilling costs consists of actual experiences of the two parties in drilling Cisco/Canyon tests in the Dagger Draw area.

(iii) Nearburg presented testimony that the Nearburg AFE was lower than the Yates AFE. Further testimony was presented that some of the discrepancies between the two AFE's were related to estimates of what size of artificial lift equipment would be required. Both companies agreed that well requirements would dictate the actual size of equipment installed, thus giving further grounds for the unreliability of attaching any significant importance to AFE numbers.

(iv) Yates presented testimony that AFE's are very subjective and are not always true estimators of what it will cost to drill a well.

(v) Yates presented testimony that when sufficient data exists, historical drilling costs should be more representative of expected costs.

(vi) Yates presented evidence that Nearburg spends, on average, \$46,000 more per well than Yates does during the drilling and completion process of Dagger Draw Cisco/Canyon wells.

(v) Yates further presented evidence showing that Nearburg completed the Tackitt "AOT" No. 2 Well in a manner such that reservoir energy was wasted and oil production was diminished.

(vi) Yates presented evidence that showed that, upon assuming operatorship of the Tackitt "AOT" No. 2 Well, Yates increased oil production thereby reducing waste created by the completion practices of Nearburg.

(vii) The Division finds that no significance can be attached to the fact that Nearburg's AFE was lower than the Yates AFE for the projected well.

(d) Proximity of Facilities and Wells:

(i) Nearburg presented evidence that it has immediately available the necessary facilities including a salt water disposal system with its Aikman SWD well disposing of the water into the Devonian formation to service the subject well if it is awarded the right to operate; that Nearburg's closest producing well in this pool is the offsetting Fairchild "24" Well No. 1. Yates presented

evidence concerning the fact that it had a salt water disposal well in Section 1, which Nearburg's engineer admitted having forgotten about, which is actually physically closer to the subject proration unit than its Aikman SWD well.

(ii) Yates testified that it likewise has sufficient capabilities of handling both the production and salt water disposal needs of the subject well.

(iii) The Division finds that both Nearburg and Yates have facilities sufficient to handle both the production and salt water disposal needs of a completed producer in Section 13 and that no advantage of either company's facilities was proven over the other.

(13) The Division finds that a subjective unilateral decision by one party in granting operatorship to another party should not play any significant role in the Division's determination concerning operatorship in the SW/4 of Section 13, because such a subjective unilateral determination has no correlation to the statutory duties of the Division to prevent waste and protect correlative rights.

(14) Based upon the foregoing, Yates' application should be approved, and Yates Petroleum Corporation should be designated as operator. Overhead charges for supervision should be set at \$5,400 while drilling and \$540 while producing, as both companies presented testimony as to the appropriateness of such amounts.

(15) Since risk of an unsuccessful completion at either location is very high, based upon testimony from both parties, the risk penalty should be set at 200%.

(16) Approval as set out in the above findings and in the following order will avoid the drilling of unnecessary wells, protect correlative rights, prevent waste, and afford 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 resulting from this order.

IT IS THEREFORE ORDERED THAT:

(1) The application of Nearburg in Case No. 11233 as described in this order is hereby DENIED.

(2) The application of Yates in Case No. 11234 as described in this order is hereby GRANTED.

(3) All mineral interests, whatever they may be, from the surface to the base of the Cisco/Canyon formation including but not limited to North Dagger Draw-Upper Pennsylvanian Associated Pool underlying the SW/4 of Section 13, Township 19 South, Range 25 East, NMPM, Eddy County, New Mexico, are hereby pooled to form a standard 160-acre spacing and proration unit to be dedicated to a well to be drilled at a standard well location 660 feet from the South line and 660 feet from the West line of said Section 13.

PROVIDED HOWEVER THAT the operator of said unit shall commence the drilling of said well on or before the ____ day of _____, 1995, and shall thereafter continue the drilling said well with due diligence to a depth sufficient to test the Cisco/Canyon formation of the subject pool.

PROVIDED FURTHER THAT in the event said operator does not commence the drilling of said well on or before the ____ day of _____, 1995, Decretory Paragraph No. (3) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER THAT, should said well not be drilled to completion or abandonment within 180 days after commencement thereof, said operator shall appear before the Division Director and show cause by Decretory Paragraph No. (3) of this order should not be rescinded.

(4) Yates Petroleum Corporation is hereby designated the operator of the subject well and unit.

(5) After the effective date of this order and prior to commencing said well, the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated well costs.

(6) Within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs 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.

(7) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs

within 90 days following completion of the well; if no objection to the actual well cost is received by the Division and the Division has not objected within 45 days following receipt of said schedule, the actual well costs shall be the reasonable well costs; provided, however, if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(8) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated 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.

(9) 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 of schedule of estimated well costs is furnished to him; and
- B. As a charge for the risk involved in the drilling of the well, 200 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 costs is furnished to him.

(10) \$5,400 per month while drilling and \$540 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.

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(11) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighths (1/8) royalty interest for the purpose of allocating costs and charges under the terms of this order.

(12) 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.

(13) All proceeds from production from the subject well which are not disbursed for any reason shall be placed in escrow in Eddy 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.

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

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

(16) 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

WILLIAM J. LEMAY, Director

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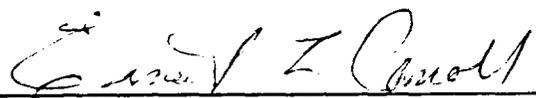
Respectfully submitted,

LOSEE, CARSON, HAAS & CARROLL, P.A.

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Attorneys for Yates Petroleum Corporation

mailed I hereby certify that I caused to be
~~faxed~~ a true and correct copy of the
foregoing to W. T. Kellahin, counsel for
Nearburg Producing Company, this
April 21, 1995.


Ernest L. Carroll