



Midland Division
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RECEIVED

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Oil Conservation Division

William J. LeMay, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87505

Re: The Production and Sale of Almost 1,000,000 Barrels of Illegal Oil by Yates Petroleum Corporation from the North Dagger Draw Upper Pennsylvanian Pool Over a Period of Nearly Three Years, Without Being Required by the Oil Conservation Division to shut-in the Overproduced Spacing Units Until the Illegal Production was Made Up by Accrued Allowable as Provided for in the New Mexico State Oil and Gas Act and the Oil Conservation Division Rules and Regulations.

Dear Mr. LeMay:

Sometime during the summer of 1995, Yates Petroleum visited the Supervisor of the Artesia District Office of the Oil Conservation Division and proposed a hypothetical situation which would allow Yates to produce its North Dagger Draw Cisco oil wells substantially above the current allowable of 700 barrels of oil per day per spacing unit. The Supervisor advised Yates that all of the offset operators must agree to this proposal before it could be considered. Apparently no claims or discovery of overproduction was made at that meeting, but it seems logical to assume that Yates would have had knowledge of their current producing status before presenting their hypothetical proposal for special approval to overproduce several of their spacing units. Conoco was never approached by Yates with such a proposal and the already significant accumulation of volumes of illegal oil from these units was not brought to the attention of the Division.

In March, 1996 the Supervisor of the Artesia District Office contacted Yates to advise them that their overproduction had been discovered and identified by the states computerized production data base, ONGARD. At this time Yates was informed that they must limit their production to the established allowable for the pool and submit a proposal for making up this illegal production. Yates was not required at that time to shut-in the overproduced units to make-up the accumulation of 988,197 barrels (as of March 1, 1996) of illegal oil.

Simply demanding that they reduce producing rates to comply with the legal allowable did not address the almost one million barrels of illegal oil that had been produced and sold to the detriment of offset operators. Oil Conservation Division Rule 502 clearly states that "Such excess production shall be considered as oil produced against the allowable assigned to the unit for the following proration period, and it may be transported from the lease tanks only as and when the unit accrues daily allowable to offset such excess production." It would appear that, under the authority of this rule, the overproduced spacing units should have been shut-in until the illegal oil had been matched by an equivalent volume of accrued allowable.

Sometime during April, 1996, in the absence of a proposal from Yates, the Artesia District Office of the Division again contacted Yates. At this time Yates agreed to restrict their producing rates to the current allowable, but still did not have a plan for making up the illegal oil. Following this second meeting to address the discovered overproduction, Yates filed the Cases No. 11525 and No. 11526 with the Division as their proposed solution to the violations.

Although cases were filed for both the North Dagger Draw (No. 11525) and South Dagger Draw (No. 11526) pools, all of their overproduction took place in the North Dagger Draw Pool. The South Pool was only included because Yates tried to "piggy-back" the allowable changes they wanted in the North to include the South Pool. Since our major concern is with the accumulated illegal oil in the North Dagger Draw Pool, the remainder of this letter will refer only to the North Dagger Draw Pool Case No. 11525.

Yates Petroleum then attempted to avoid the shut-in of their illegally produced spacing units and to avoid potential penalties, as authorized by the New Mexico Oil and Gas Act, by filing this case for an examiner hearing to (a) increase the North Dagger Draw Pool allowable from 700 barrels of oil per day to 4,000 barrels of oil per day per 160-acre spacing unit to cover their maximum level of overproduction and (b) to "forgive" retroactively all overproduction of illegal oil. This case was heard on May 2, 1996 by Oil Conservation Division Examiner, Michael Stogner.

Mr. Michael Stogner delayed for three months, until August 14, 1996, the issuing of a ruling in Order No. R-4691-E. While this order denied the request of Yates for the higher allowable, it allowed them to continue producing their overproduced spacing units at half-allowable rates (350 bopd) until the illegal oil is made up by accrued allowable. If this is not accomplished within 18 months, then at that time they must be shut-in until it is completely made up.

On August 15, 1996, Yates Petroleum filed for a De Novo Hearing before the Oil Conservation Commission and for a "stay" of Order R-4691-E. The De Novo Hearing was set for September 18, 1996 and the stay of the examiner's Order R-4691-E was granted.

Yates Petroleum has been violating the correlative rights of offset operators since November, 1993, when the first of these overproduced spacing units began to accumulate illegal oil. In the issuance of the stay of Order R-4691-E, the Division expressed its belief that "overproduced wells in the Upper Pennsylvanian reservoir in the South Dagger Draw and North Dagger Draw Pools have ample remaining producing history to be brought into balance with the Division allowables if the commission affirms the subject orders."

While there may be some textbook reservoirs with long life, homogenous matrices, and consistent pay thicknesses to which this statement may apply, it is absolutely not true of the North Dagger Draw Pool. Typically North Dagger Draw oil wells, completed in the Cisco formation, have very high initial potential rates which decline very rapidly. They only produce at significant rates toward the recovery of their ultimate reserves for approximately five years. At this point in the life of most of these wells, they have declined to stripper level producing rates and cannot significantly contribute to bringing into balance illegal drainage by overproduced offset wells. Differences in pay thickness and quality make it impossible for unfairly drained units to recover illegal drainage under any circumstances of rate restrictions or even shut-in.

The Oil Conservation Division is adequately empowered by Section 70-2-11 of the New Mexico Oil and Gas Act (New Mexico Statutes, Chapter 70) to prevent such violations of correlative rights. Additional Sections of the Oil and Gas Act which relate specifically to this case concerning the production of illegal oil are:

1. Sec. 70-2-21
Defines "illegal oil"
2. Sec. 70-2-22
Authorizes rules, regulations and orders to prohibit the purchase or handling of excess oil and provides that "Penalties shall be imposed for the commission of each transaction prohibited in Section 70-2-21 NMSA 1978 when the person committing the same knows that illegal oil or illegal oil product is involved in such transaction, or when such person could have known or determined such fact by the exercise of reasonable diligence or from facts within his knowledge."
3. Sec. 70-2-28
This section provides actions for violations and states "Whenever it shall appear that any person is violating, or threatening to violate, any statute of this state with respect to the conservation of oil or gas, or both, or any provision of this act, or any rule, regulation or order made thereunder, the division through the attorney general shall bring suit against such person for penalties, if any are applicable, and to restrain such person from continuing such violation."
4. Sec. 70-2-29
Provides actions for damages by private parties stating that "Any person so damaged by the violation may sue for and recover such damages as he may be entitled to receive. In the event the division should fail to bring suit to enjoin any actual or threatened violation of any statute of this state with respect to the conservation of oil and gas, or any provision of this act, or any rule, regulation or order issued thereunder, then any person or party in interest adversely affected by such violation, and who has notified the division in writing of such violation or threat thereof and has requested the division to sue, may, to prevent any or further violation, bring suit for that purpose in the district court."
5. Sec. 70-2-31
This section defines specific penalties for violations of the Oil and Gas Act. The penalties authorized amount to (a) \$1,000 per violation per day of continuing violation, or in the event of knowing and willful violation, (b) \$5,000 per violation per day of continuing violation. Subsection D states that " Any person who knowingly and willfully procures, counsels, aids or abets the commission of any act described in Subsection A or B of this section shall be subject to the same penalties as are prescribed therein."

Conoco views the subject violations of the New Mexico Oil and Gas Act during almost three years of unabated production of illegal oil by Yates Petroleum from the North Dagger Draw Pool as a serious infringement on the correlative rights of all offset operators. It is also Conoco's position that a significant quantity of the resultant damage and loss of correlative rights is permanent and can never be recovered through any attempt to balance offsetting producing rates among offsetting operators.

While it cannot effect a full recovery of Conoco's loss, the complete shut-in of the offending spacing units until their accumulated illegal oil is made up would provide some measure of partial recovery is certainly the minimum action that should be taken. However, it is also Conoco's contention that in light of the (a) excessive duration of the violations, (b) the unusually large volume of the illegal oil, and (c) the availability to Yates of knowledge of their overproduced status by the exercise of reasonable diligence, that the penalties authorized by Section 70-2-31 of the New Mexico Oil and Gas Act should be assessed.

Conoco recognizes that the Oil Conservation Division has through the years been instrumental in the conservation of oil and gas and in the protection of the correlative rights of all parties. That is why we are now calling on the Division to continue the fair and faithful application of the provisions and penalties of the Oil and Gas Act as they are empowered to do. To do any less opens the door of encouragement for any operator to violate the correlative rights of its offsetting neighbors.

Very truly yours,



Bob Irelan
Division Manager

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