



NEW MEXICO ENERGY, MINERALS
& NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION
2040 South Pacheco Street
Santa Fe, New Mexico 87505
(505) 827-7131

September 3, 1997

Kellahin and Kellahin
117 N. Guadalupe
P. O. Box 2265
Santa Fe, New Mexico 87504

**RE: CASE NO. 11638
ORDER NO. R-10868**

Dear Sir:

Enclosed are two copies of the above-referenced Division order recently entered in the subject case.

Sincerely,

Sally E. Martinez
Sally E. Martinez
Administrative Secretary

cc: BLM - Carlsbad

**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. 11638
Order No. R-10868**

**APPLICATION OF CITATION OIL & GAS
CORPORATION FOR TWO UNORTHODOX GAS
WELL LOCATIONS AND FOR SIMULTANEOUS
DEDICATION, LEA COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 AM on July 10 and August 7, 1997, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 3rd day of September, 1997, the Division Director, having considered the testimony, the record, 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 and the subject matter thereof.

(2) The applicant, Citation Oil & Gas Corporation (Citation), is the operator of the wells located within the E/2 of Section 20, Township 21 South, Range 36 East, NMPM, Lea County, New Mexico.

(3) The applicant seeks:

- a) approval of two unorthodox gas well locations in the Eumont Gas Pool for its existing: 1) Devonian State Well No. 2 (API No. 30-025-04729) located 660 feet from the North line and 1980 feet from the East line (Unit B) of Section 20; 2) Devonian State Well No. 3 (API No. 30-025-04730) located 660 feet from the North and East lines (Unit A) of Section 20, both in Township 21 South, Range 36 East, NMPM, which wells are located at standard oil well locations in the

Eumont Gas Pool, but by virtue of the proposed reclassification as gas wells, as described below, will be located at unorthodox gas well locations in the Eumont Gas Pool;

- b) to reclassify the aforesaid Devonian State Well No. 2, effective as of October 1, 1990, and the Devonian State Well No. 3, effective as of December 1, 1990, from oil wells to gas wells in the Eumont Gas Pool;
- c) approval to simultaneously dedicate an existing 320-acre non-standard gas spacing and proration unit in the Eumont Gas Pool comprising the E/2 of Section 20 (established by Division Order No. NSP-488, dated May 11, 1959) to the above-described Devonian State Well Nos. 2 and 3 and to its existing Devonian State Com Well No. 1 (API No. 30-025-04728) located at a standard gas well location in the Eumont Gas Pool 1980 feet from the North and East lines (Unit G) of Section 20;
- d) to present evidence and testimony with regards to the status of all Eumont Gas Pool production, both oil and gas, within the E/2 of Section 20 and the status and/or effect of Division Administrative Order No. NSL-3646 (SD) dated April 3, 1996; and,
- e) authorization to file amended Division Form C-115 (Operator's Monthly Report) showing reclassification of its Devonian State Well No. 3 effective December 1, 1990, and its Devonian State Well No. 2 effective October 1, 1990, from oil wells to gas wells, and showing certain corrected production volumes.

(4) In support of its application, Citation provided background information which demonstrates that:

- a) on August 16, 1934, Shell Petroleum Corporation drilled the Devonian State Com Well No. 1, located in Unit G of Section 20, as an oil well in the Eunice Pool. On September 22, 1953, Shell Oil Company recompleted the well for gas production and dedicated it to a 160-acre non-standard gas spacing and proration unit comprising the NE/4 of Section 20 for gas production from the Eumont Gas Pool;
- b) on October 8, 1958, Shell Oil Company (Shell), Gulf Oil Corporation (Gulf), Standard Oil Company of Texas (Standard) and Atlantic Refining Company (ARCO) entered into a "Gas Communitization and Pooling Agreement," dated October 8, 1958, which pooled the NE/4 of Section 20 with the SE/4 of Section 20 to form a 320-acre non-standard gas spacing and proration unit for gas production from the aforesaid Devonian State Com Well No. 1 in the Eumont Gas Pool;
- c) instead of entering into a Joint Operating Agreement (JOA) for operations of gas wells within the E/2 spacing unit, Shell, et al., adopted an "Agreement for Use of Well" also dated October 8, 1958. This agreement is specifically limited to the Devonian State Com Well No. 1 and makes no provisions for additional wells or subsequent operations. Further, this Agreement fails to make a provision for a Eumont Gas Pool well being reclassified from an oil well to a gas well or visa versa;
- d) on May 11, 1959, upon application by Shell Oil Company, the Division issued Order No. NSP-488, which order approved the enlargement of the spacing unit to consist of the E/2 of Section 20 for dedication to the Devonian State Com Well No. 1; and,
- e) Citation currently operates the Devonian State Com Well No. 1, having succeeded to Shell's interest as of late 1986 to become operator of this well.

(5) Citation provided expert legal opinions and testimony concerning the 1958 contracts for allocating gas and oil production among the interest owners in the E/2 of Section 20. This testimony indicates that:

- a) the Gas Communitization and Pooling Agreement dated October 8, 1958, pools the E/2 of Section 20 to form a gas spacing and proration unit in conformity with an established well-spacing program for the Eumont Gas Pool but is expressly limited to "only dry gas and associated liquid hydrocarbons produced from a gas well...";
- b) this Gas Communitization and Pooling Agreement was implemented by the "Agreement for Use of Well" also dated October 8, 1958, which was limited to operation of the Devonian State Com Well No. 1;
- c) the Devonian State Com Well No. 1 was drilled as an oil well on leases in the NE/4 of Section 20 owned 50% by Shell (now Citation) and 50% by Gulf (now Chevron USA Inc. (Chevron)). When the well was recompleted for gas production, the lands were communitized with lands in the SE/4 of Section 20 which were owned 75% by Gulf and Standard (now Chevron) and 25% by ARCO;
- d) this well was not "assigned" to the working interest owners, but instead, the costs of completion and future operations were paid from revenues. At that time, Gulf's share was the same in the NE/4 and SE/4 and it did not participate in an arrangement between Shell, ARCO and Standard to "balance" the costs and expenses. That arrangement resulted in Shell paying 50% of the costs of the gas completion by receiving 23.4375% of the revenues and with ARCO and Standard diverting 13/16th of their revenue to Shell until their 1/8th cost of completion was paid. ARCO and Gulf continued to pay 1/16th each to Citation for operating costs for the well plus their share of the 1/8th royalty to the State of New Mexico; and,

- e) this interpretation of the 1958 Agreements has resulted in the following:
 - i) revenues from gas production from the Devonian State Com Well No. 1 have been shared 53.90625% to Chevron, 23.4365% to Citation 1987 Investment Limited Partnership and 10.15625% to ARCO;
 - ii) drilling, completion, maintenance and all other costs associated with any subsequent operations on the Devonian State Com Well No. 1 have been shared 50% by Citation 1987 Investment Limited Partnership and 50% by Chevron;
 - iii) ARCO and Chevron are each paying to Citation a 1/16 of 1/8th production payment as compensation for unit operating costs for this well.

(6) Citation provided further expert legal opinions and testimony concerning flaws with the 1958 contracts. This testimony indicates that:

- a) the Commissioner of Public Lands for the State of New Mexico required an approved communitization agreement in order to consolidate acreage under multiple leases for a single spacing and proration unit, the size of which conforms to the Rules and Regulations of the New Mexico Oil Conservation Division. (See SLO Rule 1.044 to 1.051.);
- b) approval of the communitization agreement by the Commissioner of Public Lands effectively committed the state lease royalty to the agreement;

- c) communitization agreements used by the Commissioner of Public Lands, including this 1958 communitization agreement, make no provisions for the drilling, completing or operating of any well or wells within that spacing unit but leaves it up to the working interest owners to reach agreement for those activities usually by signing a JOA which sets forth specific provisions for the drilling, completing or operating of any well or wells within that spacing unit; and,
- d) unfortunately, the 1958 Agreements are limited to a single well, the Devonian State Com Well No. 1, and contain no provisions for the operations of other wells in the E/2 of Section 20. Further, the "Agreement For Use of Well" is unique to the Devonian State Com Well No. 1 and is not appropriate for other wells in this spacing unit.

(7) The Special Rules and Regulations for the Eumont Gas Pool, as promulgated by Division Order No. R-8170, as amended, provide, among other things:

- a) the Eumont Gas Pool is a prorated gas pool based upon standard 640-acre gas spacing and proration units. The Division allocates production allowables to each spacing unit using an acreage factor of 4.0 per 640-acre unit;
- b) a gas well in the Eumont Gas Pool is defined as a well producing gas at a gas-liquid ratio greater than 100,000 cubic feet of gas per barrel of oil; and,
- c) while the Eumont pool rules are silent about this, the Division discourages the practice of simultaneously dedicating the same acreage to both an oil well and a gas well if the operations are conducted by different operators.

(8) Citation provided evidence and testimony which indicates that in the spring of 1996 it conducted an audit of production data which indicated that the Devonian State Well Nos. 2 and 3 should have been reclassified from oil wells to gas wells in the Eumont Gas Pool effective October 1, 1990, and December 1, 1990, respectively.

(9) On April 3, 1996, the Division, upon application of Citation, issued Administrative Order NSL-3646(SD), which order authorized Citation to drill its Devonian State Com Well No. 2 at an unorthodox gas well location for the Eumont Gas Pool 710 feet from the South line and 660 feet from the East line (Unit P) of Section 20, to re-enter the Devonian State Com Well No. 3 (formerly the ARCO State "D" Well No. 1) located at a standard gas well location in the Eumont Gas Pool 1980 feet from the South and East lines (Unit J) of Section 20, and to simultaneously dedicate the E/2 of Section 20 to the aforesaid Devonian State Com Well Nos. 2 and 3 and to the existing Devonian State Com Well No. 1.

(10) Thereafter, Citation advised Chevron and ARCO, the working interest owners in the E/2 of Section 20, of the results of the audit which concluded that:

- a) the Devonian State Well Nos. 2 and 3 should have been reclassified as gas wells when their individual GORs exceeded 100,000 to 1; and,
- b) the gross gas revenues should be distributed to the owners in the E/2 and not just to the working interest owners in the NE/4 of Section 20.

(11) In order to correct any inequities that have occurred or may occur in the future with regards to the operation of the E/2 of Section 20 in the Eumont Gas Pool, the applicant has proposed the following solution:

- a) because, historically the parties have shared gas production from the Devonian State Com Well No. 1 based upon their proportionate interest in the existing 320-acre non-standard gas spacing and proration unit, Citation proposed that **both** gas and oil production and costs for **all existing and future** wells in the E/2 of Section 20 be shared on the same percentages;
- b) Citation will operate all existing and future oil and gas wells in this spacing unit in the Eumont Gas Pool;

- c) because the 1958 Agreements are inadequate and only apply to the Devonian State Com Well No. 1 and there was no JOA for this 320-acre spacing unit, Citation proposed and ARCO and Chevron agreed to sign an appropriately modified JOA using AAPL Form 610-1982;
- d) because the entire E/2 of Section 20 consists of State of New Mexico Oil and Gas leases and because all state royalties due have been properly paid, there is no need to amend or revise the existing communitization agreement.

(12) As a result, this settlement, which was acceptable to Chevron and ARCO, Citation had received more than its proportionate share of gas production and therefore re-distributed production by using the date at which the Devonian State Well No. 2 should have been reclassified as a gas well (October 1, 1990) and the date at which the Devonian State Well No. 3 should have been reclassified as a gas well (December 1, 1990) as the commencement dates for accounting for all gas and oil production from all wells in this spacing unit.

(13) Because all parties have now agreed to this new JOA, Citation will disburse to ARCO and Chevron their respective adjusted net share of proceeds.

(14) The working interest owners have now agreed to "share" gas/oil production among all the owners in the E/2 and not just to the owners in the NE/4 of Section 20 pursuant to the new JOA covering all operations in the E/2 of Section 20, including:

- a) all existing and future drilled oil and gas wells in the Eumont Gas Pool within the E/2 of Section 20;
- b) designation of Citation as operator; and,
- c) providing that effective as of June 1, 1997, the working interest in the E/2 of Section 20 shall share all production and pay all expenses for any existing wells and all future wells on the following percentages:

ARCO:	7.4910%
Chevron:	60.8241%
Citation:	31.6849%

(15) Chevron and ARCO, who initially opposed Citation's application in this case, have withdrawn their opposition based upon the above-described agreements.

(16) A review of the oil/gas classification for all wells in the E/2 of Section 20, including the Chevron operated Janda NCT-A Well No. 2, demonstrates that acceptable gas balancing has been accomplished for all prior gas production from the aforesaid Janda NCT-A Well No. 2 and the Citation operated wells in this 320-acre gas spacing and proration unit.

(17) Subsequent to the hearing held on July 10, 1997, the applicant provided additional notification to all offset operators advising them that the Division would continue this case to the Examiner hearing set for August 7, 1997. No other offset operator and/or interest owner appeared at the hearing in opposition to the application.

(18) Division Administrative Order No. NSL-3646(SD) should remain in full force and effect and no further approvals are necessary concerning the Devonian State Com Well Nos. 2 and 3.

(19) The applicant should be required to file amended Form C-115 for the Devonian State Well Nos. 2 and 3 reflecting reclassification as gas wells in the Eumont Gas Pool effective October 1, 1990, and December 1, 1990, respectively.

(20) Approval of the subject application will afford the applicant and the interests owners in the E/2 of Section 20 the opportunity to produce their just and equitable share of gas production from the Eumont Gas Pool, will prevent the economic loss caused by the drilling of unnecessary wells, avoid the augmentation of risk arising from the drilling of an excessive number of wells and will otherwise prevent waste and protect correlative rights.

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Citation Oil & Gas Corporation, the Division hereby approves and authorizes:

- a) the reclassification of the Devonian State Well Nos. 2 and 3, located at unorthodox gas well locations in the Eumont Gas Pool (also hereby approved) 660 feet from the North line and 1980 feet from the East line (Unit B) of Section 20, and 660 feet from the North and East lines (Unit A) of Section 20, respectively, both in Township 21 South, Range 36 East, NMPM, effective October 1, 1990, and December 1, 1990, respectively, from oil wells to gas wells in the Eumont Gas Pool; and,
- b) the simultaneous dedication of an existing 320-acre non-standard gas spacing and proration unit in the Eumont Gas Pool comprising the E/2 of Section 20 to the above-described Devonian State Well Nos. 2 and 3 and to the existing Devonian State Com Well No. 1 located at a standard gas well location in the Eumont Gas Pool 1980 feet from the North and East lines (Unit G) of Section 20;

(2) The applicant shall file amended Form C-115's for the Devonian State Well Nos. 2 and 3 reflecting reclassification as gas wells in the Eumont Gas Pool effective October 1, 1990, and December 1, 1990, respectively.

(3) Jurisdiction of this cause 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.



S E A L

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in black ink, appearing to read 'William J. Lemay', is written over the typed name and title. The signature is fluid and cursive, extending across the width of the text below it.

WILLIAM J. LEMAY
Director