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JASON KELLAHIN (RETIRED 1991)

July 21, 1997

HAND DELIVERED

Mr. David R. Catanach
Oil Conservation Division
2040 South Pacheco
Santa Fe, New Mexico 87505

*Re: NMOCD Case 11638
Citation Oil & Gas Corp.*

Dear Mr. Catanach:

In accordance with your request at the hearing of the referenced case held on July 10, 1997, please find enclosed a suggested order. The enclosed diskette contains this proposed order as file "11638.ORD" and is formatted to Word Perfect 5.1.

Very truly yours,

A handwritten signature in black ink, appearing to read 'W. Thomas Kellahin', written over a horizontal line.

W. Thomas Kellahin

cc: Citation Oil & Gas Corp.
Attn: Gary Johnson, Esq.

**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-**

**APPLICATION OF CITATION OIL & GAS
CORP. 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, 1997, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this ____ day of July, 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) That the applicant, Citation Oil & Gas Corp. ("Citation"), is the operator of the wells located in the E/2 of Section 20, T21S, R36E, NMPM, Lea County, New Mexico, to be affected by this order, and is the general partner of Citation 1987 Investment Limited Partnership, one of the working interest owners in such wells.

NMOCD REGULATORY ISSUES

(3) Citation seeks approval from the Division to:

(a) reclassify the Devonian State Well No. 3 (Unit A), effective as of December 1, 1990, and the Devonian State Well No. 2 (Unit B), effective as of October 1, 1990, from Eumont oil wells to Eumont gas wells;

(b) simultaneously dedicate both of these wells to the E/2 of Section 20 which is an existing 320-acre non-standard spacing and proration unit currently dedicated to the Devonian State Com Well No. 1 (Unit G). See Administrative NSP-488 dated May 11, 1959;

(c) produce gas from two wells located at unorthodox gas well locations; being the Devonian State Wells No. 2 and No. 3 because they are 660 feet from the two sides of the spacing unit boundary instead of being at least 990 feet from one side boundary, as required for 320 acre dedication in the Eumont Gas Pool; and

(d) file corrected Operator's monthly report (form C-115) showing reclassification of Devonian State 3 effective December 1, 1990 and Devonian State 2 effective October 1 1990 from oil wells to gas wells.

BACKGROUND

(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 in Unit G of Section 20 as an oil well in the Eunice Pool. Then on September 22, 1953, Shell Oil Company recompleted the well for gas production and dedicated it to a 160-acre gas spacing unit consisting of the NE/4 of Section 20 for gas production from the Eumont Gas Pool.

(b) On October 8, 1958, Shell, Gulf, Standard and 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 gas proration and spacing unit for gas production from the Devonian State Com Well No. 1 in the Eumont Gas Pool.

(c) Instead of entering into a Joint Operating Agreement 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. That 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 provision for a Eumont Well being reclassified from an oil well to a gas well or visa versa.

(d) On May 11, 1959, the New Mexico Oil Conservation Division issued Order NSP-488, which 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.

(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.

INTERPRETATION OF THE 1958 AGREEMENTS

(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:

(a) The Gas Communitization and Pooling Agreement dated October 8, 1958 pools the E/2 of Section 20 to form a gas proration and well spacing 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..." (Devonian State Com Well No. 1).

(b) This Communitization 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). 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 of Texas (now Chevron) and 25% by Atlantic Richfield (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, Atlantic and Standard of Texas 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 Atlantic and Standard of Texas 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.

(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% Citation 1987 Investment Limited Partnership and 50% 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.

FLAWS WITH 1958 AGREEMENTS

(6) Citation provided expert legal opinions and testimony concerning flaws with the 1958 contracts:

- (a) The Commissioner of Public Lands for 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 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 joint operating agreement which sets forth specific provisions for the drilling, completing or operating of any well or wells within that spacing unit.
- (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.

EUMONT POOL RULES

- (7) The Eumont Gas Pool Rules, among other things, provide:
 - (a) The Eumont Gas Pool is a prorated gas pool based upon standard 640-acre gas proration and spacing units. The Division allocates production allowables to each spacing unit using an acreage factor of 4 per 640-acre unit.
 - (b) A Eumont gas well is defined as a well producing gas at a gas to oil ratio greater than 100,000 cubic feet of gas per barrel of oil.

(c) While the Eumont Pool Rules are silent about this, the NMOCD-Santa Fe practice is to discourage the simultaneous dedication of the same acreage to both a gas well and to an oil well if the operations are conducted by different operators.

DEVONIAN STATE WELL NOS 2 AND 3

(8) Citation provided evidence that in the spring of 1996, while examining the feasibility of drilling the Devonian State Com Well No. 2 (Unit P) of Section 20 and re-entering the Arco State "D" Well No. 1 to be renamed the Devonian State Com Well No. 2, (Unit J) of Section 20, both as Eumont gas wells, it had conducted an audit of production data which indicated that on October 1, 1990, the Devonian State Well No. 2 and on December 1, 1990 the Devonian State Well No. 3 should have been reclassified from oil wells to gas wells.

(9) On April 3, 1996, the Division entered Administrative Order NSL-3646(D) approving Citation's application and authorizing the drilling of the Devonian State Com Well No. 2 at its proposed unorthodox gas well location and the re-entry of the Devonian State Com Well No. 2 and the simultaneous dedication of said wells to the E/2 of said Section 20.

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

(a) these two wells should be reclassified as gas wells when their individual GORs exceeded 100,000 to 1,

(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.

SOLUTION

(11) 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 unit be shared on the same percentages.

(12) Because the New Mexico Oil Conservation Division strongly requests that operations of both oil and gas wells in the same Eumont spacing unit be operated by a single operator, Citation has been authorized to operate all the existing and future oil and gas wells in this spacing unit.

(13) Because the 1958 Agreements are inadequate and only apply to the Devonian State Com Well No. 1 and there was no Joint Operating Agreement for this 320-acre spacing unit, Citation proposed and ARCO and Chevron agreed to sign an appropriately modified Joint Operating Agreement using AAPL Form 610-1982.

(14) 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.

(15) As a result this settlement which was acceptable to Chevron/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.

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

(17) 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 a new joint operating agreement covering all operations in the E/2 of Section 20, including:

(a) all existing oil and gas wells currently dedicated to the Eumont Gas Pool within the E/2 of Section 20;

(b) all future wells to be drilled and completed for production from the Eumont Gas Pool within the E/2 of Section 20:

(c) designation of Citation as operator,

(d) 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% |

(18) That Chevron and Arco have withdrawn their opposition to Citation's NMOCD application in Case 11638.

(19) That a review the oil/gas classification for **all wells in E/2 of Section including** Chevron's operated Janda NCT-A#2 Well in the E/2 of Section 20 demonstrates that acceptable gas balancing has been accomplished for all prior gas production from the Chevron operated Janda well and the Citation operated wells in the 320-acre spacing unit.

(20) 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 and at that time no other offset operator. and or interest owners appeared at the hearing in opposition to the application.

(21) There is no opposition to granting this application.

(22) Administrative Order NSL-3646(D) is still in full force and effect and no further approvals are necessary concerning the Devonian State Com Well Nos. 2 and 3.

(23) Approval of the subject application will afford the applicant and the interests owners in the 320-acre spacing unit 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) The applicant, Citation Oil & Gas Corp., is hereby **granted**.
- (2) The Division **hereby approves and authorizes**:
 - (a) the reclassification of the Devonian State Well No. 3 (Unit A), effective as of December 1, 1990, and the Devonian State Well No. 2 (Unit B), effective as of October 1, 1990, from Eumont oil wells to Eumont gas wells;
 - (b) the simultaneous dedication of those two wells to the E/2 of Section 20 which is the existing NSP currently dedicated only to the Devonian State Com Well No. 1 (Unit G). See Administrative NSP-488 dated May 11, 1959;
 - (c) unorthodox gas well locations for the Devonian State Wells No. 2 and No. 3 because they are 660 feet from the north line instead of the required 990 feet for 320 acre dedication in the Eumont Gas Pool; and
 - (d) correction of the Operator's monthly report (form C-115) showing reclassification of Devonian State 3 effective December 1, 1990 and Devonian State 2 effective October 1 1990 from oil wells to gas wells
- (3) That 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY
Director