

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. 11,638

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

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Oil Conservation Div.

OFFICIAL EXHIBIT FILE

EXAMINER HEARING

BEFORE: DAVID R. CATANACH, Hearing Examiner

July 10th, 1997

Santa Fe, New Mexico

This matter came on for hearing before the New Mexico Oil Conservation Division, DAVID R. CATANACH, Hearing Examiner, on Thursday, July 10th, 1997, at the New Mexico Energy, Minerals and Natural Resources Department, Porter Hall, 2040 South Pacheco, Santa Fe, New Mexico, Steven T. Brenner, Certified Court Reporter No. 7 for the State of New Mexico.

* * *

EXHIBIT LIST

- Exhibit 1:** a map showing the E/2 of Section 20 and all offsetting operators and summary of issues and information
- Exhibit 2:** a map showing the E/2 of Section 20
- Exhibit 3:** copy of Citation Application including:
- (1) area map
 - (2) 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
 - (3) Revised Form C-102 for Devonian State 2 & 3
- Exhibit 4:** Chevron protest and subsequent Chevron letter withdrawing protest
- Exhibit 5:** Division Order NSP-488 dated May 11, 1959
- Exhibit 6:** Division Administrative Order NSL-3646 (SD) approving Citations request to (a) drill the Devonian State Com Well No. 2 located 710 feet FSL and 660 feet FEL (Unit P) of Section 20 and attempt to complete it as a Eumont gas well;
- and(b) to re-enter the Arco State "D" Well No. 1 and rename it the Devonian State Com Well No. 2, said well being located 1980 feet FSL and FEL (Unit J) of Section 20 and attempt to recomplete it as a Eumont gas well.
- Exhibit 7:** Division letters to Chevron dated April 30, 1993 and April 27, 1994 concerning reclassification of Janda Wells from oil to gas.
- Exhibit 8:** spreadsheet showing reconciliation of gas production and agreed distribution to ARCO & Chevron for the Devonian #2 Well and for the Devonian #3 Well
- Exhibit 9:** new Revised and signed Joint Operating Agreement
- Exhibit 10:** corrected and amended Division Form C-115 for Devonian State Com Well Nos 2 and 3.

R 36 E

OPERATING AGREEMENT
 9-11-28
 amended
 10-2-40, 12-17-52
 CILP 50.00%
 Chevron 50.00%

COMMUNITIZATION AGMT.
 10-08-58
 (Eumont Gas Pool)
 CILP 25.00%
 Chevron 62.50%
 ARCO 12.50%

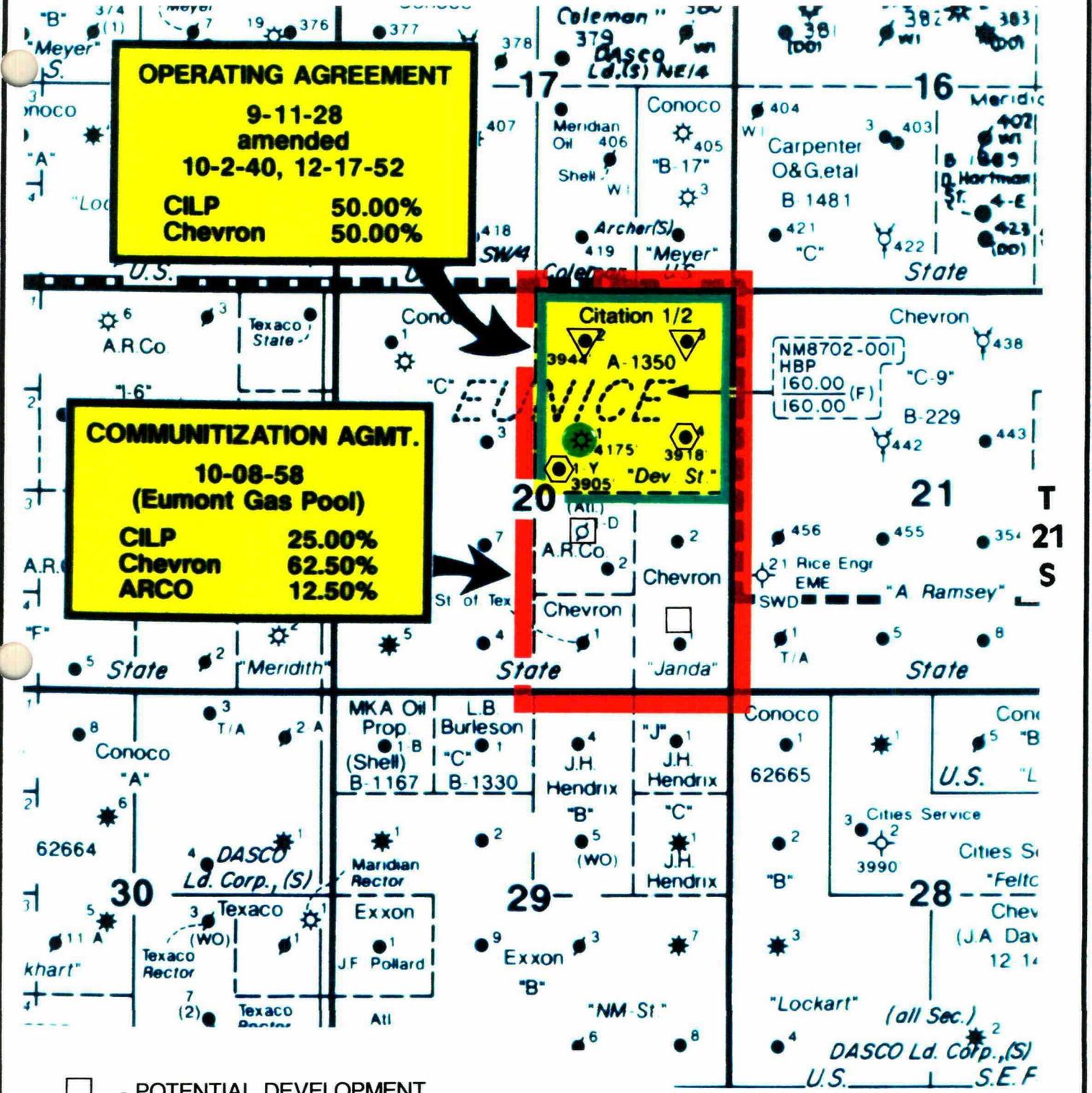
Citation 1/2
 3944 A-1350
 DEVONIAN STATE #1
 4175 3918
 3905 "Dev St."

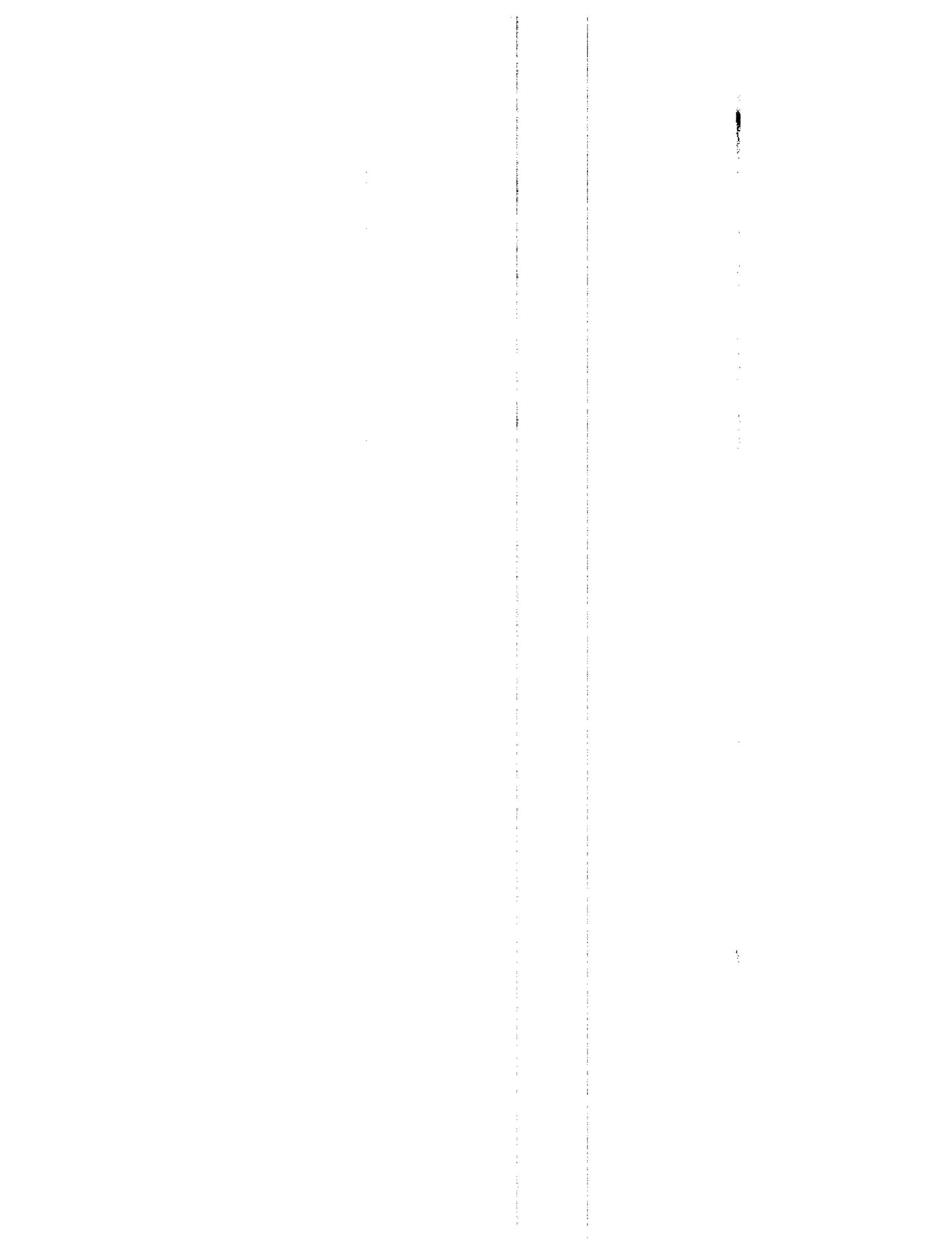
- - POTENTIAL DEVELOPMENT
- - PENROSE PRODUCERS
- ▽ - RECOMPLETIONS TO YATES/7 RVRS QUEEN
- - AGMT. dated 10-08-58
 Devonian State #1 well
 (Use of well)

Citation
 OIL & GAS CORP.

Lea County, New Mexico

**EUMONT FIELD
 LEASE MAP**





NMOCD REGULATORY ISSUES

NMOCD Case 11638 involves, among other things, Citation's request to:

(a) reclassify the Devonian State Well No. 3 (Unit A) and the Devonian State Well No. 2 (Unit B) from Eumont oil wells to Eumont gas wells;

(b) to simultaneously dedicate 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) approve unorthodox location 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) 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;

BACKGROUND

(1) 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.

(2) 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 dedicated to gas production from the Eumont Gas Pool.

(3) Instead of entering into a Joint Operating Agreement for operations of gas wells within the E/2 spacing unit, they used 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 or a gas well or visa versa.

(4) 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.

(5) Citation Oil & Gas Corp. currently operates the Devonian State Com Well No. 1 having succeeded to Shell's interest as of late 1986 and became operator of this well.

INTERPRETATION OF THE 1958 AGREEMENTS

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..."**

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 Well No. 1.

This well 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 completed 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).

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.

This interpretation of the 1958 Agreements has resulted in the following:

(a) revenues from gas production from the Devonian State Com Well No. 1 have been shared 53.90625% to Chevron, 23.4365% to Citation and 10.15625% to Arco;

(b) 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 and 50% Chevron;

(c) 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

The Commissioner of Public Lands for New Mexico requires 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

Approval of the communitization agreement by the Commissioner of Public Lands effectively commits the state lease royalty to the agreement.

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. It then is up to the working interest owners to reach agreement of 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.

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

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.

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.

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

An audit of production data indicates 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.

Exhibit 8 is a spreadsheet showing a reconciliation of gas production. This reconciliation assumes that:

- (a) these two wells were reclassified as gas wells when their individual GORs exceeded 100,000 to 1,
- (b) the gross gas revenues are distributed not to the owners in the NE/4 but to the working interest owners in the E/2 of Section 20.

Because the working interest owners in the NE/4 and the SE/4 have now entered into a new operating agreement for these wells, this reconciliation takes into account the well costs, recompletion costs and operating expenses to be charged to the SE/4 owners.

FUTURE OPERATIONS

On February 19, 1996, Charlie Adams of Citation notified Chevron/Arco of Citation's desire to:

- (a) drill the Devonian State Com Well No. 2 located 710 feet FSL and 660 feet FEL (Unit P) of Section 20 and attempt to complete it as a Eumont gas well; and(b) to re-enter the Arco State "D" Well No. 1 and rename it the Devonian State Com Well No. 2, said well being located 1980 feet FSL and FEL (Unit J) of Section 20 and attempt to recomplete it as a Eumont gas well.

When this case was filed, there was no operating agreement which provided for this re-entry or this new drill. The new operating agreement resolves this and designates Citation as the operator.

SOLUTION

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.

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.

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.

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, and if required by the Commissioner of Public Lands, will obtain an approved and revised communitization agreement.

As a result this settlement which was acceptable to Chevron/Arco, then Citation had received more than its proportionate share of gas production and 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.

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.

In summary, Citation, ARCO and Chevron have agreed to the following solution:

(1) That the parties sign a Joint Operating Agreement, (copy enclosed) and will revise the Communitization Agreement to:

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

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

(c) Designate Citation Oil & Gas Corp. as operator,

(c) provide 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 % |

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

(3) That acceptable gas balancing has been accomplished for all prior gas production from the Chevron operated Janda wells and the Citation operated wells in the 320-acre spacing unit.