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BEFORE THE
OIL CONSERVATION DIVISION
NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

OIL CONSERVATION DIVISION

IN THE MATTER OF THE APPLICATION OF
PHILLIPS PETROLEUM COMPANY FOR A
NONSTANDARD SPACING UNIT AND AN
UNORTHODOX WELL LOCATION,
LEA COUNTY, NEW MEXICO.

CASE NO. 9036

APPLICATION

COMES NOW, PHILLIPS PETROLEUM COMPANY, by and through its undersigned attorneys, and hereby makes application to the Oil Conservation Division for a nonstandard spacing unit and an unorthodox well location, and in support thereof would show the Division:

1. Applicant is the operator of the Strawn formation underlying the SE/4 SW/4 of Section 4, Township 17 South, Range 37 East, N.M.P.M., and proposes to drill a well at a point 330 feet from the South line and 2500 feet from the West line of said Section 4.

2. Applicant seeks an exception to Rule 4 of the Special Rules and Regulations for the Shipp-Strawn Pool as promulgated by Oil Conservation Division Order No. R-8062-A to permit the drilling of the well at the above-mentioned unorthodox location to a depth sufficient to adequately test the Strawn formation.

3. That a nonstandard 40-acre oil proration unit comprising the SE/4 SW/4 of said Section 4 should be dedicated to the proposed well.

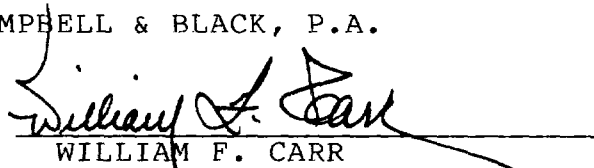
4. That approval of its application will afford Applicant the opportunity to produce its just and equitable share of the oil and gas in the Strawn formation and will otherwise be in the best interest of conservation, the prevention of waste and the protection of correlative rights.

WHEREFORE, Applicant requests that this matter be set for hearing before a duly appointed Examiner of the Oil Conservation Division on November 19, 1986, that notice be given as required by law and the rules of the Division, and that the Division enter its order approving the proposed nonstandard spacing unit and an unorthodox location for the proposed well and providing such other and further relief as is proper in the premises.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By



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OIL CONSERVATION COMMISSION
ENERGY AND MINERALS DEPARTMENT
STATE OF NEW MEXICO

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OIL CONSERVATION DIVISION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
COMMISSION FOR THE PURPOSE OF
CONSIDERING:

APPLICATION OF JEROME P. McHUGH
AND ASSOCIATES FOR AN AMENDMENT
TO THE SPECIAL RULES AND REGULATIONS
OF THE GAVILAN-MANCOS OIL POOL

Case No. 8946

APPLICATION FOR REHEARING

COME NOW MALLON OIL COMPANY and MESA GRANDE RESOURCES, INC.
and pursuant to Section 70-2-25 NMSA 1978, apply to the Oil
Conservation Commission of New Mexico for Rehearing of the
above-captioned matter, and in support thereof applicants state:

FACTUAL BACKGROUND:

The Oil Conservation Commission, hereinafter Commission,
held a hearing on the Application of Jerome P. McHugh and
Associates on August 7, 8, 21, 22 and 27, 1986. The Application
sought the imposition of reduced oil allowables and reduced
limiting gas-oil ratios for the Gavilan-Mancos Oil Pool (Gavilan
Pool), Rio Arriba County, New Mexico. This pool was created by
the Commission Order R-7407 entered on December 20, 1983. This
same order adopted special pool rules for the Gavilan Pool.

The Application of Jerome P. McHugh and Associates (Applicant), was opposed by Mallon Oil Company ("Mallon") and Mesa Grande Resources, Inc. ("Mesa Grande") and by several other interested parties. Both Mallon and Mesa Grande are interest owners in and operators of wells in the Gavilan Pool.

On September 11, 1986, the Commission entered Order R-7407-D which reduced the oil allowables and reduced the limiting gas-oil ratios for the Gavilan Pool. Applicants for Rehearing, Mallon and Mesa Grande are affected by this Order.

Pursuant to Section 70-2-25 NMSA 1978, Mallon and Mesa Grande within twenty (20) days of the entry of Order R-7407-D filed this Application for Rehearing.

POINT I: REHEARING SHOULD BE GRANTED
BECAUSE THE COMMISSION FAILED
TO MAKE "BASIC CONCLUSIONS OF
FACT"

Order R-7407-D fails to comply with applicable statutory and judicial mandates. In Continental Oil Co. v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962) the New Mexico Supreme Court in a case dealing with a natural gas pool discussed the basic conclusions of fact that the Commission is required to find prior to changing a proration formula. The requirements are that the Commission find, as far as it is practical to do so:

- (1) the amount of recoverable reserves under each producer's tract;

- (2) the total amount of recoverable reserves in the pool;
- (3) the proportionate relationship of (1) and (2); and
- (4) what portion of the reserves can be recovered without waste.

A review of Order R-7407-D shows that the Commission failed to make any of these required findings and did not discuss any of these necessary elements. The record in this matter is clear, Dugan Exhibit # 1, that the changes adopted by the Commission constitute a change in the proration formula since these changes alter the relative proportion of production between operators in the Gavilan Pool and deviate from statewide rules. Order R-7407-D is therefore contrary to law and arbitrary and capricious.

**POINT II: REHEARING SHOULD BE GRANTED
BECAUSE THE ORDER IMPAIRS THE
CORRELATIVE RIGHTS OF INTEREST
OWNERS IN THE POOL**

A. Order R-7407-D finds, Paragraph (12)(n), that a reduction in the allowable oil production rate and lower gas-oil ratio will afford an opportunity to recover more hydrocarbons because of gravity drainage. The gravity drainage claimed by Albert Greer, based solely on information from the West Puerto Chiquito-Mancos Oil Pool is based upon the angle of dip of the formation in said pool. This theory presupposes that for there to be more oil recovered from the pool, one proration must be

down-dip from another proration unit and must recover the oil from the up-dip unit. If the Commission's finding that gravity drainage will occur if production rates are slowed is correct, the correlative rights of the owners of up-dip proration units will be impaired as the reserves underlying their tracts are allowed to migrate to other proration units.

As a result, not only does the Commission's Order fail to protect the correlative rights of interest owners in the pool as is required by statutory and case law, but the Commission's Order actually acts to destroy those rights by preventing operators of up-dip proration units from recovering the reserves underlying their tracts prior to those reserves migrating to down-dip tracts. In the absence of unitization, any act by the Commission which favors gravity drainage is arbitrary and capricious and contrary to law.

B. Applying the Commission's amended gas-oil ratios and amended production allowables to the wells in the Gavilan Pool establishes that the applicant is benefitted by this order even more than requested in its application. The percentage of pool production allocated to various operators in this pool prior to these cases under the applicant's proposal and under the Commission's order are as follows:

PERCENT OF TOTAL STUDY AREA OIL PRODUCTION

<u>Operator</u>	<u>6/86(1)</u>	<u>Applicant's Proposal(1)</u>	<u>Koch Proposal 702/588 (1)</u>	<u>Order of 400/600 (2)</u>
Amoco	0.3	0.6	0.4	0.5
Dugan	2.5	4.2	2.9	3.6
Mallon	19.5	14.2	16.3	13.6
McHugh	39.7	37.5	41.7	41.6
Meridian	9.9	13.0	10.9	11.7
Merrion	0.4	0.6	0.4	0.5
Mesa Grande	10.7	13.2	10.9	11.8
Mobil	4.2	5.8	4.9	5.7
Reading & Bates	1.1	1.8	1.3	1.6
BMG	<u>11.8</u>	<u>9.1</u>	<u>9.9</u>	<u>9.5</u>
TOTALS	100.1	100.0	100.0	100.1

(1) Data taken from Dugan Production Company Exhibit No. 3 to the hearing of this matter.

(2) Calculated from data available in record.

This data clearly shows that the effect of the Commission's Order is to penalize certain interest owner's production in the Gavilan Pool much more severely than others, and even more than the applicant requested. It is also undisputable that the most equitable and balanced treatment of production curtailment in the Gavilan Pool was that proposed by Koch Production Company which was supported by Mallon and Mesa Grande.

For these reasons, Order R-7407-D violates the correlative rights of certain interest owners in the Gavilan Pool and is therefore contrary to law and is arbitrary and capricious.

C. Order R-7407-D also impairs the correlative rights of owners in the Gavilan Pool by allowing wells in the western section of the adjoining West Puerto Chiquito-Mancos Pool to receive credit for gas injection and produce at higher allowable rates than wells in the Gavilan Pool. Some of these wells were relied upon by the applicant to demonstrate the direct and high degree of communication between wells in the Gavilan Pool. The evidence submitted by all parties isolated these western wells from the other wells lying to the east in the West Puerto Chiquito-Mancos Oil Pool. Consequently, there is no justification for treating more favorably these western wells in the West Puerto Chiquito-Mancos Pool.

For this reason Order R-7406-D violates the correlative rights of interest owners in the Gavilan Pool, and is thereby contrary to law and is arbitrary and capricious.

POINT III. REHEARING SHOULD BE GRANTED
BECAUSE THE ORDER FAILS TO
CONTAIN SUFFICIENT FINDINGS

Finding 12(b) of the Order states that the Gavilan Pool is primarily a solution-gas drive reservoir with potential for substantial additional ultimate oil recovery by gravity drainage. Testimony in this case is uniformly in agreement that increasing gas-oil ratios are to be expected in solution gas drive

reservoirs and in fact John Roe found that the pressure decline curves and gas-oil ratio curves closely conform to the expected curve shown in Dugan Exhibit 2.

In Fasken v. Oil Conservation Commission, 87 N.M. 292, 532 P. 2d 588 (1975) the New Mexico Supreme Court stated that two levels of findings were necessary in Commission orders. First, those orders must contain "ultimate findings" such as that the order operates to prevent waste or protect correlative rights. Secondly, the order must contain sufficient findings to "disclose the reasoning of the Commission".

The findings of Order R-7407-D fail to set forth the reasoning of the Commission which allows it to ignore the primary production mechanism in favor of the confiscatory mechanism of drainage or some other unspecified production mechanisms.

For this reason Order R-7407-D is contrary to law and is arbitrary and capricious.

POINT IV. REHEARING SHOULD BE GRANTED BECAUSE
ORDER 7407-D IS CONTRARY TO LAW

Paragraph (11) of Order R-7407-D finds that the working interest owners in the Gavilan Pool are not in agreement on any method of operation of the pool other than that previously adopted by the Commission Order R-7407. During the presentation of testimony in support of the applicant's case, it became clear that the applicant brought this case with the intent of forcing other operators to agree to the unitization of the Gavilan Pool.

In fact, the applicant threatened that if its application did not force the desired unitization, the applicant intended to apply for even more restrictive allowables in the future.

Consequently, it is clear that the applicant seeks to have the Commission do indirectly what the New Mexico Oil and Gas Act does not authorize it to do directly. The Oil and Gas Act does not authorize statutory unitization for primary recovery of oil and gas reserves. However, Order R-7407-D essentially operates to coerce operators to unitize involuntarily and is without statutory authority.

Order R-7407-D is therefore contrary to law and is arbitrary and capricious.

POINT V. REHEARING SHOULD BE GRANTED
BECAUSE ORDER R-7407-D IS NOT
SUPPORTED BY SUBSTANTIAL EVIDENCE,
IS ARBITRARY AND CAPRICIOUS AND IS
CONTRARY TO LAW

The following findings made by the Commission Order R-7407-D are not supported by substantial evidence contained in the record as a whole.

1. Finding (11)
2. Finding (12)
3. Finding (13)
4. Finding (14)
5. Finding (15)

In the absence of such substantial evidence the Order is arbitrary and capricious and is contrary to law.

POINT VI. REHEARING SHOULD BE GRANTED
BECAUSE ORDER R-7407-D IS
CONTRARY TO THE PUBLIC INTEREST

Order R-7407-D is contrary to the public interest for the following reasons:

A. Order R-7407-D discriminates in favor of in-state New Mexico operators and against out-of-state operators, including Mallon and Mesa Grande.

B. The undisputed evidence (Koch Exploration Company's Exhibits 7, 8 and 9) demonstrates that the result of Order R-7407-D is contrary to the economic interests of the State of New Mexico. Although the issue before the Commission was loss of reservoir energy, it is clear that the resultant loss of income to the State of New Mexico through loss of severance taxes and royalty income, not to mention the loss of income to interest owners in the Gavilan Pool, far exceeds the cost of gas required to maintain the Gavilan Pool's present reservoir energy. Consequently, there is no economic justification for the order.

Therefore, Order R-7407-D violates the correlative rights of interest owners in the Gavilan Pool, is contrary to law and is arbitrary and capricious.

POINT VII. REHEARING SHOULD BE GRANTED
BECAUSE MALLON AND MESA
GRANDE HAVE BEEN DENIED DUE
PROCESS OF LAW AND A FULL AND
FAIR HEARING

At the close of the hearing of this matter on August 27, 1986, the Chairman of the Commission requested applicant's

counsel to provide him with a draft order in this matter. Subsequent to that time, Mallon and Mesa Grande have received from counsel for applicant a copy of the proposed draft order which was submitted to the Commission for its consideration. Mallon and McHugh are unaware of what further steps have been taken with regard to the drafting and preparation of the final order entered in this matter.

In Morgan v. United States, 304 U.S. 1, 58 S.Ct. 773 (1938) the United States Supreme Court considered the propriety of communications being received in administrative proceedings from only one party to that proceeding. The Court states:

If in an equity cause, a special master or the trial judge permitted the plaintiff's attorney to formulate the findings upon the evidence, conferred ex parte with the plaintiff's attorney regarding them, and then adopted his proposal without affording an opportunity to his opponent to know their contents and present objections, there would be no hesitation in setting aside the report or decree as having been made without a fair hearing. The requirements of fairness are not exhausted in the taking or consideration of evidence, but extend to the concluding parts of the procedure as well as to the beginning and intermediate steps.

58 S.Ct. at 777.

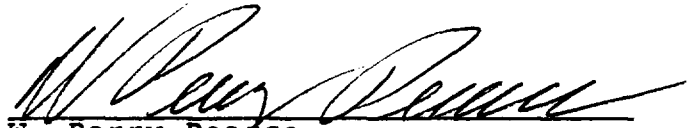
In this case, the Commission specifically requested proposed findings and conclusions from only one party to this proceeding and applicants Mallon and Mesa Grande have therefore been denied

their rights to due process of law and their rights to a full and fair hearing of this matter.

WHEREFORE, Mallon Oil Company and Mesa Grande Resources, Inc. request that the Commission grant a Rehearing in this case and that after such Rehearing, the Commission vacate and set aside its Order R-7407-D.

Respectfully submitted,

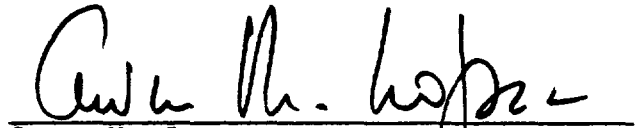
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CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed a true and correct copy of the foregoing Application for Rehearing to the following individuals on this 1st day of October, 1986:

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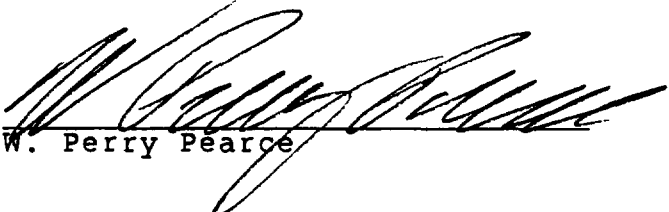
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