

**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. 15316
ORDER NO. R-14099**

**APPLICATION OF APACHE CORPORATION FOR APPROVAL OF A
PROJECT AREA ENCOMPASSING COMMUNITIZED LANDS WITHIN T17S,
R31E, NMPM, EDDY COUNTY, NEW MEXICO, APPROVAL OF SURFACE
COMMINGLING AND ESTABLISHMENT OF A NEW POOL FOR THE
COMMUNITIZED PROJECT AREA.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing on June 25, 2015 at Santa Fe, New Mexico, before Examiners Michael A. McMillan and William V. Jones and again on July 23, 2015 before Examiner Phillip R. Goetze.

NOW, on this 21st day of December, 2015, the Division Director, having considered the testimony, the record, and the recommendations of the Examiners,

FINDS THAT:

- (1) Due public notice has been given, and the Division has jurisdiction of this case and its subject matter.
- (2) The applicant, Apache Corporation ("Apache" or "Applicant") seeks approval of:
 - a. A Project Area that encompasses lands covered in a federal communitization agreement.
 - b. Wells to be located anywhere in the Project Area provided that the completed producing interval meets the setback requirements from the exterior boundaries of the Project Area.

- c. The establishment of a new pool within the Project Area and the concomitant contraction of the boundary of the Fren; Glorieta Yeso Pool (26770).
- d. Surface commingling within the Project Area.

(3) The federal Cedar Lake Communitization Agreement NM134086, or "Agreement or Agreement Area" consists of 5051.36 acres of only federal lands, described below:

Township 17 South, Range 31 East, NMPM, Eddy County, New Mexico

Sections 3 through 10: All

(4) Applicant's Exhibits A and B to the Agreement show details on tract ownership. The lands consist of seven separately owned tracts covering portions of the following four (4) federal oil and gas leases: LC-029426-A, LC-029426-B, LC-029435-A, and LC-029435-B.

(5) The Agreement contains the following stipulations:

- a. The effective date is November 1, 2013.
- b. The Agreement depths are limited to the Glorieta and Yeso formations. The Agreement is not limited to wells drilled horizontally.
- c. The lands shall be developed and operated as an entirety, with allocation based on acreage contribution of each leasehold (tract) to the Project Area.
- d. The separate measurement of production is not required from leases within the Project Area.
- e. Production and sales shall be in conformity with allocation, allotments, and quotas made or fixed by any duly authorized person or regulatory body under applicable federal or state statutes. This agreement shall be subject to all applicable federal and state laws or executive orders, rules and regulations. (Paragraph No. 9 of the Agreement)
- f. A two (2) year term is allowed to drill the first commercial well and after that the Agreement contains continuous drilling requirements.
- g. Plan of Developments ("POD") are required to be submitted annually to the Authorized Officer ("AO") and these approved PODs shall become the drilling obligation.
- h. The Agreement Area shall, when practicable, be expanded or contracted after approval of the Bureau of Land Management ("BLM").

Effective Date:

(6) On July 7, 2015, Apache petitioned the BLM to change the effective date of the Agreement to November 1, 2013. Previously, the effective date was November 1, 2013 or prior to the onset of production from communitized substances, whichever is earlier. The BLM approved the modified Agreement by letter dated July 17, 2015.

(7) Division records indicate that 16 vertically drilled Glorieta-Yeso wells began production prior to the November 1, 2013 effective date within the Agreement Area. Prior to the effective date, there were no completed horizontal wells.

(8) At least 33 horizontal wells have been completed since the effective date within the Glorieta-Yeso formations and at least another 45 horizontal wells have been permitted (four of which have been spud). No vertical wells have been permitted or completed since the effective date.

Pools:

(9) Apache has requested a new pool within the proposed Project Area and requested that the boundary of the Fren;Glorieta Yeso Pool (26770) be contracted out of the Agreement Area. Division records indicate the only pool for oil production from the Glorieta-Yeso in the Agreement Area is the Fren;Glorieta-Yeso Pool which covers the E/2 of Section 9. However, many wells have been drilled or permitted since the Division last expanded this pool.

(10) All permitted or active Glorieta-Yeso wells within the Agreement Area have been tentatively placed by the District geologist within either the Fren;Glorieta-Yeso Pool (26770) or the Cedar Lake;Glorieta-Yeso Pool (96831). The former covers Sections 3, 4, 9, and 10 and the latter covers Sections 5, 6, 7, and 8. Each of these pools are governed by Division Rule 19.15.15.9(A.) NMAC, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section, and 330-foot setbacks from the unit boundaries. Each Glorieta-Yeso horizontal well producing or permitted within the Agreement Area is dedicated to only the number of 40-acre standard oil units that are completed or developed within that well's project area as per Division Rule 19.15.16.7(L)(1) NMAC.

(11) Division nomenclature Order No. R-12638 issued in Case No. 13783 on September 20, 2006, vertically extended these pools from the Paddock formation to include the entire vertical section of the Glorieta-Yeso formation(s). The Mar Loco;Glorieta-Yeso Pool was created to consolidate many Glorieta-Yeso pools, including these two, but Division Order No. R-13382-H issued in Cases No. 14613 and 14647 abolished the Mar Loco;Glorieta-Yeso Pool and re-established the Cedar Lake;Glorieta-Yeso Pool and the Fren;Glorieta-Yeso Pool.

(12) Apache's application to contract the Fren; Glorieta-Yeso Pool (Pool Code 26770) from within the Project Area and to create a new pool within the Project Area

should be dismissed without prejudice. The Division's district geologist should assign all Glorieta-Yeso formation wells within the Project Area to only one Glorieta-Yeso Pool which may or may not be the Fren; Glorieta-Yeso Pool. Apache should supply the district geologist with a list of Project Area wells and should submit revised Forms C-104 and C-102 to the district office in Artesia moving existing or previously permitted well completions to the agreed upon pool.

Communitization/Unitization:

(13) The proposed Project Area has been consolidated into a federal Communitization Agreement or ("CA"). The following are characteristics of a CA:

- a. A CA is a form of voluntary agreement recognized by the State Land Office ("SLO") and by the BLM as a way for diversely owned leases within a spacing unit (the lessees) to pool acreage and share in the proceeds of an oil or gas well based on acreage contribution.
- b. The BLM requires both the lessees and the working interest owners to sign the CA agreements prior to ratification.
- c. The CA form of agreement has been used on the rare occasion where dedicated acreage cannot be confined to one spacing unit. For example, an oil well dedicated to only 40 acres but drilled near or on a quarter-quarter line. That well would drain (and be dedicated to) 10 acres from each of the four surrounding quarter-quarters.
- d. In recent years the form is also being used for allocating acreage of horizontal wells traversing and completed in multiple spacing units (Division defined "developed project areas").
- e. Both the SLO and the BLM have in the past agreed to recognize that dedicated acreage to any well and assignment of allowable to any well is the statutory responsibility of the Oil Conservation Division.
- f. Each of the aforementioned uses of the CA agreement has coincided with dedicated acreage formally examined and then approved by the Oil Conservation Division through either rules or hearing orders.

(14) In this instance the BLM has ratified a voluntary agreement styled on the federal CA form between the operator, Apache Corporation, the lessees, and the working interest owners of lands covering eight square miles and detailed above. However, the BLM has also recognized and acted to modify this standard CA form by adding into it several clauses intended, it seems, to prevent waste and protect correlative rights. Indeed this agreement is much closer to being an all one participating area federal voluntary Unit agreement, with allocation immediately to all lands within the Agreement, but allowing expansion and contraction, which is not possible or practical under a standard CA

agreement, and most importantly, recognizing the existing authority of state and federal agencies over these lands (Paragraph No. 9 of the Agreement).

(15) The request by Apache for recognition of this Agreement Area as a Project Area similar to the use of that term within a Participating Area of a federal Unit, per Division Rule 19.15.16.7(L)(2) NMAC should be approved.

Surface Commingling:

(16) Applicant seeks approval of surface commingling within the Agreement Area. The BLM in ratifying this Agreement has agreed to the surface commingling within the Agreement Area. In addition, Division approval of surface commingling is not required and this portion of the case should be dismissed without prejudice. Horizontal wells producing within this Agreement Area will be considered as one property or "lease" as it is defined in Division Rule 19.15.12.7(C.) NMAC and will report production to only one pool. If in the future surface commingling is required under Division rules within the Agreement Area, then the operator should apply administratively for this approval. Apache should however utilize metering or periodic well testing to accurately report production by well, and request oil allowable by spacing and proration unit, as Division rules require.

Project Area:

(17) No vertical correlative rights issues are expected from approval of this Project Area for Apache. Division records indicate that Linn Operating Inc. (OGRID 269324) operates wells in the Agreement Area for formations down to and including the San Andres formation. Apache Corporation operates all wells in the Agreement Area for the Glorieta and Yeso formations. The Glorieta seems to be a tight or non-productive sand and in general acts as a barrier between the San Andres and the Yeso formations.

(18) The productive Yeso formation was shown by Apache to be present and relatively uniform over the proposed Project Area. There is adequate well control with many wells drilled by Apache in all Sections except in Sections 4 and 5, where shallower wells are prevalent. Apache has permitted many additional wells and intends to develop all sections within the Agreement Area.

Parties and Opposition:

(19) Nestegg Energy Corporation ("Nestegg"), an overriding royalty owner within the Agreement Area, appeared at the hearing in opposition to this case. No other party appeared or indicated opposition to this application.

Testimony:

(20) The Applicant appeared at the hearing through legal counsel and presented exhibits and testimony from a Landman and Geologist as follows:

- a. Apache controls the majority of this acreage and enough for preliminary approval of the Agreement by the BLM. COG Operating LLC ("COG") controls the remainder of the lands within the Agreement Area and has supplied a letter of support for this application. All surface lands and minerals in the Agreement Area are owned by the U. S. A. and administered by the BLM.
- b. Notice of the Division hearing was provided to the lessees of record, to all working and royalty interest owners, and also to all of the overriding royalty interest owners.
- c. The contract which Nestegg Energy Corporation signed to create the overriding royalty interest also enabled the working interest owner the ability to pool that overriding royalty interest with owners of other lands for purposes of drilling. Applicant maintained that Nestegg had no standing on which to protest.
- d. The Agreement is being modified to change the language of the "effective date." The Agreement will be ratified and in effect upon final approval by the Authorized Officer of the BLM.
- e. Apache does not intend to ask the Division to abandon the concept of spacing and proration units for the pool or pools within this Agreement Area and is not asking to form a 5051.36-acre spacing unit.
- f. Many wells have already been drilled. Many are being delayed due to the lands being within the domain of protected or semi-protected species.
- g. All working interest owners and all lessees of record are being asked to sign the Agreement; however, the final version of this voluntary area will only include lands on which the lessees of record have agreed to participate. Thereafter, the owners in all lands voluntarily committed to the Agreement Area will share in each well based on acreage contribution to the Agreement Area.

(21) Nestegg appeared at the hearing through legal counsel and presented exhibits and testimony from its owner indicating the following:

- a. Nestegg believes its correlative rights are being impaired primarily because of the retroactive date of the Agreement.
- b. By styling this Agreement upon a federal CA form, the Division's clear authority over well spacing is being bypassed and all interest owners should have been formally included as signature parties to this agreement.
- c. Apache has other means of developing these lands without forming a large Agreement Area. For example, Apache could develop these lands on a lease basis and work with the Division and BLM to obtain surface commingle permits.

- d. The Division, by agreeing to this, gives up some ability to protect correlative rights or prevent waste.
- e. The overriding royalty obtained by Nestegg did not enable the lease operator to pool lands under this [exact] modified CA agreement without agreement obtained from the override owner.
- f. The lease covering Section 7 with the sliding scale royalty was unique within the Agreement Area and could be re-negotiated or that lease could have been excluded from the agreement.
- g. Creating an Agreement Area after drilling many of the wells seems not to be for purposes of exploration and only for other reasons, such as freedom from having to obtain approval for rights of way, surface commingling, and commercial determinations.

(22) The Division entered an appearance in this case and appeared through counsel with no witnesses. The Division was not in opposition or in support of the application.

(23) No other party appeared or indicated opposition to this application.

The Division Concludes As Follows:

(24) Apache challenged Nestegg's standing to oppose this application. Both parties traded written briefs on the subject and additional evidence was presented at the hearing which together indicate the following:

- a. The language within the instrument that created the overriding royalty ownership states or implies that pooling should occur under rules promulgated under authority of legislation. The Division clearly has authority given by the State of New Mexico to establish spacing and proration units for wells within New Mexico whether those wells are located upon State Trust, Federal, or Fee lands.
- b. Further, the presumptive use of a CA form for this Agreement Area has indeed implied a challenge to this authority. However, this CA as modified has most of the attributes of a Unit Agreement and does require that all federal and state rules be followed by the operator for wells within this Agreement Area.
- c. Considering the intended use of standard CA agreements for consolidating diversely owned lands within a spacing unit, the Division was correct to not include within Rule 19.15.16.7(L)(2) NMAC the de facto creation of a Project Area within the lands of a CA.

- d. The overriding royalty owners were not included as required signatures in this Agreement. The Division recognized the possibility of impaired correlative rights and required that all overriding royalty owners be provided notice of this hearing.

(25) As an overriding royalty owner who received notice, Nestegg does have standing on which to oppose the hearing application. The motion of Apache to deny standing to Nestegg should be denied.

(26) The testimony of opponent Nestegg was invaluable in bringing to light a differing look at the merits of forming the large proposed Project Area. Nestegg stated that its correlative rights were harmed by [it seems] not being made a formal party to the Agreement and by retroactive dating of the Agreement. Nestegg did not state specifically that formation of the requested Project Area would decrease or harm its overall property value. The records within the Agreement indicate the Nestegg lands are not concentrated in one area and in fact it owns representative lands within the entire proposed Project Area. The Division under its statutory powers will require the pool rules within the Agreement Area to be in place including dedication of each well to "developed" lands or well units and assignment of allowable to each well. If wells are proposed on acreage including Nestegg overriding royalty acreage, then Apache may need to obtain voluntary joinder or apply for compulsory pooling as needed.

(27) Apache's combining of these lands for purposes of efficient and prolific drilling will in all likelihood result in production of oil and gas that would not otherwise be produced and therefore prevent waste and protect correlative rights of all interest owners including the overriding royalty owners.

(28) It was not clear from the facts presented that Nestegg's correlative rights are being adversely affected. The motion of Nestegg to deny the application of Apache in this case should be denied.

(29) The change in the effective date has ensured that 16 vertical Glorieta-Yeso wells, all spaced on 40-acre spacing and proration units, will be separate properties within this commonly owned Project Area. The lessor, the lessees and the working interest owners of those vertical wells are aware of this overlapping eight section Agreement Area and have all signed the Agreement. Apache did not ask the Division for approval of surface commingling between those separately owned properties (vertical wells) and should do so administratively prior to commingling oil or gas with oil and gas from the Agreement Area for off lease storage, measurement, and sale.

(30) All of the proposed unit acreage appears prospective for recovery of oil and gas from the target formations under the concept proposed by the applicant. These acres should be included within one commonly owned Project Area for drilling and should equally share in the benefits from future oil and gas recovery. The proposed Project Area should be approved as requested within the Agreement Area and will serve to prevent waste and protect correlative rights.

(31) Apache Corporation should be allowed to drill wells anywhere within the Project Area provided that those wells are not located (on the surface) within 10 feet of any quarter-quarter section line and except wells should not be completed any closer than 330 feet from the nearest Project Area boundary.

IT IS THEREFORE ORDERED THAT:

(1) As per the application of Apache Corporation ("Apache"), a Project Area for purposes of drilling is hereby created within the lands encompassed by the federal Cedar Lake Communitization Agreement NM134086 (the "Agreement") executed by the BLM, Apache, and other owners. As within this Agreement, this Project Area shall be confined to the Glorieta-Yeso formations and contained within the following-described 5051.36 acres of federal lands, described below:

Township 17 South, Range 31 East, NMPM, Eddy County, New Mexico

Sections 3 through 10: All

(2) Apache is hereby granted the relief inherent within the definition of a Project Area as per Division Rule 19.15.16.7(L)(3) including the ability to drill and complete wells anywhere within the Project Area except closer than 330 feet of any outer boundary of the Project Area. Wells drilled within this Project Area shall not be located on the surface closer than 10 feet to any quarter-quarter section line.

(3) Apache's application to contract the Fren; Glorieta-Yeso Pool (Pool Code 26770) from within the Project Area and to create a new pool within the Project Area is hereby dismissed without prejudice. The Division's district geologist shall assign all Glorieta-Yeso formation wells within the Project Area to only one Glorieta-Yeso Pool which may or may not be the Fren; Glorieta-Yeso Pool. Apache shall supply the district geologist with a list of Project Area wells and shall submit revised Forms C-104 and C-102 to the district office in Artesia moving existing or previously permitted well completions to the agreed upon pool.

(4) The Form C-102's shall show dedicated "developed" acreage for each well as per Rule 19.15.16.7(L)(1) NMAC and in addition shall reference this hearing order allowing the 5051.36-acre Project Area. Each well considered as commercial within this Project Area and that is commonly owned shall be considered one property and shall be named with the same property name and property code.

(5) Apache's request for surface commingling is hereby dismissed without prejudice. If in the future surface commingling is required under Division rules within the Agreement Area, then the operator shall apply administratively for this approval. Apache shall however utilize metering or periodic well testing to accurately report production by well, and request oil allowable by spacing and proration unit, as Division rules require.

(6) Prior to surface commingling any separately owned properties located on or near this Project Area with oil and gas from the Project Area for off lease storage, measurement, and sale, Apache shall apply administratively and obtain permission from the Division (with like permission from the BLM).

(7) The plan contained in the Agreement for the development and operation of the above-described Project Area is hereby approved in principle; provided, however, notwithstanding any of the provisions contained in that agreement, this approval shall not be considered as waiving or relinquishing, in any manner, any right, duty, or obligation that is now, or may hereafter be, vested in the Division to supervise and control operations for the unit and production of oil and gas therefrom.

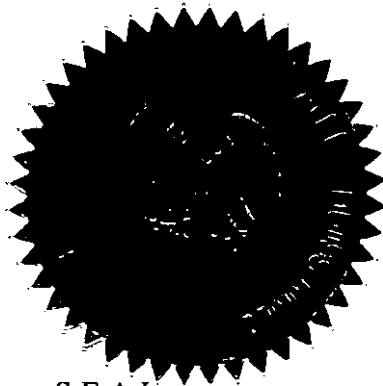
(8) The unit operator shall file with the Division an executed original or executed counterpart of the Agreement within 30 days of the effective date thereof; in the event of subsequent joinder by any other party, or expansion or contraction of the unit area, the unit operator shall file with the Division, within 30 days thereafter, copies of the Agreement reflecting the subscription of those interests having joined or ratified.

(9) All (i) plans of development and operation and (ii) expansions or contractions shall be submitted to the Division Director.

(10) This order shall be in force and effect the first day of the month following the order date or the first day of the month following final approval of the Agreement by the BLM. This order shall terminate upon the termination of the Agreement. The last operator shall notify the Division immediately in writing of such termination.

(11) Jurisdiction of this case 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.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

David R. Catanach

DAVID R. CATANACH
Director