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**STATE OF NEW MEXICO**
**ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT**
**OIL CONSERVATION COMMISSION**

**APPLICATION OF THE NEW MEXICO OIL CONSERVATION DIVISION FOR THE AMENDMENTS OF 19.15.14.8 AND 19.15.16 NMAC.**

**CASE NO. 14744**

**COMMENTS and PRE-HEARING STATEMENT of HARVEY E. YATES COMPANY**

1. Comments: See the attached Comments and Proposed Changes by Harvey E. Yates Company filed in the above referenced case on October 13, 2011.

2. Witness to be called to testify: Arlene T. Rowland

3. A concise statement of Arlene T. Rowland's testimony: Mrs. Rowland will testify regarding the applicability of the compulsory pooling rules to horizontal drilling. See also the attached Comments and Proposed Changes by Harvey E. Yates Company filed in the above referenced case on October 13, 2011.

4. The approximate time needed to present the testimony: 20 minutes

5. Exhibit attached: Comments and Proposed Changes by Harvey E. Yates Company filed in the above referenced case on October 13, 2011

Respectfully submitted,

ATRowland

Arlene T. Rowland
Vice President for
Harvey E. Yates Company
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**COMMENTS and PROPOSED CHANGES by HARVEY E YATES COMPANY**
**to the**
**OIL CONSERVATION DIVISION'S APPLICATION FOR RULE AMENDMENT**
**OF 19.15.148 and 19.15.16 NMAC**

In relation to the rule changes proposed by the Division, specifically 19.15.14.8, 19.15.16.7, 19.15.16.14, and 19.15.16.15, for the purpose of facilitating horizontal drilling in the state, we present the following comments.

New Mexico has long held to the "correlative rights" doctrine in applying rules and regulations for the oil and gas industry. Per New Mexico's own regulations; "Correlative rights" means the opportunity afforded, as far as it is practicable to do so, to the owner of each property in a pool to produce without waste the owner's just and equitable share of the oil or gas in the pool, being an amount, so far as can be practically determined,and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas under the property. If a working interest owner did not have sufficient acreage to meet the spacing rule requirements for the pool of interest, a working interest owner was required to gain consent from other parties owning sufficient acreage to meet the required spacing unit rules. Often an operator could not get agreement from adjoining owners sufficient to meet the required spacing unit rules. To address the situation New Mexico instituted compulsory pooling rules for required spacing units only. Expanding the compulsory rules to "project areas" goes beyond the reason for enacting the compulsory rules. The spacing unit sizes were established to produce, without waste, the oil and gas reservoirs. Allowing the compulsory rules to be applied to project areas goes beyond the scope and reason for the compulsory rules.

Hence, as to 19.15.16.15A (1)we request the following language be deleted ***"or"*** and the following language be added ***"and in which each tract is not included in an existing operating agreement covering the proposed geological interval" or***

As to the Division's suggested change at 19.15.16.15A (2) we request the following language be added: ***"If an existing Joint Operating Agreement is in place covering the proposed producing unit for any length of the lateral, 1) in order for the Division to consider compulsory pooling, the consent of that portion of parties to the Operating Agreement, which is required under the Operating Agreement to change the terms of said Operating Agreement, must consent, or 2) in the absence of language in the existing Operating Agreement, which sets the required percentage of ownership to amend the Operating Agreement, the requirement for the Division to consider compulsory pooling shall be the consent of two(2) or more parties owning 65%, or more, of the interest ownership governed by the existing Operating Agreement."***

The Division has allowed horizontal drilling into acreage covered by an existing Operating Agreement covering vertical wells producing from the zone targeted by the horizontal well proposal. The ownership of the horizontal well is often different than the vertical well ownership. To allow an additional well in the same formation in a spacing unit where the ownership is different does not preserve correlative rights. The Division has also issued compulsory pooling orders onto acreage covered by existing Operating Agreements where the targeted horizontal zone contains "behind the pipe reserves" owned by the parties to the Operating Agreement. Such actions do not preserve correlative rights and ultimately diminishes

the capacity of producers to gain financing, an action that inhibits, rather than promotes, drilling in New Mexico.

Hence, as to the Division's suggested change at 19.15.16.15G we request G.(1) reference Paragraphs (2), (3) and (5), and add provision (5) to read as follows: ***"Nor may a project area be extended to include acreage dedicated to an existing Operating Agreement without the consent of that portion of parties to the Operating Agreement, which is required under the Operating Agreement to change the terms of said Operating Agreement, or 2) in the absence of language in the existing Operating Agreement, which sets the required percentage of ownership to amend the Operating Agreement, the requirement for the Division shall be the consent of two(2) or more parties owning 65%, or more, of the interest ownership governed by the existing Operating Agreement."*** Alternative language would be ***"The horizontal driller shall prepare a development unit which would be mutually agreed upon with the approval of two (2) or more parties owning 65%, or more, of the interest ownership governed by the existing Operating Agreement."***

When compulsory pooling rules were instituted to remedy the problem caused by the spacing unit requirement, it was recognized that potentially the property of one party would be taken by another party. The rules sought to balance this by requiring a reversion of interest after the driller received his money back for the drilling plus compensation for taking the geologic risk. In New Mexico this compensation for taking the risk originally was set at 100% for development wells, where there was thought to be less risk, and 200% for wildcat wells. An examination of the record of the Division in recent years indicates that the Division almost always has given a 200% compensation for risk. This is unfortunate. The extent to which the Division over-compensates the driller for risk, the Division takes from the person who is force pooled and gives to the driller what should not be his.

We note that horizontal wells usually are drilled into zones which have been penetrated by a number of wells. This has been the case because horizontal wells often target "source rock," such as shale. which often lies above earlier targeted porosity zones. The fact that numerous wells earlier have penetrated the zone targeted by the horizontal well means that the geologic risk being taken by the horizontal driller often is much less than the risk taken by a wildcat driller. Consequently, the reward for taking the risk should be adjusted downward where there have been a number of earlier holes which have penetrated the targeted zone.

Consequently, at 19.15.16.15 F. Compulsory pooling, we request that the following language be added: "***During a Compulsory pooling hearing involving a horizontal well the Division is instructed to examine closely the actual geologic risk being taken by the driller considering earlier penetrations of the zone being targeted by the driller in the area in which the driller proposes to drill and to reduce the compensation to the driller for risk taken to 50% where that more closely rewards the driller for the anticipated geologic risk of the endeavor."*** Any proposed horizontal in which the driller is not doing a pilot hole or logging the lateral with the equivalent of conventional open-hole logs should be considered to have the lowest geological risk and be subject to reduced compensation to the driller. A recently published Midland Reporter Telegram interview

with Curtis Mewbourne, founder of Mewbourne Oil and of New Mexico's more active horizontal drillers, bears this out. In citing the advances in horizontal drilling and completion technology he state, "which exposes you to more are of the reservoir at greatly reduced risk" and "which give good completions and good wells where we were never able to before".

Additionally, the horizontal driller should not be rewarded with force pooled rights to more than the producing unit into which the lateral has been placed beyond the initial 40 acre or basic normal formation spacing unit (assuming an orthodox location). Horizontal target formations with great thickness such as the Delaware Mountain Group, Bone Spring, and Wolfcamp are composed of numerous potentially producing units often totally separated from the completion in horizontally drilled lateral.

We request an opportunity to comment and present testimony at any hearing related to this matter.

Respectfully submitted,

Arlene Rowland
For Harvey E. Yates Company