

**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**

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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 practically 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. 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 the Operating Agreement must consent.*”

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 19.15.15.15G (4) we request that the following language be added. “*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 the Operating Agreement to change the terms of the Operating Agreement.***” Alternatively language would be ***“The horizontal driller shall prepare a development unit which would be mutually agreed upon by the parties involved.”***

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 one of New Mexico’s more active horizontal drillers, bears this out. In citing the advances in horizontal drilling and completion technology he states, “which exposes you to more area 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 the horizontally drilled lateral. (see ex. below)

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Arlene Rowland". The signature is fluid and cursive, with a large initial "A" and a long, sweeping underline.

Arlene Rowland  
For Harvey E. Yates Company