

**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. 13537

**APPLICATION OF LANCE OIL & GAS COMPANY, INC., FOR
COMPULSORY POOLING, INCLUDING OPTIONAL INFILL WELL
PROVISIONS, SAN JUAN COUNTY, NEW MEXICO.**

AND

CASE NO. 13539

**APPLICATION OF SYNERGY OPERATING, L.L.C FOR COMPULSORY
POOLING, SAN JUAN COUNTY, NEW MEXICO.**

ORDER NO. R-12451

ORDER OF THE DIVISION

BY THE DIVISION:

These cases came on for hearing concurrently at 8:15 a.m. on August 25, and October 6, 2005, at Santa Fe, New Mexico, before Examiner Richard I. Ezeanyim

NOW, on this 10th day of November 2005, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notices have been given by both parties, and the Division has jurisdiction of these cases and of their subject matter.

(2) Division case No. 13537 and case No. 13539 were consolidated at the hearing because two operators are seeking the same relief in these matters, therefore one order will be issued in these cases.

(3) In case No. 13537, Lance Oil & Gas Company, Inc. ("Lance") seeks an order pooling all uncommitted mineral interests from the surface to the base of the Fruitland Coal and the Pictured Cliffs formations underlying the W/2 of Section 22, Township 29 North, Range 13 West, NMPM, San Juan County, New Mexico, in the following manner:

The W/2 to form a standard 320-acre gas spacing and proration unit for any production from the Basin-Fruitland Coal Gas Pool and all formations and/or pools developed on 320-acre spacing within that vertical extent.

The NW/4 and the SW/4 to form two standard 160-acre gas spacing and proration units for all formations and/or pools developed on 160-acre spacing within that vertical extent, which include but are not necessarily limited to the Fulcher Kutz-Pictured Cliffs Gas Pool.

(4) The NW/4 is to be dedicated to the proposed FRPC "22" Well No. 2 (API# 30-045-33160) to be drilled at a standard gas well location, and the SW/4 is to be dedicated to FRPC "22" Well No. 3 to be drilled at a standard gas well location, both for down hole commingled production from the Basin Fruitland Coal Gas Pool and the Fulcher Kutz-Pictured Cliffs Gas Pool.

(5) Lance also seeks to include provisions for subsequent operations and procedures for an optional infill coalbed-gas well.

(6) In case No. 13539, Synergy Operating, L.L.C. ("Synergy") seeks an order pooling all uncommitted mineral interests from the surface to the base of the Fruitland Coal and the Pictured Cliffs formations underlying the W/2 of Section 22, Township 29 North, Range 13 West, NMPM, San Juan County, New Mexico, in the following manner:

The W/2 to form a standard 320-acre gas spacing and proration unit for any production from the Basin-Fruitland Coal Gas Pool and all formations and/or pools developed on 320-acre spacing within that vertical extent.

The NW/4 and the SW/4 to form two standard 160-acre gas spacing and proration units for all formations and/or pools developed on 160-acre spacing within that vertical extent, which include but are not necessarily limited to the Fulcher Kutz-Pictured Cliffs Gas Pool.

(7) The NW/4 is to be dedicated to the proposed Dugan 29-13-22 Well No. 108 to be drilled at a standard gas well location, and the SW/4 is to be dedicated to Dugan 29-13-22 Well No. 109 to be drilled at a standard gas well location in the W/2 of Section 22.

(8) Two or more separately owned tracts are embraced within the Units, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Units that are separately owned.

(9) Both Lance and Synergy are owners of oil and gas working interest within the Units. Therefore, Lance and Synergy have the right to drill and propose to drill their respective wells at standard gas well locations in the W/2 of Section 22 to test the Fruitland Coal and the Pictured Cliffs formations.

(10) Both Lance and Synergy requested that each be designated the operator of the subject wells and of the Units.

(11) There are interest owners in the proposed Units that have not agreed to pool their interests.

(12) Both Lance and Synergy appeared at the hearing on August 25, and October 6, 2005 through counsel and presented land testimony. Lance presented the testimony of Paul Lehrman, a petroleum landman employed by Lance. Synergy presented the testimony of Patrick Hegarty, a petroleum landman and a principal with Synergy Operating, L.L.C.

Undisputed Facts:

(13) Based on the statements of counsel and testimony offered by the parties, the Division concludes that the following facts pertinent to these cases are undisputed.

(a) In October 2004, Lance bought all of Richardson Operating Company's assets in the W/2 of Section 22.

(b) Lance has the right to drill and proposes to drill its FRPC "22" Well No. 2 in the NW/4, and its FRPC "22" Well No. 3 in the SW/4 of Section 22.

(c) In May 2005, Synergy acquired its interest in the W/2 of Section 22 by a farm out agreement with Dugan Production Company.

(d) Synergy has the right to drill and proposes to drill its Dugan 29-13-22 Well No. 108 in the NW/4, and its Dugan 29-13-22 Well No. 109 in the SW/4 of Section 22.

(e) The breakdown of mineral interest ownership in the W/2 of Section 22 is as follows:

	W/2 (FC)	NW/4 (PC)	SW/4 (PC)
Lance	33.1655%	49.8265%	16.5045%
Synergy	15.5422%	14.1403%	16.9441%

(f) On June 13, 2005, Lance filed an application for permit to drill (APD) for its proposed FRPC "22" Well No. 2, and the W/2 of Section 22 is to be dedicated to this well. The Division approved this APD on June 17, 2005.

(g) On July 20, 2005, Synergy filed an application for permit to drill for its Dugan 29-13-22 Well No. 109, and the SW/4 of Section 22 is to be dedicated to this well. The Division approved this APD on July 25, 2005.

(h) Two (2) APDs were issued to two different operators pursuant to Division Rule 104 which currently allows multiple operators per spacing unit. However, the rule does not allow multiple operators for compulsory pooled units.

(i) Lance first proposed the development of this W/2 of Section 22.

(j) Negotiations between Lance and Synergy on who operates which well in this W/2 of Section 22 have broken down irreparably. The Division is now obligated to designate an operator for this unit.

(14) The counsel for Synergy argued that Synergy obtained a valid APD and has slightly bigger mineral interest in the SW/4 of Section 22, therefore Synergy should be designated the operator of the wells and of the units.

(15) Lance's counsel argued however, that Lance obtained a valid APD first and since that APD has not been properly cancelled by the Division after notice and hearing, Lance should be designated the operator of the wells and of the units. He specifically cited Finding Paragraphs 8 (f) and 8 (I) of the Commission Order No. R-12108-C. Finding Paragraphs 8 (f) and 8 (I) read in their entirety as follows:

Finding Paragraph 8 (f): "Although the Division can and should cancel an APD when it properly determines that no such good faith claim exists (as the Commission determined, based on a District Court judgment, in Order No. R-11700-B), it should not make that determination, which necessarily cannot be made on the face of the APD or from Division records, without first giving the applicant notice and an opportunity for a hearing. Although the Commission doubts that the right conferred by approval of an APD is properly characterized as "property," it nevertheless concludes that such approval confers rights that should not be revoked arbitrarily"

Finding Paragraph 8 (I): "The Commission accordingly concludes that an owner who would have a right to drill at its proposed location in the event of a voluntary or compulsory pooling of the unit it proposes to dedicate to the well has the necessary good faith claim of title to permit it to file an APD even though it has not yet filed a pooling application. If an owner uses this right to "tie-up" acreage without proceeding diligently to seek voluntary or compulsory pooling, or if the acreage can more properly be developed by inclusion in a different unit, an aggrieved owner can file an application with the Division to cancel its approval of the APD, which the Division can do after notice and hearing"

(16) The counsel for Lance Oil & Gas Company, Inc. argued that since Synergy Operating, L.L.C. an aggrieved owner in this case has not filed an application with the Division to cancel Lance's approved APD, then Lance's APD is still valid and should not be revoked arbitrarily.

(17) The Division Concludes that:

(a) The mere fact that an applicant obtained an APD first which has not been revoked does not necessarily guarantee that the applicant should be designated the operator of the wells and of the units under the compulsory pooling procedures. The Division does not want to decide this case based on a race to obtain an APD. Doing so would encourage potential operators to file for APDs strategically, to block other potential operators.

(b) The Commission stated in Order No. R-12108-C that the Division has neither the responsibility nor jurisdiction to determine whether an applicant for a permit to drill has the requisite title to the land in question before the APD is issued.

(c) Geological and engineering evidence are not relevant to this case since it involves drilling two wells by two different operators at almost the same spot in the stand-up W/2 of Section 22.

(d) The Division accordingly concludes that its decision in this case must be based on its evaluation of who owns the bigger mineral interest and has followed all the compulsory pooling procedures in the unit, irrespective of who obtained the approval of the APD first.

(e) Pursuant to finding Paragraph 13 (e) of this order, Lance has the bigger mineral interest in the W/2 Fruitland Coal Formation, and in the NW/4 Pictured Cliffs Formation, while Synergy has the the bigger interest in the SW/4 Pictured Cliffs Formation. Moreover, Lance initiated the development of this unit first.

(f) A compulsory-pooled unit should be established consisting of the stand-up west half (W/2) of Section 22, Township 29 North, Range 13 West, NMPM, San Juan County, New Mexico.

(18) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Units the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, the application of Lance Oil & Gas Company, Inc. should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Units.

(19) Lance Oil & Gas Company, Inc. should be designated the operator of the wells and of the units.

(20) The application of Synergy Operating, L.L.C. for compulsory pooling should be denied and its APD cancelled.

(21) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% (pursuant to rule 35.A) thereof as a reasonable charge for the risk involved in drilling the well.

(22) Reasonable charges for supervision (combined fixed rates) should be fixed at \$3,500.00 per month while drilling and \$350.00 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*."

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Lance Oil & Gas Company, Inc., all uncommitted mineral interests from the surface to the base of the Fruitland Coal and the Pictured Cliffs formations underlying the W/2 of Section 22, Township 29 North, Range 13 West, NMPM, San Juan County, New Mexico, are hereby pooled in the following manner:

The W/2 to form a standard 320-acre gas spacing and proration unit for any production from the Basin Fruitland Coal Gas Pool and all formations and/or pools developed on 320-acre spacing within that vertical extent;

The NW/4 and the SW/4 to form two standard 160-acre gas spacing and proration unit for all formations and/or pools developed on 160-acre spacing within that vertical extent, which includes but are not necessarily limited to the Fulcher Kutz-Pictured Cliffs Gas Pool.

The NW/4 shall be dedicated to the proposed FRPC "22" Well No. 2 (API# 30-045-33160) to be drilled at a standard gas well location, and the SW/4 shall be dedicated to FRPC "22" Well No. 3 to be drilled at a standard gas well location, both for down hole commingled production from the Basin Fruitland Coal Gas Pool and the Fulcher Kutz-Pictured Cliffs Gas Pool.

(2) Lance Oil & Gas Company, Inc., is hereby designated the operator of the subject well and of the Units.

(3) The application of Synergy Operating, L.L.C. for compulsory pooling is hereby denied and in accordance with Finding Paragraph 8 (m) of Commission Order No. R-12108-C, its APD is also hereby cancelled. Finding Paragraph 8 (m) of Commission Order No. R-12108-C states in its entirety as follows:

"Thus the existence of a properly approved APD should not be a basis for prejudging the issues in a compulsory pooling application. If the applicant prevails on its compulsory pooling application and is appointed operator in a compulsory pooling order, it is entitled to approval of an APD in any case. If the compulsory pooling application is denied, the applicant having in this case no other basis for a claim of title to the drill-site tract, cancellation of the APD would be a necessary consequence"

(4) The operator of the Units shall commence drilling the proposed well on or before February 27, 2006 and shall thereafter continue drilling the well with due diligence to test the Fruitland Coal and the Pictured Cliffs formations.

(5) In the event the operator does not commence drilling the proposed well on or before February 27, 2006, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(6) Should the subject well not be drilled and completed within 120 days after commencement thereof, Ordering Paragraph (1) shall be of no further effect, and the Units created by this Order shall terminate unless the operator appears before the Division Director and obtains an extension of time to complete the well for good cause demonstrated by satisfactory evidence.

(7) Upon final plugging and abandonment of the subject well, the pooled Units created by this Order shall terminate, unless this order has been amended to authorize further operations.

(8) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Units, including un-leased mineral interests, who are not parties to an operating agreement governing the Units.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Units an itemized schedule of estimated costs of drilling, completing and equipping the subject well ("well costs").

(9) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(10) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not

objected within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(11) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(12) The operator is hereby authorized to withhold the following costs and charges from production:

- (a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and
- (b) as a charge for the risk involved in drilling the well, 200% of the above costs.

(13) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(14) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$3,500.00 per month while drilling and \$350.00 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

(15) Except as provided in Ordering Paragraphs (12) and (14) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in San Juan County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership. The operator shall notify the Division of the name and address of the escrow agent within 30 days from the date of first deposit with the escrow agent.

(16) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(17) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(18) The operator of the well and Units shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS FURTHER ORDERED THAT:

(19) The following-described additional provisions shall be applicable to operations conducted within the Unit:

- (a) The operator or any working interest owner who consents to and has paid its share of costs of the original well, pursuant to either a voluntary agreement or a compulsory pooling order, may propose subsequent operations on either the parent or infill well by giving written notice of the proposed subsequent operations to all working interest owners and all unleased mineral owners within the Unit. Any such proposal shall specify the work to be performed, objective formation and the estimated costs of the operation;
- (b) The parties receiving such notice shall have a thirty (30) day election period after receipt of this notice within which to notify the proposing party whether they elect to participate in the costs of the subsequent operations. Failure of a party receiving such notice to deliver to the proposing party a written election, plus payment for its share of the total costs within the thirty (30) day election period shall constitute an election by that party not to participate in the costs of the proposed operation and shall be a "non consenting" party;
- (c) Any non-consenting party shall be subject to a 200% risk penalty charge for the subsequent operation;

- (d) Production from the original well cannot be used to pay for the costs of the infill well, nor can production from the infill well be used to pay for the costs of the original well. The recovery of costs for subsequent operations shall be paid by the production from the well on which those operations were conducted; and
- (e) If all parties elect to participate in the infill well or the subsequent operation, the operator shall, within ninety (90) days after the expiration of the thirty (30) day election period, actually commence and conduct operations with due diligence at the risk and expense of all parties.

(20) If less than all parties elect to participate in the infill well or the subsequent operations, then all parties who elected not to participate shall be considered non-consenting working interest owners and all the provisions of this order shall apply to the drilling of the infill well or the subsequent operations **with the following exceptions:**

- (a) The proposing party shall be solely responsible for carrying the non-consenting working interest owner's interest subject to the risk penalty charge provided for in the order. The proposing party may enter into an agreement, or recognize an existing agreement, that provides for the sharing of the non-consenting interest by the consenting parties. The proposing party, at its election, may withdraw such proposal if there is insufficient participation and shall notify the Division and all other parties of such decision;
- (b) If the operator is a non-consenting working interest owner in the infill well, the consenting parties shall either (i) request the operator to perform the work required for the account of the consenting parties, or (ii) designate one of the consenting parties as operator of the infill well. If the infill well results in a producer of oil and/or gas in paying quantities, one of the consenting parties shall be designated as operator and shall complete and equip the well to produce at the sole costs and risk of the consenting parties, and thereafter the operator designated by this compulsory pooling order shall operate this well at the expense and account of the consenting working interest owners;
- (c) To be entitled to the benefits of this order, the operator, or the designated consenting party, shall within ninety (90) days after the expiration of the

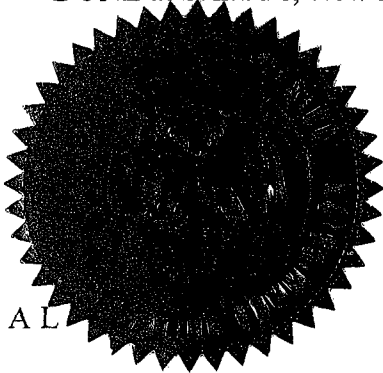
thirty (30) day election period, actually commence and conduct the operations with due diligence at the sole risk and expense of the consenting parties; and

- (d) If operations for the drilling of an infill well results in a dry hole, the consenting parties shall plug and abandon the well and restore the surface location at their sole costs, risk, and expense.

(21) If operations for the drilling of a proposed infill well or any subsequent operation for either the original well or the infill well have not been commenced within the time period provided, and if any party still desires to drill the infill well, written notice proposing same must be resubmitted in accordance with the provision hereof as if no prior proposal had been made.

(22) 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

MARK E. FESMIRE, PE
Director