

**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. 14057
ORDER NO. R-12868-C**

**APPLICATION OF BLACK HILLS GAS
RESOURCES, INC. FOR A NON-STANDARD
PRORATION UNIT, RIO ARRIBA COUNTY,
NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on January 24, 2008, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 25th day of February, 2008, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due notice has been given, and the Division has jurisdiction of the subject matter of this case.

(2) In this application, Black Hills Gas Resources, Inc. ("Black Hills" or "Applicant") seeks establishment of a non-standard 448.39-acre, more or less, gas spacing unit ("the proposed unit") in the Jicarilla Apache Tribal Lands Production Area of the East Blanco-Pictured Cliffs Gas Pool (72400), to be dedicated to a proposed horizontal well. The proposed non-standard unit would consist of Lots 1 and 2 (N/2 NE/4 equivalent) and the S/2 NE/4 of Section 7 and Lots 1 through 4 (N/2 N/2 equivalent) and the S/2 N/2 of Section 8, Township 30 North, Range 3 West, NMPM, in Rio Arriba County, New Mexico.

(3) In the original application, Applicant sought establishment of a larger spacing unit including also Lots 3 and 4 of Section 7 and Lot 10 of Section 6 of the same

township and range. However, at the hearing Applicant modified its request to that indicated in Finding Paragraph (2) above.

(4) Applicant seeks to dedicate the proposed non-standard unit to its Jicarilla 458-08 Well No. 13 (API No. 30-039-29894) [the horizontal well], a horizontal well drilled from a surface location 1000 feet from the North line and 2300 feet from the West line (Lot 2, Unit B) of Section 8, Township 30 North, Range 3 West, in Rio Arriba County, New Mexico, to a terminus or bottomhole location, 442 feet from the North line and 1717 feet from the West line (Lot 2, Unit B) of Section 7 in the same township and range. The location is standard under Division Rule 111.

(5) The proposed unit is located in the Jicarilla Apache Tribal Lands Production Area of the East Blanco-Pictured Cliffs Gas Pool. Spacing in this area is governed by the Special Rules and Regulations for the Jicarilla Apache Tribal Lands Production Area, as provided in Order No. R-12707, issued in Case No. 13816 on January 30, 2007. These rules provide for standard 160-acre units each to consist of a governmental quarter section, with provision for up to two Pictured Cliffs wells in each unit.

(6) The proposed unit would consolidate three entire units, each of which comprises a quarter section, although, due to survey irregularities, each is less than 160 acres. These are the following:

Lots 1 and 2 and the S/2 NE/4 (NE/4 equivalent) of Section 8 (151.31 acres)
Lots 3 and 4 and the S/2 NW/4 (NW/4 equivalent) of Section 8 (150.35 acres)
Lots 1 and 2 and the S/2 NE/4 (NE/4 equivalent) of Section 7 (146.73 acres)

(7) There are two existing vertical wells completed in, and producing from, the Pictured Cliffs formation within the proposed unit, as follows:

Jicarilla 458-08 Well No. 7
API No. 30-039-25759
2270 FNL & 795 FEL (Unit H) of Section 8

Jicarilla 458 Well No. 3
API No. 30-039-24167
1818 FNL & 231 FEL (Unit H) of Section 7

(8) At the hearing, Applicant appeared through counsel and presented land testimony to the effect that all of the mineral estate in the units to be consolidated to form the proposed unit is owned by the Jicarilla Apache Tribe, so royalty ownership is common throughout the proposed unit. However, there are differences in working interest and overriding royalty ownership between the units being consolidated. Applicant introduced in evidence tables showing the distribution of interest in each of the existing units, and a table showing the effect of consolidating these interests, on an acreage basis, for the proposed unit. However, Applicant neither offered testimony that

all owners of interests in all of the units had agreed to such consolidation, nor asked the Division to exercise its powers under NMSA 1978 Section 70-2-17 to issue a compulsory pooling order consolidating such interests. Neither did Applicant show that it had given notice of this application to all owners of interests in the proposed unit.

(9) Applicant's witness further testified that Applicant requested the formation of a non-standard spacing unit pursuant to the recommendation of Division personnel who were concerned about the proper way to allocate and account for production from a multi-unit project area that includes existing vertical wells dedicated to separate, existing spacing units within the project area.

(10) After full consideration of the matter, the Division has concluded that the establishment of a non-standard spacing unit comprising the entirety of a horizontal well project area formed from multiple, standard spacing units is not necessary, and where there are existing producing wells within the project area, is not ordinarily appropriate, unless an Applicant seeks to invoke the Division's compulsory pooling authority.

(11) The Division has reached this conclusion for the following reasons:

(a) Division Rule 111 (which provides for directional wells, including horizontal wells) specifically authorizes the establishment of a project area that includes a combination of spacing units. That rule further provides, in Rule 111.C(3), for consolidation of the spacing units comprising the project area for the purposes of determining the applicable allowable, but does not either require or provide for consolidating the spacing units for other purposes.

(b) If the Division were to consolidate the spacing units constituting a project area into a single, non-standard spacing unit, that action would presumably trigger the provisions of NMSA 1978 Section 70-2-18.B and C, which require the operator to consolidate the ownership interests throughout the unit from the date of first production. Where there are existing vertical wells completed in separate spacing units within the project area, such consolidation would likely not be in accord with the intentions or expectations of the owners of interests in those vertical wells, and could impair correlative rights.

(12) There is no statute or case law in New Mexico that prescribes the allocation of ownership of production from a horizontal well that penetrates multiple spacing units, and Rule 111 does not require that an operator proposing to establish such a project area give any notice to the owners of interests in the constituent spacing units. Accordingly, in order to protect correlative rights, the Division should require an operator filing a form C-102 for the purpose of establishing such a project area to file a statement, signed by an attorney or land specialist, listing all owners, and certifying that all owners of all interests (working, royalty and overriding royalty) in all of the constituent spacing units have agreed upon a formula for allocating production from the horizontal well.

(13) Since the Division's compulsory pooling authority is limited to pooling a spacing unit, if an operator applies for compulsory pooling of a project area, the operator must, in that case, apply for formation of a unit including the entire project area, give notice of its application, in accordance with Rule 1210.A(1) to all owners of all interests in any part of the proposed project area and demonstrate, by appropriate technical evidence, that the formation of such a unit will prevent waste and will not impair correlative rights. However, if the operator has secured voluntary agreement of all affected interest owners, such procedure is unnecessary.

(14) Because the Applicant here does not seek to invoke the Division's compulsory pooling powers, and because the correlative rights of the owners of the existing vertical wells could be affected, Applicant's request to form a non-standard spacing unit should be denied.

(15) The Aztec District Office of the Division should approve Applicant's request to form a project area comprising multiple spacing units, provided the application is otherwise approvable and provided that Applicant complies with the requirements of this Order concerning demonstration that all affected persons have agreed upon its proposed allocation of production from the horizontal well.

(16) Applicant is currently producing the horizontal well pursuant to temporary authority granted in Order No. R-12868-B. That order should be extended for up to 30 days to allow time for processing of a revised application by the Aztec District Office.

IT IS THEREFORE ORDERED THAT:

(1) The application of Black Hills for establishment of a non-standard spacing unit in the Jicarilla Apache Tribal Lands Production Area of the East Blanco-Pictured Cliffs Gas Pool consisting of Lots 1 and 2 (N/2 NE/4 equivalent) and the S/2 NE/4 of Section 7, and Lots 1 through 4 (N/2 N/2 equivalent) and the S/2 N/2 of Section 8, Township 30 North, Range 3 West, NMPM, in Rio Arriba County, New Mexico, is hereby denied.

(2) Applicant may re-submit to the Division's Aztec District Office its application (form C-102) for designation of a multi-unit project area to be dedicated to its Jicarilla 458-08 Well No. 113 (API No. 30-039-29894). The Aztec District Office may approve such application notwithstanding the existence of vertical wells to which individual spacing units within the project area are now dedicated, provided such application is otherwise approvable, if Applicant files with such application a statement, signed by an attorney or land specialist, listing all owners and certifying that all owners of all interests (working, royalty and overriding royalty) in all of the constituent spacing units have agreed upon a formula for allocation of production from the horizontal well (either by express agreement to the formula or by virtue of a lease provision authorizing commitment of the interest to the project area as a unit).

(3) The provisions of Order No. R-12868-B granting Applicant authority to continue producing the horizontal well shall continue in effect for 30 days from the date of issuance of this Order, or until the Aztec District Office approves or disapproves Applicant's revised C-102, whichever first occurs.

(4) The Division staff shall make such alterations to the Division's recording systems as may be necessary to track the separate dedication of horizontal wells to their designated project areas, and of any vertical wells within such project areas to the constituent spacing units.

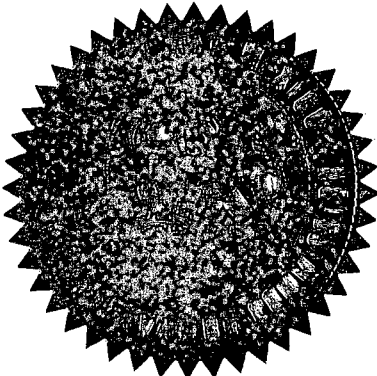
(5) The Division's District Supervisors are directed that all applications hereafter filed for the establishment of project areas for horizontal wells proposed to be completed in multiple spacing units, whether or not there are existing wells in any of the constituent units, shall include a statement signed by an attorney or land specialist, certifying that all owners of all interests in all of the constituent spacing units have agreed upon a formula for allocation of production from the horizontal well.

(6) Nothing in this order shall affect the validity of any project area heretofore established in the manner provided in Rule 111.

(7) Nothing in this order shall authorize the completion of a greater number of wells within any spacing unit or portion of a spacing unit that are authorized by applicable statewide rules or special pool orders, unless the Division approved simultaneous dedication in accordance with Rule 104.D(3).


(8) 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, P.E.
Director