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September 27, 1991

HAND-DELIVERED

Mr. David R. Catanach
Hearing Examiner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
State Land Office Building
Santa Fe, New Mexico 87503

RECEIVED

SEP 27 1991

OIL CONSERVATION DIVISION

10386

Re: Case No. 10363
Application of Yates Petroleum Corporation for Compulsory Pooling, Eddy
County, New Mexico

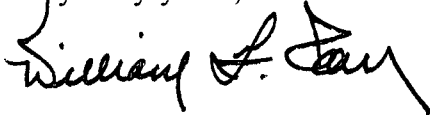
and

Case No. 10386
Application of McKay Oil Corporation for Compulsory Pooling, Eddy County,
New Mexico

Dear Mr. Catanach:

Enclosed for your consideration is Yates Petroleum Corporation's proposed Order in the
above-captioned cases.

Very truly yours,



WILLIAM F. CARR
ATTORNEY FOR YATES PETROLEUM CORPORATION

WFC:mlh

Enclosure

cc w/enc.: Randy Patterson
W. Thomas Kellahin, Esq.

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:

APPLICATION OF YATES PETROLEUM
CORPORATION FOR COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO.

Case No. 10363

and

APPLICATION OF McKAY OIL CORPORATION
FOR COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO.

Case No. 10386

Order No. R- 10386
(Consolidated)

**YATES PETROLEUM CORPORATION'S
PROPOSED ORDER OF THE DIVISION**

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on September 19, 1991, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this _____ day of September, 1991, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant in Case No. 10363, Yates Petroleum Corporation ("Yates"), seeks an order pooling all mineral interests in the Canyon formation, Undesignated South Dagger Draw-Upper Pennsylvanian Associated Pool, underlying the W/2 of Section 25, Township 20 South, Range 24 East, N.M.P.M., Eddy County, New Mexico, forming a standard 326.5-acre spacing and proration unit to be dedicated to the Yates' proposed Staghorn "AJG" Federal Well No. 1 to be drilled at a standard location in the SW/4 SW/4 of Section 25.

(3) In Case No. 10386, filed subsequent to the application of Yates, McKay Oil Corporation ("McKay") seeks an order pooling all mineral interests in the Canyon formation, Undesignated South Dagger Draw-Upper Pennsylvanian Associated Pool, underlying the N/2 of Section 25, Township 20 South, Range 24 East, N.M.P.M., Eddy County, New Mexico, forming a standard 320-acre spacing and proration unit to be dedicated to a new well to be drilled at a standard location in the NW/4 NW/4 of Section 25.

(4) Division Case Nos. 10363 and 10386 were consolidated at the time of hearing.

(5) Each party has the right to drill at its proposed location in Section 25, but the parties have been unable to reach voluntary agreement for the development of this acreage (testimony of Mecca Mauritsen).

(6) The evidence establishes that Yates' proposed location in the SW/4 SW/4 of Section 25 is the best location in this section to test the Canyon dolomite:

- A. The Canyon formation in the Undesignated South Dagger Draw-Upper Pennsylvanian Associated Pool is a complex reservoir (testimony of Ray Beck);
- B. Wells in this pool must be completed in the top of the dolomite reservoir structurally higher than the "big-water" which is a hydrodynamically tilted surface from southwest to northeast, which has been mapped by Yates throughout this area, below which the reservoir is virtually all water filled (Yates Exhibit 7, testimony of Ray Beck);
- C. The Yates Staghorn "AJG" Federal No. 1 Well located in the SW/4 SW/4 of Section 25, has a hydrocarbon bearing column between the top of the Canyon dolomite reservoir and the "big-water" of 154 feet

compared to 80 feet at the proposed McKay location (Yates Exhibit 7, testimony of Ray Beck); and

- D. Although McKay offered a volumetric analysis which favored its proposed location, this analysis did not consider the water saturation in the lower portion of the reservoir (McKay Exhibit 17, testimony of Charles Sanders).

(7) The evidence establishes that the W/2 of Section 25 is the proper acreage to be dedicated to a well to be drilled in this Section:

- A. The W/2 of Section 25 contains hydrocarbon bearing reservoir above the top of the "big-water" where the E/2 of the Section is wet and not productive (Yates Exhibit 7, testimony of Ray Beck);
- B. Most of the N/2 of Section 25 has been shown to be non-productive in the Canyon formation:
 - 1. The Coquina RS Federal No. 1 Well in Unit C had no productive potential in this zone by virtue of the water wet DST taken on the upper 85 feet of this dolomite reservoir, and
 - 2. The Charolette McKay Federal No. 1 Well in Unit H, to which the E/2 of Section 25 is dedicated in the Atoka formation, encountered no Canyon or Dagger Draw-Upper Pennsylvanian dolomite (testimony of Ray Beck); and
- C. Even McKay's geological Exhibits 12, 13 and 14 show only the W/2 of this section to be oil productive. McKay attempted to map three separate zones in the Canyon formation. Exhibit 12 shows that zone A, the upper most zone, is only gas productive. Exhibit 13 shows that in zone B only the W/2 W/2 is oil productive, and although Exhibit 14 shows that zone C is oil productive, McKay's cross-section B-B¹ shows zone C to be wet (McKay Exhibit No. 3).

(8) Including non-productive acreage from the NE/4 of Section 25 in a N/2 spacing or proration unit would result in the Yates owned acreage contributing more than 25% of the production to the proposed McKay well (See, McKay Exhibit 13) while Yates' share of production from the well would be only 12.5%.

(9) Approval of McKay's application for a N/2 spacing or proration unit in Section 25, a majority of which is non-productive acreage in the Canyon formation, would dilute the interest of Yates and thereby impairs its correlative rights and should be denied.

(10) The evidence establishes that approval of the Yates application will not result in drainage by the Yates Prickley Pear "AIE" Fed-Com. No. 1 in the SE/4 of Section 23 and from the McKay acreage in the NW/4 of Section 25:

- A. The structure on top of this dolomite reservoir abruptly drops off on the east side of the reservoir and that this steep loss of structure materially affects production from the pool (Yates Exhibit 7, testimony of Ray Beck);
- B. Closely spaced offsetting wells in the area of the proposed McKay location show dramatic differences in production (Yates Exhibit 13, testimony of Ray Beck; Yates Exhibit 15, testimony of Pinson McWhorter);
- C. Wells offsetting the McKay location in the NE/4 of Section 23, have been drilled on a 40-acre spacing pattern and, although drilled many years apart, there has been no evidence of drainage between wells (testimony of Pinson McWhorter);
- D. When special pool rules were adopted for this pool, it was recognized by the Division that wells in the pool would drain substantially less than 320-acres (Rule 2b of the General Rules and Regulations for the Associated Oil and Gas Pools of Northwest New Mexico and Southeast New Mexico);
- E. Yates will drill additional wells in the W/2 of Section 25 if justified by economics and if future geological interpretation warrants such drilling.
- F. Although McKay found evidence of drainage between the Hillview "AHE" Fed. No. 2 (G) and the Hillview "AHE" No. 4 (J) Wells, it was unaware of the problems incurred in operating and producing the Hillview No. 4 (J) Well that have adversely affected its ability to produce (See McKay Exhibit 16, testimony of Charles Sanders).

(11) The evidence establishes that Yates Petroleum Corporation is the best qualified party to operate a well in the W/2 of Section 25 in the South Dagger Draw-Upper Pennsylvanian Associated Pool:

- A. Yates currently operates 80 wells in the Dagger Draw for production from the Upper Pennsylvanian or Canyon formation and McKay operates none (testimony of Pinson McWhorter and Roy McKay);
- B. Yates has experienced based upon years of drilling and producing wells in this complex reservoir and McKay completely lacks such experience (testimony of Pinson McWhorter and Roy McKay);
- C. Yates has an established record of being the operator who is best able to effectively and efficiently produce this reservoir as shown by McKay's Exhibit 19 which demonstrates how Yates was able to improve the production rates from the Hillview No. 2 Well after taking over operations from Conoco (testimony of Pinson McWhorter and Roy McKay);
- D. Yates first proposed the development of the Canyon formation in this Section (testimony of Mecca Mauritsen) and it was only after Yates decided to develop this acreage that McKay commenced his evaluation of this acreage (testimony of Roy McKay);
- E. Yates has a gathering system in place in this area to take production from its proposed well and McKay does not (Yates Exhibits 16 and 17, testimony of Pinson McWhorter and Roy McKay);
- F. Yates' gathering system is a low pressure system which will enable it to take gas from the W/2 of Section 25 without incurring costs to install additional compression equipment (testimony of Roy McKay);
- G. Unless McKay uses Yates' facilities it will have to incur the unnecessary costs associated with installation and operation of compression and pipeline facilities (testimony of Pinson McWhorter and Roy McKay);
- H. Yates can take and sell gas while testing its proposed well and, at present, McKay cannot (testimony of Pinson McWhorter and Roy McKay);

- I. Yates has facilities available to process and sweeten gas produced from its proposed well and, at this time McKay does not (Yates Exhibits 16 and 17, testimony of Pinson McWhorter and Roy McKay); and
- J. Yates has existing facilities to dispose of the large volumes of water produced from its proposed well and McKay does not (Yates Exhibits 16 and 17, testimony of Pinson McWhorter and Roy McKay).

(12) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste and to afford to the owner of each interest in said unit the opportunity to recover and receive without unnecessary expense its just and fair share of the production from the Canyon formation, the application of Yates Petroleum Corporation should be approved by pooling all mineral interests, whatever they may be, within a standard 320-acre spacing or proration unit comprised of the W/2 of Section 25, Township 20 South, Range 24 East, N.M.P.M., Eddy County, New Mexico.

(13) The application of McKay Oil Corporation in Case No. 10386 should be denied.

(14) Yates Petroleum Corporation should be designated operator of the subject well and unit.

(15) Any non-consenting working interest owner should be afforded the opportunity to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production.

(16) Any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his share of the reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in the drilling of the well.

(17) Any non-consenting working interest owner should be afforded the opportunity to object to the actual well costs but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(18) Following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(19) There was no dispute between the parties about overhead and administrative costs and \$5,400.00 per month while drilling and \$540.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator should be authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(20) All proceeds from production from the subject well which are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(21) Upon the failure of the operator of said pooled unit to commence the drilling of the well to which said unit is dedicated within 90-days of the effective date of this order, the order pooling said unit should become null and void and of no further effect whatsoever.

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

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

IT IS THEREFORE ORDERED:

(1) The application of Yates Petroleum Corporation in Case No. 10363 is hereby granted and all mineral interests, whatever they may be, underlying the W/2 of Section 25, Township 20 South, Range 24 East, N.M.P.M., Eddy County, New Mexico, in the Canyon formation, Undesignated South Dagger Draw-Upper Pennsylvanian Associated Pool, are hereby pooled forming a standard 320-acre spacing and proration unit in this Pool. Said unit shall be dedicated to the applicant's proposed Staghorn "AJG" Federal Com. No. 1 to be drilled at a standard location within the SW/4 SW/4 (Unit M) of Section 25.

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well within 90-days of the effective date of this order, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Canyon formation.

PROVIDED FURTHER THAT, in the event the operator does not commence the drilling of said well within 90-days of the effective date of this order, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever, unless the operator obtains a time extension from the Division Director for good cause shown.

PROVIDED FURTHER THAT, should said well not be drilled to completion, or abandonment, within 120-days after commencement thereof, the operator shall appear before the Division Director and show cause why Ordering Paragraph No. (1) of this order should not be rescinded.

(2) Yates Petroleum Corporation is hereby designated the operator of the subject well and unit.

(3) After the effective date of this order and within 90-days prior to commencing said well, the operator shall furnish the Division and each known working interest owner in the subject unit an itemized schedule of estimated well costs.

(4) Within 30-days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(5) The operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90-days following completion of the 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 said schedule, the actual well costs shall be the reasonable well costs; provided however, if there is objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(6) Within 60-days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated well costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

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

- A. The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30-days from the date the schedule of estimated well costs is furnished to him.
- B. As a charge for the risk involved in the drilling of the well, 200% of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30-days from the date the schedule of estimated well costs is furnished to him.

(8) The operator shall distribute said costs and charges withheld from production to the parties who advanced the well costs.

(9) \$5,400.00 per month while drilling and \$540.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(10) Any unleased mineral interest shall be considered a seven-eighths (7/8ths) working interest and one-eighth (1/8th) royalty interest for the purpose of allocating costs and charges under the terms of this order.

(11) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(12) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Eddy 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 said escrow agent within 30-days from the date of first deposit with said escrow agent.

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

Case Nos. 10363 and 10386 (Consolidated)

Order No. _____

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

(15) Jurisdiction is hereby 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LeMAY
Director

S E A L