

**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. 13153
ORDER NO. R-12108**

**APPLICATION OF PRIDE ENERGY COMPANY FOR CANCELLATION OF A
DRILLING PERMIT AND RE-INSTATEMENT OF A DRILLING PERMIT, AN
EMERGENCY ORDER HALTING OPERATIONS, AND COMPULSORY
POOLING, LEA COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on October 23, 2003, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 2nd day of March, 2004, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

FINDS THAT:

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

(2) The applicant, Pride Energy Company ("Pride"), seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the W/2 of Section 12, Township 12 South, Range 34 East, NMPM, Lea County, New Mexico, thereby forming a standard 320-acre spacing unit for all formations and/or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated Four Lakes-Mississippian Gas Pool and the Undesignated Four Lakes-Morrow Gas Pool. This unit is to be dedicated to the plugged and abandoned State "X" Well No. 1 (API No. 30-025-01838) to be re-entered by the applicant at a standard surface location 1980 feet from the North line and 660 feet from the West line (Unit E) of Section 12.

(3) Pride also seeks an order canceling Yates Petroleum Corporation's drilling

permit (Division Form C-101, Application for Permit to Drill, Re-Enter, Deepen, Plugback, or Add a Zone ("APD")) for the State "X" Well No. 1 (designated by Yates Petroleum Corporation as the Limbaugh "AYO" State Well No. 1), which was approved by the Division on August 26, 2003. In addition, Pride seeks re-instatement of its drilling permit for the State "X" Well No. 1, which was approved by the Division on July 16, 2003, and subsequently cancelled by the Division on August 26, 2003. Pride also seeks an emergency order preventing Yates Petroleum Corporation from conducting any re-entry operations on the State "X" Well No. 1.

(4) Yates Petroleum Corporation ("Yates") appeared at the hearing through legal counsel in opposition to the application.

(5) For the purpose of this order, the subject existing wellbore, designated by Yates as the Limbaugh "AYO" State Well No. 1, and designated by Pride as the State "X" Well No. 1, will hereinafter be referred to as the State "X" Well No. 1.

(6) Prior to the hearing, both Pride and Yates filed various pleadings with the Division regarding the drilling permits for the State "X" Well No. 1 and the subject compulsory pooling application. These filings, and the Division's actions regarding these requests, are summarized as follows:

- (a) on September 10, 2003, Pride filed the compulsory pooling application for the State "X" Well No. 1 that is the subject of Case No. 13153. Additionally on this date, Pride filed a request ("Pride's motion") that the Division enter an emergency order requiring Yates to cease all re-entry operations on the State "X" Well No. 1. Yates commenced re-entry operations on the State "X" Well No. 1 on or about September 5, 2003;
- (b) on September 10, 2003, Yates filed a response to Pride's motion, and also filed a motion to dismiss Pride's compulsory pooling application ("Yates' motion");
- (c) on September 12, 2003, the Division Examiner issued a decision on the motions of Pride and Yates. In that decision, the Division Examiner determined that Pride's request for an emergency order requiring Yates to cease re-entry operations on the State "X" Well No. 1 should be deferred until such time as an evidentiary hearing on the merits of Pride's application in Case No. 13153 was conducted. Additionally, the Division Examiner denied the Yates motion to dismiss Case No. 13153;

- (d) on September 17, 2003, Yates filed an application for hearing *De Novo* before the Oil Conservation Commission to appeal the decision of the Hearing Examiner;
- (e) subsequently, Ms. Lori Wrotenbery, the Director of the Oil Conservation Division and Chair of the Oil Conservation Commission, entered a decision in Yates' *De Novo* application. In that decision, Ms. Wrotenbery determined that the Division did not dispose of any issues existing in the case, and that the Examiner decision gave few reasons for denying Yates' motion to dismiss Prides' application. Consequently, Ms. Wrotenbery ordered that:

"Case No. 13153 is remanded to the Division Hearing Examiner for full consideration of the legal issues that may be raised by Yates' Motion to Dismiss, with a decision to be issued on that matter prior to any hearing of the factual issues related to Pride's compulsory pooling application"; and

- (f) subsequent to the entry of the Director's decision, the Division Examiner met with legal counsel for Yates and Pride. In that meeting, it was determined and agreed to by all parties that the evidentiary hearing in Case No. 13153 would proceed prior to the Division entering any additional decisions on the Yates and Pride motions.

(7) Findings Nos. 8-16, as follow, depict the events that occurred prior to the hearing. This information was obtained through Pride's testimony and Division records.

(8) On May 25, 2001, the Oil Conservation Division's Hobbs District Office ("Hobbs OCD") approved Yates' APD to re-enter the plugged and abandoned State "X" Well No. 1 to test the Mississippian formation. The N/2 of Section 12 was to be dedicated to the well forming a standard 320-acre spacing and proration unit for the Undesignated Four Lakes-Mississippian Gas Pool. The approved APD stated that the permit would expire on May 25, 2002 unless re-entry operations were underway by that date.

(9) On April 15, 2002, Yates applied for a one-year extension of its drilling permit for the State "X" Well No. 1. Yates' request was granted by the Hobbs OCD on April 18, 2002.

(10) On May 30, 2003, the Hobbs OCD notified Yates by letter that its APD for the State "X" Well No. 1 had expired and that any subsequent re-entry and drilling operations on this well would require an additional permit from the Hobbs OCD.

(11) On July 15, 2003, Pride filed an APD with the Hobbs OCD to re-enter the State "X" Well No. 1 to test the Mississippian formation. The W/2 of Section 12 was to be dedicated to the well forming a standard 320-acre spacing and proration unit. This APD was approved by the Hobbs OCD on July 16, 2003.

(12) On July 15, 2003, Pride sent a well proposal to Yates for the State "X" Well No. 1. In this letter, Pride invited Yates to voluntarily participate in the re-entry of the well.

(13) On August 26, 2003, the Hobbs OCD cancelled Pride's APD for the State "X" Well No. 1. In the letter to Pride, the Hobbs OCD stated that "upon further review of the area, the North half of this section is leased to another operator."

(14) On August 26, 2003, Yates filed a new APD with the Hobbs OCD to re-enter the State "X" Well No. 1 to test the Mississippian formation. Yates' APD was approved by the Hobbs OCD on August 26, 2003.

(15) On September 5, 2003, Yates moved a rig onto the State "X" Well No. 1 and commenced re-entry operations.

(16) Prior to the hearing on October 23, 2003, Yates voluntarily moved off the State "X" Well No. 1, and as far as the Division is aware, Yates is not currently performing any re-entry operations on the well.

(17) Pride presented the following-described evidence regarding the lease status and interest ownership within Section 12:

- (a) the SW/4 of Section 12 is a single state lease (State Lease No. V-6256). Pride is the leaseholder of this acreage; and
- (b) the N/2 and SE/4 of Section 12 is a single state lease (State Lease No. V-5855). Yates is the leaseholder of this acreage. Additional working interest owners in this lease include Yates Drilling Corporation, Abo Petroleum Corporation, and MYCO Industries, Inc. (collectively "Yates").

(18) Pride contends that:

- (a) Pride was issued a valid APD to re-enter the State "X" Well No. 1 on July 16, 2003. This APD stated

that the permit would expire one year from the approval date unless re-entry operations were underway on the well. The Hobbs OCD illegally cancelled this permit by letter dated August 26, 2003;

- (b) Yates' APD filed August 26, 2003 and approved by the Hobbs OCD on August 26, 2003, was improperly granted;
- (c) Yates does not "own" the wellbore located in the NW/4 of Section 12. This well was drilled and abandoned in 1957, and the lease under which the well was drilled has long since expired. Applicable case law provides that at the expiration of a lease, the wellbore reverts back to the surface owner, in this case the Commissioner of Public Lands for the State of New Mexico. Since Yates does not "own" the wellbore, it is available for forced pooling;
- (d) Pride has a property interest in its APD, not in the NW/4 of Section 12. It is that interest that is subject to due process considerations; and
- (e) the compulsory pooling statute (NMSA 1978, 70-2-17) provides sufficient flexibility to allow the operator of a pooled unit to conduct operations anywhere on that unit, regardless of whether the owner of the land on which the well is located has consented thereto.

(19) Yates contends that:

- (a) the NW/4 of Section 12 is not available to be forced pooled by Pride because it is already included within a voluntary standard spacing unit comprised of the N/2 of Section 12;
- (b) Pride has no interest in the N/2 of Section 12, nor does it have any interest in the State "X" Well No. 1;
- (c) by virtue of being the lessee of State Lease No. V-5855, Yates does have the right to utilize this previously plugged and abandoned wellbore;

- (d) Pride's APD dated July 10, 2003 by itself does not convey to Pride an interest in the NW/4 of Section 12, nor does it convey to Pride an interest in the State "X" Well No. 1; and
 - (e) the cancellation of Pride's APD does not constitute a violation of its due process rights. For Pride's due process rights to be violated, it must first have rights in the subject acreage that are impaired by the Division's actions. Pride does not have a constitutionally protected property right in the NW/4 of Section 12.
- (20) Pride presented geologic evidence that demonstrates that:
- (a) the primary target within the State "X" Well No. 1 is the Mississippian formation;
 - (b) in July, 2001 Pride completed the State "M" Well No. 1, located 660 feet from the South and West lines (Unit M) of Section 1, Township 12 South, Range 34 East, NMPM, in the Mississippian formation. This well, which is a direct north offset to the State "X" Well No. 1, has produced from the Mississippian formation since being completed, and is currently producing at a rate of approximately 350 MCF of gas per day;
 - (c) there is a fault located on the western boundary of Section 12 that traverses this section generally in a north-south direction. The down-throne side of the fault is located on the east side of the fault line;
 - (d) the Mississippian reservoir, which is present on the down-throne side of the fault, appears to have developed along this north-south trending fault in Section 12. The greater porosity within this reservoir is located in close proximity to the fault, and has been enhanced by tectonic fracturing. This is evidenced by the porosity development within the State "X" Well No. 1, which shows 36 feet of gross pay development, and 25 feet of pay with at least 7% porosity. This well is located approximately 700 feet east of the fault;

- (e) due to the location and orientation of this Mississippian reservoir, the W/2 of Section 12 appears to have sufficient porosity development, and is therefore likely to be productive, in this interval;
- (f) the porosity within this Mississippian reservoir diminishes as you move east away from the fault. This is evidenced by the lack of porosity within the State QE "13" Well No. 1 located 660 feet from the South line and 1980 feet from the West line (Unit N) of Section 13, Township 12 South, Range 34 East, NMPM. This well is located approximately 2,640 feet east of the fault; and
- (g) a well drilled within the SW/4 of Section 12 will be located a greater distance away from the fault than the State "X" Well No. 1. Consequently, drilling a well within this quarter section is a much riskier prospect than simply re-entering and testing the State "X" Well No. 1.

(21) Pride testified that the orientation of the Mississippian reservoir in Section 12 is better suited to a stand-up proration unit comprising the W/2 of Section 12, and that due to the lack of porosity development within the E/2 of Section 12, this area will likely be non-productive in the Mississippian formation.

(22) Upon consideration of the evidence presented by both parties in this case, the Division finds that:

- (a) for a period of approximately two years following the completion of the State "M" Well No. 1, Yates possessed a valid permit to re-enter the State "X" Well No. 1. During this time period, Yates took no action with regards to the well;
- (b) Yates allowed its drilling permit for the State "X" Well No. 1 to expire on May 25, 2003;
- (c) at the time Pride filed its APD for the State "X" Well No. 1, there was no other valid APD in effect for the well. In addition, the NW/4 of Section 12 was not contained within a spacing unit, and was therefore available to be included within a W/2 dedication, either by virtue of being voluntarily committed or forced pooled;

- (d) Pride's APD was duly approved by the Hobbs OCD in accordance with Division rules; and
- (e) in accordance with a procedure widely practiced in the oil and gas industry, Pride proposed the re-entry of the State "X" Well No. 1 to Yates, the only other working interest owner in the W/2 of Section 12. After it received no response from Yates, Pride then proceeded, in accordance with the compulsory pooling statute (NMSA 1978, 70-2-17), to file an application to pool the interest of Yates within the W/2 of Section 12.

(23) Upon consideration of the evidence regarding the cancellation of Pride's APD for the State "X" Well No. 1, the Division finds that:

- (a) when an APD is filed, the Division does not determine whether the applicant can validly claim the right to drill or re-enter the well that is the subject of the application. The courts of the State of New Mexico have exclusive jurisdiction to determine such matters. It is the responsibility of the operator filing an APD to do so under a good faith claim to title and a good faith belief that it is, or in this case will be, authorized to drill or re-enter the well applied for. See Commission Order No. R-11700-B (March 26, 2002);
- (b) it appears that Pride had a good faith belief that it would be authorized to re-enter the State "X" Well No. 1 when it filed its APD and simultaneously sent a well proposal to Yates;
- (c) the principal reason for the cancellation of Pride's drilling permit by the Hobbs OCD appears to have been that the N/2 of Section 12 was leased to Yates. It is a common industry practice to submit APD's that embrace more than one lease and/or more than one lessee in a standard spacing unit. This situation generally does not preclude the approval of an APD because the applicant is then provided with flexibility to consolidate the interests within the spacing unit, either by voluntary agreement or forced pooling;

- (d) the Hobbs OCD cancelled Pride's drilling permit for the State "X" Well No. 1 without giving Pride notice of the intended action; and
- (e) the Hobbs OCD did not state sufficient cause to cancel Pride's drilling permit for the State "X" Well No. 1 and violated Pride's due process rights by canceling Pride's drilling permit without notice and opportunity to show why the drilling permit should not be cancelled.

(24) Because the drilling permit issued to Pride for the State "X" Well No. 1 was not duly cancelled, the drilling permit subsequently issued to Yates for the same well is invalid.

(25) Yates chose not to present geologic evidence in this case.

(26) The geologic evidence presented by Pride demonstrates that within Section 12, the W/2 contains the majority of the productive acreage in the Mississippian formation.

(27) The evidence further demonstrates that Pride's proposed spacing unit orientation within Section 12 conforms better, geologically, to the Mississippian reservoir underlying Section 12.

(28) The evidence further demonstrates that Pride has proceeded in a prudent manner to develop the gas reserves in the Mississippian formation underlying the W/2 of Section 12, and has conformed to Division rules and regulations in its actions.

(29) Approval of the subject application will afford Pride the opportunity to recover its equitable share of the gas reserves in the Mississippian formation underlying the W/2 of Section 12, will prevent the drilling of unnecessary wells, and will otherwise protect correlative rights.

(30) The application of Pride should be approved.

(31) Pride's APD for the State "X" Well No. 1 dated July 10, 2003 should be reinstated.

(32) Yates' APD for the State "X" Well No. 1 dated August 25, 2003 should be cancelled.

(33) The motion of Yates to dismiss Case No. 13153 should be denied.

(34) Two or more separately owned tracts are embraced within the proposed W/2 spacing unit (the "Unit"), and/or there are royalty interests and/or undivided interests

in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(35) Applicant is an owner of an oil and gas working interest within the Unit. Applicant has the right to re-enter and proposes to re-enter the State "X" Well No. 1 (the "proposed well") to test the Mississippian formation at a standard well location within the NW/4 of Section 12.

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

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

(38) Applicant should be designated the operator of the subject well and of the Unit.

(39) 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% thereof as a reasonable charge for the risk involved in re-entering and drilling the well.

(40) Reasonable charges for supervision (combined fixed rates) should be fixed at \$5,000.00 per month while drilling and \$600.00 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 Pride Energy Company, all uncommitted interests, whatever they may be, in the oil and gas from the surface to the base of the Mississippian formation underlying the W/2 of Section 12, Township 12 South, Range 34 East, NMPM, Lea County, New Mexico, are hereby pooled to form a standard 320-acre gas spacing and proration unit for all formation or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Undesignated Four Lakes-Mississippian Gas Pool and the Undesignated Four Lakes-Morrow Gas Pool. The Unit shall be dedicated to the plugged and abandoned State "X" Well No. 1 (API No. 30-025-01838) to be re-entered by the applicant at a standard surface location 1980 feet from the North line and 660 feet from the West line (Unit E) of Section 12.

(2) The operator of the Unit shall commence re-entry and drilling operations on or before June 1, 2004 and shall thereafter continue drilling the well with due diligence to test the Mississippian formation.

(3) In the event the operator does not commence re-entry and drilling operations on or before June 1, 2004, Ordering Paragraph (1) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(4) 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 unit 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.

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

(6) Applicant is hereby designated the operator of the subject well and of the Unit.

(7) 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 Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of re-entering, drilling, completing and equipping the subject well ("well costs").

(8) 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."

(9) 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.

(10) 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.

(11) 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.

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

(13) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$5,000.00 per month while drilling and \$600.00 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.

(14) Except as provided in Ordering Paragraphs (11) and (13) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Lea 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.

(15) 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.

(16) 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.

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

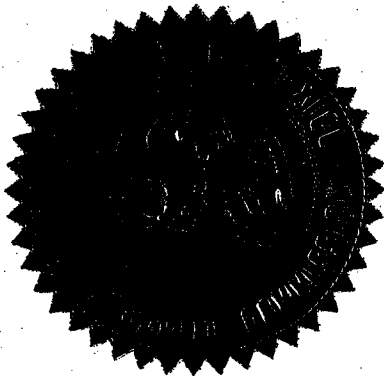
(18) Pride Energy Company's APD for the State "X" Well No. 1 dated July 10, 2003 is hereby re-instated.

(19) Yates Petroleum Corporation's APD for the State "X" Well No. 1 dated August 25, 2003 is hereby cancelled *ab initio*.

(20) Yates Petroleum Corporation's Motion to Dismiss Case No. 13153 is hereby denied.

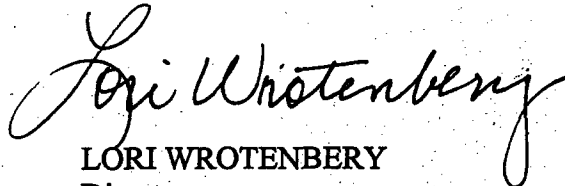
(21) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION


LORI WROTENBERY
Director