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JASON KELLAHIN (RETIRED 1991)

April 17, 1995

HAND DELIVERED

Mr. David R. Catanach
Hearing Examiner
Oil Conservation Division
2040 South Pacheco
Santa Fe, New Mexico 87505

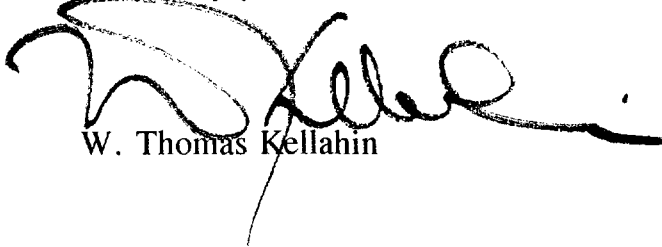
*Re: NMOCD Case 11233
Application of Nearburg Exploration Company for
Compulsory Pooling, Eddy County, New Mexico*

*NMOCD Case 11234
Application of Yates Petroleum Corporation for
Compulsory Pooling, Eddy County, New Mexico*

Dear Mr. Catanach:

On behalf of Nearburg Exploration Company, please find enclosed our proposed order for your consideration in this matter which was presented to you at the hearing held on April 4, 1995.

Very truly yours,



W. Thomas Kellahin

cc: Ernest Carroll, Esq.
Attorney for Yates Petroleum Corporation

cc: Nearburg Exploration Company
Attn: Bob Shelton

**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 11233

**APPLICATION OF NEARBURG EXPLORATION COMPANY
FOR COMPULSORY POOLING,
EDDY COUNTY, NEW MEXICO**

CASE NO. 11234

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

ORDER NO. R-__

**NEARBURG EXPLORATION COMPANY'S
PROPOSED
ORDER OF THE DIVISION**

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on April 6, 1995 at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this _____ day of April, 1995, The Division Director, having considered the testimony, the recorded 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, the parties hereto and the subject matter thereof.

(2) The applicant in Case 11233, Nearburg Exploration Corporation ("Nearburg"), seeks an order pooling all mineral interests in the North Dagger Draw-Upper Pennsylvanian Pool underlying the SW/4 of Section 13, T19S, R25E, forming a standard 160-acre oil/gas spacing unit for said pool with the subject well to be drilled at a standard location 660 feet FSL and 1980 feet FWL of said section, Eddy County, New Mexico.

(3) The applicant in Case 11234, Yates Petroleum Corporation ("Yates"), seeks an order pooling all mineral interests in the same pool in the same spacing unit **but** with the subject well to be drilled at a standard location 660 feet FSL and West lines of said Section 13.

(4) The working interest owners in this spacing unit are as follows:

Nearburg Exploration Company	50.00 %
Yates Petroleum Corporation	23.34 %
Yates Drilling Company	3.33 %
Abo Petroleum Corporation	3.33 %
Myco Industries, Inc.	3.33 %
** Holmquist Interest	16.67 %

(5) At the hearing of this case the Examiner addressed a dispute between Nearburg and Yates in which each claims to have the Holmquist interest leased as follows:

David -
this looks ok
but I'd want to
Ernie's version before
Analyzing the order.
Land

Counsel for Nearburg offered a tender of proof that Nearburg should be credited with the Holmquist interest based upon the following:

- (a) that on January 26, 1995, Nearburg received a Drilling Title Opinion from Rudi Woerndle, a New Mexico attorney specializing in preparing oil and gas title opinions that the Holmquist interest was unleased;
- (b) that on February 7, 1995 Holmquist signed a lease to Nearburg for a primary term of three years which was recorded on March 3, 1995;
- (c) that at the time Nearburg obtained the Holmquist lease, Nearburg was without knowledge that Yates had obtained from Holmquist a lease dated October 24, 1991 but which was not recorded until March 30, 1995;
- (d) that on March 3, 1995 Holmquist had verified with Nearburg that his interest was **not** leased to Yates; and
- (e) that on March 23, 1995, Nearburg received Mr. Woerndle's Supplemental Title Opinion showing the Holmquist 16.67% interest to be credited to and leased by Nearburg which now had 66.667% of the working interest in the spacing unit.

Counsel for Yates offered a tender of proof that Yates should be credited with the Holmquist interest based upon the following:

- (a) that on December 10, 1981 Yates obtained a five year lease from Holmquist which was recorded on February 9, 1982;
- (b) that on February 1, 1987 Yates obtained a five year lease from Holmquist which was recorded on February 18, 1987;

(c) that on October 24, 1991 Yates obtained a five year lease to expire on January 31, 1997 from Holmquist which was **not** recorded until March 30, 1995;

(d) that on December 27, 1994, Nearburg had proposed to Yates a Morrow gas well for the S/2 of said Section 13 which included a Joint Operating Agreement with an attached Exhibit "A" showing Nearburg with only 72.265625 % and the balance to be leased by Yates et al;

(e) that on March 3, 1995, Nearburg received Yates' well proposal for the SW/4 of said Section 13 which included a proposed JOA with an attached Exhibit "A" showing the Holmquist lease interest credited to Yates and which was then used by Nearburg in this counter-proposal to Yates dated March 7, 1995; and

(f) therefore Yates should be credited with the disputed 16.67 % Holmquist interest because Yates contended that Nearburg had knowledge of Yates' unrecorded Holmquist lease before Nearburg obtained its lease from Holmquist.

(6) The Division Examiner denied counsel for Nearburg and counsel for Yates respective offers of proof and ordered that for purposes of deciding this pooling matter, neither Nearburg nor Yates shall be entitled to claim credit for this interest.

(7) No portion of Section 13 is currently dedicated to production from this pool.

(8) The development of this spacing unit in the Cisco/Canyon formation is subject to the Special Rules and Regulations for the North Dagger Draw-Upper Pennsylvanian Pool pursuant to Division Order R-4691-D issued effective April 1, 1991.

(9) Each applicant (Nearburg and Yates) has the right to drill and each proposes to drill a well in this spacing unit, as described above in

Findings (2) and (3), to a depth sufficient to test the Upper Pennsylvanian formation (ie Cisco/Canyon).

(10) Cases Nos. 11233 and 11234 were consolidated for the purpose of hearing and should be consolidated for purpose of issuing an order since the granting of one application would require the denial of the other because these cases involve a dispute over operatorship and development of the same 160-acre spacing unit and since it is the long established practice of the Division not to have different operators in the same spacing unit even though multiple wells can be drilled therein. (See Order R-9673-A).

(11) Because of the dispute over the location of the proposed well and who should operate the well, Nearburg and Yates have been unable to agree on a voluntary basis for the pooling of their respective interests in either proposed well or spacing unit.

(12) The Division should decide this case based upon its statutory obligation to prevent waste and protect correlative rights utilizing the following criteria and analysis:

(a) Prospect Development and Well Proposals:

(i) Nearburg and Yates presented uncontested evidence: that this prospect area was originally developed by Nearburg with the successful completion in January, 1995 of its Fairchild "24" Well No. 1 in the southern offsetting spacing unit which extended the Cisco oil production in this pool some three miles farther east than was expected to exist; that on March 1, 1995 Yates filed and obtained OCD approval of an application for permit to drill its proposed well; that Yates then on March 3, 1995 proposed its well closely followed by Nearburg's well proposal on March 7, 1995; with Nearburg filing its pooling application prior to Yates' application.

(ii) The Division finds that this case cannot be decided based upon which applicant first developed this prospect then proposed its well and then filed a pooling application because each proposal was

made within less than a week of the other with each party filing a compulsory pooling application within ten days of the first well proposal;

(iii) Such activity by Yates and Nearburg is contrary to the Division's policy and practice that compulsory pooling be used as a last resort rather than as an initial "negotiating weapon" to be used against each other.

(b) Efforts to obtain voluntary agreement and willingness to negotiate a voluntary agreement:

(i) Nearburg and Yates presented uncontested evidence that: Nearburg had previously proposed to Yates that their mutual dispute over operatorship in six other spacing units in this same pool be resolved based upon which operator had the majority interest and in each of these cases Yates agreed to and accept that criteria for resolving the matter; that by letter dated March 29, 1995, Nearburg proposed to Yates that their dispute in these pending NMOCD cases be resolved in the same manner; that Yates ignored Nearburg's proposed settlement and required that this dispute be resolved by the Division.

(ii) The Division finds that in this case, Nearburg should receive credit for its attempt to reach a voluntary agreement and its willingness to settle this dispute and correspondingly Yates should be penalized for refusing to settle this case based upon the same criteria by which Yates obtained operatorship of the other six disputed spacing units.

(c) Party with Majority Interest:

(i) While Nearburg urged being credited with the 16.67% Holmquist interest which is disputed by Yates, it is uncontested by Nearburg and Yates that if that interest is excluded from both parties, then Nearburg has a majority interest of 50% compared to a 33.33% interest for Yates, et al.

(ii) The Division Finds that it is of significance in deciding this case that Yates has previously settled with Nearburg based upon the majority ownership criteria and should be bound by such criteria in this case and that Nearburg has a substantially larger working interest in this spacing unit.

(d) Geologic evidence-Well Location:

(i) Nearburg's geologist, Jerry Elger, presented subsurface geologic evidence including a structure map and cross section integrated with seismic data which established that:

the trapping mechanism for the presence of oil at the Fairchild "24" Well No. 1 location was predicated upon the non-productive limits of the dolomite being immediately updip to the west of that well;

the seismic data which has data reference points in close proximity to both well locations showed a reflection between shale and carbonate indicating the top of the Canyon Bank which was then projected to the dolomite reservoir from which it was determined that the Nearburg location had a structural advantage of approximately 40 feet over the Yates' location;

the presence of oil-water contact at approximately -4380 feet subsea and the close proximity of the western limit of the productive dolomite to the Yates' proposed location made the Yates' location too risky to drill; and

the Nearburg location was the optimum location and substantially better geologically than the Yates' location.

(ii) Yates' geologist, Brent May, presented a geologic interpretation:

which did not include a cross section and which contained a structure map prepared without the benefit of any seismic data and which failed to demonstrate the nature of the trapping mechanism to explain why the Fairchild "24" Well No. 1 produced oil in the dolomite interval;

and which failed to demonstrate any geologic difference between the Yates's location and the Nearburg location;

and then Mr. May admitted in cross examination that Nearburg's geologist in all probability had correctly defined the trapping mechanism to explain the presence of oil at the Fairchild "24 " Well No. 1 location;

(iii) The Division finds that Nearburg should receive credit for its proposed location because Nearburg had more geologic evidence (seismic data) than Yates and because Yates conceded that Nearburg's geologic explanation for the trapping mechanism was the only one which explained why oil could be produced by the Fairchild "24" Well No 1.

(iv) The Division further finds that the Nearburg's location helps both Nearburg and Yates obtain the primary objective of either proposed well in this spacing unit which is a development oil well in this pool to encounter the same productive portion of the dolomite as is now producing in the Nearburg Fairchild "24" Well No. 1 at a point in the spacing unit which represents the optimum structural position and reservoir thickness while being away from the edge of the dolomite.

(e) Estimated Well Costs ("AFE"):

(i) Nearburg presented its petroleum engineer who prepared its AFE who testified that the Nearburg AFE was a total of \$110,000

less than the Yates' AFE and concluded that a number of significant differences existed including a drilling well footage rate advantage for a Nearburg operated well;

(ii) Yates' petroleum engineer contended that a tabulation of variously selected comparisons showed that Yates's average actual well costs were less than the Yates AFE cost submitted for this well;

(iii) The Division finds that there is a significant difference in the estimated costs of the well and based upon Nearburg's immediate experience in the area which Yates does not have it is of importance that Nearburg's AFE is some \$110,000 less than Yates' AFE.

(e) Proximity of Facilities and Wells:

(i) Nearburg presented evidence that it has immediately available the necessary facilities including a salt water disposal system with its Aikman SWD well disposing of the water into the Devonian formation to service the subject well if it is awarded the right to operate; that Nearburg's closest producing well in this pool is the offsetting Fairchild "24" Well No 1.

(ii) Yates contends it also has immediately available its salt watered disposal system in this area which currently include the Cotton disposal well located in Section 14 and which is currently allowed to inject produced water into the Cisco/Canyon formation at a point upstructure from the Fairchild "24" Well No 1; and that Yates' closest producing well in this pool is some three miles to the west.

(iii) Nearburg presented evidence that proximity to either the Yates or the Nearburg salt water disposal system was one of the significant criteria used by Yates and Nearburg to voluntarily settle operatorship for certain other Cisco-Canyon wells in this same pool;

(iv) The Division finds in favor of Nearburg on the issue of proximity of adequate facilities to service the subject well and its

experience in the immediate area with the closest producing well in the pool.

(e) Issues Irrelevant in the Subject Case:

The Division finds that while in certain cases these topics may have some relevance, they are not of significance in deciding this case: risk factor penalty, overhead rates, prior operations, experience of each operator, and ability to drill and properly complete the subject well.

(13) Based upon the forgoing, Nearburg's application should be approved and Nearburg Producing Company should be designated as operator. Overhead charges for supervision should be set at \$5,400 while drilling and \$540 while producing.

(14) Since risk of an unsuccessful completion at the either location is very high, the risk penalty should be set at 200%.

(15) Approval as set out in the above findings and in the following order will avoid the drilling unnecessary wells, protect correlative rights, prevent waste and afford the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the production in any pool resulting from this order.

IT IS THEREFORE ORDERED THAT:

(1) The application of Nearburg in Case No. 11233 as described in this order is hereby **GRANTED**.

(2) The application of Yates in Case 11234 as described in this order is hereby **DENIED**.

(3) All mineral interests, whatever they may be, from the surface to the base of the Cisco/Canyon formation including but not limited to North Dagger Draw-Upper Pennsylvanian Associated Pool underlying the SW/4 of Section 13, Township 19 South, Range 25 East, NMPPM, Eddy County, New Mexico, are hereby pooled to form a standard 160-acre spacing and proration unit to be dedicated to a well to be drilled at a standard well location 660 feet from the South line and 1980 feet from the West line (Unit N) of said Section 13.

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the ___th day of _____, 1995, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Cisco/Canyon formation of the subject pool.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the ___th day of _____, 1995, Decretory Paragraph No. (3) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER THAT, should said well not be drilled to completion, or abandonment, within 180 days after commencement thereof, said operator shall appear before the Division Director and show cause why Decretory Paragraph No. (3) of this order should not be rescinded.

(4) Nearburg Producing Company is hereby designated the operator of the subject well and unit.

(5) After the effective date of this order and 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.

(6) 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.

(7) 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 cost 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 an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(8) Within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated 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.

(9) 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 of schedule of estimated well costs is furnished to him; and
- B. As a charge for the risk involved in the drilling of the well, 200 percent 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 costs is furnished to him.

(10) That the terms and conditions of the AAPL Form 610-1982 Model Form Operating Agreement (Nearburg Exhibit 5) are incorporated herein by reference.

(11) \$5,400 per month while drilling and \$540 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 such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(12) 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 the terms of this order.

(13) 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.

(14) All proceeds from production from the subject well which are not disbursed for any reason shall 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.

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

Case Nos. 11233 & 11234
Order No. R-
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(16) The operator of the subject well and unit shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this order.

(17) Jurisdiction of this cause 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.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY,
Director