

STATE OF NEW MEXICO  
ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT  
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING  
CALLED BY THE OIL CONSERVATION  
COMMISSION FOR THE PURPOSE OF  
CONSIDERING:

APPLICATION OF KCS MEDALLION  
RESOURCES, INC. (formerly known  
as INTERCOAST OIL AND GAS COMPANY)  
FOR COMPULSORY POOLING AND AN  
ORTHODOX GAS WELL LOCATION,  
EDDY COUNTY, NEW MEXICO.

CASE NO. 11666  
(de novo)

APPLICATION OF YATES PETROLEUM  
CORPORATION FOR COMPULSORY  
POOLING AND AN UNORTHODOX GAS  
WELL LOCATION, EDDY COUNTY,  
NEW MEXICO.

CASE NO. 11677  
(de novo)

ORDER NO. R-10731-A

ORDER OF THE COMMISSION

(Proposed by KCS Medallion Resources, Inc.)

BY THE COMMISSION:

This cause came on for hearing at 9:00 a.m. on February 13, 1997, at Santa Fe, New Mexico before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this \_\_\_\_ day of February, 1997, the Commission, a quorum being present, having considered the testimony, the exhibits received at said hearing, and being fully advised in the premises,

FINDS THAT:

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

(2) In Case No. 11666, KCS Medallion Resources, Inc. ("Medallion"), formerly known as InterCoast Oil and Gas Company, seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E½ of Section 20, Township 20 South, Range 28 East, N.M.P.M., to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool. Said unit is to be dedicated to the State 20 Well No. 1, located 990 feet from the North and East lines (Unit A) of Section 20.

(3) In Case No. 11677, Yates Petroleum Corporation ("Yates") seeks an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E½ of said Section 20, to form a standard 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent. Said unit is to be dedicated to the Stonewall AQK State Com. Well No. 1, located 990 feet from the North and East lines (Unit A) of Section 20.

(4) There are interest owners in the proposed proration unit who have not agreed to pool their interests.

(5) Case Nos. 11666 and 11677 were consolidated for purposes of hearing. The primary issue in these consolidated cases is operatorship of the well.

(6) Yates proposed at the hearing that interest ownership in a well unit be the sole factor in determining operatorship in contested compulsory pooling hearings. Medallion asserted that operatorship must be decided based on several factors, including interest ownership, which party developed the prospect, geology, and well costs. **See Division Memorandum dated April 5, 1995.**

(7) The geologists for both Medallion and Yates agreed that the best location for a well in the E½ of Section 20 is at a location 990 feet from the North and East lines (Unit A) of the Section. They also agreed that a 200% non-consent penalty is a proper risk factor for drilling the well. Moreover, the AFE's and operating costs of Medallion and Yates are comparable. As a result, these factors need not be considered in awarding operations in this matter.

(8) The Division held that:

In the absence of other compelling factors, the operatorship of the E½ of Section 20 should be awarded to the operator who originally developed the prospect, developed the geologic data necessary to determine the optimum well location, and initially sought to obtain farmout or voluntary agreement to drill its well.

**Division Order No. R-10731, Finding ¶24.<sup>1</sup>** Based thereon, the Division awarded operatorship to Medallion.

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<sup>1</sup>A similar finding was entered in Division Order No. R-10742 (Finding ¶22), entered three days after Order No. R-10731.

(9) The testimony presented in this matter shows the following:

- (a) The Stonewall Unit, a working interest unit, covers the entire working interest in the SE $\frac{1}{4}$  of Section 20, but only 5% of the working interest in the NE $\frac{1}{4}$  of Section 20.<sup>2</sup> Yates is the operator of the Stonewall Unit.
- (b) The 95% of the working interest in the NE $\frac{1}{4}$  of Section 20 which is not subject to the Stonewall Unit is owned by Kerr-McGee Corporation ("Kerr-McGee")<sup>3</sup> (approximately 48%) and Diamond Head Properties, L.P. ("Diamond Head") (approximately 47%).
- (c) In the Summer of 1996, Medallion's geologist determined that a Morrow well in the NE $\frac{1}{4}$ NE $\frac{1}{4}$  of Section 20 was a good prospect, and Medallion began seeking farmouts from interest owners in Section 20. (**See Medallion Exhibits 2A-2F.**) Medallion subsequently obtained a farmout of the Kerr-McGee interest in the NE $\frac{1}{4}$  of Section 20.
- (d) Medallion first proposed its well in the NE $\frac{1}{4}$  of Section 20 in late August 1996, and negotiations between interest owners have been ongoing for five months. The parties have made a good faith effort to obtain the voluntary joinder of the interest owners in the well.<sup>4</sup>
- (e) Yates had no internal proposal to drill a Morrow well in Section 20 before October 1996. Yates has not drilled a Pennsylvanian-age gas well in the Stonewall Unit since 1978. (**Medallion Exhibit B.**)

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<sup>2</sup>The Stonewall Unit also covers land in Sections 19, 29, and 30.

<sup>3</sup>Recently acquired by Devon Energy Corporation (Nevada).

<sup>4</sup>Yates' proposal on the E $\frac{1}{2}$  well unit was mailed to Medallion on November 22, 1996, and its pooling application was filed on November 26, 1996. **Division Order No. R-10731, Finding ¶15.** Because of time deadlines related to its farmout, Medallion's proposal for an E $\frac{1}{2}$  unit was mailed on November 11, 1996, and a pooling application was filed on November 12, 1996. However, by mid-November, the interest owners had been negotiating on a well located in the NE $\frac{1}{4}$ NE $\frac{1}{4}$  of Section 20 for over two months.

Yates claimed that this was due to low gas prices. However, Yates admitted to drilling hundreds of gas wells in Southeast New Mexico since 1978, and gas prices are obviously not a factor.

- (f) Medallion originally proposed its well with a laydown N $\frac{1}{2}$  well unit. However, at a meeting between Medallion and Yates, held on November 7, 1996, in Artesia, New Mexico, Yates stated it preferred a well location 990 feet from the North and West lines of Section 20 (Unit D). Each party was adamant about its proposed location. (**Division Order No. R-10731, Finding ¶15 at p. 4.**) Testimony at the Division hearing showed that Yates thought that a well in the NE $\frac{1}{4}$  of Section 20 was too risky. (**Testimony of R. Quinn, Transcript at 19; Testimony of W. Siruta, Transcript at 52, 55-56.**)
- (g) In order to resolve the well location issue, Medallion proposed that two stand-up well units be formed in Section 20, allowing each side to drill and operate its preferred location. Yates agreed to the formation of two stand-up units in Section 20.<sup>5</sup> However, Yates later contacted Medallion and stated that it desired to operate both proposed wells.
- (h) The largest interest owners in the E $\frac{1}{2}$  well unit are as follows:

<u>Company</u>	<u>Interest</u>
Medallion	24.101%
Diamond Head	23.416%
Yates	19.635%
Yates Drilling Company	7.742%
Myco Industries, Inc.	7.742%
Abo Petroleum Corporation	2.581%
Stonewall Unit owners (other than the Yates group)	14.765%

- (i) Diamond Head was neutral in this matter, and indicated a desire to join in whichever well was

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<sup>5</sup>Yates has not yet commenced its proposed well in the NW $\frac{1}{4}$  of Section 20.

approved by the Division. Diamond Head has now executed Medallion's operating agreement. **Thus, 48% of the working interest in the E½ of Section 20 is committed to Medallion's proposed well.**

- (j) There are secondary objectives in the proposed well, which are spaced on 40 or 160 acres. Ownership of the well in those formations is as follows:

<u>Company</u>	<u>Interest</u>
Medallion	48%
Diamond Head	47%
Yates group	<2%

**Therefore, 95% of the working interest in a well spaced on 40 or 160 acres is committed to Medallion's well.**

- (k) At the hearing, Yates would not commit to joining in the well unless it is named operator.
- (l) Medallion commenced its well during the weekend of February 7-8, 1997, due to rig availability problems.<sup>6</sup>

(10) Interest ownership or control of the E½ of Section 20 is roughly equal (between Medallion and Yates); however, the NE¼ of Section 20 is owned or controlled 95% by Medallion. In addition, Medallion took the initiative in getting the well drilled. Therefore, Medallion's application in Case No. 11666 should be approved, and the application of Yates in Case No. 11677 should be denied.

(11) Approval of the proposed unorthodox gas well location will afford the parties the opportunity to produce their just and equitable share of the gas in the affected pool, will prevent the drilling of unnecessary wells, and will otherwise prevent waste and protect correlative rights.

(12) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to the owner of

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<sup>6</sup>If Medallion had not contracted for a rig at that time, the next firm available date was in April 1997.

each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the production in any completion resulting from this order, the subject application should be approved by pooling all mineral interests, whatever they may be, within said unit.

(13) Medallion should be designated the operator of the subject well and unit.

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

(15) 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 percent thereof as a reasonable charge for the risk involved in drilling the well.

(16) 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.

(17) 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.

(18) \$5,819.00 per month while drilling and \$564.00 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.

(19) 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.

(20) Upon the failure of the operator of said pooled unit to commence drilling operations on the subject well on or before April 1, 1997, this order pooling the subject unit should become null and void and of no effect whatsoever.

(21) 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.

(22) 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 THAT:**

(1) The application of KCS Medallion Resources, Inc. in Case No. 11666 to pool all mineral interests, whatever they may be, from the surface to the base of the Morrow formation underlying the E½ of Section 20, Township 20 South, Range 28 East, N.M.P.M., to form a 320-acre gas spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent, which presently includes but is not necessarily limited to the Burton Flat-Morrow Gas Pool and the Undesignated West Burton Flat-Atoka Gas Pool, is hereby approved. Said unit shall be dedicated to the State 20 Well No. 1, located 990 feet from the North and East lines (Unit A) of Section 20.

(2) The application of Yates Petroleum Corporation in Case No. 11677, to pool the E½ of said Section 20, is hereby denied.

**PROVIDED HOWEVER THAT,** the operator of said unit shall commence drilling operations on the subject well on or before the 1st day of April, 1997, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Morrow formation.

**PROVIDED FURTHER THAT,** in the event said operator does not commence drilling operations on the well on or before the 1st day of April, 1997, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever, unless said 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, said operator shall appear before the Division Director and show cause why Ordering Paragraph No. (1) of this order should not be rescinded.

(3) Medallion is hereby designated the operator of the subject well and unit.

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

(5) 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.

(6) 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.

(7) 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.

(8) 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 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 well costs is furnished to him.

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

(10) \$5,819.00 per month while drilling and \$564.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rate). 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. The supervision rates shall be adjusted annually per the COPAS - 1984- Onshore Accounting Procedure.

(11) 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.

(12) 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.

(13) 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; and 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.

(14) 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.

(15) 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.

(16) Jurisdiction is hereby retained for the entry of such further orders as the Commission may deem necessary.

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

STATE OF NEW MEXICO  
OIL CONSERVATION COMMISSION

[Seal]

WILLIAM J. LEMAY  
Chairman

JAMI BAILEY  
Member

WILLIAM W. WEISS  
Member