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June 15, 1998

HAND DELIVERED

Michael E. Stogner
Hearing Examiner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
2040 South Pacheco Street
Santa Fe, New Mexico 87505

Re: *Case 11934: Application of Yates Petroleum Corporation for compulsory pooling, Lea County, New Mexico;*
Case 11958: Application of Ocean Energy, Inc. for compulsory pooling and an unorthodox well location, Lea County, New Mexico; and
Case 11959: Application of Ocean Energy, Inc. for compulsory pooling, Lea County, New Mexico

Dear Mr. Stogner:

Pursuant to your request at the May 14, 1998 Examiner hearing in the above-referenced consolidated cases, Yates Petroleum Corporation and Ocean Energy, Inc. have again attempted to reach a voluntary agreement for the development of their interests in Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico. Although these negotiations may have helped narrow certain issues between the parties, it appears that they have not been successful in settling this matter.

There are certain threshold issues which have not only made settlement impossible, but have also complicated the preparation of the proposed orders in these consolidated cases. These issues include the number of wells and spacing units necessary to develop this acreage. Until this issue is resolved, settlement is impossible.

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Furthermore, because of recent problems that were testified to at the hearing, Yates remains opposed to Ocean operating wells in which Yates owns an interest. Accordingly, the enclosed proposed Order of Yates Petroleum Corporation grants the Yates application but does not provide for Ocean to assume operations of this acreage if Yates does not timely commence its proposed Fields "APK" State Com. Well No. 3. This provision is unnecessary for Yates will drill its proposed well as soon as it has been authorized to do so. However, to address the concern expressed at the hearing that the property be promptly developed, you will note that Yates' proposed Order shortens the time within which it must commence its well to 60 days from the date of the order entered in this case and provides that if it does not commence this well within this 60 day period, the order will become void.

If you need additional information from Yates to proceed with your consideration of these applications, please advise.

Very truly yours,



WILLIAM F. CARR

Enclosure

cc: J Rand Carroll, Esq.
James Bruce, Esq.
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, LEA COUNTY, NEW MEXICO.**

CASE NO. 11934

**APPLICATION OF OCEAN ENERGY, INC.
FOR COMPULSORY POOLING AND AN
UNORTHODOX WELL LOCATION,
LEA COUNTY, NEW MEXICO.**

CASE NO. 11958

**APPLICATION OF OCEAN ENERGY, INC.
FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO.**

**CASE NO. 11959
ORDER NO. R-_____**

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

BY THE DIVISION:

This cause came on for hearing at 8:15 a. m. on May 14, 1998 at Santa Fe, New Mexico, before Examiner Stogner.

NOW, on this ____ day of June, 1998, 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) At the time of hearing Division Cases 11934, 11958 and 11959 were consolidated for the purpose of presenting testimony and, in order to provide a comprehensive decision in these cases, one order should be entered for all three cases.

(3) The applicant in Case 11934, Yates Petroleum Corporation ("Yates") seeks an order pooling all mineral interests underlying the following described acreage in irregular Section 2, Township 16 South, Range 36 East, in the following manner: Lots 11, 12, 13 and 14 and the SW/4 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; Lots 11, 12, 13 and 14 to form a standard 160-acre spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent; Lots 13 and 14 to form a standard 80-acre spacing and proration unit for any and all formations and/or pools developed on 80-acre spacing within said vertical extent; and Lot 13 to form a standard 40-acre spacing and proration unit for any and all formations and/or pools developed on 40-acre spacing within said vertical extent. Said units are to be dedicated to its Fields "APK" State Com Well No. 3 to be drilled at a standard location 3300 feet from the South line and 760 feet from the West line of said Section 2.

(4) The applicant in Case 11958, Ocean Energy, Inc. ("Ocean") seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the following described acreage in irregular Section 2, Township 16 South, Range 35 East, and in the following manner: Lots 9-16 of irregular Section 2 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, including the Undesignated Townsend-Morrow gas Pool and the Undesignated North Townsend-Morrow Gas Pool; and Lots 13 and 14 of Section 2 to form a standard 80-acre spacing and proration unit for any formations and/or pools spaced on 80 acres within said vertical extent, including the South Big Dog-Strawn Pool. Said units are to be dedicated to its Townsend State Com Well No. 2 located at an unorthodox well location 3250 feet from the South line and 1400 feet from the West line of said Section 2.

(5) The applicant in Case 11959, Ocean Energy, Inc. ("Ocean") seeks an order pooling all mineral interests from the surface to the base of the Mississippian formation underlying the S/2 of irregular Section 2, Township 16 South, Range 35 East 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, including the Undesignated Townsend-Morrow Gas Pool and the Undesignated North Townsend-Mississippian Gas Pool. Said unit is to be dedicated to its Townsend State Com. Well No. 6 located at an orthodox location 990 feet from the South line and 1650 feet from the West line of said Section 2.

(6) Yates testified that it owns all working interest in Lot 13 of said Section 2 and requested that the portion of its application which requested the pooling of 40-acre spacing and proration units be dismissed.

(7) The ownership of Yates and Ocean within the Atoka-Morrow formation in each of the proposed spacing units in Section 2 is as outlined below:

Yates proposed Morrow spacing unit: Case 11934:

Yates Petroleum Corporation	37.9775%
Ocean Energy, Inc.	37.5000%

Ocean proposed Morrow spacing unit: Case 11958:

Yates Petroleum corporation	37.5%
Ocean Energy, Inc.	37.5%

Ocean proposed Morrow spacing unit: Case 11959:

Yates Petroleum Corporation	12.5%
Ocean Energy, Inc.	75%

(8) Another primary objective in each of these wells is the Strawn formation which is developed on 80-acre spacing and both Yates and Ocean own interests in the Strawn formation under the proposed spacing and proration units.

FINDING: Since both Yates and Ocean own an interest in each of the proposed spacing units in said Section 2, both have the right to drill for and develop the minerals

underlying the proposed spacing units.

(9) Yates and Ocean have been negotiating and have both attempted to reach mutually acceptable agreement in this matter; however, they have been unable to voluntarily reach an agreement as to how this acreage should be developed.

(10) Both parties agreed at the hearing that overhead rates of \$5,400.00 per month while drilling and \$540.00 per month while producing should be adopted in this case. In addition, both parties proposed that a risk penalty of 200 percent be assessed against any non-consenting interest owners.

(11) The geological evidence presented by Yates showed a North-South trending channel in the Atoka-Morrow formation with the thickest portion of the channel under W/2 of Section 2 (See, Yates Exhibit No. 6, Testimony of May at 30, 37) whereas Ocean's geological presentation showed this channel trending northeast-southwest (See, Ocean Exhibits 13, 15 and 19, Testimony of McRae at 147, 163-164, Testimony of Huck at 209).

(12) Wells located over one mile apart in this channel in Sections 11 and 14 demonstrate there is good North-South communication in this reservoir (Testimony of Pearson at 77) and that two wells in the W/2 of Section 2 are not needed to recover the reserves under this acreage (Testimony of Pearson at 78, 97).

(13) The evidence also established that drilling two wells in the W/2 of Section 2, as proposed by Ocean, would not increase the ultimate recovery of reserves from the Atoka-Morrow reservoir but instead would only increase the rate of withdrawal from Section 2 thereby draining reserves from offsetting property to the South in Section 11 (Testimony of Pearson at 96).

FINDING: One well will efficiently drain the reserves in the Atoka-Morrow formation in the W/2 of Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico.

FINDING: A second well in the W/2 of Section 2 is unnecessary for it will only cause rate acceleration and drainage from offsetting properties and will not increase the ultimate recovery of hydrocarbons from this reservoir.

(14) The interpretations of both parties show the best productive reservoir under the Yates stand-up spacing unit in the W/2 of Section 2. (Yates Exhibit No. 6, Testimony of May at 30, 37, Ocean Exhibit No. 13).

(15) The parties interpretation that the best productive reservoir is located under the Yates proposed stand-up spacing unit in the W/2 of Section 2 is confirmed by the fact that all three of the proposed well locations for the development of this land are in the W/2 of Section 2 (Testimony of May at 37).

FINDING: The spacing unit comprised of Lots 11, 12 13 and 14 and the SW/4 of Section 2 best conforms to productive reservoir in the Atoka-Morrow formation under the subject acreage.

FINDING: Allocation of production from a well in the W/2 of Section 2 to the owners under the stand-up spacing unit will result in the production from this spacing unit being allocated to the owners thereof thereby protecting the correlative rights of all owners in the Atoka-Morrow formation under said Section 2.

(16) Ocean's two proposed lay down units in the Section 2 combine non-economic acreage in the E/2 of Section 2, owned predominantly by Ocean, with the productive acreage in the W/2 of Section 2 where Yates owns its interest thereby diluting the interest of Yates in the W/2 of Section 2 (Testimony of May at 37, 44).

FINDING: The development of Section 2 with two lay down units, as proposed by Ocean, dilutes the interest of Yates by combining Ocean's non-economic acreage with the productive acreage owned by Yates in the W/2 of Section 2 thereby denying Yates the opportunity to produce the proportion of recoverable reserves from this pool under its property.

(17) Yates' Shell Lusk "ANB" Com Well No. 1 located 1980 feet from the North and West lines of Section 11, Township 16 South, Range 35 East is producing reserves from the Atoka-Morrow channel which is the subject of the Yates and Ocean applications for the development of Section 2.

(18) Ocean proposes to drill Townsend State Com Well No. 6 in this Atoka-Morrow

channel at an location 990 feet from the South line of Section 2. By proposing a lay down unit comprised, in part of non-economic Ocean acreage, Ocean can locate this well 660 feet closer to the south line of Section 2, and 660 feet closer to the Yates operated offsetting Section 11, than it could at a standard location on a stand-up spacing unit.

FINDING: The development of Section 2 with two lay down units, as proposed by Ocean, will result in drainage from the Yates operated spacing unit in offsetting Section 11 which cannot be offset by counter drainage thereby denying Yates the opportunity to produce its fair share of the reserves in the Atoka-Morrow reservoir.

FINDING: The development of the section with two lay down spacing units, as proposed by Ocean will dilute the interest of Yates in this section and result in net drainage from Yates operated acreage in the N/2 of Section 11 thereby impairing the correlative rights of Yates.

(19) Yates presented evidence which showed that its proposed location for the Fields "APK" State Com. Well No. 3 at 3300 feet from the South line and 760 feet from the West of Section 2 would be at a slightly higher location than the proposed Ocean locations in the Atoka-Morrow formation due to a nosing effect through this location that could enhance the production from this well (Yates Exhibits 5 and 7, Testimony of May at 34-36). In the Strawn formation Yates evidence established that its location is updip from the Ocean locations (Testimony of May at 41-42), is the best possible location in the W/2 of Section 2 to make a well in the Strawn formation (Testimony of May at 43-44), and that moving the location to the south as proposed by Ocean, could result in the well completely missing the Strawn target (Testimony of May at 51).

FINDING: The location proposed by Yates for its Fields "APK" State Com. Well No. 3 is the best location in the W/2 of said Section 2 to drill a well to the Strawn and Atoka-Morrow formations.

(20) Ocean has drilled three wells in the nine section area surrounding Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico (Testimony of Johnson at 184).

(21) Ocean has experienced major problems and cost over runs with each well it has

drilled in this nine section area, (Testimony of Johnson at 184, 187-188). These problems include:

- A. Ocean unsuccessfully drilled the Townsend No. 1, located in Section 2 of Township 16 South, Range 35 East, as a straight hole to the Strawn formation and was unable to make a well (Testimony of Johnson at 185-186). It then drilled the well as a horizontal well to another bottomhole location in the Strawn and encountered mechanical problems and casing and cementing difficulties (Testimony of Pearson at 78).
- B. While drilling the Townsend No. 4, located in Section 2, Township 16 South, Range 35 East, Ocean lost circulation at approximately 10,020 feet when the casing parted (Testimony of Johnson at 184, 200). It cut and pulled the casing from the well and, although there may be no cement in the hole, Ocean shut in the well in mid December 1997 without first correcting the casing and cementing problems with this well (Testimony of Johnson at 200, 201). Ocean admitted that it was imprudent to let the well remain in this condition for five months (Testimony of Johnson at 184-185).
- C. While drilling its Carlisle Well in Section 10, Township 16 South, Range 35 East, the Ocean well blew out. It was still being worked on at the time of the hearing on its applications to force pool the two additional locations it proposed to drill in Section 2 (Testimony of Johnson at 186).

(22) Ocean charges the other working interest owners who have voluntarily joined in the wells they drill for their proportionate share of the cost overruns which result from all problems which occur while drilling (Testimony of Johnson 186).

(23) Yates objected to the applications of Ocean, questioned whether Ocean's operations in this area were prudent, and:

- A. Asserted it was unreasonable for the Division to authorize Ocean to

drill additional wells since they have not timely corrected the problems they have encountered in the wells they have previously drilled in this area, and

- B. Showed that the granting of the Ocean applications would leave Yates with two unreasonable options. Yates could either pay its share of Ocean's estimated well costs and thereby become liable for a share of the costs of future Ocean operations in this area, or go non consent in these wells and receive no production revenues from these properties until Ocean's costs including any overruns, are recovered plus up to 200% of these costs because of a Division imposed risk penalty. Both of these options deny Yates the opportunity to recover its share of the recoverable reserves under this acreage and would impair its correlative rights.

FINDING: The Division should not designate Ocean operator of wells until Ocean has demonstrated that it can prudently drill wells in this area and timely correct problems incurred while drilling.

FINDING: The application of Yates Petroleum Corporation for compulsory pooling of a stand-up Atoka-Morrow spacing unit comprised of Lots 11,12,13 and 14 and the SW/4 of Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico should be **approved** for it will prevent the drilling of unnecessary wells thereby preventing waste and will not dilute the interest of any owner in this spacing unit but, instead, will allocate to the owners therein their respective shares of the recoverable reserves thereby protecting correlative rights.

FINDING: The applications of Ocean Energy, Inc. in these consolidated cases should be **denied** for they would result in the drilling of unnecessary wells thereby causing waste, would dilute the interest of Yates thereby impairing Yates correlative rights, and would permit Ocean to drill additional wells in this area prior to its demonstrating that it can drill wells in a prudent manner.

IT IS THEREFORE ORDERED THAT:

(1) The Application of Yates Petroleum Corporation in Case 11934 is hereby granted pooling all mineral interests, whatever they may be, from the surface to the base of the Morrow formation underlying the following described acreage in irregular Section 2, Township 16 South, Range 35 East, NMPM, Lea County, New Mexico: Lots 11, 12, 13 and 14 and the SW/4 to form a standard 320-acre spacing and proration unit for any and all formations and/or pools developed on 320-acre spacing within said vertical extent; Lots 11, 12, 13 and 14 to form a standard 160-acre spacing and proration unit for any and all formations and/or pools developed on 160-acre spacing within said vertical extent; and Lots 13 and 14 to form a standard 80-acre spacing and proration unit for any formations and/or pools developed on 80-acre spacing within said vertical extent. Said units are to be dedicated to the Yates Petroleum Corporation Fields "APK" State Com Well No. 3 to be drilled at a standard location 3300 feet from the South line and 760 feet from the West line of said Section 2.

PROVIDED HOWEVER THAT, the operator of said units shall commence the drilling of said well within 60-days of the date of this order and shall thereafter continue the drilling of said well with diligence to a depth sufficient to test the Atoka-Morrow formation.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well within 60-days of the date of this order, Ordering Paragraph No. (1) of this order shall be null and void and of no effect whatsoever.

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.

(2) The portion of the application of Yates Petroleum Corporation seeking the pooling of all 40-acre spacing units comprised of Lot 13 of said Section 2 is hereby dismissed.

(3) The Applications of Ocean Energy, Inc. in Case 11958 for the compulsory pooling and an unorthodox well location and in Case 11959 for compulsory pooling are hereby denied.

(4) Yates Petroleum Corporation is hereby designated operator of the subject well and units.

(5) After the effective date of this order and within 60 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.

(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 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.

(8) 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.

(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 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.

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

(11) \$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 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 wells 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 immediately 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 said escrow agent within 30 days from the date of first deposit with said escrow agent.

(15) 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.

(16) The operator of the well and unit shall notify the Director of the Division in

Case Nos. 11934, 11958 and 11959

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writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(17) 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

LORI WROTENBERY
Director

S E A L