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November 6, 1998

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*NEW MEXICO BOARD OF LEGAL SPECIALIZATION
RECOGNIZED SPECIALIST IN THE AREA OF
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

HAND DELIVERED

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

Re: NMOCD Case 12073
Application of Nearburg Exploration Company, L.L.C.
for compulsory pooling and an unorthodox surface location and
unorthodox subsurface drilling/producing window
Eddy County, New Mexico

Dear Mr. Catanach:

On behalf of Nearburg Exploration Company, L.L.C, please find enclosed a proposed order for entry in this case which was presented to you at yesterday Examiner's hearing. I have also enclosed a computer diskette which contains this draft.

Please call me if I can be of assistance.

Very truly yours,

A handwritten signature in black ink, appearing to read 'W. Thomas Kellahin', with a large, stylized initial 'W'.

W. Thomas Kellahin

cc: William F. Carr, Esq.,
Attorney for Yates Petroleum Corporation
Nearburg Exploration Company, L.L.C.
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. 12073
ORDER NO. R-_____**

**APPLICATION OF NEARBURG EXPLORATION
COMPANY, L.L.C. FOR COMPULSORY POOLING
AND AN UNORTHODOX GAS WELL SURFACE LOCATION
AN UNORTHODOX SUBSURFACE DRILLING WINDOW
EDDY COUNTY, NEW MEXICO**

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on November 5, 1998 at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this _____ day of November, 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 over the parties, of this cause and the subject matter thereof.

(2) The applicant, Nearburg Exploration Company, L.L.C., seeks an order pooling uncommitted mineral and leasehold interest owners who have failed to agree to voluntarily commit their interests from the surface to the base of the Morrow formation underlying the following described acreage in the E/2 of Section 11, Township 17 South, Range 25 East, NMPM, Eddy County, New Mexico, 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 South Eagle Creek-Morrow Gas Pool.

(3) Said unit is to be dedicated to the applicant's proposed Eagle Creek "11 Well No. 1 (API No. 30-_____) which applicant requested be approved as a directional wellbore pursuant to Division Rule 111 except that the well is to be located at an unorthodox surface location 1070 feet from the North line and 2110 feet from the West Line (Unit C) of Section 14 and is to be drilled directionally such that at the top of the Morrow formations the subsurface Producing Area and Interval shall not be closer than 660 feet to the south, west or east boundaries of this spacing unit consisting of the E/2 of Section 11, T17S, R25E, NMPM, Eddy County, New Mexico.

(4) Applicant has the right to develop the subject unit and produce any hydrocarbons underlying the same, however, as of October 13, 1998, the date this application was filed, the following working interest owners and/or unleased mineral owners in the above described 320-acre spacing and proration units have not agreed to pool their interests:

Yates Petroleum Corporation	7.0125 %
Abo Petroleum Corporation	4.6875 %
MYCO Industries, Inc.	4.6875 %
S.P. Yates	7.03125 %
John A. Yates	1.17188 %
John A. Yates, Personal	1.17188 %
Representative of the Estate of Peggy A. Yates	
Sharbro Oil Ltd. Co.	2.34375 %
Sharbro Oil Ltd. Co.	
Unleased Minerals	12.5 %

(5) Section 70-2-17.C NMSA (1978) provides, in part that:

"Where, however, such owner or owners have not agreed to pool their interests,...the Division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste shall pool all or any part of such lands or interest or both in the spacing unit or proration unit as a unit."

(6) Applicant submitted a sworn affidavit verifying that each and every compulsory pooled party received actual notice of this hearing in accordance with Division Rule 1207 and the Division finds that each said party has been afforded a fair and reasonable opportunity to appear and participate. The Division further finds that the compulsory

pooled parties appeared through counsel and are parties of record in this case.

(7) Among the offset operators and/or mineral interest owners in the N/2 of Sections 14 and 13, Township 17 South, Range 25 East, NMPM, Eddy County, New Mexico towards whom this unorthodox location encroaches, Yates Petroleum Corporation signed a waiver of objection and no other party appeared to object.

(8) In support of its application, Nearburg Exploration Company, L.L.C. submitted the following evidence through its exhibits and the testimony of its witnesses which the Division finds to be substantial:

(a) the primary zone of interest for the subject well is the Morrow formation, therefore it was reasonable to limit applicant's geologic testimony to this interval. Based upon this evidence, including an isopach and cross section, the Morrow formation in this area is expected to be a channel and that a well at the proposed unorthodox gas well location should penetrate a thicker portion of the Morrow sand than a well drilled at the closest standard gas well location.

(b) approval of the unorthodox location will increase the likelihood of intersecting commercial grade gas bearing zones within the Morrow formation.

(c) the applicant has proposed the subject well and its appropriate spacing units to the uncommitted owners in the spacing units as identified in Finding () above.

(d) Despite its good faith efforts, applicant has been unable to obtain a written voluntarily agreement from all of these uncommitted owners voluntarily pooling their interests.

(e) Applicant's witness testified in support of the approval of an Authority for Expenditure ("AFE") for a total completed well costing and estimated \$801,530.00 and to use of its 1982-Joint Operating Agreement with overhead rates of \$6,000/month drilling and \$600/month producing.

(f) Since risk of an unsuccessful completion is very high, the risk penalty to be applied to the compulsory pooled parties who elect to be carried should be set at 200 % of their proportionate share of actual total completed well costs for the following reasons:

(i) while the unorthodox location is superior to the closest standard location, it does not reduce the risk to less than the maximum 200 %;

(ii) there is an absence of well control to the north and east of the location which increases the risk of determining if the location will be in the gross Morrow channel or on the eastern edge;

(iii) being within the gross Morrow channel is still very risky because thickness can range from 4 feet to 88 feet;

(iv) the projected thickness at the proposed location is 28 feet or less within a channel where a number of such wells are non-commercial;

(v) the fact that the proposed location is near two producing Morrow gas wells does not reduce the risk because there are several examples in this channel where a commercial well is offset by a non-commercial well;

(vi) the proposed location is near two wells which appear to be in the same correlative Morrow interval but pressure data indicates that these wells are not in good communication which makes the geologic interpretation speculative and the prospects for this well very risky.

(g) to avoid the drilling of unnecessary wells, to protect correlative rights, to prevent waste and to afford to the owners of each interest in said units the opportunity to recover or receive without unnecessary expense his just and fair share of hydrocarbon production in any pool, the subject application should be approved by compulsory pooling of any working interest owner and/or mineral owner who owned an interest not voluntarily committed to the drilling of this well as of October 13, 1998 (date the application was filed) and any said party's successors, grantees, or assignees.

(16) Approval of the application will afford the applicant the opportunity to produce its just and equitable share of the gas in these formations/pools, will prevent the economic loss caused by the drilling of unnecessary wells, avoid the augmentation of risk arising from the drilling of an excessive number of wells and will otherwise prevent waste

and protect correlative rights.

(17) Pursuant to Section 70-2-17(C) NMSA (1978) and in order to obtain its just and equitable share of potential production underlying this spacing unit, the applicant should be granted an order by the Division pooling the identified and described mineral and/or working interest owners set forth in Finding (4) above (hereinafter "compulsory pooled parties") so as to prevent waste and protect correlative rights for the drilling of the subject well at an unorthodox surface and subsurface location upon terms and conditions which include:

- (a) Nearburg Producing Company be named operator;
- (b) Provisions for all compulsory pooled parties to participate in the costs of drilling, completing, equipping and operating the well;
- (c) In the event a compulsory pooled party fails to timely elect to voluntarily commit its interest and participate pursuant to this order, then said compulsory pooled party's interest is hereby involuntarily committed to participation pursuant to the terms and conditions of the compulsory pooling provisions of this order and shall be deemed a non-consenting owner whose interest shall be carried so the carrying parties can recover out that compulsory pooled party's share of production, that compulsory pooled party's share of the costs of the drilling, completing, equipping and operating the well, including a risk factor penalty of 200 %;
- (d) Provisions for a compulsory pooled party to pay his share of overhead rates per month drilling and per month operating and a provision providing for an adjustment method of the overhead rates as provided by COPAS;

(18) Approval as set forth above 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 Exploration Company, L.L.C. in this case is

hereby **GRANTED** and Nearburg Producing Company is hereby designated operator of the subject well and the corresponding spacing unit.

(2) Each and every compulsory pooled party received actual notice of this hearing in accordance with Division Rule 1207 which the Division finds to have afforded each said party a fair and reasonable opportunity to appear and participate and that none of the compulsory pooled parties appeared and they have waived their rights to object and are **hereby compulsory pooled as set forth herein.**

(3) Effective as of the date of the filing of the application in this case, the interests of the working interest and/or mineral owners ("compulsory pooled parties") identified in Finding () above, including, if any, their assignees, successor and grantees, from the surface to the base of the Morrow formations underlying the following described acreage in Section 11, Township 17 South, Range 25 East, NMPM, Eddy County, New Mexico, **are hereby pooled** for purposes of involuntary commitment to participate in applicant's Eagle Creek "11" Well No. 1 and in the following manner:

the E/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, which presently includes but is not necessarily limited to the South Eagle Creek-Morrow Gas Pool.

(4) Nearburg Producing Company is hereby authorized to drill its Eagle Creek "11" Well No. 1 as a directional wellbore pursuant to Division Rule 111 except that the well is to be located at an unorthodox surface location 1070 feet from the North line and 2110 feet from the West Line (Unit C) of Section 14 and is to be drilled directionally such that at the top of the Morrow formation the subsurface Producing Area and Interval shall not be closer than 660 feet to the south, west or east boundaries of this spacing unit consisting of the E/2 of Section 11, T17S, R25E, NMPM, Eddy County, New Mexico.

PROVIDED HOWEVER THAT:

(5) Applicant's proposed directional drilling-completion program and the corresponding Authority for Expenditures ("AFE") is hereby **APPROVED.**

(6) The terms and conditions of the AAPL Form 610-1982 Model Form Operating Agreement are incorporated herein by reference and shall be binding upon all compulsory pooled parties, **subject to the following:**

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the ____th day of ____, 1998, and shall thereafter

continue the drilling of said well with due diligence to a depth sufficient to test both the Morrow formation.

PROVIDED FURTHER THAT, in the event said operator does not commence the drilling of said well on or before the ____th day of _____, 1999, Decretory Paragraph No. (____) 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 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Decretory Paragraph No. (2) of this order should not be rescinded.

(7) After the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish the Division and each compulsory pooled party in the subject unit an itemized schedule of estimated well costs.

(8) Within 30 days from the date the schedule of estimated well costs is furnished to him, any compulsory pooled party 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 compulsory pooled party who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk factor penalty charges.

(9) The operator shall furnish the Division and each compulsory pooled party with 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.

(10) Within 60 days following determination of reasonable well costs, any compulsory pooled party 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.

(11) The operator is hereby authorized to withhold from the compulsory pooled party the following costs and charges from production:

- A. The pro rata share of reasonable well costs attributable to each compulsory pooled party 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 compulsory pooled party who has not paid his share of estimated total completed well costs within 30 days from the date the schedule of estimated costs is furnished to him.

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

(13) \$6,000 per month while drilling and \$600 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 compulsory pooled party, 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 compulsory pooled party's interest.

(14) The operator shall furnish the Division and each compulsory pooled party with an itemized schedule of actual **operating** well costs to be charged on a monthly basis in the form of a joint interest billing within 90 days following completion of the well; if no objection to the actual operating well cost or the joint interest billing 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.

(15) Any unleased mineral interest who is a compulsory pooled party 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.

(16) 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.

(17) 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.

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

(19) The operator of the subject well and units 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.

(20) 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

LORI WROTENBERY,
Director