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RECEIVED
JUN 28 1999
OIL CONSERVATION DIV.

June 24, 1999

New Mexico Oil Conservation Division
2040 South Pacheco
Santa Fe, New Mexico 87505

Attention: Ms. Lori Wrotenbery, Director

Re: Proposed Changes
Rule 104

Dear Ms. Wrotenbery:

It has come to our attention that there has been some concern voiced about the handling of the second well on a spacing unit under the proposed new Rule 104 when there is a Force Pooling Order for the first well. This is a good question that merits some consideration but seems that it can be solved fairly simply. Following are two schools of thought and a compromise.

Well by Well Basis

When working interest owners agree to pool their interest into a spacing unit, for example 320 acres, they sign an Operating Agreement, usually an AAPL 610 form. Article VI of the Operating Agreement provides for proposal of subsequent wells on the "contract area." The proposal for a subsequent well is made by sending an AFE to each party who then has 30 days to elect to either join or go "non-consent" subject to a penalty. The operator then has 60 days to drill the well or a new proposal must be made. A copy of the language from the 1977 AAPL Operating Agreement is attached for your reference.

A Force Pooling Order is similar in that parties being forced pooled are subject to a penalty, usually 200%, as they are in the "non-consent" situation as described above. A second well on the spacing unit subject to a Force Pooling Order could be treated as if it were subject to an Operating Agreement. Therefore, when the second well is proposed to all owners, including those force pooled, the owners would have 30 days to elect to join in the drilling or be subject to the Force Pooling Order, as they were on the first well. This might require the Division to adopt their own "standard" Operating Agreement providing for the 200% penalty (the same as 300% non-consent) and, to avoid an argument over rates, adopt those published by Ernst & Young.

In many years past, Force Pooling Orders were written based on the area being pooled, i.e. the 320 acre spacing unit for a Morrow well. Any subsequent wells drilled on the area therefore would have been subject to the Force Pooling Order. In recent years, orders are written such that the area is pooled but only for the drilling of a specified well. The fear being expressed by industry is that with the change to Rule 104 allowing a second well, a party can be force pooled, thereby bearing no cost or risk, for a first well then propose and participate in a much lower risk second well on the same spacing unit.

Project Basis

To eliminate the possibility of an owner "riding you down" on the first r sky well then coming in on the second, a "project payout" could be used. Force Pooling Orders could again be written on an area basis rather than a single well. If the initial well has not recovered its cost plus penalty under the force pooling (payout), the second well costs would be accumulated with the first well. Combined revenues from both wells would apply to payout on a "project" basis.

One problem with the "project payout" basis occurs when a poor first well is drilled, one that will never payout or will take many years to payout. We are somewhat uncomfortable with the equities of keeping parties under a Force Pooling penalty for a new well when the original well has not paid out for 10 years.

In either the Project Basis or Well by Well Basis, if the first well pays out before the second well is drilled, then all owners are back into their original interests and the penalty / payout provisions of the Order is no longer in effect.

Compromise

We suggest that the Commission adopt a compromise composed of both the Project Basis and Well by Well Basis ideas. Force Pooling Orders would be written on a Project Basis for the first seven years. A second well drilled on a force pooled spacing unit within seven years of the Order would allow costs and revenues to be accumulated for payout. After seven years, the second well would be proposed on the Well by Well Basis and force pooled owners would have an election to participate or be Force Pooled on the well. The theory here is that if a well has not paid out in 7 years, it isn't very good, so let's go on with something else.

We are very pleased that the New Mexico Oil Conservation Commission is considering the currently proposed Rule 104 changes and believe that the changes will greatly benefit the State of New Mexico and smooth the regulatory process for industry. We therefore strongly recommend and encourage the Commission to adopt the proposed changes to Rule 104.

Thank you for the opportunity to comment and should you wish to discuss this further, please do not hesitate to contact me.

Very truly yours,

YATES PETROLEUM CORPORATION

Randy G. Patterson
Land Manager

RGP/mw

Enclosure

cc: Tom Kellahin
Rick Foppiano - Oxy USA, Inc.
Bob Shelton - Nearburg Exploration Company
Curtis Smith - Santa Fe Energy Resources, Inc.
Bill Carr