

**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 NOS. 10467
10473
Order No. R-9678**

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

**APPLICATION OF NEARBURG EXPLORATION
COMPANY FOR COMPULSORY POOLING AND
AN UNORTHODOX GAS WELL LOCATION, EDDY
COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on April 30, 1992, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 3rd day of June, 1992, 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) Division Case Nos. 10467 and 10473 were consolidated at the time of the hearing for the purpose of testimony, and, inasmuch as approval of one application would necessarily require denial of the other, one order should be entered for both cases.

(3) The applicant in Case No. 10467, Yates Petroleum Corporation (Yates), seeks an order pooling all mineral interests from a depth of 5,000 feet below the surface to the base of the Morrow formation underlying the N/2 of Section 27, Township 18 South, Range 27 East, NMPM, Eddy County, New Mexico, forming 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 Red Lake Atoka-Morrow Gas Pool. Said unit is to be dedicated to a well to be drilled at an unorthodox gas well location 660 feet from the North line and 1330 feet from the East line (Unit B) of said Section 27.

(4) The applicant in Case No. 10473, Nearburg Exploration Company (Nearburg), seeks an order pooling all mineral interests from the base of the Wolfcamp formation to the base of the Morrow formation underlying the N/2 of Section 27, Township 18 South, Range 27 East, NMPM, Eddy County, New Mexico, forming 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 Red Lake Atoka-Morrow Gas Pool. Said unit is to be dedicated to a well to be drilled at an unorthodox gas well location 660 feet from the North line and 1330 feet from the East line (Unit B) of said Section 27.

(5) *At the commencement of the hearing in the subject cases, Nearburg stated that it had discovered an operating agreement for the subject acreage effective March 7, 1967 which was executed by Sinclair Oil Corporation, being the predecessor leasehold owner to Nearburg, and John H. and Pauline V. Trigg, being the predecessor leasehold owner to Yates and its various interest owners, and requested a continuance for the purpose of allowing Yates the opportunity to review the document. Yates stated that it had reviewed the operating agreement and that a continuance for that purpose was unnecessary.*

FINDING: Nearburg's request for continuance was denied by the Examiner.

(6) *Both Yates and Nearburg contend that the Division does not have the jurisdiction to determine whether or not the operating agreement is in effect and whether the interests of parties in this matter are subject to this agreement. However, the provision of the compulsory pooling statute may be invoked only when there is a party who has not agreed to participate. Any decision by the Division, including a decision not to act, necessarily requires a determination about the applicability of the operating agreement.*

FINDING: The Division is empowered and required to determine if there is an interest which is subject to pooling under the statute, based upon law and evidence in the record, including a necessary determination of whether the interests are subject to an agreement.

(7) Yates contends that its interest is not subject to the operating agreement. Nearburg contends that the interests of the parties and operations of the subject lands are governed by the terms of the operating agreement. Only one well has been drilled on the lands subject to the operating agreement, and it has been subsequently plugged and abandoned, raising the question of whether or not the agreement is still in effect.

FINDING: There is a dispute between the parties with respect to the drilling and operation of a well and formation of a proration unit such that the Division has an issue within its jurisdiction and can properly enter an order pooling the interests of the parties, absent some determination by a court of competent jurisdiction that the agreement controls.

(8) Nearburg's contention is that the operating agreement purports to encumber a real property interest and bind that interest by its terms. The operating agreement was not of record in Eddy County, New Mexico, and neither party apparently knew of its existence or terms until after the competing applications were filed but prior to the hearing.

FINDING: The unrecorded operating agreement does not encumber the interest of a party who does not have knowledge of it.

(9) Both Yates and Nearburg have the right to drill a well in Section 27, both seek to be designated the operator of the proposed proration unit, and both seek the adoption of drilling and production overhead charges and risk penalties.

(10) The proposed well is located within the Red Lake Atoka-Morrow Gas Pool which is currently governed by Division General Rule No. 104 (C)(2), which requires standard 320-acre spacing and proration units with wells to be located no closer than 660 feet from the nearest side boundary nor closer than 1980 feet from the nearest end boundary of the proration unit nor closer than 330 feet from any quarter-quarter section line or subdivision inner boundary.

(11) According to evidence presented, the working interest ownership within the N/2 of Section 27 is currently distributed as follows: Yates Petroleum Corporation - 10.5%; Various Yates entities - 15.75%; 6 various other interest owners - 23.75%; Nearburg Exploration Company - 50%.

(12) The drilling prospect for the N/2 of Section 27 was initially developed by David Cromwell, a consulting geologist who currently owns a 3.125% working interest in the subject acreage.

(13) According to further evidence, Yates Petroleum Corporation is supported in its application by all of the various working interest owners with the exception of Nearburg. Yates and Nearburg therefore effectively each control 50% of the working interest in the subject acreage.

(14) Yates and Nearburg have been unable to reach an agreement on who will drill and operate the proposed well.

(15) The proposed AFE's submitted by Yates and Nearburg in these cases reflect very similar drilling costs.

(16) In addition, both Yates and Nearburg proposed identical risk penalties and overhead rates (charges for supervision).

(17) Nearburg initially proposed the drilling of its well to the Trigg Family Trust on February 11, 1992. Yates initially proposed the drilling of its well to Nearburg and the various other interest owners on March 24, 1992.

(18) In support of its request for an unorthodox gas well location, Yates presented geologic evidence and testimony which indicates that a well drilled at the proposed location should penetrate the Pennsylvanian formation at a more structurally favorable position and in an area of greater net sand thickness in the Morrow formation than would a well drilled at a standard well location thereon, thereby increasing the likelihood of obtaining commercial production.

(19) Nearburg did not present its own geologic evidence at the hearing but disputed Yates' geologic interpretation and the necessity for drilling an unorthodox location.

(20) Nearburg proposed that as operator of the proposed proration unit, it would drill either the proposed unorthodox location or a standard well location.

(21) The geologic evidence presented does indicate that a well at the proposed location will better enable the operator to produce the oil and gas reserves underlying the N/2 of Section 27.

(22) No offset operator and/or interest owner appeared at the hearing in opposition to the proposed unorthodox location.

(23) According to further evidence and testimony in this case, David Cromwell, recognizing the potential for Pennsylvanian production in Section 22, north of the subject acreage, put together a prospect for the reentry of the plugged and abandoned Chalk "AKH" Federal Com Well No. 1 located 1980 feet from the South line and 660 feet from the East line (Unit I) of Section 22, during 1991.

(24) Mr. Cromwell initially sought the participation of Nearburg to reenter and operate the well. Nearburg declined to participate.

(25) Mr. Cromwell sold this prospect to Bettis Brothers who subsequently sold it to Yates. Yates is currently in the process of completing the aforesaid Chalk "AKH" Federal Com Well No. 1.

(26) Yates has exhibited a greater willingness to take the risks associated with the reentry of the aforesaid well, which, if completed as a producer, will help prove the acreage in the N/2 of Section 27.

(27) Yates appears to have a better understanding of engineering well design and drilling costs associated with Upper Pennsylvanian completions as evidenced by the fact that Nearburg's initial AFE was considerably higher than Yates', but was adjusted for the hearing apparently after reviewing Yates' AFE.

(28) Although the proposed well location is not generally in dispute in this case, Yates presented extensive geologic evidence and testimony and appears to have a better understanding of the geology in the Pennsylvanian formation underlying the subject acreage.

(29) Yates Petroleum Corporation should be designated the operator of the subject well and unit.

(30) The application of Nearburg Exploration Company should be denied.

(31) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford to 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 completion resulting from this order, the application of Yates Petroleum Corporation should be approved by pooling all mineral interests, whatever they may be, within said unit.

(32) 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.

(33) 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 the drilling of the well.

(34) 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.

(35) 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.

(36) \$5000.00 per month while drilling and \$500.00 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.

(37) 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.

(38) Upon the failure of the operator of said pooled unit to commence the drilling of the well to which said unit is dedicated on or before September 1, 1992, the order pooling said unit should become null and void and of no effect whatsoever.

(39) 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.

(40) 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 Nearburg Exploration Company for an order pooling all mineral interests from the base of the Wolfcamp formation to the base of the Morrow formation underlying the N/2 of Section 27, Township 18 South, Range 27 East, NMPM, Eddy County, New Mexico, forming 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 to be dedicated to a well to be drilled at an unorthodox gas well location 660 feet from the North line and 1330 feet from the East line (Unit B) of said Section 27, is hereby denied.

(2) All mineral interests, whatever they may be, from a depth of 5,000 feet below the surface to the base of the Morrow formation underlying the N/2 of Section 27, Township 18 South, Range 27 East, NMPM, Eddy County, New Mexico, are hereby pooled forming 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 Red Lake Atoka-Morrow Gas Pool. Said unit shall be dedicated to a well to be drilled at an unorthodox gas well location, also hereby approved, 660 feet from the North line and 1330 feet from the East line (Unit B) of said Section 27.

PROVIDED HOWEVER THAT, the operator of said unit shall commence the drilling of said well on or before the 1st day of September, 1992, 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 the drilling of said well on or before the 1st day of September, 1992, Ordering Paragraph No. (2) 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. (2) of this order should not be rescinded.

(3) Yates Petroleum Corporation 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 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.

(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.

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(10) \$5000.00 per month while drilling and \$500.00 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.

(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.

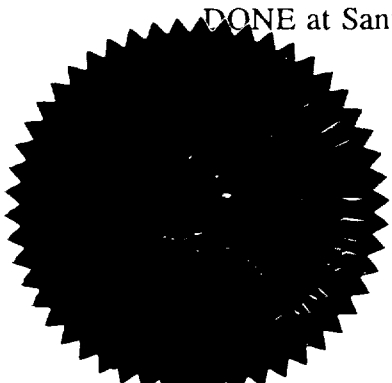
(13) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Eddy County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; the operator shall notify the Division of the name and address of said 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.

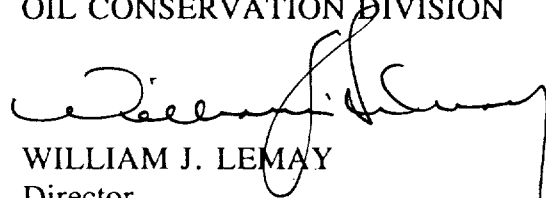
(15) The operator of the well and unit shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(16) Jurisdiction is hereby retained for the entry of such further orders as the 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