

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. 10513
ORDER NO. R-9480-C

**APPLICATION OF HANLEY PETROLEUM, INC. FOR DETERMINATION OF
REASONABLE WELL COSTS, LEA COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on June 17, 1993 and again on September 23, 1993, at Santa Fe, New Mexico, before Examiner David R. Catanach and thereafter docketed for hearing on December 5, 1996 before Examiner Michael E. Stogner.

NOW, on this 21st day of March, 1997, 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) By Order No. R-9480, issued in consolidated Case Nos. 10211 and 10219 (heard before Examiner Jim Morrow on **March 7, 1991**) and dated **March 29, 1991**, the New Mexico Oil Conservation Division ("Division") authorized the compulsory pooling of all mineral interests, whatever they may be, from the surface to the base of the Wolfcamp formation underlying the W/2 NW/4 of Section 8, Township 18 South, Range 33 East, NMPM, Lea County, New Mexico, thereby forming a standard 80-acre oil spacing and proration unit for any and all pools developed on 80-acre spacing within said vertical extent, which at the time included only the Undesignated South Corbin Wolfcamp Pool and dedicating said unit to a well to be drilled at a standard oil well location in the SW/4 NW/4 (Unit E) of said Section 8. Said Order No. R-9480 included provisions that: (i) named Santa Fe Energy Operating Partners, L.P., now known as Santa Fe Energy Resources, Inc. ("Santa Fe Energy"), the applicant in Case 10211, the operator of the subject well and 80-acre unit; (ii) assessed a 100% risk penalty factor for the drilling of said well; (iii) allotted \$5,184.00 per month while drilling and \$485.00 per month while producing as reasonable overhead charges; (iv) provided for Santa Fe Energy to commence the drilling of the proposed well on or before **June 15, 1991**; and, (v) denied the corresponding application

for the pooling of the same acreage by Hanley Petroleum, Inc. ("Hanley") in Case 10219.

(2) On **April 10, 1991** the Division Director issued Order No. R-9480-A, being an *ORDER OF THE DIVISION STAYING ORDER NO. R-9480*, which placed said Order No. R-9480 in abeyance for an indeterminate period of time.

(3) Subsequent to a de novo hearing before the New Mexico Oil Conservation Commission ("Commission") on **May 9, 1991** Order No. R-9480-B, dated **June 12, 1991**: (i) lifted the stay placed on Division Order No. R-9480 by Order No. R-9480-A; (ii) adopted said Order R-9480 as the order of the Commission; and, (iii) established **September 15, 1991** as the new drilling commencement date for Order No. R-9480.

(4) On **September 12, 1991** Santa Fe Energy spudded its Kachina "8" Federal Well No. 2 (**API No. 30-025-31371**) at a standard oil well location in the 80-acre unit comprising the W/2 NW/4 of said Section 8, 1830 feet from the North line and 660 feet from the West line (Unit E) of said Section 8.

(5) On **June 17, 1993**, the Division commenced a hearing on the immediate case called upon the application of Hanley for a determination by the Division of reasonable well costs in accordance with the terms of said compulsory pooling Order No. R-9480, as amended.

(6) At this hearing the parties commenced presenting evidence concerning certain unresolved audit exceptions still in dispute between Santa Fe Energy, the operator, and Hanley, the non-operating working interest owner.

(7) Of particular interest was a dispute involving the billing by the operator to those non-operating working interest owners for their share of \$91,670.10 expended by Santa Fe Energy on the Kachina "8" Federal Well No. 2 to repair the 24 pounds per foot with couplings ("ppf") 8-5/8 inch intermediate casing string which ultimately failed.

(8) At the original pooling hearing on **March 7, 1991** Hanley submitted an Authorization For Expenditure ("AFE") which proposed, among other things, the use of 900 feet of 32 ppf strength 8-5/8 inch intermediate casing which would cost \$2,610.00 more than the 24 ppf strength 8-5/8 inch intermediate casing which Santa Fe Energy's AFE proposed.

(9) On **June 20, 1991**, Santa Fe Energy sent a letter to Hanley, with an AFE, notifying Hanley of its right to make an election to participate under the compulsory pooling Order No. R-9480, as amended, as a consenting party. The Santa Fe Energy AFE itemized the use of 24 ppf strength 8-5/8 inch intermediate casing at a cost of \$36,804.00.

(10) On **June 25, 1991**, Santa Fe Energy sent another letter to Hanley advising Hanley it had until **July 21, 1991** to make its election.

(11) On **July 1, 1991**, Hanley sent a letter to Santa Fe Energy expressing its concern over the strength of the weaker casing. On **July 9, 1991**, Hanley attempted to contact Santa Fe Energy about this issue and on **July 12, 1991** was told an answer would be coming.

(12) In order to be a consenting party, Hanley had to make its election by Sunday, **July 21, 1991**.

(13) Despite its efforts, Hanley had not received a response from Santa Fe Energy concerning the casing strength issue and on Friday, **July 19, 1991** signed the AFE and forwarded it to Santa Fe Energy in order to make a timely election to join in the well.

(14) On **September 12, 1991**, while drilling, the 8-5/8 inch intermediate casing string collapsed.

(15) During the **June 17, 1993** proceedings in the immediate case, Examiner Catanach caused this matter to be continued to the **September 23, 1993** Examiners hearing, when the Division suspended any further proceedings pending a ruling by the Division on the following issue:

"What, if anything, is the effect of Hanley having signed the Santa Fe Energy "AFE" which included the costs for the intermediate casing string at a casing-strength which Hanley had told Santa Fe was too weak and which later failed?"

(16) Hanley contended that its signature on the Santa Fe Energy AFE was gratuitous, not necessary for the exercise of its election to participate under the pooling order and did not constitute approval for the use of the disputed casing material specified in Santa Fe Energy's AFE.

(17) Santa Fe Energy contended that Hanley's signature on the AFE constituted a waiver of any objection to the grade of casing used in the wellbore.

(18) By letter dated **June 2, 1995**, the counsel for the Division finally ruled that:

"The Division will treat Hanley's election under the

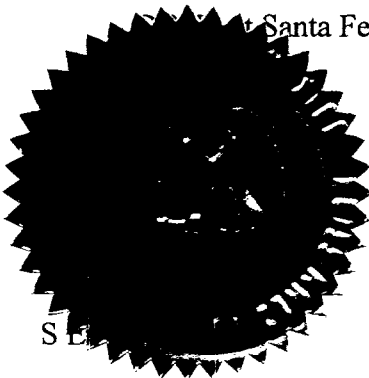
compulsory pooling order and its signing the AFE as Hanley's assent to the casing strength listed on that AFE which will foreclose Hanley from later questioning Santa Fe's decision to use that casing. Hanley's election under the compulsory pooling order evidenced its agreement to pay for its share of well costs and for that purpose was the equivalent of signing an operating agreement. The AFE will be treated as part of that agreement as it sets forth the types of costs to which the parties agreed although the amounts may later be adjusted. The OCD does not believe that signing an AFE while maintaining unexpressed reservations about certain costs should preserve Hanley's right to later contest those costs."

(19) In **October, 1996**, Hanley advised the Division that it desired to have this matter dismissed.

IT IS THEREFORE ORDERED THAT:

(1) The application of Hanley Petroleum, Inc. in Case 10513, as a working interest owner in the Santa Fe Energy Resources, Inc. (formerly Santa Fe Energy Operating Partners, L.P.) Kachina "8" Federal Well No. 2 (**API No. 30-025-31371**) located at a standard oil well location 1830 feet from the North line and 660 feet from the West line (Unit E) of Section 8, Township 18 South, Range 33 East, NMPM, Lea County, New Mexico, for a determination by the Division of reasonable well costs in accordance with the terms of a compulsory pooling order issued by the Division as Order No. R-9480, as amended, is hereby **dismissed**.

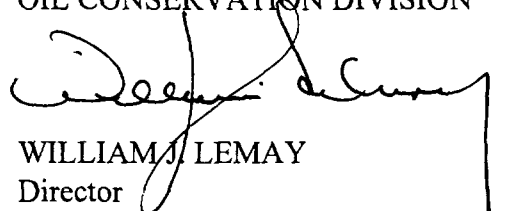
(2) Jurisdiction of this cause is retained for the entry of such further orders as the Division may deem necessary.



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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION


WILLIAM J. LEMAY
Director