

**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. 12008
Order No. R-10764-A*

**APPLICATION OF ROBERT E. LANDRETH FOR A DETERMINATION OF
REASONABLE WELL COSTS, LEA COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on June 12, 1999, at Santa Fe, New Mexico, before Examiner Rand Carroll.

NOW, on this 30th day of August, 1999, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, Robert E. Landreth, seeks a determination as to what costs may reasonably be withheld from the share of production attributable to applicant's working interest in the Gaucho Unit Well No. 2-Y pursuant to Order No. R-10764. Applicant's position is that Order No. R-10764, a compulsory pooling order, only applies to the Gaucho Unit Well No. 2 (API No. 30-025-33682) drilled by the operator, Santa Fe Energy Resources (Santa Fe), pursuant to that order and not to the Gaucho Unit Well No. 2-Y (API No. 30-025-33682) drilled by Santa Fe 75 feet from the Well No. 2 when problems were encountered with the Well No. 2.

(3) Applicant is the owner of a 37.5% working interest (WI) in the 320-acre spacing unit pooled under Order No. R-10764. Applicant voluntarily agreed to participate as to 25% of that 37.5% WI (9.375% WI) in both wells and signed a Joint Operating Agreement (JOA) as to that interest. The commitment of the remaining 75% of applicant's WI (28.125% WI) is subject to dispute. Santa Fe asserts that due to applicant signing the JOA, which references all of applicant's 37.5% WI after payout, the JOA governs the 28.125% WI too. Applicant asserts he expressly excluded that 28.125% WI from the JOA and that interest is subject to Order No. R-10764 for the Well No. 2 only.

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(4) The Division does not interpret the JOA signed by Landreth as committing his remaining 28.125% interest under the JOA.

(5) The effect of a determination that Order No. 10764 applies only to the Well No. 2 would be that Santa Fe drilled the Well No. 2-Y without obtaining either a voluntary agreement from the applicant or a compulsory pooling order for applicant's nonparticipating 28.125% WI. Santa Fe would not be able to recover the costs of the Well No. 2 from the applicant, who was compulsory pooled but elected not to participate in the Well No. 2 with his 28.125% WI. Santa Fe would have also advanced the costs allocable to the applicant's non-participating 28.125% WI in the Well No. 2-Y without any risk to the applicant—i.e., applicant would owe nothing if the Well No. 2-Y was non-productive and his share of costs would only be recoupable from his share of production if the well was productive

(6) In approximate round dollar amounts (using a \$2,500,000 total cost for both wells—\$730,000 for the Well No. 2 and \$1,770,000 for the Well No. 2-Y), applicant voluntarily paid in advance \$235,000 (his 9.375% WI share voluntarily committed under the JOA—\$68,500 for the Well No. 2 and \$166,000 for the Well No. 2-Y). The costs that could be allocable to applicant's nonparticipating 28.125% WI total \$703,000 (\$205,000 for the Well No. 2 and \$498,000 for the Well No. 2-Y). The risk penalties (at 200%) that could be applicable to the 28.125% WI would be \$1,406,000 (\$410,000 for the Well No. 2 and \$996,000 for the Well No. 2-Y).

(7) Under applicant's proposal, applicant will pay: (i) the \$235,000 allocable to his 9.375% WI voluntarily committed to both wells; (ii) \$0 allocable to his 28.125% nonparticipating WI in the Well No. 2 since it never produced (there was no revenue to pay the costs or risk penalty); and (iii) \$498,000 allocable to his 28.125% nonparticipating WI in the Well No. 2-Y (his share of costs paid out of production, with no risk penalty, since he asserts Order No. R-10764 does not apply to the Well No. 2-Y). Applicant will thus pay \$733,000 out of a total cost of \$2,500,000 (29.3% as compared to his WI of 37.5%) with \$498,000 of those costs risk free to him (i.e., if there is no production, he does not pay those costs).

(8) Under Santa Fe's proposal, applicant will pay: (i) the \$235,000 (9.375% WI) voluntarily committed to both wells, (ii) \$703,000 for applicant's 28.125% share of the costs of both the Well No. 2 and Well No. 2-Y, payable only out of production, and (iii) \$1,406,000 in risk penalties (200% of \$703,000), payable only out of production. Applicant will thus pay \$2,344,000 out of a total cost of \$2,500,000 (94% as compared to his 37.5% WI).



(9) Risk penalties are imposed to compensate the parties advancing costs for the risk they assume in advancing costs with no assurance that those costs will be repaid. Risk penalties are also imposed to penalize those parties electing not to pay their costs in advance, thus forcing the other parties to advance those costs on their behalf. With risk penalties imposed, parties frequently pay much more in costs than their WI ownership would indicate.

(10) Applicant had the right and opportunity to avoid the imposition of a risk penalty by voluntarily paying his 37.5% share of costs. For whatever reason, he elected to pay only 9.375% of his share of costs.

(11) The Division uses the well designation Y or X after a well number to signify that the well is a replacement or substitute well for that numbered well.

(12) For purposes of compulsory pooling orders, the Division will treat a replacement or substitute well as the numbered well listed in the compulsory pooling order. Order No. R-10764 will thus apply to both the Gaucho Unit Well No. 2 and the Gaucho Unit Well No. 2-Y. The existence of separate API numbers does not alter the fact that the substitute/replacement "skid" well is a continuation of the first wellbore. A "skid well" is a well drilled after (i) problems are encountered with the original wellbore requiring abandonment of that wellbore prior to completion in the targeted reservoir, and (ii) the drilling rig is skidded over a short distance and a new wellbore is drilled to the same approximate position in the targeted reservoir.

(13) Applicant did not contest the prudence of abandoning the first wellbore, skidding the drilling rig over 75 feet and drilling a new hole. He only contested the applicability of Order No. R-10764 to the second wellbore. If the first well encountered problems costing an extra necessary \$770,000 but was completed as a prolific producer, applicant could not raise the issue he is raising here—under that scenario, he would be paying the costs and risk penalty allocable to his 28.125% nonparticipating WI. The Division sees no reason for treating this situation differently than that situation.

(14) Applicant asserts that Santa Fe should have obtained an amendment to Order No. R-10764 to include the Well No. 2-Y. Since Santa Fe was in the middle of drilling, it is doubtful it could have obtained an amended order until after the well was drilled. The Division finds it unnecessary to obtain an amended order in this type of situation. As stated above, the Division will treat a substitute/replacement "skid" well with the X or Y designation after the well number as that numbered well for purposes of a compulsory pooling order. The assignment of a separate API number in this type of situation is for recordkeeping purposes, i.e., the Division needs to keep a record of a 3700 foot hole in the ground.

IT IS THEREFORE ORDERED THAT:

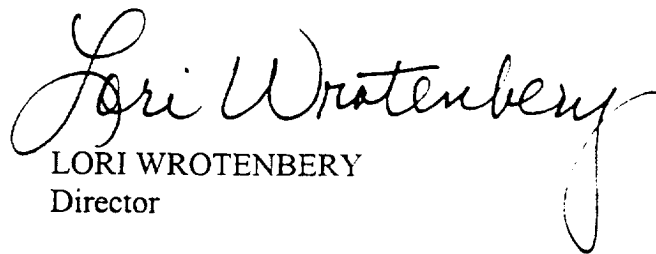
(1) For the above-stated reasons, the Division will treat the Gaucho Well No. 2-Y drilled and operated by Santa Fe Energy Resources as a continuation of the Gaucho Well No. 2 referenced in Order No. R-10764.

(2) All the provisions of Order No. R-10764 shall apply to both the Gaucho Well No. 2 and the Gaucho Well No. 2-Y.

(3) Jurisdiction of this case 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

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