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2004 SEP 29 PM 2 37

September 29, 2004

**VIA HAND DELIVERY**

Mark E. Fesmire, P.E.
Director
Oil Conservation Division
1221 South Saint Francis Drive
Santa Fe, New Mexico 87505

**Re: Case 13153 (De Novo): Application of Pride Energy Company for cancellation of a drilling permit and re-instatement of a drilling permit, an emergency order halting operations, and compulsory pooling, Lea County, New Mexico. Oil Conservation Commission Order No. R-12108-A**

Dear Mr. Fesmire:

Enclosed is the Application for Rehearing of Yates Petroleum Corporation in the above-referenced case. Yates seeks a rehearing on Order No. R-12108-A that was entered by the Commission on September 9, 2004.

Your consideration of this matter is appreciated.

Very truly yours,

William F. Carr

Enclosure

cc: Mr. Randy Patterson
David K. Brooks, Esq.
James G. Bruce, Esq.

**STATE OF NEW MEXICO**
**ENERGY, MINERALS AND NATURAL RESOURCES DEPARTMENT**
**OIL CONSERVATION COMMISSION**

**IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION COMMISSION FOR THE PURPOSE OF CONSIDERING:**

**APPLICATION OF PRIDE ENERGY COMPANY FOR CANCELLATION OF A DRILLING PERMIT AND RE-INSTATEMENT OF A DRILLING PERMIT, AN EMERGENCY ORDER HALTING OPERATIONS, AND COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.**

2004 SEP 29 PM 2 37

**CASE NO. 13153 (DE NOVO)**
**ORDER NO. R-12108-A**

## APPLICATION FOR REHEARING OF YATES PETROLEUM CORPORATION

This Application for Rehearing is submitted by William F. Carr, Esq. of Holland & Hart, LLP on behalf of Yates Petroleum Corporation ("Yates"), a party of record adversely affected by Commission Order No. R-12108-A.

In accordance with the provisions of N.M.S.A. § 70-2-25 (2004), Yates Petroleum Corporation requests the New Mexico Oil Conservation Commission grant this Application for Rehearing in Case No. 13153 (De Novo) to correct the erroneous findings, conclusions and orders of Order No. R-12108-A, and in support of this Application for Rehearing states:

## INTRODUCTION

On September 9, 2004, the New Mexico Oil Conservation Commission entered its decision in this case and in so doing the Commission made procedural, factual and legal errors that require a rehearing be held on the issues presented to it.

To reach its decision, the Commission applied different standards to the evidence presented by each party. It rejected competent technical evidence presented by Yates in favor of evidence that was identified by Pride but not presented because Pride considered it to be "proprietary." To enter this order and thereby violate the correlative rights of Yates, this Commission rejected competent evidence in favor of mere speculation.

The Commission's findings on the role and significance of an Application for Permit to Drill are contrary to law and Commission precedent.

With this decision, the Commission departed from Division precedent and forced pooled the lands of Yates without the requisite showing by Pride that it had made a good faith effort to reach a voluntary agreement with Yates for the development of these lands or had a right to re-enter the well. This order does not constitute a proper exercise of the police power of the state and amounts to an arbitrary taking of the rights and interests of Yates.

The Commission, as well as Pride, recognize that Yates had commenced the re-entry of the subject well pursuant to a valid, Divison-approved Application for Permit to Drill and that Yates owned 100% of the tract on which the well was located and 100% of the spacing unit then dedicated to the well. However, while purporting to allow Yates to recover the actual costs incurred by Yates in its efforts to re-enter a well, the Commission imposes limitations on Yates recovery of these funds that prevent Yates from receiving from Pride much of the actual costs it incurred. This arbitrary, capricious and unreasonable act by the Commission results in Yates not only having to give to Pride reserves that Pride does not own and has no right to share under the Oil and Gas Act but also requires Yates to subsidize Pride's work on this well.

In its hurry to rule against Yates, the Commission has entered findings that fail to meet basic standards for orders of administrative commissions. The findings are convoluted and simply misstate even what the Commission appears to be trying to do. If the Commission is determined to take constitutionally protected property interests from Yates with a decision that violates its statutory duties, at least its Order should clearly disclose its reasoning in rejecting the evidence presented by the parties and its decision on the correlative rights issue.

## GROUNDS FOR REHEARING

> An order will be reviewed if it is arbitrary, capricious, or an abuse of discretion; not supported by substantial evidence in the record; or, otherwise not in accordance with the law. A ruling by an administrative agency is arbitrary and capricious if it is unreasonable or without a rational basis, when viewed in light of the whole record. *Sierra Club v. New Mexico Mining Comm'n*, 133 N.M. 97, 61 P.3d 806, 813 (N.M. 2002).

As grounds for rehearing, Yates asserts that Order No. R-12108-A is erroneous in the following ways:

## POINT I

## ORDER NO. R-12108-A IS CONTRARY TO LAW FOR IT VIOLATES THE COMMISSION'S STATUTORY DUTY TO PROTECT THE CORRELATIVE RIGHTS OF YATES.

> "The Oil Conservation Commission is a creature of statute, expressly defined, limited and empowered by the laws creating it." *Continental Oil Co. v. Oil Conservation Com'n.* 70 N.M. 310, 373 P.2d 809 (N.M. 1962).
>
> "Where rulings by administrative agencies are not in accord with the basic requirements of the statutes relating to those agencies, the decisions of the agencies are void." *Foster v. Bd. of Dentistry*, 103 N.M. 776, 714 P.2d 580 (N.M. 1986).

The **central issue** in this case involves the protection of the correlative rights of the interest owners in Section 12.[1] "Correlative rights" is defined by the Oil and Gas Act as follows:

> Correlative rights means the opportunity afforded, so far as it is practicable to do so, **to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas or both in the pool**, being an amount, so far as can be practicably determined and so far as can be practicably obtained without waste, **substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool** and, for such purpose, to use his just and equitable share of the reservoir energy. N.M.S.A. § 70-2-33.H (2004) (emphasis added).

There is a dispute between the technical presentations of the parties concerning the extent of the target reservoir and the orientation of the Mississippian formation under Section 12. Pride contends that the formation trends north-south because of a fault it asserts runs along the western boundary of the Section. (Pride Exhibit 6, Testimony of Ellard at Tr. at 87, 93). Pride therefore testifies that the SW/4 of this section should contain commercial reserves. However, Pride admits that it is impossible to determine with any degree of accuracy the extent of the target reservoir with the information presently available. (Finding 1, Testimony of Ellard, Tr. 83)

Yates 3-D seismic evidence shows the fault upon which Pride relies does not exist. (Yates Exhibit 12, Testimony of Amiet, Tr. at 130-131). Yates evidence shows this reservoir to have been deposited as an alluvial fan extending across the N/2 of the Section. Yates evidence shows the NE/4 of the section to be productive. (Yates Exhibit 7, Testimony of Amiet, Tr. at 123-124).

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[1] There is no waste issue in this case since both parties desire to re-enter the well on the Yates lease and re-complete the well in the Upper Mississippian formation.

While the parties may disagree about the size and shape of this reservoir, they agree that current information on the reservoir shows that most if not all of the recoverable reserves under this acreage are found under the NW/4 of Section 12. Both Pride and Yates believe that is where a well should be drilled. Yates testified that as much as 97% of the recoverable reserves will come from the Yates tract in the NW/4 of the section. (Yates Exhibits 13 through 19, Testimony of Boneau, Tr. at 168-169). Pride testified that the NW/4 should be drilled first (Testimony of Ellard, Tr. at 68), that the SW/4 is much riskier, that Pride never considered drilling there (Testimony of Pride, Tr. at 43), and that there may be no commercial reserves under its tract in the SW/4 of the section. (Testimony of Ellard, Tr. at 90). Both parties admit that depending on the quality of the State "X" Well in the NW/4 of the Section, the other quarter sections in Section 12 may- or may not – contain recoverable reserves. The problem for Pride is that it owns no interest in the NW/4 (Testimony of Pride, Tr. at 39). It is owned 100% by Yates. (Testimony of Moran, Tr at 101).

The Commission is required by statute to afford to each owner in a pool the opportunity to produce its just and equitable share of the recoverable reserves in the pool. N.M.S.A. § 70-2-33.H (2004). However, the statutory definition of correlative rights does not stop there. It also instructs the Commission on how a party's "recoverable reserves" are to be determined. It directs that an owner's share of the recoverable reserves are those reserves under its property. On the record in this case, the known recoverable reserves under this section are located under the NW/4. This property is owned by Yates – not Pride. However, the order entered in this case ignores the rights of Yates and orders that 50% of the reserves from the Yates property be given to Pride. This Order -- its findings and order paragraphs -- is an outright and flagrant violation of the Commission's statutory duty to protect the correlative rights of the owner of each property in this pool.

To rule against Pride could not impair its correlative rights. Pride would still have, as it has had each day since it acquired its lease, the opportunity to drill a well on its land to produce the recoverable reserves under its property.

The Commission cannot hide behind the fact that this formation is developed on 320-acre spacing. The Commission established spacing rules for deep gas in southeast New Mexico and in so doing created a fiction. It knows these wells do not drain 320-acres but instead only 160-acres. To half-way address this fiction, it has authorized a second well on each 320-acre spacing unit thereby endorsing de facto 160-acre spacing patterns for deep gas in Southeast New Mexico. However, the problem with this fiction is that, as here, where there are owners of a property that contains recoverable commercial reserves and an offsetting property owned by another that does not, pooling these lands on 320-acre units takes reserves from the party that owns them and gives these reserves to someone who does not. On its face, this type of action violates the definition of correlative rights.

Until the Commission creates 160-acre non-standard units in this situation, something it has been unwilling to do, its pooling orders result in a situation where the operator who

does not own the tract containing recoverable reserves can use the rules of the Commission to take reserves from another.

Order No. R-12108-A denies Yates its just and equitable share of the recoverable reserves under its property and therefore violates the Commission's statutory duties under the Oil and Gas Act. N.M.S.A § 70-2-33.H (2004).

## POINT II

## THE COMMISSION'S DECISION THAT THE ORDER PROTECTS THE CORRELATIVE RIGHTS OF YATES IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE.

> "Substantial evidence is relevant evidence that a reasonable person might accept as adequate to support a conclusion." *In Matter of Application of PNM Electric Services v. NM Public Utility Comm'n*, 125 NM 302, 961 P.2d 147, 153 (N.M. 1998); *Viking Petroleum, Inc. v. Oil Conservation* Comm'n, 100 N.M. 451, 453, 672 P.2d 280, 282 (N.M. 1983).
>
> A ruling by an administrative agency is arbitrary and capricious if it is unreasonable or without a rational basis, when viewed in light of the whole record. *Sierra Club v. New Mexico Mining Comm'n*, 133 N.M. 97, 61 P.3d 806, 813 (N.M. 2002).
>
> "New Mexico standard of proof applied in administrative proceedings, with few exceptions is a preponderance of the evidence." *Foster v. Bd. of Dentistry*, 103 N.M. 776, 714 P.2d 580 (N.M. 1986).

The Commission determined that its decision in this case must be based on its evaluation of the technical evidence presented in support of, and against, Pride's compulsory pooling application. (**Finding 32**).

Pride's Technical Case:

Pride's technical case consisted of a geological presentation. Its case rests on two things: (1) the existence of a fault running north – south through the W/2 of Section 12 (**Findings 9 and 10**), and; (2) fracturing along that fault that increases the porosity and permeability of the formation. (**Finding 8**).

Jeff Ellard, Pride's geologist, presented a structure map, two cross sections and four log sections. (Pride Exhibits 6 through 12). His interpretation showed the Mississippian formation under Section 12 trending along a fault running north-south on the west side of the section. Mr. Ellard's interpretation is premised on the existence of this fault. He testified that it was important to be close to the fault to find commercial reservoir (Tr. at 87) for the fault not only affected the direction of permeability (Tr. at 93) but the formation close to the fault is where you encounter fracturing which increases porosity

and permeability. (Tr. at 63). He also testified that his interpretation of the "old-style log" on the State "X" Well No. 1 showed as much as 25 feet of reservoir rock in this well and that it was therefore comparable to the offsetting State "M" Well No. 1 that was a commercial well in this formation. (Tr. at 65).

Mr. Ellard's other exhibits consisted of cross sections and log sections. He agreed there was limited data on the size of the reservoir (Tr. at 83) and that all logs on these exhibits, other than the new neutron density log on the State "M" Well No. 1 in Section 1 and the old electric log on the State "X" Well No. 1 in Section 12, only showed the absence of the reservoir at those locations. (See Exhibits 7 through 12, Tr. at 66 through 85).

Yates Technical Case:

Yates interprets this reservoir to be an alluvial fan extending across the N/2 of Section 12. Yates evidence shows the fault and the fracturing upon which Pride's case is built, do not exist.

Yates' case consisted of geological and engineering presentations. John Amiet, Yates geologist, presented a structure map, a cross section, an isopach map, a section of the old electric log on the State "M" Well No. 1, a seismic cross section and related supporting exhibits that he had prepared on the top of the Austin member of the subject Mississippian formation (Yates Exhibits 5, 6, 7, 10 and 12). These maps were prepared from well data and seismic information. Contrary to Pride's presentation, Yates seismic cross section which runs through the wellbore of the State "X" Well No. 1 shows no faulting in the area of this well (Yates Exhibit 12, Tr. at 130), and the new neutron density log from the Pride State "M" Well No. 1 shows no evidence of the fracturing Mr. Ellard found in this formation. (Yates Exhibit 10, Tr. at 129). Instead, Mr. Amiet interpreted the reservoir as an alluvial fan eroding off the high to the northwest of the subject wells. The orientation of the fan is perpendicular to the face of a fault located to the northwest in Section 2 (Tr. at 123-124) and it follows the regional dip to the east-southeast (Yates Exhibit 9, Tr. at 118). Mr. Amiet testified that neither the fault (Tr. at 130) nor the fracturing (Tr. at 129) upon which Pride case rests are supported by the technical data he had reviewed and presented. (Tr. at 132). He concluded that the recoverable reserves in Section 12 were located under property owned by Yates. (Tr. at 134).

Yates also called David Boneau, a reservoir engineer. Dr. Boneau presented a volumetric calculation for the State "M" Well No. 1 (Yates Exhibit 14) and related exhibits that showed how he obtained the information used in this calculation. (Yates Exhibits 15 through 18). Based on his study, he concluded that the State "M" Well would produce approximately 2.3 BCF of gas and would drain 145 acres in the SW/4 of Section 1. (Tr. at 166). When he applied this data to the State "X" Well No. 1 he concluded that based on Yates interpretation, 97% of the reserves produced by the well will come from the Yates lease in the NW/4 of Section 12. (Tr. at 169). He also testified that even if Pride's interpretation was correct, 60-70% of the reserves still came from the Yates property. (Tr.

at 168). Dr. Boneau concluded that if Pride's application was granted, reserves will be taken from Yates and given to Pride. (Tr. at. 169).

The Commission's Analysis of the Evidence:

The Commission found that the parties agreed that on the basis of information presently available that the total quantity of reserves in the Mississippian formation underlying Section 12 or particular quarter sections thereof cannot be practicably determined. (**Finding 33**). The Commission then focuses its findings on the E/2 of the Section (**Finding 34**), and the impact on the placement of the reserves under this tract if Pride's theory is correct. (**Finding 35**). With this approach, the Commission avoids the evidence in this case and the correlative rights issue before it. *See* **Finding 34.** The question is whether the owner of the NW/4 of the section will receive its just and equitable share of the reserves produced from the property it owns by the creation of a N/2 spacing unit or if, with a W/2 unit, it will have to give half of its reserves to the owner of the SW/4 of the section – acreage that has not been shown to be productive and acreage that will not be drained by the State "X" Well No. 1.

In **Finding 36**, the Commission rejected Yates interpretation that the reservoir extended across the N/2 of Section 12 and found Pride's interpretation of the old style log to be "more convincing." What was Pride's more convincing evidence and what made it more convincing?

Mr. Ellard reviewed the "old-style log" on the State "X" Well No. 1 and, although he concluded that it contained "as much as 25 feet of reservoir rock," he qualified his answer by noting "that until we get there, we don't know." (Tr. at 65). Mr. Amiet reviewed the same log. He observed that since it only measures resisitivity, it is difficult to use this log to infer porosity. Based on his experience drilling four or five other Mississippian wells in the area, he testified that the log readings need to get below 200 ohms to have commercial production. Mr. Amiet only finds 10 feet on this log that meet this cutoff and he therefore concluded that this well would not be as good as the offsetting State "M" Well No. 1 that had approximately 25 feet of reservoir rock. (See, Testimony of Ellard, Tr. at 65; Testimony of Amiet, Tr, at 122-123).

The Commission found the data from the old style well log consistent with Pride's interpretation of the north-south fault on the west side of Section 12 and in **Findings 36 and 39** it appears to accepts Pride interpretation of the fault. Furthermore, in **Finding 40** the Commission found Pride's geologic interpretation is on the whole "more convincing." What was Pride's "more convincing" evidence of its fault?

Although Mr. Ellard had prepared a structure map of his own (Tr. at 81-82), instead of presenting it, he produced a reproduction of a commercial map Pride purchased from Geomap. (Pride Exhibit 6, Tr. at 60). Geomap does not have seismic input and therefore is based on an interpretation of well data and not an actual look at the reservoir. (See, Tr. at 133). This exhibit is a structure map on the Devonian formation, not the Mississippian formation that is the subject of this matter. (Tr. at 90). Mr. Ellard represented that he had

reviewed it and that it was "accurate within reason." (Tr. at 74). However, he also testified that the Devonian is approximately 900 feet below the Mississippian formation and agreed that there would be less displacement along this fault in the Mississippian than shown on the map of the Devonian formation. (Tr. at 90). Pride's evidence does not support the existence of a fault adjacent to the State "X" Well location. Furthermore, Yates seismic cross section (the only seismic data presented by either party) shows the fault upon which Pride relies does not exist. (Tr. at 130). **Findings 36, 39 and 40** are not supported by the evidence.

A review of the full record shows that Commission **Findings 33, 34, 35, 36, 37, 38, 39, and 40** are not supported by the evidence – but are in fact contrary to it. They cannot meet the preponderance of the evidence standard announced by our courts. The Commission's decision is unreasonable and without rational basis and a rehearing is required to correct these errors.

## POINT III

**THE COMMISSION'S HANDLING OF THE EVIDENCE PRESENTED IN THIS CASE AND ITS ENTRY OF ORDER NO. R-12108-A WAS IN BAD FAITH AND SHOWS A FAILURE TO EXERCISE HONEST JUDGMENT AND IS THEREFORE ARBITRARY CAPRICIOUS AND UNREASONABLE BECAUSE THE COMMISSION APPLIED DIFFERENT STANDARDS TO THE EVIDENCE PRESENTED BY DIFFERENT PARTIES.**

> "An arbitrary and capricious administrative action is synonymous with an illegal action." *Zamora v. Village of Ruidoso Downs*, 120 N.M. 778, 907 P.2d 182 (N.M. 1995). "Arbitrary is synonymous with bad faith or failure to exercise honest judgment and an arbitrary act is one performed without an adequate determination of principle. *Id.* at 188.

The central fact is dispute between the parties is whether the upper Mississippian reservoir runs through the W/2 of Section 12 as Pride asserts or across the N/2 of the section as Yates believes. Pride's contention is based on the existence of the fault that it interprets as running north-south on the west side of Section 12 in close proximity to the State "X" Well No. 1. (Pride Exhibit 6).

In this case, Yates presented a 3D seismic line centered on the State "X" Well that showed no evidence faulting in the area of the State "X" Well No. 1 (Yates Exhibit 12, Seismic Cross Section B-B', Tr. at 130-131) Unable to effectively challenge Yates evidence on the absence of the fault in the subject spacing unit, Pride instead questioned Yates about seismic data on the fault it had mapped a mile to the north in Sections 1 and 2. (Tr. at 144).

Mr. Amiet, Yates' geologist, testified that he did not present other seismic data on acreage to the north of the subject spacing unit because he had presented the seismic line that went through the proposed well location. (Tr. at 144). The seismic data presented

addressed the question before the Commission for, contrary to Pride's contentions, it showed no faulting at or near to the State "X" Well No. 1. Mr. Amiet also testified that although he did not have the other seismic lines with him, they justified his placement of the faults and that he could and would produce them. (Tr. at 145).

The Commission addressed this issue and announced the standard it would apply to this evidence in **Finding 38**:

> 38. Yates relies principally on its 3-D seismic to demonstrate that the critical fault is oriented northeast-southwest, not north-south. Though Mr. Amiet testified that Yates has seismic data that confirms his suggested location of the fault, Yates did not offer any such seismic data in evidence. A trier of fact is entitled to assume that if a party does not offer relevant evidence that is in its possession, such evidence would not have supported that party's position.

The Commission thereby rejected Yates seismic evidence that showed the fault relied upon by Pride did not exist. It did so, not because the seismic data Yates presented was not relevant competent evidence, but because there was other seismic evidence in Yates possession that Yates considered unnecessary and did not present – but was willing to do so. (Testimony of Amiet, Tr. at 145).

However, the Commission did not apply the same standard to Pride:

1. Pride prepared a structure map of the area and an isopach map. It did not present them because it considered them proprietary.[2] Perhaps this evidence did not support Pride's position.

2. Pride had seismic data, had it analyzed, review the work of their geophysist, but consider this data proprietary and did not present it. Perhaps this evidence does not support Pride's position.[3]

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[2] Jeff Ellard, Pride's geologist, testified that he did not create an independent map showing the location of the fault in Section 12 but relied on the Geomap he had purchased. (Tr. at 12). However, he did testify that he had constructed his own structure map and isopach map that would have revealed his placement of this fault (Tr. at 81 and 82) but that he considers them proprietary and chose not to present them. (Tr. at 82).

[3] In cross examination, Mr. Ellard admitted that Pride possesses in-house seismic data on this area. (Tr. at 69). Furthermore, when asked about the limited quality and quantity of the data he had available to him to support the placement of the fault in Section 12, Mr. Ellard testified:

A. It is limited insofar as we have seismic, other geologists have looked at this and constructed this map, I have looked at it. Based on my work, I agree with the placement of the fault.
Q. Have you looked at seismic across the area?
A. A geophysist has looked at seismic across the area at my request.
Q. And have you looked at the seismic?
A. I've looked at his interpretation.

3. Pride had discussed volumetric drainage calculations in-house but did not present them. Perhaps this evidence does not support Pride's position.[4]

Had the Commission applied the standard it announced in **Finding 38** to the evidence presented by Pride, it would have rejected Pride's commercial structure map of the Devonian formation, because it would have assumed that the structure map and isopach map Pride had in its possession, but did not present, would not have supported its position. For the same reason, the Commission would have rejected Pride's commercial structure map because it would assume that the seismic data in Pride's possession would have not supported the placement of the faults by Geomap. The Commission would also have rejected Mr. Ellards opinion on the drainage area for the State "X" Well No. 1 because, under the standard it has announced, it would have assumed that the volumetric data in Pride's possession would not have supported Mr. Ellard's position.

If the standard applied by the Commission to Yates seismic data had been applied to Pride, it would have no case.

Conversely, if the standards applied to Pride had been applied to Yates, and Yates' structure map, isopach maps, seismic data and volumetric calculations had been considered by the Commission, the evidence would establish that there is no fault running in close proximity to the State "X" Well No. 1 and that the fractures that Mr. Ellard sees in the formation do not exist. The Commission would have had to reject the central factual issues upon which Pride's case depends.

On this record, the Commission should grant a rehearing and require the parties produce the evidence that each of them discussed during the original hearing but did not produce. Yates will present the additional seismic data on faulting under other sections in this area about which it testified during Pride's cross examination of Mr. Amiet – evidence Mr. Amiet testified he could produce.[5] Pride should also be required to produce its mapping, seismic data and volumetric information. This can only be done through a rehearing.

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Q. And was any of that work integrated into this exhibit?
A. No.
Q. And you're not sharing any of that work with us either?
A. We consider that proprietary, yes. (Tr. 86-87)

[4] Mr. Ellard opined that Yates drainage calculations are conservative (Tr. at 68) and estimated that the State "X" well No. 1 will drain from 160-acres to 200-acres. (Tr. at 91). However, he testified that while he had not made a drainage calculation, his company has discussed volumetric calculations but was not presenting them to the Commission. (Tr. at 91).

[5] Pride questioned Mr. Amiet about seismic data on the tracts to the north of the acreage that is the subject of this case. (Tr. at 144-146). Although each Commissioner questioned Mr. Amiet after Pride concluded its cross examination, the first time the Commission expressed any interest in this data was in its Order.

To grant the application of Pride, the Commission applied one set of standards to the evidence presented by Yates and a different set of standards to the evidence of Pride. This action shows bad faith by the Commission and a failure to exercise honest judgment. The actions of the Commission are therefore arbitrary, capricious, contrary to law and must be set aside.

To quote Jim Bruce's closing in this case: "If you have rules, you have to follow them and they have to be followed, they have to be applied fairly to all people." (Tr. at 192).

## POINT IV

## THE COMMISSION'S FINDINGS IN ORDER NO. R-12108-A ARE INSUFFICIENT AND FAIL TO MEET THE MINIMUM STANDARDS REQUIRED FOR ORDERS OF ADMINISTRATIVE AGENCIES IN NEW MEXICO.

> Although formal and elaborate findings are not absolutely necessary, nevertheless basic jurisdictional findings, supported by substantial evidence, are required to show that the commission has heeded the mandate and the standards set out by statute. Administrative findings by an expert administrative commission should be sufficiently extensive to show not only the jurisdiction but the basis of the commission's order. *Continental Oil Co. v. Oil Conservation Comm'n*, 70 N.M. 310, 373 P.2d 809 (N.M. 1962).

The New Mexico Supreme Court has announced simple rules, stated on several occasions, that govern the findings of fact which must be contained in an order of the Oil Conservation Commission. Order No. R-12108-A is invalid for it fails to meet these standards.

### A. ORDER NO. R-12108-A DOES NOT CONTAIN REQUIRED FINDINGS ON CORRELATIVE RIGHTS.

In *Continental*, as in this case, the Court addressed an issue directly related to the correlative rights of the parties. It announced certain minimum standards that a Commission order must meet before it can act to protect the correlative rights of a party. The Court stated:

> In order to protect correlative rights, it is incumbent upon the commission to determine, 'so far as it is practicable to do so,' certain foundationary matters, without which correlative rights of the various owners cannot be ascertained. Therefore, the commission by 'basic conclusions of fact' (or what might be termed "findings"), must determine, insofar as practicable, (1) **the amount of recoverable gas under each producer's tract**; (2) the total amount of recoverable gas in the pool; (3) the proportion that (1)

> bears to (2); and (4) what portion of the arrived at proportion can be recovered *without waste*. **That the extent of the correlative right must first be determined before the commission can act to protect them is manifest.** *Id.* at 815.

Order No. R- 12108-A fails to meet the standards announced by our court in *Continental*. Under the Oil and Gas Act, the Commission is required to protect the correlative rights of each owner in a pool. The Commission is required to afford each owner an opportunity to produce the recoverable reserves under its property. Although the record in this case contains numerous exhibits and testimony by both parties that demonstrate that the reserves that will be recovered by the State "X" Well No. 1 will be drained from acreage leased to and owned by Yates, the Commission makes no effort to determine the extent of the correlative rights of Yates even to the extent of "insofar as is practicable."[6] (**Findings 33, 34, 35, 36 and 37**). If it had, it would have recognized that the reserves to be recovered by the State "X" Well were under the NW/4 of the Section, that these were owned by Yates, and that its order would reduce the interest of Yates in the production from its property by 50%.

The Commission attempts to avoid the New Mexico Supreme Court's standards with a finding that only states that the total quantity of reserves in the Mississippian formation underlying Section 12, or any quarter section thereof, cannot practicably be determined. (**Finding 33**). By so doing it is attempting to ignore the evidence that clearly shows that as much as 97% of the production from State "X" Well is owned by Yates and its Order will give half of those reserves to Pride.

Order R-12108-A lacks the basic findings necessary upon which the Commission's jurisdiction depends and it is therefore invalid and void.

## B. ORDER NO. R-12108-A DOES NOT CONTAIN A PROPER ULTIMATE FINDING ON CORRELATIVE RIGHTS OR SUFFICIENT FINDINGS TO DISCLOSE THE COMMISSION'S REASONING IN REACHING AN ULTIMATE FINDING.

> In cases where the sufficiency of Commission findings is in issue or their substantial support is questioned, after the dust of the Commission hearing has settled, the following must appear:
>
> A. Findings of ultimate facts which are material to the issues....

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[6] Yates evidence showed that when the drainage areas for the wells in this pool (Yates Exhibit 13) are compared to the ownership map (Yates Exhibit 13), of the 320 acres that are known productive in this pool (SW/4 of Section 1 and the NW/4 of Section 12) Yates owns 75% of the property and yet, because of Order No. R-12108-A, it will receive only 50% of the production. If Pride's application was denied, Yates owns 75% of the property and receives 75% of the recoverable reserves from the pool.

B. Sufficient findings to disclose the reasoning of the Commission in reaching the ultimate findings."

*Fasken v. Oil Conservation Comm'n,* 87 N.M. 292, 532 P.2d 588 (N.M. 1975).

Order No. R-12108-A fails to meet the standards set out in *Fasken.* If the Commission failed to enter an understandable ultimate finding on correlative rights. **Finding 37** is the only finding that even mentions the Commission's reasoning on the correlative rights of the parties and it is so confused it defies comprehension. As written, this finding simply makes no sense.

Furthermore, the findings in Order R-12108-A do not disclose the reasoning of the Commission in deciding to rule against Yates. Other than arbitrarily rejecting competent evidence for reasons unrelated to the evidence itself, emitting a general tenor of suspicion and disbelief of the proffered testimony, speculating about what might happen in this section at a later date based on information that does not exist and could not be before the Commission, it entered an order that declares Pride's interpretation "more convincing." However, it fails to provide any illumination as to why the testimony of Yates was wrong and should be disregarded. (**Findings 35, 36, 37, 38 and 39**); *See Fasken,* at 589.

## C. ORDER NO. R-12108-A IS ARBITRARY AND UNREASONABLE FOR IT DENIES YATES THE OPPORTUNITY TO RECOVER THE COSTS IT INCURRED RELATED TO THE RE-ENTERING THE STATE "X" WELL WHILE ACTING ON AN APD APPROVED BY THE DIVISION.

The Commission recognized that "Yates commenced operations to re-enter the subject well prior to the filing of this application, based on an AFE reflecting Division approval." **Finding 44.** It then stated "Pride should reimburse Yates for reasonable costs incurred by Yates in connection with such operation." **Finding 45.**

**Order Paragraph 9** provided, in part, that the costs that Yates would be allowed to recover were limited to the "actual well costs incurred by Yates in conducting re-entry operations on the subject well after August 25, 2003 and prior to the time when Yates received notice of the filing of the original application in this case."

Yates is attempting to determine its costs and the actual costs related to its re-entry of the subject well may be as much as $133,000. However, a substantial portion of these costs were incurred after it received actual notice of Pride's application. These are costs that are the direct result of Pride's application and the Commission's decision to rescind the APD pursuant to which Yates conducted re-entry operations of the well.

The limitations imposed by **Order Paragraph 9** are inconsistent with the provisions of **Findings 44 and 45** and are otherwise arbitrary, unreasonable and capricious.

## POINT V

## THE ORDER IS CONTRARY TO LAW FOR PRIDE FAILED TO MEET PRECONDITIONS SET BY THE OIL AND GAS ACT FOR A COMPULSORY POOLING ORDER.

> "Where rulings by administrative agencies are not in accord with the basic requirements of the statutes relating to those agencies, the decisions of the agencies are void." *Foster v. Bd. of Dentistry*, 103 N.M. 776, 714 P.2d 580 (N.M. 1986).

Compulsory pooling requires an exercise of the police power of the state to take the property interest of one owner and turn it over to another to operate. It is a power conferred on the Oil Conservation Commission by the Oil and Gas Act. N.M.S.A., § 70-2-17.C (2004). Because a pooling order affects constitutionally protected property rights, there are certain preconditions that must be met before the Commission may take the property of one party and pool it with the property of another. These include the requirement that the party seeking to invoke the state's pooling authority first make a good faith effort to reach a voluntary agreement for the drilling of the subject well. The burden to prove that a good faith effort to reach a voluntary agreement has been made falls on the person seeking to invoke the pooling authority.

Pride failed to make a good faith effort to reach a voluntary agreement for the development of a W/2 spacing unit. Mr. Pride testified concerning his efforts to reach a voluntary agreement with Yates. The record shows that Yates had an Application for Permit to Drill a well on the N/2 of this section that expired on May 25, 2003. (Yates Exhibit 4). Mr. Pride stated that he was aware of Yates APD and that he waited for it to expire. (Tr. at 27). He called the Oil Conservation Division office in Hobbs to confirm that the Yates APD had expired (Tr. at 27) and then filed his APD covering the W/2 of Section 12. Prior to contacting Yates, Mr. Pride again called the Division to confirm that his APD was approved because he believed this would (1) foreclose the drilling of a well on a N/2 unit, (2) give him half of the production from the well in the NW/4 of this section, and (3) give him the right to re-enter the State "X" Well. (Tr. at 40). After he confirmed that his APD had been approved by the Division, Mr. Pride sent one letter to Yates. (Pride Exhibit No. 4). In this letter, Pride proposes the development of the W/2 of this section just as he had in June of 2001. (Tr. at 56) In his letter, Mr. Pride did not mention an Authorization for Expenditure (AFE) for the well. He did not send Yates an AFE for the well at any time after he sent this letter. Even at the time of hearing, Mr. Pride did not have a current AFE that showed his estimated cost for this well – he just made a "guess" -- a guess that was $122,000 more than the AFE he had provided to Yates years before. (Testimony of Pride, Tr. at 33). Mr. Pride did not provide Yates an Operating Agreement. He did not mention when he planned to drill the well. In spite of a courageous effort by his attorney to find any other contact with Yates either in writing or by telephone, Mr. Pride would not and could not testify that he had done anything more than mail his original letter—it was his only attempt to contact Yates. (Tr. at 45).

Having received nothing more than Mr. Pride's letter, and consistent with its plans for its lease -- plans of which Mr. Pride was aware (Tr. at 25) -- Yates applied for a new APD for a N/2 spacing unit. There is nothing that shows that Yates was aware of the Pride APD at the time it sought approval of a new Application for Permit to Drill the State "X" Well. Yates commenced operations on the State "X" Well No. 1 pursuant to this approved APD. With knowledge that Yates was working on a well on a tract that it owned and on a dedicated spacing unit also owned by Yates, Pride contends that it still had a right to drill because of its APD. (Tr. at 40).

Yates challenged the right of Pride to a pooling order for failure to meet this precondition. It did so at the hearing. The Commission failed to address this issue in this Order but instead approved the pooling application, arbitrarily taking a property interest of Yates. Yates submits that approval of this pooling application without more of an effort by Pride to reach voluntary agreement for development of these lands -- especially where Pride claims a right to re-enter a well owned 100% by Yates on which Yates was conducting operations pursuant to a Division-approved APD -- violates the compulsory pooling provisions of the Oil and Gas Act.

Pride failed to make a good faith effort to reach a voluntary agreement for the development of the W/2 of Section 12. By pooling the interest of Yates on these facts, the Commission has violated the pooling provisions of the Oil and Gas Act.

## POINT VI

## THE FINDINGS OF THE COMMISSION ON THE PURPOSE AND EFFECT OF AN APPLICATION FOR PERMIT TO DRILL ARE CONTRARY TO LAW AND INCONSISTENT WITH RECENT COMMISSION PRECEDENT.

The Commission states that this case requires an analysis of the effect of the Division's action in approving an APD. Although the Commission later concludes that the histories of the Applications for Permits to Drill in this case will not affect the outcome of the case (*See* **Finding 32**) it devotes a portion of its Order to a discussion of these APD's and then publicly admonishes its district supervisor by name for doing nothing more than acting in a manner consistent with recent Commission precedent in approving the Application for Permit to Drill of Yates.

### A. THE DIVISION'S DISTRICT SUPERVISOR FOLLOWED COMMISSION PRECEDENT AND CORRECTLY APPROVED THE APD OF YATES.

In a recent case concerning the effect of an APD, the Commission determined that:

> **Where compulsory pooling is not required because** of voluntary agreement or because **of common ownership of the dedicated acreage,** the practice of designating the acreage to be dedicated to the well on the

> application for permit to drill furthers administrative expedience. **Once the application is approved, no further proceedings are necessary.** Case Nos. R-12731 and 12744, Order No. R-11700-B, Finding 35, April 26, 2002. (emphasis added)

In this case, Yates owns 100% of the standard N/2 spacing unit it proposed to dedicate to the State "X" Well No. 1. Pooling of this tract was unnecessary and the District Supervisor's approval of the Yates APD was consistent with recent Commission precedent.

In the same case, the Commission also stated:

> An application for permit to drill serves a different objective than an application for compulsory pooling and the two proceedings should not be confused. **The application for permit to drill is required to verify that requirements for a permit are satisfied.** For example, on receipt of an application, the Division will verify whether an operator has financial assurances on file, identify which pool is the objective of the well so as to identify the proper well spacing and other applicable requirements, that the casing and cementing program meets Division requirements and check the information provided to identify any other relevant issues. The acreage dedication plat that accompanies the application (form C-102) permits verification of the spacing requirements under the applicable pool rules or statewide rules. Finding 33; (emphasis added)

In addition to owning the spacing unit and the well, with its APD, Yates was proposing to re-enter a well on this spacing unit at a standard location. Yates had complied with all other regulatory requirements. Accordingly, when the District Supervisor approved Yates APD, his actions were consistent with recent Commission precedent because Yates had complied with all permit requirements and, contrary to **Finding 27**, Yates APD was properly approved.

## B. BY TRYING TO PROTECT PRIDE, THE COMMISSION VIOLATES THE CORRELATIVE RIGHTS OF YATES.

Here it is the Commission that has acted improperly, not the District Supervisor. It revoked Yates permit to drill after it had commenced operations on a well at a standard location on a standard spacing unit – all owned by Yates -- and then entered an order, based on nothing more than the undisclosed work of Pride, that results in 50% of the recoverable reserves from Yates' property being taken away from it and given to Pride. The Commission's actions are unlawful, unreasonable, arbitrary and capricious.

Its attempt at an ultimate finding seems to suggest that it is acting to protect Pride in the event that there are reserves under its tract – something as yet unknown[7]- and in the event that the SE/4 does not contain reserves –something unproved. It seems to say that in this

[7] Testimony of Pride at 43; Testimony of Ellard, Tr. at 90.

circumstance Pride's interest in production from the SW/4 of this section could be diluted by combining Pride acreage with less productive acreage owned by Yates. However, here the Commission does to Yates the very thing it seems to be hoping to avoid for Pride. The Commission orders the reserves owned by Yates under the NW/4 of this section – something known[8]--be diluted by being shared with the less potential and possibly non-productive acreage in the SW/4 of the section.[9]

Order No. R-12108-A is arbitrary, unreasonable, capricious and contrary to law. To correct this order a rehearing is required.

## CONCLUSION

In reaching its decision, the Commission made procedural, factual and legal errors that require the case be set for rehearing. The Commission ruled against Yates in spite of the evidence and the law. Order No. R-12108-A cannot now be rewritten by the Commission. To correct these errors, a rehearing is required.

Respectfully submitted,

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[8] Testimony of Ellard, Tr. at 68; Yartes Exhibits 55 through 7, 9, 12, and 14 through 19, Testimony of Amiet Tr. 117 through 130, Testimony of Boneau Tr. at 168-169.
[9] Testimony of Ellard at Tr. 90, Testimony of Amiet, Tr. at 126..

## CERTIFICATE OF SERVICE

I certify that on September 29, 2004 I served a copy of the foregoing Application for Rehearing by Hand Delivery or Facsimile to:

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