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

IN THE MATTER OF THE APPLICATION OF SAMSON RESOURCES COMPANY, KAISER-FRANCIS OIL COMPANY AND MEWBOURNE OIL COMPANY FOR CANCELLATION OF A DRILLING PERMIT AND APPROVAL OF A DRILLING PERMIT, LEA COUNTY, NEW MEXICO

CASE NO. 13492

APPLICANTS' JOINT HEARING MEMORANDUM

Samson Resources Company, ("Samson"), Kaiser-Francis Oil Company, ("Kaiser-Francis"), and Mewbourne Oil Company ("Mewbourne") submit this memorandum of law in connection with the hearing on the merits on the Amended Application in this matter.

SUMMARY

On April 27, 2004, Chesapeake Operating, Inc. trespassed onto Kaiser-Francis's oil and gas lease on the SE/4 of Section 4, T –21-S, R-35-E and, without notice, commenced drilling the KF "4" State Well No. 1. Chesapeake cites as its authority to do so incomplete C-101 and C-102 forms purporting to establish a 320-acre lay-down gas spacing and proration unit comprised of the SW/4 and SE/4 of irregular Section 4. However, Kaiser-Francis's lease covering the SE/4 of Section 4 is the subject of an operating agreement and a Communitization Agreement approved by the Commissioner of Public Lands establishing a 320-acre stand-up unit comprised of the SE/4 and Lots 9, 10, 15 and 16.

Chesapeake's APD was improvidently issued and should be cancelled for the following reasons:

(1) Chesapeake's claim to title to the SE/4 has no good faith basis.

(3) Chesapeake Operating, Inc.'s conduct constitutes trespass.

(4) Chesapeake did not have the valid authorization from the surface owner to enter onto the SE/4 of Section 4.

BACKGROUND FACTS

1. Kaiser-Francis, Samson Resources Company and Mewbourne Oil Company are the working interest owners in Lots 9, 10, 15, 16, and the SE/4 of Irregular Section 4, T. 21 S., R. 35 E., NMPM, Lea County, New Mexico (the "Subject Lands"). The mineral interests under the Subject Lands are owned entirely by the State of New Mexico and are subject to State Oil and Gas Lease Nos. V-7054 and B-1481-14.

2. Under that Communitization Agreement approved by the Commissioner of Public Lands on April 27, 2005, effective April 1, 2005, and pursuant to that Joint Operating Agreement dated March 24, 2005, the subject lands were consolidated to form a standard 320-acre stand-up gas spacing and proration unit comprised of Lots 9, 10, 15, 16 and the SE/4 of Section 4. Further, pursuant to the Joint Operating Agreement the Movants designated Mewbourne as operator and have agreed to drill the Osudo "4" State Com Well No. 1 at a standard gas well location 660 feet from the south line and 1,650 feet from the east line of said Section 4. Movants subsequently have designated Samson as operator of the well.

3. On March 30, 2005 Mewbourne filed with the Division's Hobbs District Office its Request for Approval of its Application for Permit to Drill ("APD") for the Osudo "4" State Comm Well No. 1. The APD was returned to Mewbourne by the Hobbs District Office without approval for the reason that the District Office had previously approved an APD submitted on behalf of Chesapeake Operating, Inc. on March 11, 2005 for Chesapeake's KF State "4" No. 1 Well in said Section 4. The C-102 form that accompanied Chesapeake's APD purported to show

the dedication of a 320-acre lay-down gas spacing and proration unit consisting of the SW ¼ and SE ¼ equivalents of Section 4. The Chesapeake APD's were also incomplete: They failed to show the consolidation code as required by Rule 1102.

4. Chesapeake Operating, Inc. owns no interest in any portion of the Subject Lands. However, Chesapeake Permian, L.P., purports to own the lease outside the Subject Lands covering the SW/4 of Section 4.

5. On approximately April 27, 2005, without notice, Chesapeake moved a drilling rig onto the location for the KF State "4" No. 1 Well and commenced drilling operations that same day.

6. On April 28, 2005, Mewbourne filed the original Application in this case to cancel the APD for the KF "4" State Well No. 1.

POINTS AND AUTHORITIES

1. An Approved APD Is Not A Sufficient Claim To Title.

New Mexico Precedent

In its earlier filings, Chesapeake has made clear that it is basing its claim to title strictly on the incomplete C-101 and C-102 forms that were ministerially approved by the Division. Chesapeake claims this was sufficient authorization for it to enter onto the Kaiser Francis lease within the Communitized Unit and to drill the KF "4" State Well No. 1.

Chesapeake is wrong. It must prove that it has a good faith claim of *title*.

In New Mexico, "title" to real property is evidenced by a conveyance "*which shall be subscribed by the person transferring his title or interest in said real estate, or by his legal agent or attorney.* " NMSA 1978 § 47-1-5. See *Kysar v. Amoco Production Company*, 135 N.M. 767, 93 P3d 1272 (2004). Likewise, NMSA 1978 § 37-1-21 requires a claimant to hold or claim "by

virtue of a deed or deeds [of] conveyance, ... purporting to convey an estate in fee simple." See also *Quarles v. Arcega*, 114 N.M. 502 (N.M.App.,1992). Therefore a claim to title must be based on a written deed, with a legal description contained therein that is easily ascertainable on the ground. See *Esquibel v. Hallmark*, 92 N.M. 254 (1928); *Cox v. Hanlen*, 1998-NMSA-015; *Ritter-Walker Co. v. Bell*, 46 N.M. 125 (1942).

As the New Mexico Court of Appeals has pointed out, Black's Law Dictionary defines "title" as: *"The union of all elements (as ownership, possession, and custody) constituting the legal right to control and dispose of property; the legal link between a person who owns property and the property itself." Santa Fe County Bd. Of County Com'rs v. Town of Edgewood*, (2004-NMCA-111) (quoting Black's Law Dictionary at 1493).

Chesapeake is unable to demonstrate any evidence of a claim to title here. Only Kaiser-Francis, as owner of the oil and gas lease on the SE/4 of Section 4 owned the right to occupy the lands and to explore for minerals by drilling. Moreover, Kaiser-Francis's right, title and interest to the SE/4 are *exclusive* [1]. See granting clause, State of New Mexico Oil and Gas Lease No. B-1481. See, also, *Grynberg v. City of Northglenn*, 739 P.2d 230 (Colo. 1987).

To justify its conduct in this case, Chesapeake has invoked the *Pride Energy* Order (Order R-12108-C) and the *TMBR/Sharp* Order (Order R-11700-B). Chesapeake misinterprets these authorities by its statement that, *"The Commission's Order in Pride tells us, as a matter of administrative law, that Chesapeake can rely upon its valid and approved APD as the "good faith" basis for doing what it did and continues to do."* (Pg. 2, Chesapeake's Motion To Dismiss.)

[1] Subject to the rights of Samson and Mewbourne under the Communitization Agreement.

Contrary to Chesapeake's interpretation, a careful reading of Order No. R-12108-C from the *Pride Energy* case will show that the Commission did *not* say that an approved APD provides the "good faith" basis for entry onto the lands. Rather, the Commission in *Pride* said, citing to Order No. R-11700-B[2], "*That an applicant for permit to drill must have a good faith claim of title.*" This, then, is the controlling criteria in this case. Notably, however, Order No. R-12108-C states that an APD should not be regarded as "property":

> *"(f) Although the Division can and should cancel an APD when it properly determines that no such good faith claim exists, as the Commission determined, based a District Court judgment, in Order No. R-11700-B', it should not make that determination, which necessarily cannot be made on the face of the APD or from Division records, without first giving the Applicant notice and an opportunity for a hearing. Although the Division doubts that the right conferred by an approval of an APD is properly characterized as "property," it nevertheless concludes that such approval confers rights that should not be revoked arbitrarily."* (Order No. R-1208-C, ¶ 8.)

This same issue arose in the *TMBR/Sharp* case, where, after an administrative challenge to Arrington's APD's, TMBR/Sharp Drilling was able to prove that it had title to support the issuance of the APD's to it, while Arrington did not. The agency correspondingly rescinded Arrington's APD's.

Order No. R-11700-B in the *TMBR/Sharp* case set forth the two criteria under which the Division may make a determination of a properly or improperly approved APD: "*It is the responsibility of the operator filing an Application for a Permit to Drill to do so under a good faith claim to title and a good faith belief that it is authorized to drill the well applied for.*" Chesapeake is unable to satisfy the *TMBR/Sharp* criteria.

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[2] *Case No. 12731, Application of TMBR/Sharp Drilling, Inc. For An Order Staying David H. Arrington Oil and Gas, Inc. From Commencing Operations, Lea County, New Mexico; Case No. 12744, Application of TMBR/Sharp Drilling, Inc. Appealing The Hobb's District Decision Approval Of Two Applications For A Permit To Drill filed by TMBR/Sharp Drilling, Inc., Lea County, New Mexico.*

The Division and the Commission have issued three principle cases interpreting an operator's entitlement to, and rights under, an approved APD from the Division. They are Order No. R-12093-A (Case No. 13215; *Application of Valles Caldera Trust to Deny Application of Geo Products of New Mexico, Inc. for Permits to Re-enter Abandoned Geothermal Wells (APDs), Sandoval County, New Mexico*), Order No. R-11700-B (from the *TMBR/Sharp* case referenced above), and Order No. R-12108-C (from the *Pride Energy* case, Case No. 13153).

In Order No. R-12093-A, the Commission said,

> *"The Order granting the permit is a purely negative pronouncement. It grants no affirmative rights to the permitee to occupy the property ... it merely removes the conservation laws and regulations as a bar to drilling the well."* Order No. R-12093-A, ¶ 11, citing to *Magnolia Petroleum Company v. Railroad Commission*, 170 Southwest 2d 189 (Tex. 1943).

The Commission went on to say,

> *"The Commission does not have jurisdiction to determine title or the rights of any party to occupy property. However, prudence dictates that the Commission ought not to issue a permit where the party applicant for the permit clearly does not have the right to conduct the contemplated activity. As stated by the Texas Supreme Court, "The Railroad Commission should not do the useless thing of granting a permit to one who does not claim the property in good faith."* Order No. R-12093-A ¶ 16.

Texas Precedent

A series of cases originating from the Texas Railroad Commission involving drilling permits are instructive. These precedent Railroad Commission cases make clear that APD's do not authorize a permittee without title to drill.

Magnolia Petroleum Company v. Railroad Commission, 170 S.W. 2d 189 (Tex., 1943) states the general rule that a permit issued by the Railroad Commission does not authorize the permittee to take possession of the land if there is a dispute regarding title to such land. It explains,

> *"The function of the Railroad Commission in this connection is to administer the conservation laws. When it grants a permit to drill a well it does not undertake to adjudicate questions of title or rights of possession. These questions must be settled in the courts.... The permit may be perfectly valid, so far as the conservation laws are concerned, and yet the permittee's right to drill under it may depend upon his establishing title in a suit at law."* *Magnolia Petroleum* at 99-100.

Since a permit does not grant the permittee any affirmative right to occupy the property, it does not cloud the adversary's title. Id. at 100; See also *Sun Oil Co. v. Railroad Commission*, 390 S.W.2d 803 (Tex. Civ. App., 1965). In other words, an APD does not effect a transfer of title and consequently cannot constitute a "claim of title".

If a person who is not in possession of the land obtains a permit to drill on that land from the Railroad Commission, that person may not drill until his or her title has been established by the court, and the persons who are in possession of the land may defend their possession by self-help or injunction proceedings. *Magnolia Petroleum* at 100. If the holder of the permit to drill brings suit to determine title to the land, the fact that a permit has been granted is not admissible in support of the permittee's title. Id.

Later cases in the Texas Court of Appeals and Supreme Court echoed *Magnolia Petroleum's* holding that a drilling permit does not constitute a claim to title. *Nale v. Carroll*, 289 S.W. 2d 743 (Tex., 1956) states that the Railroad Commission's rules and regulations for drilling do not effect the transfer of property right. A claim to title cannot be based on a permit to drill. Id. at 559; See also *Miller v. Sutherland*, 179 S.W.2d 801 (Tex. Civ. App., 1943) (denying title where claim was only based on rules of Railroad Commission and stating *"It is thought to be fundamental that the rules and regulations of the Railroad Commission cannot have the result of effecting a change or transference of property rights."*).

Oklahoma Precedent

The authority from Oklahoma supports the same conclusion that a drilling permit does not establish claim to title or a right to drill without such a claim, while strongly reiterating Oklahoma's reliance on the law of capture. The Oklahoma Supreme Court in *Frost v. Ponca City*, 541 P.2d 1321 (Okla. 1975), ruled that the state, acting pursuant to its police power, may establish regulations which have 'the effect of regulating or abrogating in a measure the law of capture. However, these regulations only restrict the landowner's right to capture minerals that underlie his property, and they do not authorize third persons to enter the land and capture these minerals without compensating the landowner. The *Frost* court reasoned that to authorize a third person to exercise such rights on a landowner's property would constitute a taking of the landowner's property.

In *Van Meter v. Wallace*, 170 Okla. 638, 41 P.2d 839 (Okla. 1935), the court reviewed the record for a drilling permit that had already been issued. It surmised that the applicant had not been in possession of the land for which he sought the permit. Therefore, the court ruled that the permit was issued erroneously and the APD was thus rescinded. This case further supports the position that in Oklahoma as well as in Texas, no claim to title or right to drill is extended to someone who does not own the land simply because a drilling permit was issued to that person.

2. Chesapeake's Conduct Constitutes Trespass.

Trespass in New Mexico is defined as a direct infringement on another's right of possession, which may be committed on or beneath the surface of the earth. *Schwartzman, Inc. v. Atchison, Topeka & Santa Fe Railroad Co.*, 857 F. Supp. 838 (D.N.M., 1994); See also *Padilla v. Lawrence*, 101 N.M. 556 (App. 1984); Restatement, Second, of Torts § 159. Any unauthorized entry upon the owner's land is trespass that entitles the owner to a verdict for damages. *North v.*

Public Service Co. of New Mexico, 94 N.M. 246 (N.M. App., 1980). Trespass contemplates actual physical entry or invasion, as differentiated from nuisance liability, which arises because of activity that falls short of tangible, concrete invasion. *Schwartzman.*

The initial burden of proof in an action of trespass, like in all actions, rests on the party who initiated the suit. See AmJur Trespass § 216. In an action of trespass, the plaintiff must show that he was in rightful possession of the land at the time of the trespass, and that the defendant made an unauthorized entry onto this land. *Pacheco v. Martinez,* 97 N.M. 37 (N.M. App. 1981). Actual exclusive possession of the land is sufficient proof. *Harrington v. Chavez*, 27 N.M. 67 (1921). Proof of constructive possession is also sufficient. *Pacheco.* Possession is presumed to accompany ownership until the contrary is proven. *First Nat. Bank of Albuquerque v. Town of Tome*, 23 N.M. 255 (1917). Therefore, possession unsupported by evidence of title can be sufficient to maintain an action of trespass. *Probst v. Trustees of the Bd. of Domestic Missions of the General Assembly of the Presbyterian Church in the USA*, 5 P. 702 (N.M. Terr., 1885) (reversed on other grounds in *Probst v. Trustees of Board of Domestic Missions, Etc.*, 129 U.S. 182 (1889)).

Chesapeake's trespass here was also clearly intentional. On April 5, 2005, Chesapeake threatened to move a drilling rig onto the SE/4 of Section 4. Chesapeake's landman and geologist were told by Kaiser-Francis that it had already entered into an agreement with Mewbourne and Samson to drill their own well and that Chesapeake's threatened conduct would be trespass. In this regard, See *Archibeque v. Miera*, 1 N.M. 419 (N.M. Terr., 1869). The evidence in this case establishes that Chesapeake had the actual purpose of interfering on the land or the knowledge that the disturbance would occur. Id. When a party claiming trespass introduces evidence that shows possession of the land as well as an intent to trespass, the burden of proving a right to the

land that is superior to that of the party claiming trespass then shifts to the trespasser. See AmJur Trespass § 216. The defendant must then prove consent or license as a defense against the claim of trespass. Id. Chesapeake can prove neither one.

In *Snyder Ranches, Inc. v. Oil Conservation Commission, et al.*, 110 N.M. 637, 798 P.2d 587 (1990), a mineral interest owner in an adjoining section opposed Mobil's application for an injection permit for its disposal well on its own lease. The mineral owner opposed the technical justification for the permit, as well as the issuance of the permit itself, contending that the Division's permit was being used to authorize a trespass. The New Mexico Supreme Court made clear that the Division's permit does not authorize the trespass or occupancy. The Court said:

> *"Having found substantial evidence to support the Commission and district court's conclusions, our analysis should end. However, in order to avoid future error, we take the opportunity to answer Snyder Ranches' assertion that the granting of Mobil's application to inject salt water into the disposal well authorizes trespass against Snyder Ranches' property. We do not agree.*
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> *The State of New Mexico may be said to have licensed the injection of salt water into the disposal well; however, such license does not authorize trespass. The issuance of a license by the State does not authorize trespass or other tortious conduct by the licensee, nor does such license immunize the licensee from liability for negligence or nuisance which flows from the licensed activity. See Lummis v. Lilly, 385 Mass. 41, ..., 429 N.E.2d 1146, 1150 (1982); Summer v. Township of Teaneck, 53 N.J. 548, 556, 251 A.2d 761, 765 (1969)."* (emphasis added).

3. The State Grazing Lessee Could Not Authorize Chesapeake's Access.

The holder of the state grazing permit on the SE/4 of Section 4 was without any authority to permit Chesapeake's access and use of the lands. Consequently, the June 3, 2005 Surface Damage Release and Grant of Surface Easement[3] Chesapeake procured from Merchant Livestock Company is a nullity.

[3] The agreement followed Chesapeake's entry onto the lands by some five weeks.

It is undisputed that both the surface and the minerals in the SE/4 of Section 4 are owned by the State of New Mexico. By statute, the rights of grazing lessees under leases for state lands are expressly limited to grazing purposes only. It has been long established that a state grazing lessee cannot authorize others to use state lands. *Burguete v. Del Curto*, 49 N.M. 292, 163 P.2d 257 (1945).

By NMSA 1978 § 19-7-5, in a sale or lease of state lands, the minerals are reserved to the State:

> 19-7-25. [Reservation from sale of saline, mineral and oil and gas lands; leasing authorized.] *State saline lands and the state lands known to contain valuable minerals, petroleum or natural gas in paying quantities, and sections of state lands adjoining lands upon which there are producing mines, oil wells or gas wells, or which are known to contain valuable minerals, petroleum or natural gas in paying quantities, shall not be sold, but may be leased as provided in this chapter.*

Also by statute, grazing leases for state lands must include a clause making specific reservations appurtenant to the minerals reserved:

> 19-7-28. [Grazing and agricultural leases; reservation of mineral deposits, products and easements.] *In all leases of state lands for grazing or agricultural purposes there shall be inserted a clause reserving the right to execute leases for mining purposes thereon, or for the extraction of petroleum, natural gas, salt or other deposit therefrom, and the right to sell or dispose of any other natural surface products of such lands other than grazing, agricultural or horticultural products; also a clause reserving the right to grant rights-of-way and easements for any of the purposes mentioned in Section 19-7-57 NMSA 1978.*

An express reservation to this effect is found in the terms of the grazing permit held by Merchant Livestock Company.

The purposes for the reservations in state lands grazing leases are also specified by statute:

> 19-7-57. [Commissioner; powers; easements; rights of way.] *The commissioner may grant rights of way and easements over, upon or across state lands for public highways, railroads, tramways, telegraph, telephone and power lines, irrigation*

works, mining, logging and other purposes upon payment by the grantee of the price fixed by the commissioner, which shall not be less than the minimum price for the lands, used, as fixed by law. The commissioner may grant a right of way or easement over, upon or across state lands for oil, hazardous liquid and gas ... .

The Legislature has also declared that those entering upon or utilizing state lands without the right to do so are in trespass:

19-6-3. [Trespass or waste; penalty.] *Any person, association of persons or corporation, in any manner entering upon, occupying or using for any purpose whatsoever any land belonging to the state, without having leased or purchased the same, or obtained a legal right to the use or occupation of the same, or any lessee of lands who shall not vacate same within thirty days after expiration or cancellation of his lease, or any person, association of persons or corporation constructing a ditch, reservoir, railroad, tramway, public or private road, telegraph, telephone or power line upon state lands, without legal authority, or any person, association of persons or corporation, whether lessee or not, committing waste upon any state lands or any lessee who shall use the lands leased for any purpose other than that specified in the lease, or purposes incident thereto, shall be guilty of a misdemeanor....*

With extensive mineral holdings in New Mexico overlain by state-owned surface, Chesapeake is in no position to claim it was unaware of the law here. By statute, Chesapeake is charged with notice of the express terms of the state grazing lease, as well as the provisions of the statutes and regulations that govern the administration of the State's lands and minerals. See NMSA 1978 § 19-10-31.

CONCLUSION

For the foregoing reasons, Samson Resources Company, Kaiser-Francis Oil Company and Mewbourne Oil Company request the Division grant the relief requested in their Second Amended Application in this matter.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was hand-delivered to counsel of record at the time of the hearing on the merits in this matter as follows:

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