

**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. 11722  
Order No. R-10792**

**APPLICATION OF NEARBURG  
EXPLORATION COMPANY, L.L.C.  
FOR COMPULSORY POOLING, LEA  
COUNTY, NEW MEXICO.**

**ORDER OF THE DIVISION**

**BY THE DIVISION:**

This cause came on for hearing at 8:15 a.m. on March 20, 1997, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 28th day of April, 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) Due public notice having been given as required by law, the Division has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Nearburg Exploration Company, L.L.C., seeks an order pooling all mineral interest from the surface to the base of the Morrow formation underlying the E/2 of Section 28, Township 20 South, Range 33 East, NMPM, Lea County, New Mexico, and in the following manner:

the E/2 forming a standard 320-acre gas spacing and proration unit for any and all formations and/or pools spaced on 320 acres within said vertical extent which presently includes but is not necessarily limited to the Undesignated South Salt Lake-Morrow Gas Pool and Undesignated Halfway-Atoka Gas Pool; and,

the SE/4 forming a standard 160-acre gas spacing and proration unit for any and all formations and/or pools spaced on 160 acres within said vertical extent.

Said units are to be dedicated to the applicant's proposed Tomahawk "28" Federal Com Well No. 1 to be drilled at a standard gas well location 1980 feet from the South line and 660 feet from the East line (Unit I) of Section 28.

(3) Subsequent to the hearing and by letter dated April 8, 1997, Nearburg Exploration Company, L.L.C. advised the Division that all working interests within the proposed spacing units have been voluntarily consolidated and requested that Case No. 11722 be dismissed.

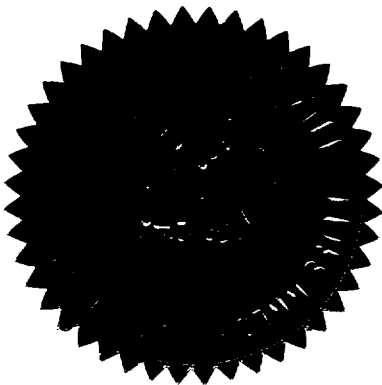
(4) At the request of the applicant, Case No. 11722 should be dismissed.

**IT IS THEREFORE ORDERED THAT:**

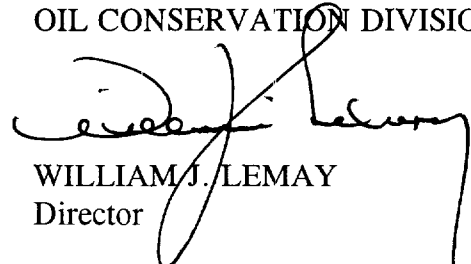
(1) Case No. 11722 is hereby dismissed.

(2) 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

0 1947

April 8, 1997

Attn: David Catanach

Dear Mr. Catanach:

If we can be of further assistance, please advise.

Duke Rausch

DR/sc

**KELLAHIN AND KELLAHIN**

ATTORNEYS AT LAW

EL PATIO BUILDING

17 NORTH GUADALUPE

POST OFFICE BOX 2265

SANTA FE, NEW MEXICO 87504-2265

W. THOMAS KELLAHIN\*

\*NEW MEXICO BOARD OF LEGAL SPECIALIZATION  
RECOGNIZED SPECIALIST IN THE AREA OF  
NATURAL RESOURCES-OIL AND GAS LAW

TELEPHONE (505) 982-4285

TELEFAX (505) 982-2047

JASON KELLAHIN (RETIRED 1991)

March 31, 1997

Mr. David R. Catanach  
Oil Conservation Division  
2040 South Pacheco  
Santa Fe, New Mexico 87504

**HAND DELIVERED**

Rand Carroll, Esq.  
Oil Conservation Division  
2040 South Pacheco  
Santa FE, New Mexico 87504

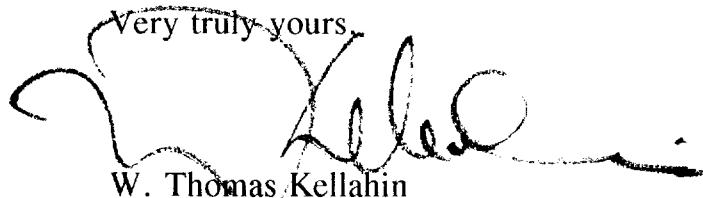
**HAND DELIVERED**

**Re: MEMORANDUM**  
*NMOCD Case 11722*  
*Application of Nearburg Exploration Company, L.L.C.*  
*for compulsory pooling, Lea County, New Mexico*

Gentlemen:

On behalf of Nearburg Exploration Company, please find enclosed our Memorandum in support of the Division's jurisdiction and authority to reduced the excessive overriding royalty burdens in this case which was heard on March 20, 1997.

Very truly yours,

A handwritten signature in dark ink, appearing to read 'W. Thomas Kellahin', is written over a horizontal line. The signature is fluid and cursive.

W. Thomas Kellahin

cc: Nearburg Exploration Company, L.L.C.  
Attn: Duke Roush

**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. 11722**

**APPLICATION OF NEARBURG EXPLORATION  
COMPANY, L.L.C. FOR COMPULSORY POOLING,  
LEA COUNTY, NEW MEXICO**

**NEARBURG EXPLORATION COMPANY'S  
MEMORANDUM**

This matter is before the Division on the application of Nearburg Exploration Company, L.L.C. ("Nearburg") for an order pooling all mineral interests from the surface to the base of the Morrow formation underlying the E/2 of Section 28, Township 20 South, Range 33 East, NMPM, Lea County, New Mexico.

**BACKGROUND**

Included in Nearburg's application is a request that sixteen overriding royalty interests totalling 34.6875 % which burden the Murphy Petroleum Corporation's net revenue interest in the SW/4SE/4 are an excessive overriding royalty burden ("ORR") which should be proportionately reduced to 12.5 % in order to provide the necessary minimum economics to support drilling, completing and operating this well.

Currently, Murphy Petroleum Corporation's net revenue interest in the SW/4SE/4 is 52.8125 % because it is burdened with a 12.5 % federal royalty and 34.6875 % overriding royalty burdens. If these total overriding royalty burdens are reduced to 12.5 % it will increase Murphy Petroleum Corporation net revenue interest to 75 % which will result in a 2.11 % return on investment and a 24.97 % rate of return.

## ISSUE

It is the compulsory pooling practice of this Division that, pursuant to a compulsory pooling order, the operator may recover the nonconsenting working interest owner's share of costs plus a risk penalty only out of the nonconsenting working interest owners share of production and not out of the share allocated to royalty owners and overriding royalty owners ("nonoperating interests"). In order to take advantage of that practice, a working interest owners might burden its interest to the point it becomes useless. Obviously, the larger the royalty interest and other nonoperating interest burdens are, the smaller is the remaining production that is attributable to the non-consenting working interest owners and to which the participating working interest owners must look in order to recover the non-consenting working interest owner's share of costs plus the appropriate penalty.

The Division is concerned that the compulsory pooling provisions of the New Mexico "Oil and Gas Act" Section 70-2-17(C) NMSA (1978) and the compulsory pooling orders issued pursuant thereto will become useless if consenting or non-consenting working interest owners can avoid the costs and penalty factor of a compulsory pooling order simply by reducing their net revenue working interest percentage by creating excessive nonoperating right burdens.

The issue is whether the Division has jurisdiction and authority to alleviate that problem by any of the following options:

- (1) placing the economic consequences of the excessive ORR directly on the ORR interest owner by **permanently** reducing the overriding royalty burden to a percentage that is not excessive;
- (2) shifting the economic consequences of the excessive ORR directly on the ORR interest owner **until the well pays out its costs and penalties** by **temporarily** reducing the overriding royalty burden to a percentage that is not excessive; or
- (3) placing the economic consequences of the excessive ORR directly on the working interest owner by requiring the working interest owner whose interest is subject to excessive ORR burdens to pay his percentage of the costs and penalties involved as if the excessive ORR did not exist.

## AUTHORITY

Nearburg contends that the Division has the necessary jurisdiction and authority to alleviate this problem by doing any of the above.

The Commission has extensive statutory authority granted to it by the Oil and Gas Act. **Santa Fe Exploration Co. v. Oil Conservation Com'n**, 114 N.M. 103, 835 P.2d 819 (1992). **Continental Oil Co. v. Oil Conservation Comm'n**, 70 N.M. 310, 373 P.2d 809 (1962).

Pursuant to Section 70-2-6 NMSA (1978), the New Mexico Legislature has delegated to and charged the Oil Conservation Division of New Mexico with the jurisdictional authority over **all matters** relating to the conservation of oil and gas:

It shall have jurisdiction, authority, and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act or any other law of this state relating to the conservation of oil or gas...."

More specifically, in Section 70-2-19(C) NMSA (1978), the New Mexico Legislature has explicitly granted to the Oil Conservation Division the jurisdiction to decide the terms and conditions of compulsory pooling orders "[F]or the purpose of determining the portion of production owned by the persons owning interests in the pooled oil or gas or both..."

There are no limitations or restrictions contained in Section 70-2-17(C) which preclude the Division from setting aside, reducing or otherwise declaring invalid excessive overriding royalty burdens. In fact the Oil and Gas Act specifically authorizes compulsory pooling of all owners **including** working interest, royalty and overriding royalty interest owners.

While Section 70-2-17(C) states the Division's order "may include a charge for risk....which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorate share of the cost of drilling and completing the well" that does not preclude the Division from determining that a nonconsenting working interest owner's "prorata share" must be increased and corresponding decrease his ORR burdens so that the well can be economically drilled and completed.

Parties by private contract, agreement or assignment, cannot circumvent or preclude the Commission for exercising its jurisdiction and authority. **Patterson v. Stanolind Oil & Gas Co.**, 182 Okla 155, 77 P.2d 83 (1938).

As the Commission has jurisdiction over all categories of owners and the authority to determine the allocation of drilling and completing costs among working interest owners, surely it has jurisdiction to determine who those working interest owners are and what percentage of their gross working interest shall be subject to such costs and penalties.

The first state compulsory pooling statutes were enacted in New Mexico in 1935.<sup>1</sup> While there is no case law in New Mexico specifically on this point, there have been four such cases in Oklahoma. In the first two cases, the Oklahoma decisions left open the resolution of this question<sup>2</sup> which was finally addressed in **O'Neill v. American Quasar Petroleum Co.** 617 P.2d 181 (Okla 1980) and in **North American Royalties Inc. v. Corporation Comm'n**, P.2d 539 (Okla. App. 1984).

In New Mexico, a party whose interest is pooled by order of the Division may elect:

- (1) to pay his share of the costs and receive a working interest share of production; or
- (2) to be carried by the operator with the carried costs to be satisfied out of production **plus** a penalty factor and thereafter to receive a working interest share of production.

In Oklahoma, a party whose interest is pooled by order of the Commission may elect among the following options:

- (1) to pay his share of the costs and receive a working interest share of production;

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<sup>1</sup> Texas does **not** allow compulsory pooling. Oklahoma's pooling statute which is substantially different from New Mexico's was also enacted in 1935.

<sup>2</sup> See **Youngblood v. Seewald**, 299 F.2d 680 (10th Cir. Okla 1961) and **Holmes v. Corporation Comm'n**, 466 P.2d 630 (Okla. 1970).

(2) to be carried by the operator with the carried costs to be satisfied out of production **plus** a penalty factor and thereafter to receive a working interest share of production; or

(3) to sell his working interest to the operator for a bonus and a retained overriding royalty percentage the amount of which **is determined** by the Commission.

This last option which is **not** available in New Mexico, has afforded a unique solution in Oklahoma to the issue of how to solve the problem of excessive nonoperating burdens such as excessive overriding royalties, production payments or net profits interest. In **North American Royalties Inc. v. Corporation Comm'n**, P.2d 539 (Okla. App. 1984), the Oklahoma Court of Appeals, relied upon **O'Neill v. American Quasar Petroleum Co.** 617 P.2d 181 (Okla. 1980), and held that the Oklahoma Commission's ability to set the amount of bonus provided a mechanism to relieve the operator of the problem of paying the same consideration to a working interest burdened with excessive burdens as it would to a working interest without such burdens.

Because Oklahoma's pooling statute is limited to pooling only working interest and unleased mineral interests, the Oklahoma Supreme Court has held that its Commission lacks the power to change an excessive overriding royalty into a working interest. **O'Neill v. American Quasar Petroleum Co.** 617 P.2d 181 (Okla 1980).

**O'Neill**, supra, involved a 77-acre working interest which was burdened by 4 overriding royalties totalling 9+ % of gross production, two of which had the option of converting to 6.25 % working interests on payout. The Oklahoma Commission force pooled this interest into a 640-acre unit, offering these ORR owners the alternative of participating in drilling or receiving reduced fractional production shares in proportion to their ownerships and acreage.

In a 5-4 decision, the court held the Commission may not convert these interests from expense free to expense bearing status.

The Oklahoma decision in **O'Neill**, supra, is distinguishable from the law in New Mexico on several grounds:

(1) In Oklahoma, unlike New Mexico, when an owner of a working interest elects not to participate in a unit well, electing rather to accept a bonus or royalty in lieu thereof, that working interest becomes the property of the operator, and the interests of the ORR owners do not come from the original lessee's interest but are attributable to the unit operator. See **Youngblood v. Seewald**, supra.

(2) In New Mexico, the compulsory pooling statute specifically authorizes the pooling of royalty interests. See Section 70-2-17(C) NMSA (1978), while Oklahoma's pooling statute is specifically limited to working interest owners and unleased mineral owners.<sup>3</sup>

(3) In Oklahoma, the creation of a drilling and spacing unit "pools" royalty interests by operation of law, but working interests are pooled by voluntary agreement or a separate Commission order. **Whitaker v. Texaco, Inc.** 283 F.2d 169 (Okla. 10 Cir 1960).<sup>4</sup>

It is of particular interest to note the well reasoned dissents in **O'Neill**, supra, which are highly critical of the Oklahoma Commission for its "utter failure to make essential explanatory findings as to the very basis upon which its determination is sought to be rested" and which urged that:

"contractual rights relating to overriding royalty interests, production payments, etc., may be amended and modified [by the Commission] to the extent necessary to conform to the requirements of forced pooling..."

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<sup>3</sup> In Oklahoma, the royalty and ORR owners are "pooled" by operation of law with the entry of a spacing order establishing well spacing. See **O'Neill**, supra, at page 184.

<sup>4</sup> Oklahoma's compulsory pooling statute is specifically limited to working interest and unleased mineral owners and does not include royalty or ORR owners.

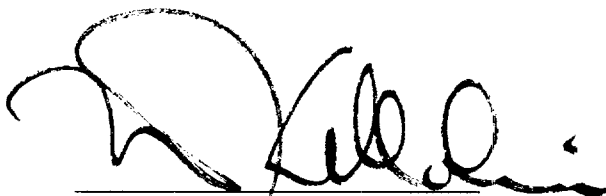
In prior New Mexico Oil Conservation Division cases, the Division has decided similar cases by entering orders which assisted the operator whose spacing units contained excessive nonoperating burdens.<sup>5</sup>

### CONCLUSION

Nearburg concurs in the suggestion made by William & Myers<sup>6</sup> that it may be necessary for the Division to reduce or eliminate excessive nonoperating interests or to subject them to the burden of operating expenses.

In such instances, the Division must and does have the power to deal with excessive nonoperating burdens by being able to reach the various burdens for necessary adjustment of the working interest value. In New Mexico, unlike Oklahoma, there is no statutory impediment to allowing flexibility in allocating lease obligations in order to prevent waste and protect correlative rights.

Respectfully submitted,



W. Thomas Kellahin  
KELLAHIN & KELLAHIN  
P. O. Box 2265  
Santa Fe, New Mexico 87504

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<sup>5</sup> See OCD Case 11472 (Order R-10552), Case 8640 (Order No. R-7998), Case 8859 (Order No. R-8047), Case 7922 (Order No. R-7335).

<sup>6</sup> See Williams and Meyers, **Oil and Gas Law**, Section 944, page 680 (1997).

**KELLAHIN AND KELLAHIN**

ATTORNEYS AT LAW

EL PATIO BUILDING

117 NORTH GUADALUPE

POST OFFICE BOX 2265

SANTA FE, NEW MEXICO 87504-2265

W. THOMAS KELLAHIN\*

\*NEW MEXICO BOARD OF LEGAL SPECIALIZATION  
RECOGNIZED SPECIALIST IN THE AREA OF  
NATURAL RESOURCES-OIL AND GAS LAW

JASON KELLAHIN (RETIRED 1991)

TELEPHONE (505) 982-4285

TELEFAX (505) 982-2047

March 24, 1997

**HAND DELIVERED**

Mr. David R. Catanach  
Hearing Examiner  
Oil Conservation Division  
2040 South Pacheco  
Santa Fe, New Mexico 87505

*Re: NMOCD Case 11722  
Application of Nearburg Exploration Company  
for Compulsory Pooling, Lea County, New Mexico*

Dear Mr. Catanach:

On behalf of Nearburg Exploration Company, please find enclosed Nearburg's proposed order for this case. I have indicated by highlighter those provisions which require your attention. Also enclosed is a diskette containing this draft.

Very truly yours,

A handwritten signature in black ink, appearing to read 'W. Thomas Kellahin', written in a cursive style.

W. Thomas Kellahin

cc: Nearburg Exploration Company  
Attn: Duke Roush