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

APPLICATION OF ROBERT E. LANDRETH
FOR DETERMINATION OF REASONABLE
WELL COSTS, LEA COUNTY, NEW MEXICO. CASE NO. 12008

ROBERT E. LANDRETH'S
MEMORANDUM BRIEF ON SCOPE OF ORDER R-10764
AND JURISDICTION OF NMOCD

Applicant Robert E. Landreth ("Landreth") submits this Memorandum Brief to aid the New Mexico Oil Conservation Division ("the Division") in its consideration of the scope of Division Order R-10764, and the jurisdiction of the Division in this matter. Order R-10764 permits Santa Fe Energy Resources ("Santa Fe") to withhold a 200% penalty for costs associated with a particular well, Santa Fe's Gaucho Unit No. 2 well, API No. 30-025-33682. The Order does not apply its penalty provision to any other wells. It also does not allow Santa Fe to recover the costs of a failed well from Landreth's share of production from a different, second well. The Division has jurisdiction to determine both whether its Order applies in this case, and whether the well costs assessed by Santa Fe pursuant to Order R-10764 are reasonable.

I. THE PENALTY PROVISION OF ORDER R-10764 APPLIES TO ONE WELL– THE GAUCHO UNIT NO. 2

In this case, Landreth is asking the Division to determine what costs may reasonably be withheld from the share of production attributed to Landreth's working interest in the Gaucho Unit No. 2-Y well, pursuant to the provisions of Order R-10764. That Order pooled all interests in the S/2 of Section 29, Township 22 South, Range 34 East, NMPM, Lea County, New Mexico. The standard spacing unit thereby formed was "dedicated to [Santa Fe's] proposed Gaucho Unit Well No. 2 (**API No. 30-025-33682**)." (Order R-10764, February 14, 1997, at 3, Decretory ¶ 1 (emphasis in original)). The Order permits Santa Fe to withhold from production "[a] · a charge for the risk involved in the drilling of **the well**, 200 percent of the pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him." (Order R-10764 at 5, Order ¶ (7)(b) (emphasis added)).

Santa Fe operates the South half of Section 29, the proration unit pooled by Order R-10764. Landreth owns 37.5% of the working interest in that proration unit. (Stip. Documents, Tab 9). On September 16, 1996, Santa Fe proposed to Landreth the drilling of the Gaucho Unit No. 2 well. At that point, the parties were unable to agree to terms by which Landreth would join the project with his interest. Because the parties were unable to reach

an agreement, Santa Fe applied to the Division and received Order R-10764 on February 14, 1997. (Stip. Documents, Tab 2).

After Order R-10764 was issued, but before Santa Fe completed drilling the Gaucho Unit No. 2 well, Landreth agreed to commit part of his interest to that well. In a March 28, 1997 letter to Santa Fe, Landreth agreed to divide his working interest in the S/2 of Section 29, Township 22 South, Range 34 East into two shares. Under this agreement, one quarter of Landreth's working interest (9.375%) was voluntarily committed to the drilling of the Gaucho Unit No. 2 well, the remaining three quarters of Landreth's working interest (28.125%) remained "**. . . subject to the Compulsory Pooling Order in effect for this well**." (Stip. Documents, Tab 9 (emphasis added)).

Santa Fe's Gaucho Unit No. 2 well was drilled. That well was plugged. That well was abandoned. (*See* Stipulated Documents, Tab 6 (Sundry Notice to BLM) ("Verbal Approval to plug the well were [sic] obtained on 3/30/97")); (Tab 25, at 3, ¶ 3/30/97 ("Day 27 3783' (0'). Plug to Abandon."))

Having plugged and abandoned the well to which the penalty provision of Order R-10764 applied, Santa Fe proceeded to drill another well on this spacing unit. (Stip. Documents, Tab 10 (letter from Santa Fe to Landreth, March 31, 1999) ("The **new well name** will be the Gaucho Unit No. 2-Y Well . . . ." (emphasis added)); (Stip. Documents, Tab 6 (Sundry Notice to BLM) ("The **New Well** here will be at 1650' FSL and 1750' ±

FWL.") (emphasis added)). When Santa Fe reported completion of the Gaucho Unit No. 2-Y well, it indicated that the well was a "**NEW WELL**" (*see* Stip. Documents, Tab 26 (Well Completion Report)), one with a different API number than the Gaucho Unit No. 2 well. (*Compare id.* (Gaucho Unit No. 2-Y well (**API No. 30-025-34026**)), *with* Order R-10764, at 3, Decretory ¶ 1 (Gaucho Unit No. 2 well (**API No. 30-025-33682**)).

Santa Fe recognized that the Gaucho Unit No. 2-Y well was a new and different well from the Gaucho Unit No. 2 well, for, prior to drilling the Gaucho Unit No. 2-Y well, Santa Fe contacted Landreth and gave him the opportunity to join in that well with 9.375% of his working interest in this spacing unit. (Stip. Documents, Tab 10). Santa Fe did not seek an amendment of Order R-10764 to extend the penalty provision to the Gaucho Unit No. 2-Y well.

Landreth did not participate in the Gaucho Unit No. 2 well with his 28.125% working interest in the subject lands. That well was unsuccessful. Santa Fe assumed the risk of drilling that well, and drilled an unsuccessful well. Under the provisions of Order R-10764, Landreth's 28.125% working interest cannot be charged for the Guacho No. 2 wellbore. If Santa Fe had abandoned the project following the plugging and abandoning of the Gaucho Unit No. 2 well, Landreth could not have been charged for the costs of that unsuccessful venture. Santa Fe may not now charge Landreth for the interest he did not commit to the well.

Santa Fe seeks to use the penalty provision of Order R-10764 to assess a 200% penalty to the non-consent portion of Landreth's interest, based on the costs of **both** the plugged and abandoned Gaucho Unit No. 2 well, **and** the completed Gaucho Unit No. 2-Y well. Order R-10764 specifies the well to which its penalty provision applies. It does not apply the penalty provision to the Gaucho Unit No. 2-Y well.

Order R-10764 means what it says. All mineral interests in the South half of Section 29 are pooled. Santa Fe is authorized to withhold a 200% penalty associated with the costs of drilling **the well**. The well specified in Order R-10764 is the Gaucho Unit No. 2 well. The Division must apply Order R-10764 as it is written, and not "insert words . . . or depart from its common sense meaning." *See High Ridge Hinkle Joint Venture*, 126 N.M. 413, 415, 970 P.2d 599, 601 (1998) ("[Z]oning regulations should not be extended by construction beyond the fair import of their language and **they cannot be construed to include by implication that which is not clearly within their express terms**") (emphasis added). *See also TBCH, Inc. v. City of Albuquerque*, 117 N.M. 569, 571-72, 874 P.2d 30, 32-33 (Ct. App. 1994) (unambiguous language of ordinance did not impose additional, unstated requirement–plain and unambiguous language of ordinance must be applied).

The plain and unambiguous language of Order R-10764 authorizes Santa Fe to recover a 200% risk penalty of the costs of drilling one well–the Gaucho Unit No. 2 well. It does not authorize the imposition of a risk penalty based on multiple wells.

Order R-10764 authorizes Santa Fe to withhold from production the reasonable well costs attributable to each not-consenting working interest owner. It authorizes a 200% risk penalty **for one** well–the Gaucho Unit No. 2 well, and authorizes Santa Fe to withhold that penalty from the production of the Gaucho Unit No. 2 well. Any costs of the Gaucho Unit No. 2 well, and any penalty provision associated with the Gaucho Unit No. 2 well, are not reasonable well costs under the plain and unambiguous language of the Order, and may not be assessed or withheld from the Gaucho Unit No. 2-Y well production under the authority of the Order. Similarly, Order R-10764 may not be used to assess any penalty on the costs of the Gaucho Unit No. 2-Y well.

II. LANDRETH'S 28.125% NON-COMMITTED INTEREST IS SUBJECT TO ORDER R-10764, AND IS NOT SUBJECT TO A JOINT OPERATING AGREEMENT

Santa Fe Energy Resources, Inc. ("Santa Fe") asks the Division to disregard its own Order, Division Order R-10764, issued on February 14, 1997, and decline to hear the objection of Landreth because of what Santa Fe characterizes as "a voluntary agreement with Santa Fe which superseded this order." The Joint Operating Agreement (JOA) to which Santa Fe refers did not replace Order R-10764, and was never intended to replace that Order.

As an initial matter, Santa Fe suggests that the Division may not consider Landreth's objection in this case. Essentially, Santa Fe contends that the Division may not interpret a contract between the parties, and consequently, the Division may not even consider this case

since Santa Fe has raised the possibility of an agreement between the parties. This suggestion is absurd.

An administrative agency has the authority to determine its own jurisdiction. "The Board retains the authority at all times to examine facts and make a finding concerning its own jurisdiction, subject, of course, to review by the courts." *Cibas v. New Mexico Energy, Minerals and Natural Resources Dep't.*, 120 N.M. 127, 132, 898 P.2d 1265, 1270 (Ct. App.), *cert. denied*, (1995). In this case, the Division certainly has the authority to determine whether its Order applies to the costs assessed against Landreth by Santa Fe explicitly pursuant to the Order, and consequently whether Santa Fe can withhold the costs for the Gaucho Unit No. 2 well out of the production from the Gaucho Unit No. 2-Y well, or impose an unauthorized risk penalty for costs incurred in drilling the Gaucho Unit No. 2-Y well. Neither of those costs are reasonable well costs under Order R-10764.

After drilling the Gaucho Unit No. 2-Y well, Santa Fe sought clarification from its attorneys as to the status of the working interest in the spacing unit. (Stip. Documents, Tab 26). Before rendering their title opinion, Santa Fe's attorneys examined Santa Fe's lease files and the joint operating agreement upon which Santa Fe now relies in arguing that Landreth committed all of his interest to the Gaucho Unit No. 2-Y well, and Order R-10764. (*Id.* at 1, 6-8). Santa Fe's attorneys concluded in October, 1997, **after the Gaucho Unit No. 2-Y well was drilled, and after Landreth executed the JOA as to the Gaucho Unit No. 2-Y**

well, that "Pursuant to the terms of this Order, Robert E. Landreth elected to participate in the drilling of the subject well with respect to an undivided 18.75% working interest in the SE/4 of Section 29, or an undivided 9.375% working interest in the proration unit for the subject well, and to be forced pooled as to an undivided 56.25% working interest in the SE/4 of Section 29, or an undivided 28.125% working interest in the proration unit for the subject well [the Gaucho Unit No. 2-Y well]." (*Id.* at 8).

The conclusion reached by Santa Fe's attorneys in 1997 is consistent with the facts. Landreth first received a copy of the JOA when Santa Fe first contacted him on September 16, 1996, and proposed the drilling of the Gaucho Unit No. 2 well. Because the parties were unable to reach an agreement, Santa Fe applied to the Division and received Order R-10764 on February 14, 1997. (Stip. Documents, Tab 2).

In a March 28, 1997 letter to Santa Fe, Landreth agreed to divide his working interest in the S/2 of Section 29, Township 22 South, Range 34 East into two shares. One quarter of Landreth's working interest (9.375%) was voluntarily committed to the drilling of the Gaucho Unit No. 2 well. The remaining three quarters of Landreth's working interest remained "**. . . subject to the Compulsory Pooling Order in effect for this well.**" (Stip. Documents, Tab 9 (emphasis added)).

As to his 9.375% interest in the unit, Landreth agreed to commit that interest to both the Gaucho Unit No. 2 well and, by subsequent agreement, the Gaucho Unit No. 2-Y well.

However, as to his 28.125% interest, the only thing to which Landreth agreed was that his 28.125% interest would remain subject to the compulsory pooling order in effect in this case. (*See* Stip. Documents, Tab 9, (3/28/97 letter from Landreth to Santa Fe) ("I elect to participate in the drilling of the captioned well to the extent of 25% of my 37.5% working interest, **with the balance to be subject to the Compulsory Pooling Order in effect for this well**") (emphasis added)); (Stip. Documents Tab 11 (4/1/97 letter from Landreth to Santa Fe) (addressing Operating Agreement "**insofar as it affects my interest**") (emphasis added)); (Stip. Documents, Tab 13 (4/15/97 letter from Landreth to Santa Fe) ("**for the purposes of my joinder**, the Initial Well shall be the Gaucho Unit #2 or #2-Y") (emphasis added)).[1]

Santa Fe's actions bear out the lack of agreement between the parties as to Landreth's

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[1] Santa Fe suggests that the Division may not consider any of the documents relevant in this case, other than the JOA, because the JOA is an agreement between the parties. The Division may not close its eyes just because one party claims there is an agreement. Instead, to determine whether a writing is a full and complete expression of the parties, agreements and negotiations prior to, or contemporaneous with, the adoption of a writing are admissible. *Locke v. Murdock*, 20 N.M. 522, 534, 151 P298, 302 (1915); see also NMSA 1978, Section 55-2-202 (1953); *see also* Arthur R. Corbin, 3 *Corbin on Contracts*, § 588 at 528-29. NMSA 1978, Section 55-2-202 provides that even when a writing "is intended by the parties as a final expression of their agreement," it is proper for a court to consider the "course of dealing," "usage of trade," and "course of performance," to "explain or supplement" the agreement.

As to Landreth's 28.125% interest, the JOA is no agreement at all. As to that interest, the JOA is not "a final and complete expression of the agreement" between Landreth and Santa Fe. Restatement (Second) of Contracts § 209 (1979). An integrated agreement is "a writing or writings constituting a final expression of one or more terms of the agreement." *Id.* "The writing cannot itself prove its own completeness and the parties may present any relevant evidence of whether the parties intended the writing to be a final and complete expression of the agreement." Restatement (Second) of Contracts § 210 comment b (1979); see also *Corbin On Contracts*, § 588 at 528-29 (1960). The dealings between the parties indicate that Landreth only agreed to commit his 9.375% interest to the JOA. The remaining 28.125% interest remained subject to Order R-10764.

28.125% interest. When Santa Fe asked Landreth to participate in the Gaucho Unit No. 2-Y well, it explicitly indicated that Landreth's well ownership was 9.375%. (Stip. Documents, Tab 10). In Exhibit A to the JOA, Santa Fe listed the interests committed to the JOA. Landreth's 9.375% interest is indicated as committed. Landreth's 28.125% interest is indicated as not committed, and is reflected in same manner as Amerada Hess's 12.50% interest. Amerada Hess never committed any of its interest to either well, and was not a party to the Operating Agreement. The only way Amerada Hess could have been assessed costs or risk penalties is through Order R-10764. Santa Fe's listing of Amerada Hess's interest next to Landreth's uncommitted 28.125% interest emphasizes the fact that Landreth's 28.125% interest was not committed, and remained subject to Order R-10764. (Stip. Documents, Tab 15 at 2 (Exhibit A to Operating Agreement)). Four months after Santa Fe drilled the Gaucho Unit No. 2-Y well, but before Santa Fe attempted to assess the costs of that well to Landreth under Order R-10764, Santa Fe obtained the title opinion from its attorneys. That title opinion indicates that, **as to the Gaucho Unit No. 2-Y well**, Landreth's 28.125% interest is subject to Order R-10764. (Stip. Documents, Tab. 24, at 8). When it attempted to assess the costs of both wells to Landreth, Santa Fe indicated that the assessment was "**[p]ursuant to the provisions of NMOCD Compulsory Pooling Order #R-10764**." (Stip. Documents, Tab 20 (emphasis added)).

Moreover, the Division is compelled to examine the dealings between the parties in

determining whether Order R-10764 applies to Landreth's 28.125% interest:

> [E]ven if the language of the contract appears to be clear and unambiguous, a court may hear evidence of the circumstances surrounding the making of the contract and of any relevant usage of trade, course of dealing, and course of performance, in order to decide whether the meaning of a term or expression contained in the agreement is actually unclear. The court is no longer restricted to the bare words of the agreement in interpreting the intent of the parties to a contract, but may also consider the context in which the agreement was made to determine whether the party's words are ambiguous.

Mark V, Inc. v. Mellekas, 114 N.M. 778, 781, 845 P.2d 1232, 1235 (1993).[2]

The JOA is not an agreement at all as to Landreth's 28.125% interest. Instead, Landreth agreed that his 28.125% interest was subject to Order R-10764. Santa Fe treated Landreth's 28.125% interest as if it were subject to Order R-10764. Neither party agreed that Landreth's 28.125% interest were subject to the JOA. Neither party acted as if Landreth's 28.125% interest were subject to the JOA. Landreth's 28.125% interest is **not** subject to the JOA. Instead, Landreth's uncommitted 28.125% interest is subject to Order R-10764, which pooled the South half of Section 29 and authorized a risk penalty only for the Gaucho Unit No. 2 well.

Any costs attributable to the Gaucho Unit No. 2 well which Santa Fe is attempting to assess to Landreth under Order R-10764 are unreasonable well costs, and must be disallowed

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[2] Santa Fe suggests that, in fact, the Division may not consider extrinsic evidence when considering an "unambiguous contract." *See* Reply of Santa Fe Energy Resources, Inc., filed December 18, 1998, at 10. Santa Fe is wrong. The Division must consider the documents surrounding the execution of the JOA to determine if the JOA says what Santa Fe claims it does. "New Mexico law, then, allows the court to consider extrinsic evidence to make a preliminary finding on the question of ambiguity." Stock v. Grantham, 125 N.M. 564, 964 P.2d 125, (Ct. App.), *cert. denied*, 125 N.M. 322, 961 P.2d 167 (1998).

by the Division. Moreover, because Order R-10764 only applied the 200% risk penalty to the Gaucho Unit No. 2 well, no penalty may be assessed on the costs of the Gaucho Unit No. 2-Y well.

III. THE DOCTRINE OF ESTOPPEL DOES NOT BAR ANY OF LANDRETH'S ARGUMENTS

Santa Fe also suggests that Landreth is somehow "estopped" from challenging reasonable well costs under Order R-10764. Santa Fe's estoppel argument does not apply in this case. There are many types of estoppel. Santa Fe does not identify the different types of estoppel, which further confuses its argument. Santa Fe cites *Rodriguez v. La Mesilla Const. Co.*, 123 N.M. 489, 943 P.2d 136 (Ct. App. 1997) to attempt to prevent Landreth from presenting its position to the Division. *Rodriguez* supports Landreth's position. *Rodriguez* concerns judicial estoppel, a doctrine which prevents a party from asserting a position which directly contradicts a position assumed previously. Judicial estoppel is disfavored and rarely applied in New Mexico. In the cases in which the doctrine has been raised in New Mexico it has only been accepted only once, and then without comment by the court. The tenth circuit has entirely refused to adopt the doctrine. *Santa Fe Village Venture v. City of Albuquerque*, 914 F. Supp. 478, 482 (1995). *Chrysler Credit Corp. v. Country Chrysler, Inc.*, 928 F.2d 1509 (10th Cir.1991).

In *Rodriguez*, the court did not apply judicial estoppel on the basis that plaintiff had not "assumed" the position that defendant claimed it had previously. As in *Rodriguez*, here

Landreth did not previously assume the position that Santa Fe claims it assumed. Landreth's position has at all times been consistent with his understanding that his 28.125% interest was subject to Order R-10764, and not to the JOA, and that he had committed his 9.375% interest to both the Gaucho Unit No. 2 well and the Gaucho Unit No. 2-Y wells.[3]

IV. CONCLUSION

Order R-10764 only authorizes Santa Fe to impose a 200% risk penalty based on reasonable well costs involved in the drilling of the Gaucho Unit No. 2 well. Santa Fe drilled, plugged, and abandoned that well. Landreth did not commit his 28.125% interest to the Gaucho Unit No. 2 well. Santa Fe may not use Order R-10764 to recover a risk penalty from the second well, or use that Order to withhold from Gaucho Unit No. 2-Y well production any of the costs attributable to the Gaucho Unit No. 2 well. All charges associated with the Gaucho Unit No. 2 well, and associated with a risk penalty for the costs of the Gaucho Unit No. 2-Y well, are not reasonable well costs under Order R-10764, and should be disallowed by the Division.

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[3] Santa Fe also suggests that Landreth and his attorney have previously taken the position that Order R-10764 should apply to the Gaucho Unit No. 2-Y well, and not the Gaucho Unit No. 2 well. *See* Reply of Santa Fe Resources, Inc. at 5. Santa Fe is wrong. Landreth's attorney merely "objects to the actual well costs for these wells and requests that the Division determine the actual well costs after public notice and hearing as provided in order paragraph 5 of Order R-10764." (Stip. Documents, Tab 21, at 2). In two subsequent letters from Landreth, proposals for settlement were made. (Stip. Documents, Tabs 24, 25). Those proposals are inadmissible to prove liability for or invalidity of Landreth's claim in this proceeding. Rule 11-408, NMRA 1999. Moreover, despite any statements by Landreth **or** Santa Fe, Order R-10764 still means what it says–that the 200% penalty only applies to the Gaucho Unit No. 2 well.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused a true and correct copy of Robert E. Landreth's Memorandum Brief on Scope of Order R-10764 and Jurisdiction of NMOCD to be hand-delivered on this 14th day of June, 1999 to the following counsel of record:

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