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

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

CASE NO. 12008

MEMORANDUM OF SANTA FE ENERGY RESOURCES, INC.

Comes now Santa Fe Energy Resources, Inc. ("Santa Fe"), by its attorney, W. Thomas Kellahin, Esq., and files this Memorandum of Facts and Authorities in support of its opposition to the application of Robert E. Landreth:

THE PROBLEM

Santa Fe commenced drilling the Gaucho Unit Well No. 2 ("the original well") which was lost when the drill string separated at 3,783 feet.[1] They continued operations by skidding the rig 75 feet and drilling the Gaucho Unit Well No. 2-Y ("the substitute well") which was completed at a depth of 13,288 feet in the Morrow formation as a very successful Morrow gas well.[2]

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[1] See **Exhibit 4**

[2] See **Exhibits 4 and 26**

When an original well fails under these circumstances, the substitute well is a continuation of the operations commenced on the original well.[3] The problem is that Landreth accepts this fact as to 9.375 % of his working interest but argues to the contrary as to the balance of his working interest.

He now wants the Division to declare that 28.125 % of his share of production from the substitute well cannot be used to pay for his share of the costs and penalty for the original well. He also now wants the Division to declare that 28.125 % of his interest in the substitute well is neither subject to the Joint Operating Agreement or the compulsory pooling order.

THE ISSUES

These are the issues involved in this case and the sequence in which those issues should be addressed by the Division: (a) did the Joint Operating Agreement, including Revised Exhibit "A" dated 4/21/97, replace the compulsory pooling order affecting Landreth's interest; (b) if not, then did the compulsory pooling order apply to Landreth's interest in the substitute well; and (c) in either case, can Landreth's share of production in the substitute well be applied to pay for his costs and penalty for the original well.

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[3] **See Steinkuehler v. Hawkins Oil & Gas, Inc. 728 P.2d 520 (Okla. App 1986)**

More specifically, does the Division have jurisdiction to interpret the intent of the parties in making this contract or should this matter be resolved by the courts.

If the Division asserts jurisdiction, then the Division must decide if Santa Fe's Joint Operating Agreement ("JOA"), including revised Exhibit "A", is clear and unambiguous. If so, then the Division must grant Santa Fe's Motion to Dismiss because on April 30, 1997, after the date of the compulsory pooling order, Landreth signed and accepted Santa Fe's JOA **including** the Revised Exhibit "A" dated 4/21/97 and in doing so, agreed to the drilling of the substitute well and agreed that he was participating for 25% of his interest (9.375% WI) and going "non-consent" as to the remaining 75% of his interest (28.125% WI) as to both the original well and the substitute well. Revised Exhibit "A" is clear and unambiguous. When the language of a contract can be fairly and reasonably construed in only one way, the contract is not ambiguous and the court cannot rely upon parol or extrinsic evidence to determine the intent of the parties.[4] If the court decides that a writing was intended as a contract, the court is bound by the parol evidence rule from hearing collateral evidence for purposes of construing the contract in a manner that varies or contradicts the clear and

[4] See **Harper Oil Company v. Yates Petroleum Corporation**, 105 N.M. 430 (1987).

unambiguous language of that contract.[5]

If the Division decides that the JOA replaced the compulsory pooling order, then this case is over. If not, then the Division must decide if the compulsory pooling order applies to the original well and the substitute well. Finally, the Division will have to decide if its compulsory pooling orders will be consistent with the oil & gas case law concerning substitute wells.[6]

RELEVANT FACTS

(1) On September 16, 1996, Santa Fe Energy Resources, Inc. ("Santa Fe") wrote to Robert E. Landreth ("Landreth") and proposed the drilling of the Gaucho Unit Well No. 2 to be dedicated to a Morrow formation spacing unit consisting of the S/2 of Section 29, T22S, R34E, Lea County, New Mexico. In addition, Santa Fe provided Landreth with a copy of Santa Fe's existing Joint Operating Agreement ("JOA") being used for the N/2 of this section. **See Exhibit 1.**

(2) Landreth owns a 37.5% working interest in this spacing unit.[7]

(3) On February 14, 1997, the Division entered order R-10764 in Case 11715 which granted the application of Santa Fe Energy Resources, Inc. ("Santa Fe") for a compulsory pooling order for the drilling of the Gaucho Unit Well No. 2 which, among other things, pooled the working interest of Landreth and of Amerada Hess from the surface to the base of the Morrow formation underlying the S/2 of Section 29, T22S, R34E, Lea County, New Mexico. **See Exhibit 2.**

(4) The balance of the working interest in this spacing unit were already subject to a JOA dated May 1, 1996. **See Exhibit 1.**

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[5] See **C. R. Anthony Company v. Loretto Mall Partners**, 112 N.M. 504 (1991). which is cited in Landreth's Response at page 8 but whose holding is exactly opposite from the point upon which Landreth wants to rely.

[6] See **Steinkuehler**, supra.

[7] See **Exhibit 25**

(5) On February 17, 1997, and in accordance with Order R-10764, Santa Fe sent Landreth an AFE for the Gaucho Well No. 2 and notice of his right to elect to participate in this well. **See Exhibit 3.**

(6) On March 4, 1997, Santa Fe commenced drilling the Gaucho Well No. 2. **See Exhibit 4.**

(7) On March 21, 1997, Landreth acknowledged that he knew the Gaucho Well No. 2 was being drilled and asked Santa Fe to extend his election period under the compulsory pooling order so he could attempt to trade his interest to Enron. **See Exhibit 5**

(8) On March 24, 1997 while drilling at 3,783 feet Santa Fe lost circulation in the Gaucho Unit Well No. 2 and the drill string separated. **See Exhibit 6.**

(9) On March 24, 1997, Santa Fe extended Landreth's election to March 28, 1997 at 5:00 PM. **See Exhibit 7.**

(10) On March 28, 1997, having been verbally notified by Santa Fe of the condition of the Gaucho Unit Well No. 2 and Santa Fe's intention to immediately redrill this well, Landreth advised Santa Fe that he desired to divide his 37.5% interest such that:

> (a) 9.375% (1/4th of his total interest) would be voluntarily committed to Santa Fe's JOA pursuant to which he would pay his share of the well costs; and
>
> (b) 28.125% (3/4th of his total interest) would be involuntarily committed to a compulsory pooling order pursuant to which he would go "non-consent" and be subject to a 200% risk factor penalty. **See Exhibit 9.**

(11) On March 31, 1997, Santa Fe formally advised Landreth of its intention to abandon the Gaucho Unit Well No. 2 and skid the rig and redrill this well as the Gaucho Well No. 2-Y and specifically advise him that **"This redrill is proposed under the existing JOA and AFE"** (emphasis added) **See Exhibit 10.**

(12) On April 1, 1997, Landreth returned to Santa Fe his signed concurrence to this abandonment and redrilling (**See Exhibit 11**) along with his cover letter dated April 1, 1997 in which he asked for modifications to the Santa Fe proposed JOA **including** his interest in both the Gaucho Unit Well No. 1 and Gaucho Unit Well No. 2-Y. (emphasis added) **See Exhibit 15.**

(13) On April 8, 1997, Santa Fe forwarded to Landreth a first revised Exhibit "A" for his review and asked that he approve Santa Fe's JOA and sign the appropriate signature page. **See Exhibit 12**

(14) The original well was abandoned on March 31, 1997, the rig was skidded 75 feet and the substitute well spudded on April 4, 1997 and successfully completed in the Morrow formation (now called the Gaucho Well No. 2-Y). **See Exhibit 6**

(15) The substitute well was commenced in time to save Landreth's lease which would have expired on June 30, 1997. **See Exhibit 8**

(16) On April 15, 1997, Landreth advised Santa Fe that he had reviewed the first revised Exhibit "A" and wanted additional changes. **See Exhibit 13.**

(17) On April 21, 1997, Santa Fe wrote Landreth stating "Your clarifications as to your override and **as to the Gaucho 2 and 2-Y well as being your initial well under the JOA are acceptable to Santa Fe** (emphasis added) **(See Exhibit 14)** and forwarded to him the final Revised Exhibit "A" dated 4/21/97. **See Exhibit 15** which showed that:

> (a) Landreth's interest in the Gaucho Wells No. 2 and 2-Y before payout is 9.375% and after payout is 37.50%;
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> (b) specifically included in Contract Area "B" **both** the Gaucho Wells No. 2 and 2-Y; **and**
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> (c) subjected his 37.5% working interest such that 28.125% of his interest in both wells was subject to a 300% penalty and that after recoupment of his share of those costs and penalty from his share of production he would regain his full 37.5% interest. **See Exhibit 15.**

(18) On April 30, 1997 Landreth accepted Santa Fe's JOA **including** the final Revised Exhibit "A" by signing the signature sheet for the Santa Fe JOA **(Exhibit 17)** and returned it to Santa Fe by cover letter dated May 2, 1997. **See Exhibit 16.**

(19) On June 9, 1997, Landreth signed a written casing point election on the Gaucho Well No. 2-Y.

(20) On June 18, 1997, Santa Fe completed the Gaucho Unit Well No. 2-Y for production from the Morrow formation. The well is currently producing 8.55 MMCFG per day and has a produced a total of 3.768 BCFG and 18,703 barrels of condensate.

(21) On March 18, 1998, Maupin and Associates, Inc. an independent auditing firm, notified Landreth that it was auditing the costs associated with the Gaucho Unit Well No. 2-Y. **See Exhibit 18.**

(22) On April 24, 1998, some 10 months after the well was completed and with knowledged that there is an ongoing audit of the well costs, Landreth complained to the NMOCD that he had not been provided with actual well costs by Santa Fe **but in doing so admitted that** he is "working interest owner and a forced pooled party..." and conceded that the "well in question was completed in June of 1997." (emphasis added) **See Exhibit 19.**

(23) On May 4, 1998, Steve Smith of Santa Fe provided Landreth with an AFE for the costs for the Gaucho Wells No 2 and 2-Y. **See Exhibit 20.**

(24) On June 4, 1998, Landreth's attorney requested a Division hearing concerning reasonable actual well costs and **admitted that the compulsory pooling order and its well cost provisions apply to both the original well and the substitute well which Santa Fe "has drilled on this pooled unit."** (emphasis added) **See Exhibit 23.**

(25) On June 29, 1998, Landreth's engineer wrote to Santa Fe **admitting that the compulsory pooling order applied to the substitute well but** contending that Landreth's share of the costs of the original well should be excluded. (emphasis added) **See Exhibit 24.**

(26) On December 4, 1998, Landreth wrote to Santa Fe **and admitted that all he wanted was "simply for an exclusion of the costs associated with the Gaucho #2 well..."** (emphasis added) **See Exhibit 25.**

(27) By November 1, 1998, the audit was complete and showed the total costs associated with this operation were $2,578,267.35 and were allocated as follows:

Gaucho Unit Well No. 2	$ 728,186.81
Gaucho Unit Well No. 2-Y	$1,797,891.98

(28) On October 6, 1997, Frank N. Cremer of Turner & Davis, Attorneys at Law, rendered a Division Order Title Opinion on this spacing unit. **See Exhibit 26.**

(29) The Gaucho Unit Well 2-Y has now cumulated sufficient production to recover the costs of both the original and substitute well plus 200% penalties for total costs as follows:

Gaucho Unit Well No. 2	$ 698,476.00
Gaucho Unit Well No. 2-Y	$1,644,861.00
	Total: $2,344,337.00

(3) The Gaucho Unit Well No. 2-Y is nearing payout of all costs and penalties incurred for both the Gaucho Unit Well No 2 and 2-Y.

ARGUMENT

In his response to Santa Fe's motion to dismiss, Landreth contends for the first time that the compulsory pooling order only covered the original well; that the pooling order expired; that by skidding the rig and redrilling the well, 28.125% of his interest in the substitute well is not subject to the compulsory pooling order; and that none of his share of production from the substitute well can be applied to pay for his share of the costs or the 200% risk penalty for the original well.

In order to support his new position, Landreth has to distort the facts, abandon previous admissions and attempt to weave his way past two very simple facts: (a) that Revised Exhibit "A" to the JOA clearly includes both the original well and the substitute well and also provides for the recovery of a 300% penalty before Landreth is entitled to his original 37.5% working interest; and (b) that the substitute well was a continuation of operations commenced on the original wellbore.

There is no question that Landreth has conceded that the costs and penalty for both wells can be paid for by production from the substitute well. In addition, there is no question that Landreth has conceded that the compulsory pooling order applies to both wells.

Only now after Santa Fe drilled the substitute well[8] in time to save Landreth's expiring lease[9] and only after the substitute well nears payout of its cost plus 200% penalty,[10] does Landreth come forward with this novel notion that he should not have to reimburse Santa Fe for the enormous risk he asked them to assume for him.

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[8] The original well was abandoned on March 31, 1997, the rig was skidded 75 feet and the substitute well spudded on April 4, 1997. See **Exhibit 6** attached.

[9] **See Exhibit 8** (Landreth's lease would have expired on June 30, 1997)

[10] **See Stipulation of Facts #(30)**

LANDRETH'S ADMISSIONS

Landreth now contends that the original pooling order does not apply to the substitute well. While it is Santa Fe's position that the JOA replaced the compulsory pooling order, if the Division concludes it did not, it must also reject Landreth's contention in his Response that the compulsory pooling order does not apply to the substitute well. Amazingly, Landreth has already rejected his own argument both before and after his attorney filed Landreth's Response. On April 24, 1998, Landreth wrote to the Division admitting that he is "a working interest owner and a forced pooled party..." and conceding that the "well in question was completed in June of 1997."[11] **See Exhibit 19.** On June 29, 1998, Landreth's engineer wrote to Santa Fe admitting that the compulsory pooling order applied to the substitute well but contending Landreth's share of the costs of the original well should be excluded. **See Exhibit 22.** On December 4, 1998, Landreth wrote to Santa Fe and admitted that all he wanted was "simply for an exclusion of the costs associated with the Gaucho #2 well..." **See Exhibit 23.** In addition, this argument is contrary to the letter his attorney filed with the Division dated June 4, 1998 admitting that the compulsory pooling order and its well cost provisions apply to both the original well and substitute well which Santa Fe "has drilled on this pooled unit." **See Exhibit 21.** Finally, it is impossible to accept Landreth's argument about

[11] Landreth is referring to the substitute well.

the Joint Operating Agreement only applying to 9.375% of his interest as to both wells when he admits that Revised Exhibit "A" "shows Landreth's 9.375% prepayout interest and his 37.5% working interest after Santa Fe recoups the actual costs and risk charged authorized by Order No R-10764." **See Landreth's Response at page 8.**

Recognizing the fatal flaw in Landreth's position, his attorney is now attempting to retract all of Landreth's admissions that the compulsory pooling order applies to the substitute well.[12] Because if he does, then he can argue that the substitute well is not a continuation of operations commenced on the original well. And if he does not, then the only logical conclusion would be that if the pooling order applies to the substitute well, then it also must still apply to the original well. When that happens, production from the substitute well can be used to pay for the original well and Landreth's claims can be denied. Fortunately, the doctrine of estoppel prevents Landreth from advancing a claim which is inconsistent with his prior position. See **Rodriguez v. La Mesilla Cost. Co.** 123 N.M. 489 (N.M.App. 1997). Fortunately, oil & gas case law establishes that there is a continuous drilling operation of a single well when, after the initial wellbore is lost, the rig is skidded followed by a second penetration of the surface and the well is drilled to completion. See **Steinkuehler**, supra.

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[12] **See Exhibit 23.**

REGARDLESS OF WHETHER THE COMPULSORY POOLING ORDER IS STILL IN EFFECT OR NOT, LANDRETH HAS AGREED THAT 28.125% OF HIS SHARE OF PRODUCTION FROM THE SUBSTITUTE WELL CAN BE USED TO PAY FOR 28.125% OF THE COSTS AND PENALTIES FOR BOTH WELLS

It is impossible to accept Landreth's argument that the Joint Operating Agreement only applies to 9.375% of his interest as to both wells and that the compulsory pooling order applies only to 28.125% of his interest in the original well, when he admits that Revised Exhibit "A" "shows Landreth's 9.375% prepayout interest and his 37.5% working interest after Santa Fe recoups the actual costs and risk charged authorized by Order No R-10764." **See Landreth's Response at page 8.** If Landreth wants to believe that Revised Exhibit "A" is consistent with his March 28, 1997 letter, then he must also concede that Revised Exhibit "A" contains the following caption: "INITIAL WELL: GAUCHO UNIT NO. 2 & 2-Y WELLS" which clearly shows that Landreth is agreeing to go non-consent for 300% as to 28.125% of his interest for both the original and substitute well.[13]

Landreth argues that Revised Exhibit "A" is simply a reflection of Landreth's "agreement"[14] with Santa Fe as set forth in his March 28, 1997 letter. **See Exhibit 9** However, his argument totally ignores the

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[13] 37.5% - 9.375% = 28.125%

[14] **Santa Fe denies that this letter was an agreement.**

consequences of his approval of a subsequent letter dated March 31, 1997 which is contrary to and replaces the prior letter. **See Exhibit 10**. Santa Fe's March 31, 1997 letter advised Landreth that the original well was lost, but more importantly states the percentages of ownership which lists Landreth with 9.375%. This means that the rest of his interest is "non-consent" and is controlled by Santa Fe and Southwestern, each with 45.3125%, until they have recovered Landreth's share of costs and penalty for the substitute well. Then Landreth's interest is increased to 37.5%. Once he agreed in writing that his interest is 9.375% then he is estopped to later claim that 28.125% of his interest has not been committed to the substitute well. On April 1, 1997 when Landreth signed and approved the March 31, 1997 letter, if he was of the opinion that he was no longer subject to the compulsory pooling order for the substitute well, then he should not have signed this letter. By approving the March 31, 1997 letter, Landreth also agreed to the continuation of operations commenced for the original well and conceded that 28.125% of his interest should be applied to pay for his share of the costs and 200% penalties for both wells.

He is barred by the doctrine of equitable estoppel from now disavowing the consequences of having approved the March 31, 1997 letter agreement. Those consequences are that Revised Exhibit "A" is consistent with the March 31, 1997 letter and not the March 28, 1997 letter; that Santa Fe and Southwestern can recover from 28.125% of Landreth's

interest the costs and non-consent penalty for both wells; and that the drilling of the substitute well is simply a continuation of the operations commenced for the original well. See **Brown v. Taylor**, 120 N.M. 302 (1995)

THE COMPULSORY POOLING ORDER FOR BOTH WELLS WAS REPLACED WHEN LANDRETH APPROVED THE REVISED EXHIBIT "A" TO THE JOA

Landreth also contends that Revised Exhibit "A" does **not** commit all of Landreth's interest in both wells to the JOA. He does so by trying to confuse the Division into incorrectly understanding Revised Exhibit "A". To do so, he directs the Division's attention to the interest of Amerada Hess whose interest continues to be subject to the compulsory pooling order and then states "Neither Amerada Hess nor Landreth ever agreed to a 300% risk penalty provision." **Landreth's Response at page 6.** Nothing could be farther from the truth. Landreth, not Amerada Hess, signed the JOA. Amerada Hess, not Landreth, is still subject to the compulsory pooling order. By signing the JOA and approving Revised Exhibit "A" Landreth agreed to the substitution of the JOA for the compulsory pooling order and agreed to a 300% penalty on both wells as to 28.125% of his interest.[15]

[15] For illustration purposes, the relevant portions of Revised Exhibit "A" have been pasted together on one page. **See Exhibit 15-A**

See Exhibits 11 & 15. If he did not, then the left column of Revised Exhibit "A" should state "37.5%" instead of "9.375%" and the caption should not include both wells.[16] If he did not, then the heading for the right column which states "WI (APO 300%)" has no purpose or meaning.

Landreth misunderstands Revised Exhibit "A". Because Amerada Hess did not sign the JOA, then its interest is "0" before 300% payout of both wells and thereafter is 12.5%. Likewise, Landreth's interest is only 9.375% in both wells until 300% payout of both wells and thereafter is 37.5%.

Landreth now wants to avoid the clear and unambiguous meaning of Revised Exhibit "A"---language which can be fairly and reasonably construed in only one way--- language in which Landreth has agreed that he is participating for 25% of his working interest (9.375%) and going "non-consent" as to the remaining 75% of his working interest (28.125%) as to both the original and substitute well.

Finally and wrongly, Landreth contends that Revised Exhibit "A" is consistent with the March 28, 1997 letter. This contention is also not true. Revised Exhibit "A" would have to be significantly different if it were to be consistent with the March 28, 1997 letter.

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[16] **See Exhibit 15**

LANDRETH IS NOT PERMITTED TO INTRODUCE EXTRINSIC EVIDENCE

In a desperate attempt to avoid the consequences of Revised Exhibit "A", Landreth incorrectly argues that the Division can use parol or extrinsic evidence to obtain a "contextual understanding" of a clear and unambiguous contract. **See Landreth Response page 8**. This is just a clever attempt to mislead the Division into allowing Landreth to improperly introduce extrinsic evidence so he can contradict the clear and unambiguous language of Revised Exhibit "A". To fall into Landreth's legal trap is to undermine the finality of an unambiguous contract.[17] It is obvious that Landreth is desperate to have the Division look behind the contract so that he can now testify that he never intended to pay for the costs of the original well. The cases cited by Landreth are either factually or legally distinguishable or do not support his contention in this case.[18] His attempt to have the Division enter into a complex evidentiary hearing to reconstruct the events leading up to his approval of Revised Exhibit "A" only induces the Division to

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[17] See **C. R. Anthony Co. v. Loretto Mall Partners**, 112 N.M. 504 (1991).

[18] The **Anthony** decision, dealing with the issues of "mutual mistake" and an "unambiguous lease", support's Santa Fe and not Landreth. The **Mark V** decision, involving an ambiguous contract, held that evidence may be presented to fact finder to aid in interpretation of ambiguous agreement, but no evidence should be received when its purpose or effect is to contradict or vary the agreement's terms. The **Jaramillo** decision, dealing with the definition of "you" in an insurance agreement and relying upon the **Anthony** and **Mark V** cases, held that the court may consider the context in which a contract was made to determine whether the parties' words are ambiguous. In Landreth's case, he concedes that Revised Exhibit "A" is **not** ambiguous.

exceed its jurisdictional authority by "construing a contract and interpreting the intent of the parties". This is an activity far outside the Division's jurisdiction, expertise and authority.

THE TURNER TITLE OPINION CONCLUDED THAT THE COMPULSORY POOLING ORDER APPLIED TO THE SUBSTITUTE WELL AND 28.125% OF LANDRETH'S INTEREST IN THE SUBSTITUTE WELL IS SUBJECT TO A 300% REIMBURSEMENT TO SANTA FE AND SOUTHWESTERN

After the substitute well is completed and production established, Santa Fe asked the Turner & Davis law firm ("Turner") to determine what parties were entitled to share in that production and in what percentages. On October 6, 1997 it rendered a Division Order Title Opinion which concluded that (a) the compulsory pooling order applied to the substitute well; and (b) that 28.125% of Landreth's interest in the substitute well is subject to a 300% reimbursement by Santa Fe and Southwestern. The opinion did not address the topic of whether the costs of the original well could be paid for with production from the substitute well.

In order to advance his argument, Landreth wants the Division to accept only that part of the Turner Opinion which he argues supports his conclusion that the JOA did not "replace" the compulsory pooling order and conveniently forgets the second part of the opinion which concluded that the pooling order applies to the substitute well for which Landreth is "300% non-consent" as to 28.125% of his interest.

Landreth cannot have it both ways. He cannot selectively adopt part of the opinion and ignore that part which he does not like. Landreth cannot reject that portion of the Turner Opinion which shows that the compulsory pooling order continues to apply to the substitute well. Landreth cannot ignore that portion of the Turner Opinion which shows that 28.125% of his interest in the substitute well is subject to a 300% reimbursement to Santa Fe and Southwestern.

The Turner Opinion does not address whether the costs of the original well can be paid for with production from the substitute well.

If the Division wants to rely upon Turner to decide this case, then the Division can conclude that (a) the compulsory pooling order applies to the substitute well and (b) 28.125% of Landreth's interest in the substitute well is subject to a 300% reimbursement to Santa Fe and Southwestern.

A UNILATERAL MISTAKE IS NO EXCUSE FOR LANDRETH TO AVOID THE CONSEQUENCES OF HIS ACTIONS

At this point, the only argument left to Landreth is to contend that he made a mistake when he approved Revised Exhibit "A". However, a unilateral mistake by Landreth is no excuse for avoiding the consequences of Revised Exhibit "A". See **Albuquerque Nat. Bank v. Albuquerque Ranch Estates, Inc.** 99 N.M. 95 (1982) where the New Mexico Supreme Court held that the equitable defense of mistake of fact is not available where the alleged mistake was occasioned by the party's own negligence.

THE SUBSTITUTE WELL WAS A CONTINUATION OF OPERATIONS COMMENCED ON THE ORIGINAL WELLBORE

If the Division decides that the JOA did not replace the compulsory pooling order, then the Division must decide if the substitute well was a continuation of the operations commenced on the original wellbore. If so, then the compulsory pooling order is still in effect for the substitute well and the production from the substitute well can be used to pay for the costs of the original wellbore.

Landreth has already conceded that the substitute well is covered by the compulsory pooling order, but then contends that the drilling of the substitute well is not a continuation of operations commenced on the original well. His position is inconsistent with fairness and contrary to case law.

In **Steinkuehler v. Hawkins Oil and Gas, Inc.,** supra, the Oklahoma Court of Appeal decided the continuation of operations issue against Landreth's position. The Court addressed this fact situation. Hawkins was the oil and gas operator subject to a lease from Steinkuehler which would expire on December 27, 1982 if Hawkins did not commence operations prior to the end of this primary term and drill the well to completion. On December 21, 1982, Hawkins spudded the well targeted for 6,100 feet but abandoned the well on January 2, 1983 when it lost

circulation of 4,839 feet when the drill pipe stuck. Hawkins then skidded the rig 50 feet and on January 5, 1983 drilled a substitute well which was completed on February 3, 1983 for production at a depth of 5,943 feet. Steinkuehler claimed that the lease had expired. Hawkins claimed that skidding the rig and commencing the substitute well was the continuation of operations commenced on the original well. Hawkins lost before the District Court, But the Court of Appeals agreed with Hawkins and stated, among other things, that because the original well never reached is intended bottom hole target, it was not neither a "dry hole" nor a "completed well" and Hawkins was simply continuing operations commenced on the original well when he skidded the rig and drilled the substitute well. The Court ruled in favor of Hawkins despite: (a) the fact that each well was considered a separate well by both the regulatory agency and Hawkins and (b) despite the fact that subsequent to the abandonment of the original well, Hawkins had obtained a compulsory pooling order against Steinkuehler for the substitute well. The Court was influenced by the fact that the original well "was abandoned solely because of technical difficulties...which made it ...infeasible to continue operations in the same hole. Likewise, there was no commencement of drilling of a second well because drilling operations on the second hole were an integral part of a singular attempt to drill to the target depth."

Santa Fe, with similar circumstances, commenced operations, but on March 24, 1997 while drilling the Gaucho Unit Well No. 2, it lost circulation at 3,783 feet when the drill string separated. It then abandoned the wellbore on March 31, 1999 in order to skid the rig 75 feet and commence drilling the Gaucho Unit Well No. 2-Y which was completed on June 18, 1997 for production from the Morrow formation at 13, 288 feet.

Accordingly, for the same reasons of fairness expressed in **Steinkuehler**, supra, which denied Steinkuehler's claims, Landreth's claims also should be denied.

CONCLUSION

It makes no sense to say that Landreth's master plan was to allow him to escape reimbursing Santa Fe for his non-consent share of the costs of the original well. If this was his plan, why did he not raise this issue with Santa Fe when he approved the redrilling of this well on April 1, 1997? Why did he not raise this issue as he received the daily drilling reports for the drilling of the substitute well which showed the costs associated with the original well"?[19] Why did he not raise this issue with Santa Fe during the period in April-May, 1997 when he was negotiating changes to the JOA? Why did he not raise this issue when he made his casing point election on June 9, 1997? Why did he wait until he knew that

[19] **See Exhibit 13** (daily drilling report summaries which Landreth received in accordance with the JOA).

the substitute well was reaching pay out to raise this issue? Why did he wait some 10 months after the substitute well was completed and with knowledge of the ongoing audit of well costs to complain?

What is the purpose for splitting his interest between the JOA and the compulsory pooling order? Was it done so he could later argue the costs of substitute well could not be used to pay for his share of the original well? No; the answer is that it was simply a vehicle to allow Landreth to participate by going non-consent on both wells for costs plus the 200% penalty as to 28.125% of his interest.

The answer is that what he originally planned to have happen did happen. What he now wants to avoid cannot be avoided. He planned to have 28.125% of his interest subject to a 300% non-consent penalty for both the original well and substitute well with his production from the substitute well paying for all those costs and penalties.

Whether the JOA replaced the compulsory pooling order or whether the compulsory pooling order applies to both wells does not matter. Either way, Landreth's looses because the substitute well is simply a continuation of the operations commenced on the original well and by his own actions is equitably estopped from arguing to the contrary.

The fundamental problem with Landreth's argument is that it just does not matter whether the compulsory pooling order is still in effect or not. He cannot escape the simple fact that either:

(a) by signing the JOA and approving its Revised Exhibit "A", his entire 37.5% interest is subject to the JOA, he has conceded that the costs and penalty for both wells can be paid for by production from the substitute well; or

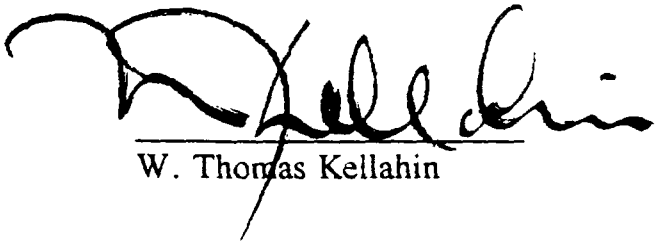
(b) Santa Fe's drilling of the substitute well was a continuation of operation commenced on the original well and by admitting that the compulsory pooling order is still in effect for the substitute well, he has conceded that the costs and penalty for both wells can be paid for by the production from the substitute well.

Santa Fe should not now be punished for selecting a course of action which "saved" Landreth's lease and resulted in a very successful Morrow well for which Landreth assumed none of the risk associated with 28.125% of his working interest.

W. Thomas Kellahin
Kellahin & Kellahin

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing memorandum was hand delivered to opposing counsel this 14th day of June, 1999.



W. Thomas Kellahin