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November 6, 2002
HAND-DELIVERED

David Brooks, Esq.
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: ***NMOCD Case No. 12943; Application of Great Western Drilling Company for Compulsory Pooling, Lea County, New Mexico***

Dear Mr. Brooks:

In the hearing on this matter on October 10, 2002, Scott Hall, counsel for David H. Arrington Oil & Gas, Inc. ("Arrington") represented that the Division had a "30-day rule," which requires an applicant for compulsory pooling to have submitted a proposal for the well at least 30 days prior to filing its application. Subsequent to the hearing, on October 11, Mr. Hall sent you a letter attaching a District of Columbia Circuit Court of Appeals case which Mr. Hall represented holds that an agency's failure to follow long-standing practice amounts to a rule-making.

This is a brief response to Mr. Hall's October 11 letter and to the cases from the Oil Conservation Division and Commission, which Mr. Hall presented in the October 10 hearing in support of his argument that a "30-day rule" exists.

Mr. Hall is wrong. There is no 30-day rule, in fact or in practice. A review of just the last five years of Division Orders reveals many in which competing compulsory pooling cases were presented to the Division. In several of those, a well proposal was made on the same day of the application for compulsory pooling, or several days thereafter. *See, e.g.*, Order No. R-10731-B (*de novo* cases 11666, 11677), February 13, 1997; Order No. R-10731 (cases 11666, 11677) January 16, 1997; Order No. R-11566 (Cases 12535, 12567, 12569, 12590), April 17, 2001; Order No. R-10742 (Cases 11660, 11667). Not one of those cases held that a well proposal must precede a compulsory pooling application by at least 30 days. Not one of those cases dismissed a party's application because its well proposal did not precede its compulsory pooling application by at least 30 days. In short, the 30-day rule does not exist.

However, a brief review of the Oil Conservation Commission's most recent treatment of this issue

is instructive. In Order No. R-10731 (cases 11666 and 11667), the Division considered competing compulsory pooling applications filed by Intercoast Oil and Gas Company("Intercoast") and Yates Petroleum Corporation ("Yates"). The well location, geologic testimony, and risk penalty were not at issue. The parties represented close to equal interests in the 320-acre spacing unit sought to be dedicated to the well. The Division approved Intercoast's application, and denied Yates's application, because (similar to the language relied upon by Mr. Hall):

> "[i]n the absence of other compelling factors, the operatorship of the E/2 of Section 20 should be awarded to the operator who originally developed the prospect, developed the geologic datsa necessary to determine the optimum well location, and initially sought to obtain farmout or voluntary agreement to drill its well."

Order No. R-10731, January 13, 1997, finding paragraph 24. In other words, the Division endorsed the "first-in-line" factor as the only determining factor because it viewed all the other factors as equal.

Significantly, however, Intercoast proposed the well on November 11, 1996, and filed its application for compulsory pooling on November 12, 1996. Yates proposed the well on November 22, 1996, and filed its application for compulsory pooling on November 26, 1996. Despite the fact that the "30-day rule" issue was squarely presented to the Division by the fact that neither party allowed 30 days to elapse between its well proposal application and its application for compulsory pooling, the Division did not discuss the "30-day rule," did not decide the case on the basis of the "30-day rule," did not dismiss either party's case on the basis of the "30-day rule," and did not even use the words "30-day rule."

Even more significant was the Commission's treatment on hearing *de novo* (Order No. R-10731-B, February 28, 1997 (*de novo* cases 11666 and 11677)). Intercoast's[1] argument in the *de novo* case was virtually identical to that advanced by Arrington in the instant case:

> it is an experienced operator and due to the fact that it took the initiative in developing the prospect and was the moving force in getting the well drilled, it should be allowed to operate its State of New Mexico "20" Well No. 1 and operate the E/2 of Section 20.

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[1]In the interim between the Division's December 19, 1996 hearing (resulting in the January 13, 1997 Order No. R-10731) and the Commission's February 13, 1997 hearing (resulting in the February 28, 1997 Order No. R-10731-B), Intercoast changed its name to KCS Medallion Resources, Inc. For consistency, and to avoid confusion, the entity is referred to as "Intercoast" in this letter.

Order No. R-10731-B at finding paragraph 22. The Commission did not find that argument persuasive. Instead, the Commission expressly found that:

> [i]n the absence of compelling factors such as geologic and prospect differences, ability to operatie prudently, or any reason why one operator would economically recover more oil or gas by virtue of being awarded operations than the other, ***"working interest control," as defined and modified by findings 23(d) and (e) should be the controlling factor in awarding operations.***

Order No. R-10731-B, finding paragraph 24 (emphasis added). In cases 11666 and 11677, although the parties' interests in the 32-acre spacing unit were close to equal (Yates 52.5%, Intercoast 47.5%), the parties also sought to have 160-acre and 40-acre proration units pooled. In those formations, Intercoast controlled 95% of the working interest, and Yates controlled 5%. Therefore, because Intercoast's working interest control in the smaller spacing units was much higher than Yates, the Commission awarded operations to Intercoast.

Once again, the Commission did not decide the case on the basis of the "30-day rule" relied upon by Mr. Hall. Despite the fact that the "30-day rule" issue was squarely presented to the Commission by the fact that neither party allowed 30 days to elapse between its well proposal and its application for compulsory pooling, the Commission did not discuss the "30-day rule," did not decide the case on the basis of the "30-day rule," did not dismiss either party's case on the basis of the "30-day rule," and did not even use the words "30-day rule."

In the instant case, the testimony at the hearing established that Great Western represents 67.969% of the working interest (represented by 14 interest owners committed to Great Western's operatorship through an executed JOA), and Arrington represents 32.0311%. Just as in cases 11666 and 11677, the geologic factors, proposed risk penalty, and costs of operation are similar. Just as in cases 11666 and 11677, both parties in the instant case have experience drilling and operating similar wells in the area (just as in this case, Intercoast argued that it had more recent experience in cases 11666 and 11677). Just as in cases 11666 and 11677, Great Western controls a great deal more of the working interest than Arrington.

There a number of other cases in the last five years, and prior to that time, in which competing compulsory pooling cases were presented to the Division and Commission. In a number of those cases, one or both parties did not allow 30 days to elapse between their well proposals and their applications for compulsory pooling. Not one of those cases mention a "30-day rule" or decide a case on that basis. If you would like full briefing on this issue, I will be happy to provide such.

The "30-day rule" does not exist. Mr. Hall's use of this "rule" as the basis for his request that Great Western's application be dismissed or denied, and his use of this "rule" as the basis for his argument that Arrington should be awarded operatorship in this case underscores the weakness in Arrington's position. Directly contrary to Arrington's position, the very concerns raised in the case law raised by Mr. Hall will in fact be implicated if the "30-day rule" is applied in this case.

Great Western controls more acreage, all of the other interest owners have voluntarily agreed to Great Western's operating this well, and Great Western has significant, proven experience operating a well in this field. We request that Great Western be awarded operatorship of the well.

We look forward to the Division's Order in this case.

Very truly yours,

Paul R. Owen

Enclosures
cc: Mr. Mike Heathington
Great Western Drilling Company
Scott Hall, Esq.