

M E M O R A N D U M

TO: Morris A. Galatzan
FROM: William J. Mounce
DATE: July 9, 1959

This memorandum will supplement the memorandum heretofore prepared by Mr. Ray C. Cowan.

There is, of course, no dispute that the Oil Conservation Commission of New Mexico has the duty to prevent waste and correlative rights. I cannot see how the inclusion of a deliverability factor in the proration formula could have any appreciable effect upon the correlative rights of the various owners in the Jalmut Pool. Apparently, the Petitioners are contending in Paragraph 6(g) of their Pleading that the inclusion of the deliverability factor would result in some loss of profits, thereby constituting waste as defined by the New Mexico Statutes. If this is their contention, I concur with the conclusions reached by Mr. Cowan that their position is untenable.

It is arguable that excessive loss of profits resulting in the abandonment of marginal wells may constitute waste. The New Mexico statutory definition of waste includes the "operating or producing of any well or wells in such a manner to reduce or tend to reduce the total quantity of crude petroleum or natural gas from any pool." However, this argument is the crux of the Petitioners contention in Paragraph 6(h). I, therefore, assume that the Petitioners in Paragraph 6(g) are concerned merely with some loss of profits.

As pointed out by Mr. Cowan in his memorandum, only one state defines "economic waste" as pertaining to natural gas in their conservation statutes; however, several state regulatory agencies have considered economic waste or economic loss as a factor in promulgating their proration and spacing rules. Even where such consideration is given, the profit or loss factor of economic waste is of very minor importance. See Railroad Commission of Texas vs. Fain, 161 S.W.2d 498 (Tex.Civ.App., Error Ref'd). In the case just cited, the Court said at Page 500:

"Any Order of the Commission limiting density of drilling, daily allowable per well, or controlling storage, transportation and marketing necessarily affects property values and profits from production of oil. But this is necessarily incident to the police power of the State to regulate any business affected with a public interest, so long as it treats all alike."

See also the case of In re: Application of Champlin Refining Company, 296 Pacific 2d 176 (Oklahoma), concerning a spacing regulation for natural gas wherein the Court rejected the "economic waste" argument advanced by Champlin and said:

"In our opinion, it is more important to secure to each lessor, lessee and owner of mineral rights in a field, his ratable share of production therefrom and to prevent underground waste, than it is to secure to some, the maximum profits from drilling and producing operations."

Accord: Application of Pepper's Refining Company, 272 Pacific 2d 416 (Oklahoma).

Prior to 1932, the Texas statutory definition of waste was similar to the present New Mexico definition except, however, the Texas Statutes expressly excluded economic waste. In discussing the term, economic waste, the Court in Danciger Oil and Refining Company vs. Railroad Commission, 49 S.W.2d 332 (Tex.Civ.App. 1932), had this to say:

"Just what the (Texas) Legislature meant by "economic waste" is not clear. It is obvious, we think, that physical waste of such resources must of necessity result in economic waste. But it is equally true that economic waste by producers, such as expenditure upon a given well or lease in bringing in production thereon, of a sum in excess of what the well or lease would return to such producers financially, does not necessarily mean physical waste of the natural resource. In the latter case, there would be economic waste of the resources of the producer; but if his wells were properly operated under regulation, there would be no physical waste of the natural resource itself, which is the only matter in which the State and the public are interested. That sort of waste, or economic loss in the production, sale, use or disposition by the owners or operators of oil properly produced by them without physical waste of the resource itself is probably what the Legislature intended; and which is a character of waste the Commissioner was without authority to prevent."

The case referred to immediately above was reversed by the Supreme Court of Texas (Danciger Oil and Refining Company vs. Railroad Commission, 56 S.W.2d 1075) due to the fact that the Conservation Statutes of Texas were drastically amended in 1932, thereby rendering the legal questions moot. Such reversal did not go to the merits of the case. As a matter of fact, the case is still good authority for the proposition quoted above and has been cited with approval numerous times in subsequent Texas decisions.

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Compare Railroad Commission of Texas vs. Rowan Oil Company, 259 S.W.2d 173 (Tex.Sup.Court 1953), wherein the Court, after citing the Danciger case with approval, held:

"The fact that some operators will have a less profitable operation, be delayed in recovering their gas, or be in trouble with their creditors does not affect the Commission's duty to enforce conservation by prevention of waste."

Based on the foregoing, I conclude that the New Mexico Statutory definition of waste does not embrace "economic waste" as that term is used by Petitioners in Paragraph 6(g) of their Pleading. Further, even if economic waste should be a factor in a proration formula, it is of very minor importance.

I haven't had an opportunity to examine a transcript of the testimony taken before the Oil Conservation Commission; however, I understand that there is substantial evidence to refute Petitioners' contention that the inclusion of a deliverability factor would result in a loss of profits. If such be the case, I suggest that a summary of the favorable evidence be included in the trial brief.


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