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To:	David Brooks, Esq. Asst. General Counsel
Fax Number:	505-476-3220
Regarding:	Sun-West Oil and Gas, Inc.
From:	Sealy H. Cavin, Jr./Susanne
Date:	May 16, 2001

JUN 13 2001

Number of Pages (Including Cover Sheet): 10

Message: Mr. Brooks, attached please find correspondence enclosing our Hearing Memorandum and Response to Applicant's Hearing Memorandum.

IMPORTANT

Should you have any problems receiving this fax, please contact Susanne at (505) 243-5400.

Our File No.: 451.001

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June 13, 2001

VIA FACSIMILE (505) 476-3462
and FIRST CLASS MAIL

Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 S. St. Francis Drive
Santa Fe, NM 87504

Re: Case No. 12601 - - Sun-West's Hearing Memorandum

Dear Ms. Wrotenbery:

Enclosed herewith is Sun-West Oil and Gas, Inc.'s Hearing Memorandum and Response to Applicant's Hearing Memorandum in connection with the captioned case.

Very truly yours,

Sealy H. Cavin, Jr.

SHC/sks
Enclosure

cc: Michael Stogner, Hearing Examiner (via facsimile and first class mail)
William F. Carr, Esq. (via facsimile and first class mail)
David Brooks, Esq. (via facsimile and first class mail)

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

APPLICATION OF BETTIS, BOYLE & STOVALL TO REOPEN CASE 12601 AND AMEND ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR THE PURPOSE OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

CASE 12601 (REOPENED)

SUN-WEST OIL AND GAS, INC.'S
HEARING MEMORANDUM AND
RESPONSE TO APPLICANT'S HEARING MEMORANDUM

BACKGROUND:

Sun-West Oil and Gas, Inc. ("Sun-West") owns an undivided 15% of the oil, gas and other minerals under the W/2 of Section 30, Township 9 South, Range 33 East, N.M.P.M., Lea County, New Mexico. Sun-West's mineral interest is now subject to an oil and gas lease in favor of Gulf Coast Oil and Gas Company ("Gulf Coast"). The oil and gas lease is a standard oil and gas lease with a one year primary term reserving unto Sun-West a 27.5% royalty; it is dated February 15, 2001 and was filed of record on February 21, 2001 at Book 1063, page 422 of the Lea County records. Sun-West is a Texas Subchapter S Corporation, and Gulf Coast is a Delaware Subchapter C corporation. Sun-West and Gulf Coast are separate legal entities with different corporate purposes and ownership. [1]

By correspondence dated December 15, 2000, Bettis, Boyle & Stovall ("Bettis") solicited a lease from Sun-West proposing a 3/16 royalty, $50.00 per net acre bonus, and a three year primary term. This was the first written communication from Bettis to Sun-West. Subsequently, by

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correspondence dated January 20, 2001, Bettis increased its offer to $100.00 per net mineral acre.[2] Sun-West responded by correspondence dated January 25, 2001 requesting a 1/4 royalty and $150.00 per net acre bonus. Bettis made no further effort to negotiate a voluntary agreement with Sun-West. Instead, Bettis filed its Compulsory Pooling Application, case 12601, on January 30, 2001.

Subsequent to the filing of the Compulsory Pooling Application, Sun-West leased its interest to Gulf Coast and notified Bettis of the lease by correspondence dated February 20, 2001. Bettis responded by correspondence dated March 22, 2001 soliciting the participation of Gulf Coast in the proposed well. The initial hearing before the Oil Conservation Division was held on April 19, 2001, more than two months after the lease by Sun-West to Gulf Coast. At the April 19th hearing, Bettis presented considerable evidence regarding the Sun-West/Gulf Coast lease, and the economics of the proposed well.[3] Bettis requested at the April 19th hearing that the Division treat the Sun-West interest as unleased. The Division subsequently issued Order No. R-11573 providing for the pooling of the Sun-West and Gulf Coast interests, and the recovery of reasonable well costs and 200% of such costs as a charge for risk.[4] The Order did not address Bettis' request that the Sun-West interest

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[2]Bettis' landman, Mark Maloney, testified at the May 31st hearing that the royalty rate and bonus offered by Bettis was determined arbitrarily. No effort was made to ascertain the "going rate" in the area. Mr. Maloney testified that Bettis made its deal with the largest interest owner and offered the same terms to the other interest owners. Mr. Maloney also testified that the royalty and bonus rates offered to Sun-West were the same as those offered for the same lands some four years earlier.

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be treated as unleased.[5]

Bettis subsequently filed an Application to reopen case number 12601 and amend Order No. R-11573 "to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well." At the hearing on May 31st, Bettis again argued that the mineral interest of Sun-West should be deemed unleased.

NEW MEXICO'S COMPULSORY POOLING STATUTE

The New Mexico Oil and Gas Act[6] provides that owners of separate tracts or separate interests, or any combination thereof, which are embraced within a spacing or proration unit may be pooled by the owners and developed as a unit.[7] If the owners cannot reach voluntary agreement to pool their interests, and where one or more of the owners has drilled or proposes to drill a well on the spacing or proration unit, the Oil Conservation Division, "to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interest or both in the spacing or proration unit as a unit."[8] All pooling orders shall be made after notice and hearing, shall be just and reasonable, and shall afford the owners in the unit the opportunity to recover their fair share of the oil and gas. [9]

The compulsory pooling statute also provides some detail regarding the allocation of production and costs in a compulsory pooling situation. Regarding the allocation of production, the

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[6]Chapter 70, Article 2 NMSA 1978 (2000 Repl.).

[7]Section 70-2-17 C. NMSA 1978 (2000 Repl.).

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statute provides that production is to be allocated to the respective tracts within the spacing or proration unit on a surface acreage basis.[10] Unleased interest which are subject to compulsory pooling shall be considered as working interest as to 7/8ths of such interest, and a royalty interest as to 1/8th of such interest.[11] Regarding costs, the statute requires that the pooling order shall make definite provisions regarding the non-consenting parties share of costs and the means of recouping such costs. The costs shall be limited to the actual, reasonable expenditures required for the operation, and shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of the well.[12] The "charge for risk shall not exceed 200% of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well." [13]

APPLICATION OF THE COMPULSORY POOLING STATUTE

In its Application to reopen case 12601, Bettis has again requested that the Oil Conservation Division deem and treat the Sun-West interest as though it is unleased. There is, however, no legal basis for this fiction. Sun-West and Gulf Coast are separate legal entities and the lease is legally enforceable against Sun-West and third parties. Moreover, to treat the Sun-West interest as unleased would result in substantial loss to Sun-West and a total loss to Gulf Coast. Clearly, treatment of Sun-West's interest as being unleased would not provide Sun-West or Gulf coast the opportunity to recover their fair share of the oil and gas as required by the pooling statute. [14]

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[10]Id.

[11]Id.

[12]Id.

[13]Id.

[14]Id.

Bettis argues that since the Sun-West interest was unleased on January 30th, it "must be treated under the Oil and Gas Act as a 7/8ths working interest and a 1/8th royalty interest." This is clearly at odds with the express language of the statute which provides as follows:

> If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest. [15]

The operative timeframe is the time of pooling and not the time the application is filed. In this case, the Sun-West mineral interest was leased to a separate legal entity some two months before the April 19th hearing and the pooling affected by Order No. R-11573.

Bettis also argues that the lease transaction improperly affects the risk charge. This argument would apparently hold true for any lease with a royalty burden in excess of 1/8th. We note that the risk charge is only applicable to cost bearing interest; it does not apply to royalty interest.[16] Moreover, the 200% risk charge provided for in Order No. R-11573 provides a significant monetary incentive to the participating parties and a substantial penalty to Gulf Coast. Finally, even the conservative economic analysis by Mr. Stubbs demonstrates the economic viability of the project based on the existing Sun-West lease.

RESPONSE TO APPLICANT'S CASE AUTHORITY

Applicant cites in its Memorandum various Oil Conservation Division and Commission cases and a 1938 Oklahoma case. These cases are each materially different from and not relevant to the case at hand.

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[15]Id.

[16]Id.

The Nearburg case[17] cited by applicant is distinguishable by the fact that Merit, a working interest owner, also owned an internal net profits interest which burdened Merit's working interest.[18] In this case, there is no internal interest and no net profits interest. Instead, Sun-West owns a mineral interest (including royalty interest) subject to a properly executed, recorded and legally enforceable oil and gas lease in favor of Gulf Coast.

The Caulkins case[19] is an extreme case which has no application to this case. The extreme circumstances in the Caulkins case are illustrated by Findings (7) and (8) of Order No. R-7998:

> (7) Evidence was presented establishing that 120 acres of the proposed 320-acre spacing unit, being the N/2 NW/4 and SW/4 NW/4 of said Section 20, is under lease to Meridian Oil, Inc. and/or El Paso Natural Gas Company, and that El Paso Natural Gas Company, predecessor in interest to Meridian Oil, Inc., hereafter referred to as "Meridian", created overriding royalty burdens on said 120 acres of $3.96 and $3.73 per mcf of gas.
>
> (8) Evidence was also presented that for each $858.37 of income per day attributable to Meridian's interest in said well, Meridian must pay out $1,508.76 per day, leaving Meridian with a negative daily working interest of $650.39. [20]

Even Mr. Stubbs' very conservative economic evaluation shows that Bettis should be able to receive a positive rate of return with the Sun-West royalty. In Caulkins, the Meridian interest would result in a $650.39 daily loss (approximately $234,000.00 loss per year) to the participating parties. Even under this extreme situation, the Oil Conservation Division was willing to allow Meridian to voluntarily reduce its override to 12.5% (apparently this would raise the total lease burdens to 25%),

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[17]Application of Nearburg Exploration Company, L.L.C. for Compulsory Pooling, Lea County, New Mexico, Case No. 12087, Order No. R-11109.

[18]Id. at 2. See Findings (7), (8) and (9).

[19]Application of Caulkins Oil Company for Compulsory Pooling, Rio Arriba County, New Mexico, Case No. 8640, Order No. R-7998.

[20]Id. at 2.

or exclude its acreage from the spacing or proration unit. [21]

Applicant argues that the Branko case[22] stands for the proposition that "the status of a mineral interest is its status at the time the application was filed." This is simply incorrect. The issue in Branko was whether Branko was entitled to notice of the compulsory pooling proceedings.[23] The Oil Conservation Commission determined that Branko did not have an interest of record until well after the drilling of the well and, therefore, Branko was not entitled to notice.[24] In this case, Bettis was provided with actual and constructive notice of the lease some two months prior to the hearing. Moreover, Gulf Coast has in fact been provided with notice of the compulsory pooling proceedings. Accordingly, the notice issue is moot and Branko is irrelevant.

Finally, we note that the Patterson case[25] is not particularly relevant. In Patterson, the Supreme Court of Oklahoma upheld the power of the state to protect correlative rights and prevent waste by the state's well spacing rules. Obviously, the State of New Mexico has the authority to regulate these matters. In this regard, we note that New Mexico has a comprehensive statutory provision dealing with compulsory pooling. In this case, Applicant would like to rewrite New Mexico's compulsory pooling statute and treat the Sun-West interest as unleased. Given the clear statutory provision, we believe that it would be improper for the Oil Conservation Division to take such action in this case.

---

[21]Id. at 5 and 6.

[22]Application of Branko, Inc. et al. to Reopen Case No. 10656 (Order No. R-9845) Captioned "Application of Mitchell Energy Corporation for Compulsory Pooling and an Unorthodox Gas Well Location, Lea County, New Mexico, De Novo Case No. 11510, Order No. R-10672-A.

[23]Id. at 8 and 9.

[24]Id.

[25]Patterson v. Stanolind Oil & Gas Co. et al., 182 Okla. 155, 77 P.2d 83 (1938).

For the reasons stated hereinabove, Sun-West respectfully requests that Order No. R-11573 be affirmed by the Oil Conservation Division without amendment.

Respectfully submitted,

STRATTON & CAVIN, P.A.

By _____
Sealy H. Cavin, Jr.

ATTORNEYS FOR SUN-WEST OIL AND GAS, INC.

CERTIFICATE OF SERVICE

I certify that on the 13th day of June, 2001, I faxed and mailed by first class mail a copy of this Hearing Memorandum to the following counsel of record.

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and
Campbell & Carr
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Santa Fe, New Mexico 87501-6525
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Energy, Minerals and Natural Resources Department
Assistant General Counsel
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Sealy H. Cavin, Jr.

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To: Michael Stogner, Hearing Examiner
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Fax Number: 505-476-3471

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From: Sealy H. Cavin, Jr./Susanne

Date: May 16, 2001

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and FIRST CLASS MAIL

Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
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1220 S. St. Francis Drive
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or exclude its acreage from the spacing or proration unit.[21]

Applicant argues that the Branko case[22] stands for the proposition that "the status of a mineral interest is its status at the time the application was filed." This is simply incorrect. The issue in Branko was whether Branko was entitled to notice of the compulsory pooling proceedings.[23] The Oil Conservation Commission determined that Branko did not have an interest of record until well after the drilling of the well and, therefore, Branko was not entitled to notice.[24] In this case, Bettis was provided with actual and constructive notice of the lease some two months prior to the hearing. Moreover, Gulf Coast has in fact been provided with notice of the compulsory pooling proceedings. Accordingly, the notice issue is moot and Branko is irrelevant.

Finally, we note that the Patterson case[25] is not particularly relevant. In Patterson, the Supreme Court of Oklahoma upheld the power of the state to protect correlative rights and prevent waste by the state's well spacing rules. Obviously, the State of New Mexico has the authority to regulate these matters. In this regard, we note that New Mexico has a comprehensive statutory provision dealing with compulsory pooling. In this case, Applicant would like to rewrite New Mexico's compulsory pooling statute and treat the Sun-West interest as unleased. Given the clear statutory provision, we believe that it would be improper for the Oil Conservation Division to take such action in this case.

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[21]Id. at 5 and 6.

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[23]Id. at 8 and 9.

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[25]Patterson v. Stanolind Oil & Gas Co. et al., 182 Okla. 155, 77 P.2d 83 (1938).

For the reasons stated hereinabove, Sun-West respectfully requests that Order No. R-11573 be affirmed by the Oil Conservation Division without amendment.

Respectfully submitted.

STRATTON & CAVIN, P.A.

By _____
Sealy H. Cavin, Jr.

ATTORNEYS FOR SUN-WEST OIL AND GAS, INC.

CERTIFICATE OF SERVICE

I certify that on the 13th day of June, 2001, I faxed and mailed by first class mail a copy of this Hearing Memorandum to the following counsel of record.

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Sealy H. Cavin, Jr.

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June 13, 2001

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Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 S. St. Francis Drive
Santa Fe, NM 87504

Re: Case No. 12601 - - Sun-West's Hearing Memorandum

Dear Ms. Wrotenbery:

Enclosed herewith is Sun-West Oil and Gas, Inc.'s Hearing Memorandum and Response to Applicant's Hearing Memorandum in connection with the captioned case.

Very truly yours,

Sealy H. Cavin, Jr.

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

APPLICATION OF BETTIS, BOYLE & STOVALL TO REOPEN CASE 12601 AND AMEND ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR THE PURPOSE OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

CASE 12601 (REOPENED)

SUN-WEST OIL AND GAS, INC.'S HEARING MEMORANDUM AND RESPONSE TO APPLICANT'S HEARING MEMORANDUM

BACKGROUND:

Sun-West Oil and Gas, Inc. ("Sun-West") owns an undivided 15% of the oil, gas and other minerals under the W/2 of Section 30, Township 9 South, Range 33 East, N.M.P.M., Lea County, New Mexico. Sun-West's mineral interest is now subject to an oil and gas lease in favor of Gulf Coast Oil and Gas Company ("Gulf Coast"). The oil and gas lease is a standard oil and gas lease with a one year primary term reserving unto Sun-West a 27.5% royalty; it is dated February 15, 2001 and was filed of record on February 21, 2001 at Book 1063, page 422 of the Lea County records. Sun-West is a Texas Subchapter S Corporation, and Gulf Coast is a Delaware Subchapter C corporation. Sun-West and Gulf Coast are separate legal entities with different corporate purposes and ownership. [1]

By correspondence dated December 15, 2000, Bettis, Boyle & Stovall ("Bettis") solicited a lease from Sun-West proposing a 3/16 royalty, $50.00 per net acre bonus, and a three year primary term. This was the first written communication from Bettis to Sun-West. Subsequently, by

[1]Although Applicant has taken the position that Sun-West and Gulf Coast are the same entities, the entities are clearly separate legal entities with different corporate purposes and ownership. Applicant has not provided any evidence to the contrary.

correspondence dated January 20, 2001, Bettis increased its offer to $100.00 per net mineral acre.[2] Sun-West responded by correspondence dated January 25, 2001 requesting a 1/4 royalty and $150.00 per net acre bonus. Bettis made no further effort to negotiate a voluntary agreement with Sun-West. Instead, Bettis filed its Compulsory Pooling Application, case 12601, on January 30, 2001.

Subsequent to the filing of the Compulsory Pooling Application, Sun-West leased its interest to Gulf Coast and notified Bettis of the lease by correspondence dated February 20, 2001. Bettis responded by correspondence dated March 22, 2001 soliciting the participation of Gulf Coast in the proposed well. The initial hearing before the Oil Conservation Division was held on April 19, 2001, more than two months after the lease by Sun-West to Gulf Coast. At the April 19th hearing, Bettis presented considerable evidence regarding the Sun-West/Gulf Coast lease, and the economics of the proposed well.[3] Bettis requested at the April 19th hearing that the Division treat the Sun-West interest as unleased. The Division subsequently issued Order No. R-11573 providing for the pooling of the Sun-West and Gulf Coast interests, and the recovery of reasonable well costs and 200% of such costs as a charge for risk.[4] The Order did not address Bettis' request that the Sun-West interest

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[2]Bettis' landman, Mark Maloney, testified at the May 31st hearing that the royalty rate and bonus offered by Bettis was determined arbitrarily. No effort was made to ascertain the "going rate" in the area. Mr. Maloney testified that Bettis made its deal with the largest interest owner and offered the same terms to the other interest owners. Mr. Maloney also testified that the royalty and bonus rates offered to Sun-West were the same as those offered for the same lands some four years earlier.

[3]Bettis, through the testimony and report of Bruce Stubbs, a petroleum engineer, argued that a so-called average Bough C well would yield a 20% rate of return assuming a 1/4 royalty interest and $150.00 per acre bonus. Mr. Stubbs' report does not give any value for any uphole zones, including the San Andres formation, nor the 200% penalty which would accrue to the participating working interest owners based on order number R-11573. Without justification, Mr. Stubbs' report provides a steep discount for dry holes and depleted reservoir. Indeed, Mr. Stubbs' report only assigned a 25% probability factor to the proximate wells which are the basis for the geologic model.

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be treated as unleased.[5]

Bettis subsequently filed an Application to reopen case number 12601 and amend Order No. R-11573 "to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well." At the hearing on May 31st, Bettis again argued that the mineral interest of Sun-West should be deemed unleased.

NEW MEXICO'S COMPULSORY POOLING STATUTE

The New Mexico Oil and Gas Act[6] provides that owners of separate tracts or separate interests, or any combination thereof, which are embraced within a spacing or proration unit may be pooled by the owners and developed as a unit.[7] If the owners cannot reach voluntary agreement to pool their interests, and where one or more of the owners has drilled or proposes to drill a well on the spacing or proration unit, the Oil Conservation Division, "to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interest or both in the spacing or proration unit as a unit."[8] All pooling orders shall be made after notice and hearing, shall be just and reasonable, and shall afford the owners in the unit the opportunity to recover their fair share of the oil and gas. [9]

The compulsory pooling statute also provides some detail regarding the allocation of production and costs in a compulsory pooling situation. Regarding the allocation of production, the

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[6]Chapter 70, Article 2 NMSA 1978 (2000 Repl.).

[7]Section 70-2-17 C. NMSA 1978 (2000 Repl.).

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statute provides that production is to be allocated to the respective tracts within the spacing or proration unit on a surface acreage basis.[10] Unleased interest which are subject to compulsory pooling shall be considered as working interest as to 7/8ths of such interest, and a royalty interest as to 1/8th of such interest.[11] Regarding costs, the statute requires that the pooling order shall make definite provisions regarding the non-consenting parties share of costs and the means of recouping such costs. The costs shall be limited to the actual, reasonable expenditures required for the operation, and shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of the well.[12] The "charge for risk shall not exceed 200% of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well." [13]

APPLICATION OF THE COMPULSORY POOLING STATUTE

In its Application to reopen case 12601, Bettis has again requested that the Oil Conservation Division deem and treat the Sun-West interest as though it is unleased. There is, however, no legal basis for this fiction. Sun-West and Gulf Coast are separate legal entities and the lease is legally enforceable against Sun-West and third parties. Moreover, to treat the Sun-West interest as unleased would result in substantial loss to Sun-West and a total loss to Gulf Coast. Clearly, treatment of Sun-West's interest as being unleased would not provide Sun-West or Gulf coast the opportunity to recover their fair share of the oil and gas as required by the pooling statute. [14]

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[10]Id.

[11]Id.

[12]Id.

[13]Id.

[14]Id.

Bettis argues that since the Sun-West interest was unleased on January 30th, it "must be treated under the Oil and Gas Act as a 7/8ths working interest and a 1/8th royalty interest." This is clearly at odds with the express language of the statute which provides as follows:

> If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest. [15]

The operative timeframe is the time of pooling and not the time the application is filed. In this case, the Sun-West mineral interest was leased to a separate legal entity some two months before the April 19th hearing and the pooling affected by Order No. R-11573.

Bettis also argues that the lease transaction improperly affects the risk charge. This argument would apparently hold true for any lease with a royalty burden in excess of 1/8th. We note that the risk charge is only applicable to cost bearing interest; it does not apply to royalty interest.[16] Moreover, the 200% risk charge provided for in Order No. R-11573 provides a significant monetary incentive to the participating parties and a substantial penalty to Gulf Coast. Finally, even the conservative economic analysis by Mr. Stubbs demonstrates the economic viability of the project based on the existing Sun-West lease.

RESPONSE TO APPLICANT'S CASE AUTHORITY

Applicant cites in its Memorandum various Oil Conservation Division and Commission cases and a 1938 Oklahoma case. These cases are each materially different from and not relevant to the case at hand.

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[15]Id.

[16]Id.

The Nearburg case[17] cited by applicant is distinguishable by the fact that Merit, a working interest owner, also owned an internal net profits interest which burdened Merit's working interest.[18] In this case, there is no internal interest and no net profits interest. Instead, Sun-West owns a mineral interest (including royalty interest) subject to a properly executed, recorded and legally enforceable oil and gas lease in favor of Gulf Coast.

The Caulkins case[19] is an extreme case which has no application to this case. The extreme circumstances in the Caulkins case are illustrated by Findings (7) and (8) of Order No. R-7998:

> (7) Evidence was presented establishing that 120 acres of the proposed 320-acre spacing unit, being the N/2 NW/4 and SW/4 NW/4 of said Section 20, is under lease to Meridian Oil, Inc. and/or El Paso Natural Gas Company, and that El Paso Natural Gas Company, predecessor in interest to Meridian Oil, Inc., hereafter referred to as "Meridian", created overriding royalty burdens on said 120 acres of $3.96 and $3.73 per mcf of gas.
>
> (8) Evidence was also presented that for each $858.37 of income per day attributable to Meridian's interest in said well, Meridian must pay out $1,508.76 per day, leaving Meridian with a negative daily working interest of $650.39. [20]

Even Mr. Stubbs' very conservative economic evaluation shows that Bettis should be able to receive a positive rate of return with the Sun-West royalty. In Caulkins, the Meridian interest would result in a $650.39 daily loss (approximately $234,000.00 loss per year) to the participating parties. Even under this extreme situation, the Oil Conservation Division was willing to allow Meridian to voluntarily reduce its override to 12.5% (apparently this would raise the total lease burdens to 25%),

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[17]Application of Nearburg Exploration Company, L.L.C. for Compulsory Pooling, Lea County, New Mexico, Case No. 12087, Order No. R-11109.

[18]Id. at 2. See Findings (7), (8) and (9).

[19]Application of Caulkins Oil Company for Compulsory Pooling, Rio Arriba County, New Mexico, Case No. 8640, Order No. R-7998.

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or exclude its acreage from the spacing or proration unit. [21]

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For the reasons stated hereinabove, Sun-West respectfully requests that Order No. R-11573 be affirmed by the Oil Conservation Division without amendment.

Respectfully submitted,

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By _____
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June 13, 2001

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and FIRST CLASS MAIL

Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 S. St. Francis Drive
Santa Fe, NM 87504

Re: Case No. 12601 - - Sun-West's Hearing Memorandum

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>
> (8) Evidence was also presented that for each $858.37 of income per day attributable to Meridian's interest in said well, Meridian must pay out $1,508.76 per day, leaving Meridian with a negative daily working interest of $650.39. [20]

Even Mr. Stubbs' very conservative economic evaluation shows that Bettis should be able to receive a positive rate of return with the Sun-West royalty. In Caulkins, the Meridian interest would result in a $650.39 daily loss (approximately $234,000.00 loss per year) to the participating parties. Even under this extreme situation, the Oil Conservation Division was willing to allow Meridian to voluntarily reduce its override to 12.5% (apparently this would raise the total lease burdens to 25%),

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[17]Application of Nearburg Exploration Company, L.L.C. for Compulsory Pooling, Lea County, New Mexico, Case No. 12087, Order No. R-11109.

[18]Id. at 2. See Findings (7), (8) and (9).

[19]Application of Caulkins Oil Company for Compulsory Pooling, Rio Arriba County, New Mexico, Case No. 8640, Order No. R-7998.

[20]Id. at 2.

or exclude its acreage from the spacing or proration unit. [21]

Applicant argues that the Branko case[22] stands for the proposition that "the status of a mineral interest is its status at the time the application was filed." This is simply incorrect. The issue in Branko was whether Branko was entitled to notice of the compulsory pooling proceedings.[23] The Oil Conservation Commission determined that Branko did not have an interest of record until well after the drilling of the well and, therefore, Branko was not entitled to notice.[24] In this case, Bettis was provided with actual and constructive notice of the lease some two months prior to the hearing. Moreover, Gulf Coast has in fact been provided with notice of the compulsory pooling proceedings. Accordingly, the notice issue is moot and Branko is irrelevant.

Finally, we note that the Patterson case[25] is not particularly relevant. In Patterson, the Supreme Court of Oklahoma upheld the power of the state to protect correlative rights and prevent waste by the state's well spacing rules. Obviously, the State of New Mexico has the authority to regulate these matters. In this regard, we note that New Mexico has a comprehensive statutory provision dealing with compulsory pooling. In this case, Applicant would like to rewrite New Mexico's compulsory pooling statute and treat the Sun-West interest as unleased. Given the clear statutory provision, we believe that it would be improper for the Oil Conservation Division to take such action in this case.

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[21]Id. at 5 and 6.

[22]Application of Branko, Inc. et al. to Reopen Case No. 10656 (Order No. R-9845) Captioned "Application of Mitchell Energy Corporation for Compulsory Pooling and an Unorthodox Gas Well Location, Lea County, New Mexico, De Novo Case No. 11510, Order No. R-10672-A.

[23]Id. at 8 and 9.

[24]Id.

[25]Patterson v. Stanolind Oil & Gas Co. et al., 182 Okla. 155, 77 P.2d 83 (1938).

For the reasons stated hereinabove, Sun-West respectfully requests that Order No. R-11573 be affirmed by the Oil Conservation Division without amendment.

Respectfully submitted,

STRATTON & CAVIN, P.A.

By _____
Sealy H. Cavin, Jr.

ATTORNEYS FOR SUN-WEST OIL AND GAS, INC.

CERTIFICATE OF SERVICE

I certify that on the 13th day of June, 2001, I faxed and mailed by first class mail a copy of this Hearing Memorandum to the following counsel of record.

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June 7, 2001

HAND DELIVERED

David Brooks, Esq.
Assistant Attorney General
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12601 (Reopened): Application of Bettis, Boyle & Stovall to reopen Case 12601 and amend Order No. R-11573 to address the appropriate royalty burdens on the proposed well for the purpose of the charge for risk involved in drilling said well, Lea County, New Mexico.

Dear Mr. Brooks;

Pursuant to your request, I enclose a copy of the opinion in Patterson v. Stanolind Oil & Gas Co. et al. which I cited in Bettis, Boyle & Stovall's Hearing Memorandum in the above referenced case. As I pointed out at the hearing, it is a lengthy opinion from an old case. I have highlighted the portion of the case for which I cited the opinion.

As you will see, the case involves a well spacing unit created pursuant to an order of the Oklahoma Corporation Commission. This unit was comprised of two leases with different ownership. Patterson, a royalty owner under the tract on which the well is located, objected to sharing production with the owners of other lands in the spacing unit and contended that the well spacing order violated his due process rights and was an abuse of the police power of the state. Patterson contended that the sharing of production which results from the spacing order is a taking which abrogates the contractual obligations of both his deed and lease.

Although the issue in Patterson is couched in terms of "well spacing," and the current matter involves compulsory pooling, an issue in both cases is whether or not private contracts can circumvent or preclude an agency from exercising its jurisdiction and authority. In Patterson, it was determined that a lease or deed could not defeat the well

spacing order of the Oklahoma Corporation Commission. In this case, the Division should not permit the lease by Sun-West to Great Lakes to be used to circumvent the pooling provisions of the Oil and Gas Act.

Very truly yours,

William F. Carr
Attorney for Bettis, Boyle & Stovall

cc: Sealy H. Cavin, Esq.
Mark Maloney

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Telephone:
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To: Lori Wrotenbery, Director
Oil Conservation Division

Fax Number: 505-476-3462

Regarding: Sun-West Oil and Gas, Inc.

From: Sealy H. Cavin, Jr./Deborah

Date: May 16, 2001

Number of Pages (Including Cover Sheet): 4

Message: Lori, attached please find correspondence and enclosure.

IMPORTANT

Should you have any problems receiving this fax, please contact Deborah at (505) 243-5400.

Our File No.: 122.130

HAROLD D. STRATTON, JR.*†**
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May 24, 2001

VIA FACSIMILE (505) 476-3462
and FIRST CLASS MAIL

Lori Wrotenbery, Director
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 S. St. Francis Drive
Santa Fe, NM 87504

Re: Pre-Hearing Statement for Case No. 12601

Dear Ms. Wrotenbery:

On behalf of Sun-West Oil and Gas, Inc., I am enclosing triplicate originals of the Pre-Hearing Statement which is filed in connection with the above-referenced case scheduled for public hearing before a Division Examiner on the docket for Thursday, May 31 2001.

Very truly yours,

Sealy H. Cavin, Jr.

SHC/sks
Enclosures

cc: William F. Carr, Esq. (via facsimile)

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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 12601

APPLICATION OF BETTIS, BOYLE & STOVALL FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO

PRE-HEARING STATEMENT

This pre-hearing statement is submitted by Sun-West Oil and Gas, Inc. as required by the Oil Conservation Division.

APPEARANCES OF PARTIES

APPLICANT

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ATTORNEY

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OPPOSITION OR OTHER PARTY

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STATEMENT OF CASE

APPLICANT

Applicant, Bettis, Boyle and Stovall seek to reopen Case No. 12601 and Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well.

OPPOSITION OR OTHER PARTY

Sun-West is opposed to the application on the grounds that there is no legal basis for taking its property.

PROPOSED EVIDENCE

APPLICANT

WITNESS	EST. TIME	EXHIBITS

To be identified by applicant.

OPPOSITION

WITNESS	EST. TIME	EXHIBITS

PROCEDURAL MATTERS

Sun-West is not aware of any procedural matters which need to be addressed prior to the hearing.

RESPECTFULLY SUBMITTED:

STRATTON & CAVIN, P.A.

By: _____
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