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January 11, 1988

"Hand Delivered"

Mr. William J. LeMay
Oil Conservation Commission
P. O. Box 2088
Santa Fe, New Mexico 87501

Mr. Erling A. Brostuen
Energy and Minerals Department
525 Camino de los Marquez
Santa Fe, New Mexico 87501

Mr. William R. Humphries
State Land Commissioner
Land Office Building
Santa Fe, New Mexico 87501

Re: Compulsory Pooling Application of
Mesa Grande Ltd Case 9225

Compulsory Pooling Application of
Mesa Grande Resources Inc. Case 9236

Gentlemen:

Our firm represents Sun Exploration and Production Company in the referenced cases which were first called to hearing by the Commission on November 19, 1987.

The Commission continued these cases until the Commission hearing on January 21, 1988 and requested counsel for the respective parties requested to submit Memorandum of Law on the issues involved in these cases. Please find our Memorandum enclosed.

Very truly yours,

W. Thomas Kellahin

WTK:ca
Enc.

cc: Owen Lopez, Esq.

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY AND MINERALS
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING CALLED BY THE COMMISSION TO CONSIDER THE APPLICATION OF MESA GRANDE LTD. FOR AN ORDER POOLING A 640-ACRE TRACT CONSISTING OF SECTION 20, T25N, R2W, NMPM, GAVILAN-MANCOS OIL POOL, RIO ARRIBA COUNTY, NEW MEXICO. CASE: 9225

IN THE MATTER OF THE HEARING CALLED BY THE COMMISSION TO CONSIDER THE APPLICATION OF MESA GRANDE RESOURCES INC. FOR AN ORDER POOLING AN IRREGULAR TRACT CONSISTING OF 650.22 ACRES BEING ALL OF SECTION 1, T24N, R2W, GAVILAN-MANCOS OIL POOL, RIO ARRIBA COUNTY, NEW MEXICO. CASE: 9236

HEARING MEMORANDUM

SUN EXPLORATION AND PRODUCTION COMPANY

This matter is currently before the New Mexico Oil Conservation Commission on applications by Mesa Grande Ltd. to form a 640-acre spacing unit in the Gavilan Mancos Oil Pool by pooling 320 additional acres in Section 20, T25N, R2W, NMPM, with the existing 320 acres already dedicated to the Loddy #1 well operated by Sun Exploration and Production Company ("Sun"), and by Mesa Grande Resources Inc. to form a 650.22-acre spacing

unit in the Gavilan Mancos Oil Pool by pooling 325.16 additional acres controlled by Sun and Dugan Production Corporation in Section 1, T15N, R2W, NMPM, with the 325.06 acres already dedicated to the Federal Invader #1 well operated by Mesa Grande Resources Inc.

These cases were originally called to hearing before the Commission on November 19, 1987 at which time the Commission took under consideration the Motion to Dismiss filed by Sun and the response by Mesa Grande and directed that both Sun and Mesa Grande submit memorandums by January 10, 1988 on the legal issues presented at the hearing and the options available to the Commission.

Sun submits this Hearing Memorandum in response to the Commission's request.

BACKGROUND

The Oil Conservation Commission of New Mexico ("Commission") has the authority to establish pool rules and to set the size of spacing units for wells in a pool.[1/] On December 23, 1983, the Commission adopted Temporary Special Rules and Regulations for the Gavilan Mancos Oil Pool in Order R-7407[2/] which provided in part:

1/ See Section 70-2-18(c) N.M.S.A., 1978 (1987 Rep), attached as Exhibit 1.

2/ See Order R-7407 attached as Exhibit 2.

Rule 2: No more than one well shall be completed or recompleted on a standard unit containing 320 acres, more or less, consisting of the N/2, S/2, E/2 or W/2 of a governmental section.

Thereafter, pursuant to those rules, on August 30, 1985, Jerome P. McHugh (now Sun) completed his Loddy #1 well to which he dedicated 320 acres, being the W/2 of Section 20, T25N, R2W, and on May 23, 1986 Mesa Grande Resources Inc. completed its Federal Invader well #1 to which it dedicated 325.25 acres, being the W/2 of Section 1, T24N, R2W.[3/]

In addition to the authority to set rules and regulations for a pool, a regulatory commission has the continuing power to modify spacing units and to increase or decrease the pool spacing. Amoco Production Company v. North Dakota Ind. Comm. 307 N.W. 2d 839 (N.D. 1981). Section 70-2-18(a), N.M.S.A., 1978 (1987 Rep.)[4/] recognizes that authority for the New Mexico Oil Conservation Division and requires that spacing unit changes shall affect production from the subject spacing units effective as of the date of the Commission's order.

3/ The Gavilan Mancos Pool Plat is attached as Exhibit 3.

4/ See Exhibit 1.

On June 8, 1987 the Commission adopted Permanent Special Rules and Regulations for the Gavilan-Mancos Oil Pool in Order R-7407-E,[5/] which amended the original Rule 2 and substituted the following:

(3) Rule 2 of the temporary special rules and regulations for the Gavilan-Mancos Oil Pool as promulgated by Order R-7407 is hereby amended as follows:

> Rule 2(a). A standard proration unit shall consist of between 632 and 648 acres consisting of a governmental section with at least one and not more than two wells drilled or recompleted thereon; provided that if the second well is drilled or recompleted on a standard unit it shall not be located in the same quarter section, nor closer than 1650 feet to the first well drilled on the unit; and provided further that proration units formed prior to the date of this order are hereby granted exception to this rule. (Emphasis added).
>
> (b). A buffer zone is hereby created consisting of the east half of sections bordering Township 1 West. Only one well per section shall be drilled in said buffer zone and if such well is located closer than 2310 feet from the western boundary of the West Puerto Chiquito-Mancos Oil Pool it shall not be allowed to produce more than one-half the top allowable for a 640-acre proration unit.

In the adoption of Rule 2, the Commission included language that exempted or "grandfathered" all proration and spacing units formed prior to the date of the June 8, 1987 order. That action has caused a controversy among working interest owners and operators in the Gavilan

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5/ Copy attached as Exhibit 4.

Mancos Pool and precipitated the filing of Mesa Grande's applications in the subject cases.

On August 20, 1987, Mesa Grande Ltd. filed an application with the Division for a compulsory pooling order pooling the E/2 of Section 20 with the W/2 of Section 20 (which was already dedicated to the Loddy No. 1 well) in order to form a 640-acre spacing unit. This application is now docketed as Case 9225.

On September 18, 1987, Mesa Grande Resources Inc. filed an application with the Division for a compulsory pooling order pooling the acreage in the E/2 of Section 1, T24N, R2W with the 325.06 acres of the W/2 (already dedicated to its Invader No. 1 Well) to form a 650.22-acre spacing unit. That application was docketed as Case 9236.

On November 19, 1987, the Commission held a hearing on this matter but did not reach a decision. The threshold issue to be decided by the Commission is the validity of its 1987 Amendment to Rule 2.

RULE 2(a) IS VALID AND
DOES NOT VIOLATE SECTION 70-2-18, N.M.S.A.

Section 70-2-18(a) states in part:

> ". . . Any division order that increases the size of a standard spacing or proration unit for a pool, or extends the boundaries of such a pool, shall require dedication of acreage to existing wells in the pool in accordance with the acreage dedication requirements for said pool, and all interests in the spacing or

proration units that are dedicated to the affected wells shall share in production from the effective date of the said order." (Emphasis added).

Mesa Grande erroneously argues that Section 70-2-18, N.M.S.A., 1978 (1987 Rep.), absolutely precludes the Commission from creating and approving the existence of non-standard spacing and proration units. The Commission's own Rules and Regulations[6/] and the action by the Division and Commission have established, approved, and created countless non-standard spacing and proration units in New Mexico.[7/]

Although Mesa Grande raises this as a point of contention, it is beyond dispute to argue that the Commission is precluded from exemption of certain spacing units.

THE APPLICATION OF MESA GRANDE CONSTITUTES IMPERMISSIBLE COLLATERAL ATTACKS ON ORDER R-7404-E

Order R-7407-E, which contains the revisions to Rule 2, is final and therefore may not be amended or modified absent a substantial change of conditions or substantial

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6/ See Exhibit 1.

7/ See Exhibit 2.

change in knowledge of conditions since the issuance of the prior order.[8/]

The language adopted by the Commission in Rule 2 as amended by Order R-7407-E clearly and specifically "grandfathered" all existing spacing units in existence in the Gavilan-Mancos Oil Pool as of June 8, 1987. This includes not only sections where there are currently two Gavilan Mancos Oil Pool wells, but ALSO those sections where there is currently only one Gavilan Mancos Pool well.

The Commission's action in Order R-7407-E is significantly different from the procedure adopted by the Commission when it entered the original spacing Order R-7404 on December 20, 1983. In the original spacing case, the Commission adopted the following language to specifically require all then existing wells spaced on 160 acres to be rededicated to the new 320-acre spacing units:

> IT IS FURTHER ORDERED:
>
> (1) That the Special Rules and Regulations for the Gavilan-Mancos Oil Pool shall become effective March 1, 1984.

8/ Phillips Petroleum Company v. Corporation Commission, 482 P.2d 607 (Okla. 1971).

(2) That any well presently producing from the Gavilan-Mancos Oil Pool which does not have a standard 320-acre proration unit, an approved non-standard proration unit, or which does not have a pending application for a hearing for a standard or non-standard proration unit by March 1, 1984, shall be shut-in until a standard or non-standard unit is assigned the well.

The procedure adopted for the 1983 transition from 160-acre to 320-acre spacing was not repeated by the Commission in Order R-7407-E entered on June 8, 1987. To the contrary, it specifically excluded any and all wells already dedicated to 320-acre units. Thus, both of the applications of Mesa Grande Resources, Inc. and Mesa Grande Ltd constitute collateral attacks on a valid, binding rule of the pool. The Commission has no alternative under the current pool rules but to dismiss the applications of Mesa Grande because they request action by the Commission in direct conflict with the pool rules.

IF THE COMMISSION DETERMINES THAT THE LANGUAGE OF RULE 2A "GRANDFATHERED" CERTAIN EXISTING SPACING UNITS THAT IT DID NOT INTEND TO EXEMPT, IT CAN NOW LEGALLY ACT TO INCLUDE THOSE SPACING UNITS ONLY UPON A CHANGE OF CONDITIONS

It is an established principal of oil & gas administrative law recognized in many producing states that the regulatory agency, in this case the Commission, is empowered to change previous spacing and pooling

orders where there is substantial evidence of a change of conditions or knowledge of conditions if such action is necessary to prevent waste or protect correlative rights. Winter v. Corporation Commission of State of Oklahoma, 660 P.2d 145, (Okla. App. 1983); Continental Oil Company v. Corporation Commission, 376 P.2d 330 (Okla. 1962).

It is also clear that the Commission has specifically retained jurisdiction in its orders to modify or change its prior orders when there is substantial evidence of a change of conditions.[9/] In addition, the Commission has preserved its flexibility to make changes by issuing temporary orders when new pool rules are first established.

However, this case presents the unique situation where the rules have been made permanent[10/] and there has been no substantial change of conditions since the order was entered.

This case presents the unique situation of whether the Commission, in the absence of substantial change in conditions, has the authority to amend or modify a prior permanent order.

9/ See Sections 70-2-11, 70-2-12, 70-2-17, N.M.S.A., 1978, attached as Exhibit 5.

10/ See Exhibit 2.

While there are no New Mexico cases involving a similar situation, other jurisdictions have decided that where the order being modified has already become final, the modification must be justified by a finding of a substantial change of conditions. Carter Oil Co. v. State, 238 P.2d 300 (Okla. 1951); El Paso Natural Gas Co. v. Corporation Commission, 640 P.2d 1336, (Okla. 1982); Phillips Petroleum Company v. Corporation Commission, 482 P.2d 607 (Okla. 1971); McDaniel v. Moyer, 662 P.2d 309 (Okla. 1983).

The rationale for such decisions is that a permanent order establishing parties specific rights and obligations should be changed only upon proof of change of conditions warranting such a change. Union Oil Co. v. Brown, 641 P.2d 1106 (Okla. 1982). Further, the Oklahoma Supreme Court has determined that the Oklahoma Corporation Commission, which functions to regulate oil and gas production in that state, cannot simply enter purely interpretive orders. Southern Union Production Company v. Corporation Commission, 465 P.2d 454 (Okla. 1970).

The change sought by Mesa Grande's applications is not merely a "clarification" of the Commission's order but is indeed a modification which is in direct conflict with a valid pool rule. In Oklahoma, while the courts

found that while the Corporation Commission had the power to clarify an order,

> the exercise of which does not affect a change in the prior order or in the rights accurred under that order, the power to effect a change in a previous order requires a showing before the Commission of a change in conditions or knowledge of conditions necessitating the repeal amendment or modification. Nilsen v. Ports of Call Oil Company, 711 P.2d 98 (Okla. 1985) at 102.

Based upon the Oklahoma decisions, the proper procedural means to modify or amend a prior order that has become final are limited to those incidents where there is substantial evidence of a change in conditions. The facts and conditions surrounding the existing Gavilan Mancos Wells have not changed since June 8, 1987.

The Commission has in the past used the concept of an Administrative "Nunc Pro Tunc" order to correct obvious errors or omissions in an order. The Latin phrase "nunc pro tunc" translated literally means "now for then" and is used to correct obvious clerical and typographical errors in orders. The "nunc pro tunc" device cannot be used by the Commission to amend an order which properly reflects a decision which the Commission later finds to be undesirable or erroneous.[11/]

11/ See, Moore Federal Practice and Procedures, Section 25.03(6).

Should the Commission elect to modify the "grandfathering" language of Rule 2 and to exempt only those sections which contained two or more Gavilan Mancos Pool wells as of June 8, 1987, it can do so only after it dockets this matter for hearing and provides notice to all affected parties.[12/]

COMPULSORY POOLING

In addition to the controversy over the "grandfathering" language of Rule 2, the two compulsory pooling applications have raised further issues for the Commission to resolve. One of these issues is the manner of assessing costs against the incoming working interest owners.

A PARTY DESIRING TO PARTICIPATE IN A PRODUCING WELL CAN BE REQUIRED BY THE COMMISSION IN A COMPULSORY POOLING ORDER TO PAY AN AMOUNT GREATER THAN THE PERCENTAGE SHARE OF THE ACTUAL ORIGINAL COSTS OF DRILLING AND COMPLETING THE WELL

Although judicially untested in New Mexico, the New Mexico Compulsory Pooling Statute has continually and repeatedly been utilized to create spacing units when the

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12/ Suggested language for revising Rule 2 is attached as Exhibit 6.

parties are unable to reach a voluntary agreement.[13/] The operation of the pooling statutes as applied by the Commission to a typical pooling case is easily summarized:

> Prior to drilling the well, one of the working interest owners will propose to act as operator and will propose a well to the other working interest owners in the spacing unit a well. Through negotiations, all but a few working interest owners agree. Having failed through fair and reasonable efforts to obtain 100 percent voluntary joinder of the working interest owners, the proposed operator will apply to the Commission for compulsory pooling. The compulsory pooling order entered will typically provide for a 30-day election period during which the party that has not yet consented will be given a chance to pre-pay its share of the estimated costs of the well or, in the alternative, to elect to "go non-consent" and have his share of the costs "carried" by the consenting owners, for which those consenting owners are entitled to recover out of production the non-consenting owner's share of the costs of the well plus an additional 200% for the risk of carrying that interest.

13/ See Section 70-2-17(c), N.M.S.A., 1978 (1987 Rep.), attached as Exhibit 6.

Is this method of assessing costs applicable, however, in determining the issues involved in Mesa Grande's pending applications? Here one of the issues is what amounts should be assessed against a consenting working interest owner who wants to force pool its way into a well which is already completed and producing. Mesa Grande argues that the Commission decided this precise issue against Mallon Oil Company in Case 8900,[14/] which was heard on May 20, 1986, and that it is the practice of the Commission in such circumstances to assess only a proportionate share of the actual well costs against the incoming working interest owners, without any risk penalty. They argue that Case 8900 is authority for the Commission to allow Mesa Grande to participate in the two subject wells without payment of any penalty.

A review of Case 8900 and a reading of the compulsory pooling statute shows that Mesa Grande misread the compulsory pooling statute and is misapplying the prior decision of the Commission.

After the Gavilan Mancos spacing was increased from 160 acres to 320 acres by Order R-7407 entered December 20, 1983, Mallon filed an application for compulsory

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14/ See Order R-8262 attached as Exhibit 7.

pooling of Mesa Grande's interest in the new 320-acre unit.[15/]

Mallon attempted to justify having the new consenting working interest owners pay not only their share of the actual well costs but an additional 100% bonus to compensate it for the benefit gained by the new participants in being allowed to know before they paid their share of the costs that they were participating in a successful commercial producing well. Mallon made the mistake of attempting to equate the hypothetical costs of a "turnkey" well with the actual costs of the subject well. As is evident from Finding (20) of R-8262, Mallon made no attempt to demonstrate any other proposal for a reasonable charge against Mesa Grande for the investment made on its behalf by Mallon.

It is unfortunate that Mallon did not present evidence of the value of the recoverable reserves and the return on investment or rate of return calculations commonly made by and relied upon by the industry in assessing the value to a new participant in obtaining a share of a producing well's proven reserves. In

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15/ As was previously discussed, the transition from 160 acres to 320-acre spacing was conducted by a provision in R-7407 that was significantly different from the language used in R-7407-E for the transition from 320 to 640 acres.

addition, it is apparent that the Commission in Finding (17) and (18) of Order R-8262 was focusing on that sentence that deals with the cost and penalty against a non-consenting party that does not join in the well pursuant to the compulsory pooling order. It is an omission from the Order that the Commission did not elaborate upon Finding (2) and established guidelines for participation by consenting parties.

Contrary to the assertions of Mesa Grande, there is nothing in the prior Mallon Case 8900, the Compulsory Pooling statute, or the practice of the Commission that precludes the owners of a producing commercial well from receiving more than the proportionate actual costs of the well from the parties who want to participate in the remaining production from that well so long as that sum is fair and reasonable.

To say that those new participants need only pay their share of the actual costs of the drilling and completion would simply allow the new participant to obtain a share of proven production for the minimal sum of their share of the actual well costs. Such a result is unfair to the original owners and a windfall to the new participants.

The compulsory pooling statutes do not compel such a result. The Commission has used its discretion in the recent past to minimize the opportunity for parties being

pooled to know and make use of the results of a well that has been drilled or completed during the time they must exercise their election.

The controlling language of Section 70-2-17(c) which sets the requirements for those parties that elect to pay their proportionate share are found in the first sentence of the second paragraph of subsection C.

> All orders affecting such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner, or owners, of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas, or both.

Nothing contained in this section says that the costs to a consenting owner for participation in the well is limited to its share of the actual costs of drilling and completion.

The controlling statutory language that applies to those parties that elect NOT to pay their share is confined to and found in the last sentence of that same paragraph and is as follows:

> Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for

> supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the unconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well. (Emphasis added).

There is no justification in limiting the costs to the consenting party by the same formula by which costs and risk are assessed against a non-consenting party.

Mesa Grande wants to take that portion of the statute that deals with the allocation of costs for a non-consenting owner which contains language about actual costs and risk factor and now apply it to restrict the Commission in its determination of reasonable costs and conditions for a consenting participating owner in a producing well. Such a construction does not establish terms and conditions that are just and reasonable.

A MAJORITY OF WORKING INTEREST OWNERS SHOULD BE ALLOWED TO EXERCISE COMPULSORY POOLING OPTION

Should the Commission after notice and hearing adopt revisions to Rule 2(a) to exempt only those sections in which two Gavilan Mancos Pool wells already existed as of June 8, 1987, and in the event, thereafter, the working interest owners in sections where only a single Gavilan Mancos Pool well existed are unable to

reach a voluntary agreement on participation in the producing well, then the Commission must decide whether the decision to drill a second well in a section is the exclusive right of the operator of the original well or whether working interest owners in the non-participating half section may obtain a compulsory pooling order.

The threshold issue at this point is whether the Commission intends that the option for determining if the original well's 320-acre spacing unit shall be reformed into a 640-acre spacing unit and the option for an additional well to be drilled be exercised by the operator of the original well or intends that any working interest or royalty may owner file for and obtain compulsory pooling in the absence of a voluntary agreement.

We find nothing in the language of the New Mexico Compulsory Pooling Statute[16/] that limits the application of that act to only an operator or to situations existing prior to the drilling of the well. To the contrary, Section 70-2-17(c) states:

> Where, however, such owner or owners have not agreed to pool their interests and where one such separate owner or owners who has the right to drill has drilled or proposed to drill a well, the division shall pool all or any part of such interests as a unit.

16/ See Exhibit 5.

Thus, it appears that any working interest owner in either the original 320-acre spacing unit or in the "new" 640-acre spacing unit should be able to utilize the compulsory pooling statute so that the Commission can determine the participation in production of each owner as a result of a spacing change even from a producing well.

Since the language of Order R-7407-E does not resolve the issue of what the Commission intended by the optional well on a 640-acre spacing unit and who it intended to have the right to exercise that option, the Commission must address this matter if it revises Rule 2(a) in the manner discussed above.

ALLOWABLES

The Commission must address what, if any, action it should take in those sections with two or more Gavilan Mancos Oil Pool wells to insure that the allowable assigned to the 640-acre spacing unit is equitable and fairly allocated to the two wells. Such action should take into consideration whether the production from the original well in the section can be applied to the costs of the second well before the proceeds are paid to the working interest owners, and whether the allocation of allowable for sections with two wells should be

determined based on the ratio of actual producing rates or by simply dividing the current allowable in half for each well.

CONCLUSION

Sun believes, supports and encourages the development of the Gavilan Mancos Oil Pool on spacing and proration units of at least 640 acres in size. In addition, Sun continues to support the need to minimize the number of wells to be drilled and produced in the Gavilan Mancos Oil Pool in order to avoid the drilling of unnecessary wells and to conserve the energy in this rate sensitive reservoir.

However, Rule 2, as amended by Order R-7407-E, specifically "grandfathered" all existing 320-acre spacing units as of June 8, 1987. That order effectively excluded those 320-acre spacing units located in sections with two such wells and those with one such well.

Now the Commission is faced with a complex and legally difficult task of attempting to modify or alter the effect of Rule 2. Should Rule 2 be modified to include what was understood by certain owners of the oil and gas in the existing 320-acre units it will have a drastic and unsettling impact on those owners.

In order to consider such a modification, the Commission, prior to making such a determination, must properly docket its own case to consider this issue and provide the appropriate notices and advertisements. After such a hearing, should the Commission enter an order excluding only those sections with two or more wells, then and only then can the two Mesa Grande compulsory pooling cases be heard.

Should the Commission reach the compulsory pooling issues then the Commission is authorized to determine an amount which is fair to the incoming working interest owners as well as the original working interest owners. For such consenting owners, that amount is not limited to simply their percentage share of the original actual costs of drilling and completing but should include an amount to compensate the original owners for participation in a known producing well. For those working interest owners that elect not to participate then the operator should be allowed to recover a 200% risk factor penalty.

Finally, the Commission needs to establish an allowable proration formula for the allocation of production for those sections that contain two or more

wells so that there is a fair and equitable means of sharing in that production without waste occuring.

W. Thomas Kellahin, Esq.
Kellahin, Kellahin & Aubrey
P. O. Box 2265
Santa Fe, New Mexico 87504

CERTIFICATE OF MAILING

I hereby certify that a true copy of the foregoing Memorandum was mailed to opposing counsel of record this 11 day of January, 1988.

W. Thomas Kelliahin, Esq.

has power to pool separately owned tracts within a spacing or proration unit, as well as concomitant authority to establish oversize nonstandard spacing units, commission also has authority to pool separately owned tracts within an oversize nonstandard spacing unit. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Elements of property right of natural gas owners. — The legislature has stated definitively the elements contained in property right of natural gas owners. Such right is not absolute or unconditional. It consists of merely (1) an opportunity to produce, (2) only insofar as it is practicable to do so, (3) without waste, (4) a proportion, (5) insofar as it can be practically determined and obtained without waste, (6) of gas in the pool. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Law reviews. — For article, "Compulsory Pooling of Oil and Gas Interests in New Mexico," see 3 Nat. Resources J. 316 (1963).

For comment on El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966), see 7 Nat. Resources J. 425 (1967).

For comment on geothermal energy and water law, see 19 Nat. Resources J. 445 (1979).

Am. Jur. 2d, A.L.R. and C.J.S. references. — 38 Am. Jur. 2d Gas and Oil §§ 159, 161, 164.

38 C.J.S. Mines and Minerals §§ 229, 230.

70-2-18. Spacing or proration unit with divided mineral ownership.

A. Whenever the operator of any oil or gas well shall dedicate lands comprising a standard spacing or proration unit to an oil or gas well, it shall be the obligation of the operator, if two or more separately owned tracts of land are embraced within the spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil or gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, to obtain voluntary agreements pooling said lands or interests or an order of the division pooling said lands, which agreement or order shall be effective from the first production. Any division order that increases the size of a standard spacing or proration unit for a pool, or extends the boundaries of such a pool, shall require dedication of acreage to existing wells in the pool in accordance with the acreage dedication requirements for said pool, and all interests in the spacing or proration units that are dedicated to the affected wells shall share in production from the effective date of the said order.

B. Any operator failing to obtain voluntary pooling agreements, or failing to apply for an order of the division pooling the lands dedicated to the spacing or proration unit as required by this section, shall nevertheless be liable to account to and pay each owner of minerals or leasehold interest, including owners of overriding royalty interests and other payments out of production, either the amount to which each interest would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of pooling, whichever is greater.

C. Nonstandard spacing or proration units may be established by the division and all mineral and leasehold interests in any such nonstandard unit shall share in production from that unit from the date of the order establishing the said nonstandard unit.

History: 1953 Comp., § 65-3-14.5, enacted by Laws 1969, ch. 271, § 1; 1977, ch. 255, § 52.

Constitutionality. — Standards of preventing waste and protecting correlative rights, as laid out in 70-2-11 NMSA 1978, are sufficient to allow commission's power to prorate and create standard or nonstandard spacing units to remain intact, and this section is not unlawful delegation of legislative power under N.M. Const., art. III, § 1. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

The terms "spacing unit" and "proration unit" are not synonymous and commission has power to fix spacing units without first creating proration units. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Authority to pool separately owned tracts. — Since commission has power to pool separately owned tracts within a spacing or proration unit, as well as concomitant authority to establish oversize nonstandard spacing units, the commission also has authority to pool separately owned tracts within an oversize nonstandard spacing unit. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Creation of proration units, force pooling and participation formula upheld. — Commission's (now division's) findings that it would be unreasonable and contrary to spirit of conservation statutes to drill an unnecessary and economically wasteful well were held sufficient to justify creation of two nonstandard gas proration units, and force pooling thereof, and were supported by substantial evidence. Likewise, participation formula adopted by commission, which gave each owner a share in production in same ratio as his acreage bore to the acreage of whole, was upheld despite limited proof as to extent and character of the pool. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Law reviews. — For comment on geothermal energy and water law, see 19 Nat. Resources J. 445 (1979).

Am. Jur. 2d, A.L.R. and C.J.S. references. — 38 Am. Jur. 2d Gas and Oil §§ 159, 164, 172.

58 C.J.S. Mines and Minerals §§ 230, 240.

Exhibit 1

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING
CALLED BY THE OIL CONSERVATION
COMMISSION OF NEW MEXICO FOR
THE PURPOSE OF CONSIDERING:

CASE NO. 7980
Order No. R-7407

NOMENCLATURE

APPLICATION OF JEROME P. McHUGH
FOR THE CREATION OF A NEW OIL POOL
AND SPECIAL POOL RULES, RIO ARRIBA
COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 a.m. on November 16, 1983, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission."

NOW, on this 20th day of December, 1983, the Commission, a quorum being present, having considered the testimony presented and the exhibits received at said hearing, and being fully advised in the premises,

FINDS:

(1) That due public notice having been given as required by law, the Commission has jurisdiction of this cause and the subject matter thereof.

(2) That the applicant, Jerome P. McHugh, seeks an order creating a new oil pool, vertical limits to be the Niobrara member of the Mancos formation, with special pool rules including a provision for 320-acre spacing, Rio Arriba County, New Mexico.

(3) That in companion Case 7979, Northwest Pipeline Company seeks an order deleting certain lands from the Basin Dakota Pool, the creation of a new oil pool with vertical limits defined as being from the base of the Mesaverde formation to the base of the Dakota formation, (the Mancos and Dakota formations), and the promulgation of special pool rules including a provision for 160-acre spacing, Rio Arriba County, New Mexico.

Exhibit 2

(4) That Cases 7979 and 7980 were consolidated for the purpose of obtaining testimony.

(5) That geological information and bottomhole pressur differentials indicate that the Mancos and Dakota Formations are separate and distinct common sources of supply.

(6) That the testimony presented would not support a finding that one well would efficiently drain 320 acres in the Dakota formation.

(7) That the Mancos formation in the area is a fractured reservoir with low porosity and with a matrix permeability characteristic of the Mancos being produced in the West Puerto Chiquito Mancos Pool immediately to the east of the area.

(8) That said West Puerto Chiquito-Mancos Pool is a gravity drainage reservoir spaced at 640 acres to the well.

(9) That the evidence presented in this case established that the gravity drainage in this area will not be as effective as that in said West Puerto Chiquito-Mancos Pool and that smaller proration units should be established therein.

(10) That the currently available information indicates that one well in the Gavilan-Mancos Oil Pool should be capable of effectively and efficiently draining 320 acres.

(11) That in order to prevent the economic loss caused b the drilling of unnecessary wells, to prevent reduced recovery of hydrocarbons which might result from the drilling of too many wells, and to otherwise prevent waste and protect correlative rights, the Gavilan-Mancos Oil Pool should be created with temporary Special Rules providing for 320-acre spacing.

(12) That the vertical limits of the Gavilan-Mancos Pool should be defined as: The Niobrara member of the Mancos formation between the depths of 6590 feet and 7574 feet as found in the Northwest Exploration Company, Gavilan Well No. 1, located in Unit A of Section 26, Township 25 North, Range 2 West, NMPM, Rio Arriba County, New Mexico.

(13) That the horizontal limits of the Gavilan-Mancos Oil Pool should be as follows:

TOWNSHIP 24 NORTH, RANGE 2 WEST, NMPM
Sections 1 through 3: All

(TOWNSHIP 25 NORTH, RANGE 2 WEST, NMPM)
Sections 19 through 30: All
Sections 33 through 36: All

(14) That to protect the correlative rights of interested parties in the West Puerto-Chiquito Mancos Oil Pool, it is necessary to adopt a restriction requiring that no more than one well be completed in the Gavilan-Mancos Oil Pool in the E/2 of each section adjoining the western boundary of the West Puerto Chiquito-Mancos Oil Pool, and shall be no closer than 1650 feet to the common boundary line between the two pools.

(15) That in order to gather information pertaining to reservoir characteristics in the Gavilan-Mancos Oil Pool and its potential impact upon the West Puerto Chiquito-Mancos Oil Pool, the Special Rules for the Gavilan-Mancos Oil Pool should provide for the annual testing of the Mancos in any well drilled in the E/2 of a section adjoining the West Puerto Chiquito-Mancos Pool.

(16) That the said Temporary Special Rules and Regulations should be established for a three-year period in order to allow the operators in the Gavilan-Mancos Oil Pool to gather reservoir information to establish whether the temporary rules should be made permanent.

(17) That the effective date of the Special Rules and Regulations promulgated for the Gavilan-Mancos Oil Pool should be more than sixty days from the date of this order in order to allow the operators time to amend their existing proration and spacing units to conform to the new spacing and proration rules.

IT IS THEREFORE ORDERED:

(1) That a new pool in Rio Arriba County, New Mexico, classified as an oil pool for Mancos production is hereby created and designated as the Gavilan-Mancos Oil Pool, with the vertical limits comprising the Niobrara member of the Mancos shale as described in Finding No. (12) of this Order and with horizontal limits as follows:

GAVILAN-MANCOS OIL POOL
RIO ARRIBA COUNTY, NEW MEXICO

TOWNSHIP 24 NORTH, RANGE 2 WEST, NMPM
Sections 1 through 3: All

TOWNSHIP 25 NORTH, RANGE 2 WEST, NMPM
Sections 19 through 30: All
Sections 33 through 36: All

(2) That temporary Special Rules and Regulations for the Gavilan Mancos Oil Pool are hereby promulgated as follows:

SPECIAL RULES AND REGULATIONS
FOR THE
GAVILAN-MANCOS OIL POOL

RULE 1. Each well completed or recompleted in the Gavilan-Mancos Oil Pool or in a correlative interval within one mile of its northern, western or southern boundary, shall be spaced, drilled, operated and produced in accordance with the Special Rules and Regulations hereinafter set forth.

RULE 2. No more than one well shall be completed or recompleted on a standard unit containing 320 acres, more or less, consisting of the N/2, S/2, E/2, or W/2 of a governmental section.

RULE 3. Non-standard spacing or proration units shall be authorized only after proper notice and hearing.

RULE 4. Each well shall be located no nearer than 790 feet to the outer boundary of the spacing or proration unit, nor nearer than 330 feet to a governmental quarter-quarter section line.

RULE 5. That no more than one well in the Gavilan-Mancos Oil Pool shall be completed in the East one-half of any section that is contiguous with the western boundary of the West Puerto Chiquito-Mancos Oil Pool, with said well being located no closer than 1650 feet to said boundary.

RULE 6. That the operator of any Gavilan-Mancos Oil Pool well located in any of the governmental sections contiguous to the West Puerto Chiquito-Mancos Oil Pool the production from which is commingled with production from any other pool or formation and which is capable of producing more than 50 barrels of oil per day or which has a gas-oil ratio greater than 2,000 to 1, shall annually, during the month of April or May, conduct a production test of the Mancos formation production in each said well in accordance with testing procedures acceptable to the Aztec district office of the Oil Conservation Division.

IT IS FURTHER ORDERED:

(1) That the Special Rules and Regulations for the Gavilan-Mancos Oil Pool shall become effective March 1, 1984.

(2) That any well presently producing from the Gavilan-Mancos Oil Pool which does not have a standard 320-acre proration unit, an approved non-standard proration unit, or which does not have a pending application for a hearing for a standard or non-standard proration unit by March 1, 1984, shall be shut-in until a standard or non-standard unit is assigned the well.

(3) That this case shall be reopened at an examiner hearing in March, 1987, at which time the operators in the subject pool should be prepared to appear and show cause why the Gavilan-Mancos Oil Pool should not be developed on 40-acre spacing units.

(4) That jurisdiction of this cause is retained for the entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

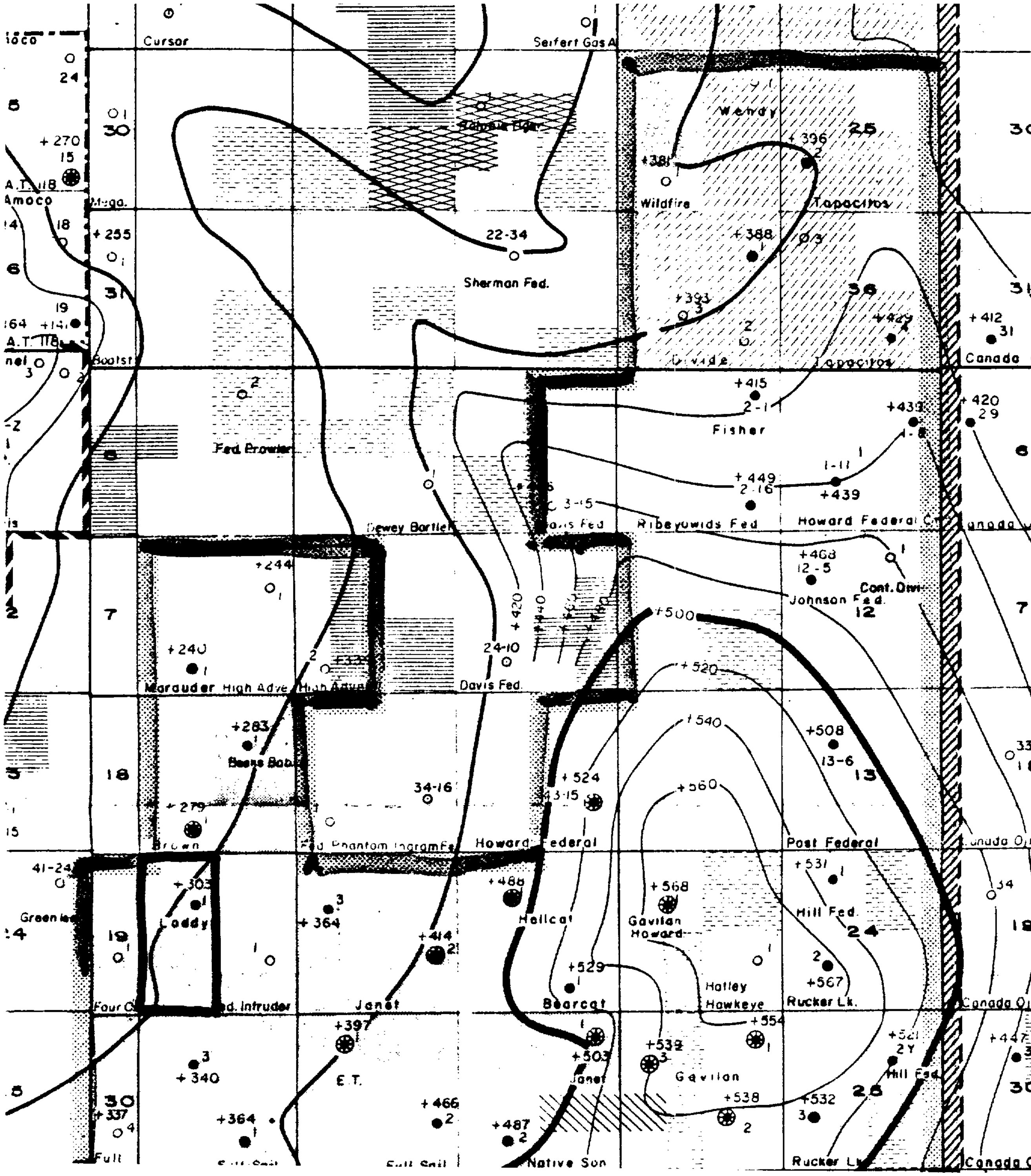
STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

JIM BACA, MEMBER

ED KELLEY, MEMBER

JOE D. RAMEY, CHAIRMAN AND SECRETARY

S E A L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Sherman Fed.
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Amoco
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Dewey Bartlett
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Johnson Fed.
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24-10
Davis Fed.
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+520
Marauder
High Adve
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+508
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+524
43-15
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+560
+279
Brown
Howard Federal
Post Federal
41-24
Greenlee
+303
Laddy
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+364
+488
Hellcat
+568
Gavilan
Howard
+531
Hill Fed.
24
+414
+529
Hatley
Hawkeye
+567
Rucker Lk.
Four
Intruder
Janet
Bearcat
Canada
+397
+503
Janet
+539
+554
+521
Hill Fed.
+447
+340
E.T.
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+337
+364
+466
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+538
+532
25
Native Son
Rucker Lk.
Canada

ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

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

CASES NOS. 7980, 8946,
9113, AND 9114
ORDER NO. R-7407-E

CASE NO. 7980

IN THE MATTER OF CASE 7980 BEING REOPENED PURSUANT TO THE PROVISIONS OF COMMISSION ORDER NO. R-7407, WHICH ORDER PROMULGATED TEMPORARY SPECIAL RULES AND REGULATIONS FOR THE GAVILAN-MANCOS OIL POOL IN RIO ARRIBA COUNTY, INCLUDING A PROVISION FOR 320-ACRE SPACING UNITS.

CASE NO. 8946

IN THE MATTER OF CASE 8946 BEING REOPENED PURSUANT TO THE PROVISIONS OF COMMISSION ORDER NO. R-7407-D, WHICH ORDER PROMULGATED A TEMPORARY LIMITING GAS-OIL RATIO AND DEPTH BRACKET ALLOWABLE FOR THE GAVILAN-MANCOS OIL POOL IN RIO ARRIBA COUNTY.

CASE NO. 9113

APPLICATION OF BENSON-MONTIN-GREER DRILLING CORPORATION, JEROME P. McHUGH & ASSOCIATES, AND SUN EXPLORATION AND PRODUCTION COMPANY TO ABOLISH THE GAVILAN-MANCOS OIL POOL, TO EXTEND THE WEST PUERTO CHIQUITO-MANCOS OIL POOL, AND TO AMEND THE SPECIAL RULES AND REGULATIONS FOR THE WEST PUERTO CHIQUITO-MANCOS OIL POOL, RIO ARRIBA COUNTY, NEW MEXICO.

CASE NO. 9114

APPLICATION OF MESA GRANDE RESOURCES, INC. FOR THE EXTENSION OF THE GAVILAN-MANCOS OIL POOL AND THE CONTRACTION OF THE WEST PUERTO CHIQUITO-MANCOS OIL POOL, RIO ARRIBA COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

These causes came on for hearing on March 30 and 31 and April 1, 2, and 3, 1987 at Santa Fe, New Mexico before the Oil Conservation Commission of New Mexico hereinafter referred to as the "Commission."

NOW, on this 8th day of June, 1987, the Commission, quorum being present, having considered the testimony presented and the exhibits received at said hearings and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Commission has jurisdiction of these causes and the subject matter thereof.

(2) At the time of hearing, Cases 7980, 8946, 8950, 9113 and 9114 were consolidated for purposes of testimony.

(3) Case 7980 involves review of temporary pool rules promulgated by Order R-7407 and Case 8946 involves reopening the matter of temporary reduction of allowable and gas/oil ratio limit, under Order R-7407-D, both orders pertaining to the Gavilan-Mancos Oil Pool.

(4) Case 8950 involves reopening the matter of temporary reduction of allowable and gas/oil ratio limit under Order R-3401-A pertaining to the West Puerto-Chiquito-Mancos Oil Pool.

(5) Case 9113 involves a proposal to abolish the Gavilan-Mancos Oil Pool and consolidate that pool into the West Puerto-Chiquito-Mancos Oil Pool and Case 9114 involves a proposal to shift the boundary between Gavilan-Mancos and West Puerto Chiquito-Mancos Oil Pools.

(6) The evidence shows that there is limited pressure communication between the two designated pools, and that there are two weakly connected areas separated by some restriction at or near the common boundary of the two designated pools.

(7) The evidence shows there are three principal productive zones in the Mancos formation in both presently designated pools, designated A, B, and C zones listed from top to bottom and that, while all three zones are productive in both designated pools, West Puerto Chiquito produces primarily from the C zone and Gavilan produces chiefly from the A and B zones.

(8) It is clear from the evidence that there is natural fracture communication between zones A and B but that natural fracture communication is minor or non-existent between zones B and C.

(9) The reservoir consists of fractures ranging from major channels of high transmissibility to micro-fractures of negligible transmissibility, and possibly, some intergranular porosity that must feed into the fracture system in order for oil therein to be recovered.

(10) The productive capacity of an individual well depends upon the degree of success in communicating the wellbore with the major fracture system.

(11) Interference tests indicate: 1) a high degree of communication between certain wells, 2) the ability of certain wells to economically and efficiently drain a large area of at least 640 acres; and 3) the probability exists that the better wells recover oil from adjacent tracts and even more distant tracts if such tracts have wells which were less successful in connecting with the major fracture system.

(12) There is conflicting testimony as to whether the reservoir is rate-sensitive and the Commission should act to order the operators in West Puerto Chiquito and Gavilan-Mancos pools to collect additional data during 90-day periods of increased and decreased allowables and limiting gas-oil ratios.

(13) Two very sophisticated model studies conducted by highly skilled technicians with data input from competent reservoir engineers produced diametrically opposed results so that estimates of original oil in place, recovery efficiency and ultimate recoverable oil are very different and therefore are in a wide range of values.

(14) There was agreement that pressure maintenance would enhance recovery from the reservoir and that a unit would be required to implement such a program in the Gavilan-Mancos Pool.

(15) Estimates of the amount of time required to deplete the Gavilan pool at current producing rates varied from 33 months to approximately five years from hearing date.

(16) Many wells are shut in or are severely curtailed by OCD limits on permissible gas venting because of lack of pipeline connections and have been so shut in or curtailed for many months, during which time reservoir pressure has been shown by pressure surveys to be declining at 1 psi per day or more, indicating severe drainage conditions.

(17) No party requested making the temporary rules permanent, although certain royalty (not unleased minerals)

owners requested a return to 40-acre spacing, without presenting supporting evidence.

(18) Proration units comprised of 640 acres with the option to drill a second well would permit wider spacing and also provide flexibility.

(19) Recognizing that the two designated pools constitute two weakly connected areas with different geologic and operating conditions, the administration of the two areas will be simplified by maintaining two separate pools.

(20) A ninety day period commencing July 1, 1987, should be given for the connection for casinghead gas sale from now-unconnected wells in the Gavilan pool, after which allowables should be reduced in that pool until said wells are connected.

(21) To provide continuity of operation and to prevent waste by the drilling of unnecessary wells, the temporary spacing rules promulgated by Order R-7407 should remain in effect until superceded by this Order.

(22) Rules for 640-acre spacing units with the option for a second well on each unit should be adopted together with a provision that units existing at the date of this order shoul be continued in effect.

IT IS THEREFORE ORDERED THAT:

(1) The application of Benson-Montin-Greer et al in Case No. 9113 to abolish the Gavilan-Mancos pool and extend the West Puerto Chiquito-Mancos pool to include the area occupied by the Gavilan-Mancos Pool is denied.

(2) The application of Mesa Grande Resources, Inc. for the extension of the Gavilan-Mancos and the concomitant contraction of West Puerto Chiquito-Mancos Pool is denied.

(3) Rule 2 of the temporary special rules and regulations for the Gavilan-Mancos Oil Pool as promulgated by Order R-7407 is hereby amended as follows:

> Rule 2 (a). A standard proration unit shall consist of between 632 and 648 acres consisting of a governmental section with at least one and not more than two wells drilled or recompleted thereon; provided that if the second well is drilled or recompleted on a standard unit it shall not be located in the same quarter section, nor

closer than 1650 feet to the first well drilled on the unit; and provided further that proration units formed prior to the date of this order are hereby granted exception to this rule.

(b). A buffer zone is hereby created consisting of the east half of sections bordering Township 1 West. Only one well per section shall be drilled in said buffer zone and if such well is located closer than 2310 feet from the western boundary of the West Puerto Chiquito-Mancos Oil Pool it shall not be allowed to produce more than one-half the top allowable for a 640-acre proration unit.

(4) Beginning July 1, 1987, the allowable shall be 1280 barrels of oil per day per 640 acres with a limiting gas-oil ratio of 2,000 cubic feet of gas per barrel of oil. Operators are required to monitor reservoir performance, including but not limited to, production rates, gas-oil ratios, reservoir pressures, and shall report this information to the Commission within 30 days after completion of the tests. Within the first week of July, 1987, bottom hole pressure tests shall be taken on all wells. Wells shall be shut-in until pressure stabilizes or for a period not longer than 72 hours. Additional bottom hole tests shall be taken within the first week of October, 1987, with similar testing requirements. All produced gas, including gas vented or flared, shall be metered. Operators are required to submit a testing schedule to the District Supervisor of the Aztec office of the Oil Conservation Division prior to testing so that tests may be witnessed by OCD personnel.

(5) Beginning October 1, 1987, the allowable shall be 800 barrels of oil per day per 640 acres with a limiting gas-oil ratio of 600 cubic feet of gas per barrel of oil. Operators are required to monitor reservoir performance as in (4) above with bottom hole pressure tests to be taken within the first week of January, 1988. This allowable and GOR limitation shall remain in effect until further notice from the Commission.

(6) In order to prevent further waste and impairment of correlative rights each well in the Gavilan-Mancos Oil Pool shall be connected to a gas gathering system by October 1, 1987 or within ninety days of completion. If Wells presently unconnected are not connected by October 1 the Director may reduce the Gavilan-Mancos allowable as may be appropriate to prevent waste and protect correlative rights. In instances where it can be shown that connection is absolutely uneconomic the well involved may be granted authority to flow or vent the

gas under such circumstances as to minimize waste as determin by the Director.

(7) The temporary special pool rules promulgated by Order R-7407 are hereby extended to the effective date of this order and said rules as amended herein are hereby made permanent.

(8) This case shall be reopened at a hearing to be held in May, 1988 to review the pools in light of information to be gained in the next year and to determine if further changes in rules may be advisable.

(9) Jurisdiction of this cause is retained for entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

WILLIAM R. HUMPHRIES, Member

ERLING A. BROSTUEN, Member

WILLIAM J. LEMAY, Chairman and Secretary

S E A L

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held by or before the said commission or division or in any cause or proceeding in any court by or against the said commission or division, relative to matters within the jurisdiction of said commission or division, on the ground or for the reason that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; provided that nothing herein contained shall be construed as requiring any person to produce any books, papers or records, or to testify in response to any inquiry, not pertinent to some question lawfully before such commission or division or court for determination. No natural person shall be subjected to criminal prosecution, or to any penalty or forfeiture for or on account of any transaction, matter or thing concerning which he may be required to testify, or produce evidence, documentary or otherwise before said commission or division, or in obedience to its subpoena, or in any cause or proceeding, provided, that no person testifying shall be exempted from prosecution and punishment for perjury committed in so testifying.

History: Laws 1935, ch. 72, § 6; 1941 Comp., § 69-207; Laws 1949, ch. 168, § 6; 1953 Comp., § 65-3-7; Laws 1977, ch. 255, § 43.

Am. Jur. 2d, A.L.R. and C.J.S. references. — 2 Am. Jur. 2d Administrative Law §§ 420, 421.
73 C.J.S. Public Administrative Bodies and Procedure §§ 127, 128.

70-2-9. Failure or refusal to comply with subpoena; refusal to testify; body attachment; contempt.

In case of failure or refusal on the part of any person to comply with any subpoena issued by said commission or any member thereof, or the director of the division or his authorized representative, or on the refusal of any witness to testify or answer as to any matters regarding which he may be lawfully interrogated, any district court in this state, or any judge thereof, on application of said commission or division, may issue an attachment for such person and compel him to comply with such subpoena and to attend before the commission or division and produce such documents and give his testimony upon such matters as may be lawfully required, and such court or judge shall have the power to punish for contempt as in case of disobedience of a like subpoena issued by or from such court, or a refusal to testify therein.

History: Laws 1935, ch. 72, § 7; 1941 Comp., § 69-208; Laws 1949, ch. 168, § 7; 1953 Comp., § 65-3-8; Laws 1977, ch. 255, § 44.

Cross-references. — As to contempt of court, see 34-1-2 to 34-1-5 NMSA 1978.

70-2-10. Perjury; punishment.

If any person of whom an oath shall be required under the provisions of this act, or by any rule, regulation or order of the commission or division, shall willfully swear falsely in regard to any matter or thing respecting which such oath is required, or shall willfully make any false report or affidavit required or authorized by the provisions of this act, or by any rule, regulation or order of the commission or division, such person shall be deemed guilty of perjury and shall be punished by imprisonment in the state penitentiary for not more than five years nor less than six months.

History: Laws 1935, ch. 72, § 8; 1941 Comp., § 69-209; Laws 1949, ch. 168, § 8; 1953 Comp., § 65-3-9; Laws 1977, ch. 255, § 45.

Meaning of "this act". — See same catchline in notes to 70-2-3 NMSA 1978.

70-2-11. Power of commission and division to prevent waste and protect correlative rights.

A. The division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the division is empowered to make and enforce rules, regulations and orders, and to do whatever may be

Exhibit 5

reasonably necessary to carry out the purpose of this act, whether or not indicated or specified in any section hereof.

B. The commission shall have concurrent jurisdiction and authority with the division to the extent necessary for the commission to perform its duties as required by law.

History: Laws 1935, ch. 72, § 9; 1941 Comp., § 69-210; Laws 1949, ch. 168, § 9; 1953 Comp., § 65-3-10; Laws 1977, ch. 255, § 46.

Meaning of "this act". — See same catchline in notes to 70-2-3 NMSA 1978.

Authority based on power of prevention of waste. — The statutory authority of the commission to pool property or to modify existing agreements relating to production within a pool under either 70-2-17C or 70-2-17E NMSA 1978 must be predicated on prevention of waste. Sims v. Mechem, 72 N.M. 186, 382 P.2d 183 (1963).

Commission has jurisdiction over matters related to conservation of oil and gas in New Mexico, but the basis of its powers is founded on the duty to prevent waste and to protect correlative rights, as set forth in this section. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Powers of proration and creation of spacing units remain intact. — The standards of preventing waste and protecting correlative rights, as laid out in this section, are sufficient to allow commission's power to prorate and create standard or nonstandard spacing units to remain intact, and 70-2-18 NMSA 1978 is not an unlawful delegation of legislative power. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Prevention of waste by pooling. — Commission's finding that most efficient and orderly development of the subject acreage could be accomplished by force pooling is not equivalent to a finding that this pooling will prevent waste. Sims v. Mechem, 72 N.M. 186, 382 P.2d 183 (1963).

Former act to prohibit waste. — There was no delegation to the commission of power to make law or determine what it shall be in the former Oil Conservation Act, but act was, in effect, a prohibition against waste. 1951-52 Op. Att'y Gen. 5397.

Protection of correlative rights. — The prevention of waste is of paramount interest to the legislature and protection of correlative rights is interrelated and inseparable from it. The very definition of "correlative rights" emphasizes the term "without waste." However, protection of correlative rights is a necessary adjunct to the prevention of waste. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Although subservient to prevention of waste and perhaps to practicalities of the situation, protection of correlative rights must depend upon the commission's findings as to extent and limitations of right. This the commission is required to do under legislative mandate. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Property rights of natural gas owners. — The legislature has stated definitively the elements contained in property right of natural gas owners. Such right is not absolute or unconditional. It consists of merely (1) an opportunity to produce, (2) only insofar as it is practicable to do so, (3) without waste, (4) a proportion, (5) insofar as it can be practically determined and obtained without waste, (6) of gas in the pool. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Law reviews. — For comment on Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962), see 3 Nat. Resources J. 178 (1963).

Am. Jur. 2d, A.L.R. and C.J.S. references. — 38 Am. Jur. 2d Gas and Oil §§ 145 to 148, 157.

58 C.J.S. Mines and Minerals §§ 229, 234.

70-2-12. Enumeration of powers.

A. Included in the power given to the oil conservation division is the authority to collect data; to make investigations and inspections; to examine properties, leases, papers, books and records; to examine, check, test and gauge oil and gas wells, tanks, plants, refineries and all means and modes of transportation and equipment; to hold hearings; to provide for the keeping of records and the making of reports and for the checking of the accuracy of the records and reports; to limit and prorate production of crude petroleum oil or natural gas or both as provided in the Oil and Gas Act [70-2-1 to 70-2-36 NMSA 1978]; to require either generally or in particular areas certificates of clearance or tenders in connection with the transportation of crude petroleum oil or natural gas or any products of either or both oil and products or both natural gas and products.

B. Apart from any authority, express or implied, elsewhere given to or existing in the oil conservation division by virtue of the Oil and Gas Act or the statutes of this state, the division is authorized to make rules, regulations and orders for the purposes and with respect to the subject matter stated in this subsection:

(1) to require dry or abandoned wells to be plugged in a way to confine the crude petroleum oil, natural gas or water in the strata in which it is found and to prevent it from escaping into other strata; the division shall require a cash or surety bond in a sum not to exceed fifty thousand dollars ($50,000) conditioned for the performance of such regulations;

(2) to prevent crude petroleum oil, natural gas or water from escaping from strata in which it is found into other strata;

(3) to require reports showing locations of all oil or gas wells and for the filing of logs and drilling records or reports;

(4) to prevent the drowning by water of any stratum or part thereof capable of producing oil or gas or both oil and gas in paying quantities and to prevent the premature and irregular encroachment of water or any other kind of water encroachment which reduces or tends to reduce the total ultimate recovery of crude petroleum oil or gas or both oil and gas from any pool;

(5) to prevent fires;

(6) to prevent "blow-ups" and "caving" in the sense that the conditions indicated by such terms are generally understood in the oil and gas business;

(7) to require wells to be drilled, operated and produced in such manner as to prevent injury to neighboring leases or properties;

(8) to identify the ownership of oil or gas producing leases, properties, wells, tanks, refineries, pipelines, plants, structures and all transportation equipment and facilities;

(9) to require the operation of wells with efficient gas-oil ratios and to fix such ratios;

(10) to fix the spacing of wells;

(11) to determine whether a particular well or pool is a gas or oil well or a gas or oil pool, as the case may be, and from time to time to classify and reclassify wells and pools accordingly;

(12) to determine the limits of any pool producing crude petroleum oil or natural gas or both and from time to time redetermine the limits;

(13) to regulate the methods and devices employed for storage in this state of oil or natural gas or any product of either, including subsurface storage;

(14) to permit the injection of natural gas or of any other substance into any pool in this state for the purpose of repressuring, cycling, pressure maintenance, secondary or any other enhanced recovery operations;

(15) to regulate the disposition of water produced or used in connection with the drilling for or producing of oil or gas or both and to direct surface or subsurface disposal of the water in a manner that will afford reasonable protection against contamination of fresh water supplies designated by the state engineer;

(16) to determine the limits of any area containing commercial potash deposits and from time to time redetermine the limits;

(17) to regulate and, where necessary, prohibit drilling or producing operations for oil or gas within any area containing commercial deposits of potash where the operations would have the effect unduly to reduce the total quantity of the commercial deposits of potash which may reasonably be recovered in commercial quantities or where the operations would interfere unduly with the orderly commercial development of the potash deposits;

(18) to spend the oil and gas reclamation fund and do all acts necessary and proper to plug dry and abandoned oil and gas wells in accordance with the provisions of the Oil and Gas Act and the Procurement Code [13-1-28 to 13-1-199 NMSA 1978], including disposing of salvageable equipment and material removed from oil and gas wells being plugged by the state;

(19) to make well price category determinations pursuant to the provisions of the Natural Gas Policy Act of 1978 or any successor act and, by regulation, to adopt fees for such determinations, which fees shall not exceed twenty-five dollars ($25.00) per filing. Such fees shall be credited to the account of the oil conservation division by the state treasurer and may be expended as authorized by the legislature; and

(20) to regulate the construction and operation of oil treating plants and to require the posting of bonds for the reclamation of treating plant sites after cessation of operations.

History: 1953 Comp., § 65-3-11, enacted by Laws 1978, ch. 71, § 1; 1986, ch. 76, § 1; 1987, ch. 234, § 61.

Cross-references. — For filing rules and regulations, see 14-4-1 NMSA 1978. As to public utilities commission's lack of power to regulate sale price at well head, see 62-6-4 NMSA 1978.

Repeals and reenactments. — Laws 1978, ch. 71,

§ 1, repealed 65-3-11, 1953 Comp. (former 70-2-12 NMSA 1978), relating to enumeration of powers, and enacted a new 70-2-12 NMSA 1978.

The 1986 amendment substituted "oil conservation division" for "division" in Subsection A and in the introductory paragraph of Subsection B; substituted "provided in the Oil and Gas Act" for "in this act provided" in Subsection A; substituted "the Oil and Gas Act" for "this act" in the introductory paragraph of Subsection B; substituted "cash or surety bond" for "corporate surety bond" in Subsection B(1); added Subsection B(19), and made minor stylistic changes throughout the section.

The 1987 amendment, effective July 1, 1987, in Subsection B(18), substituted "Procurement Code" for "Public Purchases Act"; added Subsection B(20); and made minor changes in language and punctuation throughout the section.

Effective dates. — Laws 1986, ch. 76 contains no effective date provision, but, pursuant to N.M. Const., art. IV, § 23, is effective on May 21, 1986.

Natural Gas Policy Act of 1978. — The federal Natural Gas Policy Act of 1978, referred to in Subsection B(19), appears as 15 U.S.C. § 3301 et seq.

Powers pertaining to oil well fires. — The lawmakers intended commission not only to seek fire prevention to conserve oil, but also to conserve other property and lives of persons peculiarly subject to hazard of oil well fires. Continental Oil Co. v. Brack, 381 F.2d 682 (10th Cir. 1967).

The terms "spacing unit" and "proration unit" are not synonymous and commission has power to fix spacing units without first creating proration units. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Am. Jur. 2d, A.L.R. and C.J.S. references. — 38 Am. Jur. 2d Gas and Oil §§ 145 to 163.

58 C.J.S. Mines and Minerals §§ 229 to 243.

70-2-13. Additional powers of commission or division; hearings before examiner; hearings de novo.

In addition to the powers and authority, either express or implied, granted to the oil conservation commission or division by virtue of the statutes of the state of New Mexico, the division is hereby authorized and empowered in prescribing its rules of order or procedure in connection with hearings or other proceedings before the division to provide for the appointment of one or more examiners to be members of the staff of the division to conduct hearings with respect to matters properly coming before the division and to make reports and recommendations to the director of the division with respect thereto. Any member of the commission or the director of the division or his authorized representative may serve as an examiner as provided herein. The division shall promulgate rules and regulations with regard to hearings to be conducted before examiners, and the powers and duties of the examiners in any particular case may be limited by order of the division to particular issues or to the performance of particular acts. In the absence of any limiting order, an examiner appointed to hear any particular case shall have the power to regulate all proceedings before him and to perform all acts and take all measures necessary or proper for the efficient and orderly conduct of such hearing, including the swearing of witnesses, receiving of testimony and exhibits offered in evidence subject to such objections as may be imposed, and shall cause a complete record of the proceeding to be made and transcribed and shall certify the same to the director of the division for consideration together with the report of the examiner and his recommendations in connection therewith. The director of the division shall base the decision rendered in any matter or proceeding heard by an examiner upon the transcript of testimony and record made by or under the supervision of the examiner in connection with such proceeding, and such decision shall have the same force and effect as if the hearing had been conducted before the director of the division. When any matter or proceeding is referred to an examiner and a decision is rendered thereon, any party of record adversely affected shall have the right to have the matter heard de novo before the commission upon application filed with the division within thirty days from the time any such decision is rendered.

History: 1953 Comp., § 65-3-11.1, enacted by Laws 1955, ch. 235, § 1; 1961, ch. 62, § 1; 1977, ch. 255, § 48; 1981, ch. 63, § 1.

History: Laws 1935, ch. 72, § 12; 1941 Comp., § 69-213; Laws 1949, ch. 168, § 12; 1953 Comp., § 65-3-13; Laws 1977, ch. 255, § 50; 1985, ch. 6, § 1.

Cross-references. — As to duties of oil conservation division, see 70-2-6 NMSA 1978.

Meaning of "this act". — See same catchline in notes to 70-2-3 NMSA 1978.

New proration formula to be based on recoverable gas. — Lacking a finding that a new gas proration formula is based on amounts of recoverable gas in pool and under tracts, insofar as these amounts can be practically determined and obtained without waste, a supposedly valid order in current use cannot be replaced. Such findings are necessary requisites to validity of the order, for it is upon them that the very power of the commission to act depends. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Findings required before correlative rights ascertained. — In order to protect correlative rights, it is incumbent upon commission to determine, "so far as it is practical to do so," certain foundationary matters, without which correlative rights of various owners cannot be ascertained. Therefore, the commission, by "basic conclusions of fact" (or what might be termed "findings"), must determine, insofar as practicable: (1) amount of recoverable gas under each producer's tract; (2) total amount of recoverable gas in the pool; (3) proportion that (1) bears to (2); and (4) what portion of arrived at proportion can be recovered without waste. That extent of correlative rights must first be determined before commission can act to protect them is manifest. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Relationship between prevention of waste and protection of correlative rights. — Prevention of waste is of paramount interest to legislature and protection of correlative rights is interrelated and inseparable from it. The very definition of "correlative rights" emphasizes term "without waste." However, protection of correlative rights is necessary adjunct to prevention of waste. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Production must be limited to the allowable even if market demand exceeds that amount, since the setting of allowables was made necessary in order to prevent waste. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

When Subsection C of this section and 70-2-19E NMSA 1978 are read together, one fact is evident: even after a pool is prorated, market demand must be determined, since, if allowable production from the pool exceeds market demand, waste would result if allowable is produced. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Commission to prevent drainage between producing tracts. — In addition to making findings to protect correlative rights, commission, "insofar as is practicable, shall prevent drainage between producing tracts in a pool which is not equalized by counter-drainage," under the provisions of Subsection C of this section. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Property rights of natural gas owners. — The legislature has stated definitively the elements contained in property right of natural gas owners. Such right is not absolute or unconditional. It consists of merely (1) an opportunity to produce, (2) only insofar as it is practicable to do so, (3) without waste, (4) a proportion, (5) insofar as it can be practically determined and obtained without waste, (6) of gas in the pool. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Keeping of false records as actionable offense. — The Connally Hot Oil Act (15 U.S.C. § 715 et seq.) applies only to states which have in effect proration statutes for the purpose of preventing waste of oil and gas resources, encouraging conservation of oil and gas deposits, etc., and New Mexico is among those states which has enacted a valid comprehensive oil conservation law; since Connally Act applies to this state, keeping of false records, though not in violation of any New Mexico proration order, constitutes an actionable offense under Connally Act. Humble Oil & Ref. Co. v. United States, 198 F.2d 753 (10th Cir.), cert. denied, 344 U.S. 909, 73 S. Ct. 328, 97 L. Ed. 701 (1952).

Law reviews. — For comment on Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962), see 3 Nat. Resources J. 178 (1963).

For article, "State Conservation Regulation and the Proposed R-199," see 6 Nat. Resources J. 223 (1966).

For comment on geothermal energy and water law, see 19 Nat. Resources J. 445 (1979).

Am. Jur. 2d, A.L.R. and C.J.S. references. — 38 Am. Jur. 2d Gas and Oil §§ 161, 164.

Rights and obligations, with respect to adjoining landowners, arising out of secondary recovery of gas, oil, and other fluid minerals, 19 A.L.R.4th 1182.

58 C.J.S. Mines and Minerals § 240.

70-2-17. Equitable allocation of allowable production; pooling; spacing.

A. The rules, regulations or orders of the division shall, so far as it is practicable to do so, afford to the owner of each property in a pool the opportunity to produce his just and equitable share of the oil or gas, or both, in the pool, being an amount, so far as can be practically determined, and so far as such can be practicably obtained without waste, substantially in the proportion that the quantity of the recoverable oil or gas, or both, under such property bears to the total recoverable oil or gas, or both, in the pool, and for this purpose to use his just and equitable share of the reservoir energy.

B. The division may establish a proration unit for each pool, such being the area that can be efficiently and economically drained and developed by one well, and in so doing the division shall consider the economic loss caused by the drilling of unnecessary wells, the protection of correlative rights, including those of royalty owners, the prevention of waste, the avoidance of the augmentation of risks arising from the drilling of an excessive number

of wells, and the prevention of reduced recovery which might result from the drilling of too few wells.

C. When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the 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 interests or both in the spacing or proration unit as a unit.

All orders effecting such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas, or both. Each order shall describe the lands included in the unit designated thereby, identify the pool or pools to which it applies and designate an operator for the unit. All operations for the pooled oil or gas, or both, which are conducted on any portion of the unit shall be deemed for all purposes to have been conducted upon each tract within the unit by the owner or owners of such tract. For the purpose of determining the portions of production owned by the persons owning interests in the pooled oil or gas, or both, such production shall be allocated to the respective tracts within the unit in the proportion that the number of surface acres included within each tract bears to the number of surface acres included in the entire unit. The portion of the production allocated to the owner or owners of each tract or interest included in a well spacing or proration unit formed by a pooling order shall, when produced, be considered as if produced from the separately owned tract or interest by a well drilled thereon. Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well.

In the event of any dispute relative to such costs, the division shall determine the proper costs after due notice to interested parties and a hearing thereon. The division is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to all production from such well which would be received by the owner, or owners, for whose benefit the well was drilled or operated, after payment of royalty as provided in the lease, if any, applicable to each tract or interest, and obligations payable out of production, until the owner or owners drilling or operating the well or both have been paid the amount due under the terms of the pooling order or order settling such dispute. No part of the production or proceeds accruing to any owner or owners of a separate interest in such unit shall be applied toward the payment of any cost properly chargeable to any other interest in said unit.

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 as 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.

D. Minimum allowable for some wells may be advisable from time to time, especially with respect to wells already drilled when this act takes effect, to the end that the

production will repay reasonable lifting cost and thus prevent premature abandonment and resulting waste.

E. Whenever it appears that the owners in any pool have agreed upon a plan for the spacing of wells, or upon a plan or method of distribution of any allowable fixed by the division for the pool, or upon any other plan for the development or operation of such pool, which plan, in the judgment of the division, has the effect of preventing waste as prohibited by this act and is fair to the royalty owners in such pool, then such plan shall be adopted by the division with respect to such pool; however, the division, upon hearing and after notice, may subsequently modify any such plan to the extent necessary to prevent waste as prohibited by this act.

F. After the effective date of any rule, regulation or order fixing the allowable production, no person shall produce more than the allowable production applicable to him, his wells, leases or properties determined as in this act provided, and the allowable production shall be produced in accordance with the applicable rules, regulations or orders.

History: Laws 1935, ch. 72, § 12; 1941 Comp., § 69-213½; Laws 1949, ch. 168, § 13; 1953, ch. 76, § 1; 1953 Comp., § 65-3-14; Laws 1961, ch. 65, § 1; 1973, ch. 250, § 1; 1977, ch. 255, § 51.

Meaning of "this act". — See same catchline in notes to 70-2-3 NMSA 1978.

The terms "spacing unit" and "proration unit" are not synonymous and the commission has power to fix spacing units without first creating proration units. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Proration formula required to be based on recoverable gas. — Lacking a finding that new gas proration formula is based on amounts of recoverable gas in pool and under tracts, insofar as these amounts can be practically determined and obtained without waste, a supposedly valid order in current use cannot be replaced. Such findings are necessary requisites to validity of the order, for it is upon them that the very power of the commission to act depends. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Findings required before correlative rights ascertained. — In order to protect correlative rights, it is incumbent upon commission to determine, "so far as it is practical to do so," certain foundationary matters, without which the correlative rights of various owners cannot be ascertained. Therefore, the commission, by "basic conclusions of fact" (or what might be termed "findings"), must determine, insofar as practicable: (1) amount of recoverable gas under each producer's tract; (2) the total amount of recoverable gas in pool; (3) proportion that (1) bears to (2); and (4) what portion of arrived at proportion can be recovered without waste. That the extent of the correlative rights must first be determined before commission can act to protect them is manifest. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

In addition to making such findings the commission, "insofar as is practicable, shall prevent drainage between producing tracts in a pool which is not equalized by counter-drainage," under the provisions of 70-2-16 NMSA 1978. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Four basic findings required to adopt a production formula under this section can be made in language equivalent to that required in previous decision construing this section. El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966) (explaining Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).)

Although subservient to prevention of waste and perhaps to practicalities of the situation, protection of correlative rights must depend upon commission's (now division's) findings as to extent and limitations of the right. This the commission is required to do under the legislative mandate. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Division found not to have primary jurisdiction over suit seeking an order to join in an oil well free of risk penalty. Mountain States Natural Gas Corp. v. Petroleum Corp., 693 F.2d 1015 (10th Cir. 1982).

Grant of forced pooling is determined on case-to-case basis. — The granting of or refusal to grant forced pooling of multiple zones with an election to participate in less than all zones, the amount of costs to be reimbursed to the operator, and the percentage risk charge to be assessed, if any, are determinations to be made by the commission (now the division) on a case-to-case basis and upon the particular facts in each case. Viking Petroleum, Inc. v. Oil Conservation Comm'n, 100 N.M. 451, 672 P.2d 280 (1983).

As to forced pooling of multiple zones with an election to participate in less than all zones. See Viking Petroleum, Inc. v. Oil Conservation Comm'n, 100 N.M. 451, 672 P.2d 280 (1983).

Division's findings upheld. — Commission's (now division's) findings that it would be unreasonable and contrary to the spirit of conservation statutes to drill unnecessary and economically wasteful well were held to be sufficient to justify creation of two nonstandard gas proration units, and the force pooling thereof, and were supported by substantial evidence. Likewise, participation formula adopted by commission, which gave each owner a share in production in same ratio as his acreage bore to acreage of the whole, was upheld despite limited proof as to extent and character of pool. Rutter & Wilbanks Corp. v. Oil Conservation Comm'n, 87 N.M. 286, 532 P.2d 582 (1975).

Relation between prevention of waste and protection of correlative rights. — Prevention of waste is of paramount interest to the legislature and protection of correlative rights is interrelated and inseparable from it. The very definition of "correlative rights" emphasizes the term "without waste." However, protection of correlative rights is necessary adjunct to the prevention of waste. Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 373 P.2d 809 (1962).

Division's authority to pool separately owned tracts. — Since commission (now division)

Rule 2 is hereby deleted in its entirety and replaced as follows:

Rule 2(a): In addition to those non-standard spacing and proration units previously approved by Order R-7407 and pursuant to Paragraph C of Section 70-2-18, N.M.S.A., 1978, all Gavilan Mancos Pool spacing units in Sections that have two or more Gavilan Mancos Pool wells as of June 8, 1978, are hereby established as non-standard spacing and proration units and shall be assigned production allowables based upon the ratio that the acreage in the non-standard spacing and proration unit bears to a standard 640-acre spacing and proration unit;

Rule 2(b): Except as provided in Rule 2(a) above, all Gavilan Mancos Pool wells presently completed in or drilled to and all future Gavilan Mancos Pool wells shall be on a standard proration unit which shall consist of between 632 and 648 acres consisting of a governmental section with at least one and not more than two wells drilled or recompleted thereon; provided that if the second well is drilled or recompleted on a standard unit it shall not be located in the same quarter section, nor closer than 1650 feet to the first well drilled on the unit. Failure to file a new Form C-102 with the Division dedicating 640 acres to a well or to obtain a non-standard unit approved by the Division within 60 days from the date of this order shall subject the well to cancellation of allowable. Until said Form C-102 has been filed or until a non-standard unit has been approved, and subject to said 60-day limitation, each well presently drilled to or completed in the Gavilan Mancos Oil Pool boundary area shall receive no more than one-quarter of a current restricted allowable for the pool.

A buffer zone is hereby created consisting of the E/2 of sections bordering Townhsip 1 West. Only one well per section shall be drilled in said buffer zone and if such well is located closer than 2310 feet from the western boundary of the West Puerto Chiquito-Mancos Oil Pool it shall not be allowed to produce more than one-half the top allowable for a 640-acre proration unit.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION COMMISSION

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

CASE NO. 8900
Order No. R-8262

APPLICATION OF MALLON OIL COMPANY
FOR COMPULSORY POOLING, RIO ARRIBA
COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9:00 a.m. on May 20, 1986, at Santa Fe, New Mexico, before the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission".

NOW, on this 7th day of August, 1986, the Commission, having considered the testimony, the record, and the briefs submitted by counsel for the parties appearing at the hearing, and being fully advised in the premises,

FINDS THAT:

(1) Due public notice having been given as required by law, the Commission has jurisdiction of this cause and the subject matter thereof.

(2) The applicant, Mallon Oil Company, seeks an order pooling all mineral interests from the top of the Mancos formation to the base of the Dakota formation underlying the W/2 of Section 12, Township 25 North, Range 2 West, NMPM, Rio Arriba County, New Mexico.

(3) The applicant, having the right to drill a well, drilled its Johnson Federal 12 Well No. 5 at a standard location thereon to a depth adequate to penetrate the Dakota formation, and, subsequently, completed the well as an oil well in the Mancos formation.

(4) As of the dates on which the well was drilled and completed, the Mancos formation underlying the lands which are the subject of this Order was not contained within the boundaries of any oil or gas pool established by the New Mexico Oil Conservation Division (Division) and was subject to statewide 40-acre oil spacing rules.

Exhibit 7

(5) On January 3, 1986, the Division issued its Order No. R-8063 in Case No. 8713, effective January 1, 1986, extending the horizontal boundaries of the Gavilan-Mancos Oil Pool to include the lands which are the subject of this Case.

(6) As a result of the extension of the horizontal boundaries of the Gavilan-Mancos Oil Pool and the special rules therefor, the spacing requirement applicable to the applicant's Johnson Federal 12 Well No. 5 was increased from 40 acres to 320 acres.

(7) The applicant controlled all of the leasehold operating rights applicable to the Mancos and Dakota formations underlying the 40 acre tract established as the spacing unit for the subject well prior to the extension of the horizontal boundaries of the Gavilan-Mancos Oil Pool.

(8) The applicant controls all of the leasehold operating rights applicable to the Mancos and Dakota formations underlying 240 acres of the 320 acre tract established as the appropriate spacing unit for the subject well subsequent to the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool and which 320 acre tract constitutes the lands which are the subject of this Case.

(9) Mesa Grande Resources, Inc. controls all of the leasehold operating rights applicable to the Mancos and Dakota formations underlying 80 acres being the E/2 NE/4 of said Section 12 and within the 320 acre tract established as the appropriate spacing unit for the subject well subsequent to the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool.

(10) The applicant and Mesa Grande Resources, Inc. have been unable to agree as to terms, conditions and provisions for the pooling of their interests in the lands which are the subject of this Case.

(11) The applicant expended the sum of $565,840.00 to drill and complete said Johnson Federal 12 Well No. 5; of the total costs incurred in drilling and completing the well, $255,016.00 are attributable to intangible drilling costs; and all of said costs were necessarily incurred and are reasonable in amount.

(12) The applicant has expended the sum of $24,700.00 in operating the subject well through March 31, 1986; such costs were necessarily incurred and are reasonable in amount; the applicant has incurred operating expenses attributable to the subject well from April 1, 1986 through the date of this Order

and can be expected to incur operating expenses attributable to the subject well subsequent to the date of this Order.

(13) The applicant assumed and paid for 100 percent of the risk associated with the drilling and completion of the subject well.

(14) The applicant proposed that under the foregoing conditions, it is appropriate that the risk assumed solely by it be quantified, and that the value of the risk assumed be considered an expense of drilling and completion and be included as an element of the actual costs incurred in the drilling and completion of the subject well.

(15) The applicant proposed that a value of the risk assumed solely by the applicant in the drilling and completion of the subject well equal to 100 percent of the actual intangible drilling costs incurred in the drilling of the well be established as a reasonable amount for the sharing of the risk by Mesa Grande.

(16) The authority for the Commission to compulsorily pool the subject acreage is derived from Section 70-2-17 C, NMSA 1978.

(17) This section states in part, that any pooling order "shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well."

(18) The 100 percent of actual intangible drilling costs proposed by the applicant as an additional cost or charge to Mesa Grande's interest in said well does not represent an actual expenditure and cannot therefore be allowed.

(19) While it may otherwise be reasonable for the applicant to collect some "premium" for its investment which ultimately benefits Mesa Grande, no proposal was made at the hearing on this matter other than the 100 percent of intangible well costs dealt with in Findings Nos. (14) through (18) above.

(20) In the absence of other proposals for a reasonable charge against Mesa Grande for the investment made on its behalf by the applicant, no such charge should be authorized.

(21) As the Dakota interval within the proposed unit is not productive, the pooling provisions of this order should be applicable to the Mancos formation only.

(22) To avoid the drilling of unnecessary wells, to protect correlative rights, to avoid waste, and to afford the owner of each interest in the 320 acre spacing unit the opportunity to recover or receive without unnecessary expense its just and fair share of production from the pooled area, the subject application should be approved by pooling all mineral interests, whatever they may be within the Mancos formation within said spacing unit.

(23) The applicant should be designated the operator of the subject well and spacing unit.

(24) Mesa Grande Resources, Inc. should be afforded the opportunity to elect to either pay to the operator its proportionate share of the total actual costs incurred in the drilling and completion of the subject well, or to pay its proportionate share of such costs out of production; such election should be made by Mesa Grande Resources, Inc. within fifteen (15) days after the issuance of an Order in this case by the Commission; and the operator should be entitled to withhold from production Mesa Grande Resources, Inc.'s proportionate share of such costs unless Mesa Grande Resources, Inc. so elects and tenders payment of its proportionate share of such costs to operator within thirty (30) days after the issuance of the Order in this case.

(25) Should Mesa Grande not so elect and pay its share of such well costs within said period, it should have withheld from production its share of the reasonable well costs plus an additional 200 percent thereof as a reasonable charge for the risk involved in the drilling of the well.

(26) $4,000.00 per month while drilling and $400.00 per month while producing should be fixed as reasonable charges for supervision of the subject well (combined fixed rates); that in the event Mesa Grande Resources, Inc. elects to pay its proportionate share of the actual costs incurred in the drilling, completion, and operation of the subject well out of production, then the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to the interest of Mesa Grande Resources, Inc., and in addition thereto, the operator should be

authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to the interest of Mesa Grande Resources, Inc.

(27) Should all the parties to this forced pooling reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(28) The operator of the well and unit shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

IT IS THEREFORE ORDERED THAT:

(1) All mineral interests, whatever they may be within the Mancos formation underlying the W/2 of Section 12, Township 25 North, Range 2 West, NMPM, Rio Arriba County, New Mexico, are hereby pooled to form a standard 320 acre oil spacing and proration unit to be dedicated to the Mallon Oil Company Johnson Federal 12 Well No. 5 which has been drilled and completed at a standard location thereon.

(2) Mallon Oil Company is hereby designated the operator of the subject well and unit.

(3) Within 15 days after the issuance of this Order, Mesa Grande Resources, Inc. shall elect to either pay to the operator its proportionate share of the total actual costs incurred in the drilling and completion of the subject well, or to pay its proportionate share of such costs out of production and, if so electing, shall pay such share within 30 days of the date of this order.

(4) The operator is hereby authorized to withhold the following costs and charges from production:

(A) The pro rata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of well costs as provided in Paragraph (3) of this order.

(B) As 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 well costs as provided in Paragraph (3) of this order.

(5) $4,000.00 per month while drilling and $400.00 per month while producing are hereby fixed as reasonable charges for supervision of the subject well (combined fixed rates). The operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to the interest of Mesa Grande Resources, Inc., and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating the subject well, not in excess of what are reasonable, attributable to the interest of Mesa Grande Resources, Inc.

(6) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest's share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(7) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Rio Arriba County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; the operator shall notify the Division of the name and address of said escrow agent within 30 days from the date of first deposit with said escrow agent.

(8) Should all parties to this forced pooling reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(9) The operator of the well and unit shall notify the Director of the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(10) Jurisdiction of this cause is retained for the entry of such further orders as the Commission may deem necessary.

Case No. 8900
Order No. R-8262

DONE at Santa Fe, New Mexico, on the date and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

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Chairman and Secretary

ED KELLEY, Member

JIM BACA, Member

HINKLE, COX, EATON, COFFIELD & HENSLEY

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January 11, 1988

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Re: Applications of Mesa Grande Ltd. and Mesa Grande Resources, Inc. for Compulsory Pooling Orders in Gavilan Mancos Oil Pool, NMOCD Case Nos. 9225 & 9236

Gentlemen:

We request that you dismiss Case No. 9236. The basis for our decision is that Mesa Grande Resources, Inc. has the only existing well, the Invader No. 1, drilled on a 320-acre proration unit which it operates, in which it has a working interest, and which was drilled prior to the issuance of Order R-7407-E. Therefore, Mesa Grande has determined that it should not be concerned with forcing Sun into participating in Mesa Grande's well if Sun does not want to. However, Mesa Grande has always been willing to allow Sun to participate in the well upon Sun's paying its prorata share of the well costs. Moreover, Mesa Grande hereby waives any objection to Sun's drilling its own well in the E/2 of Section 1, T24N, R2W, if that is what Sun prefers.

Mesa Grande, Ltd. does want to continue on the docket Case No. 9225 for the January 21 Commission hearing, however, and submits herewith its brief in support of its application for compulsory pooling. This case is essentially the reverse of Case 9236. Here, Sun owns and operates the well in Section 20, T25N, R2W. Mesa Grande desires to participate in the well on 640-acre spacing in accordance with Order R-7407E, is ready, willing and able to pay its prorata share of the well costs, and is clearly entitled to participate in the well without penalty in accordance with statutory law and reason.

Thank you for your consideration.

Sincerely,

Owen M. Lopez

OML:rlr
Enclosure
cc: W. Thomas Kellahin, Esquire
Mr. Larry Sweet
Mr. Greg Phillips

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY AND MINERALS
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE HEARING
CALLED BY THE COMMISSION TO
CONSIDER THE APPLICATION OF MESA
GRANDE LTD FOR AN ORDER POOLING
A 640-ACRE TRACT CONSISTING
OF SECTION 20, T25N, R2W, NMPM,
GAVILAN-MANCOS OIL POOL,
RIO ARRIBA COUNTY, NEW MEXICO. CASE: 9225

BRIEF IN SUPPORT OF THE APPLICATION OF MESA GRANDE, LTD. FOR A COMPULSORY POOLING ORDER

Introduction

Point 1

The Commission requested the parties to brief their legal positions with respect to the following issues:

(1) Is Mesa Grande, Ltd. ("Mesa Grande") entitled to force pool Sun Exploration and Production Company ("Sun") into a 640-acre spacing unit by virtue of Order R-7407-E which established amended Special Pool Rules for the Gavilan Mancos Pool?

(2) Can Sun avoid being force pooled by seeking to establish a non-standard proration unit?

(3) If Mesa Grande is entitled to force pool Sun, does the Commission have the authority to set a penalty to compensate Sun, for the risk in drilling the Loddy #1 well?

The answer to the first question is clearly yes and the answers to the last two questions are clearly no. Again, Mesa Grande adopts the Statement of Facts set forth in Sun's motion to dismiss Case No. 9225.

Position of Mesa Grande

It is a basic principle of law that regulatory or administrative bodies are bound by statutory law. As stated in the case Matter of Proposed Revocation of Food & Drink, Etc., 102 N.M. 63 (Ct.App. 1984):

> [7] Administrative bodies are creatures of statute and can act only on those matters which are within the scope of authority delegated to them. [case citation omitted] An agency cannot amend or enlarge its authority through rules and regulations. Id. Nor may an agency, through the device of regulations, modify the statutory provision. [case citation omitted]

The Commision, by its Order No. R-7407-E, established 640-acre spacing for the Gavilan-Mancos Pool. Section 71-2-18A, N.M.Stat.Ann. (1978) states in part:

> ". . . Any division order that increases the size of a standard spacing or proration unit for a pool, or extends the boundaries of such a pool, shall require dedication of acreage to existing wells in the pool in accordance with the acreage dedication requirements for said pool, and all interests in the spacing or proration units that are dedicated to the affected wells shall share in production from the effective date of the said order." (emphasis added)

Sun has suggested that Rule 2 as amended by Order R-7407-E "grandfathered out" all existing spacing units in existence in the pool as of June 8, 1987. If that is the correct interpretation of Rule 2, it is in direct conflict with the above-cited statute and cannot stand. The interpretation placed by Sun on the amendatory language for Rule 2 is absurd and would render New Mexico's spacing and pooling laws meaningless. The language

adopted by the Commission in its Order No. R-7407-E must be read to apply only to those 640-acre proration units that already had 2 wells located on them at the time the Order issued, otherwise the very basis of the Order would be undermined.

The Commission, in Order R-7407-E, determined that to prevent the drilling of unnecessary wells, the standard proration unit for the Gavilan-Mancos Oil Pool ". . . shall consist of between 632 and 648 acres consisting of a governmental section . . .." (The Order allows an interest owner the option of drilling a second well on a standard proration unit after the date of the Order, but certainly does not require it because, as explained above, to hold otherwise would render the Order and the statutes inoperative.) It is indeed ironic to have Sun oppose the statutory pooling of standard 640-acre spacing unit when Sun so vigorously supported 640-acre spacing at the hearings in March, 1987. In fact, Sun continues to state that it

> ". . . supports and encourages the development of the Gavilan-Mancos Oil Pool on spacing and proration units of at least 640-acres in size. Sun continues to believe and support the need to minimize the number of wells to be drilled and produced in the Gavilan-Mancos Oil Pool in order to avoid the drilling of unnecessary wells and to conserve the energy in this rate sensitive reservoir." (Sun's Motion, supra, p.4)

Sun succeeded in establishing the 640-acre spacing and also succeeded in having the severely restricted allowables in the Gavilan-Mancos Pool continued. The effect of this reduction in allowables not only materially limits the production in many wells in the Pool, but also discourages the drilling of any wells

on 320-acre spacing. Having succeeded in establishing the rules it wanted, Sun now arbitrarily seeks to avoid their application.

Moreover, there exists precedent directly in point where the Commission properly force-pooled Mallon Oil Company at Mesa Grande's request when the Oil Conservation Division extended the boundaries of the Gavilan-Mancos Oil Pool to include Section 12, thereby increasing the spacing from 40 to 320 acres. See Case No. 8900, Order No. R-8262. The pending Mesa Grande cases cannot be distinguished and if the Commission were to grant Sun's Motion, it would be reversing its earlier ruling contrary to law.

Point 2

The second question is whether Sun can avoid being force pooled by seeking a non-standard unit. The answer is clearly no. First, the Special Pool Rules for the Gavilan-Mancos Pool do not provide for the establishment of non-standard spacing units. Second, the statewide rules only provide the establishment of non-standard proration units for gas wells and not oil wells. See Rule 104.D.II. Finally, an applicant, in seeking a non-standard unit, must present ". . . written consent in the firm of waivers from all offset operators. . .," Rule 104D.II(c). Mesa Grande, as the offset operator in Section 20, opposes the establishment of a non-standard unit since Mesa Grande wishes to exercise its right to join in the well by paying its prorata share of the well costs.

Point 3

The last question to be considered is whether it is in the Commission's discretion to assess a penalty against Mesa Grande for the risk associated with the drilling of the Loddy #1 well in Section 20. Again, the answer is clearly no. Section 70-2-17 N.M.S.A. (1978), which addresses the matter of compulsory pooling and the orders to be issued effecting same, states in part as follows:

> ". . . Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement . . . which . . . may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the non-consenting working interest owner's or owners' prorata share of the cost of drilling and completing the well." § 70-2-17(C).

Again, there is clear and unambiguous statutory language that makes it a condition precedent that the working interest owner must be unwilling to pay his prorata share of the well costs. That condition is missing in this case. Mesa Grande has always been ready, willing and able to pay its proportionate share of the well costs and has sought to do so as will be demonstrated at the hearing.

Conclusion

It has always been the Commission's practice and procedure, when increasing the size of a spacing unit in a given pool, to require acreage dedication to conform with the new spacing size. That was done in the first Order R-7407 entered in 1983 which

established Special Pool Rules for the Gavilan-Mancos Pool. It is obvious that this procedure is required by statutory and regulatory mandate. There is a decided case involving identical issues in the Gavilan-Mancos Pool where the Commission followed this procedure. We know of no instances where the Commission has not followed this procedure. If the Commission were not to follow this procedure now, it would be reversing long-established precedent, contrary to law and contrary to reason since Sun urged 640-acre spacing in the first instance.

If Sun prefers to remain on 320-acre spacing, Mesa Grande would support such a position. But to allow Sun to effectively protect its acreage on 320-acre spacing while requiring others to abide by 640-acre spacing is unfair. It has to be one way or the other. You cannot have it both ways.

Respectfully submitted,

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Case 8940