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

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

APPLICATION OF SYNERGY OPERATING, L.L.C., FOR COMPULSORY POOLING, SAN JUAN COUNTY, NEW MEXICO

CASE NO. 13486
ORDER NO. R-12376-C

ORDER OF THE OIL CONSERVATION COMMISSION

BY THE COMMISSION:

THIS MATTER came before the Oil Conservation Commission (the Commission) on February 9, 2006, and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 23rd day of March, 2006,

FINDS,

1. Notice has been given of the application and the hearing of this matter, and the Commission has jurisdiction of the parties and the subject matter.

2. Synergy Operating, L.L.C. ("Applicant") filed the original application in this case seeking an order pursuant to Section 70-2-17 NMSA 1978, as amended, pooling all interests in the W/2 of Section 8, Township 29 North, Range 12 West, NMPM, in San Juan County, New Mexico, to form a 320-acre compulsory-pooled gas spacing unit ("the Unit") as to all pools or formations spaced on 320 acres, from the surface to the base of the Fruitland Coal, including but not limited to the Basin-Fruitland Coal Gas Pool. Applicant asked that the proposed unit be dedicated to its proposed Duff 29-11-8 Well, to be drilled to the Fruitland Coal formation at an unspecified orthodox location in the NW/4 of Section 8.

3. Applicant also originally sought an order pooling all interests in the SW/4 of Section 8 to form a 160-acre compulsory-pooled gas spacing unit as to pools and formations within that vertical extent that are spaced on 160 acres. However, Applicant has withdrawn this request.

4. Edwin Smith ("Smith, individually") and Jerry Walmsley, Trustee of the Bypass Trust under the will of June H. Walmsley, deceased, (Walmsley, Trustee), claiming to be owners of mineral interests in the proposed unit, appeared before the Oil Conservation Division ("the Division") and asked that the Division deny the application.

5. On June 16, 2005, the Division issued Order No. R-13486 in this case, granting Applicant's application.

6. On July 1, 2005, within the time provided by Section 70-2-13 NMSA 1978, as amended, Edwin Smith, LLC ("Smith LLC) filed an application for hearing de novo before the Commission.

7. On July 18, 2005, within the time provided by Section 70-2-13 NMSA 1978, as amended, Walmsley, Trustee filed an application for hearing de novo before the Commission.

Applicant's Motion to Dismiss

8. Applicant filed a Motion to Dismiss the respondents' applications for de novo review by the Commission on the ground of lack of standing. Applicant contended that Smith LLC did not have standing to apply for a de novo hearing because only Smith, individually, and not Smith LLC, was a party of record to the proceeding before the Division. Applicant further contended that Walmsley, Trustee did not have standing to apply for de novo review because Walmsley, Trustee signed a joint operating agreement committing his interest to the proposed unit, and therefore was not "adversely affected" by the Division's order.

9. Walmsley Trustee presented evidence that he claims title to additional interests in the unit area, in addition to the interest committed to the proposed unit in the joint operating agreement he signed, including the unleased mineral interest that Applicant attributes to the Heirs of Margaret H. Jones, deceased.

10. Since the Heirs of Margaret H. Jones, deceased, did not appeal or participate in any of the proceedings in this case, and the Division's order, in effect, allows Applicant to recover a risk charge, in addition to its costs, out of production attributable to that interest, the Commission concludes that Walmsley, Trustee is adversely affected by the Division's order and had standing to apply for hearing of the case de novo by the Commission.

11. Since it is uncontested that Smith LLC did not appear or participate in the proceedings before the Division, the Commission concludes that Smith LLC did not have standing to file an application for hearing de novo by the Commission. However, since the Commission acquired jurisdiction by virtue of the timely and proper application of Walmsley, Trustee, the Commission concludes that it has discretion to, and should, allow Smith LLC to participate in the do novo proceedings.

The Pooling Application - Evidence

12. The following requisites for compulsory pooling are established by undisputed evidence:

a. The Unit is a standard spacing unit in the Basin Fruitland Coal-Gas Pool.

b. There are separately owned tracts of land embraced within the Unit, and there are owners of undivided interests in oil and gas minerals in the unit which are separately owned.

c. There are owners of interests in the Unit who have not agreed to pool their interests. This is true regardless of the interpretation placed on conflicting title evidence. Applicant presented evidence that the Heirs of Margaret H. Jones own interests in the Unit and have not agreed to pool their interests. While respondents, Smith LLC and Walmsley, Trustee ("Respondents") presented evidence indicating that the Heirs of Margaret H. Jones owned no title, their evidence also indicated that no agreement existed between the owners of the NW/4 and the owners of the SW/4 of Section 8.

d. Applicant proposes to drill a well on the Unit to a common source of supply.

13. The dispute between the parties concerns the status of Applicant as an "owner, who has a right to drill."

14. Applicant presented evidence that it owns an undivided 25% mineral interest in the SW/4 of Section 8, derived from the Heirs of Julia Hasselman Keller, deceased (12.5%) and from the heirs of Heirs of May Hasselman Kouns, deceased (12.5%). Applicant also presented a copy of a Judgment of the District Court of San Juan County, New Mexico, undated, but filed in the Court on August 19, 1958, in Cause No. 5994, awarding title to an undivided one-half interest in the SW/4 to "Margaret Hasselman Jones, Julia Hasselman Keller, Jennie Hasselman Hill and May Hasselman Kouns, [hereinafter "the Hasselman sisters"] as heirs at law of Herman Hasselman, deceased."

15. Applicant also presented evidence that it has the right to drill a well on the Unit pursuant to a farm-out agreement from Joseph C. Robbins who owns an undivided 3.125% unleased mineral interest in the SW/4 of Section 8.

16. Respondents claim that Walmsley, Trustee, and not Applicant, owns the undivided 25% interest in the SW/4 described in Finding Paragraph 14. This evidence consists of the following:

a. copy of warranty deed dated April 26, 1951, from the Hasselman sisters to Earl M Kouns describing an undivided one-half interest in the SW/4 of Section 8;

b. copy of warranty deed dated April 26, 1951 from Earl M. Kouns to the Hasselman sisters "not in tenancy in common but in joint tenancy, the survivor of them, their assigns and the heirs and assigns of such survivor forever";

c. copy of warranty deed dated September 8, 1981 from Jennie Hasselman Hill, "surviving joint tenant of Margaret Hasselman Jones, Julia Hasselman Keller and May Hasselman Kouns, all deceased" to June Hill Walmsley.

17. Respondents also offered in evidence a copy of an affidavit purportedly executed by Joseph C. Robbins in which he asserts that he signed the farmout agreement to Applicant based on certain representations and that he is "contemplating rescinding the farmout." Respondents also presented an un-sworn statement by Joseph C. Robbins purporting to rescind the farmout agreement between himself and Applicant. Joseph C. Robbins, however, did not appear personally, or testify, at the hearing, and these documents, purportedly signed by him, were not authenticated.

18. Applicant also presented in evidence a portion of a Joint Operating Agreement covering the Unit Area and naming Applicant as operator. The portion of the Operating Agreement presented contained only the signatures of Applicant and of Walmsley, Trustee. However, Mr. Hegarty testified, without objection, that Burlington Resources Oil & Gas Co., the undisputed owner of an oil and gas lease covering the NW/4 of Section 8, had also executed the Operating Agreement.

The Pooling Application - Commission Conclusions

19. Based on the foregoing evidence, the Commission finds and concludes:

a. The Commission has no jurisdiction to determine title to any interest in real property.

b. In a compulsory pooling case, however, the Commission must determine whether or not the party proposing to drill a well "has a right to drill" a well on the proposed unit. That determination, which is a prerequisite to the exercise of the Commission's compulsory pooling power under Section 70-2-17.C NMSA 1978, as amended, is solely for the purposes of the compulsory pooling proceeding, and cannot vest title in any person who does not own it or divest any title that any person owns.

c. The Commission need not, however, in this case, make even an *ad hoc* decision about whether the Applicant has a right to drill pursuant to the interests it claims to derive from the Heirs of Julia Hasselman Keller, deceased,

and from the heirs of Heirs of May Hasselman Kouns, deceased. This is true because Applicant's right to drill is independently established by evidence that it holds a farmout from Joseph C. Robbins, and that it is the named operator in a joint operating agreement executed by both Walmsley, Trustee and Burlington Resources Oil & Gas Co.

d. Respondents contend that Robbins has "rescinded" the farm-out to applicant. There is, however, no admissible evidence in this case of any basis to conclude the farm-out has been legally rescinded.

e. Although Respondents point to a provision of the Operating Agreement to the effect that, "If Operator . . . no longer owns an interest in the Contract Area, . . . Operator shall be deemed to have resigned without any action by Non-Operators, except the selection of a successor." However, because of the Robbins farm-out, there is no evidence that Applicant no longer owns an interest in the Contract Area, regardless of the title dispute between Applicant and Walmsley, Trustee. Furthermore, there is no evidence that the Non-Operators named in the Operating Agreement have selected a successor operator as therein provided.

f. Accordingly, the Commission concludes that Applicant "has a right to drill," within the meaning of Section 70-2-17.C NMSA.

20. To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

21. Applicant should be designated the operator of the proposed well and of the Unit.

22. Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the well.

23. Reasonable charges for supervision (combined fixed rates) should be fixed at $5,000 per month while drilling and $500 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*"

IT IS THEREFORE ORDERED THAT:

(1) Applicant's Motion to Dismiss the de novo application of Walmsley, Trustee is denied. Because of the denial of the motion to dismiss the application of

Walmsley, Trustee, the Commission has jurisdiction to proceed in this matter, and the Motion to Dismiss the de novo application of Smith LLC is moot.

(2) All uncommitted interests, whatever they may be, in the oil and gas from the surface to the base of the Fruitland Coal formation underlying the W/2 of Section 8, Township 29 North, Range 11 West, NMPM, San Juan County, New Mexico, are hereby pooled, forming a standard 320-acre gas spacing unit in all pools or formations within that vertical extent spaced on 320 acres, including but not limited to the Basin-Fruitland Coal Gas Pool. The above-described unit ("the Unit") shall be dedicated to the applicant's proposed Duff 29-11-8 Well No. 104 (API No. 30-045-33350) ("the proposed well"), to be located 955 feet from the North line and 885 feet from the West line (Unit D) of Section 8.

(3) Applicant is hereby designated the operator of the proposed well and of the Unit.

(4) Upon final plugging and abandonment of the well and any other well drilled on the Unit pursuant to Division Rule 36 [19.15.1.36 NMAC], the pooled unit created by this Order shall terminate, unless this order has been amended to authorize further operations.

(5) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit as established by this order.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(6) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(7) If any pooled working interest owner who has heretofore paid its share of estimated well costs pursuant to Order R-12376 elects, within the 30-day period provided in Ordering Paragraph (6) to not pay its share of estimated well costs, the operator shall promptly refund to such owner the amounts paid pursuant to Order R-12376.

(8) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no

objection to the actual well costs is received by the Division, and the Division has not objected within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(9) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

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

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

(b) as a charge for the risk involved in drilling the well, 200% of the above costs.

(11) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5,000 per month while drilling and $500 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*" The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

(13) Except as provided in Ordering Paragraphs (10) and (12) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in San Juan 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 the escrow agent within 30 days from the date of first deposit with the escrow agent.

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

(15) The operator shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the pooling provisions of this order.

(16) Jurisdiction of this case 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

JAMI BAILEY, C.P.G., MEMBER

WILLIAM OLSON, MEMBER

MARK E. FESMIRE, P.E., CHAIRMAN

SEAL