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

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

Case No. 11510
Order No. R-10672

APPLICATION OF BRANKO, INC. ET AL., TO REOPEN CASE NO. 10656 (ORDER NO. R-9845) CAPTIONED "APPLICATION OF MITCHELL ENERGY CORPORATION FOR COMPULSORY POOLING AND AN UNORTHODOX GAS WELL LOCATION, LEA COUNTY, NEW MEXICO."

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on May 2, 1996, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 2nd day of October, 1996, the Division Director, having considered the record and recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

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

(2) On December 7, 1992, Mitchell Energy Corporation (Mitchell) filed its application for compulsory pooling and an unorthodox gas well location. Case No. 10656 was heard on January 21, 1993, after which Order No. R-9845 was issued on February 15, 1993.

(3) Strata Production Company ("Strata") was served with the application on December 9, 1992, and appeared at that hearing in opposition to the granting of Mitchell Energy Corporation's (Mitchell) application, particularly Mitchell's proposed W/2 orientation of the 320-acre spacing unit, the well location, and the overhead charges. In addition, Strata contended that Mitchell failed to provide notification to Strata's "undisclosed partners" as identified on Mitchell Exhibit No. 17 in that case.

(4) Strata was the owner of record of a federal lease covering 80 acres (25%) of the 320 acres sought to be pooled by Mitchell (the "Strata lease").

(5) Evidence was introduced by applicants in this case, Branko, Inc. et al., (the "undisclosed partners" hereafter referred to just as "partners") purporting to show that they owned working interests in the acreage being force pooled by Mitchell (a total of 81.5% of the Strata lease with Strata owning the remaining 18.5%) at the times the application in Case No. 10656 was filed, the case was heard and the order was issued. Evidence was also introduced by applicants Branko et al. indicating they were not provided notice by Mitchell pursuant to Division Rule 1207.

(6) Up until a January 12, 1996, letter from Mark Murphy (Murphy), President of Strata, to Mitchell, Strata represented to Mitchell that Strata could act for and bind its "partners" in selling the Strata lease to Mitchell and that "Strata would defend itself and it's [sic] partners rights during any proceeding including a forced pooling hearing." The January 12, 1993, letter from Strata to Mitchell was the first written communication to Mitchell from Strata that the Strata "partners" should be notified directly.

(7) The nature of the interests owned by Strata's "partners" is not disclosed in writing until the January 13, 1993 letter from Strata to Mitchell. Whether in fact there was a formal limited or general partnership (with a written partnership agreement) or another type of business relationship whether formalized (e.g., stockholders in Strata) or informal (e.g., these "partners" were mere investors with the option to participate in Strata's activities) is unclear up to that point. The Division is aware in a general business sense of the term "silent partner" which term indicates that the principal does have a partner/investor but that partner/investor desires not to have its identity disclosed.

(8) The record shows that Mitchell provided only Strata, and not the previously "undisclosed" partners of Strata, with the election to participate in the subject well pursuant to the pooling order by letter dated February 17, 1993.

(9) The duty of Mitchell to inquire as to the nature of these "partners"' interests and to notify these "partners" of the force pooling case is unclear when Strata (I) is the only owner of public record, (ii) does not disclose the nature of these "partners"' interests and (iii) Strata represents that it can bind its "partners" in the sale of the lease and that it will "defend itself and it's [sic] partners rights during any proceeding including a forced pooling proceeding". Strata did in fact appear at the hearing and did defend its rights. Presumably, Strata's positions in the hearing regarding its 18.5% interest in the Strata lease would equally apply to those of its "partners"' 81.5% interest.

(10) It would circumvent the purposes of the New Mexico Oil and Gas Act to allow a record owner of a working interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid or delay having that entire percentage interest pooled by (I) assigning, conveying, selling or otherwise burdening or reducing that interest; or (ii) disclosing previously undisclosed partners or other interest owners who obtained their ownership through the record owner and who are not of public record; after the application and notice of hearing are filed with the Division and served on the party. Taken to the extreme, Strata could have disclosed, one at a time, each of its "partners" each week before a hearing date to delay the hearing 15 times.

(11) A cutoff date for notification of affected interest owners is necessary. If not, an applicant seeking to pool interests in a drilling and spacing unit would be required to daily check county records and verify with record owners that no other owners exist from the day of application until the pooling order is issued. This was never the intent of the pooling statute. Absence of a cutoff date would also permit adverse parties to the pooling application to defeat it by transferring their property to another at or about the time the pooling hearing was held and/or to stand by and, if the well be a producer, elect to participate.

(12) A party seeking a compulsory pooling order from the Division is required to attempt to obtain voluntary joinder of all owners of interests in that unit prior to filing a compulsory pooling application. It is incumbent upon any record owner of interest in that unit to disclose to the party seeking commitment of that interest to that unit the nature and extent of interests not of public record which have been obtained through that record owner in order that a party may attempt to obtain voluntary commitment of those interests to the unit or to notify those owners of a compulsory pooling action. Otherwise, the party seeking compulsory pooling has no notice that these owners exist.

(13) To require the party seeking compulsory pooling to obtain an affidavit from each owner of record certifying that there are no other owners not of record who obtained their title through him or listing all such owners is unduly burdensome and the Division will not impose such a burden. Presumably, if any such owner was listed, then affidavits would need to be obtained from that owner and so on and so on. The record owner may also not be forthcoming with that information. Any such owner can readily protect his interest by filing it of record, which is the purpose of filing a record of ownership.

(14) There are a number of peculiarities in this proceeding that are troubling to the Division and are worth noting:

(A) The geology witness for Strata at the hearing in this case was a Mr. George L. Scott, Jr. who testified that he owned some of the stock of Strata and that Scott Exploration was his organization. He and Scott Exploration were thus on actual notice of the

pooling proceeding. Affidavits have been received from Scott Exploration, Inc., signed by Charles Warren Scott; George L. Scott III and Lori Scott Worrall, who both list the same address as Scott Exploration and which address is in the same building as Strata; and Susan Scott Murphy for Winn Investments, Inc. These affidavits state that until November 1995, they were unaware of the subject well and the compulsory pooling case. Stephen T. Mitchell, with the same address and owning the same overriding royalty interest as George L. Scott III and Scott Exploration, Inc., states in his affidavit that he became aware of the subject well in May, 1993 and of the pooling case in May, 1993, so he somehow had actual notice of the pooling proceeding also. The extent of the stock ownership in Strata and in Scott Exploration, Inc. of the above named persons as well as Mark Murphy and the other partners may need to be examined as well as the personal relationships among all these parties in determining whether actual notice was received.

(B) Two of the "partners", Arrowhead Oil Corporation of Artesia, NM and Warren, Inc. of Albuquerque, NM, failed to join the applicants in this action to reopen this case, although John M. Warren signed an affidavit on behalf of Warren, Inc. stating that he first became aware of the subject well and pooling case on November 6, 1995. Why two of the "partners" (owning 6.25% and 5.0% of the Strata lease and according to Strata's November 6, 1995 letter to the "partners" would be entitled to $45,500 and $37,500 risk free) would not join in an action to reopen a case and be allowed, after the risk has passed, to avoid a risk penalty on a successful well is bewildering. The Division is open to subpoenaing these witnesses to learn the extent of their knowledge of what transpired.

(C) The Division notes the possibility of a conflict of interest on the part of counsel for applicants in this case based upon counsel's representation of Strata during the years in issue here, 1992 and 1993, where Strata failed to advise its "partners" of the compulsory pooling proceeding even though Strata was acting as agent (the extent of such agency is undetermined) for these "partners" during negotiations with Mitchell regarding the acreage that was pooled, and then counsel's subsequent representation of applicants in this case where their claim is based upon not being notified of that same compulsory pooling proceeding.

(D) One of the partners, S.H. Cavin of Roswell, NM, is the father of counsel for the applicants.

(E) In his January 13, 1996, correspondence to Mitchell, Murphy of Strata stated that "Strata has or is in the process of making a direct assignment of each partners [sic] proportionate ownership". In fact, the transfers were not carried out until November, 1995 (which was after the well proved profitable), which occurred in conjunction with the notification to the "partners" by Strata that the "partners" may have a good claim against Mitchell for recoupment of their 200% risk penalty.

(F) Strata takes the position that it was under no duty to its "partners" to inform them of the compulsory pooling case which would allow Mitchell to pool their leasehold interests to drill the subject well. Yet Strata apparently felt it had a duty to them to provide their names to Mitchell in early 1993 so Mitchell could notify them of the hearing. The distinction drawn is very fine. Strata also felt it had a duty to keep them informed as to the sale of their leasehold interests to Mitchell so Mitchell could drill the well. Murphy had numerous discussions with Strata's "partners" during the time period from October 1992 and May 1993 regarding their leasehold interests and Mitchell's desire to drill a well which included their interests. With the apparently large discretion given Strata to negotiate and sell the Strata lease to Mitchell by the "partners", it seems unlikely to the Division that the agency granted to Strata by the "partners" would not encompass the duty to inform the principals ("partners") of any action taken by Mitchell regarding their acreage interests in attempting to drill its well. The Division is curious as to what reports or other communications were made to the "partners" by Strata both before and after the negotiations with Mitchell for sale of the Strata lease had failed.

(G) The duty to inform Strata's "partners" of the pooling case and the subject well, apparently sprang into being in November, 1995 when Strata wrote its partners informing them of the pooling order, the status of the well and that they "may have the right to join in the Mitchell well without application of the 200% risk penalty". Long before then, Strata had dismissed its De Novo appeal of the pooling order in which appeal it could have contested the "all or none" election option given Strata by Mitchell as to payment for well costs for the entire 25% interest represented by the Strata lease. Strata had also acknowledged that "Strata's 18.5% interest is subject to the Order" in a May 11, 1993 letter from its attorney to the attorney for Mitchell. By such actions, Strata apparently waived its rights to assert that it too could join in the Mitchell well without a risk penalty. Nevertheless, Strata apparently felt a "compulsion" in November 1995 to finally inform its "partners" of the pooling order, the Mitchell well, and their rights as to joining in the well risk free as well as aid the "partners" in this proceeding by providing testimony.

(H) No evidence, in the form of written instruments, canceled checks, or otherwise, has shown exactly how and when the "partners" acquired their interests, when they paid for such interests and what interests were actually acquired. The documentation for the transfers was not prepared until late 1995.

(15) The Division believes that the issue of actual notice is important under the circumstances of this case. If the applicants knew of the force pooling hearing and/or the drilling of the subject well and made no attempt to inquire as to their interest in such hearing or inquire as to their respective obligations to pay their proportionate shares of the well expenses until the well became profitable, then even if applicants had been entitled to participate in the well at their election, they may have waited too long to voice their decision.

(16) The Division is concerned with the equity of allowing parties, with knowledge of the facts, and without risk to themselves, to stand by an unreasonable amount of time and see another assume all the risks of drilling a well in which such parties might have shared, and, after success of the well, seek to share in the benefits thereof. The injustice of such a situation is obvious: of permitting ones holding the right to assert ownership in such property to voluntarily await the event determining success or failure, and then decide, when the danger which is over has been at the risk of another, to come in and share the profit. If the Division is unable to fashion an equitable solution based upon the facts in this case, the Division is hopeful a court can do so.

(17) Regardless of whether the "partners" should have been notified pursuant to Division Rule 1207 prior to the compulsory pooling hearing, the Division is reopening this case for the reason stated below.

(18) Ordering Paragraphs (4) and (5) of Order No. R-9845 provide that "each known working interest owner" shall be furnished an itemized schedule of estimated well costs and that such working interest owner shall have a right to participate in the well by paying his share of estimated well costs.

(19) Based on the absence of any notice sent by Mitchell to applicants in this case informing them of their election rights to participate in the subject well under Division Order No. R-9845 issued on February 15, 1993, in view of the fact that Mitchell prior to that time (on January 13, 1993) had been given a list of such working interest owners and had also been notified at that same time that those interest owners should be contacted directly regarding the compulsory pooling case, **Case No. 10656 should be reopened** to examine the share of costs that should be apportioned to each interest owner in the subject well as well as determine how future operations should be conducted for such well.

IT IS THEREFORE ORDERED THAT:

(1) **Case No. 10656 is hereby reopened** with the date for hearing to be set no later than the second Division hearing in December 1996. Mitchell shall provide notice to all known interest owners of the hearing.

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

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

WILLIAM J. LEMAY
Director

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