**JAMES BRUCE**
**ATTORNEY AT LAW**

**POST OFFICE BOX 1056**
**SANTA FE, NEW MEXICO 87504**

**369 MONTEZUMA, NO. 213**
**SANTA FE, NEW MEXICO 87501**

**(505) 982-2043 (Phone)**
**(505) 660-6612 (Cell)**
**(5050 982-2151 (Fax)**

jamesbruc@aol.com

2006 JUN 12 PM 2 29

June 8, 2006

William Jones
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 13,724/Chaparral Oil & Gas Company

Dear Mr. Jones:

Enclosed are copies of the two orders I mentioned at the hearing today. In the Bettis, Boyle & Stovall case, the Division held that an excessive overriding royalty created after pooling commenced was invalid as against the operator. In the Concho Resources case, the Division held that an onerous lease executed after pooling commenced was invalid as against the operator.

In the Chaparral case, the excessive interests pre-date the pooling, so the above cases do not apply, which is why the non-standard unit is requested.

Very truly yours,

James Bruce

Attorney for Chaparral Oil & Gas Company

SEP 28 2001

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:**

**REOPENED**
**CASE NO. 12601**
**ORDER NO. R-11573-A**

**APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.**

## ORDER OF THE DIVISION

**BY THE DIVISION:**

This case came on for hearing at 8:15 a.m. on May 31, 2001, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this 24th day of September, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

**FINDS THAT:**

(1) On April 26, 2001, pursuant to the Application of Bettis, Boyle and Stovall ("Applicant"), the Division entered Order No. R-11573, providing for the compulsory pooling of all uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying Lots 3 and 4 (W/2 SW/4 equivalent) in Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico, as therein provided.

(2) Division Order No. R-11573 provided for recovery out of production attributable to the interest of non-consenting working interest owners of reasonable well costs of Applicant's proposed McGuffin "C" Well No. 1, together with an additional 200% of such costs as a charge for the risk involved in drilling such well.

(3) Order No. R-11573 further provided, in ordering paragraph (12), that:

"Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests."

(4) On May 3, 2001, Applicant requested the Division to reopen this case "for the purpose of amending Division Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the non-consent penalty."

(5) In the reopened hearing, Applicant seeks an order allowing it to recover the portion of well costs, and of the 200% risk charge, attributable to the mineral interest of Sun-West Oil & Gas, Inc. ("Sun-West") in the Unit out of 87.5% of production attributable to such interest, as though such interest were unleased, thereby disregarding the terms of a lease from Sun-West Oil & Gas, Inc. to Gulf Coast Oil and Gas Company ("Gulf Coast"), which provides for a royalty of 27.5%.

(6) Applicant presented testimony that:

(a) on the date its application was filed seeking an order pooling the subject units, Sun-West was an owner of an unleased 15% mineral interest in the lands sought to be pooled;

(b) Applicant was unable to reach a voluntary agreement for the development of the subject lands because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which, in Applicant's opinion, would have rendered the drilling of the proposed well uneconomic;

(c) Applicant proposed to lease Sun-West's mineral interest on terms providing for a royalty of 18.75%, but Sun-West was unwilling to lease to Applicant on those terms. In the opinion of Applicant's expert a larger royalty than 18.75% would render the prospect undesirable;

(d) Applicant filed its application in this case on January 30, 2001;

(e) notice of the filing of the application in this case and of the hearing thereon was sent by certified mail and received by Sun- West on February 6, 2001; and

(f) on February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving a royalty of 27.5%.

(7) Applicant further presented testimony that:

(a) Gulf Coast has the same address, telephone number and officers as Sun-West; and

(b) when applicant sought to contact Gulf Coast to negotiate terms of pooling of its interest in the proposed Unit, the individual who contacted Applicant to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West.

(8) Sun-West appeared by counsel at the hearing on the re-opened application, but presented no testimony.

(9) The interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and on February 6, 2001, when Sun-West received notice of the application.

(10) The subsequent lease of the 15% mineral interest from Sun-West to Gulf Coast was not an arms-length transaction, but was consummated for the apparent purpose of increasing the share of production that Sun-West would be entitled to receive free of costs in the event of the entry of a compulsory pooling order by the Division.

(11) NMSA 1978 Section 70-2-17.C provides that:

"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." [Emphasis added.]

(12) However, NMSA 1978 Section 70-2-17.C also provides that:

> "All orders effecting such pooling 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 and gas, or both."
>
> It further provides:
>
> "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, . . . ."

(13) It would circumvent the purposes of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 70-2-38, as amended) to allow a party owning an unleased mineral interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid the cost recovery and risk charge provisions of the Act by leasing or otherwise burdening or reducing that interest through a transaction with an affiliated entity after the application and notice of hearing are filed with the Division and served on the party.

(14) In previous cases where an interest subject to compulsory pooling carried a burden so large that it could not be pooled in a manner that afforded to other owners in the spacing unit the opportunity to recover their just and fair share of the oil or gas, the Division has allowed the owners of the burdened interest the alternatives of voluntarily reducing the interest not subject to cost recovery or being excluded from the unit. This was done in Division Orders No. R-7335 and R-7988.

(15) The remedy of excluding the burdened interest from the unit is not available in this case because the interest owned by Sun-West is an undivided interest in the entire spacing unit, and not a separate tract.

(16) In order to effect pooling of the subject unit on terms that are just and reasonable under the peculiar circumstance of this case, and to allow Applicant the opportunity to recover or receive without unnecessary expense its just and fair share of the oil underlying the subject unit, the interest of Sun-West should be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573.

(17) The Division has not been asked to address, and should not address, any issue regarding rights or duties as between Sun-West and Gulf Coast.

(18) Due to the delay occasioned by the reopening of this Case No. 12601, the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573, should be extended to December 31, 2001.

(19) In all other respects, Division Order No. R-11573 should remain in full force and effect.

**CONCLUSION OF LAW:**

The Division concludes that the power expressly conferred on the Division by the portion of NMSA 1978 Section 70-2-17.C quoted in finding paragraph (11) is cumulative and not exclusive, and that the Division has power, pursuant to NMSA 1978 Section 70-2-11.A, and to the directive set forth in that portion of Section 70-2-17.C quoted in finding paragraph (12), to allow recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

**IT IS THERE FORE ORDERED THAT:**

(1) Pursuant to the application of Applicant, this Case No. 12601 is reopened for the purpose of reconsidering the allocation of costs and risk charges as to the interest of Sun-West.

(2) Division Order No. R-11573 is hereby amended to provide that the interest owned by Sun-West in the Unit as of the date of the filing of the original application in this case shall be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573, but not otherwise.

(3) The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573, is hereby extended to December 31, 2001.

(4) In the event the operator does not commence drilling the well on or before December 31, 2001, Ordering Paragraph (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

(5) In all other respects, Division Order No. R-11573 is hereby confirmed and shall be and remain in full force and effect.

(6) Jurisdiction of this case 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

Lori Wrotenbery

LORI WROTENBERY
Director

SEAL

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. 12674**
**ORDER NO. R-11666**

**APPLICATION OF CONCHO RESOURCES, INC. N/K/A DEVON ENERGY PRODUCTION COMPANY, L.P. FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.**

## ORDER OF THE DIVISION

**BY THE DIVISION:**

This case came on for hearing at 8:15 a.m. on August 9, 2001, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 16th day of October, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

**FINDS THAT:**

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) Concho Resources, Inc. n/k/a Devon Energy Production Company, L.P., ("Applicant"), seeks an order pooling all uncommitted mineral interests from the surface to 200 feet below the top of the Mississippian formation underlying the S/2 of Section 32, Township 18 South, Range 24 East, NMPM, Eddy County, New Mexico, in the following manner:

> The S/2, forming a standard 320-acre gas spacing and proration unit (the 320-acre "Unit") for all formations or pools spaced on 320 acres within this vertical extent, which presently include, but are not necessarily limited to, the Antelope Sink-Morrow Gas pool.
>
> The SW/4, forming a standard 160-acre gas spacing and proration unit (the 160-acre "Unit") for all formations or pools spaced on 160 acres within this vertical extent.

(3) The above-described units (the Units) are to be dedicated to Applicant's proposed Southern Cross "32" State Com. Well No. 1, which has been drilled at a standard gas well location within the NE/4 SW/4 (Unit L) of Section 32.

(4) Two or more separately owned tracts are embraced within the Units, and/or there are owners of royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Units which are separately owned.

(5) Applicant is an owner of an oil and gas working interest within each of the Units. Applicant has the right to drill and has drilled its Southern Cross "32" State Com. Well No. 1 (the "well") to a common source of supply at a standard gas well location within the NE/4 SW/4 of Section 32.

(6) There is at least one interest owner in each of the proposed units that has not agreed to pool her interest.

(7) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Units 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 mineral interests, whatever they may be, within the Units.

(8) Applicant should be designated the operator of the well and of the Units.

(9) After pooling, uncommitted working interest owners are referred to as non-consenting working interest owners. ("Uncommitted working interest owners" are owners of working interests in any of the Units, including unleased mineral interests, who are not parties to an operating agreement governing the Units.)

(10) Any non-consenting working interest owner who has not paid its share of well costs should have withheld from production its share of reasonable well costs.

(11) Applicant does not seek recovery of an allowance for risk in addition to reasonable well costs.

(12) Any non-consenting working interest owner should be afforded the opportunity to object to the actual well costs, but actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(13) Following determination of reasonable well costs, any non-consenting working interest owner who has paid its share of well costs should receive from the operator any amount that paid well costs exceed reasonable well costs.

(14) Reasonable charges for supervision (combined fixed rates) should be fixed at $5,220.00 per month while drilling, and $558.00 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.*" The operator should be 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 each non-consenting working interest.

(15) Except as noted in Findings (10) and (14) above, all proceeds from production from the well that are not disbursed for any reason should be placed in escrow to be paid to the true owner thereof upon demand and proof of ownership.

(16) Applicant further seeks an order allowing it to recover the portion of well costs attributable to the mineral interest of Virginia Collier Howell ("Howell") in the Unit out of 87.5% of production attributable to such interest, as though such interest were unleased, thereby disregarding the terms of a lease from Howell to Rhinoceros Ventures Group, Inc. ("Rhinoceros"), which provides for a royalty of 25%, and which contains other unusual provisions and stipulations. A copy of the lease from Howell to Rhinoceros was admitted as Applicant's Exhibit 3.

(17) Applicant presented testimony that:

(a) on the date its application was filed seeking an order pooling the subject units, Howell was an owner of an unleased 3.75% mineral interest in the lands sought to be pooled;

(b) Applicant was unable to reach a voluntary agreement with Howell for the development of the subject lands because Howell directed that all correspondence be conducted with her attorney, Robert Wade, who never responded to Applicant's lease proposal;

(c) Applicant filed its application in this case on May 3, 2001;

(d) notice of the filing of the application in this case and of the hearing thereon was sent by certified mail and received by Howell on May 7 , 2001; and

(e) on May 14, 2001, Howell executed a lease of her interest in the lands that were the subject of the application in this case to Rhinoceros, reserving a royalty of 25%.

(18) Applicant further presented testimony that:

(a) Howell's attorney, Robert Wade, is the secretary and a director of Rhinoceros, and the only other officer and director of Rhinoceros is Annette Hall Wade; and

(b) Applicant received a proposal to farm-out the Rhinoceros lease, reserving a 2% overriding royalty, from Robert Wade.

(19) Although Howell and Wade were duly notified of the hearing on this Application, they neither entered any appearance in this case nor appeared at the hearing.

(20) The interest of Howell in the proposed units was an unleased mineral interest on May 3, 2001, when an application for compulsory pooling of all interests therein was filed, and on May 7, 2001, when Howell received notice of the application.

(21) The subsequent lease of the 3.75% mineral interest from Howell to Rhinoceros was not an arms-length transaction, but was consummated for the apparent purpose of increasing the share of production that Howell would be entitled to receive free of costs in the event of the entry of a compulsory pooling order by the Division.

(22) NMSA 1978 Section 70-2-17.C provides that:

"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." [Emphasis added.]

(23) However, NMSA 1978 Section 70-2-17.C also provides that:

"All orders effecting such pooling 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 and gas, or both."

It further provides:

> "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, . . . ."

(24) It would circumvent the purposes of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 70-2-38, as amended) to allow a party owning an unleased mineral interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid the cost recovery provisions of the Act by leasing or otherwise burdening or reducing that interest through a transaction with an affiliated entity after the application and notice of hearing are filed with the Division and served on the party.

(25) In previous cases where an interest subject to compulsory pooling carried a burden so large that it could not be pooled in a manner that afforded to other owners in the spacing unit the opportunity to recover their just and fair share of the oil or gas, the Division has allowed the owners of the interest the alternatives of voluntarily reducing the interest not subject to cost recovery or being excluded from the unit. This was done in Division Orders No. R-7335 and R-7988.

(26) The remedy of excluding the burdened interest from the unit is not available in this case because the interest owned by Howell is an undivided interest in the entire spacing unit, and not a separate tract.

(27) In order to effect pooling of the subject unit on terms that are just and reasonable under the peculiar circumstances of this case, and to allow Applicant the opportunity to recover or receive without unnecessary expense its just and fair share of the gas underlying the subject unit, the interest of Howell should be treated as an unleased mineral interest for the purpose of applying the cost recovery provisions of this Order.

(28) The Division has not been asked to address, and should not address, any issue regarding rights or duties as between Howell and Rhinoceros.

**CONCLUSION OF LAW:**

The Division concludes that the power expressly conferred on the Division by the portion of NMSA 1978 Section 70-2-17.C quoted in finding paragraph (22) is cumulative and not exclusive, and that the Division has power, pursuant to NMSA 1978 Section 70-2-11.A, and to the directive set forth in that portion of Section 70-2-17.C quoted in finding paragraph (23), to allow recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

**IT IS THEREFORE ORDERED THAT:**

(1) Pursuant to the application of Concho Resources, Inc. n/k/a Devon Energy Production Company, L.P., all uncommitted mineral interests from the surface to 200 feet below the top of the Mississippian formation underlying the S/2 of Section 32, Township 18 South, Range 24 East, N.M.P.M., Eddy County, New Mexico, are hereby pooled, as follows:

(a) The S/2, forming a standard 320-acre gas spacing and proration unit for all formations or pools spaced on 320 acres within this vertical extent, which presently include but are not necessarily limited to the Antelope Sink-Morrow Gas pool.

(b) The SW/4, forming a standard 160-acre gas spacing and proration unit for all formations or pools spaced on 160 acres within this vertical extent.

The Units shall be dedicated to Applicant's Southern Cross "32" State Com. Well No. 1, which has been drilled at a standard gas well location within the NE/4 SW/4 (Unit L) of Section 32, and has been completed in the Morrow formation.

(2) Applicant is hereby designated the operator of the proposed well and of the Units.

(3) The operator shall furnish the Division and each known non-consenting working interest owner an itemized schedule of actual well costs within 30 days following the date of this order. 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 deemed to be the reasonable well costs; provided,

however, that if there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after notice and hearing.

(4) The operator is hereby authorized to withhold from production the proportionate share of reasonable well costs attributable to each non-consenting working interest owner who has not paid its share of reasonable well costs within thirty (30) days after the determination of reasonable well costs as provided in ordering paragraph (3).

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

(6) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5,220 per month while drilling and $558 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 each non-consenting working interest.

(7) Except as provided in Ordering Paragraphs (4) and (6) above, all proceeds from production from the well that are not disbursed for any reason shall be placed in escrow in Eddy 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.

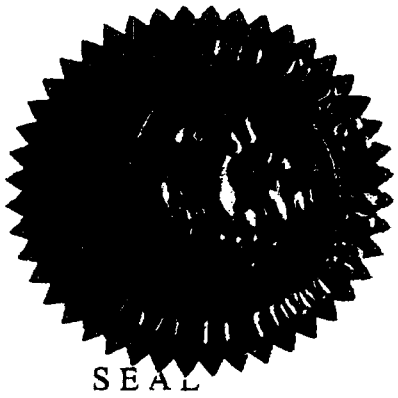
(8) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests; provided, however, that the interest owned by Howell in the Unit as of the date of the filing of the original application in this case shall be treated as an unleased mineral interest for the purpose of applying ordering paragraph (4) and this paragraph (8), but not otherwise.

(9) 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.

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

(11) Jurisdiction of this case 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.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director