Brooks, David K., EMNRD

From: jamesbruc@aol.com
Sent: Thursday, September 23, 2010 4:37 PM
To: Brooks, David K., EMNRD
Subject: Re: Cases 14504 and 14505; Applications of Celero Energy II, LP for Statutory Unitization, etc

David; I will get back to you. Thanks.

Jim

-----Original Message-----
From: Brooks, David K., EMNRD, EMNRD <david.brooks@state.nm.us>
To: jamesbruc <jamesbruc@aol.com>
Cc: Warnell, Terry G, EMNRD, EMNRD <TerryG.Warnell@state.nm.us>
Sent: Thu, Sep 23, 2010 4:32 pm
Subject: Cases 14504 and 14505; Applications of Celero Energy II, LP for Statutory Unitization, etc

Dear Jim

I have looked at this file, and I have several questions, at this point related only to the statutory unitization portion of the case.

1. One of the requirements for stat un is that we find that the method of allocation of production among tracts is fair and reasonable. There is no evidence on that issue. The allocation seems to be the same as that provided in the previous voluntary unit; so I suppose we could find that the allocation is fair and reasonable on the basis that all parties, or their predecessors in interest, agreed to it, if we were sure that was the fact. So that leads to my questions below which go to whether we can actually find from the record that that is the fact.

2. The land witness testified (TR 6) that "about 3.015 % of the working interest owners did not ratify the unit." It is not entirely clear to me whether he was talking about the original unit or the amendment. If he is talking about the original unit, then it seems that negates the proposition that all the working interest owners agreed to the tract allocation. While clearly more than 75% have agreed, and approval under the Stat Un Act would require only Celero and one other WI owner, which we have per the testimony, the fact that some did not ratify the original unit agreement, if that is the case, defeats the proposition that the agreement of the original parties to the tract allocation would be a basis to find that the tract allocation is fair and reasonable.

3. You indicated that we should not require approval by royalty owners because their interests are not affected, citing Section 70-7-9 dealing with amendments to units. It is not clear to me that Section 70-7-9 was intended to allow amendment of a voluntary unit to make it a statutory unit w/o the approvals required to create a statutory unit. However, since the language does not rule out that interpretation, and I do not see how anyone would be harmed, I am willing to accept that interpretation. For that to work, however, it is necessary to conclude that the royalty owners are unaffected. Royalty owners who are bound by the previous voluntary unit are, it seems, unaffected, because the tract allocations are not changed. However, any royalty owners who were not bound by the voluntary unit would be affected because they would remain entitled to royalties based only on production from the particular tract where they own. Royalty interests would be bound by a voluntary unit, of course, only if they ratified the unit agreement, or if the terms of their particular leases authorized the lessee to commit their interest to this type of unit. There is no evidence from which we could reach that conclusion. I asked you if all royalty interests were committed (Tr 18), but I did not actually get an answer.

4. There is the question of Tract 8. Tract 8 is shown as "uncommitted" on the Exhibit B to the old unit agreement, and also on the Exhibit B to the new unit agreement, which is, in substance anyway, the same exhibit. No tract allocation is given for Tract 8. However, Tract 8 is included in the unit on the various plats admitted in evidence. I did not total the tract allocation percentages to see if they add to 100%, or if an allocation is reserved for Tract 8. But either way we are not free from problems. If an allocation was reserved for Tract 8, we have to reconstruct what it was, and we have the problem of whether it can be supported if the owners of that tract never agreed to it. If a tract allocation was not reserved for Tract 8, then all the tract allocations need to be revised. Plus, the presence of a tract listed as "uncommitted" raises

another question about whether all royalty owners have, in fact, committed their interest. And, of course, if the tract allocations are changed in any way, the royalty interests are affected even if they are committed.

I will continue studying the technical aspects of these cases, but would appreciate a response to these questions.

Sincerely

David K. Brooks
Legal Examiner