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& SHERIDAN, P.A.

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September 27, 1991

HAND-DELIVERED

Mr. David R. Catanach
Hearing Examiner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
State Land Office Building
Santa Fe, New Mexico 87503

RECEIVED
SEP 27 1991
OIL CONSERVATION DIVISION
10386

Re: Case No. 10363
Application of Yates Petroleum Corporation for Compulsory Pooling, Eddy
County, New Mexico

and

Case No. 10386
Application of McKay Oil Corporation for Compulsory Pooling, Eddy County,
New Mexico

Dear Mr. Catanach:

Yates Petroleum Corporation has discovered that on September 16, 1991 - *three days before the Examiner hearing on the above-referenced applications* Roy L. McKay as President of McKay Oil Corporation created by assignment two overriding royalty interests in the acreage it owns in Section 25, which is the subject of the above-referenced compulsory pooling applications.

One of these assignments is to Talent Energy Corporation whose President is Roy L. McKay. This assignment is equal to 20% overriding royalty interest in the McKay acreage in Section 25. The other assignment is equal to 10% overriding royalty interest in the McKay area and was to Sanders Petroleum Corporation. Charles Sanders, McKay's expert witness at the September 19, 1991 Examiner hearings, is the agent for Sanders Petroleum Corporation.

Mr. David R. Catanach
Hearing Examiner
Oil Conservation Division
September 27, 1991
Page Two

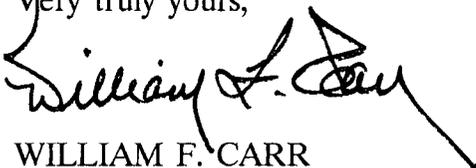
These overriding royalty interests, when subtracted from the 75% net revenue interest McKay owns in these properties, reduces the net revenue interest in these lands to only 45%. This has the effect of undermining the effectiveness of any risk penalty that could be imposed on this acreage by a force pooling order.

We are aware of only one prior attempt to undermine the regulatory process in this way. In 1983, Ralph Nix and Loneta Curtis created a 50% overriding royalty burden on their interest in favor of their children in certain lands subject to a compulsory pooling application filed by Rio Pecos. In Case No. 7922, Order No. R-7335, a copy of which is enclosed for your review, the Division found that a reasonable override in this proration unit would not be in excess of 12.5% (Finding 7) rendering the NRI interest to be 75% and that, because of the Nix overriding royalty interest, the payoff period for these interests would be much longer than for comparable interests in other tracts dedicated to the well. (Findings 8 through 10). Concluding that this situation was not "just and reasonable to ... the owners of participating interests in the proposed proration and spacing unit" (Finding 11), the Division pooled the lands, gave Nix, et al. the opportunity to reduce this burden, or, if not, to have the spacing or proration unit contracted to exclude their lands.

Because of the McKay assignments, copies of which are attached hereto, Yates Petroleum Corporation asks the Division to either take administrative notice of these documents from the records of Eddy County, New Mexico and enter an Order requiring McKay to remove these overriding royalty interests in Section 25. A complete removal of these interests is necessary in view of the fact that the property is already encumbered with royalty and overriding royalty equal to 25%.

If the Division cannot take administrative notice of these documents from the records of Eddy County, New Mexico, we request that these consolidated cases be reopened at the next available Examiner hearing to enable Yates Petroleum Corporation to make these assignments part of the Examiner hearing record and to otherwise present testimony as to why we believe McKay is not an appropriate operator for a well in Section 25.

Very truly yours,



WILLIAM F. CARR
ATTORNEY FOR YATES PETROLEUM CORPORATION

WFC:mlh

Enclosure

cc w/enc.: Randy Patterson
W. Thomas Kellahin, Esq.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

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

CASE NO. 7922
Order No. R-7335

APPLICATION OF RIO PECOS CORPORATION
INC. FOR COMPULSORY POOLING, EDDY
COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 9 a.m. on July 20, 1983, at Santa Fe, New Mexico, before Examiner Richard L. Stamets.

NOW, on this 22nd day of August, 1983, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS:

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

(2) That the applicant, Rio Pecos Corporation, Inc., seeks an order pooling all mineral interests in the Wolfcamp and Pennsylvanian formations underlying the N/2 of Section 2, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico.

(3) That the applicant has the right to drill and proposes to drill a well at a standard location thereon.

(4) That there are interest owners in the proposed proration unit who have not agreed to pool their interests.

(5) That the evidence establishes that after receiving notice of the subject compulsory pooling application, Ralph Nix and Loneta Curtis created a 50 percent overriding royalties burden on their interest to Ralph Nix, Jr. and Sarah Garretson, their son and daughter, respectively, in the NE/4 NW/4 of said Section 2.

(6) That the evidence presented established that all other working interest owners in the N/2 of said Section 2 had voluntarily agreed to a 6.25 percent overriding royalty interest.

(7) That the evidence established that a reasonable overriding royalty interest in this proration and spacing unit would be not in excess of 12.5 percent.

(8) That for each \$800.00 of income attributable to a well which might be drilled and completed on the N/2 of said Section 2 under terms of this order, the operator would receive, exclusive of expenses and taxes, \$37.50 attributable to the NE/4 NW/4.

(9) That as to any comparable 40-acre tract comprising the N/2 of said Section 2, the operator would receive \$81.25.

(10) That if the owners in the NE/4 NW/4 of said Section 2 proved to be non-consenting participants in the proposed well, the payout period for their interest in well costs would be 76 percent longer than for comparable interests in other tracts in the N/2 of said section.

(11) That it would not be just and reasonable to require the owners of participating interests in the proposed proration and spacing unit to bear extra costs and risks associated with well cost payout requiring 76 percent more time than others in the unit.

(12) That the smaller share of operating income attributable to the NE/4 NW/4 of said Section 2 could result in operating expenses exceeding operating income as to said tract while the rest of the unit was being operated profitably.

(13) That compulsorily pooling the proposed proration unit under such conditions would not be just or reasonable.

(14) That to compulsorily pool the entire N/2 of said Section 2 would cause the operator of the well to bear an unreasonable, and therefore unnecessary, cost burden as to that portion of the proration unit bearing said 50 percent overriding royalty.

(15) That in order to protect correlative rights, prevent waste, and to avoid compulsory pooling under terms that are not just or reasonable, any compulsory pooling order issuing in this case should provide for voluntary reduction of the overriding royalty for the NE/4 NW/4 to a reasonable figure,

within a reasonable time, or for the pooling of the N/2 of said Section 2 exclusive of the NE/4 NW/4.

(16) That, subject to conditions contained in Finding No. (15) above, to avoid the drilling of unnecessary wells, to protect correlative rights, and to afford to the owner of each interest in said unit the opportunity to recover or receive without unnecessary expense his just and fair share of the gas in any Wolfcamp or Pennsylvanian Pool lying under the proposed proration unit, the subject application should be approved by pooling all mineral interests, whatever they may be, within said unit.

(17) That as requested by the applicant, Costa Resources, Inc., should be designated the operator of the subject well and unit.

(18) That any non-consenting working interest owner should be afforded the opportunity to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(19) That any non-consenting working interest owner who does not pay his share of estimated well costs should have withheld from production his 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.

(20) That any non-consenting interest owner should be afforded the opportunity to object to the actual well costs but that actual well costs should be adopted as the reasonable well costs in the absence of such objection.

(21) That following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs should pay to the operator any amount that reasonable well costs exceed estimated well costs and should receive from the operator any amount that paid estimated well costs exceed reasonable well costs.

(22) That \$4,000.00 per month while drilling and \$400.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); that the operator should be authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, 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 each non-consenting working interest.

(23) That all proceeds from production from the subject well which 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.

(24) That upon the failure of the operator of said pooled unit to commence drilling of the well to which said unit is dedicated on or before December 1, 1983, the order pooling said unit should become null and void and of no effect whatsoever.

IT IS THEREFORE ORDERED:

(1) That all mineral interests, whatever they may be, in the Wolfcamp and Pennsylvanian formations underlying the N/2 of Section 2, Township 18 South, Range 28 East, NMPM, Eddy County, New Mexico, are hereby pooled to form a standard 320-acre gas spacing and proration unit to be dedicated to a well to be drilled at a standard location thereon.

PROVIDED HOWEVER, that the operator of said unit shall commence the drilling of said well on or before the 1st day of December, 1983, and shall thereafter continue the drilling of said well with due diligence to a depth sufficient to test the Wolfcamp and Pennsylvanian formations;

PROVIDED FURTHER, that in the event said operator does not commence the drilling of said well on or before the 1st day of December, 1983, Order (1) of this order shall be null and void and of no effect whatsoever, unless said operator obtains a time extension from the Division for good cause shown.

PROVIDED FURTHER, that should said well not be drilled to completion, or abandonment, within 120 days after commencement thereof, said operator shall appear before the Division Director and show cause why Order (1) of this order should not be rescinded.

(2) That Costa Resources Inc. is hereby designated the operator of the subject well and unit.

(3) That after the effective date of this order and within 90 days prior to commencing said well, the operator shall furnish to the Division; Ralph Nix, Loneta Curtis, Ralph Nix, Jr., and Sarah Garretson, and any other known working interest owner an itemized schedule of estimated well costs.

(4) That within 30 days from the date the schedule of estimated well costs is furnished to Ralph Nix, Jr. and Sarah Garretson, each shall make an election to voluntarily reduce their share of the 50 percent overriding royalty to an overriding royalty not in excess of a total 12.5 percent for their 40 acre lease and that in the event they do not make that election, the NE/4 NW/4 of said Section 2 shall be excluded from the proration and spacing unit and the Division shall automatically approve the unit as a non-standard proration and spacing unit consisting of all of the N/2 of Section 2 except the NE/4 NW/4.

(5) That the operator shall notify the Division of the decision of Ralph Nix, Jr. and Sarah Garretson requesting approval of the non-standard proration unit if said parties chose to not amend their overriding royalty interest.

(6) That within 30 days from the date the schedule of estimated well costs is furnished to him, any non-consenting working interest owner participating in the well under terms of this order shall have the right to pay his share of estimated well costs to the operator in lieu of paying his share of reasonable well costs out of production, and that any such owner who pays his share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges.

(7) That the operator shall furnish the Division and each known working interest owner an itemized schedule of actual well costs within 90 days following completion of the well; that 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 said schedule, the actual well costs shall be the reasonable well costs; provided however, that if there is an objection to actual well costs within said 45-day period the Division will determine reasonable well costs after public notice and hearing.

(8) That within 60 days following determination of reasonable well costs, any non-consenting working interest owner who has paid his share of estimated costs in advance as provided above shall pay to the operator his pro rata share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator his pro rata share of the amount that estimated well costs exceed reasonable well costs.

(9) That 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 estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.
- (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 estimated well costs within 30 days from the date the schedule of estimated well costs is furnished to him.

(10) That the operator shall distribute said costs and charges withheld from production to the parties who advanced the well costs.

(11) That \$4,000.00 per month while drilling and \$400.00 per month while producing are hereby fixed as reasonable charges for supervision (combined fixed rates); that the operator is hereby authorized to withhold from production the proportionate share of such supervision charges attributable to each non-consenting working interest, and in addition thereto, the operator is hereby authorized to withhold from production the proportionate share of actual expenditures required for operating such well, not in excess of what are reasonable, attributable to each non-consenting working interest.

(12) That any unsevered 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 the terms of this order.

(13) That 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.

(14) That all proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Eddy County, New Mexico, to be paid to the true owner thereof upon demand and proof of ownership; that 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.

-7-

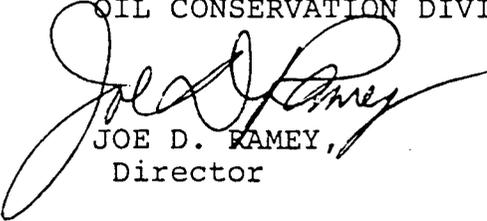
Case No. 7922

Order No. R-7335

(15) That 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



JOE D. RAMEY,
Director

S E A L

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

BOOK **104** PAGE **1165**

FORM APPROVED
OMB NO. 1004-0034
Expires: August 31, 1989

**TRANSFER OF OPERATING RIGHTS (SUBLEASE) IN A
LEASE FOR OIL AND GAS OR GEOTHERMAL RESOURCES**

Mineral Leasing Act of 1920 (30 U.S.C. 181 et seq.)
Act for Acquired Lands of 1947 (30 U.S.C. 351-359)
Geothermal Steam Act of 1970 (30 U.S.C. 1001-1025)
Department of the Interior Appropriations Act, Fiscal Year 1981 (42 U.S.C. 6508)

Lease Serial No.

NM-34647

Type or print plainly in ink and sign in ink.

PART A: TRANSFER

1. Transferee (Sublessee)* Sanders Petroleum Corporation
Street P.O. Box 2918
City, State, ZIP Code Roswell, New Mexico 88202

*If more than one transferee, check here and list the name(s) and address(es) of all additional transferees on the reverse of this form or on a separate attached sheet of paper.

This transfer is for: (Check one) Oil and Gas Lease, or Geothermal Lease

Interest conveyed: (Check one or both, as appropriate) Operating Rights (sublease) Overriding Royalty, payment out of production or other similar interests or payments

2. This transfer (sublease) conveys the following interest:

Land Description <small>Additional space on reverse, if needed. Do not submit documents or agreements other than this form; such documents or agreements shall only be referenced herein.</small>	Percent of Interest			Percent of Overriding Royalty or Similar Interests	
	Owned <small>b</small>	Conveyed <small>c</small>	Retained <small>d</small>	Reserved <small>e</small>	Previously reserved or conveyed <small>f</small>
Township 20 South, Range 24 East, NMPM Section 25: Lots 1, 2, 3, E/2 containing 446.50 acres more or less		10.0% ORRI			

RECEPTION
919656

FOR BLM USE ONLY—DO NOT WRITE BELOW THIS LINE

THE UNITED STATES OF AMERICA

This transfer is approved solely for administrative purposes. Approval does not warrant that either party to this transfer holds legal or equitable title to this lease.

Transfer approved effective _____

By MCKAY OIL CORP
PO Box 2014
ROSWELL NM (Authorized Officer)
88202

(Title)

(Date)

THIS ASSIGNMENT SHALL BE EFFECTIVE AS OF SEPTEMBER 1, 1991.

It is the intent of the Assignor to assign to Assignee 10% of 8/8th Overriding Royalty Interest in and to the Lease.

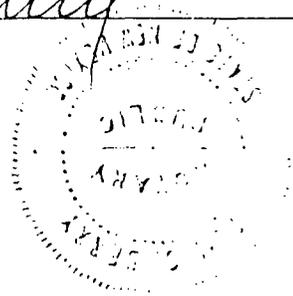
STATE OF NEW MEXICO)
) SS.
COUNTY OF CHAVES)

The foregoing instrument was acknowledged before me this 16th day of September, 1991, by Roy L. McKay, President of MCKAY OIL CORPORATION, a New Mexico Corporation, on behalf of said corporation.

My Commission Expires:

2/19/95

[Signature]
Notary Public



STATE OF NEW MEXICO)
) SS.
COUNTY OF CHAVES)

The foregoing instrument was acknowledged before me this 16th day of September, 1991, by Alden Forbau, Vice President of Sanders Petroleum Corporation, a New Mexico corporation, on behalf of said corporation.

My Commission Expires:

2/19/95

[Signature]
Notary Public



Executed this 16th day of September, 19 91

Name of Transferor McKay Oil Corporation
Please type or print

Transferor by: [Signature]
or Roy L. McKay, (Signature) President

Attorney-in-fact _____
(Signature)

P.O. Box 2014
(Transferor's Address)

Roswell, NM 88202
(City) (State) (Zip Code)

Executed this 16th day of September, 19 91

Sanders Petroleum Corporation

Transferee by: [Signature]
or Alden L. Forbau, (Signature) V. Pres.

Attorney-in-fact _____
(Signature)

Under U.S.C. Sec. 1001 makes it a crime for any person knowingly and willfully to make to any Department or agency of the United States any false, fictitious or fraudulent statements or representations as to any matter within its jurisdiction.

STATE OF NEW MEXICO, County of Eddy, ss. I hereby certify that this instrument was filed for record on the 17 day of September, A.D. 19 91 at 2:52 P. and duly recorded in BOOK 104 PAGE 1165 of the Eddy County Records.

KAREN DAVIS, County Clerk

By [Signature] Deputy

Form 3000-3a
(June 1988)

UNITED STATES
DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT

FORM APPROVED
OMB NO. 1004-0034
Expires: August 31, 1989

TRANSFER OF OPERATING RIGHTS (SUBLEASE) IN A
LEASE FOR OIL AND GAS OR GEOTHERMAL RESOURCES

Lease Serial No.

NM-34647

Mineral Leasing Act of 1920 (30 U.S.C. 181 et seq.)
Act for Acquired Lands of 1947 (30 U.S.C. 351-359)
Geothermal Steam Act of 1970 (30 U.S.C. 1001-1025)
Department of the Interior Appropriations Act, Fiscal Year 1981 (42 U.S.C. 6508)

Type or print plainly in ink and sign in ink.

PART A: TRANSFER

Transferee (Sublessee)*
Street
City, State, ZIP Code

Talent Energy Corporation
2323 Bryan, Lock Box 101
Dallas, Texas 75201

*If more than one transferee, check here and list the name(s) and address(es) of all additional transferees on the reverse of this form or on a separate attached sheet of paper.

This transfer is for: (Check one) Oil and Gas Lease, or Geothermal Lease

Interest conveyed: (Check one or both, as appropriate) Operating Rights (sublease) Overriding Royalty, payment out of production or other similar interests or payments

2. This transfer (sublease) conveys the following interest:

Land Description <small>Additional space on reverse, if needed. Do not submit documents or agreements other than this form; such documents or agreements shall only be referenced herein.</small>	Percent of Interest			Percent of Overriding Royalty or Similar Interests	
	Owned	Conveyed	Retained	Reserved	Previously reserved or conveyed
a	b	c	d	e	f
Township 20 South, Range 24 East, NMPM Section 25: Lots 1, 2, 3, E/2 containing 446.50 acres more or less		20.0%	ORRI		

RECEPTION
919655

FOR BLM USE ONLY—DO NOT WRITE BELOW THIS LINE

THE UNITED STATES OF AMERICA

This transfer is approved solely for administrative purposes. Approval does not warrant that either party to this transfer holds legal or equitable title to this lease.

Transfer approved effective _____

By McKay Oil Corp
PO Box 2014
Roswell NM (Authorized Officer)
88202

(Title)

(Date)

