MILLER, STRATVERT & TORGERSON, P.A.

LAW OFFICES

RANNE B. MILLER
ALAN C. TORGERSON
ALICE T. LORENZ
GREGORY W. CHASE
LYMAN G. SANDY
STEPHEN M. WILLIAMS
STEPHAN M. VIDMAR
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AMINA QUARGNALI-LINSLEY
JENNIFER D. HALL
MARY A. WOODWARD
JENNIFER L. OLSON
TODD A. SCHWARZ
JULIE A. COLEMAN

COUNSEL

PAUL W. ROBINSON
ROSS B. PERKAL
JAMES J. WIDLAND
BRADLEY D. TEPPER**
GARY RISLEY

OF COUNSEL

WILLIAM K. STRATVERT
JAMES B. COLLINS
RALPH WM. RICHARDS

ALBUQUERQUE, NM
500 MARQUETTE N.W., SUITE 1100
POST OFFICE BOX 25687
ALBUQUERQUE, NM 87125-0687
TELEPHONE: (505) 842-1950
(800) 424-7585
FACSIMILE: (505) 243-4408

SANTA FE, NM
150 WASHINGTON AVE., SUITE 300
POST OFFICE BOX 1986
SANTA FE, NM 87504-1986
TELEPHONE: (505) 989-9614
FACSIMILE: (505) 989-9857

FARMINGTON, NM
300 WEST ARRINGTON, SUITE 300
POST OFFICE BOX 869
FARMINGTON, NM 87499-0869
TELEPHONE: (505) 326-4521
FACSIMILE: (505) 325-5474

LAS CRUCES, NM
500 S. MAIN ST., SUITE 800
POST OFFICE BOX 1209
LAS CRUCES, NM 88004-1209
TELEPHONE: (505) 523-2481
FACSIMILE: (505) 526-2215

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* NEW MEXICO BOARD OF SPECIALIZATION RECOGNIZED SPECIALIST IN NATURAL RESOURCES - OIL & GAS LAW
** NEW MEXICO BOARD OF SPECIALIZATION RECOGNIZED SPECIALIST IN REAL ESTATE LAW

May 24, 2001

BY HAND-DELIVERY
Michael Stogner
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Application of McElvain Oil & Gas Properties, Inc. for Compulsory Pooling, Rio Aruba County, New Mexico; NMOCD # 12,635

Dear Mr. Stogner:

Enclosed is D.J. Simmons, Inc.s' Post Hearing-Memorandum in the above-referenced matter.

Sincerely,

MILLER, STRATVERT & TORGERSON, P.A.

Amanda Olsen, CLA

Amanda Olsen, CLA
Paralegal

Enclosure(s) – as stated
JSH/ao

cc: Michael Feldewert, Esq. (with enclosure)

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

IN THE MATTER OF THE APPLICATION
OF McELVAIN OIL & GAS PROPERTIES, INC.
FOR COMPULSORY POOLING,
RIO ARRIBA COUNTY, NEW MEXICO CASE NO. 12,635

D.J. SIMMONS, INC.'S POST-HEARING MEMORANDUM

D.J. Simmons, Inc., ("Simmons"), through its counsel, submits this memorandum of points and authorities following the May 17, 2001 Division Examiner hearing on the application for compulsory pooling filed by McElvain Oil and Gas Properties, Inc., ("McElvain").

INTRODUCTION

McElvain initiated this force pooling proceeding on November 10, 2000 when it issued its pro-forma well proposal to Simmons, followed by the filing of its Application for Compulsory Pooling on March 15, 2001 seeking to pool unjoined interests in the SE/4 of Section 25, T-25-N, R-3-W to create a 320 acre lay-down spacing unit for the re-entry and re-completion of its Naomi Com No. 1 well. McElvain's application is unnecessary because it already owns 100% of the oil and gas leases underlying the W/2 of Section 25, and is free to dedicate that acreage to its well located in the SW/4 of the section. McElvain proposes to re-complete its well in the Blanco-Mesaverde pool only. McElvain's proposal to ignore its pre-existing W/2 unit and instead initiate compulsory pooling proceedings to dedicate a S/2 unit to its well made little sense and was contra-indicated by the known geology and the prevailing north-south drainage patterns in the

area. Moreover, McElvain's proposal would preclude any further development and recovery of Gallup-Dakota reserves underlying the SE/4 of Section 15.

It was not until the hearing on May 17th that McElvain's motive was made clear: During cross-examination, McElvain's landman and engineer both admitted that the only reason they weren't dedicating their 100% owned W/2 unit to the well and were instead asking the Division to force-pool the SE/4 of the section for a S/2 unit was to require others to bear the costs of their operation. As was said during the hearing, McElvain is using the Division's compulsory pooling process as a tool for "mitigating its risk".

McElvain's invocation of the compulsory pooling statutes[1] for the purpose of mitigating its economic risk is an abusive and impermissible use of the Division's police powers. The Division should act to prevent such abuse by denying McElvain's application.

The application must be denied for the following additional reasons:

- McElvain failed to overcome the showing made by Simmons that waste would result if the application were granted pooling the SE/4 of Section 25.
- McElvain failed to prove that it would be denied an opportunity to drill (or re-enter and re-complete its well) if its application were not granted.
- McElvain failed to establish that it was being denied "the opportunity to produce [its] just and equitable share of the oil and gas"[2].
- McElvain failed to establish that granting its application was necessary to protect its correlative rights.

[1] N.M. Stat. Ann. (1978) §§ 70-2-17 and 70-2-18
[2] 70-2-17.A

- Finally, McElvain's effort to obtain the voluntary participation of Simmons were inadequate.

1. McElvain's Misuse Of The Compulsory Pooling Statute.

McElvain is seeking to use the compulsory pooling process for purposes that are not authorized by the applicable statutes.

Under questioning, McElvain's landman and engineering witnesses both acknowledged that McElvain owns 100% of the working interest underlying the W/2 of Section 25 and that there is nothing preventing the applicant from dedicating its W/2 acreage to its proposed re-entry and re-completion of the Naomi Com No. 1 well. McElvain's landman witness also acknowledged that by dedicating the 320 acre spacing and proration unit it already controls, it could have spared the parties and the Division the time, effort and expense precipitated by its forced-pooling application. Then, when asked to justify the need to force-pool the SE/4 of Section 25, McElvain's witnesses made an eyebrow-raising admission: Not just once, but several times, McElvain's witnesses testified that it was forcing the SE/4 into a 320 acre lay-down drilling unit in order to have other working interest owners bear a portion of the well costs and reduce McElvain's economic risk. In other words, by forsaking its pre-existing stand-up spacing unit and forcing the interest owners in the SE/4 of the section into a lay-down S/2 unit, McElvain was engaging in a risk-mitigation exercise: same well, same location, but at a fraction of the cost to it. According to McElvain's witnesses, this was the "primary" consideration for bringing its forced-pooling application.

Under cross-examination, McElvain's landman witness, while purporting to be familiar with the Division's compulsory pooling statutes, could point to no provision in those statutes that authorizes the Division to utilize risk mitigation as a basis for the forced-pooling of a third party's property interests. Indeed, no such provision exists, either express or implied, under even the broadest reading of the law.[3]

In Section 70-2-17 (C), the New Mexico Legislature has specified the circumstances where the Division is authorized to exercise its compulsory pooling powers. That authority is limited to the following circumstances:

- Where there are two or more separately owned tracts within a spacing unit;
- One of the owners who has a right to drill proposes to drill on the unit to a common source of supply;
- The separate owners have not agreed to pool their interests; and
- The Division finds pooling is necessary to:
- - avoid the drilling of unnecessary wells,
- - protect correlative rights, or
- - to prevent waste.

The mitigation of risk is not included within the enumerated circumstances where the compulsory pooling authority may be invoked. Moreover, the Division is constrained from reading such a provision into its authority. "The Oil Conservation [Division] is a creature of statute, expressly defined, limited and empowered by the laws creating it." *Continental Oil Co. v. Oil Conservation Commission*, 70 N.M. 310, 318, 373 P.2d 809, 817 (1962). McElvain's use of the Division's processes and the compulsory pooling

[3] The non-consent risk penalty provision of Section 70-2-17(C) is entirely separate and wholly inapplicable to a discussion of the basis and extent of the Division's authority to force pool working interests.

statutes as a means to reduce its economic risk is wholly outside the Divisions statutory authority. Risk mitigation is a complete misapplication of the law and should not be allowed. Were it to grant McElvain's application, the Division would be acting in excess of its clearly delineated authority.

We suggest that the Division put all operators on notice by way of specific findings in an order denying the McElvain application that the use of the compulsory pooling process for such unauthorized purposes is not permitted.

2. The Applicant Failed To Meet Its Burden Of Proof.

McElvain has approached this proceeding as if the granting of a compulsory pooling order were an entitlement.

As McElvain would have it, under the compulsory pooling statute, an operator need do nothing more than appear at a hearing and show (1) it has the right to drill, (2) that there are one or more interest owners in a spacing unit, (3) that the owners have not agreed to pool their interests, and (4) it made a well proposal to the other owners, as cursory as that effort might have been. Under McElvain's reading of the statute, the prevention of waste and the protection of correlative rights are secondary concerns and only conclusory, unsubstantiated testimony would be offered on those points. McElvain eschews any need to look beyond the Division's compulsory pooling authority under Section 70-2-17, calling the other provisions of the New Mexico Oil and Gas Act "irrelevant". However, the law directs that the Division apply all relevant statutes. The compulsory pooling statute cannot be read in isolation as McElvain suggests. ("Where two [or more] statutes are related to the same general subject matter, the court will

generally construe them *in pari materia* to give effect to each." *State v. Alvrado*, 1997-NMCA-027, 123 N.M. 187, 936 P.2d 869.) Under the particular circumstances of the case, the Division must also give effect to the statutory prohibition of waste under Section 70-2-11.

By adopting such an approach, McElvain has failed to sustain its burden of proof under Section 70-2-17, as well as under a number of other clearly relevant provisisions of the Oil and Gas Act.

A. The Waste Issue. First, McElvain failed to establish that the granting of its application would result in the prevention of waste. McElvain's petroleum engineering witness, in response to the standard format question from his counsel, stated only that "yes", waste would be prevented. No substantiating evidence was offered. This was not even a prima facie showing. Under cross-examination, the same witness admitted that McElvain sought only the dedication of the Blanco-Mesaverde pool to its well at its unorthodox location[4] and that there were no plans to develop the Gallup-Dakota reserves underlying the SE/4 of Section 25.

On the other hand, Simmons's expert geology and petroleum engineering witnesses provided substantial evidence establishing the existence of recoverable Gallup-Dakota reserves in the SE/4 that would go un-recovered unless Simmons or another operator had the ability to develop them in conjunction with a Blanco-Mesaverde dual completion. McElvain's forced-pooling of the SE/4 would preclude anyone from doing so. According to the evidence, without the economic support of Blanco-Mesaverde production from an E/2 proration unit, the development of Gallup-Dakota reserves alone

could not be justified with the result that approximately 388 MMcf gas and 14.2 MBO would be left in the ground. McElvain offered no evidence to rebut this showing made by Simmons.

Having established by a preponderance of the evidence, wholly unchallenged, that the forced-pooling of the SE/4 of Section 25 would in fact result in waste rather than prevent it, the denial of McElvain's application is mandated. (Section 70-2-11: "The [D]ivision is hereby empowered, and it is its duty, to prevent waste prohibited by this act...". *emphasis added.)* And, as the New Mexico Supreme Court has stated a number of times, "Prevention of waste is paramount[.]" *Grace v Oil Conservation Commission*, 87 N.M. 205, 212, 531 P.2d 939, 945 (1975).

Not only does McElvain's proposal to remove the Gallup-Dakota reserves in the SE/4 of the section from production result in waste, but it contravenes the Legislature's purpose in adopting the compulsory pooling statute "to encourage the exploration and development of oil and gas...". *Viking Petroleum v. Oil Conservation Commission*, 100 N.M. 451, 453, 672 P.2d 280, 282 (1983).

B. The Opportunity To Drill.

McElvain cannot claim that it will be denied the opportunity to drill, or in this case, re-complete, its well if its application is not granted. The evidence is undisputed that McElvain is free to dedicate its 100%-owned W/2 acreage to its well without the need to bring a compulsory pooling proceeding. Moreover, since the surface and the minerals of the W/2 are fee-owned, McElvain's permitting problems are eliminated.

[4] 1650' FSL and 450' FWL

C. The Opportunity To Produce.

McElvain presented zero evidence that it would be denied the opportunity to produce its just and equitable share of the oil and gas in the pool if its application is not granted. To the contrary, the evidence established that the Naomi Com No. 1 well, at its unorthodox location in the far southwest corner of the section, is not well situated to recover reserves from a S/2 unit. Instead, the preponderance of the geologic and reservoir engineering testimony established that with the prevailing north-south fracture drainage patterns in the area, the well will more efficiently drain reserves from the NW/4 and SW/4. Drainage of the SE/4 by McElvain's well, situated just 450 feet off the west line of the section, is not realistic.

McElvain presented nothing to rebut this evidence. Moreover, its land witness acknowledged that McElvain had a number of other Blanco-Mesavere wells in the area, dedicated to either lay-down or stand-up units, proving that geology and drainage are secondary concerns to it.

D. The Correlative Rights Issue.

Again, in response to the stock question, McElvain's petroleum engineering witness said only that "yes", the granting of the application was necessary to protect correlative rights, but offered no other substantiation for his conclusory statement. There is no drainage by an offsetting well that requires McElvain to dedicate a S/2 unit to its Naomi Com No. 1 well, and as explained above, McElvain presented no proof that it would be prevented from producing its just and equitable share of oil or gas in the pool if its application were denied.

E. The Voluntary Agreement Issue.

Under Section 70-2-18 (A), an operator proposing to dedicate separately-owned lands to a proration unit has an "obligation" to negotiate a voluntary agreement with the other interest owners to pool their lands. The Division has always required operators to show that they have made a "good faith" effort to negotiate a voluntary agreement before a compulsory pooling application may be filed.

Here, McElvain made only a token, cursory effort to obtain Simmons's participation in its re-completion proposal. On November 10, 2000, McElvain sent a bare-bones proposal to Simmons, but failed to include either a drilling and completion procedure or an AFE, which is a standard part of any proposal. After its November 10th letter, McElvain initiated no further contacts before filing its compulsory pooling application on March 15, 2001. All other contacts were initiated by D.J. Simmons's staff, primarily for the purposes of obtaining specific geologic, engineering and cost information, as well as some justification for a S/2 unit. It was not until the evening before the hearing on its application that McElvain's landman made any effort to initiate a discussion on her own.

These efforts fall far short of the standards that the industry and the Division expect an operator to meet when negotiating for an interest owner's voluntary participation in a well proposal. McElvain's inadequate effort in this regard is an additional reason justifying the denial of its application.

CONCLUSION

McElvain failed to establish by a preponderance of the evidence a number of the statutory pre-conditions to the granting of a compulsory pooling order. Moreover, the evidence establishes that granting the relief McElvain requests will, in fact, result in the waste of this state's resources. These grounds, alone, mandate the denial of McElvain's application. Of greater concern, however, is the admitted attempt by McElvain to utilize the compulsory pooling process as a means to reduce its costs and mitigate its economic risk. It is a disturbing abuse of the agency's compulsory pooling authority that the Division should go out of its way to discourage. For all these reasons, the application should be denied.

Respectfully submitted,

MILLER, STRATVERT & TORGERSON, P.A.

By J. Scott Hall

J. Scott Hall
Attorneys for D. J. Simmons, Inc.
Post Office Box 1986
Santa Fe, New Mexico 87504-1986
(505) 989-9614

Certificate of Mailing

I hereby certify that a true and correct copy of the foregoing was mailed to counsel of record on the 24 day of May, 2001, as follows:

Michael Feldewert, Esq.
P.O. Box 2208
Santa Fe, New Mexico 87504

J. Scott Hall

J. Scott Hall