JAMES BRUCE
ATTORNEY AT LAW

POST OFFICE BOX 1056
SANTA FE, NEW MEXICO 87504

3304 CAMINO LISA
HYDE PARK ESTATES
SANTA FE, NEW MEXICO 87501

(505) 982-2043
(505) 982-2151 (FAX)

August 18, 2001

Via Fax and U.S. Mail

David Brooks
Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12674 (Concho/Devon)

Dear Mr. Brooks:

Enclosed is the memorandum you requested in the above case.

Very truly yours,

James Bruce

Attorney for Devon Energy
Production Company, L.P.

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:

APPLICATION OF CONCHO RESOURCES, INC. FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO. **Case No. 12674**

MEMORANDUM

This memorandum is submitted by applicant as permitted by the Division. **Concho Resources, Inc. ("Concho"), the original applicant, has merged into Devon Energy Production Company, L.P ("Devon").**

I. FACTS.

A. General Information: Devon seeks an order pooling the S½ of Section 32, Township 18 South, Range 24 East, NMPM, from the surface to the top 200 feet of the Mississippian formation, for all pools or formations spaced on 320 acres (including the Antelope Sink-Morrow Gas Pool), and the SW¼ of Section 32 for pools or formations spaced on 160 acres. The units are dedicated to the Southern Cross St. Com. Well No. 1, located 1750 feet from the south line and 1980 feet from the west line of the section. The well was spudded on May 13, 2001, and was completed as a producing Morrow well on June 6, 2001. **Because the well has been drilled and completed, Devon does not seek a risk charge against the non-consenting interest owner.**

B. Ownership of the Well Unit: The S½ of Section 32 is comprised of two separate tracts of land: The N½S½ of Section 32

is covered by State Lease V-4972, and the S½S½ of Section 32 is a fee tract covered by numerous leases. Mineral interest ownership is undivided in each tract. The oil and gas leases are owned by Devon, Yates Petroleum Corporation, and other entities. All other lessees have signed an operating agreement, and have either participated in the well or gone non-consent under the agreement.

There is one non-consenting interest in the well unit, being the 7.5% undivided mineral interest in the S½S½ of Section 32 owned by Virginia Collier Howell of Beaumont, Texas.

C. Pooling Timeline: Concho originally started putting together the well unit about a year ago. It had a title opinion prepared, which showed Mrs. Howell's unleased mineral interest, which she acquired by a deed executed in the early 1950s. An independent landman tried to track down Mrs. Howell, and gave Concho an incorrect Virginia address for her. The correct Mrs. Howell was subsequently located, and she was contacted in late March or early April to see if she would lease her interest. The sequence of events since then is as follows:

(1) Concho mailed a letter to Mrs. Howell on April 5, 2001, which enclosed title data and a proposed lease form. No response was received by Concho.

(2) On April 20, 2001 a proposal letter with an AFE was mailed by Concho to Mrs. Howell.[1]

(Both the April 5th and April 20th letters were also mailed to Robert Wade, the attorney for Mrs. Howell.)

---

[1]At that time, it was thought that her children (Charles A. Howell, Jr. and Caroline Howell Lee) may have acquired an interest in the S½S½ of Section 32 due to the death of Mrs. Howell's spouse, and they were also sent proposal letters. It was later determined that only Mrs. Howell owns the interest.

(3) Concho received a letter dated May 2, 2001 from Robert Wade, requesting title data and geologic data. Mr. Wade also verbally requested Concho to pay him $2000 to prepare a lease form.

(4) Due to rig scheduling problems, a pooling application was filed on May 3, 2001. Concho hoped to accomplished pooling promptly, but was willing to carry Mrs. Howell in the well.

(5) The letter giving notice of the pooling application was received by both Mrs. Howell and Robert Wade on May 7, 2001. Mr. Wade then called Concho's attorney and asked for geologic data and a continuance of the hearing. He also asked that no further contact be made with Mrs. Howell; that all contact was to be with him.

(6) By letter to Mr. Wade dated May 7, 2001, Concho agreed to show its geologic data to Mrs. Howell or her representative. Concho's letter asked Mr. Wade to provide a lease form for review if Mrs. Howell was interested in leasing her interest, and enclosed an operating agreement if she wished to participate in the well. Mrs. Howell never provided a lease form for review, nor did she sign the operating agreement.

(7) Concho's attorney received a letter from Mr. Wade on May 30, 2001, stating that Mrs. Howell had leased her interest, and asking if Concho would be interested in acquiring the lease for $2000 (the same fee previously requested) and a 2% overriding royalty. Concho continued the pooling hearing, scheduled for May 31, 2001, in order to review the lease.

(8) Concho wrote to Mr. Wade on June 6,2001 requesting a copy of the lease. On about June 20, 2001, Concho's attorney called Mr. Wade, and finally the lease was faxed to Concho.

(9) The Concho-Devon merger occurred in late June 2001, and this case was continued until August 9, 2001.

The lease obtained from Mr. Wade is dated May 14, 2001, and is from Mrs. Howell, by her alleged attorney-in-fact, to Rhinoceros Ventures Group, Inc. ("Rhinoceros") of Beaumont, Texas. The lease is dated <u>after</u> the pooling application was filed, and <u>after</u> the pooling notice was received by Mrs. Howell and Mr. Wade. Devon's

witness testified that Devon will not accept an assignment of this lease because of its extremely onerous terms and the uneconomic cost to Devon of monitoring compliance with the lease's provisions.

Devon also contacted the Texas Secretary of State, and was informed that Robert Wade is the secretary, a director, and the registered agent of Rhinoceros. In addition, a woman named Annette Hall Wade is the president and a director of the corporation.

II. ARGUMENT.

A. Devon's Request to the Division: Devon requests that the Division either (1) hold that the interest force pooled by Devon is Mrs. Howell's unleased mineral interest, or (2) hold that the Rhinoceros lease is not effective until payout is reached under the terms of the pooling order.

B. Statutory Authority: The Division has the authority to pool interest owners in a well unit where they have not voluntarily agreed to do so:

> ... Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing and proration unit as a unit.
>
> All orders effecting such pooling shall be made after notice and hearing, and shall be **upon such terms and conditions as are just and reasonable** and will afford 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 or gas, or both. ...

NMSA 1978 §70-2-17.C (emphasis added).

C. Argument: (1) The interest being force pooled should be considered unleased, because Mrs. Howell's interest was unleased (i) at the time the pooling application was filed, and (ii) at the time the notice letters were received by Mrs. Howell and her attorney. At some point, the interests of the parties to a pooling application must become fixed to prevent subsequent acts by a party being pooled which may detrimentally affect the drilling of a well. Devon suggests that the time when interests being pooled become fixed must be no later than the date a pooling application is filed.

Devon, as operator, is under an obligation to negotiate in good faith with interest owners in a well unit to obtain their voluntary joinder in the well. A similar good faith obligation must apply to the non-consenting interest owner(s). In the present case, the testimony is clear that Mrs. Howell and her attorney refused to negotiate with Concho in good faith, and unilaterally sought to impose an unreasonable lease form on Devon. The Division has other cases pending where, during the pooling process, a non-consenting interest owner created an unusually large overriding royalty, which could adversely affect well economics. These acts are designed to thwart the pooling process, which the Division should not allow. The pooling statutes are designed to encourage, not discourage, the drilling of wells.

In effect, Devon is asking that the order entered herein be made retroactive to the date the pooling application was filed. Retroactive dating of an order is permissible. **Roberts v. Funk**

Exploration, Inc., 764 P.2d 147 (Okla. 1988); **Hair v. Corporation Comm'n**, 740 P.2d 134 (Okla. 1987). Both the Roberts and Hair decisions upheld Corporation Commission orders made retroactive to the date a spacing[2] application was filed. Similar relief should be granted in the present case to avoid the inequitable effects of the Rhinoceros lease.

(2) In the alternative, the Rhinoceros[3] lease should not be deemed effective until payout is reached under the terms of the pooling order issued herein, and Devon has recouped the share of well costs attributable to Mrs. Howell's mineral interest. The revenues attributable to Mrs. Howell's interest, if the lease is effective, are as follows:

(a) 7.5% x 160/320 = 3.75%. (This is Mrs. Howell's/ Rhinoceros' working interest in the Southern Cross St. Com. Well No. 1.)

(b) 3.75% x 75% = 2.8125%. (This is Rhinoceros' net revenue interest in the well unit, with a 25% royalty.)

(c) Assuming the gross value of production is $500,000 per year, the net annual revenue attributable to Devon on the non-consent interest is $500,000 x 2.8125% = $14,062.50. Of course, over time revenues will decrease.

---

[2]In Oklahoma, a spacing order has the effect of pooling interest owners, and thus is equivalent to a pooling order in New Mexico.

[3]Rhinoceros will be pooled by the Division's order because proper notice was given to Mrs. Howell, the record owner at the time the pooling application was filed. See the Division's Brando/Mitchell decision. In addition, Mr. Wade, the registered agent of Rhinoceros, received notice of the application.

As Devon's witness testified, Devon would be required to assign an employee solely to monitor compliance with lease terms. The cost of such employee will exceed the share of production proceeds allocated to the interest being pooled.

The pooling statute provides that the operator of the well shall be entitled to the share of production from the well attributable to the non-consent interest "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." **NMSA 1978 §70-2-17.C.** If the Rhinoceros lease is effective before payout of the well, Devon may never recover the share of drilling and operating costs attributable to the Mrs. Howell's interest. In fact, it may lose money.

The alternative request is fair because, once payout is reached, Rhinoceros can be compelled to take and market its share of oil and gas from the well and pay royalties thereon according to the terms of the lease it "negotiated." Devon will not be burdened with the leasehold obligations.

III. CONCLUSION.

Either request by Devon is just and reasonable, as required by statute. In addition, either request will allow Devon to recover its share of proceeds without unnecessary expense, as required by statute. The Division has broad authority under the Oil and Gas Act to prevent waste and protect correlative rights. **Santa Fe Exploration Co. v. Oil conservation Comm'n, 114 N.M. 103, 835 P.2d 819 (1992).** It should exercise that authority in this matter to

cure the problems caused solely by the party being pooled.

Respectfully submitted,

James Bruce
Post Office Box 1056
Santa Fe, New Mexico 87504
(505) 982-2043

Attorney for Devon Energy Production Company, L.P.