Jason Kellahin
W. Thomas Kellahin
Karen Aubrey

KELLAHIN and KELLAHIN
Attorneys at Law
El Patio - 117 North Guadalupe
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

Telephone 982-4285
Area Code 505

May 19, 1986

HAND-DELIVERED

RECEIVED
MAY 19 1986
OIL CONSERVATION DIVISION

Jeff Taylor, Esq.
Oil Conservation Division
Post Office Box 2088
Santa Fe, New Mexico 87504-2088

Re: Case 8897
Application of Mesa Grande Resources

Dear Mr. Taylor:

This letter will confirm my understanding of the time period in which we may brief the legal issues raised in the above case. It is my understanding that the brief to be filed by Chevron, USA is due May 28, 1986, and that Mesa Grande Resources has ten (10) days in which to reply to that brief. If this is not your understanding, please let me know.

Sincerely,

Karen Aubrey

Karen Aubrey
KA:mh
cc: Scott Hall, Esq.
Campbell & Black
Post Office Box 2208
Santa Fe, New Mexico 87504-2208

Mark Costello
Chevron, USA
Post Office Box 1635
Houston, Texas 77251

CAMPBELL & BLACK, P.A.
LAWYERS

JACK M. CAMPBELL
BRUCE D. BLACK
MICHAEL B. CAMPBELL
WILLIAM F. CARR
BRADFORD C. BERGE
J. SCOTT HALL
PETER N. IVES
JOHN H. BEMIS

GUADALUPE PLACE
SUITE I - IIO NORTH GUADALUPE
POST OFFICE BOX 2208
SANTA FE, NEW MEXICO 87504-2208
TELEPHONE: (505) 988-4421
TELECOPIER: (505) 983-6043

April 24, 1986

HAND DELIVERED

Case 8897

R. L. Stamets, Director
Oil Conservation Division
New Mexico Department of
Energy and Minerals
State Land Office Building
Santa Fe, New Mexico 87501

Re: Application of Mesa Grande Resources, Inc. for Compulsory Pooling, Rio Arriba, New Mexico.

Dear Mr. Stamets:

Enclosed in triplicate is the Application of Mesa Grande Resources, Inc. in the above-referenced case. Mesa Grande Resources respectfully requests that this matter be placed on the docket for the Examiner hearings scheduled on May 16, 1986.

Very truly yours,

William F. Carr

WFC/cv
enclosures

cc: (w/enclosure)
Ms. Kathy Michael
Mesa Grande Resources, Inc.

KELLAHIN and KELLAHIN
Attorneys at Law
El Patio - 117 North Guadalupe
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

Jason Kellahin
W. Thomas Kellahin
Karen Aubrey

Telephone 982-4285
Area Code 505

May 28, 1986

Hand-Delivered

Mr. David Catanach
Examiner
Oil Conservation Division
Post Office Box 2088
Santa Fe, New Mexico 87504-2088

Re: APPLICATION OF MESA GRANDE RESOURCES FOR COMPULSORY POOLING, RIO ARRIBA COUNTY, NEW MEXICO
CASE NO. 8897
ORDER NO. R-_____

Dear Mr. Catanach:

We have prepared, and enclose, a proposed order for the Division's consideration in the above matter. As you recall, in this case the applicant, Mesa Grande Resources seeks to pool the interests of Chevron, USA, in the SE/4 of Sec. 5, T25N, R2W. As you will also recall, the well to be dedicated to this acreage has been drilled and completed, at least to the extent that surface and production casing have been set and cemented. Because of the Division's ruling on the evidentiary issues of relevancy of the completion data, we do not know what additional completion procedures have been performed on the well.

In our opinion, the issue which the Division needs to decide is whether or not any risk factor should be awarded to Mesa Grande Resources in connection with the drilling of this well. As you will recall, the testimony shows that the well was spudded on March 28, 1986. As your file will show, the application to pool Chevron's interests was not filed until April 24, 1986. My examination of previous Commission Orders reveals that the long-standing position of the New Mexico Oil Conservation Division has been that an operator who drills a well without first pooling all working interest owners takes the risks of receiving no penalty at all. As we discussed on May 14, 1986,

the 200% penalty provided for in N.M.S.A. 70-2-17 is the statutory maximum, and is certainly not required in every case. Williams and Meyers, in their treatise, Oil and Gas Law, recognize that the maximum penalty need not be imposed. In their discussion at Sec. 905.2, they quote from an address by Daniel S. Nutter, then Chief Engineer of the NMOCD as follows:

> While it may sound somewhat inconsistent that no risk be assessed if the non-consentor chooses to pay in advance, we believe that for the good of all concerned it is a logical solution. The well has been drilled and is presumed to be productive. The one risk remaining is whether it will be sufficiently productive to pay out the cost of completion. This risk is judged by the Commission in terms of known reserves in the area, productivity of offsetting wells, current and expected demand as related to anticipated income from the well, and the time necessary to obtain a pay out.
>
> It is my personal belief that the legislature, in fixing the 50% maximum risk factor, was contemplating that this be the extreme case where considerable risk is involved, and that the factor be reduced considerably for a well drilled in a proven area where chances of obtaining production are good. To my knowledge, under the new statute, there has never been a risk factor in excess of 25% assessed against a non-consentor.

I have briefly researched the files of the Oil Conservation Division and have discovered four (4) orders in which the Division either denied the penalty entirely or imposed a minimum penalty of 50% where the subject well had been drilled prior to the force pooling application.

Those are Orders No. R-5452; R-5286; R-5773 and R-6946. I would expect that there would be additional orders that I have not found.

I particularly call your attention to Order No. R-5773. The determination of the Examiner in that case is not readily apparent from the order. That case was an application by Read & Stevens, Inc., for compulsory pooling of a well which had already been completed. A Motion to Dismiss was made by the A. L. Hill Trust, on the grounds that the Hill Trust had tendered an amount of money which represented their proportionate share of the estimated well costs. Read & Stevens responded that the case could not be dismissed because the Commission had not made a decision as to the amount of the risk penalty which applied to the case. The Examiner, R. L. Stamets, granted the Motion to Dismiss for the reason that the "long term policies of the Commission and Division on compulsory pooling leaves me with no alternative but to dismiss this case." (Transcript of Hearing at page 48). As we discussed on May 14, 1986, Chevron USA has no objection to being pooled in this well, but strongly asserts that **no risk factor should be imposed for the benefit of an operator who chooses to drill and complete his well prior to obtaining the Commission's order granting the pooling of the acreage.**

We believe it is fair and appropriate that where an operator takes the risk of drilling a well without regard to the correlative rights of the working interest owners in the unit which would need to be dedicated to that well, and that where the operator completes the well without problems, and where no economic information is given to the Examiner, the

only result the Examiner can reach is that there should be no penalty imposed.

If we may provide you with additional information, please let us know.

Sincerely,

Karen Aubrey

Karen Aubrey
KA:mh
Enclosures

cc: Scott Hall, Esq. (w/enc.)
Campbell & Black
Post Office Box 2208
Santa Fe, New Mexico 87504-2208

Mark Costello (w/enc.)
Chevron, USA

CAMPBELL & BLACK, P.A.
LAWYERS

JACK M. CAMPBELL
BRUCE D. BLACK
MICHAEL B. CAMPBELL
WILLIAM F. CARR
BRADFORD C. BERGE
J. SCOTT HALL
PETER N. IVES
JOHN H. BEMIS

GUADALUPE PLACE
SUITE 1 - 110 NORTH GUADALUPE
POST OFFICE BOX 2208
SANTA FE, NEW MEXICO 87504-2208
TELEPHONE: (505) 988-4421
TELECOPIER: (505) 983-6043

June 9, 1986

HAND DELIVERED

Mr. David Catanach
Hearing Examiner
Oil Conservation Division
New Mexico Department of
Energy and Minerals
State Land Office Building
Santa Fe, New Mexico 87501

Re: Case No. 8897: Application of Mesa Grande Resources, Inc. for Compulsory Pooling, Rio Arriba County, New Mexico.

Dear Mr. Catanach:

Pursuant to your request, please find enclosed Mesa Grande's Memorandum Brief and proposed Order in the above-referenced case.

Thank you for your consideration.

Very truly yours,

J. Scott Hall

JSH/cv
enclosures

cc: Karen Aubrey, Esq.
(w/enclosures)

BEFORE THE
OIL CONSERVATION DIVISION
NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION
OF MESA GRANDE RESOURCES, INC.,
FOR COMPULSORY POOLING, RIO
ARRIBA COUNTY, NEW MEXICO. Case No. 8897

APPLICANT'S MEMORANDUM BRIEF

On April 24, 1986, Mesa Grande Resource, Inc. submitted its application for an order pooling all of the mineral interests in the Pictured Cliffs Formation located in the SE/4 of Section 5, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico. Pursuant to a hearing held on the application on May 14, 1986, evidence in the record will show the following:

- On February 14, 1986, Mesa Grande sent to Chevron a proposal to drill the subject well (then proposed as a Gallup completion). An AFE accompanied the proposal. At that time, Chevron was made aware of the impending expiration date for the lease covering the subject lands (April 1, 1986).
- After the completion interval was changed to the Pictured Cliffs Formation, Mesa Grande again afforded Chevron the opportunity to voluntarily participate in the well on March 14, 1986.
- Following several intervening attempts to negotiate voluntary participation, Chevron

verbally advised Mesa Grande that it would not consent to participate in the well.

- On March 28, 1986, Chevron advised Mesa Grande in writing that it would not voluntarily participate in the well.
- The subject well was spudded on March 28, 1986, but has not yet made first production.
- After the spudding of the well, several additional attempts to obtain voluntary participation failed.
- On May 5, 1986, Mesa Grande once again extended Chevron an opportunity to voluntarily participate in the well according to the terms of the standard Operating Agreement and AFE previously made available to Chevron.
- Chevron did not reply to the May 5, 1986 offer.
- Chevron does not oppose the pooling of its interests.
- Chevron asserts that the imposition of the standard risk penalty is improper under these facts.
- Chevron was afforded an opportunity to voluntarily participate in the well and pay its proportionate share of costs under reasonable terms by industry standards.
- Chevron made an affirmative election not to

pay its proportionate share of costs in advance of drilling.

- Chevron elected to bear none of the risks in the drilling of the subject well.
- Mesa Grande was obliged to assume 100% of the risk involved that was otherwise attributable to Chevron's share.
- The imposition of a charge for the risk involved in the drilling of the subject well at the rate of 200% of Chevron's non-consenting proportionate share of the cost of drilling and completing the well is appropriate.
- Chevron has failed to adduce any countervailing evidence that the imposition of a 200% risk penalty is not appropriate.

Sections 70-2-17 and 70-2-18 of the New Mexico Oil and Gas Act set out the procedures to be followed and elements to be found when pooling mineral interests: (1) There must be two or more separately owned tracts within a proration unit that is the subject of the pooling application; (2) the pooling party must have made a legitimate effort to obtain the voluntary joinder of the otherwise non-consenting party; (3) the pooling party and the party owning the unjoined interest have not reached agreement for the voluntary contribution of the pooled interest; (4) that each interest owner is afforded an opportunity to produce or receive his just and fair share of production without unnecessary

expense; and (5) where it is found that the owner of the non-participating interest has elected not to pay his proportionate share of expenses, then the Division is free to impose a charge for the risk involved in the drilling of the well according to the evidence presented to it.

Chevron's argument opposing the imposition of the customary risk penalty is premised on the fact that the subject well was spudded prior to the hearing on Mesa Grande's pooling application. Chevron contends that an operator who drills a well without first pooling all working interest owners may not receive any proceeds for assuming the risks. The logic of such an argument escapes us. Indeed, a review of the applicable statutes (§§70-2-17 and 70-2-18, supra) evidences no such limitation. If Chevron's reading of the operation of the pooling statutes were allowed to become a reality, then any recalcitrant mineral interest owner would be allowed to take advantage of a situation where, for instance, an operator faced with a drilling deadline commenced his well before receiving a pooling order, thus allowing the unjoined party to take a "free ride" down the hole before deciding whether to participate. In such a situation, the unjoined mineral interest owner would be allowed to completely circumvent the risk that is normally attendant in the oil and gas business.

If operators who have assumed the risk in commencing a well cannot expect to receive some compensation for that risk simply because the pooled interest owner has ignored efforts to secure its voluntary joinder, then the operator will be chilled in the

exercise of its rights to drill the tract. In effect, drilling will be deterred. As a consequence, the correlative rights of the operator and the other interest owners who have voluntarily contributed their acreage and share of costs are impaired. It is likely to develop that because of such a circumstance, proposed prospects will go undrilled and waste will result. Such an operation of the pooling and risk penalty provisions of the Oil and Gas Act is directly opposed to the policy articulated by the New Mexico Legislature that correlative rights be protected and waste prevented.

Mesa Grande believes that the compulsory pooling statutes seek to encourage negotiations for the voluntary pooling of interests. The evidence in this case certainly supports a finding that Mesa Grande made a good faith and reasonable effort to secure Chevron's voluntary participation. However, when it became clear that Chevron was electing not to pay its share of costs then by deciding to proceed with the spudding of the well, Mesa Grande was then locked into the assumption of risk at that point in time. Although somewhat different in operation, the Texas Mineral Interest Pooling Act is analagous. (Tex. Nat. Res. Code Ann. §102.013.) The Texas Pooling Act requires the pooling applicant to make a "fair and reasonable offer" before pooling. What constitutes a "fair and reasonable" effort to secure voluntary joinder is determined by taking into consideration those relevant facts existing at the time of the offer. (See, Carson v. Railroad Commission of Texas, 669 S.W.2d 315 [Tex. 1984]).

"In essence, risk is assessed and assumed at the time of the offer based upon the facts then available. The pooled party may not ride the well down in order to garner information about the well in addition to that existing at the time the offer is made. To allow otherwise is to permit an election ex post facto while avoiding the risk as it was known before the well was commenced.

The Division, by analogy, may also look to the Oklahoma pooling statutes. (52 OSA 1971, §81, et seq.). In a pooling case similar to that here, a mineral owner did not indicate its willingness to participate in a well and likewise failed to pay its proportionate share of costs. (Buttram Energies, Inc. v. Corporation Commission, 629 P.2d 1252 [Okla. 1981]). There, the pooled interest owners sought to avoid having its ownership interest reduced under the pooling act after the commercially successful well was completed. The Oklahoma Supreme Court was highly critical of the non-consenting party and commented:

> Mineral interest owners in this case chose to do nothing until an obvious producer was on the horizon and to me this amounts to an estoppel by laches, or perhaps even a violation of the clean hands doctrine. In any event the mineral owner has no right to demand a "free ride" to production without the assumption of risks of development. Id.

Chevron has cited four instances of pooling orders issued by the OCD where risk penalties were deleted or limited to 50% where wells had been drilled prior to the issuance of the order. Without specific citation, it is well known to the Division that several cases exist where risk penalties of 200% have been imposed on non-participating interests where the orders were issued after the wells had been spudded. This instance of a

drilling deadline occurring before the issuance of a pooling order is certainly not unique.

Chevron also seeks to escape the imposition of a risk penalty by stating "... no economic information was given to the Examiner ...". Chevron's statement is incorrect. At hearing, Mesa Grande presented sufficient evidence, both technical and economic, to support the imposition of a 200% risk penalty. Conversely, Chevron adduced absolutely no evidence at all establishing the lack of risk in drilling the subject well. To enter an order for anything other than a 200% risk penalty when the record contains no evidence that such an amount is not proper would be error.

Finally, in support of its contention that the risk penalty should, at most, be limited to 50%, Chevron cites comments of Daniel S. Nutter from the Williams & Myers Oil and Gas Law treatise. In this regard, we would point out to the Division that Mr. Nutter's comments were made in 1962 and are over 24 years old. Those comments were made when the oil and gas industry operated in a completely different economic environment. Moreover, we would point out that at the time Mr. Nutter's comments were made, a 50% risk penalty was the maximum available under the terms of the pooling statute in effect in 1962. In 1973, the New Mexico Legislature increased the statutory risk penalty to 200%.

In conclusion, Mesa Grande Resources, Inc. submits that based upon the evidence in the record and the operation of the pooling statutes, a 200% risk penalty is required. Any other

conclusion will result in a frustration of those policies contemplated in the New Mexico Oil and Gas Act.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By _____
J. Scott Hall
Post Office Box 2208
Santa Fe, New Mexico 87501
(505) 988-4421

ATTORNEYS FOR APPLICANT
MESA GRANDE RESOURCES, INC.

CERTIFICATE OF MAILING

The undersigned hereby certifies that he caused to be mailed a true and correct copy of the foregoing to Karen Aubrey, Esquire, at Post Office Box 2265, Santa Fe, New Mexico 87504-2265, by First Class United States Mail, postage prepaid, on this 9th day of June, 1986.

_____

BEFORE THE
OIL CONSERVATION DIVISION
NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION
OF MESA GRANDE RESOURCES, INC. FOR
COMPULSORY POOLING, RIO ARRIBA COUNTY,
NEW MEXICO.

Case No. 8897
Order R-

ORDER OF THE DIVISION

BY THE DIVISION:

This cause came on for hearing at 8:15 a.m. on May 14, 1986, at Santa Fe, New Mexico, before Examiner David Catanach.

NOW, on this ____ day of _____, 1986, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner, and being fully advised in the premises,

FINDS THAT:

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

(2) The applicant, Mesa Grande Resources, Inc., seeks an order pooling all mineral interests in the undesignated Gavilan-Pictured Cliffs Pool underlying the SE/4 of Section 5, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico.

(3) The applicant has the right to drill and proposes to drill a well at a standard location on the proration unit.

(4) There are interest owners in the proration unit who have not agreed to pool their interests and who have made an affirmative election not to participate in their share of costs.

(5) To avoid the drilling of unnecessary wells, to protect correlative rights, to prevent waste, 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 oil in any pool completion resulting from this order, the subject application should be approved by pooling all mineral interests, whatever they may be, within said unit.

(6) The applicant should be designated the operator of the subject well and unit.

(7) 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.

(8) 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% thereof as a reasonable charge for the risk involved in the drilling of the well.

(9) 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.

(10) 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.

(11) $3,150.00 per month while drilling and $300.00 per month while producing should be fixed as reasonable charges for supervision (combined fixed rates); 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.

(12) 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.

IT IS THEREFORE ORDERED THAT:

(1) All mineral interests, whatever they may be in the undesignated Gavilan-Pictured Cliffs Pool underlying the SE/4 of Section 5, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, are hereby pooled to form a standard 160-acre gas spacing and proration unit to be dedicated to applicant's Guardian No. 1 Well, drilled at a standard location thereon.

(2) Mesa Grande Resources, Inc. is hereby designated the operator of the subject well and unit.

(3) Within thirty days after the effective date of this

order, the operator shall furnish the Division and each working interest owner in the subject unit, an itemized schedule of actual well costs.

(4) Within thirty days from the date the schedule of actual well costs is furnished to him, any non-consenting working interest owner shall have the right to pay his share of actual well costs to the operator in lieu of paying his share of reasonable well costs out of production.

(5) Any non-consenting working interest owner may, at least 45 days after receiving the schedule of actual well costs, but not more than 90 days after such receipt, file with the Division an objection to said well costs; if no objection to actual well costs is received by the Division and the Division has not objected within the period from at least 45 days to within 90 days following the receipt of said schedule, the actual well costs shall be reasonable well costs; provided, however, that if there is an objection to actual well costs within the aforesaid 45 to 90-day period, the Division will determine reasonable well costs after public notice and hearing.

(6) The operator is hereby authorized to withhold the following costs and charges from production:

A. The prorata share of reasonable well costs attributable to each non-consenting working interest owner who has not paid his share of well costs.

B. As a charge for the risk involved in the drilling of the well, 200% of the prorata share of well costs attributable to each non-consenting working interest owner who has not paid his share of well costs.

(7) $3,150.00 per month while drilling and $300.00 per month while producing, are hereby fixed as reasonable charges for supervision (combined fixed rates); 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.

(8) Any unsevered mineral interest shall be considered a 7/8ths working interest and a 1/8th royalty interest for the purpose of allocating costs and charges under the terms of this order.

(9) Any well costs or charges which are to be paid out of production shall be withheld only from the working interest share of production, and no costs or charges shall be withheld from

production attributable to royalty interests.

(10) All proceeds from production from the subject well which are not disbursed for any reason shall immediately be placed in escrow in Rio Arriba 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 said escrow agent within 90 days from the date of this order.

(11) 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

Richard L. Stamets
Director

S E A L

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

TONEY ANAYA
GOVERNOR

July 10, 1986

POST OFFICE BOX 2088
STATE LAND OFFICE BUILDING
SANTA FE, NEW MEXICO 87501
(505) 827-5800

Mr. Scott Hall
Campbell & Black
Attorneys at Law
Post Office Box 2208
Santa Fe, New Mexico

Re: CASE NO. 8897
ORDER NO. R-8245

Applicant:

Mesa Grande Resources, Inc.

Dear Sir:

Enclosed herewith are two copies of the above-referenced Division order recently entered in the subject case.

Sincerely,

R. L. STAMETS
Director

RLS/fd

Copy of order also sent to:

Hobbs OCD x
Artesia OCD x
Aztec OCD x

Other Karen Aubrey