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

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

Re: Case No. 8900: Application of Mallon Oil Company for Compulsory Pooling, Rio Arriba County, New Mexico.

Dear Mr. Stamets:

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

J. Scott Hall

JSH/cv
enclosures

cc: Tommy B. Roberts, Esq.
(w/enclosures)

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

IN THE MATTER OF THE APPLICATION
OF MALLON OIL COMPANY FOR COMPULSORY
POOLING, RIO ARRIBA COUNTY, NEW
MEXICO.

Case No. 8900

MESA GRANDE'S MEMORANDUM BRIEF

On April 29, 1986, Mallon Oil Company filed its application for an order pooling all of the mineral interests from the top of the Mancos formation to the base of the Dakota formation located in the W/2 of Section 12, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico. The Commission convened a hearing on Mallon's application on May 20, 1986. Mesa Grande Resources, Inc. appeared at the hearing and opposed Mallon's attempts to pool its interests. The Commission Chairman requested that the parties submit written comments, along with proposed Orders by June 9, 1986.

Before the Commission may issue an order pooling mineral interests, it must make the requisite findings and follow the procedures set out in §§ 70-2-17 and 70-2-18, N.M.S.A. (1978) of the New Mexico Oil and Gas Act: (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 a risk penalty may be imposed.

In this case, the evidence contained in the record will show the absence of two of the statutory elements. Firstly, Mallon did not meet its statutory obligation to obtain voluntary joinder by allowing Mesa Grande to contribute its acreage and pay its proportionate share of costs. At best, Mallon attempted to compel Mesa Grande to give a farmout of its acreage on unconscionable terms. When that proposal was rejected, Mallon later offered to let Mesa Grande participate via a standard form operating agreement. However, the AFE accompanying that operating agreement sought to impose a "risk penalty" on Mesa Grande's share. Throughout however, Mesa Grande had clearly expressed its offer to contribute its acreage and pay its share of costs from day one. Indeed, Mallon was aware of Mesa Grande's offer to participate before the well was spudded. Importantly, none of the acts or conduct of Mesa Grande may be construed as an affirmative election not to pay its proportionate share of expenses. The converse has been true throughout. However, as a result of Mallon's conduct, Mesa Grande has been deprived of its right to participate voluntarily.

Secondly, Mallon's attempt to impose risk penalties both through "offers" to participate and in this proceeding is an "unnecessary expense" burdening Mesa Grande's share of produc-

tion. The attempted imposition of such an unnecessary expense is a prima facie showing that Mesa Grande's correlative rights are impaired. This is particularly true in view of Mesa Grande's repeated offers to voluntarily join the well.

If the risk penalty is imposed, Mesa Grande's correlative rights in the oil and gas are devalued in an inequitable manner to the extent of the penalty. Likewise, any incentive to try and negotiate a voluntary participation in the future is lost -- that is tantamount to economic waste and is abusive of the pooling statute.

As the Commission is aware, Mesa Grande is the applicant in Division Case No. 8897 in which it seeks to pool the interests of Chevron U.S.A. In that case, Mesa Grande also seeks the imposition of a risk penalty. The concern has been raised that the two seemingly opposed applications pose the risk of conflicting rulings. However, the two cases are distinguishable. The evidence in Case 8897 shows that Chevron, the non-consenting party, made an affirmative election not to pay its proportionate costs under the meaning of §70-2-17(C). That case is further distinguishable by virtue of the fact that throughout, Chevron was afforded advance opportunities to voluntarily participate in the well by the applicant, Mesa Grande, as required by §70-2-18. Both of those facts are absent here. Of particular note here, however, is the fact that Mallon has already had sales from production. The Mesa Grande well has not yet produced.

Because the statutory conditions precedent necessary for the Commission to authorize a pooling of the subject mineral inter-

ests are not present here, then the application cannot proceed and must be dismissed. If, however, the pooling is to be allowed, then due to the applicant's failure to allow for voluntary joinder, the provisions of §70-2-18(B) become effective. That statute provides that where the operator fails to obtain a voluntary pooling agreement or apply for an order pooling the lands before production, it shall nevertheless account to the owner of the interest sought to be pooled the greater of the amount to which each interest would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of the pooling. In other words, the owner of the unjoined interest is to receive his share of working interest proceeds on the basis of the ownership of each and every interest in the lands dedicated to the proration unit (7/8ths x 320) as opposed to the pooled party's proportionate ownership interest in the proration unit (7/8ths x 40 x 320). A risk penalty may not be imposed under any interest dedicated to a proration unit under §70-2-18(B), N.M.S.A. (1978). Although the operation of §70-2-18(B) may seem harsh, it is a compromise struck by the New Mexico Legislature that allows the production of oil and gas in a pooling situation without impairment of correlative rights while ameliorating the adverse impact to the owner of the pooled interest who is having his lands produced without his consent. That statutory provision also acts as a deterrent to conduct of the kind exhibited, intentionally or unintentionally, by Mallon.

In view of the circumstances surrounding this case, it is respectfully submitted that the application must be dismissed.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By 

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

ATTORNEYS FOR MESA GRANDE
RESOURCES, INC.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION COMMISSION

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

Case No. 8900
Order No. R-

APPLICATION OF MALLON OIL
COMPANY FOR COMPULSORY POOLING,
RIO ARRIBA COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 a.m. on May 20, 1986, at Santa Fe, New Mexico, before the Commission.

NOW, on this _____ day of _____, 1986, the Commission having considered the testimony, the record, and being fully advised in the premises,

FINDS:

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

(2) That the applicant, Mallon Oil Company, seeks an order pooling all mineral interests from the top of the Mancos formation to the base of the Dakota formation underlying the W/2 of Section 12, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, to be dedicated to its Johnson Federal No. 12-5 Well located in the NW/4 of said Section 12.

(3) That the evidence presented in this case does not demonstrate that there are interest owners in the proposed proration unit who have not agreed to pool their interests.

(4) That Case No. 8900 should be dismissed.

IT IS THEREFORE ORDERED:

That Case No. 8900 is hereby dismissed.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

Ed Kelley, Member

Jim Baca, Member

R. L. Stamets
Chairman and Secretary

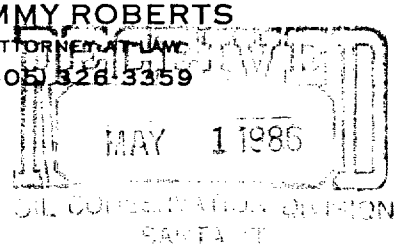
S E A L

TOMMY ROBERTS
ATTORNEY AT LAW
(505) 326-3359

P. O. BOX 129
FARMINGTON, NEW MEXICO 87499

OFFICE
3005 NORTHRIDGE DR. • SUITE G

COPY



CERTIFIED MAIL P 638 547 476
RETURN RECEIPT REQUESTED

April 28, 1986

Mesa Grande Resources, Inc.
1200 Philtower Building
Tulsa, Oklahoma 74103

Re: Application for Compulsory Pooling
by Mallon Oil Company
Johnson Fed No. 12-5 Well
Rio Arriba County, New Mexico

Gentlemen:

The purpose of this letter is to provide notice to you, in accordance with the rules and regulations of the New Mexico Oil Conservation Division, that Mallon Oil Company has filed an application with the New Mexico Oil Conservation Commission seeking an Order pooling all mineral interests from the top of the Mancos formation to the base of the Dakota formation underlying the W/2 of Section 12, Township 25 North, Range 2 West, forming a standard 320 acre spacing and proration unit to be dedicated to its Johnson Fed No. 12-5 Well which has been drilled at a standard location thereon. Also to be considered will be the costs incurred in the drilling and completion of the well and the allocation of those costs, as well as actual operating costs and charges for supervision, designation of Mallon Oil Company as operator of the well and a charge for risk involved in drilling the well.

This application has been placed on the May 20, 1986 docket of the New Mexico Oil Conservation Commission and is scheduled to be heard on that date in Santa Fe, New Mexico. In accordance with the rules and regulations of the New Mexico Oil Conservation Division, you are entitled to be present at the hearing to present testimony and to submit evidence in support of your position regarding the merits of the application.

Do not hesitate to contact me should you have any questions regarding the application of Mallon Oil Company in this matter.

Sincerely,

Tommy Roberts

TOMMY ROBERTS
Attorney for Mallon Oil Company

TR:nk

xc: Mallon Oil Company
2850 Security Life Building
Denver, Colorado 80202

New Mexico Oil Conservation Division ✓
Attn: R. L. Stamets
P. O. Box 2088
Santa Fe, New Mexico 87501-2088

BEFORE THE

OIL CONSERVATION DIVISION

NEW MEXICO DEPARTMENT OF ENERGY AND MINERALS

IN THE MATTER OF THE APPLICATION
OF MALLON OIL COMPANY FOR COMPULSORY
POOLING, RIO ARRIBA COUNTY, NEW MEXICO. Case No. 8900

ENTRY OF APPEARANCE

Comes now, CAMPBELL & BLACK, P.A., and hereby enters its appearance in the above-referenced cause for Mesa Grande Resources.

Respectfully submitted,

CAMPBELL & BLACK, P.A.

By _____
William F. Carr
Post Office Box 2208
Santa Fe, New Mexico 87501
(505) 988-4421

ATTORNEYS FOR MESA GRANDE
RESOURCES

AFFIDAVIT

STATE OF NEW MEXICO)
) ss.
COUNTY OF SAN JUAN)

TOMMY ROBERTS, being first duly sworn, states as follows:

1. That I am the attorney for Mallon Oil Company, the Applicant in Case No. 8900 before the New Mexico Oil Conservation Commission.

2. That Mallon Oil Company has conducted a good-faith diligent effort to find the correct address of all persons entitled to receive notice of its application in Case No. 8900 pursuant to the Rules and Regulations of the New Mexico Oil Conservation Division.

3. That to the best of my knowledge, Mesa Grande Resources, Inc. is the only party entitled to receive such notice and that notice has been given to Mesa Grande Resources, Inc. at the correct address as provided by rule.

4. That, more specifically, on April 28, 1986, I caused to be mailed to Mesa Grande Resources, Inc., 1200 Philtower Building, Tulsa, Oklahoma, 74103, by certified mail, return receipt requested, notice of the application of Mallon Oil Company in Case No. 8900, all in accordance with Rule 1207 of the Rules and Regulations of the New Mexico Oil Conservation Division. A copy of the return receipt is attached hereto as Exhibit "A".

5. That the notice provisions of Rule 1207 of the Rules and Regulations of the New Mexico Oil Conservation Division have been fully complied with.

Further affiant sayeth not.

Tommy Roberts
TOMMY ROBERTS

STATE OF NEW MEXICO)
) ss.
COUNTY OF SAN JUAN)

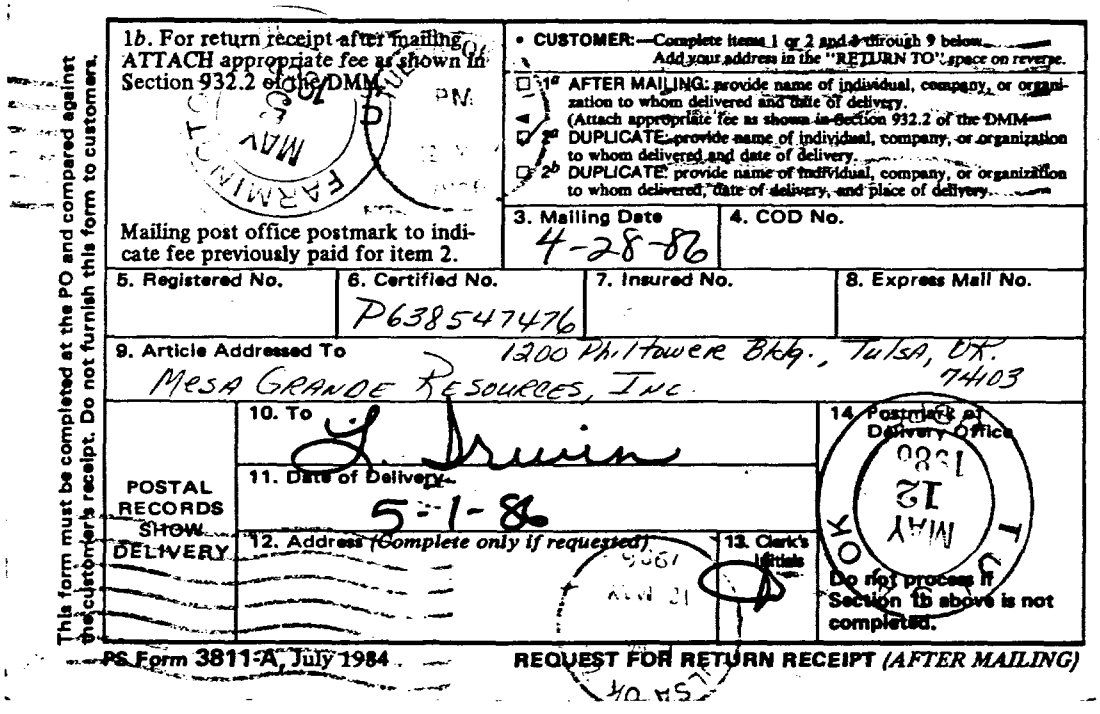
The foregoing instrument was acknowledged before me this 19th day of May, 1986, by Tommy Roberts.

My commission expires:

3-8-90

Notary Public

EXHIBIT "A"



This form must be completed at the PO and compared against the customer's receipt. Do not furnish this form to customers.

1b. For return receipt after mailing, ATTACH appropriate fee as shown in Section 932.2 of the DMM.

Mailing post office postmark to indicate fee previously paid for item 2.

• CUSTOMER:—Complete items 1 or 2 and 3 through 9 below. Add your address in the "RETURN TO" space on reverse.

- ☐ 1a AFTER MAILING: provide name of individual, company, or organization to whom delivered and date of delivery. (Attach appropriate fee as shown in Section 932.2 of the DMM.)
- ☐ 2a DUPLICATE: provide name of individual, company, or organization to whom delivered and date of delivery.
- ☐ 2b DUPLICATE: provide name of individual, company, or organization to whom delivered, date of delivery, and place of delivery.

3. Mailing Date	4. COD No.
4-28-86	

5. Registered No.	6. Certified No.	7. Insured No.	8. Express Mail No.
	P638547476		

9. Article Addressed To: Mesa Grande Resources, Inc. 1200 Philtower Bldg., Tulsa, OK. 74103

POSTAL RECORDS SHOW DELIVERY

10. To: L. Irwin

11. Date of Delivery: 5-1-86

12. Address (Complete only if requested)

13. Clerk's Initials

14. Postmark of Delivery Office

Do not process if Section 1b above is not completed.

PS Form 3811-A, July 1984 REQUEST FOR RETURN RECEIPT (AFTER MAILING)

MALLON OIL COMPANY

2850 Security Life Building, Denver, Colorado 80202
(303) 572-1511

June 6, 1986

Oil Conservation Division
State Land Office Building
Old Santa Fe Trail
P.O. Box 2088
Santa Fe, New Mexico 87501-2088

ATTN: Mr. R.L. Stamets

Re: Application for Compulsory Pooling
Mallon #12-5 Johnson Federal Well
Rio Arriba County, New Mexico

Dear Mr. Stamets:

Per your request at our commission hearing of May 20, 1986, enclosed please find the Accounting Procedure Wage Index Adjustment for 1986 and copies of page 3 of Exhibit "C" attached to our Operating Agreements for the Gavilan Area. The pages are marked as to the Operator, Non-Operators, date of Operating Agreement and Contract Area in which the Operating Agreement covers.

The overhead rates charged to our working interest owners are in line with the area, as per the National Energy Industry Services survey, administered by Ernst and Whinney, prepared specifically for determining the overhead rates in a particular area. The average overhead rate for the Gavilan Area, as per the survey for 1985, is $3,861 for drilling and $444 for producing rates.

If you have any questions, or are in need of anything further, please advise.

Sincerely,

MALLON OIL COMPANY

Karen E. McClintock
Landman

KEM:er
Enclosure

Employee Benefit Limitation

Effective January 1, 1979, and each January 1 thereafter, the Council of Petroleum Accountants Societies (COPAS) has recommended an appropriate adjustment to the limitation of Employee Benefits chargeable under COPAS accounting procedures.

In order to determine this percentage, a COPAS Committee mails survey forms each year to COPAS member companies requesting payroll and related employee benefit information for domestic operations, both onshore and offshore. The percentage is calculated from the answers received.

Following are the recommended percentages for the years for which calculations have been made:

Effective Date	Percentage Limitation
January 1, 1979	22%
January 1, 1980	23%
January 1, 1981	26%
January 1, 1982	26%
January 1, 1983	24%
January 1, 1984	23%
January 1, 1985	23%
January 1, 1986	21%

Accounting Procedure Wage Index Adjustment for 1986

The Petroleum Accountants Society of Oklahoma—Tulsa has computed for COPAS the percentage Wage Index Adjustment to be an increase of 4.4 percent. This adjustment applies to the Administrative Overhead and/or combined fixed rates as of April 1, 1986, based on the index of average weekly earnings of crude petroleum and gas production workers as published by the United States Department of Labor, Bureau of Labor Statistics. These adjustments are provided for in the COPAS Accounting Procedures dated 1962, 1968, 1974, 1984, and the 1976 Offshore Accounting Procedure.

The computation is as follows:

1985 Average Earnings	$563.01
1984 Average Earnings	539.32
Increase	$23.69

$23.69 ÷ $539.32 = 4.4%

Effective with April 1986 business, increase 1985 rates by 4.4%

Following are the past years' increases:

1963	1.6%	1975	16.7%
1964	3.9%	1976	10.3%
1965	.8%	1977	10.5%
1966	2.2%	1978	10.3%
1967	3.6%	1979	11.0%
1968	5.4%	1980	9.3%
1969	1.9%	1981	9.3%
1970	7.0%	1982	13.0%
1971	5.9%	1983	9.9%
1972	8.9%	1984	5.9%
1973	7.5%	1985	2.7%
1974	5.2%	1986	4.4%

Loading and Unloading Cost Escalation

The 1984 On-Shore Accounting Procedure provides in Section IV, Paragraph 2E (1) that the 25¢ per hundred weight on all tubular goods movements shall be adjusted by the same percentage increase or decrease as used to adjust overhead rates, rounded to the nearest cent. Effective with April 1985 business, the 25¢ per hundred weight was increased by 1¢ or to the rate of 26¢ per hundred weight. Effective with April 1986 this rate increased to 27¢ per hundred weight.

COPIES

d upon or in connection with the Joint Property, the operaaxes have been paid by the Operator for the benefit of the

Net premiums paid for insurance required to be carried for the Joint Operations for the protection of the Parties. In the event Joint Operations are conducted in a state in which Operator may act as self-insurer for Workmen's Compensation and/or Employers Liability under the respective state's laws, Operator may, at its election, include the risk under its self-insurance program and in that event, Operator shall include a charge at Operator's cost not to exceed manual rates.

12. Other Expenditures

Any other expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III, and which is incurred by the Operator in the necessary and proper conduct of the Joint Operations.

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either:

(XX) Fixed Rate Basis, Paragraph 1A, or
~~( ) Percentage Basis, Paragraph 1B~~

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall not (X) be covered by the Overhead rates.

A. Overhead - Fixed Rate Basis

(1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate $ 4,000.00
Producing Well Rate $ 400.00

(2) Application of Overhead - Fixed Rate Basis shall be as follows:

(a) Drilling Well Rate

[1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge. (6)*

(3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

*(6) A one-well charge per month shall apply to an active well that may, for any reason, become inactive for a period of time no longer than sixty (60) days.

) or in connection with the Joint Property, the opera-
ave been paid by the Operator for the benefit of the

the Joint Operations for the protection of the Par-
in which Operator may act as self-insurer for Work-
e respective state's laws, Operator may, at its election,
its self-insurance program and in that event, Operator shall include a charge at Operator's
manual rates.

Expenditures

Except expenditure not covered or dealt with in the foregoing provisions of this Section II, or in Section III
incurred by the Operator in the necessary and proper conduct of the Joint Operations.

III. OVERHEAD

Drilling and Producing Operations

As full consideration for administrative, supervision, office services and warehousing costs, Operator shall charge
drilling and producing operations on either:

1. Fixed Rate Basis, Paragraph 1A, or
2. ~~Percentage Basis, Paragraph 1B~~.

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices
and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable
under Paragraph 3A, Section II. The cost and expense of services from outside sources in connection with
matters of taxation traffic, accounting or matters before or involving governmental agencies shall be considered
included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such
costs are specifically agreed to by the Parties as a direct charge to the Joint Account.

The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant
services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall
not be covered by the Overhead rates.

1A. Fixed Rate Basis

Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate $ 4,000.00

Producing Well Rate $ 400.00

(1) Application of Overhead - Fixed Rate Basis shall be as follows:

(a) Drilling Well Rate

(1) Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on
the date the drilling or completion rig is released, whichever is later, except that no charge shall
be made during suspension of drilling operations for fifteen (15) or more consecutive days.

(2) Charges for offshore drilling wells shall begin on the date when drilling or completion equipment
arrives on location and terminate on the date the drilling or completion equipment moves off loca-
tion or rig is released, whichever occurs first, except that no charge shall be made during suspen-
sion of drilling operations for fifteen (15) or more consecutive days.

(3) Charges for wells undergoing any type of workover or recompletion for a period of five (5) con-
secutive days or more shall be made at the drilling well rate. Such charges shall be applied for
the period from date workover operations, with rig, commence through date of rig release, except
that no charge shall be made during suspension of operations for fifteen (15) or more consecutive
days.

(b) Producing Well Rates

(1) Any active well either produced or injected into for any portion of the month shall be considered
as one well charge for the entire month.

(2) Each active completion in a multi-completed well in which production is not commingled down-
hole shall be considered as a one-well charge providing each completion is considered a separate
well by the governing regulatory authority.

(3) Each inactive gas well shut in because of overproduction or failure of purchaser to take the pro-
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manent sales outlet.

(4) One active well charge may be made for the month in which plugging and abandonment operations
are completed on any well.

(5) All other inactive wells (including but not limited to inactive wells covered by unit allowable,
lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(2) ** See below.

The Fixed Rates shall be adjusted as of the first day of April each year following the effective date of the
agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multi-
plying the rate currently in use by the percentage increase or decrease in the average weekly earnings of
Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year
preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Produc-
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equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be
the rates currently in use, plus or minus the computed adjustment.

** A one-well charge per month shall apply to an active well that may, for any
reason become inactive for a period of time no longer than sixty (60) days.

COPAS

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normal rates

xpenditures

not covered or dealt with in the foregoing provisions of this Section II, or in Section III
ed by the Operator in the necessary and proper conduct of the Joint Operations

III. OVERHEAD

Drilling and Producing Operations

For services for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either

Fixed Rate Basis, Paragraph 1A, or

~~Percentage Basis, Paragraph 1B~~

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 1A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such costs are agreed to by the Parties as a direct charge to the Joint Account.

Salaries, Wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall ( ) be covered by the Overhead rates.

1A. Fixed Rate Basis

(1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate $ 4,000.00

Producing Well Rate $ 400.00

(2) Application of Overhead - Fixed Rate Basis shall be as follows:

(a) Drilling Well Rate

(1) Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

(2) Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

(3) Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

(1) An active well either produced or injected into for any portion of the month shall be considered as one well charge for the entire month.

(2) Each active completion in a multi-completed well in which production is not commingled downhole shall be considered as a one-well charge providing each completion is considered a separate completion by the governing regulatory authority.

(3) An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

(4) No overwell charge may be made for the month in which plugging and abandonment operations are completed on any well.

(5) All other inactive wells (including but not limited to inactive wells covered by unit allowable, shut-in allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(c) Adjustment. See below.

(3) Adjustment. Overhead rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rates currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

(4) Well Rate Charge While Shut-In or Inactive. Any well charge per month shall apply to an active well but may not be made for any well that becomes inactive for a period of time no longer than, e.g., 60 days.

Operator: Mallon Oil Company
Non Operators: R.L. Bayless
K.M. Production
Robert Mitchem
Thomas, Ltd,

Mallon Minerals Corp.
Carlyle A. Peterson
Kevin M. Fitzgerald
David L. Heppe
George O. Mallon, Jr.
James Wallis
Colton Exploration

Dated: October 4, 1984

Contract Area: S/2 T26N, R2W
All T25N, R2W
N/2 T24N, R2W

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een paid by the Operator for the benefit of the

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Joint Operations for the protection of the Par-
ıich Operator may act as self-insurer for Work-
)ective state's laws, Operator may, at its election,
ıt, Operator shall include a charge at Operator's

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g provisions of this Section II, or in Section III,
: conduct of the Joint Operations.

III. OVERHEAD

1. Overhead - Drilling and Producing Operations

i. As compensation for administrative, supervision, office services and warehousing costs, Operator shall charge drilling and producing operations on either:

(X) Fixed Rate Basis, Paragraph 1A, or
~~( ) Percentage Basis, Paragraph 1B.~~

Unless otherwise agreed to by the Parties, such charge shall be in lieu of costs and expenses of all offices and salaries or wages plus applicable burdens and expenses of all personnel, except those directly chargeable under Paragraph 2A, Section II. The cost and expense of services from outside sources in connection with matters of taxation, traffic, accounting or matters before or involving governmental agencies shall be considered as included in the Overhead rates provided for in the above selected Paragraph of this Section III unless such cost and expense are agreed to by the Parties as a direct charge to the Joint Account.

ii. The salaries, wages and Personal Expenses of Technical Employees and/or the cost of professional consultant services and contract services of technical personnel directly employed on the Joint Property shall ( ) shall not (X) be covered by the Overhead rates.

A. Overhead - Fixed Rate Basis

(1) Operator shall charge the Joint Account at the following rates per well per month:

Drilling Well Rate $ 4,000.00
Producing Well Rate $ 400.00

(2) Application of Overhead - Fixed Rate Basis shall be as follows:

(a) Drilling Well Rate

[1] Charges for onshore drilling wells shall begin on the date the well is spudded and terminate on the date the drilling or completion rig is released, whichever is later, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days.

[2] Charges for offshore drilling wells shall begin on the date when drilling or completion equipment arrives on location and terminate on the date the drilling or completion equipment moves off location or rig is released, whichever occurs first, except that no charge shall be made during suspension of drilling operations for fifteen (15) or more consecutive days

[3] Charges for wells undergoing any type of workover or recompletion for a period of five (5) consecutive days or more shall be made at the drilling well rate. Such charges shall be applied for the period from date workover operations, with rig, commence through date of rig release, except that no charge shall be made during suspension of operations for fifteen (15) or more consecutive days.

(b) Producing Well Rates

[1] An active well either produced or injected into for any portion of the month shall be considered as a one-well charge for the entire month.

[2] Each active completion in a multi-completed well in which production is not commingled down hole shall be considered as a one-well charge providing each completion is considered a separate well by the governing regulatory authority.

[3] An inactive gas well shut in because of overproduction or failure of purchaser to take the production shall be considered as a one-well charge providing the gas well is directly connected to a permanent sales outlet.

[4] A one-well charge may be made for the month in which plugging and abandonment operations are completed on any well.

[5] All other inactive wells (including but not limited to inactive wells covered by unit allowable, lease allowable, transferred allowable, etc.) shall not qualify for an overhead charge.

(6) ** See below

(3) The well rates shall be adjusted as of the first day of April each year following the effective date of the agreement to which this Accounting Procedure is attached. The adjustment shall be computed by multiplying the rate currently in use by the percentage increase or decrease in the average weekly earnings of Crude Petroleum and Gas Production Workers for the last calendar year compared to the calendar year preceding as shown by the index of average weekly earnings of Crude Petroleum and Gas Fields Production Workers as published by the United States Department of Labor, Bureau of Labor Statistics, or the equivalent Canadian index as published by Statistics Canada, as applicable. The adjusted rates shall be the rates currently in use, plus or minus the computed adjustment.

**(6) A one-well charge per month shall apply to an active well that may, for any reason, become inactive for a period of time no longer than sixty (60) days.

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

TONEY ANAYA
GOVERNOR

August 11, 1986

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

Mr. Tommy Roberts
Attorney at Law
P. O. Box 129
Farmington, New Mexico 87499

Re: CASE NO. 8900
ORDER NO. R-8263

Applicant:

Mallon Oil Company

Dear Sir:

Enclosed herewith are two copies of the above-referenced Commission 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 Scott Hall

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 27, 1986

Mr. George O. Mallon, Jr.
Mallon Oil Company
2850 Security Life Bldg.
Denver, Colorado 80202

Re: OCC Case No. 8900

Dear Mr. Mallon:

I have received your correspondence of June 24, 1986. I am upset.

It is the thrust of your letter that I have distorted the facts in my brief to the Oil Conservation Commission in the above case. In particular, you refute the statement that Mallon was aware of Mesa Grande's offer to participate in the well before it was spudded. In this regard, I have reviewed the transcript of testimony from the Commission hearing and have determined that you are correct. My statement was in error and I am so advising the Commission by providing them with a copy of this letter.

At the time I drafted my comments, the hearing transcript had not yet been prepared and I was thus compelled to rely upon my notes and memory which may explain the error. However, I must respectfully disagree with your assertion that my misstatement deals with a "key fact" which may affect the outcome. In my view, the "key fact" to be considered under the pooling statutes is the failure to obtain joinder or a pooling order prior to production. I made that point in my brief and you must agree that it is supported by the evidence in the record.

Again, the misstatement was my fault and I stand corrected. However, your inference that through my misstatement I somehow intentionally labeled yourself, Karen McClintock and Kevin Fitzgerald as "liars" is downright wrong and is discourteous. Nonetheless, if my mistake caused offense, I apologize to each of you.

It is my wish that this matter will not be considered as affront by Mesa Grande or Campbell & Black. Our firm has represented Mallon Oil in the past and I hope we will have that opportunity in the future. It has always been my goal to represent my clients in as amicable and effective a manner as possible. Accordingly, I hope you will re-assess your comments about my ethics. I stand ready to place my ethical standards up against any man's.

Sincerely,

J. Scott Hall

JSH/ep

cc: Dick Stamets
Greg Phillips
Tommy Roberts, Esq.
Campbell & Black, P.A.

MALLON OIL COMPANY

2750 Security Life Building, Denver, Colorado 80202
(303) 572-1511

August 26, 1986

Case F.L.
BFL

State of New Mexico
Energy and Minerals Department
Oil Conservation Division
P.O Box 2088
Santa Fe, NM 87501

Attn: Mr. R.L. Stamets

RE: Case No. 8900
Order No. R-8262

Dear Mr. Stamets:

This letter is to advise you that Mallon Oil Company and Mesa Grande, Ltd. have reached a voluntary agreement subsequent to the entry of Order No. R-8262, regarding Case No. 8900.

If you should have any questions, please advise.

Sincerely,

MALLON OIL COMPANY

Karen E. McClintock
Landman

KEM:sb

CC: Mesa Grande, Ltd.
Attn: Mr. Larry Sweet

TOMMY ROBERTS
ATTORNEY-AT-LAW
(505) 326-3359

P. O. BOX 129
FARMINGTON, NEW MEXICO 87499

OFFICE
3005 NORTHRIDGE DR. • SUITE G

June 10, 1986

R. L. Stamets, Chairman
New Mexico Oil Conservation Commission
State Land Office Building
310 Old Santa Fe Trail
Santa Fe, New Mexico 87501

RECEIVED
JUN 11 1986
OIL CONSERVATION DIVISION

Re: Commission Case No. 8900
Application of Mallon Oil Company
for Compulsory Pooling,
Rio Arriba County, New Mexico

Dear Mr. Stamets:

Pursuant to your request of May 20, 1986, enclosed please find Brief and proposed Order prepared and submitted on behalf Mallon Oil Company.

Thank you for giving me an additional day or two to get these items to you.

Sincerely,

Tommy Roberts

TOMMY ROBERTS

TR:nk

Enclosures

Mesa Grande, Ltd.

1305 PHILTOWER BUILDING
TULSA, OKLAHOMA 74103

August 18, 1986

Case File

CERTIFIED MAIL #621164

Mr. George Mallon
1616 Glenarm Place
Denver, CO 80202

Re: NMOCD Case No. 8900
Order No. R-8262
Johnson Federal #12-5
W½ Sec. 12-T25N-R2W
Rio Arriba Co., NM

Dear Mr. Mallon:

In accordance with the above referenced Order, Mesa Grande, Ltd. and Arriba Company, Ltd., successors in interest to Mesa Grande Resources, Inc., hereby elect to pay to Mallon Oil Company (Operator) our proportionate share of the total actual costs incurred in the drilling and completion of the above captioned well. Enclosed is a check in the amount of $147,635.00 for our 25% participation as follows:

	Total	Mesa Grande, etal 25%
Drilling & completion costs	$565,840	$141,640.00
Operating expenses thru March 31, 1986	24,700	6,175.00
		$147,635.00

Please provide us with copies of all invoices and supporting documentation for our files as soon as possible. Also, please send us a copy of the Division Order Title Opinion and any other documentation needed to expedite placing our interest in "pay" status.

Thank you for your assistance.

Very truly yours,

L. Sweet

LDS:rbs

Enclosure

cc: NMOCD

STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION COMMISSION

APPLICATION OF MALLON OIL COMPANY
FOR COMPULSORY POOLING, RIO ARRIBA
COUNTY, NEW MEXICO CASE NO. 8900

CLOSING ARGUMENT BRIEF

STATEMENT OF FACTS

On August 22, 1985, Mallon Oil Company (hereinafter referred to as "Mallon") commenced the drilling of its Johnson Federal No. 12-5 Well (hereinafter referred to as "the well") at a standard location in the Southwest Quarter of the Northwest Quarter of Section 12, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico. The primary objective of the well was the Gallup formation, which formation was not subject to any special pool rules approved by the New Mexico Oil Conservation Division. Therefore, the well was drilled on a standard forty (40) acre spacing unit basis with Mallon owning one hundred percent (100%) of the record title and leasehold operating rights interest applicable to that spacing unit.

Total depth in the well was reached on September 10, 1985 at a depth of eight thousand one hundred fifty feet (8,150') -- a depth sufficient to penetrate the Dakota formation. The

well was completed in the Gallup formation, as an undesignated Gallup oil well, on October 24, 1985. The date of first production from the well was October 24, 1985 and was achieved by swabbing oil to the tank. A completion report for the well was filed on November 5, 1985 and was subsequently accepted for record by the Farmington Resource Area Office of the Bureau of Land Management. First sales of oil from the well occurred in December, 1985 and first sales of gas from the well occurred in January, 1986. The costs incurred by Mallon in drilling and completing the well totaled Five Hundred Sixty-Five Thousand Eight Hundred Forty Dollars ($565,840.00). Of that total cost, $255,016.00 was attributable to intangible drilling costs. Operating costs incurred by Mallon through March 31, 1986 totaled $24,700.00.

On October 9, 1985, subsequent to the date on which total depth was reached in the well, the New Mexico Oil Conservation Commission, in Case No. 8713, heard an application requesting the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool to include, among other lands, all of Section 12 of Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico. Pursuant to the provisions of Commission Order R-8063, dated January 3, 1986, all of Section 12 of Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, was brought within the horizontal boundaries of the Gavilan Mancos Oil Pool effective January 1, 1986.

One of the principal provisions of the pool rules applicable to the Gavilan Mancos Oil Pool is the requirement

for 320 acre spacing units. 70-2-18 N.M.S.A. 1978 Compilation provides that "Any division order that increases the size of a standard spacing or proration or spacing unit for a pool, or extends the boundaries of such a pool, shall require dedication of acreage to existing wells in the pool in accordance with the acreage dedication requirements for said pool, ...". In accordance with the provisions of state law and the rules applicable to the Gavilan Mancos Oil Pool, Mallon established a 320 acre spacing unit for the well consisting of the acreage in the W/2 of Section 12 of Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico. The W/2 of Section 12 is comprised of acreage contained in three (3) separate federal oil and gas leases. Mallon ultimately obtained control of all of the leasehold operating rights interest attributable to the Gallup and Dakota formations underlying 240 acres of the 320 acres comprising the W/2 of Section 12. Mesa Grande Resources, Inc. (hereinafter referred to as "Mesa Grande") ultimately obtained control of all of the leasehold operating rights interest attributable to the Gallup and Dakota formations underlying 80 acres of the 320 acres comprising the W/2 of Section 12.

In accordance with the provisions set forth in 70-2-18 N.M.S.A. 1978 Compilation, Mallon attempted to obtain the voluntary agreement of Mesa Grande for the pooling of its interest to facilitate the formation of a standard 320 acre spacing unit in compliance with the spacing requirements set forth in the rules applicable to the Gavilan Mancos Oil Pool.

The efforts of Mallon to obtain the voluntary pooling of the interest controlled by Mesa Grande proved unsuccessful and, consequently, Mallon filed its application for compulsory pooling, thereby requesting an Order of the New Mexico Oil Conservation Commission (hereinafter referred to as the "Commission") pooling all mineral interests from the top of the Mancos formation to the base of the Dakota formation underlying the W/2 of Section 12, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, to form a standard 320 acre spacing unit to be dedicated to the well which had been drilled at a standard location thereon. The application of Mallon for compulsory pooling was assigned Case No. 8900 and was heard by the Commission on May 20, 1986, at which time Mallon and Mesa Grande were directed to submit, by written brief, closing arguments in support of their respective positions.

STATEMENT OF ISSUE

Conducting its operations in accordance with the rules and regulations of the New Mexico Oil Conservation Division governing spacing requirements, Mallon commenced the drilling of the well on August 22, 1985 and prosecuted the drilling of the well to a total depth of 8,150 feet on September 10, 1985. Subsequent to the date total depth was reached in the well, Mallon learned of the efforts of a group of operators to seek an extension of the horizontal boundaries of the Gavilan Mancos Oil Pool to include, among other lands, all of Section 12, Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County,

New Mexico. Those efforts resulted in the filing of an application with the Commission requesting the extension of those horizontal boundaries, the hearing of that application by the Commission on October 9, 1985, and, subsequently, the issuance by the Commission of an Order extending the horizontal boundaries of the Gavilan Mancos Oil Pool effective January 1, 1986.

Under the factual circumstances presented in this case, Mallon took the position that any agreement providing for the pooling of the interests in an enlarged spacing unit applicable to the well, as required by the Commission's Order extending the horizontal boundaries of the Gavilan Mancos Oil Pool and by applicable state statute, should take into consideration the fact that Mallon had assumed 100% of the risk inherent in drilling and completing the well. Based on that position, Mallon attempted to obtain the voluntary pooling of Mesa Grande's 25% operating rights interest in the new spacing unit for the well on terms that would have provided Mallon with a proportionate reimbursement from Mesa Grande for the value of the risk assumed. In response to the voluntary pooling attempts by Mallon, Mesa Grande stated a willingness to pay 25% of the actual costs of drilling and completing the well, but would not agree to reimburse Mallon for any part of the value of the risk assumed solely by Mallon. As a result of the inability of the parties to negotiate the voluntary pooling of the interests in the enlarged spacing unit, Mallon filed its application with the Commission seeking the compulsory pooling

of the interest controlled by Mesa Grande in the enlarged spacing unit.

Consequently, the primary issue confronting the Commission by virtue of the application of Mallon in Case No. 8900 is whether it is appropriate, under the factual circumstances presented in this case, that Mesa Grande reimburse Mallon for a proportionate part of the risk associated with the drilling of the well which was assumed solely by Mallon.

RELIEF REQUESTED

Pursuant to its application for compulsory pooling in Case No. 8900, Mallon requests relief as follows:

(1) That the Commission enter its Order providing for the compulsory pooling of all mineral interests in the W/2 of Section 12 of Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, from the top of the Mancos formation to the base of the Dakota formation to be dedicated to the well which has been drilled at a standard location thereon;

(2) That the Commission enter its Order determining that the actual costs incurred in the drilling, completion and operation to date of the well are reasonable and were necessarily incurred by Mallon;

(3) That the Commission enter its Order determining that, under the factual circumstances presented in this case, risk assumed in the drilling of the well is a proper and legitimate expense to be charged as an actual cost incurred in the drilling of the well;

(4) That the Commission enter its Order determining that, under the factual circumstances presented in this case, a charge for risk equal to 100% of the actual intangible drilling costs incurred in the drilling of the well constitutes a reasonable valuation of the risk expense incurred in the drilling of the well;

(5) That the Commission enter its Order requiring Mesa Grande to elect within a specified period of time after the date of the issuance of an Order in this case to either pay its proportionate share of actual costs incurred in the drilling, completion and operation to date of the well, including the risk expense to be charged as an actual cost, or to have its proportionate share of these costs recovered by Mallon from production from the well;

(6) That the Commission enter its Order officially designating Mallon as the operator of the well; and

(7) That the Commission enter its Order establishing as reasonable charges for supervision of the well the sum of Four Thousand Dollars ($4,000.00) per month while drilling and the sum of Four Hundred Dollars ($400.00) per month while producing.

ARGUMENTS

1. At all times material hereto, Mallon has acted in good faith and as a prudent operator.

Mesa Grande has attempted to cast doubts on the motivation of Mallon in deciding to commence the drilling of the well in August 1985. Mesa Grande asks the Commission to believe that Mallon commenced the drilling of the well with knowledge that the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool, or an application therefor, was imminent. Based on that allegation of knowledge, Mesa Grande would have the Commission determine that Mallon assumed the risk of drilling the well with full knowledge that the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool was imminent and that other leasehold operating rights or mineral interest owners would be entitled to participate in the well and, therefore, that Mallon should bear fully and without contribution from other interest owners the full burden of the risk associated with the drilling of the well.

The uncontradicted testimony and evidence presented at the hearing in this case on May 20, 1986 does not support the position of Mesa Grande. First, Mallon's oil and gas lease covering the W/2 of the NW/4 of Section 12 of Township 25 North, Range 2 West, N.M.P.M., Rio Arriba County, New Mexico, was due to expire in March, 1986. Mallon commenced the drilling of the well on acreage covered by that lease in August, 1985 to avoid adverse winter weather conditions and to assure the extension of its oil and gas lease beyond its primary term. Second, at the time of the commencement of the well, the Gallup formation underlying Section 12 of Township 25 North, Range 2 West was not subject to pool rules. In the absence of pool

rules, the well was drilled in accordance with statewide spacing requirements, established by the New Mexico Oil Conservation Division, providing for 40 acre spacing for oil wells. Third, the uncontradicted testimony presented at the hearing in this case indicates that Mallon did not learn of the desire of a group of operators to obtain the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool until September 11, 1985 -- the day after total depth was reached in the well. By this time, most, if not all, of the intangible drilling costs associated with the drilling of the well and the risks attendant thereto, had been incurred. It would not be reasonable to expect Mallon to have postponed further operations on the well given its reasonable concerns about the status of its lease and potentially inclement winter weather conditions. Fourth, in August, 1985, it would have been unreasonable to have expected Mallon to foresee the extension of the horizontal boundaries of the Gavilan Mancos Oil Pool to include Section 12 of Township 25 North, Range 2 West and, even if it could have been foreseen that a request for the extension of those boundaries would be made, it would be unreasonable to expect Mallon to have delayed its drilling plans given the circumstances with which it was confronted.

In addition, Mesa Grande asks the Commission to believe that Mallon failed to negotiate in good faith for the voluntary pooling of the interests in the W/2 of Section 12. Again, the uncontradicted testimony and evidence presented at the hearing in this case does not support the contention of Mesa Grande. First, all information available to Mallon indicated that the

leasehold record title and operating rights interest under the E/2 of the NW/4 of Section 12 were owned by Northwest Pipeline Corporation as late as October 8, 1985. On that date, Mallon submitted a bid to Northwest Pipeline Corporation to acquire that acreage. Second, when Mallon learned that Mesa Grande had assumed control of that acreage, Mallon submitted a farmout proposal to Mesa Grande. When Mesa Grande rejected the farmout proposal and notified Mallon of its desire to participate in the already drilled and completed Johnson Federal No. 12-5 well, Mallon promptly mailed an operating agreement and an authority for expenditure to Mesa Grande. Incorporated into that authority for expenditure was a charge for risk -- a charge to which Mallon believed, in good faith, it was entitled by virtue of having assumed all of the risk associated with the drilling and completion of the well. Third, only after Mesa Grande refused to execute the operating agreement and the authority for expenditure and after other attempts failed to provide for the participation of Mesa Grande on an equitable basis did Mallon proceed to file its application for compulsory pooling in this case.

In summary, the testimony and evidence presented at the hearing in this case supports Mallon's contention that at all times material hereto it conducted its operations in good faith and in accordance with prudent operator standards.

2. <u>All actual costs incurred by Mallon in drilling, completing and operating the well were reasonable in amount and necessarily incurred.</u>

The testimony and evidence presented by Mallon at the hearing in this case indicates the actual costs incurred in drilling and completing the well totaled Five Hundred Sixty-Five Thousand Eight Hundred Forty Dollars ($565,840.00). Of those total costs, $255,016.00 was attributable to intangible drilling costs. Actual operating costs of the well through March 31, 1986 totaled $24,700.00.

The testimony and evidence presented by Mallon indicates these costs were extremely reasonable in amount when compared with actual costs incurred in drilling, completing and operating other wells in the area of the Gavilan Mancos Oil Pool. In addition, Mesa Grande submitted no testimony or evidence to challenge the reasonableness or the necessity of the actual costs incurred by Mallon in drilling, completing and operating the well.

3. Under the factual circumstances presented in this case, risk assumed in the drilling of the well is a proper and legitimate expense to be charged as an actual cost incurred in the drilling of the well.

It is the contention of Mallon, under the factual circumstances presented in this case, that it has "turn-keyed" the well for the benefit of Mesa Grande.

Although an actual "turn-key" agreement was not negotiated and consummated by and between the parties, the circumstantial result of the actual operations conducted by Mallon on the well is very similar to a "turn-key" operation.

The only difference in the situation in which the parties now find themselves and the situation in which they would have been under a negotiated "turn-key" operation is that in the latter situation Mesa Grande would have shouldered a reasonable share of the risk associated with the drilling and completion of the well.

At the hearing in this case, George Mallon, President of Mallon Oil Company, described the mechanics of a "turn-key" operation from the perspective of the operator of a well. In a typical situation, the operator obtains a "turn-key" drilling bid from a drilling contractor, incorporates the estimated contract drilling costs in an authority for expenditure and submits the authority for expenditure to the non-operating working interest owners in the well with a request for the payment of their proportionate shares of the estimated costs of drilling and completing the well. At this point, the risk of cost overruns associated with the drilling and completion of the well, as between the operator and the non-operating working interest owners, is borne fully by the operator. In the event actual costs exceed estimated costs, the operator bears the full burden of such excess costs and the non-operating working interest owners are insulated therefrom.

Price M. Bayless, testifying at the hearing in this case as an expert in the field of contract drilling, stated that although a true "turn-key" drilling contract theoretically places the risk associated with drilling on the contractor, a true "true-key" drilling bid is normally developed by the

contractor in such a manner as to attempt to transfer as much of that risk as is possible back to the operator of the well. In other words, the drilling contractor will build enough "cushion" into its bid to adequately protect itself from significant cost overruns. This "cushion" represents the transfer of risk to the operator of the well which is, in turn, proportionately transferred by the operator to the non-operating working interest owners in the form of an estimated expense of drilling the well.

By virtue of the circumstances presented in this case, Mallon and Mesa Grande now find themselves in a position that closely resembles a "turn-key" drilling venture operation. Mallon has drilled and completed a well for the benefit of itself and a non-operating working interest owner and has borne the full burden of the risk associated with the drilling of the well. Mesa Grande, as the non-operating working interest owner, has been shielded from any exposure to risk inasmuch as Mallon has fully assumed that burden.

Now, equity requires that the "turn-key" analysis be made complete with a determination of the reasonable value of the risk expense to be charged as an actual cost incurred in drilling and completing the well.

4. Under the factual circumstances presented in this case, a charge for risk equal to 100% of the actual intangible drilling costs incurred in the drilling of the well constitutes a reasonable valuation of the risk expense incurred in the drilling of the well.

Given the validity of the argument of Mallon that a charge for risk is a proper and legitimate expense to be charged as an actual cost incurred in the drilling of the well, it remains to place a value on the risk assumed solely by Mallon.

Mr. Bayless testified that, due to the extreme risk associated with drilling in the Gavilan Mancos Oil Pool area, he would not voluntarily contract to drill on a true "turn-key" basis, but if he were required to submit a true "turn-key" drilling proposal for that area, he would base that proposal on actual worst case drilling expenditures in the area.

Mr. Mallon testified that as an operator under a true "turn-key" operation he would pass on to the non-operating working interest owners in proportion to their interests all estimated costs of drilling and completing the well, including those costs associated with the "turn-key" drilling contract.

Kevin Fitzgerald, a petroleum engineer employed by Mallon Oil Company, testified, based on his knowledge, that the worst case drilling experience in the Gavilan Mancos Oil Pool area resulted in total intangible drilling costs of $900,000.00. If these costs had been the basis for determining Mesa Grande's participation in the Johnson Federal No. 12-5 well on a "turn-key" basis, Mesa Grande would have paid $225,000.00 in intangible drilling costs (25% of $900,000.00) instead of $63,754.00 in intangible drilling costs (25% of $255,016.00) which it now seeks to pay to participate in the well. A comparative analysis of those costs translates into a 250% risk factor.

Mr. Fitzgerald further testified that Mallon's worst case drilling experience in the area of the Gavilan Mancos Oil Pool resulted in total intangible drilling costs of $570,000.00. If these costs had been the basis for determining Mesa Grande's participation in the Johnson Federal No. 12-5 well on a "turn-key" basis, Mesa Grande would have paid $142,500.00 in intangible drilling costs (25% of 570,000.00) instead of $63,754.00 in intangible drilling costs (25% of $255,016.00) which it now seeks to pay to participate in the well. A comparative analysis of those costs translates into a 125% risk factor.

Given the validity of the "turn-key" operation analysis, it is readily apparent that a charge for risk equal to 100% of the actual intangible drilling costs incurred in the drilling of the well is reasonable.

5. The Commission is vested with statutory authority to issue orders providing for the compulsory pooling of mineral interests on such terms and conditions as are just and reasonable and which afford to the owners of such interests the opportunity to recover or receive without unnecessary expense their just and fair shares of the oil or gas produced.

70-2-17 N.M.S.A. 1978 Compilation provides the Commission statutory authority for the compulsory pooling of mineral interests in a spacing unit when the owners of the mineral interests in the spacing unit cannot voluntarily pool those interests. The statute gives the Commission broad authority to fashion pooling orders that fit the equities presented in each particular case, including the authority to determine the

appropriateness of the imposition of a charge associated with the risk of drilling and completing any particular well.

Mesa Grande would argue that the Commission's statutory authority to impose a charge for risk against a non-joining party may be invoked only to provide an incentive for that party to voluntarily participate in the drilling and completion of a well and as a penalty to be charged against that party for its failure to elect to participate. Mallon recognizes that, historically, the incentive and penalty justification has been the basis for the imposition of charges for risk in compulsory pooling situations. However, Mallon also notes that, historically, the overwhelming majority of compulsory pooling cases heard by the Commission have involved pre-drilling circumstances.

Adoption by the Commission of Mesa Grande's very narrow interpretation of the Commission's statutory authority would severely restrict the Commission's ability to carry out its statutory obligation to facilitate the pooling of interests that cannot be voluntarily pooled on such terms and conditions as are just and reasonable.

70-2-17(C) N.M.S.A. 1978 Compilation provides, in part, that where "... owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill <u>has drilled</u> 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 or proration unit as a unit.". (emphasis added). 70-2-17(C) further provides, in part, that such compulsory pooling orders "... shall be upon such terms and conditions as are just and reasonable and will afford to 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.". (emphasis added). Mallon contends that the statutory provision cited in this paragraph provides the Commission with the flexibility to fashion orders which can fairly and equitably accommodate the factual circumstances presented in any situation where interest owners have not agreed to pool their interests.

In the case which is the subject of this brief, Mallon, in good faith reliance upon the rules and regulations of the New Mexico Oil Conservation Division and pool rules then in effect, drilled and completed its Johnson Federal No. 12-5 well. In accordance with applicable state statute and the Order of the Commission extending the horizontal boundaries of the Gavilan Mancos Oil Pool, Mallon made a good faith effort to obtain the voluntary pooling of the interest of Mesa Grande to satisfy the spacing unit requirements of the Gavilan Mancos Oil Pool. Under the circumstances presented in this case, Mallon contends that a charge for risk associated with the drilling of the well is appropriate and reasonable inasmuch as Mesa Grande has received the benefit of the assumption of that risk solely by Mallon.

In this brief, Mallon has set forth the justification for the Commission to find that the actual costs incurred in

drilling and completing the well should include a charge for risk. If the Commission fails to include a charge for risk as an actual cost incurred in drilling and completing the well, then Mallon's correlative rights will be violated inasmuch as it will not have the opportunity to recover its just and fair share of production without unnecessary expense. An Order of the Commission in this case which burdens Mallon with all of the expense attributable to the risk assumed in the drilling and completion of the well would be unjust and unreasonable given the factual circumstances presented in this case.

6. The sum of $4,000.00 per month while drilling and the sum of $400.00 per month while producing are reasonable charges for the supervision of the drilling and operation of the well.

Mallon proposes that the sums of $4,000.00 per month while drilling and $400.00 per month while producing be fixed by the Commission as reasonable charges for supervision of the well. These charges are consistent with oil and gas industry standards for the area of drilling, the type of well drilled and the depth of drilling. These charges are also consistent with Mallon's past practice in the area of the Gavilan Mancos Oil Pool and are consistent with charges made by other operators in the area of the Gavilan Mancos Oil Pool. Under separate cover, a representative of Mallon has mailed to the Commission evidence of past practice of Mallon in the area of the Gavilan Mancos Oil Pool and evidence of industry standards.

CONCLUSION

The factual circumstances existing in this case present a matter of first impression to the Commission. The overwhelming majority of the compulsory pooling cases heard by the Commission have involved pre-drilling circumstances. Those few post-drilling compulsory pooling cases which have been heard by the Commission have not involved factual circumstances similar to those which are presented in this case. Because this a matter of first impression, the Commission must reach a reasonable and rational conclusion; one which protects the correlative rights of the parties involved in the dispute, one which is consistent with industry practice and standards and one which satisfies the statutory obligations of the Commission.

In this case, Mallon has at all times acted in good faith and in accordance with existing state statutes and existing rules and regulations of the New Mexico Oil Conservation Division. In reliance on existing rules and regulations of the New Mexico Oil Conservation Division, Mallon drilled and completed its Johnson Federal No. 12-5 well assuming all of the risk associated therewith. Subsequent to the date of the drilling and completion of the well, an Order of the Commission extended the horizontal boundaries of the Gavilan Mancos Oil Pool to include the lands on which this well was drilled, and, pursuant to the operation of applicable state statute, the guidelines under which the well was drilled and completed were altered.

These circumstances have placed Mallon in a very vulnerable position with respect to its ability to protect its

correlative rights. It is the contention of Mallon that the specific items of relief requested herein are necessary for the protection of those rights.

If Mallon's request for relief, as itemized herein, is not granted by the Commission, then Mesa Grande will find itself in an enviable position -- it will have received a windfall in the form of the total avoidance of the risk associated with the drilling and completion of the well. As a corollary to the windfall provided to Mesa Grande, Mallon will have incurred a disproportionate amount of the expense incurred in the drilling and completion of the well in the form of the assumption of 100% of the risk associated therewith. This would be an unusual result by oil and gas industry standards in that it would be totally contradictory to the generally accepted premise in the industry that the risk of operations should be shared by the owners of the expense-bearing interests in a well.

In addition, if Mallon's request for relief, as itemized herein, is not granted by the Commission, then the Commission, by implication, will be making a statement that the laws of the State of New Mexico which place an interest owner such as Mallon in the dilemma it now finds itself do not, in turn, provide an adequate remedy to that dilemma for that interest owner.

The rationale behind the arguments posed by Mallon in this case have been set forth in this brief in detail. Now, the Commission is provided a unique opportunity -- the opportunity to establish guidelines by which the parties to similar disputes in the future may voluntarily resolve those disputes. In

determining whether the establishment of new guidelines is appropriate in this case, Mallon urges the Commission to rely on the flexibility inherent in the statute that vests in the Commission the authority to issue compulsory pooling orders. Mallon urges the Commission to avoid analyzing the circumstances presented in this case in terms of historical pre-drilling compulsory pooling concepts. Those concepts, though familiar to the Commission, cannot be utilized to achieve an equitable result in a post-drilling compulsory pooling situation where culpability or fault of one or more interest owner is not at issue.

In conclusion, Mallon requests that the Commission issue its Order granting the relief requested herein. These requests are reasonable, both conceptually and practically. The grant of these requests will be in the best interests of conservation and will facilitate the protection of correlative rights and the prevention of waste.

Respectfully submitted,

Tommy Roberts

TOMMY ROBERTS
Attorney for Mallon Oil Company
P. O. Box 129
Farmington, New Mexico 87499
(505) 326-3359

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