



STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

TONY ANAYA
GOVERNOR

November 10, 1986

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

Mr. Thomas Kellahin
Kellahin & Kellahin
Attorneys at Law
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

Dear Mr. Kellahin:

Based upon your letter of November 6, 1986, and provisions of Order No. R-8047-C, Robert E. Chandler is hereby granted an extension of time to begin the well on the unit pooled by said order until 90 days after the entry of a non-appealable decision in Lea County District Court Case CV 86-1061 FR.

It shall be the obligation of Mr. Chandler or his attorneys to notify this office of the entry of such decision within 30 days thereof.

Sincerely,

A handwritten signature in cursive script, appearing to read "R. L. Stamets".

R. L. STAMETS
Director

RLS/fd

cc: Case 8859
Jerry Sexton

W. Thomas Kellahin
Karen Aubrey

Jason Kellahin
Of Counsel

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

November 6, 1986

Mr. Richard L. Stamets
Oil Conservation Division
P. O. Box 2088
Santa Fe, New Mexico 87501

Re: Application of Chandler
Order R-8047

Dear Mr. Stamets:

On behalf of Mr. Chandler, we have been advised that on October 28, 1986 the Commission was served with a copy of the Petition for Review filed by Klein & Hendrix, et al, in the Lea County District Court.

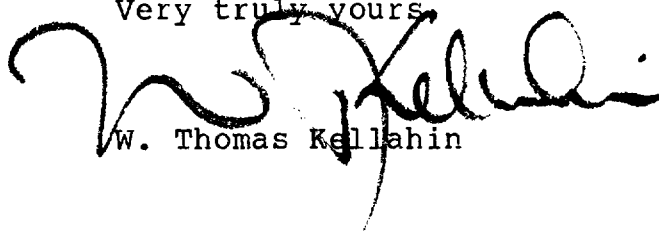
As a result of the appeal to District Court, Mr. Chandler is unable to drill the subject well prior to the December 1, 1986 deadline set forth in the Commission Order R-8047-C.

Pursuant to the provisions of Order R-8047, and on behalf of Mr. Chandler, we hereby request that the forced pooling order and the commencement date of the subject well be extended as follows:

"That the operator of said unit shall commence the drilling of said well on or before 90 days after the entry of a nonappealable decision in Lea County District Court Case CV 86-1061 FR"

With the entry of such an extension, Mr. Chandler's rights under the order have been protected and the status quo of the parties has been preserved.

Very truly yours,



W. Thomas Kellahin

WTK:ca

cc: Robert E. Chandler
Ernest L. Padilla, Esq.

RECEIVED
NOV 7 1986
OIL CONSERVATION DIVISION



STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
OIL CONSERVATION DIVISION

TONY ANAYA
GOVERNOR

June 16, 1986

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

Mr. Ernest L. Padilla
Padilla & Snyder
Attorneys at Law
P. O. Box 2523
Santa Fe, New Mexico 87504-2523

Re: CASE NO. 3850
ORDER NO. R-3047-B

Applicant:
Robert E. Chandler Corporation

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

Other Thomas Kellahin



STATE OF NEW MEXICO
ENERGY AND MINERALS DEPARTMENT
 OIL CONSERVATION DIVISION

TONY ANAYA
 GOVERNOR

May 9, 1986

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

Mr. Thomas Kellahin
 Kellahin & Kellahin
 Attorneys at Law
 Post Office Box 2265
 Santa Fe, New Mexico

Re: CASE NO. 3359
 ORDER NO. R-2047-A

Applicant:

Robert E. Chandler Corporation

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

Other Ernest L. Padilla

PADILLA & SNYDER
ATTORNEYS AT LAW
200 W. MARCY, SUITE 212
P.O. BOX 2523
SANTA FE, NEW MEXICO 87504-2523
(505) 988-7577

April 4, 1986

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APR 4 1986

OIL CONSERVATION DIVISION

HAND DELIVERED

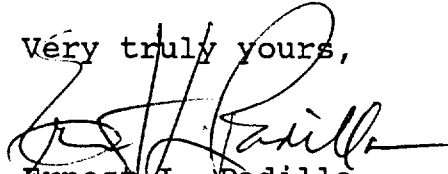
Mr. David R. Catanach
New Mexico Oil Conservation Division
Old Santa Fe Trail
Santa Fe, New Mexico

Re: Oil Conservation Division Case No. 8859

Dear Mr. Catanach:

Enclosed is the original Reply Memorandum of Protestants for filing in the above-referenced action on behalf of Michael L. Klein, John H. Hendrix, John H. Hendrix Corporation, and Ronnie H. Westbrook. Also enclosed for your reference are copies of the cases cited in the Memorandum.

Very truly yours,



Ernest L. Padilla

ELP:jmo
Enclosures

Copies (w/ Reply Memorandum only):

W. Thomas Kellahin, Esq.
Jeffery Taylor, Esq.
✓ Mr. R. L. Stamets
Mr. Michael L. Klein
Mr. John H. Hendrix

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY AND MINERALS
OIL CONSERVATION DIVISION

IN THE MATTER OF THE APPLICATION
OF ROBERT E. CHANDLER CORPORATION
FOR AN AMENDMENT TO DIVISION
ORDER R-8047.

CASE NO: 8859

REPLY MEMORANDUM OF PROTESTANTS

In our Memorandum in Support of Motion to Dismiss, we directed the Division's attention to Continental Oil Co. v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962) for the proposition that the Division's powers and jurisdiction are strictly limited to matters related to the conservation of oil and gas in New Mexico.

Protestants in this case do not quarrel or in any way question the Division's basis of authority for issuance of Order R-8047. Unquestionably, the Division had the authority to force pool the nonconsenting working interest under the terms and conditions of that Order. However, it is quite another thing for the Division to even attempt the construction and interpretation of Protestant's net profits interest and change such net profits interest into a working

interest and, therefore, subject said interest to the provisions of the Order.

We must again turn to Continental Oil Co. v. Oil Conservation Commission, supra, for guidance on the Division's authority in this case. In Continental, the New Mexico Supreme Court, at page 324, deals with the doctrine of separation of powers and whether the Oil Conservation Commission was a necessary party in that case, stating:

If the protection of correlative rights were completely separate from the prevention of waste, then there might be no need in having the commission as a party; but if such were true, it is very probable that the commission would be performing a judicial function, i.e., determining property rights, and grave constitutional problems would arise. For the same reason, it must follow that, just as the commission cannot perform a judicial function, neither can the court perform an administrative one. (Citations omitted.)

It is submitted, purely and simply, that should the Division construe Protestants' net profits interest as a working interest, the Division would be performing a judicial function. Let us, however, examine this situation more closely. If the net profits interest is indeed a working interest as Applicants seem to contend, why then is it necessary to amend Order R-8047? Applicant's motive,

following the hearing, is simply that Applicant's desire to eliminate the net profits interest in order to make the proposed drilling venture more desirable to a third party who will actually expend the necessary funds to drill the proposed well. (The Applicant's witness at hearing testified Applicant would not be drilling the well and would be carried to casing point.)

The proposed change of Protestants' property interest makes Applicant's anticipated transaction presumably salable -- at Protestants' expense.

The issue concerning the authority of oil and gas conservation has been addressed by Texas courts on numerous occasions where jurisdictional issues involving the Texas Railroad Commission have arisen. Mueller v. Sutherland, 179 S.W.2d 801, 808 (1943), involving a spacing case, early decided it was fundamental that the rules and regulations of the Railroad Commission could not have the result of effecting a change or transfer of property rights. See also Whelan v. Placid Oil Company, 274 S.W.2d 125 (1954), citing Mueller v. Sutherland, which further states that the Railroad Commission had no jurisdiction to determine matters of title although in that case its action, based on conservation rules and regulations, was proper. Ryan Consolidated Petroleum Corp. v. Pickens, 285 S.W.2d 201, 207 (1956) also held that the Texas Railroad Commission was

powerless to determine property rights although the Texas legislature has conferred broad, extensive, and exclusive regulatory powers for the regulation of the oil and gas industry in Texas.

Pan American Production Company v. Hollandsworth, 294 S.W.2d (1956), like Ryan Consolidated, supra, was a "Rule 37" case and gives us exceptional guidance as to a conservation agency's role with respect to title. The Court in that case held that all the Railroad Commission was required to do was determine that the applicant for a drilling permit had a good faith claim to the tract being drilled and that the rules of the Commission were met.

Section 70-2-12(B)(8) N.M.S.A. 1978 Compilation empowers the Division to "identify the ownership of oil and gas leases, properties. . . ." We submit that this statutory provision is a standard which goes no further than the test enunciated in Pan American Production Company v. Hollandsworth. In our case, the quoted statutory provision merely allows the Oil Conservation Division to "identify" Protestants' interest as a net profits interest -- no more, no less.

If the instrument creating Protestants' net profits interest is ambiguous or subject to interpretation, a court of competent jurisdiction is to determine whether such instrument is ambiguous and, if not, to determine from the

terms and provisions of the instrument itself the intent of the parties. See Pan American Petroleum Corp. v. Railroad Commission, 318 S.W.2d 17 (1958), which cites liberally from the earlier Texas case of Magnolia Petroleum Co. v. [Railroad] Commission, 170 S.W.2d 189, as follows:

The function of the Railroad Commission in this connection is to administer the conservation laws. When it grants a permit to drill a well it does not undertake to adjudicate questions of title or rights of possession. These questions must be settled in the courts. When the permit is granted, the permittee may still have no such title as will authorize him to drill on the land. * * *if he has possession, or can obtain possession peaceably, his adversary may resort to the courts for a determination of the title dispute, and therein ask for an injunction or for a receivership. In short, the order granting the permit is purely a negative pronouncement. It grants no affirmative rights to the permittee to occupy the property, and therefore would not cloud his adversary's title. It merely removes the conservation laws and regulations as a bar to drilling the well, and leaves the permittee to his rights at common law. Where there is a dispute as to those rights, it must be settled in court. The permit may thus be perfectly valid, so far as the conservation laws are concerned, and yet the permittee's right to drill under it may depend upon his establishing title in a suit at law. In such a suit the fact that

a permit to drill had been granted would not be admissible in support of permittee's title.

* * * If the applicant makes a reasonably satisfactory showing of a good-faith claim of ownership in the property, the mere fact that another in good faith disputes his title is not alone sufficient to defeat his right to the permit; neither is it ground for suspending the permit or abating the statutory appeal pending settlement of the title controversy.

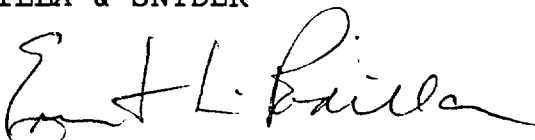
CONCLUSION

The foregoing language from Magnolia Petroleum Co. v. [Railroad] Commission clearly establishes jurisdictional boundaries between a conservation agency and a court with respect to ascertainment of a private contractual interest. We do not quarrel with a valid exercise of the State's police powers and delegations thereof to the Division resulting in issuing a compulsory pooling order such as R-8047 to prevent waste. However, for the Division to

adjudicate a change of a property right is clearly beyond the scope of the Divisions authority.

Respectfully submitted,

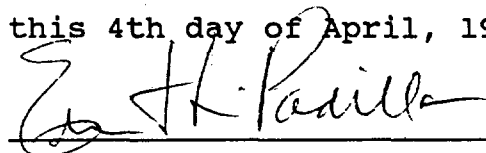
PADILLA & SNYDER

By 
Ernest L. Padilla
Post Office Box 2523
Santa Fe, New Mexico 87504-2523
(505) 988-7577
Attorneys for Protestants

This is to certify that the undersigned caused a true and correct copy of the foregoing Reply Memorandum of Protestants to be mailed first class, postage prepaid to:

W. Thomas Kellahin, Esq.
Kellahin & Kellahin
Post Office Box 2265
Santa Fe, New Mexico 87504-2265

this 4th day of April, 1986.



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

March 25, 1986

RECEIVED

MAR 25 1986

OIL CONSERVATION DIVISION

Mr. Richard L. Stamets
Oil Conservation Division
P. O. Box 2088
Santa Fe, New Mexico 87504

"Hand Delivered"

Mr. David R. Catanach
NM Oil Conservation Division
P. O. Box 2088
Santa Fe, New Mexico 87504

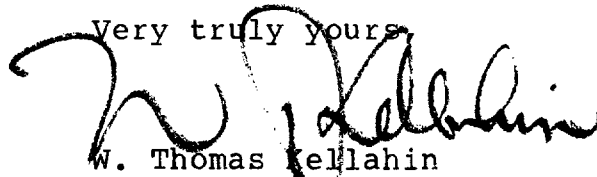
Re: Robert E. Chandler
NMOCD Case 8859

Gentlemen:

On behalf of Robert E. Chandler Corporation, please find enclosed our Memorandum in response to Mr. Padilla's Motion on behalf of Michael L. Klein to dismiss our application.

This case was heard on the Examiner Docket of March 19, 1986.

Very truly yours,



W. Thomas Kellahin

WTK:ca
Enc.

cc: Robert E. Chandler Corp.
341 Mid-America Building
Midland, Texas 79701

Ernest L. Padilla, Esq.
P. O. Box 2523
Santa Fe, New Mexico 87504

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY AND MINERALS
OIL CONSERVATION DIVISION

OIL CONSERVATION DIVISION

IN THE MATTER OF THE APPLICATION
OF ROBERT E. CHANDLER CORPORATION
FOR AN AMENDMENT TO DIVISION
ORDER R-8047.

CASE: 8859

MEMORANDUM OF ROBERT E. CHANDLER
CORPORATION IN SUPPORT OF DIVISION
JURISDICTION IN THIS MATTER AND
IN OPPOSITION TO MICHAEL L. KLEIN,
et al, MOTION TO DISMISS

The application of Robert E. Chandler Corporation ("Chandler") seeks to have the Division decide a disputed factual issue and to determine what leasehold interests are operating interests from which Chandler can collect the costs of the well and the risk factor penalty pursuant to Division Pooling Order R-8047.

Michael L. Klein and other owners of a net profits interest in the affected acreage contend that a net profits interest they own is not subject to its share of the costs of the well or penalty because it is not a working interest. Klein contends that the Division lacks jurisdiction to determine if the net profits interest is subject to the costs of the well and the risk factor and that matter should be resolved in a declaratory action in District Court.

Contrary to the contentions of Klein, it is not the District Court's job to determine working interest under a Division pooling order. The Division has jurisdiction over the subject matter in dispute in this case; i.e., what are the working interests?

FACTS:

Chandler seeks to drill an oil well on a 40-acre tract in which he owns 50% of the leasehold working interest. The remaining 50% working interest in the 40-acre tract was owned by Sun Exploration and Production Company.

Despite Chandler's efforts, Sun refused to voluntarily participate in the drilling of the well and on September 25, 1985, the Division held a hearing in Case 8686 on Chandler's application to force pool the balance of the interest in this tract. The testimony established that the well would cost approximately \$500,000 and that Chandler anticipated recoverable reserves of 100,000 barrels of oil. The Division entered Pooling Order R-8047 pooling the Sun interest and granting Chandler a 200% risk penalty.

Sun was notified, pursuant to the Pooling Order, and failed to participate within the time limits required by the order. During this period, Sun and Klein, with others, were in litigation over the Sun interest in this acreage and other acreage. Further, the Sun interest was

subject to an April 1, 1966 Agreement between Prudential Insurance Company and Seagram & Sons, which among other things, created a 50% net profits interest.

Chandler sought and obtained an extension of the Pooling Order drilling date to April 1, 1986 in order to await the settlement of Sun-Klein litigation. That litigation is being settled and as a result Sun is to assign its interest in this tract along with the net profits interest to Klein.

Klein has asserted that if Chandler drilled the oil well pursuant to the Pooling Order that he will demand that the net profits interest which he obtained from Sun must be paid to him from initial production and is not subject to share in the costs of the well and penalty.

On March 19, 1986, the Division held a hearing upon Chandler's application for a decision by the Division to define what constitutes a working interest against which the costs and penalty can apply. Mr. John Savage, a petroleum engineer with 35 years of experience, testified that if the Klein 25% net profits interest was treated like a true overriding royalty then it would constitute an excessive burden upon Chandler and he could not drill the well despite having a pooling order.

Mr. Savage testified that if the 25% net profits interest was subject to the costs of the well (see Chandler Exhibit 8), then one-half of the costs of the well would be charged to Klein (\$250,000) and Chandler

would have one-half of the reserves (50,000 barrels x \$17/per barrel) at a value of \$850,000 from which to recover the Klein cost that Chandler would have to carry. If the net profits interest is charged with its share of the costs and penalty, the economics of the project show it is only marginally profitable taking 66 months to payout, showing a return on investment of 2.4 to 1 and a rate of return of 22.4%. However, if the 25% net profits interest is NOT subject to pay its share of the costs and penalty, then there will only be available \$425,000 from Klein's share of production from which Chandler can recover \$750,000 to which Division Order R-8047 says he is entitled.

A net profits interest is defined by Williams and Meyers as an interest which "continues for the duration of the leasehold, one party continuing to bear costs and the other receiving a share of proceeds after payment of such costs." 8 H. Williams and C. Meyers, Oil and Gas Law at 102 (1984). Indeed, the interest covered by the Prudential-Seagram Agreement is expressly defined on page 10 of the document as follows:

Against the net profits account shall be charged the following:

(a) All capital costs incurred by Seagram in connection with its owning, operating, exploring, developing, maintaining or abandoning the Subject Interests or any part thereof or any wells thereon which are incurred and paid by Seagram after the Effective Date;

(b) All direct costs of operation of the Subject Interests (including all wells located thereon) which are incurred and paid by Seagram after the discharge of the Reserved Production Payment.

(c) That portion of the reasonable district office expenses of Seagram incurred after the discharge of the Reserved Production Payment for any district of Seagram in which any of the Subject Interests are located which is properly allocable to the Subject Interest, such allocation to be made on the basis of the ratio of the number of producing wells in such district subject to the Net Profits Overriding Royalty which are operated by Seagram to the total number of producing wells in such district operated by Seagram, provided, however, that the charges to the net profits account for district expense shall not duplicate any charges for district expenses receivable by Seagram as operator under any operating agreement or any charges properly made under any other clause hereof.

JURISDICTION:

Pursuant to Section 70-2-6 NMSA-1978, the New Mexico Legislature has delegated to and charged the Oil Conservation Division of New Mexico with the jurisdictional authority over all matters relating to the conservation of oil and gas:

It shall have jurisdiction, authority, and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act or any other law of this state relating to the conservation of oil or gas...

More specifically, in Section 70-2-17(c) NMSA-1978, the New Mexico Legislature has explicitly granted to the Oil Conservation Division the jurisdiction to decide the terms and conditions of forced pooling orders "[F]or the

purpose of determining the portions of production owned by the persons owning interests in the pooled oil or gas or both..."

It is basic Hornbook Law that where a court or administrative body is dealing with a controversy of the kind it is authorized to adjudicate, and has the parties before it, it has jurisdiction. In this case we have the parties before the Division to discuss the terms and conditions of a pooling order entered by the Division, so that the Division can define the types of non-consenting working interests, which are subject to paying costs and penalty under such an order. See Thermoid Western v. Union Pacific Railroad Company, 365 P.2d 65 (Utah 1961).

The forced pooling statutes and orders of this Division become useless if non-consenting working interest owners can avoid the cost and penalty factors of a pooling order simply by declaring their working interest to be subject to excessive overriding royalty burdens. In this case Klein seeks to escape the effects of the pooling order by declaring its 25% net profits interest to be of the same nature as an overriding royalty. Klein then argues that the Division has no jurisdiction to modify its interest. Chandler contends that the question before the Division is not the modification of Klein's interest, whatever it may be, but whether or not it is a working interest subject to its

share of well costs. This the Division may do under Mitchell v. Simpson, 493 P.2d 399 (Wyo. 1972).

In order to effectuate such powers (prevent waste and protect correlative rights), the Commission had jurisdiction and authority over all persons necessary for such effectuation, including oil and gas lessor or one having only royalty interests.

As the Commission has jurisdiction to determine the allocation of drilling costs among working interest owners, surely it has jurisdiction to determine who those working interest owners are.

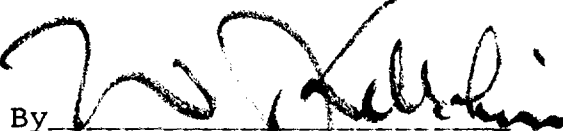
The evidence at the March 19, 1986 hearing was that if the 25% net profits interest is treated as an overriding royalty, then that excessive royalty burden would be too high and the entire spacing unit uneconomic, thus precluding Chandler from drilling the well despite having obtained a pooling order.

It is the practice of this Division that the consenting owners may recover the non-consenting owner's share of costs plus risk penalty only out of the non-consenting owners share of production and not out of the share allocated to royalty owners and overriding royalty owners. In order to take advantage of that practice, Klein declares its "net profits interest" not to be a "working interest" and thus free of the costs. Obviously, the larger the royalty interest and other non-working interest burdens are, the smaller is the remaining production that is attributable to the non-

consenting owners and to which the participating owners must look in order to recover the non-consenting owner's share of costs plus the appropriate penalty.

The undisputed testimony in this case is that the 25% net profits interest was made subject to the cost in the original 1966 Agreement with Prudential and Seagram and must be subject to the costs and penalty or the well cannot be economically drilled, thus violating the correlative rights of Chandler and circumventing the Division's pooling order.

Kellahin & Kellahin



By
W. Thomas Kellahin
P. O. Box 2265
Santa Fe, New Mexico 87501