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

APPLICATION OF BETTIS, BOYLE & STOVALL TO REOPEN CASE 12601 AND AMEND ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE PROPOSED WELL FOR THE PURPOSE OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO. **CASE 12601 (REOPENED)**

BETTIS, BOYLE & STOVALL'S HEARING MEMORANDUM

By Order No. R-12601 dated April 26, 2001, the Oil Conservation Division granted the application of Bettis, Boyle & Stovall and, pursuant to the provisions of Section 70-2-17(C) of the Oil and Gas Act, pooled all uncommitted mineral interests, whatever they may be, under certain spacing units in the W/2 SW/4 of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico. Sun-West Oil and Gas, Inc. ("Sun-West") owned 15% of the mineral interest under the pooled acreage. With this application, Bettis, Boyle & Stovall asks the Oil Conservation Division[1] to determine the appropriate royalty burdens on the Sun-West interest for this burden will impact the charge for risk paid by Sun-West and, therefore, the economics of the development of this property. Sun-

[1] In this memorandum the term Oil Conservation Division also is intended to include the Oil Conservation Commission.

West opposes this application for the stated reason, "there is no legal basis for taking its property." *See*, Sun-West Prehearing Statement.

FACTS:

Sun-West owned 15% of the unleased mineral interest in certain acreage in Section 30, including the acreage pooled by Order No. R-12601. Commencing December 15, 2000, Bettis Boyle & Stovall attempted to lease the Sun-West interest or otherwise reach a voluntary agreement with Sun-West for the development of the W/2 SW/4 of Section 30. No agreement could be reached concerning an appropriate royalty burden for the Sun-West tract; and on January 30, 2001, pursuant to the compulsory pooling provisions of the Oil and Gas Act, Bettis, Boyle & Stovall filed an application with the Oil Conservation Division. The application and notice of hearing thereon were sent by Certified Mail which was received by Sun-West on February 6, 2001. On February 15, 2001, Sun-West leased its mineral interest in the W/2 SW/4 of Section 30 to Gulf Coast Oil & Gas Company and made subject to a **27.5%** royalty burden.

NEW MEXICO COMPULSORY POOLING STATUTE:

The New Mexico Oil and Gas Act authorizes the Oil Conservation Division to pool oil and gas interests where the owners "... have not agreed to pool their interests, and where one such separate owner, or owners, ... has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply...." This statute also provides that a Division pooling order "...may

include a charge for risk... which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well."

In carrying out its statutory duties, the Division has been granted broad authority. *See*, Santa Fe Exploration Co. v. Oil Conservation Commission, 114 N.M. 103, 835 P.2d 819 (1992); Continental Oil Company v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962).

In the past the Oil Conservation Division has been presented with similar situations where an interest owner has burdened its acreage in a way which undercuts its pooling authority. In those cases, the Division has not allowed that to happen.[2] It has recognized that the creation of a non-cost bearing interest out of the working interest, like the royalty interest in this case, decreases the risk borne by the person creating this interest and increases the risk for the remaining working interest owners in the well. It is nothing more than an attempt through private agreement to circumvent or preclude the Division from exercising of its

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[2] In Case 12087, Nearburg Exploration Company, L.L.C. sought an order pooling certain lands in Lea County, New Mexico. The evidence showed that Merit Energy Company had an internal "nets profits interest" which might unnecessarily burden Merit's working interest. Since this "net profits interest" would not be subject to bear any of the costs of drilling or completing the well nor be subject to the risk penalty imposed by a pooling order, the Division ordered that this net profits interest be liable for its share of the drilling and completion costs and that it be subject to the risk factor penalty. Order No. R-11109, Findings (7) through (9),December 11, 1998.

In Case No. 8640, Order No. R-7998, August 8, 1985, Caulkins Oil Company obtained an order which required the "voluntary reduction" of the overriding royalty interest which was considered to be excessive.

jurisdiction and authority. *See,* Patterson v. Stanolind Oil & Gas Co. 182 Okla 155, 77 P2d 83 (1938).

In this case, Bettis, Boyle & Stovall had advised Sun-West that the royalty burden it sought was unacceptable and at the April 19th Examiner hearing on this application testified that the creation of a 27.5% royalty burden on the Sun-West interest would put the project in unfavorable economics. *See*, Testimony of Stubbs, Tr. at 32. Having been unsuccessful in negotiating an agreement with Bettis, Boyle & Stovall and after receiving the application for compulsory pooling, Sun-West imposed the royalty burden on this acreage through a private agreement with Gulf-Coast.

This negotiation of this lease was not an arms-length transaction. It was an attempt to circumvent the Oil Conservation Division. As the testimony showed at the April 19th Examiner hearing in this matter, a review of the Armstrong Oil Directory shows Sun-West and Gulf Coast have the same officers, same address and same phone numbers. Furthermore, when Gulf Coast was contacted by Bettis, Boyle & Stovall, the person who responded was the same person who had previously responded for Sun-West. He confirmed that these entities were the same. *See*, Transcript in Case 12601, April 19, 2001, at pp. 16-17.

Bettis, Boyle & Stovall asks the Division to treat the Sun-West interest as it was on the day this compulsory pooling application was filed -- as an unleased mineral interest. This is appropriate under New Mexico law and under the

decision in Case No. 11510, R-10672-A for in that case the Division recognized that in compulsory pooling proceedings, the status of a mineral interest is its status at the time the application was filed. The Sun-West interest was unleased on January 30th and as such must be treated under the Oil and Gas Act as a seven-eighth's working interest and a one-eighth's royalty interest[3].

The Oil Conservation Division has jurisdiction over all interest owners in a spacing and proration unit[4] and the power to reduce burdens imposed to circumvent its jurisdiction. It has exercised this authority in the past to reduce unreasonable non-cost bearing burdens on acreage subject to pooling and should do so now. To do otherwise would encourage parties subject to a pooling hearing to attempt to circumvent Division jurisdiction with a private agreement.

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[3] "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest." NMSA 1978, Section 70-2-17(c).

[4] NMSA 1978, Section 70-2-17(c) authorizes compulsory pooling where "...two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof embraced within such spacing or proration unit..."

Respectfully submitted,

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AND
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CERTIFICATE OF SERVICE

I certify that on this 31st day of May, 2001, I hand delivered a copy of this Hearing Memorandum to the following counsel of record.

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