MEMORANDUM

9/19/01

To: Lori Wrotenbery
Richard Ezeanyim
Michael Stogner
David Catanach

From: David Brooks

Date: September 18, 2001

Re: Case No. 12601, Bettis, Boyle and Stovall

The attached, proposed order involves an important issue of law. In this compulsory pooling case, the owner of an unleased mineral interest entered into a lease with an affiliate providing for a 27.5% royalty after the compulsory pooling application was filed and after receipt of notice thereof, but prior to the hearing. The question is whether the Division can, under those circumstances, treat the interest as unleased, and allow recovery of costs and risk penalty out of 87.5%, or whether it must limit cost recovery and risk penalty to the 72.5% net revenue interest accruing to the working interest under the terms of the affiliate lease.

I have written this order to treat the interest as unleased.

Briefs and my research did not reveal any New Mexico authority in point. The Supreme Court of Oklahoma, in *O'Neill v. American Quasar Petroleum Co.*, 617 P.2d 181, 68 O.&G.R. 282 (Okla. 1980), a 5 to 4 decision, held that the Oklahoma Corporation Commission did not have that authority. However, that decision was premised on the terms of the Oklahoma statute which gave the Commission authority to pool only the interests of "owners." Although the New Mexico statute defines "owners" in the same manner as the Oklahoma statute, limiting that term to owners of interests that entail the right to drill, the New Mexico statute expressly permits pooling all interests. The *O'Neill* case is the only one cited that I believe to be in point. However, for the reason indicated, I believe it to be distinguishable.

The Division has skirted this issue several times. Finding No. 13 in my proposed order is a close paraphrase of Finding No. 12 in Division Order No. R-9845, authored by Hon. Michael E. Stogner. However, neither that order, which involved the issue of whether notice was required to owners of unrecorded interest, nor the orders cited in Finding No. 14 of my proposed order, required the Division to address directly the legal issue here presented.

My analysis of the pertinent statutory language is set out in the proposed order.

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

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

REOPENED
CASE NO. 12601
ORDER NO. R-11573-A

APPLICATION OF BETTIS, BOYLE AND STOVALL TO RE-OPEN COMPULSORY POOLING ORDER NO. R-11573 TO ADDRESS THE APPROPRIATE ROYALTY BURDENS ON THE WELL FOR THE PURPOSES OF THE CHARGE FOR RISK INVOLVED IN DRILLING SAID WELL, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on May 31, 2001, at Santa Fe, New Mexico, before Examiner Michael E. Stogner.

NOW, on this ___ day of September, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) On April 26, 2001, pursuant to the Application of Bettis, Boyle and Stovall ("Applicant"), the Division entered Order No. R-11573, providing for the compulsory pooling of all uncommitted mineral interests from the surface to the base of the Undesignated South Flying "M" Bough Pool underlying Lots 3 and 4 (W/2 SW/4 equivalent) in Section 30, Township 9 South, Range 33 East, NMPM, Lea County New Mexico as therein provided.

(2) Division Order No. R-11573 provided for recovery out of production attributable to the interest of non-consenting working interest owners of reasonable well costs of Applicant's proposed McGuffin "C" Well No. 1, together with an additional 200% of such costs as a charge for the risk involved in drilling such well.

(3) Order No. R-11573 further provided, in ordering paragraph (12), that:

> "Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests."

(4) On May 3, 2001, Applicant requested the Division to reopen this case "for the purpose of amending Division Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the non-consent penalty."

(5) In the reopened hearing, Applicant seeks an order allowing it to recover the portion of well costs, and of the 200% risk charge, attributable to the mineral interest of Sun-West Oil & Gas, Inc. ("Sun-West") in the Unit out of 87.5% of production attributable to such interest, as though such interest were unleased, thereby disregarding the terms of a lease from Sun-West Oil & Gas, Inc. to Gulf Coast Oil and Gas Company ("Gulf Coast"), which provides for a royalty of 27.5%.

(6) Applicant presented testimony that:

(a) On the date its application was filed seeking an order pooling the subject units, Sun-West was an owner of an unleased 15% mineral interest in the lands sought to be pooled.

(b) Applicant was unable to reach a voluntary agreement for the development of the subject lands because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which, in Applicant's opinion, would have rendered the drilling of the proposed well uneconomic.

(c) Applicant proposed to lease Sun-West's mineral interest on terms providing for a royalty of 18.75%, but Sun-West was unwilling to lease to Applicant on those terms. In the opinion of Sun-West's expert a larger royalty than 18.75% would render the prospect undesirable.

(d) Applicant filed its application in this case on January 30, 2001.

(e) Notice of the filing of the application in this case and of the hearing thereon was sent by certified mail and received by Sun-West on February 6, 2001.

(f) On February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving a royalty of 27.5%.

(7) Applicant further presented testimony that:

(a) Gulf Coast has the same address, telephone number and officers as Sun-West; and

(b) When applicant sought to contact Gulf Coast to negotiate terms of pooling of its interest in the proposed Unit, the individual who contacted Applicant to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West.

(8) Sun-West appeared by counsel at the hearing on the re-opened application, but presented no testimony.

(9) The interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and when Sun-West was served with notice of the application.

(10) The subsequent lease of the 15% mineral interest from Sun-West to Gulf Coast was not an arms-length transaction, but was consummated for the apparent purpose of increasing the share of production which Sun-West would be entitled to receive free of costs in the event of the entry of a compulsory pooling order by the Division.

(11) NMSA 1978 Section 70-2-17.C provides that:

> The division is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to all production from such well which would be received by the owner, or owners, for whose benefit the well was drilled or operated, *after payment of royalty as provided in the lease, if any, applicable to each tract or interest*, and obligations payable out of production, until the owner or owners drilling or operating the well or both have been paid the amount due under the terms of the pooling order or order settling such dispute." [Emphasis added]

(12) However, NMSA 1978 Section 70-2-17.C also provides that:

> All orders effecting such pooling 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 and gas, or both."

and further provides:

> 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, ...

(13) It would circumvent the purposes of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 70-2-38, as amended) to allow a party owning an unleased mineral interest in the spacing unit at the time said party was served with a compulsory pooling application to avoid the cost recovery and risk charge provisions of the Act by leasing or otherwise burdening or reducing that interest through a transaction with an affiliated entity after the application and notice of hearing are filed with the Division and served on the party.

(14) In previous cases where an interest subject to compulsory pooling was carried a burden so large that it could not be pooled in a manner that afforded to other owners in the spacing unit the opportunity to recover their just and fair share of the oil or gas, the Division has allowed the owners of the burden ~~in question~~ the alternatives of voluntarily reducing the interest not subject to cost recovery or being excluded from the unit. This was done in Division Orders No. R-7335 and R-7988.

(15) The remedy of excluding the burdened interest from the unit is not available in this case because the interest owned by Sun-West is an undivided interest in the entire spacing unit, and not a separate tract.

(16) In order to effect pooling of the subject units on terms ~~which~~ that are just and reasonable under the peculiar circumstance of this case, and to allow Applicant the opportunity to recover or receive without unnecessary expense its just and fair share of the oil underlying the subject units, the interest of Sun-West should be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Division No. Order R-11573.

(17) The Division has not been asked to address, and should not address, any issue regarding rights or duties as between Sun-West and Gulf Coast.

(18) Due to the delay occasioned by the reopening of this Case No., the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573 should be extended to December 31, 2001.

(19) In all other respects, Division Order No. R-11573 should remain in full force and effect.

CONCLUSION OF LAW:

The Division concludes that the power expressly conferred on the Division by the portion of NMSA 1978 Section 70-2-17.C quoted in finding paragraph (11) is cumulative and not exclusive, and that the Division has power, pursuant to NMSA 1978 Section 70-2-11.A, and to the directive set forth in that portion of Section 70-2-17.C quoted in finding paragraph (12), to allow recovery of costs and risk charges out of production attributable to a non-expense-bearing interest where necessary to effect pooling upon terms that are fair and reasonable and to protect correlative rights, at least with respect to interests created subsequent to attachment of the Division's jurisdiction.

IT IS THERE FORE ORDERED THAT:

(1) Pursuant to the application of Applicant, this Case No. 12601 is reopened for the purpose of reconsidering the allocation of costs and risk charges as to the interest of Sun-West.

(2) Division Order No. R-11573 is hereby amended to provide that the interest owned by Sun-West in the Units as of the date of the filing of the original application in this case shall be treated as an unleased mineral interest for the purpose of applying ordering Paragraphs (8), (11) and (12) of Division Order No. R-11573, but not otherwise.

(3) The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573 is hereby extended to December 31, 2001.

(4) In all other respects, Division Order No. R-11573 is hereby confirmed and shall be and remain in full force and effect.

(6) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

LORI WROTENBERY
Director

S E A L

PROPOSED FINDINGS FOR DIVISION ORDER NO. R-11573-A:

(__) Bettis, Boyle & Stovall was unable to reach a voluntary agreement for the development of the subject spacing and proration units because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which was so high it would have jeopardized the drilling of the well. (April 19, 2001 Examiner Hearing, Testimony of Stubbs at Tr. 32).

(__) Bettis, Boyle & Stovall testified that on the date its application was filed seeking an order pooling the subject spacing units in the W/2 SW/4 of said Section 30, Sun-West Oil & Gas, Inc., was an unleased mineral owner of 15% of the mineral interests in these tracts. (April 19, 2001 Examiner Hearing, Testimony of Maloney at __).

(__) Pursuant to the provisions of the Oil and Gas Act, when an unleased mineral interest is pooled, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest and thereby not subject to payment of the costs of drilling and completing the well or charge for risk imposed by the pooling order. (NMSA 1978, Section 70-2-17(C)).

(__) Notice of the Bettis, Boyle & Stovall compulsory pooling application and the hearing thereon was sent by certified mail and received by Sun-West Oil & Gas, Inc. on February 6, 2001. (April 19, 2001 Examiner Hearing, Bettis, Boyle & Stovall Exhibit No. 6).

(__) On February 15, 2001, Sun-West leased its 15% mineral interest under the W/2 SW/4 of Section 30 to Gulf Coast Oil & Gas Company. (April 19, 2001 Examiner Hearing, Bettis, Boyle & Stovall Exhibit No. 4).

(__) Gulf Coast Oil & Gas Company has the same officers, address and owners as Sun-West. (April 19, 2001 Examiner Hearing, Testimony of Maloney at ___).

(__) The lease of the 15% mineral interest from Sun-West to Gulf Coast was not at arms length, but for the purpose of burdening the interest with an excessive royalty interest, was for the purpose of circumventing the pooling authority of the Division.

(__) At the time the Bettis, Boyle & Stovall compulsory pooling application was filed, Sun-West's 15% mineral interest in the subject lands was unleased and should be considered as seven-eighths working interest and one-eighth royalty interest. (See, Order No. R-10672-A, Conclusions of Law No. 3, January 16, 1997).

(__) Gulf Coast's seven-eighth's working interest, including any royalty interest carved out of this working interest should be liable for its share of drilling and completion costs and be subject to the risk factor penalty.

HOLLAND & HART LLP
AND
CAMPBELL & CARR
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August 31, 2001

01 SEP -3 PM 2:35

OIL CONSERVATION DIV

HAND DELIVERED

David Brooks, Esq.
New Mexico Department of Energy,
Minerals and Natural Resources
1200 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: Case No. 12601 (Reopened): 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.

Dear Mr. Brooks:

This matter was heard by the Division on May 31, 2001. The last Memorandum on the issues was provided to you by Mr. Cavin's office on June 13th. The Applicant informs me that it will not be able to proceed with this wildcat well if the Division does not issue an order on the application soon.

We respectfully request that the Division issue an order on this application as quickly as possible. Thank you for your attention to this matter.

Very truly yours,

Michael H. Feldewert

MHF/keh
cc. Sealy H. Cavin, Jr., Esq.
Mark Maloney

HOLLAND & HART LLP AND CAMPBELL & CARR

ATTORNEYS AT LAW

PARTNERING LAW AND TECHNOLOGY TO MEET YOUR NEEDS
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Friday, August 31, 2001

To:	Mr. David Brooks Oil Conservation Division	Fax : 476-3462 Phone: 476-3440
To:	C. Mark Maloney Bettis, Boyle & Stovall	Fax : 505.622.8340 Phone: 505.622.9907
To:	Sealy H Cavin, Jr., Esq. Stratton & Cavin PA	Fax : 505.243.1700 Phone: 505.243.5400

From: Michael H. Feldewert

Fax : 505.983.6043
Phone: 505.988.4421

Message:

Attached is a copy of a letter to David Brooks for your information.

☒ No Confirmation Copy Number of pages including cover sheet: 2

Attorney Number:	5101	Client/Matter Number:	44525.0001	Time Deadline:	
Operator Initials:	KEH	Date Transmitted:	8.31.2001	Time:	

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August 31, 2001

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