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August 1, 2006

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VIA HAND DELIVERY

Ms. Florene Davidson, Clerk
Oil Conservation Commission
New Mexico Energy, Minerals and Natural Resources Department
1220 South St. Francis Drive
Santa Fe, NM 87505

Re: Case No. 13367 (de novo): Application of Bass Enterprises Production Co. for an Order authorizing the drilling of a well in the potash area, Eddy County, New Mexico.

Case No. 13368 (de novo): Application of Devon Energy Production Company, L.P. for an Order authorizing the drilling of a well in the potash area, Eddy County, New Mexico.

Case No. 13372 (de novo): Application of Devon Energy Production Company, L.P. for approval of an unorthodox well location and authorization to drill a well in the potash area, Eddy County, New Mexico.

Dear Ms. Davidson:

Enclosed is an ***Application for Rehearing of Bass Enterprises Production Company and Devon Energy Production Company*** in the above referenced cases. Please call if you have any questions.

Very truly yours,

William F. Carr
of Holland & Hart LLP

WFC:keh
Enclosure

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

APPLICATION OF BASS ENTERPRISES PRODUCTION CO. FOR AN ORDER AUTHORIZING THE DRILLING OF A WELL IN THE POTASH AREA, EDDY COUNTY, NEW MEXICO.

CASE NO. 13367
(DE NOVO)

APPLICATION OF DEVON ENERGY PRODUCTION COMPANY, L.P. FOR AN ORDER AUTHORIZING THE DRILLING OF A WELL IN THE POTASH AREA, EDDY COUNTY, NEW MEXICO.

CASE NO. 13368
(DE NOVO)

APPLICATION OF DEVON ENERGY PRODUCTION COMPANY, L.P. FOR APPROVAL OF AN UNORTHODOX WELL LOCATION AND AUTHORIZATION TO DRILL A WELL IN THE POTASH AREA, EDDY COUNTY, NEW MEXICO.

CASE NO. 13372
(DE NOVO)

2006 JUL 13 PM 4 56

APPLICATION FOR REHEARING
OF
BASS ENTERPRISES PRODUCTION COMPANY
AND DEVON ENERGY PRODUCTION COMPANY

This Application for Rehearing is submitted by Holland & Hart LLP on behalf Bass Enterprises Production Company ("Bass") and Devon Energy Production Company ("Devon"). Bass is a party of record adversely affected by Oil Conservation Commission Order No. R-12402-A and Devon is a party of record adversely affected by Oil Conservation Commission Order No. R-12403-A. In accordance with the provisions of N.M.S.A. §70-2-25 (2006), Bass and Devon request the New Mexico Oil Conservation Commission ("Commission") grant this Application for Rehearing in Case Nos. 13367, 13368 and 13372 to correct the erroneous findings, conclusions and order paragraphs of Order Nos. R-12402-A and R-12403-A, and in support of this Application for Rehearing state:

INTRODUCTION

On July 13, 2006, the Oil Conservation Commission entered Order No. R-12402-A in Case No. 13367 and Order No. R-12403-A in Case Nos. 13368 and 13372 denying the applications of Bass and Devon for authorization to drill wells in the Potash Area. With these orders, the Commission has announced a new interpretation of Order No. R-111-P and adopted a new Oil Conservation Division ("Division") and Commission policy concerning the regulation of oil and gas drilling and potash development in the Potash

Area.[1] With this new policy, the Commission steps outside its jurisdiction, violates its duties under the Oil and Gas Act, authorizes the waste of oil and gas, and impairs the correlative rights of the owners of oil and gas rights in the Potash Area. This new policy violates the due process rights of the owners of oil and gas interests in the Potash Area and constitutes a taking of property without compensation. The findings in these orders are inadequate for they are (i) inconsistent with the evidence presented in these cases, and (ii) do not disclose the Commission's reasoning in rejecting the Bass and Devon applications – applications that are consistent Order R-111-P and with well established Division precedent. The orders and the new policy announced therein represent arbitrary, capricious and unreasonable actions by the Commission that are contrary to the statutes that empower the Commission to act.

BACKGROUND

Potash and oil and gas are produced from the same lands and this has created problems for the oil and gas industry for decades. It has also created problems for the Division since it is charged by the Oil and Gas Act with the prevention of waste of both resources.[2]

In 1988, because operations had become "virtually unworkable because of the lack of tolerance on the part of both oil / gas and Potash Industries regarding the activities of the other industry in areas where leasehold interests are overlapping..." [Order No. R-111-P, Finding (3)], the Division convened a study committee from both the oil and gas and potash industries to develop amendments to the regulations governing the development of these resources in the Potash Area.

The study committee reached an agreement ("Industry Agreement") which the Commission considered at its February 18, 1988 hearing. On April 21, 1988, Order R-111-P was adopted which promulgated "The Rules and Regulations Governing the Exploration and Development of Oil and Gas in Certain Areas Herein Defined, Which are Known to Contain Potash Reserves" ("the Potash Rules"). In adopting these rules the Commission accepted much of the Committee's report. It found that the agreement

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[1] The Potash Area is the area in which potash mining operations are now in progress, or in which core tests indicate commercial potash reserves. This area is coterminous with the Known Potash Leasing Area as determined by the BLM. See Order No. R-111-P Rule B.

[2] The Oil and Gas Act defines "waste" as "drilling or producing operations for oil or gas within any area containing commercial deposits of Potash where such operations would have the effect unduly to reduce the total quantity of such commercial deposits of potash which may reasonably be recovered -- or where such operations would interfere unduly with the orderly commercial development of such potash deposits" [N.M.S.A. § 70-2-3.F (1978)] and empowers the Division to regulate and prohibit drilling for oil and gas where necessary to prevent the waste of potash. See, N.M.S.A. § 70-2-12.B(17) (2006).

The Division and Commission are also charged by statute with the prevention of waste of oil and gas. This is the primary basis of the Commission's jurisdiction as conferred by the Oil and Gas Act. *See*, N.M.S.A. § 70-2-2 (2006).

was a compromise by both industries and expressly recognized its statutory obligations to both industries. [3]

ORDER NO. R-111-P – THE POTASH RULES

The Potash Rules adopted by Order R-111-P apply only to State lands and may apply to fee lands in the Potash Area[4] and are the rules which have governed drilling in the Potash Area since 1988. These rules specifically require a balancing of the interests of these competing industries. They provide:

> "The objective of these Rules and Regulations is to prevent waste, protect correlative rights, assure maximum conservation of oil, gas and potash resources in New Mexico, and permit the economic recovery of oil, gas and potash minerals in the area hereinafter defined." (Emphasis added) (Order No. R-111-P, Rule A).

These rules authorize potash lessees to annually designate lands for inclusion in a "Life of Mine Reserves" Area.[5] The data supporting the inclusion of these lands is submitted for review by the potash lessees to the State Land Office for state and fee lands and to the BLM for federal lands. If the agency agrees with the potash lessee's interpretation of the data, the acreage is included in an LMR and may not be developed except as authorized by Order No. R-111-P. Pursuant to R-111-P, "Information used by the potash lessee in identifying its LMR shall be filed with the BLM and SLO but will be considered privileged and confidential 'trade secrets and commercial . . . information' within the meaning of 43 C.F.R. §2.13(c)(4) (1986), Section 19-1-2.1 NMSA 1978, and not subject to public disclosure."

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[3] Order R-111-P.C provides:

> (2) No wells shall be drilled for oil or gas at a location which, in the opinion of the Division or its duly authorized representative, would result in undue waste of potash deposits or constitute a hazard to or interfere unduly with the mining of potash deposits.
>
> (3) No mining operations shall be conducted in the Potash Area that would, in the opinion of the Division or its Duly authorized representative, constitute a hazard to oil or gas production, or that would unreasonably interfere with the orderly development and production from any oil and gas pool. (Emphasis added).

[4] Federal lands are separately administered by the BLM which did not adopt the agreement reached between the oil and gas and the potash industry in 1988.

[5] A Life of Mine Reserves area ("LMR") is those potash deposits within the Potash Area reasonably believed by the potash lessee to contain potash ore in sufficient thickness and grade to be mineable using current day mining methods, equipment and technology." Order R-111-P, Rule G.(a).

When an oil and/or gas well is proposed, the Division contacts the State Land Office for state and fee lands, or the BLM for federal lands, to confirm if the proposed well is in a LMR. If it is, the application to drill is denied unless certain conditions set out in the order are met.[6] Order No. R-111-P, Rule G.(e)(3). At no time in this process is the owner of oil and gas mineral rights permitted to participate in the process for the designation of a LMR nor is it permitted to review or challenge any of the data produced by the potash lessee.

The Potash Rules also provide that (1) notice of any plan to drill an oil or gas well must be provided to all potash operators holding a potash lease within one mile of the proposed location, and (2) potash operators have 20 days after the receipt of the notice to object to the proposed well. Order R-111-P, Rule G.(e)(3).

In adopting the Potash Rules, the Commission added language to the Industry Agreement that provides for development in the LMR area and buffer zones under limited circumstances. The Commission's addition to the Industry Agreement provides:

> "Any application to drill within the LMR area, including buffer zones, may be approved only by mutual agreement of lessor and lessees of both potash and oil and gas interests." Order No. R-111-P, Rule G. (e)(3).

The language of Order R-111-P clearly shows that the Potash Rules are based on the individual ownership of these minerals. For example, under the Potash Rules, only owners may designate lands to be included in LMR's and only owners may give waivers for the drilling of wells in an LMR. These rule, as they have been interpreted in the past, recognize that all who own mineral interests in the Potash Area have constitutionally protected property interests in those minerals. Nothing in R-111-P provides that those who do not own an interest in the mineral estate can control how those who own the minerals can develop their interests.

SUBSEQUENT DECISIONS

Yates / NM Potash ("NM Potash") (Case Nos. 10446 and 10447, Order Nos. R-9650 and R-9651, R-9650-A and R-9651-A).

In 1992, the Oil Conservation Division and Commission entered orders that interpreted the Potash Rules in a way that affords the owners of oil and gas rights the opportunity to drill in the LMR area. These were the first cases to come before the Division and Commission after the adoption of the Potash Rules and represent an attempt by the Commission to address its statutory duty to prevent the waste of both of these resources.

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[6] This policy seems to be based on two fictions. The first is that the data must be kept confidential because of the highly competitive nature of the potash industry. The second is based on the assumption that potash can be mined first and then the oil and gas can be produced. The record and order in this case show neither of these arguments to be true.

The cases were heard by the Division and then appealed to the Commission. Each took the opportunity to interpret Order No. R-111-P and explain what was required of both oil and gas and potash owners who were developing the mineral resources in this area. These interpretations have been followed by the agency and the oil and gas industry since that time.

In these orders, the Commission found that:

> 1. "Waste occurs if oil and gas operations prevent NM Potash from safely mining commercial potash reserves and waste occurs and Yates' correlative rights are violated if Yates is prevented from developing their oil and gas reserves under the north half of Section 2." Order No. R- 9650 and Order No. R-9651-A, Finding 10.
>
> 2. The owner of the oil and gas rights under a lease may drill thereon where an agreement has been reached with the owner of the potash rights under that lease. See Case Nos. 10446 and 10447, Order Nos. R-9650 and R-9651, Finding 5, (denied application because no agreement with potash lessee), Order Nos. R-9650-A and R-9651-A, Finding 5 (oil and gas operator is entitled to drill if agreement with potash lessee **or** if an exception granted by the Commission). (Emphasis added).
>
> 3. Before an oil and gas operator may drill a well in the R-111-P area it must provide notice to all potash lessees within one mile of the proposed well and if there is no objection from a potash lessee to the proposed well, it may be drilled.

With these orders, the Commission did not endorse a regulatory system that allows the potash industry to keep its information secret from both the Division and the oil and gas operator. It did not treat the State Land Office process for the creation of an LMR as something that relieves it of its duty to prevent the waste of oil and gas.
It found that "mining plans are ... little more than a "guess" of future activity and should not be relied upon until they incorporate oil and gas activity and firm development commitments by both NM Potash and Yates." (Finding 15(6) R-9650-A and R-9651-A). It also observed there had been no documented cases of oil and/or gas migration into New Mexico potash mines due to oil and gas operations" (Order No. R-9650-A and R-9651-A, Finding 14) and concluded that the evidence presented in these cases by both sides on safety issues, including subsidence, were argued from "a theoretical perspective." It characterized the data of the potash industry as "conjecture" and stated that "hard data" was needed. (Findings 12 and 15, Order Nos. R-9650-A and R-9651-A).

To avoid mere conjecture, the Commission prescribed the type of proof that it would require of potash operators to establish that oil and gas drilling would cause the waste of potash. These requirements are set out in Order Nos. R-9650-A and R-9651-A, Finding 15, and includes facts concerning the economics of drilling, actual methane measurements at the wells, core information to develop ore body information, actual subsidence measurements and "hard data" from pilot holes. The Commission also

formed a Technical Committee and directed the Committee to develop a plan for the development of these resources. It directed this committee to "examine the confidentiality issues" and find a way "to promote cooperation in the use of this information in the LMR designation process."

Yates / Noranda ("Noranda") (Case No. 10490, Order No. R- 9990).

The facts of the 1993 Noranda case are virtually identical to those presented in this case. Yates proposed to drill in the LMR area on a fee tract at a location 330 feet from a Noranda Minerals, Inc. potash lease. Noranda objected to the well location. The fee owner of the potash rights in the lease supported the Yates plan to drill the well and appeared at the hearing in support of Yates.

In its findings in the order approving the application of Yates[7], the Division summarized its interpretation of the Potash Rules and expanded on the findings in Commission Cases Nos. 10446 and 10447. In approving the application for Permit to Drill the Division found: "The fundamental difference still remains however that all parties owning potash and oil and gas interests underlying a particular lease reached agreement on the extraction of their minerals." (Emphasis added) Order No. R-9990,

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[7] (10) According to Order No. R-111-P, an LMR determination by either the SLO of the BLM is within the exclusive authority of those agencies and such a determination by them is binding upon the Division.

(11) However, Order No. R-111-P makes no provision for an LMR determination when the proposed well is located on fee lands, nor does Order No. R-111-P authorize a potash lessee to designate an LMR over lands not leased to that potash lessee.

(12) While this particular matter is yet unresolved, it is a moot issue in this particular instance in that the proposed well location is within the half-mile buffer zone of a declared and recognized LMR filed by Noranda and designated by both the BLM and SLO.

(13) Sub-part G(e)3 of the Rules and Regulations Governing said oil/potash area, Order No. R-111-P, provides that:

> "applications to drill in the LMR area, including buffer zones, may be approved only by mutual agreement of lessor and lessees of both potash and oil and gas interests".

(14) Snyder Ranches, as the owner of the unleased potash underlying its acreage, has consented to Yates drilling the Snyder "AKY" Well No. 1 and desires to have its oil and gas minerals developed first and in preference to any potash reserves underlying its fee property.

(15) Yates has followed the provisions of Order R-111-P, sub-part G(e)2, which requires it to provide notice of its intent to drill to all potash lessees within one mile of the proposed well location.

(23) "Many of the same technical issues such as waste, safety, and the methodology pf determining LMR's brought out in this case parallel those of said Commission Cases 10446 and 10447. The fundamental difference still remains however that all parties owning potash and oil and gas interests underlying a particular lease reached an agreement on the extraction of their minerals. Further, the Division's potash / oil and gas rules provide no opportunity for those lessors owning potash leases within one mile to the proposed well to present evidence and air its concerns and gives them the opportunity to witness the critical operations over the life of the subject well.

Finding 23. The Division found that a potash lessee may not include in a LMR lands in which it has no potash lease. Order No. R-9990, Finding 11. It observed that the subject well location was within the Noranda LMR buffer zone (Order R-9990, Finding 12) but that there was agreement between the owner of the potash rights and the oil and gas operator and that the application therefore should be approved. Order No. R-9990, Findings 13 through 15. The Division determined that the Yates APD's were in full force and effect and ordered that the provisions of R-111-P concerning the operations of the well be "strictly adhered to." Order No. R-9990, Order paragraph 4).

With these orders, the Commission tried to meet its statutory charge to both industries. The interpretations announced in these orders have served as precedent for the Division and the industry since that time. Prior to the Commission orders at issue in these cases, the Division consistently recogniozed that wells may be drilled on leases where there is agreement for the drilling of the well between the owners of the potash and the oil and gas rights. *See*, Yates / NM Potash, Case Nos. 10446 and 10447, Order No. R-9650-B and R-9651-B, Finding 8; Yates / Noranda, Case No. 10490, Order No. R- 9990; Devon / Mosaic, Case No. 13272, Division Order No. R-12158; and Bass / Mosaic, Case No. 13367, Order No. R-12402. Prior to the Commission orders at issue in these cases, the Division has consistently approved applications for well permits in the Potash Area where there is no objection form the owner of the potash rights. *See,* Yates / Noranda, Case No. 10490, Order No. R- 9990; Yates / Mississippi, Case Nos. 11913. 11914, 11915, 11916, Order No. R- 10950; Hallwood / Mississippi, Case Nos. 12055, 12056, Order Nos. R-11092 and R-11093; Devon / Mosaic, Case No. 13272, Division Order No. R-12158; and Bass / Mosaic, Case No. 13367, Division Order No. R-12402.

Since the adoption of R-111-P, the Division and Commission have approved numerous drilling permits where there is an agreement between the owners of the oil and gas and potash under the lease on which the well is proposed and also approved applications for permits to drill wells where there is no objection to a proposed well from the owner of the potash interest. The Commission has called for the adoption of standards to govern the creation of an LMR and has announced the type of proof it requires from operator who attempts to prove that potash will be wasted where oil and gas wells are drilled. In short, the Commission has been attempting to regulate these resources in a manner that meets its statutory obligations to both industries.

DEVON AND BASS APPLICATIONS

The Applications for Permits to Drill of Bass and Devon comply with the provisions of Order No. R-111-P for mutual agreements for the development of these lands have been reached between the owners of the potash reserves and the owners of oil and gas rights in the tracts upon which these wells are proposed to be drilled.

Bass:

Bass is the lessee of the oil and gas rights under the NE/4 NE/4 of Section 7, Township 23 South, Range 31 East, NMPM, Eddy County, New Mexico. Bass has the right to develop the oil and gas reserves underlying this property and proposes to drill its James Ranch Unit Well No. 93 (Case No. 13367) at a standard location 660 feet from the

North and East lines of the section to test from the surface to the Morrow formation, Los Medanos-Morrow Gas Pool. This acreage is within the LMR area of Mosaic Potash Company, Inc. ("Mosaic") but is on a tract of fee land on which Mosaic owns no interest.

Bass leased the oil and gas rights under this fee acreage from Stacy Mills and his family who together own 53% of the oil and gas and potash mineral rights under this tract. Mr. Mills appeared at the hearing and testified that he was an owner of mineral interests under the 40-acre fee tract on which Bass proposes to drill and that he and his family prefer to have their oil and gas reserves produced before the potash reserves, if any, are mined. (Testimony of Mills at Tr. 108). Bass has also leased the remaining oil and gas rights under this acreage. These interests are administered by Wells Fargo Bank. Wells Fargo Bank confirmed that the potash rights under these tracts are unleased and that the bank supports Bass' application to drill the James Ranch Well No. 93 (Bass Exhibits 7 and 8). Therefore, the owners of the potash reserves under the NE/4 NE/4 of Section 7 support the drilling of the oil and gas well proposed by Bass prior to mining the potash reserves under this tract.

Order R-111-P provides that "[b]efore commencing drilling operations for oil or gas on any lands within the Potash Area" the operator of the well shall provide to each potash operator holding a potash lease within a radius of one mile of the proposed well a copy of its Notice of Intention to Drill and plat showing the location of the well. Order No. R-111-P, Rule G(2).

Bass followed the provisions of Order R-111-P, and prepared an Application for Permit to Drill (Form C- 101) and a Well Location and Acreage Dedication Plat (Form C- 102) showing the location of the James Ranch Unit Well 93. On August 16, 2004, by Express Mail-Return Receipt Requested, Bass notified IMC Potash Carlsbad, Inc., (predecessor to Mosaic) the only lessee of potash reserves within one mile of the proposed well location, of its intent to drill this well and sought IMC's waiver of objection to the proposed location. This notice was received by IMC on August 19, 2004. No objection to the application for permit to drill was received by the Division or Bass within the 20 days provided for objections by Order R-111-P and Bass' Application for Permit to Drill was approved by the Division on September 15, 2004. (Bass Exhibit No. 3, APD approved September 15, 2004).

On September 17, 2004, after the period for filing objections had run and the APD for the James Ranch Unit Well No. 93 had been approved by the Division, IMC wrote the Division and stated that the Division was "in error approving any APD within an LMR." By letter dated September 18, 2004, without providing Bass notice or an opportunity for hearing, the Oil Conservation Division rescinded Bass' Application for Permit to Drill.

IMC objected to the Bass permit by quoting the provision in R-111-P that provides "[a]ny application to drill in the LMR area, including buffer zones, may be approved only by mutual agreement of the lessor and lessees of both potash and oil and gas interests."

Devon:

Devon is the lessee of the oil and gas mineral rights under the SW/4 NW/4 of Section 24, Township 22 South, Range 30 East, NMPM, Eddy County, New Mexico on which it proposes to drill its Apache 24 Fee Well No. 6 (Case No. 13368) at a standard

location 1980 feet from the North line and 660 feet from the West line to test the Delaware formation. Devon also proposes to drill its proposed Apache 24 Fee Well No. 7 (Case No. 13372) from this 40-acre tract at a standard location 1460 feet from the North line and 1150 feet from the West line of the section to test the Devonian formation, Southeast Quadada Ridge-Delaware Pool. This acreage is within the LMR area of Mosaic Potash Company, Inc. ("Mosaic") but is on a tract of fee land on which Mosaic owns no interest.

Devon has leased oil and gas rights under this fee acreage from Kenneth Smith and his family who also own the potash mineral rights under this tract. Mr. Smith appeared at the hearing and testified that he was the owner of mineral interests under the 40-acre fee tract on which Devon proposes to drill and that he and his family prefer to have their oil and gas reserves produced before the potash reserves, if any, under their acreage is mined. (Testimony of Smith at Tr. 169). Therefore, the owners of the potash reserves under the SWE/4 NW/4 of Section 24 support the drilling of the oil and gas wells proposed by Devon prior to mining the potash reserves under this tract, if any.

Devon followed the provisions of Order R-111-P, and prepared an Application for Permit to Drill (Form C-101) and a Well Location and Acreage Dedication Plat (Form C-102) showing the location of the Apache 24 Fee Well No. 6. On January 23, 2004, by Certified Mail-Return Receipt Requested, Devon notified IMC Potash Carlsbad, Inc., the only lessee of potash reserves within one mile of the proposed well location, of its intent to drill this well and sought IMC's waiver of objection to the proposed location. This notice was received by IMC on January 26, 2004. No objection to the Application for Permit to Drill was received by the Division or Devon within the 20 days provided by Order R-111-P and Devon's Application for Permit to Drill was approved by the Division on February 19, 2004. On April 12, 2004, after the period for filing objections had run and the APD for the Apache 24 Fee Well No. 6 had been approved by the Division, IMC wrote Devon with copies to the Division objecting to the proposed well location and stating that its five year mine plan shows that IMC expects to mine within 1/4 mile of this location in the year 2007. By letter dated September 20, 2004, without notice and an opportunity for hearing, the Oil Conservation Division rescinded Devon's Application for Permit to Drill.

Devon also followed the provisions of Order R-111-P, and prepared an Application for Permit to Drill (Form C-101) and a Well Location and Acreage Dedication Plat (Form C-102) showing the location of the Apache 24 Fee Well No. 7A. In September 2004, by Certified Mail-Return Receipt Requested, Devon notified IMC Potash Carlsbad, Inc., the only lessee of potash reserves within one mile of the proposed well location, of its intent to drill this well and sought IMC's waiver of objection to the proposed location. IMC Potash Carlsbad, Inc. filed written objections to Devon's Application and by letter dated September 20, 2004, the Oil Conservation Division rejected Devon's Application for Permit to Drill.

IMC objected to Devon's applications for permits to drill asserting "there is no point within this tract that is outside the ¼ mile buffer required by R-111-A and any well within the tract would not constitute a hazard to the mining of federally owned potash reserves currently under lease to IMC."

OIL CONSERVATION DIVISION HEARING:

In response to the objections of IMC, the Division either rescinded previously approved permits or refused to approve the application for permit to drill for each well that is the subject of these consolidated cases. No notice was provided to Bass or Devon before these permits were rescinded or denied and there was no opportunity for a hearing prior to these denials and revocations.

Bass and Devon filed applications for hearing before the Oil Conservation Division seeking authorization to drill in the Potash Area. These applications came to hearing before a Division Examiner on December 2, 2004 and on August 8, 2005, the Division entered orders approving the applications for permits to drill. In approving these applications, the Division found as follows:

> (11) According to Order R-111-P, an LMR determination by either the SLO or the BLM is within the exclusive authority of those agencies and such a determination by them is binding on the Division.
>
> (12) However, Order R-111-P makes no provision for an LMR determination when the proposed well is located on fee lands, nor does Order R-111-P authorize a potash lessee to designate an LMR over lands not leased to a potash lessee.
>
> (13) Sub-part G (e) 3 of these rules, provides that: "application to drill in the LMR area, including buffer zones, may be approved only by mutual agreement of lessor and lessee of both potash and oil and gas interests."

Mosaic timely filed its appeal of these orders to the Oil Conservation Commission.

COMMISSION'S NEW INTERPRETATION (Orders Nos. No. R-12402-A and R-12403-A)

With the entry of Order Nos. R-12402 and R-12403-A, the Commission has changed its interpretation of the Potash Rules adopted by Order R-111-P. Mutual agreement between the owners of both the oil and gas and potash interests to first develop their oil and gas interests no longer assures these owners the right to do so - as it has been since the order in Noranda. Under this new interpretation, the absence of an objection by the owner of the potash rights under the lease on which a well is proposed to be drilled does not clear the way for drilling. Furthermore, the standards of proof that had to be met before and oil and gas owner could denied the right to drill were not applied in these cases resulting in the denial of the right to drill based on the mere conjecture of the potash lessee.

These new orders do not attempt to balance the interests of the two industries and prevent the waste of oil and gas or protect the correlative rights of the owners of these

mineral interests. The Commission's new interpretation of R-111-P effectively creates areas that are off limits to oil and gas drilling.

As hereinafter shown, this new interpretation creates confusion as to what is required of owners who desire to develop these minerals. The new policy fails to prevent waste or protect the correlative rights of the owners of oil and gas minerals interests. Under these orders the fundamental due process rights of oil and gas owners to notice and an opportunity to be heard when their interests are at risk are denied by a system that permits mineral interests to be taken by *ex parte* proceedings between the potash lessees and the State Land Office or the BLM - proceedings from which the oil and gas operators are excluded and decisions reached based on information the oil and gas operator may not see. Furthermore, the owners of oil and gas interests now have no forum in which they can effectively challenge the taking of their property. These orders are also defective for they do not contain findings that disclose the reasoning of the Commission in rejecting the applications of Bass and Devon and, in fact, contain findings that either are not supported by the evidence – or merely misstate it. The new Commission interpretation denies the owners of oil and gas rights the opportunity to produce these reserves thereby taking these resources without compensation.

GROUNDS FOR REHEARING

> An order will be reviewed if it is arbitrary, capricious, or an abuse of discretion; not supported by substantial evidence in the record; or, otherwise not in accordance with the law. A ruling by an administrative agency is arbitrary and capricious if it is unreasonable or without a rational basis, when reviewed in the light of the whole record. *Sierra Club v. New Mexico Mining Comm'n, 133 N.M. 97, 61 P.3d 806, 813 (N.M. 2002).*

As grounds for rehearing, Bass and Devon assert that Order Nos. R-12402-A and R-12403-A violate these grounds for rehearing in the following ways:

POINT I
ORDER NOS. R-12402-A AND R-12403-A ARE CONTRARY TO LAW

> "The Oil Conservation Commission is a creature of statute, expressly defined, limited and empowered by the laws creating it." *Continental Oil Co. v. Oil Conservation Comm'n.* 70 N.M. 310, 373 P.2d 809 (N.M. 1962).
>
> "Where rulings by administrative agencies are not in accord with the basic requirements of the statutes relating to those agencies, the decisions of the agencies are void." *Foster v. Bd. of Dentistry*, 103 N.M. 776, 714 P.2d 580 (N.M. 1986).

ORDER NOS. R-12402-A AND R-12403-A CAUSE WASTE OF OIL ND GAS

The Commission's new interpretation of the Potash Rules causes the waste of oil and gas. It deletes the protection which the Commission inserted into R-111-P that permits the owners of the oil and gas and the potash rights to agree on how their minerals will be developed.

The Oil and Gas Act charges the Commission with the prevention of the waste of oil and gas and potash. It is its primary duty and its paramont power. *Continental, 70 N.M.* at 319. "Waste" is defined in the Act to include both (1) oil and gas drilling that would unduly reduce the total recovery of commercial potash and (2) drilling and operating practices that "reduce or tend to reduce the total quantity of crude petroleum oil or natural gas ultimately recovered from any pool..." N.M.S.A. § 70-2-3.A (2006). There is no dispute that the Commission must prevent waste of oil and gas as well as potash. (Order No. R-9650-A and R-9651-A, Finding 10.)

The decisions in the NM Potash cases recognized that waste occurs when the owner of an oil and gas interest is prevented from developing its oil and gas reserves in the Potash Area and authorized the drilling of a well where the parties who owned interest under the subject land had reached a mutual agreement to do so (Order No. R-9650-A and No. R-9651-A, Finding 10.). However, in these cases, the Commission has ignored the mutual agreement of all owners in these leases and denied their applications for a permit to drill thereby denying their right to recover the full value therefrom.

This new interpretation of the Potash Rules means that owners of oil and gas leases, like Bass, Devon, Mills and Smith, who hold oil and gas leases on fee tracts cannot develop their oil and gas rights. Suggestions to the contrary are simply untrue and not supported by the record in these cases. Here the Commission erroneously found that both Bass and Devon have alternative methods to develop the fee minerals under these tracts (Order Nos. R-12402-A, Finding 44 and R-112403-A, Finding 47). The Commission determined that Bass and Devon could develop the reserves under the subject tracts from other locations by employing directional or horizontal drilling techniques. These findings ignore the provisions of Order R-111-P that declare an objective of the order is the "economic recovery of oil, gas and potash minerals" in the potash area. It also ignores the undisputed testimony in the record of the only witnesses with expertise in the drilling of wells who stated that it is not "economically feasible" to develop the oil and gas rights under these properties in as many as six potential horizons by horizontal or directional drilling. (Testimony of Daniels at Tr. 102-103; Testimony of Blount at Tr. 148), See Point III. The evidence in these cases established that Bass and Devon cannot economically develop these reserves by drilling horizontal or directional wells and that the Commission orders in these cases will cause substantial oil and gas to be left in the ground thereby causing waste.

Although "waste" is also defined in the Oil and Gas Act as if the reserves that can ultimately be recovered from a tract, this does not mean that the owners of oil and gas rights can just wait until the potash has been mined. Contrary to prior interpretations of these rules, the Commission found that "[d]rilling for oil and gas after potash mining has occurred is difficult, if not impossible, because of the caverns created during the potash ore's extraction." (Orders R-12402-A and R-12403-A, Finding 12.) The mining of

potash can preclude the development of the underlying oil and gas reserves and an order that prevents the development of these resources causes waste.

The operating and production requirements now imposed by the Commission will result in the wells that are the subject of the Bass and Devon applications not being drilled and reserves under the subject fee leases will be left in the ground and wasted.

Furthermore, Mosaic failed to prove that the drilling of the wells proposed by Bass and Devon will cause waste of potash. It offered in support of its waste and safety claims only conjecture – the type of proof rejected by the Commission in the NM Potash Case.

ORDER NOS. R-12402-A AND R-12403-A IMPAIR CORRELATIVE RIGHTS

The powers vested in the Division and Commission are also founded on the protection of correlative rights. The term "correlative rights" is defined by the Oil and Gas Act as follows:

> Correlative Rights shall mean the opportunity afforded, as far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas , or both, in the pool, being an amount, so far as can be practically determined, and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas, or both, under such property bears to the total recoverable oil or gas, or both, in the pool. (Emphasis added)

The protection of correlative rights is also a stated objective of the Potash Rules. Order No. R-111-P, Rule A OBJECTIVE at p.4.

Correlative rights are based on the individual ownership of the oil, gas and potash minerals under a property. Those who own mineral interests have constitutionally protected property rights in those minerals and are guaranteed by the Oil and Gas Act an opportunity to produce them. For the Commission to permit, as here, those who do not own the minerals to control the interests of others who do is a violation of its duty to protect correlative rights.

Bass, Devon, and the interest owners represented by Stacy Mills, Wells Fargo Bank and Kenneth Smith all own oil and gas and potash rights under the fee tracts at issue in these cases. By law, the Commission is required to protect the correlative rights of all of the owners– not some of the owners – in these lands. To do that, the Commission is required to afford each of them the opportunity to produce their reserves – oil and gas as well as potash.

However, in these cases, the Commission improperly uses R-111-P to deny the owners of the minerals under these fee tracts the opportunity to develop their reserves. The Commission interprets Order R-111-P to replace, or somehow override, a mineral lease and gives non-owners the right to prevent the production of minerals on adjoining tracts.

Although the Commission still appears to believe that Order R-111-P does not authorize a potash lessee to designate a LMR over lands not leased to a potash lessee, its

recent orders (Orders No. R-12402-A and R-12403-A) prevent Mills, Smith, Bass and Devon from developing their lands because they are within the 1/2 mile buffer zone surrounding the LMR. These orders are in direct conflict with the terms of Rule G(3) of Order R-111-P quoted above which expressly include "buffer zones" in the area where wells can be drilled by agreement of the owners of the minerals under these tracts. This interpretation denies to the owners of these fee tracts upon which Bass and Devon propose to drill the opportunity to produce their just and equitable share of the reserves under these tracts and therefore violates their correlative rights.

POINT II

ORDER NO. R-111-P AS INTERPRETED BY COMMISSION ORDER NOS. R-12402-A AND R-12403-A VIOLATE THE DUE PROCESS RIGHTS OF THE OWNERS OF OIL AND GAS INTERESTS IN THE POTASH AREA.

Order No. R-111-P authorizes potash lessees to annually designate lands for inclusion in a "Life of Mine Reserves" area. Data supporting the inclusion of lands in a LMR is submitted for review by the potash lessees to the State Land Office for state and fee lands and to the BLM for federal lands. If the agency agrees with the potash lessee's interpretation of the data, the acreage is included in a LMR. When an oil and/or gas well is proposed, the Division contacts the State Land Office for state and fee lands, or the BLM for federal lands, to confirm if the proposed well is in a LMR. If it is, the application to drill is denied unless certain conditions set out in the Potash Rules are met. Order No. R-111-P, Rule G(e)(3).

The data presented by the potash lessee in support of the LMR is kept confidential and not shared with either the owner of the oil and gas interests or the Division or Commission.[8] At no time does the owner of affected oil and gas interests have notice of the inclusion of its lands in a LMR and at no time is the owner of affected oil and gas interests permitted to participate in the process for the designation of a LMR, permitted to review or challenge any of the data produced by the potash lessee or afforded an opportunity to present their objections to this determination – a determination that can prevent it from ever being able to develop its oil and gas reserves. This process denies to the owners of oil and gas interests "an opportunity to be heard at a meaningful time and in a meaningful manner" and denies them their due process rights. *New Mexico ex rel Children, Youth & Families Dept. v. Maria C, et al,* 136 N.M. 53, 62, 4 P. 3d 796, 805 (N.M. Ct. App. 2004)(internal citations omitted).

Constitutional problems with the Potash Rules have always been of concern to the Division. In 1992, in the NM Potash case, the Division found that since the "information filed with the SLO by the mine operator is confidential and not subject to inspection by the Division or any other party"" [Finding (9)], and since "only the SLO could challenge the geologic basis for designating an LMR. . . the designation of an LMR effectively

[8] Pursuant to R-111-P, "Information used by the potash lessee in identifying its LMR shall be filed with the BLM and SLO but will be considered privileged and confidential 'trade secrets and commercial . . . information' within the meaning of 43 C.F.R. §2.13(c)(4) (1986), Section 19-1-2.1 NMSA 1978, and not subject to public disclosure."

deprives the owner of oil and gas interests the right to develop those interests without any forum or opportunity to be heard," and that "such interpretation could raise constitutional questions concerning the validity of R-111-P." (Finding 8, Order Nos. R-9650 and R-9651) (Emphasis added).

As our Supreme Court has found that additional process may be required in administrative proceedings depending on "The importance of the individual's and administrative body's interests, together with the 'risk of an erroneous deprivation of such [private] interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards,'" *Archuleta v. Santa Fe Police Dept.*, 2005-NMSC-006, 108 P. 3d 1019 (N.M. 2005) (internal citations omitted). In the past the Commission has attempted to meet these due process concerns by creating exceptions to the drilling prohibitions in Order No. R-111-P and permitted development where the oil, gas and potash owners reach a mutual agreement for the drilling of oil and gas wells. The Commission has also (1) called for the production to affected oil and gas operators of data used by the potash lessee to support a LMR determination. [9], (2) adopted additional procedural safeguards and announced standards of proof that would have to be met before an oil and gas owner could be denied the right to drill and (3) required the potash lessee provide "hard facts", not mere "conjecture," that reserves would be lost and mine safety compromised.

The Commission's new interpretation of R-111-P fundamentally changes the way these resources are regulated. It requires more than the mutual agreement of all mineral owners in a lease to approve the drilling of a well thereon and it abandons the procedural safeguards and required standards of proof announced in NM Potash. Under the Commission's new interpretation of Order No. R-111-P, the owners of constitutionally protected mineral interests are denied the opportunity to develop these reserves as the result of a proceeding where they were neither in attendance or permitted to review or respond to the data used to deny their property interest. In these proceedings, the due process rights of all owners of oil and gas interests in the subject leases are violated.

Furthermore, under R-111-P, the oil and gas operator is required to make a "clear demonstration that commercial potash will not be wasted unduly as a result of the drilling of the well." (Finding 20)[10] The burden of proof under this order is on the oil and gas operator who is also the party that is denied access to the data needed to make such a demonstration.

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[9] "When the designation of an LMR by a Potash operator may prevent an oil and gas operator from accessing its property, the oil and gas operator must be given the opportunity to review the geologic basis for the designation, with appropriate restrictions to protect the confidentiality of the data, in order to make a meaningful challenge." (Order No. R-9650-A and R-9651-A, Finding 7)

[10] Order No. R-111-P, Finding (20): "The commission cannot abdicate its discretion to consider applications to drill as exceptions to its rules and orders but in the interest of preventing waste of potash should deny any application to drill in commercial potash as recommended in the work committee report, unless a clear demonstration is made that commercial potash will not be wasted unduly; as a result of the drilling of the well."

Under the Commission's prior orders (Order No. R-9650 et al.) the Commission imposed additional procedural safeguards by establishing standards of proof for the potash lessees and rejected mere conjecture to support their waste and safety assertions.

These standards of proof were not applied to the evidence in the subject cases. Accordingly, the resulting orders are constitutionally defective for while the Commission applies a "trust me standard" and accepts mere conjecture from the potash company, it requires a "clear demonstration" from the oil operator and, at the same time, prevents the oil operator from access to the data it needs to make such a demonstration. In these cases, the due process rights of Bass and Devon have been denied.

There are similar due process concerns where the applications for permits to drill each of these wells was rescinded or denied without notice or an opportunity to be heard on the permit application.

POINT III

THE COMMISSION'S NEW INTERPRETATION OF ORDER NO. R-111-P WILL CAUSE AN UNCONSTITUTIONAL TAKING OF OIL AND GAS INTERESTS WITH OUT COMPENSATION TO THE OWNERS THEREOF.

Commission Order Nos R-12402-A and R-12403-A cause an unconstitutional taking of the oil and gas interests in the subject leases.

Interests in oil and gas are property rights and any taking away of these property rights without just compensation constitute a taking under the Takings Clause of the United States Constitution. The Fifth Amendment provides that private property "[shall not] be taken for public use, without just compensation." The courts have found that a regulation that deprives a person of their property rights can constitute a taking. *Manning v. Mining and Minerals* Div. 2006-NMSC-027 (N.M. 2006) ("for over a century, the Fifth Amendment has been made applicable to the states through the Fourteenth Amendment guarantee of due process. In regard to the Takings Clause, the state must provide a "reasonable , certain and adequate provision for obtaining compensation, both when property is physically taken as well as when a regulation greatly reduces the economic viability of the property." (emphasis added) (internal citations omitted).

A takings claim is "ripe" for review if "the government entity charged with implementing the regulation has reached a final decision regarding the application of the regulations to the property at issue," and a determination whether a taking has occurred cannot be made until the court knows the extent of permitted development on the land in question. *Palazzolo v. Rhode Island*, 533 U. S. 606, 618 (2001) (quoting *Williamson County Reg'l Planning Comm'n v. Hamilton Bank*, 473 U. S. 172, 186 (1985), and *MacDonald, Sommer & Frates v. Yolo County*, 477 U. S. 340, 351 (1986).

To assert a takings claim, a plaintiff must establish two things: (1) the governmental entity has reached a final decision on the applicability of the regulation to the plaintiff's property; and (2) the plaintiff is unable to receive just compensation from the government. *Suitam v. Tahoe Reg'l Planning Agency*, 520 U. S. 725, 729-31 (1997). In these cases, each of these conditions are easily met. Unless a rehearing is granted, the decision of the Commission is final. Furthermore, there is no way for the owners of these interests in oil and gas to recover from the Commission for the loss of this property right.

Commission Orders No. R-12402-A and R-112403-A interpret the Potash Rules adopted by Order R-111-P so as to deny Stacy Mills, Kenneth Smith, Bass, Devon and others the right to develop their oil and gas property interests. Unless a rehearing is granted and the Commission authorizes the drilling of the wells that are the subject of this application, the rights of all owners of oil and gas interests under the subject leases are taken without compensation in violation of the Fifth Amendment of the U. S. Constitution.

In the past, even the Commission has recognized that the regulatory scheme announced in R-111-P when applied to the owners of oil and gas interests as it is here constitutes a taking. In Orders R-9650-A and R-9651-A, the Commission reviewed the exact issue present in this case: "whether one mineral estate, federal lands in Section 35, can prevent resource development under a different mineral estate, state lands under Section 2, by virtue of the fact that it was designated by the federal estate to bear the burden of providing a measure of safety to the development of resources on its land." The Commission found that:

> "Denying Yates the opportunity to access for the purpose of recovering oil and gas under their state oil and gas lease in order to provide a buffer for the development of potash on an adjacent federal tract would be confiscation of both Yates and the State's oil and gas rights without compensation." (Finding 9, Order Nos. R-12402-A and R-12403-A).

POINT IV

THE FINDINGS IN ORDERS R-12402-A AND R-12403-A ARE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE, DO NOT DISCLOSE THE REASONING OF THE COMMISSION IN REJECTING ITS PRIOR INTERPRETATION OF R-111-P NOR IN DENYING THE APPLICATIONS OF BASS AND DEVON.

> "Substantial evidence is relevant evidence that a reasonable person might accept as adequate to support a conclusion." *In Matter of Application of PNM Electric Services v. NM Public Utility Com'n*, 125 N.M. 302, 961 P.2d 147, 153 (N.M. 1998); *Viking Petroleum, Inc. v. Oil Conservation Com'n,* 100 N.M. 451, 453, 672 P.2d 280, 282 (N.M. 1983).
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> A ruling by an administrative agency is arbitrary and capricious if it is unreasonable or without a rational basis, when viewed in light of the whole record. *Sierra Club v. New Mexico Mining Comm'n*, 133 N.M. 97, 61 P.3d 806, 813 (N.M. 2002).
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> "In New Mexico the standard of proof applied in administrative proceedings, with few exceptions, is a preponderance of the evidence." *Foster v. Bd. of Dentistry*, 103 N.M. 776, 714 P.2d 580 (N.M. 1986).

> Although formal and elaborate findings are not absolutely necessary, nevertheless basic jurisdictional findings, supported by substantial evidence, are required to show that the commission has heeded the mandate and the standards set out by statute. Administrative findings by an expert administrative commission should be sufficiently extensive to show not only the jurisdiction but the basis of the commission's order. *Continental Oil Co. v. Oil Conservation Comm'n*, 70 N.M. 310, 373 P.2d 809 (N.M. 1962).

In *Fasken v. Oil Conservation Commission*, 87 N.M. 292, 294, 532 P. 2d 588, 590 (N.M. 1975), the court found that the following three categories of findings must appear in the Order: (1) Findings of ultimate facts which are material to the issues; (2) Sufficient findings to disclose the reasoning of the Commission in reaching its ultimate findings; and (3) The findings must have substantial support in the record.

In these orders, the Commission wholesale rejects the arguments of Bass and Devon and in large part ignores their evidence. Instead, the Commission accepted mere conjecture from Mosaic. In doing so, the Commission has reversed its own precedent and provided a new interpretation of Order No. R-111-P.

A. THE ORDERS CONTAIN INSUFFICIENT FINDINGS TO DISCLOSE THE REASONING OF THE COMMISSION

"'Administrative findings by an expert administrative commission should be sufficiently extensive to show...the basis of the commission's order.'" *Fasken,* 532 P. 2d at 590 (quoting *Continental Oil Co. v. Oil Conservation Com'n*, 70 N.M. 310, 373 P. 2d 809 (1962)). As in *Fasken*, "such findings are utterly lacking here and reversal is thereby required." *Id.* The findings in Orders R-12402-A and R-12403-A do not contain the "vaguest notion of how the Commission reasoned its way to its ultimate findings." *Id.*

The findings in Order No. R-12042-A and 12403-A are inadequate for they fail to disclose the reasoning of the Commission in rejecting the express language in Order No. R-111-P that permits the drilling of wells on lands on which there is no LMR and where the owners of the potash and the oil and gas rights agree that the oil and gas should be developed first.

The Orders Provide No Explanation As To Why Commission Precedent And Standards Were Reversed And/Or Ignored

Orders R-12402-A and 12403-A represent a change in long-standing Commission and Division interpretation of the provisions of R-111-P as announced in prior decisions including the NM Potash and Noranda cases which are summarized above. These interpretations were followed by three Division directors and relied on by the oil and as industry to develop a strategy for the development of oil and gas resources. Agency precedent is now altered by the current orders without any explanation to disclose the Commission's reasoning.

In R-12402-A (Finding 43), the Commission finds that in order to protect federal lands, a different mineral estate will not be developed. However, Order R-9650-A/9651-

A, addressed this very issue and found that denying the recovery of the oil and gas under an oil and gas lease "in order to provide a buffer for the development of potash on an adjacent federal tract would be confiscation of....oil and gas rights without compensation." See Finding 9.

In the NM Potash cases, the Commission also set certain standards to prevent "confiscation" of the oil and gas resources because the oil and gas owner is at a disadvantage for rebutting the information supplied to the SLO and BLM to support its LMR designation. The Commission found that theory and conjecture is not enough. *See e.g.* Findings 9, 10, 12 and 13 (Order R-9650-A/9651-A); Order R-9990. The orders in the subject cases present findings which are based on theory and conjecture by the potash company. *See* Finding 38, 39, 40, 41, 42 (Order R-12402-A); See Findings 23, 40, 43, 44, 45, 46 and 47 (Order R-12403-A). In these cases these standards were not applied and Mosaic did not present the required evidence on the issues of mine safety and waste of potash. Under the standards announced by the Commission in the NM Potash Case, these issues remain unproven.

B. THE COMMISSION'S FINDINGS DO NOT HAVE SUBSTANTIAL SUPPORT FROM THE RECORD AND ARE CONTRARY TO THE RECORD

In both orders, the Commission found that Bass and Devon had not applied with the BLM for an APD to directionally drill (Finding 33) the proposed wells from federal tracts. (Finding 33, Order 12402-A and Findings 36 and 38, Order R-12403-A). These findings misstate the testimony on a full record review and reject prior interpretations of R-111-P.

First, all offsetting lands are federal and the BLM has in recent times refused to approve ADP's on federal lands in this area. See Tr. 30, 31, 32, 39, 40, 53 (Testimony of Bailey). This is true even when Mosaic has agreed to the proposed well locations. Mosaic Exhibit No. 2; Testimony of Bailey.

Second, Bass and Devon presented evidence from expert drilling engineers that a vertical well is the only way to test all potentially productive formations. Drilling from alternate locations would require the drilling of directional and horizontal well bores. These well bores cannot intersect and produce the reserves form each potentially productive formation under each of these 40-acre tracts. See Tr. 81 (Testimony of Dannels), Tr. 148 (Testimony of Blount). For example, the evidence shows that the Delaware formation is comprised of multiple potentially productive horizons. It is located immediately below the potash deposits. It is impossible to "snake" a directional well to intersect each of the four primary potential zones with a directional well. Tr. 148 (Testimony of Blount). Horizontal wells only intersect one productive horizon. Therefore each potentially productive zone requires a separate horizontal well bore making production of all the reserves under this tract with horizontal well bores economically impossible. Tr. 163 (Testimony of Blount). To produce four zones in the upper Delaware as well as the Wolfcamp and the Bone Spring formations in this area could require six horizontal well bores to access reserves that could be produced with one vertical well. Tr. 102 (Testimony of Dannels). Accordingly, wells cannot be economically directionally or horizontally drilled to test and produce all prospective zones under these tracts.

The Commission also found that Bass did not show potential for zones other than the Morrow (Order R-12042-A Findings 35 and 45). This finding is not supported by a full record review and creates a dual standard for proof. Bass and Devon presented experts in petroleum engineering who testified as to the potential for productive zones in the area. See e.g. Tr. 95, -96, 101-102 (Testimony of Dannels); Tr. 160, 163 (Testimony of Blount). Mosaic did not provide an expert or any evidence to contradict this testimony. On the other hand, the Commission accepts mere conjecture from the potash company. See e.g. Findings 25, 40 in Order R-12402-A and Findings 23, 43, 44 in Order R-12403-A. In other words, the Commission accepts the testimony of Mosaic's expert who admitted he had no experience with drilling directional or horizontal wells but rejects the testimony of Bass and Devon's experts and thereby applies different standards to the parties. This different standard is exacerbated by the fact that the oil and gas owner is unable to refute the potash owner's testimony as in large part the information is kept secret from the oil and gas owner. See also Findings 39, 40 and 42 in Order R-12042-A as examples of mere conjecture not supported by any evidence.

Some of the findings are not only contrary to the record but contrary to law. Finding 43 in Order R-12402-A and Finding 46 in Order R- 12403-A misstates the express language in R-111-P and creates a new rule: "While the proposed location is on fee land, where life-of-mine reserves are not designated, the location is still less than one-half mile from Mosaic's life-of-mine reserves located on federal lands." In this finding, the Commission decides to protect federal acreage when R-111-P only governs state and perhaps fee lands and manifests a constitutional violation as discussed in Point III. The practical effect of this finding is to burden fee lands for the development of federal minerals.

Finding 44 is in addition to being contrary to the evidence on a full record review, it misstates the rule in R-111-P. The question is not whether it is "technically" feasible to drill six horizontal wellbores to test all horizons -- the question is whether it is "economically" feasible (See R-111-P "A. OBJECTIVE"). The evidence in the record shows it is not economically feasible. Tr. 94, 102-103 (Testimony of Dannels); Tr. 148 (Testimony of Blunt). Although the expert for Mosaic stated his preference was that the Bass and Devon wells be horizontally drilled, this does not constitute evidence nor is Mr. Morehouse an expert in directional or horizontal drilling.

Although Bass and Devon never stated the value of the oil and gas, R-111-P and Commission precedent does not require such evidence to be presented. See Order R-9650-A/9651-A (Finding 11). If this data was needed Bass could show that the value of the production from a well on the Mills lease should be $ 61,450,000 if productive in all potentially productive horizons with $11,500,000 of that amount being apportioned to the royalty owners' share.

Finding 38 in Order R-12043-A is contrary to the evidence on a whole record review. The Commission found that Devon could have accessed the SW/4 NW/4 of Section 24, Township 22 South, Range 30 East, NMPM "had it chosen to do so." However, Devon's expert explained that it was not only economically not feasible but was probably not technically feasible. Tr. 148, 155-156, 160 (Testimony of Blount).

C. ON A WHOLE RECORD REVIEW, THE ORDERS ARE NOT SUPPORTED BY SUBSTANTIAL EVIDENCE

Furthermore, when the mining plans of Mosaic are considered as part of a whole record review, it is obvious that Mosaic's mining plans are continually changing, they are much farther away from the subject leases than they projected less than two years ago and that their plans are no more than a mere "guess." These plans have not been supported by the proof required by the Commission in the NM Potash case. The Commission's decision to deny the applications of Bass and Devon where no showing was made that the potash in this area will ever be produced constitutes and arbitrary and capricious action by the Commission. *Sierra Club v. New Mexico Mining Com'n*, 133 N.M. 97, 61 P.3d 806, 813 (N.M. 2002).

The Commission's new interpretation of R-111-P finds that Bass and Devon's permit must be denied. Prior Commission precedent interpreted R-111-P to allow the development of oil and gas resources under certain limited circumstances. Prior interpretation balanced the interests of oil and gas and potash and provided that certain conditions were met, avoided constitutional and other legal issues from arising. Prior interpretation was in keeping with the heart of R-111-P. This new interpretation departs from this balanced and reasonable approach.

POINT V

THE NEW INTERPRETATION OF THE POTASH RULES IS CONFUSING, WILL DISCOURAGE THE DEVELOPMENT OF MINERALS IN NEW MEXICO, CAUSE WASTE AND CONTRAVENES THE PUBLIC INTEREST.

The Commission orders denying the applications of Bass and Devon change the long-standing Division and Commission interpretation of the provisions of R-111-P. These provisions and interpretations were relied on by the oil and gas industry as it developed its strategy for the development of oil and gas resources in the Potash Area. The new interpretation raises questions that, until answered, create uncertainty and confusion concerning the development of the oil, gas and potash in the Potash Area and impact all other issues in the subject cases.

WHAT LANDS ARE COVERED BY R-111-P?

The first question concerns the lands that are subject to the provisions of R-111-P and how the Commission is exercising its jurisdiction over these lands.

Under the Commission's new interpretation it is unclear what lands are subject to and burdened by these Potash Rules It is clear that State of New Mexico lands are subject to the provisions of Order No. R-111-P and the oil, gas and potash minerals under these lands are regulated by appropriate state agencies. Furthermore federal lands are not subject to Order No. R-111-P for these lands are regulated by the BLM pursuant to Sec. of Inter. Order, Oct. 12, 1986 (51 Fed. Reg. 39425).

However, it is unclear if fee lands are subject to R-111-P. Ordering paragraph G(3) of R-111-P provides that drilling applications on state and fee land "will be

processed by the Division." However, Potash Rule G(1)(b), which addresses the approval of LMR's, only applies to federal and state land and even the Division observed in the Noranda order, that there is no process under this rule for approval of a LMR on fee lands. (Order No. R-9990, Finding 1)

Furthermore, Mosaic's counsel also addressed this issue at the hearing and stated that at the time Order R-111-P was drafted and adopted, fee land was not considered.[11] Accordingly, there remains a real question as to whether of not Order R-111-P applies to fee lands. If it does not, the Commission's orders denying the applications to drill of Bass and Devon are not supported by R-111-P and should be approved.

However, the new Commission interpretation of Order R-111-P makes this question more important than in the past. The Commission now cites R-111-P in support of the new orders which burden fee lands and deny the development of the resources under these lands. (Orders R-12402-A and R-12403-A, Finding 43). These fee lands and the owners of interests therein are lands and owners which the Commission is required by the Oil and Gas Act to protect. Yet The Commission now denies these owners the opportunity to develop these fee minerals to provide protection for those who desire to develop another mineral estate that is outside its jurisdiction - federal lands under offsetting leases. In denying development of lands under its jurisdiction to assist those who desire to produce minerals from offsetting federal lands, the Commission acts outside its jurisdiction. In so doing, it causes waste of oil and gas and impairs the correlative rights of the owners of oil and gas under fee tracts. The new interpretation of its rules creates issues that the Commission must address. Until it does no one knows whether fee lands will be subject to and regulated by R-111-P or how these interests can be developed or the owners of the mineral interests in these lands protected. The Commission can only correct this problem with a rehearing.

WHO MAY DEVELOP - WHO MAY PREVENT DEVELOPMENT

The new Commission interpretation writes out of R-111-P the provision that permits drilling where agreement is reached between the owners of the oil and gas interests and those who own the potash. No longer can an oil and gas operator drill if, as in the past, it has reached an agreement with the owners of the potash mineral rights under the lease. Now the Commission ignores the ownership of mineral interests and the character of the lands. Now owners of interests not within the jurisdiction of the

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[11] Statement of Charles High: "I negotiated R-111-P, I wrote the industry agreement, I was there. And I will tell you that the idea of fee land never came up. No one ever had a clue about how fee would be handled under R-111-P. And when it did come up, the Snyder Ranch case (Noranda), we argued about how it was, we had one view of what it ought to do, and somebody else had another one. And the OCC – or the OCD made a decision as to how it would be handled. But that was never contemplated under R-111-P if what you would do if you had fee simple land, as opposed to State land or BLM land, which is – what 99-point whatever percent of the land down there. So there was never any consideration ever given to that." (Tr. at 236).

Commission, are permitted to prevent the development of minerals on fee and, presumably, state lands.

This new policy takes from the fee owners like Stacy Mills and Kenneth Smith their right to develop the oil and gas rights under their lands for the foreseeable future and denies these owners access to these reserves because a potash company speculates that it may someday develop the potash reserves, if any, under these lands. Even where, as here, the potash operators have failed to even lease the potash reserves. This policy needs clarification.

WHAT WAIVERS – AGREEMENTS ARE NEEDED?

Although the Division has found that Order R-111-P does not authorize a potash lessee to designate an LMR over lands not leased to a potash lessee, the Commission's new interpretation prohibits drilling by Bass and Devon, because they are within a 1/2 mile buffer zone surrounding an LMR. This argument is in direct conflict with the terms of Rule G(3) of Order R-111-P quoted above which expressly include "buffer zones" in the area where wells can be drilled by agreement of the owners of the minerals under these tracts.

Under the Commission's new interpretation it is unclear what owners are required to enter agreements for the drilling of oil and gas well or waive objection thereto. This should be clarified by the Commission in a new order entered after rehearing.

BURDEN OF PROOF

In 1992, the Commission announced in the NM Potash cases what standard of proof it would require of a potash operator when it was opposing a proposed drilling location. These standards appear to have been abandoned by the Commission in the Bass and Devon cases. There was no proof that complied with these standard on the waste of potash or the safety issues that may result from the drilling of an oil and gas well in the Potash Area. This creates confusion as to what must be presented by mineral owners in future cases in support of and in opposition to an application and by whom must this evidence be presented. Furthermore, if the new interpretation places the burden of proof in these cases solely on the oil and gas industry, the Commission must assure access to information needed to make the required showings.

The new interpretation of Order No. R-111-P creates confusion as to how the minerals in the Potash Area are to be developed. It creates confusion as to how lands that are not leased and are not included in a LMR can be developed. This confusion must be clarified by the Commission. Failure to act will prevent the development of the State's mineral resources and will result in orders that are contrary the conservation of the State's oil, gas and mineral resources. Surely the intent of this statute and rule R-111-P is to encourage the production of both oil and gas and potash. This new policy conflicts with this intent and needs clarification – it is in the public interest to do so.

CONCLUSION

With Order Nos. R-12402-A and R-12403-B, the Oil Conservation Commission has announced a new interpretation of Order No. R-111-P and adopted a new Oil Conservation Division ("Division") and Commission policy concerning the regulation of oil and gas drilling and potash development in the Potash Area. With this new policy, the Commission steps outside its jurisdiction, violates its duties under the Oil and Gas Act, authorizes the waste of oil and gas, and impairs the correlative rights of the owners of oil and gas rights in the Potash Area. This new policy violates the due process rights of the owners of oil and gas interests in the Potash Area and constitutes a taking of property without compensation. The findings in these orders are inadequate for they are (i) inconsistent with the evidence presented in these cases, and (ii) do not disclose the Commission's reasoning in rejecting the Bass and Devon applications – applications that are consistent Order R-111-P and with well-established Division precedent. The orders and the new policy announced therein represent arbitrary, capricious and unreasonable actions by the Commission that are contrary to the statutes that empower the Commission to act. These cases should be set for rehearing to address each of these issues.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I certify that on August 1, 2006 I served a copy of the foregoing Memorandum Brief by Hand Delivery, Facsimile or by Overnight Delivery to:

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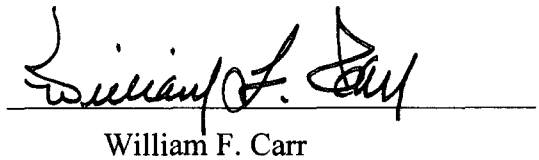

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