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September 26, 2003

VIA HAND DELIVERY

David Catanach, Examiner
Oil Conservation Division
New Mexico Department of Energy,
Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: New Mexico Oil Conservation Division Case No. 13151: Application of Pride Energy Company for Cancellation of a Drilling Permit and Re-instatement of a Drilling Permit, an Emergency Order Halting Operations, and Compulsory Pooling, Lea County, New Mexico.

Dear Mr. Catanach:

Enclosed is the Memorandum of Yates Petroleum Corporation et al. in opposition to the Application of Pride Energy Company for Cancellation of a Drilling Permit, an Emergency Order Halting Operations, and Compulsory Pooling. I can be available at your convenience to argue this matter if you desire.

By copy of this letter, I am providing this memorandum to James Bruce, Esq., attorney to Pride Energy Company.

Very truly yours,

William F. Carr

cc: Gail MacQuesten, Esq.
James Bruce, Esq.
Randy Patterson

BEFORE THE
NEW MEXICO ENERGY, MINERALS AND
NATURAL RESOURCES DEPARTMENT
OIL CONSERVATION DIVISION

APPLICATION OF PRIDE ENERGY COMPANY FOR CANCELLATION OF A DRILLING PERMIT AND RE-INSTATEMENT OF A DRILLING PERMIT, AND EMERGENCY ORDER HAULTING OPERATIONS, AND COMPUSLORY POOLING. LEA COUNTY, NEW MEXICO.

CASE NO. 13153

MEMORANDUM OF YATES PETROLEUM CORPORATION ET AL. IN OPPOSITION TO THE APPLICATION OF PRIDE ENERGY COMPANY FOR CANCELLATION OF A DRILLING PERMIT, RE-INSTATEMENT OF DRILLING PERMIT AND AN EMERGENCY ORDER HAULTING OPERATIONS, AND IN SUPPORT OF ITS MOTION TO DISMISS THE COMPULSORY POOLING APPLICATION OF PRIDE ENERGY COMPANY

"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 Com.
70 N.M. 310, 373 P.2d 809 (1962).

With its application, Pride Energy Corporation ("Pride") seeks an order of the Division that violates constitutional and statutory law and is contrary to the rules, regulations and orders of the Oil Conservation Division and Commission. Yates asks the Division to follow the law and precedent.

FACTS

1. Yates Petroleum Corporation, Yates Drilling Company, ABO Petroleum Corporation and MYCO Industries, Inc. (hereinafter collectively referred to as "Yates") own 100% of the working interest in State of New Mexico Oil and Gas lease No. V-5855 that covers the N/2 and SE/4 of Section 12, Township 12 South, Range 34 East, NMPM, Lea County, New Mexico.

2. Yates also owns the State "X" Well No. 1 located 1980 feet from the North line and 660 feet from the West line of Section 12 ("the Yates Well").

3. Pride owns the working interest in the SW/4 of Section 12. It does not own an interest in the Yates Well nor in any of the lease acreage on which this well is located.

4. Without notice to Yates, Pride filed an Application for Permit to Drill proposing to re-enter the Yates Well and dedicate thereto a spacing unit comprised of the W/2 of Section 12.

5. On July 16, 2003, the Division's District Office in Hobbs, New Mexico approved Pride's APD – again without notice to Yates.

6. On August 25, 2003, Yates filed its APD for the re-entry of its State "X" Well No. 1 and dedicated thereto a standard spacing unit comprised of its acreage in the N/2 of the section. This APD was approved by the District Office and on September 5, 2003, Yates moved a rig onto the location and commenced re-working activities.

7. By letter dated August 26, 2003, the Pride APD was cancelled by the Division because "With further review of the area," the Division determined that "the N/2 of this section is leased to another operator." That other operator is Yates.

8. After Yates had commenced operations on the well, Pride filed an application with the District Office seeking an order (a) canceling the Yates APD, (b) re-instating its drilling permit and (c) halting Yates operations on its well. Pride also sought an order compulsory pooling the W/2 of this Section and designating it the operator of the Yates well and the Yates acreage in the NW/4 of this section. In its application, Pride contends that the cancellation of its APD impairs its property rights without due process of law. *See*, Application of Pride Energy Company, paragraph 9(c).

9. Yates opposes Pride's application and also seeks an order dismissing Pride compulsory pooling application. Yates motion was referred to a Division Examiner for decision.

10. On September 12, 2003, a Division Examiner entered a decision in which he (a) deferred ruling on Pride's application for an order requiring Yates to cease all re-entry and drilling operations on the State "X" Well No. 1 "until such time as an evidentiary hearing on the merits of Pride's application in Case No. 13153 is conducted" and (b) denied Yates application to dismiss pride's compulsory pooling application.

11. On September 13, 2003, Yates filed an application for *de novo* review of this decision of the Examiner pursuant to NMSA § 70-2-13 (1978).

12. On September 22, 2003, the Director of the Division denied Yates application for hearing *de novo* because "The Decision did not dispose of any issues existing in the case" and because "the Decision gave few reasons for denying the request of Yates to dismiss Pride's application for compulsory pooling in Case No. 13153." The Director remanded Case 13153 "...to the Division Hearing Examiner for full consideration of the legal issues that may be raised by Yates' Motion to Dismiss, with a decision to be issued on that matter prior to any hearing of the factual issues related to Pride's compulsory pooling application."

ARGUMENT

Pride's application raises issues concerning Applications for Permit to Drill and compulsory pooling. Each of these issues has recently been addressed and decided by the Oil Conservation Commission. In this case, Yates only asks the Division to follow Commission precedent and the law.

COMPULSORY POOLING ISSUES

YATES IS THE DULY AUTHORIZED OPERATOR OF THE SPACING UNIT COMPRISED OF THE N/2 OF SECTION 12

In recent hearings the Commission considered competing compulsory pooling applications and related Applications for Permits to Drill. (Oil Conservation Division Cases 12816, 12841, 12859 and 12860). Although the facts in that dispute differ from those presented here by Pride,[1] the resulting Commission order is instructive in this case because it discusses the purpose and effect of an APD and explains how it differs from a compulsory pooling order. These findings also clarify what is required of an operator

[1] The case involved competing pooling applications of TMBR/Sharp Drilling, Inc., David H. Arrington Oil & Gas, Inc. and Ocean Energy, Inc. who proposed to drill wells at different locations and on different spacing units without common ownership. Here there is **(i)** an approved spacing unit comprised of acreage with common ownership dedicated to an existing well and **(ii)** an application for compulsory pooling of lands already dedicated to the existing well on the Division approved spacing unit.

who proposes to drill where there is common ownership of acreage to be dedicated to a well. (See order No. R-11700-B, copy attached)

In Order No. R-11700-B the Commission stated:

1. an APD simply enables the Division "to verify that requirements for the permit are satisfied" including compliance with Division requirements for well spacing and casing and cementing programs. Findings 33.

2. the practice of designating the acreage to be dedicated to the well on the application for permit to drill furthers administrative expedience. Finding 35

3. where there is common ownership of all working interest in a standard spacing unit, pooling, either voluntary or compulsory, is not needed. Finding 35

4. Where there is common ownership of the acreage to be dedicated to the well and the administrative requirements are met, the APD is approved and "no further proceedings are necessary." Finding 35

Yates' Motion to Dismiss the Pride's compulsory pooling application only asks the Examiner to apply the Commission's findings to the facts of this case. When they are, it is clear that once Yates APD was approved, no further proceedings were needed and Yates was authorized to re-enter its well. Furthermore, since the ownership is common in the acreage dedicated to the Yates well, compulsory pooling is not needed.

Here the Yates owns 100% of the working interest in the standard 320-acre spacing unit comprised of N/2 of Section 12, has obtained an approved APD to re-enter their well at a standard location, and has commenced re-entry operations in their own well. As such, Yates is the duly authorized operator in charge of the development of these lands. It has exercised rights given to it by statute. All of its actions are consistent with Division Rules.

On the other hand, Pride owns no interest in these lands nor in the Yates well. It has no right to drill or produce a well on this acreage nor to appropriate the production form this acreage either to its self or to anyone else. Because it is proposing operations on the property of another, it asserts that "It is immaterial that the N/2 is leased to another operator." Pride Application, Paragraph 9(e). Here, however, the N/2 is not just leased to another. The N/2 is being <u>developed</u> pursuant to an approved AFE with the well <u>owned</u> by the lessee of a spacing unit that has common ownership. As a result,

pooling is not needed and Yates has been duly authorized and charged by the Division with the operation of this property. Pride also states: "An operator, whether under voluntary agreement or under a compulsory pooling order, has the right to drill on another person's lease." Pride Application, Paragraph 9(e). The problem with Pride's argument is that in this case there is no voluntary agreement for pooling, there is no compulsory pooling order, and there is no need for a compulsory pooling order.

All Yates asks the Division to do is to apply the Commission's findings in Order No. R-11700-B to this case and dismiss Pride's pooling application.

PRIDE'S APPLICATION CANNOT MEET THE STATUTORY REQUIREMENTS FOR COMPULSORY POOLING AND MUST BE DISMISSED

Before the W/2 of Section 12 can be pooled, Pride must establish (1) that the acreage in the proposed unit is available for pooling, and (2) that it has a right to re-enter the Yates State "X" Well No. 1. It can do neither.

The NW/4 of the section cannot be included in a W/2 spacing unit because it is dedicated to a N/2 unit and to an offsetting well. To set aside the existing N/2 spacing unit, Pride must show some violation of statute or rule. This it cannot do. In forming this unit and re-entering this well, Yates has complied with each and every regulatory requirement of the Division. There is no waste issue in this case for Pride proposes to do exactly what Yates is doing – re-enter the Yates well to test the same formations Yates proposes to test.

Pride has no right to re-enter the Yates State "X" Well No. 1 in the NW/4 of Section 12. Pride does not own the well it seeks to re-enter or own an interest in the NW/4 of this section. Pride has no voluntary agreement for the development of these lands or to use this well. As a result, necessary preconditions for an application for compulsory pooling are not present in this case. The spacing unit Pride proposes to pool is not available for pooling and Pride does not have the right to drill as it proposes. Pride therefore has no right to bring this application and its compulsory pooling application must be dismissed.

PRIDE SEEKS AN ORDER THAT WOULD IMPAIR YATES' CORRELATIVE RIGHTS

The purpose of the Pride application is to deny Yates the opportunity to produce its reserves in the N/2 of Section 12 with its own well. The Oil and Gas Act defines correlative rights as '...the opportunity afforded, so far as it is practical 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 practicably 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 the property bears to the total recoverable oil or gas or both in the pool,...." NMSA 1978, § 70-2-33(H).

By re-entering its State "X" Well No. 1 Yates has availed itself of the opportunity to produce with its well its fair share of the reserves located under its tract -- it is exercising it correlative rights.

Pride seeks an order that would set aside Yates APD, pool the Yates acreage in the NW/4 of this section with acreage owned by Pride and prevent Yates from returning its well to production. Pride seeks an order that would deny Yates the opportunity to produce its share of the reserves with its well and is contrary to statute, rule and precedent and impairs Yates' correlative rights.

Pride only owns the working interest in the SW/4 of Section 12. The Yates N/2 spacing unit does not interfere with the statutory rights of Pride to produce its fair share of the reserves under its tract with a well drilled in the S/2 of the Section. The existence of the N/2 spacing unit just means that Pride will have to produce its minerals with its well instead of taking Yates minerals with a Yates well.

APPLICATION FOR PERMIT TO DRILL ISSUES

PRIDE'S DUE PROCESS ARGUMENT

Pride asks the Division to cancel Yates' APD covering the N/2 of Section 12 and re-instate its APD covering the W/2 of the section. It contends that cancellation of its APD and the approval of the Yates APD violates its due process rights. For Pride's due process rights to be violated, it must first have rights in the subject acreage that are

impaired by the Division's actions. Pride does not have a constitutionally protected property right in the NW/4 of Section 12.

Interests in oil and gas rights are rights in real property. *Duvall v. Stone*, 54 N.M. 27, 32, 213 P.2d 212, 215 (1949). As such they are protected under the due process clause of the New Mexico Constitution (Art. II, Sec. 18) and the United States Constitution (14th Amendment). *Uhden v. New Mexico Oil Conservation Commission*, 112 N.M. 528, 530. 817 P.2d 721, 723. They cannot be impaired without notice and an opportunity for hearing.

Pride seems to contend that it gained a property right in the NW/4 of Section 12 through its APD. However, Pride cites no authority for its proposition that an APD grants a property right, and the Commission has completely disavowed any such notion. In Order No. R-11700-B, the Commission discussed the purpose and effect of an APD. It reviewed the administrative objectives served by the APD and noted that "An application for a permit to drill serves different objectives than an application for permit for compulsory pooling and the two proceedings should not be confused."[2] It "expressly disavowed" that the acreage dedication plat attached to an application for permit to drill somehow pools acreage.[3]

Therefore, the approval of Pride's APD with attached acreage dedication plat did not and can not create in Pride any interest in the NW/4 of Section 12 and the cancellation of the APD covering the W/2 of the section could not impair any right owned by Pride.

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[2] Finding 33: "... An application for a permit to drill serves different objectives than an application for compulsory pooling and the two proceedings should not be confused. The application for permit to drill is required to verify that requirements for a permit are satisfied. For example, on receipt of an application, the Division will verify whether an operator has financial assurance on file, identify which pool is the objective of the well so as to identify the proper well spacing and other applicable requirements, ensure that the casing and cementing program meets Division requirements and check the information provided to identify any other relevant issues. The acreage dedication plat that accompanies the Application (Form C-102) permits verification of the spacing requirements under applicable rules or statewide rules. Compulsory pooling is related to these objectives in that compulsory pooling would not be needed in the absence of spacing requirements. 1 Kramer & Martin, The Law of Pooling and Unitization, § 10.01 (2001) at 10-2. But its primary objectives are to avoid the drilling of unnecessary wells and to protect correlative rights. NMSA 1978, § 70-2-17(C)."

[3]Order No. R-11700-B, Finding paragraph No. 34 on page 7.

Pride has every right to develop its acreage in the SW/4 of the section by drilling a well. It just does not have the right to produce reserves from a Yates tract with a well it does not own. Furthermore, since Pride has no interest in the N/2 of this section, no violation of due process can occur by the dedication of acreage in which it owns no interest to a well in which it owns no interest.

PRIDE'S DUE PROCESS ARGUMENT IGNORES THE RIGHTS OF YATES AND WOULD CREATE IMPOSSIBLE ADMINISTRATIVE BURDENS

Yates is the owner of the working interest in the N/2 of Section 12. These oil and gas rights are also constitutionally protected property rights and may not be impaired without notice and an opportunity for hearing. However, Pride obtained approval of an APD covering the W/2 of Section 12 without notice to Yates and now attempts to use the APD for a W/2 spacing unit to prevents Yates from developing its mineral rights. Pride's due process argument is based on violation of the due process rights of Yates.

If Pride's understanding of an APD was correct – if their APD either confers on Pride some interest in Yates property in the NW/4 of Section 12 or denies Yates the right to develop its constitutionally protected interests in this acreage, the Division could never issue an APD unless:

1. 100% of the working interest in the proposed spacing unit is owned by the applicant,
2. there is voluntary agreement combining the interests in the spacing unit,
3. A compulsory pooling order covering the proposed spacing unit has been entered, or
4. notice and an opportunity for hearing on the proposed APD is provided to all affected parties before the APD is approved.

CONCLUSION

Yates has the right to do each and every thing it is doing on its acreage in the N/2 of Section 12. Each and every thing it is doing is in full compliance with the applicable rules, regulations and orders of the Oil Conservation Division. Pride is attempting to prevent Yates from developing its interests in this section and through administrative action take valuable property interests from Yates. The Division should not allow its

administrative procedures to be used this way and should immediately dismiss in total the Pride's application.

Respectfully submitted,

HOLLAND & HART, L.L.P.

By: _____
William F. Carr

ATTORNEYS FOR YATES PETROLEUM CORPORATION

CERTIFICATE OF SERVICE

I certify that I have caused a copy of the foregoing pleading to be delivered to James Bruce, Esq., attorney for Pride Energy Company, by facsimile [FAX NO. (505) 982-2151] on this 26th day of September, 2003.

_____
William F. Carr