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

APPLICATION OF TMBR/SHARP DRILLING, INC., FOR AN ORDER STAYING DAVID H. ARRINGTON OIL AND GAS, INC., FROM COMMENCING OPERATIONS, LEA COUNTY, NEW MEXICO

CASE NO. 12731

APPLICATION OF TMBR/SHARP DRILLING, INC. APPEALING THE HOBBS DISTRICT SUPERVISOR'S DECISION DENYING APPROVAL OF TWO APPLICATIONS FOR PERMIT TO DRILL FILED BY TMBR/SHARP DRILLING, INC., LEA COUNTY, NEW MEXICO

CASE NO. 12744

Order No. R-11700-B *De Novo*

NOTICE OF APPEAL

David H. Arrington Oil and Gas, Inc., ("Appellant"), through its counsel of record, Miller, Stratvert & Torgerson, P.A. (J. Scott Hall), pursuant to NMSA 1978 Section 70-2-25 of the New Mexico Oil and Gas Act and Section 39-3-1.1 (Repl. Pamp. 1995), hereby files this Notice of Appeal from Order No. R-11700-B issued by the New Mexico Oil Conservation Commission on April 26, 2002 and from the Commission's disposition of Appellants' Application For Rehearing and Request for Partial Stay of Order No. R-11700-B filed pursuant thereto.

Appeal is made to the District Court for the County of Santa Fe, New Mexico. The Appeal is taken against the Commission and against TMBR/Sharp Drilling, Inc. Copies of Order No. R-11700-B and the Application For Rehearing and Request for Partial Stay are attached hereto.

Respectfully submitted,

MILLER, STRATVERT & TORGERSON, PA.

By _____

J. Scott Hall, Esq.
Post Office Box 1986
Santa Fe, New Mexico 87504
(505) 989-9614

ATTORNEYS FOR DAVID H. ARRINGTON OIL AND GAS, INC.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Application for Rehearing was mailed on this 25th day of June, 2002 to the following:

Steve Ross
New Mexico Oil Conservation Commission
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

William F. Carr, Esq.
Holland & Hart
Post Office Box 2208
Santa Fe, New Mexico 87504
Attorneys for Yates Petroleum Corp.

James Bruce, Esq.
Post Office Box 1056
Santa Fe, New Mexico 87504-1056
Attorneys for Ocean Energy, Inc.

W. Thomas Kellahin, Esq.
Kellahin & Kellahin
Post Office Box 2265
Santa Fe, New Mexico 87504-2265
Attorneys for TMBR/Sharp Drilling, Inc.

_____
J. Scott Hall, Esq.

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

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

APPLICATION OF TMBR/SHARP DRILLING, INC. FOR AN ORDER STAYING DAVID H. ARRINGTON OIL & GAS, INC. FROM COMMENCING OPERATIONS, LEA COUNTY, NEW MEXICO. **CASE NO. 12731**

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ORDER NO. R-11700-B

ORDER OF THE OIL CONSERVATION COMMISSION

BY THE COMMISSION:

THIS MATTER came before the Oil Conservation Commission (hereinafter referred to as "the Commission") on March 26, 2002, at Santa Fe, New Mexico, on application of TMBR/Sharp Drilling Inc. (hereinafter referred to as "TMBR/Sharp"), *de novo*, and opposed by David H. Arrington Oil and Gas Inc. (hereinafter referred to as "Arrington") and Ocean Energy Inc. (hereinafter referred to as "Ocean Energy") and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 26th day of April, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. In Case No. 12731, TMBR/Sharp seeks an order voiding permits to drill obtained by Arrington and awarding or confirming permits to drill to TMBR/Sharp concerning the same property.

3. In Case No. 12744, TMBR/Sharp appeals the action of the Supervisor of District I of the Oil Conservation Division denying two applications for permit to drill.

4. Arrington and Ocean Energy oppose[1] both applications.

5. The cases were consolidated by the Division for purposes of hearing and remain so before the Commission.

6. Still pending before the Division are two applications for compulsory pooling. They are: Case No. 12816, Application of TMBR/Sharp for compulsory pooling, Lea County, and Case No. 12841, Application of Ocean Energy Inc. for compulsory pooling, Lea County.

7. The Commission conducted an evidentiary hearing on March 26, 2002, heard testimony from witnesses called by TMBR/Sharp, and accepted exhibits. The Commission also accepted pre-hearing statements from TMBR/Sharp and Arrington and heard opening statements from TMBR/Sharp, Arrington and Ocean Energy and accepted brief closing statements from TMBR/Sharp and Arrington.

8. Following the hearing, TMBR/Sharp filed a Motion to Supplement the Record to include the April 10, 2002 letter of Arrington to the Oil Conservation Division's Hobbs District Office and a portion of Arrington's Supplemental Response to Plaintiff's Motion for Reconsideration in Lea County Cause No. CV-2001-315C. Ocean filed a response to that motion that argued the items add nothing to the record, and Arrington filed a response arguing that the supplemental material is not new or inconsistent. The Motion to Supplement the Record should be granted as no party seems to object to review of the documents; the objections seem to relate only to the significance of the documents to this matter.

9. Applications for permit to drill were filed with the Division in Sections 23 and 25 by Arrington and TMBR/Sharp. The applications filed by TMBR/Sharp and Arrington both proposed a well in the NW/4 of in Section 25. In Section 23, the application for permit to drill filed by TMBR/Sharp proposed a well in the NE/4, and the application of Arrington proposed a well in the SE/4.

10. Arrington's application in Section 25 was filed on July 17, 2001 and sought a permit to drill its proposed "Triple-Hackle Dragon "25" Well No. 1." This application was approved on July 17. On or about August 7, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Blue Fin "25" Well No. 1" in the same section. That application was denied on August 8, 2001.

11. Arrington's application in Section 23 was filed on July 25, 2001 and sought a permit to drill its proposed "Blue Drake "23" Well No. 1." This application was

[1] On April 10, 2002 Arrington agreed to release its permit to drill to TMBR/Sharp. A dispute may no longer therefore exist concerning Section 23 although the parties apparently do not agree with this assessment.

approved on July 30, 2001. On or about August 6, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Leavelle "23" Well No. 1" in the same section. That application was denied on August 8, 2001.[2]

12. TMBR/Sharp's applications in Sections 23 and 25 were denied on the grounds of the permits previously issued to Arrington for the "Triple-Hackle Dragon "25" Well No. 1" and the "Blue Drake "23" Well No. 1." The Townsend Mississippian North Gas Pool, the pool from which the wells are to produce, is governed by the spacing and well density requirements of Rule 104.C(2) [19 NMAC 15.C.104.C(2)]. That rule imposes 320-acre spacing on wells producing from that pool. TMBR/Sharp's applications were denied because, if granted, more than one well would be present within a 320-acre spacing unit, in violation of Rule 104.C(2).

13. Before an oil or natural gas well may be drilled within the State of New Mexico, a permit to drill must be obtained. See NMAC 19.15.3.102.A, 19 NMAC 15.M.1101.A. Only an "operator" may obtain a permit to drill, 19 NMAC 15.M.1101.A, and an "operator" is a person who is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." NMAC 19.15.1.7.O(8).

14. The central issue in this case is whether Arrington was eligible to become the operator of the wells in question. If not, Arrington should not have received the permits to drill. If Arrington was eligible to become the operator, then the permits were properly issued to Arrington.

15. A dispute exists concerning the validity of Arrington and TMBR/Sharp's mineral leases in Sections 23 and 25. As will be seen below, resolution of this dispute in favor of Arrington or TMBR/Sharp determines which party is eligible to be the operator and thus, who should receive the permits to drill.

16. TMBR/Sharp is the owner of oil and gas leases comprising the NW/4 of Section 25 and the SE/4 of Section 23 (along with other lands) pursuant to leases dated August 25, 1997 granted by Madeline Stokes and Erma Stokes Hamilton. TMBR/Sharp Exhibit 6. The leases were granted to Ameristate Oil & Gas, Inc. (hereinafter referred to as "Ameristate") and were recorded respectively in Book 827 at Page 127 and in Book 827 at Page 124 in Lea County, New Mexico.

17. TMBR/Sharp and Ameristate entered into a Joint Operating Agreement along with other parties on July 1, 1998 and TMBR/Sharp was designated as the operator in Section 25. See TMBR/Sharp Exhibit 7.

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[2] Apparently TMBR/Sharp reapplied for the permits to drill that were previously denied, and the Division approved those permits on March 20, 2002.

18. Although the primary terms of the TMBR/Sharp leases have apparently expired, TMBR/Sharp alleges that the leases were preserved by the drilling of the "Blue Fin 24 Well No. 1" and subsequent production from that well. The Blue Fin 24 Well No. 1 is located in the offsetting section 24.

19. Subsequent to Stokes and Hamilton's execution of leases in favor of Ameristate Oil & Gas Inc., they granted leases in the same property to James D. Huff on March 27, 2001. See TMBR/Sharp Exhibit 9. The leases to Mr. Huff were recorded in Book 1084 at Page 282 and in Book 1084 at Page 285 in Lea County, New Mexico. The parties referred to these leases as "top leases," meaning that according to their terms, they would not take effect until the prior or "bottom" leases became ineffective. See TMBR/Sharp Exhibit 9, ¶ 15.

20. Arrington alleges Mr. Huff is an agent of Arrington but presented nothing to support that contention.

21. In July and August 2001, Ocean acquired a number of farm-out agreements in Section 25. See TMBR/Sharp Exhibit 10, Schedule 1. By an assignment dated September 10, 2001, Ocean assigned a percentage of the farm out agreements to Arrington under terms that require Arrington to drill a test well in Section 25 known as the Triple Hackle Dragon "25" Well No. 1 in the NW/4 of that section.

22. On August 21, 2001, after receiving the denials of the applied-for permits to drill from the District office, TMBR/Sharp filed suit against Arrington and the lessors of its mineral interests in the Fifth Judicial District Court of Lea County, New Mexico. In that case, styled "TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*", TMBR/Sharp alleged that its leases were still effective and the Arrington top leases were ineffective. The District Court, in its Order Granting Partial Summary Judgment, dated December 24, 2001, agreed with TMBR/Sharp's contention. See TMBR/Sharp's Exhibit No. 12,

23. During the hearing of this matter, TMBR/Sharp argued that because the Fifth Judicial District Court found that Arrington's "top leases" had failed, TMBR/Sharp was entitled to permits to drill in Sections 23 and 25 and Arrington was not entitled to permits to drill and its permits should be rescinded. TMBR/Sharp also argued that Arrington had filed applications to prevent TMBR/Sharp from being able to drill and to place its obligations under the continuous drilling clauses of the oil and gas leases in jeopardy. TMBR/Sharp argued that Ocean Energy's letter agreement with Arrington could not revive Arrington's claim of title and that Ocean Energy's pending pooling application with the Division is essentially irrelevant to the question of whether TMBR/Sharp should have been granted a permit to drill.

24. Arrington argued in response that the title issue ruled upon by the District Court with respect to section 25 is irrelevant because Arrington acquired an independent

interest in that section by virtue of a farm out agreement in September of 2001. Arrington also argued it was willing to assign the disputed acreage in Section 23 to TMBR/Sharp in order to resolve the present controversy. Arrington also argued that it doesn't intend to actually drill at the present time under either approved permit to drill and argued, citing Order No. R-10731-B, that the Commission's practice has not been to rely on "first in time, first in right" principles in deciding competing applications on compulsory pooling, but instead on geological evidence. Arrington seemed to argue that a compulsory pooling proceeding is the place to present such geologic evidence. Arrington argues that these proceedings are unnecessary and that the Commission should rely upon the Division's pending pooling cases to decide who of the various parties should properly possess the permit to drill.

25. Ocean Energy argued that since its farm out agreement terminates on July 1, 2002 time is of the essence and that the matters at issue here should be resolved in the pending compulsory pooling proceeding instead of this proceeding. Ocean Energy argued that the permit to drill is meaningless in this context, that TMBR/Sharp is essentially asking the Commission to determine pooling in the context of the permit to drill, and that the dedication of acreage on the acreage dedication plat should not determine what acreage would be pooled to the well. If the Commission were to adopt this approach, Ocean Energy argues, the compulsory pooling statutes would be written out of existence.

26. The parties seem to agree that in a situation where the bottom lease has not failed, a person owning a top lease is not a person duly authorized to be in charge of the development of a lease or the operation of a producing property, and is therefore not entitled to a permit to drill. NMAC 19.15.1.7(O)(8). See also 1 Kramer & Martin, The Law of Pooling and Unitization, 3rd ed., § 11.04 at 11-10 (2001). Moreover, because only an "owner" may seek compulsory pooling, it seems that a person owning a top lease where the bottom lease has not failed might not be entitled to compulsory pooling either. See NMSA 1978, § 70-2-17(C).

27. When an application for permit to drill is filed, the Division does not determine whether an applicant can validly claim a real property interest in the property subject to the application, and therefore whether the applicant is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." The Division has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico. The Division so concluded in its Order in this matter. See Order No. R-11700 (December 13, 2001).

28. It is the responsibility of the operator filing an application for a permit to drill to do so under a good faith claim to title and a good faith belief that it is authorized to drill the well applied for. It appears to this body that Arrington had such a good faith belief when it filed its application, but subsequently the District Court found otherwise.

It is not within the purview of this body to question that decision and it should not do so in this case.

29. As of the date of this order, TMBR/Sharp, by Court declaration, is the owner of an oil and gas lease in both Section 23 and Section 25, and Arrington, also by Court declaration, is not an owner in those sections. Therefore, Arrington, who the Court has now decreed has no authority over the property, should not have been granted permits to drill in those sections and TMBR/Sharp should have been granted a permit.

30. Both Arrington and Ocean Energy imply that an appeal will be filed of the District Court's decision. Until the issue of title in Sections 23 and 25 is finally resolved by the courts or by agreement of the parties, the outcome of this proceeding is therefore uncertain. As of the present time, TMBR/Sharp has prevailed on the title question and this Order reflects that (present) reality. However, as an appeal could change that conclusion, jurisdiction of this matter should therefore be retained until matters are finally resolved.

31. The permits to drill issued by the Division in July 2001 to Arrington were issued erroneously and should be rescinded *ab initio*. The applications to drill submitted by TMBR/Sharp in August 2001 should have been processed within a few days of receipt. Arrington's later acquisition of an interest in section 23 and 25 through a farm out agreement doesn't change this analysis; Arrington had no interest by virtue of farm out as of the date of TMBR/Sharp's applications.

32. On another issue, Arrington and Ocean Energy have both urged this body to stay these proceedings pending the resolution of the applications for compulsory pooling, arguing that a decision on those matters will effectively resolve the issues surrounding the permits to drill.

33. Arrington and Ocean Energy's conclusion does not necessarily follow. 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 a 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 the applicable pool 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).

34. It has long been the practice in New Mexico that the operator is free to choose whether to drill first, whether to pool first, or whether to pursue both contemporaneously. The Oil and Gas Act explicitly permits an operator to apply for compulsory pooling after the well is already drilled. See NMSA 1978, § 70-2-17(C) (the compulsory pooling powers of the Division may be invoked by an owner or owners "... who has the right to drill *has drilled* or proposes to drill a well [sic] ..."). Issuance of the permit to drill does not prejudge the results of a compulsory pooling proceeding, and any suggestion that the acreage dedication plat attached to an application to drill somehow "pools" acreage is expressly disavowed. If acreage included on an acreage dedication plat is not owned in common, it is the obligation of the operator to seek voluntary pooling of the acreage pursuant to NMSA 1978, § 70-2-18(A) and, if unsuccessful, to seek compulsory pooling pursuant to NMSA 1978, § 70-2-17(C).

35. Thus, where compulsory pooling is not required because of voluntary agreement or because of common ownership of the dedicated acreage, the practice of designating the acreage to be dedicated to the well on the application for a permit to drill furthers administrative expedience. Once the application is approved, no further proceedings are necessary. An operator may first apply for a permit to drill a well and may thereafter pool (on a voluntary or compulsory basis) separately owned tracts to the well. Alternatively, the operator may first pool and later seek a permit to drill. The two are not mutually exclusive, and there is no preferred methodology.

36. Thus, the process fosters efficiency by permitting a simple approach in cases where ownership is common and pooling, voluntary or compulsory, is not necessary.

37. Ocean's expiring farm-outs present a difficult problem because the delay occasioned by this proceeding and any delay that might occur in the pending compulsory pooling cases may place Ocean's interests in jeopardy. It is worth noting that Ocean's interests seem to be free of the title issues plaguing the other parties, but since Ocean Energy intended that Arrington drill and become operator, Ocean isn't planning on preserving its rights by drilling a well itself and hasn't applied for a permit to drill. Unfortunately, this body is without authority to stay expiration of the farm-outs; Ocean should petition the District Court for relief if the expiring farm-outs are a concern.

CONCLUSION OF LAW:

The Oil Conservation Commission has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico.

IT IS THEREFORE ORDERED:

1. The portion of TMBR/Sharp's application in Case No. 12731 seeking to void permits to drill obtained by Arrington is granted. The permits to drill awarded to

Arrington shall be and hereby are rescinded *ab initio* and the applications originally filed by TMBR/Sharp in August, 2001 shall be and hereby are remanded to the District Office for approval consistent with this Order provided the applications otherwise meet applicable Division requirements.

2. TMBR/Sharp's application in Case No. 12744, appealing the decision of the Supervisor of District I of the Oil Conservation Division, is granted and the decision shall be and hereby is overruled.

3. The motions of Arrington and Ocean to continue this proceeding until after the decision in Cases No. 12816 and No. 12841 shall be and hereby are denied.

4. The motion of TMBR/Sharp to Supplement the Record is hereby granted.

5. Jurisdiction of this case is retained for the entry of such further orders as may be necessary given subsequent proceedings in TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

LORI WROTENBERY, CHAIR

JAMI BAILEY, MEMBER

ROBERT LEE, MEMBER

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

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

APPLICATION OF TMBR/SHARP DRILLING, INC. FOR AN ORDER STAYING DAVID H. ARRINGTON OIL AND GAS, INC. FROM COMMENCING OPERATIONS, LEA COUNTY, NEW MEXICO — CASE NO. 12731

APPLICATION OF TMBR/SHARP DRILLING, INC., APPEALING THE HOBBS DISTRICT SUPERVISOR'S DECISION DENYING APPROVAL OF TWO APPLICATIONS FOR PERMIT TO DRILL FILED BY TMBR/SHARP DRILLING, INC., LEA COUNTY, NEW MEXICO — CASE NO. 12744

ORDER NO. R-11700-B

APPLICATION FOR REHEARING
AND
REQUEST FOR PARTIAL STAY OF ORDER NO. R-11700-B

David H. Arrington Oil and Gas, Inc., ("Arrington"), through its attorneys, Miller Stratvert & Torgerson, P.A., (J. Scott Hall), moves pursuant to NMSA 1978 Section 70-2-25 of the New Mexico Oil and Gas Act and 19 NMAC 15.N.1222 for rehearing on the issuance of Order No. R-11700-B issued by the Commission on April 26, 2002. Arrington also moves pursuant to 19 NMAC 15.N.1220.B for entry of an order staying Order No. R-11700-B

BACKGROUND FACTS

Case Nos. 12731 and 12744 involve consolidated applications filed by TMBR/Sharp Drilling, Inc., ("TMBR/Sharp"), challenging and APD issued on July 17, 2001 to Arrington for its Triple-Hackle Dragon 25 Well No. 1 covering lands in the W/2 of Section 25[1] as well as the

[1] All referenced lands are located in Township 16-South, Range 35-East, NMPM in Lea County.

permit approved on July 30, 2001 for Arrington's Blue Drake 23 Well No. 1 covering lands in the E/2 of Section 23. Applications filed in August, 2001 by TMBR/Sharp for permits to drill its Leavelle 23 No. 1 well and the Blue Fin 25 No. 1 well in Sections 23 and 25, respectively, had been denied by the Division's District I office due to the previous approval of the Arrington drilling permits for the same lands.

The consolidated administrative cases ultimately resulted in the issuance by the New Mexico Oil Conservation Commission of Order No. R-11700-B on April 26, 2002, which found, among other things, that the Division's District I Supervisor should issue an APD to TMBR/Sharp for its proposed Blue Fin 25 Well No. 1 in the NW/4 of Section 25 to which TMBR/Sharp proposes to dedicate a N/2 spacing and proration unit. The Order also directed that a drilling permit should be approved for TMBR/Sharp's Blue Drake 23 Well No. 1 to which it proposed to dedicate the E/2 of Section 23. In addition, the Commission expressly retained jurisdiction over the matter, noting that separate court proceedings to resolve title issues could affect the outcome these pending administrative cases. At issue in that collateral litigation presently pending before the 5th Judicial District Court in Lovington is whether the filing of a C-102 form with the Division's District I office in Hobbs for TMBR/Sharp's Blue Fin 24 No. 1 well in Section 24, T-16-S, R-35-E, was sufficient to perpetuate TMBR/Sharp's leases from Madeline Stokes and Erma Stokes Hamilton to Ameristate Oil and Gas (and, by assignment, to TMBR/Sharp) that covered portions of lands in Sections 23 and 25 identified in the APD's filed both by TMBR/Sharp and Arrington. In that litigation, the lessors and Arrington, the owner of top-leases executed by the Stokes family (by way of farmouts through Ocean Energy, Inc.), contend that the leases held by TMBR/Sharp had lapsed.

In the interim, on January 28, 2002, TMBR/Sharp had filed an application for compulsory pooling in Case No. 12816 seeking to consolidate the working interests in the N/2 of Section 25

for its Blue Fin 25 Well No. 1. Ocean Energy, Inc. also filed separate compulsory pooling applications (Case No. 12841 and Case No. 12860) seeking to pool the W/2 of Section 25 for two alternative proposed Mississippian formation well locations in the NW/4 and SW/4, respectively. More recently, Arrington has filed its application for compulsory pooling in Case No. 12859 to create an E/2 unit in Section 25 for its Glass-Eyed Midge 25 No. 1 Atoka/Morrow/Mississippian well to be drilled in the NE/4. Arrington's C-101 APD for the Glass-Eyed Midge 25 No. 1 well was issued by the Division on December 17, 2001 and its C-102 reflecting an E/2 unit was filed on November 29, 2001. The N/2 TMBR/Sharp unit is in obvious conflict with the E/2 and W/2 units proposed by Arrington and Ocean Energy. Case Nos. 12816, 12859, 12860 and 12841 are all scheduled to be heard by the Division's examiner on May 16, 2002.

Significantly, Arrington's Application does not present a title issue like TMBR/Sharp's Applications in Case Nos. 12731 and 12741 did, and the lands under its proposed E/2 unit were not involved in those two cases. Arrington's lease interests are wholly independent from the lease title currently in dispute in the 5th Judicial District Court litigation.

On March 15, 2002, without notice to the Applicant and ***before*** the issuance of Order R-11700-B, TMBR/Sharp Drilling, Inc. filed another C-101 APD with the Division's District I office for its Blue Fin 25 Well No. 1 (API No. 30-025-35865) which was also proposed to be drilled to the Mississippian formation in the NW/4 of Section 25. The C-102 acreage dedication plat which accompanied the filing of the TMBR/Sharp Drilling, Inc. APD proposed to dedicate the N/2 of said Section 25 to the Blue Fin 25 Well No. 1.

On March 20, 2002, again without notice to Arrington and ***before*** the issuance of Order No. R-11700-B, the Division's District I office approved the APD for the Blue Fin 25 Well No. 1. As a consequence of the actions of the Division's District I office, there existed two

simultaneously approved APD's with attached C-102's that both operators proposed to dedicate the NE/4 of Section 25 to their respective wells.

At the time of the filing of the APD's, there were owners of other interests in the N/2 and E/2 of Section 25, respectively, who had not voluntarily agreed to participate in the drilling of the proposed wells. Neither the Arrington nor TMBR/Sharp compulsory pooling cases had been heard and neither operator had consolidated the interests of all the non-participating owners either by way of a voluntary agreement, communitization agreement, or otherwise. Although TMBR/Sharp, Ocean Energy and Arrington now all have compulsory pooling applications pending before the Division to consolidate the unjoined interests, TMBR/Sharp moved to continue its own pooling case (Case No. 12816) and to dismiss Cases 12859, 12860 and 12841. The Division's examiner denied the TMBR/Sharp motion at a hearing on May 14, 2002.

To date, however, no geologic, engineering or equitable evidence having a bearing on the development of Section 23 and 25 has been presented to the Division or the Commission.

Significantly, it was learned on May 14th that TMBR/Sharp began drilling its Blue Fin 25 Well No. 1 on May 7, 2002, without having consolidated the unjoined interests and without allowing the Division to determine the final configuration of the spacing and proration units in Section 25.

On May 15, 2002, Arrington filed with the Division its *Application To Reinstate Drilling Permit* whereby it seeks an order directing the Division's District I office to reinstate the drilling permit for its Glass-Eye Midge 25 Well No. 1 previously approved on December 17, 2001. (A copy of the Application is attached as Exhibit "A".)

THE REQUEST FOR REHEARING

Arrington respectfully submits that Case Nos. 12731 and 12744 should be reheard for the reasons that (1) Order R-11700-B is based, in part, on error, (2) was improvidently issued, and (3) its operation allows a ministerial act to supersede the agency's statutory functions.

Order R-11700-B Is Based On Error.

In Order No. R-11700-B, the Commission, citing to the separately pending litigation in the district court involving conflicting leases, found that APD's previously issued to Arrington for wells in the S/2 of Section 23 and the W/2 of Section 25, T-16-S, R-35-E should not have been granted because Arrington was not an owner in those lands and had "no authority over the property". (Order R-11700-B, Par. 29.) This finding was the primary basis for the Commission's determination. This finding is clearly based on error. Arrington established that it had the right to drill and operate as the owner of lease interests in the W/2 of Section 25 separate and apart from the oil and gas leases involved in the district court litigation.

In addition, at the time it filed the APD for its Glass Eye Midge 25 No. 1 Well, Applicant owned separate oil and gas lease interests in the E/2 of Section 25 that were independent from the conflicting leases that are the subject of the district court litigation cited by the Commission in Order No. R-11700-B. As such, Applicant was eligible to become the operator of that well and the permit to drill that was issued to it on December 17, 2001 should have been undisturbed. In this regard, the findings in Paragraph 14 of Order No. R-11700-B are telling:

> *"14. The central issue in this case is whether Arrington was eligible to become the operator of the wells in question...If Arrington was eligible to become the operator, then the permits were properly issued to Arrington."*

In its findings at Paragraph 29 of Order R-11700-B, the Commission erroneously assumed that the rulings issued by the 5th Judicial District Court served to adjudicate all of the title owned by Arrington. Instead, the scope of the district court rulings affected only the lands encumbered

by the Stokes/Hamilton base lease claimed by Ameristate and TMBR/Sharp and the top-lease claimed by Arrington. The interests separately owned by Arrington remained unaffected, and as such, Arrington continued to be eligible to become operator throughout.

The agency's determination of the geologic and economic waste issues before it should determine the outcome of these disputed cases, not resolution of collateral title issues. Accordingly, the Division should discharge its statutory function and resolve these matters at the earliest opportunity.

Order R-11700-B Was Improvidently Issued.

Order No. R-11700-B was improvidently issued, failing to completely resolve the dispute before the agency or accord full relief to the affected parties. The initial determination of Cases 12731 and 12744 has allowed the permitting issue to unduly influence events and has pre-empted proper consideration by the agency's of its statutory mandates to prevent waste, protect correlative rights and avoid the drilling of unnecessary wells. As a further consequence of its issuance, Order No. R-11700-B has precipitated more problems for the parties, including the Division, that have become manifest in the frustrated efforts of Arrington to develop the E/2 of Section 25, acreage that should not have been affected by the proceedings.

Through no fault of the Commission, the scope of the TMBR/Sharp applications in Case Nos. 12731 and 12744 was limited to the issuance of drilling permits for its two proposed wells. That circumstance was the product of one single act of neglect on the part of TMBR/Sharp: That is, TMBR/Sharp's failure to abide by the terms of one of its oil and gas leases and properly file a pooled unit designation in the county records for their Blue Fin 24-1 well. That single failure or omission has consequently determined all of TMBR's actions, legal positions and arguments ever since, both in court and before the Division and Commission. That same omission has, by necessity, caused TMBR/Sharp to argue that it is not necessary to file a unit designation in the

county to perpetuate its lease interests. Rather, TMBR/Sharp has been compelled by events to assert that the mere filing of a C-102 with the Division is sufficient to perpetuate their lease on Section 25.

As a further consequence, TMBR/Sharp has placed itself in the position of having to argue to the Division that compulsory pooling is unnecessary altogether. (*See* April 29, 2002 Motion of TMBR/Sharp Drilling, Inc. To Continue Case No. 12816 And To Dismiss Cases 12859, 12860, and 12841.) As TMBR/Sharp asserts, the C-102 is sufficient to "consolidate" interests and that is enough to determine the unit configuration which will, in turn, determine the ultimate development of the entirety of Section 25.

It is apparent that issues of waste, correlative rights, and unnecessary drilling are inextricably bound with the issue of which operator may be entitled to drilling permits. These interrelated disputes cannot be resolved separately until the agency discharges its statutory obligations to consider the pooling applications and make its determinations, based on geologic. and engineering evidence that the resulting development will prevent waste and protect correlative rights.

The Operation Of Order R-11700-B Allows A Ministerial Act To Supersede The Agency's Statutory Functions.

The determination, first, that TMBR/Sharp may have been entitled to have its drilling permits approved before issues of correlative rights and waste are considered exalts a mere ministerial act over the substantive and discretionary quasi-judicial function that the Division is *mandated* to perform under N.M. Stat. Ann. 1978 Sections 70-2-17 and 70-2-18.[2]

[2] Compulsory Pooling proceedings are identified as adjudicatory matters at 19 NMAC 15N.1207.A(1).

In a situation such as this, where multiple owners have not agreed to pool their interests, under the Division's compulsory pooling statutes, on application, the agency is obliged to convene a hearing and consider evidence probative of whether pooling is necessary "...to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste". N. M. Stat. Ann. 1978 Section 70-2-17(C). See Simms v. Mechem 72 N.M. 186, 188, 382 P.2d 183, 184 (1963). ("Unquestionably the commission is authorized to require pooling of property when such pooling has not been agreed upon by the parties[.]") Where the evidence presented substantially supports affirmative findings and conclusions on any one of these issues, then the statute directs that the Division "***shall pool*** all or any part of such lands or interests or both in the spacing or proration unit." *Id.*, (emphasis added). Even under this statutory hearing process, depending on the evidence, the issuance of a compulsory pooling order is discretionary and is by no means an entitlement. This quasi-judicial function is expressly reserved to the Commission and the Director or her duly appointed examiners (N. M. Stat. Ann. 1978 sec. 70-2-13) and ***no part*** of it may be delegated by fiat under the guise of a ministerial approval of a drilling permit. *See* Kerr-McGee Nuclear Corp. v. New Mexico Environmental Improvement Board, 97 N.M. 88, 97, 637 P.2d 38, 47 (Ct. App. 1981). In Kerr-McGee, the Court of Appeals held that duties which are quasi-judicial in nature, and which require the exercise of judgment cannot be delegated. Id. As Kerr-McGee was a case of first impression in New Mexico, the Court of Appeals relied on Oklahoma case law. The Supreme Court of Oklahoma in Van Horn Oil Co. v. Okla. Corp. Com'n., 753 P.2d 1359, 1363 (1988) cited to the same authority relied on the New Mexico Court of Appeals when it quoted:

> Administrative bodies and officers cannot alienate, surrender, or abridge their powers and duties, or delegate authority and functions which under the law may be exercised only by them; and, although they may delegate merely ministerial functions, in the absence of statute or organic act permitting it, they

> cannot delegate powers and functions discretionary or quasi-judicial in character, or which require the exercise of judgment.

Citing, Anderson v. Grand River Dam Authority, 446 JP.2d 814 (1968). The Anderson Court also quoted with approval from American Jurisprudence and Corpus Juris Secundum:

> In 2 Am. Jur. 2nd Administrative Law, Section 222, it is said: It is a general principal of law, expressed in the maxim "delegates no protest delegare", that a delegated power may not be further delegated by the person to whom such power is delegated and than in all cases of delegated authority, or personal trust or confidence is reposed in the agent and especially where the exercise and application of the power is made subject to his judgment and discretion, the authority is purely personal and cannot be delegated to another***. A commission charged by law with power to promulgate rules, cannot in turn, delegate that power to another."

Because New Mexico has expressly adopted Oklahoma law, it is the law in this state that an administrative body may not delegate a statutory function, particularly in the manner that TMBR/Sharp advocates.

In making any determination under the compulsory pooling statute, under long-standing practice,[3] the Division will consider evidence relating to, among other matters: (1) the presence or absence of a voluntary pooling agreement; (2) whether a reasonable and good-faith effort was made to obtain the voluntary participation of others; (3) reasonableness of well costs; (4) geologic and engineering evidence bearing on the avoidance of waste and the protection of correlative rights, including the drilling of unnecessary wells; (5) the assessment of a risk penalty; and (6) whether a proposal is otherwise in the interests of conservation. The mere approval of a drilling permit and the filing of an acreage dedication plat serve to do none of these things and neither have any of the functions enumerated above been delegated outside the Division's regular hearing process.[4]

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[3] *See* Morris, Richard, *Compulsory Pooling of Oil and Gas Interests in New Mexico*, 3 Nat. Resources J. 316 (1963).

[4] N. M. Stat. Ann. 1978 Section 70-2-17(C): "All orders effecting such pooling shall be made after notice and hearing[.]"

It is inappropriate to allow any portion of the pooling process to be subsumed by the mere processing of an APD. Order No. R-11700-B, Par. 33. ("An application for a permit to drill serves different objectives than an application of compulsory pooling and the two proceedings should not be confused.") Moreover, the issuance of a drilling permit does not constitute any determination of a property right. *See* Gray v. Helmerich & Payne, Inc., et al. 843 S.W. 2d 579 (Tex. 2000).

Whether intentional or not, the practical effect of Order R-11700-B was to allow a ministerial event to dictate events to the exclusion of the statutory adjudicatory functions that ought first be performed by the Division and the Commission.

THE REQUEST FOR PARTIAL STAY

Arrington requests that Order No. R-11700-B be stayed to the extent it operates to prevent the reinstatement of its drilling permit and otherwise prevents it from commencing the drilling of it Glass-Eye Midge 25 Well No. 1 in the NE/4 of Section 25.

Further stay of Order R-11700-B is requested to the extent it approves, by implication or otherwise, the creation of a N/2 spacing and proration unit for TMBR/Sharp's Blue Fin 25 Well No. 1 pending the agency's consideration of geologic and engineering evidence and the issuance of an order determining the proper orientation of the 320 acre units in Section 15.

A proposed Order of Partial Stay is attached hereto as Exhibit "B".

CONCLUSION

For the reasons outlined above, Arrington respectfully requests the Commission immediately enter its Order of Partial Stay and then set all these matters for rehearing at the next regularly scheduled Commission hearing docket set for June 21, 2002.

Respectfully submitted,

MILLER, STRATVERT & TORGERSON, P.A.

By _____

J. Scott Hall
Attorneys for David H. Arrington Oil & Gas, Inc.
Post Office Box 1986
Santa Fe, New Mexico 87504-1986
(505) 989-9614

Certificate of Mailing

I hereby certify that a true and correct copy of the foregoing was faxed to counsel of record on the 15th day of May, 2002, as follows:

James Bruce, Esq.
Post Office Box 1056
Santa Fe, New Mexico 87504

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

David Brooks, Esq.
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87505

Susan Richardson, Esq.
Cotton Bledsoe Tighe & Dawson
500 W Illinois Ave # 300
Midland, Texas 79701

William F. Carr, Esq.
Post Office Box 2208
Santa Fe, New Mexico 87504

J. Scott Hall

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

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

APPLICATION OF TMBR/SHARP DRILLING, INC.
FOR AN ORDER STAYING DAVID H. ARRINGTON
OIL AND GAS, INC. FROM COMMENCING
OPERATIONS, LEA COUNTY, NEW MEXICO — CASE NO. 12731

APPLICATION OF TMBR/SHARP DRILLING, INC., — CASE NO. 12744
APPEALING THE HOBBS DISTRICT SUPERVISOR'S
DECISION DENYING APPROVAL OF TWO
APPLICATIONS FOR PERMIT TO DRILL FILED BY
TMBR/SHARP DRILLING, INC.,
LEA COUNTY, NEW MEXICO

ORDER OF PARTIAL STAY
OF ORDER NO. R-11700-B

THIS MATTER, having come before the Commission on the Application For Rehearing And Request For Partial Stay Of Order No. R-11700-B filed by David H. Arrington Oil and Gas, Inc., and the Commission, being duly advised, ORDERS as follows:

1. Order No. R-11700-B is stayed to the extent it may operate to prevent the reinstatement of the drilling permit previously issued to David H. Arrington Oil and Gas, Inc. on December 17, 2001 for the drilling of the Glass-Eye Midge 25 Well No. 1 (API No.30-025-35787) 803' from the north line and 962' from the east line in the NE/4 of Section 25, Township 16-South, Range 35-East, NMPM, Lea County, New Mexico. Order No. R-11700-B is

further stayed to the extent it prevents Arrington from commencing drilling operations for the referenced well.

2. Order No. R-11700-B is further stayed to the extent it may be regarded as approving, by implication or otherwise, the establishment of a spacing and proration unit consisting of the N/2 of Section 25, Township 16-South, Range 35-East, NMPM, Lea County, New Mexico, for the TMBR/Sharp Drilling, Inc. Blue Fin 25 Well No. 1 located in the NW/4 of said Section 25.

3. Jurisdiction over these cases is retained for the entry of such further orders as may be necessary.

DONE at Santa Fe, New Mexico, on this ____day of May, 2002.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

By:_____
Lori Wrotenbery, Chair.

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

IN THE MATTER OF THE APPLICATION OF
DAVID H. ARRINGTON OIL AND GAS, INC.
TO REINSTATE DRILLING PERMIT,
LEA COUNTY, NEW MEXICO CASE No. _____

APPLICATION

DAVID H. ARRINGTON OIL AND GAS, INC., by its undersigned attorneys, Miller, Stratvert & Torgerson, P.A. (J. Scott Hall), hereby makes application pursuant to Section 70-2-11 N.M.S.A. (1978) for an order reinstating its previously approved C-101 and C-102 drilling permit for Applicant's proposed Glass-Eyed Midge 25 Well No. 1 (API No. 30-025-35787) to be drilled at a standard 320-acre spacing and proration unit gas well location 803 feet from the North line and 902 feet from the East line in E/2 of Section 25. Township 16-South, Range 35-East, NMPM, Lea County, New Mexico. Applicant, in support thereof would show the Division:

1. Applicant owns a substantial portion of the working interest in and under the E/2 of Section 25, and Applicant has the right to drill thereon.
2. Applicant first acquired its lease interests in the E/2 of Section 25 in approximately January, 2001.
3. On November 29, 2001, Applicant filed with the Division's District I office in Hobbs its C-101 Application for Permit to Drill, ("APD"), for the Glass Eye Midge 25 Well No. 1 which it proposed to drill to the Townsend-Mississippian Gas pool. Applicant simultaneously filed a C-102 acreage dedication plat form proposing to dedicate the E/2 of said Section 25 to the subject well.

EXHIBIT A

4. On December 17, 2001, the Division's District I office approved Applicant's permit to drill the subject well.

5. On March 15, 2002, without notice to the Applicant, TMBR/Sharp Drilling, Inc. filed another C-101 APD with the Division's District I office for its Blue Fin 25 Well No. 1 (API No. 30-025-35865) which was also proposed to be drilled to the Mississippian formation in the NW/4 of Section 25, T-16-S, R-35-E, NMPM in Lea County. The C-102 acreage dedication plat which accompanied the filing of the TMBR/Sharp Drilling, Inc. APD proposed to dedicate the N/2 of said Section 25 to the Blue Fin 25 Well No. 1.

6. On March 20, 2002, without notice to the Applicant, the Division's District I office approved the APD for the Blue Fin 25 Well No. 1.

7. As a consequence of the actions of the Division's District I office, there existed two simultaneously approved APD's with attached C-102's that both proposed to dedicate the NE/4 of Section 25 in violation of, *inter alia*, 19 NMAC 15.C.104(C)(2)(c).

8. At the time of the filing of the APD's, there were owners of other interests in the N/2 and E/2 of Section 25, respectively, who had not voluntarily agreed to participate in the drilling of the proposed wells. Neither Applicant nor TMBR/Sharp Drilling, Inc. had consolidated the interests of all the non-participating owners either by way of a voluntary agreement, communitization agreement, or compulsory pooling order. Both Applicant and TMBR/Sharp Drilling, Inc. subsequently initiated separate compulsory pooling proceedings before the Division seeking to consolidate those interests.

9. On April 26, 2002, the New Mexico Oil Conservation Commission issued Order No. R-11700-B in Case Nos. 12731 and 12744. In Order No. R-11700-B, the Commission, citing to separately pending litigation in the district court involving conflicting leases, found that APD's previously issued to Arrington for wells in the S/2 of Section 23 and the W/2 of Section 25, T-16-S, R-35-E should not have been granted because Arrington was not an owner in those lands.

10. At the time it filed the APD for its Glass Eye Midge 25 No. 1 Well, Applicant owned separate oil and gas lease interests independent from the conflicting leases that are the subject of the district court litigation cited by the Commission in Order No. R-11700-B. As such, Applicant was eligible to become the operator of the subject well and should have received the permit to drill that was issued to it on December 17, 2001.

11. On May 1, 2002, the Division's District I office notified Applicant that its approved APD was canceled. Applicant received the notification on May 7, 2002.

12. Applicant continues to own lease interests underlying the E/2 of said Section 25 and continues to be eligible to be operator.

13. The cancellation of Applicant's permit by the Division's District I office was arbitrary, capricious and otherwise unreasonable.

14. Geological, engineering and equitable considerations mandate that development occur by way of a 320 acre spacing and proration unit located in the E/2 of said Section 25 dedicated to Applicant's proposed well in order to avoid the drilling of unnecessary wells, prevent waste and protect correlative rights.

WHEREFORE, Applicant prays that this application be set for hearing before a duly appointed examiner of the Oil Conservation Division no later than June 13, 2002, and that after notice and hearing as required by law, the Division enter its order reinstating the drilling permit for Applicant's proposed well and making such other and further provisions as may be proper in the premises.

Respectfully submitted,

MILLER, STRATVERT & TORGERSON, P.A.

By _____

J. Scott Hall
Post Office Box 1986
Santa Fe, New Mexico 87504
(505) 989-9614

ATTORNEYS FOR DAVID H. ARRINGTON OIL AND GAS, INC.