

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

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

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

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

ORDER OF THE DIVISION

BY THE DIVISION:

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

NOW, on this 24th day of September, 2001, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

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

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

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

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

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

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

(6) Applicant presented testimony that:

- (a) on the date its application was filed seeking an order pooling the subject units, Sun-West was an owner of an unleased 15% mineral interest in the lands sought to be pooled;
- (b) Applicant was unable to reach a voluntary agreement for the development of the subject lands because, although Sun-West was willing to lease its interest in the acreage, it demanded a royalty rate which, in Applicant’s opinion, would have rendered the drilling of the proposed well uneconomic;
- (c) Applicant proposed to lease Sun-West’s mineral interest on terms providing for a royalty of 18.75%, but Sun-West was unwilling to lease to Applicant on those terms. In the opinion of Applicant’s expert a larger royalty than 18.75% would render the prospect undesirable;
- (d) Applicant filed its application in this case on January 30, 2001;
- (e) notice of the filing of the application in this case and of the hearing thereon was sent by certified mail and received by Sun- West on February 6, 2001; and

- (f) on February 15, 2001, Sun-West executed a lease of its interest in the lands that were the subject of the application in this case to Gulf Coast, reserving a royalty of 27.5%.
- (7) Applicant further presented testimony that:
 - (a) Gulf Coast has the same address, telephone number and officers as Sun-West; and
 - (b) when applicant sought to contact Gulf Coast to negotiate terms of pooling of its interest in the proposed Unit, the individual who contacted Applicant to negotiate on behalf of Gulf Coast was the same individual with whom Applicant had previously discussed leasing of this interest from Sun-West.
- (8) Sun-West appeared by counsel at the hearing on the re-opened application, but presented no testimony.
- (9) The interest of Sun-West in the proposed units was an unleased mineral interest on January 30, 2001, when an application for compulsory pooling of all interests therein was filed, and on February 6, 2001, when Sun-West received notice of the application.
- (10) The subsequent lease of the 15% mineral interest from Sun-West to Gulf Coast was not an arms-length transaction, but was consummated for the apparent purpose of increasing the share of production that Sun-West would be entitled to receive free of costs in the event of the entry of a compulsory pooling order by the Division.
- (11) NMSA 1978 Section 70-2-17.C provides that:

“The division is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to all production from such well which would be received by the owner, or owners, for whose benefit the well was drilled or operated, *after payment of royalty as provided in the lease, if any, applicable to each tract or interest*, and obligations payable out of production, until the owner or owners drilling or operating the well or both have been paid the amount due under the terms of the pooling order or order settling such dispute.” [Emphasis added.]
- (12) However, NMSA 1978 Section 70-2-17.C also provides that:

“All orders effecting such pooling shall . . . be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil and gas, or both.”

It further provides:

“If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest,”

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

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

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

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

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

(18) Due to the delay occasioned by the reopening of this Case No. 12601, the time for commencement of Applicant's McGuffin "C" Well No. 1, as provided in ordering paragraph (2) of Division Order No. R-11573, should be extended to December 31, 2001.

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

CONCLUSION OF LAW:

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

IT IS THEREFORE ORDERED THAT:

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

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

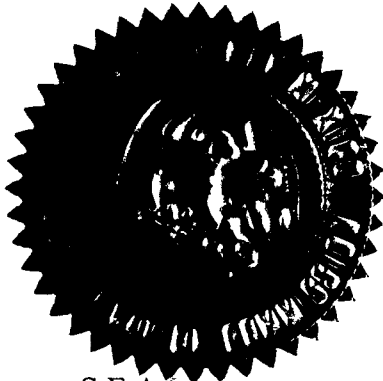
(3) The date for the commencement of Applicant's McGuffin "C" Well No. 1, as provided in Ordering Paragraph (2) of Division Order No. R-11573, is hereby extended to December 31, 2001.

(4) In the event the operator does not commence drilling the well on or before December 31, 2001, Ordering Paragraph (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause.

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

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

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



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in cursive script that reads "Lori Wrotenbery".

LORI WROTENBERY
Director