

**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:**

**CASE NO. 12601 *DE NOVO*
ORDER NO. R-11573-A**

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OIL CONSERVATION DIVISION

**APPLICATION OF BETTIS, BOYLE & 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.**

PRE-HEARING STATEMENT

This pre-hearing statement is submitted by Holland & Hart LLP as required by Oil Conservation Division Rule 1208.B.

APPEARANCES OF PARTIES

APPLICANT:

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OPPOSITION:

Sun-West Oil and Gas, Inc.

ATTORNEY:

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STATEMENT OF THE CASE

On April 26, 2001 the Oil Conservation Division entered Order No. R-11573 granting the application of Bettis, Boyle & Stovall for the compulsory pooling of all uncommitted mineral interests under Lots 3 and 4 (W/2 SW/4 equivalent) of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico. This order imposed on non-participating interest owners a 200% charge for risk involved in the drilling of a well on this pooled unit.

At the examiner hearing, Bettis, Boyle & Stovall asked the Division to order that the interest of Sun-West Oil and Gas, Inc. ("Sun-West") be treated as it was on the date the pooling application was filed -- as an unleased mineral interest -- not as it was on the date of the pooling order after Sun-West, with a private contract, had carved out of its interest a large non-cost bearing royalty burden. Order No. R-11573 was silent on this request and Bettis, Boyle & Stovall asked the Division to re-open the case to address this issue.

On September 24, 2001 the Division entered Order No. R-11573-A which found that the interest of Sun West should be treated as an unleased mineral interest.

With this appeal, Sun-West does not challenge the pooling of these lands nor the amount of the risk penalty. Instead, it challenges the Division's determination that Sun-West cannot defeat the Commission's statutory pooling authority with a private contract.

FACTS:

The undisputed facts in this case show that commencing on December 15, 2000, Bettis, Boyle & Stovall attempted to reach a voluntary agreement with Sun-West for the development of the W/2 SW/4 of Section 30. Sun-West owned an unleased 15% undivided mineral interest in this acreage. Since no agreement could be reached on an appropriate royalty burden for the Sun-

West tract, on January 30, 2001, Bettis, Boyle & Stovall filed an application with the Oil Conservation Division seeking an order pooling the W/2 SW/4 of Section 30 for a well to be drilled to test the San Andres and Pennsylvanian formations.

After Sun-West received notice of Bettis, Boyle & Stovall's pooling application, it leased its interest to Gulf Coast Oil and Gas Company ("Gulf Coast"). Gulf Coast and Sun-West have the same directors and representatives and share the same address and telephone number. When Bettis, Boyle & Stovall contacted Gulf Coast about this pooling application, the person who responded was the same person who had previously responded for Sun-West. The Sun-West lease to Gulf Coast contained a royalty rate in excess of the burden which Bettis, Boyle & Stovall had advised Sun-West would make the drilling of the proposed well uneconomic.

A chronology of relevant events which have resulted in this dispute was admitted into evidence at the May 31, 2001 Division hearing as Bettis, Boyle & Stovall Exhibit No. 3. A copy of this exhibit is attached to this Pre-hearing Statement.

ARGUMENT:

Bettis, Boyle & Stovall asserts that the Sun-West lease to Gulf Coast is an attempt by Sun-West through a private contract to avoid the provisions of the Oil and Gas Act and defeat the Oil Conservation Division's pooling authority.

In carrying out its statutory duties, the Oil and Gas Act confers on the Oil Conservation Commission "...jurisdiction, authority, and control of and over all persons, matters, or things necessary or proper to enforce effectively the provisions of this act or any other law of this state relating to the conservation of oil or gas...."

NMSA 1978 Section 70-2-6. In carrying out its statutory duties, the Commission has been granted broad authority. See, Santa Fe Exploration Co. v. Oil Conservation Commission, 114 N.M. 103, 835 P.2d 819 (1992); Continental Oil Company v. Oil Conservation Commission, 70 N.M. 310, 373 P.2d 809 (1962).

The New Mexico Oil and Gas Act authorizes the Oil Conservation Division to pool oil and gas interests where the owners "...have not agreed to pool their interests, and where one such separate owner, or owners,...has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply." This statute also provides that a Division pooling order "...may include a charge for risk...which charge for risk shall not exceed two hundred percent of the non-consenting working interest owner or owner's prorata share of the cost of drilling and completing the well." NMSA 1978 Section 70-2- 17.C.

Although the Oil and Gas Act provides that the owner who pays for the drilling of the well is entitled to all non-participating interest owners share of production from the well "...after payment of royalty as provided in the lease, if any, applicable to each tract or interest...." until the owners who drilled or paid for the drilling have paid the amount due under the pooling order. The Oil and Gas Act 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." NMSA 1978, Section 70-2-17.C.

The Oil and Gas Act also provides that "If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths or such

interest shall be considered as a working interest and one-eighth shall be considered a royalty interest....” NMSA 1978 Section 70-2-17.C

In the past the Division has been presented by other situations where operators have attempted to create burdens on tracts which are subject to a pooling application.¹ The Division has not permitted private agreements to defeat its pooling orders. See, Order No. R-11573-A, Finding 14.

In answering questions concerning the exercise of its statutory duties, the Commission acts on a case-to-case basis and upon the particular facts of each case. See, Viking Petroleum, Inc. v. Oil Conservation Commission, 100 N.M. 451, 672 P.2d 280,284 (1983). The Division reviewed the particular facts of this case and found in Order No. R-11573-A:

“It would circumvent the purpose of the New Mexico Oil and Gas Act (NMSA 1978 Sections 70-2-1 to 72-2-38, NMSA, 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.” (Finding 13)

¹ In Case No. 12087, Order No. R-11109, dated November 19, 1998, Nearburg Exploration Company, L.L.C. sought an order pooling certain lands in Lea County, New Mexico. The evidence showed that Merit Energy Company has an internal “net profits interest” which might unnecessarily burden Merit’s working interest. Since this net profits interest would not be subject to bear any costs of drilling or completing the well nor be subject to the risk penalty imposed by a pooling order, The Division ordered that this net profits interest be liable for its share of the drilling and completion costs and that it be subject to the risk factor penalty. Order No. R-11109, Findings (7) through (9), December 11, 1998.

In Case No. 8640, Order No. R-7998, dated August 8, 1985, Caulkins Oil Company obtained an order which required the “voluntary reduction” of the overriding royalty interest which was considered excessive.

“In order to effect pooling of the subject unit on terms that are just and reasonable under the circumstances 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 interest for the purpose of applying the cost recovery and risk charge provisions of Division Order No. R-11573.” (Finding 16)

In this appeal, Sun-West challenges these findings of the Division and seeks a new review of the facts of this particular case. Bettis, Boyle & Stovall contends that to permit Sun-West to assign its interest to Gulf Coast, after being notified of Bettis Boyle & Stovall’s compulsory pooling application, to carve out a royalty interest for itself in an amount which puts the drilling of the well in jeopardy is nothing more than an attempt by Sun-West to defeat the compulsory pooling power of the Commission through a private contract with an affiliated entity.


Bettis, Boyle & Stovall asks the Commission exercise the powers conferred on it by the Oil and Gas Act in Sections 70-2-11.A and 70-2-17.C quoted above and enter its order directing that the interest of Sun-West shall be treated for the purpose of this pooling order as an unleased mineral interest. Bettis, Boyle & Stovall asks the Commission reject the attempt of Sun-West to carve create new cost free interests in its land after a pooling application has been filed and Commission jurisdiction has attached. It asks the Commission to disallow for the purpose of this pooling order interests which can defeat the Commission’s pooling authority. Bettis, Boyle & Stovall asks the Commission to provide for pooling upon terms which are fair and reasonable to all owners in the pooled unit.

The issue presented by this appeal is of importance to the parties. The Commission’s decision in this case is also of importance to the oil and gas industry for

it will set the precedent which interest owners will follow in future negotiations and applications to pool spacing units in the State of New Mexico.

PROPOSED EVIDENCE -- PROCEDURAL MATTERS:

Pursuant to agreement between counsel the record will comprise the transcripts and exhibits from the April 19 and May 31, 2001, Oil Conservation Division hearings in Case No. 12601. No additional evidence or testimony will be presented at the December 4, 2001 Oil Conservation Commission hearing. Each party requests an opportunity to argue the case to the Commission.



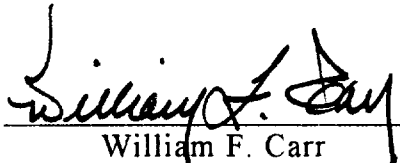
William F. Carr
Attorney for Bettis, Boyle & Stovall

CERTIFICATE OF SERVICE

I certify that on November 27, 2001, I delivered by facsimile and U. S. Mail a copy of this Pre-Hearing Statement to the following counsel of record:

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William F. Carr

CHRONOLOGY

December 15, 2000 Letter to Sun-West Oil & Gas, Inc. from Bettis, Boyle & Stovall proposing to lease its interest for the drilling of a well in the W/2 of Section 30, Township 9 South, Range 33 East, NMPM, Lea County, New Mexico.

January 20, 2001 Letter to Sun-West Oil & Gas, Inc. from Bettis, Boyle & Stovall referencing prior conversations and advising that a 25% royalty was unacceptable. Bettis, Boyle & Stovall expressed interest in drilling as soon as possible to take advantage of current high product prices.

January 30, 2001 Application for compulsory pooling filed at Oil Conservation Division by Bettis, Boyle & Stovall.

January 25, 2001 Letter to Bettis, Boyle & Stovall from Sun-West Oil & Gas, Inc. offering to lease for a 25% royalty.

February 6, 2001 Application for compulsory pooling and notice of hearing received by Sun-West Oil & Gas, Inc.

February 15, 2001 Lease by Sun-West Oil & Gas, Inc. to Gulf Coast Oil & Gas Company of Sun-West interest in Spacing units at a 27.5% royalty.

February 20, 2001 Letter to William F. Carr, attorney for Bettis Boyle and Stovall, from Sun-West Oil & Gas, Inc. acknowledging receipt of the application for compulsory pooling and advising that their interest had been leased for a 27.5% royalty.

February 21, 2001 Gulf Coast Oil & Gas Company lease recorded in Lea County, New Mexico.

March 22, 2001 Letter to Gulf Coast Oil & Gas Company from Bettis, Boyle & Stovall offering them an opportunity to join in the well and advising them that Bettis, Boyle & Stovall cannot carry a 27.5% royalty.

March 23, 2001 Telephone from Shane Spear advising Mark Maloney that Sun-West Oil & Gas, Inc. and Gulf Coast Oil & Gas, Company were essentially the same entities.

BEFORE THE OIL CONSERVATION DIVISION
Santa Fe, New Mexico
Case No. 12601 Exhibit No. 3
Submitted by:
Bettis, Boyle & Stovall
Hearing Date: May 31, 2001

**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:**

**REOPENED
CASE NO. 12,601
(DE NOVO)**

**APPLICATION OF BETTIS, BOYLE & 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.**

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PRE-HEARING STATEMENT

This Pre-Hearing Statement is submitted by Sun-West Oil and Gas, Inc. ("Sun-West") as required by the Oil Conservation Commission.

APPEARANCE OF PARTIES

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STATEMENT OF CASE

APPLICANT

Bettis, Boyle & Stovall applied to the Oil Conservation Division to reopen Case No. 12,601 and Order No. R-11573 to address the appropriate royalty burdens on the proposed well for purposes of the charge for risk involved in drilling said well. The Division reopened Case No. 12,601 and issued Order No. R-11573-A to provide that the interest owned by Sun-West in the subject unit as of the date of the filing of the original application for compulsory pooling by Bettis, Boyle & Stovall would be treated as an unleased mineral interest for the purpose of applying the cost recovery and risk charge provisions of Order No. R-11573.

OPPOSITION OR OTHER PARTY

Sun-West submits that the Division exceeded its authority in issuing Order No. R-11573-A so as to deem Sun-West's mineral interest as unleased for the purpose of Bettis, Boyle & Stovall's compulsory pooling application. The Division's findings were not supported by substantial evidence, the Division's order was arbitrary and capricious, the Division's order constituted an abuse of discretion, and the Division's order amounted to an unlawful deprivation of protected property interests.

PROPOSED EVIDENCE

APPLICANT

WITNESS

None

ESTIMATED TIME

N/A

EXHIBITS

See Procedural Matters Below

OPPOSITION OR OTHER PARTY

WITNESS

None

ESTIMATED TIME

N/A

EXHIBITS

See Procedural Matters Below

PROCEDURAL MATTERS

The parties have stipulated that the following will be introduced and admitted into evidence and made part of the record for the Commission hearing:

1. Transcript of the April 19, 2001 hearing in Case No. 12,601 and all exhibits admitted therein;
2. Transcript of the May 31, 2001 hearing in Case No. 12,601 and all exhibits admitted therein;
3. Order No. R-11573;
4. Order No. R-11573-A.

Sun-West may submit its memoranda previously submitted to the Division hearing officer.

RESPECTFULLY SUBMITTED,

STRATTON & CAVIN, P.A.

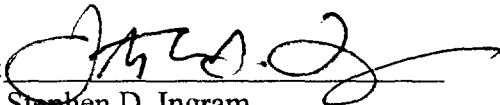
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Attorneys for Sun-West Oil and Gas, Inc.

I hereby certify that a true and correct copy of the foregoing pleading was served via facsimile and first-class mail on this 26th day of November, 2001 to the following:

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