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# Oil and Gas—New Mexico Oil Conservation Commission—Findings of Fact

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# Oil and Gas—New Mexico Oil Conservation Commission—Findings of Fact*

It has been established, as a general proposition, that the effect of the "rule of capture" may be considerably weakened by a state's efforts to prevent waste and protect correlative rights.[1] The specific problem, however, often concerns the propriety of actions by the state administrative agency responsible for carrying out the aim of this general proposition. Section 65-3-14(a) of the New Mexico statutes provides that the Oil Conservation Commission has the duty to limit production of a given pool in such a manner as to prevent waste, while affording

> to the owner of each property in the pool the opportunity to produce his just and equitable share of the . . . gas . . . in the pool, being an amount, . . . so far as can be practicably obtained *without waste,* substantially in the proportion that the quantity of the recoverable gas . . . under such property bears to the total recoverable . . . gas . . . in the pool. . . .[2]

In attempting to fulfil this duty, the Oil Conservation Commission may establish proration formulae for lands where owners seek to extract gas from the common pool. The power to set up a *proration formula* is to be distinguished from the power of *proration* generally. Proration is based on a public interest concept, in that the Commission determines the maximum amount of production allowable to each field.[3] The proration formula, however, is a determination of how each field's allowable production is to be divided among

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* El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966).

1. Cases such as Jones v. Forest Oil Co., 194 Pa. 379, 44 A. 1074 (1900) to the effect that if possession of the land is not necessarily possession of the oil and gas, there is no reason why an oil and gas operator should not be permitted to make the production of his wells as large as possible, were countered by a line of cases holding that states have the power to regulate both the distribution and the production of oil and gas. *See e.g.,* New Orleans Gas Co. v. Louisiana Light Co., 115 U.S. 650 (1885); Ohio Oil Co. v. Indiana, 177 U.S. 190 (1900). *See also* Clyde, *Problems of Regulatory Agencies in Administering Conservation Statutes—With Particular Reference To Well Spacing,* 7 Rocky Mountain Mineral Law Institute 165, 170 (1962):

> It now appears settled that provisions which bear a reasonable relationship either to the conservation of natural resources or the adjustment of correlative rights of the owners thereof was valid.

2. N.M. Stat. Ann. § 65-3-14(a) (Repl. 1960).

3. Comment, Amazon Pet. Co. v. Railroad Comm'n Nat. Res. 5 F. Supp. 633 (E.D. Tex. 1934); *see also* 3 Natural Resources J. 178, 181 (1963).

the individual owners of the field.[4] Although at least one major oil and gas producing state has taken the opposite position,[5] the New Mexico Supreme Court decided in *Continental Oil Co. v. Oil Conservation Comm'n*[6] that the protection of correlative rights alone is insufficient to give the Commission the necessary jurisdiction to establish a proration formula. The court said that the Commission has jurisdiction to protect correlative rights only after making preliminary findings of fact which "determine, insofar as practicable, (1) the amount of recoverable gas under each producer's tract; (2) the total amount of recoverable gas in the pool; (3) the proportion that (1) bears to (2); and (4) what portion of the arrived at proportion can be recovered *without waste*."[7]

Any questions as to the court's willingness to apply this strict standard were eliminated by the subsequent case of *Sims v. Mechem*.[8] In that case, which involved a Commission order establishing two separate production units, the Commission made a general finding that "the most efficient and orderly development of the subject-acreage can be accomplished by force pooling the NW/4 of said Section 25 and the SW/4 of said Section 25 to form two standard gas proration units in the Tubb Gas Pool. . . ."[9]

In rejecting the Commission's contention that this was equivalent to a finding that the ordered pooling would prevent waste, the court said:

> There is nothing in evidence before the commission tending to support a finding of waste or the prevention of waste by pooling the property into two standard units . . . since [the] Commission Order . . . contains no finding . . . that pooling would prevent waste, based on evidence to support such a finding, the commission was *without jurisdiction* . . . .[10]

The New Mexico Supreme Court's insistence in *Continental and Sims*, that the Oil Conservation Commission make these four preliminary findings was regarded by some as absolutely destructive of

4. *Id.*

5. *See* R.R. Comm'n v. Sterling Oil and Ref. Co., 147 Tex. 547, 218 S.W.2d 415 (1949) for the proposition that a conservation commission can issue orders based solely on the protection of correlative rights.

6. 70 N.M. 310, 373 P.2d 809 (1962).

7. *Id.* at 319, 373 P.2d at 815.

8. 72 N.M. 186, 382 P.2d 183 (1963).

9. *Id.* at 189, 382 P.2d at 185.

10. *Id.*

the Commission's power to establish proration formulae. After the general finding of *Sims* was rejected as insufficient, there was a possibility that the court would rule that the four *Continental* points required that the Commission determine the *exact quantitative portion*, in cubic feet of gas, of each producer's recoverable gas in place in the ground which could be recovered or brought to the surface without waste before the Commission could proceed to consider various proration formulae that would protect correlative rights. This would have presented the Commission with the duty to make findings that were technically impossible to accomplish.[11] The direct result of the materialization of this possibility would have been to render the Commission powerless to fulfill its duty under Section 65-3-14(a) to protect correlative rights in situations where a proration formula would make for more efficient development of a common pool. Moreover, in denying jurisdiction over these matters to the Commission, the court would have inflicted upon itself the burden of deciding complicated engineering questions when the oil companies came into conflict over their correlative rights. By placing the impossible task of making the above described preliminary findings, the court would have succeeded only in depriving itself of the help of the Commission's expertise when a correlative rights question eventually came before it.

Thus, the problems of *Continental* and *Sims* reached beyond the area of oil and gas law; the questions posed concerned the broader principles of administrative law: how much power should the Commission have over what are technically "private" rights? How can an admittedly non-expert court make sure that a body of experts such as the Oil Conservation Commission is in fact making intelligent use of its expertise to the greatest extent possible? More specifically, how can the courts look behind the Commission's various proration formulae and determine whether the complicated figures and equations carry out the policy expressed by the New Mexico statutes?

In *El Paso Natural Gas Co. v. Oil Conservation Comm'n*[12] the New Mexico Supreme Court wrote an opinion that reveals a comprehensive understanding of both the nature of the administrative process, and the technical complexities of the oil and gas industry. In *El Paso*, the Oil Conservation Commission issued order # R-2259-

11. Brief for Appellee, p. 23; El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966).

12. 76 N.M. 268, 414 P.2d 496 (1966).

B[13] (amending order R-1670-C) which changed the proration formula in the Basin-Dakota gas pool from a "25-75" formula (25% acreage plus 75% acreage, times deliverability) to a "60-40" formula.[14] The Commission made several findings of fact supported by extensive testimony and other data. Three of the findings, #11, #13, and #14, are especially significant: In finding #11, the Commission defines each tract's A/R factor as:

> the percentage of total pool allowable apportioned to each . . . tract as compared to its percentage of total pool reserve . . .
> A = % of total pool allowable
> R = % of the total pool reserves
> The A/R factor is substantially different from the ratio of each tract's reserves to the total pool reserves, which are conceded by appellants [El Paso Nat. Gas Co.] to be found in Column C of Exhibit A. That ratio could be expressed:
> $\frac{\text{Tract reserves}}{\text{Pool reserves}} \times 100 =$ % of total pool reserves and is obviously the denominator "R" of the A/R ratio above. The numerator "A" equals the *percentage of total pool allowable attributed to each well* by application of a proration formula. . . .[15]

The Commission was, in Finding #11, thinking of the last of the four basic findings required by *Continental* when it said "More exactly, the A/R factor for each tract is a mathematical definition of 'what portion of the arrived at proportion can be recovered' from that tract under that allocation formula. Thus, Column J of Exhibit A which sets forth the A/R factor for each well under the 60-40 allocation formula is a precise and complete fulfilment by the Commission of the . . . fourth finding demanded by *Continental.*"[16] Finding #13 was that under the 25-75 formula, correlative rights were not being protected and that, correlative rights being a necessary adjunct to the prevention of waste, waste would result unless the Commission could act to protect correlative rights.[17] Finding #14 was that the production of the portion of the total pool allowable allocated to each tract under the 60-40 formula would "more adequately . . . prevent waste."[18]

13. Commission Order No. R-2259-B (1965).
14. *Id.*
15. Brief for Appellee, p. 3.
16. *Id.*
17. Brief for Appellee, p. 10.
18. *Id.* at 10.

The El Paso Natural Gas Company contended that these three findings were not sufficient to establish the Commission's jurisdiction according to the *Continental* criteria.[19] It claimed that finding #14, to the effect that the 60-40 proration formula would *prevent waste*, is not equivalent to a finding of "what portion of the arrived at proportion can be recovered *without waste*."[20] Thus, the Gas Company argued that the Commission, in order to establish its jurisdiction, must make the "impossible" preliminary finding[21] of the *exact quantitative portion* (in cubic feet of gas) of each producer's recoverable gas in place which can be recovered without waste. The district court found in favor of the Commission. On appeal to the New Mexico Supreme Court, *held*, affirmed.[22] (This was the Commission's first substantive victory in the high court.[23])

The importance of *El Paso* in the oil and gas area cannot be questioned. For those who saw *Continental* and *Sims* as destructive of the Commission's power to establish proration formulae, it is a welcome affirmation of the Commission's rightful function as an arbiter in the complicated disputes involving oil and gas companies. It is now clear that cases such as *State v. Mechem*,[24] will not be used to remove the Commission's power to rule over technically "private rights." The *Continental* rule has been interpreted in favor of having experts decide controversies demanding expertise rather than going to a non-expert court for a fortuitous decision.

The *El Paso* decision is perhaps even more significant in the area of administrative law and the New Mexico court's conception of the

19. El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966).

20. *Id.* at 271, 414 P.2d at 498; the gas company was trying to persuade the court to apply the *Continental* requirements literally. Fortunately, the court reviewed *Continental* and the conservation statutes to arrive at a reasonable combined effect of strictly controlling, but not destroying, the power of the Commission.

21. See p. 5 *supra*; the showing, by the Commission, that a strict interpretation of *Continental* would render the Commission powerless to act concerning correlative rights may have been the single most important element in determining the outcome of the case. The strictness of the *Continental* standard itself, however, can be regarded as an "overaction" (on the Court's part) to the failure of the Commission to make its best effort to determine those facts logically necessary to sustain a proration formula order.

22. El Paso Natural Gas Company v. Oil Conservation Comm'n, 76 N.M. 268, 414 P.2d 496 (1966).

23. Pubco Petroleum Corp. v. Oil Conservation Comm'n, 75 N.M. 36, 399 P.2d 932 (1965).

24. 63 N.M. 250, 316 P.2d 1069 (1957). This case involved the validity of the workman's compensation statute under the N.M. Constitution. The court held that agencies were not to decide cases dealing with individual's rights.

administrative process. *El Paso*'s requirement of exhaustive findings by the Commission is "the other side of the coin." That is, in its insistence that the Commission make more fundamental findings than those presented in either *Continental*[25] or *Sims*,[26] the court was forced to make the difficult decision of how much to insist upon without (a) destroying the Commission's utility, or (b) allowing it unbridled power to prorate gas between private organizations. With regard to this problem, Professor Davis has said that:

> Judicial decisions on inadequacy of administrative findings are . . . one of the principal tools by which courts impose their limited control of administrative development of law and policy.[27]

The New Mexico court, after reviewing the exhaustive findings made by the Commission, said in effect that the Commission had done enough, had studied the controversy carefully enough, had *done its job.*

Although couched in the technical language of oil and gas law, the decision was based upon the court's examination of what the Commission had done and an intelligent appreciation that this was all that should be required of the Commission. Thus, the court was aware that expertise alone is not a sufficient basis for an administrative order; it realized that the duty of the court is to make sure that the experts are doing all that they can possibly do before arriv-

25. The findings actually presented by the Commission in *Continental* were:

> (5) That the applicant has proved that there is a general correlation between the deliverabilities of the gas wells in the Jalmat Gas Pool and the [recoverable] gas in place under the tracts dedicated to said wells, and that the inclusion of a deliverability factor in the proration formula for the Jalmut Gas Pool would therefore result in a more equitable allocation of the gas production in said pool than under the present gas proration formula.
>
> (6) That the inclusion of a deliverability factor in the proration formula for the Jalmat Gas Pool will result in the production of a greater percentage of the pool allowable, and that it will more nearly enable the various gas producers . . . to meet the market demand for gas for said pool.

The court said

> We have not overlooked . . . Finding No. 3 which is the only one mentioning "waste" but this particular finding . . . did not apply to the method of computing allowables.

70 N.M. at 318, 373 P.2d at 814.

26. See p. 4 *supra.*

27. 2 K. Davis, Administrative Law 436 (1958).

ing at a ruling.[28] Yet the court stopped short of insisting upon a finding that would be practically impossible for the Commission to reach, realizing that:

> Sometimes the reason for tolerating a gap between evidence and findings or between findings and decision has to do with limitations of human intellects or limitations on the magnitude of investigations that may be conducted in particular circumstances. Not all propositions of fact that are useful and used in the Administrative process are susceptible of proof with evidence.[29]

The New Mexico Supreme Court said that the Commission must determine:

> the portion which the gas underlying each tract bears to the total recoverable gas in the pool which can be produced with the least waste. . . . We think the Commission made that determination in this instance.[30]

The validity of this latter statement is questionable. The Commission made exhaustive investigations and arrived at the finding said by the court to be sufficient, but did it in fact make this determination? It probably came very close, but an absolute statement that such and such a formula will produce the recoverable gas without waste (or with the *least waste*, as the court interpreted the *Continental* phrase "without waste"[31]) is not likely to be reached before actually seeing how the formula works in practice.[32] This is not a weakness of the court's decision, however, but is its strength. By rejecting the Commission's counter argument that even though it did make

28. For an articulate protest against an overly lenient policy toward administrative agencies, *see* dissent of Douglas, J. in New York v. United States, 342 U.S. 882, 884 (1951).

> Unless we make the *requirements for administrative action strict and demanding, expertise*, the strength of modern government, can become a monster which rules with no practical limits on its discretion. (emphasis added).

29. 2 K. Davis, *supra* note 27, at 475.

30. El Paso Natural Gas Co. v. Oil Conservation Comm'n, 76 N.M. 268, 272, 414 P.2d 496, 499 (1966).

31. *Id.* at 270, 414 P.2d at 497.

32. See note 33 *infra*.

the required determination, such a determination was unnecessary,[33] the court was attempting to tell the Commission that it must be diligent, it must work hard at its job, and it must grapple with some very difficult problems before the court will "O.K." its orders. In continuing its demand for findings supported by the best evidence possible, the New Mexico Supreme Court thus not only prevents any arbitrary action by the Commission, but retains its rightful position as the high judicial body: the coordinator of administrative rulings and the guardian of basic concepts of the law in a legal community where more and more preliminary legal decisions are being made by boards of experts instead of judges.

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33. Brief for Appellee, pp. 16-20.

The Commission argued that neither *Continental* nor N.M. Stat. Ann. §§ 65-3-29 (h) and 65-3-14 (a) required it to determine exactly "that portion of the recoverable gas underlying each producer's tract which can be recovered without waste before it can act to protect correlative rights." This was a separate line of argument which might have endangered the Commission's other line which was that it *had* in fact made all necessary findings. The court did not accept the Commission's point that the findings were unnecessary and held that the findings were actually made. The Commission may thus be said to have "lost" the case in the sense that future orders can be issued only after difficult surveys and tests have been diligently carried out; *El Paso* did not remove the judicial "sword" that continues to hang over the Commission's head.

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