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

APPLICATION OF OIL CONSERVATION DIVISION TO ADOPT 19.15.27 NMAC AND 19.15.28 NMAC, AND TO AMEND 19.15.7 NMAC, 19.15.18 NMAC, AND 19.15.19 NMAC; STATEWIDE

CASE NO. 21528

NMOGA'S MOTION TO STRIKE 19.15.27.8.G(4) FROM PROPOSED PART 27 RULE ON VENTING AND FLARING OF NATURAL GAS

The New Mexico Oil & Gas Association ("NMOGA") moves the Oil Conservation Commission to strike 19.15.27.8.G(4) from the proposed Part 27 rule on venting and flaring of natural gas. The requirement to report vented and flared gas to all royalty owners in the mineral estate being produced by wells on a monthly basis, which by definition includes overriding royalty owners, *see* 19.15.2.7.R(7) NMAC, is not authorized by the New Mexico Oil and Gas Act (the "Act"), nor is it reasonably related to the protection of correlative rights or the prevention of surface waste.

I. Introduction

When it enacted the Oil and Gas Act, the Legislature created the Oil Conservation Commission and gave "the Commission and Division two major duties: the prevention of waste and the protection of correlative rights." *Santa Fe Expl. Co. v. Oil Conservation Comm'n*, 1992-NMSC-044, ¶ 27, 114 N.M. 103, 835 P.2d 819 (citing NMSA 1978, § 70-2-11(A) *Cont'l Oil Co. v. Oil Conservation Comm'n*, 1962-NMSC-062, ¶ 26, 373 P.2d 809). The Legislature also vested the Oil Conservation Division and Commission with certain specific powers enumerated in Section 70-2-12. "The Oil Conservation Commission is a creature of statute, expressly defined, limited and empowered by the laws creating it." *Cont'l Oil Co.*, 1962-NMSC-062, ¶ 11. The

Commission's authority to make rules and regulations is therefore defined and limited by the express authority and powers conveyed through the Oil and Gas Act.

Proposed Part 19.15.27.8.G(4) requires operators to "report the vented and flared natural gas on a volumetric and percentage basis to all royalty owners in the mineral estate being produced by the well on a monthly basis, keep such reports for not less than five years and make such records available for inspection by the division upon request." No provision in the Act supports this monthly reporting obligation to contractual royalty owners or overriding royalty interest owners. Contractual owners in the revenue generated by oil and gas development do not have the right to operate or produce a well and, therefore, do not have correlative rights to be protected. The Commission's expressly enumerated powers under Section 70-2-12 of the Act, which serve to prevent waste and protect correlative rights, also do not provide a basis to authorize the proposed requirement. The proposed requirement to report flared and vented gas on a volume and percentage basis to royalty and overriding royalty interest owners does nothing to further the Commission's duty to prevent surface waste.

Moreover, the proposed rules require the volumes of gas vented and flared by operators in New Mexico to be reported monthly to the Division. Accordingly, these volumes will be readily available to the public—including all royalty and overriding royalty interest owners—through its online database. Imposing the additional burden of reporting these same volumes to royalty and overriding royalty owners, many of whom may not understand these reports, contributes nothing to physically reducing surface waste nor does it provide any additional incentive for operators to reduce waste. As important, reporting obligations to royalty and overriding royalty interest owners are governed by contract, negotiated between the parties,

making the relationship inappropriate for regulation by the Commission, especially where the proposed rule is not authorized by any provision under the Act.

II. Argument

A. Monthly reporting to royalty and overriding royalty interest owners does not protect correlative rights.

Royalty and overriding royalty owners do not have correlative rights under New Mexico law. Because these contractual owners in revenue generated from oil and gas development have no correlative rights, the proposed monthly reporting is without authority and should be stricken.

Section 70-2-11(A) empowers the Commission with the duty "to protect correlative rights, as in this act provided." The Act defines "correlative rights" to mean

> the opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool to produce without waste the owner's just and equitable share of the oil or gas or both in the pool, being an amount, so far as can be practicably determined and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool and, for such purpose, to use the owner's just and equitable share of the reservoir energy[.]

NMSA 1978, § 70-2-33(H) (emphasis added). In other words, correlative rights, as defined by the Act, protect only the interests of owners who have retained the right to produce oil or gas. The statutory doctrine of correlative rights does not extend to interest owners who do not retain the right to produce oil or gas.

Under the Commission's own definitions, only "working interest owners" have an "operating interest under an oil and gas lease," and "have the exclusive right to exploit the oil and gas minerals." *See* 19.15.2.7.W(10) NMAC (defining "working interest owner") (emphasis added); *see also* 8 Williams & Meyers, Oil and Gas Law (2020) (defining "working interest" as "[t]he operating interest under an oil and gas lease."). The Commission recognizes that a "royalty

interest owner" is the "owner of an interest in oil and gas that does not presently entitle the owner to explore, drill or otherwise develop those minerals, including lessors, royalty interest owners and overriding royalty interest owners." *See* 19.15.2.7.R(7) NMAC; 8 Williams & Meyers, Oil and Gas Law (2020) (defining "royalty interest" as "absence of operating rights"); *see also Duvall v. Stone*, 1949-NMSC-074, ¶ 15, 213 P.2d 212 (defining royalty interest as "a share of the product or profits (ordinarily 1/8) reserved by the owner for permitting another to develop his property for oil and gas"); *Christy v. Petrol Res. Corp.*, 1984-NMCA-108, ¶ 21, 691 P.2d 59 ("An overriding royalty is, first and foremost, a royalty interest."). Royalty interest owners, in exchange for a cost-free share of the production or profits, have contractually conveyed away the exclusive right to explore, operate, and produce to the lessee, or working interest owner. *See, e.g.*, *Anderson Living Tr. v. ConocoPhillips Co., LLC*, 952 F. Supp. 2d 979, 1025 n.7 (D.N.M. 2013) (discussing in general the tradeoff of operating rights for a cost-free royalty interest). Having given up the operating rights, royalty interest owners are outside the protections afforded under the doctrine of correlative rights, as defined by the Oil and Gas Act.

In addition, operator obligations to royalty and overriding royalty owners are governed by contracts and quasi-contractual duties imposed by courts as a matter of law. Beside the express covenants and obligations imposed on working interest owners through the terms of the governing lease, royalty interest owners are also afforded broad protections in their relationship with lessees through various judicially recognized implied covenants, such as the implied covenants to market[1] and to act as a reasonably prudent operator.[2] There is no need, let alone authority, for the Commission to interject itself into the contractual relationship between royalty interest owners and working interest owners. The Legislature has not seen fit to burden the

[1] *Libby v. De Baca*, 1947-NMSC-007, ¶ 7, 179 P.2d 263.
[2] *Cont'l Potash, Inc. v. Freeport-Mcmoran, Inc.*, 1993-NMSC-039, ¶ 62, 858 P.2d 66.

Commission, or the Division, with the role of monitoring or refereeing the contractual relationship between working interest owners and private royalty or overriding royalty interest owners.

Because the Commission is limited by the statutory definition of correlative rights to protect only interest owners with the right to produce oil or gas, the proposed regulation goes beyond the powers authorized under the Act and should be omitted.

B. The Commission's enumerated powers also do not Authorize the reporting requirements proposed under 19.15.27.8.G(4) NMAC.

In furtherance of the Commission's "two major duties" under the Oil and Gas Act—to prevent waste and protect correlative rights—the Legislature conveyed a series of enumerated powers upon the Commission defined in Section 70-2-12. None of these enumerated powers authorize the reporting required under proposed 19.15.27.8.G(4).

Subpart A of Section 70-2-12 generally authorizes the Division to collect data; make investigations and inspections; examine properties, leases, books and records; examine oil field facilities and equipment; hold hearings; provide for record keeping, making reports, and checking the accuracy of the records and reports; limit and prorate production of oil or gas; and require certification to transport or tender oil, gas, or any products of both. *See* NMSA 1978, § 70-2-12(A)(1)-(8). None of those expressly defined powers can be reasonably construed to authorize the Commission to require an operator to prepare monthly reports on vented and flared gas volumes to working interest owners, royalty interest owners, overriding royalty interest owners or any other interest owners.

Subpart B of Section 70-2-12 identifies the "subject matter" over which the Commission is expressly authorized to make rules and regulations. Twenty-two different subject areas are specifically enumerated. However, none of them can be read to authorize the Commission to

require operators to prepare and provide reports to interest owners on any matter, let alone on volumes of vented and flared gas. Nor do any of the expressly enumerated subjects touch on or relate to any sort of implied mandate to require operators to prepare such reporting.

Because the Commission is "expressly defined, limited and empowered by the laws creating it[,]" and no enumerated provision in the Oil and Gas Act authorizes the required reporting, or can be implied to authorize it, the proposed language under 19.15.27.8.G(4) should be stricken. *See Cont'l Oil Co.*, 1962-NMSC-062, ¶ 11.

C. Monthly reports to royalty and overriding royalty owners will not further the prevention of surface waste.

Surface waste is defined as the "unnecessary or excessive surface loss or destruction without beneficial use" of oil and gas. *See* NMSA 1978, § 70-2-3(B). Reporting vented and flared volumes on a monthly basis to contractual royalty and overriding royalty interest owners has no nexus to the prevention of surface waste.

A rule is arbitrary or capricious when "the rule's requirements are not reasonably related to the legislative purpose[.]'" *See Earthworks' Oil & Gas Accountability Project v. N.M. Oil Conservation Comm'n*, 2016-NMCA-055, ¶ 11, 374 P.3d 710 (quoting *Old Abe Co. v. N.M. Mining Comm'n*, 1995-NMCA-134, ¶ 10, 908 P.2d 776).

The rule's required reporting to royalty and overriding royalty interest owners does not further the prevention of surface waste. Under other language in proposed Part 27, operators will be required to measure and report the volumes of vented and flared gas to the Division on a monthly basis for the purpose of tracking the rule's gas capture requirement. *See* Proposed Rule 19.15.27.8.F & G(1)-(3). Imposing the additional burden of reporting those volumes on a volumetric and percentage basis to various owners in the mineral estate will contribute no incremental benefit to the goal of reducing volumes of gas vented or flared. It will do nothing to

physically reduce volumes vented or flared. It also creates no additional incentive for operators to reduce surface waste because they already will be required to disclose those volumes in monthly reporting to the Division and meet the yearly gas capture requirements.[3]

D. Monthly volumes of vented and flared gas will be reported to the Division and readily available on the Division's website to anyone interested in this information.

Not only is there no legislative authority to support separate monthly reporting of venting and flared volumes to contractual mineral owners, but the proposed reporting will be duplicative of publicly available information under the proposed rule. Under the proposed rule, monthly volumes of vented and flared gas will be reported to the Division on a volumetric and percentage basis and will be readily available to the public—and all royalty and overriding royalty interest owners—through the Division's online database. Division records for compulsory pooling proceedings reflect that horizontal well spacing units often include dozens of royalty and working interest owners; in some instances, the number of royalty and working interest owners for a single spacing unit can be in the hundreds. Imposing the additional requirement of reporting these same publicly available volumes on a monthly basis to dozens, and sometimes hundreds, of contractual interest owners—many of whom may not even burden the operator's working interest—across every operated spacing unit is unnecessarily duplicative and unreasonably burdensome. It also raises the specter of interfering with pre-existing contractual relationships between operators, working interest owners and their royalty and overriding royalty interest owners without any legislative mandate.

Given the absence of any discernible benefit to the Commission's expressed authority under the Oil and Gas Act, the proposed monthly reporting requirement to royalty and overriding

[3] This lack of any nexus to the prevention of waste extends equally to working interest owners and any other interest owner in the production.

royalty owners is an arbitrary requirement that must be omitted from proposed Part 27. *See Earthworks' Oil & Gas Accountability Project*, 2016-NMCA-055, ¶ 11.[4]

CONCLUSION

For the reasons stated, the Motion should be granted and the language suggested under 19.15.27.8.G(4) should be stricken from the proposed rule in Part 27.

Respectfully submitted,

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[4] This unnecessary and arbitrary burden extends equally to any suggested reporting to working interest owners and any other contractual interest owner in the production.

CERTIFICATE OF SERVICE

I hereby certify that on December 17, 2020, I served a copy of the foregoing document to the following counsel of record via Electronic Mail to:

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