F I S C A L I M P A C T R E P O R T

SPONSOR Jennings **DATE TYPED** 2/10/2005 **HB**

SHORT TITLE "Division Order" In Oil & Gas Payments Act **SB** 256/aSJC

ANALYST Aguilar

APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY05	FY06	FY05	FY06		
	NFI				

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Energy, Minerals and Natural Resources Department (EMNRD)
Commissioner of Public Lands (SLO)

SUMMARY

Synopsis of SJC Amendment

The Senate Judiciary Amendment changes the term "division order" to "reasonable division order", removes a provision that a division order would not relieve the lessee of any liabilities or obligations under the oil and gas lease and provides applicability for division orders executed on or after the effective date.

Significant Issues

The Oil Conservation Division (OCD) reports the original bill would have provided that a division order "does not relieve the lessee of any liabilities or obligations under the oil and gas lease." This provision had potentially far-reaching implications because there has been extensive litigation in other states about the extent to which a division order may modify or supplement the payment terms of leases or other instruments. Cases on this subject have reached conflicting conclusions, and the law of New Mexico on this subject is unsettled. The amended bill would leave this issue for later resolution by the New Mexico courts.

OCD further notes Section 70-10-5 NMSA 1978 provides that a party responsible for payment of oil and gas proceeds is excused from statutory liability for interest and costs resulting from delay in payment of an interest owner if the interest owner refuses to execute a "reasonable division order." The amended bill would provide that the form of division order set forth in the bill would constitute a "reasonable division order." However, the bill does not mandate the use of the form provided.

Synopsis of Original Bill

Senate Bill 256 amends the Oil and Gas Payments Act to include a definition of "division order," to provide that a division order "does not relieve the lessee of any liabilities or obligations under the oil and gas lease".

SB 256 further sets out an acceptable form of division order.

Significant Issues

The division order is an instrument that has been used for many years in the oil and gas industry to confirm ownership and title to production from a well. In more recent times the division order has been used as part of the legal debate between producers and royalty owners over proper payment of royalties.

Division orders are prepared by the party responsible for disbursing the proceeds from the sale of crude oil, natural gas or condensate, and set forth the exact percentage interest in the well owned by each owner of any leasehold, royalty, overriding royalty or other interest in production from the well. Each owner is required to sign a counterpart of the division order prior to receiving any proceeds.

A portion of the legal debate over division orders is whether a division order can be used to explain, change or modify lease terms. The issue has been centered on what deductions (typically for gathering and processing) may properly be subtracted from royalty payments. Division orders may contain terms which are different than those contained in the underlying oil and gas lease.

This bill is presumably intended to prevent oil and gas lessees from relying on provisions contained in division orders signed by royalty owners to limit the amounts that royalty owners can recover as royalties under the terms of the leases. SB 256 specifically provides that division orders do not amend any lease or operating agreement.

TECHNICAL ISSUES

EMNRD notes the following as issues the legislature may wish to consider:

1. The bill states that a division order does not relieve a "lessee" of any liabilities or obligations under an "oil and gas lease." This specific language may give rise to some uncertainty as to whether it applies where the interest of the claimant arises from some instrument other than an "oil and gas lease," for example an overriding royalty created by an assignment or contract.

2. While the bill expressly provides that if the division order overstates the claimant's interest,

the claimant is liable to refund the excess paid for that reason, it is unclear in its effect where the division order understates the claimant's interest, *i.e.,* where the claimant actually owns a greater percentage interest in production than is reflected in the division order.

PA/rs:yr