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

APPLICATION OF MACK ENERGY CORPORATION FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO

CASE NO. 14763 *DE NOVO*

PROPOSED FINDINGS AND CONCLUSIONS

Siana Oil and Gas LLP and Tom M. Ragsdale submit the following proposed findings and conclusions in this matter:

FINDINGS:

1. Mack Energy seeks an order pooling all mineral interests from the surface to the base of the Abo formation underlying the SE/4 NW/4 of Section 32, Township 17 South, Range 33 East, NMPM, to form a standard 40-acre oil spacing and proration unit in the Corbin-Abo Pool (Pool Code 13150) for (1) the Cockburn A State Well No. 5 located 1980 feet from the North and West lines of Section 32, (2) the initial consolidation of interests to be dedicated to the well, (3) designation of Applicant as operator, (4) approval and allocation of the costs of recompleting the well, including overhead and supervision charges, and (5) authorizing the operator to assess a risk penalty of costs plus 200% against the interests of non-consenting owners.
2. Mack Energy seeks the consolidation of interests and recovery of costs not for the initial drilling of a well, but for the proposed fracture recompletion of an existing well that has been producing for a number of years.
3. Applicant appeared at the hearing through counsel and presented evidence through its land, consulting and engineering witnesses.

4. Ownership of the 40 acre spacing unit is divided. Siana Oil and Gas LLP (Tom M. Ragsdale, President) is the owner of oil and gas leasehold working interests (approximately 6.25%) located in the spacing and proration unit that is the subject of Mack's Application. Mr. Ragsdale also owns an overriding royalty interest (1.041667%). The remaining 93.75% of the working interest is owned by Chase Oil Corporation and a number of additional third parties who are not identified.

5. Siana/Ragsdale appeared at the hearing through counsel and presented evidence through Mr. Ragsdale, a qualified petroleum engineer, in opposition to Mack Energy's Application.

6. The testimony and evidence established that Mack Energy assumed operations of the well in 2004 when it was plugged-backed, recompleted and production was established from the Corbin-Abo pool. Although Mack has operated the well since that time, it never consolidated and dedicated the divided interests in the spacing unit to the well either by a voluntary agreement or by obtaining an order of the Division pooling the lands. It was not until an unrelated dispute arose between the parties that Mack Energy was motivated to withhold Mr. Ragsdale's production revenues and then to apply to the Division for an order force pooling his working interest.

7. Mr. Ragsdale contends that Mack Energy's ongoing acts and omissions violate the Division's rules and precedent adjudicatory orders, as well as the Oil and Gas Act. Mr. Ragsdale challenges the proposed fracture recompletion as unnecessary. Mr. Ragsdale further contends that Mack is without authority to recover the costs of the proposed fracture recompletion or past operating costs and expenses.

8. Mr. Ragsdale further asserts that Mack Energy has failed to act with diligence and did not attempt to obtain his voluntary joinder and participation through good faith negotiations, but has instead engaged in economic coercion.

9. In 2004, Caza Energy LLC acquired 100% of the interests in the well and spacing unit, from 100 feet below the top of the San Andres formation to the base of the Abo formation, from Siana Oil and Gas LLP, Tom M. Ragsdale, and Mr. Ragsdale's partners who had acquired the non-producing well from the previous owner. Caza Energy LLC then re-assigned 100% of the working interest in the well, 6.25% to Mr. Ragsdale and 93.75% to several other entities and individuals. Mack Energy does not own an interest in the well or lands. Instead of cash consideration for the assignment, Mr. Ragsdale received a credit against which Mack Energy billed monthly operating expenses. Mr. Ragsdale also advanced payments for his share of workover and recompletion costs.

10. Previously, Mack Energy had asserted that an Operating Agreement dated May 25, 1960 between Carper Drilling Company, Inc. and James P. Dunigan applied to the lands and well. Mack Energy subsequently changed its position and determined that the 1960 Agreement was not an operating agreement but was instead an assignment. However, the amended C-102 form which Mack Energy filed with the Division in 2004 establishes that the operator was then aware that the interests of other owners had not been consolidated by voluntary agreement or by compulsory pooling.

11. As a consequence of an unrelated dispute between Mack and Mr. Ragsdale, in August of 2011, in violation of law and over the objection of its staff,[1] Mack Energy stopped payment of all production proceeds attributable to Mr. Ragsdale's working interests and overriding royalty interests in the Cockburn A State Well No. 5, as well as in the nearby

[1] Oil and Gas Proceeds Payment Act, NMSA 1978 §70-10-1, *et seq.*

State CD No. 1 well which is also operated by Mack. Simultaneously, Mack Energy sent an AFE for a fracture recompletion, but without balloting the other interest owners or providing terms that would afford them the opportunity to go non-consent. The parties subsequently communicated about the recompletion and the AFE, but on inquiry by Siana and Mr. Ragsdale, Mack Energy's land department was unable to explain how a non-consent election could be made or how the operator was authorized to recover costs. Mr. Ragsdale further testified that the operator refused to provide him with any information regarding the arrangements and terms for the sale of oil from the well.

12. Mack Energy did not communicate again with Siana until November 2, 2011 when it filed its Application for Compulsory Pooling. On December 7, 2012, and only in response to a request from Siana's counsel, Mack Energy sent a form of joint operating agreement to Siana. To that time, Mack Energy had never proposed the consolidation of interests. However, Mack Energy continued to withhold Mr. Ragsdale's working interest and overriding royalty interest production proceeds from the Cockburn A State No. 5 and State CD No. 1 wells and further prevented him from receiving payments directly from the crude oil purchaser. Mr. Ragsdale testified that he determined that executing the joint operating agreement presented by Mack Energy was contrary to his interests because under its terms, doing so would result in the waiver of his right to production proceeds, waive his audit and adjustment rights and would grant the operator and the other interest owners with a contractual lien against his working interests.

13. The net amount of production proceeds from the Cockburn A State No. 5 and State CD No. 1 wells withheld from Mr. Ragsdale was approximately $61,722.93. Throughout their dispute, Mack Energy continued to withhold working interest and overriding royalty

interest proceeds from both wells until one day before the hearing before the Commission, when only a portion of the proceeds was released. At the hearing, Mack Energy's landman witness was unable to explain any basis for withholding the production proceeds or the recoupment of any operating expenses or overhead charges. The witness acknowledged that Mr. Ragsdale had executed division orders and that there was no title opinion indicating a lack of good and marketable title or other information calling into question Mr. Ragsdale's entitlement to payment of the proceeds. Under such circumstances, Mack Energy is obliged to pay interest on the withheld amounts at the applicable statutory rate (NMSA 1978 §70-10-5) for a total payment of $68,008.41.

14. Mack Energy's engineering witnesses testified regarding the proposed recompletion and hydraulic fracturing of the Cockburn A State No. 5 well. The well is completed in the Abo formation which is a carbonate reef. Through its current completion, the well's cumulative production exceeds 82,235 barrels of oil and 90,436 mcf of gas and currently produces approximately 700 barrels of oil, 609 mcf gas and 537 barrels of water per month. The well produces at a stable, relatively flat rate of decline and is expected to do so for the foreseeable future.

15. Mack Energy's witnesses acknowledged that the fracture recompletion is not necessary to preserve the well or its current rate of production. Neither was there any evidence that the underlying oil and gas lease is at risk of termination for cessation of production. Mack Energy's hydraulic fracturing consultant testified that a frac job would likely result in the accelerated recovery of reserves, but did not quantify any incremental volumes that might be produced. The consultant testified regarding the risks attendant with a frac job, including the risk of increased water production, and guessed that there was a fifty

percent chance that the proposed fracture recompletion would be successful. In reaching this conclusion, the witness testified that no analogous fracture recompletions of other Abo formation wells were examined or considered.

16. Mr. Ragsdale, a qualified petroleum engineer, testified of his experience with the completion and operation of Abo formation wells in the Permian Basin. Mr. Ragsdale's testimony established that it is typically unnecessary to perform hydraulic fracture completions of Abo formation wells and that acid stimulations are the preferred and more economic means of treatment. Mr. Ragsdale further testified that the well records do not reflect the placement of perforations, only that they are located within a 270 foot interval. Mr. Ragsdale and his engineering staff concluded that, based on their review of data from five other Abo wells in the vicinity, conducting the recompletion treatment at the rates and volumes proposed by Mack Energy would extend the fractures beyond the perforated zone by as much as 100 feet upward and 250 feet downward. Consequently, the possibility that significant water producing zones would be encountered is substantially increased. Further, the evidence from the initial completion indicates that even if the fracture treatment remains contained within the perforated interval, water production from the producing formation itself may increase substantially, thereby further jeopardizing the economic recovery of reserves.

17. Mr. Ragsdale further testified that the frac job is speculative and that it is not necessary to preserve the well or the lease. Mr. Ragsdale's testimony also established that hydrocarbon reserves in the spacing unit are being efficiently and economically recovered through the well's current completion.

18. Mack Energy did provide testimony regarding the reasonableness of the cost of the proposed fracture recompletion and the basis for its request for a two hundred percent risk penalty. However, the testimony of Mack Energy's engineering witnesses and Mr. Ragsdale established that the risks of the recompletion cannot be equated with those attendant with drilling a new well for the reasons, among other, that there is no geologic risk or mechanical drilling risks.

19. Mack Energy's land witness provided testimony regarding the reasonableness of the fracture recompletion costs and the administrative overhead charges it seeks to recover prospectively. However, Mack Energy presented no evidence and sought no determination, by its Application or otherwise, with respect to the reasonableness of past lease operating expenses and overhead charges.

20. Accordingly, Siana and Mr. Ragsdale have asked the Commission for the following relief: (1) denying the Application for compulsory pooling in its entirety; (2) requiring Mack Energy to render a full accounting for production revenues and operating expenses, including overhead and supervision charges, from the time Mack became operator of the well in 2004 to the present; (3) requiring Mack to account and pay to Mr. Ragsdale the amount attributable to his interest in the absence of pooling in accordance with NMSA 1978 §70-2-18 B; and (4) denying Mack Energy's request for recovery of the 200% risk penalty for the cost of the proposed fracture recompletion, including any supervision and overhead charges, in accordance with §19.15.13.8 D NMAC.

21. The Applicable Standards of Good Faith and Diligence. Applicants for compulsory pooling orders must demonstrate that they acted with diligence and good faith. ("It has long been the practice of the Commission to require parties to show good faith and

diligence in proposing a well to other interest owners in the unit as a prerequisite of a compulsory pooling order. See Morris, Richard, Compulsory Pooling of Oil and Gas Interests in New Mexico, 3 Nat. Res. J. 316 (1963). The Oil and Gas Act may require such efforts.") Order No. R-11663-C, Case No. 12705 De Novo, *Application of D.J. Simmons Inc. for Compulsory Pooling* (December 5, 2001), Conclusion of Law ¶ 24.

22. Under NMSA 1978, §70-2-18(A), an applicant proposing to dedicate separately-owned lands or undivided interests to a spacing and proration unit has an "obligation" to negotiate a voluntary agreement with the other interest owners to pool their lands. The Division and the Commission require operators to show that they have made a "diligent" and "good faith" effort to negotiate a voluntary agreement before a compulsory pooling application may be filed.[2] And while compulsory pooling may be sought after a well has been drilled, it is now established that an operator has a duty to consolidate interests prior to producing the well. ("This Order shall not be construed to in any way relieve [the operator] or any successor in interest, of the duty to comply with the requirements of NMSA 1978 §70-2-18 regarding consolidation of ownership within the applicable spacing units by voluntary or compulsory pooling prior to producing the...wells.") Order No. R-13547, Case No. 12601, *Application of Reliant Exploration and Production Company, LLC to Terminate the Temporary Abandonment Status of Two CO2 wells Drilled by Oxy USA, Inc., and for Compulsory Pooling*, (May 10, 2012), Conclusion of Law ¶ 3.

23. It is the established policy of the Division that compulsory pooling applications are to be filed no sooner than thirty days after the operator has furnished to all owners in the

[2] The "good faith" requirement has been expressly codified in the compulsory unitization procedures of the Statutory Unitization Act at NMSA 1978, §70-7-6-A(5).

proposed unit a formal well proposal sufficiently informative to allow the owners to evaluate the proposal and to determine the terms of their participation. In this case, Mack Energy's proposal consisted of an AFE and nothing more. Mr. Ragsdale was consequently unable to evaluate the terms for his participation in the proposal and Mack Energy was unable to explain those terms before it filed its application for compulsory pooling. These acts and omissions which followed the unauthorized suspension of production proceeds do not satisfy the standards of good faith that an operator is expected to abide by when negotiating for an interest owner's voluntary participation in a well proposal. Correspondingly, the application for compulsory pooling should be denied.

24. **The request for relief under §70-2-18 B**. Mack Energy has been aware since 2004 that the interests in the Cockburn State A No. 5 well were not consolidated, but it made no efforts to combine them until it invoked the jurisdiction of the Division to force pool them in 2011. Inaction for such an extended period of time establishes a lack of diligence on the part of the operator.

25. Moreover, the authority of the operator to recover past lease operating expenses and overhead charges was not established. Mack Energy presented no evidence and sought no determination, by its Application or otherwise, with respect to the reasonableness of past lease operating expenses and overhead charges. Therefore, there is no basis for the Commission to authorize the operator's recovery of past costs and charges. Further, Mack Energy did not provide satisfactory explanation of the terms and prices it receives for sales of crude oil from the well and the distribution of revenues to the non-operators.

26. Siana Oil and Gas LLP and Mr. Ragsdale ask the Commission to enter an order denying Mack Energy's recovery of past expenses pursuant to §70-2-18 B. They ask also that

Mack Energy render a full accounting for production revenues and operating expenses for both wells, including overhead charges back to 2004 and that the operator make payment to Mr. Ragsdale the amounts attributable to his interest without deduction for such expenses.

27. §70-2-18 NMSA (1978) of the Oil and Gas Act is unambiguous and all of its provisions must be read together:

> **Spacing or proration unit with divided mineral ownership.**
> A. Whenever the operator of any oil or gas well shall dedicate lands comprising a standard spacing or proration unit to an oil or gas well, it shall be the obligation of the operator, if two or more separately owned tracts of land are embraced within the spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil or gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, to obtain voluntary agreements pooling said lands or interests or an order of the division pooling said lands, which agreement or order shall be effective from the first production. Any division order that increases the size of a standard spacing or proration unit for a pool, or extends the boundaries of such a pool, shall require dedication of acreage to existing wells in the pool in accordance with the acreage dedication requirements for said pool, and all interests in the spacing or proration units that are dedicated to the affected wells shall share in production from the effective date of the said order.
> B. Any operator failing to obtain voluntary pooling agreements, or failing to apply for an order of the division pooling the lands dedicated to the spacing or proration unit as required by this section, shall nevertheless be liable to account to and pay each owner of minerals or leasehold interest, including owners of overriding royalty interests and other payments out of production, either the amount to which each interest would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of pooling, whichever is greater.
> C. Nonstandard spacing or proration units may be established by the division and all mineral and leasehold interests in any such nonstandard unit shall share in production from that unit from the date of the order establishing the said nonstandard unit.
> (Emphasis added.)

28. The Commission has in the past provided for accounting and payment relief. *See, e.g.,* Order No. R-1960-B, Case No. 13957 De Novo, *Application of Energen Resources Corporation to Amend the Cost Recovery Provision of Compulsory Pooling Order No. R-1960, Etc.* (August 13, 2009).

29. Under §70-2-18 B, the Commission is authorized to enter an order requiring Mack Energy (1) to render a full accounting for production revenues and operating expenses, including overhead and supervision charges from 2004 to the present, and (2) directing it to pay to Mr. Ragsdale the greater amount attributable to his interests in the absence of pooling, *without* deductions for charges and expenses. The same provision of the Oil and Gas Act also authorizes the Commission to direct the payment to owners of overriding royalty interests.

30. §70-2-18 A also provides that regardless of when an order pooling separately owned interests is obtained, even after drilling, it is to be "effective from the first production." Yet, the operator of a drilled and completed well obtaining the compulsory pooling order must not be dilatory in the consolidation of un-joined interests as §70-2-18 B is intended to operate as a disincentive to such conduct. Similarly, the Division's rules at §19.15.16.19 A (1) and (3) NMAC, specify that interests are to be consolidated before an allowable may be assigned to a well.

31. Absent a voluntary agreement or a compulsory pooling order, Mack Energy was never authorized to recover the historic "costs of development and operation" from any of the non-operators. Such authority derives specifically from §70-2-17 B, but only on the Division's or Commission's determination of justness and reasonableness. Mack Energy sought no such determination, but a non-operator is clearly authorized to raise such matters as §70-2-17 B specifies that "[i]n the event of any dispute relative to such costs, the division shall determine the proper costs after due notice to interested parties and a hearing thereon."

32. Because in this case there is "the absence of pooling" of an undivided interest, §70-2-18 B directs that the owner of the un-pooled interest, Mr. Ragsdale, be paid the "greater amount." In this case, that amount should be 6.25% of gross production, from both the Cockburn State A No. 5 and the State CD No. 1 wells. Such payment shall be without deduction for the costs of development and operation.

CONCLUSIONS

1. In this case, the Applicant did not act with diligence and the evidence does not support that there was a good faith effort to obtain the voluntary participation of the owner of the unpooled interest.
2. The evidence establishes that the Cockburn A State No. 5 well as currently completed is capable of efficiently and economically recovering the reserves underlying the spacing unit. The Applicant failed to demonstrate that the fracture recompletion of the well was necessary to preserve the well or the lease and that the recompletion could be performed without incurring unnecessary risk or waste.
3. The Application for Compulsory Pooling filed in this case by Mack Energy Corporation should be denied.
4. **(In the event the Application for Compulsory Pooling is not denied, then the following Conclusions apply.)** Pursuant to the application of Mack Energy Corporation, all uncommitted interests, whatever they may be, in the oil and gas from 100 feet below the top of the San Andres formation to the base of the Abo formation in the SE/4 NW/4 of Section 32, Township 17 South, Range 33 East, NMPM, in Lea County, New Mexico, are pooled to form a standard 40-acre oil spacing and proration unit for all formations or pools spaced on 40 acres within this vertical extent, which presently include, but are not

necessarily limited to, the Corbin-Abo Pool. This paragraph shall be effective from and after the date of first production of the well described in Finding Paragraph 1.

5. The Unit shall be dedicated, to Applicant's Cockburn A State Well No. 5 (API No. 30-025-25286), located at a standard location 1980 feet from the North line and 1980 feet from the West line (Unit F) of Section 32, Township 17 South, Range 33 East.
6. Upon final plugging and abandonment of the well and any other well, drilled on the Unit pursuant to Division Rules 19.15.13.9 through 19.15.13.11, the pooled unit created by this Order shall terminate, unless this order has been amended to authorize further operations.
7. Mack Energy Corporation (OGRID 13837) is hereby designated the operator of the well and of the Unit.
8. After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of its proposed fracing re-completion operation ("fracing costs").
9. Within 30 days from the date the schedule of estimated fracing costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated fracing costs to the operator in lieu of paying its share of reasonable fracing costs out of production as hereinafter provided, and any such owner who pays its share of estimated fracing costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share

of estimated fracing costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

10. The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual fracing costs within 90 days following completion of the proposed operation. Within 60 days following determination of reasonable costs, any pooled working interest owner who has paid its share of estimated fracing costs in advance as provided above shall pay to the operator its share of the amount that reasonable fracing costs exceed estimated fracing costs and shall receive from the operator the amount, if any, that the estimated fracing costs it has paid exceed its share of reasonable fracing costs.

11. The operator is hereby authorized to withhold only the following costs and charges from prospective production:

    (a) the proportionate share of reasonable fracing costs attributable to each non-consenting working interest owner; and

    (b) as a charge for the risk involved in fracing the well, 100% of the above costs.

12. The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the fracing costs.

13. Reasonable prospective charges for supervision (combined fixed rates) are hereby fixed at $6,500 per month while drilling and $650 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is authorized to withhold from prospective production the proportionate share of both the supervision charges and

the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

14. **(The following Conclusions support the request for relief under §70-2-18 B and should be included in all events.)** The operator shall also furnish, within 30 days from the date of this Order, an accounting of all revenues, including prices and terms for crude oil sales, and costs attributable to the joint account for the Cockburn A State No. 5 and State CD No. 1 wells (historical revenues and costs) since October 2004. If no objection to the actual historical revenues and costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual historical revenues and costs shall be deemed to be reasonable. If there is an objection to any actual historical revenues or costs within the 45-day period, the Division will determine reasonable revenues and costs after public notice and hearing.
15. Within 60 days following determination of reasonable historical revenues and costs, any pooled working interest owner shall receive from the operator the amount of historical revenues, but without deduction of historical costs, which is the amount the pooled working interest owner is entitled in the absence of pooling, in accordance with NMSA 1978 §70-2-18 B. The owners of overriding royalty interests shall also receive from the operator their proportionate amount of historical revenues. All amounts of historical revenues received from the operator shall include interest at the statutory rate specified under NMSA 1978 §70-10-5.
16. Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

17. The operator of the well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

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

Respectfully submitted,

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Certificate of Service

I hereby certify that on September 27, 2012, a true and correct copy of the foregoing was sent via e-mail to the following parties:

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