MILLER STRATVERT

PROFESSIONAL ASSOCIATION

Reply to Santa Fe

150 Washington Ave., Suite 300
Santa Fe, NM 87501

Mailing Address:
P.O. Box 1986
Santa Fe, NM 87504-1986

Telephone: (505) 989-9614
Facsimile: (505) 989-9857

Writer's Direct E-Mail:
shall@mstlaw.com

* Board Certified Specialist: Natural Resources - Oil & Gas Law
** Board Certified Specialist: Real Estate Law

May 11, 2006

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HAND-DELIVERED
Ms. Florene Davidson
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico

Re: NMOCD Case No. 13686; Amended Application of DKD, LLC for an Order Revoking the Injection Authority for the Gandy Corporation State "T" Well No. 2, Lea County, New Mexico

Dear Florene:

Enclosed for filing in reference to the captioned matter is an original one copy of DKD, LLC's Memorandum On The Division's Jurisdiction And Authority.

Very truly yours,

MILLER STRATVERT P.A.

J. Scott Hall

JSH/glb
Enclosure

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

IN THE MATTER OF THE APPLICATION OF DKD, LLC FOR AN ORDER REVOKING THE INJECTION AUTHORITY FOR THE GANDY CORPORATION STATE "T" WELL NO. 2, LEA COUNTY, NEW MEXICO

CASE NO. 13686

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MEMORANDUM ON THE DIVISION'S JURISDICTION AND AUTHORITY

Applicant, DKD, LLC ("DKD") thorough its undersigned counsel, provides this Memorandum Brief addressing the jurisdiction and authority of the Division to accord the relief requested in the Application filed in this matter. This Memorandum Brief was requested by the Division's counsel at the Examiner hearing on the Application on April 27, 2006. At the hearing, counsel for Gandy Corporation objected that the Application stated a private cause of action that is beyond the Division's jurisdiction. The objection thus implicates the issues of (1) the primary jurisdiction of the agency and (2) the Applicant's standing.

Summary

Applicant, DKD, is the owner and the operator of the Watson 6 No. 1 well located 2857' FSL and 1417' FWL in Unit N, Section 6, T16S, R36E which is utilized for the disposal of produced water by injection into the Cisco and Canyon formations (SWD 834). Applicant also owns and operates the Snyder A No. 1 well located 2319' FSL and 330' FWL in Unit L of said Section 6. Gandy Corporation operates the State "T" Well No. 2 for the disposal of produced water pursuant to SWD-836 and Order No. R-12171. DKD's wells and mineral interests are within the one-half mile area of review of the State "T" Well No. 2.

DKD contends that Gandy Corporation has operated the State "T" Well No. 2 in violation of the Division's rules and orders with the result that injected waters have escaped from the permitted injection intervals to other formations and onto adjoining properties causing damages to wells and property, including DKD's. Applicant seeks the entry of an order immediately revoking Gandy Corporation's injection authority and directing it to take such other actions necessary to reduce pressures in the injection formation and other formations so as to prevent further waste and damage to property. Applicant also seeks an order directing that the State "T" Well No. 2 be plugged and abandoned. Gandy's operations have resulted in the plugging and abandonment of two other wells that were otherwise capable of producing hydrocarbons, thereby causing waste. Applicant has also contended that there also exists the reasonable likelihood that the continued injection operations will cause the damage or loss of additional wells in the area, including the Watson 6 No. 1 well for the reason, among others, that the location and quality of the cement surrounding the wellbore cannot be determined with certainty.

In its original Application and as amended, the Applicant invoked the Division's authority under, *inter alia*, NMSA 1978 § 70-2-12(2) (escape of water from strata into other strata); § 70-2-12(4) (drowning by water of any strata or part thereof capable of producing oil or gas; and § 70-2-12(15) (disposition of water produced ... in a manner that will afford reasonable protection against contamination of fresh water supplies). The Applicant specifically requested the Division to take such actions as may be necessary to immediately reduce pressures in the injection formation and other formations so as to prevent further waste and to avoid further damage to other property, as well as providing such additional relief the Division determines appropriate.

On April 27, 2006, a hearing was convened on the merits of the Application. There, the Applicant established by a preponderance of the evidence that Gandy Corporation's injection operations on the State "T" Well No. 2 have resulted in the escape of fluids from the permitted injection intervals. It was also established that the original injection authority for the State "T" Well No. 2 was based on information contained in the original C-108 Application that included the erroneous calculation of cement tops in offsetting wells within the one-half mile area of review. The casings of these offsetting wells have no cement protection in the equivalent of the permitted injection interval which is a known corrosive zone.

Soon after commencing injection operations, injection pressures on the State "T" Well No. 2 went from a vacuum to a positive pressure that significantly increased over time, and at times exceeded the injection pressure limitations set forth in the Division's orders. Correlating pressure responses were observed in three of the offset wells. Further, flows of significant volumes of waters through casing leaks occurred at intervals equivalent to the injection intervals in the Energen Synder "A" Com No. 1 and the Snyder "B" No. 2 wells in Section 6. Both of the Energen wells experienced casing collapse and, although they were otherwise capable of producing in paying quantities, were plugged and abandoned.

Witnesses presented by Gandy Corporation admitted that the pressure responses observed in the Applicant's Watson Synder "A" No. 1 well and the Energen Synder "A" Com No. 1 Snyder "B" No. 2 wells may be attributable to the injection operations on the State "T" Well No. 2. Gandy Corporation's petroleum engineer witness also admitted that Gandy Corporation's injection operations could be the cause of the casing collapse and flows of water to the surface through the two Energen wells. Gandy Corporation's witnesses asserted that the significant pressure increases observed on the State "T" Well No. 2 were attributable to scale and clogged

perforations caused by the receipt and disposal of one or more loads of contaminated produced water in late March or early April of 2005. However, the pressure responses observed in the offsetting DKD and Energen wells occurred before the time Gandy Corporation contends it received the contaminated water.

The overwhelming preponderance of evidence established that the State "T" Well No. 2 is the cause of the abnormal pressures in the disposal reservoir and that a number of conduits to the surface and other zones exist in the immediate area. It was further established that the injection operations and the abnormal pressures caused or contributed to casing leaks in the offsets. The DKD Watson 6 No. 1 Well was eliminated as a cause of abnormal reservoir pressures or the escape of fluids for the reason that it has consistently injected under a vacuum. The point in time when Gandy's injection operations went from a vacuum to a positive pressure in August 2004 corresponds in time to the occurrence of problems in the offsetting wells. Further, the observed pressures in the offsets had a virtual direct correlation with injection operations.

Produced water disposal operations through the State "T" Well No. 2 were first authorized on April 30, 2002 under Administrative Order SWD-836. The authorization was issued pursuant to the Division's administrative processes for C-108 applications pursuant to Rule 708. The State "T" Well No. 2 was subsequently the subject of a number of additional actions and orders of the Division and the Commission:

April 30, 2002	Administrative Order SWD-836 approving of Pronghorn Management Corporation's administrative application for salt water disposal, Lea County, New Mexico.
July 9, 2002	Director's letter order suspending Order SWD-836 due to the receipt of an objection from offsetting lease holder.

May 15, 2003	Order No. R-11855-B (De Novo) approving of Pronghorn Management Corporation's application for salt water disposal.
May 3, 2004	The Department Secretary and Acting Division Director issued an Emergency Shut-in Order due to injections through intervals not permitted under Order No. R-11855-B.
July 1, 2004	Division Order No. R-12161 denying Gandy Corporation's application for an emergency order authorizing it to operate the State "T" No. 2 Well until a decision is issued after a hearing on the merits of Gandy's main application.
July 9, 2004	Order No. R-12171 approving of Gandy Corporation's application for disposal into additional perforated intervals in the State "T" Well No. 2.
December 19, 2005	Division Order No. IPI-264 authorizing Gandy Corporation to increase the surface injection pressure to 1930 psig.

The last of these orders resulting from a hearing was Order No. R-12171 issued on July 8, 2004 in Case No. 12393. In Order No. R-12171, the wellhead injection pressure was limited to 962 psi. That injection pressure limitation was increased 1930 psig on December 19, 2005 by Division Order No. IPI-264 pursuant to the provisions for administrative approval set forth in Order No. R-12171, although no notification of the pressure increase was provided to third parties.

During the course of testimony at the hearing on the Application in this matter, the Applicant's principal, Mr. Danny Watson, testified that he had informed three different individuals from the Division's Hobbs District office of the problems resulting from Gandy Corporation's injection operations. Complaints to the Hobbs District office by a third party operator, Energen Resources Corporation, resulted in the issuance of a shut-in order on April 22, 2005. On February 23, 2006, Applicant, through its counsel, wrote to the Division's Director requesting the Agency to take action to correct the apparent violations of the Division's statutes,

regulations and orders by Gandy Corporation. The Application was filed with the Division that same day.

The Division Has Primary Jurisdiction

The jurisdiction and the authority of the Division to grant the relief sought by the Application in this matter are clearly established in the Oil and Gas Act. NMSA 1978 §70-2-1 et seq. Section 70-2-12(B) of the Act provides:

> "Apart from any authority, express or implied, elsewhere given to or existing in the Oil Conservation Division by virtue of the Oil and Gas Act or the statutes of the state, the Division is authorized to make rules, regulations and orders for the purposes and with respect to the subject matter stated in this subsection;
>
> (2.) To prevent crude petroleum oil, natural gas or water from escaping from strata in which it is found into other strata; ...
>
> (4.) To prevent the drowning by water of any stratum or part thereof capable of producing oil or gas or both oil and gas in paying quantities and to prevent the premature and irregular encroachment of water or any other kind of water encroachment which reduces or tends to reduce the total ultimate recovery of crude petroleum oil or gas or both oil and gas from any pool; ...
>
> (7.) To require wells to be drilled, operated and produced in such manner to prevent injury to neighboring leases or properties; ... [and]
>
> (15.) To regulate the disposition of water produced or used in connection with the drilling for or producing of oil and gas or both and to direct the surface or subsurface disposal of the water in a manner that will afford reasonable protection against contamination of fresh water supplies designated by the state engineer[.]

Section 70-2-11 of the Oil and Gas Act makes clear that the Division has a duty to act on the Application in this matter. That section provides: "(a.) The Division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the Division is empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purposes of this act,

whether or not indicated or specified in any section hereof."[1] In past cases, the Division has cited to this specific provision of the Oil and Gas Act as authority supporting the Agency's broad construction of its powers to act as "cumulative and not exclusive". *See*, Order No. R-11573-B, Case No. 12601; *Application of Bettis Boyle and Stovall To Reopen Compulsory Pooling Order No. R-11573 To Address The Appropriate Royalty Burdens On The Well For Purposes Of The Charge For Risk Involved In Drilling Said Well, Lea County, New Mexico*

The fact that the Division's jurisdiction here has been triggered by an operator's application under Division Rule 1206-A rather by the Division itself under Rule 1227 does not mean that the Division is somehow required to abstain from or defer action on this application. Indeed, the opposite is true. The agency has a clear duty to act. As the Division does consistently, Order No. R-12171, the last hearing order authorizing Gandy Corporation's injection operations, expressly provided that "*Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.*" Any argument that the Division cannot assume jurisdiction over the subject matter and the parties arising under the terms of Order No. R-12171 is baseless.

In a number of instances in the past, the Division has acted authoritatively on similar or analogous applications brought by affected operators and third parties.

In Case No. 6987, operator Doyle Hartman invoked the Division's jurisdiction to halt numerous violations of the Oil and Gas Act resulting from the operation of the Myers-Langley Maddox Unit by Oxy USA, Inc. Chief among Hartman's complaints was the injection of water for Oxy's enhanced recovery operations in excess of authorized surface injection pressures

[1] *See, also*, NMSA 1978, § 70-2-6; "...[The Division] shall have jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act ...."

resulting in the escape of waters from the authorized injection zone into Hartman's properties.[2] In the course of the *Hartman/Oxy* case, the Division denied Oxy's Motion to Dismiss and found that it had ongoing jurisdiction over the subject matter and the parties, simultaneously with the pendency of separate but related litigation in the Lea County District Court.

In Case No. 11996, the *Pendragon* case, the Division assumed and maintained jurisdiction over an application invoking the Division's jurisdiction to address the claimed escape of gas and water from one formation into another as the result of hydraulic fracturing operations in the separately owned Pictured Cliffs and Basin-Fruitland Coal formations.[3] In the *Pendragon* case, the Division specifically rejected arguments that the application raised a dispute between private parties over which jurisdiction was reserved exclusively to the courts.

In consolidated Cases Nos. 12441 and 12588, the *Grama Ridge* cases, the Division assumed jurisdiction over the applications filed by LG&E Natural Pipeline, LLC and Raptor Natural Pipeline, LLC, the operators of the Grama Ridge Gas Storage Unit, over concerns that the drilling and completion by Nearburg Exploration Company, LLC of a well in the Morrow formation would lead to the escape of gas from one strata into another.[4]

The Division also recently heard the application of the owners of leased and unleased mineral interests who sought the termination of an operator's salt water disposal well permit in

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[2] *Amended Application of Doyle Hartman to Give Full Force and Effect to Commission Order No. R-6447, to Revoke or Modify Order No. R-460-A, To Alternatively Terminate the Myers Langley Maddox Unit, Lea County, New Mexico.*

[3] *Application of Pendragon Energy Partners, Inc. and J. K. Edwards Associates, Inc. To Confirm Production From The Appropriate Common Source Of Supply, San Juan County, New Mexico.*

[4] See Order No. R-11611; *Application of Raptor Natural Pipeline, LLC f/k/a LG&E Energy Corporation for Special Rules for the Grama Ridge Morrow Gas Storage Unit, Lea County, New Mexico, Case No. 12588; Case No. 12441, Application of LG&E Natural Pipeline, LLC for Special Rules for the Grama Ridge Morrow Gas Storage Unit, Lea County, New Mexico.* See also, Case No. 12622, *Application of Nearburg Exploration Company, LLC for Two Non-Standard Gas Spacing and Proration Units, Lea County, New Mexico and Case No. 12908-A, Application of the Oil Conservation Division for an Order Creating, Re-designating and Extending the Vertical and Horizontal Limits of Certain Pools in Lea County, New Mexico, Order No. R-11768-B.*

Case No. 13532, *Application of J. W. Neal, Patricia Neal and the Claudia Young Trust to Rescind Division Administrative Order No. SWD-984, Lea County, New Mexico.*

There is also currently pending before the Division another application for the rescission or amendment of another operator's salt water disposal permit. *See*, Case No. 13707, *Application of Yates Petroleum Corporation to Rescind or Amend Administrative Order SWD-1021, Lea County, New Mexico.*

Under the Doctrine of Primary Jurisdiction, the Division must assume jurisdiction over the application in this matter. No other body, judicial, administrative or otherwise has been charged with the specific statutory mandate to exercise jurisdiction, authority and control over oil and gas operations in this state. *See*, NMSA 1978, § 70-2-6-A; *see also Continental Oil Co. v. Oil Conservation Commission*, 70 N.M. 310, 323, 373 P.2d 809, 817 (1962). Moreover, no other body in the state possesses the requisite technical expertise in geology and petroleum engineering necessary to effect a solution to the issues raised in the Application here. Only the Division can resolve the factual questions that have been presented to it. *See*, *Far East Conference v. the United States*, 342 U.S. 570 (1952). This view has been acknowledged by the New Mexico Supreme Court when it affirmed that NMOCD decisions are accorded special weight and credence in light of the Division's technical competence and specialized knowledge. *See*, *Grace v. Oil Conservation Commission*, 87 N.M. 203, 531 P.2d 939 (1975).

New Mexico courts, both Federal and State, have long recognized the Doctrine of Primary Jurisdiction. The Doctrine often comes into play where issues requiring a regulatory body's technical expertise are involved. In such cases, the Doctrine recognizes that the administrative process should be allowed to proceed whenever a dispute requires the resolution of issues which, under our regulatory scheme, have been placed within the competency of an

administrative body. *See, State ex rel. Norvell v. Arizona Public Service Co.*, 85 N.M. 165, 510 P.2d 98 (1973).

This case is a perfect example of the applicability of the Primary Jurisdiction Doctrine and the proper invocation of the agency's jurisdiction.

DKD, LLC Has Requisite Standing

To acquire standing, a party must demonstrate "(1) an injury in fact,[5] (2) a causal relationship between the injury and the challenged conduct, and (3) a likelihood that the injury will be redressed by a favorable decision. *John Does I Through III v. Roman Catholic Church of The Archdiocese, Inc.*, 1996-NMCA-094, 122 N.M. 307, 924 P.2d 273. In addition, a party must also establish "that the injury alleged is within the zone of interests to be protected by a... statute." *Forest Guardians v. Powell,* 2001-NMCA-028, 130 N.M. 368, 375, 24 P. 3d 803, citing to *Key v. Chrysler Motors Corp.,* 121 N.M. 764, 774, 918 P.2d 350, 360 (1996).

DKD's wells and mineral interests are literally within the one-half mile area of review prescribed by the Division's rules and C-108 forms. Both of DKD's wells and Gandy's disposal well operate under Division-issued permits and regulations. DKD has alleged and proved injury in-fact resulting from Gandy Corporation's operations, as well as the threat of future injury.

Under NMSA 1978 §70-2-23, as an interested party, DKD is entitled to be heard. Further, Rule 1206 makes specific provision for such matters to be raised by an application filed by *"[t]he Division, attorney general, <u>any operator or producer or any other person with</u>*

[5] The <u>threat</u> of injury is also sufficient to establish standing. *Am. Civil Liberties Union v. City of Albuquerque*, 1999-NMSC-044, 128 N. M. 315, 992 P. 2d 866.

standing..." (emphasis added).[6] DKD's interests fall squarely within the zone of interests the legislative enactments referenced above are intended to protect and DKD may accordingly invoke the Division's administrative processes to protect those interests. It need not wait until further harm is caused.

Gandy Corporation asserts that DKD, LLC's Application cannot lie because it alleges a "private cause of action" that is not authorized under the Oil and Gas Act or the Divisions rules. This is rather beside the point. It is inconsequential how the issues raised by the Application are characterized. It remains that the subject matter of DKD's Application invokes numerous provisions of the Oil and Gas Act. Yet, nowhere does that act, or do the Division's rules, restrict operators or other parties from invoking the agency's statutory jurisdiction. Neither do they reserve the invocation of the agency's remedial authority only to the agency or the attorney general. Standing to enforce the Oil and Gas Act is not limited to the Division or the attorney general. This very argument was squarely rejected by the Court of Appeals in *Forest Guardians v. Powell, supra*, 130 N.M. 368, 374.

The Division is fully authorized to bring Gandy Corporation's salt water disposal well into compliance with the Agency regulations by a variety of means. There is nothing in Rule 1227 which would preclude the Division from acting on an application properly brought before it by an operator pursuant to Rule 1206-A. The exercise of authority in such a manner is fully in accord with the Division's mandate to prevent waste, prevent water from escaping from strata and to prevent entry onto neighboring leases. (Section 70-2-12-B (2), (4) and (7)).

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[6]The current version of Rule 1206 is little changed from its earlier iteration as Rule 1203 A:
19.15.14.1203 NMAC INITIATING A HEARING.
A. The division, the attorney general, any operator or producer or any other person may apply for a hearing.

Accordingly, proceedings addressing matters such as those raised by the Application here are not limited exclusively to compliance proceedings brought by the Division pursuant to Rule 1227. Rather, common sense and the authorities referenced above demand that operators have full access to the Division's administrative processes in order to seek redress for any number of matters within the agency's special expertise.

Conclusion

The evidence supports the conclusion that Gandy Corporation's injection operations should be immediately terminated and that the State "T" Well No. 2 should be plugged and abandoned in order to prevent the escape of additional volumes and further harm to offsetting wells and properties. The applicable provisions of the Oil and Gas Act mandate that the agency order such action.

Respectfully submitted,

MILLER STRATVERT P.A.

By: _____

J. Scott Hall
Attorneys for DKD, LLC
Post Office Box 1986
Santa Fe, New Mexico 87504-1986
(505) 989-9614

CERTIFICATE OF SERVICE

The undersigned hereby certifies he faxed a true and accurate copy of the foregoing to:

Pete Domenici, Esq.
Charles Lakins, Esq.
Domenici Law Firm, P.C.
320 Gold Avenue SW
Suite 1000
Albuquerque, New Mexico 87102

Gail MacQuesten
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87504

Will Jones
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, New Mexico 87504

on this 11th day of May, 2006.

J. SCOTT HALL

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