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Joseph A. Sommer
(1922-2006)

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May 21, 2009

Via Hand Delivery

Oil Conservation Division
1220 South St. Francis Dr.
Third Floor
Santa Fe, NM 87505

Re: NMOCD Case No: 13957; In Re Application of Energen Resources Corporation to Amend the Cost Recovery Provisions of Compulsory Pooling Order No. R-1960, Rio Arriba County, New Mexico

Dear Sir or Madam:

In connection with the hearing scheduled on May 27, 2009, in the above-referenced matter, please find enclosed six (6) copies of Opponent's (Estate of Joseph A. Sommer, Joseph A. Sommer Revocable Trust and JAS Oil and Gas Co., LLC) Pre-Hearing Statement and accompanying Exhibits Nos. 1-14.

Thank you.

Sincerely yours,



Candice Lee

Enclosures

cc: J. Scott Hall, Esq.
James Bruce, Esq.

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

**IN THE MATTER OF THE HEARING CALLED
BY THE OIL CONSERVATION DIVISION FOR
THE PURPOSE OF CONSIDERING:**

**APPLICATION OF ENERGEN RESOURCES
CORPORATION TO AMEND THE COST RECOVERY
PROVISIONS OF COMPULSORY POOLING ORDER
NO. R-1960, TO DETERMINE REASONABLE COSTS,
AND FOR AUTHORIZATION TO RECOVER COSTS
FROM PRODUCTION OF POOLED MINERAL
INTERESTS, RIO ARriba COUNTY, NEW MEXICO.**

**Case No. 13,957 (*de novo*)
Order No. R-1960-A**

PRE-HEARING STATEMENT

This pre-hearing statement is submitted by opponent as required by the Oil Conservation Division.

APPEARANCES

APPLICANT

Energen Resources Corporation

OPPONENT

Estate of Joseph A. Sommer
Joseph A. Sommer Revocable Trust
JAS Oil and Gas Co., LLC
P.O. Box 1984
Santa Fe, New Mexico 87504

Attention: Kurt A. Sommer
(505) 982-4676

APPLICANT'S ATTORNEY

J. Scott Hall

OPPONENT'S ATTORNEY

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STATEMENT OF THE CASE

APPLICANT

OPPONENT

The Estate of Joseph A. Sommer, Joseph A. Sommer Revocable Trust, and JAS Oil and Gas Co., LLC are collectively referred to herein as "Sommer."

I. FACTS.

A. The land involved in this case is the Pictured Cliffs formation underlying the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM (the "well unit").

B. Sommer owns an unleased mineral interest in the well unit.

C. Commission Order No. R-1960 force pooled Sommer (and others) into the well unit, and contained the following provisions:

PROVIDED HOWEVER, That the proportionate share of the costs of development and operation of the pooled unit shall be borne by each consenting working interest owner in the same proportion to the total costs that his acreage bears to the total acreage in the pooled unit.

PROVIDED FURTHER, That the proportionate share of the costs of development of the pooled unit, including a reasonable charge for supervision, shall be paid out of production by each nonconsenting working interest owner and shall be 110 per cent of the same proportion to the total costs of drilling and completing the well that his acreage bears to the total acreage in the pooled unit.

PROVIDED FURTHER, That the share of the costs for development of the pooled unit, as determined above, which is to be paid by the mineral interest owners shall be withheld only from the working interests' share (7/8) of the revenues derived from the sale of the hydrocarbons produced from the well on the pooled unit. Royalty payments are not to be affected by the Withholding of any funds for the purpose of paying out a proportionate share of the costs of development and operation of the pooled unit.

D. The supervision charges are not specified in the original order. In addition, the order does not provide for escalation of supervision charges.

E. The subject well (the Martinez Well No. 1) was drilled and completed as a producer. The costs of drilling and completing the well (plus risk charge) have paid out, and there is no issue as to those costs.

F. For decades, the operator of the well unit sold all gas produced from the well, and accounted to and paid all interest owners for their respective shares of production. Thus, after payout of well costs, Sommer received (i) its 1/8 "royalty" interest, and (ii) its 7/8 working interest, less operating costs.

G. Energen Resources Corporation ("Energen") is now operator of the well unit. Although Energen has sold all gas produced from the well unit, Energen is paying only the 1/8 royalty interest. It is not paying Sommer its working interest share of production. In addition, it is not using Sommer's share of working interest proceeds to pay ongoing operating costs.

Energen filed this application, seeking (i) to establish supervision charges, and escalate those charges under the COPAS accounting procedure, (ii) impose a gas balancing agreement upon Sommer, and (iii) make these provisions of a pooling order retroactive to the date Energen assumed operations.

Order No. R-1960-A, issued after the Division hearing, provided that: (1) effective as of first date of production, the overhead rate shall be \$350.00/month, adjusted under the COPAS accounting procedure. Taking inflation adjustments into account, the overhead rate is now approximately \$750.00/month; (2) the operator is authorized (but apparently not required), after August 1, 2008 to sell each non-consenting interest owner's share of production, deduct the consenting interest owner's share of operating costs, and account for the balance. The Division denied Energen's request to impose a gas balancing agreement on Sommer.

II. GOVERNING STATUTE.

The statute governing this case is NMSA 1978 §70-2-17.C, which provides in pertinent part:

All orders effecting such pooling shall be made after notice and hearing, and shall be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas, or both. Each order shall describe the lands included in the unit designated thereby, identify the pool or pools to which it applies and designate an operator for the unit. All operations for the pooled oil or gas, or both, which are conducted on any portion of the unit shall be deemed for all purposes to have been conducted upon each tract within the unit by the owner or owners of such tract. For the purpose of determining the portions of production owned by the persons owning interests in the pooled oil or gas, or both, such production shall be allocated to the respective tracts within the unit in the proportion that the number of surface acres included within each tract bears to the number of surface acres included in the entire unit. The portion of the production allocated to the owner or owners of each tract or interest included in a well spacing or proration unit formed by a pooling order shall, when produced, be considered as if produced from the separately owned tract or interest by a well drilled thereon. Such pooling order of the division shall make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement **solely out of production** to the parties advancing the costs of the development and operation, which shall be limited to the actual

expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well.

In 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. The division is specifically authorized to provide that the owner or owners drilling, or paying for the drilling, or for the operation of a well for the benefit of all shall be entitled to all production from such well which would be received by the owner, or owners, for whose benefit the well was drilled or operated, after payment of royalty as provided in the lease, if any, applicable to each tract or interest, and obligations payable out of production, until the owner or owners drilling or operating the well or both have been paid the amount due under the terms of the pooling order or order settling such dispute. No part of the production or proceeds accruing to any owner or owners of a separate interest in such unit shall be applied toward the payment of any cost properly chargeable to any other interest in said unit.

If the interest of any owner or owners of any unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest.

III. SOMMER'S POSITION.

Sommer does not dispute that the Division has limited jurisdiction to determine prospective reasonable supervision charges, and that the operator of the well unit is entitled to reasonable supervision charges. However, Sommer contends that: (a) Energen must account to and pay Sommer for its pro rata share of production of gas produced from the well and which is sold by Energen; (b) Energen's proposed supervision charges for the year 2007 are unreasonable; (c) retroactive relief going back over a decade is improper and is beyond the scope of the Division's jurisdiction; and (d) the Division does not have the authority to impose a gas balancing agreement on Sommer.

A. Energen Must Sell, Account, and Pay for Gas Produced: Order No. R-1960-A is unclear on whether the operator may, or is required, to sell all gas produced from the well. Also, with respect to the duty to account imposed by the Division's order, said order does not require Energen to account and pay.

When a pooling order is issued, and an interest owner non-consents the well, the operator must sell the non-consenting interest owner's share of production to pay drilling costs, operating costs, and the risk charge. As a non-consenting owner, Sommer asserts that the proceeds attributable to Sommer's share of production are properly reduced by payment of drilling costs (no longer at issue as the well is fully drilled), operation costs and the risk charge. Energen, on the other hand, asserts that it only needs to maintain a gas balancing account for the benefit of

Sommer as a non-consenting owner, and does not need to account to or pay Sommer for its share of production, less the aforementioned costs. The Division should not adopt Energen's position for the reasons set forth below.:

1. Taking Energen's position to its logical conclusion, during the BPO period Energen's "gas balancing credits" attributable to a non-consenting owner, results in the non-consenting owner never reaching payout status.
2. Under modern pooling orders, an operator, regardless of a well's BPO or APO status, must sell the gas of an unlocatable owner and place that money in escrow in a bank account. There should be no difference in the Division's orders between a locatable owner and an unlocatable owner.
3. Operators of a well often change, and may even go out of business. If an operator is only required to maintain a gas balancing account for a non-consenting owner, these accounts may be lost and the operator has had use of the proceeds of gas sales without paying the interest owners, or there may be a dispute as to whether the current operator is liable for prior operators' gas balancing accounts. This uncertainty is likely to lead to a non-consenting interest owner never having the "opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas."
4. If Energen must sell gas to pay Sommer's 1/8 royalty share, and to pay Sommer's 7/8 working interest share of operating costs, how much more effort is required to account and pay to Sommer its working interest balance? None.
5. Many non-consenting interest owners are small, leased or unleased, mineral interest owners. Requiring them to market their share of gas, or maintain gas balancing accounts, and waiting for a well to cease producing before recovery, is impractical and unreasonable.

Energen must sell Sommer's share of gas, deduct overhead costs, account to Sommer, and pay Sommer its share of proceeds.

B. The Supervision Charges are not Reasonable: Energen presented testimony that overhead rates of \$748/month (\$350/month, escalated) were reasonable, based on a 1983 operating agreement (with an escalation provision) which Sommer never executed. The mere existence of an operating agreement from 25 years ago, which was not signed by Sommer, is insufficient to prove reasonableness. Energen did not produce an accountant who could testify as the reasonableness or necessity of these charges. In addition, the comparable rates submitted by Energen (Energen Exhibit 22 at the Division hearing) show that the rates requested by Energen are excessive: The rates for Pictured Cliffs wells are \$400-\$500/month, much lower than the rates proposed by Energen. Further, Energen's witness admitted that the well, because it produces gas only, is inexpensive to operate. Energen also failed to produce any evidence reflecting what rates were reasonable in 1997 and ensuing years, the period when Energen operated the well.

C. Retroactive Relief is Improper: The Division denied Energen retroactive relief for past production issues, but issued retroactive relief going back decades for the overhead rates. While the Division has authority to grant retroactive relief where necessary, it should be granted only in special circumstances, such as specifically authorized for pooling of uncommitted interests or for non-standard units under NMSA 1978 §70-2-17.C and NMSA 1978 §70-2-18.C. The circumstances of this case do not merit the Division exercising its discretionary authority to grant retroactive relief for overhead rates.

D. Gas Balancing: Sommer agrees with the Division's decision not to impose a gas balancing agreement on Sommer.

PROPOSED EVIDENCE

APPLICANT

WITNESSES

EST. TIME

EXHIBITS

OPPONENT

WITNESSES

EST. TIME

EXHIBITS

Kurt A. Sommer
(possible witness)

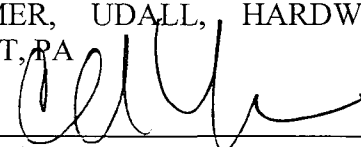
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PROCEDURAL MATTERS

-None-

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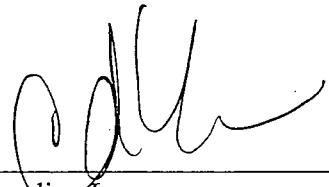
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Attorneys for the Estate of Joseph A. Sommer,
Joseph A. Sommer Revocable Trust, and JAS Oil and
Gas Co., LLC

CERTIFICATE OF SERVICE

The foregoing pleading was hand delivered the following counsel of record this 21st day of May, 2009:

J. Scott Hall
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Candice Lee