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:

CASE NO. 15072
ORDER NO. R-10154-A

APPLICATION OF ENERGEN RESOURCES CORPORATION TO AMEND COMPULSORY POOLING ORDER NO. R-10154, SAN JUAN COUNTY, NEW MEXICO

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on April 3, 2014, at Santa Fe, New Mexico, before Examiner Richard Ezeanyim.

NOW, on this 28th day of July, 2016, the Division Director, having considered the record and the recommendations of the Examiner,

FINDS THAT:

[1] Due public notice has been given, and the Division has jurisdiction of this case and the subject matter.

[2] Energen Resources Corporation ("Applicant" or "Energen") seeks to amend a compulsory pooling order issued in 1994 with respect to a unit on which two wells have been drilled, in order to pool interests of parties whose interests were not pooled in the original pooling order and who did not receive notice of the original proceeding.

Background:

[3] On July 19, 1994, in Case No. 11007, *Application of Maralex Resources, Inc. for Compulsory Pooling, San Juan County, New Mexico,* the Division issued Order No. R-10154, pooling Lots 3, 4, and 5, and the E/2 SW/4, the N/2 SE/4 and the SW/4 SE/4 (collectively, the South half equivalent) of Section 19, Township 30 North, Range 11 West, to form a 326.26-acre unit (the Unit) in the Fruitland Coal

formation, to be dedicated to the Flora Vista 19 Well No. 2, (API No. 30-045-29139), located 833 feet from the South line and 1465 feet from the West line (Unit N) of said Section 19. The Flora Vista Well No. 2 was subsequently spudded on August 18, 1994, and completed in the Fruitland Coal formation (Basin; Fruitland Coal Gas Pool).

[4] Applicant became operator of the Unit effective August 1, 2004, and thereafter, on November 21, 2004, spudded the Flora Vista Well No. 3 (API No. 30-045-32574) at a location within the above described unit, 675 feet from the South line and 1025 feet from the East line (Lot 5 – Unit P) of said Section 19. The said well was completed in the Basin; Fruitland Coal Gas Pool and was dedicated to the above-described unit as an infill well.

[5] Order No. R-10154 incorporated an Exhibit A specifically identifying Norman Gilbreath and Loretta E. Gilbreath ("the Gilbreaths") as the only parties whose interests were to be pooled thereby, and stating their interest as 48.60000% of the Unit. The evidence indicates that before the Flora Vista #3 was drilled, the Gilbreaths joined in an operating agreement covering the unit, dated (effective) November 21, 2004, thereby effectively terminating Order No. R-10154. No compulsory pooling proceeding was filed for the Flora Vista Well No. 3.

[6] On September 10, 2013, Frank A. King and Paula S. Elmore f/k/a Paula S. King ("the Kings") filed suit in Cause No. 1:13-cv-00862, in the United States District Court for the District of New Mexico ("the federal court case"), against Applicant, the Gilbreaths and other parties, claiming that they, the Kings, are the owners of the mineral fee estate underlying a part of the Unit, being the W/2 of the NW/4 SE/4 (Unit J) of Section 19 except 1.63 acres thereof, ("the King tract"). They further alleged that though the King tract had been formerly leased to the Gilbreaths, that lease expired due to cessation of production prior to the issuance of Order No. R-10154, and that they, the Kings, were and are the owners thereof free of any lease. Exhibit A to Order No. R-10154 and the subsequently executed operating agreement between the Gilbreaths and Energen evidently included a leasehold interest on the King tract in the percentage interest in the Unit attributed to the Gilbreaths.

[7] It is undisputed that the Kings were not notified of the filing of Case No. 11007, or of the hearing thereon. Order No. R-10154 does not name the Kings as parties or otherwise and does not purport to pool any unleased mineral interest they then owned.

[8] On December 10, 2013, Applicant filed its application in the present case seeking to pool any previously unconsolidated interest in the Unit, retroactively to the date of first production of the Flora Vista Well No. 2.

[9] On February 12, 2013, the Kings appeared in this case as respondents and filed a Motion to Dismiss by reason of the pendency of their suit in the United States District Court. Alternatively, the Kings moved to stay this application until the federal court suit is resolved.

[10] At the conclusion of the hearing, the Division took the Kings' Motion to Dismiss under advisement along with the case on the merits.

[11] On March 30, 2016, the United States District Court for the District of New Mexico entered an interlocutory summary judgment in favor of the Kings, finding that the oil and gas lease from the Kings to the Gilbreaths terminated on July 1, 1990, prior to the issuance of Order No. R-10154.

[12] The summary judgment, however, did not determine any of the other issues before the court in that case, including what parties may be liable, and to what extent, to compensate the Kings for proceeds of production they have not received, either pursuant to common law or pursuant to NMSA 1978, Section 70-2-18 (discussed *infra).*

Analysis of the Issues:

[13] Order No. R-10154, unlike the form of order now used by the Division in most compulsory pooling cases, expressly limits the interests pooled to "[a]ll mineral interests, whatever they may be . . . owned by the parties over whom the Division has jurisdiction as identified in Exhibit 'A'." [emphasis added] The Kings are not identified in Exhibit "A". Hence their interest, which the federal court has determined was an unleased mineral interest in a specific 18.37-acre tract, was expressly excluded. *Cf. Uhden v. New Mexico Oil Conservation Com'n,* 112 N.M. 528, 531 (Sup. Ct. 1981).

[14] Neither of the wells drilled on the Unit is located on, or penetrates, the King tract.

Jurisdiction for Compulsory Pooling

[15] The Kings' Motion to Dismiss alleges that the Division has no jurisdiction by reason of the pending federal court case. Undoubtedly, the Division does not have jurisdiction to determine whether or not the Gilbreaths' lease covering the Kings' mineral interest has expired, or, if so, when that occurred. As the Commission stated in Order No. R-11700-B, issued in Case No. 12731, *Application of TMBR/Sharp Drilling, Inc., etc.*, "The Division has no jurisdiction to determine the validity of any title, or continuation in force and effect of any oil and gas lease." ₱27. However, the federal district court has now resolved those issues. As in the *TMBR/Sharp* case, the Division is bound to recognize the Kings' judicially ascertained title although that determination remains subject to the possibility of modification by the issuing court or to reversal by an appellate court.

[16] It does not follow, however, that the Division lacks jurisdiction to order the Kings' interest pooled. NMSA 1978 Section 70-2-17.C authorizes the Division to pool a unit if the owners have not agreed to pool their interests, and one such owner, who has the right to drill, has drilled or proposes to drill a well on the unit. The federal district court has determined that the Kings are owners who have not agreed to pool

their interest, and the Kings do not challenge the right of either of the operators who have drilled wells on this unit to drill such wells at the times when, or at the locations where, those wells were drilled. The Division accordingly has jurisdiction to pool the Kings' interest, and the Kings' Motion to dismiss the pooling application should be denied.

Prospective or Retroactive Pooling

[17] Applicant has asked the Division to order the Kings' interest pooled retroactively to the date of first production. The Kings oppose this request.

[18] In New Mexico compulsory pooling of spacing units retroactively to first production is the norm. NMSA 1978 Section 70-2-18.A requires an operator of a well in a spacing unit to consolidate ownership by voluntary agreement or a compulsory pooling order "which agreement or order shall be effective from the first production." Thus, cases from other jurisdictions on very different facts which the Kings cite for the proposition that retroactive pooling is "extraordinary relief" are not persuasive.

[19] The above statutory language clearly imports that the Division has the power, and arguably the duty, to force pool a unit on which a producing well has been drilled, retroactively.

[20] NMSA 1978 Section 70-2-17 directs that any pooling order,

> . . . 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 the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas or both.

[21] An order pooling the Kings' interest retroactively to first production would not be just and reasonable to the Kings if it did not provide a means for the Kings to recover the amounts to which they are entitled from past production which accrued while Applicant operated the well.

[22] Both of the wells on this unit have been producing for a considerable time, and no estimates of probable future production are provided in the record. Hence, the Division has no basis upon which to provide for reimbursement out of future production.

[23] Commission Precedent exists for requiring an operator under a compulsory pooling order to account and pay to a pooled party amounts necessary to reasonably compensate that party for past production. The Commission did so in Order No. R-1960-B, issued on August 13, 2009 in Case No. 13957 *Application of Energen Resources Corporation, etc.* In that case the Commission ordered an operator to account and pay to a pooled party amounts to which that party was entitled by reason of its inability to market its share of past gas production.

[24] Although *Application of Energen, supra,* involved gas balancing rather than a title dispute, it is otherwise closely analogous. Significantly, the Commission there set aside an order in which the Division had concluded that:

> the parties should be left to their remedies in the courts for determining when, and in what manner, [the pooled party] shall receive its share of past production from the Unit for which it has not received payment. [Order R-1960-A issued on November 29, 2007, p. 8, at ¶ 20]

[25] NMSA Section 70-2-18.B describes the compensation to which an owner is entitled from an operator who has not procured voluntary or compulsory pooling of a spacing unit:

> 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.

[26] The Division has not been cited to, nor has it found, any opinion or order wherein any court, the Commission, or the Division, has undertaken to interpret Section 70-2-18.B, or has opined as to the Division's jurisdiction to enforce the liability therein provided.

[27] As applied to this case, however, Section 70-2-18.B entitles the Kings only to that interest in past production to which they would be entitled had their interest been pooled. Since neither of the wells drilled on this unit is located on, or drilled into, the Kings' tract, they would be entitled to nothing in the absence of pooling.[1] The Division is an appropriate forum to determine the amount to which the Kings would have been entitled in the event of pooling, since the Division is vested by NMSA 1978 Section 70-2-17.C with jurisdiction, in the context of a compulsory pooling case, to make provision for recovery of costs and to determine the reasonableness of costs.

[28] It is not necessary, however, to decide whether or not the Legislature has specifically vested the Division with jurisdiction to enforce Section 70-2-18.B. The Division has jurisdiction to issue compulsory pooling orders for units on which there are existing wells to prevent waste, expressly including orders retroactive to date of first production. In so doing, it has the power and duty to protect correlative rights,

[1] Interpreting "the amount to which each party is entitled in the absence of pooling" in Section 70-2-18.B as allowing a party to recover its interest in past production without deduction for costs would not be reasonable since that amount would always exceed "the amount to which a party would be entitled if pooling had occurred," thereby rendering the statutory provision for recovery of the greater of these alternatives meaningless.

which requires that it make provision for reimbursement to interest owners, where possible, for their share of past as well as future production from wells on the Unit.

[29] Requiring Energen to account to the Kings out of proceeds it has received from this Unit since becoming operator is necessary in this case to secure to the Kings their correlative rights. Such a provision is just and reasonable to Energen, which could have protected its position by conducting a careful title investigation when it assumed operations.

[30] In this case, where a well has produced from the pooled unit for more than twenty years, and no evidence has been presented from which the Division can estimate future production, the Division cannot practicably allocate proceeds from the date of first production in a manner that will protect correlative rights except by requiring an accounting from the operator, whom the Legislature has unequivocally determined is the responsible party.

[31] At the same time, it would not be just and reasonable to require Energen to account to the Kings for their share of production that occurred prior to Energen's assumption of operations. And the Division cannot decree an accounting by Maralex Resources, Inc., the original applicant for compulsory pooling in Case No. 11007, nor by SG Oil & Gas Interests, the operator appointed in that case by Order No. R-10154, if for no other reason, because those persons are not parties to the present case.

[32] This Order leaves the Kings free to seek recovery in their court case of their interest in production that occurred before Energen assumed operations, against any party responsible therefor under Section 70-2-18.B or under the common law.

[33] For the foregoing reasons, Applicant's request for issuance of an order pooling the King's interest in the Unit retroactively to the date of first production should be granted, and provision should be made therein for Energen to account to the Kings for their share of production, net of reasonable costs, from August 1, 2004 to the date this order is issued.

Findings Concerning Compulsory Pooling

(34) Applicant seeks an order pooling all uncommitted interests in the Unit, including, but not necessarily limited to, the Kings' unleased mineral interest.

(35) The Unit is dedicated to the Flora Vista 19 Well No. 2 and the Flora Vista 19 Well No. 3, described in Finding Paragraphs (3) and (4) above (the Existing Unit Wells). The Existing Unit Wells are located at standard locations.

(36) The Existing Unit Wells are completed in the Basin-Fruitland Coal Gas Pool (pool code 71629). Spacing in this pool is based on 320-acre units, each comprising a governmental half section. Two wells may be located in each 320-acre unit provided that both of said wells are not located in the same quarter section.

(37) Two or more separately owned tracts are embraced within the Unit that are separately owned.

(38) Applicant is owner of an oil and gas working interest within the Unit. Applicant has the right to drill, and has drilled, the Flora Vista Well No. 3, and Applicant's predecessor in title had the right to drill, and drilled, the Flora Vista Well No. 2, to a common source of supply within the Unit.

(39) There are interest owners in the Unit that have not agreed to pool their interests.

(40) To avoid the drilling of unnecessary wells, to provide for the operation of the Existing Unit Wells to prevent waste, including the possibility of premature abandonment, and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons in the Unit, this application should be approved by pooling the interest in the oil and gas within the Unit that the federal district court has adjudged to the Kings.

(41) Pursuant to NMSA 1978 Section 70-2-18-A, this order should be made retroactive from date of first production of the Flora Vista Well No. 2.

(42) Applicant should be designated the operator of the Existing Unit Wells and of the Unit.

(43) Applicant does not seek recovery of any risk charge in connection with the drilling of the Existing Unit Wells, and, in any event, should not be entitled to recover a risk charge out of the Kings' interest, since the Kings were not afforded an opportunity to participate in either well.

(44) Reasonable charges for supervision (combined fixed rates) should be computed at the rate of $3,500 per month while drilling and $350 per month while producing (the rates provided in Order No. R-10154) from first production until April 1, 2014, and thereafter at the rate of $940.97 per well, per month, while producing, adjusted annually from that date forward pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations."

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of Energen Resources Corporation, all uncommitted interests in the oil and gas in the Bone Spring formation underlying Lots 3, 4, and 5, and the E/2 SW/4, the N/2 SE/4 and the SW/4 SE/4 (collectively, the South half equivalent) of Section 19, Township 30 North, Range 11 West ("the Unit"), including the unleased mineral interest in the W/2 of the NW/4 SE/4 (Unit J) of Section 19 except 1.63 acres thereof ("the King tract"), that the federal district court has adjudged to the Kings, are hereby pooled.

(2) The Unit shall be dedicated to the Flora Vista 19 Well No. 2 (API No. 30-045-29139), located 833 feet from the South line and 1465 feet from the West line (Unit N) of said Section 19, and the Flora Vista 19 Well No. 3 (API No. 30-045-32574) located 675 feet from the South line and 1025 feet from the East line (Lot 5 – Unit P) of said Section 19 (the Existing Unit Wells).

(3) Upon final plugging and abandonment of the Existing Unit Wells and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit created by this Order shall terminate unless this Order has been amended to authorize further operations.

(4) Energen Resources Corporation (OGRID 162928) is hereby designated the operator of the Existing Unit Wells and of the Unit.

(5) 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, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.)

(6) From and after the effective date of this Order, the operator is authorized to withhold from production from each well the proportionate share of both the supervision charges, computed as provided in Finding Paragraph 44, and the actual expenditures required for operating the wells, not in excess of what are reasonable, attributable to pooled working interest owners.

(7) Except as provided in Paragraph (6) above, all proceeds from production from the Existing Unit Wells that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not sooner disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8a-1 through 7-8a-31, as amended).

(8) Energen shall select and pay for an independent auditor to audit the revenue and expense accounts related to each of the Existing Unit Wells. The audit will cover the period from August 1, 2004, when Energen became operator of the wells, to the date of this order ("Audit Period"). The audit will determine for each historic sale by Energen of production from the Existing Unit Wells during the Audit Period (i) the amount of production that is attributable to the Kings' interest (ii) the historic price at which Energen sold such production, (iii) the amount that Energen charged working interest owners for the actual operating expenses of the Existing Unit Wells, and (iv) anything else necessary for calculating the Kings' share of revenues from the said wells based on the historic proceeds received by Energen. The auditor also will calculate the Lump Sum Payment (hereinafter defined).

(9) Results of the audit will be used to calculate a Lump Sum Payment by Energen to the Kings for the net value of their share of production, deemed to have been produced and sold by Energen for the account of the Kings during the Audit Period. The Lump Sum Payment will be a sum computed based on the volume of gas produced during the Audit Period that is attributable to the Kings' interest in the Existing Unit Wells, as though their interest were included in the original pooling of the Unit, and Energen were marketing their gas at the time, valued at the historic prices received by Energen, less the proportionate share of actual operating expenses (not to exceed reasonable operating expenses), and an allowance overhead determined as provided in Finding Paragraph 44; provided that the Lump Sum Payment, excluding interest, shall in no event be less than one-eighth of the gross proceeds of sales attributed to the Kings' interest during the Audit Period. The Lump Sum Payment shall include interest calculated on the pooled parties' net interest in each sale, for the time provided in NMSA 1978, Section 70-10-3, at the rate provided in NMSA 1978 Section 70-10-4.

(10) The audit shall be completed no later than six months after the date that this Order is issued. Upon completing the audit, the auditor will deliver complete copies thereof to each party and to the Division. Any party, within 30 calendar days of receiving the auditor's report, may appeal all or a portion of the report to the Division, and/or may file objections to any expenses allowed therein that it asserts are not reasonable. The Division retains jurisdiction for the purpose of ruling on any such appeal or objection, and as otherwise allowed by law.

(11) Upon final determination of the amount of the Lump Sum Payment, Energen shall either pay the Lump Sum Payment to the Kings or their successors or hold it for their account pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended) until final determination of the federal court case or as otherwise directed by the court.

(12) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(13) Except as herein specifically provided, this Order shall be effective from December 1, 1994, the date of first production of the Flora Vista 19 Well No. 2.

(14) 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.

(15) The operator of the Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this Order.

(16) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary, including but not limited to any further orders that may become appropriate in view of, and consistent with, the final disposition of Cause No. 1:13-cv-00862, styled *Frank A. King, et al. v. Norman L. Gilbreath, et al.*, pending in the United States District Court for the District of New Mexico.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

David R. Catanach

DAVID R. CATANACH
Director