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January 31, 2012

Ms. Jami Bailey, Director
New Mexico Oil Conservation Division
1220 S. St. Francis Drive
Santa Fe, NM 87501

HAND DELIVERED

Re: NMOCD Case No. 14763: In The Matter of the Application of Mack Energy Corporation for Compulsory Pooling, Lea County, New Mexico

Dear Ms. Bailey:

On behalf of Siana Oil and Gas, LLC ("Siana"), enclosed for filing is an original and one copy of Siana's Reply Pursuant to Motion to Dismiss in the above-referenced case.

Thank you.

Very truly yours,

J. Scott Hall

JSH:kw

cc: James Bruce, Esq. (via email)
David Brooks, Esq. (via email)

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

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

CASE NO. 14763

REPLY PURSUANT TO
MOTION TO DISMISS

Siana Oil and Gas LLP and Tom M. Ragsdale, ("Siana" or "Ragsdale"), submit this Reply pursuant to their Motion To Dismiss filed at the January 5, 2012 Examiner hearing on Mack Energy Corporation's Application for compulsory pooling.

Background

Mack Energy Corporation has invoked the jurisdiction of the Division under the Oil and Gas Act to obtain an order authorizing it to re-enter and perform a fracture stimulation of the Cockburn A State Well No. 5 producing from the Abo formation in the SE/4 NW/4 of Section 32, Township 17 South, Range 33 East, NMPM. Although it has been producing the well since 2004, Mack Energy also seeks, for the first time, (1) the formal consolidation of interests to be dedicated to the well, (2) designation of Mack Energy as operator, (3) approval and allocation of the costs of recompleting the well, (4) authorization to recover well costs along with ongoing overhead and supervision charges, and (5) imposition of a risk penalty of costs plus 200% against the interests of non-consenting owners.

A hearing on the merits on Mack Energy's Application was held on January 5, 2012. At the hearing, Siana Oil and Gas and Tom M. Ragsdale moved to dismiss the Application and the Examiners received brief argument from counsel.

Points and Authorities

In 2004, Caza Energy LLC acquired 100% of the interests in the well and spacing unit from Siana Oil and Gas LLP, Tom M. Ragsdale, and Mr. Ragsdale's partners who had acquired the non-producing well from Oxy. 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. (*See* Assignment of Oil and Gas Leases dated May 13, 2004, Siana Oil and Gas Exhibit 3; November 1, 2011 Operating Agreement and Exhibit "A" therein, Mack Energy Corporation Exhibit 11.)

Earlier, Mack Energy had asserted that an Operating Agreement dated May 25, 1960 between Carper Drilling Company, Inc. and James P. Dunigan had applied to the lands and well. Then, Mack Energy subsequently changed its position and on November 7, 2011 filed its Application in this matter, effectively admitting that the interests in the SE/4 NW/4 were not consolidated or governed by an operating agreement.[1] Siana's original Pre-Hearing Statement And Motion To Continue Hearing filed on approximately November 28, 2011 pointed out that Mack Energy was taking inconsistent positions in this regard and it was only afterward, on December 7, 2011, that Mack Energy sent a proposed operating agreement to Mr. Ragsdale. At the hearing, no witness was able to explain how Mack Energy's September 6, 2011 AFE afforded an interest owner the opportunity to go "consent" or "non-consent" to the proposed fracture stimulation operation, or the terms under either election. Understandably, Mr. Ragsdale did not agree to commit his interests under such uncertain circumstances or consent to a speculative operation that has not been demonstrated to be necessary.

[1] This includes the 93.75% owned by third parties.

Statutory pooling vs. common law remedies

Mack Energy argues that the Division should designate it as operator of the well *and* declare that it has been entitled to operate the well without an operating agreement as well as recover costs, citing to the co-tenancy theories discussed in *Bellet v. Grynberg*, 114 N.M. 690, 845 P.2d 784 (1992).

Mack's reliance on co-tenancy theories and common law remedies do not resolve this proceeding. Mack Energy has invoked a purely statutorily prescribed remedy pursuant to §70-2-17 NMSA (1978) of the Oil and Gas Act. In *Bellet v. Grynberg*, no party sought compulsory pooling relief, so it is not meaningful authority here.[2] Moreover, compulsory pooling does not create a co-tenancy with all the attendant common law rights. *Schulte v. Apache Corp.*, 814 P.2d 469, 471 (Okla. 1991). It would be a mistake for the Division to make such a leap and imply a contract between the parties, as Mack Energy suggests, for in doing so the agency would surely be acting in an *ultra vires* capacity in excess of its statutory authority. 1 B. Kramer & P. Martin, *Pooling and Unitization*, §4.03[1][c] (1996).

Having itself initiated this administrative proceeding for a statutory compulsory pooling remedy, Mack Energy may not now invoke common law theories for absolution of its past regulatory non-compliance.

[2] Mack Energy's reference to *Hegarty v. Board of Oil, Gas and Mining* is equally inapposite. Utah's compulsory pooling statutes, U.C.A. §§40-6-5 and 40-6-6, (copies attached) do not contain a provision equivalent to §70-2-18 A NMSA (1978) mandating operators to pool separately owned interests within a spacing unit.

Mack Energy's Failure of Proof

It is significant that Mack Energy Corporation does not own an interest in the well or acreage. In paragraph 1 of its Application Mack Energy alleges that "...it has the right to drill or re-complete a well [on the SE/4 NW/4 of Section 32]...". But at the hearing, Mack Energy offered no evidence to support this fundamental allegation. It can point to nothing establishing the terms of any agency, and Mack admits there is no operating agreement. Consequently, Mack Energy failed to prove, and the Division cannot find, that Mack has a right to drill, re-complete or even operate on the lands. Proof of this pre-requisite element is required by §70-2-17 C, [3] and Mack Energy's failure to prove it mandates dismissal of the Application.

Siana's request for relief under §70-2-18 B

Mack Energy completely misapprehends the request by Siana Oil and Gas and Mr. Ragsdale for relief under §70-2-18 B. As indicated in its December 29, 2011 Amended Pre-Hearing Statement, under the clear authority of this particular provision of the Oil and Gas Act, Siana asks the Division 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 Siana the greater amount attributable to its interest in the absence of pooling, *without* deductions for charges and expenses, in accordance with the statute.

[3] §70-2-17 C states: "When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests, *and where one such separate owner, or owners, who has the right to drill* has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit." (emphasis added).

Mack mistakenly believes that Siana and Mr. Ragsdale have invoked the statute in order to inflate Mr. Ragsdale's interest in the well's production, as if he were the owner of a separate, unconsolidated *tract* within the spacing unit. Mr. Ragsdale does not so contend. It is undisputed that Mr. Ragsdale owns a 6.25% undivided working interest[4] throughout the 40-acre spacing unit (and in other lands not at issue here). Mr. Ragsdale does not assert that he should be paid for a larger interest. §70-2-18 B is not limited to protection of only owners of un-pooled *tracts* within a spacing unit, but also includes separately owned undivided interests, as §70-2-18 A makes clear.[5]

§70-2-18 A also makes clear that regardless of when an order pooling separately owned interests is obtained, it is to be "effective from the first production."[6] Yet, the operator of a producing well obtaining the pooling order must not be dilatory in the consolidation of un-joined interests as §70-2-18 B is quite evidently intended to operate as a disincentive to such conduct.[7] Because there is "the absence of pooling", the statute directs that the un-pooled interest owner, Mr. Ragsdale, be paid the "greater amount". In this case, that amount should be 6.25% of gross production, without deduction for costs or expenses.

Absent an agreement or a pooling order, Mack Energy was never authorized to recover "the costs of development and operation" from any of the non-operators. Such authority derives from §70-2-17 B, but only on the Division's determination of justness and reasonableness. Mack

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[4] And a separate overriding royalty interest burdening Caza Energy's interest.

[5] § 70-2-17 A provides, in part: "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."

[6] Utah's compulsory pooling statute lacks such a mandatory requirement. Hence, the result in *Hegarty*.

[7] Similarly, under §19.15.16.19 A (1) and (3) NMAC, interests are to be consolidated before an allowable may be assigned.

Energy sought no such determination, but a non-operator is clearly authorized to pursue such 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." In this case, there are certainly good grounds supporting Siana's claim for relief.

The testimony at hearing established that Mack Energy remits payment directly to the non-operators, but that the basis for payment and any deductions is not clear. Mack Energy has refused to let the purchaser of gas and oil production to remit payments directly to the working interest owners. No joint interest billings are provided. Lease operating expenses are not accounted for and it is not known what overhead charges may have been recovered. Mr. Ragsdale was not paid for the lease interest conveyed to Caza Energy, but instead was given a credit by Mack Energy. Mack then proceeded to net expenses against the credit until it was reduced to zero. The Mack Energy check stubs and revenue payments spreadsheets are not informative. The operator's accounting practices are, and have been uncertain, regardless of the absence of authority to recover any costs or charges from production from Mr. Ragsdale or anyone else, *including* the owners of the other 93.75%.

Conclusion

The Application of Mack Energy Corporation should be denied. The requests for relief of Siana Oil and Gas LLP and Tom M. Ragsdale should be granted. Mack Energy Corporation should be ordered to render a full and complete accounting of all production revenues, development and operating expenses, including overhead and supervision charges. (*See* Order No. R-1960-B.) Mack Energy Corporation should then be required to pay the proper amounts attributable to the non-operating interests without deduction of expenses absent compulsory pooling and any authority to make such deductions historically.

Respectfully submitted,

MONTGOMERY & ANDREWS, P.A.

By: _____

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Tom M. Ragsdale

Certificate of Service

I hereby certify that a true and correct copy of the foregoing was delivered by electronic mail to counsel of record on the 31 day of January, 2012:

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_____

J. Scott Hall

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NOTES OF DECISIONS (19)

§ 40-6-6.5. Pooling of interests for the development and operation of a drilling unit--Board ma...
West's Utah Code Annotated
West's Utah Code Annotated Title 40. Mines and Mining
Title 40. Mines and Mining
Chapter 6. Board and Division of Oil, Gas, and Mining (Refs & Annos)

U.C.A. 1953 § 40-6-6.5

§ 40-6-6.5. Pooling of interests for the development and operation of a drilling unit--Board may order pooling of interests--Payment of costs and royalty interests--Monthly accounting

Currentness

(1) Two or more owners within a drilling unit may bring together their interests for the development and operation of the drilling unit.

(2)(a) In the absence of a written agreement for pooling, the board may enter an order pooling all interests in the drilling unit for the development and operation of the drilling unit.

(b) The order shall be made upon terms and conditions that are just and reasonable.

(c) The board may adopt terms appearing in an operating agreement:

(i) for the drilling unit that is in effect between the consenting owners;

(ii) submitted by any party to the proceeding; or

(iii) submitted by its own motion.

(3)(a) Operations incident to the drilling of a well upon any portion of a drilling unit covered by a pooling order shall be deemed for all purposes to be the conduct of the operations upon each separately owned tract in the drilling unit by the several owners.

(b) The portion of the production allocated or applicable to a separately owned tract included in a drilling unit covered by a pooling order shall, when produced, be deemed for all purposes to have been produced from that tract by a well drilled on it.

(4)(a)(i) Each pooling order shall provide for the payment of just and reasonable costs incurred in the drilling and operating of the drilling unit including, but not limited to:

(A) the costs of drilling, completing, equipping, producing, gathering, transporting, processing, marketing, and storage facilities;

(B) reasonable charges for the administration and supervision of operations; and

(C) other costs customarily incurred in the industry.

(ii) An owner is not liable under a pooling order for costs or losses resulting from the gross negligence or willful misconduct of the operator.

(b) Each pooling order shall provide for reimbursement to the consenting owners for any nonconsenting owner's share of the costs out of production from the drilling unit attributable to his tract.

(c) Each pooling order shall provide that each consenting owner shall own and be entitled to receive, subject to royalty or similar obligations:

(i) the share of the production of the well applicable to his interest in the drilling unit; and

(ii) unless he has agreed otherwise, his proportionate part of the nonconsenting owner's share of the production until costs are recovered as provided in Subsection (4)(d).

(d)(i) Each pooling order shall provide that each nonconsenting owner shall be entitled to receive, subject to royalty or similar obligations, the share of the production of the well applicable to his interest in the drilling unit after the consenting owners have recovered from the nonconsenting owner's share of production the following amounts less any cash contributions made by the nonconsenting owner:

(A) 100% of the nonconsenting owner's share of the cost of surface equipment beyond the wellhead connections, including stock tanks, separators, treaters, pumping equipment, and piping;

(B) 100% of the nonconsenting owner's share of the estimated cost to plug and abandon the well as determined by the board;

(C) 100% of the nonconsenting owner's share of the cost of operation of the well commencing with first production and continuing until the consenting owners have recovered all costs; and

(D) an amount to be determined by the board but not less than 150% nor greater than 300% of the nonconsenting owner's share of the costs of staking the location, wellsite preparation, rights-of-way, rigging up, drilling, reworking, recompleting, deepening or plugging back, testing, and completing, and the cost of equipment in the well to and including the wellhead connections.

(ii) The nonconsenting owner's share of the costs specified in Subsection (4)(d)(i) is that interest which would have been chargeable to the nonconsenting owner had he initially agreed to pay his share of the costs of the well from commencement of the operation.

(iii) A reasonable interest charge may be included if the board finds it appropriate.

(e) If there is any dispute about costs, the board shall determine the proper costs.

(5) If a nonconsenting owner's tract in the drilling unit is subject to a lease or other contract for the development of oil and gas, the pooling order shall provide that the consenting owners shall pay any royalty interest or other interest in the tract not subject to the deduction of the costs of production from the production attributable to that tract.

(6)(a) If a nonconsenting owner's tract in the drilling unit is not subject to a lease or other contract for the development of oil and gas, the pooling order shall provide that the nonconsenting owner shall receive as a royalty the average landowner's royalty attributable to each tract within the drilling unit.

(b) The royalty shall be:

(i) determined prior to the commencement of drilling; and

(ii) paid from production attributable to each tract until the consenting owners have recovered the costs specified in Subsection (4)(d).

(7) The operator of a well under a pooling order in which there are nonconsenting owners shall furnish the nonconsenting owners with monthly statements specifying:

(a) costs incurred;

(b) the quantity of oil or gas produced; and

(c) the amount of oil and gas proceeds realized from the sale of the production during the preceding month.

(8) Each pooling order shall provide that when the consenting owners recover from a nonconsenting owner's relinquished interest the amounts provided for in Subsection (4)(d):

(a) the relinquished interest of the nonconsenting owner shall automatically revert to him;

(b) the nonconsenting owner shall from that time:

(i) own the same interest in the well and the production from it; and

(ii) be liable for the further costs of the operation as if he had participated in the initial drilling and operation; and

(c) costs are payable out of production unless otherwise agreed between the nonconsenting owner and the operator.

(9) Each pooling order shall provide that in any circumstance where the nonconsenting owner has relinquished his share of production to consenting owners or at any time fails to take his share of production in-kind when he is entitled to do so, the nonconsenting owner is entitled to:

(a) an accounting of the oil and gas proceeds applicable to his relinquished share of production; and

(b) payment of the oil and gas proceeds applicable to that share of production not taken in-kind, net of costs.

Credits

Laws 1992, c. 34, § 3; Laws 2010, c. 324, § 64, eff. May 11, 2010.

Notes of Decisions (19)

Current through 2011 Third Special Session.

End of Document

NOTES OF DECISIONS (11)

Claim on production
Cooperative development
Effective date of pooling orders
Enforcement of correlative rights
Punitive damages
Waiver of interest

§ 40-6-6. Drilling units--Establishment by board--Modifications--Prohibitions
West's Utah Code Annotated
Title 40. Mines and Mining
Chapter 6. Board and Division of Oil, Gas, and Mining (Refs & Annos)

U.C.A. 1953 § 40-6-6

§ 40-6-6. Drilling units--Establishment by board--Modifications--Prohibitions

Currentness

(1) The board may order the establishment of drilling units for any pool.

(2) Within each drilling unit, only one well may be drilled for production from the common source of supply, except as provided in Subsection (6).

(3) A drilling unit may not be smaller than the maximum area that can be efficiently and economically drained by one well.

(4)(a) Each drilling unit within a pool shall be of uniform size and shape, unless the board finds that it must make an exception due to geologic, geographic, or other factors.

(b) If the board finds it necessary to divide a pool into zones and establish drilling units for each zone, drilling units may differ in size and shape for each zone.

(5) An order of the board that establishes drilling units for a pool shall:

(a) be made upon terms and conditions that are just and reasonable;

(b) include all lands determined by the board to overlay the pool;

(c) specify the acreage and shape of each drilling unit as determined by the board; and

(d) specify the location of the well in terms of distance from drilling unit boundaries and other wells.

(6) The board may modify an order that establishes drilling units for a pool to provide for:

(a) an exception to the authorized location of a well;

(b) the inclusion of additional areas which the board determines overlays the pool;

(c) the increase or decrease of the size of drilling units; or

(d) the drilling of additional wells within drilling units.

(7)(a) After an order establishing drilling units has been entered by the board, the drilling of any well into the pool at a location other than that authorized by the order is prohibited.

(b) The operation of any well drilled in violation of an order fixing drilling units is prohibited.

Credits
Laws 1992, c. 34, § 2.

Notes of Decisions (11)