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

2009 JUL -8 A 8:39

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

Case No. 13957 (*de novo*)
Order No. R-1960-B

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.

SOMMER'S (REVISED) PROPOSED FINDINGS AND CONCLUSIONS

The following findings and conclusions are submitted by the Estate of Joseph A. Sommer, Joseph A. Sommer Revocable Trust, and JAS Oil and Gas Co., LLC (collectively, "Sommer").

A. FINDINGS.

1. Commission Order No. R-1960, dated May 5, 1961, force pooled Sommer (and other interest owners) into the well unit for the Martinez Well No. 1 (API No 30-039-06124), comprised of the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, as to the Pictured Cliffs formation (the "well"). The original operator of the well was Southern Union Production Company, and there have been several different operators since then.

2. Sommer owns an unleased mineral interest in the well, and has never executed an operating agreement or gas balancing agreement for the well.

3. Sommer was a non-consenting interest owner in the well, and pursuant to statute the unleased interest was treated 1/8 as a "royalty" interest and 7/8 as a working interest.

4. Supervision charges for the well are not specified in the order, and it does not provide for escalation of such charges. In addition, the order is silent as to selling a non-operating interest owner's share of production.

5. The well 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.

6. Until the mid-1990s the operators 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 after deducting overhead rates and operating costs.

7. In August 1997 Energen Resources Corporation ("Energen") became operator of the well. **Energen Exhibit 23**. Although Energen has sold all gas produced from the well unit, Energen is only paying Sommer its 1/8 "royalty" interest. It is not paying Sommer its 7/8 working interest share of production, nor is it deducting from production proceeds Sommer's proportionate share of reasonable overhead charges and operating costs.

8. Energen is maintaining a gas balancing account for the well, under which working interest owners are credited with underproduced or overproduced amounts of gas.

9. Energen filed this application seeking to amend Order No. R-1960 (i) to establish reasonable overhead charges, and escalate those charges under the COPAS accounting procedure, (ii) impose a gas balancing agreement upon Sommer, and (iii) make these provisions of the order retroactive to the time Energen assumed operations.

10. When Energen's took over operation of the well, Sommer was overproduced in the amount of 1031 MCF of gas. **Testimony of Paul Rote, Tr. at 23**. As of January 2009, Sommer was underproduced in the amount of 8378 MCF of gas. **Energen Exhibit 25**. It is unknown whether, when Energen purchased the well, it received a credit on the purchase price due to Sommer's overproduction.

11. Certain unleased mineral owners in the well (excluding Sommer) executed an operating agreement for the well with Union Texas Petroleum Corporation, dated December 12, 1984, which provided for overhead rates for a producing well of $350/month, subject to escalation under the COPAS accounting procedure. **Sommer Exhibit 12**. Under the cost escalation provision, operating costs for the well would be $866.16/month in 2009. **Energen Exhibit 22**.

12. Although Sommer is not subject to the operating agreement, Energen has applied the agreement's overhead rates to Sommer, and has billed Sommer on a monthly basis for overhead charges and operating costs.

13. Sommer's position has consistently been that it will accept fair overhead rates, but that the overhead rates charged by Energen are not fair. In addition, Sommer has asserted that (i) reasonable overhead charges and operating costs should be deducted from its share of production from the well, and (ii) it should not be charged if it is not receiving its share of proceeds. As a result, monthly operating costs have not been paid by Sommer.

14. Sommer and Energen are subject to an operating agreement executed dated March 1, 2006 for the McCroden Well No. 1, a well completed in the Mesa Verde formation located in the W½ of the same Section 2, Township 25 North, Range 3 West, NMPM. **Energen Exhibit 18**. The initial producing well overhead rates in the agreement are $350/month.

15. Energen's list of producing overhead rates for its non-operated Pictured Cliffs wells shows that a large majority of the overhead rates are below $500/month. **Energen Exhibit 20**.

16. The Ernst & Young overhead rate survey for 2008-2009 reflects a median rate for wells in the San Juan Basin completed at depths of 5000-10000 feet of $550/month. **Testimony of Paul Rote, Tr. at 57**.

17. Energen asserted that Sommer refused to market its share of production. However, when Sommer requested delivery of gas in September 2005, Energen did not respond. **Sommer Exhibit 4**.

18. Energen's position at the hearing was that Sommer may make up its underproduction by taking 40% more gas than it is entitled to for its 8⅓% working interest. Under such an arrangement it would take Sommer 49 years to make up its underproduction. **Testimony of Paul Rote, Tr. at 70**.

19. The well is currently producing 24 MCF/day, and no water. Energen's witness testified that the well would produce for another 49½ years. However, that is not an economic limit, since it does not take into account future gas pricing or operating costs. **Testimony of Paul Rote, Tr. at 70, 94**.

20. 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.

21. Under modern pooling orders, an operator, regardless of a well's before payout or after payout status, must sell the gas of an unlocatable interest owner and place that money in escrow in a bank account in the county where the well is located. **Sommer Exhibit 3**. Energen's practice of maintaining gas balancing credits would not satisfy the terms of such an order.

22. The operator of a well often changes, or an operator may go out of business. If an operator is only required to maintain a gas balancing account, such accounts may be lost, or there may be a dispute as to whether the current operator is liable for a prior operator's overproduction or undeproduction amounts.

23. Many non-consenting mineral interest owners under pooling orders own small interests or are individuals who are unsophisticated in the oil and gas business. Requiring such owners to market their share of gas, or maintain gas balancing accounts until a well ceases producing, and then seeking payment, is impractical.

24. Sommer asserts that there is no reason under a pooling order to treat locatable owners, like Sommer, different than unlocatable owners.

25. Energen has never submitted a Division Order to Sommer, unlike previous operators.

B. CONCLUSIONS.

1. New Mexico's pooling statute, NMSA 1978 §70-2-17.C, provides in part:

(a) All orders effecting such pooling ... 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.

(b) 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.

(c) 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.

2. The Commission has the authority to set reasonable overhead charges and determine actual operating costs.

3. A reasonable overhead rate for a producing Pictured Cliffs well for the year 2009 is $550/month. That rate shall be de-escalated according to the COPAS wage index adjustment, providing for retroactive overhead rates as provided in Exhibit A.

4. Energen's gas balancing proposal will not allow Sommer the opportunity to recover or receive without unnecessary expense its just and fair share of the oil or gas produced or to be produced from the well.

5. Energen shall select and pay for an independent auditor to audit Sommer's gas balancing account in the well, covering the period from the effective date on which Energen purchased its predecessor-in-title's interest in the well to the date this order is entered. The audit shall determine (i) if, when Energen purchased the well, it received a credit on the purchase price for Sommer's overproduction, (ii) the volume of produced gas attributable to Sommer's interest in the well, (iii) the historic prices for which Energen sold production from the well, and (iv) actual operating costs for the well.

6. The audit report shall be completed within six (6) months of the date this order is entered. Either party may appeal to the Commission all or any portion of the report within thirty (30) days from date of receipt of the audit. The Commission retains jurisdiction of this case for that purpose.

7. The final results of the audit shall be used to calculate a lump sum buy-out by Energen of Sommer's underproduction amount, using historic prices, less actual operating costs and overhead rates as provided in Exhibit A.

8. Energen shall pay interest on the buy-out amount at the historic prime interest rate at time of sale of the gas, plus 1½%, as provided in NMSA 1978 §70-10-4.

9. Energen shall prepare and file with the Commission a schedule or Division Order showing the net revenue interests of all interest owners in the well. Sommer shall execute the Division Order.

10. From the date this order is entered, Energen shall have the right, but not the obligation, to sell Sommer's share of gas produced from the well and allocate proceeds. If Sommer does not market its gas, Energen may sell all gas from the well and deduct therefrom Sommer's proportionate share of overhead rates of $550/month, to be escalated under the COPAS accounting procedure, plus actual operating costs. In such event Energen shall account and pay to Sommer for its share of gas.

11. The Commission refuses to adopt a gas balancing agreement in this order. Such a provision is best left to an Division-industry committee to determine a fair and reasonable form.

12. This order shall completely replace Division Order No. R-1960-A.