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

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IN THE MATTER OF THE AMENDED 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. 13957

APPLICANT'S POST-HEARING MEMORANDUM

Applicant, Energen Resources Corporation is the successor operator of the Martinez Well No. 1 drilled to and producing from the Pictured Cliffs formation, (Tapacito-Pictured Cliffs Gas Pool) underlying the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, in Rio Arriba County. The unleased mineral interests of Joseph A. Sommer, now JAS Oil and Gas, LLC in the SW/4 of Section 2 were consolidated pursuant to Order No. R-1960. The form of this compulsory pooling order issued in 1961 is unclear and does not directly comport with the form of orders currently in use by the Division setting forth the means by which well operators may obtain reimbursement for operating costs and supervision charges. Order No. R-1960 neither contains findings establishing the amount of supervision charges, nor does it expressly provide for their periodic adjustment. (See *NMSA 1978 §70-2-17 C).*

Sommer/JAS has disputed the operating expenses and supervision charges for the well. In addition, Sommer/JAS has failed to make arrangements for the sale of its gas and has refused to permit the Applicant to market its gas on its behalf. As a consequence, the

operator has been prevented from deducting proportionate operating costs and supervision charges. Further, Sommer/JAS has taken the position that the operator may not sell its gas from the well when the JAS/Sommer working interest share is not being marketed. Energen's application accordingly requests the Division to (1) amend Order No. R-1960 to include new provisions allowing for the pro rata reimbursement of the operator's costs of operations and supervision charges which may be adjusted annually, (2) further authorizing Applicant to sell a portion or all of the production attributable to the pooled working interest of the non-selling mineral interest owner, and (3) making such other provisions as may be proper.

At the November 29, 2007 examiner hearing on Energen's Application, Energen presented testimony and other evidence establishing the reasonableness of its lease operating expenses, including overhead and supervision charges. Energen also presented testimony and evidence supporting its request for relief to sell all or a portion of the production allocated to the working interest of a non-marketing interest owner in accordance with the established practice of gas balancing. Energen does not seek to have the Division write a gas balancing agreement. Rather, it seeks authorization to sell all or a portion of the non-marketing party's working interest share in accordance with Division Rule 414, the enabling order for which acknowledges the industry custom and practice of gas balancing.

At the November 29, 2007 hearing, the parties were requested to submit briefs addressing the agency's jurisdiction.

The Division's 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 70-2-11 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.*

Sommer/JAS do not seriously dispute the applicability of the Division's jurisdiction here. Rather, it is more accurate to say that they simply dispute the relief requested.

Reimbursement of Operating Expenses and Supervision Charges

The terms of the 1961 compulsory pooling order, together with the applicable statute, NMSA Section 70-2-17 (C), make clear that the operator is entitled to

[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 ...."

reimbursement for operating expenses and a reasonable charge for supervision. The order provides:

> *"[T]he 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."...[The proportionate share of the costs of development of the pooled unit, including reasonable charges for supervision, shall be paid out of production by each non-consenting working interest owner."*

The compulsory pooling statute, in part, states:

> *"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 prorate 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..."* NMSA 1978 Section 70-2-17(C).

It has been the practice of the Division, and the Commission, to retain jurisdiction over its compulsory pooling orders to, among other things, resolve disputes over development and operating costs: *"In the event of any dispute relative to such costs, the division shall determine the proper costs after due notice to the interested parties and a hearing thereon."* Id. The relevant terms of the 1961 compulsory pooling order do not reflect the cost recovery provisions found in contemporary pooling orders, which typically provide as follows:

> *(12) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $6000 per month while drilling and $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to each non-consenting working interest.*

There should be no question that the Division has ongoing jurisdiction to resolve the dispute over the operator's entitlement to reimbursement for operating expenses under the order and to establish overhead charges comporting with current industry rates for the area.

It should also be without question that the Division has jurisdiction to address the *means* by which an operator may obtain reimbursement for operating expenses and supervision charges. In this particular circumstance, Energen's invocation of the Division's Rule 414 is consistent with, and facilitates the operator's request to obtain reimbursement from an obdurate working interest owner.

Rule 414

That the Division deemed appropriate to promulgate Rule 414 conclusively establishes the existence the agency's jurisdiction over the subject matter of this Application.

Sommer/JAS have failed to make arrangements for the sale of their gas and have refused to allow Energen to market gas on their behalf. Consequently, Energen has been prevented from recovering reimbursement of Plaintiffs' proportionate share of operating costs and supervision charges which the compulsory pooling order authorizes. The operation of the order is thwarted as a consequence. At the same time, Sommer/JAS challenge the operator's authority to sell gas for its own account or for any other interest owner, threatening that such sales constitute conversion, thereby placing the operator in an impossible position. The end-result of the Sommer/JAS reasoning, were it to be put into practice, would place all other interest owners at the mercy of the non-selling party and would prevent any sales from the well. The well would necessarily have to be shut-

in until arrangements were made to market all interest owners' gas simultaneously. Plaintiffs' position, then, directly implicates the correlative rights of the operator and other interest owners.

Correspondingly, under 19.15.6.414 NMAC, the Division has established a procedure in aid of its statutory mandate to protect correlative rights in such a situation:

19.15.6.414 Gas Sales By Less Than One Hundred Percent Of The Owners In A Well *When there are separate owners in a well and where any such owner's gas is not being sold with current production from such well, such owner may, if necessary to protect his correlative rights, petition the Division for a hearing seeking appropriate relief.*

In the process of promulgating Rule 414, the Division expressly recognized the industry practice of gas balancing. (See Order No. R-8361.) Energen does not in this case seek to have the Division write a gas balancing agreement for the parties. Rather, the Division is asked to recognize that the request for authorization to sell a portion or all of the production attributable to the pooled working interest of the non-selling mineral interest owner to enable the reimbursement of costs is consistent with long-standing industry custom and practice.

There is also precedent for oil and gas regulatory agency authorization for gas balancing in Amoco Production Company v. Thompson, 516 So. 2d 376 (La. App. 1st Cir. 1987), *writ denied* 520 So. 2d 118 (La. 1988). In Thompson, Amoco Production Company, as the operator of a compulsory pooling unit, filed an application with the Louisiana Commissioner of Conservation of the Department of Natural Resources for an order which would allow it to separately market its share of production from the unit and balance the share of the non-marketing owners at a later date. As in this case, Amoco and the non-marketing interest owners were not parties to an operating agreement. The

Louisiana Commission granted Amoco's application which was subsequently reviewed by the Louisiana Circuit Court of Appeals. That court engaged in an analysis of that state's oil and gas conservation and compulsory pooling statutes, statutes strikingly analogous to New Mexico's and went on to uphold the Commission's order authorizing the operator to separately market its share of production and implement a form of balancing for the non-marketing owner. Gas balancing and the Thompson decision is discussed further by Prof. Patrick H. Martin, in his 1990 article, *The Gas Balancing Agreement: What, When, Why and How*, (36 Rocky Mtn. Min. L. Inst. 1990; A copy of the article is being provided to the examiner and to opposing counsel.)

As indicated, Energen requests (1) the amendment of the earlier compulsory pooling order, Order No. R-1960, to include new provisions allowing for the pro-rata reimbursement of the operator's costs of operations and supervision charges which may be adjusted annually, (2) further authorizing Applicant to sell a portion or all[2] of the production attributable to the pooled working interest of the non-selling mineral interest owner to enable the reimbursement of those costs. These requests for relief neatly overlap and are not inconsistent. Further, invocation of these administrative remedies is consistent with the agency's express reservation of jurisdiction that is set forth in the 1961 compulsory pooling order.

Primary Jurisdiction

Under the Doctrine of Primary Jurisdiction, the Division must assume jurisdiction over the application in this matter. No other body, judicial, administrative or otherwise

[2] In accordance with its testimony, it is Energen's preference to have authorization to sell all of the non-marketing interest owner's share of gas production because it is more administratively efficient and less burdensome to do so.

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 oil and gas operations necessary to effect a solution to the issues raised in the Application here. Under the Oil and Gas Act, the Division is best situated to 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).

Further, Rule 1206 makes specific provision for such matters to be raised by an application filed by *"[t]he Division, attorney general, any operator or producer or any other person with standing..."* (emphasis added). Energen's interests as operator fall squarely within the zone of interests the enactment of Rule 414 are intended to protect and Energen may accordingly invoke the Division's administrative processes to protect those interests. The exercise of authority in such a manner is fully in accord with the Division's mandate "*...to do whatever may be reasonably necessary to carry out the purposes of [the oil and gas act]*.... NMSA 1978 §70-2-11 A.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 8th day of January, 2008 the foregoing was sent electronically to the following counsel of record:

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