STATE OF NEW MEXICO
COUNTY OF RIO ARRIBA
FIRST JUDICIAL DISTRICT

THE ESTATE OF JOSEPH A. SOMMER, Deceased, THE JOSEPH A. SOMMER REVOCABLE TRUST, and JAS OIL & GAS CO., LLC a New Mexico limited liability company,

Plaintiffs,

v. **No. D-117-CV-07-128**

ENERGEN RESOURCES CORPORATION, an Alabama corporation,

Defendant.

DEFENDANT'S MOTION TO DISMISS, OR IN THE ALTERNATIVE, TO STAY THESE PROCEEDINGS DUE TO THE PRIMARY JURISDICTION OF AN ADMINISTRATIVE AGENCY

Defendant, Energen Resources Corporation, ("Energen"), moves the Court enter its order dismissing Plaintiffs' Complaint or alternatively staying this matter pending the resolution of relevant proceedings presently pending before the New Mexico Oil Conservation Division, ("NMOCD" or "Division"), the administrative agency that has primary jurisdiction over the subject matter underlying the claims set forth in the Complaint.

Plaintiffs' Complaint purports to set forth claims for Unfair Trade Practices (Count I), Conversion (Count II) and violation of the New Mexico Oil and Gas Act (NMSA 1978 §§70-2-1, *et seq.)* and the Oil and Gas Proceeds Payments Act (NMSA 1978 §§70-10-1, *et seq.*) (Count III*)*. Plaintiffs' Complaint is founded on the operation of the Martinez No. 1 gas well located in Rio Arriba County, New Mexico. Defendant, Energen Resources Corporation, ("Energen"), is the current operator of the well under the authority of Compulsory Pooling Order No. R-1960, an

administrative regulatory order originally issued by the New Mexico Oil Conservation Commission ("NMOCC") in 1961.

All of Plaintiffs' allegations and the purported causes of action stemming therefrom directly implicate the statutory authority and regulations of the Oil Conservation Division under the New Mexico Oil and Gas Act, NMSA 1978 §§70-2-1, *et seq.* and the prior order of the Commission. Further, the matters raised by Plaintiffs' Complaint are the subject of an administrative proceeding currently pending before the Division. Correspondingly, the doctrine of primary jurisdiction indicates that these matters should be deferred to the administrative agency.

WHEREFORE, Defendants request the Court enter its order dismissing Plaintiffs' Complaint, or alternatively staying this matter pending the completion of the related administrative proceeding.

Defendant's memorandum in support of this Motion is filed herewith.

Respectfully submitted,

MILLER STRATVERT P.A.

By: _____

J. Scott Hall
Scott P. Hatcher
Post Office Box 1986
Santa Fe, New Mexico 87504-1986
(505) 989-9614
Attorneys for Energen Resources Corporation

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 24th day of July, 2007, the foregoing was mailed by U. S. mail, postage prepaid to the following counsel of record:

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J. Scott Hall

STATE OF NEW MEXICO
COUNTY OF RIO ARRIBA
FIRST JUDICIAL DISTRICT

THE ESTATE OF JOSEPH A. SOMMER,
Deceased, et al.,

Plaintiffs,

v.

No. D-117-CV-07-128

ENERGEN RESOURCES CORPORATION,
an Alabama corporation,

Defendant.

MEMORANDUM IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS, OR IN THE ALTERNATIVE, TO STAY THESE PROCEEDINGS DUE TO THE PRIMARY JURISDICTION OF AN ADMINISTRATIVE AGENCY

Plaintiffs' March 26, 2007 Complaint is founded on the operation of the Martinez No. 1 gas well located in Rio Arriba County, New Mexico. Defendant, Energen Resources Corporation, ("Energen"), is the current operator of the well. Energen seeks entry of the Court's order dismissing Plaintiffs' Complaint or alternatively staying this matter pending the resolution of relevant proceedings presently before the New Mexico Oil Conservation Division, ("NMOCD" or "Division"), the administrative agency that has primary jurisdiction over the subject matter underlying the claims set forth in the Complaint.

Plaintiffs' Complaint sets forth claims for Unfair Trade Practices (Count I), Conversion (Count II) and violation of the New Mexico Oil and Gas Act (NMSA 1978 §§70-2-1, *et seq.)* and the Oil and Gas Proceeds Payments Act (NMSA 1978 §§70-10-1, *et seq.*) (Count III*)*. According to their Complaint, each of these causes of action is a result of the operation by Energen and its predecessors of the Martinez Well No. 1 under the authority of Compulsory Pooling Order No. R-1960, an administrative regulatory order originally issued by the New Mexico Oil

Conservation Commission ("NMOCC") in 1961.[1] (*See Complaint, paragraphs 7 through 18.*) Plaintiffs generally challenge the operator's authority to recover operating and supervision costs from the joint account, the disposition of production from the well and the owners' entitlement to receive payment for royalty and working interest proceeds from the sale of gas.

All of Plaintiffs' allegations and the purported causes of action stemming therefrom directly implicate the statutory authority and regulations of the Oil Conservation Division under the New Mexico Oil and Gas Act, NMSA 1978 §§70-2-1, *et seq.* and the prior order of the Commission. Further, the matters raised by Plaintiffs' Complaint are the subject of an administrative proceeding currently pending before the Division. Correspondingly, the doctrine of primary jurisdiction indicates that these matters should be deferred to the administrative agency.

BACKGROUND

Plaintiff JAS Oil & Gas Company, L.L.C. succeeded to the ownership of Joseph A. Sommer, now deceased, and The Joseph A. Sommer Revocable Trust[2] in an undivided 8.3333% mineral interest in portions of the SW/4 of Section 2, T25N R3W in Rio Arriba County. In approximately 1961, Southern Union Production Company ("Supron") acquired oil and gas leases on portions of the SW/4 of Section 2 and proposed to drill a well there. To do so, Supron was required to obtain the voluntary participation by lease or other means of all the other interest owners in the SW/4 of Section 2 and to dedicate the 160-acres comprising the SW/4 to the well in conformance with the State's gas well spacing regulations. However, Plaintiffs refused Supron's offers to lease their mineral interest. Plaintiffs also refused to voluntarily participate in the drilling of the well.

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[1] The Oil Conservation Division was subsequently established by the Legislature in 1977. The Commission and the Division have concurrent jurisdiction and authority. *See NMSA 1978 §70-2-6 .B.*

[2] Referred to together as the Plaintiffs.

Rather than let unresponsive or unwilling interest owners prevent the drilling of the well and in order to exercise its correlative rights, Supron made application invoking the authority of the NMOCC for the compulsory pooling of the un-joined interests pursuant to 1953 Comp., §65-3-14[3]. On May 5, 1961 in Case No. 2249[4], the Division issued Order No. R-1960 pooling the uncommitted interests in the SW/4 of Section 2 preparatory to the drilling by Supron of the Martinez No. 1 well. (*Exhibit A*, attached.)

Subsequent to the issuance of Order No. R-1960, Supron drilled and successfully completed the Martinez No. 1 well. Supron continued to operate the Martinez No. 1 well until approximately July 23, 1982 when Union Texas Petroleum Company acquired the property and became operator of the well. On approximately June 23, 1990, Meridian Oil, Inc. acquired Union Texas Petroleum's assets and became operator of the well. Meridian was then succeeded as operator by Burlington Resources Oil and Gas Company on July 11, 1996. Taurus Exploration USA, Inc. subsequently acquired the lease and well from Burlington and became operator on August 1, 1997. On October 1, 1998, through a change of name, Taurus became Energen Resources Corporation. Applicant is the current operator of the well which continues to produce to this day.

For more than ten years, the Plaintiffs have maintained a long-running dispute with the operators of the well, including Energen, over the recovery of operating and supervision costs from the joint account, the disposition of production from the well and the owners' entitlement to receive payment for royalty and working interest proceeds from the sale of gas. In addition, despite being notified in 1992 that it should do so, Plaintiffs failed to make arrangements to market their share of gas production from the well and have refused to permit Energen and other

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[3] NMSA 1978 §70-2-17.

[4] *Application of Southern Union Production Company For An Order Force-Pooling A Standard 160-Acre Gas Proration Unit In The Tapacito-Pictured Cliffs Gas Pool, Rio Arriba County, New Mexico.*

third parties to market their share for them. (See *Exhibit B*, attached.) As a consequence, for those periods, the Plaintiffs' interests were "balanced". As is common in the industry, when a party's gas is not sold, the well may be continued to be produced for the benefit of the other interest owners so that shutting-in the well can be avoided. Gas balancing is then implemented and the account of the non-selling party is deemed to be under-produced. Plaintiffs contend that this method of operating the well is unlawful. Energen attempted to address the Plaintiffs' objections, but despite its efforts, Energen was unable to resolve these matters to the Plaintiffs' satisfaction.

Each of the Plaintiffs' objections and the matters set forth in their Complaint directly implicates the provisions and operations of Order No. R-1960. With respect to the operator's authority to recover the costs of development and operation, the unnumbered decretal portions of the Commission's Order No. R-1960 contain the following provisions:

> *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 non-consenting 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.*

In its compulsory pooling orders, the agency is required by statute to include provisions allowing the operator to be reimbursed for operating expenses and a reasonable charge for supervision:

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

It is the practice of the Division and the Commission to retain jurisdiction over their 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. Order No. R-1960 accordingly provides:

> *That jurisdiction of this cause is retained for the entry of such further orders as the Commission may deem necessary.*

Further, the Commission has adopted a specific rule that sets forth the regulatory procedure for addressing one of the central objections raised by the Plaintiffs resulting from their failure to make arrangements for the disposition of their gas. *See* Rule 414, NMAC 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. Id.*

Consequently, in view of the nature of the Plaintiffs ongoing objections, on March 9, 2007, Energen made application to the Division to address these matters. On April 30, 2007, Energen filed its Amended Application and the matter is scheduled for hearing by the NMOCD on July 26, 2007. A copy of Energen's Amended Application is attached hereto as *Exhibit C*. Each of the matters set forth in the administrative application overlays squarely the matters raised in the Complaint.

Energen has sought relief from NMOCD in order to promote the efficient and orderly operation of the Martinez Well No. 1, to protect the rights of the operator and interest owners, including their correlative rights, and to prevent waste. The determination by the NMOCD of the matters raised in the administrative proceeding should substantially resolve Plaintiffs' claims in the instant lawsuit.

POINTS AND AUTHORITIES

Plaintiffs' Complaint, and the allegations contain therein, are in denial of the customs and practices of the New Mexico oil and gas industry and circumvent the statutory scheme regulating the field. Defendant Energen has already initiated NMOCD action to resolve many of the points of contention between the parties and amend the provisions of Order No. R-1960 to better regulate the relationship between the Plaintiffs and Energen. The NMOCD is better placed than the Court to resolve the dispute between the parties at this time. Accordingly, the Court should defer to the primary jurisdiction of the NMOCD to address issues regarding well operations, cost recovery and revenue issues relating to the Martinez Well No. 1, and dismiss - or in the alternative, stay - Plaintiffs' claims against Energen.

I. THE COURT SHOULD DEFER TO THE PRIMARY JURISDICTION OF THE NMOCD

Primary jurisdiction is a doctrine of comity between courts and administrative agencies. It applies to claims that, although cognizable in court, contain some issue within the special competence of an administrative agency. *See, e.g., Schwartzman, Inc. v. Atchison, Topeka & Santa Fe Railway Co.,* 857 F. Supp. 838, 841 (D.N.M. 1994). The primary jurisdiction doctrine "provides courts with flexible discretion to refer certain matters to a specialized administrative agency." *Id.* The doctrine has been broadly recognized and adopted by New Mexico courts. *See, e.g., Norvell v. Arizona Public Service Co.,* 85 N.M. 165, 170, 510 P. 2d 98, 103 (1973). The *Norvell* court recognized that the doctrine of primary jurisdiction "comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special competence of an administrative body." *Id.* Thus, the New Mexico courts have the discretion to abstain from hearing a case that has been brought simultaneously before an administrative tribunal. *See Gandy v. Wal-Mart Stores, Inc.,* 117 N.M. 441, 445, 872 P. 2d 859, 863 (1994). A court will typically avail itself of this option when it is in

the interests of judicial economy because the agency is in a better position to fully develop the grievance. *See McDowell v. Napolitano,* 119 N.M. 696, 700, 895 P. 2d 218, 222 (1995).

Courts have generally considered the following five factors when determining whether to defer to the jurisdiction of an administrative agency:

1. whether the issue raised falls within the court's conventional experience;
2. whether a party would be subject to conflicting orders of both the court and the administrative agency;
3. whether relevant agency proceedings have actually been initiated;
4. whether the agency involved has demonstrated diligence in resolving the issue; and
5. the type of relief sought by the claim.

See Schwartzman, 857 F. Supp. 838 at 842-843. A strong majority of these factors militate in favor of dismissing, or in the alternative, staying the proceedings in Plaintiffs' lawsuit and deferring to the primary jurisdiction of the NMOCD. A review of each factor follows.

A. The NMOCD Has The Special Expertise As Well As The Jurisdiction To Determine The Rights and Responsibilities Of Energen As Well Operators.

The NMOCD is singularly qualified to determine the rights and responsibilities of Energen and the Plaintiffs with respect to well operations, disposition of gas and revenues, and the recovery of operating costs associated with the Martinez Well No.1 – the very matters which underpin Plaintiffs' lawsuit. The NMOCD originally made these determinations in 1961 when issuing Order R-1960, and has expressly retained jurisdiction to amend the Order as it deems necessary. *See* Background, *infra.* Based on its broad statutory authority and unparalleled technical expertise, the NMOCD has the special competence to resolve this dispute over operating costs and revenues. The expertise of the NMOCD has been acknowledged by the New Mexico Supreme Court. In *Grace v. Oil Conservation Comm'n,* 87 N.M. 203, 531 P. 2d 939 (1975), the Court affirmed that NMOCD decisions are accorded special weight and credence in light of the Division's technical competence and specialized knowledge.

The Commission, concurrently with the Division, has jurisdiction over "all matters relating to the conservation of oil and gas ... in this state." Section 70-2-6A NMSA (1935). The NMOCD has "jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of the [Oil and Gas] Act or any law of this state relating to the conservation of oil or gas." *Id.* The Oil and Gas Act entrusts the NMOCD with two major duties: the prevention of waste and the protection of correlative rights. *See* Section 70-2-11 NMSA 1978 (1935); *see also Continental Oil Co. v. Oil Conservation Comm'n,* 70 N.M. 310, 323, 373 P. 2d 809, 817 (1962).

These NMOCD powers broadly encompass prevention of underground waste, defined as the "prevention of inefficient, excessive or improper use or dissipation of reservoir energy" and "the locating, spacing, drilling, equipping, operating or producing, of any well or wells in a manner to reduce or tend to reduce the total quantity of ... natural gas ultimately recovered from the pool." Section 70-2-33H NMSA 1978 (1935). The power of the NMOCD further extends to protect the correlative rights between owners without waste. *See* Section 70-2-33H NMSA 1978 (1935); *see also Continental Oil,* 70 N.M. 310 at 323-24, 373 P. 2d at 814-14. The goal is to avoid the waste of an irreplaceable natural resource. *See El Paso Natural Gas Co. v. Oil Conservation Comm'n,* 76 N.M. 268, 414 P. 2d 496 (1966). To that end, the NMOCD may make and enforce rules, regulations, and orders and do "whatever is necessary to carry out the purpose of the [Oil and Gas] Act, whether or not indicated or specified in any section hereof." Section 70-2-11A, NMSA 1978 (1935).

The determination of drilling, development and operating costs and well operations is a complex area that has been regulated by the agency since 1935. The NMOCD is not only intimately familiar with the statutory and regulatory scheme governing this field, it also has the institutional expertise to address the technical issues related to well operations that are central in

this dispute. Defendant Energen has already initiated proceedings with the NMOCD to do just that. *See* Exhibit C at 3-4. For both of these reasons, this Court's deference to the administrative judgment of the NMOCD is appropriate.

Plaintiffs have disputed the operating expenses and supervision charges for the well. In addition, they have failed to make arrangements for the sale of their gas and have refused to permit the operator to market gas on their behalf. As a consequence, Energen, as operator of the well, has been prevented from deducting proportionate operating costs and supervision charges that are allocable to the Plaintiffs interests under the compulsory pooling order. Plaintiffs also assert that Energen may not sell its gas or any other interest owner's gas from the well when the Plaintiff's working interest share is not being marketed. To remedy this situation, Energen's administrative application asks the Division enter its Order (1) amending 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.

Given the specialized nature of the issues involved in the oil and gas industry, and in the operation of the Martinez Well No.1 in particular, the Court would have to venture well beyond the boundaries of conventional judicial experience in determining the proper outcome of this case. While the Court could undertake that demanding task, there is no reason for it to do so at this time. Conversely, there are compelling reasons for the court to defer to the NMOCD. The agency is "a body far better suited" to resolve the complex issues at stake "by reason of 'specialization, by insight gained through experience, and by more flexible procedure.'" *Schwartzman,* 857 F. Supp. At 842, *quoting Far East Conference v. United States,* 342 U.S. 570, 575 (1952).

B. Energen Could Be Subject to Conflicting Orders from the Court and NMOCD

As noted above, Energen has already instituted proceedings with the NMOCD to address the cost recovery provisions of Order R-1960 and the under-production of Plaintiffs in the Martinez Well No. 1. If, as Energen expects, the NMOCD grants the relief requested in its Application, there is a very real possibility that any relief ordered by this Court could conflict with the administrative agency's order. Such a conflict would create needless logistical difficulties for both Energen and Plaintiffs and could only be resolved by resorting, once again, to the judicial or administrative processes. Such an outcome is not in the interests of judicial economy or any of the parties to this lawsuit.

One purpose of the doctrine of primary jurisdiction is to promote uniformity and harmony in the regulatory sphere the agency is trusted to govern. *See Schwartzman,* 857 F. Supp. at 842. The potential threat of conflicting orders is neither warranted nor justified. The Court should defer to the ongoing efforts of the NMOCD to avoid the very real potential for conflict.

C. NMOCD Action Has Been Initiated

Energen's administrative application to the NMOCD pre-dates the filing of the Plaintiffs' Complaint. A hearing before the NMOCD on the merits of the application is set for July 26, 2007. The fact that agency work is well underway makes the application of the primary jurisdiction doctrine particularly appropriate in this case. "It is axiomatic that the advisability of invoking primary jurisdiction is greatest where the issue is already before the agency." *Schwartzman,* 857 F. Supp. at 842, quoting *Roberts v. Chemlawn Corp.,* 716 F. Supp. 364 (N.D. Ill. 1989).

Here, just as in *Schwartzman,* the relevant agency has already begun the process of reviewing this matter. Any effort by the Court to impose new and potentially different demands

on that process through a separate order would, at best, merely duplicate the NMOCD efforts. More likely, however, it would serve to complicate this process, thereby creating even further confusion among the parties regarding gas production costs and revenues on the Martinez Well No. 1.

D. The NMOCD Has Demonstrated Proper Diligence

With the hearing on the merits of the administrative application set for July 26, 2007, there is every reason to expect that the NMOCD will issue a ruling on this matter long before the instant lawsuit has reached the point of resolution. No reason for delaying the administrative proceeding has been indicated.

E. Relief

The type of relief requested by Plaintiffs should be considered when the primary jurisdiction doctrine has been asserted. *See Schwartzman,* 857 F. Supp. at 843. The doctrine is most readily applicable when injunctive relief requiring scientific or technical expertise is requested. *See id.* Energen concedes that is not in the case in this lawsuit: Plaintiffs' are seeking the type of relief courts routinely consider - money damages. However, even in this case for money damages, technical expertise will be required. The relief being sought by Plaintiffs directly implicates well operations.

Plaintiffs' limited understanding of the oil and gas industry permeates both the factual allegations of the Complaint and the relief requested. The NMOCD is perfectly situated to resolve the matters of cost recovery provisions, revenues, and under-production with regard to the operation of the Martinez Well No. 1. The NMOCD is empowered to amend the cost recovery provisions of Order No. R-1960 to reflect the current custom and practice of the industry. An amended pooling order would provide certainty with regard to the proper calculation of costs and revenues attributable to Plaintiffs, and would substantially resolve this

lawsuit. If, at such a time when NMOCD has addressed this matter, Plaintiffs still have grievances, they would be entitled to re-file this lawsuit – or, in the alternative, have the stay on these proceedings lifted – to seek redress from Energen. A court dealing with the lawsuit at that stage, however, would have the invaluable benefit of NMOD expertise on which to rely.

CONCLUSION

For all of the foregoing reasons, Energen respectfully requests that the Plaintiffs' claims be dismissed, without prejudice, in favor of the primary jurisdiction of the New Mexico Oil Conservation Division. In the alternative, Energen respectfully requests that Plaintiffs' claims be stayed pending the outcome of the Energen Application currently before the NMOCD.

Respectfully submitted,

MILLER STRATVERT P.A.

By: _____

J. Scott Hall
Scott P. Hatcher
Post Office Box 1986
Santa Fe, New Mexico 87504-1986
(505) 989-9614

Attorneys for Energen Resources Corporation

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 24th day of July, 2007, the foregoing was mailed by U.S. mail, postage prepaid to the following counsel of record:

Kurt A. Sommer, Esq.
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James Bruce, Esq.
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Santa Fe, New Mexico 87504

_____
J. Scott Hall

BEFORE THE OIL CONSERVATION COMMISSION
OF THE STATE OF NEW MEXICO

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

CASE No. 2249
Order No. R-1960

APPLICATION OF SOUTHERN UNION PRODUCTION COMPANY FOR AN ORDER FORCE-POOLING A STANDARD 160-ACRE GAS PRORATION UNIT IN THE TAPACITO-PICTURED CLIFFS GAS POOL, RIO ARRIBA COUNTY, NEW MEXICO.

ORDER OF THE COMMISSION

BY THE COMMISSION:

This cause came on for hearing at 9 o'clock a.m. on April 19, 1961, at Santa Fe, New Mexico, before A. L. Porter, Jr., Examiner duly appointed by the Oil Conservation Commission of New Mexico, hereinafter referred to as the "Commission," in accordance with Rule 1214 of the Commission Rules and Regulations.

NOW, on this 5th day of May, 1961, the Commission, a quorum being present, having considered the application, the evidence adduced, and the recommendations of the Examiner, A. L. Porter, Jr., and being fully advised in the premises,

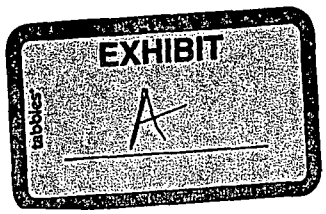
FINDS:

(1) That due public notice having been given as required by law, the Commission has jurisdiction of this cause and the subject matter thereof.

(2) That the applicant, Southern Union Production Company, is the owner and operator of Federal Lease No. NM 014856, comprising the N/2 SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, Rio Arriba County, New Mexico.

(3) That the applicant seeks an order force-pooling all mineral interests in the Tapacito-Pictured Cliffs Gas Pool in the SW/4 of said Section 2, in order to form a 160-acre gas proration unit.

(4) That inasmuch as denial of the subject application would deprive, or tend to deprive, the mineral interest owners in the above-described 160-acre tract of the opportunity to recover their just and equitable share of the hydrocarbons in the Tapacito-Pictured Cliffs Gas Pool, all mineral interests therein should be force-pooled.



(5) That the applicant should furnish the Commission with an itemized schedule of well costs upon completion of a well on the subject gas proration unit.

IT IS THEREFORE ORDERED:

That the interests of all persons having the right to drill for, produce, or share in the production of hydrocarbons from the Tapacito-Pictured Cliffs Gas Pool underlying the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, Rio Arriba County, New Mexico, are hereby force-pooled to form a standard 160-acre gas proration unit comprising all of said acreage. Said unit is to be dedicated to a well to be located at an orthodox location thereon.

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 non-consenting 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.

PROVIDED FURTHER, That the applicant shall furnish the Commission with an itemized schedule of well costs upon completion of a well on the subject gas proration unit.

IT IS FURTHER ORDERED:

That jurisdiction of this cause is retained for the entry of such further orders as the Commissiom may deem necessary.

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

EDWIN L. MECHEM, Chairman

E. S. WALKER, Member

A. L. PORTER, Jr., Member & Secretary

S E A L

esr/

MERIDIAN OIL

March 17, 1992

Dear Joint Working Interest Owners:

Our records reflect that you are a joint working interest owner in a well or wells operated by one of the following Meridian Oil production affiliates, Meridian Oil Inc., Meridian Oil Production Inc., Southland Royalty Company or El Paso Production Company, collectively referred to herein as "Meridian Oil." Under the terms of various Joint Operating Agreements, Meridian Oil, as operator, has the right to sell the gas of those parties failing to dispose of their share of gas. The purpose of this letter is to notify you that effective May 1, 1992, Meridian Oil will no longer exercise this right.

Meridian Oil encourages you to immediately begin to investigate the marketing opportunities available to you and to have your arrangements in place prior to May 1, 1992. As previously communicated in our letter dated August 12, 1991, Meridian Oil sells its undedicated gas at the wellhead to its marketing affiliate, Meridian Oil Trading Inc. Under separate cover, you can anticipate receiving an offer from Meridian Oil Trading Inc. to purchase your gas pursuant to the terms of a gas contract.

Beginning May 1, 1992, Meridian Oil, as operator, will not sell gas attributable to your interest under the terms of any Joint Operating Agreements. If you choose not to sell your gas, the respective Joint Operating Agreements and the appropriate balancing agreements in place will control your right to production volumes and revenues. If no such agreements exist, applicable state laws will be applied.

If you desire to sell your gas to a purchaser other than Meridian Oil Trading Inc., which you are free to do, you will be required to comply with the scheduling procedures of Meridian Oil, any gatherer or transporting pipeline. You may call a Meridian Oil representative at 713/831-1691 during normal business hours for answers to any questions concerning scheduling procedures.

Very truly yours,

Randolph P. Mundt
Senior Vice President

cwh

1-800-398-5581

NMOCD CASE #13957
ENERGEN RESOURCES
EXHIBIT

EXHIBIT
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MAR 20 1992

STATE OF NEW MEXICO
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES
OIL CONSERVATION DIVISION 2007 APR 30 PM 3 20

IN THE MATTER OF THE 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. _____

AMENDED APPLICATION

ENERGEN RESOURCES CORPORATION, by its undersigned attorneys, Miller, Stratvert, P.A., (J. Scott Hall) hereby makes application pursuant to NMSA 1978 §70-2-17 (1995) for an order amending the cost recovery provisions of Order No. R-1960 pooling all interests in the Pictured Cliffs formation, (Tapacito-Pictured Cliffs Gas Pool) underlying the SW/4 of Section 2, Township 25 North, Range 3 West, NMPM, Rio Arriba County, New Mexico, forming a standard 160-acre spacing and proration unit. Applicant also seeks authorization to sell a portion or all of the pooled working interest share of production of a non-selling mineral interest owner and to obtain reimbursement of costs therefrom. In support thereof, Applicant would show the Division:

1. On May 5, 1961, pursuant to a hearing held on April 19, 1961 in Case No. 2249[1], the Division issued Order No. R-1960 pooling certain uncommitted interests in the SW/4 of Section 2 preparatory to the drilling by Southern Union Production Company, ("Supron"), of its Martinez No. 1 well at a standard location in the N/2 SW/4 of said Section 2 to a depth sufficient to test the Pictured Cliffs formation. (*Exhibit 1*, attached.)

EXHIBIT C tabbies

[1] *Application of Southern Union Production Company For An Order Force-Pooling A Standard 160-Acre Gas Proration Unit In The Tapacito-Pictured Cliffs Gas Pool, Rio Arriba County, New Mexico.*

2. The evidence at the hearing established that the Applicant in that case owned or controlled 100 percent of the available working interest in the N/2 SW/4 of Section 2 and that Applicant sought to pool the remaining interests, including unleased mineral interests, whose owners did not agree to participate in the drilling of the well. The quantum of non-participating interests constituted a relatively small percentage of the interests in the unit. The Commission accordingly granted Supron's request to pool those interests.

3. Subsequent to the hearing and the issuance of Order No. R-1960, Supron drilled and successfully completed the Martinez No. 1 well in the Pictured Cliffs formation. Supron continued to operate the Martinez No. 1 well until approximately July 23, 1982 when Union Texas Petroleum Company acquired the property and became operator of the well. On approximately June 23, 1990, Meridian Oil, Inc. acquired the well and became operator. Meridian was then succeeded as operator by Burlington Resources Oil and Gas Company on July 11, 1996. Taurus Exploration USA, Inc. subsequently acquired the lease and well from Burlington and became operator on August 1, 1997. On October 1, 1998, through a change of name, Taurus became Energen Resources Corporation. Applicant is the current operator of the well.

4. The unnumbered decretal portions of Order No. R-1960 contained the following provisions authorizing the operator to recover the costs of development and operation:

> *"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 non-consenting 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."*

5. In its compulsory pooling orders, the Division is required by statute to include provisions allowing the operator to be reimbursed for operating expenses and a reasonable charge for supervision:

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

6. It has been the practice of the Division 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.

7. JAS Oil and Gas Co., LLC, the successor to one of the owner's whose unleased mineral interests were pooled under Order No. R-1960 has disputed the operator's entitlement to reimbursement for reasonable operating costs, as wells as supervision costs, and the method for reimbursing such costs.

8. 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:

> *( ) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $5000 per month while drilling and $500 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

9. Applicant proposes the amendment of the cost recovery provisions under the original version of Order No. R-1961 to reflect the current custom and practice of the industry and the Division which allows well operators to recover the costs of operations and supervision and which may be periodically adjustable.

10. Applicant seeks an order amending Order No. R-1961 retroactively by substituting the unnumbered decretal portions of the Order set forth in Paragraph 4, above, with contemporary compulsory pooling cost recovery provisions in substantially the same form as reflected in Paragraph 8, above, and at reasonable rates.

11. In addition to disputing the operator's entitlement to reimbursement for reasonable operating costs and charges, the interest owner referenced in paragraph 7, above, and its predecessors, has failed to take its share of production in-kind or otherwise market or dispose of its working interest share of gas production, and has further refused to permit Applicant and other third parties from marketing or disposing its share. When a party's gas is not sold, the well may be continued to be produced for the benefit of the other interest owners. Gas balancing is then implemented and the account of the non-selling party is deemed to be under-produced.

12. As a consequence of the referenced interest owner's failure and refusal to market its gas, there have been no sales proceeds attributable to its seven-eighths working interest and Applicant has been prevented from deducting that interest owner's share of costs and expenses from production.

13. Simultaneous with its failure and refusal to arrange or permit the sale or disposition of its seven-eighths working interest share of production, the referenced interest

owner has simultaneously demanded payment for eight-eighths. Under circumstances such as these, NMSA 1978 §70-2-17 C does not require that more than one-eighth be paid to an unleased mineral interest owner whose interest is pooled.

14. The failures and refusals of the interest owner to sell its gas, its demands for payment and the inability of the operator to obtain reimbursement for monthly operating expenses frustrate the operation of the agency's compulsory pooling order and circumvent the Oil and Gas Act.

15. Applicant seeks authorization to sell a portion of JAS Oil & Gas Co. LLC's pooled working interest in sufficient amounts to permit Applicant to obtain the prorata reimbursement for such costs and charges the Division determines are proper. Alternatively, Applicant seeks authorization to sell all of the working interest share of production attributable to the JAS working interest and seek appropriate reimbursement from a portion of the proceeds therefrom.

16. The Division has ongoing jurisdiction over its compulsory pooling orders by virtue of the express terms thereof, and pursuant to, *inter alia,* NMSA 1978 §70-2-17 C. The Division also has authority to accord appropriate relief under Rule 414 (NMAC 19.15.6.414: **Gas Sales By Less Than One Hundred Percent Of The Owners In A Well.)**

17. Granting the relief requested will promote the efficient and orderly operation of the subject well, will protect the rights of the operator and the interest owners, will serve to protect correlative rights, prevent waste and is otherwise in the interests of conservation.

WHEREFORE Applicant requests that this Application be set for hearing before a duly appointed examiner of the Oil Conservation Division on July 26, 2007 and that after

notice and hearing as required by law, the Division enter its Order (1) amending Order No. R-1960 to include new provisions reflecting the current custom and practice of the industry and the Division allowing for the prorata reimbursement of the operator's costs of operations and supervision, (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.

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