



**MONTGOMERY
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August 7, 2009

Florene Davidson
New Mexico Oil Conservation Division
1220 S. St. Francis Drive
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HAND DELIVERED

Re: NMOCD Case No. 14331: First Amended Application of XTO Energy Inc. for Compulsory Pooling and Downhole Commingling, San Juan County, New Mexico

Dear Ms. Davidson:

Enclosed for filing is and original and two copies of SG Methane Company's Supplement to its Response to XTO Energy's Objections to Subpoena.

Very truly yours,

J. Scott Hall

JSH:kw
Enclosures

cc: W. Thomas Kellahin
Richard Ezeanyim
David Brooks

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

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IN THE MATTER OF THE FIRST AMENDED
APPLICATION OF XTO ENERGY INC. FOR
COMPULSORY POOLING AND DOWNHOLE
COMMINGLING, SAN JUAN COUNTY, NEW MEXICO

CASE NO. 14,331

SUPPLEMENT TO

**S.G. METHANE COMPANY'S RESPONSE TO
XTO ENERGY'S OBJECTIONS TO SUBPOENA**

At the request of the Division's Examiner and counsel, SG Methane Company, ("SG"), provides this supplement to its earlier response to XTO Energy, Inc.'s Objections To Subpoena Dated July 8, 2009. This supplemental response briefly addresses (1) whether in this case the well logs and other geologic information derived from the drilling of a well may qualify as a "trade secret", and (2) whether such information may be withheld from a co-owner of the property from where the information is derived.¹

Summary

SG and XTO both own oil and gas leasehold working interests in the Pictured Cliffs formation underlying the NE/4 of Section 24, T29N, R10W in San Juan County. It is undisputed that both companies had the right to explore for, develop and produce oil and gas pursuant to their lease interests. In November of 2008, XTO unilaterally entered onto the co-owned lands and drilled the Martinez Gas Com D Well No. 001R. XTO drilled the well before obtaining the

¹ The only information and materials at issue are (a) well logs; (b) DST results (gas curve and penetration rates; and (c) daily drilling reports. Seismic data and other similar geophysical information are not being sought.

participation of all the interest owners in the NE/4 of Section 24. The parties were subsequently unable to come to terms on an agreement for SG's participation in the well and XTO's compulsory pooling proceeding was commenced. SG Methane is now faced with defending its position in the pooling proceeding. Among the several issues to be decided are: (1) whether SG will be allowed to assess the geologic risks and make an informed decision whether to participate in the well; (2) justification and reasonableness of well costs; (3) the proper allocation of costs among owners and depths; and (4) whether a risk penalty is appropriate for a pre-drilled well.

On July 8, 2009, at the request of SG Methane, the Division issued its Subpoena Duces Tecum specifying the discovery of a number of items before the hearing on the merits on the Application in this case. On July 13, 2009, XTO objected to the Division's subpoena. In a number of instances, XTO asserted that the information sought is protected by the privileges accorded to confidential trade secrets. In no case did XTO indicate that it was withholding seismic data, estimates of reserves or other similar analytical information. SG does not seek to obtain such interpretive information. Rather, SG's seeks to obtain only the underlying data such as well logs and test results.² See February 15, 1991 Ruling of the Commission; Case No. 10211; Application of Santa Fe Energy Operating Partners, L.P., for Compulsory Pooling, Lea County, New Mexico (Exhibit A).

SG's right to discovery.

XTO's trade secrets objection notwithstanding, it is beyond dispute that SG is entitled to discovery of the information it seeks. The information is clearly "pertinent" within the meaning of NMSA 1978 Section 70-2-8. Under applicable case law, discovery will be required unless the

² In this regard, 19.15.7.16 C of the Division's rules provides that on the operator's request, C-105 data and well logs can be held confidential for 90 days following a well's completion. "...*provided, however, that the report, logs and other attached data may, when pertinent, be introduced in a public hearing before division examiners, the commission or in a court of law regardless of the request that they be kept confidential...*".

matters inquired into have "no possible bearing upon" the subject matter of the action. United Nuclear Corp., 96 N.M. at 174, 629 P.2d at 250. Broad discovery is firmly established as Division policy under directly applicable precedent orders. Two of several examples are: (Case No. 13492; *Application of Mewbourne Oil Company for Cancellation of Two Drilling Permits and Approval of a Drilling Permit, Lea County, New Mexico, Order No. R-12343-A*; and Case No. 13603; *Application of Devon Energy Corporation for Compulsory Pooling*; consolidated with Case No. 13628; *Application of LCX Energy LLC for Compulsory Pooling, Lea County, New Mexico, Order No. R-12511*. In both of these cases, trade secrets objections were overruled by the Division.

Trade secrets.

To withhold discovery under the privilege justification of Rule 11-508 NMRA 2004, XTO must first demonstrate that the information or materials qualify as "trade secrets".

New Mexico adopted the Uniform Trade Secrets Act in 1989. N.M. Stat. Ann. §§57-3A-1 to 57-3A-7 (1989). Under §57-3A-2 D, "*trade secret*" means information, including a formula, pattern, compilation, program, device, method, technique or process, that:

(1) *derives independent economic value, actual or potential, from not being generally known to and not being readily ascertainable by proper means by other persons who can obtain economic value from its disclosure or use; and*

(2) *is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.*

XTO has not demonstrated any one of these components. Its blanket objection, without more, is an insufficient basis for invoking the privilege as a basis for withholding all the data and materials sought.

The Co-Tenancy Relationship.

With the ownership of their respective lease interests in the NE/4 of Section 24, it should be undisputed that both SG and XTO are the owners of the “right to exploration”, a protected property right. See Phillips Petroleum Co. v. Cowden, 241 F.2d 586, 590 (5th Cir. 1957.) Each company could reasonably be said to be a co-tenant to the other and each had operating rights or the “right to drill” within the meaning of NMSA 1978 §70-2-17. This relationship was fundamentally changed when XTO unilaterally entered onto the lands to drill the Martinez Gas Com D Well No. 1. At that point, XTO appropriated exclusively to itself the right to drill and operate in this subdivision and SG is now effectively precluded from obtaining any data on its own. Consequently, the co-tenancy relationship was altered: one co-tenant has appropriated an outstanding *adversarial* or superior interest of claim to one element of the co-tenancy property that it seeks to assert exclusively for itself: the operating rights. Under such circumstances, courts have determined that a fiduciary relationship will arise under the co-tenancy. See generally, 2 The American Law of Property § 6.16 at 67 – 69 (A. Casner, ed. 1952).

Now in a superior position, the withholding of well information by XTO is inconsistent with the fiduciary duties that XTO may have to its disadvantaged co-tenant. At a minimum, withholding the data would also be inconsistent with the duties of “utmost” good faith and fair dealing that the owner of the executive rights or the operating rights would owe its co-owners.

Such fiduciary obligations requires that if one co-tenant acquires an outstanding, paramount or hostile right then he may within a reasonable time be compelled, upon reimbursement, to let his co-tenant participate in the benefits of his purchase. *Sharples Corp. v. Sinclair Wyoming Co.*, 167 P.2d 29, 34, 62 Wyo. 341, 357 (Wyo. 1946). When a superior or

paramount right exists, one cotenant cannot make an *adversary* claim to the common estate and assert it for his exclusive benefit, to the injury and prejudice of the other co-tenants *Id.* at 37.

A fiduciary duty arises not from any contract between them, but from the *relationship* of the parties, which requires that the holder of the executive right acquire for the non-executive party every benefit that he exacts for himself. *Manges v. Guerra*, 673 S.W.2d 180, 183 (Tex. 1984).

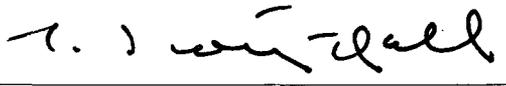
In *Manges v. Guerra*, 673 S.W.2d 180, (Tex. 1984), the defendant purchased mineral rights from various estates, and thereby created a co-tenancy between him and the plaintiffs. The sale made to the defendant included the executive right to the one-half mineral interest reserved by the plaintiffs. The plaintiffs allege that the defendant used its executive powers to only benefit himself and not extend the same benefit to the non-executive co-tenants by selling all of the oil and gas produced by the estate, without consulting or even informing the plaintiffs of this transaction. *Id.* at.182

The Court held that the possessor of an executive right owes to the co-mineral owners a duty to use the “utmost good faith and fair dealing” as to the interest of the non-executive mineral interest owners. The court went on to say that while a contract or deed may create the relationship, the duty of the executive arises from the relationship and not from express or implied terms of the contract or deed. “That duty requires the holder of the executive right . . . to acquire for the non-executive every benefit that he exacts for himself.” *Id.* at 184 citing to R. Hemmingway, *The Law of Oil & Gas*, 2.2(D) (2d ed. 1983). In other words, the benefits must be shared and this should by logic apply to well information.

Conclusion

XTO's position directly contravenes the well-established authority requiring compliance with a pre-hearing discovery subpoena. Neither has XTO established that the information it seeks to withhold qualifies for trade secret protection. XTO's unilateral conduct has altered the co-tenants' relationship, giving rise to a fiduciary relationship and a duty of utmost good faith and fair dealing. XTO's refusal to provide well information is inconsistent with its duties under such a relationship. XTO may not exercise its superior position to withhold data and materials in this way in order to gain an unfair advantage in a compulsory pooling proceeding.

MONTGOMERY & ANDREWS, P.A.

By: 

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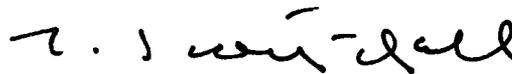
Certificate of Service

I hereby certify that a true and correct copy of the foregoing was e-mailed to counsel of record on the 7th day of August, 2009 as follows:

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J. Scott Hall

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

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

Case 10211

APPLICATION OF SANTA FE ENERGY OPERATING
PARTNERS, L. P., FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO, BEING HEARD BY THE
COMMISSION AS AN INTERLOCUTORY APPEAL FROM AN
ORDER OF THE EXAMINER SUSTAINING CERTAIN PORTIONS
OF A SUBPOENA DUCES TECUM.

RULING OF THE COMMISSION

BY THE COMMISSION:

This matter came before the Oil Conservation Commission of New Mexico hereinafter referred to as the "Commission" at 9:00 a.m. on January 17, 1991, at Santa Fe, New Mexico.

NOW, on this 15th day of February, 1991, the Commission, a quorum being present, having considered the argument of counsel and being fully advised in the premises,

FINDS THAT:

(1) The Commission has jurisdiction of this cause and the subject matter thereof, and no additional notice is required for this interlocutory-type hearing.

(2) Santa Fe Energy Operating Partners, L.P. ("Santa Fe") filed an application with the Division seeking to compulsory pool mineral interests, including those of Hanley Petroleum, Inc., in the W/2 NW/4 of Section 8, Township 18 South, Range 3 East, NMPM, Lea County, New Mexico; said proration unit to be dedicated to the Kachina "8" Federal No. 2 to be drilled at an orthodox location in a separate proration unit.

(3) On January 3, 1991, at the request of Hanley Petroleum, Inc. and pursuant to Division Rule 1211, the Director signed a Subpoena (attached hereto as Exhibit A) directing Santa Fe to produce certain documents, as identified in the separate paragraphs, relating to information on the Kachina "8" Federal Well No. 1, a tight hole, located in

EX. A

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the NE/4 NW/4 of Section 8, Township 18 South, Range 33 East, NMPM, Lea County, New Mexico.

(4) On January 9, 1991, Santa Fe Energy Operating Partners, L.P. filed a motion to quash the aforementioned Subpoena.

(5) On January 10, 1991, the Examiner heard argument of Counsel on the Motion to Quash the Subpoena in Case No. 10211 and ruled orally that Hanley was not entitled to receive those items requested in the Subpoena which were the result of Santa Fe's interpretation of data or information which was available from other sources, including Oil Conservation Division records. The Examiner therefore quashed the request for item no. 6 reserve calculations, item no. 7 reservoir studies, item no. 8 economic studies, and item no. 10 geologic interpretations. The Examiner further ruled that Hanley was entitled to receive and the Subpoena should stand with respect to requests for raw data which include item 1 pressure data, item 2 mechanical and mud logs, item 3 gas-oil ratio tests, item 4 specific gravity information, item 5 production information, and item 9 daily drilling and completion reports, as those items relate to the Kachina "8" Federal Well No. 1. The Examiner further ordered that these items be produced and made available to Hanley under an order of confidentiality and that Hanley be prohibited from disclosing this information to any other person.

(6) On January 14, 1991, Santa Fe requested from the Division, that the Commission consider an appeal of the Examiner's decision, reverse the Examiner and quash the Subpoena in toto. All parties involved concurred with the request for an appeal to the Commission to consider the matter.

(7) There are no expiring leases in Section 8 requiring a well to be drilled expeditiously.

(8) The Division recognizes that it has been industry practice to honor and to hold confidential information which a party has acquired by drilling a well and to allow that party spending their money to acquire that information the opportunity to use it for their competitive advantage.

(9) Rule 1212 of the Rules and Regulations of the Oil Conservation Division states that the rules of evidence normally applicable in court proceedings can be relaxed where the ends of justice can be better served, and the Commission has implemented this concept by limiting the discovery principal in its application to very explicit areas involving waste and correlative rights.

(10) Santa Fe argues that because it has offered to make the information requested available to Hanley if Hanley will commit beforehand to either farm-out or to join in the drilling of the well, that it should not.

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be required to disclose the information prior to Hanley making that commitment.

(11) Hanley was unwilling to commit its interest to the well in any manner without receiving the information from Santa Fe and Santa Fe therefore filed this forced pooling application pursuant to the Oil & Gas Act asking the Division to use the police powers of the State to force a private property interest to be committed to this drilling venture. As a result, Hanley is forced to decide between accepting Santa Fe's farm-out offer, joining in the drilling of the well by paying its proportionate share of costs in advance or being force pooled and allowing Santa Fe to recover out of production Hanley's proportionate share of drilling and completing and equipping the well, plus a risk penalty established by the Division, without having access to information about a direct offset well operated by Santa Fe which information is now available only to Santa Fe.

(12) When a party asks the Division to use the police power of the State to impose a burden upon a private property interest, minimum due process requires a departure from usual industry practice with respect to the disclosure of the information, and Hanley should be allowed access to the raw data information from the offsetting Kachina "8" Federal No. 1 well which is not otherwise available from public sources, but it should not be allowed to compel Santa Fe to produce Santa Fe's interpretations of this data, whether or not those interpretations are based on information from just this well or from all of the available information.

(13) Rule 1105 of the Rules and Regulations of the Oil Conservation Division requires the filing of Form C-105 which includes all special tests conducted on the well (item 1, 3, 4, and 5 of the Subpoena), one copy of all electrical and radio-activity logs run on the well (part of item 2 of the Subpoena), which information becomes of public record immediately, or if so requested by the operator of the well, after being held confidential for 90 days. Daily drilling and completion reports (item 9 of the Subpoena) could be public record if they contain testing information. Rule 1105 further provides that the data may be introduced in public hearing regardless of the request that it be held confidential.

(14) Santa Fe could keep all information on the Kachina "8" Federal No. 1 well confidential for 90 days from completion if it dismisses the pending application and does not seek to involve the police powers of the State to force pool Hanley.

(15) In order to comply with minimum due process requirements implicated by State action and to protect the correlative rights of Hanley, Santa Fe should be required to provide sufficient information for Hanley to make an informed decision as to which of the alternatives set forth above it elects to follow by having access to data which normally

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accompanies Form C-105 but none of the interpretative information from the Kachina "8" Federal No. 1 well which is in the possession of Santa Fe and not normally a part of the public record. The information should be disclosed only to Hanley and subject to prohibition against Hanley revealing that information to any other person, provided however, that such data may be introduced at the hearing and become part of the public hearing record.

(16) The disclosure of information required by this order should only be available to parties to a case where property rights are immediately and directly affected by the imposition of police power on those rights.

IT IS THEREFORE ORDERED THAT:

(1) The order of the Examiner quashing the Subpoena with respect to items 6, 7, 8 and 10 is hereby upheld and the Subpoena is hereby quashed with respect to those items.

(2) The order of the Examiner holding the Subpoena and requiring the documents identified in paragraph (1), (3), (4) and (5) is upheld in its entirety.

(3) The order of the Examiner requiring the production with respect to items no. 2 and no. 9 is modified and Santa Fe must produce these documents requested in those paragraphs as follows:

(a) mechanical logs (all electrical and radio-activity logs); and

(b) any testing information contained in daily drilling and completion reports from inception to the latest available data.

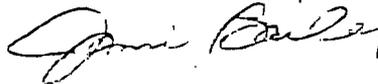
(4) Santa Fe is hereby directed and required to produce to the Division within ten days from the date of this order for the use of Hanley Petroleum those documents identified in ordering paragraphs (2) and (3).

(5) This production and discovery shall be for the exclusive use of Hanley Petroleum, Inc. and Hanley shall not reveal any information produced in accordance with this order to any other person for any reason so long as such information is confidential pursuant to the Rules and Regulations of the Division.

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Page 5

(6) Done at Santa Fe, New Mexico, on the day and year hereinabove designated.

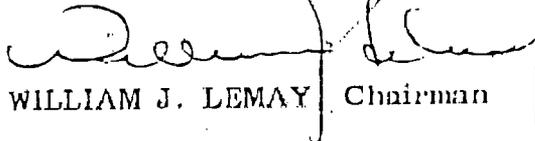
STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION



JAMI BAILEY, Member



WILLIAM W. WEISS, Member



WILLIAM J. LEMAY, Chairman

S E A L

dr/