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Via Email & FEDEX

Members, Board of Oil & Gas Conservation
State of Montana
2535 St. Johns Avenue
Billings, Montana 59102

Re: Docket No. 73-2018 – Chaco Energy Company's Request for Rehearing

Gentlemen:

Please consider this letter as the objection of Denbury Onshore LLC ("Denbury") to Chaco Energy Company's ("Chaco") December 28, 2018 request for a rehearing of Docket No. 73-2018. Chaco's request should be denied for the following reasons.

- A rehearing pursuant to Mont. Code Ann. § 82-11-143 contemplates some ***material*** substantive change in the facts or arguments presented at the original hearing. Chaco's December 28, 2018 letter fails to raise any new facts or arguments – Chaco simply doesn't like the Board's decision. The fact is, Chaco's "lost" production from the Interlake Formation was discussed at length throughout the hearing, and ultimately, it was unanimously determined by the Board that unitization is necessary to increase ultimate recovery, is in the interest of conservation, and serves to protect the correlative rights of Chaco and all interested parties. *See Corrected Order No. 89-2018, ¶¶ 6, 11.* Accordingly, all relevant facts, courses of action and arguments were fully proffered and considered by the Board during the original hearing, and the doctrine of administrative finality precludes a second "bite at the apple" under the present circumstances. *See NASI v. State Dept., of Highways*, 231 Mont. 395 (1988).

- Chaco's primary argument, that it will suffer from loss of short term revenue, is not a valid reason for rehearing. All parties suffer loss of short term revenue in exchange for increased revenue over the life of the unit. That is the very nature of a secondary recovery unit. *See e.g., Trees Oil Co. v. State Corp. Comm'n*, 279 Kan. 209, 220 (2005) (upholding unitization and stating that while short-term revenue loss to Trees will occur due to unitization, "all participants lose short-term cash flow but will recover [their] allocated share of unit production.").

- The Board's Order certainly does not equate to a regulatory taking as Chaco argues. *Chaco Letter, p. 2 at 6.* A regulatory taking occurs when agency action deprives an owner of *all* economic value or use of the owner's property. *Kafka v. Montana Dep't of Fish, Wildlife & Parks*, 2008 MT 460, ¶ 67. The Board's Order does not deprive Chaco of *all* economic value or use. Rather, unitization entitles Chaco to its proportionate share of *all* production within the unit boundaries. Production that will greatly exceed the ~5 barrels of oil per day that Chaco claims it is losing because of the

Board's Order. Indeed, other jurisdictions have recognized that unitization under similar circumstances is not a taking. *See Trees Oil Co.*, 279 Kan. at 233 ("The Commission's orders are not in any way a 'taking' as Trees argues. [Kansas' compulsory unitization act] sets out in detail the findings that must be made and the provisions required in the unitization and unit operation order. There is clearly legislative authority for the Commission's actions, and all of the statutory requirements were followed."). Here, Denbury complied with all statutory requirements, the Board correctly issued Order No. 89-2018, and a taking did not occur.

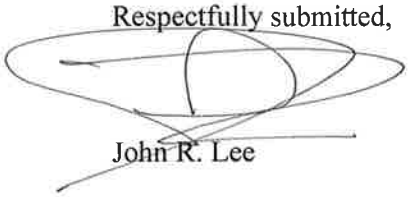
- Preventing Chaco from producing ~5 barrels of oil per day in exchange for approving unitization in the public interest does not constitute waste as Chaco argues. *Chaco Letter, p. 2 at 8.* Rather, the opposite is true; waste would be committed if the Board elected not to approve the unit in exchange for insignificant amounts of Interlake Production. *See e.g., Majority of Working Interest Owners in Buck Draw Field Area v. Wyoming Oil and Gas Conservation Comm'n*, 721 P.2d 1070 (Wyo. 1986) (upholding Commission's order requiring producers to shut in an entire field to force unitization to prevent waste). The Board certainly has jurisdiction to curtail or prevent production at any point in the interest of conservation.

- Chaco fails to mention, as discussed at the hearing, that it was offered multiple options by Denbury. Specifically, Chaco had the option to: (1) participate in the unit; (2) elect not to participate in the unit and be carried at prime plus 2%; (3) accept the good faith offer made by Denbury and immediately acquire revenue by selling its interest; (4) allow Denbury to squeeze off all production from the Red River Formation and continue producing the well from the Interlake; or (5) allow Denbury to squeeze off production from the Interlake Formation and utilize the existing well for unit operations (and then retain ownership of the well at the end of the life of the unit to resume production from the Interlake). Accordingly, Chaco's rights were adequately protected.[1]

- Finally, even if Chaco's arguments did have merit, its claim involves private rights of the parties in a non-unitized formation. Therefore, the Board lacks jurisdiction to resolve the dispute. *U.V. Industry Inc. v. Danielson*, 184 Mont. 203, 219 (1974) ("the Board of Oil and Gas Conservation does not have authority to adjudicate disputes involving private rights.").

Frankly, the public interest is better served by denying Chaco's request and leaving the present Order as is. Denbury complied with all of the statutory requirements for compulsory unitization and the Board correctly approved the Mystery Creek plan of unit operations after considering all of Chaco's arguments. Thanks you for consideration of our position.

Respectfully submitted,



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[1] Note that Chaco, per Montana law and the plan of unit operations approved by the Board, will be compensated for any existing equipment used by Denbury for unit operations. Mont. Code Ann. § 82-11-206(4); Unit Operating Agreement, Article 10. Further, the unit will in no way benefit from the lack of production from the Interlake; thus, Chaco is not entitled to compensation under 82-11-206(9) as it suggests. *Chaco Letter, p. 2 at 9.*