BEFORE THE

OIL CONSERVATION DIVISION

NEW MEXICO DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES

IN THE MATTER OF THE APPLICATION OF DAVID H. ARRINGTON OIL AND GAS, INC. FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO — CASE NO. 12922

and

IN THE MATTER OF THE APPLICATION OF GREAT WESTERN DRILLING COMPANY FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO. — CASE NO. 12943

ARRINGTON'S REPLY
PURSUANT TO ITS MOTION TO DISMISS

Against a backdrop of thirty-years of inaction, Great Western now makes a last minute attempt to play "catch-up" in this proceeding. Great Western's untimely post-hearing response to Arrington's speaking motion to dismiss is yet another example of its reactive, rather than proactive approach to development and reveals one more facet of its relative lack of experience as an operator.

Experienced operators in New Mexico know that they may not rely on the Division to conduct their due diligence for them. Experienced operators know the Division expects them to demonstrate that they have exercised good-faith in the conduct of negotiations to obtain the voluntary participation of other working interest owners as a pre-condition to making application for compulsory pooling. Experienced operators know the Division will recognize that a well proposal made on the day after a compulsory pooling application is filed does not constitute good-faith negotiations. Experienced operators know that the failure to comply with the

Division's good-faith negotiation requirement can result in the dismissal of their compulsory pooling applications. *See* Order No. R-10977, Case No. 11972, *Application of Redstone Oil and Gas Company for Compulsory Pooling, Eddy County, New Mexico.*[1]

Given its relative lack of experience as an operator, Great Western's unfamiliarity with the policy behind the long-standing 30-day requirement is perhaps understandable.

Under NMSA 1978, §70-2-18(A), an operator proposing to dedicate separately-owned lands to a proration unit has an "obligation" to negotiate a voluntary agreement with the other interest owners to obtain their participation. The Division and the Commission require operators to show that they have made a "diligent" and "good faith" effort to negotiate a voluntary agreement before a compulsory pooling application may be filed.[2] This policy has become manifest in the custom and practice that requires operators to make a lease, farmout or well proposal to the other interest owners at least thirty days before initiating a compulsory pooling proceeding.[3]

In this regard, the historic treatment by the agency of its compulsory pooling powers is revealing: The first compulsory pooling orders made by the Oil Conservation Commission were made with some reluctance. In many instances, the Commission ordered pooling but further ordered that a continuing effort be made to secure the consent of all the interests involved. Morris, Richard, *Compulsory Pooling of Oil and Gas Interests in New Mexico*, 3 Nat. Resources

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[1] Great Western's reliance on Order Nos. R-10731-B, R-10742 and R-11566 as authority for its position is misplaced. The findings in Order No. R-10731-B make clear that pre-application negotiations between Medallion and Yates were not an issue. Regardless, Yates's untimely compulsory pooling application was ultimately dismissed. In Order No. R-10742, Penwell's compulsory pooling application that was filed on October 15, 1997, two weeks after making its October 1st "formal" well proposal, was dismissed and then was re-filed on November 12th. Again, pre-application negotiations were not disputed. In Order No. R-11566, Yates filed its compulsory pooling applications on December 20, 2000 and, afterwards, made its well proposals on December 27th. Even though pre-application negotiations were not disputed, the Yates pooling applications were denied outright. (*See* Finding No. 21, Order No. R-1156.)

[2] Indeed, the "good faith" requirement has been expressly codified in the compulsory unitization procedures of the Statutory Unitization Act at NMSA 1978, §70-7-6-A(5).

[3] The Division may take administrative notice of its own policies and practices.

J. 316 (1963). After a few cases had been decided, the Commission adopted the attitude toward compulsory pooling that still remains today. In each case there is an inquiry concerning the efforts made by the operator to secure the consent of the interests being pooled. The reasonableness of the offer may also be questioned. Morris, Richard, *Compulsory Pooling of Oil and Gas Interests in New Mexico*, 3 Nat. Resources J. 316, 318 (1963). The Division continues to recognize the importance of good faith efforts to negotiate before commencing compulsory pooling actions, and uses it as one criterion to determine if the application will be accepted or denied.

While the parameters of what constitutes a "good faith" effort have not been precisely defined in any order of the Commission or the Division, or in any reported court decision, the consistent application of the so-called "30-day rule" is well known. Over the years, operators have come to rely on the practice, and the requirement, that they must not invoke the Division's compulsory pooling powers as a matter of first resort, but rather that negotiations, beginning with a well proposal, must occur first.

The reasons for requiring these acts of good faith are readily understood. The procedure for force pooling is strikingly analogous to the procedures under the eminent domain code, where one, who seeks to invoke the state's police powers, can condemn or expropriate private lands for public use. Both compulsory pooling and eminent domain proceedings dramatically affect the rights landowners have in their lands, and both compel the landowner into an action that was not of his or her own desire. Enforcing a good faith effort to negotiate is one way the Division and the courts safeguard private property rights before the State's police powers are exercised. While condemnation can dissolve all rights of the owner in a property, its application

is very similar to compulsory pooling, and can shed light on the proper procedures when the State's police powers are invoked.

Eminent domain is the power of a government entity to take private lands and convert them for public use, with just compensation. Eminent domain is liberally interpreted in New Mexico. *Landavazo v. Sanchez*, 111 N.M. 137, 140, 802 P.2d 1283, 1286 (1990). The decision of the grantee of the power of eminent domain as to the necessity, expediency, or propriety of exercising that power is political, legislative, or administrative and its determination is conclusive and not subject to judicial review, absent fraud, bad faith, or clear abuse of discretion. *Id.* at 140, 1286; *North v. Public Service Co. of New Mexico*, 101 NM 222, 680 P.2d 603 (N.M. App. 1983). While eminent domain is not often subject to the judicial review, it is expressly subject to the courts supervision when it has been exercised in bad faith, or when one has exercised the power and has failed to make a good faith effort to negotiate with landowners commencing the action. NMSA 1978 § 42-A-1-4A states, "A condemnor shall make reasonable and diligent efforts to acquire property by negotiation." NMSA 1978 § 42-A-1-6A further states "...an action to condemn property may not be maintained over timely objection by the condemnee unless the condemnor made a good faith effort to acquire the property by purchase before commencing the action." (emphasis added). Just as NMSA 1978 §§ 70-2-17 and 70-2-18 set out the requirements before commencing compulsory pooling proceedings, the eminent domain statutes stress the importance and lay out the requirement of good faith negotiations with the landowners before any further action is taken.

There are many eminent domain cases that analyze good faith efforts in negotiations. "What constitutes a good faith offer must be determined in light of its own particular circumstances." *Unger v. Indiana & Michigan Electric Co.*, 420 N.E.2d 1250, 1254 (Ind. App.

1981). A good faith offer is one where a reasonable offer is made in good faith and a reasonable effort is made to induce the owner to accept it. Perfunctory offers are not sufficient. *Id.* at 1254 (emphasis added.)

In making a determination whether the condemnor engaged in good faith negotiations the courts will inquire whether the condemnor made a good faith effort to acquire the property or rights by conventional agreement before the expropriation suit was filed. *Transcontinental Gas Pipeline Corp. v. 118 Acres of Land, etc.* 745 F.Supp. 366 (1990).

In the present case, Great Western's actions fall far short of these analagous standards.

Great Western has held its lease interest in Section 34 since 1972. Arrington acquired its lease interest[4] in January, 2001, and immediately began its geologic evaluation of the acreage. Arrington, after conducting its due diligence, identified Great Western's ownership interest and proposed the drilling of the Huma Huma well to Great Western on June 18, 2002. In the interim, Arrington acted with dispatch in obtaining BLM approval for its well location, archaeological survey and rights of way. Although it had been given adequate opportunity to respond to the well proposal, nothing was heard from Great Western and the evidence at hearing established that Great Western made no other effort to develop or even evaluate its lease acreage. It was not until September 5, 2002, the day of the hearing on its compulsory pooling application, that Arrington received its first reaction from Great Western in the form of an inconsistent well proposal and Great Western's own compulsory pooling application. Great Western's conduct evidences a wholesale failure to negotiate with Arrington at all. Great Western's conduct constitutes neither diligence nor good faith.

CONCLUSION

Great Western has failed to demonstrate adequate diligence or that it made a reasonable, good faith effort to obtain the voluntary agreement of Arrington before invoking the Division's compulsory pooling powers. For these reasons, it is in violation of NMSA 1978 §§ 70-2-17 and 70-2-18 and Great Western's Application must therefore be dismissed.

Respectfully submitted,

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Certificate of Mailing

I hereby certify that a true and correct copy of the foregoing was hand-delivered to counsel of record on the 6 day of November, 2001, as follows:

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[4] Arrington owns the largest interest in Section 34.