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

APPLICATION OF GOODNIGHT MIDSTREAM PERMIAN, LLC TO AMEND ORDER NO. R-7765, AS AMENDED, TO EXCLUDE THE SAN ANDRES FORMATION FROM THE UNITIZED IINTERVAL OF THE EUNICE MONUMENT SOUTH UNIT, LEA COUNTY, NEW MEXICO.

CASE NO. 24278

APPLICATION OF GOODNIGHT MIDSTREAM PERMIAN, LLC TO AMEND ORDER NO. R-7767 TO EXCLUDE THE SAN ANDRES FORMATION FROM THE EUNICE MONUMENT OIL POOL WITHIN THE EUNICE MONUMENT SOUTH UNIT AREA, LEA COUNTY, NEW MEXICO.

CASE NO. 24277

EMPIRE NEW MEXICO, LLC'S
REPLY TO OIL CONSERVATION DIVISION'S RESPONSE TO EMPIRE'S
MOTION TO DISMISS APPLICATIONS TO AMEND ORDERS R-7765 AND R-7767

Empire New Mexico, LLC, ("Empire"), by and through its undersigned counsel of record, hereby submits its Reply to the Oil Conservation Division's ("Division") Response to Empire's Motion to Dismiss Applications to Amend Orders R-7765 and R-7767 ("Motion"). For the following reasons, Empire's Motion should be granted.

ARGUMENTS AND AUTHORITIES

I. The Division's arguments regarding the scope of the Division's subject matter jurisdiction do not ameliorate Goodnight's lack of standing.

As discussed in Empire's Motion, Goodnight lacks standing to file the applications at issue

because unlike Empire, Goodnight is not a party to the Unit Agreement[1] governing the mineral rights on which the applications seek to encroach; namely, the ability to expand or contract the vertical limits of the Eunice Monument South Unit ("Unit"). As such, Goodnight cannot enforce the terms of either the Unit Agreement, or the related Operating Agreement.

In its response to the Motion, the Division argues that the Division has jurisdiction over these matters, and therefore that the Commission should disregard Goodnight's lack of standing and decide Goodnight's applications on the merits. This argument is misguided. Whether the Division might – in some future proceeding not already pending before the Commission – have subject matter jurisdiction over the applications at issue has nothing to do with whether Goodnight has met New Mexico's threshold standing requirements in this case; *i.e.*, injury in fact, causation, and redressability. The Division concedes that "OCD is not concerned with Empire's legal basis for its Motion…" Division Response at 3. Thus, the Division's response does not address the question of whether Goodnight, as a non-party to the Agreements, lacks standing to enforce property rights under the Agreements.

Instead of addressing the legal arguments in the Motion, the Division urges the Commission to decide Goodnight's applications to help clarify "situations faced by Operators" for the Division and "provide guidance to the industry as a whole and this specific region." *See* Division Response at 5. In other words, the Division asks the Commission to render an advisory opinion to guide the Division in future cases not presently before the Commission. This is precisely the kind of speculative, hypothetical outcome the standing doctrine is intended to prevent. *See Am. Fed'n of State v. Bd. of Cnty. Com'rs of Bernalillo Cnty.*, 2016-NMSC-017, ¶ 20, 373 P.3d 989 ("If the facts are uncertain and the court is being asked to make a legal ruling based on the

[1] Unless otherwise noted, capitalized terms have the same meaning as in the Motion.

possibility that certain facts will be found to exist at some point in the future, then a decision would constitute nothing more than an advisory opinion based on a hypothetical scenario."); *see also New Energy Econ., Inc. v. Shoobridge*, 2010-NMSC-049, ¶ 16, 149 N.M. 42 ("[P]rudential rules of judicial self-governance, like standing, ripeness, and mootness, are founded in concern about the proper—and properly limited—role of courts in a democratic society and are always relevant concerns."). The Division cannot utilize the Commission's hearing process to inform the Division in future disputes over pore space ownership and operator's rights. *See* Order No. R-12790 (Exhibit A).

For these reasons, the Division's response does nothing to avoid the inescapable conclusion that Goodnight lacks standing to prosecute its claims. The Motion should be granted.

II. The Division's jurisdiction is limited by the Oil and Gas Act and does not extend to contested pore space ownership issues.

In addition to not addressing standing, the Division's response to Empire's Motion is procedurally improper and exceeds the scope of Division's statutory authority. To determine whether the Division's involvement in this matter falls within its authority under the New Mexico Oil and Gas Act ("Oil and Gas Act" or "Act"), NMSA 1978, Sections 70-2-1 to -38 (1935, as amended), the Commission must examine whether the Legislature granted the Division or the Commission authority to adjudicate private contractual rights. As set forth below, the Legislature did not.

While the Oil and Gas Act confers upon the Division "jurisdiction and authority over all matters relating to the conservation of oil and gas . . . in this state,"[*see* NMSA 1978, § 70-2-6(A)],[2] this authority does not extend to private commercial contracts governing property rights.

[2] The Commission has two primary duties regarding the conservation of oil and gas: prevention of waste and protection of correlative rights. NMSA 1978, § 70-2-11(A); *Santa Fe Exploration Co. v. Oil Conservation Comm'n*, 114 N.M. 103, 112, 835 P.2d 819, 828 (1992). The Commission may also adopt

As the New Mexico Supreme Court has recognized, "grave constitutional problems would arise" if the Division were to determine property rights or assume other similar judicial functions because it serves in an administrative capacity in carrying out the limited, legislative directives in the Oil and Gas Act. *See Cont'l Oil Co. v. Oil Conservation Comm'n*, 1962-NMSC-062, ¶ 28, 373 P.2d 809 (holding the Division lacked authority to issue a finding that did not stem from or was necessary to prevent waste or protect correlative rights).

Perhaps recognizing these jurisdictional limitations, the Division itself has held that a case involving a dispute over wellbore ownership "raise[s] issues of property and contractual rights that the Division does not have jurisdiction to determine." Order No. R-12790, ¶ (15) (Exhibit A); *see also* Order No. R-13789 (Exhibit B), at ¶ (16) (Division "does not have jurisdiction concerning the content of lease agreements …"); Order No. R-14304, at ¶ 8 (Exhibit C) ("The Division does not have jurisdiction to determine who owns any interest in real property or whether or not their interest is marketable."); Order No. R-11700-B, at ¶ 27 (Exhibit D) (recognizing Division's lack of jurisdiction over title matters). The Division has also determined that "the rights of a surface owner do not constitute 'correlative rights' [as defined by the New Mexico Oil and Gas Act]." *See* Order No. R-12754 at 6, ¶ 24 (Exhibit E).

Here too, the Division lacks authority to weigh in on Empire's rights under the Unit Agreement, a private commercial contract. The issues raised in Goodnight's applications – namely, the San Andres formation's inclusion in the Unit and the primacy of ownership of the contested pore space operatorship – are purely contractual matters, governed by the Unit Agreement. Nor

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rules and regulations to implement and enforce the Act. *See* § 70-2-11(A) (granting the Division the authority to make and enforce rules, regulations, and orders); § 70-2-11(B) (granting the Commission concurrent jurisdiction with the Division "to the extent necessary for the [C]omission to perform its duties as required by law"). In other words, the Commission's specialized expertise pertains to the regulation and conservation of oil and gas. *See* § 70-2-4 (stating that the commissioners "shall be persons who have expertise in the regulation of petroleum production by virtue of education or training.").

do Goodnight's rights as a surface owner constitute "correlative rights" triggering the Division's subject matter jurisdiction. Accordingly, the Division lacks authority over the two salient issues in Goodnight's applications: (1) primacy of ownership of subsurface pore space; and (2) the unit agreement. Thus, the Division's response to the Motion is procedurally improper and *ultra vires*.

Additionally, the Division's interpretation of the scope of its own statutory authority is a pure question of law on which the Division should be afforded little to no deference. *State v. Romero*, 2006-NMSC-039, ¶ 6, 140 N.M. 299, 142 P.3d 887 ("Statutory construction is a question of law.");*see also Marbob Energy Corp. v. N.M. Oil Conservation Comm*., 2009-NMSC-013, ¶ 7 ("[I]f statutory construction is not within the agency's expertise, this Court should afford little, if any, deference to the agency on issues of statutory construction) (citing *N.M. Indus. Energy Consumers v. N.M. Pub. Regulation Comm'n*, 2007-NMSC-053, ¶ 19, 142 N.M. 533, 168 P.3d 105 ("Statutory interpretation is . . . review[ed] *de novo*.")). For these reasons, the Motion should be granted.

III. Conclusion

The Division's response to Empire's Motion ignores Goodnight's lack of standing and seeks a decision on the merits that is tantamount to an improper advisory opinion. Further, the legal issues in this proceeding involve property and contractual rights over which the Division lacks jurisdiction. The Division's response is therefore improper and Empire's Motion should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing was sent to counsel of record by electronic mail this 28th day of May, 2024, as follows:

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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 FOR THE PURPOSE OF CONSIDERING:

APPLICATION OF TMBR/SHARP DRILLING, INC. FOR AN ORDER STAYING DAVID H. ARRINGTON OIL & GAS, INC. FROM COMMENCING OPERATIONS, LEA COUNTY, NEW MEXICO. **CASE NO. 12731**

APPLICATION OF TMBR/SHARP DRILLING, INC. APPEALING THE HOBBS DISTRICT SUPERVISOR'S DECISION DENYING APPROVAL OF TWO APPLICATIONS FOR PERMIT TO DRILL FILED BY TMBR/SHARP DRILLING, INC., LEA COUNTY, NEW MEXICO. **CASE NO. 12744**

ORDER NO. R-11700-B

ORDER OF THE OIL CONSERVATION COMMISSION

BY THE COMMISSION:

THIS MATTER came before the Oil Conservation Commission (hereinafter referred to as "the Commission") on March 26, 2002, at Santa Fe, New Mexico, on application of TMBR/Sharp Drilling Inc. (hereinafter referred to as "TMBR/Sharp"), *de novo*, and opposed by David H. Arrington Oil and Gas Inc. (hereinafter referred to as "Arrington") and Ocean Energy Inc. (hereinafter referred to as "Ocean Energy") and the Commission, having carefully considered the evidence, the pleadings and other materials submitted by the parties hereto, now, on this 26th day of April, 2002,

FINDS,

1. Notice has been given of the application and the hearing on this matter, and the Commission has jurisdiction of the parties and the subject matter herein.

2. In Case No. 12731, TMBR/Sharp seeks an order voiding permits to drill obtained by Arrington and awarding or confirming permits to drill to TMBR/Sharp concerning the same property.

3. In Case No. 12744, TMBR/Sharp appeals the action of the Supervisor of District I of the Oil Conservation Division denying two applications for permit to drill.

EXHIBIT
A

4. Arrington and Ocean Energy oppose[1] both applications.

5. The cases were consolidated by the Division for purposes of hearing and remain so before the Commission.

6. Still pending before the Division are two applications for compulsory pooling. They are: Case No. 12816, Application of TMBR/Sharp for compulsory pooling, Lea County, and Case No. 12841, Application of Ocean Energy Inc. for compulsory pooling, Lea County.

7. The Commission conducted an evidentiary hearing on March 26, 2002, heard testimony from witnesses called by TMBR/Sharp, and accepted exhibits. The Commission also accepted pre-hearing statements from TMBR/Sharp and Arrington and heard opening statements from TMBR/Sharp, Arrington and Ocean Energy and accepted brief closing statements from TMBR/Sharp and Arrington.

8. Following the hearing, TMBR/Sharp filed a Motion to Supplement the Record to include the April 10, 2002 letter of Arrington to the Oil Conservation Division's Hobbs District Office and a portion of Arrington's Supplemental Response to Plaintiff's Motion for Reconsideration in Lea County Cause No. CV-2001-315C. Ocean filed a response to that motion that argued the items add nothing to the record, and Arrington filed a response arguing that the supplemental material is not new or inconsistent. The Motion to Supplement the Record should be granted as no party seems to object to review of the documents; the objections seem to relate only to the significance of the documents to this matter.

9. Applications for permit to drill were filed with the Division in Sections 23 and 25 by Arrington and TMBR/Sharp. The applications filed by TMBR/Sharp and Arrington both proposed a well in the NW/4 of in Section 25. In Section 23, the application for permit to drill filed by TMBR/Sharp proposed a well in the NE/4, and the application of Arrington proposed a well in the SE/4.

10. Arrington's application in Section 25 was filed on July 17, 2001 and sought a permit to drill its proposed "Triple-Hackle Dragon "25" Well No. 1." This application was approved on July 17. On or about August 7, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Blue Fin "25" Well No. 1" in the same section. That application was denied on August 8, 2001.

11. Arrington's application in Section 23 was filed on July 25, 2001 and sought a permit to drill its proposed "Blue Drake "23" Well No. 1." This application was

[1] On April 10, 2002 Arrington agreed to release its permit to drill to TMBR/Sharp. A dispute may no longer therefore exist concerning Section 23 although the parties apparently do not agree with this assessment.

approved on July 30, 2001. On or about August 6, 2001, TMBR/Sharp filed its application for a permit to drill its proposed "Leavelle "23" Well No. 1" in the same section. That application was denied on August 8, 2001.[2]

12. TMBR/Sharp's applications in Sections 23 and 25 were denied on the grounds of the permits previously issued to Arrington for the "Triple-Hackle Dragon "25" Well No. 1" and the "Blue Drake "23" Well No. 1." The Townsend Mississippian North Gas Pool, the pool from which the wells are to produce, is governed by the spacing and well density requirements of Rule 104.C(2) [19 NMAC 15.C.104.C(2)]. That rule imposes 320-acre spacing on wells producing from that pool. TMBR/Sharp's applications were denied because, if granted, more than one well would be present within a 320-acre spacing unit, in violation of Rule 104.C(2).

13. Before an oil or natural gas well may be drilled within the State of New Mexico, a permit to drill must be obtained. See NMAC 19.15.3.102.A, 19 NMAC 15.M.1101.A. Only an "operator" may obtain a permit to drill, 19 NMAC 15.M.1101.A, and an "operator" is a person who is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." NMAC 19.15.1.7.0(8).

14. The central issue in this case is whether Arrington was eligible to become the operator of the wells in question. If not, Arrington should not have received the permits to drill. If Arrington was eligible to become the operator, then the permits were properly issued to Arrington.

15. A dispute exists concerning the validity of Arrington and TMBR/Sharp's mineral leases in Sections 23 and 25. As will be seen below, resolution of this dispute in favor of Arrington or TMBR/Sharp determines which party is eligible to be the operator and thus, who should receive the permits to drill.

16. TMBR/Sharp is the owner of oil and gas leases comprising the NW/4 of Section 25 and the SE/4 of Section 23 (along with other lands) pursuant to leases dated August 25, 1997 granted by Madeline Stokes and Erma Stokes Hamilton. TMBR/Sharp Exhibit 6. The leases were granted to Ameristate Oil & Gas, Inc. (hereinafter referred to as "Ameristate") and were recorded respectively in Book 827 at Page 127 and in Book 827 at Page 124 in Lea County, New Mexico.

17. TMBR/Sharp and Ameristate entered into a Joint Operating Agreement along with other parties on July 1, 1998 and TMBR/Sharp was designated as the operator in Section 25. See TMBR/Sharp Exhibit 7.

[2] Apparently TMBR/Sharp reapplied for the permits to drill that were previously denied, and the Division approved those permits on March 20, 2002.

18. Although the primary terms of the TMBR/Sharp leases have apparently expired, TMBR/Sharp alleges that the leases were preserved by the drilling of the "Blue Fin 24 Well No. 1" and subsequent production from that well. The Blue Fin 24 Well No. 1 is located in the offsetting section 24.

19. Subsequent to Stokes and Hamilton's execution of leases in favor of Ameristate Oil & Gas Inc., they granted leases in the same property to James D. Huff on March 27, 2001. See TMBR/Sharp Exhibit 9. The leases to Mr. Huff were recorded in Book 1084 at Page 282 and in Book 1084 at Page 285 in Lea County, New Mexico. The parties referred to these leases as "top leases," meaning that according to their terms, they would not take effect until the prior or "bottom" leases became ineffective. See TMBR/Sharp Exhibit 9, ¶ 15.

20. Arrington alleges Mr. Huff is an agent of Arrington but presented nothing to support that contention.

21. In July and August 2001, Ocean acquired a number of farm-out agreements in Section 25. See TMBR/Sharp Exhibit 10, Schedule 1. By an assignment dated September 10, 2001, Ocean assigned a percentage of the farm out agreements to Arrington under terms that require Arrington to drill a test well in Section 25 known as the Triple Hackle Dragon "25" Well No. 1 in the NW/4 of that section.

22. On August 21, 2001, after receiving the denials of the applied-for permits to drill from the District office, TMBR/Sharp filed suit against Arrington and the lessors of its mineral interests in the Fifth Judicial District Court of Lea County, New Mexico. In that case, styled "TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*", TMBR/Sharp alleged that its leases were still effective and the Arrington top leases were ineffective. The District Court, in its Order Granting Partial Summary Judgment, dated December 24, 2001, agreed with TMBR/Sharp's contention. See TMBR/Sharp's Exhibit No. 12,

23. During the hearing of this matter, TMBR/Sharp argued that because the Fifth Judicial District Court found that Arrington's "top leases" had failed, TMBR/Sharp was entitled to permits to drill in Sections 23 and 25 and Arrington was not entitled to permits to drill and its permits should be rescinded. TMBR/Sharp also argued that Arrington had filed applications to prevent TMBR/Sharp from being able to drill and to place its obligations under the continuous drilling clauses of the oil and gas leases in jeopardy. TMBR/Sharp argued that Ocean Energy's letter agreement with Arrington could not revive Arrington's claim of title and that Ocean Energy's pending pooling application with the Division is essentially irrelevant to the question of whether TMBR/Sharp should have been granted a permit to drill.

24. Arrington argued in response that the title issue ruled upon by the District Court with respect to section 25 is irrelevant because Arrington acquired an independent

interest in that section by virtue of a farm out agreement in September of 2001. Arrington also argued it was willing to assign the disputed acreage in Section 23 to TMBR/Sharp in order to resolve the present controversy. Arrington also argued that it doesn't intend to actually drill at the present time under either approved permit to drill and argued, citing Order No. R-10731-B, that the Commission's practice has not been to rely on "first in time, first in right" principles in deciding competing applications on compulsory pooling, but instead on geological evidence. Arrington seemed to argue that a compulsory pooling proceeding is the place to present such geologic evidence. Arrington argues that these proceedings are unnecessary and that the Commission should rely upon the Division's pending pooling cases to decide who of the various parties should properly possess the permit to drill.

25. Ocean Energy argued that since its farm out agreement terminates on July 1, 2002 time is of the essence and that the matters at issue here should be resolved in the pending compulsory pooling proceeding instead of this proceeding. Ocean Energy argued that the permit to drill is meaningless in this context, that TMBR/Sharp is essentially asking the Commission to determine pooling in the context of the permit to drill, and that the dedication of acreage on the acreage dedication plat should not determine what acreage would be pooled to the well. If the Commission were to adopt this approach, Ocean Energy argues, the compulsory pooling statutes would be written out of existence.

26. The parties seem to agree that in a situation where the bottom lease has not failed, a person owning a top lease is not a person duly authorized to be in charge of the development of a lease or the operation of a producing property, and is therefore not entitled to a permit to drill. NMAC 19.15.1.7(O)(8). See also 1 Kramer & Martin, The Law of Pooling and Unitization, 3rd ed., § 11.04 at 11-10 (2001). Moreover, because only an "owner" may seek compulsory pooling, it seems that a person owning a top lease where the bottom lease has not failed might not be entitled to compulsory pooling either. See NMSA 1978, § 70-2-17(C).

27. When an application for permit to drill is filed, the Division does not determine whether an applicant can validly claim a real property interest in the property subject to the application, and therefore whether the applicant is "duly authorized" and "is in charge of the development of a lease or the operation of a producing property." The Division has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico. The Division so concluded in its Order in this matter. See Order No. R-11700 (December 13, 2001).

28. It is the responsibility of the operator filing an application for a permit to drill to do so under a good faith claim to title and a good faith belief that it is authorized to drill the well applied for. It appears to this body that Arrington had such a good faith belief when it filed its application, but subsequently the District Court found otherwise.

It is not within the purview of this body to question that decision and it should not do so in this case.

29. As of the date of this order, TMBR/Sharp, by Court declaration, is the owner of an oil and gas lease in both Section 23 and Section 25, and Arrington, also by Court declaration, is not an owner in those sections. Therefore, Arrington, who the Court has now decreed has no authority over the property, should not have been granted permits to drill in those sections and TMBR/Sharp should have been granted a permit.

30. Both Arrington and Ocean Energy imply that an appeal will be filed of the District Court's decision. Until the issue of title in Sections 23 and 25 is finally resolved by the courts or by agreement of the parties, the outcome of this proceeding is therefore uncertain. As of the present time, TMBR/Sharp has prevailed on the title question and this Order reflects that (present) reality. However, as an appeal could change that conclusion, jurisdiction of this matter should therefore be retained until matters are finally resolved.

31. The permits to drill issued by the Division in July 2001 to Arrington were issued erroneously and should be rescinded *ab initio*. The applications to drill submitted by TMBR/Sharp in August 2001 should have been processed within a few days of receipt. Arrington's later acquisition of an interest in section 23 and 25 through a farm out agreement doesn't change this analysis; Arrington had no interest by virtue of farm out as of the date of TMBR/Sharp's applications.

32. On another issue, Arrington and Ocean Energy have both urged this body to stay these proceedings pending the resolution of the applications for compulsory pooling, arguing that a decision on those matters will effectively resolve the issues surrounding the permits to drill.

33. Arrington and Ocean Energy's conclusion does not necessarily follow. An application for a permit to drill serves different objectives than an application for compulsory pooling and the two proceedings should not be confused. The application for a permit to drill is required to verify that requirements for a permit are satisfied. For example, on receipt of an application, the Division will verify whether an operator has financial assurance on file, identify which pool is the objective of the well so as to identify the proper well spacing and other applicable requirements, ensure that the casing and cementing program meets Division requirements and check the information provided to identify any other relevant issues. The acreage dedication plat that accompanies the application (form C-102) permits verification of the spacing requirements under the applicable pool rules or statewide rules. Compulsory pooling is related to these objectives in that compulsory pooling would not be needed in the absence of spacing requirements. 1 Kramer & Martin, The Law of Pooling and Unitization, § 10.01 (2001) at 10-2. But its primary objectives are to avoid the drilling of unnecessary wells and to protect correlative rights. NMSA 1978, § 70-2-17(C).

34. It has long been the practice in New Mexico that the operator is free to choose whether to drill first, whether to pool first, or whether to pursue both contemporaneously. The Oil and Gas Act explicitly permits an operator to apply for compulsory pooling after the well is already drilled. See NMSA 1978, § 70-2-17(C) (the compulsory pooling powers of the Division may be invoked by an owner or owners "... who has the right to drill *has drilled* or proposes to drill a well [sic] ..."). Issuance of the permit to drill does not prejudge the results of a compulsory pooling proceeding, and any suggestion that the acreage dedication plat attached to an application to drill somehow "pools" acreage is expressly disavowed. If acreage included on an acreage dedication plat is not owned in common, it is the obligation of the operator to seek voluntary pooling of the acreage pursuant to NMSA 1978, § 70-2-18(A) and, if unsuccessful, to seek compulsory pooling pursuant to NMSA 1978, § 70-2-17(C).

35. Thus, where compulsory pooling is not required because of voluntary agreement or because of common ownership of the dedicated acreage, the practice of designating the acreage to be dedicated to the well on the application for a permit to drill furthers administrative expedience. Once the application is approved, no further proceedings are necessary. An operator may first apply for a permit to drill a well and may thereafter pool (on a voluntary or compulsory basis) separately owned tracts to the well. Alternatively, the operator may first pool and later seek a permit to drill. The two are not mutually exclusive, and there is no preferred methodology.

36. Thus, the process fosters efficiency by permitting a simple approach in cases where ownership is common and pooling, voluntary or compulsory, is not necessary.

37. Ocean's expiring farm-outs present a difficult problem because the delay occasioned by this proceeding and any delay that might occur in the pending compulsory pooling cases may place Ocean's interests in jeopardy. It is worth noting that Ocean's interests seem to be free of the title issues plaguing the other parties, but since Ocean Energy intended that Arrington drill and become operator, Ocean isn't planning on preserving its rights by drilling a well itself and hasn't applied for a permit to drill. Unfortunately, this body is without authority to stay expiration of the farm-outs; Ocean should petition the District Court for relief if the expiring farm-outs are a concern.

CONCLUSION OF LAW:

The Oil Conservation Commission has no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease. Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico.

IT IS THEREFORE ORDERED:

1. The portion of TMBR/Sharp's application in Case No. 12731 seeking to void permits to drill obtained by Arrington is granted. The permits to drill awarded to

Arrington shall be and hereby are rescinded *ab initio* and the applications originally filed by TMBR/Sharp in August, 2001 shall be and hereby are remanded to the District Office for approval consistent with this Order provided the applications otherwise meet applicable Division requirements.

2. TMBR/Sharp's application in Case No. 12744, appealing the decision of the Supervisor of District I of the Oil Conservation Division, is granted and the decision shall be and hereby is overruled.

3. The motions of Arrington and Ocean to continue this proceeding until after the decision in Cases No. 12816 and No. 12841 shall be and hereby are denied.

4. The motion of TMBR/Sharp to Supplement the Record is hereby granted.

5. Jurisdiction of this case is retained for the entry of such further orders as may be necessary given subsequent proceedings in TMBR/Sharp Drilling, Inc. v. David H. Arrington Oil & Gas, Inc., *et al.*

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

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

LORI WROTENBERY, CHAIR

JAMI BAILEY, MEMBER

ROBERT LEE, MEMBER

S E A L

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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 13870
ORDER NO. R-12754

APPLICATION OF QUEST CHEROKEE, LLC FOR APPROVAL OF AN APPLICATION FOR PERMIT TO DRILL, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on February 15, 2007, at Santa Fe, New Mexico, before Examiner David R. Catanach.

NOW, on this 3rd day of May, 2007, the Division Director, having considered the testimony, the record, and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and its subject matter.

(2) The applicant, Quest Cherokee, LLC ("Quest") seeks approval of a Division Form C-101 (Application for Permit to Drill, Re-Enter, Deepen, Plugback or Add a Zone ("APD")) for its State 9-4 Well No. 1, which is proposed to be drilled at a standard oil well location 990 feet from the North line and. 2310 feet from the West line (Unit C) of Section 9, Township 18 South, Range 38 East, NMPM, Lea County, New Mexico, to test the San Andres formation, Undesignated West Bishop Canyon-San Andres Pool (Oil - 05790). The NE/4 NW/4 of Section 9 is to be dedicated to the well forming a standard 40-acre oil spacing and proration unit for this pool.

(3) Barbara A. Cox, Steve Cox, Lee Roberson and Tom Duncan, ("The Cox Group") all surface owners at or in the vicinity of Quest's proposed well, appeared at the hearing in opposition to the application.

(4) At the hearing, Quest testified that the advertisement for this case

EXHIBIT B

incorrectly stated the name of its proposed well. Quest's evidence shows the name of the proposed well to be the West Bishop State Well No. 1, hereinafter referred to as the "subject well" or "proposed well".

(5) The evidence and testimony presented demonstrates that prior to Quest filing an APD for the proposed well, the Hobbs District office of the Division ("Hobbs OCD") received a letter of objection to the proposed well dated December 1, 2006, from Mr. Michael Newell, legal counsel for the opponents in this case. The Hobbs OCD subsequently advised Quest that the APD for the proposed well would not be approved at the district level, and that the application would require a hearing before a Division examiner.

(6) Quest presented evidence that demonstrates that:

(a) the proposed well is located on the northern edge of the city of Hobbs, New Mexico. While the well is not located within the city limits of Hobbs, it is located in a populated area containing houses, schools and businesses;

(b) the NW/4 of Section 9 is contained within State of New Mexico Lease No. VA-3080. This lease was obtained by Upland Corporation on February 1, 2004. The acreage was subsequently assigned to Chesapeake Exploration Limited Partnership ("Chesapeake") and then to Tierra Oil Company, LLC ("Tierra"). Quest has purchased the right to develop this lease from Tierra. Pursuant to the term assignment from Chesapeake to Tierra, Quest is obligated, unless an additional extension of time is obtained, to commence drilling the proposed well by May 1, 2007;

(c) the proposed well is situated in empty pastureland that is bordered on the north and west by family residences. The closest residence appears to be approximately 600 feet northwest of the proposed well; and

(d) the surface of the land on which the proposed well is located is owned by Barbara A. Cox.

(7) Prior to Quest obtaining the rights to develop the NW/4 of Section 9, Tierra conducted an investigation into the surface issues at the proposed well site. As evidence in support of its application, Quest presented the following additional evidence obtained by Tierra:

(a) Tierra contacted the Hobbs City Engineer's office and verified that the drill site for the proposed well is not located within the city limits of Hobbs, nor within any extra territorial jurisdiction controlled by the city of Hobbs;

(b) Tierra contacted the Lea County Manager and verified that there are no county regulations applicable to the acreage at the drill site;

(c) Tierra verified with the New Mexico State Land Office that there are no special lease stipulations that would govern development at the proposed well site; and

(d) Tierra stated that a portion of the surface fee acreage within the NE/4 NW/4 of Section 9 may be within a housing subdivision known as the Country Living Estates Subdivision No. 2. The covenants for this subdivision state that the land is to be used for residential purposes, and that no noxious or offensive trade or activity is to occur on the land. However, the covenants do not specifically restrict oil and gas activity, which, in any event, would not be binding on the reserved mineral interest of the State of New Mexico.

(8) Quest has attempted to negotiate with Barbara A. Cox regarding surface use issues at the proposed well site, but has been unsuccessful in these efforts.

(9) The proposed West Bishop State Well No. 1 is Quest's attempt to re-establish production within the West Bishop Canyon-San Andres Pool. There are currently no active wells producing from this pool.

(10) The proposed West Bishop State Well No. 1 is a northwest step-out from wells within Section 9 that previously produced from the West Bishop Canyon-San Andres Pool. Quest's geologic interpretation shows that there is a thickening of the San Andres pay zone within the NW/4 of Section 9.

(11) The West Bishop Canyon-San Andres Pool has been substantially depleted by production. Consequently, Quest does not expect to encounter abnormal pressures during the drilling of the well.

(12) Quest's evidence further shows that directionally drilling the proposed well from a different surface location would add substantial drilling costs and would likely render the drilling of the well uneconomic.

(13) Quest stated in its testimony that it is willing to do whatever the Division deems necessary in order to protect the health and safety of the residents and the public in this area from any potential hazards associated with drilling and producing the proposed West Bishop State Well No. 1.

(14) The Cox Group presented evidence to support its opposition to the drilling of the West Bishop State Well No. 1. Much of the data cited in its testimony was obtained from a publication entitled "Oil and Gas at Your Door? A Landowners Guide to Oil and Gas Development." This publication was developed by the Oil & Gas Accountability Project, Durango, Colorado. The specific complaints are described as follows:

(a) **The well is located in close proximity to houses, a school and a retirement home.** The proposed well is located approximately 567 feet from the nearest residence, approximately 1439 feet from an elementary school, and approximately 2055 feet from a retirement home;

(b) **Noise levels.** The Cox Group contends that noise levels during drilling and production operations at the proposed well will be excessive. In support of this contention, it cited a study conducted in La Plata County, Colorado that demonstrates that various oil and gas activities emit noise levels in the range of 50-88 DBA's (A-Weighted Decibel). Further evidence was presented to show that the State of Colorado has promulgated noise control regulations for oil and gas development in residential areas that limit noise levels to 50-55 DBA's at a distance of 350 feet from the source;

(c) **Property values.** The Cox Group contends that their property values will decline as a result of the drilling of the West Bishop State Well No. 1. In support of this contention, it cited a study conducted in La Plata County, Colorado which shows that despite an overall increase in housing values between 1990 and 2000, the selling price for properties that had an oil or gas well on them was 22% less than a similar property without a well on site;

(d) **Health and safety concerns related to the discharge of Hydrogen Sulfide (H_2S) and Volatile Organic Compounds (VOC's).** The Cox Group is concerned that H_2S and VOC's will be discharged to the atmosphere from production facilities at or near the well site. Discharges of this nature may endanger the health and safety of the residents and the public in the vicinity of the well or the production facility;

(e) **Health, environmental and safety concerns related to the use of various chemical additives used in drilling and production operations.** The Cox Group is concerned that the use of chemicals and/or additives used in drilling and production operations will pose a threat to the surface and subsurface environment and pose safety and health hazards to the residents and the public in the vicinity of the proposed well;

(1) **The use of earthen pits for drilling and/or production operations may pose a threat to groundwater in the vicinity of the proposed well.** The Cox Group is concerned that the use of earthen pits for drilling and/or production operations may endanger ground water; and

(g) **The possibility of a well blowout during drilling operations poses a significant threat to the health and safety of the residents and the public in the vicinity of the proposed well.**

(15) Barbara A. Cox ("Mrs. Cox"), the surface owner at the proposed well site, testified at the hearing via conference phone from Hobbs, New Mexico. Mrs. Cox stated in her testimony that she is opposed to the drilling of the West Bishop State Well No. 1, even if the Division imposes additional requirements to protect the health and safety of the residents and the public.

(16) The Cox Group further contends that the application should be denied based upon Quest's failure to comply with Division rules and procedures, including:

(a) Quest's failure to register with the Division;

(b) Quest's failure to file Division Forms C-101 and C-102 (Well Location and Acreage Dedication Plat) with the Hobbs OCD; and

(c) Quest's notice of hearing incorrectly described the location of the West Bishop State Well No. 1 as being five miles north-northwest of Hobbs, New Mexico.

(17) Mr. Cliff Burch, Superintendent of the Hobbs Municipal Schools, sent a letter to the Division dated February 13, 2007. In his letter, Mr. Burch expressed concern that the West Bishop State Well No. 1, being in close proximity to the College Lane Elementary School, will pose a threat to the health and safety of the students attending that school.

(18) The position of the Cox Group is that the application of Quest should be denied. In the alternative, however, the Cox Group requests that in the event the application is approved, Quest should be required to take measures to protect the health and safety of the residents and the public, among them: i) the well and/or production facilities should be fenced; ii) pipelines should be employed to transport production or waste out of the area so as to minimize truck and transport traffic; iii) no flaring of gas or waste should be allowed; iv) the location should be constructed with a lightning suppression grid system; v) a vapor recovery system should be utilized; and vi) a closed loop drilling technology should be utilized.

(19) The evidence presented demonstrates that Quest's notice of hearing in this case is sufficient, and that the other procedural issues raised by the Cox Group are not grounds for dismissal or denial of this application.

(20) The evidence and testimony presented in this case demonstrates that Quest, by virtue of obtaining certain operating rights from Tierra, has the right to develop the oil and gas reserves underlying the NW/4 of Section 9.

(21) The geologic evidence presented by Quest is sufficient to justify the drilling of the West Bishop State Well No. 1 at the proposed location.

(22) "Correlative Rights" is defined by the New Mexico Oil and Gas Act [NMSA 1978, Section 70-2-33.H], in part, as "the opportunity afforded, as far as it is practicable to do so, to the owner of each property in a pool to produce without waste his just and equitable share of the oil or gas, or both, in the pool".

(23) In order to protect correlative rights, Quest should be authorized to drill its West Bishop State Well No. 1 at the proposed location in Section 9.

(24) The rights of a surface owner do not constitute "correlative rights" within the above definition.

(25) The Cox Group presented sufficient evidence to demonstrate that due to the proximity of the West Bishop State Well No. 1 to houses, schools and other facilities, Quest should be required to take special precautions during drilling and production operations.

(26) The New Mexico Oil and Gas Act [NMSA 1978, Section 70-2-12.B] authorizes the Division to "prevent fires", "to require wells to be drilled, operated and produced in such manner as to prevent injury to neighboring leases or properties" and "to regulate the disposition of nondomestic wastes resulting from oil and gas production".

(27) Quest presented little, if any, engineering evidence relating to its proposed drilling and production operations. Consequently, there is insufficient evidence to impose specific requirements at this time.

(28) The Hobbs OCD routinely approves, oversees and controls drilling and production operations within the city of Hobbs. Consequently, the Hobbs OCD should be the lead entity to determine the measures to be taken by Quest in order to protect the health and safety of the residents and the public at the vicinity of the well and production facilities, and in order to protect the surface and subsurface environment from contamination. The issues to be addressed by the Hobbs OCD should include, but are not necessarily limited to:

(a) blowout Prevention;
(b) possible use of closed loop drilling technology;
(c) fencing of the well and production facilities;
(d) the flaring or venting of H2S and VOC's;
(e) pipelines and/or production facilities; and
(f) lightning protection

(29) Approval of the application, subject to certain provisions and restrictions relating to drilling and production operations, will afford the applicant the opportunity to produce its just and equitable share of the oil and gas reserves underlying the NE/4 NW/4 of Section 9, will allow the recovery of oil and gas reserves underlying the NE/4 NW/4 of Section 9 that may otherwise not be recovered, thereby preventing waste, and will protect the health and safety of the residents and the public in the vicinity of the well and production facilities.

IT IS THEREFORE ORDERED THAT:

(1) The applicant, Quest Cherokee, LLC is hereby authorized to drill its West Bishop State Well No. 1 at a standard oil well location 990 feet from the North line and 2310 feet from the West line (Unit C) of Section 9, Township 18 South, Range 38 East, NMPM, Lea County, New Mexico, to test the San Andres formation, Undesignated West Bishop Canyon-San Andres Pool (Oil - 05790). The NE/4 NW/4 of Section 9 shall be

dedicated to the well forming a standard 40-acre oil spacing and proration unit for this pool.

(2) Prior to commencing drilling and production operations, the applicant shall consult with the Hobbs OCD in order to determine the measures to be taken to protect the health and safety of the residents and the public at the vicinity of the well and production facilities, and in order to protect the surface and subsurface environment from contamination. The issues to be addressed by the Hobbs OCD shall include, but are not necessarily limited to:

(a) blowout prevention;
(b) possible use of closed loop drilling technology;
(c) fencing of the well and production facilities;
(d) the flaring or venting of H_2S and VOC's;
(e) pipelines and/or production facilites; and
(f) lightning protection.

(3) The Hobbs OCD shall issue a conditional APD approval setting forth the specific conditions it deems appropriate, and shall cause copies of the APD to be delivered to counsel who have appeared in this case.

(4) Quest shall not commence drilling operations until five business days after the issuance of the APD approval specifying applicable conditions, and shall conduct all operations in compliance with such conditions.

(5) Jurisdiction is hereby retained for the entry of such further orders as the Division may deem necessary.

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

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P.E.
Director

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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 13927
ORDER NO. R-12790

APPLICATION OF YATES PETROLEUM CORPORATION FOR A NON-STANDARD GAS SPACING UNIT, EDDY COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on June 7 and June 21, 2007, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 16th day of July, 2007, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) In this application, Yates Petroleum Corporation ("Yates" or "Applicant") seeks approval of a non-standard, 160-acre gas spacing unit in the Strawn formation ("the proposed unit"), comprising the SW/4 of Section 28, Township 20 South, Range 28 East, in Eddy County, New Mexico.

(3) Applicant proposes to dedicate this unit to its Hedgerow BFH State Com Well No. 1 (API No. 30-015-33715), located 660 feet from the South line and 1136 feet from the West line (Unit M) of Section 28 ("the subject well").

(4) The proposed unit is located in the Saladar-Strawn Gas Pool (Pool Code 84412). Spacing in this pool is governed by statewide Rule 104.C(2), which provides for units comprising 320 acres.

EXHIBIT C

(5) In support of its application, Yates presented evidence of the following:

(a) The Division, by Order No. R-11928, issued on March 26, 2003 in Case No. 12932, established a non-standard, 160-acre gas spacing unit in the Strawn formation comprising the SE/4 of Section 28. That unit is dedicated to the existing Burton Flat Deep Unit Well No. 13 (API No. 30-015-21125), located 660 feet from the South line and 1980 feet from the East line (Unit O) of Section 28.

(b) The N/2 of Section 28 is dedicated in the Atoka formation to the Blue Ridge 28 State Well No. 1 (API No. 30-015-34416), located 800 feet from the North line and 660 feet from the East line (Unit A) of Section 28, operated by COG Operating, LLC ("COG"). Although that well is not completed in the Strawn formation, it may be so completed in the future.

(c) A well was formerly drilled and completed in the Strawn formation in the NW/4 of Section 28, but has been plugged and abandoned.

(d) COG does not object to the formation of a non-standard Strawn unit limited to the SW/4.

(e) Yates and related entities collectively own the entire working interest in the SW/4 of Section 28 (the proposed unit).

(6) Ard Energy Group, LLC, ("Ard"), an owner of a working interest in the Burton Flat Deep Unit, and therefore also an owner of a working interest in the SE/4 of Section 28, offsetting the proposed unit, appeared through counsel in opposition to the application.

(7) Ard did not controvert any of the evidence presented by Applicant, nor did it contend, or present any evidence, that its correlative rights as an owner of oil and gas rights in the SE/4 of Section 28 or elsewhere would be adversely affected by approval of the proposed unit.

(8) Through cross-examination of Applicant's witness, Ard presented evidence that the subject well was drilled pursuant to a Joint Operating Agreement to which the working interest owners in the SE/4 are parties, and which defines the "contract area" as the S/2 of Section 28, excluding the Strawn formation.

(9) Ard contends that because the subject well was drilled pursuant to an operating agreement to which it is a party, Applicant does not have a right to use this well to produce from the Strawn formation without Ard's consent.

(10) The existence of a previously approved non-standard unit and the dedication thereto of a well completed in the Strawn formation preclude the formation of a standard, lay-down 320-acre unit including the SW/4 of Section 28.

(11) Approval of the proposed non-standard, 160-acre unit will prevent waste by allowing production of the Strawn reserves underlying the SW/4.

(12) A standard, 320-acre stand-up unit could be formed comprising the W/2 of Section 28, and including the proposed unit. However, the NW/4 can also be included in a standard, lay-down N/2 Strawn unit, and Rule 104.C(2) would permit an infill well in the NW/4 in either configuration.

(13) Accordingly, absent qualitative differences in the Strawn's productivity in different parts of the Section (of which there is no evidence in this case), approval of the proposed non-standard unit comprising only the SW/4 will not adversely affect the correlative rights of the owners in the NW/4, nor will it alter the permitted well density in Section 28.

(14) The proposed non-standard Strawn gas spacing unit, and the dedication of the subject well thereto, should accordingly be approved, *unless* such approval is precluded by the considerations advanced by Ard.

(15) Ard's contentions regarding wellbore ownership raise issues of property and contractual rights that the Division does not have jurisdiction to determine.

(16) The Division's approval of a spacing unit, or of the dedication of a well to a spacing unit, does not confer upon Applicant a right to commit a trespass or to breach a contract. As explained by the Texas Supreme Court in *Magnolia Petroleum Co. v. Railroad Com'n*, 141 Tex. 98, 170 SW2d 189, 191 (1943),

> It [the Railroad Commission's approval of a drilling permit] merely removes the conservation laws as a bar to the drilling of the well, and leaves the permittee to his rights at common law.

(17) Thus, the Division's approval of the proposed unit would not impair any property or contractual rights Ard may have, but would merely relegate Ard to the courts for enforcement of those rights should Yates encroach upon them.

(18) The New Mexico Oil Conservation Commission, however, in Order No. R-12343-E, issued on March 16, 2007 in combined Cases 13492 and 13493 (*Application of Samson Resources Co.* and *Application of Chesapeake Operating, Inc.*, respectively), admonished the Division that it ought not to grant an approval that would sanction a trespass. Order R-12343-E, Finding Paragraphs 29 through 33.

(19) The question now before the Division is whether, based on the evidence presented in this case, the Commission's admonition in *Samson/Chesapeake* precludes approval of the proposed unit absent Ard's consent or a judicial declaration of Applicant's rights. The Division concludes that it does not, for the following reasons:

(a) In *Samson/Chesapeake,* Chesapeake drilled a well on land in which it admittedly owned no interest, and had only an extremely dubious claim to a contractual right. In this case Yates and its related entities own 100% of the working interest in the land where the subject well is located.

(b) Ard did not refer the Division to any body of judicial authority in New Mexico or elsewhere, and the Division is aware of none, discussing the incidents of wellbore ownership as a property right separate and distinct from ownership of the land where the wellbore is located.

(c) The Joint Operating Agreement ("JOA") that forms the basis of Ard's claim does not explicitly address, affirmatively or negatively, the issue of use of the wellbore, or of the jointly owned equipment, for production from formations not included in the "contract area," other than to provide that the operator is not *required* to test such formations. JOA Article VI.A.

(d) With respect to the jointly owned equipment, and also to the wellbore if the parties of the JOA own the wellbore, as Ard contends, Applicant is an owner of an undivided interest, and has the express consent of the owners of approximately 99.5% of the total interest therein to its proposed dual completion of the well in the Strawn formation.

(e) As a general rule, use or occupation of property by a co-owner does not constitute a trespass, but merely gives rise to a duty of accountability.

(20) The Division accordingly concludes that the Yates' application for a non-standard 160-acre Strawn gas spacing unit should be approved.

IT IS THEREFORE ORDERED THAT:

(1) The application of Yates Petroleum Corporation to form a 160-acre non-standard gas spacing unit in the Saladar-Strawn Gas Pool (84412), comprising the SW/4 of Section 28, Township 20 South, Range 28 East, NMPM, in Eddy County, New Mexico, is hereby approved.

(2) The unit so formed shall be dedicated to Yates' Hedgerow BFH State Com Well No. 1 (API No. 30-015-33715), located 660 feet from the South line and 1136 feet from the West line (Unit M) of Section 28, in the event that well is completed in the Strawn formation.

(3) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

MARK E. FESMIRE, P.E.
Director

SEAL

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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 15054
ORDER NO. R-13789

APPLICATION OF COG OPERATING, LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on November 14, 2013, at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 21st day of January, 2014, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of these cases and of the subject matter.

(2) COG Operating, LLC ("Applicant" or "COG") seeks approval of a non-standard 160-acre oil spacing and proration unit and project area ("the Unit") in the Yeso formation consisting of the W/2 of the E/2 of Section 9, Township 19 South, Range 26 East, NMPM, in Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit for the Yeso formation inclusive of all pool(s) developed on 40-acre spacing within the vertical extent of the formation.

(3) The Unit will be dedicated to Applicant's **Stonewall 9 Fee Well No. 3H** ("the proposed well"; API No. 30-015-41555), a horizontal well to be drilled from a surface location 150 feet from the South line and 2310 feet from the East line (Unit letter O) of Section 9 to a standard terminus 330 feet from the North line and 2298 feet from the East line (Unit letter B) of Section 9. The completed interval of the well in the Yeso formation will be orthodox with the penetration point located 330 feet from the South line and 2310 feet from the East line (Unit letter O) of Section 9.

EXHIBIT
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(4) The proposed well is within the Atoka-Glorieta-Yeso Pool (Pool code 3250). Spacing in this pool is governed by statewide Rule 19.15.15.9A. NMAC, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section. The proposed Unit and project area consists of four adjacent quarter-quarter sections.

(5) Applicant appeared at the hearing through counsel and presented the following testimony:

(a) the Yeso formation in this area is suitable for development by horizontal drilling;

(b) the proposed orientation of the horizontal well South to North or North to South is appropriate for the proposed Unit;

(c) this well is being completed to test the Paddock member of the Yeso formation; and

(d) all quarter-quarter sections to be included in the Unit are expected to be productive in the Yeso formation, so that formation of the Unit as requested will not impair correlative rights.

(6) Appearance was made by counsel representing several uncommitted mineral interests within one of the tracts of the Unit. No other party appeared at the hearing, or otherwise opposed the granting of this application.

(7) Trustee representing the uncommitted interests provided testimony in support of the well completion but objected to Applicant's exclusion in the drilling program of testing shallower zones with hydrocarbon potential while retaining the rights to those shallower zones.

The Division concludes that:

(8) Approval of the proposed non-standard unit will enable Applicant to drill a horizontal well that will efficiently produce the reserves underlying the Unit, thereby preventing waste, and will not impair correlative rights.

(9) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(10) Applicant is owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

(11) There are interest owners in the Unit that have not agreed to pool their interests.

(12) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(13) COG should be designated the operator of the proposed well and of the Unit.

(14) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the proposed well.

(15) Reasonable charges for supervision (combined fixed rates) should be fixed at $5,450 per month while drilling and $545 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*"

(16) With regards to the *pro se* appearance by the Trustee, the Division does not have jurisdiction concerning the content of lease agreements between Applicant and parties with working or mineral interests in the area to be pooled and the Division's authority to pool is limited to the formation(s) or pool(s) identified by Applicant in the application presented at hearing.

IT IS THEREFORE ORDERED THAT:

(1) A non-standard 160-acre oil spacing and proration unit ("the Unit") is hereby established for the Yeso formation consisting of the W/2 of the E/2 of Section 9, Township 19 South, Range 23 East, NMPM, in Eddy County, New Mexico.

(2) Pursuant to the application of COG, all uncommitted interests, whatever they may be, in the oil and gas located in the Yeso formation underlying the Unit inclusive of all pool(s) developed on 40-acre spacing within the vertical extent of the formation, are hereby pooled.

(3) The Unit shall be dedicated to Applicant's **Stonewall 9 Fee Well No. 3H** ("the proposed well"; API No. 30-015-41555), a horizontal well to be drilled from a surface location 150 feet from the South line and 2310 feet from the East line (Unit letter O) of Section 9 to a standard terminus 330 feet from the North line and 2298 feet from the East line (Unit letter B) of Section 9. The completed interval of the well in the Yeso formation will be orthodox with the penetration point located 330 feet from the South line and 2310 feet from the East line (Unit letter O) of Section 9.

(4) The operator of the Unit shall commence drilling the proposed well on or before January 31, 2015, and shall thereafter continue drilling the proposed well with due diligence to test the Yeso formation.

(5) In the event the operator does not commence drilling the proposed well on or before January 31, 2015, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the unit and project area created by this order shall terminate, unless operator appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence. If the proposed well is not completed in all of the quarter-quarter sections included in the proposed Unit within 120 days after commencement of drilling, then the operator shall apply to the Division for an amendment to this Order to contract the Unit so that it includes only those quarter-quarter sections in which the well is completed.

(7) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit created by this Order shall terminate, unless this Order has been amended to authorize further operations.

(8) COG Operating, LLC (OGRID 229137) is hereby designated the operator of the well and the Unit.

(9) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(10) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(11) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule

of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(12) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(13) The operator is hereby authorized to withhold the following costs and charges from production from each well:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

(b) as a charge for the risk involved in drilling the well, 200% of the above costs.

(14) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(15) Reasonable charges for supervision (combined fixed rates) for the well are hereby fixed at $5,450 per month while drilling and $545 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 pooled working interest owners.

(16) Except as provided in Paragraphs (13) and (15) above, all proceeds from production from the proposed well that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8A-1 through 70-8A7-8A-28, as amended).

(17) Any unleased mineral interests shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of

production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(18) Should all the parties to these compulsory pooling orders reach voluntary agreement subsequent to entry of this Order, this order shall thereafter be of no further effect.

(19) The operator of the well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this Order.

(20) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

JAMI BAILEY
Director

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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 15568
ORDER NO. R-14304

APPLICATION OF COG OPERATING LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on October 27, 2016, at Santa Fe, New Mexico, before Examiner William V. Jones.

NOW, on this 24th day of February, 2017, the Division Director, having considered the testimony, the record and the recommendations of the examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and the subject matter.

(2) COG Operating LLC ("Applicant") seeks approval of a 240-acre, more or less, non-standard oil spacing and proration unit and project area (the "Unit") comprising the E/2 W/2 of Section 10 and the E/2 NW/4 of Section 15, all in Township 17 South, Range 32 East, NMPM, Lea County, New Mexico, for oil and gas production from the Yeso formation, Maljamar; Yeso, West Pool (Pool code 44500). Applicant further seeks an order pooling all uncommitted interests in the Unit.

(3) The Unit will be dedicated to Applicant's proposed Nelson Federal Com Well No. 13H (the "proposed well"; API No. 30-025-pending), a horizontal well to be drilled from a surface location 2358 feet from the South line and 1895 feet from the West line (Unit K) of Section 15, to a bottom-hole location 330 feet from the North line and 1650 feet from the West line (Unit C) of Section 10, both in Township 17 South, Range 32 East, NMPM, Lea County, New Mexico. The first take point will be approximately 2310 feet from the North line and 1874 feet from the West line (Unit F) of Section 15, and the last

EXHIBIT
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take point will be approximately at the bottom hole location. The location of the completed interval will be standard for oil production within the Unit.

(4) The proposed well will be completed within the Maljamar; Yeso, West Pool and is subject to Division Rule 19.15.15.9(A) NMAC, which provides for 330-foot setbacks from the unit boundaries and standard 40-acre units each comprising a governmental quarter-quarter section. The proposed Unit and project area consists of six adjacent quarter-quarter sections oriented south to north.

(5) Applicant appeared through counsel and presented the following land and geologic evidence:

(a) The Yeso formation in this area is suitable for development by horizontal drilling.

(b) the proposed orientation of the horizontal well from south to north is appropriate for the Unit.

(c) all quarter-quarter sections to be included in the Unit are expected to be productive in the prospective portion of the Yeso formation, so that the Unit as requested will not impair correlative rights.

(d) Applicant is requesting to compulsory pool the Yeso formation within the Unit.

(e) Notice of the application and hearing in this case was provided to lessees or operators of surrounding tracts as affected parties of the proposed non-standard spacing unit.

(f) Notice by certified mail was provided to all interest owners in the proposed Unit whose interests were evidenced by a conveyance instrument, either of record or known to Applicant when the Application was filed, and to heirs known to Applicant of deceased persons who appear as owners in such instruments, and whose identity and whereabouts could be ascertained by exercise of reasonable diligence.

(g) Those potentially affected parties whose whereabouts could not be ascertained were noticed by publication as provided in Rule 19.15.4.12.B NMAC.

(6) No other party entered an appearance or otherwise opposed this application.

The Division concludes as follows:

(7) There is an issue concerning notice in this case because of the characterization in an exhibit of certain persons as "unmarketable title owners." This characterization suggests a possibility that other, possibly unidentified, persons may in fact own interests in the Unit due to defects in the titles of the persons so identified.

(8) The Division does not have jurisdiction to determine who owns any interest in real property or whether or not their interest is marketable. However, the Division does have a responsibility to determine whether all persons entitled to notice by Division rules, or by judicial decisions, have been duly notified. To fulfill this responsibility the Division should require that the Applicant present evidence unequivocally identifying those persons to whom notice is required.

(9) To facilitate the Division's consideration of notice evidence in future compulsory pooling cases, we encourage the following:

[a] Applicants should distinctly identify those persons described in Rule 19.15.4.12.A(1)(a), whether those persons' whereabouts are known or not. If Applicant knows that any such person is deceased, that fact should be indicated. If any such person's whereabouts are unknown, or if personal service by certified mail has failed, so that compliance with the notice requirement of that rule depends upon the validity of publication, Applicant should present testimony, in person or by affidavit, that Applicant "has been unable to locate persons entitled to notice after exercising reasonable diligence" as required by Rule 19.15.4.12.B, and describing the diligence exercised. Persons to whom the rule requires notice must be accorded actual or constructive notice as required whether their titles are marketable or not.

[b] In addition, applicants should distinctly identify persons whom it knows or believes to be owners of interests in the proposed unit even if they are not named in any conveyance instrument (for example, persons known or believed to own interests as heirs of a deceased record owner whose estate has not been the subject of probate). Such persons would be constitutionally entitled to notice if their identity and whereabouts are ascertainable under the Supreme Court's holding in *Uhden v. OCC*, 112. NM 528, 531 (1991). Constructive notice to persons whose whereabouts are unknown, however, is not required by the *Uhden* opinion, and accordingly should not be required except as to persons described in Rule 19.15.4.12.A(1)(a).

[c] In uncontested cases, or in absence of objection, the testimony of a qualified land man by reference to a sponsored exhibit or otherwise will be accepted as fulfilling the above requirements.

[d] Nothing in this discussion should be construed as disapproving or discouraging any applicant's giving notice to additional persons in an abundance of caution and providing evidence of such notice at the hearing.

(10) Although the evidence in the present case is not as detailed as recommended above, the Division concludes that it is sufficient to demonstrate due notice.

(11) Accordingly, the proposed non-standard unit should be approved to enable Applicant to drill a horizontal well that will efficiently produce the reserves underlying the Unit, thereby preventing waste and protecting correlative rights.

(12) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(13) Applicant is owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

(14) There are interest owners in the Unit that have not agreed to pool their interests.

(15) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense a just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(16) COG Operating LLC should be designated the operator of the proposed well and the Unit.

(17) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the proposed well.

(18) Reasonable charges for supervision (combined fixed rates) should be fixed at $7,000 per month, per well, while drilling and $700 per month, per well, while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*"

IT IS THEREFORE ORDERED THAT:

(1) Pursuant to the application of COG Operating LLC, a 240-acre, more or less, non-standard oil spacing and proration unit and project area (the "Unit") comprising the E/2 W/2 of Section 10 and the E/2 NW/4 of Section 15, all in Township 17 South, Range 32 East, NMPM, Lea County, New Mexico, is hereby established for oil and gas production from the Yeso formation, Maljamar; Yeso, West Pool (Pool code 44500).

(2) All uncommitted interests, whatever they may be, in the oil and gas in the Yeso formation underlying the Unit, are hereby pooled.

(3) The Unit shall be dedicated to Applicant's proposed Nelson Federal Com Well No. 13H (the "proposed well"; API No. 30-025-pending), a horizontal well to be drilled from a surface location 2358 feet from the South line and 1895 feet from the West line (Unit K) of Section 15, to a bottom-hole location 330 feet from the North line and 1650 feet from the West line (Unit C) of Section 10, both in Township 17 South, Range 32 East, NMPM, Lea County, New Mexico. The first take point will be approximately 2310 feet from the North line and 1874 feet from the West line (Unit F) of Section 15, and the last take point will be approximately at the bottom hole location. The location of the completed interval will be standard for oil production within the Unit.

(4) The operator of the Unit shall commence drilling the proposed well on or before January 31, 2018, and shall thereafter continue drilling the proposed well with due diligence to test the Paddock interval within the Yeso formation.

(5) In the event the operator does not commence drilling the proposed well on or before January 31, 2018, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the Unit and project area created by this order shall terminate, unless operator appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence. If the proposed well is not completed in all of the standard spacing units included in the proposed project area (or Unit), then the operator shall apply to the Division for an amendment to this order to contract the Unit so that it includes only those standard spacing units in which the well is completed.

(7) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit created by this order shall terminate, unless this Order has been amended to authorize further operations.

(8) COG Operating LLC (OGRID 229137) is hereby designated the operator of the well and the Unit.

(9) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(10) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(11) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(12) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated well costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(13) The operator is hereby authorized to withhold the following costs and charges from production from each well:

(a) The proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

(b) As a charge for the risk involved in drilling the well, 200% of the above costs.

(14) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(15) Reasonable charges for supervision (combined fixed rates) for the well are hereby fixed at $7,000 per month, per well, while drilling and $700 per month, per well, 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 pooled working interest owners.

(16) Except as provided in Paragraphs (13) and (15) above, all proceeds from production from the proposed well that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8A-1 through 7-8A-31, as amended).

(17) Any unleased mineral interests shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this Order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(18) Should all the parties to this compulsory pooling order reach voluntary agreement after entry of this order, this order shall thereafter be of no further effect.

(19) The operator of the well and the Unit shall notify the Division in writing of the subsequent voluntary agreement of all persons subject to the compulsory pooling provisions of this order.

(20) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

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

SEAL

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OIL CONSERVATION DIVISION

David R. Catanach

DAVID R. CATANACH
Director