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

APPLICATIONS OF TEXAS STANDARD OPERATING NM LLC FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO **CASE NOS. 23823-23824**

ARMSTRONG ENERGY CORP. AND SLASH EXPLORATION LP'S PRE-HEARING STATEMENT

Armstrong Energy Corp. ("Armstrong") and Slash Exploration LP ("Slash") submit their Pre-Hearing Statement in accordance with the New Mexico Oil Conservation Division's ("Division") Amended Pre-Hearing Order (issued May 29, 2024).

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STATEMENT OF THE CASE

In Case No. 23823, Texas Standard Operating NM LLC's ("TSO") seeks an order pooling uncommitted interests in the Upper Penn Shale formation underlying the W/2 SE/4 of Section 11,

W/2 E/2 of Section 14, and W/2 NE/4 of Section 23, Township 17 South, Range 36 East and proposes to dedicate the unit to the Lap Dog State No. 1H and 2H Wells. In Case No. 23824, TSO seeks an order pooling uncommitted interests in the Upper Penn Shale formation underlying the E/2 SE/4 of Section 11, E/2 E/2 of Section 14, and E/2 NE/4 of Section 23, Township 17 South, Range 36 East and proposes to dedicate the unit to the Lap Dog State No. 3H and 4H Wells. TSO's applications should be denied because it has failed to negotiate with Slash in good faith.[1] In addition, there is no basis for the Division to invalidate Slash's contractual overriding royalty interest ("ORRI") in the acreage at issue, as requested by TSO.

Slash owns the lease that includes the NE/4 of Section 23, which amounts to 80 acres—25%—of the working interest in each of TSO's proposed spacing units. *See* TSO Exhibit 2-B. Armstrong owns operating rights under the lease. *See* Self-Affirmed Statement of Kyle Armstrong, Armstrong/Slash Exhibit A, at ¶ 8. In fact, Slash owns far more of the interest in TSO's proposed spacing units than TSO. TSO only owns an 8.57% working interest in its proposed spacing unit in Case No. 23823 and 7.84% of the working interest in its proposed spacing unit in Case No. 23824. *See* TSO Exhibit 2-B. TSO seeks to pool all other interests, which amount to 91.43% of the working interest in Case No. 23823 and 92.16% of the working interest in Case No. 23824. Exh. A at ¶ 9. *This means that TSO failed to reach voluntary agreements with over 91% of the interest owners in these cases*, including Slash, demonstrating a lack of good faith negotiation. *Id.* at ¶ 10.

Slash attempted to negotiate with TSO regarding these matters for months. *See* Exh. A at ¶ 11; *see also* TSO Exhibit 2-E. TSO refused to offer market rates for Slash's significant interest in the spacing units. Specifically, TSO refused to agree to a lease bonus, which is standard in this area and price environment. Exh. A at ¶ 13. As Mr. Roberson stated in his October 26, 2023 email,

[1] Operators seeking compulsory pooling are required to engage in good faith negotiations. *See, e.g.,* Order No. R-20223.

TSO concluded it could not afford to pay a bonus and "[had] to pool everyone to drill the unit anyway." TSO Exh. 2-E. This statement is concerning given that TSO proposes to drill four horizontal wells that will cost $12.5 million each. *See* TSO Exh. 2-D. Further, Mr. Roberson's testimony admits that TSO would only make offers that would deliver a 75% net royalty interest to TSO. *See* TSO Exhibit 2 at ¶ 14.

Slash made reasonable counteroffers in an attempt to negotiate, but TSO ultimately refused to engage in further discussions. *See* Exh. A at ¶¶ 13-14. Slash informed TSO that it would carve out an overriding royalty interest if necessary, and sent TSO the proposed assignment on April 29th. *See* Exh. A at ¶ 14 and Exh. A-1 at 15. Slash also informed TSO that based on the override assignment, it would withdraw its objection to these cases proceeding by affidavit. *Id.* TSO did not respond. As a result, Slash carved out an 11.25% overriding royalty interest to ensure it received fair compensation for its significant interest, which results in a 67% net royalty interest to TSO. *See id.; see also* TSO Exh. 2-E. Given the significance of Slash's interest in the proposed units and TSO's refusal to pay market rates, the royalty assignment was reasonable and necessary to protect Slash's correlative rights. Exh. A at ¶ 15.

Because Slash had appropriately carved out an override that would protect its interest, Slash and Armstrong withdrew their objection to these cases proceeding by affidavit on May 16, 2024. Exh. A at ¶ 17. TSO did not notify Slash that it was concerned about the assignment or that it would effectively seek to invalidate it. Instead, TSO filed its prehearing statement and exhibits arguing that the royalty assignment should be disregarded for purposes of these pooling cases. *See* TSO Prehearing Statement; TSO Exhibit 2 at ¶ 15. TSO's position that anything less than a 75% net royalty interest violates its correlative rights is extraordinary, would improperly inject the

Division into contractual matters, and would deprive Slash of a benefit it is entitled to receive via an enforceable contract under New Mexico law.

The Division does not have jurisdiction over contractual matters and does not have the authority to adjudicate private civil claims. *See* NMSA 1978, § 70-2-6 (Division and Commission have authority to prevent waste and protect correlative rights); *Marbob v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, 146 N.M. 24 (Because the Division is a creature of statute, its jurisdiction is limited by the Act). Further, all pooling orders must be issued on terms that are just and reasonable. *See* NMSA 1978, § 70-2-17(C). Accordingly, the Division and Commission have rarely disregarded royalty assignments and have done so only in extraordinary circumstances. The Commission has stated:

> Under certain circumstances, leasing, burdening or otherwise carving out a large non-cost-bearing interest may violate the correlative rights of interest owners and create waste *if the non-cost-bearing interest is so large as to affect the economic viability of a prospect and prevent the drilling of a well*.

Order No. R-11573-B (emphasis added) at ¶ 10.

In Case No. 12601, the Commission determined that a working interest owner's retention of a 27.5% royalty interest was sufficiently high that it would render the well uneconomic by reducing the rate of return to approximately 20%. *See* Order No. R-11573-B. The applicant presented expert testimony that the well would not be drilled at a 20% rate of return, and the Commission determined that the failure to drill the well would violate the correlative rights of the interest owners. Based on evidence presented at hearing, the Commission also expressly determined that the interest owner had carved out the royalty interest in a deliberate attempt to thwart pooling. *See* Order No. R-11573-B at ¶¶ 13-15. As a result, the Commission treated the interest as unleased, and subject to a statutory 1/8 royalty, for purposes of the pooling order. *See id.* at ¶¶ 20-22; *see also* NMSA 1978, § 70-2-17(C) ("If the interest of any owner or owners of any

unleased mineral interest is pooled by virtue of this act, seven-eighths of such interest shall be considered as a working interest and one-eighth shall be considered a royalty interest, and he shall in all events be paid one-eighth of all production from the unit and creditable to his interest.").

In Case No. 7922, the Division addressed a 50% royalty carve-out and determined that the parties should voluntarily agree to reduce the royalty to 12.5% or that the acreage should be excluded from the unit. *See* Order No. R-7335 at ¶ 4. The Division found that the 50% royalty would render the well uneconomic. *Id.* at ¶ 12.

Case Nos. 12601 and 7922 were extraordinary because the royalty carve-out was so significant that it rendered the wells uneconomic such that they would not be drilled. Otherwise, the Division has declined to rule on these types of contractual matters. Contrary to TSO's position, it is certainly not the case that parties are generally precluded from assigning royalty interests after a pooling application is filed or that TSO is entitled to a 75% net royalty interest as a matter of law.

Here, Slash only retained a 11.25% overriding royalty interest, nowhere near the 27.5% royalty interest at issue in Order No. R-11573-B or the 50% royalty interest at issue in Order No. R-7355. Indeed, Slash's ORRI is less than the royalty the Division approved in Order R-7355. Unlike the cases cited by TSO, Slash's ORRI was assigned to protect its significant interest in the spacing units. It was not intended to preclude TSO from pooling its proposed units. *See* Exh. A.

In addition, unlike the applicants in Case Nos. 12601 and 7922, TSO's testimony fails to state that Slash's ORRI will render the wells uneconomic. Rather, TSO states that it acquires leases in this area with a 75% net royalty interest and has not seen lease burdens of this nature. TSO Exh. 4. This claim, even if true, does not mean the wells are uneconomic or will not be drilled. Accordingly, there is no basis for the Division to disregard Slash's ORRI.

Further, Slash has continued to attempt to work with TSO in good faith and determined that its interest was carved to a 67% net royalty interest in error and will amend it to a 70% net royalty interest. Slash would also be willing to agree that its acreage be removed from TSO's proposed spacing units. To date, TSO has not been willing to engage in further negotiations with Slash.

Neither the Oil and Gas Act nor Division precedent support TSO's position that anything less than a 75% net royalty interest violates its correlative rights. TSO's "my way or the highway" approach demonstrates a lack of good faith negotiation that warrants denial of its applications. Alternatively, if the Division is inclined to approve the applications, then it should: (1) reject TSO's request to disregard Slash's ORRI; or (2) exclude Slash's acreage in the NE/4 of Section 23 from the proposed units.

PROPOSED EVIDENCE

Witness	Occupation	Estimated Time	Exhibits
Kyle Armstrong	President and CEO	20 minutes	1

PROCEDURAL MATTERS

None at this time.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 17, 2024, I served a true and correct copy of the foregoing pleading on the following counsel of record by electronic mail:

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QUESTIONS

Action 355088

QUESTIONS

Operator: ARMSTRONG ENERGY CORP P.O. Box 1973 Roswell, NM 88202	OGRID: 1092
	Action Number: 355088
	Action Type: [HEAR] Prehearing Statement (PREHEARING)

QUESTIONS

Testimony

Please assist us by provide the following information about your testimony.

Number of witnesses	*Not answered.*
Testimony time (in minutes)	*Not answered.*