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

APPLICATION OF AVANT OPERATING, LLC FOR COMPULSORY POOLING AND APPROVAL OF NON-STANDARD HORIZONTAL SPACING UNIT, LEA COUNTY, NEW MEXICO

Case No. 24544

REPLY TO AVANT OPERATING, LLC'S RESPONSE IN OPPOSITION TO PRIMA'S MOTION TO DISMISS POOLING APPLICATION ON THE BASIS OF EXCESSIVE INITIAL WELLS

Prima Exploration, Inc. ("Prima") submits its Reply to Avant Operating, LLC's Response in Opposition ("Response") to Prima's Motion to Dismiss ("Motion to Dismiss") Pooling Application on the Basis of Excessive Initial Wells. In support of this Reply, Prima states the following:

1. In Paragraph 1 of its Response, Avant references 19.15.13.9 NMAC, which provides that an operator may propose drilling an "infill" well "any time after completion of *the initial well*." (Emphasis added). The language of this Rule reflects how operators proposed in a pooling application "the initial well" as the defining well as a long-standing practice. Thus, after the Oil Conservation Commission adopted the horizontal rules in 2018, it was common practice for pooling applications to propose a single initial well. Periodically there were applications with multiple initial wells but such applications would often be accompanied by a special provision requesting more than one year to batch drill the wells. The requirement that "the initial well" be drilled and completed before drilling additional infill wells provided substantial certainty that an applicant to whom the Division granted operatorship would be able to perfect and secure the spacing unit and pooling order without overly burdening working interest owners with the

excessive upfront costs of numerous initial wells. As a result, the practice of proposing single initial wells provided an element of fundamental fairness to the pooling process that allowed working interest owners who wanted to participate in the initial well to pay more reasonable upfront costs and have greater confidence that the unit they were investing in would be perfected and secured. The Division has always allowed multiple wells to be drilled and developed in a spacing unit; the issue is at what point in the pooling process does the unit and pooling order become perfected and secure – thus immune to challenge or termination – in a manner that provides for stable and uninterrupted development.

2. When the Division began relaxing the meaning of "the initial well" to allow applicants to propose multiple initial wells on a regular basis in order to accommodate batch drilling, it benefited operators by improving the efficiency of rig scheduling and thereby promoted development, which is consistent with preventing waste. On the other hand, this change increased the burden on non-operator working interest owners who could face significant cash calls that negatively affected many working interest owners' ability to participate and receive their just and equitable share of production.

3. Another critical issue that arose from applicants proposing multiple initial wells concerns the heightened risk that an operator would fail to perfect the pooling and units under the terms of Paragraph 20 and 21 of the Division Order. Parties have sometimes relied on the assumption that drilling and completing one of the initial wells proposed would perfect the unit and order, but this assumption is no longer valid pursuant to *Notice: OCD Hearing Updates and Clarification Processes,* dated April 24, 2024 ("OCD's First Update Letter") and *Notice: OCD Clarification of Compulsory Pooling Processes Updates,* dated July 12, 2024 ("OCD's Second Update Letter"). Furthermore, the assumption never tracked the plain language and meaning of

Paragraph 21 which plainly states that the order "shall terminate automatically if Operator fails to comply with Paragraph 20 [the commencement of all initial wells within one year after the date of the order and complete each well no later than one year after commencement of drilling the Well] unless Operator obtains an extension by amending Order for good cause shown."

4. There are a variety of parties -- owners and operators -- involved in the oil patch of New Mexico's Permian Basin, and each party who owns interest, however small or large, has a variety of rights protected by the Oil and Gas Act ("Act"). Some operators have long established histories and develop lands for long term production over the course of decades; some parties such as non-operator owners acquire smaller interests and participate in wells and/or place the interest on the market, and some operators will develop a substantial prospect at an accelerated rate not necessarily for establishing long term production but over a shorter period of time for the purpose of building and acquiring a valuable asset to place in a portfolio for asset management, which can include placing the prospect on the market for purchase. All of these varieties of parties have rights under the Act, rights that should be respected, and each party pursues its rights and interests under the oversight of the Division so that waste is prevented and correlative rights (the right of an owner to its just and equitable share of production) are protected.

5. Avant Operating, LLC, ("Avant"), represents itself as "a company at the forefront of energy asset management," *see* https://www.avantnr.com/. A review of its pooling applications filed with the Division over the past three years indicates that Avant is pursuing development of a particular area in Lea County, New Mexico, at what appears to be an accelerated rate: Avant had zero pooling applications in 2020 and 2021, followed by only three applications in 2022, and then a dramatic jump of six (6) applications in 2023, and now, less than 9 months into 2024, Avant has filed thirteen (13) new pooling applications, more than double the number of applications it

filed last year. *See* Exhibit 1, attached hereto (a list of pooling applications filed by Avant since January 1, 2020). Concurrently with its increase in the number of applications filed, Avant has steadily increased the number of initial wells in its pooling applications. In its first two (2) applications filed in 2022, Avant proposed three (3) initial wells in Case No. 22895 and three (3) initial wells in Case No. 22896 for a total of six (6) initial wells. Then at the very end of 2022, Avant proposed nine (9) initial wells in Case No. 23246.

6. The first two (2) cases in 2023 are Case Nos. 23677 and 23678 with Order Nos. R-22957 and R-22958, respectively. These Orders were the first Orders issued in 2023, with only fifteen (15) wells in the queue from Avant's 2022 applications, and these two Orders include the sixteen (16) wells Avant describes drilling in the timely manner of eight (8) months to demonstrate that this number, or comparable number, of initial wells in an application is within Avant's capabilities. *See* Avant's Response at ¶ 7. However, Avant accomplished this at a time when (based on the number of applications listed by the OCD) it only had fifteen (15) wells in its queue from its 2022 pooling applications, and some of those may have already been drilled prior to drilling the first set of sixteen (16) wells from 2023 applications. Thus, the burden of Avant's drilling schedule was relatively low when Avant timely drilled sixteen (16) wells in eight (8) months under the two Order Nos. R-22957 and R-22958.

7. Fast forward to Avant's present Case No. 24544, filed May 13, 2024, and already Avant has eight (8) applications in the queue that precede the present case and seven (7) applications filed and in the queue after this case, thereby burdening Avant at the present time with an additional 15 (15) applications. *See* Exhibit 1, attached hereto. From just three (3) samples of the applications already in Avant's queue, Case Nos. 24118, 24254, and 24376, two of which have Orders issued, as highlighted in red in Prima's Exhibit 1, one can see Avant's dramatic

increase of initial wells included in its applications. Avant's application in Case No. 24118, filed December 5, 2023, includes twenty-six (26) initial wells; its application in Case No. 24254, filed February 2, 2024, includes eighteen (18) initial wells; and its application in Case No. 24376, filed March 28, 2024, also includes eighteen (18) initial wells. These three (3) cases alone currently obligate Avant to drill sixty-two (62) initial wells pursuant to the terms of Paragraphs 20 and 21 of the Division's Pooling Order, and there are fourteen (14) additional cases Avant filed in 2023 and 2024 reflecting a multitude of initial wells. Thus, the burden of the drilling schedule Avant currently faces in the present case is much more intense than the burden at the time it drilled the sixteen (16) initial wells listed in Order Nos. R-22957 and R-22958 from Avant's first two (2) cases in 2023. Prima, as stated in its Motion to Dismiss, has concluded that Avant has over-extended itself, knowingly so, with drilling and completion obligations. *See* Motion to Dismiss at ¶ 4. And it should be noted: Avant continues to file pooling applications at an accelerated rate.

8. Units developed in such an accelerated manner can indicate that oil and gas assets are being built for the purpose placing them on the market. When an asset company files a pooling application, a larger number of wells drilled in a unit can increase the value of the unit as an asset so there is incentive to increase the number of initial wells in a pooling application if it is part of an oil and gas prospect being developed for sale at some point in the near future. By proposing a large number of initial wells in each application, an asset company can then proceed to drill and produce as many wells as possible to increase the value of its asset even if the company cannot drill and complete all the wells by the required deadlines under a pooling order or sells the asset prior to drilling and completing all the initial wells.

9. <u>Concerns regarding the applicability of the Development Plan Option ("DPO") as outlined in OCD's Second Update Letter</u>: It is clear that the Division's recently announced

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Development Plan Option ("DPO") can serve as an important tool to enhance the Division's ability to introduce accountability with respect to Paragraphs 20 and 21. Prima respectfully requests that the Division consider the best manner in which the DPO should be allowed and the conditions under which it should be applied. For example, the DPO might be more applicable to the plans of an applicant that can demonstrate long-term intent and stability for development and production and may be less applicable to an applicant that plans to place its collection of pooled units on the market when they are ripe to sell irrespective of whether any progress has been made toward drilling the wells listed on the DPO at the time of the sale. Once a unit is sold, the seller no longer has any obligation to fulfill a DPO drilling list that the seller had originally developed and proposed.

10. In the past when drilling and completing "the initial well," as the defining well, would perfect a pooling order and unit, an operator could readily secure the unit for future development by infill wells. Under such conditions, there was no risk that the unit would terminate under the pooling order when bought or sold and transferred to another operator because the unit was already perfected, and if the new operator wanted to expand the development of the unit, it could do so by proposing infill wells. The infill well process is governed by Chapter 15, Part 13 of NMAC, and incorporates a number of requirements, such as proposing the infill wells, notice to and communication with working interest owners, and timelines for elections, which work to ensure due process, protect rights, and balance interests. *See, e.g.,* Rules 19.15.13.10 through 19.15.13.13. When applicants were granted permission to propose multiple initial wells, this development was helpful for facilitating batch drilling, but to a certain extent, it allowed operators to bypass and short circuit the infill well process because what would have been previously drilled

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as infill wells can now be drilled upfront as additional initial wells after a "batch pooling" before the Division.

11. The challenge in this matter would seem to be finding the right balance between facilitating batch drilling by allowing a sufficient number of additional initial wells in an application to promote responsible development on the one hand and ensuring that pooling orders and units can be readily perfected for successful, long-term development that prevents waste, protects correlative rights, and avoids the drilling of unnecessary wells, on the other. For example, if an applicant is allowed to propose a large number of initial wells and further expand the number of initial wells by using a DPO to project drilling of the wells over the course of up to five years, the cash call on such wells required to be paid upfront could easily prohibit any number of owners from ever being able to participate in the development, and therefore they would be systematically barred from obtaining the just and equitable share of production that they might seek otherwise.

12. Avant suggests that the Division should view Prima's motion to dismiss Avant's pooling application as "a motion to dismiss a case for failure to state a claim on which relief can be granted." *See* Avant's Response at ¶ 9. Avant's suggestion is without merit. A party seeking to dismiss a claim for failure to state a cause of action files its motion under Rule 1-012(B)(6) NMRA. This Rule of Civil Procedure is designed to allow a defendant to seek dismissal of a claim lodged against it that is set forth in a complaint or counterclaim seeking some sort of monetary, declaratory, and/or injunctive relief against the defendant. Avant desires to have the Division apply the standards of Rule 12(B)(6) since the standards for granting such a motion is understandably stacked heavily in favor of the claimant and against the movant. *See, e.g., Trujillo v. Berry*, 1987-NMCA-072, ¶ 3, 738 P.2d 1331, 1333 (noting that in considering a Rule 1-012(B)(6), "the well-pleaded facts alleged in the complaint are taken as true" and the motion is

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only granted if "the claimant cannot recover under any provable state of facts" [citations omitted]"); and *Madrid v. Village of Chama*, 2012-NMCA-071,¶ 18, 283 P.3d. 871, 876 (same).

13. However, Rule 1-012(B)(6) is not applicable in this case because Prima is not seeking to defend against a claim that Avant has lodged against it that would result in any monetary, declaratory, or injunctive relief being imposed against Prima. Thus, the standards applicable under deciding whether to grant a motion to dismiss filed under Rule 1-012(B)(6) are not applicable to Prima's Motion to Dismiss.

14. Pooling applications before the Division are commonly dismissed without prejudice for any number of reasons ranging from an application's extended presence on the docket rendering the case stale to the discovery of a typographical error that might have affected notice. The Division has full jurisdiction and authority over the management its own docket and the parties and interests subject to its docket. *See* Avant's Response at ¶ 10 (*citing* NMSA 1978 §70-2-2: The Division has "jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively" the Act). Certainly, managing the docket and the parties and cases on the docket to address an issue such as the appropriate number of initial wells that should be proposed in an application is within the power of the Division. If the Division should reasonably conclude, based on the arguments and evidence provided in Prima's Motion to Dismiss and Reply, that Avant's pooling application should be dismissed, and the reasons for the dismissal are not arbitrary or capricious, then the Division has the authority and right to dismiss Avant's pooling applications without prejudice to allow Avant to revise them.

15. A dismissal without prejudice does not bar Avant from a hearing; it would only delay the hearing until the pooling applications are in order to mitigate against the substantial risk that Avant will not be able to perfect its pooling order. Proposing and simultaneously drilling

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multiple initial wells pursuant to a pooling application is not a right under the Division's rules; it is a privilege provided to applicants by the Division's recently expanded interpretation of what the rules mean by "the initial well." If the Division discovers, whether prior to or during a hearing, that an applicant is using this privilege to substantially increase the number of initial wells in a manner that substantially increases the risk that neither the applicant nor a buyer who might acquire the unit after the pooling order is issued would be able to perfect the pooling order and unit, the Division has plenary authority to dismiss the application without prejudice.

16. Developing oil and gas prospects as assets for purchase and acquisition is an important part of the industry, but it is pursued differently, with different objectives, than long-term development pursued by industrial-sized companies, at one end of the spectrum, or private efforts to participate in a unit made by owners with smaller interests, at the other end of the spectrum. All parties involved, as well as the public at large, rely on the Division to balance all the competing interests involved in developing New Mexico's energy resources. *See, e.g., Continental Oil Co. v. Oil Conservation Comm'n*, 1962-NMSC-062, ¶ 28, 70 N.M. 310, 373 P.2d 809 (stating that "absent the Commission [and/or Division], the public would not be represented).

17. The risk with a DPO seems to be the potential for the Division to become burdened by excessive entanglement with an applicant for extended periods of time. Allowing an applicant with confirmed long-term intent and a well-established development plan to proceed with a DPO that extends the plan to drill initial wells up to five years may be the best decision for preventing waste and protecting correlative rights. Such conditions would likely not heavily burden the Division. Although it should be noted that even the best operators with the best thought-out plans encounter situations that require changes and modifications, for which the OCD's Second Update Letter accounts.

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18. However, an applicant that cannot or will not confirm its intent to remain as the operator while efforts are still needed to perfect the pooling order and unit may require a different approach than the multi-year DPO so that that the Division can avoid excessive entanglement with overseeing a plan that will require additional hearings and amendments. In general, it appears that whenever a DPO is utilized, it creates extra burdens on the Division that requires the use of its administrative resources. Avant could have provided its DPO as an attachment to its Response to demonstrate to the OCD its intent to remain as operator at least to see through the perfection of the pooling order and unit, but Avant did not, stating only that it reserved its right to propose an extended development plan at the hearing. *See* Avant's Response at ¶ 3.

19. Therefore, a focus on an approach to the initial well issue in the present case that would facilitate and promote an efficient and timely means of perfecting pooling orders and units to prevent disruptions to the development plan, protect correlative rights, and avoid the drilling of unnecessary wells is what Prima is seeking. Prima submits that the Division can protect these goals by dismissing Avant's case without prejudice so that the number of initial wells can be modified to a reasonable number that will mitigate the risk of not being able to satisfy the terms of the pooling order.

20. If Avant reduces its initial wells to a manageable number and then after drilling the wells in compliance with the pooling order discovers that additional wells are warranted, Avant can drill the additional wells by proposing infill wells to the working interest owners under the Division rules as originally conceived, a process which provides due process protections that would better balance the interests of the parties for purposes of expanding development and that would avoid excessive entanglement with the Division because the operator and owners can

propose and pursue the drilling of infill wells independently with little to no Division involvement. *See* 19.15.13.9 et al.

21. For the foregoing reasons, Prima respectfully requests that the Division grant its motion to dismiss without prejudice Avant's pooling application with instructions to refile a revised application at Avant's discretion that reduces the number of initials wells to a reasonable number under the circumstances, nine or less, in order to mitigate the substantial risk of failing to perfect the proposed unit. If the Division should decide to deny Prima's request or decide that the applications should go to hearing as drafted to have these issues addressed at that time, as requested by Avant, then Prima requests that the Division give consideration at the hearing to the applicability of a DPO in this case, should Avant submit one, and inquire into Avant's short-term and long-term intent and plans as an asset company for perfecting the proposed unit by drilling and completing all the initial wells it proposed in its present application in addition to drilling all the initial wells Avant concurrently obligated itself to drilling in the numerous additional applications it filed in 2023 and 2024.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed with the New Mexico Oil Conservation Division and was served on counsel of record via electronic mail on August 12, 2024:

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