

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

**APPLICATIONS OF SPUR ENERGY PARTNERS, LLC
FOR COMPULSORY POOLING, EDDY COUNTY,
NEW MEXICO.**

**Case Nos. 21880, 21881,
21882 and 21883**

PRE-HEARING STATEMENT

Jalapeno Corporation (“Jalapeno”) provides this Pre-Hearing Statement as required by Rule 19.15.4.13B NMAC. The issues in each of the above-referenced cases are identical with respect to the relief sought in the application and the basis for Jalapeno’s opposition.

APPEARANCES

APPLICANT

Spur Energy

ATTORNEY

Dana S. Hardy.
Michael Rodriguez
Hinkle Shanor. LLP
P.O. Box 2068
Santa Fe, NM 87103-2168
dhardy@hinklelawfirm.com
mrodriguez@hinklelawfirm.com

OPPONENT

Jalapeno Corporation

ATTORNEY

J.E. Gallegos
Michael J. Condon
Gallegos Law Firm, P.C.
460 St. Michael’s Drive, Bldg. 300
Santa Fe, NM 87505
jeg@gallegoslawfirm.net
mjc@gallegoslawfirm.net

STATEMENT OF THE CASES

Spur Energy Partners, LLC (“Spur”) has filed the four force pooling applications referenced above which are currently set for hearing on June 17, 2021. Two of the applications (Cases 21880 and 21881) seek approval of spacing units covering the N/2 of Section 27, Township 17 South, Range 28 East, Eddy County, New Mexico. The spacing units are to be dedicated to a total of eight (8) horizontal Yeso wells (Halberd wells). The other two applications (Cases 21882 and 21883) seek approval of spacing units covering the S/2 of Section 27, Township 17 South, Range 28 East, Eddy County, New Mexico. These spacing units are to be dedicated to a total of five (5) horizontal Yeso Halberd wells.

In each case, Spur seeks an order “pooling all uncommitted mineral interests,” approving the wells proposed, designating Spur as the operator of the unit, approving Spur’s charges for the well, and imposing a 200% non-consent penalty.

On March 2, 2021, Spur sent Jalapeno three packages, one for the proposed wells in the N/2 and two for the proposed wells in the S/2 of Section 27. Each package included:

- A cover letter proposing a Drilling Spacing Unit covering the relevant acreage
- An Authority for Expenditure (AFE) for each of the Halberd wells ranging from \$2,791,000 to \$3,041,000
- Election forms for each of the Halberd wells

On the election forms, Spur asked Jalapeno to choose one of four options regarding the Halberd wells. Spur attempted to condition Jalapeno’s agreement to participate in the drilling and completion of the wells on Jalapeno’s acceptance of the

proposed JOA. However, Spur did not include a complete copy of its proposed JOA in the packages. Instead, it stated that the JOA would be “a modified 2015 Horizontal AAPL Form 610 Operating Agreement.” The modifications were not disclosed. The cover letter only lists 6 “general provisions” of the JOA.

Jalapeno wrote Spur on April 2, 2021. As to each of the Halberd wells, Jalapeno agreed to pool its interest in the acreage for purposes of drilling the wells. Jalapeno signed each AFE. Jalapeno elected the option “to participate in the drilling and completion of the [Halberd well] with the cost and maintenance of all surface facilities, including any shared well pads, being reapportioned between each well drilled in the DSU.” Jalapeno objected to any request that it consent to the proposed JOA and crossed out the language in the election form that would have constituted acceptance of the JOA terms.

Spur listed one of the general provisions of the JOA as a 100%/300%/300% non-consent penalty. Jalapeno objected to this disclosed provision. Jalapeno stated it would agree to a 100%/40% non-consent penalty. Alternatively, Jalapeno proposed a JOA with a “farmout in lieu” of a non-consent penalty, with a 25% back-in after payout. Jalapeno finally proposed that if Spur was unwilling to negotiate on the JOA, the parties should enter into a letter agreement that would set forth the basic principles of a drilling agreement.

Following receipt of Jalapeno’s election to pool its interests and participate in the Halberd wells, Spur Senior Landman Morgan Landry wrote Jalapeno by email April 15, 2021 stating that Spur did not intend to force pool Jalapeno given Jalapeno’s election to participate. On May 6, 2021, Spur changed its position and stated that because Jalapeno did not agree to the JOA terms, Jalapeno’s election to participate in the wells was

ineffective. Spur finally provided Jalapeno with a complete copy of its proposed JOAs for the S/2 of Section 27 on May 11, 2021. Spur still has not provided a copy of the JOA for the N/2 of Section 27. Spur is still unwilling to negotiate on the non-consent penalty rates.

JALAPENO'S OBJECTIONS TO THE FORCE POOLING APPLICATIONS

Jalapeno contends the applications should be denied as having any force or effect on Jalapeno for the following reasons:

1. Jalapeno has agreed to pool its interests in the affected acreage so that Spur can drill and complete the Halberd wells. NMSA 1978 § 70-2-17(C) authorizes the Division to approve a force pooling application only where an interest owner has not agreed to pool its interest. The Division lacks the authority under the statute to force pool Jalapeno in these cases.

2. Jalapeno has done everything necessary to agree to pool its interests and for purposes of Section 70-2-17(C). Spur's contention that Jalapeno must agree to all the terms of Spur's proposed JOA in order to avoid being force pooled is wrong. The statute does not prescribe any specific method an owner must follow in order to agree to pool its interests to develop the lands. The statute does not require an owner to accept an applicant's proposed JOA in order to agree to pool its interest. Spur is attempting to improperly use the force pooling procedure to strongarm Jalapeno into accepting Spur's JOA terms, including the non-consent penalty terms. The irrationality of Spur's position is demonstrated by the fact that Spur required Jalapeno to agree to all terms of a JOA before Spur provided Jalapeno with a complete copy of its proposed JOA.

3. The proposed JOA is objectionable for several reasons. First, the non-consent penalty is not supported by the evidence. Second, in Article III.C, the JOA makes any burden not listed on Exhibit A to the JOA, an exhibit Spur created, a subsequently

created interest even if the interest is presently of record. Third, Spur has added several non-standard provisions in Article XVI. Most egregious is the provision that allows Spur to require prepayment of all costs for all proposed wells to be drilled in the Contract Area, irrespective of when or whether they will actually be drilled. Given that Spur seeks approval of 13 wells costing either \$2.8 or \$3.0 million, the type of prepayment obligation Spur seeks to force on Jalapeno would be a tremendous burden on Jalapeno and other interest owners. The prepayment provision is contrary to the custom and practice in the industry that calls for non-operators to pay their share of expenses as they are incurred by the operator or, at most, the preceding month before expenses are incurred.

4. The Division has historically imposed on force pooling applicants an obligation to make a good faith effort to secure voluntary agreement of affected interest owners. Spur has failed to make such a good faith effort. First, the issues Jalapeno has raised do not negate or minimize Jalapeno's agreement to participate and pay its share of well costs for 13 Halberd wells. Second, Spur has no reasonable explanation as to why the alternatives to the JOA offered by Jalapeno are unworkable or unacceptable.

5. The Yeso formation underlying the acreage at issue is a resource play extensively developed by horizontal wells and presents a dependable low risk, highly favorable return on investment. The very fact that Spur intends to drill 13 horizontal Yeso wells in Section 27 is a testament to the low-risk Spur anticipates in developing the acreage. Under these facts, a 200% non-consent penalty is not warranted. Spur cannot meet its burden to support such a non-consent penalty. Any non-consent penalty must be supported by evidence using an objective standard for the imposition of risk penalties.

Application of a 200% non-consent penalty would result in a loss of a property interest for working interest owners who go non-consent.

6. Any force pooling order in this case should make provision for a just and reasonable payment plan for owners like Jalapeno who agree to participate in the drilling of multiple wells. That is, an operator such as Spur should not be entitled to provide AFEs for the 13 Halberd wells totaling over \$37 million and require immediate payment by Jalapeno of its pro rata share of total costs for drilling all 13 wells up front and months before most of the wells are even started. A payment plan that requires payment by Jalapeno for costs invoiced for the following month would be just and reasonable.

PROPOSED EVIDENCE

Jalapeno will present evidence of the history of the parties' communications and Spur's position. Jalapeno will present evidence to support its position that it has agreed to pool its interest, and has offered terms accepted by other oil and gas operators to resolve the JOA issue. Spur has not acted in good faith in the negotiations and has not made a good faith effort to reach voluntary agreement. Jalapeno will also present evidence that a 200% non-consent penalty is unwarranted, and to establish that a 40% non-consent penalty would be appropriate. Finally, Jalapeno will present evidence of the impropriety of Spur's proposed prepayment provision in its JOA.

WITNESSES

EST. TIME EXHIBITS

Harvey Yates (operator/landman)

1 hour

5 approx.

Emmons Yates (practical oil man/landman)

45 min.

5 approx.

PROCEDURAL ISSUES

Given the nature of the issues and Jalapeno's objections, it will be important for the examiner to evaluate the credibility of the witnesses. In order to do that, cross-examination of the witnesses should be allowed. Jalapeno objects to having these cases presented and decided by affidavit.

Respectfully submitted,

GALLEGOS LAW FIRM, P.C.

By /s/ J.E. Gallegos

J.E. GALLEGOS

MICHAEL J. CONDON

460 St. Michael's Drive, Bldg. 300

Santa Fe, New Mexico 87505

(505) 983-6686

jeg@gallegoslafirm.net

mjc@gallegoslafirm.net

Attorneys for Jalapeno

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served on counsel of record by electronic mail this 10th day of June, 2021.

/s/ J.E. Gallegos
J.E. Gallegos