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

APPLICATION OF NOVO OIL & GAS NORTHERN DELAWARE, LLC FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

Case No. 20916

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BTA OIL PRODUCERS, LLC'S POST-HEARING BRIEF

BTA Oil Producers, LLC ("BTA") submits the following Post-Hearing Brief in opposition to Novo Oil & Gas Northern Delaware, LLC's ("Novo") applications for compulsory pooling.

I. Introduction

In these cases, Novo seeks to eviscerate BTA's correlative rights by pooling acreage that BTA controls under a Joint Operating Agreement ("JOA"). BTA acquired the JOA for the purpose of fully developing the N/2 of Section 7 and the NW/4 of Section 8, Township 23 South, Range 29 East in Eddy County (the "Ochoa Acreage"). Novo was aware of the JOA when it acquired its adjacent acreage and was also aware that development would be restricted because the acreage is located in the Potash Area. Novo acquired the acreage despite these risks, and its decision to do so should not tie BTA's hands and preclude BTA from developing the acreage that it acquired under the JOA.

Novo's applications should also be denied because Novo failed to engage BTA in a good-faith effort to secure BTA's voluntary participation in Novo's proposed wells and because granting Novo's applications would run contrary to the Oil and Gas Act's preference for voluntary

agreements over compulsory pooling and New Mexico's public policy on enforcement of contracts. The JOA is a voluntary agreement that should be honored. The reasonable expectations of the parties also favor denial of the applications. BTA, through the JOA, has secured 100% of the working interest in its acreage, while Novo, in contrast, acquired its interests with the knowledge that BTA's position foreclosed the two-mile lateral wells Novo now claims are essential. Novo's request that the New Mexico Oil Conservation Division ("Division") issue an order pooling the Ochoa Acreage is inconsistent with New Mexico law and should be denied.

II. Factual Background

Pursuant to the JOA, BTA is the operator of the Ochoa Acreage. *See* [11-15-19 Tr. 90:1-17]. 100 percent of the working interest in the lands covered by the JOA is committed to the JOA. *Id.* BTA owns 73 percent of the working interest and Oxy Y-1 Company ("Oxy") owns the remaining 27 percent of the working interest. *Id.* Because all of the working interest owners are committed to the JOA, BTA can develop the Ochoa Acreage without the need for compulsory pooling – and it was precisely the existence of the JOA that made the acreage attractive to BTA. *See* [11-15-19 Tr. 96:15-19]. BTA already operates a producing well under the terms of the JOA, has proposed four lateral wells in the Wolfcamp formation, and has present plans to propose further drilling in the Bone Spring formation. *See* [11-15-19 Tr. 90:18-91:6]. BTA intends to fully develop the Ochoa Acreage under the JOA. *Id.* BTA's development plans are based on extensive experience and expertise in the Loving area of Eddy County, where it is an active and successful operator. *See* [11-15-19 Tr. 105:5-15]

Approximately eight months after BTA acquired its interests, Novo acquired its interest in adjacent tracts. *See* [11-15-19 Tr. 102:8-19]. Novo knew at the time of the acquisition that there would be restrictions on development and that the acreage could not be fully developed without

horizontally drilling through BTA's acreage. *See* [11-15-19 Tr. 63:13-64:24]. Despite this knowledge, Novo proceeded to acquire the acreage and took no steps to engage BTA in discussions to reach an amicable solution. *See* [11-15-19 Tr. 93:9-11]. The first communication to BTA from Novo regarding the wells proposed in this proceeding was the well proposal itself. *Id.* After receiving the well proposal, BTA initiated discussions with Novo, hoping to reach a voluntary agreement. *See* [11-15-19 Tr. 94:1-3]. The discussions between the parties resulted in Novo making one offer to BTA whereby BTA would swap its operating interests in the area for non-operating interests held by Novo. *See* [11-15-19 Tr. 96:7-14]. BTA reasonably rejected the offer based on its general preference to develop its interests as an operator and based on its specific intention in acquiring the acreage subject to the JOA. *Id.* Novo made no other offers to BTA and now seeks an order from the Division pooling BTA's interests. Novo now asks the Division to extinguish BTA's operating rights under the JOA, rendering the JOA meaningless and eviscerating BTA's correlative rights.

III. Argument

A. The applications should be denied because Novo's proposal would impair BTA's correlative rights.

"The Oil Conservation Commission is a creature of statute, expressly defined, limited and empowered by the laws creating it. The commission has jurisdiction over matters related to the conservation of oil and gas in New Mexico, but the basis of its powers is founded on the duty to prevent waste and to protect correlative rights." *Continental Oil Co. v. Oil Conservation Commission*, 1962-NMSC-062, ¶ 11, 70 N.M. 310. Here, granting Novo's application would destroy BTA's correlative rights in the acreage subject to the JOA. Novo is seeking compulsory pooling in an attempt to mitigate risks it knew were inherent in the acreage when it was acquired, which is an improper use of compulsory pooling.

As explained above, BTA controls 100% of the Ochoa Acreage under the JOA and acquired the JOA precisely because it wanted to develop the acreage. BTA acquired its interests in a trade with EOG for the purpose of fully developing the Bone Spring and Wolfcamp formations under the JOA. The acreage is particularly desirable because it can be developed from a surface location outside of the potash area.

At the hearing in this matter, Novo suggested that because BTA would become a non-operating revenue recipient if the applications are granted, BTA's correlative rights would not be impaired. This position is untenable – if correlative rights only encompass the right to passively receive revenue, there would be no basis for the Division to deny an application for the sake of protecting those rights. Correlative rights, in fact, encompass a much broader concept and are defined as "the opportunity afforded, so far as it is practicable to do so, to the owner of each property in a pool to produce without waste the owner's just and equitable share…" 1978 NMSA, § 70-2-33(H).

In determining what is meant by a "just and equitable share," courts generally agree that a person's correlative rights include more than the right to simply receive a pro rata share of production. Texas courts, for example, have found that proration based only on acreage is not sufficient to ensure each party receives a just and equitable share; consideration must be given to the different burdens placed on the respective parties. *See, e.g. Coleman v. Railroad Commission*, 445 S.W.2d 790, 797 (Tx. Ct. App. 1969) ("[I]t should be pointed out that determining whether or not an offer meets the statutory test of being fair and reasonable, etc., would ordinarily require consideration of more than the acreage of the owners.").

The Supreme Court of Oklahoma has held that the measure of a just and equitable share is the present market value of the *right to drill* on a tract of land. *See Home-Stake Royalty Corp. v.*

Corporation Commission, 594 P.2d 1207, 1210 (Okla. 1979). Oklahoma's interpretation of "just and equitable" in this context is particularly instructive. Oklahoma is both a major oil-producing state and a state with a compulsory pooling regime similar to New Mexico's. *See* U.S. ENERGY INFORMATION ADMINISTRATION, THE DISTRIBUTION OF U.S. OIL AND NATURAL GAS WELLS BY PRODUCTION RATE B43 (2019) (indicating there were 15,077 horizontal wells in Oklahoma as of December 2019); Okla. Stat. § 165:5-7-7, *et seq.*; § 165:5-15-3, *et seq*. By placing the right to drill at the center of the correlative rights inquiry, the rule recognizes that the right to develop one's resources is the very heart of a person's correlative rights. New Mexico's statutory language makes this clear as well by stating that correlative rights include "the opportunity…to produce…the owner's just and equitable share." § 70-2-33(H). Thus, the right to actually direct the development of the mineral estate is part of – and the very core of – BTA's correlative rights.

This fact underscores the severe damage to BTA's correlative rights that Novo's applications would cause. BTA is not a mineral owner in the area by happenstance. BTA is a company actively engaged in drilling operations and the production of oil – it acquired its interests under the JOA for the express purpose of developing the acreage and specifically contracted for the operating rights. In addition to the considerable resources expended to acquire the interest and operating rights, BTA has invested substantial time and money in forging its own development plan. Loss of its opportunity to produce would mean loss of these investments, loss of business, and loss of revenue to BTA.

Additionally, BTA's correlative rights are threatened by the fact that BTA's acreage subject to the JOA is encumbered by a 1/8 royalty while Novo's acreage is not. *See* [11-15-19 Tr. 106:14-107:16]. This reality further demonstrates the harm to BTA's correlative rights. Because part of Novo's proposed pool is subject to a 1/8 royalty, future wells may be economical to Novo

but not economical to BTA, and Novo could develop its acreage in a manner that benefits Novo but not BTA. *Id.* BTA's loss of its operating rights would mean that BTA cannot direct the development of its acreage in an economically appropriate manner but must rely on the good will of a competitor for its "just and equitable share." Because Novo proposes to impair BTA's correlative rights by rendering the JOA meaningless, its applications must be denied.

B. The applications should be denied because Novo failed to make a good-faith effort to secure BTA's voluntary participation in the proposed wells.

New Mexico law and Division precedent require parties to make a good-faith effort to secure voluntary participation prior to seeking a compulsory pooling order. *See* 1978 NMSA, § 70-2-18(A) (obligation of operator to obtain voluntary agreements). The factual record in this case demonstrates that Novo did not make a good-faith effort to secure BTA's voluntary participation. In fact, BTA is the only party who has made a good-faith effort to resolve this matter.

Despite knowing that its acreage could likely not be developed without securing BTA's agreement or force pooling BTA's interest, Novo made no attempt to contact BTA until sending the well proposal letters. After the well proposals were sent, *BTA initiated a meeting with Novo.* BTA's representatives traveled to Novo's office in Oklahoma City in an attempt to find a solution that worked for all parties involved – BTA proposed that both BTA and Novo drill one and a half mile laterals, or that Novo secure a new well site. None of these proposals were acceptable to Novo, who ultimately proposed swapping non-operating interests for BTA's operating interest.

Novo's proposal, on its face, was not a good faith offer. Novo knows that BTA is an operating company seeking operating rights, not passive income. Novo's disregard for BTA's rights under the JOA is underscored by the fact that it made no subsequent offers, even after BTA indicated its strong preference for operating interests. Under these circumstances, the Division cannot conclude that Novo made anything other than a perfunctory effort to secure BTA's

voluntary participation. *See The Comparisons, Contrasts, and Effects of Compulsory Pooling Statutes,* 28 RMMLF-INST 15 (1982) ("At a minimum, it seems that the person requesting compulsory pooling should be required to show that he has made a firm, fair, and reasonable offer in writing to all parties. Ideally, the terms of the offer should be identical with the terms which the applicant requests the agency to fix."); *see also Railroad Comm'n of Texas v. Pend Oreille Oil & Gas Co., Inc.*, 817 S.W.2d 36, 40 (Tex. 1991) (an offer must consider the facts relevant to the party who may enter into the voluntary agreement).

Here, Novo's offer was decidedly unreasonable. Novo asked BTA to exchange operating rights for non-operating interests even after BTA indicated its strong preference to acquire operating rights. And Novo only agreed to a meeting after BTA asked for one and refused to make any follow-up offers even though BTA did not indicate that additional offers would be futile. Novo's failure to negotiate with BTA in good faith prior to seeking compulsory pooling warrants denial of Novo's applications.

C. Granting Novo's applications would run contrary to the purposes of the Oil and Gas Act and New Mexico public policy by discouraging voluntary agreements.

The statutory scheme created by the New Mexico Oil and Gas Act favors voluntary agreements over compulsory pooling. This is evident in Section 70-2-17's prohibition of compulsory pooling when all parties have entered into a voluntary agreement and is also evident in the requirement that a party seeking a compulsory pooling order must first attempt to secure the voluntary participation of the parties it seeks to pool.

In this regard, the Oil and Gas Act is no different from the law in general, which favors voluntary agreement over government action. *See, e.g., Attorney General of the State of New Mexico v. New Mexico Public Service Commission,* 1991-NMSC-021, ¶ 13, 111 N.M. 636 ("a

cooperative approach in reconciling the interests of the parties was consistent with the public policy favoring settlement of disputes."). New Mexico's courts have long recognized that "public policy favors freedom to contract and enforces contracts that do not violate law..." *McMillan v. Allstate Indemnity Co.*, 2004-NMSC-002, ¶ 10, 135 N.M. 17. The heavy weight given to private contracts has been described by our Supreme Court as "The paramount public policy..." *Tharp v. Allis-Chalmers Manufacturing Co.,* 1938-NMSC-044, ¶ 13, 42 N.M. 443. To this end, a private agreement should only be voided by government action "in cases free from doubt." *Id.*

Here, granting Novo's applications would void the JOA and run afoul of this important public policy. BTA's extensive efforts to develop its acreage entirely through voluntary agreement would be rendered meaningless, and the Division would be incentivizing the offensive use of compulsory pooling, rather than subordinating government action to the preferred method of private negotiation. Further, the invalidation of the JOA would result in instability and discourage development in violation of the Oil and Gas Act. Section 70-2-17, in conjunction with New Mexico's public policy of encouraging and enforcing voluntary agreements, demonstrates the longstanding and consistent policy in favor of voluntary agreements that permeates the Oil and Gas Act and New Mexico law in general. This public policy precludes the Division from allowing Novo to extinguish BTA's rights under the JOA.

D. Any argument that the JOA is irrelevant to Novo's applications lacks merit.

As explained above, Novo's applications request that the Division allow Novo to impair BTA's correlative rights by precluding BTA from developing the Ochoa Acreage under the JOA. Although the Division denied a motion to dismiss a compulsory pooling application based on a JOA in Case No. 15433 in Order No. R-14140, that case is inapposite. In that proceeding, Nearburg sought to dismiss Matador's compulsory pooling application based on the existence of a JOA.

Nearburg did not present evidence or argument that it was the designated operator under the JOA or that pooling would impair its correlative rights, and the Division did not address that issue. *See Nearburg's Motion to Dismiss* filed in Case No. 15433; Order No. R-14140. Thus, the case has no bearing here, where BTA has presented evidence that it is the designated operator under the JOA and that granting Novo's applications would impair its correlative rights.

Granting Novo's application would impair BTA's correlative rights by rendering the JOA meaningless. This result is contrary the Oil and Gas Act and New Mexico public policy, which express a strong preference for voluntary agreements. Further, BTA presented evidence that it acquired the Ochoa acreage for the sake of fully developing it, without the need for compulsory pooling – BTA is not a holdout landowner stalling the efficient development of the mineral estate. Any argument that the JOA is irrelevant lacks merit and should be rejected.

E. The reasonable expectations of the parties require denial of Novo's applications.

The Division is charged with ensuring that its pooling orders are issued "upon such terms and conditions as are just and reasonable..." § 70-2-17(C). Novo's applications are neither. The facts show that Novo acquired its interest: (A) after BTA acquired its interests subject to the JOA; (B) with full knowledge that BTA's position, in conjunction with development restrictions, could preclude the two-mile lateral wells that Novo now claims are essential; and (C) without a willingness to fairly compensate BTA for its operating rights. BTA, on the other hand, acquired a 100% working interest in its acreage through the JOA and has present plans to fully develop its position without the need to pool adjacent mineral owners.

Under these circumstances, Novo's proposal is neither just nor reasonable. It is unjust and unreasonable for one operator to pay a premium for operating rights and complete control of an area, only for another operator to later purchase neighboring interests – which are incapable of

development without compulsory pooling – and insist that the first operator abandon its plans and investments. Neither the Oil and Gas Act nor Division precedent permit this result.

IV. Conclusion

For the reasons discussed above, the Division should deny Novo's request that the Division eviscerate BTA's correlative rights by pooling the acreage that BTA acquired under the JOA. BTA acquired the JOA prior to Novo's acquisition of the acreage Novo seeks to pool, and Novo acquired its acreage with full knowledge of the development constraints that would apply. Novo also failed to negotiate with BTA in good faith prior to seeking compulsory pooling. The Oil and Gas Act and New Mexico public policy preclude compulsory pooling in this circumstance. Novo's applications must be denied.

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CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of January, 2020 I served a true and correct copy of the foregoing ***BTA Oil Producers, LLC's Post-Hearing Brief*** on the following counsel of record by electronic mail.

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