STATE OF NEW MEXICO

ENERGY, MINERALS, AND NATURAL RESOURCES DEPARTMENT

OIL CONSERVATION DIVISION

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

CASE NO. 21346

APPLICATION OF ALLAR DEVELOPMENT
TO REOPEN DEVON ENERGY CASE NOS.
21119, 21120, 21121, 21122, 21123
In EDDY COUNTY, NEW MEXICO

# REPORTER'S TRANSCRIPT OF PROCEEDINGS

EXAMINER HEARING
MOTION TO DISMISS
THURSDAY, AUGUST 20, 2020
SANTA FE, NEW MEXICO

This matter came on for hearing before the New Mexico Oil Conservation Division, FELICIA ORTH Hearing Examiner, and Technical Examiners SCOTT COX and DEAN McCLURE on Thursday, August 20, 2020, Via Webex Video conferencing

REPORTED BY: Mary Therese Macfarlane
New Mexico CCR 122
Paul Baca Professional Court Reporters
500 Fourth street NW, Suite 105
Albuquerque, New Mexico 87102
(505) 843-9241

A P P E A R A N C E S

FOR ALLAR DEVELOPMENT: Ernest L. Padilla, Esq.
Padilla Law Firm
1512 St. Francis Drive
Santa Fe, NM 87505
(505) 988-7677
padillalaw@qwestoffice.net

FOR DEVON ENERGY: Darin C. Savage, Esq.
Abadie & Schill
214 Mackenzie Street
Santa Fe, NM 87501
(970) 385-4401
darin@abadieschill.com.

I N D E X

| CASE NO. 21345 CALLED | PAGE |
|---|---|
| ARGUMENT BY MR. SAVAGE: | 4, 18 |
| ARGUMENT BY MR. PADILLA: | 10 |
| INQUIRY BY MR. McCLURE: | 21 |
| TAKEN UNDER ADVISEMENT: | 23 |

E X H I B I T I N D E X

(Note: No exhibits marked.)

(Time noted 10:18 a.m.)

HEARING EXAMINER ORTH: Finally moving on to our last case. This is 21346. Allar Development is the Applicant.

Mr. Padilla, I believe you entered an appearance for the Applicant.

MR. PADILLA: Yes, I did.

Ernest L. Padilla for Allar Development.

HEARING EXAMINER ORTH: All right. Thank you.

And Devon Energy entered an appearance. I see Avadie & Schill.

Mr. Savage, is that true again for Devon?

MS. SAVAGE: Yes, Madam Examiner. Darin Savage with Avadie & Schill on behalf of Devon Energy Production Company, LP.

HEARING EXAMINER ORTH: Thank you. Let me pause a moment to see if there are any other appearances.

(Note: No response.)

We have argument today on Devon's Motion to Dismiss. The pleadings I have in connection with this motion are the Motion to Dismiss by Devon, the Response to the Motion to Dismiss by Allar, and Devon's Reply to Allar's Response.

Mr. Savage, if you would begin. It was your motion.

MR. SAVAGE: Yes. Thank you, Madam Examiner.

So this case seems pretty straightforward to us, to Devon. And looking at the case law that was used by both Devon and Allar that both parties rely on, this seems to be clear that the case law supports Devon's position. So I'll just -- I'll go step by step through this, hopefully provide some clarity.

So one, No. 1, the main issue. The main issue is whether the Division should open Devon's pooling cases based on the contractual terms of an exploration agreement, an exploration agreement that has expired under its own terms 17 years ago or thereabouts, and over which Allar Development and Devon are in disagreement.

So this is basically a dispute over contractual terms.

Now, the exploration agreement, and it's just the exploration agreement, is referenced in an assignment from Oxy to Devon, and this is the assignment by which Devon gets its interest in the unit.

So both parties acknowledge that this assignment was referenced, and therefore it provides constructive notice of record, and -- but it only provides constructive notice as to the terms of the agreement itself and nothing else.

And so Devon did a review of the record,

they noted the exploration agreement, and then they reviewed and investigated the terms of the exploration agreement.

When they looked at the terms of the exploration agreement they came to Article 5, and that's part 5.1. And 5.1 is a rather ambiguous provision. It -- it gives us contractual contingency. It's -- you know, the parties in the exploration agreement are trying to develop multiple sections, a large geographic area, and even can have provisions to expand the geographic area. And so once they zero in on a prospect, that provision 5.1 requires the parties or a successor party who participates when the exploration agreement is in effect, it requires the parties to choose between two operators, KOC or ECHO, those were the operators at the time of the agreement, and then it gives them the option to, once they choose an operator, to enter into a JOA. There's no JOA executed or set in place. They get the option to enter into a JOA.

And then there's a recommended form for that JOA, or a template that's attached as an appendix in this exploration agreement.

So the terms of the exploration agreement -- because they do not provide and execute a valid JOA, it basically goes to another level of inquiry, and that's an Inquiry Notice.

So once Devon's satisfied there's Constructive Notice of the exploration agreement, then they step down to looking at the Inquiry Notice, and that is, you know, the obligation to investigate whether a governing JOA exists.

So Devon entered into communications with Allar Development by email and exchanged information, exchanged -- uh, proposed a JOA that Devon had, made inquiries with other parties regarding the exploration agreement. Made inquiries with Oxy, for example. And Oxy said, "No, we never exec -- there was never executed a JOA pursuant to the exploration agreement."

So Devon satisfied, as far as we can tell, all standards of diligent inquiry and search in review of the record and in its communications with Allar, and was not able to find or obtain any existing JOA.

In fact, in our Reply, in Devon's Reply to Allar's Motion to Dismiss, Response to Motion to Dismiss, Devon communicated with Allar right up to the day before the hearing, March 4th. The hearing was on March 5th. So Devon communicated with Allar right up to the day before the hearing, trying to find out what the status of Allar was, whether a JOA existed, and they included that communication as Exhibit B of Devon's Reply to Allar's Development Response, Allar's Response to Motion to

Dismiss.

If I could just read that email that Allar sent to Devon. It said: Verl, (phonetic), we would have no problem signing a JOA in this area if everyone signs and we can see the final version.

And then he says: Please send the latest JOA version so we can evaluate.

So this is the day before the hearing, the pooling hearing, so if you -- so, Madam Examiner, if you would put yourself in Devon's shoes. I mean it looks to Devon -- Devon saw this. If there was an existing JOA that governed the subject lands then you would think that Allar would have presented it at this point. You would think that they would not have agreed to sign Devon's proposed JOA, and not -- and see the latest version of the JOA.

So they put -- basically Allar put Devon in the position of that -- you know, being informed that they are not going to sign the JOA before the hearing but being informed that they would sign the JOA after they look at it after everybody else has signed it. The only conclusion for Devon was that Allar presents itself as an uncommitted interest owner, uh, and they are willing to be -- are consenting to the pooling and they are willing to be subject to the pooling until after they see the

final version of the JOA.

And that seems like a reasonable conclusion.

So Allar failed to provide the JOA to Devon prior to the hearing; Allar failed to make an appearance under proper procedural due process and protest the hearing; they have not produced a JOA to the Division at the hearing; they have not produced a JOA in its Applications for Reopen; and more recently they have not produced the JOA in response to Devon'a motion.

So in looking at the case law, the case law seems to support Devon. Allar cites two cases, NBI Services v. Commission, Corporations Commission. That's an Oklahoma case. And then also another Oklahoma case, Chesapeake v. Burlington.

NBI Services, is really -- it's a textbook example of what Allar would need to do to prevail in its position. So in NBI Services, NBI is a party, received Notice of the pooling from the Commission, from the Corporation Commission in Oklahoma. And it didn't disregard that Notice. It respected the procedural due process that was required of a hearing and the authority of the Commission, and so it made an appearance into the hearing and it entered a protest, and then at the hearing it presented to the Commission. And the other party an

existing, valid governing JOA to which NBI was subject. And as a result the court under those facts said, yes, under those facts NBI is subject to the JOA and therefore the Commission does not have jurisdiction to pool the interest.

So that's what Allar, you know, should have done if they wanted to prevail in this application, but what they did is what they did in the other case they have cited, and that's Chesapeake v. Burlington. And in that case Burlington received Notice of the pooling hearing, failed to respond to the Notice, failed to make an appearance, failed to protest because it believed it was subject to this JOA that it had, and then it failed to make a selection under the Pooling Order that was issued.

So when Burlington challenged this matter, the OCC, the Commission said the Pooling Order stands, the trial court said the pooling order stands, and the appellate court said the Pooling Order stands.

The JOA at that point, because -- uhm, did not override a valid Pooling Order that was issued under the powers of the Commission, and the proper venue for the dispute of the JOA as a contract then becomes the district court's, and the appellate court confirmed that.

So if we believe this is a proper decision of the Division here to protect the integrity of the

procedural due process in its hearings, on which all parties rely, both interest owners and the applicants both rely on the integrity of the due process, we respectfully request that Allar's application to reopen be dismissed.

Thank you.

HEARING EXAMINER ORTH: All right. Thank you, Mr. Savage.

Mr. Padilla, your response, please.

MR. PADILLA: In the argument that Mr. Savage made in the Mewbourne cases, all of a sudden I looked to make sure that I was in the right case, because he seemed to be making a case identical to the one that he made here. Just judging from the pleadings in the Mewbourne cases, Ascent and Apache cases, it seems to me that that argument has to be reviewed by the Division over again

The argument of res judicata and collateral estoppel really doesn't make any sense when it becomes a jurisdictional argument based on Section 17-2-17C.

If you have a consenting interest owner to a joint operating agreement that is attached in this case to the exploration agreement, then I think -- and we've demonstrated that when you have essentially covenants running with the land, any subsequent assignee is going to be bound by the terms of that.

Devon chose to ignore the operating

agreement that has been used in about 25 wells that have been drilled under the exploration agreement.

That joint operating agreement has been followed and most recently was followed by Oxy in 2016, I believe, and drilled using that joint operating agreement.

The argument that is made by Devon is that operating agreement was not signed.

When I attach something to an agreement, or agreements that I have seen that attach something to be followed as the guide for operating and drilling wells, it's incorporated into the base agreement. That agreement was signed by all the interest owners, and we demonstrated that in the chain of title, uhm, that exploration continues.

There's an argument about that the agreement terminated, no one continued, but it created a covenant that runs with the land irrespective of whether or not the terms of the agreement have expired or the term.

The -- I recall arguing cases, take-or-pay natural gas contract cases, where in interstate commerce that once dedicated always dedicated was the rule. That seems to be applicable here because it runs with the land.

We've cited this TransTexas Gas Corporation vs. Forcenergy Onshore case that says you got to follow

and take subject to the agreements.

What is amazing in this case is that Devon argues that the assignment it took from Oxy means nothing, essentially; that they can ignore the fact that they took subject to the exploration agreement, which had the format for the operating agreement attached to it.

If you go to Section 70-2-17(c) we have alleged there's nothing factual. We did not attach affidavits or anything, neither did Devon, other than its interpretation and our interpretation of what went on in the negotiations.

One of the -- but one of the concerns was that at least from the Allar standpoint is that they were willing to participate in the wells under the operating agreement which they thought they were bound by.

So -- and they stood by that.

I recall a case a few years ago where I filed a Compulsory Pooling Application for a client. The other party, one of the majors, brought out an operating agreement that called for the drilling of a deep gas well, and it did not have any segregation, vertical segregation. And essentially the Division told me: If you want to find out whether this 35-year-old operating agreement is any good, you're going to have to go to court.

The practical choice there was we had to

withdraw the Application because the operating agreement was there. In other words, the decision at that time -- there was no written decision. We had a hearing, or some type of a consensus hearing that was being held at the time. They said, "Well, there's an operating agreement."

And I argued it was 35 years old, it didn't apply to the upper formation that we sought to force pool, and so that's where it stood.

So I -- when you look at Section 70-2-17 we are contending that jurisdictionally the Oil Conservation Division could not have made those Orders as to Allar because there was an existing operating agreement. There has to be a factual finding not about interpretation of the agreement or whether the agreement applies but whether there is a -- an operating agreement that binds Devon and whether or not the Division in an affidavit case could essentially destroy property rights held by Allar.

I know underlying all of this is the same argument that Mr. Savage made earlier about the issues have changed -- or one of the counsel made, I'm not attributing it to Mr. Savage, but in the Mewbourne cases where conditions in the oil industry dictate prudence as far as an evaluation of wells and whether to go forward with the continuous development plan that Devon seems to be applying here.

The motivation for that we don't know, and it shouldn't be part of this consideration, but the argument made by Devon is, uh, -- in a jurisdiction case should be reviewed by the Oil Conservation Commission, because I learned a long time ago that jurisdiction trumps anything in terms of whether or not there was Notice. If the Division did not have Notice or did not have jurisdiction because Allar was a consenting party to a joint operating agreement, then the argument that Allar's bound by didn't appear at the hearing but is bound by the Order, or the various Orders that were issued.

The fact of the matter is, is that all of the lands in Section 26 and 23 underlying the spacing units are subject, we contend, to the Operating Agreement and the exploration agreement that was signed by all of the parties at that time. But as that agreement is succeeded, we don't -- everybody continues to be bound by the chain of title, the documents that are subject to the exploration agreement.

One of the cases we cited includes areas of mutual interest and that sort of thing. Those are bound by -- those are subject to the main agreement. You know, I've never seen where a -- you attach a document to something and everybody has to sign that when it's incorporated by reference.

There's an argument whether or not it's incorporated by reference. Mr. Savage argues that it's not incorporated, it's referred to, or something in terms of a reference. And that seems absurd.

Now, in the Reply filed by Devon the argument is made that we, or Allar, speculates that there exists an operating agreement. There's no speculation about that. The original contract package that was signed by Allar's predecessors-in-interest and that has been followed since that time, whether or not some of the lands that followed have stayed under the terms of that exploration agreement, is not really relevant. The question is that Sections 22 and -- 23 and 26 are, all of those lands are committed to that operating agreement and the exploration agreement.

We submit that it's one and the same.

So I don't see the distinction. And this argument of preclusive effect is not applicable because it becomes a jurisdictional argument under 70-2-17(c).

That statute is very clear. We have cited Oklahoma, and Mr. Savage has referenced those cases and discussed those cases in his argument, and they just call for re-opening these cases for only the specific determination as to whether Allar is a consenting or nonconsenting party under this statute.

If it's a consenting party then the jurisdiction of the Division to issue an Order is not applicable. They don't have jurisdiction where there is a consenting party.

And it goes back to the same experience I had before where I was told by the Division essentially: If you want to find out whether or not this 35-year-old joint operating agreement applies to the upper formation you're going to have to go to court.

And I don't want to go to court, but this is where this is heading in terms of -- and luckily -- we don't have case law in New Mexico, but Mr. Savage is correct Oklahoma does have considerable, or at least some case law on this issue where you have identical spacing statutes -- or not spacing but compulsory pooling statutes that are applicable.

The case law supports Allar in this case that the JOA attached to that original agreement should -- is the one that should be followed.

Now, whether or not Devon likes it or doesn't like the terms of it, we argue that they're bound by it and under the terms of that JOA Allar was willing to participate in drilling these wells.

And I know this is not relevant to this case or anything, but the compulsory pooling cases, in

today's climate, you know when you have essentially, my understanding is they have three rigs ready to drill these wells. That means Allar would have a commitment of roughly $10 million that they have to pony up immediately.

But I think the jurisdictional issue is there, and I think that the Division should reopen this case to determine whether or not you have -- it is a nonconsenting interest owner or whether or not it is a consenting owner subject to the operating agreement.

I think Mr. Savage's argument on Oklahoma case law is -- uh, he argues that it applies/doesn't apply, but if you read those cases closely, and the parts that we have cited in our response points to a determination that the -- that this case should be reopened to decide whether or not the issuance of the Orders were procedurally correct and whether or not it had subject matter jurisdiction to issue the Orders.

So I'm not -- I think that the Division should, as we requested, should reopen these cases for the limited purpose of deciding whether or not it's a consenting -- Allar was a consenting or nonconsenting party under 70-2-17(c).

Once that finding gets made, and -- but I think out of prudence and caution on the jurisdictional issue under that statute, it -- we're not asking the

Division to determine a private dispute as between whether or not the contract is any good or whether it runs with the land or anything else. Case law points to that.

And I think the Division should look at this and decide that, yeah, we overstepped.

But to be fair, the Division did not know that, and neither did Devon disclose or say anything with respect to whether or not is there maybe an existing joint operating agreement that controlled the drilling of wells in Sections 23 and 26.

I'll leave it at that, and I think we stand by the argument that we made in our Response and that these cases should be reopened.

HEARING EXAMINER ORTH: Thank you, Mr. Padilla.

Mr. Savage, do you have anything to add to your...

(Note: Pause.)

MR. SAVAGE: So every case that was cited in the filings, in every agreement that was part of the facts there was a JOA that was executed, specifically executed by the parties. It describes, I believe with legal specificity, the lands involved, and it was produced as a governing JOA for those lands. Here we do not have that. We have a contractual contingency and an exploration agreement that gives a contractual option for the parties

to enter a JOA, but there is no JOA entered. If there was a JOA entered into it would have been produced by now, especially given the last correspondence between Devon and Allar.

Mr. Padilla says that if that template is not binding then the exploration agreement doesn't mean anything.

Well, the exploration agreement does mean something, and what the exploration agreement means is that there's Notice of record that a JOA could exist. And if a JOA was entered into and executed under that provision, paragraph 5.1, then that JOA would be binding on the lands and on the parties, and Devon would have acknowledged that and would have viewed Allar differently.

But it didn't view Allar differently because of the last communication that they were going to sign Devon's JOA and the language of this exploration agreement that shows that there was no JOA, only a recommended template should the parties enter into a JOA under those contractual terms.

So if the Division tries to find a JOA they are going to have to interpret those contractual terms to see if the parties, while the agreement was in effect prior to its expiration, to see if those terms allowed the parties to have entered a JOA for the lands.

So all these arguments -- all these arguments Allar could have made, Allar could have made had they respected the procedural due process of the hearings and had they entered an appearance prior to the hearing and showed up and objected and protested.

It's as easy as that. If they had done that then we wouldn't be having this post hoc argument or application to reopen. It would have been decided at the time of the hearing.

And just one last point. So Allar Company -- Allar Development, the Applicant in this hearing, in this motion hearing, they received their interest in the subject lands, Section 23 and 26, from Allar Company, the Allar Company, and that was by an assignment that I have attached in my Reply.

And this was done after the Oxy/Devon assignment.

So Allar Company was an original party to the exploration agreement. Allar Company, if they were subject to a JOA or if they were subject to the exploration agreement that -- of which, you know, a JOA would have existed, they certainly would have been aware of that and they would have, I would assume would have put that in as a reference in the conveyance from the Allar Company to Allar Development. But they did not. In fact

that assignment from the Allar Company, who was the original member of the exploration agreement, it references neither the exploration agreement nor does it reference any existing JOA.

So that seems to be rather telling that a JOA does not exist.

And for those reasons we ask that the Division deny the application to reopen.

Thank you.

HEARING EXAMINER ORTH: Thank you, Mr. Savage.

Mr. Cox, did you have questions of either counsel?

MR. COX: No, Madam Examiner. I have no questions at this time.

HEARING EXAMINER ORTH: Thank you.

Mr. McClure?

MR. McCLURE: Yes, ma'am. I do have a few questions.

MR. McCLURE: In regards to the original exploratory unit agreement, has that been submitted to the OCD as of yet? Do we have that?

MR. SAVAGE: Mr. Examiner, yes, you have it as an exhibit in our filings regarding the Application to Reopen. It's -- the relevant sections that are involved are included and they can be reviewed by the OCD.

MR. McCLURE: Okay. Sounds good.

I was just confirming that we did have that.

The other question I had: Mr. Padilla references a case involving a 35-year-old JOA that was dismissed. Do you have reference with anything being submitted to us in regards to the case number that that was?

MR. PADILLA: I have -- I didn't want to mention the innocent parties in this case, but that case involved an application of Lime Rock Resources that I filed, and Mewbourne Oil opposed that and brought out the joint operating agreement. I can get you that case.

But we saw the light at the end of the tunnel in that case, and we decided to withdraw the application based on the OCD's consensus.

It wasn't -- the way they had those hearings it was more like a status conference where I think the counsel for the Division at that time, Mr. Brooks, pretty much said, "You better go to court to find out whether or not you have -- the contract exists."

But I can make that available to you.

MR. McCLURE: That could potentially be helpful.

The other question I guess I have that may be more prudent in regards to that is: Is the original

joint operating agreements that was involved in that case, is that a part of that case file, do you know?

MR. PADILLA. I think it is. I think when Mewbourne pulled it out we had a copy of it.

And I know that we argued the contract area strenuously because it didn't have any depth limitations, it was just -- I think it may have said from the surface to the base of the Morrow Formation, but I can't remember. All I know is that my client decided to withdraw the case because court proceedings would take fairly -- too much time.

MR. McCLURE: Okay. Sounds good. That was all the questions that I had. Thank you, Madam Examiner.

HEARING EXAMINER ORTH: Thank you, Mr. McClure.

It seems like we've come to the end of our docket this morning. The Motion to Dismiss will be taken under advisement and an Order will be forthcoming at some point. If there's nothing else, I'm hoping everyone has a great rest of the week, and we will talk with you again two weeks from now. Thank you all very much.

MR. SAVAGE: Thank you, Madam Examiner. Have a good day.

MR. PADILLA: Thank you.

HEARING EXAMINER: Thank you.

(Note: Time noted 10:40 a.m.)

STATE OF NEW MEXICO )
:SS
COUNTY OF TAOS )

REPORTER'S CERTIFICATE

I, Mary Therese Macfarlane, a duly licensed Certified Court Reporter for the State of New Mexico, do hereby certify that on Thursday, August 20, 2020, the proceedings in the above-captioned matter were taken before me; that I did report in stenographic shorthand the proceedings set forth herein, and the foregoing pages are a true and correct transcription to the best of my ability and control.

I further certify that I am neither employed by nor related to nor contracted with (unless excepted by the rules) any of the parties or attorneys in this case, and that I have no interest whatsoever in the final disposition of this case in any court.

/s/ Mary Macfarlane
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