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

APPLICATION OF NEARBURG EXPLORATION COMPANY, SRO2 LLC AND SRO3 LLC FOR AN ACCOUNTING AND LIMITATION ON RECOVERY OF WELLS COSTS, AND FOR CANCELLATION OF APPLICATION FOR PERMIT TO DRILL, EDDY COUNTY, NEW MEXICO.

CASE NO. 15441 (de novo)

APPLICATION OF COG OPERATING LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

CASE No. 15481 (de novo)

APPLICATION OF COG OPERATING LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

CASE No. 15482 (de novo)

COG's APPLICATION FOR REHEARING

COG Operating LLC ("COG"), a party of record adversely affected by Order No. R-14187-E ("Order") of the New Mexico Oil Conservation Commission ("Commission"), timely applies for rehearing before the Commission pursuant to NMSA 1978 § 70-2-25(A) and 19.15.4.25 NMAC. In support of this Application, COG states as follows:

INTRODUCTION

1. On February 28 and March 1, 2017, the Commission conducted a *de novo* hearing of Case Nos. 15441, 15481, and 15482. These cases were consolidated for hearing.

2. In Case No. 15441, Nearburg Exploration Company, SRO2 LLC, and SRO3 LLC ("Nearburg") filed an application (Case No. 15441) requesting the following relief:

A. To declare COG "did not have the right to drill" the 43H and 44H wells (Application at paragraph A);

B. To determine COG violated Division rules when it filed forms C-101 and C-102s for the 43H and 44H wells, and when it drilled these wells (Application at paragraph B);

C. To declare that "COG is required to account and pay to Nearburg the amount to which it is entitled in the absence of pooling and that COG is prohibited from recovering well costs or expenses from the time of first production" for the 43H and 44H wells (Application at paragraph C);

D. To cancel the drilling permit for the SRO State Com 069H well filed on May 5, 2015 (Application at paragraph D); and

E. To provide "appropriate relief" regarding the 16H well that "may include designating Nearburg Producing Company as operator of the well." *See* Order, ¶ 2.

3. In Case No. 15481, COG sought an order (1) creating a non-standard 320-acre spacing and proration unit in the Bone Spring formation comprised of the W/2 W/2 of Section 17 and the W/2 W/2 of Section 20, Township 26 South, Range 28 East, NMPM, Eddy County, New Mexico; (2) pooling the uncommitted interests in said unit; and (3) dedicating the unit to the SRO State Com Well No. 43H. *See* Order, ¶ 38.

4. In Case No. 15482, COG sought an order (1) creating a non-standard 320-acre spacing and proration unit in the Bone Spring formation comprised of the E/2 W/2 of Section 17 and the E/2 W/2 of Section 20, Township 26 South, Range 28 East, NMPM, Eddy County, New Mexico; (2) pooling the uncommitted interests in said unit; and (3) dedicating the unit to the SRO State Com Well No. 44H. *See* Order, ¶ 39.

5. COG and Nearburg presented extensive testimony and evidence.

6. The Commission deliberated in executive session on April 25, 2017, in Santa Fe New Mexico.

7. The Commission entered its Order on May 18, 2017.

ARGUMENT

8. COG seeks rehearing on three components of the Order: (A) the Commission's dismissal for lack of jurisdiction for failure to comply with certain Division regulations, *see* Order, ¶¶ 24, 26, and 27; (B) the Commission's corresponding failure to exercise jurisdiction over COG's good faith belief that it had a right to drill, *see* Order, ¶¶ 23 and 27; and (C) the Commission's dismissal of COG's compulsory pooling applications for lack of jurisdiction, *see* Order, ¶ 43.

A. A Determination of Whether COG Violated Agency Regulations Is Within the Agency's Exclusive Jurisdiction.

9. Paragraphs 24, 26, and 27 of the Order state:

> 24. Nearburg also requests a declaration that COG violated Division Rule 19.15.16.15F, requiring an operator of a horizontal well to consolidate ownership of interests in the well's project area by voluntary or compulsory pooling.
>
> . . .
>
> 26. *Until the District Court resolves these legal issues, the Division cannot determine whether any violation of Rule 19.15.16.15F occurred.*
>
> 27. . . . Nearburg's request . . . for a declaration that in so doing COG violated Division Rules 19.15.14.8B and or 19.15.16.15A (both of which require authorization from an owner prior to drilling on or into a tract of land), should be DIMISSED (sic) for lack of jurisdiction.

See Order, ¶¶ 24, 26 and 27 (emphasis added). These findings are erroneous and not in accordance with law. *See In re Pub. Serv. Co. of N.M.*, 1998-NMSC-017 at ¶ 10; *see also V.P. Clarence Co. v. Colgate,* 1993-NMSC-022, ¶ 8, 115 N.M. 471 ("Statutory language that is clear and unambiguous must be given effect.").

10. This regulatory agency has *exclusive jurisdiction* to establish regulations to prevent waste and protect correlative rights, and to determine whether a party before it has violated said regulations. NMSA 1978, § 70-2-11(A) and (B). "The broad grant of power given

to the Commission to protect correlative rights and prevent waste allows the Commission 'to require wells to be drilled, operated and produced in such manner as to prevent injury to neighboring leases or properties.'" *Santa Fe Expl. Co. v. Oil Conservation Comm'n*, 1992-NMSC-044, ¶ 28, 835 P.2d 819 (quoting NMSA 1978, § 70-2-12(B)(7)). It is further "'empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purpose of this act, whether or not indicated or specified in any section hereof.'" *Id.* (quoting NMSA 1978, § 70-2-11); *see also* NMSA 1978, § 70-2-6(A) ("*The division shall have, and is hereby given, jurisdiction and authority over all matters relating to the conservation of oil and gas*[.]" (emphasis added)).

11. Having "jurisdiction and authority over all matters relating to the conservation of oil and gas," § 70-2-6(A), and having enacted Rule 19.15.16.15F, 19.15.14.8B and 19.15.15.16A, this administrative agency has exclusive jurisdiction to determine violation of its regulations. *See U.S. Xpress, Inc. v. N.M. Taxation & Revenue Dept.*, 2006-NMSC-017, ¶ 13, 1136 P.3d 999 (stating that a district court lacks subject matter jurisdiction until a party has exhausted all administrative remedies); *Cont'l Oil Co. v. Oil Conservation Comm'n*, 1962-NMSC-062, ¶ 28, 373 P.2d 809 (holding that the courts cannot perform "administrative" functions delegated by the Legislature to an agency with expertise).

12. Dismissal or deferral of Nearburg's claim to a judicial forum is an impermissible avoidance and abdication of this agency's exclusive jurisdiction and constitutes a violation of the doctrine of separation of powers. *See Mountain States Nat'l Gas Corp. v. Petroleum Corp. of Texas*, 693 F.2d 1015, 1019 (10th Cir. 1982) (explaining that an administrative "agency alone has exclusive jurisdiction" over a matter when the exhaustion of administrative remedies applies); *see also* NMSA 1978 § 70-2-6 (providing that "[t]he commission shall have concurrent jurisdiction and authority with the division to the extent necessary for the commission to perform

its duties as required by law."). When an agency fails to act "in the areas of its responsibility, means are available to compel it to do so." *State ex rel. Norvell v. Ariz. Pub. Serv. Co.*, 1973-NMSC-051, ¶ 45, 510 P.2d 98.

13. Contrary to the Commission's Order, the judiciary does not have concurrent, let alone primary jurisdiction, to assess whether COG violated 19.15.14.8.B, 15.16.A, and 16.15.F NMAC. That decision, grounded on this agency's unique oil and gas expertise, belongs exclusively to this administrative agency. The Commission should correct this error on rehearing.

B. The Commission Erred As A Matter of Law, and Acted Arbitrarily, When It Failed To Apply The Correct "Good Faith Belief" Standard And Make A Determination Under Its Own Regulations.

14. The Commission is required to exercise its exclusive jurisdiction to determine whether, under the Division's regulations, COG had a "good faith belief" that it had a right to drill the 43H and 44H wells. The Commission erroneously determined, however, that it lacked jurisdiction to apply the Division's own regulations 19.15.14.8.B, 15.16.A, and 16.15.F NMAC in this case. That determination, which applied the wrong standard, is incorrect. The Commission should reconsider that issue, apply the correct standard, and rule that COG did not violate the Division's regulations because it had a "good faith belief" that it had a right to drill the 43H and 44H wells.[1]

15. The Commission erroneously framed the issue for determination under Nearburg's Paragraph B as "[w]hether COG had an actual right to drill the 43H or the 44H Wells[.]" *See* Order, ¶ 23. By thus framing the issue as a "contractual issue," the Commission

[1] Failure of the Commission to conclude that COG possessed the requisite good faith belief in its right to drill injects an immense amount of uncertainty into compulsory pooling and oil and gas development in New Mexico. The effect of the Commission's refusal to acknowledge COG's good faith belief in its right to drill, based on the State Land Office forms, necessarily means that no oil and gas lessee in New Mexico can rely in good faith on the State Land Office form of ratification or Article 22 of the State Land Office form of unit agreement as providing a good faith basis to drill in this state. Either of these State Land Office forms provides an independent and sufficient basis for COG's good faith belief in this case, in addition to the other bases discussed herein.

ruled that it "does not have jurisdiction" to determine whether COG violated the Division's regulations. *Id.* ¶¶ 23, 27 (emphasis added).

16. But "[w]hether COG had an actual right to drill the 43H or the 44H Wells[,]" is the incorrect standard for determining whether COG violated the Division's regulatory requirements under 19.15.14.8.B, 15.16.A, and 16.15.F NMAC. By applying the incorrect standard—applicable to a contractual dispute—the Commission improperly avoided making a regulatory ruling on the merits and erroneously determined that it did not have jurisdiction. *See* Order, ¶¶ 26-27.

17. The correct regulatory standard for COG's right to drill the subject wells is whether COG can certify as "true and correct to the best of [its] knowledge and belief," that it "either owns a working interest or unleased mineral interest in the land" or has a right that it was authorized to operate on a separately owned tract by virtue of an agreement or some other contractual arrangement. *See* Order R-12343-E ¶ 33 (emphasis added). The Division held that "COG did have the requisite good faith belief." *See,* Order No. R-14187 ¶ 27.

18. By applying the incorrect standard and determining that the Division did not have jurisdiction, the Commission acted arbitrarily and erred as a matter of law. This deprived COG of a determination that it had a good faith belief that it had a right to drill the 43H and 44H wells and did not violate the Division's regulations.

19. Because application of rules 19.15.14.8.B, 15.16.A, and 16.15.F are "initially cognizable exclusively at the administrative level," the Division/Commission have exclusive jurisdiction in the first instance to determine whether COG violated the Division's rules. *See Mountain States Nat'l Gas Corp.*, 693 F.2d 1015 at 1019.

20. Instead, the Commission stated that "[u]ntil the District Court resolves these [contractual] legal issues, the Division cannot determine whether any violation of Rule

19.15.16.15.F occurred." Order ¶ 26. On the contrary, the district court's legal conclusions regarding what the contracts actually require will not answer, and has no bearing on, the regulatory question of what COG believed in good faith regarding the effect of the relevant agreements.

21. Having duly enacted rules 19.15.14.8.B, 15.16.A, and 16.15.F, the Commission has exclusive jurisdiction—and the requisite particularized expertise—to determine whether an operator has a "good faith belief that it is authorized to drill the well applied for" under the Division's own regulations. *See Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶ 7, 206 P.3d 135, 139 ("The Commission's specialized expertise pertains to the regulation and conservation of oil and gas.").

22. The Division correctly applied this regulatory standard, and determined that "[t]he evidence indicates that COG did have the requisite good faith belief that it was the duly authorized 'operator' of the W/2 of Section 20 on the dates when it commenced drilling the 43H Well and the 44H Well." *See* Order R-14187 ¶ 27.

23. The evidence presented establishes COG had the requisite good faith belief when it permitted and drilled the 43H and 44H Wells either through 1) Nearburg's ratification of the Operating Agreement in 2009; 2) Nearburg's obligation to join the Operating Agreement under Article 22 of the SLO form unit agreement; 3) the course of performance under the Operating Agreement; 4) the continued negotiations of the Term Assignment; 5) the fact that COG was operating the 16H Well on the Nearburg lease without objection; and 6) Nearburg's execution of the Communitization Agreements. *See, e.g.*, *Valence Operating Co. v. Dorsett*, 164 S.W.3d 656, 663 (Tex. 2005) (holding that an operator's failure to provide 30 days' notice of drilling pursuant to an operating agreement did not impair the operator's right to drill the well); *Bonn Operating Co. v. Devon Energy Prod. Co., L.P.*, 613 F.3d 532, 535 (5th Cir. 2010) (late notice of drilling

under an operating agreement favors the non-operator, who gets to make his election with the benefit of hindsight, even after the well is drilled).

24. Applying this standard under the Division's regulations "does *not* determine whether an applicant can validly claim a real property interest in the property subject to the application[.]" *See* Order R-11700-B ¶ 27 (stating that the Division does not undertake this "property interest" analysis, which is reserved to the exclusive jurisdiction of the courts) (emphasis added).

25. In its Order, the Division correctly distinguished between its regulatory standard and the contractual standard reserved to the courts. "Whether either or both of these propositions [under the Division's regulatory standard] was legally correct, and conferred on COG an actual right to drill the 43H and 44H wells when and where it did, are issues that the Division does not have jurisdiction to determine." *See* Order R-14187 ¶ 29 (emphasis added). This administrative agency has exclusive jurisdiction, however, to determine whether the Division's rules were violated.

26. "[J]ust as the commission cannot perform a judicial function, neither can the court perform an administrative one." *See Cont'l Oil Co.*, 1962-NMSC-062, ¶ 28. The Commission's application of the incorrect regulatory standard and determination that it lacks jurisdiction will "inevitably lead[] to the substitution of the court's discretion for that of the expert administrative body." *Id.* That "would be a delegation of administrative authority in violation of the Constitution." *Id.*; *see also Johnson v. Sanchez*, 1960-NMSC-029, ¶ 23, 351 P.2d 449.

27. Whether COG had a "good faith belief" that it had a right to drill the 43H and 44H wells and violated the Division's regulations "is a purely administrative" determination, "and not a judicial duty." *Johnson*, 1960-NMSC-029, ¶ 24. The Commission should correct this

error on rehearing and apply the correct regulatory standard to rules 19.15.14.8.B, 15.16.A, and 16.15.F.C.

C. The Commission Has Exclusive Jurisdiction And A Statutory Mandate To Compulsory Pool Uncommitted Interest Owners In A Spacing Unit.

28. The Oil Conservation Division and Oil Conservation Commission have exclusive jurisdiction to enter orders for compulsory pooling. NMSA 1978, § 70-2-6(A) and (B) and § 70-2-17(C).

29. By dismissing COG's applications to compulsory pool for lack of jurisdiction, the Commission violated its statutory mandate and thereby failed to act in accordance with law. *See N.M. Regulation & Licensing Dep't v. Lujan*, 1999-NMCA-059, ¶ 8, 127 N.M. 233 ("[A]n agency's decision is not in accordance with the law if the decision or action taken by the agency was based on an error of law."); *see also In re Pub. Serv. Co. of N.M.*, 1998-NMSC-017, ¶10, 125 N.M. 302 (administrative "agencies are limited to the power and authority that is expressly granted and necessarily implied by statute.").

30. Paragraph 43 of the Order states:

> On the other hand, *if* the Ratification did not ratify the Unit Operating Agreement, or if it effectively committed thereto only Nearburg's overriding royalty interest reserved in the subsequently executed Term Assignment, and the Term Assignment had not been renewed or extended, then *COG was not an owner who had the right to drill the 43H and 44H wells at the time it did so, or at the present time, and so is not entitled to invoke the remedy of compulsory pooling. See* Order, ¶ 43 (emphasis added).

31. The Oil and Gas Act mandates that the Division enter a compulsory pooling order where certain statutory preconditions for a pooling order are satisfied. Section 70-2-17(C) states:

> When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. *Where, however, such owner or owners have not*

> *agreed to pool their interests*, and where one such separate owner, or owners, *who has the right to drill has drilled or proposes to drill a well* on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit. (emphasis added).

32. The first statutory requirement is creation of a single spacing or proration unit containing separately owned tracts of land. A "proration unit" is defined as "the area in a pool that can be effectively and efficiently drained by one well . . . ." 19.15.2.7.P(17) NMAC.

33. Once a spacing or proration unit is created, an interest owner has the authority and right to drill a well and compulsory pool any uncommitted interest owners within the spacing or proration unit. NMSA 1978, § 70-2-17(C) (an owner "who has the right to drill has drilled or proposes to drill a well" has the authority and right to pool).

34. Through its applications in Case Nos. 15481 and 15482, and pursuant to the statute and Division regulations, COG sought to create two non-standard, 320-acre spacing and proration units, in which it owned an undisputed interest.[2]

35. Having properly invoked the Division's authority to create a non-standard spacing and proration unit and negotiated in good faith with the owners of separate tracts, COG satisfied all statutory prerequisites to compulsory pooling. The Commission was thereby required to compulsory pool uncommitted interest owners within the proposed non-standard spacing and proration unit. *See, e.g.*, Commission Order No. R-12108-C (authorizing compulsory pooling of a spacing unit that included a tract in which the operator owned no interest) and Commission Order No. R-13228-F (same).

[2] The other prerequisite to compulsory pooling is negotiating in good faith with uncommitted interest owners. *See* NMSA 1978, § 70-2-17(C). COG presented extensive evidence related to its good faith negotiations to reach a voluntary agreement with Nearburg. *See* Tr. Vol. II, 3/1/17 at pp. 149-155.

36. In direct contravention of Section 70-2-17(C) of the Oil and Gas Act, and despite COG having a separate interest in the proposed spacing unit and a right to drill thereon, the Commission refused to grant COG's request for compulsory pooling. *See* Order, ¶ 46.

37. It is undisputed by the parties that this regulatory agency has exclusive authority to pool oil and gas acreage, and furthermore that pooling under the facts of this case is required to protect the correlative rights of the parties while the courts address the parties' contractual rights and obligations Indeed, even Nearburg admits that compulsory pooling is required in this case. *See* Tr. Vol. II, 3/1/17 at p. 21 ("Q. Mr. Griffin, in your opinion, is the consolidation of Sections 17 and 20 by way of compulsory pooling an appropriate way for the Commission to reconcile and protect Nearburg's correlative rights in this acreage? A. Yes."); *id.* at p. 34 (Griffin) (***"Q. Okay. Do you agree now that a pooling order is appropriate for this acreage? A. Yes."***); *id.* at pp. 138-39 (Owen).

38. Accordingly, the Commission erroneously concluded, in violation of the Oil and Gas Act, that COG compulsory pooling "is not appropriate at this time." *See* Order ¶ 29. Moreover, the Commission additionally concluded that, in the absence of a voluntary agreement, COG had no right to compulsory pooling. *See* Order ¶ 43. Both these conclusions are incorrect as a matter of law. It is precisely the absence of a voluntary agreement that entitles COG to compulsory pooling in this matter. Since NEX has repudiated or otherwise denied the existence of a voluntary agreement, compulsory pooling is mandatory.

WHEREFORE, COG respectfully requests that the Commission schedule a rehearing for this matter, and enter an order consistent with the points and authorities set forth in this pleading.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 6, 2017, I served a copy of the foregoing document to the following counsel of record via electronic mail:

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