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February 21, 2017

HAND-DELIVERED

Florene Davidson
New Mexico Oil Conservation Division
1220 South St. Francis Drive
Santa Fe, NM 87505

Re: NMOCD Case No. 15441: Application of Nearburg Exploration Company, L.L.C., SRO2 LLC, and SRO3 LLC for an Accounting and Limitation on Recovery of Well Costs, and for Cancellation of Permit to Drill, Eddy County, New Mexico

NMOCD Case No. 15481: Application of COG Operating LLC for a Non-Standard Spacing and Proration Unit and Compulsory Pooling, Eddy County, New Mexico

NMOCD Case No. 15482: Application of COG Operating LLC for a Non-Standard Spacing and Proration Unit and Compulsory Pooling, Eddy County, New Mexico

Dear Ms. Davidson:

Enclosed please find for filing the original and six copies of Applicant's Pre-Hearing Statement. Also enclosed are six Exhibit Notebooks for the Oil Conservation Commission hearing on February 28, 2017 in the above matters. Thank you.

Very truly yours,

J. Scott Hall

J. Scott Hall

Enclosures
cc (w/encs): William R. Brancard, Esq., NMOCC (hand-delivery – Pre-Hearing Statement only)
Michael H. Felderwert and Jordan L. Kessler (Holland & Hart, LLP) (hand-delivery)
Nearburg Exploration Company (via email – Pre-Hearing Statement only)
David Harper (via email – Pre-Hearing Statement only)
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STATE OF NEW MEXICO
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES
OIL CONSERVATION COMMISSION

IN THE MATTER OF THE APPLICATION OF NEARBURG EXPLORATION COMPANY, L.L.C., SRO2 LLC AND SRO3 LLC FOR AN ACCOUNTING AND LIMITATION ON RECOVERY OF WELL COSTS, AND FOR CANCELLATION OF APPLICATION FOR PERMIT TO DRILL, EDDY COUNTY, NEW MEXICO

CASE NO. 15441

PRE-HEARING STATEMENT

This Pre-Hearing Statement is submitted by Montgomery and Andrews, P.A. (J. Scott Hall, Sharon T. Shaheen) on behalf of Nearburg Exploration Company, L.L.C., SRO2 LLC, and SRO3 LLC ("NEX").

APPEARANCES

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STATEMENT OF THE CASE

Applicants seek an order determining that COG Operating LLC ("COG") did not have the right to permit, drill, or produce two two-mile long lateral wells that COG drilled and completed in the Bone Spring formation from surface locations in Section 17 onto unconsolidated and unpooled lease acreage owned by Nearburg Exploration Company in the W/2 of Section 20, Township 26 South, Range 28 East, N.M.P.M., in Eddy County, New Mexico. The wells are the SRO State Com 043H (API 30-015-41141) located in the W/2 W/2 of Sections 17 and 20 ("043H") and the SRO State Com 044H (API 30-015-41142) located in the E/2 W/2 of Sections 17 and 20 ("044H"). Both wells were drilled to and completed in the 2nd Bone Spring Sand, Hay Hollow Bone Spring Pool (30215). Applicants further seek an order requiring COG to account and pay to Applicants the amounts of production proceeds they are entitled to in the absence of pooling, without recovery of well costs or expenses. Applicants also seek cancellation of the application for permit to drill the COG SRO State Com 069H Well (API 30-015-43093) projected to be drilled to the 3rd Bone Spring formation in the E/2 W/2 of Sections 17 and 20, T-26-S, R-28-E. Applicants will seek the removal of COG and designation of Nearburg Producing Company as the operator of the SRO State Com 016H well (API 30-015-38071) producing from the Avalon member and located entirely on NEX's lease in the W/2 W/2 of Section 20, T-26-S, R-28-E. Applicants will address the past and ongoing violation of NEX's

correlative rights and will ask the Commission to bring all three of the producing wells into regulatory compliance.

In related cases 15481 and 15482 before the Division, COG sought an order (1) retroactively approving of two non-standard, 320-acre spacing and proration units in the W/2 of Section 17 and the W/2 of Section 20, Township 26 South, Range 28 East, NMPM, Eddy County, New Mexico; and (2) pooling all mineral interests in the Bone Spring formation underlying this acreage. COG did not seek Commission review of cases 15481 and 15482.

In addition, Applicants provide below the factual background, legal argument, and authority regarding the issues raised by the Application.

PROPOSED EVIDENCE		
NEX'S WITNESSES	EST. TIME	EXHIBITS
Randy Howard, Landman	2 ½ hrs.	32
Michael Griffin, Petroleum Engineer	20 min.	5
WITNESSES SUBPOENAED BY NEX	EST. TIME	EXHIBITS
Aaron Myers	1 hr.	30
Brent Sawyer	1 hr.	

I.

Key Background Facts

The parties have stipulated to certain facts, filed concurrently. In addition, NEX will offer evidence at hearing that establish the following facts.

1. NEX is the owner of New Mexico State Oil and Gas Lease No. V-7450-0001 (the "Lease") comprised of the W/2 of Section 20, T-26-S, R-28-E.

2. NEX term-assigned its lease acreage in Section 20 to Marbob, effective July 1, 2009, reserving an overriding royalty interest.[1] The Term Assignment was limited to a term that extended only so long as the Lease was subject to the Unit Agreement. After the Lease was added to the Unit on August 1, 2009, it was designated as Tract 26.

3. The Unit Agreement, by its own terms, did not become effective until approval by the Commissioner and the Division. On June 12, 2009, the Division approved the SRO State Exploratory Unit established by the Unit Agreement (Order No. R-13136). The Division's approval did not become effective until the Commissioner of Public Lands approved the Unit Agreement. The Commissioner approved the commitment of the Lease and other lands effective August 1, 2009.

4. NEX term-assigned its lease acreage in Section 20 to Marbob, effective July 1, 2009, reserving an overriding royalty interest.[2] The Term Assignment was limited to a term that extended only so long as the Lease was subject to the Unit Agreement. After the Lease was added to the Unit on August 1, 2009, it was designated as Tract 26.

5. COG initiated the process of terminating the Unit Agreement in October 2013.

6. Effective March 1, 2014, COG voluntarily terminated its right to drill and produce oil and gas from the Lease.[3]

7. When the Unit Agreement terminated on March 1, 2014, all parties agree that the NEX-Marbob Term Assignment terminated automatically.[4] The lease acreage in Section 20 simultaneously reverted to NEX.

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[1] NEX Hearing Exhibit 2.
[2] *Id.*
[3] NEX Hearing Exhibit 9.
[4] NEX Hearing Exhibit 16.

8. Five days after having voluntarily terminated its right to drill on NEX's Lease, COG filed C-102s for the SRO State Com 043H well and for the SRO State Com 044H well.[5]

9. COG certified and filed these C-102s without an updated title opinion on the former SRO Unit wells.[6]

10. In July 2014, NEX received a proposed communitization agreement from COG.[7] The day that NEX received that proposed agreement, NEX's Randy Howard called COG's Kelly Fuchik and explained that NEX could not agree to the communitization agreement because the Term Assignment had expired. Further, NEX expressly told COG that COG was not authorized to operate on NEX's Lease.

11. In spite of the Term Assignment's expiration and NEX's express refusal to execute the communitization agreement and assertion that COG had no right to operate on NEX's Lease, COG spud 043H on August 2, 2014. COG still did not have an updated title opinion on the SRO Unit wells.[8] At no time prior to August 2, 2014, did COG provide NEX with "written notice of the proposed operation, specifying the work to be performed" (in accordance with the Operating Agreement) nor did COG provide NEX with 24-hour notice of spudding (as required by the then-terminated Term Assignment). Neither did COG seek Division approval of a non-standard spacing and proration unit or obtain the requisite authorization to produce the 043H well. 19.15.15.11.B. NMAC.

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[5] NEX Hearing Exhibits 28 and 29.

[6] NEX Hearing Exhibit 35A (March 20, 2014 email from COG's Brent Sawyer – "our title lawyer is currently working on getting supplementary opinions for each individual well's proration unit, since the SRO state unit has terminated:").

[7] NEX Hearing Exhibit 10.

[8] NEX Hearing Exhibit 40 (Nov. 3, 2014, COG's Brent Sawyer tells NEX that "we are still waiting on the opinion(s) for the SRO Operating Agreement wells which calculate everything on a well by well basis.").

12. COG received a drilling title opinion on other wells in the SRO Unit on October 8, 2014. That drilling title opinion made clear to COG that all of the interests under the Lease had reverted back to NEX.[9]

13. COG spud 044H on October 10, 2014. At no time prior to October 10, 2014, did COG provide NEX with "written notice of the proposed operation, specifying the work to be performed" (in accordance with the Operating Agreement) nor did COG provide NEX with 24-hour notice of spudding (as required by the then-terminated Term Assignment). When 044H was drilled, COG had title opinions that informed it that the Term Assignment (and therefore, COG's right to drill) had expired.

16. Throughout these periods, COG did not inform NEX that it had drilled any wells on the former unit other than certain Avalon wells.

II.

Points and Authorities

An operator seeking to permit a well must have a good faith claim to title ***and*** the right to drill on the lands involved at the time a well is drilled. COG cannot establish that it satisfied either element. At the May 4, 2016 hearing before the Division, COG asserted that its actions were justified based on a "good faith belief that it had *the right to drill*" the 043H and 044H wells at the time. COG misstates the standard. Nonetheless, even if COG's misstated standard applied, COG cannot satisfy it—COG had no good faith belief that it had the right to drill.

A. COG Held No Right, Title, or Interest in Section 20.

To invoke the Division's compulsory pooling authority, an applicant must have the "right to drill." NMSA 1978 §70-2-17 C. Further, an applicant for a permit to drill "must have a good

[9] NEX Hearing Exhibits 20 and 23.

faith claim of title." Order No. R-12108-C, *Rehearing*, Findings ¶ 8(e) (December 9, 2004).[10] In this instance, COG had neither.

An interest in an oil and gas lease is an interest in real estate. *See Angle v. Slayton,* 102 N.M. 521, 523, 697 P. 2d 940, 942 (1985). Real property laws, therefore, govern COG's claim to title.

When COG finalized the termination of the Unit Agreement, COG lost any vestige of an interest to the Lease. On March 1, 2014, SRO State Exploratory Unit terminated and NEX's interest in the Lease automatically reverted to NEX.[11] COG's title in Section 20 was not "free from any encumbrances, burdens, or other limitations" and was neither clear nor marketable. *See* Black's Law Dictionary, 1522 (8th ed. 2004). *See also Campbell v. Doherty,* 53 N.M. 280, 286, 206 P.2d 1145, 1148 (1949) ("a 'marketable title' is not subject to such reasonable doubt as would create a just apprehension of its validity in the mind of a reasonable, prudent, and intelligent person.").

B. COG has no good faith claim to title in the Lease.

An applicant for a permit to drill must have a good faith claim to title. *See* Order No. R-11700-B. COG does not have record title. Neither can it reasonably claim that it had a good faith claim to title at the time the wells were drilled.

"Title" to real property is evidenced by a conveyance "*which shall be subscribed by the person transferring his title or interest in said real estate, or by his legal agent or attorney.*" NMSA 1978 § 47-1-5. *See Kysar v. Amoco Production Co.*, 135 N.M. 767, 93 P.3d 1272 (2004). Likewise, NMSA 1978 § 37-1-21 requires a claimant to hold or claim "by virtue of a deed or deeds [of] conveyance, ... purporting to convey an estate in fee simple." *See also*

[10] Application of Pride Energy Company for Cancellation of a Drilling Permit and Reinstatement of a Drilling Permit, etc., Lea County, New Mexico; Case No. 13153 de novo.
[11] NEX Hearing Exhibit 20 – COG's own title opinion.

Quarles v. Arcega, 114 N.M. 502 (Ct. App. 1992). Therefore, a claim to title must be based on a written deed, with a legal description contained therein that is easily ascertainable on the ground. *See Esquibel v. Hallmark*, 92 N.M. 254 (1928); *Cox v. Hanlen*, 1998-NMSA-015; *Ritter-Walker Co. v. Bell*, 46 N.M. 125 (1942).

As the New Mexico Court of Appeals has pointed out, Black's Law Dictionary defines "title" as: *"The union of all elements (as ownership, possession, and custody) constituting the legal right to control and dispose of property; the legal link between a person who owns property and the property itself." Santa Fe County Bd. of County Comm'rs v. Town of Edgewood*, 2004-NMCA-111 (quoting Black's Law Dictionary at 1493).

Neither the NMOCD nor the New Mexico courts have defined what exactly it means to have a "good faith claim to title." One Washington court, in the context of adverse possession, has articulated: "claimant must have an honest belief, based on reasonable grounds, that he or she has acquired a valid legal title." *Williams v. Striker*, 627 P.2d 590, 29 Wash. App. 132 (1981). Case law originating from the Texas Railroad Commission also establishes that an applicant for a permit to drill must make "a reasonably satisfactory showing of a good-faith claim of ownership." *Magnolia Petroleum Co. v. Railroad Comm'n,* 170 S.W.2d 189 (Tex. 1943). A finding of a good faith assertion of title must be based on substantial evidence.

New Mexico does not adhere to a single definition of good faith, recognizing that the concept arises in a variety of disparate situations. *See Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co.*, 102 N.M. 28, 31, 690 P. 2d 1022, 1025 (1984). In light of New Mexico's analysis of "good faith belief" in other areas of the law, it appears that the legal definition of good faith is a belief based upon a reasonable assessment of the facts. *See, e.g., State v. Sanchez*, 88 N.M. 378, 382, 540 P. 2d 858, 862 (1975) ("by a good faith belief, we mean a reasonable

belief, one resting on a reasonable assessment of the facts"); *Fife v. Barnard*, 186 F. 2d 655, 660 (10th Cir. 1951) (good faith in asserting color of title in an adverse possession case must be based upon an honest belief based on reasonable grounds).

A reasonable assessment of the facts in this case would have easily uncovered (and actually did uncover) that the Term Assignment rights had terminated. COG cannot explain how the 43H well was drilled without a drilling title opinion. COG's own title opinions, received at least twice before either well was completed, emphasized to COG what it already knew: it no longer had an interest in Section 20 as of March 1, 2014. In addition, prior to spudding the 043H and 044H wells, NEX had refused to agree to a communitization agreement and expressly told COG it had no right to operate on NEX's Lease.

COG may have hoped that it was going to work out something with NEX, but that is not a "good faith claim to title." In order to meet the standard, COG had to actually believe it had acquired an interest in title. In light of NEX's express objections and COG's own lawyers recognizing it did not actually have title, any claim to title by COG is unreasonable under the facts of this case and does not meet a good faith standard.

C. Applicable Regulatory Law Precedent.

In *Pride Energy*, the Oil Conservation Commission, citing to Order No. R-11700-B,[12] said "[t]hat an applicant for permit to drill must have a good faith claim of title." Order No.R-12108-C, Findings ¶ 8(e) (December 9, 2004). The agency then established a specific administrative procedure to make a determination whether or not a good faith claim of title exists:

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[12] *Case No. 12731, Application of TMBR/Sharp Drilling, Inc. For An Order Staying David H. Arrington Oil and Gas, Inc. From Commencing Operations, Lea County, New Mexico; Case No. 12744, Application of TMBR/Sharp Drilling, Inc. Appealing The Hobb's District Decision Approval Of Two Applications For A Permit To Drill filed by TMBR/Sharp Drilling, Inc., Lea County, New Mexico.*

> "(f) Although the Division can and should cancel an APD when it properly determines that no such good faith claim exists (as the Commission determined, based on a District Court judgment, in Order No. R-11700-B), it should not make that determination, which necessarily cannot be made on the face of the APD or from Division records, without first giving the Applicant notice and an opportunity for a hearing. Although the Division doubts that the right conferred by an approval of an APD is properly characterized as "property," it nevertheless concludes that such approval confers rights that should not be revoked arbitrarily." Order No. R-12108-C, ¶ 8.

The Division and Commission followed this procedure in the *TMBR/Sharp* case, where, after the administrative challenge to Arrington's APD's, TMBR/Sharp Drilling was able to prove-up that it had title to support the issuance of its APD's. Further, Order No. R-11700-B in the *TMBR/Sharp* case set forth the two criteria under which the Division may make a determination of a properly or improperly approved APD: "It is the responsibility of the operator filing an Application for a Permit to Drill to do so under a good faith claim to title and a good faith belief that it is authorized to drill the well applied for." Order No. R-11700-B, Finding ¶ 28 (April 26, 2002).

In 2007, the Commission clarified *Pride* and made clear that its findings related to the order of approval (pooling then APD or APD then pooling) only applied ***before*** work began – "[the Commission] did not find that an operator could actually drill a well on acreage in which it had no interest before the Division or Commission decided a pooling application."[13] There, Chesapeake drilled a well on acreage it did not have an interest in. The Commission went on to state: "An Operator shall not file an application for permit to drill or drill a well unless it owns an interest in the proposed well location or has a right to drill the well as stated in Division Form

[13] Application of Samson Resources, Kaiser-Francis Oil Company and Mewbourne Oil Company for Cancellation of Two Drilling Permits and Approval of a Drilling Permit, Lea County, New Mexico, Case No. 13492; Application of Chesapeake Operating, Inc. for Compulsory Pooling, Lea County, New Mexico.; Case No. 13493, de novo (consolidated), Order No. R-12343-E, Conclusions ¶ 30, (March 16, 2007).

C-102." Order No. R-12343-E, Conclusions ¶ 33 (March 16, 2007). The Division's Form C-102 now provides for Operator Certification:

> *"I hereby certify that the information contained herein is true and complete to the best of my knowledge and belief, and that this organization either owns a working interest or unleased mineral interest in the land including the proposed bottom hole location(s) or has a right to drill this well at this location pursuant to a contract with an owner of such a mineral or working interest, or to a voluntary pooling agreement or a compulsory pooling order heretofore entered by the Division."*

Prior to drilling, Samson had elected to participate in the well and had approved an authorization for expenditures. Samson rescinded both of those before Chesapeake drilled the well. Because the off-lease vertical well on that tract had already been drilled and completed by the time the case was heard, the Commission's solution in-part was to remove Chesapeake as operator. Order No. R-12343-E, Conclusions ¶ 3.

NEX's position in this matter is similar to Samson's. COG owns no interest in Section 20. NEX did not enter into to an Operating Agreement with COG. Even if the Examiners find that NEX is bound by the Operating Agreement, in July 2014, NEX expressly told COG that COG was not authorized to operate on NEX's Lease. Like Samson, any implied right COG might have had was rescinded prior to either 043H or 044H being drilled (043H was spud on August 2, 2014).

In 2009, Case No. 14323[14] was one of the first disputes to come before the Division addressing the certification of a drilling permit for a horizontal well. There, COG obtained the Division's approval of an APD for a project area comprised of the S/2 S/2 of Section 11 prior to obtaining voluntary or compulsory pooling. Order No. R-13154-A (September 21, 2009). It was undisputed that COG's only "ownership interest" in the S/2 SW/4 area was a contractual license

[14] Application of Chesapeake Energy Corporation for Cancellation of a Permit To Drill (APD) Issued To COG Operating, LLC, Eddy County, New Mexico.

or easement to utilize the surface. Order No. R-13154-A, Finding ¶ 4(a). The working interest was owned by Chesapeake. Because COG proposed to complete a well in Chesapeake's acreage, Chesapeake sought cancellation of COG's APD.

The Division found its prior ruling in *Chesapeake/Samson* controlled and accordingly cancelled COG's APD. ("COG's ownership of an easement or license authorizing its use of the surface location of the proposed well does not distinguish this case from the case decided in Order No. R-12343-E because a surface easement or license does not, and cannot, authorize the drilling and completion of a horizontal well in the subsurface without the approval (actual or compelled) of at least one owner of oil and gas rights in each tract to be included in the project area.") Order No. R-13154-A, Findings ¶ 12. In this matter, COG does not own title to the minerals in Section 20, it has no contractual right and even if it had, it was revoked before it drilled the first of the two wells.

D. Right to Drill

Even if a "good faith right to drill" were the standard, as COG erroneously claims, COG's reliance on the Ratification and Joinder of Unit Agreement and Operating Agreement (the "Ratification") is unfounded. The Division's approval of APDs does not determine whether an applicant can validly claim the right to drill. It is the operator's responsibility to first obtain the right, actual or compelled.

COG appears to contend that it had the right to drill both 043H and 044H based on the Ratification and Unit Operating Agreement and correction or replacement of the Term Assignment, which it never achieved. The text of the Ratification, signed by NEX on June 26, 2009, does not address the operating agreement. Instead, the Ratification specifically states that

NEX "expressly ratifies, approves and adopts said **Unit Agreement**."[15] No one disputes that the Unit Agreement terminated. COG could not have a good faith belief in its right to drill based on an Operating Agreement that NEX was not a party to. If "good faith" means anything, it must mean a simple reading of the Ratification. In addition, it is undisputed that COG did not follow the notice requirements of the Operating Agreement before drilling 043H and 044H. COG never submitted a well proposal or AFE to NEX for the 043H or 044H. Instead, without informing NEX of COG's plans to drill, or the fact that COG had drilled and completed both wells, COG attempted to negotiate an extension of the expired term assignment.

Finally, COG's reliance on an extension of Term Assignment is unfounded and COG's own actions show that this is an afterthought in an attempt to support its improper actions. An interest in an oil and gas lease is real property and therefore the statute of frauds applies. To satisfy the statute:

> A memorandum, in order to make enforceable a contract within the statute, may be any document or writing, formal or informal, signed by the party to be charged or by his agent actually or apparently authorized thereunto, which states with reasonable certainty, (a) Each party to the contract either by his own name, or by such a descriptions as will serve to identify him, or by the name or description of his agent, and (b) the land, goods, or other subject-matter to which the contract relates, and (c) the terms and conditions of all the promises constituting the contract and by whom and to whom the promises are made.

Piteck v. McGuire, 1947-NMSC-053, ¶29. There is no writing here. COG's own lawyers recognized that if COG "considered" the Term Assignment either extended or in full force and effect, it had to get a written amendment to the Term Assignment and if it could not, the title opinions would change.[16] COG cannot have a "good faith" basis to drill based on an alleged agreement that expressly violated the statute of frauds and that its attorneys expressly required but COG failed to negotiate.

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[15] NEX Hearing Exhibit 7.
[16] NEX Hearing Exhibits 21 and 22.

III.

Conclusion

NEX respectfully requests that the Commission find that in 2014, COG did not have the right to permit or drill the SRO State Com 043H or 044H wells onto NEX's lease in Section 20 and that COG did not have the right to permit the SRO State Com 069H well. NEX further requests that COG's applications for compulsory pooling be denied outright, or approved only on terms that are just and reasonable under these circumstances, if granted.

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ATTORNEYS FOR NEARBURG EXPLORATION COMPANY, L.L.C., SRO2 LLC and SRO3 LLC

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served on counsel of record by electronic mail on February 21, 2017:

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