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 (*de novo*)**

IN THE MATTER OF THE 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*)**

IN THE MATTER OF THE 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*)**
Order No. R-14187-E

NEX'S POST-HEARING MEMORANDUM

This Post-Hearing Statement is submitted by Montgomery and Andrews, P.A. (J. Scott Hall and Sharon T. Shaheen) and Haynes and Boone, LLP (David Harper, Aimee Furness, and Sally Dahlstrom) on behalf of Nearburg Exploration Company, L.L.C., SRO2 LLC, and SRO3 LLC ("NEX" or "Applicants").

INTRODUCTION

COG Operating LLC's ("COG") case to the Commission confirms that COG did not have the right to permit, drill, or produce two two-mile long lateral wells, 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").

The Commission's rules are clear: an operator seeking to permit a well must have a good faith claim to title ***and*** a right to drill on the lands involved at the time a well is drilled. COG cannot establish that it satisfied either element. COG voluntarily terminated its right to drill and produce oil and gas from NEX's lease and then filed false documents with the Division to obtain permission to drill and complete two new horizontal wells in the 2nd Bone Spring formation of that same NEX-leased interest. Without any authorization from or notice to NEX, COG drilled those two wells through NEX's mineral estate and started taking NEX's oil and gas. COG's own statements and documents show that COG had no right to drill on NEX's Lease at the time the wells were drilled; nor did it have a good faith claim to title. Despite COG's numerous opportunities to tell NEX about the wells, COG concealed the wells for approximately nine months, until it was under pressure from the New Mexico State Land Office. In the face of this overwhelming evidence, COG nevertheless asks the Commission to ignore its own rules—creating a precedent that oil and gas operators do not have to abide by the Commission's rules.

Accordingly, NEX respectfully requests that the Commission find that in 2014, COG did not have the right to permit or drill the 043H or 044H wells onto NEX's lease, and that COG did not have the right to permit the SRO State Com 069H well. NEX further seeks an order requiring COG to account for and pay to NEX the amounts of production proceeds it is entitled to in the absence of pooling, without recovery of well costs or expenses. NEX asks the Commission to set reasonable charges for the costs of operating and supervision to be paid prospectively only. In addition, NEX asks the Commission to limit the depths of the proration units for the 043H and the 044H to the 2nd Bone Spring and to limit the depth of the proration unit for the SRO State Com 016H well (API 30-015-38071) ("016H") to the Avalon member.

Finally, NEX asks the Commission to remove COG and designate Nearburg Producing Company as the operator of the 016H.

KEY FACTS AND AUTHORITIES

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. On June 12, 2009, the Division approved the SRO State Exploratory Unit established by the Unit Agreement (Order No. R-13136).

3. 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.[2]

4. NEX signed the Ratification for the Unit Agreement, not the Unit Operating Agreement.[3] The Ratification specifically states that NEX "expressly ratifies, approves and adopts said **Unit Agreement**."[4]

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

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

7. When the Unit Agreement terminated on March 1, 2014, the Term Assignment terminated automatically and the lease acreage in Section 20 simultaneously reverted to NEX. [7]

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

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[1] NEX Hearing Exhibit 2.
[2] *Id.*
[3] NEX Hearing Exhibit 7.
[4] *Id.*
[5] NEX Hearing Exhibit 9.
[6] *Id.*
[7] NEX Hearing Exhibit 16; Testimony of Ryan Owen, Hearing on March 1, 2017, 62:24-63:1-4, 119:19-23.

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

10. On July 9, 2014, COG and NEX exchanged emails regarding "complicated issues with the SRO Unit wells."[10] At this time, the spudding of the 043H was imminent, but COG did not mention the 043H to NEX.[11]

11. In July 2014, NEX received a proposed communitization agreement on the 043H well from COG.[12] NEX expressly told COG that it would not agree to the communitization agreement for the 043H well because the Term Assignment had expired and COG did not have the right to operate on the Lease.[13]

12. COG never sent NEX a proposed communitization agreement on the 044H well.[14]

13. COG spud the 043H well on August 2, 2014. At that time, COG still did not have an updated title opinion on the SRO Unit wells.[15]

14. On August 22, 2014, NEX and COG exchanged emails regarding the expired Term Assignment and SRO Unit.[16] Again, COG did not mention that the 043H had been spud or that the drilling of the 044H was imminent.[17]

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[8] NEX Hearing Exhibits 28 and 29.

[9] COG Hearing Exhibit 13 (March 20, 2014 email from COG's Brent Sawyer – "our title lawyer is working on getting supplementary opinions for each individual well's proration unit, since the SRO state unit has terminated"; May 5, 2014, COG's Brent Sawyer tells NEX that "We are still waiting to get updated title opinions on all 23 SRO wells . . .Hopefully we will get those opinions this month . . ."; September 30, 2014, COG's Brent Sawyer tells NEX that COG is still waiting on updated title opinions, "Latest word from the attorney is they will be ready next week.").

[10] NEX Hearing Exhibit 39; Testimony of Ryan Owen, Hearing on March 1, 2017, 78:4-10.

[11] *Id.*

[12] COG Hearing Exhibit 12.

[13] Testimony of Randy Howard, Hearing on February 28, 2017, 74:6-22, 77:21-25, 78:1-2. COG may dispute the *date* the call between NEX and COG occurred, but it offered no evidence to dispute that NEX called COG and expressly stated that NEX would not agree to the communitization agreement for the 043H.

[14] Testimony of Randy Howard, Hearing on February 28, 2017, 79:22-24.

[15] COG Hearing Exhibit 13 (March 20, 2014 email from COG's Brent Sawyer – "our title lawyer is working on getting supplementary opinions for each individual well's proration unit, since the SRO state unit has terminated"; May 5, 2014, COG's Brent Sawyer tells NEX that "We are still waiting to get updated title opinions on all 23 SRO wells . . .Hopefully we will get those opinions this month . . ."; September 30, 2014, COG's Brent Sawyer tells NEX that COG is still waiting on updated title opinions, "Latest word from the attorney is they will be ready next week."); Testimony of Ryan Owen, Hearing on March 1, 2017, 79:18-23.

15. COG received a drilling title opinion on other wells in the SRO Unit on October 8, 2014. That drilling title opinion expressly stated to COG that all of the interests under the Lease had reverted back to NEX.[18] COG did not tell NEX about its October 8, 2014 title opinion at that time.

16. COG spud the 044H well on October 10, 2014. [19]

17. COG did not send NEX the October 8, 2014 title opinion until January 27, 2015.[20] COG did not mention the 043H or the 044H in its January 27, 2015 email.[21]

18. On October 14, 2014, COG and NEX exchanged emails regarding the expired Term Assignment and SRO Unit. [22] At this time, both the 043H and the 044H had been drilled. COG did not mention either well to NEX.[23]

19. On October 15, 2014, COG met with NEX regarding the expired Term Assignment and SRO Unit.[24] At this time, both the 043H and the 044H had been drilled.[25] COG did not mention either well to NEX at the meeting.[26]

20. On November 3, 2014, NEX and COG exchanged emails regarding the expired Term Assignment and SRO Unit.[27] At this time, both the 043H and the 044H had been drilled.[28] COG did not mention either well to NEX.[29]

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[16] NEX Hearing Exhibit 11; Testimony of Ryan Owen, Hearing on March 1, 2017, 79:2-5.
[17] *Id.*
[18] NEX Hearing Exhibit 20, page 22.
[19] Testimony of Randy Howard, Hearing on February 28, 2017, 85:24-86:4.
[20] NEX Hearing Exhibit 23; Testimony of Randy Howard, Hearing on February 28, 2017, 85:6-23.
[21] NEX Hearing Exhibit 23.
[22] NEX Hearing Exhibit 47; Testimony of Ryan Owen, Hearing on March 1, 2017, 82:14-23.
[23] *Id.*
[24] Testimony of Randy Howard, Hearing on February 28, 2017, 87:5-16.
[25] *Id.*
[26] *Id.*
[27] NEX Hearing Exhibit 25 and 26.
[28] Testimony of Randy Howard, Hearing on February 28, 2017, 87:5-16.
[29] Testimony of Randy Howard, Hearing on February 28, 2017, 90:4-13, 91:9-11.

21. On November 18, 2014 and November 25, 2014, NEX and COG exchanged emails regarding the expired Term Assignment and the SRO Unit.[30] At this time, both the 043H and the 044H had been drilled.[31] COG did not mention either well to NEX.[32]

22. In communications with NEX in December 2014, COG failed to inform NEX that the 043H and 044H had been drilled.[33]

23. On January 8, 2015, NEX sent COG a list of wells indicating its understanding of the wells in the SRO Unit.[34] NEX did not know about the 043H or the 044H so they were not included on the list.[35] Again, COG did not tell NEX that either well had been drilled.[36]

24. On January 19, 2015 and January 20, 2015, NEX and COG exchanged emails regarding the expired Term Assignment and related title opinions.[37] Again, COG did not tell NEX that the 043H or the 044H had been drilled.[38]

25. Despite numerous opportunities throughout these periods, COG did not inform NEX that it had drilled any wells on the SRO Unit other than certain Avalon wells.[39]

26. COG never received any form of consent from NEX before drilling and completing the 043H and 044H wells onto NEX's Lease.[40]

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[30] NEX Hearing Exhibits 27 and 41.
[31] Testimony of Randy Howard, Hearing on February 28, 2017, 87:5-16.
[32] NEX Hearing Exhibit 27 and 41; Testimony of Randy Howard, Hearing on February 28, 2017, 99:2-4; Testimony of Ryan Owen, Hearing on March 1, 2017, 83:13-16, 85:1-3.
[33] NEX Hearing Exhibit 21.
[34] NEX Hearing Exhibit 13.
[35] NEX Hearing Exhibit 13; Testimony of Randy Howard, Hearing on February 28, 2017, 112:11-19; Testimony of Ryan Owen, Hearing on March 1, 2017, 88:24-89:1-5, 90:2-5.
[36] NEX Hearing Exhibits 13 and 60; Testimony of Randy Howard, Hearing on February 28, 2017, 112:16-19; Testimony of Ryan Owen, Hearing on March 1, 2017, 88:24-89:1-5, 90:2-5.
[37] NEX Hearing Exhibit 21.
[38] Testimony of Randy Howard, Hearing on February 28, 2017, 120:4-18.
[39] Testimony of Randy Howard, Hearing on February 28, 2017, 66:18-25, 67:1-9.
[40] Testimony of Randy Howard, Hearing on February 28, 2017, 81:17-20.

27. The Term Assignment contained reporting and notification requirements for the Unit Operator to provide to Nearburg with respect to all wells drilled on the Subject Interests or on lands covered by the Unit Agreement ("Well Information Requirements"), including:

- Copy of the drilling and completion procedures 48 hours prior to the commencement of operation.
- Copy of survey plats, permit to drill, and other regulatory forms and letters filed with any governmental agencies.
- One (1) copy each of all title opinions, governmental OCD examiner and commission hearing orders and curative instruments covering the spacing unit.
- Nearburg should receive 24-hour notice of the following events: spudding, wireline logging, open hole testing, coring, or plugging of the well.
- Prior to any operation, Operator shall furnish to Nearburg, a well/completion prognosis specifying in reasonable detail the procedure of work for the proposed operation. Such prognosis shall be sent to Nearburg not later than 48 hours prior to commencement of any such operation.[41]

28. The Operating Agreement also provided pre-drilling requirements for proposing wells to the other interest owners, obtaining their advance consent and participation and authorizations for expenditures.[42]

29. COG did not comply with the notice requirements of the expired Term Assignment or the Operating Agreement as to the 043H or the 044H as to NEX.[43]

30. COG did not provide any well information to NEX on either the 043H or the 044H until at least May 2015.[44]

31. COG never provided notice to NEX that the 043H well was going to be or had been spud until April 2015—approximately 9 months after the 043H well had been spud.[45]

32. COG never provided notice to NEX that the 044H well was going to be or had been spud until April 2015—approximately six months after the 044H well had been spud.[46]

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[41] NEX Hearing Exhibit 2.
[42] COG Hearing Exhibit 14.
[43] Testimony of Ryan Owen, Hearing on March 1, 2017, 72:12-15, 71:12-16, 105:13-17.
[44] Testimony of Ryan Owen, Hearing on March 1, 2017, 71:12-16.
[45] Testimony of Randy Howard, Hearing on February 28, 2017, 78:16-18.

33. COG never submitted a well proposal or AFE to NEX for the 043H or the 044H.[47]

34. COG never provided a casing point election letter to NEX for the 043H or the 044H.[48]

35. NEX did not sign a communitization agreement before the 043H was spud.[49]

36. COG never sent NEX a communitization agreement on the 044H before the well was spud. So NEX did not sign a communitization agreement for the 044H before it was spud. [50]

37. COG never notified NEX that it was proposing a nonstandard spacing and proration unit on NEX's Lease.[51]

38. COG did not consolidate the lands in Section 17 and Section 20 before it drilled and completed the 043H and 044H.[52]

39. COG never solicited a farmout agreement from NEX for Section 20.[53]

40. COG did not obtain a voluntary pooling agreement from NEX before it drilled the 043H and 044H.[54]

41. COG did not obtain a compulsory pooling order for NEX's Lease before it drilled the 043H and 044H.[55]

42. COG drilled the 043H and 044H without any term assignment in place.[56]

43. COG did not disclose the 043H and 044H to NEX until April 22, 2015.[57]

44. On June 10, 2015, relying on COG's representations that unless NEX and COG executed communitization agreements, the State of New Mexico would cancel NEX's Lease, NEX

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[46] Testimony of Randy Howard, Hearing on February 28, 2017, 79:15-18.
[47] NEX Hearing Exhibit 43; Testimony of Ryan Owen, Hearing on March 1, 2017, 75:22-24.
[48] NEX Hearing Exhibit 35; Testimony of Ryan Owen, Hearing on March 1, 2017, 79: 6-17, 82:7-13.
[49] Testimony of Randy Howard, Hearing on February 28, 2017, 79:25-80:1-3.
[50] Testimony of Randy Howard, Hearing on February 28, 2017, 79:15-24.
[51] Testimony of Randy Howard, Hearing on February 28, 2017, 80:12-17.
[52] Testimony of Randy Howard, Hearing on February 28, 2017, 81:2-7.
[53] Testimony of Randy Howard, Hearing on February 28, 2017, 81:8-10.
[54] Testimony of Randy Howard, Hearing on February 28, 2017, 86:5-8.
[55] Testimony of Randy Howard, Hearing on February 28, 2017, 82:4-6.
[56] Testimony of Ryan Owen, Hearing on March 1, 2017, 88:4-9.
[57] NEX Hearing Exhibit 14; Testimony of Randy Howard, Hearing on February 28, 2017, 127:19-23.

executed communitization agreements limited to the 2nd Bone Spring (the "2nd Bone Spring Communitization Agreements") and hand-delivered a letter agreement (the "June 10, 2015 Letter Agreement") to COG.[58] NEX only executed the 2nd Bone Spring Communitization Agreements because it was under duress and did not want to lose its Lease.[59] Further, by signing the Letter Agreement, COG recognized and agreed that NEX was not waiving any rights held by it as owner and holder of the Lease.

POINTS AND AUTHORITIES

The Commission has specified that an operator seeking to permit a well must have a good faith claim to title ***and*** that it must have a right to drill on the lands involved at the time a well is drilled. COG failed to establish either element. NEX expressly rejected the communitization agreement for the 043H and told COG that it did not have any right to drill on NEX's Lease. Throughout 2014 and 2015, COG had repeated opportunities to tell NEX about the 043H and 044H wells. During this time, COG and NEX exchanged multiple phone calls and emails, and had meetings. If COG had been dealing in good faith, it would have had no reason to conceal the wells from NEX. COG even sent NEX a proposed term assignment for Section 20, yet it did not tell NEX about the two wells it had drilled onto the section. If COG had been acting in good faith, it would have certainly told NEX about the wells. However, it was not until COG was under pressure from the State Land Office that it finally disclosed the 043H and 044H to NEX. Good faith means acting in an open, honest, and forthright manner.[60] COG actions were not open, honest, or forthright.

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[58] Pursuant to the terms of the June 10, 2015 Letter Agreement, COG specifically agreed that NEX was not waiving any rights held by it as owner and holder of the lease by executing the 2nd Bone Spring Communitization Agreements.

[59] Testimony of Randy Howard, Hearing on February 28, 2017, 144:9-13.

[60] *See* Merriam-Webster Dictionary, www.merriam-webster.com, last accessed April 10, 2017.

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 faith claim of title." Order No. R-12108-C, *Rehearing*, Findings ¶ 8(e) (December 9, 2004).[61] Here, COG did not have either.

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, the SRO State Exploratory Unit terminated and COG's interest in the Lease automatically reverted to NEX.[62] COG did not have "clear title" in Section 20 because it 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.*"

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[61] 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.
[62] NEX Hearing Exhibit 22, pg. 2 – COG's own title opinion.

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 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).

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 did uncover) that the Term Assignment rights had terminated. COG cannot explain how the 043H

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 expressly refused to agree to a communitization agreement for the 043H well and expressly told COG it had no right to operate on NEX's Lease. COG cannot explain why it never told NEX about the 043H and 044H wells before they were spud. It seems clear why COG did not reveal what was going on: COG kept the information from NEX to try to get a new Term Assignment from NEX. Telling NEX about the 043H and 044H wells would have interfered with that goal. So, COG only disclosed the wells to NEX when it was forced to do so by the New Mexico State Land Office. Obviously, that is not good faith.

While COG may have hoped that it was going to work out something with NEX, 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. Regulatory Precedent Establishes that COG Had No Good Faith Claim to Title.

In *Pride Energy*, the Oil Conservation Commission, citing to Order No. R-11700-B,[63] 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:

[63] *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 the 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."[64] 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

[64] 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).

Form 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 an Operating Agreement with COG, and NEX expressly told COG that COG was not authorized to operate on NEX's Lease.[65] Like Samson, any implied right COG might have had was rescinded prior to either the 043H or 044H well being drilled.

In 2009, Case No. 14323 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 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.

[65] NEX Hearing Exhibit 7; Testimony of Randy Howard, Hearing on February 28, 2017, 74:6-22, 77:21-25, 78:1-2.

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. COG Had No 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. Moreover, 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 a good faith belief that it had the right to drill both the 043H well and the 044H well based on the (1) Ratification and Joinder of Unit Operating Agreement, or (2) some never agreed to correction or amendment of the Term Assignment. Neither theory can be sustained.

First, 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**."[66] It is undisputed that the Unit Agreement

[66] NEX Hearing Exhibit 7.

terminated and NEX's interest reverted back to NEX.[67] In addition, the Unit Agreement, by its own terms, did not become effective until approval by the Commissioner of Public Lands and the Oil Conservation 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 approved the Unit Agreement. The Commissioner approved the commitment of NEX's Lease and other lands effective August 1, 2009. After the Lease was added to the Unit on August 1, 2009, it was designated as Tract 26. So COG did not have the right to drill based on the Operating Agreement as NEX was never a party to it.

Neither did COG have a good faith belief based on the Operating Agreement that it had the right to drill. COG could not have a good faith belief in its right to drill based on an Operating Agreement to which NEX was not a party. If "good faith" means anything, it must mean a simple reading of the Ratification. Moreover, it is undisputed that COG did not follow the notice requirements of the Operating Agreement before drilling the 043H and 044H wells. COG never submitted a well proposal or AFE to NEX for the 043H well or 044H well.[68] Instead, despite numerous opportunities, COG did not inform NEX of its plans to drill or that it had in fact drilled and completed both wells.

Additionally, as noted above, if COG really believed it had any such right, it would have told NEX about its plans to drill and about drilling these wells; but it never did. So as NEX was not a party to the Operating Agreement and COG did not comply with its notice requirements, COG could have no good faith belief about NEX being subject to the Operating Agreement, and the Operating Agreement cannot be COG's basis for an alleged right to drill.

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[67] NEX Hearing Exhibits 16 and 20; Testimony of Ryan Owen, Hearing on March 1, 2017, 62:24-63:1-4, 119:19-23.
[68] Testimony of Ryan Owen, Hearing on March 1, 2017, 75:22-24.

Second, COG's reliance on an alleged extension or replacement of Term Assignment is unfounded. 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. 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.[69] COG concedes that no new term assignment was ever executed by the parties.[70] COG cannot have a "good faith" basis to drill based on an alleged agreement that violated the statute of frauds and that its attorneys expressly required but COG failed to obtain.

And, if COG thought the Term Assignment (or some extension or replacement of it) applied, COG would have complied with the extensive notice requirements of the Term Assignment. COG admits that it did not comply with any of the Term Assignment's notice requirements.[71] It should also be noted that COG did not even request a communitization agreement from NEX for the 044H in advance as it had for the 043H,[72] which makes its conduct as to the 044H well even more egregious and clearly not in good faith. Again, all of COG's explanations and arguments about "good faith" are simply manufactured after the fact to try to justify what was really going on: COG was concealing what it was doing on NEX's Lease to try to get a new Term Assignment without telling NEX about the wells. That is not "good faith."

[69] NEX Hearing Exhibit 22.
[70] Testimony of Ryan Owen, Hearing on March 1, 2017, 88:4-9.
[71] Testimony of Ryan Owen, Hearing on March 1, 2017, 114:14-16.
[72] Testimony of Randy Howard, Hearing on February 28, 2017, 79:22-24.

E. COG's Conduct Resulted in Additional Violations of the Commission's Rules.

COG's position is that the Commission's rules do not apply to it. This cannot be the precedent set by the Commission. COG has violated numerous NMOCD rules, and there should be consequences.

Following termination of the SRO State Unit, the lands in Section 20 were not consolidated with the lands in Section 17. COG was required to consolidate the interests in the two 320 acre project areas as Sections 70-2-17 and 70-2-18 of the Oil and Gas Act make clear.[73] This statutory requirement is further reflected in NMOCD's horizontal well rules which prohibit operators from submitting an application for permit to drill without first obtaining the consent of a lessee or unleased mineral interest owner at the bottom hole location of a proposed well, or obtaining a compulsory pooling order. Rules 19.15.14.8.B and 19.15.16.15 NMAC.

At the time the SRO Unit agreement terminated on March 1, 2014, the Project Area comprised of the SRO Unit Area was simultaneously abolished. See Rule 19.15.16.7.L(2) NMAC. When COG filed C-102s for the SRO State Com 043H and SRO State Com 044H wells on March 6, 2014, it failed to comply with the requirements of Rule 19.15.16.15.E NMAC for providing notice and obtaining Division approval of the new non-standard horizontal well project areas. It follows that had COG done so, NEX would have been alerted to act to protect its Lease interests in the W/2 of Section 20.

In addition, for the reason that COG failed to follow the Division's procedures for obtaining advance approval of the two non-standard horizontal well project areas under either

[73] Section 70-2-17.A provides, in part: "Whenever the operator of any oil or gas well shall dedicate lands comprising a standard spacing or proration unit to an oil or gas well, it shall be the obligation of the operator, if two or more separately owned tracts of land are embraced within the spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil or gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, to obtain voluntary agreements pooling said lands or interests or an order of the division pooling said lands, which agreement or order shall be effective from the first production."

19.15.15.11.B or 19.15.16.15.F NMAC, the 043H and 044H wells should not have been produced and were not entitled to receive allowables. Until COG brought the wells into compliance with the Divisions rules, the C-104 Request for Allowable and Authorization to Transport Oil or Gas should not have been submitted for approval by COG.

The well path for 043H well extended from Section 17 into the pre-existing 160-acre Bone Spring formation project area for the former SRO State Unit Well 016H in Section 20, resulting in conflicting, overlapping project areas. The Division's rules for horizontal wells provide that subsequent wells cannot be drilled without the approval of all working interest owners in the project area, or by order of the Division after notice and opportunity for hearing. Rule 19.15.16.15.B NMAC. In this case, COG did not seek NEX's consent, did not notify NEX of its plans, and did not apply for a hearing to obtain the Division's approval. Again, it follows that had COG done so, NEX would have been alerted to act to protect its Lease rights and prevent the violations of the Division's rules.

COG's applications for retroactive compulsory pooling in Cases 15481 and 15482 are clear admissions that there were no voluntary agreements covering the lands where the 043H and 044H are located. The applications also serve as admissions that COG never obtained orders from the Division pooling the unconsolidated interests, or approving the non-standard units or overlapping project areas. It is noted further that in its applications COG did not assert that it had the right to drill the 043H or 044H.

Mere designation of a 320 acre project area on the NMOCD Form C-102 acreage dedication plat does not constitute consolidation or otherwise establish any right to drill. In each case, the C-102's for the 043H, the 044H, and the SRO State Com No. 69H reflect a signed Operator Certification by COG that the operator has the right to drill the well at the locations

indicated pursuant to either a contract with the owner of a mineral or working interest, a voluntary pooling agreement, or a compulsory pooling order. None of these circumstances existed at any relevant time. In each case, the line item on the C-102's for operator entry of a consolidation code was left blank.

CONCLUSION

COG's alleged "good faith" is contradicted by facts, events, and COG's own admissions that have occurred during the course of this dispute. COG does not dispute that it had numerous opportunities to inform NEX about the wells—but did not. COG did not send NEX notice in accordance with the Operating Agreement (that COG says applied) or the expired Term Assignment (which COG wanted to extend) for the 043H or the 044H. NEX expressly rejected COG's proposed communitization agreement for the 043H. COG did not even bother to send a proposed communitization agreement for the 044H. If COG was acting in good faith, it would have told NEX about the wells and sent NEX information regarding the wells. Instead, COG did not inform NEX about the wells until COG was under pressure from the State Land Office to do so. COG's actions show—contrary to COG's allegations—that COG was not acting in good faith. These improper actions by COG, as well as all of its other violations of the Commission's rules, justify substantive relief.

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 well or 044H well 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 seeks an order requiring COG to account for and pay to NEX the amounts of production proceeds it is entitled to in the absence of pooling, without recovery of well costs or expenses. NEX asks the Commission to set reasonable charges for the costs of operating and supervision to

be paid prospectively only. In addition, NEX asks the Commission to limit the depths of the proration units for the 43H and the 44H to the 2nd Bone Spring and to limit the depth of the proration unit for the SRO State Com 016H well (API 30-015-38071) ("016H") to the Avalon member. Finally, NEX asks the Commission to remove COG and designate Nearburg Producing Company as the operator of the 016H.

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I hereby certify that a true and correct copy of the foregoing was served on counsel of record by electronic mail on April 11, 2017:

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