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

NEARBURG EXPLORATION COMPANY, L.L.C 'S
PROPOSED ORDER OF THE COMMISSION

BY THE COMMISSION:

This case came on for hearing at 9:00 a.m. on February 28, 2017 and 9:00 a.m. on March 1, 2017, at Santa Fe, New Mexico, before the Oil Conservation Commission (the "Commission").

NOW, on this ___ day of May, 2017 the Commission, having considered the testimony and the record,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) Case Nos. 15441, 15481 and 15482 were consolidated at the time of hearing for the purposes of testimony.

(3) In Case No. 15441, Nearburg Exploration Company, L.L.C., SRO2 LLC and SRO3 LLC, (together, "Nearburg" or "NEX") 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 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).

(4) NEX further seeks 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.

(5) NEX also seeks 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.

(6) NEX further seeks 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.

(7) NEX seeks to have the Commission to address the past and ongoing violation of NEX's correlative rights and asks the Commission to bring all three of the producing wells into regulatory compliance by *inter alia* (1) vertical contraction of the project areas for the 043H and 044H wells to be limited to the Second Bone Spring Sand, and (2) vertical contraction of the project area for the 016H well to be limited to the Avalon member of the Bone Spring formation.

(8) In Cases 15481 and 15482 COG seeks orders (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) compulsory pooling the unjoined mineral interests of NEX, SRO2 and SRO3 in the Bone Spring formation underlying this acreage where it drilled, completed and produced the SRO State Com 043H and SRO State Com 044H wells.

(9) Spacing in the Hay Hollow Bone Spring pool is governed by statewide Rule 19.15.15.9.A NMAC, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section.

(10) At the hearings on February 28 and March 1, 2017, NEX appeared and presented the following evidence:

(A) 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.

(B) NEX term-assigned its lease acreage in Section 20 to Marbob, effective July 1, 2009, reserving an overriding royalty interest. Marbob then contributed the Lease to the SRO Unit. The Term Assignment was limited to a term that extended only so long as the Lease was subject to the Unit Agreement. The Term Assignment states: "The Subject Interests and Assignor's reserved overriding royalty interest shall, during the term of this Assignment and not thereafter, be subject to the terms and provisions of that certain Unit Agreement for the Development and Operation of the SRO Unit Area, Eddy County, New Mexico." [1]

(C) When the 016H well was drilled, but before the 043H and 044H wells were drilled, the lands in Sections 17 and 20 were part of a voluntary unit established under that Unit Agreement for the Development and Operation of the SRO State Exploratory Unit dated May 8th, 2009. COG Exh. 4.

(D) 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.

(E) COG is the successor operator to Marbob Energy Corporation ("Marbob"), the named operator under an Operating Agreement for the SRO State Exploratory Unit dated May 8, 2009. The Operating Agreement includes specific pre-drilling requirements for proposing wells to the other interest owners, obtaining their advance consent and participation and authorizations for expenditures.

(F) The State Land Office requires that the lessees of record ratify state lands exploratory unit agreements. On June 26, 2009, at the request of Marbob, Nearburg ratified the Unit Agreement. NEX Exh.7. Nearburg was not a party to the Operating Agreement for the SRO Unit and never signed or ratified it.

(G) In October 2010, COG succeeded Marbob as the Operator under the Operating Agreement.

(H) In 2012, COG drilled and completed the 016H Well on the Nearburg lease in the W/2 W/2 of Section 20.

(I) 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.

[1] NEX Exhibit 2.

- 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.

COG Exh. 1, Term Assignment, Exhibit A.

(J) COG initiated the process of terminating the Unit Agreement in October 2013, with termination to be effective on March 1, 2014.

(K) When the Unit Agreement terminated on March 1, 2014, all parties agree that the NEX-Marbob Term Assignment terminated automatically.[2] The lease acreage in Section 20 simultaneously reverted to NEX.

(L) Five days after having voluntarily terminated its right to drill on NEX's Lease, COG filed signed C-102s for the SRO State Com 043H well and for the SRO State Com 044H well.[3] On the C-102s, COG made the following 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.

(M) COG certified and filed these C-102s without an updated title opinion on the former SRO Unit wells.[4]

(N) Under the Unit Operating Agreement's Loss of Title provision (Article IV B.1. Failure of Title) COG, as successor to Marbob, had ninety days to cure the loss of title caused by the reversion of the Lease to Nearburg on March 1, 2014. The Operating Agreement

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[2] NEX Hearing Exhibit 16.

[3] NEX Hearing Exhibits 28 and 29.

[4] 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").

provides: *"[F]ailing to do so, this agreement, nevertheless, shall continue in force as to all remaining oil and gas leases and interests[.]"* NEX Exh. 42, pg. 3, Art. IV.B.1.

(O) In July 2014, NEX received a proposed communitization agreement from COG.[5] Shortly thereafter, NEX's Land Manager 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.

(P) 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 former SRO Unit wells.[6] 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. See 19.15.15.11.B. NMAC.

(Q) 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.[7]

(R) The October 8, 2014, title opinion for the SRO State Unit Com 38H, 39H and 40H wells in Section 34, T-25-S, R-28-E states:

> Because the SRO State Exploratory Unit was voluntarily terminated effective March 1, 2014, it appears that the primary term of the Term Assignment is now expired and the interests assigned thereunder in all of the Subject Lands except Tracts 7 and 8, which comprise the spacing unit for the SRO State Unit Com #11H Well, have reverted back to Nearburg Exploration Company, L.L.C. We have reported title accordingly.

(S) 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.

(T) Throughout these periods, COG did not inform NEX that it had drilled any wells on the former unit other than certain Avalon wells, although COG continued to discuss the possibility of amending, correcting or replacing the expired Term Assignment. Throughout the

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[5] NEX Hearing Exhibit 10.

[6] NEX Hearing Exhibit 26 (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.").

[7] NEX Hearing Exhibits 20, page 22.

course of those discussions, COG concealed the existence of the 043H and 044H from NEX on the following occasions:

(1) In March 2014, COG knew that the Term Assignment had expired. See NEX Exh. 35 (C 044723); see also id. at C 044724-25 (Emails, COG Landman Brent Sawyer to NEX's Kathie Craft (Mar. 20, 2014)).

(2) In communications with NEX in March 2014, Mr. Sawyer failed to inform NEX that applications for permits to drill had been filed for the 043H and the 044H. NEX Exh. 3; NEX Exh. 4.

(3) In communications with NEX in July 2014, Mr. Sawyer failed to inform NEX that they planned to drill the 043H in August 2014. *See* NEX Exh. 39.

(4) In communications with NEX in August 2014, Mr. Sawyer failed to inform NEX that COG planned to drill the 043H or, subsequently, that they had spud the 043H. NEX Exh. 40.

(5) In communications with NEX in September 2014, Mr. Sawyer failed to inform NEX that the 043H had been drilled and that it planned to spud the 044H in October 2014. NEX Exh. 47 (NEX00002400).

(6) In communications with NEX in October 2014, Mr. Sawyer failed to inform NEX that the 043H and the 044H had been spud. *See* NEX Exh. 25 (C 046413-14); NEX Exh. 47.

(7) In communications with NEX in November 2014, Mr. Sawyer failed to inform NEX that the 043H and 044H had been drilled. *See* NEX Exh. 21 (C 046277-80); NEX Exh. 27 (C 046396).

(8) In communications with NEX in December 2014, Mr. Sawyer failed to inform NEX that the 043H and 044H had been drilled. *See* NEX Exh. 21 (C 046276-77).

(9) In communications with NEX in January 2015, Mr. Sawyer failed to inform NEX that the 043H and 044H had been drilled. *See* NEX Exh. 21 (C 046273-76); NEX Exh. 23 (NEX00001895).

(U) The surface hole locations for the 043H and 044H wells are located on the W/2 of Section 17, a state lease (V-7470) in which Yates Petroleum Corporation is the lessee of record.

(V) The 016H well and the bottom hole locations for the 043H and the 044H wells are located in the W/2 of Section 20, a state lease (V-7450) in which Nearburg Exploration Company ("Nearburg") is the lessee of record.

(W) Nearburg was not provided with a communitization agreement for the 044H well prior to COG drilling or completing the well.

(X) COG did not provide any of the Well Information Requirements attached to the Term Assignment to Nearburg before drilling the 043H and 044H wells. Specifically, COG did not provide a "copy of survey plats, permit to drill, and other regulatory forms and letters filed with any governmental agencies." COG Exh. 1, Term Assignment, Exhibit "A."

(Y) On March 9 and March 12, 2015, COG filed "As Drilled" C-102 Well Location and Acreage Dedication Plats for the 043H and the 044H wells. COG left the consolidation codes blank and signed the certification that "this organization either owns a working interest or unleased mineral interest in the land including the proposed bottom hole location or has a right to drill this well at this location." NEX Exhs. 3, 4.

(Z) Again, in April 2015, COG contacted NEX regarding the need to communitize the lands within the W/2 W/2 and E/2 W/2 of Sections 17 and 20. COG represented to NEX that the State Land Office had threatened to cancel the oil and gas leases on these lands unless NEX and COG agreed to execute communitization agreements. During these discussions, NEX first discovered that COG had drilled the 043H and 044H wells without notifying NEX. COG was aware as early as December 2014 that NEX had no knowledge that COG was in the process of drilling 043H and 044H.

(AA) On April 22, 2015, in advance of a planned meeting, COG provided Nearburg with communitization agreements for the spacing units dedicated to the 043H and 044H wells and an agenda for the meeting. This was the first time that COG disclosed the existence of the 043H and 044H wells and the dates they had been spud. NEX Exh. 14.

(BB) On the morning of April 24, 2015, COG and Nearburg met to discuss COG's proposed communitization agreements, an amendment to the Term Assignment, and data on the SRO Unit wells, including the 043H and 044H wells. COG Exh. 19. Immediately following that meeting, Nearburg sent the following documents via email to COG:

- A spreadsheet of the SRO Unit wells showing the "NEX ORRI" and identifying wells for which Nearburg was missing well information.

- "Our most updated Well Information Requirements" to make sure COG had the right contact information. COG Exh. 19; Tr. at 220:19-221:1.

(CC) On May 14, 2015, COG forwarded Nearburg an email from the State Land Office where it "threatens to expire the leases involved with the well and charge the operator DOUBLE the value of oil/gas removed from the well" if the proper communitization agreements were not filed. NEX Exh. 49 (C 044651).

(DD) NEX refused to sign the communitization agreements proffered by COG, which included the entire Bone Spring formation. Instead, relying on the representations COG made regarding the imminent cancellation of its Lease, NEX proposed, and COG agreed, that the communitization agreements would be limited to the 2nd Bone Spring interval and would be subject to NEX retaining its rights against COG for its wrongful conduct.

(EE) On May 28, 2015, Nearburg sent COG a letter stating:

- "The Term Assignment has expired by its own terms and has not been extended. We would request that you inform us as to the source of the COG's authority to drill the Wells utilizing the acreage covered by the Lease. Nearburg is not aware of any Operating Agreement related to the Wells or any other arrangement which would grant COG the right to drill the Wells with the acreage covered by the Lease."

- In an effort to comply with the SLO's request, Nearburg would consider executing the communitization agreements; however, Nearburg explicitly stated that the agreements should be limited to the "2nd Bone Spring interval" and that "[a]ny execution of the Agreements would not extend or ratify the Term Assignment and Nearburg would not waive any rights held by it as owner and holder of the Lease. Nearburg would consider executing the Agreements merely to comply with the State of New Mexico Land Office requirements, but Nearburg would specifically reserve all rights relating to this situation." NEX Exh. 15.

(FF) On June 2, 2015, COG forwarded revised communitization agreements that limited the communitized interval to the "2nd Bone Spring interval" as requested by Nearburg.

(GG) By a letter agreement dated June 10, 2015, Nearburg provided COG with the executed Communitization Agreements for filing with the State Land Office, requested specific well information to "to further evaluate our working interest in the Wells" and requested that "going forward" it be provided with expense and revenue information "provided to other working interest owners in the Wells." Under this letter agreement, COG expressly recognized that "Nearburg's execution and delivery of the enclosed Agreements does not extend or ratify the Term Assignment and Nearburg does not waive any rights held by it as owner and holder of the Lease and that Nearburg specifically reserves all rights relating to this situation." NEX Exh. 16.

(HH) On June 23, 2015, COG filed communitization agreements with the State Land Office that incorrectly identified the communitized interval as the entire "Bone Spring Formation" rather than the "2nd Bone Spring interval." NEX did not agree to these communitization agreements and never consented to their filing. These altered instruments do not constitute "voluntary agreements" pooling the lands.

(II) On July 2, 2015, the State Land Office approved the communitization agreements filed by COG and they were recorded in Eddy County. COG Exhs. 26 and 27.

(JJ) NEX never received copies of the Recorded Agreements from COG. Acting on its own, NEX obtained copies of the Recorded Agreements from the Eddy County Clerk's Office. The Recorded Agreements were not the 2nd Bone Spring

Communitization Agreements that NEX executed and delivered to COG. COG was unable to account for the disposition of the originals of the 2nd Bone Spring Communitization Agreements and they were never submitted to or approved by the State Land Office.

(KK) By letter dated July 14, 2015, Nearburg informed COG that with the termination of the SRO Unit, COG's contractual obligation to pay Nearburg an overriding royalty interest in the SRO wells terminated, but that Nearburg had continued to receive payments from COG. Nearburg enclosed a check to reimburse COG for the overpayments it received after the SRO Unit terminated and requested that no future payments of these overrides be sent to Nearburg. COG Exh. 24.

(LL) On July 20, 2015, Nearburg informed COG by email that "[t]he July 13 offer of COG to extend the Term Assignment is not acceptable" and that by virtue of drilling the 043H and 044H wells COG had "committed mineral trespass and converted Nearburg hydrocarbons." COG Exh. 30.

(MM) On August 17, 2015, NEX sent a letter to COG revoking Division Orders for SRO Unit wells crediting an overriding royalty interest to Nearburg. COG Exh. 24.

(11) Testimony by Nearburg's petroleum engineering witness Michael Griffin established:

(A) Thirteen wells in the SRO Unit were drilled to and completed in the Avalon member of the Bone Spring formation between July 2009 and June 2011. Marbob and then COG timely provided well information in conformance with the Term Assignment for these wells. From December 2011 to April 2015, COG drilled and completed 19 wells in the 2nd Bone Spring sand, 2 wells in the 3rd Bone Spring Sand and one well in the Delaware formation. COG did not provide well information on any of the wells drilled outside the Avalon until June 2015, and only after NEX demanded it. NEX Exh. 32.

(B) Not having the well information it was entitled to under the Term Assignment prevented NEX from making an informed business decision at relevant times whether it should agree to reinstate its terminated overriding royalty interest or continue to own its working interest under the Lease in Section 20.

(C) From Division records available at the time of hearing through December 2016, the 043H has produced 218,809 barrels of oil and 1,515,646 mcf of gas. For the same period, the 044H has produced 218,170 barrels of oil and 1,427, 661 mcf of gas. The 016H has produced 11,174 barrels of oil and over 1,152,262 mcf of gas.

(D) COG has not provided NEX with division orders for the 043H and 044H wells. COG did not provide a correct division order for the 016H well. COG has not accounted for or paid to NEX any revenues attributable to its Lease working interest in Section 20 resulting from the sale of production from the 043H, 044H or 016H wells and COG has not placed such revenues in suspense or paid them into an escrow account.

(E) The 043H, 044H and 016H wells continue to be produced by COG. COG's violation of NEX's correlative rights began on first production from the wells and is ongoing.

(F) Effective July 1, 2015, NEX assigned its interests in the Lease to SRO2 LLC, limited to the 2nd Bone Spring productive interval. Effective July 1, 2015, NEX assigned its interests in the Lease to SRO3 LLC, limited to the 3rd Bone Spring interval. The remaining depths were retained by NEX.

(G) Compulsory pooling and the vertical contraction of the project areas for the 043H and 044H wells to the 2nd Bone Spring interval from 8,805 feet – 9,155 feet as measured on the log from the Marbob Energy SRO State Unit N0. 1H located in Section 4, T-26-S, R-28-E, N.M.P.M. is an appropriate means to pool the unconsolidated interests in conformance with the depth severed ownership of SRO2 LLC. With the concomitant vertical contraction of the 160 acre project area dedicated to the 016H well limited to the Avalon member of the Bone Spring formation, pooling and contraction of the 043H and 044H project areas would also correct COG's violation of Rules 19.15.14.8.B and 19.15.16.15 NMAC.

(H) Within the project areas for the 043H, 044H and 016H wells, the Avalon member and the 2nd Bone Spring are not in communication with each other and can be produced independently.

(I) The acreage dedicated to the 043H and 044H wells consists of eight (8) adjacent quarter-quarter sections for each well.

(J) No structural or geologic impediments exist for the Second Bone Spring interval in the subject area and the dedicated acreage is suitable for development by horizontal wells.

(K) The Second Bone Spring interval is continuous across Sections 17 and 20, and all quarter-quarter sections within the dedicated non-standard spacing and proration units are productive.

(12) Testimony by COG's landman Ryan Owen established:

(A) COG agreed that at all relevant times the Term Assignment had expired and the working interest in Section 20 had reverted back to Nearburg.

(B) The possibility of a replacement for the Term Assignment had been discussed, but no agreement was ever reached.

(C) COG did not notify NEX it was drilling the 043H and 044H wells or propose the wells under the Joint Operating Agreement.

(D) COG did not obtain the consent of NEX when it drilled the 043H or 044H wells, never sought NEX's voluntary participation in the wells, and did not obtain orders for them from the Oil Conservation Division.

The Commission concludes as follows:

(1) Following the voluntary termination of the SRO Unit agreement on March 1, 2014, the subsequent permitting, drilling and producing of the SRO State Com 043H and SRO State Com 044H by COG did not comply with the Oil and Gas Act and the Division's rules and regulations in a number of respects.

(2) The 043H and 044H were drilled by COG after the termination of the SRO State Exploratory Unit on March 1, 2014 and the reversion of the leasehold in the W/2 of Section 20 back to NEX. At the time, NEX had no knowledge that the wells were being drilled. Both wells were drilled from surface locations in Section 17 to bottom hole locations in Section 20.

(3) 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 §§ 70-2-17 and 70-2-18 of the Oil and Gas Act make clear.[8] 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.

(4) 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 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.

(5) 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 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.

(6) 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,

[8] § 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."

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.

(7) The Commission does not have jurisdiction to determine conflicting claims to title. In this case, however, no such determination is necessary. The parties do not dispute that State Lease No. V-7450-0001 reverted to NEX.

(8) Similarly, the Commission need not interpret the provisions of the Term Assignment, the Unit Operating Agreement or the Communitization Agreements. These documents are not ambiguous. However, the Commission should make the threshold determination whether there existed voluntary agreements for the dedication of NEX's Lease to the project areas for the State Com 043H and 044H wells at the time these wells were permitted, drilled and produced. The Commission concludes there were none.

(9) 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 wells 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.

(10) 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-102s for the SRO State Com No. 043H, the SRO State Com No. 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-102s for operator entry of a consolidation code was left blank.

(11) At the time the Applications for Permits to Drill (APDs) for these wells were submitted, COG did not have the right to drill on NEX's Lease on Section 20. Accordingly, the APDs did not qualify for approval or should have been made the subject to a Condition of Approval that the acreage comprising the project area spacing units be consolidated by way of a communitization agreement or compulsory pooling order. Consolidation was never achieved. Absent consolidation, under NMOCD rule 19.15.16.15.F, COG was not entitled to receive approved allowables to produce the wells.

(12) In 2007, before the adoption of the current horizontal drilling rules, the Commission made clear that any optional timing in the process of obtaining 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."[9]

(13) COG's production and sale of hydrocarbon production attributable to NEX's Lease interests in Section 20 without accounting to NEX for the same has resulted in the ongoing violation of NEX's correlative rights from the dates of first production of the 043H and 044H wells and from March 1, 2014 in the case of the SRO State Com 016H well.

(14) When COG filed the C-102s for the SRO State Com 043H and SRO State Com 044H and then drilled those wells, it effectively appropriated exclusively for its own benefit the right to permits and regulatory authorization to operate throughout the two project areas, including Section 20. As a result, the relationship between COG and NEX was altered and a fiduciary duty arose, not by deed or contract but by conduct. In *Manges v. Guerra,* 673 S.W.2d 180 (Tex. 1984), the defendant purchased various mineral rights including the executive rights to the one-half mineral interest reserved by the plaintiffs. The defendant then used its executive powers to benefit himself and not extend the same benefit to the non-executive owners by selling all of the oil and gas produced from the lands, without consulting or informing the owners of the reserved interests. *Id.* at 182. The Court held that the possessor of the executive right owed a duty to use the "utmost good faith and fair dealing" as to the interest of the non-executive mineral rights owners.

(15) The permitting of the SRO State Com No. 043H and SRO State Com No. 044H, the subsequent drilling and production of the wells and the extended concealment of their existence from NEX are all inconsistent with COG's duty of utmost good faith and fair dealing. COG's conduct also undermines COG's claims that it had a good faith belief that it had a right to drill the wells and that it had a good faith claim of title at the time the wells were drilled.

(16) The concealment of the wells and the failure to provide well information impaired NEX's ability to protect its interest in the Lease and make informed business decisions on how to correct a situation that NEX did not create. The Commission concludes that by its concealment, COG acted in bad faith and that COG's conduct should be taken into consideration in establishing terms in this Order that are just and reasonable under these circumstances.

(17) COG's production and sale of hydrocarbon production attributable to NEX's Lease interests in Section 20 without accounting to NEX for the same has resulted in the ongoing violation of NEX's correlative rights from the dates of first production of the 043H and 044H wells and from March 1, 2014 in the case of the SRO State Com 016H well.

(18) There are no voluntary agreements or compulsory pooling orders authorizing COG to recover any well costs, non-consent penalties or monthly operating expenses. COG offered no evidence of drilling and completion costs or that COG has not been reimbursed for

[9] 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). It was this case that led the Commission to require the Operator Certification on C-102s, leading later to its codification in the Division's horizontal drilling rules.

such costs by other interest owners. COG's compulsory pooling Applications do not request penalties for risk. At hearing, COG's witness proposed only that it recover monthly overhead and operating expenses.

(19) COG's conduct and its numerous violations of the Division's rules have presented the Commission with a *fait accompli* in many respects. Nevertheless, both the Division and Commission have a compelling interest in ensuring that the Division's rules and procedures are enforced and that operators abide them. Violations should not go uncorrected or be without consequences in circumstances such as those presented here.

(20) NEX's proposals to correct the several instances of non-compliance for the 043H, 044H, and the 016H wells and the APD for the 069H are reasonable, as are its proposals to correct the violation of NEX's correlative rights.

(21) NEX's request to vertically contract the project areas for the 043H, O44H and 016H wells is warranted under these circumstances and is supported by applicable authority.

(22) The Oil and Gas Act authorizes the Division and Commission to compulsory pool oil and gas interests in "all ***or any part of*** such lands or interests or both ***in the spacing or proration unit*** as a unit." NMSA 1978 § 70-2-17.C (emphasis added). The Division's rules define a proration unit as "***the area in a pool*** that can be effectively and efficiently drained by one well". Rule 19.15.2.7.P(17) NMAC. Previously, the Division granted an Application brought by Mewbourne Oil Company to pool certain un-joined interests from the base of the Second Bone Spring Carbonate to the base of the Bone Spring formation, in recognition of different ownership above the pooled interval. Order No. R-13882 ¶ (2) (August 27, 2014).

(23) In 2015, the Commission granted COG Operating LLC's Application to pool a limited interval within the West Maljamar Yeso Pool. In doing so, the Commission cited to its broad authority under the Oil and Gas Act to "make and enforce rules, regulations and orders, and ***do whatever may be reasonable necessary*** to carry out the purposes of this act, ***whether or not indicated or specified in any section of the act.***" NMSA 1978 §§70-2-11(A) (emphasis added). Order No. R-14023-A, Conclusions ¶ 3.c. (December 10, 2015).

(24) The designated project areas of the 043H and 044H should be vertically contracted to conform with the top and bottom of the productive interval of the 2nd Bone Spring sand identified as the equivalent depths of 7,760 feet and 8,130 feet as defined on the SRO Unit Type log for the Marbob SRO State Well No. 1 located in Section 4, Township 26 South, Range 28 East N.M.P.M. Doing so will conform the vertical extent of project areas for these wells with the depth-severed ownership of SRO2 LLC in that acreage.

(25) The designated project area for the 016H should be vertically contracted to conform with the top and bottom of the Avalon shale identified as the equivalent depths of 6,416 feet and 6,763 feet as also defined on the SRO Unit Type log for the Marbob SRO State Well No. 1. Doing so will conform the vertical extent of the project area with Nearburg's depth-severed ownership and will eliminate the unapproved conflicting overlapping project area of the 043H well. The resulting non-standard spacing and proration unit conforming with these depths

and comprised of the W/2 W/2 of Section 20, Township 20 South, Range 28 East, N.M.P.M. and dedicated to the 016H well should also be approved.

(26) No consolidation of the resulting project area for the 016H is necessary for the reason that one hundred percent of the Lease acreage therein is owned by NEX. However, COG should be removed as operator of the well and Nearburg Producing Company designated as the successor operator of record. Nearburg Producing Company and NEX should then negotiate a mutually satisfactory arrangement for COG to continue to serve as contract operator of the well on just and reasonable terms.

(27) The APD for the 069H well should be cancelled.

(28) With respect to COG's request to approve the non-standard spacing and proration units for the 043H and 044H wells, the Division's rules do not provide for retroactive approval. However, under the circumstances of this case, approval is warranted as a partial means to correct the non-compliance.

(29) Approval of the non-standard unit will enable COG to operate the two horizontal wells that will efficiently produce the reserves underlying the unit, thereby preventing waste, and will not impair correlative rights in adjoining units.

(30) With respect to the request to compulsory pool the unconsolidated interests in the two non-standard spacing and proration units, such relief is also necessary to bring the wells into further regulatory compliance, but must be done only on terms that are just and reasonable under these circumstances. Section 70-2-17 of the Oil and Gas Act directs that any pooling order "*...**shall be upon such terms and conditions as are just and reasonable** and will afford to the owner or owners of each tract or interest the opportunity to recover without unnecessary expense his just and fair share of the oil or gas or both.* NMSA 1978 §§ 70-2-17 (C) (emphasis added).

(31) Two or more separately owned tracts are embraced within the units, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(32) There was no agreement among COG, NEX or SRO2 LLC to pool the un-joined interests in the W/2 of Section 20.

(33) To correct the past and ongoing violation of correlative rights, to prevent future violations, and to afford to the owner of each interest in the unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, COG's applications should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the units as further provided in this Order. Such pooling should be effective as of the dates of first production from the wells. Retroactive approval should not be construed to mean that COG had the right to permit, drill or produce the wells at the relevant times.

(34) COG Operating LLC should be designated the operator of the 043H and 044H wells and of the units.

(35) NMSA 1978 § 70-2-18 B sets forth the compensation due to the owner from an operator who has not obtained voluntary or compulsory pooling of a spacing unit:

> Any operator failing to obtain voluntary pooling agreements, or failing to apply for an order of the division pooling the lands dedicated to the spacing or proration unit as required by this section, shall nevertheless be liable to account to and pay each owner of minerals or leasehold interest, including owners of overriding royalty interests and other payments out of production, either the amount to which each interest would be entitled if pooling had occurred or the amount to which each interest is entitled in the absence of pooling, whichever is greater.

(36) Consistent with § 70-2-18 B and under the circumstances of these cases, it would not be "just and reasonable" to allow for the retroactive recovery of well costs and operating expenses from the production attributable to the NEX Lease interests in Section 20. It is therefore unnecessary for COG to provide itemized schedules of well costs at this time.

(37) Pooling the unconsolidated interests retroactively to first production would not be just and reasonable if it did not provide a means for NEX to recover the amounts to which it is entitled from past production.

(38) Order No. R-1960-B[10] establishes clearly that directing an operator to render an accounting and pay for production is well within the agency's jurisdiction. Order No. R-1960-B, Order ¶¶ (a)-(e) (August 13, 2009).

(39) COG should be required to account and pay to NEX for the proceeds from the sale of production attributable NEX's interests from the dates of first production for the 043H and 044H wells and from March 1, 2014 for the 016H well.

(40) Neither would it be "just and reasonable" to allow for the recovery of a charge for the risk involved in drilling the wells as NEX was never afforded an opportunity to participate in either well. Accordingly, COG should be allowed to recover only monthly lease operating expenses and supervision charges accruing prospectively from the date of this Order.

(41) Reasonable charges for supervision (combined fixed rates) should be fixed at $600 per month while producing, provided that these rates should be adjusted annually pursuant to Section III. I.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations."

IT IS THEREFORE ORDERED THAT:

(1) A non-standard 320-acre oil spacing and proration unit (the "043H Unit") is hereby established in the 2nd Bone Spring sand interval within the Hay Hollow Bone Spring Pool (30215), consisting of the W/2 W/2 of Sections 17 and 20 in Township 26 South, Range 28 East, NMPM, in Eddy County, New Mexico. The vertical limits of the 043H Unit shall conform with

[10] Case No. 13957, *Application of Energen Resources Corporation to Amend the Cost Recovery Provisions of Compulsory Pooling Order No. R-1960, to Determine Reasonable Costs, and for Authorization to Recover Costs from Production of Pooled Mineral Interest, Rio Arriba County, New Mexico.*

the top and bottom of the productive interval of the 2nd Bone Spring sand identified as the equivalent depths of 7,760 feet and 8,130 feet as defined on the SRO Unit Type log for the Marbob SRO State Well No. 1 located in Section 4, Township 26 South, Range 28 East N.M.P.M.

(2) Pursuant to the application of COG Operating LLC, all uncommitted interests, whatever they may be, in the oil and gas in the 2nd Bone Spring sand interval within the Bone Spring formation underlying the Unit, are hereby pooled.

(3) The 043H Unit shall be dedicated to the SRO State Com 043H Well (API No. 30-015-411141), drilled from a surface location 190 feet from the North line and 990 feet from the West line (Unit D) of Section 17 to a standard terminus, or bottomhole location 351 feet from the South line and 918 feet from the West line (Unit M) of Section 20.

(4) A second non-standard 320-acre oil spacing and proration unit (the "044 Unit") is hereby established in the 2nd Bone Spring sand interval within the Hay Hollow Bone Spring Pool (30215), consisting of the E/2 W/2 of Sections 17 and 20 in Township 26 South, Range 28 East, NMPM, in Eddy County, New Mexico. The vertical limits of the 044H Unit shall conform with the top and bottom of the productive interval of the 2nd Bone Spring sand identified as the equivalent depths of 7,760 feet and 8,130 feet as defined on the SRO Unit Type log for the Marbob SRO State Well No. 1 referenced in paragraph (1), above.

(5) Pursuant to the application of COG Operating LLC, all uncommitted interests, whatever they may be, in the oil and gas in the 2nd Bone Spring sand interval within the Bone Spring formation underlying the 044H Unit, are hereby pooled.

(6) The 044H Unit shall be dedicated to the SRO State Com 044H Well (API No. 30-015-411142), drilled from a surface location 190 feet from the North line and 2020 feet from the West line (Unit C) of Section 17 to a standard terminus, or bottom hole location 378 feet from the South line and 2216 feet from the West line (Unit N) of Section 20.

(7) Upon final plugging and abandonment of the wells and any other well drilled on the 043H and 044H Units pursuant to Division Rule 13.9, the pooled units created by this Order shall terminate, unless this order has been amended to authorize further operations.

(8) COG Operating LLC (OGRID 229137) is hereby designated the operator of the wells and of the 043H and 044H Units.

(9) The operator is hereby authorized to withhold the following costs and charges from production, prospectively from the effective date of this Order:

(a) Monthly operating expenses;

(b) Monthly charges for overhead (supervision).

(10) Reasonable charges for supervision (combined fixed rates) are hereby fixed at $600 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "Accounting Procedure-Joint Operations." The

operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

(11) A non-standard 160-acre oil spacing and proration unit (the "016H Unit") is hereby established in the Avalon shale member of the Bone Spring formation within the Hay Hollow Bone Spring Pool (30215), consisting of the W/2 W/2 of Section 20 in Township 26 South, Range 28 East, NMPM, in Eddy County, New Mexico. The vertical limits of the Unit shall conform with the top and bottom of the productive interval of the Avalon shale identified as the equivalent depths of 6,416 feet and 6,763 feet as defined on the SRO Unit Type log for the Marbob SRO State Well No. 1 referenced in paragraph (1), above.

(12) This 016H Unit shall be dedicated to the SRO State Com 016H Well (API No. 30-015-38071) ("the well"), drilled from a surface location 660 feet from the South line and 330 feet from the West line (Unit M) of Section 20 to a standard terminus, or bottom hole location 331 feet from the South line and 369 feet from the West line (Unit D) of Section 20.

(13) COG Operating LLC is hereby removed as Operator of the 016H Well and Nearburg Producing Company is designated as successor Operator. COG Operating LLC shall serve as contract operator of the well for Nearburg Producing Company on terms that are just and reasonable.

(14) COG shall immediately place NEX on pay status for all its proportionate share of monthly production from the 043H and 044H wells and for all of its working interest share of production from the 016H well.

(15) COG shall select and pay for an independent auditor to audit the revenue and expense accounts related to each of the 043H, 044H and 016H Wells. The audit will cover the periods from March 1, 2014 as to the 016H, and from the dates of first production for the 043H (approximately February 25, 2015) and for the 044H (approximately March 4, 2015), to the date of this order ("Audit Period"). The audit will determine for each historic sale by COG of production from each of the Wells during the Audit Period (i) the amount of production that is attributable to the NEX's interest, (ii) the historic price at which COG sold such production, and (iii) anything else necessary for calculating the NEX's share of revenues from the said wells based on the historic proceeds received by COG. The auditor also will calculate the Lump Sum Payment (hereinafter defined).

(16) Results of the audit will be used to calculate a Lump Sum Payment by COG to NEX for the value of its share of production, deemed to have been produced and sold by COG for the account of NEX during the Audit Period. The Lump Sum Payment will be a sum computed based on the volumes of oil and gas produced during the Audit Period that are attributable to NEX's interests in the well units valued at the historic prices received by COG; provided that the Lump Sum Payment, excluding interest, shall in no event be less than one hundred percent of the gross proceeds of sales attributed to NEX's interest during the Audit Period. The Lump Sum Payment shall include interest calculated on NEX's net interest in each sale, for the time provided in NMSA 1978, Section 70-10-3, at the rate provided in NMSA 1978 Section 70-10-4. Consistent with the other provisions of this Order, there shall be no deductions

from the Lump Sum Payment for well costs (drilling costs) and operating expenses from the production attributable to the NEX Lease interests through the date of this Order.

(17) The audit shall be completed no later than three months after the date that this Order is issued. Upon completing the audit, the auditor will deliver complete copies thereof to each party and to the Commission. Any party, within 30 calendar days of receiving the auditor's report, may appeal all or a portion of the report to the Commission, and/or may file objections to any provisions therein that it asserts are not reasonable. The Commission retains jurisdiction for the purpose of ruling on any such appeal or objection, and as otherwise allowed by law.

(18) Upon final determination of the amount of the Lump Sum Payment, COG shall immediately pay the Lump Sum Payment to NEX.

(19) The approval of the Application for Permit To Drill for the SRO State Com 069H is cancelled.

(20) Should all the parties to the compulsory pooling provisions of this order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(21) The operator of the wells and Units shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this order.

(22) Jurisdiction of this case is retained for the entry of such further orders as the Commission may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year designated above.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION

_____
ROBERT BALCH, MEMBER

_____
PATRICK PADILLA, MEMBER

_____
DAVID CATANACH, CHAIRMAN

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Nearburg Exploration Company, L.L.C 's Proposed Order of the Commission was served on counsel of record by electronic mail on April 11, 2017:

Michael H. Feldewert
Jordan L. Kessler
Holland & Hart, LLP
Post Office Box 2208
Santa Fe, NM 87504-2208
mfeldewert@hollandhart.com
jlkessler@hollandhart.com

J. Scott Hall