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

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

**CASE NO. 15441 (de novo)**

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

**CASE No. 15481 (de novo)**

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

**CASE No. 15482 (de novo)**

## COG's POSTHEARING BRIEF AND PROPOSED ORDER

COG Operating LLC ("COG"), pursuant to the instructions from the Commission at the *de novo* hearing in these consolidated matters, submits this brief on the primary issues of good faith and pooling, as well as a proposed order (Attachment A) for consideration.

## INTRODUCTION

The Application filed by Nearburg Exploration Company, SRO2 LLC and SRO3 LLC ("Nearburg") under Case No. 15441 seeks the following relief:

> A. To declare COG "did not have the right to drill" the 43H and 44H wells (Application at paragraph A);
>
> B. To determine COG violated Division rules when it filed forms C-101 and C-102s for the 43H and 44H wells, and when it drilled these wells (Application at paragraph B);
>
> C. To declare that "COG is required to account and pay to Nearburg the amount to which it is entitled in the absence of pooling and that COG is prohibited from

recovering well costs or expenses from the time of first production" for the 43H and 44H wells (Application at paragraph C);

D. To cancel the drilling permit for the SRO State Com 069H well filed on May 5, 2015 (Application at paragraph D);[1] and

E. To provide "appropriate relief" regarding the 16H well that "may include designating Nearburg Producing Company as operator of the well" (Application at paragraph E).

The declarations and legal interpretations requested under paragraphs A and C mirror the relief sought under the Complaint Nearburg contemporaneously filed in the First Judicial District Court. *See, e.g.* COG Ex. 6.[2] These contractual and legal issues will be decided by the appropriate district court and are not issues that are properly before the Commission. *See* Commission Order R-11700-B (*TMBR/Sharp*) at ¶ 27 ("Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico."); Division Order R-14187 at ¶ (29) (holding same). The "appropriate relief" sought under paragraph E for the 16H well, which was drilled entirely on the Nearburg state lease in March of 2011, was dismissed by Nearburg at the Division hearing. *See* Order R-14187 at p. 9, ¶¶ (49)-(51). Further, any decision to "remove" COG as operator of the 16H well requires a legal interpretation of the parties' contractual rights, something the Commission does not have jurisdiction to address. *See* Commission Order R-11700-B (*TMBR/Sharp*) at ¶ 27; Division Order R-14187 at ¶ (29).[3] However, the relief sought under paragraphs B and D is properly before the Commission and subject to the "good faith belief" standard discussed below.

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[1] COG has not drilled the 69H well, which was permitted in May of 2015. Since COG has not sought an extension of that drilling permit, it will expire in May of 2017.

[2] *See also* Complaint filed in *Nearburg Exploration Company, L.L.C., SRO2 LLC, and SRO3 LLC v. COG Operating LLC, CV-2015-0254* at page 11 (Count 1, trespass alleging no right to drill); page 13, at ¶ 65 (Count Two, seeking an accounting without credit for any costs of development or production); page 14 (Count Four, seeking an accounting); page 14 at ¶ 77 (seeking a declaration COG "was no longer entitled to drill the Wells" and that NEARBURG is "not subject to the Operating Agreement" governing the subject area). The New Mexico Court of Appeals is currently determining the proper venue in which to determine the parties' contractual rights.

[3] Moreover, the requested relief is inconsistent with Nearburg's statement at the Commission hearing that it desires COG to continue to operate this long-standing well. *See* Tr. Vol. I at p. 15; Tr. Vol. II at p. 28. Nearburg further

Following Nearburg's formal repudiation of an Operating Agreement covering the W/2 of Section 20, COG filed applications to pool Nearburg's interests in the spacing and proration units dedicated to the 43H and 44H wells. Case No. 15481 contains the pooling application for the acreage dedicated to the 43H well, while Case No. 15482 contains the pooling application for acreage dedicated to the 44H well. As noted in Section B below, the parties agree pooling is now necessary to fill the "regulatory gap" that exists until the district courts confirm that the working interest in the W/2 of Section 20 is subject to the Operating Agreement.

**A. The Commission's Jurisdiction Is Limited To Whether COG Had A Good Faith Belief That It Was Authorized To Operate On The Nearburg State Lease In The W/2 Of Section 20.**

The Division properly concluded that the issue under Nearburg's application is whether COG had a "good faith belief" that it was authorized to operate on the W/2 of Section 20 when it commenced drilling of the 43H and 44H wells and permitted the 69H well. *See* Order R-14187 at p. 5-6, ¶¶ (25)–(28). Citing confusing language in Commission Order R-11700-B (*TMBR/Sharp)*, Nearburg's prehearing statement suggests the Division erred and that any applicant for a permit to drill must demonstrate a good faith claim to "record title," which Nearburg describes as akin to a "written deed" to the acreage dedicated to the well. Nearburg PHS at p. 7-8. Under Nearburg's interpretation, reliance on an operating agreement would not meet the "good faith" requirement, thereby rendering thousands of wells across the state out of compliance in circumstances where an operator relied on the authority granted in an operating agreement, but where the operator did not own "record title" to the acreage dedicated to the well.

Fortunately in a case subsequent to R-11700-B (*TMBR/Sharp)*, the Commission eliminated the "confusion" arising from the "title" language Nearburg relies upon, stating:

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informed Commissioner Catanach that the 16H is an "Avalon well that we wanted nothing to do with at the time....I don't know if we want anything to do with it still today." Tr. Vol. I at p. 247.

> 33. To prevent further misunderstandings in the interpretation of the Commission's orders, particularly in Case No. 13153, *Application of Pride Energy Company, etc.,* Order No. R-12108-C and *Application of TMBR/Sharp, Inc.,* Order R-11700-B, the Commission approves of the language on Division Form C-102, field 17, concerning the operator's certification and asks the Division to continue its use and to notify the Commission if it plans to discontinue its use. That certification states "I hereby certify that the information contained herein is true and correct to the best of my knowledge and belief and that the organization *either* owns a working interest or unleased mineral interest in the land, including the proposed bottomhole location, *or* has a right to drill this well at this location pursuant to a contract with an owner of such mineral or working interests or in a voluntary pooling agreement or compulsory pooling order hereto entered by the Division.

Order R-12343-E (*Samson*) at p. 6 (emphasis added). Accordingly the issue before the Commission is whether COG had a "good faith belief" that it was authorized to operate on the Nearburg lease by virtue of an agreement or some other contractual arrangement. The evidence presented at the hearing establishes numerous bases for this "good faith belief."

1. The Ratification executed by Nearburg in June of 2009 provides the good faith belief.

In June of 2009, Nearburg executed a form promulgated and utilized by the New Mexico State Land Office ("SLO") for the very purpose of ratifying a Unit Operating Agreement. *See* COG Ex. 2 at p. 4; COG Ex. 3. When Nearburg signed this Ratification form, it held all the working interest in the W/2 of Section 20. *See* COG Ex. 2, last two pages. SLO records reflect that this Ratification form has been utilized for years to ratify unit operating agreements. Indeed the Yates Entities executed this same Ratification form to commit their working interest in the W/2 of Section 17 (and other acreage) to the Unit Operating Agreement. *See* COG Ex. 4 at p. 19.

Nearburg now suggests the language in this state form does not accomplish the intent set forth in the title.[4] Whatever merit exists to that argument is for the appropriate district court to

[4] Nearburg not only blames the SLO for these contractual issues, but Nearburg also claims it subsequently executed Communitization Agreements recognizing COG as operator of the acreage only because it was "under duress" by the SLO's threat to cancel Nearburg's lease.

decide under the filed complaints. *See, e.g.*, COG Ex. 6 (Complaint); Commission Order R-11700-B (*TMBR/Sharp*) at ¶27 ("Exclusive jurisdiction of such matters resides in the courts of the State of New Mexico."); Division Order R-14187 at ¶(29) (holding same). The question before the Commission is whether COG, as the successor operator of the contract area subject to the Unit Operating Agreement, could believe in "good faith" that the SLO Ratification form committed the working interest in the Nearburg lease to the Unit Operating Agreement. The evidence demonstrates COG had every reason to believe that this Ratification form promulgated by the SLO did exactly what the title states, just like other operators and non-operators around the state have similarly concluded for years.

2. The representations in Marbob's 2009 submissions to the SLO provide the good faith belief.

In 2009, when Marbob presented the Nearburg lease to the SLO for inclusion in the SRO Unit, it informed the SLO that Nearburg has "subscribed to the Unit Operating Agreement" and provided the SLO with a copy of the executed Ratification form. COG Ex. 2 at p. 2. When COG inherited this file in October of 2010 and proceeded to develop the Nearburg lease, it had no reason to believe otherwise. *See* COG Ex. 7 at p. 3 (Change of Operator form).

3. Paragraph 22 of the Unit Agreement provides the good faith belief.

The SLO's acceptance of the Nearburg state lease into the SRO Unit in 2009 was done "[i]n accordance with Article 22 of the unit agreement." *See* COG Ex. 2 at p. 1. Article 22 of the Unit Agreement (entitled "Subsequent Joinder" ) requires any working interest owner in the subsequently committed acreage to subscribe "to the operating agreement providing for the allocation of costs of exploration, development and operation." COG Ex. 5, last page.[5] Nearburg did not execute the assignment of its working interest in the Nearburg lease to Marbob until August 24, 2009, over a

[5] Indeed without this mandatory joinder provision, there would be no agreement with the committed working interest governing the "allocation of costs of exploration, development and operation" of the committed state lease. *See also* COG Ex. 2 (Unit Agreement) at Art. 6 (mandating an operating agreement between unitized working interest owners).

month after Nearburg's state lease and corresponding working interest were committed to the Unit Agreement and, per Article 22, the Unit Operating Agreement. *See* COG Ex. 1, last page. When COG inherited this file in 2010 and proceeded to develop the Nearburg lease, it had every reason to believe the working interest in the Nearburg state lease was committed to the Unit Operating Agreement.

4. The Unit Operating Agreement itself provides the good faith belief.

The Unit Operating Agreement lists the Nearburg state lease (W/2 of Section 20) as part of the contract area. COG Ex. 4 at p. 22 (Exhibit A). It further lists the Nearburg state lease and the working interest in that state lease as committed to the Operating Agreement. *Id.* at p. 29-30 (Exhibit A-1 and Recapitulation). When COG inherited the SRO Unit and the governing Unit Operating Agreement from Marbob in October of 2010, it had every reason to believe the contract area included the Nearburg state lease and that the working interest in that state lease had been committed to the Operating Agreement.[6]

5. The course of performance by the working interest owners in the contract area provides the good faith belief.

The evidence presented at the Commission hearing demonstrates that since 2009 the Operator (first Marbob and then COG) and the non-operators developed the contract area and allocated costs, expenses and revenue on the basis that the working interest in the Nearburg state lease is committed to the Operating Agreement. This includes the drilling and operation of the 16H well solely on the Nearburg state lease since March of 2011, and the permitting of the 43H and 44H wells on the Yates and the Nearburg state leases in February of 2013. Indeed, Nearburg's witness

[6] The fact that the Exhibit A-1 Recapitulation shows Nearburg holding an ORRI does not negate the fact that the working interest in the Nearburg state lease is shown as committed to the Operating Agreement. As successor-in-interest to Nearburg's leasehold following the term assignment, Marbob was obligated to satisfy any unsatisfied covenants of Nearburg under the Unit Agreement because those covenants run with the land and are binding on successors-in-interest. See COG Ex. 2 (Unit Agreement) at Art. 16. Thus, even if Nearburg had failed to fulfill its obligations under the Unit Agreement to join the Operating Agreement, Marbob remedied that failure by amending Exhibit A to the Operating Agreement to show the working interest in the Nearburg lease committed to the Operating Agreement and Nearburg retaining an overriding royalty interest in the contract area.

confirmed that when COG drilled the 16H well and permitted the 43H and 44H wells, it was authorized to operate on the Nearburg lease under the Operating Agreement:

> Q. And I believe you testified that at the time this well was drilled by Concho under this operating agreement, they were authorized to operate on your lease?
> A. Sure.
> Q. Pursuant to this operating agreement?
> A. Yes.
> Q. Because there is no other agreement that controls the operations of the 16H? This is the only one?
> A. That's the only one I'm aware of.

Tr. Vol. I at p. 173:10-20 (Howard).

> Q. Okay. And at the time these were permitted, COG is already operating the 16H on the Nearburg lease?
> A. Yes.
> Q. And doing so under the operating agreement?
> A. Yes.
> Q. And you agreed with me at the hearing below that when COG filed and permitted these wells, they were authorized to operate on the Nearburg lease?
> A. Yes.
> Q. And they were authorized to operate pursuant to the operating agreement?
> A. Yes.

Tr. Vol. I at p. 176:2-13 (Howard).

When COG proceeded to drill the 43H and 44H Wells in August and October of 2014, it was drilling on acreage that was listed as committed to the Operating Agreement, under permits filed under that Operating Agreement, and on acreage where COG was already operating the 16H Well pursuant to the Operating Agreement without objection by Nearburg. COG had no reason to believe the Nearburg lease and the working interest in that lease were not committed to the Operating Agreement. It was not until months after these wells were drilled that Nearburg first suggested no operating agreement covered its acreage. *See* COG Ex. 22 (May 28, 2015, letter).

6. The written communications between Nearburg and COG prior to drilling the 43H and 44H wells confirm the good faith belief.

In March of 2014, following termination of the SRO Unit, COG informed Nearburg that the Marbob Term Assignment had "technically terminated," that COG intended to proceed to develop the contract area "at will subject to the JOA already in place" and that COG understood Nearburg "intended to keep the assignment and the ORR effective until all wells in (or formerly in) the unit are plugged, so we need to paper that up." COG Ex. 10 at p. 2-3. At no point did Nearburg inform COG that it disagreed with any of these statements.[7] On the contrary, Nearburg proceeded to take actions in the subsequent months that were only consistent with COG's right to operate on the Nearburg lease. These actions included:

- invoicing COG for the annual rental payment for the Nearburg lease (COG Ex. 11);
- addressing the proper ORRI for the 43H, 16H and other SRO Unit wells (COG Exs. 12A - 13A); and
- working with COG to "paper up" an extension of the Term Assignment culminating in Nearburg informing COG it was "agreeable" to the proposed language of a "Corrected Term Assignment" and providing updated well information requirements to be attached to the "agreeable" Corrected Term Assignment. *See* COG Exs. 15-19A.

Throughout all of this time, COG continued to operate the 16H on the Nearburg's lease without objection and Nearburg continued to accept monthly ORRI payments for wells within the contract area subject to the Operating Agreement. *See* Tr. Vol.. 1 at p. 198 (Howard); COG Ex. 24 (July and August 2015 letters revoking Division Orders and ORRI payments). These actions confirm COG's good faith belief that it was authorized to operate on the Nearburg lease under the Operating

[7] Mr. Howard's claim that around July 9, 2014, he called a land technician (Kelly Fuchik) "at her office" (Tr. Vol. I at p. 189:25) to inform her Nearburg did not intend to execute the communitization agreement for the 43H well (forwarded under COG Ex. 12) is not corroborated by any subsequent written correspondence and directly contradicted by the telephone records. *See* COG Exs. 34- 35; Tr. Vol. II at p. 51, 55-56 (Davis). Mr. Owen further testified that Ms. Fuchik never informed him or anyone else at COG about an alleged telephone call from Mr. Howard. Tr. Vol. II at pp. 146-148. Subsequent emails reflect that Nearburg did not execute the communitization agreement because it was still trying to determine the proper percentage of its ORRI in the 43H and other SRO Unit wells. *See* COG Exs. 12A – 13A.

Agreement and that Nearburg desired to continue to receive an ORRI under an extension of the Term Assignment at the time the 43H and 44H wells were drilled.[8]

7. The Communitization Agreements executed by Nearburg confirm COG's good faith belief.

Finally, after Nearburg received requested information on the 43H and 44H wells, it executed and delivered for filing with the SLO Communitization Agreements for the spacing units dedicated to each of these wells. *See* COG Exs. 26 and 27. These executed agreements are effective before the 43H and 44H wells were drilled (*id.* at p. 1 of each Agreement) and inform COG and the public at large, in bolded type, the following:

> **COG Operating LLC shall be the Operator of said communitized area and all matters of operation shall be determined and performed by COG Operating LLC.**

*Id.* at ¶ 8.[9] The weight of the evidence establishes that when the 43H and 44H wells were drilled, COG had a good faith belief that it was authorized to operate on the Nearburg state lease under the Operating Agreement and that Nearburg desired to continue to receive an ORRI under an extension of the Term Assignment.

**B. The Parties Agree Pooling Orders for the 43H and 44H Wells Are Now Necessary Until The Courts Sort Out The Contractual Rights.**

Nearburg concedes that if COG had a good faith belief that it was authorized to operate on the Nearburg lease at the time it permitted and drilled the 43H and 44H wells, a pooling order was not necessary "at that point in time:"

> Q. Mr. Howard, didn't you agree with me at the last hearing that if COG understood that Nearburg's lease had been committed to the operating

[8] Nearburg's suggestion at the Commission hearing that the expiration of the Marbob Term Assignment in March of 2014 constituted a "title failure" under the Operating Agreement is not only the first time such a suggestion has been made, but does not conform with the normal understanding of that provision. *See* Tr. Vol. II at p. 148-150 (Howard). Further, the Commission does not have jurisdiction to adopt Nearburg's new-found legal position. *See* Commission Order R-11700-B (*TMBR/Sharp*) at ¶ 27.

[9] As noted by COG Ex. 31, these communitization agreements are in effect and the SLO has disbursed royalties pursuant to these agreements.

agreement, the working interests in that lease, then it would have a voluntary agreement allowing it to move forward to develop and operate the lease, correct?
A. Right.
Q. Okay.
A. At that point in time, yeah.
Q. You wouldn't need a pooling order?
A. No, not at that point in time.

Tr. Vol. I at pp. 159–160. Now that Nearburg has filed a complaint in state district court and an application with the Division repudiating the Operating Agreement and COG's authority to operate on the Nearburg lease, a pooling order is necessary to consolidate the working interest in the W/2 of Section 17 and the W/2 of Section 22. *See* COG Exs. 8, 9 and 25; *see also* NMSA 1978 § 70-2-17(C) ("shall pool" for wells "drilled") and § 70-2-18(A) (pooling orders "shall be effective from first production").[10] Unlike the Division hearing, Nearburg now concedes pooling is necessary:

Q. Mr. Griffin, in your opinion, is the consolidation of Sections 17 and 20 by way of compulsory pooling an appropriate way for the Commission to reconcile and protect Nearburg's correlative rights in this acreage?
A. Yes.

Tr. Vol. II at p. 21:3-8.

The Division routinely pools acreage subject to contract or title disputes with the normal caveat that "[t]he operator of the well and the Unit shall notify the Division in writing of the subsequent voluntary agreement of parties subject to the compulsory pooling provisions of this order." *See, e.g.,* Order R-14145 at p. 5, ¶(17) (Example of a standard pooling order). By statutory directive, the pooling order "shall be effective from the first date of production." NMSA 1978, § 70-2-18(A). As a matter of practice, the standard pooling order will afford Nearburg an opportunity to elect to challenge the reasonableness of the well costs and to elect to participate or not participate in the 43H and 44H wells. *See, e.g.,* Order R-14145 at p. 4-5. However, no risk penalty will apply

[10] Yates Petroleum, which holds the state lease covering the W/2 of Section 17, has not repudiated the Operating Agreement to which it and the other Yates Entities subscribed using the same Ratification form as that executed by Nearburg in 2009. *See* COG Ex. 4 at p. 19.

in this circumstance since COG did not request a risk penalty. *See also* Tr. Vol. II at p. 151:21-22 (Owen).

WHEREFORE, COG respectfully requests that the Commission deny the relief sought under Nearburg's application. COG further requests that the Commission issue pooling orders for the spacing and proration units dedicated to the 43H and 44H wells that are consistent with the Communitization Agreements filed with the SLO, and which will remain in effect until a district court confirms that the Operating Agreement applies to the working interest in the W/2 of Section 20. A proposed order affording this relief is submitted as Attachment A hereto.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that on April 11, 2017, I served a copy of the foregoing document to the following counsel of record via electronic mail:

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