

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

**APPLICATION OF NEARBURG EXPLORATION COMPANY LLC, SRO2 LLC
AND SRO3 LLC FOR AN ACCOUNTING AND LIMITATION ON RECOVERY
OF WELL COSTS, AND FOR CANCELLATION OF APPLICATIONS 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)
ORDER NO. R-14187-E**

ORDER OF THE COMMISSION

These matters came before the Oil Conservation Commission ("Commission") for a *de novo* hearing on February 28 and March 1, 2017. All three cases were consolidated for hearing, and a single order is being issued. The Commission, having conducted a public hearing and having considered the testimony, the record in this case, the arguments of the parties, and being otherwise fully advised, enters the following findings, conclusions and order.

THE COMMISSION FINDS THAT:

(1) Notice has been given of this *de novo* hearing and the Commission has jurisdiction of the parties and the subject matter herein.

(2) In Case No. 15441, Nearburg Exploration Company LLC, SRO2 LLC and SRO3 LLC (collectively, "Nearburg") seek an order:

[a] declaring that COG Operating, LLC ("COG") did not have the right to permit, drill and produce two horizontal wells that penetrate lands where Nearburg contends that it is the sole owner of the oil and gas working interest. The subject wells are the following:

SRO State Com Well No. 043H

API No. 30-015-41141

("the 43H Well")

Surface Location: 190' FNL & 990' FWL, Unit D, Section 17-26S-28E

SRO State Com Well No. 044H

API No. 30-015-41142

("the 44H Well")

Surface Location: 190' FNL & 2220' FWL, Unit C, Section 17-26S-28E

[b] declaring that COG violated Sections 14.8.B, 15.16.A and 16.15.F of Division Rules [all included in 19.15 NMAC], by drilling the subject wells without first obtaining the consent of Nearburg, and without securing voluntary consolidation or compulsory pooling of the project areas dedicated to the wells;

[c] requiring COG to account and pay to Nearburg amounts for which it contends that COG would be liable to Nearburg as a working interest owner, pursuant to NMSA 1978 Section 70-2-18.B, due to COG's failure to obtain voluntary consolidation or compulsory pooling of the project areas dedicated to the subject wells, without recovery of well costs or expense;

[d] cancelling the Division's approval of an Application for Permit to Drill ("APD") filed by COG for its proposed, but not yet drilled, SRO State Com Well No. 69H (API No. 30-015-43093) ("the 69H Well"), to be located 200 feet from the North line and 1980 feet from the West line (Unit C) of Section 17, Township 26 South, Range 28 East, NMPM; and

[e] removing COG and designating Nearburg as the operator of the SRO State Com Well No. 16H (API No. 30-015-38071) ("the 16H Well"), located 660 feet from the South line and 330 feet from the West line (Unit M) of Section 20, Township 26 South, Range 28 East, NMPM:

(3) At the hearing, both parties appeared through counsel and presented evidence and argument in support of their respective positions. Only the evidence and contentions material to the Commission's conclusions are detailed in this order.

Finding of Facts.

(4) This case involves the development of the W/2 of Section 17 and the W/2 of adjacent Section 20, both in Township 26 South, Range 28 East, in Eddy County, New Mexico. The oil and gas estate underlying these tracts is owned by the State of New Mexico. Nearburg is the lessee of record of the state trust lease, and present owner of record of the entire working interest in the W/2 of Section 20. Nearburg claims no interest in Section 17. (Nearburg's title to the working interest is a subject matter in a pending district court proceeding).

(5) Both Sections 17 and 20 were formerly included in the SRO State Unit, a State exploratory unit which was approved by the Commissioner of Public Lands ("State Land Office" or "SLO") on June 29, 2009 and subsequently terminated effective March 1, 2014.

(6) COG, as successor to Marbob Energy Corporation ("Marbob"), is the operator under the Unit Operating Agreement for the SRO State Unit. The Unit Operating Agreement, by its terms, continues in force notwithstanding termination of the Unit. [COG Exhibit 4]

(7) By instrument executed on June 26, 2009 [COG Exhibit 3] Nearburg ratified the SRO State Unit Agreement. The ratification document Nearburg signed, a form drafted by the SLO, is entitled "Ratification and Joinder of Unit Agreement and Unit Operating Agreement." Although that document explicitly ratifies the Unit Agreement, there is no language in the body of the document providing for ratification of the Unit Operating Agreement.

(8) By instrument entitled Term Assignment of Oil and Gas Lease ("Term Assignment") [COG Exhibit 1], executed on August 24, 2009 but dated (effective) July 1, 2009, Nearburg assigned its entire working interest in its lease covering the W/2 of Section 20 to Marbob, COG's predecessor in interest. The Term Assignment provides that it continues in force only so long as the assigned lease is subject to the Unit Agreement. So long as the Term Assignment was in effect, Nearburg owned only an overriding royalty interest in the W/2 of Section 20.

(9) COG, the Unit Operator, spudded the 16H Well on March 4, 2011, and completed it on June 22, 2012 [COG Exhibit 7], while the SRO State Unit Agreement was in effect.

(10) The 16H Well is a one-mile horizontal well located entirely within Section 20 and dedicated to a project area comprising the W/2 W/2 of Section 20 only. It is located entirely on land to which Nearburg now claims exclusive ownership.

(11) The 43H Well and the 44H Well are horizontal wells, each approximately two miles in length, located, respectively, in the W/2 W/2, and in the E/2 W/2, of Sections 17 and 20, and completed in the Second Bone Spring [Hay Hollow Bone Spring Pool (30215)]. COG filed APDs for the 43H Well and the 44H Well on February 21, 2013, while the SRO State Unit was in effect. [COG Exhibits 8 and 9].

(12) The SRO State Unit was terminated effective March 1, 2014.

(13) On August 2, 2014, and October 10, 2014, respectively, COG spudded the 43H Well and the 44H Well [COG Exhibits 8 and 9], without first proposing these wells to Nearburg, which it would have been required under the Unit Operating Agreement if Nearburg then owned a working interest. It also did not give Nearburg 24-hour notice prior

to commencement of these wells, as it would have been required to do under the Term Assignment if that agreement remained in effect [COG Exhibit 1, Exhibit A, page 2].

(14) COG prepared Communitization Agreements ("CAs") on SLO forms for the 43H and 44H Wells, and signed those agreements on July 3, 2014 and August 21, 2014, respectively. The CAs prepared by COG purported to communitize the W/2 W/2 of Sections 17 and 20 for the 43H Well, and the E/2 W/2 of Sections 17 and 20 for the 44H Well, as to "the Bone Spring formation." [COG Exhibits 26 and 27]

(15) Nearburg executed both CAs on May 20, 2015 as lessee of record in Section 20, after changing the form to limit the communitized formation to the Second Bone Spring interval.

(16) The CAs were subsequently filed with SLO, approved by SLO, and filed for record in Eddy County. However, the copies recorded in Eddy County, although they included Nearburg's signature pages, do not reflect Nearburg's change limiting the communitized formation. [COG Exhibits 26 and 27] There is no evidence that this change was ever filed with, or approved by, SLO.

(17) COG filed an APD for the 69H Well on May 5, 2015, which date is after the termination of the Unit. The 69H Well was proposed as a two-mile horizontal well to be completed in the Third Bone Spring interval [Hay Hollow Bone Spring Pool], to be dedicated to a 320-acre project area comprising the E/2 W/2 of Sections 17 and 20. [Nearburg Exhibit 6] At the time of the hearing, drilling of this well had not commenced.

Issues:

(18) In support of its Application, Nearburg contends that:

[a] COG did not have the right to drill or operate wells penetrating Section 20 pursuant to the Unit Operating Agreement because the alleged ratification of that agreement that Nearburg signed [Nearburg Exhibit 10] refers to the Unit Operating Agreement only in the title, and not in the body of the document, and thus cannot properly be construed as a ratification of that agreement, and

[b] COG did not have such a right pursuant to the Term Assignment because the Term Assignment expired on March 1, 2014, when the Unit terminated, before the 43H or 44H Wells were commenced and before the APD for the 69H Well was filed.

(19) Nearburg presented evidence that COG had been advised by its title attorneys on October 8, 2014, prior to commencement of the 43H and 44H Wells, that the Term Assignment had expired. [Nearburg Exhibit 20]

(20) Nearburg presented evidence that COG had been advised by its title attorneys on January 9, 2015 that the Term Assignment "has clearly expired". [Nearburg Exhibit 22]

(21) COG presented evidence of continuing negotiations between COG and Nearburg looking toward the renewal or reinstatement of the Term Assignment. Some of the communications placed in evidence can be read as indicating that both parties contemplated a renew or extension of the Term Assignment, although there is no exhibit that is signed by both parties and provides for renewal or extension on terms therein set forth.

(22) Nearburg's land witness confirmed that there were ongoing negotiations for renewal of the Term Assignment until Nearburg learned, on April 22, 2015 that the 43H and 44H Wells had already been drilled.

(23) Whether COG had an actual right to drill the 43H or the 44H Wells is a contractual issue between COG and Nearburg that the Division does not have jurisdiction to determine and is a pending matter before the District Court in Case D-101-CV-2015-02541.

(24) Nearburg also requests a declaration that COG violated Division Rule 19.15.16.15.F, requiring an operator of a horizontal well to consolidate ownership of interests in the well's project area by voluntary or compulsory pooling.

(25) The Unit Operating Agreement, if binding on Nearburg, at least arguably constituted such a consolidation. The CAs modified by Nearburg could also arguably be considered as constituting a consolidation if they are construed as contractually binding on COG and Nearburg even though they would not be binding on the Commissioner.

(26) Until the District Court resolves these legal issues, the Division cannot determine whether any violation of Rule 19.15.16.15.F occurred.

(27) For the foregoing reasons, Nearburg's requests for a declaration that COG did not have the authority to drill the 43H and 44H Wells, and for a declaration that in so doing COG violated Division Rules 19.15.14.8.B and/or 19.15.16.15.A (both of which require authorization from an owner prior to drilling on or into a tract of land), should be DIMISSED for lack of jurisdiction.

(28) Nearburg seeks an order requiring COG to account and pay to Nearburg amounts COG claims that Nearburg should be entitled under NMSA 1978 Section 70-2-18.B on account of COG's failure to consolidate ownership of the project areas for the 43H and 44H Wells.

(29) The Commission has determined, as discussed below, that issuance of any compulsory pooling order in these cases is not appropriate at this time.

(30) Accordingly, Nearburg's request for an order that COG render an accounting under the cited statute, should be DIMISSED for lack of jurisdiction.

(31) Nearburg seeks an order cancelling Division approval of COG's APD, filed on May 5, 2015, for the proposed 69H Well, to be drilled in the Third Bone Spring interval.

(32) Whether COG had the right to file the APD will be determined by the pending District Court case.

(33) Accordingly, the APD for the proposed 69H Well should be suspended until the conclusion of the District Court case. COG should not be authorized to proceed to drill the 69H Well.

(34) Nearburg seeks removal of COG as operator and designating Nearburg Producing Company as operator of the 16H Well.

(35) Whether COG should be removed and Nearburg designated operator of the 16H Well will be clarified by the decision in the pending District Court case.

(36) Accordingly, Nearburg's request for removal and designation, should be DIMISSED for lack of jurisdiction at this time.

Cases Nos. 15481 and 15482

(37) The foregoing Findings (1) through (36) are incorporated herein insofar as they are relevant.

(38) In Case No. 15481, COG, as applicant, seeks an order (1) creating a non-standard, 320-acre spacing and proration unit in the Bone Spring formation comprising the W/2 W/2 of Section 17, and the W/2 W/2 of Section 20, Township 26 South, Range 28 East, NMPM, Eddy County, New Mexico; (2) pooling all uncommitted interests in said unit; and (3) dedicating said unit to COG's SRO State Com Well No. 43H (API No. 30-015-41141), a two-mile long horizontal well having its surface location in the NW/4 NW/4 (Unit D) of Section 17, and its bottom hole location in the SW/4 SW/4 (Unit M) of Section 20.

(39) In Case No. 15482, COG, as applicant, seeks an order (1) creating a non-standard, 320-acre spacing and proration unit in the Bone Spring formation comprising the E/2 W/2 of Section 17, and the E/2 W/2 of Section 20, Township 26 South, Range 28 East, NMPM, Eddy County, New Mexico; (2) pooling all uncommitted interests in said unit; and (3) dedicating said unit to COG's SRO State Com Well No. 44H (API No. 30-015-41142), a two-mile long horizontal well having its surface location in the NE/4 NW/4 (Unit C) of Section 17, and its bottom hole location in the SE/4 SW/4 (Unit N) of Section 20.

(40) NMSA 1978 Section 70-2-17.C directs the Commission to pool a spacing unit if two conditions are satisfied: (1) the owners have not agreed to pool their interests; and (2) an owner who has the right to drill has drilled or proposes to drill a well on said unit.

(41) In this case, the Commission cannot determine that either of these conditions precedent to compulsory pooling is satisfied.

(42) If the Ratification committed the entire lease interest that Nearburg owned of record on June 26, 2009 to the Unit Operating Agreement, or the altered CAs were accepted by COG and can operate as agreements between the parties absent the Commissioner's approval, then the owners *have* agreed to pool their interests, and the Division cannot order compulsory pooling, even if the Term Assignment has expired and has not been renewed or extended.

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

(44) Again, the Commission does not have jurisdiction to construe contracts or to determine their validity. The Commission cannot determine whether or not either of the statutory prerequisites for compulsory pooling have been satisfied.

(45) The determination of rights of the parties is pending in the District Court proceeding.

(46) Accordingly, COG's applications for compulsory pooling should be DIMISSED for lack of jurisdiction.

IT IS THEREFORE ORDERED:

[1] The Application of Nearburg Exploration Company LLC, SRO2, LLC and SRO3, LLC (collectively "Nearburg") in Case No. 15441 for an order declaring that COG Operating LLC ("COG") did not have the right to drill the SRO State Com Well No. 43H (API No. 30-015-41141) and the SRO State Com Well No. 44H (API No. 30-015-41142) into the Bone Spring formation underlying the W/2 of Section 20, Township 26 South, Range 28 East, NMPM; and that, in so doing, COG violated Division Rules 19.15.14.8.B and 19.15.16.15.A, is hereby dismissed.

[2] The Application in Case No. 15441 for an order declaring that COG Operating LLC ("COG") violated Division Rule 19.15.16.15.F by failing to consolidate the project areas dedicated to the SRO State Com Wells No. 43H and 44H is hereby dismissed.

[3] The Application of Nearburg in Case No. 15441 for an order requiring COG to account to Nearburg for proceeds of past production from the SRO State Com Wells No. 43H and 44H to which Nearburg claims to be entitled under NMSA 1978 Section 70-2-18.B is hereby dismissed.

[4] The Application of Nearburg in Case No. 15441 for an order cancelling the Division's approval of COG's Application for Permit to Drill its proposed SRO State Com Well No. 69H (API No. 30-015-43093), a two-mile horizontal well that will be dedicated to a 320-acre spacing and proration unit comprising the E/2 W/2 of Sections 17 and 20, Township 26 South, Range 28 East, NMPM, in the Third Bone Spring, is hereby denied. However, the APD for the 69H Well is suspended pending resolution of the District Court case and COG shall not proceed in drilling the 69H Well until further authorization by the Division.

[5] The Application of Nearburg in Case No. 15441 for removal of COG as operator and designating Nearburg Producing Company as operator of the SRO State Com Well No. 16H is dismissed.

[6] The Applications of COG in Cases No. 15481 and 15482 for creation of two 320-acre non-standard spacing and proration units in the Bone Spring formation (Hay Hollow Bone Spring Pool, 30215) comprising, respectively, the W/2 W/2 of Sections 17 and 20, and the E/2 W/2 of Sections 17 and 20, both in Township 26 South, Range 28 East, NMPM, in Eddy County, New Mexico, to be dedicated to the SRO State Com Well No. 43 and the SRO State Com Well No. 44, respectively, and for compulsory pooling of the spacing units so created, are hereby dismissed.

[7] Jurisdiction of these cases is retained for the entry of such further orders as may be deemed necessary, including, but not limited to, such orders as may be appropriate in the light of any decision in Case No. D-101-CV-2015-02541, now pending in the District Court of Santa Fe County, New Mexico.

DONE at Santa Fe, New Mexico, on the date hereinabove stated.

STATE OF NEW MEXICO
OIL CONSERVATION COMMISSION




ROBERT BALCH, Member


ED MARTIN, Member


DAVID R. CATANACH, Chair

SEAL