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

APPLICATION OF ALLAR DEVELOPMENT, LLC TO REOPEN DEVON ENERGY CASE NOS. 21119, 21120, 21121, 21122, and 21223 EDDY COUNTY, NEW MEXICO

CASE NOS. 21119, 21120, 21121, 21122, and 21123
Re-Open Case No. 21346

RESPONSE TO MOTION TO DISMISS

For its Response to Devon Energy Production Company LP ("Devon"), Allar Development, LLC ("Allar") states:

A. Introduction.

The issue in this case is whether Devon could have unilaterally decided that an existing agreement that ran with the land did not apply when it brought its compulsory pooling applications before the Oil Conservation Division. Effectively, Devon used the Division process to extinguish an agreement to which the lands covered by Devon's spacing units applied. An Exploration Agreement dated July 1, 1999, incorporated a Joint Operating Agreement ("JOA") and made part of the Exploration Agreement, has been tied to the land covering Devon's spacing units. Additionally, the parties to the Exploration Agreement and their successors in interest have governed oil and gas operations since then pursuant to the JOA. As recent as June 30, 2017, OXY USA, Inc., which had drilled a horizontal well pursuant to the JOA, made an assignment of oil and gas leasehold interests including the lands committed to the spacing units to Devon.

The assignment to Devon was made specifically subject to the Exploration Agreement covering Sections 23, 26, 27 and 35, T23S, R29E, Eddy County, New Mexico. Devon's spacing

units are in Sections 23 and 26 and designed to drill two-mile laterals. Here, Allar does not argue whether two-mile laterals should be drilled, take issue with well orientation, challenge well location, or the size of spacing units. As stated above, the issue is whether Devon, in proposing the wells to Allar, could substitute a compulsory pooling order for the JOA that has governed the conduct of the original parties and their successors in interest since 1999.

B. The OCD Orders effectively determined property rights.

A Texas Court of Appeals case best illustrates the effect of a JOA on land that has been committed to a JOA. TransTexas Gas Corp. v. Forcenergy Onshore, Inc., 13-10-00446-CV, 2012 WL 1255218, at *6 (Tex. App.--Corpus Christi Apr. 12, 2012) states:

> With respect to TransTexas's argument that it never signed the joint operating agreements and they were amended, in *Westland Oil Development Corp. v. Gulf Oil Corp.,* the supreme court noted that every purchaser is bound by every "recital, reference, and reservation contained in or fairly disclosed by any instrument which forms an essential link in the chain of title under which he claims." 637 S.W.2d 903, 908 (Tex.1982); *see also Hi–Mountain Energy Corp. v. Avra Oil Co.,* Cause No. 08–00–00243–CV, 2002 WL 660891, at *4 (Tex.App.-El Paso 2002, pet denied) (holding that parties were bound by unrecorded joint operating agreements referenced in their chain of title). TransTexas admitted that it had constructive notice of the joint operating agreements because of assignments to Conoco that referenced the joint operating agreements. An operating agreement is typically in effect for as long as any of the oil and gas leases subject to the joint operating agreement remain in effect. *See* Ernest E. Smith & Jacqueline Lang Weaver, Texas Law of Oil and Gas § 17.3(A)(1) (2009).

Devon became bound by the joint operating agreement when it took its assignment from OXY. The affidavit of Devon's landman submitted in the Devon cases did not disclose the existence of the JOA. It did list parties which Devon deemed to be non-consenting parties to Devon's proposed intended drilling program. Absent the JOA, unquestionably compulsory pooling under NMSA 1978, § 70-2-17(C) may have been applicable. In issuing its orders, the Oil Conservation Division never, under the circumstances, considered whether Allar was a

consenting party or non-consenting party. The first part of Section 70-2-17(C) was satisfied by the JOA. It reads:

> When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit.

In other words, the pooling procedure should have been governed by the JOA.

The second part of 70-2-17(C) was not applicable because Allar was willing to participate under the terms of JOA. The second part states:

> Where, however, such owner or owners have not agreed to pool their interests, and where one such separate owner, or owners, who has the right to drill has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, or to prevent waste, shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit. (emphasis added).

The Division's inquiry or lack thereof as to consent was incomplete irrespective of whether Devon gave Allar notice of the hearing. Allar did not have to appear at the hearing since the JOA already defined the conduct of the parties subject to the JOA. Effectively, the Division's orders, through Devon's surreptitious presentation, defaulted Allar out of its contractual interests under the JOA.

Anderson Energy Corp. v. Dominion Oklahoma Texas Expl. & Prod., Inc., 469 S.W.3d 280, 293–94 (Tex. App.--San Antonio 2015) states the purpose of a JOA:

> Based on the nature of a joint operating agreement, and particularly the nature of AMI and PRP provisions as real property covenants running with the land,[6] we conclude that a reasonable term should be implied into the JOA. *See Seagull Energy,* 207 S.W.3d at 344 n.1 (stating an operating agreement "is a contract typical to the oil and gas industry whose function is to designate an 'operator, describe the scope of the operator's authority, provide for the allocation of costs and production among the parties to the agreement, and provide for recourse among the parties if one or more default in their obligations' "); *EOG Res., Inc. v. Killam Oil Co., Ltd.,* 239 S.W.3d 293, 298 (Tex.App.–San Antonio

2007, pet. denied) (discussing the function of an oil and gas operating agreement in connection with its term).

All of the factors mentioned in Anderson Energy were already covered in the JOA.

C. Allar, by its application, does not seek a judicial interpretation of the JOA, but a finding that a JOA existed and covered the spacing units.

The authority of the Division is limited to a decision of whether Allar is a consenting or non-consenting party to Devon's drilling proposals. In this case all of the lands covered by Devon's drilling proposals fall under the terms of the JOA. The Division cannot perform judicial function of determining property rights. See, Continental Oil Co. v. Oil Conservation Comm., 373 P.2d 809, 818–19 (N.M. 1962).

Obviously, the issue of whether the JOA may be enforced or is in effect has to be a judicial function. Certainly, Devon cannot unilaterally decide that it does not like the terms of the JOA, which binds all working interest owners, and therefore set it aside. Devon cannot come to the Division and file an application knowing that the JOA was in effect at the time of its assignment from OXY and represent that Allar is a non-consenting interest owner. Discussions over the JOA had occurred between Devon and Allar after Devon's well proposals were made to Allar. A concern of Allar under the orders is its inability to evaluate well performance of wells as they are drilled before payment requirements on subsequent wells are due. The JOA allows for such evaluation.

There is no question but that the JOA encumbers Sections 23 and 26 through which Devon's proposed wells will be drilled.

Nearburg v. Yates Petroleum Corp., 123 N.M. 526, 529, 943 P.2d 560, 563, 1997 - NMCA- 069 said the following with respect to operating agreements:

> Operating agreements are commonly used in the oil and gas industry in New Mexico and other producing states to set forth the arrangement between interest owners as to exploration and development of jointly owned interests. *See generally* Gary B. Conine, *Property Provisions of the Operating Agreement—Interpretation, Validity, and Enforceability,* 19 Tex.Tech L.Rev. 1263, 1265 n. 3 (1988) [hereinafter Conine, *Property Provisions*] (citing numerous articles on operating agreements). (emphasis added).

There is no direct New Mexico case authority that has determined the issue with which we are confronted. However, an Oklahoma case, NBI Services, Inc. v. Corp. Commn. of State, 241 P.3d 685, 689–90 (Okla. App. Div. 2, 2010) considered a similar case. We quote liberally from that case:

> In *Tenneco Oil Co. v. El Paso Natural Gas Co.,* 1984 OK 52, 687 P.2d 1049, the Oklahoma Supreme Court "stated that the parties to [an OCC] forced pooling order [can] flesh out that arrangement through contract," and "the parties' rights and obligations under the contract [are] a matter for determination in the district courts, the proper forum for questions dealing with the respective rights of private parties." *Samson Resources Co. v. Corporation Commission,* 1985 OK 31, ¶ 7, 702 P.2d 19, 21. In *Samson,* the parties did not "flesh out" the arrangement set forth in a forced pooling order (as occurred in *Tenneco*); instead, the spacing *690 unit in question had been developed pursuant to a voluntary pooling agreement. The Court stated that this situation "appears, even more clearly than *Tenneco,* to involve a question of private rights." *Id.* at ¶ 8. "To prevent drainage and the concomitant waste occurring in a unit in which interest owners are *not* able to come to terms regarding voluntary development, [the OCC] is empowered, upon proper application, to order those interests pooled." *Id.* at ¶ 11 (emphasis added). In *Samson,* however, because the interest owners were able to come to terms regarding voluntary development, the Court found that it was not within the OCC's jurisdiction to override such a private contractual relationship. (emphasis added).

This finding is in line with 52 O.S. Supp.2007 § 87.1(e), which states:

> When two or more separately owned tracts of land are embraced within an established spacing unit, or where there are undivided interests separately owned, or both such separately owned tracts and undivided interests embraced within such established spacing unit, the owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owners have not agreed to pool their interests and where one such separate owner has drilled or proposes to drill a well on said unit to the common source of supply, the [OCC], to avoid the drilling of unnecessary wells, or to protect correlative rights, shall, upon a proper application therefor and a hearing thereon, require such owners to pool and develop their lands in the spacing unit as a unit.

> Therefore, a pooling applicant must establish that there is no agreement among the owners of the oil and gas rights for the development of the property. Only, among other things, "[w]here ... [the] owners have not agreed to pool their interests" does the OCC have the authority to enter a forced pooling order. *Id.* (emphasis added).

It is clear that the Division in this case does not have jurisdiction to consider a compulsory pooling case when lands included in the Contract Area of the JOA are involved. The Oklahoma statute is identical to that portion of NMSA 1978, § 70-2-17 (C).

Another Oklahoma case, applying the same statute, is to the same effect that where a private contract is involved the remedy is in the district court. Chesapeake Operating, Inc. v. Burlington Resources Oil & Gas Co., 60 P.3d 1052, 1057 (Okla. App. Div. 3 2002), states:

> Burlington's underlying argument-that it should not be subject to the Commission's force pooling order and the Commission is without jurisdiction to force pool Burlington because a private agreement, the JOA, controls-is not a dispute over rights and equities of interest owners within a drilling and spacing unit "which actually affects [correlative] rights within a common source of supply and thus affects the public interest in the protection of production from that source as a whole," but a private dispute over the application and interpretation of a contract. *Samson Resources Co. v. Corporation Comm'n,* 1985 OK 31, ¶ 9, 702 P.2d 19, 22; *see also Atlantic Richfield Co. v. Tomlinson,* 1993 OK 106, 859 P.2d 1088. "[D]isputes over *private rights* are properly brought in the district court .... the [C]ommission's jurisdiction is limited to protection of public rights in development and production of oil and gas." *Leck v. Continental Oil Co.,* 1989 OK 173, ¶ 7, 800 P.2d 224, 226 (emphasis in original). Interpretation of the applicability of the JOA would be beyond the Commission's conferred jurisdiction because it concerns a dispute between private parties in which the public interest in correlative rights is not concerned. *Id.* Accordingly, Burlington's recourse properly lies with the District Court.

The Division has no jurisdiction to override a purely private contract. Issues of waste and protection of correlative rights are misplaced because they are not at issue in this case.

D. Conclusion.

Devon's mere recitals that Allar was a non-consenting working interest owner when in fact

an operating agreement was in force needs further inquiry as to whether Allar was a non-consenting interest owner. If the Division had no jurisdiction to render its orders because a private agreement existed, then the orders can have no preclusive effect on Allar. In a Fifth Circuit Court of Appeals case, Bonn Operating Co. v. Devon Energy Prod. Co., L.P., 613 F.3d 532, 533 (5th Cir. 2010), Devon enforced the provisions of a 1956 form of operating agreement, which had been executed by the parties' predecessors in interest, against another working interest. Inference can readily be made that the operating agreement ran with the land and bound the successors in interest.

Devon's cases need to be reopened for further inquiry, as to, for example, the contract area of the JOA, and more importantly, the existence of the JOA.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing pleading was electronically mailed to the following:

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on this 7th day of August, 2020.

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