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

IN THE MATTER OF THE HEARING CALLED
BY THE OIL CONSERVATION DIVISION FOR
THE PURPOSE OF CONSIDERING:

Case No. 14558
Order No. R-7900-C
De Novo

APPLICATION OF MARBOB ENERGY CORPORATION
(NOW COG OPERATING LLC) FOR VERTICAL
EXPANSION OF THE BURCH-KEELY UNIT,
EDDY COUNTY, NEW MEXICO

COG'S MOTION TO LIMIT TESTIMONY AND ARGUMENT

COG Operating LLC (COG), through its predecessor Marbob Energy Corporation (Marbob), was the applicant in this matter before the Oil Conservation Division (OCD) Hearing Examiners, and is the Operator of the Burch-Keely Unit in Eddy County, New Mexico (Unit). COG moves the Director and the Oil Conservation Commission (Commission) to strike all references made by ConocoPhillips Company (ConocoPhillips) for its proposal for a buffer zone in this Unit and prevent any testimony or argument at the upcoming hearing regarding its proposed buffer zone. COG brings this Motion because the issue of a buffer zone is not properly before the Commission at this time. In support of this Motion, COG states that the notice in this case is not sufficient for ConocoPhillip's requested relief of the creation of a buffer zone and that any proposal for a buffer zone be raised as a proposal for rulemaking.

1. This case started as a relatively simple request to extend the vertical limit of the existing Unit downward a few hundred feet to the 5,000 foot mark, which is the deepest subsurface depth owned by COG under the lands covered by the Unit. Prior to the Division

hearing, COG caused notice to be published in the form shown in Exhibit 1. A similar notice went to interest owners and to neighboring operators. Case No. 14558; Hearing Transcript; pages 12 – 13; October 28, 2010. The notices did not contain any information about a proposed buffer zone or "the depth limit equivalent to the areal spacing restraint of 330 feet above the 5,000 feet below the surface," as it is called by ConocoPhillips.

2. In this De Novo appeal of the OCD decision, ConocoPhillips inappropriately raises the issue of a buffer zone. The action by ConocoPhillips is inappropriate because no notice was provided that ConocoPhillips intended to turn this case into an effort to impose rules for vertical setbacks on wells in order to regulate hydraulic fracturing that may be conducted by a neighboring owner. The notices in this case meet the requirements for an adjudicatory hearing to extend the depth of a unit, but the notices do not advise anyone that ConocoPhillips is actually seeking what is, in effect, a new rule.

3. ConocoPhillips states in its Motion for a Partial Stay that it seeks "the depth limit equivalent to the areal spacing restraint of 330 feet...." Spacing requirements are set forth in OCD Rule Part 15. The rules require that an oil well, "shall be located on a spacing unit consisting of approximately 40 contiguous surface acres" and the well "shall be located no closer than 330 feet to the boundary of the unit." Rule 19.15.15.9A. ConocoPhillips wants to create a new requirement for spacing by having the Commission order COG that no wells may be drilled 330 feet from the vertical end of the Unit. It wants the Commission to take a rule designed to determine the surface location of a well and turn it into a rule for the total depth of a well within the Unit. Such an action by the Commission would be arbitrary and without support in the OCD Rules.

4. There is no OCD Rule providing for the depth limit restraint ConocoPhillips is advocating. Creating a buffer zone at a vertical ownership division is a novel concept rather than a matter of applying an existing rule. The proposal should go through the same process as any other rulemaking and the same process that resulted in the rules for surface locations for wells. ConocoPhillips is attempting to create a new rule without meeting any of the requirements of OCD Rule Part 3 which addresses rulemaking. 19.15.3 NMAC. Rulemaking has special notice

requirements (19.15.3.9 NMAC), a commenting process that encourages broad participation (19.15.3.10 NMAC), a process that emphasizes the input from more than just the parties to the hearing (19.15.3.11), and special rules for conducting the hearing and deliberating in public. None of these rules apply to the adjudicatory hearing scheduled for this case. This adjudicatory hearing is governed by OCD Rule Subpart 4 which provides a process that differs greatly from the process for rulemaking in OCD Rule Subpart 3. The Subpart 3 rules are designed to let all of industry and the interested public participate in the review of the proposed rule. It is virtually a certainty that if ConocoPhillips' buffer zone proposal was treated as a proposed rule many operators, in addition to COG and ConocoPhillips, and other interested persons would participate so that the Commission could hear all views before making a decision. None of the protection or opportunities of the rulemaking process is provided by ConocoPhillips' novel backdoor approach.

5. Another indication that ConocoPhillips is proposing a new rule is the fact that it does not propose to fully apply the existing OCD horizontal spacing rule as a vertical spacing rule. The 330 foot setback from the boundaries of a spacing unit for locating the well applies on both sides of the spacing unit boundary. If ConocoPhillips actually wanted to apply the concepts of the surface boundary limits to vertical boundaries it would have proposed a similar buffer for itself below the 5,000 foot mark so that none of its wells would be completed or perforated within 330 feet below the ownership dividing line. Curiously, it does not offer that reciprocity as part of its request. Instead its request is unabashedly one sided. Additionally, if ConocoPhillips were attempting to apply an existing rule it would also have to apply other OCD rules that allow wells to be drilled in nonstandard locations. Instead it appears ConocoPhillips only wants to bar COG from producing hydrocarbons from the area 330 feet above the 5,000 foot vertical ownership division. The one-sided restriction will result in either wasting the hydrocarbon resources there or allowing ConocoPhillips to drain the oil and gas from the area while COG's production from its own lands is barred and, thereby, denying COG its correlative rights to produce its share of the oil and gas resource.

6. ConocoPhillips wants to ignore the safeguards and opportunities of the rulemaking requirements. It is not equitable to enter an order such as the one sought by ConocoPhillips to

impose a new rule without following the rulemaking process. It is especially inequitable in this case because ConocoPhillips *itself* created the 5,000 foot ownership dividing line when it sold the upper area and reserved the deep zone. In 1992, Phillips Petroleum Company and Marbob, the predecessors of ConocoPhillips and COG, entered into a purchase and sale agreement. ConocoPhillips' predecessor, which was the seller, created the ownership division at the 5,000 foot mark when it assigned its interests above that mark to COG's predecessor, which was the purchaser, and as part of the transaction included language to protect its rights to drill in the area below 5,000 feet:

> V.(b) Notwithstanding anything herein, it is specifically understood and agreed that Seller retains and reserves all rights below five thousand feet (5,000') subsurface and the rights with respect to the surface for all purposes permitted by the pertinent leases of which a portion are to be conveyed to Purchaser and the right to drill through the formations being conveyed for the purposes of discovering and producing oil, gas and other minerals from the premises below the depths to be assigned: provided, however, that all operations of Seller shall be conducted in such manner so as not unreasonably to interfere with or hamper Purchaser in any present or future operations conducted by Purchaser in or upon the lands and leases in which an interest is being conveyed. Agreement of Purchase and Sale Between Phillips Petroleum Company, Seller and Marbob Energy Corporation, Purchaser Dated the 23rd Day of October, 1992 and Made Effective the 1st Day of November, 1992; pages 5 and 6.

ConocoPhillips now apparently believes it is entitled to more protection than it included in the contract for its hydrocarbons located below 5,000 feet and is not the least bit hesitant to ask the Commission nearly thirty years later for such relief, despite the obvious interference with COG's effort to produce from the area above 5,000 feet. ConocoPhillips should not be able to complain now about the results of its own actions. In fact, the Commission may be without the authority to grant ConocoPhillips the relief requested because, arguably, the action could be seen as interference with or impairment of the terms of the contract. The relief ConocoPhillips requests would amount to the Commission rewriting the terms of the 1992 contract between the predecessors of the parties to this proceeding.

7. The purpose of the setback from the boundary lines is to protect correlative rights and to promote the conservation of the oil and gas resource. The setback requirement appears to be

based on the anticipated drainage of most wells. Drainage in a vertical well is typically cone shaped and illustrated as a V-shape. That means it is wider at the top and much narrower at the bottom, but ConocoPhillips wants the wide, top protections applied to the bottom of the well. The 330 foot buffer is pulled from a rule for horizontal limits and if misapplied to vertical divisions it will be arbitrary and without a basis in rule.

8. From reading the Motion for a Partial Stay and noting the emphasized words, it appears that what ConocoPhillips really wants is to control and limit COG's hydraulic fracturing despite the fact that the Commission has not adopted any rules to limit fracturing and may continue to choose to do that. Hydraulic fracturing is not new or uncommon. It was first used in 1947 and in common usage by 1949. Today 90 percent of the oil and gas wells in the United States are completed using hydraulic fracturing. Theresa D. Poindexter, Comment, *Correlative Rights Doctrine, Not the Rule of Capture, Provides Correct Analysis for Resolving Hydraulic Fracturing Cases*, 48 Washburn L. J. 755, at 756.

ConocoPhillips expresses a concern that fractures may extend beyond ownership boundaries and on that basis wants to bar COG wells below a certain depth throughout the unit with no regard for the exact location of the well; the nature of the well, vertical or horizontal; or the conditions of the of the rock and reservoir with full consideration of the fracture pressure, fracture gradient, porosity and permeability; desired result; and other relevant factors. If these factors are to be adequately addressed to substantiate an order then ConocoPhillips should be challenging individual permits to drill because the facts will be different for each well and most certainly do not apply to all wells universally. For example, recent testimony in cases before the OCD shows the variety in fracturing results. Cory Mitchell from Mewbourne Oil Company testified that most of their fractures went up: "We think 200 to 250 feet is how much we go up. We think we go up more than we go down." Case No. 14643, Hearing Transcript, page 23. That differs greatly from the testimony of Mark Jacoby, an engineer with Burnett Oil Co. Inc., offered by ConocoPhillips' own counsel in this proceeding, who said their fractures were designed for about 500 feet, but had been known to go as far as 900 feet and communicate with another well. Case Nos. 14613 and 14647, Hearing Transcript, pages 82-83.

In the matter now before the Commission for the determination of Unit boundaries, no specific well is at issue so the facts that should be considered for a sound decision for a single

well will not be in front of the Commission. ConocoPhillips' proposal for a buffer zone in the entire Unit is, in effect, a rule when it is to be applied to all the wells in the Unit without a factual basis justifying the need for and the extent of the zone based on individual well conditions. Furthermore, without the open participation allowed for in rulemaking, the public policy considerations associated with increased production from fracturing will not be adequately examined in a case addressing only unit expansion. ConocoPhillips should be instructed to file a petition for rulemaking if it wants to proceed and allow other operators and the public to participate in the first New Mexico rulemaking proposed to limit or prohibit hydraulic fracturing.

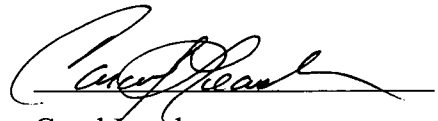
9. Public policy considerations are important in examining the impacts of hydraulic fracturing. Across the state line, the Texas Supreme Court has looked at the issues of fractures crossing ownership lines and determined that a claim for damages from drainage is not appropriate and the neighboring owner should drill offset wells to avoid drainage. See Costal Oil & Gas v. Garza Energy Trust, 268 S.W.3d 1 (Tex. 2008). In that case the fractures were designed to extend 1,000 feet and the lease line was 660 feet from the well, but the Court recognized that efforts to measure the length of fractures are imprecise. *Garza* at 7. The Texas Supreme Court justices considered a number of public policy issues in reaching their decision. The analysis focused on the fact that hydraulic fracturing prevented the waste of hydrocarbons by allowing recovery from tight reservoirs that otherwise would not be productive. *Garza* at 16-17. The majority opinion also noted nowhere in the numerous amicus curiae briefs from every corner of the industry--regulators, landowners, royalty owners, operators and fracturing service providers – no one wanted a change in the common oil and gas law as it applies to fracturing. The opinion noted that, "Though hydraulic fracturing has been commonplace in the oil and gas industry for over sixty years, neither the Legislature nor the Commission has even seen fit to regulate it, though every other aspect of production has been thoroughly regulated." *Garza* at 17. Justice Willett, in a separate concurrence, discussed the high price of crude oil and gasoline, the need for domestic production, and the revenue benefits to the state, in reaching his conclusion that, "Texas common law must accommodate cutting-edge technologies to extract untold reserves from unconventional fields." *Garza* at 29. These public policy issues are better analyzed with the input from a broad section of the industry and the public within a rulemaking case rather than from just two parties in an adjudicatory case.

CONCLUSION

There are many uncertainties involved in fracturing a well. COG has mastered enough of them to encourage drilling in the Blinebry section of the Yeso formation. The jobs associated with drilling new wells and the revenue to New Mexico are just two of the many public policy issues to consider before taking an unprecedented action to impose the restraint on drilling and production from hydraulic fracturing requested by ConocoPhillips. If the complex issues related to fracturing are to be fully considered, then ConocoPhillips' proposal for a ruling that would require a vertical buffer zone needs to be the subject of a rulemaking effort rather than reviewed in an adjudicatory hearing to address a unit expansion. The proposal to apply a surface spacing rule for locating a well to a vertical division would be a new rule and would be put into place without adequate notice or participation by interested parties. For these reasons, the Director and the Commission should advise ConocoPhillips to introduce its proposed rule to the Commission through OCD Rules Subpart 3, and not through this action and order ConocoPhillips not to raise the issue of the restraint it wants on COG drilling and production during the hearing on the expansion of the vertical boundary of this Unit.

Respectfully submitted this 16th day of June, 2011.

Beatty & Wozniak, P.C.



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ATTORNEYS FOR COG OPERATING LLC

Affidavit of Publication

NO. 21379

STATE OF NEW MEXICO

County of Eddy:

Walter L. Green Walter L. Green

being duly sworn, says that he is the **Publisher**

of the Artesia Daily Press, a daily newspaper of general circulation, published in English at Artesia, said county and state, and that the hereto attached

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was published in a regular and entire issue of the said Artesia Daily Press, a daily newspaper duly qualified for that purpose within the meaning of Chapter 167 of the 1937 Session Laws of the state of New Mexico for

1 Consecutive weeks/days on the same day as follows:

First Publication September 23, 2010

Second Publication

Third Publication

Fourth Publication

Fifth Publication

Subscribed and sworn to before me this

23rd day of September 2010

OFFICIAL SEAL
Danny Scott
NOTARY PUBLIC-STATE OF NEW MEXICO
My commission expires: 3/18/2014

Danny Scott

Danny Scott
Notary Public, Eddy County, New Mexico

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LEGAL NOTICE

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

The State of New Mexico through its Oil Conservation Division hereby give notice pursuant to law and the Rules and Regulations of the Division of the fo lowing public hearing to be held at 8:15 A.M. on October 14, 2010 in the O Conservation Division Hearing Room at 1220 South St. Francis, Santa Fe, Ne Mexico before an examiner duly appointed for the hearing. If you are an ind vidual with a disability who is in need of a reader, amplifier, qualified sign lan guage interpreter, or any other form of auxiliary aid or service to attend or pa ticipate in the hearing, please contact Florene Davidson at 505-476-3458 o through the New Mexico Relay Network 1-800-659-1779 by October 4, 2010 Public documents including the agenda and minutes can be provided in variou accessible forms. Please contact Florene Davidson if a summary or other typ of accessible form is needed.

STATE OF NEW MEXICO TO:
All named parties and persons
having any right, title, interest
or claim in the following cases
and notice to the public

(NOTE: All land descriptions herein refer to the New Mexico Principal Meridia whether or not so stated.)

CASE 14558:
Application of Marbob Energy Corporation for vertical expansion of the Burch Keely Unit, Eddy County, New Mexico. Applicant in the above-styled cause seeks an order amending Order No. R-7900-A to extend the vertical limits in the Burch Keely Unit to expand the Unitized Formation to 5000 feet. The Unit Area consists of lands in Sections 12, 13, 23 through 26 in Township 17 South, Range 29 East and Sections 18, 19 and 30 in Township 17 South, Range 30 East, NMPM, Eddy County, New Mexico. Said area is located approximately 2 miles west of Loco Hills, New Mexico.

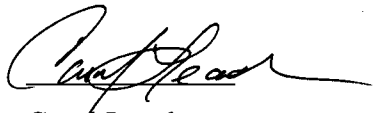
Given under the Seal of the State of New Mexico Oil Conservation Division at Santa Fe, New Mexico on this 21st day September 2010.

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION
Mark E. Fesmire, P.E., Director

Published in the Artesia Daily Press, Artesia, N.M., September 23, 2010 Legal No. 21379

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of June, 2011, I sent notice of this filing to counsel of record in this proceeding.



Carol Leach