

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

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

**APPLICATION OF SAMSON RESOURCES
COMPANY 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 13492

**APPLICATION OF CHESAPEAKE OPERATING, INC.
FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO**

CASE 13493

CHESAPEAKE'S HEARING BRIEF

Chesapeake Operating, Inc. and Chesapeake Permian, L.P. (collectively "Chesapeake") submit the following brief addressing the issues to be decided at the August 22, 2005 hearing in the above referenced cases before the Division.

INTRODUCTION AND FACTUAL BACKGROUND

This case calls for the Division to apply the Oil and Gas Act and prior Division and Commission precedent in determining whether Chesapeake's proposal for the formation of a compulsory pooling of all mineral interests from the top of the Wolfcamp formation to the base of the Morrow formation underlying the S/2 of Section 4, T21S, R35E is appropriate. Chesapeake is the current lessee of State of New Mexico Oil & Gas Lease #VO-7063-1, effective May 1, 2004, covering the SW/4 of Irregular Section 4.

The SE/4 of this section is subject to a State of New Mexico Oil & Gas Lease #B1481, effective December 19, 1932 that as of March 9, 2005 the working interest owners are Kaiser Francis Oil Company with 36.5625% interest, Mewbourne Oil Company with a 7.1875% interest and Samson Resources Company with 6.25% interest (sometimes collectively referred to herein as "Kaiser").

On March 9, 2005, Chesapeake, by letter including an AFE, proposed the drilling of its KF State 4 Well No. 1 for an estimated completed well costs of \$2,012,000.00 to be dedicated to a standard 320-acre gas spacing unit consisting of the S/2 of this irregular section to both Kaiser Francis Oil Company and Samson Resources Company. The AFE was initially approved by Samson but Samson subsequently attempted to withdraw its approval. Chesapeake negotiated a surface damages and easement from the surface owner obtained the requisite approval from the Division to drill the well and sought further approval to form a proration unit for the well in accordance with the prior orders by the Division and Oil Conservation Commission. Specifically, the following events transpired:

- On March 10, 2005 Chesapeake staked the subject well and on March 11, 2005, obtained Division approval of Chesapeake's application for permit to drill ("APD") this wellbore.
- On April 26, 2005, Chesapeake filed its compulsory pooling application for a S/2 spacing unit to be dedicated to its K-S 4 State Well No. 1.
- On April 27, 2005, Chesapeake in accordance with the Division approval APD and in compliance with Division rules spudded the KF State 4 Well No 1 located in Unit X of this section.
- On April 27, 2005, Mewbourne filed its application to cancel Chesapeake's approval ADP docketed as Case 13492 and as an attempt to stop the drilling and as a vehicle to dispute Chesapeake's orientation of the spacing unit for the K-F State 4 Well No. 1.

- On May 2, 2005, the Director denied Mewbourne's application for an emergency order to stop Chesapeake from drilling the K-F 4 State Well No. 1.
- On May 3, 2005, the State District Court denied Samson's application, based upon a claim of trespass, for a restraining order to stop Chesapeake from continuing to drill the K-F 4 State Well No.1.
- On May 24, 2004 the Division Order R-12343-A that, among other things, denied Kaiser's joint motion to limit drilling operations for the K-F 4 State Well No.1.
- On August 9, 2005, Chesapeake completed the K-F State 4 Well No.1 and there is every indication that it will be a commercial well.

At all times, Chesapeake has conducted its operations in good faith and has complied with the Division's orders and subpoena and voluntarily produced information to Kaiser. By contrast, Kaiser Francis has made unfounded accusations against Chesapeake and filed frivolous motions before the Division in an effort to avoid a decision on the merits. The Division should reject Kaiser's efforts to consider the false issue of whether Chesapeake committed a trespass in this proceeding. Instead, all relevant evidence necessary to decided issues properly within the Division's jurisdiction will demonstrate that the Division acted properly in issuing the APD to Chesapeake and allowing the continued drilling, thereby allowing the Division to consider the matters with the benefit of data developed from the drilling and completion of the well.

Now that the well has been completed it is clear that Chesapeake's proposal for the orientation of the spacing unit is superior the competing proposal by Kaiser. Accordingly, the Division should deny Kaiser's application to revoke Chesapeake's APD for the well and grant Chesapeake pooling application and assess an appropriate risk penalty allowing Chesapeake to recover the costs of drilling the well.

I. THE COMMISSION'S RULING IN *PRIDE* CONCLUSIVELY ESTABLISHES THAT CHESAPEAKE HAD THE AUTHORITY REQUIRED TO CONDUCT DRILLING OPERATIONS.

Chesapeake obtained a valid permit to drill this well from the Division and has dedicated to this well a standard spacing unit consisting of the S/2 of Irregular Section 4, T21S, R35E. *See* API # 30-025-37129. In accordance with Division rules and the Oil & Gas Act, Chesapeake commenced drilling of this well prior to obtaining a compulsory pooling order. Chesapeake's conduct was in conformity with New Mexico precedent, as determined by the Commission in the *Pride* case.

In *Pride*, the Division determined that "the compulsory pooling statute NMSA 1978, 70-2-17) provides sufficient flexibility to allow the operator of a pooled unit to conduct operations anywhere on that unit, *regardless of whether the owner of the land on which the well is located has consented thereto.*" *See* Order R-12108, findings (18), (19) and (23) (Emphasis added). Thus, Division's order in *Pride* gave Chesapeake ample authority for drilling the KF State conducting the operations at issue here.

In the *Pride* case, the Division allowed Pride to: (1) re-enter a well on the Yates tract in which Pride had no interest; (2) compulsory pool a stand-up W/2 spacing unit dedicated to this well even though Yates had previously formed a lay-down N/2 spacing unit in which Pride had no interest; (3) compulsory pool Yates into the Pride spacing unit even though Yates had formed a voluntary spacing unit that require no compulsory pooling order; (4) change the orientation of Yates' spacing unit; and (5) cause Yates' approved APD to be revoked and to obtain an approved APD for Pride reinstated.

On rehearing, the rule established by the Commission in the *Pride* case in the Commission's December 9, 2004 order was:

[a]n owner who would have a right to drill at its proposed location in the event of a voluntary or compulsory pooling of the unit it proposes has the necessary good faith claim of title to permit it to file an APD even though it has not yet filed a pooling application.

Order No R-12108-C ¶8(i) (Emphasis added). Significantly the Commission's decision in *Pride* was issued several months after its decision in the *Valles Caldera* which is relied upon the Kaiser. Chesapeake clearly had a right to rely upon the Commission's most recent interpretation of the Oil and Gas Act and its establishment in that case of the requirements for establishing a good faith claim of title for the filing of an APD.

There is no material difference between what Chesapeake seeks in this proceeding and what was approved by the Division in the *Pride* case. The only difference between the two cases is that in *Pride* the Division had cancelled Pride's APD after Yates filed a competing APD for the well. Here, the Division approved Chesapeake's APD and rejected the one submitted by Kaiser. Thus, based on *Pride*, it is clear that Chesapeake had the authority to conduct the operations at issue here.

II. ISSUES SURROUNDING TITLE DISPUTES AND CLAIMS OF TRESPASS ARE BEYOND THE DIVISION'S JURISDICTION, THOUGH CHESAPEAKE'S CONDUCT HAS ALWAYS BEEN IN GOOD FAITH.

It is improper for the Division to consider issues surrounding property rights, including allegations of trespass; as such issues lie outside of its jurisdiction. Indeed, there is no New Mexico statute which confers jurisdiction upon the Division to adjudicate issues relating to trespass or title disputes, particularly *claims* of trespass or title disputes. The Division is vested with authority over the conservation of oil and gas. NMSA 1978, § 70-2-6 (1935). Such authority is not unbounded, and thus, the Division cannot rule on matters outside of its jurisdictional power. See *Continental Oil Co.*, 70 N.M. 310, 321,

373 P.2d 809, 816 (1962); *Santa Fe Exploration Co.*, 114 N.M. 103, 112, 835 P.2d 819, 828 (1992).

Trespass and title disputes do not implicate the Division's duty to prevent waste or to protect correlative rights. Rather, they involve issues of property ownership and are inherently judicial in nature. As such, matters relating to trespass and title disputes do not fall within the jurisdictional ambit of the Division. The Oil Conservation Commission's and Division's past precedent support this principle. *See* Order No. R-11700 (concluding that the Division had "no jurisdiction to determine the validity of any title, or the validity or continuation in force and effect of any oil and gas lease," leaving these issues for the District Court to decide); *Pride* ("As this Commission observed in Order No. R-11700-B... the *Division has neither the responsibility nor jurisdiction to determine whether an applicant for a permit to drill has the requisite title to the land in question.*") (Emphasis added).

Furthermore, Chesapeake has at all times acted in good faith as established by the rules and precedent of the Division and Commission. Chesapeake has 100% of the working interest ownership ("WIO") in the SW/4 of Section 5, which is 50% of the WIO in the proposed spacing unit. Prior to initiating drilling activity, Chesapeake negotiated a surface use and damages agreement with the surface owner and at all times had the surface owner's permission to enter upon the property. And, the Commissioner of Public Lands has taken the position that Chesapeake's entry onto state trusts land was not in bad faith, making clear that the SLO makes no allegation that Chesapeake trespasses onto state lands. The issue of "good faith" is therefore confined to whether Chesapeake could validly rely upon prior rulings by the OCD and OCC which have allowed an operator to

apply for an APD for well on a tract that will included in a spacing unit for the well though a compulsory pooling.

Finally, the *Pride* case stands for the proposition that Chesapeake's conduct was in good faith. In Order R-12108-A, an owner, Pride, had the right to drill at a proposed location in the event of a voluntary or compulsory pooling of the unit it proposed to dedicate to the well. As noted above, the Commission held that Pride had the necessary good faith claim of title to permit it to file an APD, even though it had not yet filed a pooling application. Chesapeake's conduct was in complete conformity with the order in *Pride*. The Division cannot, consistent with the Due Process Clause, change the rules for obtaining an APD for a well that will be forced pooled. *See, e.g., Hobbs Gas Co. v. New Mexico Pub. Serv. Comm'n*, 115 N.M. 678, 684, 60, 858 P.2d 54, 60 (1993) (regulatory body cannot, without prior notice, abruptly depart from past practice on which the regulatee has relied); *State v. Alderette*, 111 N.M. 297, 300, 804 P.2d 1116, 1119 (Ct. App. 1990) (The Due Process Clause prevents retroactive application of a changed construction of a statute and that application of the new construction must be prospective only).

Because it has no jurisdiction to hear claims involving property rights, all evidence regarding Kaiser's allegations of trespass should be excluded from the hearing. However, to the extent the Division intends to hear argument on this issue, the weight of the evidence establishes that Chesapeake possessed the requisite good faith when it proposed and was granted its APD for the well and has acted in good faith at all times.

III. THE EVIDENCE WILL DEMONSTRATE THAT CHESAPEAKE'S PROPOSAL FOR A LAY DOWN SPACING UNIT IS SUPERIOR TO KAISER'S PROPOSAL

Section 4 is an Irregular Section containing 960 and consists entirely of lands leased by the Commissioner of Public Lands ("SLO"). Chesapeake's proposed orientation for the spacing unit is for a lay down unit in the S/2 while Kaiser's proposal is for a stand up unit containing lots 9, 10, 15, 16, and the SE/4 (hereafter referred to as "E/2") of Section 4. Regardless of the orientation, the royalty interest of the Commissioner of Public Lands is unaffected and although Kaiser has attempted to inject the false issue of trespass in this proceeding, the Commissioner of Public Lands has stated his position that:

The SLO does not believe that this entry onto State Trust Lands by Chesapeake was in bad faith and understands that issues pertaining to the configuration for the spacing unit for this well will be resolved in the proceedings pending in the Oil Conservation Division. As expressed at our meeting the Land Office believes that geology should solely dictate the correct spacing and all the parties will have their opportunity to be heard at the Oil Commission proceeding.

The geologic evidence will demonstrate that the K-F State 4 Well No.1 will likely be a commercial well, is in communication with the same geologic formation as the Osudo No. 9 well which presents the risk of drainage to lands in the S/2 of Section 4. The geologic evidence demonstrates that the greatest potential for commercial production lies in the lay-down unit proposed by Chesapeake. By contrast, there is no indication that there are commercial sands to the north in the same zone that would support the orientation of the standup unit proposed by Kaiser. As such, the lay down unit proposed by Chesapeake offers the greatest opportunity to protect correlative rights, prevent drainage and ensure that the reservoir is efficiently developed.

CONCLUSION

Chesapeake respectfully requests that the Division: (1) deny the Application by Kaiser seeking to cancel Chesapeake's APD for the KF 4 State No. 1 well; (2) approve the spacing unit for the well proposed by Chesapeake; (3) grant Chesapeake's Application for compulsory pooling of all mineral interests from the top of the Wolfcamp formation to the base of the Morrow formation underlying the S/2 of Section 4, T21S, R35E to form a standard spacing unit for the well; and (4) set appropriate allocations of the costs of drilling the same with a 200% risk penalty.

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WE HEREBY CERTIFY that a true and correct copy of the foregoing pleading was hand- delivered to the following counsel of record this 22nd day of August, 2005:

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