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

APPLICATION OF COG OPERATING LLC FOR COMPULSORY POOLING, LEA COUNTY, NEW MEXICO.

Case No. 22474 (*De Novo*) OCD Case No. 22294

COG OPERATING LLC'S CLOSING STATEMENT

COG Operating LLC ("COG") submits its closing statement in accordance with the Oil Conservation Commission's ("Commission") request at the April 14, 2022 hearing.

I. INTRODUCTION

COG's Application seeks an order pooling uncommitted interests in the Wolfbone Pool underlying a 960.16-acre standard horizontal spacing unit ("Unit") that includes six wells, two of which are proximity tract wells located within 330' of the internal quarter-quarter section lines. At the *de novo* hearing in this matter, COG presented unrebutted expert testimony that its proposed Unit will best protect correlative rights and prevent surface, environmental, and economic waste in accordance with the requirements of the Oil and Gas Act ("Act") and Oil Conservation Division ("Division" or "OCD") regulations. COG also explained that the Act, the Horizontal Well Rule,[1] and controlling Division precedent authorize operators to incorporate acreage from multiple proximity tract wells into a standard horizontal spacing unit.

The Division did not present testimony at the hearing and opposes COG's Application based entirely on legal grounds. OCD argues that Section 70-2-17(B) of the Act only authorizes spacing units that can be drained by one well and that the proximity well provision of the Horizontal Well Rule, 19.15.16.15(B)(1)(b) NMAC ("Proximity Well Rule"), only authorizes operators to incorporate acreage from one proximity tract well into a standard horizontal spacing

[1] 19.15.16.15 NMAC.

unit. But Section 70-2-17(B) of the Act applies to proration units rather than horizontal spacing units, and the Division's interpretation of the Proximity Well Rule is inconsistent with the Act, the purpose and language of the Rule, and its own precedent. The Division's arguments should be rejected, and COG's Application should be approved.

II. ARGUMENT

A. COG's unrebutted technical evidence established that the proposed Unit will best protect correlative rights and prevent surface, economic, and environmental waste.

At the hearing, COG demonstrated though unrebutted expert land, geology, and engineering testimony that the proposed Unit will best protect correlative rights and prevent surface, economic, and environmental waste. New Mexico law defines "correlative rights" as:

> The opportunity afforded, as far as it is practicable to do so, to the owner of each property in a pool to produce without waste the owner's just and equitable share of the oil or gas in the pool, being an amount, so far as can be practically determined, and so far as can be practicably obtained without waste, substantially in the proportion that the quantity of recoverable oil or gas under the property bears to the total recoverable oil or gas in the pool, and for the purpose to use the owner's just and equitable share of the reservoir energy.[2]

The Oil and Gas Act defines "waste" to include waste of surface or mineral resources, including "the inefficient, excessive or improper, use or dissipation of the reservoir energy . . . and the locating, spacing, drilling, equipping, operating or producing, of any well or wells in a manner to reduce or tend to reduce the total quantity of crude petroleum."[3]

As COG's reservoir engineering witness explained, the inclusion of acreage from multiple proximity wells within a standard horizontal spacing unit enables operators to use less surface infrastructure to develop the underlying acreage, which: (1) prevents environmental waste by protecting surface resources and air quality; and (2) prevents economic waste by reducing costs.[4]

[2] NMAC 19.15.2.7.C(15).
[3] NMSA 1978, § 70-2-3.
[4] *See* COG Exh. 17; April 14, 2022 Hearing Transcript ("Tr.") at 50:6-53:12 (E. Angelos).

Specifically, COG's proposed Unit will use 21% less surface acreage and reduce greenhouse gas emission points by 50% compared to a scenario that involves multiple spacing units.[5] As a result, the proposed Unit prevents surface and economic waste and protects human health and the environment. The proposed Unit will also conserve resources and prevent waste by allowing COG to optimally develop its resources and most efficiently produce the underlying reserves.[6]

One of the main tools the Division utilizes to protect correlative rights is procedural due process, which affords affected parties notice and an opportunity to object at hearing. Here, the Division's regulations set 330 feet as the minimum setback required for any point in the completed interval of an oil well in relation to the outer boundary of the unit.[7] This requirement demonstrates that when a well complies with the setback requirement, the well will not impact offset owners and those owners have no interest that requires protection.

As COG's landman explained, COG's proposal protects correlative rights. Numerous parties located within the Unit, including experienced operators, were notified of COG's Application and none objected.[8] In addition, the Unit will not impair correlative rights in any of the offsetting tracts because COG's proposed wells comply with the Division's 330 foot setback requirement to prevent drainage of the offsetting tracts.[9] The use of standard spacing units that include multiple proximity tract wells also reduces the resources necessary for operators and the Division to file, review and monitor non-standard spacing units, commingling applications, and for operators to obtain surface use agreements. COG's unrebutted evidence established that the

[5] *Id.*
[6] *See* COG Exhs. 12-16 and 18; Tr. at 53:20-56:11 (E. Angelos).
[7] 19.15.16.C.1 NMAC.
[8] COG Exhs. 1-9; Tr. at 21:12-23:11 (M. Solomon).
[9] Tr. at 25:16-27:17, 32:25-33:17, 38:4-18, 40:3-9 (M. Solomon); Tr. at 56:12-57:5, 67:7-18 (E. Angelos).

proposed Unit will best protect correlative rights and prevent surface, environmental, and economic waste.

B. The Division's argument that a spacing unit can only contain one proximity tract defining well is predicated on a misinterpretation of Section 70-2-17(B).

The Division argues that a horizontal spacing unit is the same as a proration unit and must be capable of being drained by only one well because Section 70-2-17(B) of the Act states: "The division may establish a proration unit for each pool, such being the area that can be efficiently and economically drained and developed by one well . . ." The Division's argument conflates proration units and spacing units, ignores that the statute is permissive, ignores that proration units apply to vertical – not horizontal – wells, and ignores its own definition of spacing unit.

The New Mexico Supreme Court has expressly held that proration units and spacing units are separate concepts under the Act and that the Division's authority to establish proration units does not limit its authority to create spacing units. As far back as 1975, in *Rutter & Willbanks Corp. v. Oil Conservation Commission*, the appellant argued that spacing units and proration units were equivalent and that the Division lacked authority under the Act to establish spacing units that do not also qualify as proration units.[10] The Court rejected the appellant's argument and held that the Division's authority to establish spacing units exists separate and apart from its authority to establish proration units. The Court also recognized that the Division's authority to establish proration units under the Act is permissive because the statute uses the term "may."[11] The Division's argument here is directly inconsistent with *Rutter* and must be rejected as a matter of law.

[10] *Rutter & Willbanks Corp. v. Oil Conservation Commission*, 1975-NMSC-006, ¶¶ 5-7, 87 N.M. 286. In *Rutter,* the Court applied the 1953 codification of the Act, but the applicable provisions are currently found in Sections 70-2-12(A)(10) and 70-2-17(B).

[11] *Id.*

The Division's interpretation of Section 70-2-17(B) also ignores that proration units were established to apply to vertical wells. Section 70-2-17(B) was adopted in 1935 and has not been amended since at least 1977, long before the development of horizontal drilling. The Division's regulations, however, affirmatively recognize the distinction between vertical and horizontal wells, the key concept being that unlike vertical wells, horizontal wells have no allowables.[12] In accordance with *Rutter,* the Division's regulations authorize the Division to establish horizontal well spacing units separate and apart from any authority to establish proration units. In fact, when the Commission amended its regulations in 2018, it adopted the following definition of the term "spacing unit":

> [T]he area allocated to a well under a well spacing order or rule. Under the Oil and Gas Act, Paragraph (1) of Subsection B of Section 70-2-12 NMSA 1978, the commission may fix spacing units without first creating proration units. See *Rutter*. . . . This is the area designated on form C-102.[13]

The Division's argument that Section 70-2-17(B) limits the Division's ability to establish spacing units is inconsistent with its own regulations.

C. The Division's narrow construction of Rule 19.15.16.15(B)(1)(b) is inconsistent with the Oil and Gas Act's fundamental requirement that the Division prevent waste and protect correlative rights.

The Division argues that 19.15.16.15(B) NMAC limits standard horizontal spacing units to those that include one proximity tract defining well because 19.15.16.15(B) NMAC states that a standard horizontal spacing unit includes tracts penetrated by "*the* horizontal oil well." Thus, the Division would require COG to seek approval of a non-standard spacing unit anytime a proposed spacing unit involves more than one defining proximity tract well even though the rule does not expressly limit the number of wells that may utilize proximity tracts or limit the number of

[12] *See* 19.15.15.14 NMAC.

[13] 19.15.2.7(S)(9) NMAC (emphasis added).

proximity tracts that can be included in a spacing unit. The Division's narrow construction of the rule ignores that the Division's regulations must be construed in conjunction with the Act and the Division's overarching obligation to prevent waste and protect correlative rights.

Under New Mexico law, the Commission must construe statutes and regulations to effectuate their purpose and avoid an absurd result.[14] In essence, statutes and regulations must be construed in accordance with their "obvious spirit or reason."[15] They are not to be given a literal or "wooden" meaning when such an interpretation is inconsistent with the purpose of the rule or statute, which in this case is to prevent waste and protest correlative rights.[16]

The Division's narrow construction of the Proximity Well Rule ignores that the rule must be construed in accordance with the Act's mandate that the Division and Commission protect correlative rights and prevent waste. In this case, the Division has not presented any evidence that construing the Rule as COG has proposed would violate correlative rights or result in waste. Rather, the Division relies on the fact that the Rule refers to "the well" instead of multiple wells. This restrictive construction of the rule ignores the Division's fundamental obligation to prevent waste and protect correlative rights because no concerns have been presented here regarding those issues.

In reality, the Division's determination that COG should seek approval of a non-standard spacing unit, which requires notice to parties in all surrounding tracts, fails to protect correlative rights.[17] In this case, that notice would not serve any legitimate purpose because COG's wells

[14] *See Quynh Truong v. Allstate Ins. Co.,* 2010-NMSC-009, ¶ 29, 147 N.M. 583; *Tolley v. Assoc. Elec. & Gas Ins. Services, Ltd (AEGIS)*, 2010-NMSC-029, ¶ 8, 148 N.M. 436.

[15] *See Baker v. Hedstrom,* 2013-NMSC-043, ¶¶ 11, 34-36, 309 P.3d 1047; *Alb. Bernalillo Co. Water Util. Auth. v. NMPRC*, 2010-NMSC-013, ¶ 51, 148 N.M. 21 (New Mexico's canons of statutory construction also govern the interpretations of administrative regulations).

[16] *See Sims v. Sims,* 1996-NMSC-078, ¶ 21, 122 N.M. 618.

[17] *See* Order at ¶¶ 7-8.

comply with the Division's 330-foot setback requirement to prevent offset drainage of surrounding tracts. As COG's landman has explained, notifying parties in the surrounding tracts – when they are not actually impacted by COG's application – harms COG's correlative rights by allowing those parties to object, and cause delay, when they have no legitimate basis to do so. Notifying parties in all surrounding tracts also consumes considerable resources because it requires operators to obtain title information regarding those tracts. COG should not be required to expend those resources when the surrounding tracts are not impacted by COG's proposed development and would not benefit from the notice anyway. It does not make sense for the Division to require notice to offset interests simply because a unit includes more than one proximity tract well, when no such notice would be required when a unit includes a single proximity tract well. If wells are at orthodox locations, neither scenario impacts the offset tracts. The Division's narrow construction of the rule elevates form over substance and is inconsistent with the Act.

D. The Division's narrow construction of Rule 19.15.16.15(B)(1)(b) is inconsistent with the purpose of the Horizontal Well Rule, which is to modernize and facilitate horizontal well development.

As discussed above, statutes and regulations must be construed as a whole to effectuate their purpose and avoid an absurd result.[18] The Division's narrow construction of the Rule would impede horizontal well development and result in waste, which is inconsistent with the purpose and language of the rule.

In 2018, the Commission modernized its horizontal well rules in response to the current and expanding technological advancements in horizontal drilling and completion operations.[19]

[18] *See Quynh Truong v. Allstate Ins. Co.,* 2010-NMSC-009, ¶ 29, 147 N.M. 583; *Alb. Bernalillo Co. Water Util. Auth. v. NMPRC*, 2010-NMSC-013, ¶ 51, 148 N.M. 21.

[19] *See, e.g., Jalapeno Corp. v. N.M. Oil Conservation Comm'n*, 2020 WL 5743659 at *6 (N.M. Ct. App., Sept. 23, 2020) (unpublished) ("In taking both [the prevention of waste and the protection of correlative rights] into consideration, members of the Commission acknowledged the need to 'adopt a horizontal rule that is designed for the

Prior to the amendments, the Division required operators to obtain approval of non-standard spacing units for horizontal wells – which is exactly what the Division proposes here. The Division amended the rules in part so that practice would no longer be necessary. In particular, the Commission recognized the production optimization and operational efficiencies achieved from the adoption of multi-well development practices such as batch drilling, pad drilling and zipper fracking.[20] The Commission intended to "further the goals of the [Oil and Gas] Act" of reducing waste and protecting correlative rights by providing operators the opportunity to simultaneously propose, drill and complete multiple wells dedicated to a spacing unit.[21] As recognized during the rulemaking, the Division proposed to amend the rule to afford operators flexibility with respect to well spacing and the drilling of horizontal wells to more efficiently produce reserves.[22] The rulemaking testimony further recognized that larger and larger units are being developed to efficiently produce reserves and that "the more the rules work in that direction, the more we're actually going to be preventing waste in a way that protects correlative rights."[23]

As part of its effort to modernize its horizontal well rules, the Commission adopted the Proximity Well Rule, which allows operators to include quarter-quarter sections or equivalent tracts in the standard horizontal spacing unit that are located within 330 feet of the proposed horizontal oil well's completed interval.[24] This rule incorporates the Commission's recognition of

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21st century,' requiring that the Commission 'consider these factory mining techniques [of drilling multiple wells simultaneously] that people are doing in other parts of the country'").

[20] *Id.*

[21] *See id.*

[22] Oil Conservation Commission Case No. 15957, *Application of the New Mexico Oil Conservation Division to Amend Rules of the Commission Concerning the Drilling, Spacing, and Operation of Horizontal Wells and Related Matters,* April 17, 2018 Hearing Tr. at 12:12-19 (D. Brooks).

[23] *Id.,* Case No. 15957, April 18, 2018 Hearing Tr. at 123:19-125:19 (R. Foppiano).

[24] 19.15.16.15(B)(1)(b) NMAC.

the additional efficiencies achieved from larger-scale, multi-well developments driven by modern drilling and completion innovations.

The revised horizontal well rules provide flexibility to adapt to current and future technological innovations and no longer limit development with arbitrary impediments like internal setbacks. In conjunction with one another, the revised horizontal well rules further the goals of the Act by affording operators the ability to choose how to best develop the underlying acreage based on technology-driven operations, thereby enhancing the protection of correlative rights and the conservation of resources. The Division's restrictive interpretation of the Rule is inconsistent with the rule's goals of modernizing development and allowing operators flexibility to choose the best development plan and should be rejected.

E. The Division's narrow interpretation of Rule 19.15.16.15(B)(1)(b) is inconsistent with its construction of other portions of the Horizontal Well Rule.

The Division has consistently construed other provisions of the Horizontal Well Rule that refer to one well as pertaining to multiple wells. For example, 19.15.16.15(A)(2) NMAC states: "*Each* horizontal well shall be dedicated to *a* standard horizontal spacing unit or an approved non-standard horizontal spacing unit, except for infill horizontal wells and multi-lateral horizontal wells . . ." Similarly, 19.15.16.15(B)(1) NMAC states, "the operator shall dedicate to *each* horizontal oil well *a* standard horizontal spacing unit…." Although a literal application of these provisions would require an operator to dedicate one spacing unit to each well, the Division has frequently approved horizontal spacing units that include multiple batch-drilled wells.[25] Thus, the Division has never construed these provisions in a manner that would require an operator to designate one well to each spacing unit.

[25] *See, e.g.,* Division Order Nos. R-21089, R-21949, R-22070, R-22071.

Likewise, the Proximity Well Rule states, "the operator may include quarter-quarter sections or equivalent tracts in the standard horizontal spacing unit that are located within 330 feet of the proposed horizontal oil well's completed interval." It would not make sense to narrowly construe this provision as allowing only one proximity tract well within a spacing unit when the Division construes the other provisions to allow multiple wells. And as discussed above, interpreting the rule in that manner does not protect correlative rights or prevent waste.

F. The Division's position conflicts with precedent that allows the use of multiple proximity wells to create a standard horizontal spacing unit.

At the hearing, COG's witnesses discussed prior orders in which the Division approved standard horizontal spacing units that incorporated proximity tract acreage from multiple wells.[26] In Order No. R-21089, the Division approved a Bone Spring 1280-acre standard horizontal spacing unit that incorporated acreage from three proximity tract wells, and in Order No. R-21055, the Division approved a Wolfcamp 900-acre standard horizontal spacing unit that incorporated acreage from two proximity tract wells. These orders demonstrate that the Division originally construed the Horizontal Well Rule as authorizing operators to incorporate acreage from multiple proximity tract wells into a single standard horizontal spacing unit.

Precedent is meaningful both to the continued practice of the Division but also for operators who spend years planning, permitting, contracting, analyzing, and preparing to develop a particular tract. Operators rely on Division orders in determining how to best develop their acreage within the confines of the Rules, balancing risk and other impediments to drilling against the benefits. In *Hobbs Gas Co. v. Public Service Commission*, the New Mexico Supreme Court held that principles of *res judicata* and equitable estoppel precluded the agency from changing its policy on a specific

[26] Tr. at 17:4-18:4, 38:20-40:1 (M. Solomon).

issue in similar factual circumstances.[27] Because the Division previously approved the type of horizontal spacing unit proposed here, it should not be permitted to reverse its position.

III. CONCLUSION

For the foregoing reasons, the Commission should issue an order approving COG's application.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 5, 2022, I caused a true and correct copy of the foregoing pleading to be electronically served on the following:

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[27] *See Hobbs Gas Co. v. Pub. Serv. Comm'n,* 1980-NMSC-005, ¶¶ 13-16, 94 N.M. 731 ("In the present case, the trial court found that the specific issue of acquisition adjustment had been dealt with by the Commission in a previous proceeding in a manner inconsistent with its theory in this case. Under the facts in this case that inconsistency was not allowed by the district court. We affirm the trial court on this issue.").