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

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

APPLIJCATION 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 NO. 13492-DeNovo

2007 APR 5 AM 9 43

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

CASE NO. 13493-DeNovo

ORDER NO. R-12343-E

APPLICATION FOR REHEARING

This Application for Rehearing is submitted on behalf of Chesapeake Operating Inc. and Chesapeake Permian, L.P. (collectively "Chesapeake") parties of record adversely affected by Oil Conservation Commission Order R-12343-E. In accordance with the provisions of NMSA 1978, §70-2-25, Chesapeake requests the New Mexico Oil Conservation Commission ("Commission") grant this Application for Rehearing in Cases 13492 and 13493 to correct erroneous findings, conclusions and order paragraphs of Order R-12343-E. In support of this Application for Rehearing, Chesapeake states:

INTRODUCTION

On March 16, 2007, the Commission entered Order R-12343-E establishing a 640-acre spacing unit for Chesapeake's KF "4" State No. 1 well ("KF-4") and designating Samson Resources Company ("Samson") as operator of the well. In doing so, the Commission arbitrarily and capriciously: (1) established a 640-acre proration unit that was requested by no one; (2) appointed an operator for the well that was requested by no one; and (3) departed from the Commission's rules and precedents in establishing the unit.

The proceeding before the Commissions in these combined cases involved an application by Chesapeake to force pool acreage in the bottom third of irregular Section 4, T. 21S, R. 35E,

NMPM, Lea County, New Mexico to form a lay-down proration unit for the KF-4 well and Mewbourne Oil Company's ("Mewbourne") Application seeking to cancel Chesapeake's APD for the KF-4 well and to designate Mewbourne as operator of the well. The parties to the proceeding before the Commission, Chesapeake, Kaiser Francis Oil Company and Samson were not provided any notice that additional acreage might be subject to pooling. Although all of the land in Section 4 is comprised of oil and gas leases issued by the State of New Mexico through its Commissioner of Public Lands, there was no evidence that overriding royalties ownership is uniform throughout Section 4 or that overriding royalty owners were notified of proceedings. There was no contention by any party or the Division that the proceedings before the Commission embraced the potential pooling of acreage beyond that requested by Chesapeake and Mewbourne in their competing applications.

Under these circumstances, the Commission's Order No. R-12343-E creating a 640-acre proration unit for the KF-4 that conflicts with the Commission's rules for the South Osudo-Morrow Gas Pool and appointing a new operator for the well and any subsequent wells was arbitrary, capricious and otherwise not in accordance with the law. The Commission should reconsider its decision and establish a spacing unit for the KF-4 which comports with the Commission's findings concerning the deposition of Morrow sands in Section 4 with Chesapeake designated as operator of the well.

GROUNDS FOR REHEARING

An order by Commission cannot stand if it is arbitrary, capricious, or an abuse of discretion; not supported by substantial evidence in the record; or, otherwise not in accordance with the law. A ruling of an administrative agency is arbitrary and capricious if it is unreasonable or without a rational basis, when reviewed in the light of the whole record. *Sierra Club v. New Mexico Mining Comm'n*, 133 N.M. 97, 61 P. 3d 806, 813 (2002). Order R-12343-E violates each of these standards in the following ways:

POINT I: THE COMMISSION'S ORDER IS ARBITRARY, CAPRICIOUS AND CONTRARY TO THE POOLING STATUTE.

"The Oil Conservation Commission is a creature of statute, expressly defined, limited and empowered by the laws creating it." *Continental Oil Co. v Oil Conservation Comm'n.* 70 N.M. 310, 373 P.2d 809 (1962). "Where rulings by administrative agencies are not in accord with the basic requirements of the statute relating to those agencies, the decision of the agencies are void." *Foster v. Bd. of Dentistry,* 103 N.M. 776, 714 P. 2d 580 (1986).

Without notice to anyone that the proceedings before the Commission involved the potential to compulsory pool an additional 320 acres of land that was neither the subject of

Chesapeake's pooling application nor Mewbourne's competing application, the Commission created a 640-acre spacing unit and designated a party as the operator that no party requested. The Commission's action is contrary to the Pooling Statute and deprived Chesapeake of its right to due process.

The Pooling Statute, NMSA 1978, §70-2-17, provides that "all orders effecting [compulsory] pooling shall be made after notice and hearing." Obviously, there was notice of the hearing the parties participated in that led to the issuance of the order, but no notice was provided of the establishment of 640-acre nonstandard spacing unit for the KF-4 well. There was no evidence presented concerning the ownership of overriding royalty owners within the additional acreage embraced by the Commission's order, the Commissioner of Public Lands was not provided with notice that additional acreage under State leases was being considered for pooling and the parties were deprived of any opportunity to present evidence as to whether a 640-acre unit, their competing 320 units or a unit embracing all or a different portion of the lands would fulfill the Commission's directive to establish a unit which best prevents waste and protects correlative rights and "will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and fair share of the oil or gas or both." *Id.*

Although the Commission is vested with discretion under the Pooling Statute, it is not free to disregard its own rules and prior decisions and cannot change its position without good cause and prior notice to the affected parties. *See Hobbs Gas Co. v. New Mexico Pub. Serv. Comm'n*, 115 N.M. 678, 681, 858 P.2d 54, 57 (1993). The Commission's decision to pool an additional 320 acres was made without ***any*** notice to the affected parties and cannot stand on that basis alone. Moreover, the legal conclusions in the Order are arbitrary and inconsistent with the Commission's prior orders. When these same facts were presented to the Division's Director, he entered Order R-12343-B, dated January 10, 2006, concluding that: "[t]he facts existing at the time of the Division's approval of Chesapeake's APD were not materially distinguishable from the facts of the Pride Case." (Case 13153, Order R-12108-C). When these same facts were presented to the Division's Director now sitting as the Chairman of the Commission, he entered Order R-12343-E concluding that these same facts are now "materially distinguishable." The facts have not changed. The law has not changed.

The Director having change his mind has also created a conflict between the order in this case and the Commission order of the *TMBR/Sharp* Case that authorized *TMBR/Sharp* to drill first and obtain a compulsory pooling order afterwards. *See* Order R-11700-B. The Order attempts to justify this contradiction by declaring "[i]t [the Pride Case] did not find that an operator could actually drill a well or acreage in which if had not interest before the Division or Commission decided a pooling application." Apparently, the Commission has forgotten its decision in the *TMBR/Sharp* Case, where it stated:

> It has long been the practice in New Mexico that the operator is free to choose whether to drill first, whether to pool first, or whether to pursue both

> contemporaneously. The Oil and Gas Act specifically permits an operator to apply for compulsory pooling after the well is drilled.
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> An operator may first apply for a permit to drill a well and may thereafter pool (on a voluntary or compulsory basis separately owned tracts to the well. Alternatively, the operator may first pool and later seek a permit to drill. The two are not mutually exclusive, and there is no preferred methodology.

Order No. R-11700-B, ¶¶34-35. The Order also ignores the fact that Chesapeake was specifically granted authority by the Division to drill the KF-4, over the objection of Mewbourne because the evidence presented that there was a threat of drainage from the Osudo No. 9 well, there was no material difference between the location for the well proposed by Chesapeake and Mewbourne, and Chesapeake had sufficient expertise and experience to drill the well.

POINT II: BY IGNORING UNCONTRADICTED ENGINEERING EVIDENCE, THE ORDER VIOLATED THE *FASKEN* DECISION

The Commission failed to make findings concerning the petroleum engineering data, findings that were necessary because they are ultimate facts that were material to the issues. *See Fasken v. Oil Conservation Commission*, 87 N.M. 292, 294, 532 P. 2d 588, 590 (1975)

This case involved a dispute between Chesapeake which sought the establishment of a 320-acre lay-down spacing unit and Samson/Kaiser who wanted a 320-acre standup spacing unit. Using the same geological data, Chesapeake and Samson/Kaiser reach diametrically opposed geologic conclusions. Chesapeake presented petroleum engineering evidence that confirmed: (1) Chesapeake's geologic interpretation was correct and (2) proved that Samson/Kaiser's geologic interpretation was wrong. Samson/Kaiser presented an argument that, at best, contended that the petroleum engineering data was insufficient to confirm either geologic interpretation. The Commission's order makes no mention of the petroleum engineering evidence that should have been used to: (1) confirm or reject the geologic interpretation of Chesapeake; or (2) confirm the Commission unilateral declaration of a non-standard 640-acre spacing unit. Having failed to enter factual findings supported by engineering evidence, the Commission's Order is fatally flawed.

The Commission's Order contains insufficient findings to disclose the reasoning of the Commission and its failure to explain the petroleum engineering evidence. Perhaps, the Commission disregarded this evidence because it is contrary to the formation of an unconventional 640-acre spacing unit. However, in doing so, the Commission has abandoned its obligation to enter an order that decided the issues presented to it based upon the evidence adduced at the hearing and arbitrarily substituted an order for a 640-acre spacing unit that is lacking evidentiary support.

POINT III: THE ORDER CONFLICTS WITH THE DIVISION'S SPACING RULES

The only basis recited in the Commission's Order for establishing a 640-acre unit is Finding ¶51 by which the Commission took administrative notice of the Division's rule for the North Osudo Morrow Gas Pool which provides for 640-acre spacing. However, Order R-12343-E provides no explanation for departing from the Division's 320-acre spacing rules for the pool that encompassed the KF-4, the South Osudo-Morrow Gas Pool. The Commission cannot modify its rules in the context of an adjudicatory hearing without providing adequate notice of the contemplated action. *Cf. Johnson v. N.M. Oil Conservation Comm'n*, 1999 NMSC 21, ¶27, 1999 NMSC 21, 127 N.M. 120, 978 P.2d 327

The Commission's decision gratuitously approved a 640-acre spacing unit that none of the parties proposed and that is contrary to the 320-acre spacing units already established by the Division's own rules for the South Osudo-Morrow Gas Pool. Under Section 70-2-23, The Commission was required to give notice of its contemplated action modifying the spacing rules for the South Osudo Morrow Gas Pool. *See* NMSA 1978, §70-2-23 ("before any rule ... including revocation, change, renewal or extension thereof, shall be made under the provisions of this act, a public hearing shall be held ... [and] the Division shall first give reasonable notice of such hearing...").

Additionally, the Commission's rules require that when a 640-acre proration unit is established for a well, it must embrace the entire government section. *See* NMAC, §19.15.8.605. (Requiring that when 640 acre proration unit is utilized "a government section shall comprise the proration unit.") Therefore, if the Commission was going to depart from its 320-acre spacing rule for the South Osudo Morrow Gas Pool and establish a bigger unit, its own rules required it to include all of the lands within irregular Section 4 in the unit. The Commission's failure to do so violated its rules and is erroneous.

POINT IV: THE COMMISSION'S ORDER CONTAINS INSUFFICIENT FINDINGS TO DISCLOSE THE REASONING OF THE COMMISSION AND IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE

The Commission's ultimate decision adopting an unorthodox 640-acre spacing unit is not supported by substantial evidence and failed to disclose the reasoning of the Commission in rejecting Chesapeake's request for the formation of a standard 320-acre lay-down spacing unit (or Mewbourne's competing stand-up unit).

"Administrative findings by an expert administrative commission should be sufficiently extensive to show...the basis of the commission's order." *Fasken*, 532 P. 2d at 590 (quoting *Continental Oil*. As in Fasken, "such findings are utterly lacking here and reversal is thereby required" Id.

The findings in Order R-12343-E do not contain the "vaguest notion of how the Commission reasoned its way to its ultimate findings." *Id.*

The Findings in this order are inadequate for they are: (1) inconsistent with the evidence presented by all parties; (2) do not disclose the Commission's reasoning in rejecting both applications is these cases for dedication of a 320-acre spacing unit, (3) disregarding the petroleum engineering evidence; and (4) arbitrarily substituting a 640-acre spacing unit that is contrary of the spacing rule for the South Osudo-Morrow Gas Pool.

POINT V: THE ORDER VIOLATES CHESAPEAKE'S CORRELATIVE RIGHTS

The Commission violated correlative rights by including a 160-acre tract in the 640-acre spacing unit that all parties considered non-productive.

Section 70-2-33(H) of the Oil and Gas Act defines "correlative rights" as:

> the opportunity afforded, as far as it is practicable to do so, to the owners of each property in a pool to produce without waste his ***just and equitable share of the oil or gas or both in the pool, being an amount*** so far as can be practicably determined and so far as can be practicably obtained without waste, ***substantially in the proportion that the quantity of recoverable oil or gas or both under the property bears to the total recoverable oil or gas or both in the pool*** and for such purpose, to use his just and equitable share of the reservoir energy;"

NMSA 1978, §70-2-33(H) (Emphasis added). Section 70-2-17(C) similarly requires that all compulsory pooling orders issued by the Division "shall be upon such terms and conditions as are just and reasonable and will afford to the owner or owners of each tract or interest in the unit the opportunity to recover or receive without unnecessary expense his just and far share of the oil or gas or both."

Therefore, by including a 160-acre unproductive tract in the Commission's 640-acre unit the Commission's Order R-12343-E violates these directives of the Oil and Gas Act. As much as the Commission may wanted to avoid the task of determining whether a 320-acre standup (Samson/Kaiser's proposal) or a 320-are laydown unit (Chesapeake's proposal) was best fulfilled the requirements of Section 70-2-17(C), there was no evidence introduced to support the Commission arbitrary creation of a 640-acre that gives Samson a windfall at the expense of all the other working interest owners. .

Samson's interest in the Commission's 640-acre spacing unit is 53.125% while its share would be 6.25 of a laydown or 56.25% of a stand-up. Correspondingly Chesapeake's share of a

640-acre is 25% while its share would be 50% of a laydown and -0-% of a standup. The Commission has violated the correlative rights of Chesapeake by issuing an order that is arbitrary, capricious and unreasonable.

POINT VI: THE ORDER WILL CREATE WASTE

The Commission has created a 640-acre spacing unit that obligates the parties to "deal" with 4 wellbores. Ordering Paragraph (2), page 8, Order-12343-E. By doing so, the Commission's order will cause waste—waste by requiring the parties to either pay for and participate in additional wells or have their share of production used to pay for wells that are not necessary. *See* Rule 19.15.1.7 (W)

CONCLUSION

In entering Order R-12343-E establishing a 640-acre spacing unit for the KF-4 well and designating Samson as operator of the well, the Commission acted arbitrarily, capriciously and violated Chesapeake's correlative rights and right to due process. The Order is not supported by substantial evidence, and is contrary to the Pooling Statute, the Commission's rules and prior precedents. The Commission should therefore reconsider its decision and grant Chesapeake's Application for the establishment of 320-acre lay-down proration unit for the KF-4 and designating Chesapeake as operator of the well.

Respectfully submitted,

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WE HEREBY CERTIFY that a true and correct copy of the foregoing pleading was transmitted by facsimile to the following counsel of record this 5thday of April, 2007:

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