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

CASE NO. 14323 (DeNovo)

Order R-13154-A

APPLICATION OF CHESAPEAKE ENERGY CORPORATION FOR CANCELLATION OF A PERMIT TO DRILL ("APD") ISSUED TO COG OPERATING L.L.C., EDDY COUNTY, NEW MEXICO
(Blackhawk "11" Fed Com No. 1-H)

CASE NO. 14382

APPLICATION OF CHESAPEAKE ENERGY CORPORATION FOR CANCELLATION OF A PERMIT TO DRILL ("APD") ISSUED TO COG OPERATING L.L.C., EDDY COUNTY, NEW MEXICO
(Blackhawk "11" Fed Com No. 2-H)

CASE NO. 14365 DeNovo
Order R-13155

APPLICATION OF COG OPERATING LLC FOR DESIGNATION OF A NON-STANDARD SPACING UNIT AND FOR COMPULSORY POOLING EDDY COUNTY, NEW MEXICO
(Blackhawk "11" Fed Com No. 1-H)

CASE NO. 14366 DeNovo
Order R-13155

APPLICATION OF COG OPERATING LLC FOR DESIGNATION OF A NON-STANDARD SPACING UNIT AND FOR COMPULSORY POOLING EDDY COUNTY, NEW MEXICO
(Blackhawk "11" Fed Com No. 2-H)

CHESAPEAKE ENERGY CORPORATION AND
CHESAPEAKE OPERATING, INC.'S PREHEARING STATEMENT

Chesapeake Energy Corporation and Chesapeake Operating, Inc. (collectively "Chesapeake") submits this Prehearing Statement in accordance with Rule 19.15.14.1211(B) NMAC of the New Mexico Oil Conservation Commission.

I. APPEARANCES OF THE PARTIES

APPLICANT in Case 14382 OPPONENT in Cases 14365 & 14366 Chesapeake Operating, Inc. 6100 N. Western Ave Oklahoma City, OK 73118	ATTORNEY Thomas Kellahin, Esq. Kellahin & Kellahin P. O. Box 2265 Santa Fe, NM 87504 (505) 982-4285 and Earl E. DeBrine, Jr., Esq. Modrall, Sperling, Roehl, Harris & Sisk, PA P. O. Box 2168 Albuquerque NM 87103 (505) 848-1800
OPPONENT in Case 14382 APPLICANT in Case 14365 and 14366 COG Operating, LLC	ATTORNEY J. Scott Hall, Esq. Montgomery & Andrews PA P.O. Box 2307 Santa Fe, NM 87504-2307 (505) 988-4421
INTERESTED PARTY Devon Energy Production Company, LP	ATTORNEY James Bruce, Esq. P. O. Box 1056 Santa Fe, NM 87504 (505) 982-2043

II. CHESAPEAKE'S STATEMENT OF THE CASE

These combined cases involve COG Operating LLC's filing a false certification on Division Form C-102 in order to obtain approval to drill two horizontal wells at a surface location without having a mineral interest or contractual right to drill therein. COG's APDs for these two horizontal wellbores at issue are as follows:

a. About April 30, 2008, COG Operating, LLC filed an application for permit to drill ("APD") with the Bureau of Land Management-Roswell that were approved on August 4, 2008 for the Blackhawk "11" Federal Coin Well No. 1-H, (API # 30-015-36541) a horizontal wellbore with a surface location in Unit M and a subsurface ending location in Unit P of Section 11, T16S, R28E, Eddy

County and to be dedicated to a non-standard 160-acre spacing unit consisting of the S/2S/2 of this section.

b. About February 27, 2008, COG Operating, LLC filed an application for permit to drill ("APD") with the Bureau of Land Management-Roswell that were approved on May 22, 2008 for the Blackhawk "11" Federal Corn Well No. 2-H, (API # 30¬015-37106) a horizontal wellbore with a surface location in Unit K and a subsurface ending location in Unit I of Section 11, T16S, R28E, Eddy County and to be dedicated to a non-standard 120-acre spacing unit consisting of the NE/4SW/4 and N/2S/2 of this section.

At the time COG Operating filed its applications for permit to drill both the Blackhawk"11" Federal Corn Well No. 1-H, (API # 30-015-36541) and the Blackhawk "11" Federal Com Well No. 2-H (API # 30-015-37106), both in Section 11, T16S, R28E, COG did not have any interest in the oil & gas minerals under the surface location for either wellbore. Chesapeake is the current operator of the SW/4 of Section 11, T16S, R28E which is subject to a Joint Operating Agreement (AAPL form 610-1989) dated January 26, 1998, and successor to Penwell Energy, Inc. as the original operator of a Contract Area including all of Section 11, T16S, R28E, Eddy County, NM such that the working interest owners for the SW/4 of Section 11 are Chesapeake with 56.18%; Devon with 43.75% and MacDonald with 00.07%.Chesapeake's case to cancel COG's other APD for the Blackhawk "11" Federal Corn Well No. 2-H was filed August 11, 2009 and because it involved the same issues was placed on the Commission's docket to be heard with the de novo hearing of Case 14323.

More than one year after obtaining approval of this APDs, COG Operating filed its compulsory pooling applications but did so without first proposing either wellbore to Chesapeake and the other affected working interest owners within these non-standard spacing units. Only after Chesapeake had filed its application to cancel COG's APD for the Blackhawk "11" Federal Corn Well No 1-H did COG Operating file its compulsory pooling applications.

By Order R-13155, dated August 11, 2009, the Division granted Chesapeake's motion to dismiss because COG had prematurely filed its compulsory pooling application without first providing a written well proposal letters and AFEs to Chesapeake and the other working interest owner By Order R-13154-A, dated September 23, 2009, the Division granted CHK's application and cancelled COG's APD for the Blackhawk "11" Federal Com 1-H well finding that COG did not have any oil and gas ownership in two of the 40-acre tracts of the proposed 160-acre non-standard spacing units to be pooled.

At the time OCG filed its APDs, the Division Form C-102 attached to the APDs contained the following certification:

> I hereby certify that the information contained herein is true and complete to the best of my knowledge and belief, and that this organization either owns a working interest or unleased mineral interest in the land including the proposed bottom hole location or has a right to drill this well at this location pursuant to a contract with an owner of such a mineral or working interest, or to a voluntary pooling agreement or a compulsory pooling order heretofore entered by the division.

The Commission has previously ruled that an operator seeking to obtain an APD must certify to the Division that it either owns an interest in the land, including the bottomhole location of the proposed well or has a right to drill under a contract with a working interest owner who owns the subject interest, a voluntary pooling agreement or compulsory pooling order. *See* Order R-12343-E, dated March 16, 2007 entered in the *Chesapeake v. Samson, et al*, combined Cases 13492 and 13493 (DeNovo). To ensure that operators would not obtain APDs until they had reached a voluntary agreement or obtained compulsory pooling orders consolidating all of the acreage in the spacing unit, the Commission directed the Division to maintain a recent change to the operator's certification under Division form C-102, ruling:

> 33. To prevent further misunderstandings in the interpretation of the Commission's orders, particularly in Case No. 13153, *Application of Pride Energy Company, etc.*, Order No. R-12108-C and *Application of TMBR/Sharp, Inc.*,

> Order R11700-B, the Commission approves of the language on Division Form C-102, field 17, concerning the operator's certification and asks the Division to continue its use and to notify the Commission if it plans to discontinue its use. That certification states **"I hereby certify that the information contained herein is true and correct to the best of my knowledge and belief and that the organization either owns a working interest or unleased mineral interest in the land, including the proposed bottomhole location, or has a right to drill this well at this location pursuant to a contract with an owner of such mineral or working interests or in a voluntary pooling agreement or compulsory pooling order hereto entered by the Division**".

Order No. R-12343-E, p.6 (emphasis added). The Commission further determined that "[a]n operator **shall not file an application for a permit to drill or drill a well unless it owns an interest in the proposed well location or has a right to drill the well as stated in Division Form C-102**." *See* Order R-12343-B, Finding ¶14 (emphasis added).

Despite this clear precedent, COG filed APDs which falsely certified that it owned an interest in each of tracts that would be penetrated by the wellbores for the Blackhawk 11 Federal Com 1 and 2H wells. Before the Division, it tried every conceivable tactic to cover its tracks but the Divison by Order No. R-13154-A in Case No. 14323 granted Chesapeake's application, finding:

> This case is controlled by the decision of the Oil Conservation Commission ("the Commission") in Order No. R-12343-E. ... Although Order No. R-12343-E concerned, and the certification language it approved for APDs was drafted with reference to, a vertical well, the same concerns that evidently prompted the Commission's approval of this certification language apply equally to horizontal well. ... COG now has an approved APD which, under applicable Division rules, authorizes it to proceed at any time to drill the proposed well and complete it in all four of the units included in the proposed project area even though it owns no interest in the oil and gas in two of those units. If COG were to do this prior to obtaining voluntary or compulsory pooling, it would undoubtedly constitute a trespass under applicable property law, and it would pre-empt the Division's authority to determine the configuration of any compulsory pooled unit by confronting the Divison with a *fait accompli*.

Order No. R-131454-A, Findings¶¶8, 9, 10.I

Subsequent to the Examiner's hearing, by letter dated September 23, 2009, COG Operating claimed that it cured the fraudulent certification by obtaining a signed AFE more than one year after it had used the C-102 for the APD approval process and that this should apply retroactively to fix the flawed certifications. However, COG's false certification cannot be cured after the fact by securing the signing of an AFE for well from a person who owned a 00.07% interest who was already a party to a JOA and had contractually assigned the developments rights to the lands covered by the JOA to Chesapeake. McDonald's election to join in the COG wellbore is a nullity because Chesapeake has exclusive control of these rights.

MacDonald did not have the right to sign COG's well proposal letter because he relinquished his executive rights and operating rights which are controlled by Chesapeake as the operator under the JOA. Article V of the JOA states "A. Designation and Responsibilities of Operator. Operator "shall conduct and direct and **have full control of all operations on the Contract Area as permitted**...." (Emphasis added). MacDonald no longer had the ability to sign a third-party well proposal for a wellbore to be located within the Contract Area of CHK's JOA.

If MacDonald desired for a well to be drilled in the S/2SW/4 within the Contract Area, the JOA mandates specific procedures to be followed by nonoperators for proposing a well, including: (1) delivering written notice of the well proposal; and (2) allowing the other parties 30 days to elect to participate or go nonconsent. See JOA Article VI(B)(1). McDonald's has committed his 0.07% interest in the subject lands to be operated by Chesapeake and cannot agree to allow a third-party like COG to be the operator. By executing the JOA, each working interest owner, included McDonald, commits their interest within the Contract Area to joint operations to

be operated by CHK as the operator unless CHK relinquished its right to operate the well by electing not to participate in the well.

It has been the Division's longstanding interpretation of Section 70-2-17.0 of the New Mexico Oil & Gas Act that an applicant is first required to make a good faith effort to obtain the voluntary commitment of interests in a spacing unit before seeking their compulsory pooling. Generally, that effort is commence by sending a written well proposal letter, including an AFE that specifies the spacing unit, the well locations, estimated costs and depth and then waiting approximately 30-day thereafter before filing. The waiting period follows the industry's custom set forth in standard Joint Operating Agreements and is meaningful because it provides a period for the party to received the proposal, respond and to obtain further information from the proposing party or otherwise and then make an informed decision.

COG's actions in these cases are contrary to this practice and if allowed by the Commission will encourage COG Operating and others to use compulsory pooling as a negotiating weapon rather than as a remedy of last resort. The Division's files are replete with cases that were dismissed for the same reasons that COG's cases should be dismissed. For example, *See* NMOCD Cases 9939, 106635. 10636, 11107, 11434, 11461, 11927, 11999 and 12014.

III. RELIEF REQUESTED BY CHESAPEAKE

A. Chesapeake's correlative rights are adversely affected by COG's actions which have resulted in Chesapeake's acreage being "locked-up" for since May, 2008 some eighteen months.

B. COG's C-102 for these wellbores were improperly certified because COG Operating LLC had placed the surface location and approximately 1,604 feet of the production

interval within two 40-acre tracts of the spacing unit location in which at the time of filing COG had no interest and had not reached a voluntary agreement with Chesapeake or obtained a Division compulsory pooling order.

C. If allowed by the Commission, this will encourage COG Operating and others to obtaining an APD affecting acreage its does not control and to use it as a negotiating weapon rather than as a permit to drill **after** obtaining a appropriate agreement or compulsory pooling order.

D. It is time for the Commission to send notice to the COG Operating, including other operators, that they must not be using the APD procedure including improperly filed certification on Division Form C-102 as a strategy to block other potential operators or to control development.

E. Chesapeake believes that it is appropriate for the Commission to impose a fine upon COG Operating for its violations of the Division's "operator's certification"

IV. CONCLUSION

There is no reason for treating horizontal wellbores differently than vertical wellbore. If an operator of a horizontal wellbore at the time it files its APD proposed to combine the 40-acre tracts to be included in the non-standard unit which will be penetrated by the wellbore, the operator must certify that its owns or has a contractual right to drill in each tract. COG admittedly had not such interest when it obtained its APDs. If not, then a horizontal wellbore APD violates the very activity that the Commission was seeking to prevent when it amended the certification contained on the Division Form C-102 in a case involving a vertical wellbore.

V. PROPOSED EVIDENCE

WITNESSES	EST. TIME	NO. OF EXHIBITS
Craig Barnard (Land)	1 Hour	5
Jan Spradlin (Land)	½ Hour	1

VI. PROCEDURAL MATTERS

None anticipated.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on May 13, 2010, I hand-delivered a copy of the foregoing documents to the following:

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and mailed to the following:

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