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December 10, 2008

HAND DELIVERED

Ms. Florene Davidson
New Mexico Oil Conservation Division
1220 St. Francis
Santa Fe, NM

Re: NMOCC Case No. 14255: Application of the New Mexico Oil
Conservation Division For Adoption of an Amendment to 19.15.39,
Santa Fe, Sandoval and San Miguel Counties, New Mexico

Dear Ms. Davidson:

Enclosed for filing on behalf of Approach Operating, LLC are the original
and six copies of our Hearing Memorandum.

Very truly yours,

J. Scott Hall

JSH:kw
Enclosures

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

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**IN THE MATTER OF THE APPLICATION OF THE NEW MEXICO OIL
CONSERVATION DIVISION, THROUGH THE ENVIRONMENTAL BUREAU CHIEF,
FOR ADOPTION OF AN AMENDMENT TO 19.15.39 NMAC ADDING NEW
SECTIONS TO BE CODIFIED AT 19.15.39.9 AND 19.15.39.10 NMAC ADDRESSING
SPECIAL PROVISIONS FOR SANTA FE COUNTY AND THE GALISTEO BASIN,
SANTA FE, SANDOVAL AND SAN MIGUEL COUNTIES, NEW MEXICO**

CASE NO. 14255

HEARING MEMORANDUM

Approach Operating, LLC, through its attorneys, Montgomery and Andrews, P.A. (J. Scott Hall) submits this hearing memorandum addressing the scope and purpose of this proceeding and the authority of the Oil Conservation Commission and Oil Conservation Division to regulate the field of oil and gas exploration, drilling and production to assure the prevention of waste and protection of correlative rights, and to protect water, human health and the environment.

Approach Resources Inc., through Approach Oil and Gas Inc. and Approach Operating, LLC, is the owner of significant oil and gas lease interests and other valid existing rights in New Mexico. As such, Approach has an interest in promoting a well-reasoned, informed and balanced process for the promulgation of regulations affecting operators. In the formulation and implementation of its regulatory scheme it is important that New Mexico strive for predictability, reliability and uniformity. Piecemeal regulation is to be avoided to the greatest extent possible.

As discussed below, the State dominates this technically complex regulatory field. Its authority is well established and its regulatory powers are applied based on extensive professional experience. Any perceived need to change the established regulatory scheme is best

accomplished through the existing processes of the state. The participation of all interested parties should be accommodated, beginning with meaningful consultation with stakeholders and continuing through an orderly hearing process.

The Proceeding

This proceeding had its genesis in concerns raised by area residents and state and local officials over the prospect of oil and gas exploration efforts in an area experiencing suburban and ex-urban population growth that had in the past had seen only limited E&P activity. In response, the established administrative processes of the State were triggered.

By Executive Order 2008-038, the Division was directed to do the following:

The Oil Conservation Division shall investigate and begin drafting, if appropriate, rules, regulations and statutory changes, including but not limited to (1) permitting by area, (2) the allowance of notice and public input for all applications for permits to drill, and (3) the adoption of special rules concerning the Galisteo Basin, all in an effort to protect this fragile and ecologically sensitive area.

Subsequently, on November 10, 2008, the Application was filed in this matter and Rule 19.15.39.9 was first proposed. In its Application, the Division stated “[t]he goal of [the] proposed rule is to establish a new process for evaluation and regulating exploration and development in Santa Fe County and the Galisteo Basin that meets the directive of Executive Order 2008-038.” The statutory and regulatory framework for the Division to do so is discussed by the Energy, Minerals and Natural Resources Department in its contribution to the *Galisteo Basin Report* (OCD Exhibit 20). The Department makes clear that the authority for the State to occupy this regulatory field is broad and that its regulatory scheme is comprehensive, citing the Oil and Gas Act,¹ the Water Quality Act,² agency primacy over federal environmental programs

¹ NMSA 1978 §§70-2-1, *et seq.*

² NMSA 1978 §§74-6-1, *et seq.*

and case law precedent. At the same time, the Department is mindful of the Division's responsibilities under NMSA 1978 §70-2-11 to prevent waste and protect correlative rights. (*"These two mandates remain central to the OCD/OCC's function today."* OCD Ex. 20, pg. 8.) The New Mexico Supreme Court has directed that the Commission must address these statutory mandates in its orders. *Continental Oil Company v. Oil Conservation Commission*, 70 N.M. 310, 373 P.2d 809 (1962).

The Galisteo Basin Report guides the Commission accordingly: *In regulating oil and gas development, the OCD/OCC must balance the need to protect water and the environment with its statutory requirement to prevent waste and protect correlative rights. In practice this had often meant imposing additional requirements or restrictions on operators designed to protect the environment, while still allowing development.* (OCD Ex. 20, pg. 19.)

The Agency's Authority

For decades, the Commission and Division³ have regulated oil and gas drilling and production operations pursuant to the New Mexico Oil and Gas Act, Chapter 70, Article 2, NMSA 1978, and the New Mexico Water Quality Act, Chapter 74, Article 6, NMSA 1978.

No other body has been charged with the specific statutory mandate to exercise jurisdiction, authority and control over oil and gas operations in this state. *See*, NMSA 1978, § 70-2-6-A; *see also Continental Oil Co. v. Oil Conservation Commission*, 70 N.M. 310, 323, 373 P.2d 809, 817 (1962); Hence, the specific guidance provided to the Division by the Governor in Executive Order 2008-004, ¶ 7, OCD Exhibit 18. Moreover, no other body in the state possesses the requisite experience and technical expertise in geology, hydrogeology and petroleum

³ The Division and Commission have concurrent jurisdiction. NMSA 1978 § 70-2-6.

engineering necessary to address issues such as those raised in the *Galisteo Basin Report*. This view has been acknowledged by the New Mexico Supreme Court when it affirmed that NMOCD decisions are accorded special weight and credence in light of the Division's technical competence and specialized knowledge. *See, Grace v. Oil Conservation Commission*, 87 N.M. 203, 531 P.2d 939 (1975).

The jurisdiction and the authority of the Division are broad in scope, both by express legislative authorization and by the agency's own construction. Relevant to the Commission's consideration here, a number of provisions of the Oil and Gas Act directly address the concerns that gave rise to this proceeding.

Section 70-2-12(B) of the Act provides:

Apart from any authority, express or implied, elsewhere given to or existing in the Oil Conservation Division by virtue of the Oil and Gas Act or the statutes of the state, the Division is authorized to make rules, regulations and orders for the purposes and with respect to the subject matter stated in this subsection;

(2.) To prevent crude petroleum oil, natural gas or water from escaping from strata in which it is found into other strata; ...

(7.) To require wells to be drilled, operated and produced in such manner to prevent injury to neighboring leases or properties; ...

(15.) To regulate the disposition of water produced or used in connection with the drilling for or producing of oil and gas or both and to direct the surface or subsurface disposal of the water in a manner that will afford reasonable protection against contamination of fresh water supplies designated by the state engineer[.] ...[and]

(22.) To regulate the disposition of nondomestic wastes resulting from the oil field service industry, the transportation of crude oil or natural gas, the treatment of natural gas or the refinement of crude oil to protect public health and the environment including administering the Water Quality Act [Chapter 74, Article 6 NMSA 1978] as provided in Subsection E of the Section 74-6-4 NMSA 1978.

Section 70-2-11 of the Oil and Gas Act provides: “(a.) *The Division is hereby empowered, and it is its duty, to prevent waste prohibited by this act and to protect correlative rights, as in this act provided. To that end, the Division is empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purposes of this act, whether or not indicated or specified in any section hereof.*”⁴ In past cases, the Division has cited to this specific provision of the Oil and Gas Act as authority supporting the Agency’s broad construction of its powers to act as “cumulative and not exclusive”. See, Order No. R-11573-B, Case No. 12601.

The NMOCC interprets the agency’s jurisdiction to include protection of the environment in a broad sense. It is currently the agency’s view that it has the authority to address the issues of concern which precipitated this particular rulemaking. In a recent interpretation of its jurisdiction in the adoption of Rule 17, the Commission made the following findings:

“16. The Commission and the Division have the authority, pursuant to NMSA 1978 Section 70-2-12-B(15), as amended, to regulate the disposition of produced water, and, pursuant to Section 70-2-12.B(21) to regulate the disposition of nondomestic wastes resulting from oil and gas industry operations including exploration, development, production, or storage to protect fresh water, public health, and the environment.

See NMOCC Order No. R-12939; May 9, 2008.

Addressing surface land use and environmental concerns through the agency’s administrative processes is not new. It is the clear interpretation by the Division of its own authority that it can do so. The Division has previously reviewed drilling permits when questions of potential hazards from drilling and producing operations were raised by surface owners. In

⁴ See, also, NMSA 1978, § 70-2-6; “...[The Division] shall have jurisdiction, authority and control of and over all persons, matters or things necessary or proper to enforce effectively the provisions of this act”

Order No. R-12754⁵, the NMOCD addressed the adequacy of a drilling permit for a well planned by the operator in close proximity to houses, a school and a retirement home near the incorporated city limits of Hobbs. In that order, the Division made note of its authority under the Oil and Gas Act:

“(26) The New Mexico Oil and Gas Act [NMSA 1978, Section 70-2-12.B] authorizes the Division to “prevent fires”, “to require wells to be drilled, operated and produced in such manner as to prevent injury to neighboring leases or properties” and “to regulate the disposition of non-domestic wastes resulting from oil and gas production”.” Order No. R-12754.

In this same order, the Division observed that its district office “routinely approves, oversees and controls drilling and production operations within the City of Hobbs.” In approving the operator’s APD, the Division directed its district office to be the lead entity to determine the measures to be taken by the operator *“in order to protect the health and safety of the residents and the public at the vicinity of the well and production facilities, and in order to protect the surface and subsurface environment from contamination.”*

The legislative mandates, regulations and agency precedent orders make clear the scope and extent of the Division’s regulatory dominance over oil and gas drilling activities in this state.

While in this case we cannot agree with all aspects of proposed rule 19.15.39.9, Approach Operating, LLC does support the proper exercise of authority by the State through its Oil Conservation Division to make appropriate determinations whether drilling and development anywhere in the state can be conducted in a manner so that waste is prevented, correlative rights unimpaired, and that water, human health and the environment are appropriately protected.

⁵ NMOCD Case No. 13870; *Application of Quest Cherokee, LLC for Approval of an Application for Permit to Drill, Lea County, New Mexico*; May 3, 2007.

Montgomery and Andrews, P. A.



By: _____

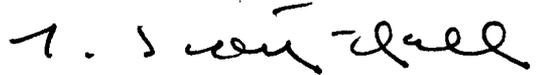
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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was faxed to counsel of record on the 10th day of December, 2008, as follows:

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