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

APPLICATION OF CHISHOLM ENERGY OPERATING, LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

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CASE NOS. 16115 & 16116

CHISHOLM ENERGY OPERATING, LLC'S CLOSING STATEMENT

Chisholm Energy Operating, LLC ("Chisholm"), by and through its undersigned attorneys, submits this closing statement in support of its applications in Case Nos. 16115 and 16116 following the hearing for these consolidated cases which were presented to a Division Examiner on Thursday, May 3, 2018.

INTRODUCTION AND BACKGROUND

As part of a complete development plan using preferred two-mile horizontal wells, Chisholm proposes two north-south wells in the E/2 of Sections 31 in Township 22 South, Range 26 East, and Section 6 in Township 23 South, Range 26 East, NMPM. The first well, which is the subject of Case No. 16115, will be dedicated to a 640-acre, more or less, non-standard spacing and proration unit comprised of the E/2 of Sections 31 and 6 in the Wolfcamp formation (Purple Sage; Wolfcamp Pool). The second well, which is the subject of Case No. 16116, will be dedicated to a 320-acre, more or less, non-standard spacing and proration unit comprised of the E/2 E/2 of Sections 31 and 6 in the Bone Spring formation.

Chisholm owns approximately 57.5 percent working interest in the proposed spacing and proration units and has obtained the voluntary commitment of 90 percent of the working interests to their proposals. The only uncommitted working interest is Premier Oil & Gas, Inc. ("Premier"), which accounts for the remaining 10 percent working interest in both proposed

spacing and proration units. However, Premier has not presented a competing well proposal, authorization for expenditure, or development plan and, after owning an interest in the acreage for approximately a decade, still has no plans to drill a well. Premier agrees that two-mile horizontal wells are the most efficient and effective means to develop the acreage, but nevertheless objects to Chisholm's plan on essentially three meritless grounds, outlined below. Chisholm's evidence and testimony, including unrebutted geologic testimony, refutes every contention. Chisholm's applications should be approved.

ARGUMENT

I. Chisholm is the Only Operator with a Complete and Formal Well Proposal, AFE, and Well Development Plan for the Subject Acreage.

Premier has owned a minority working interest in Sections 31 and the E/2 of Section 32 for approximately 10 years, but has never drilled or proposed a well in the area in all that time and has no concrete plans to do so now. Premier presented no competing well proposal, authorization for expenditure, or well development plan for the acreage. It has no rigs under contract in the area. Even after receiving Chisholm's formal well proposal and AFE in February 2018, Premier undertook no effort to formulate a competing well proposal and plan of development. Instead, it presented to Chisholm for the first time at hearing a hastily hand-drawn sketch of its preferred well-orientation and well development plan for the acreage based on speculative well cost estimates that did not appear to include all surface facilities.

In contrast, Chisholm, which owns a majority working interest in the proposed spacing units, formally proposed the two planned wells in February 2018, worked with all working interest owners on the proposed AFEs, and has obtained commitment from 90 percent of the working interests in support of its proposals. Chisholm has been running four drilling rigs in the northern Delaware Basin in New Mexico, with one of those rigs committed to drill in the

immediate vicinity of the proposed Ocotillo wells. And, Chisholm is prepared to drill the first of the two proposed wells this month.

Chisholm should be designated operator of the proposed spacing units and wells.

II. The Parties' JOA in Section 31 and E/2 of Section 32 Does Not Preclude Chisholm from Force-Pooling Premier into a Spacing Unit for which there is no Agreement.[1]

Citing only the compulsory pooling statute, Premier contends that because it is a party with Chisholm to a JOA which covers all of Section 31 and the E/2 of Section 32, Chisholm is somehow precluded from force-pooling Premier into spacing units that partially overlap the JOA but in which the parties have not agreed to combine their interests. Recent Division authority and case law directly on point refutes that contention.

The Division recently evaluated this precise issue in the context of horizontal well development and confirmed, in a case directly on point, that "[i]n the absence of an agreement as to how production from the proposed horizontal well is to be divided between the lands within and without the defined contract area, the JOA does not constitute an agreement of the parties to pool their interests in such production, and accordingly does not preclude compulsory pooling[.]" *See* Division Order R-14140, ¶ 17, attached as Exhibit A (with relevant facts and holdings highlighted). Because all mineral interests within the proposed non-standard spacing and proration units have not reached voluntary agreement to combine their interests, "the division . . . shall pool all or any part of such lands or interests or both in the spacing or proration unit as a unit." NMSA 1978, § 70-2-17(C) (emphasis added).

This same result obtains in this factually similar circumstance where, as with the facts underlying Order R-14140, the subject JOA contract area covers only a portion of a proposed spacing and proration unit, and the parties to the JOA have no agreement regarding production

[1] Chisholm adopts and incorporates its arguments and authorities raised in its Response in Opposition to Premier's Motion to Dismiss, which was filed with Division on April 30, 2018.

from outside the JOA's contract area. As in Order R-14140, Premier's interests must be pooled. This outcome is driven by the black letter law governing JOA contract areas and the facts precedent necessary to invoke the Division's pooling authority.

In general, a "JOA is designed for use by the owners of leases in a contract area for the purpose of drilling an initial well in the contract area, completing and operating such well, conducting future operations in the contract area, and marketing production therefrom." 2 Kuntz, Law of Oil and Gas § 19A.6 (2018) (emphasis added). While a JOA thus represents an agreement governing the parties within the contract area, it does not imply agreement to pool interests in a proposed spacing and proration unit covering lands overlapping with, but extending outside the JOA contract area.

In such circumstances, the Division's pooling authority is directly implicated. The Division is required to issue a force-pooling order where (1) "two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interests in oil and gas minerals which are separately owned or any combination thereof, embraced within such a spacing or proration unit"; (2) "such owner or owners have not agreed to pool their interests"; and (3) "where one such separate owner or owners, who has the right to drill . . . on said unit to a common source of supply[.]" § 70-2-17(C). Accordingly, where owners in a JOA with a contract area partially included within a proposed spacing and proration unit do not agree to pool their interests in the spacing unit, the Division "shall pool" such lands into the spacing unit to avoid drilling unnecessary wells, protect correlative rights and to prevent waste. *See id.*; *see also* William M. Kerr, Jr., *Navigating an Imperfect Oilfield: Drilling with no JOA or With Multiple JOAs*, 62 RMMLF-INST 25-1 (2016) ("[P]ooling is required and not discretionary under most compulsory pooling statutes upon a showing of the applicable elements of the statute." (emphasis added)).

The Division has fully evaluated these circumstances, and the law and authority supporting its pooling authority with respect to horizontal wells. *See* Order R-14140. The rationale, authority, and decision supporting Order R-14140 is dispositive here. In any event, "[w]here conflict exists, private contractual rights must yield to the valid exercise of the police power." Morris G. Gray and Hugh V. Schaefer, *Conflict Between Voluntary Pooling Agreements and State Spacing and Pooling Orders*, 27 RMMLF-INST 6 (1982) (citing 5 Kuntz 3 § 77.3(e)); see also Division Order R-10878 (ruling that the Division has the authority to pool all interests in a spacing unit . . . [and that] such authority supersedes any contractual agreements of the parties," in the context where a lease agreement limits pooling authority (emphasis added)).

Moreover, where a proposed spacing and proration unit includes lands outside the contract area of a JOA between parties, the failure to agree "is not a dispute over rights and equities of interest owners within a drilling and spacing unit 'which actually affects [correlative] rights within a common source of supply and thus affects the public interest in the protection of production from that source as a whole,' but a private dispute over the application and interpretation of a contract." *See, e.g.*, *Chesapeake Operating, Inc. v. Burlington Res. Oil & Gas Co.*, 60 P.3d 1052, 1057 (Okla. Civ. App. 2002);[2] *see also Samson Res. Co. v. Oklahoma Corp. Comm'n*, 742 P.2d 1114, 1116. "[D]isputes over private rights are properly brought in the district court . . . . the [C]ommission's jurisdiction is limited to protection of public rights in development and production of oil and gas." *Id.*; *see also Hartman v. El Paso Nat. Gas Co.*, 1988-NMSC-080, ¶ 30763 P.2d 1144 (recognizing distinction between "public rights vs. private rights" with respect to the Division (citing *Tenneco Oil Co.*, 687 P.2d 1049)).

[2] *See* William M. Kerr, Jr., 62 RMMLF-INST 25-1 ("*Chesapeake* strongly suggests that it is even within the power of the regulatory authority to force pool over existing operating agreements among the parties, subject of course to whatever the state courts might have to say about the parties' respective rights and obligations under their operating agreements.").

The Division thus is required to pool Premier's interests where the parties have not otherwise reached agreement to combine their interests within the proposed spacing and proration units. And, it has no jurisdiction or authority to rule that the JOA relied on by Premier precludes Chisholm's proposal to drill across and outside of a contract area subject to a JOA.

III. Premier's Support for its Preferred East-West Horizontal Well Orientation is Cherry-Picked, Distinguishable, And Unsupported by Geologic Testimony.

Premier favors a two-mile, lay-down (east-west) horizontal well orientation. It contends that Chisholm's proposed stand-up (north-south) horizontal well orientation for both wells will result in waste. In support and without the testimony of a geologist, Premier relied on outdated, cherry-picked information from distant wells in which the geology, depositional environment, formation stress profiles, and reservoir characteristics are distinguishable. Conversely, Chisholm presented unrebutted data from fully analogous north-south wells compared to east-west wells in the immediate vicinity which strongly support their preferred well orientation.

Chisholm's geologist presented unrebutted testimony and evidence that a north-south orientation is parallel to the depositional strike and will, therefore, maximize exploitation of favorable stratigraphic patterns compared to an east-west orientation. The wells and production Premier relies on in support of their preferred east-west orientation are more than 10 miles away and are in a disparate depositional setting. Moreover, the geology, stress profiles and reservoir character are demonstrably different. The wells and production data Premier contends favor an east-west orientation simply are not analogous.

In contrast, Chisholm's geologist and engineer presented testimony confirming that north-south oriented wells within the same Section in the Second Bone Spring show superior performance compared to east-west wells. These data are strong indicators for a north-south well orientation, because the depositional and stress character are not materially different from the Wolfcamp.

Premier simply has not presented evidence to support their claim that north-south wells will result in waste or will impair their correlative rights. Chisholm's evidence and testimony, much of it unrebutted, solidly refutes their claims.

IV. Premier's Environmental Concerns Are Speculative and Unsubstantiated.

Premier contends that, for various ill-defined and unsubstantiated reasons, environmental concerns relating to future proposed drilling in the W/2 of Section 31 favor an east-west horizontal well orientation to avoid rugged surface terrain and municipal freshwater wells in the SW/4 of the Section. Chisholm refuted these speculative concerns, demonstrating that the use of an existing two-track road, favorable topography, and negative VS swingout will enable effective and efficient development of the W/2 of Sections 31 and 6 while minimizing surface disturbance and environmental risks.

Since the hearing presentations, Chisholm has obtained the lease in the W/2 of Section 6. Chisholm's preferred surface locations for development of the W/2 of Section 31 and 6 is in Section 6, along existing roads and adjacent to already-approved Marathon well permits.

All of the objections raised by Premier are without merit.

CONCLUSION

For all of the foregoing reasons, Chisholm's applications should be granted.

Respectfully submitted,

HOLLAND & HART LLP

Michael H. Feldewert
Adam G. Rankin
Julia Broggi
Post Office Box 2208
Santa Fe, New Mexico 87504-2208
(505) 988-4421
(505) 983-6043 Facsimile
mfeldewert@hollandhart.com
agrankin@hollandhart.com
jbroggi@hollandhart.com

ATTORNEYS FOR CHISHOLM ENERGY OPERATING, LLC

CERTIFICATE OF SERVICE

I hereby certify that on May 21, 2018, I filed a copy of the foregoing document with the Oil Conservation Division clerk and served a copy to the following counsel of record via Electronic Mail:

Ernest L. Padilla, Esq.
Padilla Law Firm, P.A.
P.O. Box 2523
Santa Fe, New Mexico 87504
(505) 988-7577
padillalaw@qwestoffice.net

Attorneys for Premier Oil & Gas, Inc.

Adam G. Rankin

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