

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

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

CASE NO. 14418
ORDER NO. R-13228

APPLICATION OF CIMAREX ENERGY CO. FOR A NON-STANDARD OIL
SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY
COUNTY, NEW MEXICO.

ORDER OF THE DIVISION

BY THE DIVISION:

This matter came on for hearing at 8:15 a.m. on February 4, 2010, at Santa Fe, New Mexico, before Examiner Richard Ezeanyim.

NOW, on this 18th day of March, 2010, the Division Director, having considered the testimony, the record and the recommendations of the Examiner,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) Cimarex Energy Co. ("Cimarex" or "Applicant") seeks approval of a non-standard 160-acre oil spacing and proration unit and project area ("the Unit") for oil production in the Bone Spring formation consisting of the W/2 W/2 (Units D, E, L, and M) of Section 21, Township 19 South, Range 31 East, NMPM, in Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit in the Bone Spring formation in the following manner:

- (i) The NW/4 NW/4 of Section 21 from the surface to the base of the Bone Spring formation; and
- (ii) The W/2 W/2 of Section 21 from 2,500 feet subsurface to the base of the Bone Spring formation.

(3) At the hearing, the Applicant withdrew the portion of the application that sought the pooling of the NW/4 NW/4 of Section 21 from the surface to the base of the Bone Spring formation.

(4) The remaining Unit or project area (the W/2 W/2 of Section 21) is to be dedicated to Applicant's Penny Pincher 21 Federal Well No. 1 ("the proposed well"), a horizontal well to be drilled from a standard surface location 660 feet from the North line, and 990 feet from the West line (Unit D) of Section 21. The well will penetrate the Bone Spring formation at a standard oil well location 660 feet from the North line and 990 feet from the West line (Unit D), and continue South horizontally in the Bone Spring formation to a standard terminus, or bottomhole location, 330 feet from the South line and 330 feet from the West line (Unit M) of Section 21.

(5) The spacing in this area is governed by statewide Rule 15.9.A, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section. The Unit or project area consists of four adjacent quarter-quarter sections.

(6) Applicant appeared at the hearing through counsel and presented the following testimony:

- (a) Cimarex acquired interest in the N/2 of Section 21 by a farm-out Agreement from Devon Energy Production Company, but does not have any interest in the S/2 of this section;
- (b) Cimarex withdrew the Application for Permit to Drill (APD) the Penny Pincher 21 Federal Well No. 1 it filed with the Bureau of Land Management (BLM), because it does not have any interest in the W/2 SW/4 of Section 21. However, the witness testified that if the Division approves the non-standard 160-acre project area in the W/2 W/2 of Section 21, then Cimarex will re-apply for the APD to drill the Penny Pincher well;
- (c) In the Second Bone Spring Sand, the orientation of the productive channels is basically North to South, and Cimarex's objective is to place the horizontal well in the thickest portion of the channels to encounter the most pay;
- (d) Experience in the area demonstrates that a 10% density porosity cut-off is necessary to be productive in the Second Bone Spring Sand, and this porosity cut-off appears to be continuous in the W/2 W/2 of Section 21 along the path of the proposed horizontal well;
- (e) All the quarter-quarter sections to be included in the Unit or project area are expected to be equally productive in the Second Bone Spring formation because the reservoir is continuous in the North-South

direction with identical pay thickness, porosity, and initial water saturation; and

- (f) Cimarex would not like to drill the well on an 80-acre project area in the W/2 NW/4 of Section 21 only because it would be uneconomic to do so.

(7) Lynx Petroleum Consultants, Inc. appeared at the hearing through legal counsel and opposed the granting of this application. The witness, Larry Scott of Lynx Petroleum Consultants, Inc., stated that he was appearing on behalf of himself, Lynx Petroleum Consultants, Inc., Marbob Energy Corporation, Harvey E. Yates Company, OXY USA, and several other interest owners which are collectively called Lynx Petroleum Consultants, Inc. et al (Lynx et al). The witness presented the following testimony:

- (i) Cimarex does not have any interest in the W/2 SW/4 of Section 21, and therefore does not have the right to form the 160-acre project area that includes the W/2 SW/4 of Section 21. In addition, Cimarex does not have the right to pool the interest owners in this W/2 SW/4 of Section 21;
- (ii) Lynx et al believes that based on the production history of the offset wells in the area, the W/2 SW/4 of Section 21 would be more prospective than the W/2 NW/4 of this section;
- (iii) There is no substantial control in this area to determine conclusively the most profitable orientation of horizontal wells. However, the witness opined that the West-East horizontal orientation will be more attractive than the North-South horizontal orientation; and
- (iv) If Cimarex's application is approved, Lynx et al would like each individual 40-acre tract tested to determine the tract contribution to the project area, and allocation of production be based on the results of those tests.

The Division concludes as follows:

(8) Lynx Petroleum Consultants, Inc. proposed a well some years ago in the S/2 of Section 21, but the Application for Permit to Drill (APD) for this well expired two (2) years ago. The well was never drilled and Lynx et al have no plans to drill a vertical or horizontal well in the S/2 of Section 21 in the immediate future.

(9) Cimarex has no interest in the S/2 of Section 21. However, it has interest in the N/2 of Section 21, and plans to drill a horizontal well in the W/2 W/2 of this Section to form a non-standard 160-acre spacing and proration unit and project area.

(10) To prevent waste and protect correlative rights, the Division must decide whether the North-South horizontal well orientation will be more productive than the West-East orientation.

(11) Only very few wells have been drilled in the vicinity of this area; therefore there is not enough geological and engineering data to determine which orientation will be more productive than the other. However, the geological and engineering analyses of this data presented by Cimarex appear to be more convincing than those presented by Lynx Petroleum Consultants, Inc. or Lynx et al.

(12) The Division has no authority to require that tests be conducted on each individual 40-acre tract and use the results of these tests to allocate production among the interest owners in the project area because NMSA 1978 Section 70-2-17 dictates that production from a compulsory pooled unit will be allocated on an acreage basis. However, the Division is charged with preventing waste and protecting correlative rights. Section 70-2-33 (H) of the Statutes defines correlative rights as follows:

“correlative rights means the opportunity afforded, so far as it is practicable to do so, to the owner 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”

(13) Based on the above analyses, the Division concludes that approval of the proposed non-standard unit or project area will enable Applicant to drill a horizontal well in the North-South orientation (W/2 W/2 of Section 21) that will most efficiently produce the reserves underlying the Unit, thereby preventing waste.

(14) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(15) Applicant is an owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

(16) There are interest owners in the Unit that have not agreed to pool their interests. There are no unlocated owners in the Unit, and there is no evidence of a title dispute.

(17) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they

may be, in the oil and gas within the Unit.

(18) Cimarex Energy Company of Colorado should be designated the operator of the proposed well and of the Unit.

(19) Any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 200% thereof as a reasonable charge for the risk involved in drilling the well.

(20) Reasonable charges for supervision (combined fixed rates) should be fixed at \$7,000 per month while drilling and \$700 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*."

IT IS THEREFORE ORDERED THAT:

(1) A non-standard 160-acre oil spacing and proration unit (the Unit or project area) is hereby established in the Bone Spring formation, consisting of the W/2 W/2 of Section 21, Township 19 South, Range 31 East, NMPM, in Eddy County, New Mexico.

(2) Pursuant to the application of Cimarex Energy Co., all uncommitted interests, whatever they may be, in the oil and gas in the Bone Spring formation underlying the Unit or project area, are hereby pooled.

(3) The Unit or project area (the W/2 W/2 of Section 21) shall be dedicated to Applicant's Penny Pincher 21 Federal Well No. 1 ("the proposed well"), a horizontal well to be drilled from a standard surface location 660 feet from the North line and 990 feet from the West line (Unit D) of Section 21. The well will penetrate the Bone Spring formation at a standard oil well location 660 feet from the North line and 990 feet from the West line (Unit D), and continue South horizontally in the Bone Spring formation to a standard terminus, or bottomhole location, 330 feet from the South line and 330 feet from the West line (Unit M) of Section 21.

(4) The operator of the Unit shall commence drilling the proposed well on or before March 30, 2011, and shall thereafter continue drilling the well with due diligence to test the Bone Spring formation.

(5) In the event the operator does not commence drilling the proposed well on or before March 30, 2011, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the unit and project area created by this order shall terminate, unless operator

appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence.

(7) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 13.9, the pooled unit created by this Order shall terminate, unless this order has been amended to authorize further operations.

(8) Cimarex Energy Company of Colorado (OGRID 162683) is hereby designated the operator of the well and of the Unit.

(9) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) After the effective date of this order, the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs").

(10) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. Pooled working interest owners who elect not to pay their share of estimated well costs as provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(11) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(12) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(13) The operator is hereby authorized to withhold the following costs and charges from production:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

(b) as a charge for the risk involved in drilling the well, 200% of the above costs.

(14) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(15) Reasonable charges for supervision (combined fixed rates) are hereby fixed at \$7,000 per month while drilling and \$700 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations*." The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

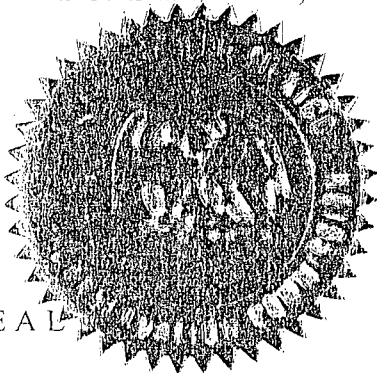
(16) Any unleased mineral interest shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(17) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this order, this order shall thereafter be of no further effect.

(18) The operator of the well and Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the forced pooling provisions of this order.

(19) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.



STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

A handwritten signature in dark ink, appearing to read "Mark E. Fesmire".

MARK E. FESMIRE, P.E.
Acting Director

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