

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

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

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

De Novo
CASE NO. 14418

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

Reopened
CASE NO. 14480

ORDER NO. R-13328-F

**CIMAREX ENERGY CO.'S
APPLICATION FOR REHEARING**

Pursuant to NMSA 1978, § 70-2-25(A) and 19.15.4.25 NMAC, Cimarex Energy Co. ("Cimarex") applies for a rehearing of these consolidated cases and requests that the Commission reconsider and reverse its initial ruling and issue a new order granting Cimarex's applications for approval of two 160-acre non-standard spacing and proration units and the pooling of all of the uncommitted working interests in the proposed non-standard units. In support of its application, Cimarex states:

1. Cimarex submits that Order No. R-13228-F is erroneous because the order: (a) arbitrarily and capriciously (i) mischaracterizes the relief requested by Cimarex in its applications, (ii) selectively cites certain testimony while disregarding other related testimony, (iii) ignores Cimarex's expert testimony addressing the homogeneity of the reserves throughout the proposed non-standard units and the efficiencies achieved by horizontal drilling, and (iv)

does not take Cimarex's correlative rights into account; and (b) is not otherwise in accordance with the law in that it (i) relies on an inapplicable statute instead of the governing pooling statute, (ii) misapplies the pooling statute, and (iii) lacks the requisite findings necessary to reveal the Commission's reasoning and the basis for its legal conclusions.

2. The order characterizes the relief requested by Cimarex as being in "the nature of unitization." *Order No. R-13228-F at 5*. However, Cimarex's applications clearly seek approvals under §§ 70-2-17 and 70-2-18. *See Applications*. Flowing from the inappropriate characterization of the relief requested by Cimarex is a misplaced reliance on the Statutory Unitization Act, which governs unitization for secondary or tertiary recovery and, therefore, has no relevance to Cimarex's applications. *Order No. R-13228-F at 5; see NMSA 1978, §§ 70-7-5 and 70-7-6*.

3. Under §§ 70-2-17 and 70-2-18, the Commission is authorized to form non-standard spacing and proration units and to pool all uncommitted working interests in the units. *NMSA 1978, §§ 70-2-17(B) and 70-2-18*. That is precisely the relief requested by Cimarex. *See Applications*. Under the New Mexico Supreme Court's interpretation of the statute, the Commission is afforded virtually unbridled discretion to grant such relief. *Rutter & Wilbanks Corp. v. Oil Conservation Comm'n*, 87 N.M. 286, 289, 532 P.2d 582, 585 (1975). Contrary to the statement in the order that § 70-2-17 "allows" for the allocation of production on a straight acreage basis, the statute unambiguously mandates that production be allocated solely on that basis. *Order No. R-13228-F at 5, ¶ 8; see NMSA 1978, § 70-2-17(C)*.

4. Apparently based on the inapplicable allocation provision in the Statutory Unitization Act, the order focuses exclusively on the correlative rights of Lynx Petroleum Consultants, Inc. ("Lynx"). The order cites at length the testimony of Lynx witness Larry Scott

regarding his estimates of the reserves in the SW/4 of Section 21, but simply ignores testimony by Cimarex's geologist, Lee Catalano, and its engineer, Michael Swain, regarding the reserves. After offering his opinions in both Examiner hearings that the reserves are substantially similar throughout the proposed non-standard units, Mr. Catalano informed the Commission that, based on his mapping, on the correlations on his cross-section, and on data from Cimarex's completed Penny Pincher Federal Com No. 1H horizontal well, his opinions regarding the homogeneity of the reserves remain unchanged. *Transcript of 11/4/10 Commission Hearing ("11/4/10 Tr.") at 34, 36; Transcript of 2/4/10 Examiner Hearing in Case No. 14418 ("2/4/10 Tr.") at 36, 37; Transcript of 6/10/10 Examiner Hearing in Case No. 14480 ("6/10/10 Tr.") at 23.* Similarly, Mr. Swain testified that the reserves are substantially similar in each quarter-quarter section. *11/4/10 Tr. at 53-54, 58, 94.*

5. For a reason that is not apparent, the Commission relied solely on the testimony of Mr. Scott, who is not a geologist and personally has never developed a horizontal well, while giving no consideration to the above-cited testimony of Mr. Catalano, an expert geologist who has evaluated the prospects for more than 100 horizontal wells, and Mr. Swain, an expert reservoir engineer who has been involved in the completion of more than 50 horizontal wells in southeastern New Mexico, that the reserves are substantially similar in each quarter-quarter section of the proposed non-standard units. *See Order No. R-13228-F at 4; 11/4/10 Tr. at 30-31 (Catalano), 94 (Swain), and 114 (Scott).* Cimarex is at a loss to ascertain whether the Commission determined that the testimony presented by Messrs. Catalano and Swain addressing the available reserves was technically incorrect, or should otherwise be disregarded, because there are no findings in the order that might reveal the Commission's reasoning. *See Fasken v. Oil Conservation Comm'n*, 87 N.M. 292, 293, 532 P.2d 588, 589 (1975).

6. The consequences of that omission are compounded by the readily apparent inconsistencies in Mr. Scott's calculations of the recoverable oil in the SW/4 of Section 21. After dismissing Cimarex's volumetric calculations as "an educated guess" because there "is no way of determining what the actual porosity is outside of the vertical wellbore," Mr. Scott proceeded to offer his belief that, based on Lynx's Exhibit No. 9, which is the confidential mudlog of the lateral portion of the Penny Pincher Federal Com No. 1H well, he believes that 70% of the reserves are in the S/2. *Order No. R-13228-F at 4, ¶26; 11/4/10 Tr. at 125; see Lynx Exhibit No. 9.* Not only is Mr. Scott's testimony internally inconsistent and contradictory, his volumetric calculation became a moving target, as he later testified that 66.7% of the pay is in the S/2 based on his interpretation of the mudlog, and that his bulk volume calculation of "a minimum of 75%" was based on his structure and isopach map. *11/4/10 Tr. at 124-25, 139.* Nevertheless, the Commission overlooked these inconsistencies in concluding, based on Mr. Scott's testimony, that Lynx's correlative rights would be violated if Cimarex's applications were granted.

7. Also omitted from the order is any mention of the unrebutted testimony by Messrs. Catalano and Swain that the horizontal drilling technique yields higher economics than the drilling of 40-acre vertical wells and captures more oil than would be recovered by individual vertical wells, and that horizontal wells in the W/2 of Section 21 will capture reserves that would not otherwise be recovered. *11/4/10 Tr. at 56 (Swain); 2/4/10 Tr. at 68-69 (Swain); 6/10/10 Tr. at 24, (Catalano) and 38-39 (Swain).* Clearly, their testimony is germane to the prevention of waste and avoidance of drilling of unnecessary wells issues that the Commission is obligated to consider and apply under § 70-2-17. *See NMSA 1978, § 70-2-17(B) and (C).* Nevertheless, these issues merit no mention in the order. *See Order No. R-13228-F (Case No. 14418) (concluding*

that the horizontal well will most efficiently produce the reserves underlying the unit, thereby avoiding the drilling of unnecessary wells and preventing waste).

8. Not only does the order omit the testimony by Messrs. Catalano and Swain regarding their steadfast opinions that the reserves are substantially similar throughout the proposed non-standard units and that the horizontal drilling is more efficient than drilling vertical wells and will capture reserves that would not otherwise be recovered, the order selectively cites to certain testimony while disregarding other testimony that either counters or provides the appropriate context for the selectively cited testimony.

9. One example of this selectivity is found in relation to the statements concerning Cimarex's development of the Penny Pincher Federal Com No. 1H horizontal well in the W/2 W/2 of Section 21. Citing to the testimony of Cimarex's expert landman, Mark Compton, the order states that Cimarex did not ask for an extension of a March 31, 2010 drilling deadline under its farm-out agreement with Devon Energy Production Company, and faults Cimarex for not drilling a well in the N/2 that would have satisfied the terms of the farm-out agreement. *Order No. R-13228-F at 2, ¶ 13.* Yet the order does not reference Mr. Compton's testimony that Cimarex would have lost its interest in the N/2 of the proposed non-standard units if it had not commenced developing the well prior to the March 31 deadline, and that Cimarex continued to develop the well after the Commission Chair denied Lynx's motion for a stay of the Division order granting Cimarex's application. *11/4/10 Tr. at 19 (Compton).* Nor does it mention Mr. Swain's testimony during the Examiner hearing in Case No. 14418 that Cimarex would not drill an 80-acre horizontal well in the N/2 because it would be uneconomic. *2/4/10 Tr. at 73 (Swain).*

10. A second example of the selective nature of the testimony cited in the order is the references to Messrs. Catalano's and Swain's testimony about the mudlog of the lateral portion

of the Penny Pincher Federal Com No. 1H well. *See Order No. R-13228-F at 3, ¶ 15.* The order correctly notes that both testified that the mudlog is qualitative rather than quantitative, i.e., the mudlog does not demonstrate that there is equal pay along the lateral. *See id.* However, the order mistakenly states that Mr. Catalano based his opinion that the pay is substantially similar throughout the proposed non-standard units on the mudlog, and that Messrs. Catalano's and Swain's opinions about the distribution of the reserves had changed after the Examiner hearings. *Id.*; *see id.*, at 3, ¶ 17. Their omitted testimony cited in ¶ 4, above, clearly indicates that the mudlog, along with other data, actually supports and confirms their unwavering opinions that the reserves are substantially similar throughout the proposed 160-acre non-standard units. As Mr. Swain testified, his Exhibit No. 14 – a digitized version of the mudlog that Mr. Scott relied on and introduced as Lynx's Exhibit No. 9 – supported his original prognosis that the reserves are substantially similar. *11/4/10 Tr. at 52-53, 94; see 6/10/10 Tr. at 52-53 (Swain); see Cimarex Exhibit No. 14.* Mr. Catalano similarly testified that Cimarex Exhibit No. 14 confirmed, rather than refuted, his earlier conclusion that there is essentially equal pay throughout. *11/4/10 Tr. at 36.*

11. Yet another example of selective references to the hearing testimony is the order's citation to Mr. Scott's belief that the granting of Cimarex's applications would result in waste because the proposed horizontal wells would prevent the development of other minerals in the S/2 of the proposed 160-acre non-standard units. *Order No. R-13228-F at 4, ¶ 29.* Yet Mr. Scott acknowledged that even if Cimarex's applications were granted, Lynx would not be prevented from drilling its own horizontal well in another trend and thereby recover reserves in the S/2 of the proposed non-standard units. *11/4/10 Tr. at 142.*

12. The order does not acknowledge, much less consider, Cimarex's correlative rights. *See Order No. R-13228-F at 4-6.* The record demonstrates that Cimarex holds 81% of the working interests in the N/2 of the W/2 of Section 21, and 52.5% of the working interests in the S/2, or a total of 66.6% of the working interests throughout the proposed non-standard units. *11/4/10 Tr. at 12, 19 (Compton); 6/10/10 Tr. at 72-73 (Compton).* Despite this undisputed evidence, the order contains no findings that might indicate that the Commission calculated the amount of recoverable oil in the proposed non-standard units or the extent of the parties' respective correlative rights, or even considered Cimarex's majority working interests or the impact of its ruling on Cimarex's correlative rights. *NMSA 1978, § 70-2-33(H) (addressing Cimarex's right to produce without waste its just and equitable share of the oil in the proposed non-standard units); see Fasken, 87 N.M. at 294, 532 P.2d at 590; Continental Oil Co. v. Oil Conservation Comm'n, 70 N.M. 310, 319, 373 P.2d 809, 818 (1962).*

13. Thus, the order provides no basis from which to conclude that the Commission properly considered Cimarex's statutory right to drill in the W/2 of Section 21 or to ascertain its reasoning that resulted in the unstated conclusion that Cimarex's correlative rights have not been impaired as a result of the Commission's ruling. *Continental Oil, 70 N.M. at 319, 373 P.2d at 818.* Nor is it possible to ascertain why the Commission believes it is preferable to disallow development in an area where no wells have ever been drilled and where Lynx has not had and does not currently have any plans to pursue development and has not taken the opportunity to recover its reserves in the SW/4 of Section 21. *11/4/10 Tr. at 140-41 (Scott); 2/4/10 Tr. at 110 (Scott); see Bellet v. Grynberg, 114 N.M. 690, 695, 845 P.2d 784, 789 (1992) (emphasizing that "[t]he law of oil and gas is designed to further oil and gas exploration and development").*

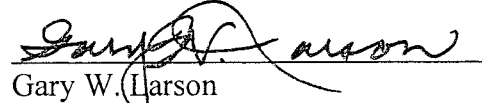
14. The impact of the Commission's order extends beyond Cimarex's interests. It may well affect the recent trend of operators utilizing the efficient horizontal drilling method to recover untapped reserves. Beginning with Order No. R-12683-A, the Division has approved numerous applications for non-standard horizontal well spacing and proration units, including two applications filed by Cimarex for the E/2 of Section 21, in the past three and a half years. Moreover, it may well affect oil and gas revenues accruing to the State of New Mexico at a time when the state is facing a substantial budgetary shortfall.

15. Under 19.15.4.25 NMAC, the Commission normally would have ten business days to act on this application. Given the advent of a new administration in state government and the fact that the Commission's membership is in a state of flux, Cimarex requests that the Acting Chair deem the ten-day rule to be inapplicable and hold Cimarex's application in abeyance until the newly-constituted Commission is in place. This request is reasonable in light of the considerable prospective impact of Order No. R-13228-F.

WHEREFORE, Cimarex requests that the Acting Chair hold its application in abeyance until the new Commission is in place, and further requests that the new Commission (i) grant the application for hearing, (ii) reconsider and reverse the previous Commission's ruling, (iii) enter an order granting Cimarex's applications in Case Nos. 14418 and 14480, and (iv) grant Cimarex such additional relief as the new Commission deems appropriate.

Respectfully submitted,

HINKLE, HENSLEY, SHANOR &
MARTIN, LLP



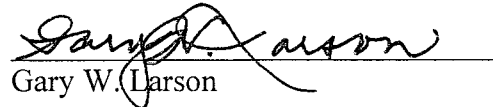
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CERTIFICATE OF SERVICE

I hereby certify that on this 10th day of January, 2011, I sent a true and correct copy of the foregoing *Cimarex Energy Co.'s. Application for Rehearing* via email to:

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