

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

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

CASE NOS. 14480 & 14418

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

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RESPONSE TO CIMAREX ENERGY CO.'S APPLICATION FOR REHEARING

Lynx Petroleum Consultants, Inc. ("Lynx") submits this response to Cimarex Energy Company's ("Cimarex") Application for Rehearing and states as follows:

The primary statutory duties of the Oil Conservation Commission ("Commission") are the prevention of waste and the protection of correlative rights. NMSA 1978, § 70-2-11. The Commission has broad powers to carry out these duties. But, as we learned in *Marbob*¹, the Commission does not have "virtually unbridled discretion" in implementing its statutory mandates. Its authority to act is both defined and limited by law. In this case, the Commission followed the law and rejected the applications of Cimarex because they impair correlative rights.

With its Application for Rehearing, Cimarex misreads the Commission's Order in Cases 14480 and 14418 just as it has misread and misinterpreted the applicable portions of the Oil and Gas Act. To support its position in these cases, Cimarex: (1) confuses basic oil and gas terminology; and (2) misapplies statute and rules by ignoring the express limitations in the sections of the Oil and Gas Act upon which it relies. Most importantly, Cimarex advocates a

¹ *Marbob Energy Corp. v. Oil Conservation Comm'n*, 2009-NMSC-013, ¶2, 146 N.M. 24, 206 P. 3d 135.

position that conflicts with the Commission's statutory mandate to protect correlative rights of all interest owners in a pool.

Compulsory pooling is authorized by the Oil and Gas Act. NMSA 1978, § 70-2-17. The pooling statute requires an exercise of the police power of the State to combine all interests in a spacing or proration unit. It does this by taking of the interest of one owner and giving that interest to another to operate. Since this action affects the property interests of individual owners, the statute defines and limits the circumstances in which it may be used. Among the statutory limits imposed on the pooling authority is that it is limited to single spacing and proration units.²

A. POOLING IS ONLY ALLOWED FOR SINGLE SPACING UNITS NOT PROJECT AREAS.

To fit under the pooling statute, Cimarex first asks the Commission to combine the four standard spacing units in its proposed "horizontal well project area" into a "non-standard unit," and then pool all interests in the new "non-standard unit." The Oil and Gas Act defines a "spacing unit" as "the area that is allocated to a well under a well spacing order or rule." NMAC 19.15.2.7(S)(9). Forty-acre oil spacing and proration units for Bone Spring formation wells in the subject lands have been established by the general rules of the Oil Conservation Division. NMAC 19.15.15.9.A. These rules are the applicable spacing order for these wells. No special

² Cimarex also confuses the concepts of "pooling" and "unitization". While the concepts of are related, they are distinct. Pooling is tied to individual well spacing units. See, NMSA 1978, §70-2-17(C). Unitization deals with the unified development of all or a portion of a common source of supply. See generally, 6 Kramer and Martin, Williams & Myers §910. New Mexico's Oil and Gas Act recognizes this distinction. Pooling is authorized where "two or more separately owned tracts of land are embraced within a spacing or proration unit." Section 70-2-17. Unitization is approved where more than one spacing unit is combined by voluntary agreement. NMAC 19.15.20.14.

rule changing this spacing requirement for the subject Bone Spring wells has been adopted by the Division.

Cimarex's proposed "non-standard unit," violates the Oil and Gas Act and the Rules of the Division. "Non-standard spacing units" for wells developed, as here, under 40-acre spacing rules must lie "wholly within a single quarter section." NMAC 19.15.15.11.B(2)(b). The configuration of Cimarex's non-standard units are not allowed under Division Rules. Cimarex also proposes "non-standard units" which conflict with the Division's definition of a "horizontal well project area." A horizontal well "project area" is defined by Oil Conservation Division Rules as "an area the operator designates on form C-102 that a spacing unit's outer boundary enclose, a combination of complete spacing units or an approved Secondary, tertiary or pressure maintenance project." NMAC 19.15.16.7.I. Here, by definition, Cimarex has a "horizontal well project area," not a spacing or proration unit, and compulsory pooling is not allowed under Division Rules.

B. THE COMMISSION MUST PROTECT CORRELATIVE RIGHTS OF ALL INTEREST OWNERS.

Cimarex accuses the Commission of selectively citing certain testimony and disregarding other testimony. *See* Application for Rehearing, Paragraph 8. However, Cimarex has selectively relied on certain isolate portions of the Oil and Gas Act while disregarding others. It states that its "applications clearly seek approvals under §§ 70-2-17 and 7-2-18." *Id.* at Paragraph 2.

Section 70-2-17 is entitled "Equitable Allocation of Allowable Production; Pooling; Spacing." Subsection A contains the statutory definition of correlative rights and states that this concept affords to the owner of each property in a pool the opportunity to produce his just and equitable share of the oil or gas in the pool being an amount "substantially in the proportion that the quantity of recoverable oil and gas, or both, under such property bears to the total recoverable

oil or gas, or both in the pool.” This is the standard that the Commission found that Cimarex had failed to meet and therefore denied its applications.

Subsection B authorizes the Division to establish proration units for each “pool.” Here Cimarex attempts to apply this statute to a “non-standard proration unit” it wants to create for its own individual well that is larger than the proration unit for the pool and not allowed by the spacing rules of the Division. Cimarex is outside this statute.

Cimarex then asks the Commission to use Subsection C to take the interest of Lynx in this one well non-standard proration unit and give it to Cimarex to operate. In so doing, Cimarex ignores the statutory limitation on compulsory pooling to single proration units. It also tries to misuse this section of statute to permit Cimarex to take a substantially larger share of the production from this non-standard unit than is under its property – all at the expense of Lynx. Cimarex contends that this result is required because, once pooling occurs, this statute “unambiguously mandates that production be allocated solely on a straight acreage basis.” Application for Rehearing, Paragraph 3. However, Section 70-2-17 does not authorize pooling of the “non-standard units” proposed by Cimarex.

C. THE COMMISSION’S FINDINGS ARE SUFFICIENT.

In 2010, the Court of Appeals observed that the Commission’s findings must be sufficient to disclose the reasoning of the Commission. *Bass Enterprises Prod. Co., et al. v. Mosaic Potash Carlsbad, Inc.*, 2010-NMCA-065, 239 P. 3d 885. In these cases, geological and engineering evidence were presented to the Commission. It is well-established that the Commission has special expertise and competence in issues related to the development of oil and gas. *Marbob*, 2009-NMSC-013 at ¶ 7.

Cimarex alleges the Commission ignored the testimony of its geologist and engineering witnesses. A review of the Order shows the contrary to be true. Citing the testimony of Mr.

Catalano and Mr. Swain, the Commission found that the mud logs did not show similarity of pay along the lateral portion of the wells (Finding 15). Citing Mr. Swain, the Commission observed that the south-half of the Section could contribute twice that of the north-half (Finding 17). Comparing the testimony of Mr. Catalano at the Examiner hearing to his testimony in this case, the Commission found that the estimate of feet of pay had decreased under the Cimarex acreage in the north-half of the Section from 75 feet to 32 feet (Findings 18 and 19). Relying on Mr. Swain, it observed that Cimarex no longer presented volumetrics on each 40-acre proration unit in the proposed units (Finding 20). Citing Mr. Catalano's testimony that the well need to be drilled in a north-south orientation, the Commission noted that new Cimarex mapping shows that there is no longer a north/south orientation of the sand in this reservoir (Finding 21).

The findings conclude with the Commission's observation that Cimarex had failed to establish that its proposed project will not impair correlative rights (Finding 31) and that "the evidence indicates that there are disparate interests in the proposed project areas such that allocating on a straight acreage basis would violate correlative rights by not allowing Lynx to receive its just and fair share of production" (Finding 32).

The findings clearly reflect the reasoning of the Commission that the application, if granted, would violate its statutory duty to protect correlative rights.

D. IMPACT BEYOND CIMAREX'S INTERESTS

Cimarex notes that the Commission has "virtually unbridled discretion" to grant pooling applications [Paragraph 3] and argues that the Commission's requirement that the evidence show that correlative rights will be protected could affect the recent trend of operators utilizing horizontal drilling methods to recover untapped reserves. Cimarex forgets that in the *Marbob* case, the Supreme Court rejected the argument that the Division had broad discretionary powers when the exercise of these powers conflicted, as here, with statute.

The Commission's Order does not say that units cannot be formed for horizontal drilling or that this new method cannot be used to recover untapped reserves. The Order only says that an operator like Cimarex cannot misuse the pooling statutes to impair the correlative rights of others when it tries to form a horizontal well project area comprised of a combination of complete spacing units.

Order No. R-13228-F is a well reasoned order that fully complies with the Commission's statutory duty to protect the correlative rights of the owner of each property in a pool. It correctly applies the law to the facts of these cases and its findings disclose its reasoning in reaching its decision. Cimarex' Application for Rehearing should be denied.

E. ACTING COMMISSIONER DECISION TO DELAY CONSIDERATION OF THE APPLICATION FOR REHEARING.

Cimarex filed its Application for Rehearing on January 10, 2011. The Oil and Gas Act provides that "The commission shall grant or refuse any such application in whole or in part within ten days after the same is filed, and failure to act thereon within such period shall be deemed a refusal thereof and a final disposition of such application." NMSA 1978, §70-2-25³. This provision cannot be altered by an act of the Acting Chair of the Commission as Cimarex suggests. The ten-day period is set by statute and unless the application for rehearing is granted, Order No. R-13228-F becomes final on January 24, 2011.

Respectfully submitted,
HOLLAND & HART, LLP

³ NMAC 19.15.4.25 states that the commission shall grant or deny the application within 10 business days.

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CERTIFICATE OF SERVICE

I certify that on January 21, 2011 I served a copy of the foregoing document to the following by

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