

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

**APPLICATIONS OF CIMAREX ENERGY CO.
FOR A HORIZONTAL SPACING UNIT
AND COMPULSORY POOLING, LEA COUNTY, NEW MEXICO**

Case Nos. 23448 – 23455

**APPLICATIONS OF CIMAREX ENERGY CO.
FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO**

Case Nos. 23594 – 23601

**APPLICATIONS OF READ & STEVENS, INC.
FOR COMPULSORY POOLING,
LEA COUNTY, NEW MEXICO**

Case Nos. 23508 – 23523

**CIMAREX ENERGY CO.’S BRIEF PROVIDING THE BASIS FOR EVALUATING A
SINGLE RESERVOIR SITUATED IN THE THIRD SAND OF THE BONE SPRING
FORMATION IN AN AREA THAT LACKS A BAFFLE SEPARATING IT FROM THE
UNDERLYING WOLFCAMP FORMATION,**

Cimarex Energy Co., (“Cimarex”), through its undersigned attorneys, respectively submits this Brief in support of the options that it believes that the New Mexico Oil Conservation Division (“Division”) should consider in resolving the above-referenced cases.

These cases involve development plans proposed by Cimarex, on the one hand, and Read & Stevens, Inc., in association with Permian Resources Operating, LLC (collectively “Permian Resources”), on the other hand, that reflect a magnitude of differences in cost, prevention of waste, and the protection of correlative rights. The fundamental differences between the plans can be traced to Permian Resources’ deliberate decision to ignore a significant geological feature of the area to be developed – the lack of a baffle between the 3rd Sand of the Bone Spring and the Upper

Wolfcamp Formation. This geological feature militates against employing a cookie-cutter application for determining what constitutes the prevention of waste and correlative rights and necessitates a close examination of how the statutory and regulatory framework must be applied to the cases pursuant to the Oil and Gas Act, §§ 72-2-1, *et seq.*, NMSA 1978 (the “Act”).

Permian Resources’ plan results in an additional \$130 to 147 million in costs for the wells it plans to drill in the Bone Spring plus an additional \$95 million in costs for the wells it plans to drill in the Upper Wolfcamp with no corresponding increase in the recoverable reserves. The enormous and unnecessary economic burden that Permian Resources seeks to impose on working interest owners constitutes gross waste thus undermining any reasonable notion of correlative rights.

Permian Resources has stated in its pleadings before the Division that Cimarex’s plan violates textbook correlative rights. *See, i.e.*, Permian Resources’ Response to Motion to Continue (“Permian Resources’ Response”), at ¶ 3. Permian Resources’ argument not only mischaracterizes this important right, but completely fails to address the massive amount of waste in its own plans. According to Kramer and Martin, “The doctrine of correlative rights is not a rule that a court or party can express in a flat and unyielding statement. Rather, the concept of correlative rights is in the nature of a guide or precept that is to be applied to particular facts.” *See* Bruce M. Kramer & Patrick H. Martin, *The Law of Pooling and Unitization*, § 5.01(4) at 24 (LexisNexis Matthew Bender 3d ed. 2022). “Some courts occasionally will state that protection of correlative rights is secondary to the prevention of waste,¹... The more correct and certainly

¹ In *Denver Producing & Refining Co. v. State*, 199 Okla. 171, 184 P.2d 961, 964 (Okla. 1947), a case involving a fair allocation formula, the Oklahoma Supreme Court stated: “In striking a balance between conservation of natural resources and protection of correlative rights, the latter is secondary and must yield to a reasonable exercise of the former...”; *see also Continental Oil Co. v. OCC*, 1962-NMSC-062, ¶ 11 (showing that prevention of waste is paramount and its priority is an integral part of the definition of correlative rights.)

preferable view is that protection of correlative rights, properly understood, is equal in weight, dignity, and importance to the prevention of waste in agency regulation.” Kramer & Martin, *supra* § 5.01(1) at 3, 4. Said another way, “Prevention of waste and protection of correlative rights are more properly understood as complementary, not competing, functions of the state conservation agency.” *Id.* at 5.

As demonstrated and discussed in detail below, all the owners of working interest in the Wolfcamp will realize significantly greater financial and pecuniary gain under Cimarex’s plan as compared to Permian Resources’ competing plan. Simply put, Cimarex’s plan prevents waste and fully protects correlative rights, while Permian Resource’s plan does neither.

Thus, should the Division find Cimarex’s testimony accurate, it cannot approve Permian Resources plan without violating its primary statutory purpose to prevent waste and protect correlative rights.

Permian Resources has stated repeatedly both in pleadings and in oral presentations before the Division that Cimarex’s assertion in the present cases – that the Division is faced with a number of novel questions of first impression – is invalid, going as far as to refer to Cimarex’s requesting the Division consider the importance of these questions as a “red herring.” *See* Permian Resources’ Response, at ¶ 9. However, the good faith nature of Cimarex’s efforts are illustrated by its response to Permian Resources’ argument that Cimarex’s plan violates the allocation language of NMSA 1978 § 70-2-17, such that Cimarex did not try to squelch the argument but pointed out to the Division that Permian Resources “raises important legal questions” regarding the statute and that the Division should be provided background to assess the complexity of how the seemingly straight forward language of § 70-2-17 should be applied to the complicated geology and engineering of the present cases. *See* Cimarex’s Reply to

Response to Motion to Continue at ¶ 7.

There are certainly situations when a party justifiably advocates for the exclusion of evidence and additional inquiry if, for example, further consideration would be irrelevant or highly prejudicial, but that is not the case in this situation as shown by Case Nos. 23853 and 23295 between Cimarex and Pride Energy Company (“Pride”), two cases which lay to rest any question whether the matters and questions in the present cases are complex and novel.

What makes the application of the statutory and regulatory framework under the Act more nuanced in the present cases is not necessarily an understanding of the statutes and rules themselves. As Permian Resources points out the language of § 70-2-17 in and of itself appears straight-forward. However, the temptation to rely upon a myopic interpretation of the regulatory framework for the sake of simplicity, the course that Permian Resources suggests the Division to take, should be eschewed when that framework must be applied to the unusual geology and engineering challenges present in Subject Lands.

The Subject Lands are located in an area that has a unique geological feature – the lack of natural barriers that would otherwise prevent communication between the Third Bone Spring Sand and Upper Wolfcamp, thus creating a single reservoir, or common source of supply, that is located predominantly in the 3rd Bone Spring Sand. As a result, operators drilling in this area have historically targeted and, based on production data, continue to target almost exclusively the 3rd Bone Spring Sand because it is the landing zone that provides the primary and prolific production of oil and gas in the Subject Area. When the Bone Spring is developed and “produced,” operators have almost universally refrained from drilling the Wolfcamp because it is uneconomic and wasteful to do so. One co-development plan of both the Bone Spring and Wolfcamp in a section

located two miles from the Subject Lands produced unfavorable results and a degradation of reserves.²

Geology and engineering should be the driving force when considering how to accurately apply the regulatory framework to the Subject Lands in order to optimize production not the other way around. When the regulatory framework becomes the primary consideration over well understood geology and engineering, then the risk of a mismatch between the two is high resulting in high costs, inferior production, waste, the drilling of unnecessary wells, and most importantly, the violation of correlative rights instead of their protection.

Cimarex has been studying the Subject Lands for the past four years and has crafted and proposed a development plan that will recover optimal amounts of production in a manner that is fully tailored to the geological and engineering challenges of the Subject Lands in a manner that it believes will better ensure optimal production at reasonable costs that protect correlative rights, prevent waste, and prevent the drilling of unnecessary wells. In contrast, Permian Resources appears to be satisfied with a coarse and conventional application of the regulatory framework to the Subject Lands that is readily applicable to conventional formations with conventional barriers and baffling but is not tailored to the unique characteristics of the single reservoir, located predominately in the Bone Spring, and the unusual geology of the Subject Lands. By proposing to force a square peg into a round hole, Permian Resource is proposing to drill unnecessary wells in the Upper Wolfcamp along with over-spacing of the Bone Spring, both at great and unnecessary cost thus violating all participants correlative rights and causing gross waste.

To place these matters into perspective, one should consider what happens when an operator applies to the Division to pool just the Bone Spring formation and not the Wolfcamp, as

² The testimony and exhibits of Cimarex's Production Engineer that are being submitted for the upcoming hearing support the factual assertions set forth in this Paragraph.

is done in the overwhelming number of units in the area surrounding the Subject Lands (“Subject Area”). The geological data provided by Cimarex shows that the reservoir in the Subject Area that is most productive is the single reservoir (common source of supply) situated predominately in the Third Bone Spring. It is a common source of supply because there is no baffling or natural barriers that divides the Third Bone Spring and the Upper Wolfcamp. Thus, when an operator pools and spaces just the Bone Spring pursuant to the pooling statutes, the operator “produces” hydrocarbons from the Bone Spring; however, this production will also naturally drain a certain percentage from the Upper Wolfcamp because of the communication between the formations. The exact amount of production attributable to the Upper Wolfcamp is uncertain but can range anywhere from 5 to 10 percent up to approximately 26 percent. Such drainage, distinct from production, is incidental to producing the target formation which is the Bone Spring.

Consider the other units proposed and pooled by Permian Resources in cases outside the contested hearing with Cimarex but within the Subject Area. In addition to the pooling applications filed by Permian Resources in the present cases, Permian Resources, since 2020, when it appeared to become active in the Subject Area, has filed 11 pooling applications in the Subject Area within Lea County. Ten of Permian Resources’ applications³ in this area pool only the Bone Spring and do not pool the Wolfcamp, nor does Permian Resources account for any of the purported correlative rights of owners in the Wolfcamp whose interests have been drained. Furthermore, Permian Resources pooling the Bone Spring in all of these units and not pooling the Wolfcamp demonstrates that Cimarex is correct about the geology in the Subject Area, that operators who pool the Bone Spring will not pool the Wolfcamp because it is uneconomical to do so based on the lack of any frac baffle. Permian Resources did have one application in Case No.

³ Permian Resources’ applications in Case Nos. 23508, 23509, 23510, 23511, 23524, 23525, 23526, 23527, 23528, 23529.

23530 in which it pooled the Wolfcamp but not the Bone Spring, showing that operators pool and drill one formation or the other but not both, and predominately will drill the Bone Spring over the Wolfcamp. Why would an operator who drills the Bone Spring in this area spend a massive amount of additional money to drill the Upper Wolfcamp when the operator knows that the Bone Springs is the primary target and reservoir?

Permian Resources feigns concern for the Wolfcamp working interest owners in the present contested cases, proudly pointing to their cookie-cutter development plans that ignore the lack of a baffle in the Subject Lands. Permian Resources intentionally designed these plans to win approval in a hearing room based on its stunted interpretation of the Act, but its plans are doomed to failure in the real world. Moreover, if Permian Resources were to prevail, there is a significant question as to whether Permian Resources will co-develop the 3rd Sand with the Upper Bone Spring based on its past performance – over its short history in the Delaware Basin, Permian Resources has developed eleven proration units. In the 11 units, all of its development has been limited to the Bone Spring. These 11 units provides rubber meets the road proof that Cimarex’s position that the 3rd Sand is the optimal single landing zone for developing hydrocarbons from the Subject Lands.

Typically, no operator would return to a unit where it drilled and pooled the Bone Spring formation in an uncontested hearing because under the Act and its statutory scheme, there is a clear distinction between “producing” and “production,” on the one hand, and “draining” and “drainage,” on the other hand. First, prior to pooling the unit, the Division may establish a proration unit for each pool based on the geological characteristics that determine the extent to which the area can be “efficiently and economically drained.” *See, i.e.*, NMSA 1978 § 70-2-17(B). Once the spacing unit is established, the owners of the tracts in the unit may “validly pool their

interests and develop their lands as a unit.” *See id.* at § 70-2-17(C). If the owners cannot agree to pool their interest, the Division shall pool all or any of such interests in the spacing unit as a unit. *See id.* It is at this point in the process that whatever was determined to be efficiently and economically “drained” in the established pool, becomes a pooled unit, and the category applied to the hydrocarbons extracted from the unit shifts from being defined as “drainage” to being defined as “production” and “produced.” This shift becomes clear in the latter part of the pooling statute (70-2-17) where once the unit is pooled, then for “the purpose of determining the portions of production owned by the persons owning interests in the pooled oil or gas, or both, such production shall be allocated to the respective tracts within the unit in the proportion that the number of surface acres included within each tract bears to the number of surface acres included in the entire unit.” *Id.* (emphasis added).

Throughout the Act, a number of statutes refer to pooled units as being “produced” or the extraction of hydrocarbons from the pooled units as “production,” thereby reinforcing the distinction between drainage and production. For example, the pooling order “shall make definite provisions” as to any owners who elect not to pay their proportionate share in advance for the prorated reimbursement “solely out of production” to the parties advancing the costs of development and operations. *Id.*(emphasis added). And, the owners paying for the drilling and operation of the well for the benefit of all shall be entitled to all production after payment of obligations out of production. Such shift to the categorical usage of “produced” and “production” is consistent with NMSA1978 § 70-2-12, which states that portions of the “the unit production allocated to a separately owned tract in a unit area shall, when produced, be deemed, for all purposes, to have been actually produced from such tract by a well drilled thereon.” (emphasis added). Finally, this distinction between “produced” and “production” versus “drainage” is utilized

extensively in NSMA 1978 § 70-2-16, where once a unit and its tracts have been developed under the regulatory framework for pooling and drilling, and the tracts are then “producing,” the Division may take actions pursuant to equitable considerations to “prevent drainage between producing tracts in a pool which is not equalized by counter-drainage.” *See* § 70-2-16 (C)(emphasis added). Thus, if there is drainage that emerges from the geological characteristics of a formation in relation to adjacent formations that affects the producing tracts, that is, affects the production from the tracts, then the Division may alter or restrict what is allowed to be produced under the regulatory framework to account for the separate category of drainage.

This distinction between production and drainage is also reinforced by how terms in the Act are defined. For example, “owner” is defined as the person who has the right to drill into “and produce” from any pool. *See* NMSA 1978 § 70-2-33 (E). The act does not define an owner as a person who has the right to drill into and drain from any pool, because an owner must first satisfy the regulatory framework to achieve what legally constitutes production, which would include pooling the unit whether voluntarily or through a compulsory forced pooling. Likewise, a “producer” is defined as an owner of a well capable of “producing oil or natural gas, or both, in paying quantities,” not a well capable of draining oil and gas. *See* § 70-2-33(F). The well under this definition is capable of producing oil and gas because the well and its operations have been subjected to the regulatory framework under the Act, and thus the well under the regulatory scheme becomes “capable of producing.” And, finally, but most importantly, “correlative rights” are defined as “the opportunity afforded, so far as practicable to do so, to the owner of each property in a pool to produce without waste, the owner’s just and equitable share of the oil or gas or both in a pool.” (emphasis added). Thus, correlative rights of an owner arise only after the unit is established and pooled and production is deemed to be available to the owner.

It is the achievement of optimal production of the Subject Lands that Cimarex, as a prudent operator, seeks with its development plan. However, because Cimarex adheres to its scientific and engineering data based on its close study of the geology, Cimarex did not and will not propose additional wells in the Wolfcamp that are clearly unnecessary and would create massive additional costs with no concomitant increase in ultimate recoverable reserves. It is Cimarex's position that the regulatory framework should conform as closely as possible to the existing geology, not the other way around, and therefore Cimarex respectfully presents two viable options for its proposed development plan for properly producing the Subject Lands under the pooling statutes what is essentially a single reservoir and common source of supply, one option ("Option 1") proposes to pool the Bone Spring formation without the need to force pool the Wolfcamp formation, and the other option ("Option 2") proposes to force pool both the Bone Spring formation and the Wolfcamp formation should the Division decide that any incidental drainage from the Upper Wolfcamp must be accounted for under a forced pooling in order to shift the capture of oil and gas from "drainage" to "production," at which point Cimarex would produce the both the Bone Spring and the Wolfcamp

I. OPTION 1 FOR CIMAREX'S DEVELOPMENT PLAN

In Option 1, as presented in its hearing packet, Cimarex proposes to pool just the Bone Spring formation, and not the Wolfcamp formation. Pooling solely the Bone Springs formation follows long established and time-tested practice of how prudent operators, including Cimarex's extensive operations in the Subject Area, have optimized development of similar lands in the Subject Area. The predominate and overwhelming majority of units in the Subject Area are Bone Spring units, with primary focus on the Third Bone Spring. This outcome is the direct result of the unique geology of the area, which has no natural barrier between the Third Bone Spring and

the Upper Wolfcamp, being a single reservoir that is located primarily in the Bone Spring formation. As a result, Cimarex submits that the best plan for drilling and developing the Subject Lands is to pool only the Bone Spring, and then, pursuant to the applicable regulations, fully “produce” and develop the Bone Spring formation to achieve the most efficient and optimal production of this reservoir, as Permian Resources has also done in 10 of the 11 applications it filed for units in the Subject Area besides those in the present contested cases.

Under Option 1, any drainage of the Upper Wolfcamp that may occur should be naturally characterized as incidental to the primary target in the Bone Springs, as it has been viewed in the hundreds of Bone Spring wells that form the vast majority of units in the Subject Area. The production from Bone Spring units will result in some undetermined drainage from the Upper Wolfcamp, which may range anywhere from 5 percent on the low end to 26 percent on the high end, being an exact amount which cannot be fully determined until data is collected from the drilling operations. For its exhibits covering the Subject Lands, Cimarex has in good faith included in its testimony the higher end of the range, although production from the Upper Wolfcamp could actually end up being on the lower end.

Option 1 would allow Cimarex to pool, and consequently, produce the Bone Spring formation as a unit. All the WI owners in the Bone Spring formation are represented as WI owners in the Wolfcamp formation, except for two WI owners, CLM Production (“CLM”) and Warren Associates (“Warren”). CLM and Warren only own a very small interest in the W/2 W/2 units of the Subject Lands and do not own in any other units that have been proposed; however, Cimarex has an open offer to CLM and Warren to provide them the same working interest in the Bone Spring that each of them own in the Wolfcamp formation the W/2 W/2 of the Subject Lands, thus affording them the opportunity to have their just and equitable share in the Bone Spring if they

decide to claim the interest.

The only remaining issue raised by Permian Resources is that because a handful of WI owners⁴ own a higher interest in the Wolfcamp than the Bone Spring their correlative rights are not protected under Option 1. However, the small variation in ownership between the Bone Spring and Wolfcamp for these 8 owners is irrelevant when one accounts for the costs owners would have to pay to participate in the Cimarex's plan compared to the burden of the massive additional costs they would have to pay to participate in Permian Resources' plan to recover substantially the same amount of production.

For example, Northern Oil & Gas owns a .369075% WI in the Bone Spring but a little more in the Wolfcamp. If Cimarex's Option 1 plan to pool just the Bone Spring were adopted for development of the Subject Lands, Northern Oil's share of estimated costs would be \$1,045,418.83 while their share of estimated costs under Permian Resources plan would be \$2,835,005.00.⁵

What becomes readily evident when reviewing the return on investment for these eight owners is how small the variations of working interest that Permian Resources is trying to account for by pooling and drilling the Wolfcamp in the name of protecting correlative rights compared to the additional \$95 million dollars all working interest owners would have to bear to account for these minor variations. These eight owners would have a greater return on investment if the Division adopts Cimarex's plan pursuant to Option 1 to pool and develop just the Bone Spring formation.

Permian Resources might try to argue that not accounting for the incidental drainage is a violation of correlative rights, but such an argument would be an ineffectively narrow application

⁴ Read & Stevens, MRC Permian, Northern Oil & Gas, First Century, CBR Oil, Marks Oil, Wilbanks, and HOG Partnership LP.

⁵ These differences will be provided by exhibit at the hearing.

of the statutory meaning of correlative rights. Under the Act, “‘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 the owner’s just and equitable share of the oil and 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 the owner’s just and equitable share of the reservoir energy.” Section 70-2-33 (Emphasis supplied).

There are a number of important items to unpack in this definition; first, the Division should note that that the owner has no absolute right under the statute to a concrete and specific percentage. Permian Resources lists Read & Stevens and HOG Partnership LP as having different percentages of ownership in the Bone Spring and the Wolfcamp and therefore claims their correlative rights would be violated. *See* Permian Resources Response, Para. 1 Permian Resources, for example lists Read & Stevens as owning 23.0056% in the Wolfcamp underlying the W/2 W/2 of Sections 4 and 9, and 23.006% in the Bone Spring unit underlying the same W/2 W/2, representing a 0.0004% difference between the formations, and they list HOG Partnership LP as owning 6.8787% in the Wolfcamp unit underlying the same W2 W 2 and 4.380% in the Bone Spring under the same W2 W2, representing an approximate 2.5% difference, which is one of the larger differences among the 8 owners listed by Permian Resources. Assuming that the W2 W2 of Section 4 and 9 is a 320-acre unit, Permian Resources would likely argue that HOG has an absolute right to 320 X 6.8787% in the Wolfcamp or about 22 net acres and HOG has an absolute right to 320 X 4.380% in the Bone Spring or about 14 net acres, a difference of 6 net acres.

But this is not the case under the statutory meaning of correlative rights as there are a

number of qualifications inherent to the definition that come into play. For example, the owner is afforded an opportunity not an absolute right, and it is an opportunity as far as practicable to do so to produce without waste the owners just and equitable share of hydrocarbons. Thus, if the granting of the opportunity is not practical, then the Division has the authority to alter the amounts involved. And, the owners share has to be a just and equitable share, not an unqualified percentage. Thus, if under Permian's Resources' plan which burdens HOG with its proportionate share of an additional \$225 million in costs (\$130 million added to the Bone Spring development and \$95 million added to the Wolfcamp development), HOG receives much less for its 6.8787% in the Wolfcamp under Permian Resources' plan that it would receive for its 4.380% in the Bone Spring; thus, the just and equitable share to HOG would be the greater amount paid to HOG based on the 4.380% HOG owns in the Bone Spring, and payment of the lesser amount of revenue to HOG even though it has a slightly higher percentage ownership in the Wolfcamp would be an unjust and inequitable share.⁶ Thus, it is the massive costs associated with Permian Resources' plan that undermines and violates the owners' correlative rights, not Cimarex's plan to pool and produce solely the Bone Springs Formation

Kramer and Martin echo this conclusion by stating: "Having correlative rights in a common source of supply does not mean that each owner is guaranteed to recover a proportionate share of the oil and gas in the reservoir, but only that each owner shall be afforded the opportunity to produce or to share in the production on a reasonable and fair basis. The point bears repeating for emphasis: The correlative right is having the opportunity to produce, not having a guaranteed share of production. Once the state has afforded that opportunity, it has protected the correlative rights of a party; it need not ensure a share of production to a party." Kramer & Martin, *supra* §5.01(4)

⁶ Cimarex's exhibits at the hearing will show exact numbers and percentages.

at 24. Thus, the Division allowing HOG to receive the substantially extra amounts of revenue (and other owners to receive more based on the same calculations) by approving Cimarex's plan for the pooling and producing only the Bone Spring formation better protects HOG's correlative rights in the common source of supply situated predominately in the Bone Spring than if the Division allowed Permian Resources to subdivide the common source with a severance at the top of the Wolfcamp that would result in HOG receiving much less for its percentage ownership due to the magnitude of costs imposed by Permian Resources' plan. Furthermore, "the Division as a general policy avoids the vertical subdivision of common sources of supply." See Division Order No. R-14051, Para. 20(b). And, Cimarex's development plan under Option 1 better upholds this policy. Thus, Cimarex's Option 1, if selected by the Division, would consist of the Division allowing Cimarex to pool the Bone Spring formation and denying Permian Resources' applications for the Wolfcamp formation.

II. OPTION 2 FOR CIMAREX'S DEVELOPMENT PLAN

There is a second option ("Option 2") that the Division can approve for the drilling and development of Cimarex's proposed plan to have wells located in the Bone Spring, particularly the Third Bone Spring, but not in the Upper Wolfcamp, thereby saving the owners from a proportionate burden of an extra \$95 million in costs. Cimarex has in good faith been grappling with the best approach for complying with and satisfying the regulatory framework, and Cimarex's prevailing philosophy regarding the application of the statutes and rules is that that the regulatory framework to the extent possible should be tailored to the geology in order to achieve the most efficient and economical production without waste while protecting correlative rights. Cimarex could have proposed additional wells in the Upper Wolfcamp, as Permian Resources did after it filed its competing Bone Spring applications, but Cimarex has confirmed from its study of the

geological data that drilling additional wells in the Upper Wolfcamp would be costly, unjustified, and would result in the drilling of unnecessary wells, which is a direct violation of the pooling statute. See Section 70-2-17(B) (showing the Division, when establishing a proration unit for a pool, is required to consider and address the “economic loss caused by the drilling of unnecessary wells” and the “avoidance of the augmentation of risks arising from the drilling of an excessive number of wells.”)

Cimarex could have taken a conventional approach and proposed wells in the Upper Wolfcamp, but since it knew that the geology did not justify such wells, Cimarex understood that such a conventional approach would be misleading to the Division, an artificial contrivance used to cross T’s and dot I’s at great extra costs rather than actually preventing waste and protecting correlative rights as required by the Act.

Instead, Cimarex has stood firmly by the geological data and has made every effort to devise approaches that would allow Cimarex to apply the existing regulatory framework in a manner that (1) complies with and satisfies the statutory requirements of the Act and its rules, and (2) that allows Cimarex to drill its wells into the Third Bone Spring for the efficient, economic, and proper development of the Subject Lands. Cimarex explained above one approach as Option 1, which would pool and produce the Bone Spring in a manner such that the optimal production from the Bone Spring itself would fully protect correlative rights and properly compensate owners. Here, Cimarex provides another approach to its development plan, as Option 2, which also complies with and satisfies the statutory and regulatory requirements of the Act.

In Option 1, the focus was on producing the Bone Spring formation and allowing any drainage that might come from the Wolfcamp to be deemed as an acceptable level of incidental drainage. However, if the Division decides that it would be better to reclassify the drainage from

the Wolfcamp as production, then Option 2 would allow for this reclassification by pooling the Wolfcamp formation in addition to the Bone Spring formation. In order to provide the Division with Option 2, Cimarex filed pooling applications in Case Nos. 23594-23601 in which it proposed to pool the Wolfcamp formation based not on drilling unnecessary and costly additional wells in the Wolfcamp itself, but by dedicating the Wolfcamp units to Cimarex's wells that it had already proposed to drill into the Third Bone Spring as part of the Bone Spring applications. This novel approach to proposing a unit in the Wolfcamp is made possible by the unique geology that shows no baffles or natural barriers between the Bone Spring formation and the Wolfcamp formation, thus, resulting in a single reservoir as a common source of supply situated predominately in the Bone Spring, particularly the Third Bone Spring. As previously noted, given this unique geology, a well drilled into the Third Bone Spring will result in a certain amount of drainage from the Wolfcamp, whether 5, 10, 15 or 25 percent, to be determined after drilling and testing.

This drainage can be accounted for as production if the Division decides to allow Cimarex to produce the Wolfcamp formation based on the location of its Third Bone Spring Wells as wells dedicated to producing the Wolfcamp formation once it is pooled. To be clear, Cimarex when it first considered this approach was uncertain that it could constitute a valid approach because conventionally it appeared as if just about all horizontal units covering a formation had its dedicated well drilled into the formation itself. But a close examination of the rules and the geology of the Subject Lands reveals that Option 2 is not only a viable approach, but in the end, there may be grounds for the Division to consider it to be the best approach.

Rule 19.15.16.15 specifically states that “[e]ach horizontal well shall be dedicated to a standard horizontal spacing unit or an approved non-standrard horizontal spacing unit.” The plain language meaning of “dedicate,” as described in a number of online dictionaries, is “to devote.”

There is nothing in the Rule that requires the well that is dedicated or devoted to a unit to have to be actually drilled in the formation that the unit covers. In most cases, it would make sense to drill the dedicated well into the same formation as the unit being pooled because in most cases there are natural barriers and baffles between the formations that confine the common source of supply to the formation itself; however, in the Subject Lands the common source of supply, located predominately in the Bone Spring, communicate openly with the Wolfcamp, and therefore, there is justification to pool the Wolfcamp by dedicating Cimarex's Third Bone Spring wells to the Wolfcamp unit so that any percentage of hydrocarbons drained from the Wolfcamp formation would be classified as production and thus produced from the Wolfcamp.

In this way, Cimarex, in its Option 2, applies and tailors, with precision, the regulatory framework to the unique geology in order accommodate the best location of the wells in the Third Bone Spring in a manner that complies with and satisfies the statutory and regulatory requirement, and more importantly, in a manner that avoids the unnecessary drilling of wells in the Upper Wolfcamp at an extra cost of \$95 million.

Given that, under Option 2, the majority of production would come from the Bone Spring formation, from 74 to 95 percent, and the minority of production would come from the Wolfcamp formation, from 5 to 26 percent, the proper application of the allocation language in Section 70-2-17 in order comply with and satisfy the statutory requirements would be as follows: First, the allocation language requires that “[f]or purposes of determining portions of production owned by the persons owning interests in the pooled oil or gas, or both, such production shall be allocated to the respective tracts within the unit in the proportion that the number of surface acres included in each tract bears to the number of surface acres included in the entire unit.” Section 70-2-17(C).

Second, in Option 2, even though there is one common source of supply for the two

formations, the two formations, Bone Spring and Wolfcamp, have a severance between them to account for the differences of ownership between the formations, as one would sever a single formation and pool separate intervals to account for differences of ownership in order to comply with the statutory allocation language. Thus, once separated out, the ownership in each separate formation is uniform, same as the ownership would be uniform in each separate interval of a severed formation. Now, let us assume that after Option 2 has been applied as the proper regulatory framework, Cimarex drilled and tested the Third Bone Spring wells and determined that 85 percent of hydrocarbons were coming from the Bone Spring and 15 percent were coming from the Wolfcamp. That 85 percent would constitute 100 percent of production from the pooled Bone Spring unit, and that amount would be allocated to the respective tracts in the Bone Spring unit which have uniform ownership and proportioned so that that the number of surface acres in each tract of the Bone Spring unit bears to the number of surface acres included in the entire Bone Spring unit. In the same way, the 15 percent would constitute 100 percent production from the pooled Wolfcamp unit, and that amount would be allocated to the respective tracts in the Wolfcamp unit in which ownership is uniform and proportioned so that the number of surface acres in each tract of the Wolfcamp unit bears to the number of surface acres included in the entire Wolfcamp unit. Thus, Cimarex's Option 2 as applied in the present cases complies with and satisfies the statutory and regulatory requirements of the pooling statute and the Act, and it directly account for the differences of ownership between the Bone Spring and the Wolfcamp.

III. CONCLUSION:

These contested cases boil down to a few indisputable and dispositive facts based on clear differences between the competing development plans. Permian Resources has proposed a plan that costs, and burdens the owners, with what is almost an additional quarter of a billion dollars

(approximately 225 million dollars) to produce oil and gas in a quantity that is no more, and possibly significantly less, than the amount that Cimarex will produce at significantly less costs. Usually competing applications that propose to develop the same Subject Lands will vary in their costs by no more than 15 to 20 percent, but the variation between the two plans before the Division is dramatic to the point of being absurd. Cimarex submits that the difference in the magnitude of costs is a direct result of Permian Resources not taking into account the unique geology of the Subject Lands, its lack of baffles and barriers between the Bone Spring and Wolfcamp formations, that allow an applicant to utilize some ingenuity to apply in a more precise manner the regulatory framework to the actual, physical geology as it exists in this area. When there are barriers and baffles between the formations that result in more than one reservoir and more than one common source of supply, then the conventional use of the regulatory framework to drill wells into both formations might make sense.

But if the conventional means of applying the regulatory framework to the Subject Lands does not match the geology and results in massive amounts of unnecessary costs and drilling, then the Division should seriously consider other approaches that would better suit the Subject Lands and still comply with and satisfy the statutory and regulatory requirements. Cimarex respectfully submits that its Option 1 and Option 2 as described herein both satisfy the requirements of the regulatory framework under the Act and its rules.

The Act grants the Division a great amount of discretion to fashion solutions to difficult and complex situations that require the prevention of waste and protection of correlative rights. In *Santa Fe Exploration v. Oil Conservation Comm'n* 1992-NMSC-044, ¶ 29, the Supreme Court of New Mexico approached an analogous problem, in which a pool was located under three separate tracts and a well threatened to drain the entire pool under the tracts. The Commission intervened

in an unconventional manner by placing a production penalty on the well in an attempt to avoid waste while protecting correlative rights. The court ruled that the Commission with its active intervention did not exceed its broad statutory authority under the Act. *See Sante Fe*, 1992-NMSC-044, ¶ 29. The court based its ruling on provisions in the Act that state “the Division and the Commission are ’empowered to make and enforce rules, regulations and orders, and to do whatever may be reasonably necessary to carry out the purpose of this act, whether or not indicated or specified in any section hereof.” *Id.* (citing NMSA 1978, § 70-2-11).

If the Division finds that Cimarex’s analysis and presentation of the nature of the geology and the engineering requirements for the Subject Lands are accurate, then Cimarex submits that given the fact that Permian Resources’ plan results in massive costs, and massive amounts of waste and violation of correlative rights directly caused by the magnitude of its costs, the Division must rule in favor of Cimarex, and in doing so, the Division is empowered to choose between Cimarex’s two Options provided herein on which to make its ruling.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed with the New Mexico Oil Conservation Division and was served on counsel of record via electronic mail on July 26, 2023:

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