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

RESPONSE TO CIMAREX'S LEGAL MEMORANDUM

Read & Stevens, Inc. ("Read & Stevens") and Permian Resources Operating, LLC ("Permian Resources"), through undersigned counsel, submit this response to Cimarex's legal memorandum, filed on July 26, 2023.

INTRODUCTION

To validate its development plan and overcome legal infirmities, Cimarex attempts to reform the structure and meaning of New Mexico's oil and gas law, ignoring longstanding interpretation and application of the Oil and Gas Act (the "Act") and its express provisions and governing regulations. The principal target of Cimarex's flawed reinterpretation is New Mexico's definition of correlative rights. Rather than apply the "classic canons of statutory construction"[1] to

[1] *Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 2009-NMSC-013, ¶ 9, 206 P.3d 135 (applying the canons of statutory construction courts "look first to the plain language of the statute, giving the words their ordinary meaning, unless the Legislature indicates a different one was intended," and "must give effect to that language and refrain from further statutory interpretation" when the language is clear and unambiguous).

correctly construe the Act, Cimarex asks the Division to adopt its geologic and economic assertions as proven, and then choose between "two Options" that deny the owners in the Wolfcamp formation the opportunity to produce their just and equitable share of the oil and gas reserves in the Division-designated Wolfcamp pool. Cimarex's request is an unprecedented trampling of the correlative rights of mineral owners in the Wolfcamp formation and will cause waste.

Plainly stated, the Division is obligated to enter compulsory pooling orders in these consolidated cases that, "so far as it is practicable to do so, afford to the owner of each property in [the] pool[s] the opportunity to produce his just and equitable share of the oil or gas, or both," without waste. *See* NMSA 1978, § 70-2-17(A). New Mexico courts have held for more than six decades that "prevention of waste is of paramount interest, and protection of correlative rights is interrelated and inseparable from it," because "protection of correlative rights is a necessary adjunct to the prevention of waste." *See Cont'l Oil Co. v. Oil Conservation Comm'n*, 1962-NMSC-062, ¶ 27, 373 P.2d 809 (emphasis added). In short, "[w]aste will result unless the [Division] can also act to protect correlative rights." *Id*. (emphasis added). Because the "two Options" Cimarex proposes seek to prevent offsetting wells in the Wolfcamp formation (which the Division has designated as a separate pool) the correlative rights of owners in the Wolfcamp formation are extinguished. This result is fatal to the "two Options" Cimarex has proposed.

Unable to demonstrate how its plans fit under the Act, the Division's regulations, or the Division's designated pools, Cimarex relies on a combination of conclusory or assumed geologic and engineering statements. These flawed assumptions and factual contentions will be addressed, as needed, by Permian Resources at the hearing.[2] However, the dispositive issue here is a legal one: The Division's obligation to protect correlative rights.

[2] Read & Stevens and Permian Resources have conducted a careful and thoughtful empirical assessment of the geology and engineering factors in the specific acreage at issue and will vigorously rebut

The only way for the Division to fulfill its dual obligations to prevent waste and protect correlative rights is to allow development of both Division-designated Bone Spring and the Wolfcamp pools by the mineral owners in those pools. Cimarex's suggestion that the Division should issue a proclamation that the upper Wolfcamp is "uneconomic" and prevent the mineral owners in the Wolfcamp pool from developing what they perceive as economic minerals is in direct contravention to correlative rights afforded by the Act and decades of case law.

ARGUMENT

Cimarex's legal analysis supporting its two options is flawed, contravenes the plain language of the Act, and is at odds with longstanding case law construing the statutory provisions at issue. Neither of Cimarex's "two options" is legally valid because they clearly impair the correlative rights of Wolfcamp owners.

B. CIMAREX'S OPTION 1 RESULTS IN TEXTBOOK IMPAIRMENT TO CORRELATIVE RIGHTS.

Under its first option, Cimarex contends it should be permitted to pool the Bone Spring formation and that the Division should prevent the owners in the Wolfcamp formation from drilling any offsetting wells. Cimarex contends any "drainage" from the Wolfcamp by the wells in the Bone Spring should be deemed "incidental" and not "production." *See* Cimarex Memo. Br. at 11, 16. Cimarex washes away any harm to the correlative rights of Wolfcamp owners by suggesting that in most cases, the differences in ownership are only slight and outweighed by Cimarex's more favorable economics for the Bone Spring owners. *Id.* at 12-14, 16. Cimarex concludes that even if there are concerns about correlative rights, the Division has authority to allocate production

Cimarex's contention that developing the Wolfcamp is uneconomic and will cause waste. But those are fact issues to be addressed at hearing.

between different owners in the pools, notwithstanding express statutory mandates to the contrary. *Id.* at 13-14. Each contention offered in support of this option is without legal basis and unsupported by case law or basic principles of statutory interpretation.

Cimarex's effort to prevent the mineral owners in the Wolfcamp formation from developing their oil and gas reserves is a textbook impairment of correlative rights.

1. Correlative Rights are Determined by Evaluating Whether Owners are Afforded an Opportunity to Produce, Not Economics.

Cimarex relies on legal treatises to contend protection of correlative rights under New Mexico law is a malleable concept that functions more as a "guide" and "not a rule." See Cimarex Memo. Br. at 2-3. Yet, New Mexico law is clear that "[w]aste will result unless the [Division] can also act to protect correlative rights." Cont'l Oil Co., 1962-NMSC-062, ¶ 27. Cimarex suggests that correlative rights is an evaluation of competing economics.[3] Yet, the plan language of the statute states that correlatives rights is an "opportunity to produce" their just and equitable share of the oil and gas in the pool. *See* NMSA 1978, § 70-2-17(A). Read & Stevens, Permian Resources and other affected working interest owners dispute Cimarex's economic arguments. But differing opinions over the economics of a drilling proposal is not a recognized test to gauge impairment of correlative rights, or even a factor. If an owner believes a proposed development is economically unsound that owner may simply opt against participating in one or more of the proposed initial wells without bearing any financial burden or risk for those wells. *See* § 70-2-17(C). Clear statutory provisions, adopteded in Division pooling orders, address the protection of owners who do not agree with a plan of development and do not want to undertake the financial risk or burden by

[3] *See* Cimarex Memo. Br. at 2-3, contending that Cimarex's plans "will realize significantly greater financial and pecuniary gain" thereby preventing waste and protecting correlative rights. *See also, id.*, at 5 (stating that Permian Resources' plan will be at "both great and unnecessary cost thus violating all participants correlative rights and causing gross waste.").

allowing them to opt out of a drilling project. But those economic concerns and protections are not incorporated into the concept of correlative rights.

Here, two owners[4] who favor Read & Stevens' plan of development own interests only in the Wolfcamp and others own a greater share of interests in the Wolfcamp than in the Bone Spring.[5] Under Cimarex's "two options," no wells will be allowed in the Upper Wolfcamp and the Division would impose a "buffer" preventing drilling in the separate Wolfcamp pool. The correlative rights of Wolfcamp owners would be irreparably impaired because they would be precluded from producing their share of production from the upper Wolfcamp intervals while those intervals are purportedly being drained by Cimarex's Bone Spring wells. No economic analysis can undo that harm. Under New Mexico law, such impairment of correlative rights is per se waste.

2. Correlative Rights Protect Against Unfair Production and Drainage.

Cimarex next confuses "proration units" with "spacing units" to distinguish "drainage" from "production" in an effort obfuscate the correlative rights issue that mandates denial of Cimarex's applications.

Reconfiguring the statute, Cimarex first invokes the definition of a proration unit, which defines the area that can be efficiently and economically drained by one well. *See* Cimarex Memo. Br. at 7; *see also* § 70-2-17(B). However, proration units are not at issue in this case. The Division has not prorated either pool at issue. What are proposed instead are horizontal well spacing units. *See Rutter & Wilbanks Corp. v. Oil Conservation Comm'n*, 1975-NMSC-006, ¶ 6, 532 P.2d 582 (stating the Act "explicitly maintain the distinction by the use of the phrase 'spacing or proration unit', indicating that the terms are not synonymous and implying that a spacing unit may be created

[4] *See* Read & Stevens Exhibit C-12 at 10-13 (CLM letter of support) and Exhibit C-12 at 15-16 (Warrant Associates letter of support).

[5] *See* Read & Stevens Exhibits C-8 and C-9.

independently of a proration unit."); *see also* § 70-2-17(C) (referring to the pooling of a "spacing or proration unit"). The area that may be drained by a single well has no bearing on the creation or force pooling of horizontal well spacing units and no part in this analysis.

Nor is there any basis to conclude from the language of the Act that "drainage" is somehow distinct from "production" for purposes of assessing impairment to correlative rights. Cimarex's suggestion that drainage is "incidental" and does not count as the type of "production"[6] bearing upon correlative rights contrasts with express language of the Act. The Act clearly recognizes that "drainage," which is the migration of oil or gas within the reservoir due to production from wells,[7] will impact the correlative rights of owners in offsetting tracts and must be prevented. *See* § 70-2-16(C) ("In protecting correlative rights, the division . . . shall prevent drainage between producing tracts in a pool which is not equalized by counter-drainage." (emphasis added)). While acknowledging that Cimarex does not know what amount of drainage their Bone Spring wells will cause in the Wolfcamp formation, Cimarex admits it could be as high as 26%.[8] Yet, Cimarex terms this "incidental" and suggests the Division is free to take away from the Wolfcamp owners the opportunity to produce their equitable share of that Wolfcamp production, protect against drainage,

[6] *See* Cimarex Mem. Br. at 6 (stating that "such drainage, as distinct from production[,]") and at 11 (stating that "any drainage of the Upper Wolfcamp that may occur should be naturally characterized as incidental to the primary target in the Bone Spring[.]").

[7] *See* Williams & Meyers Manual of Oil and Gas Terms (14th Ed. 2009) (defining "drainage" as the "[m]igration of oil or gas in a reservoir due to a pressure reduction caused by production from wells bottomed in the reservoir.").

[8] *See* Cimarex Application in Case No. 23594-23601, stating that proposed Bone Spring wells "will properly produce both the Wolfcamp and Third Bone Spring, as demonstrated by the history of production in this area[.]"; *see also* Cimarex Supplement to Proposal to Drill, dated June 15, 2023, attached as Exhibit A to Read & Stevens' Resp. in Opposition to Motion for Continuance, filed on July 18, 2023 (stating that Cimarex's wells will "produce the primary concentrations of hydrocarbons in the Wolfcamp").

and produce what Cimarex's Bone Spring wells are unable to produce in the proposed "buffer." *See* Cimarex Memo. Br. at 11. Nothing in the Act supports such a conclusion.

B. CIMAREX'S OPTION 2 IS LEGALLY INVALID.

Under this option, Cimarex contends it can simultaneously dedicate its proposed Bone Spring wells to a Bone Spring spacing unit and an underlying Wolfcamp spacing unit, even though no well will penetrate or be completed in the Wolfcamp pool. *See* Cimarex Memo. Br. at 17. Similar legal infirmities that invalidate Cimarex's first option defeat its second option with some additional statutory and regulatory deficiencies.

1. Cimarex's Proposed "Option 2" to Mitigate Violation of Correlative Rights Is Not Authorized by the Pooling Statute.

The Division does not have authority to allocate production between owners in different pools in the manner Cimarex proposes under "Option 2." Pooling is done by division designated pools. Once the Division determines a pool, the New Mexico's compulsory pooling statute mandates that production from a spacing unit created for that pool be shared strictly in proportion to each owners' surface acreage ownership within the spacing unit. *See* § 70-2-17 ("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." (emphasis added)).

Because the Bone Spring and Wolfcamp formations have been designated by the Division as separate pools, and have separate owners and ownership percentages, it is not possible to issue an order pooling Bone Spring spacing units and then allocate production to separate owners in the Wolfcamp pool on a surface acreage basis. Any portion of production from a Bone Spring spacing unit allocated to owners in the Wolfcamp to purportedly mitigate impairment to their correlative

rights would reduce by some amount the share of production allocated to the Bone Spring owners. Each Bone Spring owners' share would be something less than their proportionate interest in 100% of the production attributable to the spacing unit on a surface acreage basis. The Division has no legal authority to impose such an allocation.

Cimarex ignores this legal impediment by asserting correlative rights do not guarantee a "concrete and specific percentage" of production from a pool. *See* Cimarex Memo. Br. at 13. Cimarex confuses the concept of correlative rights with the statutory requirement under compulsory pooling orders to allocate production within a spacing unit on a surface acreage basis. These provisions must be read in harmony.[9] While correlative rights afford the opportunity to produce a just and equitable share of the oil and gas in a pool, once a spacing unit is subject to a compulsory pooling order and initial wells commence production the Division is mandated to allocate 100% of that production to the owners in the spacing unit on a strict surface acreage basis. *See* 70-2-17(C). The Act does not authorize the Division to allocate the production to the owners in the Wolfcamp formation from wells dedicated to a spacing unit in a Bone Spring pool.

Cimarex contends the Division's broad grant of authority "to do whatever may be reasonably necessary to carry out the purpose" of the Act means the Division can ignore this express mandate and invoke its discretion to implement a different result. While the Division's powers are broad, it is nevertheless "a creature of statute, expressly defined, limited and empowered by the laws creating it." *Cont'l Oil Co.*, 1962-NMSC-062, ¶ 11. "By its plain language," the allocation method under 70-2-17(C) is a "mandatory rule of law." *See Yedidag v.*

[9] *See Albuquerque Cab Co. v. N.M. Pub. Regulation Comm'n*, 2017-NMSC-028, ¶ 9, 404 P.3d 1 ("We read related statutes in harmony and give effect to all provisions.").

Roswell Clinic Corp., 2015-NMSC-012, ¶ 53, 346 P.3d 1136. The Division has no authority or discretion to contradict it.

2. Spacing Units Must Have a Well Proposed or Drilled (Completed and Perforated) in the Formation Targeted.

Cimarex astonishingly suggests nothing in the Act or Division regulations requires a horizontal well spacing unit to have a well actually drilled in the unit or completed in the pool or formation the unit covers.[10] That is simply wrong.

By statute, the Division is authorized to pool interests in a proposed spacing unit where owners have not agreed to pool their interests and where a well has been drilled or is proposed to be drilled "on said unit." *See* NMSA § 70-2-17(C) (emphasis added).[11] Accordingly, under the statute, a well must be drilled on the spacing unit—not merely "dedicated" to it and completed in another pool. Cimarex has not drilled a well nor has it proposed a well be drilled on its proposed Wolfcamp spacing units. The Division has no authority to pool owners into spacing units where no well has been drilled or proposed for the affected pool.

Division rules further require that horizontal well spacing units be comprised of tracts "that the horizontal oil well's *completed interval* penetrates[.]" 19.15.16.15.B(1)(a) NMAC (emphasis added). A horizontal well by definition must extend "a minimum of 100 feet laterally in the target zone" and the "completed interval" is the portion of the wellbore in that target zone that is "perforated." 19.15.16.7.G &19.15.16.7.B NMAC. Infill horizontal wells are further defined by reference to the "previously drilled or

[10] Cimarex Memo. Br. at 18.

[11] *See also id.* ("The portion of the production allocated to the owner or owners of each tract or interest included in a well spacing or proration unit formed by a pooling order shall, when produced, be considered as if produced from the separately owned tract or interest by a well drilled thereon." (emphasis added)).

proposed horizontal well in the same pool…" 19.15.16.7.H NMAC (emphasis added). A horizontal well must therefore penetrate and perforate the targeted pool underlying the tracts comprising the horizontal well's spacing unit to perfect that spacing unit.

For these reasons, all Division pooling orders always identify the pool for which the spacing unit is created and require a well to be drilled within that pool to perfect the spacing unit. Cimarex has not pointed to any Division pooling order stating otherwise. It is simply wrong to suggest the Division can create a horizontal well spacing unit for a Wolfcamp pool and not require a horizontal well to be completed and perforated in that Wolfcamp pool.

As with Option 1, Cimarex's Option 2 fails to protect correlative rights or prevent waste and conflicts with express mandates under the Act.

CONCLUSION

Cimarex's applications and its proposed alternatives would impair correlative rights of Wolfcamp owners and conflict with longstanding interpretation and application of the Act and its express provisions and governing regulations. Cimarex's applications and its alternatives must be rejected. The only way for the Division to fulfill its dual obligations to prevent waste and protect correlative rights is to approve co-development of both Division-designated Bone Spring and the Wolfcamp pools. Besides complying with the statutory and regulatory framework, this approach is also the most practicable to prevent waste and protect the correlative rights of all owners.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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