

**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. 14661
ORDER NO. R-13425**

**APPLICATION OF OGX RESOURCES LLC FOR APPROVAL OF A NON-
STANDARD OIL SPACING AND PRORATION UNIT AND COMPULSORY
POOLING, EDDY COUNTY, NEW MEXICO.**

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on June 9 and June 23, 2011 at Santa Fe, New Mexico, before Examiner David K. Brooks.

NOW, on this 11th day of July, 2011, 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) OGX Resources LLC ("Applicant"), seeks approval of a non-standard 183.9-acre, more or less, oil spacing and proration unit and project area ("the proposed Unit") in the Bone Spring formation consisting of Lots 2, 3 and 4 of Section 30 and Lots 1 and 2 of Section 31, Township 26 South, Range 29 East, NMPM, in Eddy County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit in the Bone Spring formation.

(3) Applicant proposes to dedicate the Unit to its Copperhead Fee A Well No. 1H [API No. 30-015-38227] ("the proposed well"), a horizontal well to be drilled from a standard surface location 480 feet from the South and West lines (Lot 2) of irregular Section 31. The well will penetrate the Bone Spring formation at a standard oil well location approximately 660 feet from the South line and 476 feet from the West line (Lot 2) of Section 31 and continue horizontally in the Bone Spring to a standard terminus, or

bottomhole location, 1650 feet from the North line and 330 feet from the West line (Lot 2 - Unit E) of Section 30.

(4) This is a wildcat area in the Bone Spring formation. Accordingly, spacing is governed by statewide Rule 15.9.A [19.15.15.9.A NMAC], which provides for standard 40-acre units, each comprising a governmental quarter-quarter section or lot. The proposed Unit consists of five adjacent lots, as platted on the official survey, each of which is a quarter-quarter section equivalent.

(5) Applicant appeared at the hearing through counsel and presented geologic evidence by affidavit to the effect that:

(a) this area is suitable for development by horizontal drilling; and

(b) all lots to be included in the Unit are expected to be productive in the Bone Spring, so that formation of the Unit as requested will not impair correlative rights.

(6) The Division's geologic witness did not, however, explain the reasons for the size or configuration of the proposed Unit. Specifically, he did not testify to any geologic reason for excluding Lot 1 of Section 30, which lies immediately north of the proposed north-south oriented Unit. Nor did he or any other witness testify that a geologic or economic basis exists for including portions of Section 31 in the proposed Unit rather than developing the undeveloped portion of Section 31 with three-quarter mile east-west laterals.

(7) Chesapeake Operating, Inc., an owner of a working interest in the proposed Unit that is not committed to the proposed well, appeared at the hearing through counsel but presented no evidence.

The Division concludes that:

(8) This case involves important issues concerning the extent of the Division's authority to order compulsory pooling of "project areas" for horizontal wells and the manner in which the Division should exercise that authority.

(9) Division Rule 19.15.16.7.I [19.15.16.7.I NMAC] authorizes an operator to designate a "project area" for a "directional well" which may include multiple spacing units. This provision does not limit the size or configuration of a project area otherwise than by requiring that it include only complete, contiguous spacing units. However, by providing that a project area may comprise multiple spacing units, this rule clearly distinguishes a "project area" from a "spacing unit."

(10) The New Mexico Oil and Gas Act limits the Division's compulsory pooling authority to pooling separate, individual "spacing units". NMSA 1978, Section 70-2-17, as amended.

(11) The Supreme Court of New Mexico, in *Rutter & Wilbanks Corporation v. Oil Conservation Commission*, 87 N.M. 286, 532 P.2d 939 (1975), recognized that the Division and the Commission have power to create spacing units, including "non-standard" spacing units which may be larger than standard spacing units in the pool or area where they are located. Thus the Court in that case upheld the Commission's order establishing two non-standard gas units comprising 409.22 acres and 407.20 acres, respectively, in a single 916.42-acre, irregular section, and ordering compulsory pooling of those large units. Standard spacing for the subject pool would have been 320 acres. The non-standard units approved, however, were within a single section and only 127% of the size of standard units.

(12) The Court in *Rutter & Wilbanks* did not discuss the limits of OCD's authority to create non-standard units in compulsory pooling cases. However, it stands to reason that there must be some limits. Otherwise the Legislature's mandate that compulsory pooling be on a spacing unit basis would be defeated.

(13) In recent months the Division has been besieged with applications to establish non-standard spacing units for horizontal wells that comprise multiple standard units and to compulsory pool the units so established. No existing OCD rule addresses this issue.

(14) A Division appointed task force is studying horizontal wells and is expected to propose rule amendments to address this and other issues. However, in the meantime, there is a need for guidance for operators and Division hearing examiners on this subject.

(15) Most of the applications seeking establishment of non-standard units for horizontal wells have sought to combine up to four 40-acre, more or less, oil units aligned north to south or east to west within a single governmental section. This configuration for horizontal well project areas has become sufficiently common in New Mexico that it can be described as approaching the status of an industry standard.

(16) In order to comply with statutory policy and to protect correlative rights, the Division Director has concluded that applications for establishment and compulsory pooling of non-standard oil units departing from the parameters described in Finding Paragraph (15) should not be granted except in unusual cases where persuasive technical evidence demonstrates that departure from these parameters is essential to prevent waste or to protect correlative rights.

(17) Such evidence is not present in this case. Applicant's geologist did not testify to any geologic reason for excluding Lot 1 of Section 30 from the proposed Unit. Nor did he or any other witness testify that a geologic or economic basis exists for including portions of Section 31 in the proposed Unit rather than developing Section 31 with three-unit, east-west laterals. Indeed, the maps that Applicant presented show numerous east-west oriented horizontal wells in the Bone Spring in this vicinity, and Applicant is proposing another east-west horizontal in adjoining Section 32.

(18) The witness presented an isopach map which shows only minor differences in indicated formation thickness throughout all of Sections 30 and 31, and suggests that a well anywhere in either of those sections would likely encounter greater formation thickness than the well Applicant is simultaneously proposing in Section 32. Furthermore, the witness did not testify that the variations depicted on his isopach map controlled or even influenced the size or configuration of the proposed Unit.

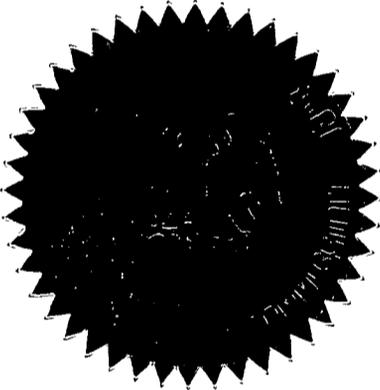
(19) Thus the Division cannot conclude that the establishment in this case of a non-standard unit comprising more than four standard units, and parts of two different sections, is necessary to prevent waste or to protect correlative rights.

IT IS THEREFORE ORDERED THAT:

(1) The application of OGX Resources LLC for establishment of a non-standard 183.9-acre, more or less, oil spacing unit in the Bone Spring formation consisting of Lots 2, 3 and 4 of Section 30 and Lots 1 and 2 of Section 31, Township 26 South, Range 29 East, NMPM, in Eddy County, New Mexico, and for compulsory pooling of the proposed Unit, is hereby denied.

(2) 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.



SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

JAMI BAILEY
Director