

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

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**IN THE MATTER OF THE APPLICATION OF THE
NEW MEXICO OIL CONSERVATION DIVISION
FOR ADOPTION OF AMENDMENTS TO 19.15.14.8
AND 19.15.16 NMAC**

CASE NO. 14744

**THE OIL CONSERVATION DIVISION'S PROPOSED
FACT AND CONCLUSIONS OF LAW**

COMES NOW the Oil Conservation Division (Division), Applicant for adoption of amendments to 19.15.14.8 and 19.15.16 NMAC, with the following proposed facts and conclusions of law:

Facts:

1. This matter came before the Oil Conservation Commission (Commission) on October 20th and 21st of 2011.
2. The Division proposed amendment of 19.15.14.8 and 19.15.16 in order to better address the new technology of horizontal drilling. *Transcript* pg 17 lines 12-17.
3. The Division formed a workgroup consisting of members from the oil and gas industry, New Mexico State Land Office, Bureau of Land Management and the Division. Pgs. 23-24, lns. 25-5.
4. David Brooks was co-chair of the workgroup and is an expert in oil and gas law, land matters and oil and gas regulations. Pg. 29, lns 13-16. Pg. 31 lns. 8-9.

5. The Division proposed amendment of 19.15.14.8 NMAC in order to add the requirements to an application for permit to drill that prior to application the applicant must have the permission of at least one owner at the proposed bottom hole location of the well. Pgs 31-32, lns 22-4.
6. The proposed amendment of 19.15.14.8 NMAC would codify the certification already required on Form C-102. Pg. 32, lns 9-19.
7. The Division has proposed a special consent provision for horizontal wells at 19.15.16.15.A which would require an operator to have the consent of lessee or owner of an unleased mineral interest in each tract the horizontal well penetrates prior to approval of an application for permit to drill. Pgs 33-34, lns 19-8.
8. The Division has proposed the definition for “completed interval” (19.15.16.7.B) in order to define that portion of a horizontal wellbore that will draw hydrocarbons from the formation and that is located within the required setbacks. Pg. 35, lns 19-25.
9. Requiring only the “completed interval” of a horizontal well to be beyond the setbacks from adjoining tracts does not interfere with correlative rights because the portion of the wellbore not included in the completed interval is behind pipe and will not be drawing hydrocarbons from the formation. Pg. 38, lns 2-20.
10. Adopting the definition for “completed interval” would reduce the number of non-standard location requests. Pgs. 38-39, lns 25-9.
11. The Division has proposed a definition for “horizontal well” because there currently is not one in Division regulations and in order to clarify the difference between directional well and horizontal well. Pgs. 40-41, lns 19-15.

12. The definition for “project area,” proposed by the Division (19.15.16.7.K) is a slightly modified definition because it expressly provides that project area boundaries may cross section lines and that certain types of units that exist under present law, including state exploratory units, may be treated as a project area. Pgs. 41-42, Ins. 19- 22.
13. A “standard project area” (19.15.16.7.L) is a “project area” that is rectangular in shape. Pg. 45, Ins. 9-17.
14. A “project area” consisting of three 40-acre, more or less, spacing units within a single section, and excluding a fourth section adjacent thereto is rectangular and would be a “standard project area.” However, this is the result of a drafting error because the Division intended that a project area configured in this way be “non-standard” due to the omission of the fourth 40-acre unit. Pg. 48, Ins 1-7.
15. The Division has proposed amendment 19.15.16.15.G, formation of project area, in order to provide a notice requirement to affected offsetting owners and operators as a prerequisite to forming a “non-standard project area.” Pgs. 48-49, Ins 23-8.
16. Correlative rights are protected by the proposed amendments for “project areas,” “standard project areas,” “non-standard project areas” and formation of project areas. Pgs. 50-51, Ins 23-4. The formation of standard project areas, except perhaps in the situation described in Finding 14, will not impair correlative rights, and where a non-standard project area is proposed, owners who have concerns about correlative rights will have an opportunity to present those concerns to the Division before the project area can be formed.

17. The proposed amendment for unorthodox locations requires an operator to obtain approval for a well bore's completed interval which is located more than 50 feet from its projected location. This is similar to the existing requirements for a vertical well. Pgs. 51-52, lns 24-10.
18. The proposed amendment concerning allowables for horizontal wells in a unit that includes an existing vertical well will provide for computation of the allowable by multiplying the number of spacing units times the per-unit allowable as provided in the present rule and then deducting the entire production of that vertical well, so that the vertical well is not adversely affect as to its allowable by a subsequent horizontal well. Pg. 53, lns 9-15.
19. An allowable should be calculated by subtracting the lesser of the actual production from any existing well or the applicable unit allowable since an existing well that is overproducing its allowable should not be allowed to continue to do so. Pg. 53, lns 16-25.
20. Correlative rights will be protected by computing the allowable for a horizontal well by multiplying the number of spacing units times the per-unit allowable and then deducting the lesser of actual production or the applicable unit allowable of the vertical well so that the vertical well is not adversely affect as to its allowable by a subsequent horizontal well. Pg. 55, lns 2-8.
21. The words "or develops" should be deleted from the provisions regarding computation of allowable in 19.15.16.B(3) because it adds uncertainty to the determination of allowables and is difficult to administer. Pg. 59, lns 7-22.

22. Proposed amendment 19.15.16.15.B requires two form C-102s should be filed with the appropriate district office to show the project area as well as the area that the horizontal well actually penetrates. This provision will assist the district offices. Pg 58, lns 17-21.
23. A new well in an existing project area can only be drilled pursuant to a joint operating agreement or consent of all the working interest owners or pursuant to a Division order, which would protect correlative rights [proposed 19.15.16.15.D(2)]. Pg 63-64, lns 14-5.
24. Consolidation of ownership in a project area is necessary prior to production of a well dedicated to a project area [proposed 19.15.16.15.H]. Pg. 76, lns 11-25.
25. A project area that crosses section lines is not an “exploratory unit” if it is to be dedicated to a single well. Pg. 82-83, lns 3-10.
26. Compulsory Pooling Rule 19.15.13 is not being amended. Pg 106-107, lns 21 -2.
27. Proposed Rule 19.15.16.15.F, entitled “Compulsory pooling” should be deleted in order to remove any suggestion that all project areas are subject to compulsory pooling. 19.15.16.15.G and 19.15.16.15.H should be re-numbered as 19.15.16.15.F and 19.15.16.G, respectively.
28. Proposed 19.15.16.15.H (re-numbered as 19.15.16.15.G) should be changed to read, in lieu of “voluntary agreement for compulsory pooling”, “voluntary agreement or, if applicable, compulsory pooling” for the same reason.
29. The proposed amendments will further conservation and prevention of waste by facilitating the drilling or horizontal wells that will produce additional hydrocarbons

that may not be produced by vertical wells and will protect correlative rights. Pg. 127, lns 9-12. and Pg 201, lns 14 -24.

30. The proposal of Harvey E Yates Company (“Heyco”) to amend 19.15.16.15.A(1) to prohibit drilling a horizontal well into a tract covered by an operating agreement (JOA), without the consent of the parties to the JOA, and the proposals of Heyco and Jalapeno Corporation (“Jalapeno”) to prohibit designation of a project area including a tract covered by a JOA without such consent, are not necessary to protect correlative rights because, if the project area is subject to compulsory pooling, the Division has a duty to protect those owners’ correlative rights in any order, and if it is not subject to compulsory pooling, the well could not be produced without the agreement of all owners.
31. The proposals of Heyco and Jalapeno concerning the risk charge to be assessed against non-participating interest owners in compulsory pooling proceedings should not be adopted because (a) it, in effect, amends 19.15.13 NMAC, which the notice of this proceeding did not contemplate amending, and (b) there is no evidence that the proposed presumption of a 50% risk charge for horizontal wells is appropriate.
32. The proposal of Jalapeno to limit compulsory pooling for a horizontal well to the area that would constitute a single spacing unit for a vertical well should not be adopted because there is no evidence that the same size or configuration of spacing unit is always, or in any particular pool or area, appropriate for horizontal as for vertical wells.
33. Conclusions of Law:
 1. The Commission is empowered to adopt rules. NMSA 70-2-11.

2. The Commission (and the Division) has statutory duty to prevent waste and protect correlative rights. NMSA 70-2-11(A) and *Continental Oil Co. v. OCC*, 70 N.M. at 323, 373 P.2d at 817 (Sup. Ct. 1962).
3. The legislature has prohibited the waste of crude petroleum oil or natural gas of any type or in any form. NMSA 70-2-2.
4. 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 his just and equitable share of the oil or 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 his just and equitable share of the reservoir energy. NMSA 70-2-33
5. The Commission and the Division have the statutory authority and duty, upon appropriate application, to compulsory pool any “spacing or proration unit” the owners of which have not agreed to pool, in order to prevent the drilling of unnecessary wells, prevent waste or protect correlative rights. NMSA 1978 Section 70-2-17.
6. This power extends to non-standard, as well as standard, spacing units. NMSA 1978 Section 70-2-18. *Rutter and Willbanks v. OCC*, 87 N.M. 286, 532 P.2d 582 (Sup. Ct. 1975).
7. A non-standard spacing unit may be approved and compulsory pooled in the same proceeding. *Rutter and Willbanks*.

8. The Commission and the Division have the power to establish both standard and non-standard spacing and proration units. NMSA 1978, Section 70-2-11.B(10).
9. However, the extent of the Commission's and the Division's authority to establish non-standard spacing or proration units or special spacing or proration for horizontal wells has not been clearly delineated by either judicial or Commission precedent.
10. Accordingly, the Commission concludes that it would be inappropriate to adopt a rule on this subject at this time.
11. In order to forestall any possibility that the rule amendments being adopted would be construed to authorize compulsory pooling of horizontal well "project areas" without regard to applicable statutory and regulatory limitations, the changes to the proposed amendments set forth in the Division's Supplemental Application (Fact Findings 28 and 29) should be adopted.
12. The adoption of the amendments proposed by the Division, as modified, will assist the Division in carrying out its statutory mandates of preventing waste and protecting correlative rights, and aid oil and gas companies in utilizing horizontal well technology.
13. The requirements of the amendments proposed by the Division, as modified, are reasonable and alternative regulatory methods would not accomplish the Division's objectives.
14. Since the Division has a mandatory duty to compulsory pool a spacing or proration unit upon appropriate application where the prescribed predicate facts are shown, the Commission lacks power to limit by rule the Division's authority to pool spacing units or to require the consent of particular owners to compulsory pooling.

15. Accordingly Heyco's proposal to require the consent of parties to a JOA covering only part of an area to be pooled, and Jalapeno's proposal to limit compulsory pooling for horizontal wells to spacing units already established for vertical wells, only and in all circumstances, should not be adopted.

WHEREFORE, the Division asks the Commission to adopt these facts and conclusions of law.

RESPECTFULLY SUBMITTED,



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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing pleading was electronically mailed on the following party on November 21, 2011:

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I hereby further certify that a copy of the foregoing pleading was mailed on November 21, 2011 to:

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A handwritten signature in black ink, appearing to read "Gabrielle A. Gerholt", written over a horizontal line.

Gabrielle A. Gerholt