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February 10, 2016

Via Email & U.S. Mail
florene.davidson@state.nm.us
Florene Davidson
Oil Conservation Division
New Mexico Department of Energy, Minerals and Natural Resources
1220 South Saint Francis Drive
Santa Fe, New Mexico 87505

Re: Application of Matador Production Company, Case No. 15366

Dear Ms. Davidson:

Transmitted herewith for filing is Matador Production Company's Reply In Support of Its Motion to Dismiss in the above-referenced case. I am also sending the same to you today by First Class U.S. mail.

Thank you for your assistance. Please contact me if you have any questions.

Sincerely,

Jennifer L. Bradfute

Enclosures
cc w/encl.: J.E. Gallegos
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STATE OF NEW MEXICO
DEPARTMENT OF ENERGY, MINERALS AND NATURAL RESOURCES
OIL CONSERVATION COMMISSION

APPLICATION OF MATADOR PRODUCTON COMPANY FOR A NON-STANDARD OIL SPACING AND PRORATION UNIT, COMPULSORY POOLING, AND NON-STANDARD LOCATION LEA COUNTY, NEW MEXICO.

CASE NO. 15366
ORDER NO. R-14097

MATADOR PRODUCTION COMPANY'S REPLY IN SUPPORT OF ITS MOTION TO DISMISS

Matador Production Company ("Matador") submits this reply to Amtex Energy, Inc.'s Response dated February 2, 2016.

INTRODUCTION

Amtex Energy, Inc. ("Amtex") is an experienced operator in New Mexico, familiar with the Division's hearing and notice procedures, and the express requirement that a person must enter an appearance or alternatively appear at the Division hearing in order to preserve the right to request a *de novo* appeal with the Commission. Nonetheless, despite the fact that it was provided notice of the Division's hearing, it failed to enter an appearance or request a continuance in Case No. 15366 until 22 days after the hearing was held. As a result, Amtex's Entry of Appearance was properly stricken by the Division it has no standing to seek *de novo* review of the Division's order.

The arguments asserted by Amtex in its Response are without merit. First, Amtex is not a party of record because the Division granted Matador's motion to quash Amtex's untimely entry of appearance. Second, Amtex inexcusably waited to assert its legal challenge to the

Division's regulations. Since the issuance of the horizontal well rule, numerous compulsory pooling orders have been entered by the Division for the development of horizontal wells allowing for a 200% risk penalty. Furthermore, Amtex previously allowed its interest to be compulsorily pooled for the development of a horizontal well drilled by Matador in an adjacent section. As a result, Amtex, through its inaction, waived any objections that it has vis a vis the application of the Division's rules for compulsory pooling of a non-standard proration unit. Third, Amtex's arguments concerning the validity of compulsory pooling of horizontal wells and the 200% risk are frivolous. The Division has a statutory obligation to pool separate tracts within non-standard proration units for the development of wells, to prevent waste and drilling of unnecessary wells. Furthermore, Amtex is precluded from challenging the 200% penalty in this case because it has repeatedly represented to both the Division and the Commission that it will not present any technical evidence at a Commission hearing. Accordingly, Amtex cannot, as a matter of law, satisfy its burden under 19.15.13.8 NMAC.

ARGUMENT

I. AMTEX IS NOT ENTITLED TO APPELLATE REVIEW OF THE DIVISION'S DECISION BECAUSE IT IS NOT A PARTY OF RECORD.

Amtex confuses the difference between who is a party entitled to notice and who is a party of record. Amtex was a party entitled to notice, but failed to assert itself as a party of record. To be a party of record, you have to appear before the Division before or during the Division hearing on an application. The Division did not recognize Amtex's entry of appearance because Amtex improperly waited until ***22 days after the Division hearing*** to file its entry of appearance with the Division. In its response, Amtex fails to provide an explanation for this delay. Amtex instead argues that the Oil and Gas Act does not limit when a party can request a *de novo* hearing. This argument is incorrect for several reasons.

The Division is vested with broad discretion to prescribe rules of order or procedure in connection with hearings and other proceedings. In NMSA (1978), 70-2-13, the Oil and Gas Act provides that:

> In addition to the powers and authority, either express or implied, granted to the oil conservation commission or division by virtue of the statutes of the state of New Mexico, the division is hereby authorized and empowered in prescribing its rules of order or procedure in connection with hearings or other proceedings before the division to provide for the appointment of one or more examiners to be members of the staff of the division to conduct hearings with respect to matters properly coming before the division and to make reports and recommendations to the director of the division with respect thereto.

As a result, the Oil and Gas Act in no way limits the Division's authority to determine whether an entry of appearance has properly been filed. Pursuant to this authority, the Division promulgated Rule 19.15.4.10(C) NMAC, which explains that a party who has not entered an appearance at least one business day prior to the pre-hearing statement filing date "shall not be allowed to present technical evidence at the hearing unless the commission chairman or the division examiner, for good cause, otherwise directs." In this case, Amtex did not enter an appearance at the requisite time before the hearing on the matter, did not both to show up for hearing to present any objections for the hearing officer's consideration, and did not have good cause, nor any cause, for its 22 day delayed attempt to enter an appearance.

Amtex asks that the Commission overlook the deadlines established in Rule 19.15.4.10(C) NMAC by broadly construing Rules 19.15.4.10(B) NMAC and 19.15.4.23 NMAC.[1] This argument is not in accordance with New Mexico law. The New Mexico Courts have long held that regulations must be construed in a manner which does not render one of the

[1] In doing so, Amtex relies on *Green v. Kase*, 1992-NMSC-004, ¶ 7, 113 N.M. 76 which involved the Human Rights Commission and inapposite statute which allowed "any person" aggrieved by the proceeding to request a de novo appeal. Here, the Oil and Gas Act does not give an automatic appellate right to "any person."

provisions superfluous. *See, e.g., Regents of Univ. of N.M. v. N.M. Fed'n of Teachers*, 1998-NMSC-20, ¶ 28, 125 N.M. 401, 962 P.2d 1236; *Romero v. Laidlaw Transit Servs.*, 2015 N.M. App. LEXIS 85, *10-11 (N.M. Ct. App. July 31, 2015) (slip opinion); *Pub. Serv. Co. v. N.M. Taxation & Revenue Dep't*, 2007-NMCA-050, ¶ 39, 141 N.M. 520. If the Commission accepts Amtex's unwarranted construction of Rules 19.15.4.10(B) NMAC and 19.15.4.23 NMAC, it would render the deadlines established in 19.15.4.10(C) meaningless. There would simply be no point in establishing a deadline to present evidence to the Division if someone could interject themselves into the case after the Division has held its hearing, enter an appearance and obtain a *de novo* hearing with the Commission. Furthermore, it was never the intent of the Legislature in establishing a separate Oil and Gas Division and Commission, to allow parties to circumvent the Division hearing process. Indeed, Amtex fails to cite to a single Commission Case in which a party was allowed to file a *de novo* appeal to the Commission without first participating in the underlying hearing being appealed.

II. AMTEX SEEKS TO RAISE UNTIMELY JURISDICTIONAL AND LEGAL ISSUES

Amtex argues in its Response that it intends to limit its assertions to a legal challenge as to: (1) the Division's authority to compulsory pool proration units established for horizontal wells under Rule 19.15.16.15(F) NMAC, and (2) the 200% risk penalty established in Rule 19.15.13.8 NMAC.

Amtex should be prevented from asserting a challenge to the Division's authority to compulsory pool a non-standard unit. In 2014, Amtex's interests were pooled in an almost identical case in the E/2 E/2 of Section 16 under Order No. 15243. In Paragraph 15 of the Order, the Division concluded that a 200% risk penalty was appropriate. Amtex did not assert any objections to these findings. Moreover, Rule 19.15.16.15 NMAC was originally

promulgated in 2008 and was subsequently amended in 2012. Rule 19.15.13.8 NMAC was issued in 2008 and the rules providing for a presumptive 200% risk penalty were later addressed during a 2012 rulemaking proceeding. Prior to issuing and amending these rules, the Division initiated rulemaking proceedings in which it examined evidence and allowed for industry participation. Amtex did not participate in the rulemaking process, nor did it make its objections known to the Division or the Commission. Following the issuance of these rules, innumerable Division orders have been issued which pool contiguous spacing units for the development of horizontal wells and impose a 200% risk penalty for non-operators who elect not to participate in the costs of drilling the well. As a result, Amtex's arguments are untimely and would significantly prejudice the Division, Commission and numerous operators within the State.

Amtex's delay in asserting a challenge to the foregoing rules is not only improper, but it also could have a significant impact on the majority of compulsory pooling orders issued over the last decade. In similar circumstances, the Tenth Circuit and United States Supreme Court have held that untimely regulatory challenges are either waived or barred by the doctrine of laches. *See, e.g., New Mexico Envtl. Imp. Div. v. Thomas*, 789 F.2d 825, 835 (10th Cir. 1986) (refusing to consider an argument that the agency's decision resulted in "illegal discrimination" because such argument was not presented to the agency during the notice-and-comment period of rulemaking); *Dep't of Transp. v. Pub. Citizen*, 541 U.S. 752, 764-65, 124 S. Ct. 2204, 159 L. Ed. 2d 60 (2004) (refusing to examine an argument that the agency failed to consider possible alternatives to its final regulations because such argument was not presented to the agency "in order to allow the agency to give the issue meaningful consideration"); *Biodiversity Conservation All. v. Jiron*, 762 F.3d 1036, 1091 (10th Cir. 2014) (holding that laches applies to

untimely challenges); *J.D. Kirk, LLC v. Cimarex Energy Co.*, 604 Fed. Appx. 718, 728 (10th Cir. 2015) (same). As a result, Amtex's delay in asserting its arguments has resulted in a waiver of its right to challenge the validity of Rules 19.15.16.15(F) NMAC and 19.15.13.8 NMAC. This is especially true since, as discussed below, these Rules were issued in accordance with the Oil and Gas Act.

III. AMTEX'S ARGUMENTS AND WITHOUT MERIT AND SUPPORT THE GRANTING OF MATADOR'S MOTION

A. Matador's Application Properly Sought the Creation of a Non-Standard Proration Unit.

Amtex's argument that Division is not entitled to form non-standard spacing and proration units for the development of horizontal wells is without merit. In NMSA (1978), §§ 70-2-17 and 70-2-11, the Legislature vested Division with authority to create the rules for spacing and proration units. This authority is not limited to the creation of standard proration units for vertical wells. Instead, the Division is empowered generally to pool interests located in spacing and proration units, including non-standard spacing units and project areas for horizontal wells. *See* NMSA (1978), § 70-2-11 (empowering the Division with authority to "make and enforce rules, regulations and orders, and do whatever may be necessary to carry out the purpose of" the Oil and Gas Act.); NMSA (1978), § 70-2-17 (vesting the Division with authority to establish "proration units" and issue compulsory pooling orders for development within lands located with a "spacing or proration unit, without any limitation.").

Similarly, in *Rutter & Wilbanks Corp. v. Oil Conservation Comm'n*, 1975-NMSC-006, ¶ 15, 87 N.M. 286, 289, the New Mexico Supreme Court held that "it would be absurd to hold the Commission does not have authority to pool separately owned tracts within an oversize non-standard spacing unit." Pursuant to the holding in *Rutter & Wilbanks Corp.*, the Commission

found in Order No. R-13499, p. 11 that the "Commission and Division have the power to establish both standard and non-standard spacing and proration units under NMSA 1978 Section 70-2-11.B(10)," and that "[a] non-standard spacing unit may be approved and compulsory pooled in the same proceeding."

Tellingly, Amtex does not specifically take issue with the Division and Commission's authority to create non-standard proration units. Amtex instead argues that the Division's rules do not allow horizontal well project areas to be pooled. This argument conflates a request for the establishment of a non-standard proration unit with the establishment of a horizontal well project area, and the Division and the Commission have repeatedly rejected the arguments being asserted by Amtex. *See* Division Order Nos. R-14053; Commission Order No. R-13708-A (for Case No. 14966). In Commission Order No. R-13708-A, the Commission found that "[t]he amended horizontal well rules do not restrict the lateral length of a horizontal well that may be drilled, ***or the size of a non-standard spacing unit*** for a horizontal well which may be pooled. Commission Conclusions, ¶ 5 (emphasis added). As a result, the Commission concluded in Order R-13708-A that it was appropriate to pool interests when pooling would prevent waste and the drilling of unnecessary wells. This is because the primary responsibility of the Division and the Commission is to prevent waste. *See, e.g.*, NMSA (1978), §§ 70-2-2, 11. The applications and issues of law in Case Nos. 14966 and 15363 are indistinguishable from the issues in this case. As a result, it is clear that the Division and Commission have discretion to issue orders which create non-standard proration units and compulsory pool interests within those units.

B. Rule 19.15.16.15(F) Does Not Violate the Oil and Gas Act.

Rule 19.15.16.15(F) NMAC does not contradict the Oil and Gas Act, but instead

requires compulsory pooling for the development of horizontal wells in cases where:

> ...a horizontal well is dedicated to a project area in which there is more than one owner of any interest in the mineral estate, the operator of the horizontal well ***shall*** cause the project area to be consolidated by voluntary agreement or, if applicable, compulsory pooling before the division may approve a request for form C-104 for the horizontal well.

(Emphasis added). Nothing within rule states that horizontal well project areas can be pooled without a separate request for a non-standard proration unit. Matador's application complied with these requirements because it sought to consolidate the project area for the Cimarron State 16-19S-34E RN #133H well. As a result, Amtex's challenge to Rule 19.15.16.15(F) is unfounded.

Furthermore, consolidation of a project area through compulsory pooling is necessary when interest owners within the proration unit will not agree to participate in the development of a well. Rule 19.15.16.15(A) states:

> An operator shall not file an application for permit to drill nor commence drilling of a horizontal or directional well until the operator has either:
>
> (1) received the consent of at least one lessee or owner of an unleased mineral interest in each tract (in the target pool or formation) in which any part of the well's completed interval will be located; or
>
> (2) ***obtained a compulsory pooling order from the division.***

Rule 19.15.16.15(A) NMAC (emphasis added). Thus, the above language clearly indicates that pooling is the proper and required procedure to follow when an operator does not receive consent from at least one lessee or owner in each tract within a project area for a proposed horizontal well. Indeed, it is often the case that a lease does not cover an entire tract or proration unit. As a result, it is not uncommon for parties to seek compulsory pooling orders from the Division in these circumstances.

C. The Commission has Determined that a 200% Risk Penalty is Proper.

Amtex presents an unsupported argument that the 200% risk penalty is inappropriate. The plain language of Rule 19.15.13.8(D) NMAC states that who intend to challenge the 200% risk penalty have the burden of proving that the 200% risk charge sought is inappropriate. That burden must be met by presenting relevant geologic or technical evidence. *Id.* Here, Amtex has already argued to the Commission that it will not present any evidence at a de novo hearing. As a result, it cannot satisfy its evidentiary burden under Rule 19.15.13.8(D) NMAC.

Failing to recognize the plain language of 19.15.13.8 NMAC, Amtex instead incorrectly argues that Matador had a burden to present evidence to the Division to affirmatively establish that the 200% risk penalty was justified in this case. Instead, in Rule 19.15.13.8(A) NMAC, the Division and Commission have affirmatively established a presumptive 200% risk penalty is appropriate. In fact, to challenge the 200% risk penalty a party must file a "timely pre-hearing statement" and present relevant geologic or technical evidence on the record at the Division hearing to show that a lesser risk penalty is justified. *See* 19.15.13.8 NMAC. As discussed above, Amtex did not file a timely pre-hearing statement, attempt to file a request for a continuance, or submit any technical evidence to the Division after it filed its entry of appearance. As a result, Amtex failed to present any evidence to the Division that the 200% risk penalty should not apply. More importantly, Amtex stated in the Response that it plans on raising purely legal positions before the Commission in a *de novo* appeal. Response, 3-4. As a result, it is clear that Amtex cannot satisfy the requirements established in 19.15.13.8 NMAC.

Nevertheless, Amtex seeks to assert a purely legal challenge to the 200% risk penalty created in Rule 19.15.13.8 NMAC. In doing so, Amtex does not indicate that Rule 19.15.13.8 NMAC violates the Oil and Gas Act. Amtex also does not argue that the Commission lacked a

reasonable basis for promulgating the rule. The New Mexico Courts have held that "[r]egulations that have been enacted by an agency 'are presumptively valid and will be upheld if [they are] reasonably consistent with the authorizing statutes.'" *Gila Res. Info. Project ex rel. King v. N. M Water*, 2015-NMCA-076, ¶ 20 (quoting *N.M. Mining Ass'n v. N.M. Water Quality Control Comm'n*, 2007-NMCA-010, ¶ 11, 141 N.M. 41, 150 P.3d 991). Here, there is nothing within the Oil and Gas Act that prohibits the creation of a presumed risk penalty. To the contrary, the Legislature mandated that when the Division issues a pooling order, the order must make definite provision for the advance payment of costs and may include a reasonable charge for risk involved in drilling the well, not to exceed 200%:

> ***Such pooling order of the division shall*** make definite provision as to any owner, or owners, who elects not to pay his proportionate share in advance for the prorata reimbursement solely out of production to the parties advancing the costs of the development and operation, which shall be limited to the actual expenditures required for such purpose not in excess of what are reasonable, but which shall include a reasonable charge for supervision ***and may include a charge for the risk involved in the drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' prorata share of the cost of drilling and completing the well.***

NMSA (1978), §70-2-17(C) (emphasis added).

Rule 19.15.13.8 NMAC was enacted to allow non-operating working interest owners the opportunity to challenge the presumptive 200% risk penalty on a case-by-case if and only if they followed the proper procedures. Namely, a challenge to the standard may be made by: (1) filing a timely pre-hearing statement with the Division, and (2) by satisfying its burden to produce evidence that a 200% risk penalty is not warranted. The ability for parties to appear at the Division hearing and present evidence affords the opportunity for case-by-case review according to *Viking Petroleum, Inc. v. Oil Conservation Comm'n of the State*, 1983-NMSC-091, ¶ 21, 100 N.M. 451 (affirming an order which allowed a 200% risk penalty). Furthermore,

Matador presented testimony at the Division hearing which established that the 200% risk penalty was appropriate. As a result, Amtex's arguments challenging the validity of Rule 19.15.13.8 NMAC are unfounded, and Amtex is precluded from raising these arguments since it failed to comply with the clear requirements in this rule.

CONCLUSION

For the foregoing reasons, Matador Production Company respectfully requests that the Commission grant its Motion to Dismiss.

Respectfully submitted,

MODRALL, SPERLING, ROEHL, HARRIS
& SISK, P.A.

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WE HEREBY CERTIFY that a true and correct copy of the foregoing pleading was mailed to the following counsel of record this 10 day of February, 2016:

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