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

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

Case No. 15782

MOTION TO DISMISS APPLICATION

Amtex Energy, Inc. ("Amtex"), by and through counsel the Gallegos Law Firm, P.C., requests that the New Mexico Oil Conservation Division enter its order dismissing this proceeding on several grounds: (1)) Matador does not have the right to drill in 80 of the 160 acres of the proposed spacing and proration unit so the Division has no statutory authority to order same; (2) the Division has no authority under statute or rule to enter a force pooling order on Matador's application which seeks approval of a non-standard oil spacing unit comprised of four separate forty acre oil spacing units for a horizontal oil well testing the Bone Spring formation; (3) Matador's application is brought pursuant to Commission Rule 19.15.13.8 (A), (C) and (D) NMAC, which is invalid and in violation of NMSA 1978, §70-2-17(C) in providing for a presumptive 200% risk penalty without the need for supporting evidence; and in shifting the evidentiary burden to a party contesting the 200% risk penalty; (4) Matador's application is invalid to the extent it seeks an order authorizing a 200% risk penalty on surface facility costs or other costs in excess of those provided by statute; and (5) the Division is not authorized to assess any risk penalty because proceedings in prior Division and Commission proceedings, notably Case No. 15363, have demonstrated that there is no objective standard utilized by the agencies to assess or impose a risk penalty.

As grounds for this Motion, Amtex states as follows:

1. Matador seeks approval of a non-standard oil spacing unit in the Bone Spring formation comprised of four separate 40 acre oil spacing units comprising the W/2 W/2 of Section 16, T-19-S, R-34-E, Lea County, New Mexico. Matador seeks to pool all mineral interest owners in order to drill the Cimarron State 16-19S-34E RN No. 131H Well, a horizontal well which will traverse all 160 acres. Matador seeks to pool "all mineral interests in the Bone Spring formation." The well will be drilled in an established oil pool.

2. Matador owns working interests in eighty acres comprising the N/2 of the acreage at issue in this application, but owns no working interests in the eighty acres comprising the S/2 of the acreage.

3. Amtex owns working interests affected by the compulsory pooling application and opposes this application. Amtex owns approximately 92.8% of the working interests in the S/2 of the acreage at issue. The other 7.2% is owned by parties aligned with Amtex in this proceeding.

A. Matador has no right to drill in the S/2 of the proposed unit.

4. As creatures of statute the Division and the Oil Conservation Commission are established by and their authority is limited to the enabling legislation as set forth in the New Mexico Oil and Gas Act, NMSA 1978 §70-2-1 et seq.; *Continental Oil Co. v. Oil Conservation Comm'n,* 1962-NMSC-1962, ¶ 11, 70 N.M. 301, 373 P.2d 809; *Marbob v. Oil Conservation Comm'n,* 2009-NMSC-13, ¶ 23, 146 N.M. 24.

5. Force pooling the two southern 40 acre units under the guise of forming a "Unit" is not authorized by the Oil and Gas Act under these facts. NMSA 1978 § 70-2-17(C) requires that an owner seeking authority to force pool acreage must have "the right to drill" on the acreage.

6. Matador owns no interest in the southern 80 acres of the proposed unit. Amtex owns 92.8% of the working interest in that acreage. It is entitled to develop wells and share in the oil from the Bone Springs formation on its two 40 acre existing oil spacing units. In fact, Amtex has current plans to develop its acreage. Granting Matador's application would result in a trespass, and a taking of Amtex's property and the correlative rights to production for the benefit of Matador who owns no interest in the 80 acres.

7. Matador has no working interest and no such right to drill on the two southern units comprising 80 of the acres at issue in this application. The Division has no authority to order compulsory pooling crossing spacing units at all, much less where the applicant owns no interest in some of the affected units. § 70-2-17. Statutory unitization does not apply to Matador's request. NMSA 1978 § 70-7-1 et seq.

B. The Division Has No Authority to force pool across spacing units

8. While the New Mexico Legislature in NMSA 1978 § 70-2-17 has authorized compulsory pooling *within spacing or proration units*, it has not authorized compulsory pooling of project areas linking and crossing multiple, standard spacing units. The Division authority to allow force pooling reads as follows:

> When two or more separately owned tracts of land are embraced within a spacing or proration unit, or where there are owners of royalty interests or undivided interest in oil and gas minerals which are separately owned or any combination thereof, embraced within such spacing or proration unit, the owner or owners thereof may validly pool their interests and develop their lands as a unit. Where, however, such owner or owners have not agreed to pool their interests and where one such separate owner or owners, who has the right to drill, has drilled or proposes to drill a well on said unit to a common source of supply, the division, to avoid the drilling of unnecessary wells or to protect correlative rights, shall pool all or any part of such lands or interests or both *in the spacing or proration unit as a unit.*

Emphasis added.

9. The lawful authority of the Division is related to pooling of interests in a spacing unit, be it a 320 acre gas unit or a 40 acre oil unit. Rule 19.15.15.11(B)(1) permits a non-standard spacing unit that is not less than 70 percent or more than 130 percent of a standard spacing unit.

10. A practice has arisen before the Division to consider force pooling applications seeking to combine four forty (40) acre oil spacing units into a 160 acre "project area." This practice has been entertained by the Division under the Special Rules for Horizontal Wells. Rule 19.15.16.15 NMAC. The Oil and Gas Act makes no mention of or allowance for what the Division has entitled a "project area." There is no legislative grant of authority to create project areas for a horizontal well comprised of a combination of complete, contiguous spacing units. The Commission has previously ruled that combining complete, contiguous spacing units is in the nature of unitization and is not properly considered in the creation of a non-standard spacing unit. *See Order* No. R-13228-F (November 4, 2010).

11. The stacking of 40 acre oil spacing units implicates multiple complex issues of ownership, of reservoir inconsistencies, of royalty responsibilities, of conflicts in the owner or owner who has the right to drill, and other factors that must be systematically and thoroughly analyzed in order for the legislature to consider the industry and public interest in determining whether authorizing legislation should be enacted. The Division is and has been exceeding its statutory authority by its *ad hoc* approach to this highly important subject.

12. The Commission has adopted and required observance by the industry of its Rules establishing spacing units. In the case of a well in a defined oil pool the spacing unit shall consist "of approximately 40 contiguous surface areas substantially in the form

of a square . . . ". Rule 19.15.15.9(A) NMAC. NMSA 1978 § 70-2-18(C) provides authority for the Division to establish nonstandard spacing units. The Commission has adopted and required observance of Rules governing nonstandard spacing units limiting, for example, a 40 acre oil spacing unit to a configuration of not less than 70 percent nor more than 130 percent of a standard spacing unit. Rule 19.15.15.11(B)(1) NMAC. The Special Rules for Horizontal Wells relied upon by Matador in this proceeding (19.15.16.15) are in conflict with the rules and procedures set forth above governing spacing units and the provisions controlling nonstandard spacing units.

13. Moreover, the Commission has previously entertained an application by the Division to amend Rule 19.15.14.8 NMAC and Rule 19.15.16 NMAC to address and allow for non-standard spacing or proration units or special spacing or proration for horizontal wells. The Commission properly declined to do so because its authority "has not been clearly delineated by either judicial or Commission precedent." See Order No. R-13499 (January 23, 2012).

14. The Commission has authority to create non-standard spacing units and to compulsory pool separately owned tracts "within an oversize non-standard spacing unit." *Rutter & Wilbanks Corp. v. Oil Conservation Comm'n*, 1975-NMSC-006, ¶ 15, 87 N.M. 286, 532 P.2d 582 (emphasis added); NMSA 1978, § 70-2-18(C). This authority allows an alteration of the acreage of a single spacing unit to be larger or smaller than a standard spacing unit which does not fit neatly into the standard acreage allocation, typically because of an irregular survey subdivision or topography. *Rutter* did not involve compulsory pooling across existing spacing units. The Court's decision in that case is not authority for the proposition that the Commission can establish a non-standard spacing unit which combines multiple, contiguous spacing units, though it has been so

cited in agency orders. The *Rutter* decision has been stretched beyond recognition to excuse creation of project areas.

C. Rule 19.15.13.8 is invalid as contrary to NMSA 1978 § 70-2-17

15. The New Mexico Oil Conservation Commission has held that Rule 19.15.13.8 NMAC "is a reasonable interpretation of the pooling statutes." Order R-14053-E entered in Case No. 15363. The Division has routinely applied the rule in force pooling applications. Amtex anticipates the Division will decide this force pooling application under the rule, and therefore raises its challenge to the rule at this stage of the proceedings.

16. Pooling orders authorized by §70-2-17(C) "may include a charge for the risk involved in drilling of such well, which charge for risk shall not exceed two hundred percent of the nonconsenting working interest owner's or owners' pro rata share of the cost of drilling and completing the well." Thus, the Legislature provided that risk penalties are discretionary, not mandatory. *State v. Guerra*, 2001-NMCA-031, ¶ 14, 130 N.M. 302, 24 P.3d 334 (word "shall" in statute construed as mandatory, and where shall and may have been juxtaposed in same statute, it must be concluded that the legislature was aware of and intended different meanings). The "may include a charge" language anticipates that there will be no risk penalty where there is no risk.

17. The Legislature intended, and the New Mexico Supreme Court has confirmed, that a party requesting imposition of a risk penalty is required to appear before the Division or the Commission and support the request with competent evidence. *Viking Petroleum, Inc. v. Oil Conservation Com'n of New Mexico*, 1983-NMSC-091, ¶ 20, 100 N.M. 451, 672 P.2d 280 (substantial evidence must be presented to support a risk determination).

18. Rule 19.15.13.8 provides that without any proof by the applicant, compulsory pooling orders shall provide the applicant will recover from the portion of nonparticipating owners' revenue, in addition to reasonable wells costs, a charge for risk of 200%. Moreover, any party to a compulsory pooling application seeking a different risk penalty "shall have the burden to prove justification for the risk charge sought by relevant geologic or technical evidence."

19. The rule improperly creates a presumption of a 200% risk penalty and improperly reverses the burden of proof relieving the applicant of its legal burden of proof. The Commission cannot modify Section 70-2-17 in the interest of efficiency and convenience.

20. Section 70-2-17(C) expressly provides that the risk penalty is to be assessed only "on the cost of drilling and completing the well." The Commission by Rule 35 (19.15.13.8 NMAC) has de facto amended the statute to allow a risk penalty to be charged on "well costs" defined to include the statutorily approved costs for drilling and completing, but unlawfully adding "the reasonable costs of . . . equipping the well for production." A well is routinely equipped on the land surface with a separator, pump jack, tanks, wellhead, and so on, only after it has been proven to be productive. There is no risk associated with that expense. The statute and common sense excludes any risk penalty on such costs.

21. In Case No. 15363, Matador asked in its force pooling application for a risk charge only on the cost of drilling and completing the well. However, in the course of the proceedings, Matador requested, and the Division granted, a risk charge on well costs as provided by the rule. Amtex raises this issue at this stage of the proceedings in the event

Matador requests a risk charge on costs in excess of those authorized by Section 70-2-17(C).

22. The Commission in Order R-14053-E refused to apply Rule 19.15.13.8 as written and denied Matador's request for a risk charge on the costs of equipping the well for production. See Order No. R-14053-E. The Commission's ruling on this issue was a de facto admission that the rule is contrary to law. The Commission's ruling in Order R-14053-E was proper, consistent with its authority under Section 70-2-17, and should be applied in all force pooling applications, including this one.

D. There is no established standard for assessing a risk charge

23. The Division and the Commission have made risk charge determinations in other force pooling applications where the parties disputed the appropriate risk charge. A reasoned reading of those evidentiary presentations, and the agencies' decisions, confirms that there is no objective standard used by either the Division or the Commission in assessing a risk penalty. See Case No.15363; Order R-14053-B; Order R-14053-E.

24. The Legislature did not specify a standard for assessing a risk charge in Section 70-2-17, leaving that task to the Commission. However, the Commission has never adopted a rule or regulation which sets forth the standard by which a request for a risk charge should be analyzed. The closest the Commission has come is in Rule 19.15.13.8(D) where it requires the party opposing an application to justify a lesser charge by "relevant geologic or technical evidence."

25. An agency decision is arbitrary and capricious if "lacking a standard or norm." *Planning & Design v. City of Santa Fe,* 194-NMSC-112, *¶ 23,* 118 N.M. 707, 713, 885 P.2d 628 (1994). It is arbitrary and capricious if "it is without a rational basis, when

viewed in light of the whole record." *Colonia Dev'p Council v Rhino Environmental Services,* 2005-NMSC-024, ¶13, 138 N. M. 133, 117 P.3d 939 (2005).

26. Because there is no standard for assessing risk in force pooling applications, parties such as Amtex must guess at what the Division or the Commission will consider relevant in each particular case in deciding the issue. That should not be how adjudicatory proceedings are handled, particularly for parties to whom the Commission has assigned the burden to establish a risk penalty other than the presumptive 200%.

WHEREFORE, Amtex requests that the Division dismiss Matador's Application in this proceeding and for such further relief as it deems appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served on the following counsel of record by electronic mail this 21st day of August, 2017.

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