



New NMOCD Horizontal Well Rules Appear Parallel with Industry Horizon

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On January 23, 2012, the New Mexico Oil and Gas Conservation Commission (“NMOCC”) unanimously approved new Rules for horizontal wells which set forth a more complete regulatory framework for drilling horizontal wells and forming project areas for horizontal wells in New Mexico (the “Rules”).¹

One of the key components of the Rules, and one of the major sources of discussion, is the definition and application of a “project area.” The originally proposed horizontal well Rules provided that “[i]f the project area to be dedicated to a horizontal well includes one or more spacing units that the well bore will not *penetrate* the operator shall file with the application for permit to drill two well dedication and acreage plats Form C-102 one of which shall depict the outer boundaries of the project area and the other of which shall depict the spacing unit or units the well bore will *penetrate*.”² This original language was logical because often times the horizontal well will not penetrate every spacing unit within the designated project area, and two plats would enable the Division to analyze both the outer boundaries of the project area and the spacing units in which the wellbore would penetrate.

Under the new Rules, however, the definition of “project area” changed to effectively require that the designated project area be *developed* by the horizontal well. The new meaning recites: “an area the operator designates on form (C-102), well location and acreage dedication plat, that comprises (1) one or more complete, contiguous spacing units (in one section or in more

¹ 19.15.16 *et seq.* NMAC, available at <http://www.emnrd.state.nm.us/ocd/Rules.htm>.

² See Original Proposed 19.15.16.15 NMAC, Application for Rule Amendment, Case No. 14744.

than one section) *that are developed by the horizontal well*; or (2) an entire voluntary or statutory unit for an approved enhanced recovery or pressure maintenance project, an approved state exploratory unit, or a participating area in a federal unit.” 19.15.16.7(L) NMAC.³ Although the operators continue to get the benefit of elimination of internal setbacks and no density limitations, newly adopted Paragraphs B-F of 19.16.16.15 NMAC eliminate any reference to filing two C-102s and to the term “penetrate”. Instead, the OCC deleted the entirety of the paragraph and relied solely on the new “develop” term in the definition of project area.⁴

Other noteworthy additions of the new Rules are set forth below:

- 1) Consent Required. 19.15.16.15(A) NMAC. When an operator files an APD to commence drilling of a horizontal well, it must also receive 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 obtain a compulsory pooling order from the Division. For ease in getting approval for a project area, when planning a new drilling unit, operators should set up its project area so that either no consent is required (i.e., it holds 100% working interest) or that its partner or partners will consent to the proposed plan.
- 2) Setbacks for Horizontal Wells. 19.15.16.15(B) NMAC. Horizontal wells drilled in project areas shall have setbacks from the outer boundaries of the project area the same as if the well were drilled in a single spacing unit for the pool (usually 330 feet for oil wells and 660 feet for gas wells). Furthermore, except for unorthodox locations, every point of the completed interval must meet the minimum setback requirement from the outer boundaries of the project area or the operator will have to get approval for an unorthodox location. These requirements will apply only to the portion of the well beyond the casing shoe of the last cemented casing string (in an open hole) or the first perforation (in a cased hole). This permits drilling outside the setbacks and building a curve that will allow the wellbore to penetrate the particular zone or member of the target formation close to the 330-foot, 660-foot, or

³ For provisions on how to form a project area, see 19.15.16.15(E) NMAC.

⁴ See transcript of the December 9, 2011 Case No. 14744 Commission hearing and Order No. R-13499 for the discussion of the term “penetrate” versus “develop” in designating a project area.

other, setback line. As before, no internal setbacks are required within the project area. Additionally, the horizontal well's surface location may be outside the setbacks or outside the project area itself, provided that the completed interval is entirely located within the project area and complies with the setback requirements.

- 3) Existing Wells. 19.15.16(C)(1) NMAC. Existing wells in existing spacing units or project areas included in new project area will remain dedicated to their existing spacing or project areas and will not become a part of the new project area unless otherwise agreed by all working interest owners in the project area.
- 4) Subsequent Wells. 19.15.16.15(C)(2) NMAC. Unless the joint operating agreement provides otherwise, an operator is only permitted to drill subsequent wells in a project area in the same, completed interval with the approval of ALL working interest owners in the project area or by order of the Division after notice to all working interest owners in the project area and opportunity for hearing. When entering into operating agreements or assuming operations under an existing agreement, operators should ensure that each working interest owner consents to drilling subsequent wells in the project area.
- 5) Pool Rules. 19.15.16.15(D) NMAC. Statewide rules or special pool orders currently in effect do NOT apply to horizontal wells. If another owner or operator of a tract in the same pool as the project area (that is not included in the new project area) contends that a horizontal well in the project area is impairing or will impair that owner or operator's correlative rights, may be granted relief after application, notice, and hearing as is necessary and appropriate. One remedy that the Division may impose is to limit the rate or amount of production from the project area. It appears that this works similar to how Colorado and Wyoming OCD's set up a "horizontal well spacing unit" which overlay existing vertical spacing units whether or not it produces from the same pool. NOTE: Although it would appear that the Division would not approve two different operators to bottom hole horizontal and vertical wells in the same, basic location and pool, recently the Division did just that. *See Application of Cimarex Energy Co., et al.*, NMOCD Order No. R-13490 (Dec. 14, 2011) (competing with Application of COG Operating LLC).
- 6) Allowables. Existing vertical wells within a horizontal well's project area will share the unit's allowable with the horizontal well. 19.15.16.20 NMAC. NOTE: Although allowable rules still apply, the great news is there are no density limits in these project areas.

- 7) Compulsory Pooling. Industry is uncertain as to whether tracts within a project area may be force pooled the same as within a spacing unit and whether the same provisions and process applies. *See* 19.15.16.15(F) NMAC. But it appears the Division is given authority under the rules to make it possible. Some dispute, however, whether the Division has statutory authority. *See* NMSA 1978, §70-2-17(c). To keep pace, NM Legislature should consider amending the same.
- 8) Multiple Completions (including Stacked Completions). The new Rules do NOT change multiple completions in New Mexico. 19.15.16.16 NMAC. Multilaterals are still one well. The process is the same. It appears that an operator can complete in different formations but that particular bottom hole must be separately assessed in a different project area and/or spacing unit.

Although there is some uncertainty as to the application of the new Rules, they generally provide much needed answers for New Mexico operators who intend to develop and operate horizontal wells.

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