



New Mexico's Evolving Horizontal Well Rules Leave Many Open Questions

By [Craig M. Berube](#)

When New Mexico enacted one of the nation's first compulsory pooling statutes in 1935, the technology did not yet exist to drill horizontal wells. Prior to 2008, most of the oil and gas wells were drilled vertically, and the existing New Mexico Oil Conservation Division (OCD) Rules did not adequately address horizontal well drilling and the approval of non-standard spacing units for horizontal wells. In May of 2009, the percentage of horizontal wells being drilled in the United States surpassed the number of vertical wells being drilled and, by 2014, most of the oil and gas wells drilled in the United States were hydraulically fractured horizontal wells. This raised questions about whether New Mexico's compulsory pooling statute applied to horizontal drilling, and the criteria by which spacing or proration units would be established for horizontal wells.

This article discusses the history of pooling in New Mexico, the recent 2018 amendments, and the questions that remain for operators navigating the legal landscape in New Mexico. We highlight some specific changes made by the 2018 rulemaking which, like the 2012 rulemaking, mostly sidesteps any comprehensive rewrite of pooling rules, especially as they pertain to compulsory pooling.

Legal Background

N.M. STAT. ANN. §70-2-17(C) grants the OCD the authority to pool two or more separately owned tracts of land embraced within a "spacing or proration unit," however a horizontal well typically traverses a larger project area made up of multiple spacing units. In *Rutter & Wilbanks Corporation v. Oil Conservation Commission*, 87 N.M. 286, 532 P.2d 582 (N.M. 1975), the New Mexico Supreme Court suggested that, because the OCD had the authority to establish oversize, non-standard spacing units, the OCD also had the power to compulsory pool non-standard spacing units created by horizontal wells. Still, *Rutter's* factual background was limited to an examination of vertical wells and the court did not decide whether the OCD had the authority to pool horizontal spacing units. As horizontal wells became one of the most valuable and emerging technologies in the oil and gas industry, the OCD undertook the development of horizontal well rules to clarify the specific criteria it applied to the creation of non-standard spacing units for horizontal wells.

2012 Rulemaking

In January 2012, the New Mexico Oil Conservation Commission codified (among other amendments) changes to N.M. CODE R. §19.15.16.15 pertaining to special rules for horizontal wells. These rules were developed by a work group formed by the OCD with input from the Regulatory Practices Committee of the New Mexico Oil and Gas Association. The horizontal well rules were substantially changed in 2018, and so for purposes of this article we simply note that

the 2012 rules were the first codification of special rules for horizontal wells by the OCD, and that the rules generally required (among other provisions):

- An operator have the consent of at least one lessee or owner of a mineral interest in each tract the horizontal well penetrates prior to approval of an application for permit to drill or the operator has obtained a compulsory pooling order from the OCD for an appropriate horizontal spacing unit;
- Existing wells in newly designated spacing units to remain dedicated to their existing spacing units unless otherwise agreed by all working interest owners;
- A new well in an existing spacing unit can only be drilled pursuant to a joint operating agreement or consent of all working interest owners or pursuant to a division order which would protect correlative rights; and
- Pool rules that limit the number of wells that may simultaneously produce from the portion of a pool or area underlying a spacing unit, or a particular portion of a spacing unit, do not apply to horizontal wells.

In addition, an excluded owner or operator of a tract in the same pool or spacing unit can apply for a hearing on the alleged impairment of the party's correlative rights.

2018 Rulemaking

The Commission made substantial changes to the horizontal well rules, by Order of the Commission, Case No. 15957, Order No. R-14689, issued May 22, 2018, to bring the rules more in line with current industry standards for horizontal drilling. These amendments create new definitions for horizontal spacing units, affected persons in spacing units, first take point, last take point, infill horizontal wells, multi-lateral horizontal wells, and unitized areas, among other terms.

The 2018 amendments further allow for: (1) Wells to be drilled with smaller setbacks within a spacing unit; (2) Wells to be drilled in spacing units larger than 40-acres; and (3) Simultaneous drilling of infill horizontal wells that fall within a single horizontal spacing unit. The amendments also create new provisions that specify standard and non-standard horizontal spacing units for horizontal wells and that allow for the drilling of multi-lateral horizontal wells. The 2018 rulemaking did not create any new rules or address any issues related to compulsory pooling or risk penalties provisions.

The Commission added a definition for "affected persons" to N.M. CODE R. §19.15.2.7 and amended N.M. CODE R. §19.15.4.12 to provide notice to "affected persons" for specific adjudications. The Commission also added definitions to N.M. CODE R. §19.15.16.7 to define "first take point," "last take point," and "multi-lateral well."

In addition, "infill horizontal well" is defined to mean a horizontal well the completed interval or intervals of which are located wholly within the horizontal spacing unit dedicated to a previously drilled or proposed horizontal well in the same pool and that the operator designates as an infill horizontal well on form C-102.

The Commission defined "unitized area" as any area where ownership of production from the relevant pool or formation is consolidated pursuant to an agreement, whether voluntary and filed

in the county land records, or approved by federal or state authority, including but not limited to a statutory unit, an approved enhanced recovery unit, a participating area in a federal exploratory unit, a federal unit which does not provide for participating areas, a state exploratory unit, or a communitized unit if all interests in the communitized unit are committed to the communitization agreement.

Amendments to N.M. CODE R. §19.15.16.14 apply to vertical and deviated well bores and make clear that horizontal wells are no longer treated as a type of directional well.

N.M. CODE R. §19.15.16.15 was rewritten and expanded upon to include all requirements for horizontal wells. A summary of the most important changes to well spacing in N.M. CODE R. §19.15.16.15(B) are as follows:

- Each horizontal oil or gas well must be dedicated to a standard or approved non-standard horizontal spacing unit, except that certain infill wells and laterals can be dedicated to an existing or proposed spacing unit.
- The rules define what qualifies as a standard horizontal spacing unit for both horizontal oil wells and gas wells and provides a process for approval of a non-standard horizontal spacing unit.
- The rules clarify how the spacing unit requirements apply to infill horizontal wells, multi-lateral horizontal wells, and wells on state, federal or tribal lands and in unitized areas.
- The rules include specific provisions for existing wells that are included in a new horizontal spacing unit, and for subsequent wells in an existing spacing unit. The rules allow for protest by an owner of an adjoining tract who contends that their correlative rights may be impaired.
- Standard horizontal spacing units for horizontal oil wells must be comprised of one or more contiguous tracts, each of which consists of a governmental quarter-quarter section or equivalent that the well's completed interval penetrates and any quarter-quarter section or equivalent located within 330 feet of the well's completed interval, subject to minimum acreage requirements imposed by special pool orders. If the perimeter of all the tracts penetrated by the well is substantially rectangular, the operator may not bring in additional tracts that would result in a non-rectangular horizontal spacing unit.
- Standard horizontal spacing for gas wells are subject to essentially the same criteria as oil wells, except that "tract" is defined as a governmental quarter section of land as opposed to a quarter-quarter section, subject to minimum acreage requirements imposed by special pool orders. If the perimeter of all the tracts penetrated by the well is substantially rectangular, the operator may not bring in additional tracts that would result in a non-rectangular horizontal spacing unit.
- Exceptions to standard spacing rules exist for a horizontal well the completed interval of which is located wholly within a unitized area, and an exception exists for oil and gas wells with special pooling orders for tracts that exceed 40-acres for oil, and that exceed 160-acres for gas.

- Non-standard horizontal spacing units may be approved by the OCD upon application, notice and hearing as provided for director approval of non-standard spacing units in Paragraphs (3) through (5) of Subsection B, N.M. CODE R. §19.15.15.11. As subsequently drilled wells are subject to the notice requirements of N.M. CODE R. §19.15.4.12, the notice requirements extend to interest owners in tracts of land adjacent to the horizontal spacing unit, and such parties are provided a procedure to protest approval of a horizontal spacing unit as impairing their correlative rights.
- The rule changes provide for existing wells to remain in their existing spacing unit unless all working interest owners consent to be included in a new horizontal spacing unit and an amended Form C-102 is filed. Subsequent wells may be drilled only with the approval of, or, in the absence of approval, after notice and opportunity for hearing to all operators and working interest owners in the well's spacing unit as provided in Subsection B, N.M. CODE R. §19.15.15.12. Exceptions to the requirement of dedication to a horizontal spacing unit exist for an "infill horizontal well," which are subject to the same rules for other infill wells found at N.M. CODE R. §19.15.13.10 and N.M. CODE R. §19.15.13.11.

One principal change to the horizontal well rule is to reduce the setback requirements in N.M. CODE R. §19.15.16.15(C). For initial and last take points, the distance to the outer boundary of the spacing unit is reduced to 100 feet for horizontal oil wells and 330 feet for horizontal gas wells. The perpendicular setback from the outer boundary of the spacing unit is now 330 feet for horizontal oil wells and 660 feet for horizontal gas wells. The new rules also have the effect of allowing the creation of horizontal spacing units that are not traditional "stand-up" or "lay-down" in shape.

The rules define when a well location is considered "unorthodox" for setback purposes either before or after drilling and sets forth the process for obtaining approval of an unorthodox well location. Finally, the rules assign an allowable to each horizontal oil or gas well that is equal to the amount of oil or gas that the well can produce; however, the OCD is authorized to assign a lower allowable to any pool if necessary to prevent waste.

Minor technical changes were made to the horizontal well rules by an Order of the Commission, Case No. 16376, Order No. R-20194, issued October 15, 2018, which changes are incorporated in the discussion above.

Legal Questions Remain

The horizontal well rules leave open certain questions. The central question that the 2018 rulemaking sought to address is whether the OCD has the statutory authority to create and compulsory pool horizontal well spacing units. The limit of the OCD's authority beyond that expressly granted by the Oil and Gas Act (N.M. STAT. ANN. §§70-2-1 to 70-2-38) was questioned by the New Mexico Supreme Court in *Marbob Energy Corp. v. N.M. Oil Conservation Comm'n*, 206 P.3d 135, 143 (Colo. 2009), which states that "[w]hile not unsympathetic to the Commission's professed need for greater enforcement authority, we defer, as we must, to the Legislature for the grant of that authority, and so too must the Commission." That legislative grant of authority was not forthcoming, and the pooling statute limits pooling to lands "embraced within a spacing or proration unit." N.M. STAT. ANN. §70-2-17(C). By granting itself the authority to pool separately owned tracts within an oversize non-standard spacing unit, the OCD seeks to accomplish administratively what it had not been expressly authorized to do legislatively; that is, define a

horizontal well spacing unit as a single unit under New Mexico's existing compulsory pooling statute.

Other unanswered questions include whether the same risk charge will be applied to infill horizontal wells as is applied to the initial well in connection with compulsory pooling. The OCD found that the scope of the 2018 rulemaking did not include amending the rules pertaining to compulsory pooling and risk charges at N.M. CODE R. §19.15.13, and it deferred such concerns for consideration in a future rulemaking. Questions over the vagueness of the size of horizontal spacing units were dismissed as the OCD found sufficient clarity and direction in the rules as written to meet statutory direction. Questions over the protection of correlative rights where horizontal well direction led to an uneven drainage pattern were addressed by the OCD's finding that the rules maximize recovery and minimize waste.

For help navigating these issues, please contact [Candace Callahan](#), [Jill Fulcher](#), and [Craig Berube](#).