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

IN THE MATTER OF THE HEARING CALLED BY THE OIL CONSERVATION DIVISION FOR THE PURPOSE OF CONSIDERING:

CASE NO. 15363
ORDER NO. R-14053-B

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

ORDER OF THE DIVISION

BY THE DIVISION:

This case came on for hearing at 8:15 a.m. on September 3, 2015, at Santa Fe, New Mexico, before Examiner Phillip R. Goetze and legal counsel Gabriel Wade, and on September 29, 2015, before Examiners Phillip R. Goetze and William V. Jones

NOW, on this 25th day of April, 2016, the Division Director, having considered the testimony, the record and the recommendations of the Examiners,

FINDS THAT:

(1) Due public notice has been given, and the Division has jurisdiction of this case and of the subject matter.

(2) Matador Production Company ("Applicant" or "Matador") seeks approval of a non-standard 154.28-acre (more or less) oil spacing and proration unit and project area (the "Unit") in the Airstrip; Wolfcamp Pool (Pool code 970) consisting of Lots 1 - 4 (the W/2 W/2 equivalent) of Section 31, Township 18 South, Range 35 East, NMPM, Lea County, New Mexico. Applicant further seeks an order pooling all uncommitted interests in the Unit for the Wolfcamp formation and all pools or formations developed on 40-acre spacing within that vertical extent.

(3) The Unit will be dedicated to Applicant's Airstrip 31 18 35 RN State Com. Well No. 201H (the "proposed well"; API No. 30-025-41678), a horizontal well to be drilled from a surface location 150 feet from the South line and 330 feet from the West line (Lot 4) of Section 31 to a terminus 330 feet from the North line and 710 feet from the West line (Lot 1) of Section 31, both in Township 18 South, Range 35 East, NMPM. The

completed interval of the proposed well is entirely within the prescribed setbacks from the outer boundaries of the project area.

(4) The proposed well is within the Airstrip; Wolfcamp Pool. Spacing in this pool is governed by Division Rule 19.15.15.9(A) NMAC, which provides for standard 40-acre units, each comprising a governmental quarter-quarter section. The proposed Unit and project area consists of four adjacent quarter-quarter sections.

(5) Matador filed the application with the Division for Case No. 15363 on July 21, 2015.

(6) On August 12, 2015, Jalapeno Corporation ("Jalapeno") and Yates Energy Corporation ("Yates"; collectively the "Intervenors"), both interest owners in the proposed Unit, filed a *"Motion for Continuance."*

(7) On August 28, 2015, Matador filed a *"Response to Motion for Continuance."*

(8) On August 28, 2015, Division issued a Subpoena to Matador on behalf of Intervenors.

(9) On August 28, 2015, Intervenors filed a *"Motion to Dismiss Application for Non-Standard Oil Spacing Project Area."*

(10) On August 31, 2015, Matador filed a *"Response in Opposition to Motion to Dismiss."*

(11) On August 31, 2015, Division issued a Subpoena to the Intervenors on behalf of Matador.

(12) On August 31, 2015, Intervenors filed a *"Response and Objection to Subpoena."*

(13) On September 17, 2015, Intervenors filed a *"Statement of Supplemental Authority."*

(14) At hearing on September 3, 2015, Division considered the Motion to Dismiss but continued the case while the Motion to Dismiss was taken under advisement.

(15) On September 22, 2015, Matador filed a *"Response to Statement of Supplemental Authority."*

(16) On September 24, 2015, Division entered Order No. R-14053 in Case No. 15363 denying the Intervenors' Motion to Dismiss and the case was set for hearing on September 29, 2015.

(17) At hearing on September 29, 2015, the Intervenors appeared through legal counsel and provided testimony. No other party appeared at the hearing, or otherwise opposed the granting of this application.

(18) On October 22, 2015, after the case was taken under advisement, Intervenors filed an application for *De Novo* hearing of this case before the Oil Conservation Commission ("Commission"). The Commission issued Order No. 14053-A "*Order on Unopposed Motion for Stay*" on November 6, 2015.

Applicant appeared at hearing through counsel and presented the following testimony.

(19) The proposed well was originally designated for completion in the Scharb; Bone Spring Pool, (3rd Bone Spring sand) which is stratigraphically above the Wolfcamp formation.

(20) Matador acquired through merger the mineral interest for acreage within the Unit and modified the target interval to the deeper Wolfcamp formation. Applicant testified that the Wolfcamp target would provide a viable producing well that would include the opportunity to complete in the shallower Bone Spring target at a later date.

(21) All of the mineral estate within the Unit is owned by the State of New Mexico and administered through two leases issued by the State Land Office.

(22) Applicant holds 89.85 percent of the working interest in the Unit and has obtained voluntary joinders for an additional 2.83 percent. Applicant seeks compulsory pooling of the remaining uncommitted 7.32 percent which includes the 7.24 percent working interest of the Intervenors.

(23) Applicant testified that there had been a good faith effort to obtain a voluntary joinder or other agreement with Intervenors. Applicant presented the following dates with significant actions:

(a) March 24, 2015: Matador forwarded well proposal package to working interest owners including each party of Intervenors.

(b) April 28, 2015: Jalapeno responded to proposal in written correspondence.

(c) June 3, 2015: Matador personnel and Intervenors' representatives met to discuss proposal and alternatives to participating.

(d) June 22, 2015: Yates provided proposal to Matador. Matador agreed in principal to Yates' term sheet. Matador contacted Jalapeno regarding status of well proposal and formally notified Jalapeno of possibility for a compulsory pooling application.

(e) July 14 to July 16, 2015: Applicant claimed multiple efforts to contact Jalapeno to discuss well proposal.

(f) July 21, 2015: Matador contacted Jalapeno regarding possible alternatives to compulsory pooling. Matador stated that Jalapeno declined to participate in the well, to sell its interest, or to commit to a Joint Operating Agreement ("JOA") without a reduction in the non-consent penalty. Matador filed application with the Division for a non-standard spacing and proration unit and compulsory pooling for the proposed well.

(g) August 6, 2015: Intervenors filed entry of appearance for this case.

(24) Matador provided a copy of the authorization for expenditure ("AFE"), dated March 18, 2015, that was submitted to all working interest owners in the Unit. The AFE identified the upper Wolfcamp formation as the target interval and provided total completed well cost of $9,099,800 for a horizontal well with 15-stage fracturing program and total vertical depth of 10,840 feet (measured depth of 15,500 feet).

(25) Applicant stated that the increase in estimated costs of the AFE when compared to the previous AFE for the original well proposed for the Bone Spring target was the result of the deeper target interval which required additional time and material including the following factors:

(a) inclusion of a fourth casing string for well control through the Bone Spring into the deeper target interval;

(b) significant changes in the drilling program such as a heavier drilling mud weight to control the different formation pressure of the target interval; and

(c) a larger reservoir stimulation program resulting in increased costs associated with the new completion activities.

(26) Applicant testified that characteristics of the reservoir remain unknown due to either limited regional data for the formation or parameters such as permeability that can only be assessed following the drilling of the proposed well.

(27) Applicant stated the unknown reservoir characteristics including the evaluation of the reservoir within the Unit based on older wells located at distance from the proposed well justified the 200 percent risk penalty charge.

(28) Applicant anticipated an estimated ultimate recovery of 350,000 to 400,000 barrels of oil for the proposed well with the Wolfcamp target.

(29) Applicant testified that all quarter-quarter sections to be included in the

Unit are expected to be productive in the Wolfcamp, so that formation of the Unit as requested will not impair correlative rights. Applicant's experts further testified the following:

(a) that every quarter-quarter section will have similar geology including uniform thickness of the Wolfcamp target interval;

(b) that there are no geologic impediments to drilling a horizontal well in the Unit; and

(c) that the Applicant did not require any additional data such as a pilot well or core sampling for this drilling effort to be successful.

(30) Applicant provided evidence of notice of this application to all uncommitted mineral interest owners by certified mail, return receipt requested and by publication in a newspaper in general circulation in Lea County, New Mexico, for unlocatable uncommitted mineral interest owners.

(31) Applicant also provided evidence of notice of this application for the non-standard unit to offset operators and offset working interest owners.

(32) Applicant requested charges for supervision (combined fixed rates) of $7,000 per month while drilling and $700 per month while producing and that these rates should be adjusted annually as provided by the COPAS accounting procedure.

Intervenors appeared at hearing through counsel and presented the following testimony.

(33) Intervenors challenged the application by Applicant based on the following arguments:

(a) Matador did not make a good faith effort in negotiating a voluntary joinder of Intervenors' interest within the Unit;

(b) the final AFE provided by Matador in March for the proposed well was not accurate respective to current market expenses related to the reduced demand as oil commodity prices declined; and

(c) the approval of a 200 percent risk penalty charge is inappropriate for the proposed well.

(34) Intervenors offered Jalapeno's correspondence, dated August 17, 2015, that provide three possible alternatives to compulsory pooling and a request for additional information on the geology, other Wolfcamp completions by Matador, and the sources of costs used in the AFE. In this correspondence, Jalapeno offered the three following solutions for agreement:

(a) change the terms of the non-consent provisions in its proposed JOA as to 100 percent / 150 percent;

(b) trade its Section 17 Chaves County acreage for our interest in the Airstrip spacing unit at the earlier specified prices; or

(c) purchase Jalapeno's acreage within Section 31 of Township 18 South, Range 35 East, NMPM on a term assignment and convey to us its acreage in W/2 of Section 17, Township 9 South, Range 27 East, NMPM.

(35) Intervenors offered a copy of the AFE, dated July 15, 2014, prepared for the proposed well with the lower Bone Spring formation as the target interval. This AFE provided a total completed well cost of $7,317,030 for a horizontal well with a fracturing program and a total vertical depth of 10,510 feet (measured depth of 15,185 feet).

(36) Intervenors stated that the AFE included estimates for individual items that were inflated above historical costs. Examples cited were charges for drilling supervision and the individual contingency charges for specific activities, such as drilling, completion, and production, in addition to the risk penalty charge.

(37) Intervenors disputed the default risk penalty charge rate of 200 percent provided for in Division Rule 19.15.13.8(A) NMAC as inappropriate and presented testimony that the geologic risk was reduced due to the subsurface information available to the Applicant through prior testing in vertical wells and recent horizontal completions in the Wolfcamp formation in this general area. Intervenors also stated that the associated risks would be reduced by the contingency cost estimated in the AFE submitted by the Applicant.

The Division concludes as follows:

(38) The minimum requirements for good faith negotiation were established in Division Orders No. R-13155 and No. R-13165. Division stated in Ordering Paragraph (5) of Order No. R-13165 the following pertinent guidance:

> *(a) "At least thirty days prior to filing a compulsory pooling application, in the absence of extenuating circumstances, an applicant should send to locatable parties it intends to ask the Division to pool a well proposal identifying the proposed depth and location and target formation, together with a proposed Authorization for Expenditures (AFE) for the well. The proposal should specify the footages from section lines of the intended location, and, in the case of a directional well, of the intended point of penetration and bottomhole location. The Division understands these requirements to be comparable to the proposal requirements included in forms operating agreements generally used in the industry".*

(c) "A proposed form of joint operating agreement should not be required in every case but should be furnished with reasonable promptness if requested".

(39) Based on the testimony and exhibits submitted at hearing, Applicant has complied with the minimum requirements for good faith negotiation delineated in the referenced orders. Additionally, there is no evidence that Applicant refused to discuss its proposal with Intervenors during period either preceding or following the filing of this application.

(40) Intervenors argument contesting the validity of the drilling costs was based on the proposed well being completed in the original target, the lower Bone Spring formation, and the shallower formations of the Delaware Mountain group. Intervenors' evidence made cost comparisons with horizontal wells completed in the Bone Spring formation, but did not include any cost information for similar completions of horizontal wells in the Wolfcamp formation. Applicant's evidence supported the increased cost for completion due to the deeper target interval. Conversely, recent decreases in commodity prices have impacted the demand for companies that provide services included in the well costs. Intervenors' petition that the estimate provided in the AFE dated March 18, 2015, be revised due to this change is a reasonable business request and should be provided by the Applicant.

(41) Approval of the proposed non-standard unit will enable Applicant to drill a horizontal well that will efficiently produce the reserves underlying the Unit, thereby preventing waste, and will not impair correlative rights.

(42) Two or more separately owned tracts are embraced within the Unit, and/or there are royalty interests and/or undivided interests in oil and gas minerals in one or more tracts included in the Unit that are separately owned.

(43) Applicant is owner of an oil and gas working interest within the Unit. Applicant has the right to drill and proposes to drill the proposed well to a common source of supply within the Unit at the proposed location.

(44) There are interest owners in the Unit that have not agreed to pool their interests.

(45) To avoid the drilling of unnecessary wells, protect correlative rights, prevent waste and afford to the owner of each interest in the Unit the opportunity to recover or receive without unnecessary expense its just and fair share of hydrocarbons, this application should be approved by pooling all uncommitted interests, whatever they may be, in the oil and gas within the Unit.

(46) Matador should be designated the operator of the proposed well and the Unit.

(47) Intervenors' evidence concerning the 200 percent risk penalty charge was sufficient to support an exception as offered under Division Rule 19.15.13.8(D) NMAC. As detailed in Commission Order No. R-11992, the Division considers the calculation of risk based on three components: 1. the geological risk, 2. the operational risk, and 3. the reservoir risk. Findings Paragraph (13) of Order No. R-11992 further acknowledges Division's allocating the 200 percent risk penalty in equal parts to each of the three components and assigning approximately 66 percent factor to each type of risk.

(48) Both Intervenors and Applicant have established that the target interval is present at depth within the entire Unit.

(49) The testimony and exhibits have sufficiently demonstrated that the geologic risk for the proposed well is significantly diminished. Applicant's testimony regarding operation risk and reservoir risk showed no substantial reduction in the uncertainty for these two elements. Therefore, any pooled working interest owner who does not pay its share of estimated well costs should have withheld from production its share of reasonable well costs plus an additional 133 percent thereof, as a reasonable charge for the risk involved in drilling the proposed well.

(50) Reasonable charges for supervision (combined fixed rates) should be fixed at $7,000 per month while drilling and $700 per month while producing, provided that these rates should be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled "*Accounting Procedure-Joint Operations.*"

IT IS THEREFORE ORDERED THAT:

(1) A non-standard 154.28-acre (more or less) oil spacing and proration unit and project area ("Unit") is hereby established for the Wolfcamp formation [Airstrip; Wolfcamp Pool (Pool code 970)] consisting of Lots 1 - 4 (the W/2 W/2 equivalent) of Section 31, Township 18 South, Range 35 East, NMPM, Lea County, New Mexico.

(2) Pursuant to the application of Matador Production Company, all uncommitted interests, whatever they may be, in the oil and gas in the Wolfcamp formation underlying the Unit, are hereby pooled.

(3) The Unit shall be dedicated to Applicant's **Airstrip 31 18 35 RN State Com. Well No. 201H** ("proposed well"; API No. 30-025-41678), a horizontal well to be drilled from a surface location 150 feet from the South line and 330 feet from the West line (Lot 4) of Section 31 to a terminus 330 feet from the North line and 710 feet from the West line (Lot 1) of Section 31, both in Township 18 South, Range 35 East, NMPM.

(4) The operator of the Unit shall commence drilling the proposed well on or before April 30, 2017, and shall thereafter continue drilling the proposed well with due diligence to test the Wolfcamp formation.

(5) In the event the operator does not commence drilling the proposed well on or before April 30, 2017, Ordering Paragraphs (1) and (2) shall be of no effect, unless the operator obtains a time extension from the Division Director for good cause demonstrated by satisfactory evidence.

(6) Should the proposed well not be drilled and completed within 120 days after commencement thereof, then Ordering Paragraphs (1) and (2) shall be of no further effect, and the unit and project area created by this order shall terminate, unless operator appears before the Division Director and obtains an extension of the time for completion of the proposed well for good cause shown by satisfactory evidence. If the proposed well is not completed in all of the spacing units included in the proposed Unit within 120 days after commencement of drilling, then the operator shall apply to the Division for an amendment to this Order to contract the Unit so that it includes only those spacing units in which the well is completed.

(7) Upon final plugging and abandonment of the proposed well and any other well drilled on the Unit pursuant to Division Rule 19.15.13.9 NMAC, the pooled Unit created by this Order shall terminate, unless this Order has been amended to authorize further operations.

(8) Matador Production Company (OGRID 228937) is hereby designated the operator of the well and the Unit.

(9) After pooling, uncommitted working interest owners are referred to as pooled working interest owners. ("Pooled working interest owners" are owners of working interests in the Unit, including unleased mineral interests, who are not parties to an operating agreement governing the Unit.) ***After the effective date of this Order and subject to Ordering Paragraph (20), the operator shall furnish the Division and each known pooled working interest owner in the Unit an itemized schedule of estimated costs of drilling, completing and equipping the proposed well ("well costs") prepared to reflect current competitive costs for these services.***

(10) Within 30 days from the date the schedule of estimated well costs is furnished, any pooled working interest owner shall have the right to pay its share of estimated well costs to the operator in lieu of paying its share of reasonable well costs out of production as hereinafter provided, and any such owner who pays its share of estimated well costs as provided above shall remain liable for operating costs but shall not be liable for risk charges. In such event, the operator shall furnish to such interest owner, during the drilling and completion of the proposed well, and upon establishing production therein, all information reasonably available to the operator including daily drilling reports, all geophysical and mud logs, results of any formation test, all productivity tests, completion data, all results of oil and gas analyses, and like information; provided that nothing herein shall require the operator to perform any additional tests not conducted in the reasonable and ordinary course of its business. Pooled working interest owners who elect not to pay their share of estimated well costs as

provided in this paragraph shall thereafter be referred to as "non-consenting working interest owners."

(11) The operator shall furnish the Division and each known pooled working interest owner (including non-consenting working interest owners) an itemized schedule of actual well costs within 90 days following completion of the proposed well. If no objection to the actual well costs is received by the Division, and the Division has not objected, within 45 days following receipt of the schedule, the actual well costs shall be deemed to be the reasonable well costs. If there is an objection to actual well costs within the 45-day period, the Division will determine reasonable well costs after public notice and hearing.

(12) Within 60 days following determination of reasonable well costs, any pooled working interest owner who has paid its share of estimated costs in advance as provided above shall pay to the operator its share of the amount that reasonable well costs exceed estimated well costs and shall receive from the operator the amount, if any, that the estimated well costs it has paid exceed its share of reasonable well costs.

(13) The operator is hereby authorized to withhold the following costs and charges from production from the well:

(a) the proportionate share of reasonable well costs attributable to each non-consenting working interest owner; and

(b) as a charge for the risk involved in drilling the well, 133 percent of the above costs.

(14) The operator shall distribute the costs and charges withheld from production, proportionately, to the parties who advanced the well costs.

(15) Reasonable charges for supervision (combined fixed rates) for the well are hereby fixed at $7,000 per month while drilling and $700 per month while producing, provided that these rates shall be adjusted annually pursuant to Section III.1.A.3. of the COPAS form titled *"Accounting Procedure-Joint Operations."* The operator is authorized to withhold from production the proportionate share of both the supervision charges and the actual expenditures required for operating the well, not in excess of what are reasonable, attributable to pooled working interest owners.

(16) Except as provided in Paragraphs (13) and (15) above, all proceeds from production from the proposed well that are not disbursed for any reason shall be held for the account of the person or persons entitled thereto pursuant to the Oil and Gas Proceeds Payment Act (NMSA 1978 Sections 70-10-1 through 70-10-6, as amended). If not disbursed, such proceeds shall be turned over to the appropriate authority as and when required by the Uniform Unclaimed Property Act (NMSA 1978 Sections 7-8A-1 through 7-8A-31, as amended).

(17) Any unleased mineral interests shall be considered a seven-eighths (7/8) working interest and a one-eighth (1/8) royalty interest for the purpose of allocating costs and charges under this Order. Any well costs or charges that are to be paid out of production shall be withheld only from the working interests' share of production, and no costs or charges shall be withheld from production attributable to royalty interests.

(18) Should all the parties to this compulsory pooling order reach voluntary agreement subsequent to entry of this Order, this Order shall thereafter be of no further effect.

(19) The operator of the well and the Unit shall notify the Division in writing of the subsequent voluntary agreement of all parties subject to the compulsory pooling provisions of this Order.

(20) Jurisdiction of this case is retained for the entry of such further orders as the Division may deem necessary.

DONE at Santa Fe, New Mexico, on the day and year hereinabove designated.

SEAL

STATE OF NEW MEXICO
OIL CONSERVATION DIVISION

David R. Catanach

DAVID R. CATANACH
Director