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

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

APPLICATIONS OF MATADOR PRODUCTION COMPANY FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

Case Nos. 21543 and 21630

APPLICATIONS OF FLAT CREEK RESOURCES, LLC FOR HORIZONTAL SPACING UNITS AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO

Case Nos. 21560 and 21747

FLAT CREEK RESOURCES, LLC'S CLOSING BRIEF

Flat Creek Resources, LLC ("Flat Creek") submits its Closing Brief with respect to the competing Applications filed by Flat Creek and Matador Production Company ("Matador") for Section 23, Township 23 South, Range 27 East, NMPM, in which the parties are seeking to pool uncommitted interests in the Wolfcamp formation.

A. Matador's Pooling Proposals are Preempted by the Mineral Leasing Act

1. Matador seeks two separate forced pooling orders. In Case No. 21543, Matador requests an order pooling the S/2 of Section 23. In Case No. 21630, Matador requests an order pooling the N/2 of Section 23. In order to implement either of its requested pooling orders, Matador will have to obtain communitization agreements from the BLM to communitize the Federal minerals covered by Federal Lease NMNM139351, which includes the NW/4SE/4, W/2NE/4, and SE/4NE/4 of Section 23. Flat Creek Ex. A-2. Flat Creek is the sole working interest owner of this Federal Lease. *Id.*

2. However, the BLM is precluded, as a matter of law, from issuing the necessary communitization agreements for either of Matador's proposed pooling applications because the Mineral Leasing Act (MLA) preempts Matador's proposed pooling units.

3. The New Mexico State Office of the BLM generally defers to the Division's pooling decisions and will usually issue a communitization agreement that is consistent with the Division's pooling order. However, the Property Clause of the United States Constitution, U.S. Const. art. IV, § 3, cl. 2, bars the states from regulating federal lands in a manner that is inconsistent with federal legislation.

4. The MLA authorizes the communitization of federal leases "when determined by the Secretary of the Interior to be in the public interest . . ." 30 U.S.C.§ 226(m). Thus, if the Division issues a pooling order that is not in the public interest, then the state pooling order is

preempted by the MLA and the BLM is barred from issuing the communitization agreement that is required to implement the pooling order. *See, e.g.*, *Kirkpatrick Oil and Gas, Inc. v. U.S.*, 675 F.2d 1122, 1126 (10th Cir. 1982).

5. Matador's proposed S/2 pooling unit is preempted by the MLA because Matador is seeking to burden the N/2 S/2 of Section 23, which includes 40 acres of Federal minerals in the NE/4 SE/4, with the poorly producing Norris Thornton #204H well located in the S/2 S/2 of Section 23. The uncontroverted testimony of Anand Kote, a Reservoir Engineer, established that based on the production data from this well, which has been producing since 2018, the Estimated Ultimate Recovery (EUR) of this well will be 306 MBO (thousands of barrels of oil) versus an expected average of 465 EUR for Wolfcamp wells to be drilled in Section 23. Kote Testimony at ¶¶ 5 and 7;[1] Exhibit C-1; Tr. 145:22-146:12; 165:3-11; 165:18-21. The reason that Flat Creek did not include the S/2 S/2 of Section 23 in its pooling applications is because the Norris Thornton #204H is a poor producer. Gregory Testimony at ¶ 20.

6. Goodwin conceded that the "Norris Thornton #204H has produced . . . under expectations." Tr. 94:16-20. Parker agreed. *Id*. at 117:9-11. Matador failed to present any reservoir engineering testimony to explain why this well was underperforming or whether Matador had corrected any operational issues to prevent it from completing another poorly preforming well in the N/2 S/2 of Section 23. When Flat Creek requested information from Matador to explain the Norris Thornton #204H well's poor performance, Matador refused to provide such evidence. Flat Creek Exhibit E-1. Parker claims that Matador "steered the well and executed the well . . . flawlessly", blaming the geology for the poor performance of this well. Tr. 119: 10-21. Blaming the geology for the well's poor performance rings hollow considering Parker's acknowledgment that the Wolfcamp sands are

[1] All references to Written Testimony and Exhibits are to those in Case No. 21560.

optimal across the entire section. *Id*. at 116:20-117:8. As Anderson testified, the issue was not geology, it is mechanical; Matador failed to pay attention to the geo steering and failed to account for the bed dip of the producing interval causing the lateral to be in and out of the sand along the lateral and that Matador had severe hydraulic depletion. *Id*. at 215:19-216:24.

7. Based on these facts, a pooling unit consisting of the S/2 of Section 23 would adversely affect the United States because it would significantly decrease the yield on the United States' 12.5% royalty on its 160 acres of Federal minerals in Section 23. Under Flat Creek's proposed 480-acre pooling unit, the United States would earn 58.125 MBO (12.5% of 160 acres/480 acres times 1,395 MBO [3 times 465 MBO]). On the other hand, if Section 23 was divided into two 320-acre pooling units, the United States would earn 53.15625 MBO (12.5% of 160 acres/640 acres times 1,701 MBO [3 times 465 MBO, plus 306 MBO]). This amounts to a difference of 4,968.75 barrels of oil, diluting the United States' revenue by approximately 8.6%. (This assumes that if Matador is the operator, it performs better on the three new laterals than it did with respect to its existing well, a questionable proposition since Matador blames the geology rather than admitting it simply failed to properly drill the lateral.) Simply put, the BLM cannot issue a communitization agreement for the S/2 of Section 23 since it is against the public interest to dilute the revenues that the United States will earn on its mineral royalty where Flat Creek's proposed 480-acre communitized area will not result in any dilution.

8. Matador's proposed N/2 pooling unit is also preempted by the MLA because its proposed well locations fail to protect the United States' correlative rights by allowing drainage of the N/2 N/2 of Section 23. Although both Matador and Flat Creek propose 1,320 feet spacing between each of their three respective proposed wells, Flat Creek's wells are to be located 400 feet to the north of the Matador wells, *i.e*., centered in each quarter/quarter section. Matador Ex. C-6.

Matador claims that the 990-foot spacing between the Kathy Coleman #208H well and Flat Creek's northernmost well, the Thirteen Seconds 23 Fed-Fee 701H well, and the 1,680-foot spacing between Matador's poorly producing Norris Thornton #204H well and Flat Creek's southernmost well, the Thirteen Seconds 23 Fed-Fee 703H well, "would not result in the full or efficient drainage of the Wolfcamp formation in Section 23." Parker Testimony at ¶ 13.

9. However, as Anderson testified, because the Kathy Coleman #208H, well, which Division records show Matador drilled in 2018 and which his currently being operated by Matador, is located at the minimum 330-foot set back distance from the North section line of Section 23, it is imperative to place the northernmost well in Section 23 closer to the North section line than the location proposed by Matador in order to protect the mineral interests in the N/2 N/2 of Section 23, including those of the United States, from being drained by the Kathy Coleman #208H well. Tr. 218:9-219:16. Parker's testimony concedes that Matador's proposed well locations will be detrimental to production from Section 23 since he correctly assumes that the Kathy Coleman #208H well will drain lands 660 feet on either side of its lateral, which includes 330 feet within Section 23. Tr. 113:5-21. Matador's placement of Kathy Coleman #208H well too close to the North section line of Section 23 is contrary to the accepted practice for spacing of Wolfcamp wells in the Permian Basin. Matador caused the "inconsistent spacing" alluded to by Parker (Parker Testimony at ¶ 14), by spacing its Kathy Coleman #208H well 330 feet from the North Section line of Section 23 and its placement of the Norris Thornton #204H well 330 feet from the South Section line.

10. Matador's proposed spacing of its wells in the N/2 of Section 23 will protect Matador's interests in Section 14 to the detriment of the mineral owners in the N/2 of Section 23, including the United States. Per the BLM's Manual 3160-9 at Section.11A.2, a justification for a

communitization agreement is that "[a]dequate engineering and/or geological data is presented to indicate that communitizing two or more leases or unleased Federal acreage will result in more efficient reservoir management of an area." There is no such justification for Matador's N/2 pooling unit since it will not result in the efficient reservoir management of the N/2 of Section 23, while Flat Creek's proposed 480-acre unit will.

11. Finally, both of Matador's pooling proposals are preempted by the MLA since they fail to provide the largest Federal participation among the possible options. As provided by the BLM Communitization Handbook, BLM Manual 3160-9, Section .11A.1:

> If the Federal tract cannot be independently developed and there are a number of spacing options, the authorized officer should require the one that is in the best interest of the Federal Government, *i.e.*, the one that provides the largest Federal participation.

12. In this case, Flat Creek's proposed 480-acre pooling unit would result in the United States owning one-third of the mineral interests in the spacing unit (160/480) versus a 25% mineral interest if the S/2 and the N/2 half were pooled into two units, totaling 640 acres (160/640). The only pooling proposal that passes this test is Flat Creek's 480-acre proposal.

13. In sum, Matador's proposals to pool the S/2 of Section 23 and to pool the N/2 of Section 23 are exercises in futility because the BLM is precluded from issuing a communitization agreement for either proposal. Thus, the Division should deny Matador's proposed pooling units for the S/2 and N/2 of Section 23.

B. Flat Creek's Proposal to Create a 480-acre Spacing and Proration Unit is Superior to Matador's Two Pooling Proposals

14. Even if Matador's proposal were not riddled with the fundamental, disqualifying defects described above, Flat Creek's proposed 480-acre pooling proposal prevails based on geology and the risk that Matador will not drill it proposed wells in a timely fashion, if at all.

15. Flat Creek's 480-acre proposal is decisively superior to Matador's because, as set

forth above, the location of Flat Creek's wells will protect production in Section 23 while Matador's locations will protect its production in Section 14. See Order R-10731-B at ¶ 23(f) ("The most important consideration in awarding operations to competing interest owners is geological evidence as it related to well location and recovery of oil and gas and associated risk.")

16. Moreover, there is significant risk that Matador will not drill its three proposed one-mile laterals in a timely fashion, if at all. In its First Quarter Earnings Report, published on April 28, 2021, Matador represented to its shareholders and to potential investors that based on the economics of horizontal drilling, it did not plan to drill any one-mile lateral wells in 2021. Flat Creek Ex. E-3 at Slide E (p. 7). That representation, which is subject to various statutes and regulations governing the sale of securities, is consistent with Matador's four-year trend of increasing the length of its horizontal drilling laterals from 4,700 feet in 2018 to an estimated 10,400 feet in 2021, resulting in lowering its capital expenditure from $1,528 per lateral foot in 2018 to an estimated $730 per lateral foot in 2020. *Id*. *See also*: Tr. 96:24-97:2.

17. Thus, even if Matador decided to start drilling one-mile lateral wells in 2022, one-mile lateral wells would be at the bottom of its priority list based on its four-year trend of eschewing one-mile laterals in favor of two-mile and longer lateral wells and their more favorable return on capital expenditures. Although Goodwin claims that one-mile laterals are not at the bottom of Matador's priority list (Tr. 105:13-18), Matador is selling securities to the public based on the opposite representation. Since one has to assume that Matador is not making material misrepresentations in connection with the sale of securities, Goodwin's testimony cannot be given any weight.

18. Matador cannot overcome Flat Creek's significant advantages with respect to these two decisive factors, when there is little, if any, difference between the parties' proposals. For

example, both parties proposed overhead and administrative rates of $8,000/month for drilling the well and $800/month for producing the well. Flat Creek Ex. A-3; Matador Exhibits A-5, A-6, A-8, and A-9. Both parties also proposed a 200% risk charge be assessed against non-consenting working interest owners. *Id*. Order No. R-10731-B, at Para. 23(h).

19. In addition, Matador's midstream affiliate has the ability to transport oil, gas, and water from all production from Section 23. Goodwin Testimony at ¶ 6(d). Goodwin acknowledged that if Flat Creek operates its proposed wells in Section 23, there is no impediment to Flat Creek using Matador's midstream affiliate to transport oil, gas, and water from Flat Creek's wells. Tr. 81:23 – 83:9.

20. Flat Creek acted in good faith to attempt to negotiate a voluntary pooling agreement, including proposing swaps of land and the purchase of Matador's interests. Beginning in September 2019, after Flat Creek reached a level of confidence that the BLM would be issuing Federal Lease NMNM139351 in a few months, Flat Creek reached out to Matador about developing Section 23. Gregory Testimony at ¶ 21; Tr. 186:9-187:13; 188:18-189:6. A list of the communications between Flat Creek and Matador are set forth in Flat Creek's Ex. A-4, which established that there were approximately 42 emails from Flat Creek to Matador and approximately 29 emails from Matador to Flat Creek. *See also* Exhibit E-2 (a series of emails between Gregory and Jonathan Filbert, Matador's Senior Vice President – Land, and Trey Goodwin, Matador's Area Land Manager – Delaware Basin); Tr. 207:11-208:20.

21. Matador also provided a timeline for Section 23, which listed some of the numerous communications between the parties involving discussions seeking a voluntary pooling agreement, including two face-to-face meetings, one held at Flat Creek's offices on June 17, 2020 and a lunch meeting held on January 12, 2021, which were initiated by Flat Creek. Matador's Ex. A-4. Flat

Creek Ex. E-2 (at p. 11; December 14, 2020 email from Gregory to Filbert).

22. Although Hartsfield opined that Flat Creek "did not engage in good faith efforts with Matador to reach an agreement for the continued development of the Wolfcamp formation underlying Section 23," Hartsfield Testimony at ¶ 10, she admitted that she did not attend the January 12, 2021 face-to-face meeting (Tr. 55:5-9) and did not consider the exchange of emails in January 2021 (Exhibit E-2) between more senior land personnel at Matador and Flat Creek, in forming her opinion. Tr. 61:4-21. She also admitted that Flat Creek's offer in its April 22, 2021 email to Matador for Matador to operate the S/2 while Flat Creek would operate the N/2 (Ex. E-2 at p. 1) would have resolved the development of Section 23 without the need for compulsory pooling. Tr. 70:24-71:6. However, Matador never responded to this offer. *Id*. at 97:24 – 98:10. Matador bid the same amount for the Federal lease as Flat Creek but offered to purchase Flat Creek's interest in the Lease at 40% of Flat Creek's successful bid price. *Id*. at 206:18-207:10.

23. Furthermore, Hartsfield's testimony that "except for its forced pooling filings, Flat Creek has not raised concerns with Matador's development plans in Section 23," Hartsfield Testimony at ¶ 10, is directly contradicted by her April 2020 email in which she rejected Matador's request for information on why the Norris Thornton #204H well was lagging in production. Exhibit E-1 (at pp. 1-2). In sum, her accusation of bad faith lacks any credibility.

24. Flat Creek is capable of operating its proposed unit prudently. While Flat Creek is a new company, its professional team represents 98 years of cumulative experience between four key personnel in Land (Gregory, with 13 years of experience), Geology (Anderson, with 40 years of experience) Engineering (Kote, with 5 years of experience) and Rodney Littleton, who was the Vice President of Drilling and Completions for Pioneer Natural Resources before joining Flat Creek and who has about 40 years of experience. Gregory Testimony at ¶ 22; Tr. 197:2-7; 204:22-

205:14; and the resumes of Gregory, Anderson, and Kote, attached to their respective Written Testimony. For example, in the three years preceding the formation of Flat Creek, Anderson was the operations geologist for approximately 35 laterals up to 3 miles in length that were flawlessly planned and executed in New Mexico with similar results. Anderson Testimony at ¶ 5.

25. In addition, John Wierzowiecki, who was the operations manager of Black Mountain Operating, LLC, is employed by Flat Creek. Tr. 201:18-20. Black Mountain Operating, LLC drilled and completed many horizontal wells in the Permian Basin in New Mexico, including the Cypress 1H well (API 30-015044046), a Wolfcamp well located within three miles of the Norris Thornton #204H well that is significantly outperforming the Norris Thornton #204H well. Wierzowiecki was the operations manager for this well and Kote was a key member in developing that well. Tr. 199:11-200:7; 201:6-20 and Exhibit E-4.

26. Although Matador's AFEs are less then Flat Creek's, "differences in AFEs and other operational criteria are not significant factors in awarding operations and have only minor significance in evaluating an operator's ability to prudently operate the property." Order R-10731-B at ¶ 23(f). This is especially true since, as Matador conceded, AFEs are only estimates that will vary based on actual market conditions at the time the wells are actually drilled and do not take into account completion techniques, which can have significant impacts on the success of a horizontal well. Tr. 86:3-87:14. Further, as Goodwin testified, Matador would not drill its proposed three one-mile lateral wells in 2021. Tr. 93:1-19. Thus, Matador's proposed AFEs are not realistic estimates of what the actual costs will be.

27. The only advantage that Matador holds is that it owns a greater working interest in the proposed units. However, even assuming that Matador's proposed pooling units are not preempted by the MLA, these advantages cannot overcome Flat Creek's advantage in the most

important factor – geological evidence as it related to well location and recovery of oil and gas, as well as the risk that Matador's publicly stated corporate policy will delay, if not preclude, drilling the proposed three one-mile lateral wells.

C. Flat Creek Properly Noticed Its Pooling Application in Case No. 21560

28. Flat Creek's description of its proposed 480-acre unit as a standard unit in its Application in Case No. 21560 was an oversight; it is a non-standard unit, which Matador was fully aware upon receipt of the Application. Tr. 69:5-9. Matador is the only other working interest owner within Flat Creek's 480-acre nonstandard unit and the only working interest owner in lands excluded by this unit. Matador Ex. A-2 and Flat Creek Exhibit A-2 in Case No. 21560.

29. Flat Creek provided adequate notice under Rules 19.15.4.8(A)(4) and 19.15.4.9 with respect to its non-standard proposal by sending notice of the hearing on Flat Creek's Application in Case No. 21560 to Matador, as well as to all overriding royalty interest owners in the 480-acre nonstandard unit, and to all of the overriding royalty interest owners in lands excluded by the nonstandard unit. Flat Creek Ex. D. Flat Creek satisfied the requirements of its application in the three wells under § 70-2-17(C) by (1) proposing a well, and (2) having a right to drill.

30. Flat Creek also satisfied 19.15.16.15B(9)(b) for giving notice of subsequent wells in existing spacing units by giving notice to Matador, the only operator and working interest owner in the Wolfcamp formation of Section 23. The requirement of 19.15.15.12B for providing notice of the intention to operate a well in spacing unit containing another well is to be satisfied at the time Flat Creek applies for its application to drill the well in the N/2 S/2 of Section 23.

31. If Flat Creek's foregoing analysis does not account for all irregularities, as the Hearing Examiner noted, if he dismisses Case 21560, "it will undoubtedly be with the option to refile it in some form or another" and would not end that portion of the case. Tr. 27:6-12.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed with the New Mexico Oil Conservation Division and was served on counsel of record via electronic mail on May 21, 2021:

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