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

APPLICATION OF CHEVRON U.S.A. INC. FOR A NON-STANDARD OIL SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case No. 16132

APPLICATION OF CHEVRON U.S.A. INC. FOR A NON-STANDARD OIL SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case No. 16133

APPLICATION OF TAP ROCK RESOURCES, LLC FOR A NON-STANDARD SPACING AND PRORATION UNIT AND COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case No. 16160

APPLICATION OF TAP ROCK RESOURCES, LLC FOR COMPULSORY POOLING, EDDY COUNTY, NEW MEXICO.

Case No. 16134

CHEVRON U.S.A. INC.'S WRITTEN CLOSING STATEMENT

In accordance with the Examiner's directive at the May 18, 2018 hearing in these consolidated cases, Chevron U.S.A. Inc. ("Chevron") submits its closing statement.

I. Chevron's applications – Case Nos. 16132 and 16133

Chevron has demonstrated that it (i) timely submitted well proposal letters to all uncommitted interests in the proposed project areas, (ii) had substantive and good faith follow-up communications with the uncommitted interest owners, and (iii) satisfied all of the Division's hearing notice requirements. After receiving Chevron's well proposals, Douglas McLeod, who

has working interests in the S/2 of Section 14, signed AFEs for all of Chevron's proposed wells, and Vladin, LLC, a working interest owner of the S/2 of Section 14 from the surface down to 10,000 feet, signed AFEs for Chevron's Bone Spring wells. On the eve of the hearing, Vladin withdrew its approval pending the outcome of the hearing and indicated that it may recommit to joining Chevron's wells. Without Mr. McLeod's and Vladin's approvals, Chevron holds 66.66% of the working interest in each of the proposed Bone Spring and Wolfcamp project areas.

Contrary to the representations of Tap Rock Resources LLC's ("Tap Rock's") land witness, Chevron made a good faith effort to obtain Tap Rock's voluntary joinder in Chevron's wells. In an attempt to justify Tap Rock's own negligence in satisfying the requirements of the farmout it received from Mr. McLeod on June 6, 2017, Tap Rock's land witness claimed that Tap Rock had a "deal" with Chevron and stated that Chevron did not negotiate in good faith with regard to its proposals. The record does not support Tap Rock's claim. Chevron timely proposed its wells to Tap Rock on March 13, 2018, then engaged in discussions with Tap Rock that primarily concerned Tap Rock's competing well proposals for the E/2 of Section 14. Only when it became apparent that it could not come to an agreement with Tap Rock regarding landing zones did Chevron file its applications. The record is undisputed that at no time did Chevron agree to a deal with Tap Rock, nor did the parties memorialize such an agreement in a JOA. Failure to agree on terms does not equal failure to negotiate in good faith.

Chevron's geology and engineering testimony – and the subsequent support of that testimony by the EOG entities' ("EOG's") witnesses – conclusively demonstrate that Chevron (i) is preventing waste by prioritizing the full development of proven, highly economic intervals in the Bone Spring and Wolfcamp formations, and (ii) will drill and complete wells that will maximize the recovery of reserves and prevent waste in accordance with §70-2-17 NMSA.

Chevron plans to drill three mile-and-a-half horizontal wells in each project area at target intervals that have no geologic faults or impediments. By drilling mile-and-a-half wells, Chevron's wellbores will drill through the 330-foot offset required at lease lines, thereby picking up an additional 660 feet of productive lateral length and preventing waste. Additionally, Chevron will achieve efficiencies by simultaneously drilling and zipper fracking its wells, thereby eliminating the loss of reserves resulting from the parent-child relationship and frac hits that can occur when adjoining wells are drilled and completed sequentially. Chevron's drilling program enables more efficient operations and improves the ultimate oil and gas recovery from the reservoir.

Chevron also will prevent waste by forming a BLM exploratory unit, which will allow production from the proposed wells to be handled by off-lease production facilities. The centralization of facilities in Chevron's proposed federal unit will minimize surface disturbances, simplify surface commingling, and enable the use of shared rights-of-way. Minimizing surface disturbances will both protect the environment and preserve pad locations for future development targets that have yet to be determined. However, none of these efficiencies will be realized if either of Tap Rock's applications is approved, given that the BLM will not allow a reservoir operated by Tap Rock to be included in Chevron's proposed unit.

In opposition to Chevron's applications, Tap Rock's geologist and petroleum engineer did not dispute Chevron's testimony that it will be developing proven reserves. Tap Rock's petroleum engineer touted the four-well-per-half-section drilling pattern as compared to Chevron's three-well-per-half-section pattern. However, he did not offer any testimony that a four-well pattern is appropriate for the acreage at issue, and he certainly did not say that Tap Rock will itself employ a four-well pattern if its applications are granted. Chevron continually evaluates the optimal

spacing of each target interval and is committed to drilling the most appropriate well spacing based on internal and industry data.

II. Tap Rock's applications – Case Nos. 16134 and 16160

All of the geology experts who testified agree that Tap Rock has selected unproven targets for its one proposed Bone Spring wildcat well and its one proposed Wolfcamp wildcat well, and both Chevron's and EOG's witnesses testified that Tap Rock's single wells would cause waste by creating poor parent-child relationships within the target intervals. Further, Tap Rock acknowledged that its wells would be drilled for exploration purposes. However, it is industry standard to plan for exploratory wells using seismic data and core analysis to identify the most appropriate target, and Tap Rock admitted it used neither type of information in its analysis. Additionally, Tap Rock provided no specific information about its development plans for its proposed project areas.

Those deficiencies aside, Tap Rock's Bone Spring application should be denied because the undisputed evidence establishes that Tap Rock failed to propose its Bone Spring well to EOG, which has a working interest in the S/2 of Section 14 above 10,000 feet, and also failed to notify EOG of the hearing. It was Chevron that informed EOG about Tap Rock's well proposal and application. Another basis for the denial of Tap Rock's applications is the fact that Tap Rock, by its own admission, filed APDs for its wells with the BLM without having a working interest, or the consent of another working interest owner, in each 40–acre spacing unit within its proposed project areas.

Chevron acknowledges that Tap Rock faces the prospect of losing its farmout from Mr. McLeod. Despite its attempt to shift the blame to Chevron, the fact that Tap Rock's correlative rights are in jeopardy is entirely the result of Tap Rock's lack of diligence in timely proposing its

wells and filing its applications. Tap Rock sent its first well proposal to Chevron for a Wolfcamp well – albeit with a different landing zone than the well in its application – in November 2017, more than five months after signing its farmout agreement. After receiving a negative response from Chevron, Tap Rock waited another three months again to contact Chevron again. In the interim, according to Tap Rock's testimony, the company was focused on efforts to trade out of the subject acreage with Oxy. Tap Rock ultimately proposed its Bone Spring well to Chevron on February 28, 2018, just three months before Tap Rock's drilling deadline.

Tap Rock's subsequent discussions with Chevron about joining the well were unsuccessful, as Chevron never agreed to a negotiated resolution of the parties' competing well proposals and never executed a JOA for Tap Rock's wells. Tap Rock may have had a subjective belief that Chevron would join its wells or otherwise agree to an accommodation with Tap Rock, but such a mistaken belief in no way excuses Tap Rock's lack of diligence in seeking a Division order within the time constraints it knew it was facing when it received the farmout from Mr. McLeod. The first docket for which Tap Rock applied to present its case to the NMOCD was in May 2018, less than a month before its drilling needed to commence. Also, knowing that it usually takes more than seven months to receive a permit from the BLM, Tap Rock submitted its APDs in February 2018, less than four months in advance of its deadline. It was Tap Rock's responsibility – not Chevron's – to take prudent measures to preserve Tap Rock's correlative rights under its farmout agreement, and Tap Rock was negligent in doing so.

Apparently recognizing the problems with its Bone Spring application, Tap Rock has floated the possibility of a depth severance in the Cotton Draw-Bone Spring Pool and the approval of two separate and distinct project areas in the Bone Spring formation. Tap Rock has provided no legal authority or geologic evidence that might support its proposal, and Chevron is not aware

of any. In its testimony, Tap Rock claimed that the Cotton Draw-Bone Spring Pool (which completely encapsulates the entire Bone Spring formation) already was depth segregated, but its attorney has since admitted to the Division that is not the case. In keeping with Division precedent, any project area in the Bone Spring formation should include the entire formation.

Not only should the Cotton Draw-Bone Spring Pool not be severed, development of the Cotton Draw-Bone Spring Pool and the Purple Sage-Wolfcamp Gas Pool should be controlled by a single operator to maximize efficiencies and prevent waste. Assigning different operators to different pools would create waste due to parent-child depletion effects, especially at the base of the Third Bone Spring formation, which has the potential to drain the top of the Wolfcamp formation. Having two operators would increase surface disturbance, safety concerns related to increased activity, and the risk of subsurface collision. Further, splitting operatorship by formation would prevent the inclusion of Section 14 in Chevron's proposed federal exploratory unit, causing all related efficiencies to be lost.

III. EOG Well Proposals

Two days before the hearing, EOG proposed wells that would be drilled into the SE/4 of Section 14, which is acreage that is included in both of Chevron's proposed project areas. EOG had filed applications addressing those wells the week of the hearing, but had not yet been assigned case numbers or listed on any docket. Nevertheless, the Division allowed EOG to present testimony and introduce exhibits at the hearing.

With the understanding that the Division's decision to allow EOG's evidentiary presentation was based solely on the time constraints presented by Tap Rock's farmout agreement, and would have no precedential value, Chevron did not object to EOG's evidentiary presentation.

But Chevron submits that its applications cannot be denied on the basis of competing EOG well proposals that are not ripe for a decision by the Division.

On a substantive level, EOG's evidentiary presentation likewise does not provide a basis for the Division to deny Chevron's applications. EOG's presentation focused almost exclusively on the deficiencies in Tap Rock's applications, including Tap Rock's failures to timely propose its Bone Spring well to EOG and notify it of the hearing. EOG also provided testimony regarding the unproven nature of Tap Rock's target intervals. Consequently, EOG did not present evidence sufficient to rebut Chevron's evidentiary presentation.

CONCLUSION

Chevron's testimony and exhibits establish that Chevron has met its burden of demonstrating that its applications for the creation of 480-acre Bone Spring and Wolfcamp project areas in the E/2 of Section 14 and the SE/4 of Section 11, and the pooling of the uncommitted interests in those project areas, should be granted. Conversely, the Division should deny the Tap Rock applications as they are procedurally deficient, propose wells in unproven target intervals, and will result in significant waste. Because of (i) Chevron's prevention of waste through a comprehensive development plan, (ii) Tap Rock's negligence in protecting its own correlative rights, and (iii) Tap Rock's procedural and technical missteps that have caused confusion among all parties, the Division should find in Chevron's favor.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of May, 2018 I served a true and correct copy of the foregoing Chevron U.S.A. Inc.'s Written Closing Statement via email to:

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